Directors' Liability and Climate Risk: *United Kingdom - Country Paper*

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About the Commonwealth Climate and Law Initiative

The Commonwealth Climate and Law Initiative (CCLI) is a research, education, and outreach project focused on four Commonwealth countries: Australia, Canada, South Africa, and the United Kingdom. CCLI is examining the legal basis for directors and trustees to take account of physical climate change risk and societal responses to climate change, under prevailing statutory and common (judge-made) laws. In addition to the legal theory, it also aims to undertake a practical assessment of the materiality of these considerations, in terms of liability, and the scale, timing, probability of this and the potential implications for company and investor decision-making.

Australia, Canada, South Africa, and the UK, despite only producing 6% of current annual global GHG emissions, account for 13% of global coal reserves and 11% of global oil reserves. Their stock exchanges also have 27% of all listed fossil fuel reserves and 36% of listed fossil fuel resources. They each have large and highly developed financial systems and account for 23% of the global pension assets and contain within the G20 the 8th, 5th, 14th, and 4th largest stock markets by market capitalisation respectively.

The significant commonalities in the laws and legal systems of each of the four countries makes the initiative's work and outcomes readily transferable. They each operate a common law legal system. Their corporate governance laws are based on common fiduciary principles. Whilst their laws may differ at the margins, legal developments and judicial precedents are influential in each others' jurisdictions.

The core research findings are contained in the national legal papers for the four jurisdictions. These have been complemented by conferences in Australia (August 2016), Canada (October 2017), South Africa (January 2018) and the UK (June 2016). The national legal papers are organised by jurisdiction and follow a uniform structure to facilitate the creation of a subsequent comparative paper, which will aim to identify the strengths, weaknesses, opportunities and threats in each jurisdiction.

These papers represent a lead up to the creation of a White Paper that identifies policy recommendations for directors' associations and financial regulators in relation to the proper implementation and enforcement of directors' fiduciary laws in each of the observed jurisdictions. Moreover, the comparative work will be used to design an actionable framework for directors to integrate climate change issues into governance practice. This paper will be made available to the public at large and aim at creating a broad discussion among all targeted stakeholders.

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Disclaimer

The Commonwealth Climate & Law Initiative (CCLI), its founders, and partner organisations make no representations and provide no warranties in relation to any aspect of this publication, including regarding the advisability of investing in any particular company or investment fund or other vehicle. While we have obtained information believed to be reliable, we shall not be liable for any claims or losses of any nature in connection with information contained in this document, including but not limited to, lost profits or punitive or consequential damages. This paper represents the law as at December 2017.

1. Introduction

This paper has been produced by the Commonwealth Climate and Law Initiative (CCLI), a comparative law project established in November 2015 by Oxford University's Smith School for Enterprise and the Environment, The Prince of Wales' Accounting for Sustainability Project, and ClientEarth, an environmental law NGO with legal expertise in climate risk and corporate reporting. The CCLI was established to consider the application of directors' duties laws to climate risk in four Commonwealth countries: Australia, Canada, South Africa and the United Kingdom (UK). This paper represents the UK component of the research and foreshadows the publication of a comparative report, which will analyse and compare the findings in each of the four country papers.

Company directors owe many duties and obligations under UK[1] company and securities law, both to the company itself and more generally.[2] This paper analyses the extent to which some of these laws – in particular, directors' general duties under the Companies Act 2006 – require company directors to assess, manage and report on the financial risks that climate change presents to their company, and the circumstances in which directors could be held personally liable for failing to do so. The technical legal basis for directors' liability is considered, as well as practical issues, such as the factual circumstances in which liability might arise and factors that could affect the availability of legal intervention, including evidentiary and procedural barriers. While the primary focus is on company directors, the paper also briefly considers the legal duties of directors of key financial services system participants — corporate trustees of pension funds, banks and insurance firms — and the extent to which their duties differ from those owed by company directors.

The paper unfolds as follows. **Part 1** outlines how industry conceptions of climate change have evolved in recent years – while traditionally understood to be an 'ethical externality', there is now widespread recognition that climate change presents a material financial risk to companies, and to the economy as a whole. Part 1 also includes an overview of the fiduciary precepts underlying directors' duties laws. **Parts 2** and **3** examine two directors' duties most relevant to climate risk management – the duty to promote the success of the company, and the duty to exercise reasonable care, skill, and diligence – and how they might apply and be breached in this context. **Part 4** then considers how companies' disclosure and reporting obligations apply to climate risk, and how breach of these reporting laws might also contribute to directors' liability exposure regarding climate risk management. **Part 5** briefly considers the duties of directors of corporate trustees, banks and insurance firms, and the extent to which their duties differ from company directors' duties. **Parts 6** and **7** discuss practical issues regarding legal interventions for breach of directors' duties in a climate risk context, including evidentiary requirements, possible defences and the extent to which directors' and officers' (D&O) insurance might be available. Remedies and procedural considerations, such as standing, are also

[1] The law discussed in this paper is largely applicable across the UK – for example, The Companies Act 2006 applies to England, Wales, Scotland and Northern Ireland (although different provisions apply to Scotland in some parts). As such, the paper refers to 'UK law', however it does not consider the law in other parts of the UK to the extent that such laws differ to the law of England.

[2] In addition to the general duties owed by directors to their company under the Companies Act 2006, directors also owe numerous other duties and obligations under statutory and common law, for example, to creditors, and in relation to loans and substantial property transactions: see Victor Joffe QC et al, *Minority Shareholders: Law, Practice, and Procedure* (Oxford University Press, 2015) 34, [1.80]. Numerous criminal provisions also apply to directors, including under the Companies Act 2006.

considered. **Part 8** concludes that the current trajectory indicates that directors will be held to increasingly stringent standards in relation to their assessment and management climate risk, and that such litigation for breach of directors' duties in this context is a real possibility. As such, prudent directors ensure that they have adequate systems in place to assess and manage climate change where it poses a material financial risk to their company.

a) Climate change as a material financial risk

Anthropogenic climate change is now generally accepted as an incontrovertible reality.[3] However, historically it has been understood as an environmental or ethical concern – an issue that a company might address as a moral imperative, but which is less relevant to long-term business viability or risk management, beyond reputational concerns.[4] In recent years, however, there has been a fundamental shift in perspective, with increasing recognition by key stakeholders across the financial and corporate sectors that climate change presents material financial risks not just for companies, but for the financial system as a whole.[5] This is because climate change not only impacts individual companies' profitability and long-term success but can also 'act as sources of credit, market and legal risks for financial institutions'.[6] In January 2017, the World Economic Forum's annual Global Risks Report identified the top five risks to the global economy in terms of impact, with four of these risks being climate change related.[7] Former deputy head of the UK's Prudential Regulation Authority recently stated that '[i]is not difficult to imagine scenarios in which climate change directly causes a financial crisis'.[8]

In its seminal report on the risks to the insurance industry arising from climate change,[9] the Bank of England identified the following three categories of financial risk associated with climate change (collectively referred to in this paper as '**climate risk**'): [10]

[3] See, e.g., International Energy Agency, International Energy Agency (2015) http://www.iea.org/; United Nations, Intergovernmental Panel on Climate Change (IPCC), AR5, Climate Change 2013: The Physical Science Basis – Headline Statements from the Summary for Policymakers, Working Group I Contribution to the IPCC Fifth Assessment Report (IPCC, 27 September 2013).
[4] See Baker McKenzie and Principles for Responsible Investment, 'Recommendations of the Task Force on Climate-related Financial Disclosures – Review of Local Relevance', Country Review Paper: United Kingdom (2017), 3.
[5] Bank of England, the UN Environment Inquiry and the University of Cambridge Institute for Sustainability Leadership 'Enhancing Environmental Risk Assessment in Financial Decision-Making, July 2017, 4.
[6] Ibid. However, not all climate change risks are long-term risks. Blackrock Investment Institute has stated that 'even short-term investors can be affected by regulatory and policy developments, the effect of rapid technological change or an extreme weather event': BlackRock Investment Institute, 'Adapting Portfolios to Climate Change: Implications and Strategies for All Investors', September 2016, 2. Available at: https://www.blackrock.com/investing/literature/whitepaper/bii-climate-change-2016-us.pdf. See also: Elisa de Wit and Victoria Vilagosh, 'Climate Change Risks: What Do You Need to Know?', *Governance Directions*, March 2017, 78.
[7] The top five risks identified were: extreme weather events; water crises; major natural disasters and a failure of climate change mitigation and adaptation: World Economic Forum, 'Global risks Report 2017', Figure 2, available at: http://reports.weforum.org/global-risks-2017/part-1-global-risks-2017/. See also Minter Ellison Briefing – Bank of England Eyeballs the Financial Sector on Climate Risk', 22 June 2017, available at: http://www.minterellison.com/files/uploads/documents/email%20marketing/alert%20files/Bank%20of%20England%20climate%20risk%20alert-%20June%202017.pdf
[8] Paul Fisher, 'Comment: Could Climate Cause the Next Financial Crisis?', IPE, 29 June 2017.
[9] Bank of England Prudential Regulation Authority, 'The Impact of Climate Change on the UK Insurance Sector', September 2015, available at: http://www.bankofengland.co.uk/pra/Documents/supervision/activities/pradefra0915.pdf.

1. **Physical risks** – risks arising from weather-related events, such as floods, droughts and storms which can impact on infrastructure and workforce productivity, disrupt global supply chains and cause resource scarcity. Extreme weather events could also 'overwhelm the ability of insurance markets to absorb the resulting loss'.[11]

2. **Transition risks** – risks arising from the transition to a lower-carbon economy, including increased regulation or disruptive technological change, such as the growth of renewable energy or increased uptake of electric vehicles. These developments may reduce for certain products or services and can lead to premature devaluing of corporate assets ('stranded assets'). Transition risks are particularly heightened in the wake of the Paris Agreement, which entered into force in November 2016 and has now been ratified by over 110 states, including the UK.[12] The Paris Agreement commits states to limit global warming to no more than 2°C above pre-industrial levels (and to strive for warming of no more than 1.5°C). Bank of England Governor Mark Carney has stated that if the UK adheres to the Intergovernmental Panel on Climate Change's (IPCC) estimate of the carbon budget needed to limit the temperature rise to well below 2°C, the vast majority of oil, gas and coal reserves will be stranded – i.e. 'literally unburnable' in the absence of expensive carbon capture technology.[13] Furthermore, if financial markets suddenly re-price the risk of investing in those companies most exposed to these transition risks, there may be a rapid collapse in the value of entire industrial sectors.[14] The recent demise of the coal industry in the United States (US) provides a clear example of this.[15]

3. **Liability risks** – the potential exposure of companies and directors to legal liability in relation to: (a) the company's contribution to anthropogenic climate change;[16] (b) failure to adequately

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[10] Bank of England Prudential Regulation Authority, above n 9. This taxonomy of climate-related financial risk has been widely adopted by other institutions, including the G20 Financial Stability Board's (FSB) Taskforce on Climate-related Financial Disclosures (TCFD).
[11] Fisher, above n 8.
[12] Paris (France), 13 Dec. 2015, in force 4 Nov. 2016, UNFCCC Secretariat, Decision 1/CP.21 'Adoption of the Paris Agreement', UN Doc. FCCC/CP/2015/10/Add.1, Annex, available at: http://unfccc.int/resource/docs/2015/cop21/eng/10a01.pdf ('Paris Agreement').
[13] Mark Carney, 'Breaking the Tragedy of the Horizon - Climate Change and Financial Stability', speech delivered on 29 September 2015 at Lloyd's of London, London, UK, available at: http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx#1. For example, the total value of stranded assets – defined as 'those which do not recover all or part of their investment during the time that they are operational' – for the oil and gas industry has been estimated at US$852 billion between 2014 and 2050: EU High-Level Expert Group on Sustainable Finance, 'Financing a Sustainable European Economy', Interim Report (July 2017) 35, fn 44 (citing OECD report, *Investing in Climate, Investing in Growth*, June 2017), available at: http://ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report_en.pdf.
[14] Fisher, above n 8.
[15] Ibid.
[16] For example, through tort or human rights claims, such as the current investigation by the Commission on Human Rights in the Philippines in relation to alleged human rights violations by 47 carbon majors as a result of the effects of their greenhouse gas emissions. See: John Vidal, 'World's Largest Carbon Producers Face Landmark Human Rights Case', *The Guardian*, 27 July 2016, available at: https://www.theguardian.com/environment/2016/jul/27/worlds-largest-carbon-producers-face-landmark-human-rights-case. In addition, in July 2017 three local governments in California filed lawsuits against 37 carbon

manage the physical and transition risks of climate change;[17] and/or (c) inaccurate, misleading or fraudulent reporting of climate change risks as required by corporate disclosure laws.[18]

Certain sectors are particularly vulnerable to climate risk. For example, the TCFD recommendations state that companies engaged in fossil-fuel based industries, energy-intensive manufacturing, and transportation activities are most exposed to transition risks, while those engaged in agriculture, transportation and building infrastructure, insurance and tourism are more exposed to physical risks.[19] This has significant implications in the UK, where 19 per cent of FTSE 100 companies are in natural resource and extraction sectors and 11 per cent are in power utilities, chemicals, construction and industrial goods – these sectors account for approximately one third of equity and fixed income assets.[20] However, no company escapes climate risk entirely.[21] The impact of climate change on market and regulatory dynamics will mean that 'virtually every company's activities, business models and strategies will need to be completely rethought'.[22]

On the other side of climate risk is 'climate opportunity' – companies that continue to pursue carbon-intensive, business-as-usual strategies not only expose themselves to financial risk, they may also miss out on the significant opportunities presented by the transition to a low-carbon economy.[23] As de la Mare notes, 'the risks of not investing in next-generation technology are greater [than the risks of investing] and the business opportunities of early investment are growing'.[24] In July 2017, the International Energy Agency (IEA) stated that in 2016, investments in electricity had surpassed those

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majors, seeking compensation for costs associated with adapting to sea level rises linked to climate change: Laura Paddison, 'Exxon, Shell and Other Carbon Producers Sued for Sea Level Rises in California', *The Guardian*, 26 July 2017, available at: https://www.theguardian.com/sustainable-business/2017/jul/26/california-communities-lawsuit-exxon-shell-climate-change-carbon-majors-sea-level-rises. Such cases are predicted to increase, as the future of costs of climate change 'become exponentially higher' and governments seek contributions from those responsible: Martin Olszynski, Sharon Mascher and Meinhard Doelle, 'From Smokes to Smokestacks: Lessons from Tobacco for the Future of Climate Change Liability' (2017) *Georgetown Environmental Law Review*, 36 (forthcoming).

[17] This type of liability is the subject of this paper.

[18] For example, in August 2017, Australian shareholders commenced proceedings against Commonwealth Bank for its alleged failure to properly disclose climate risk. See: Michael Slezak, 'Commonwealth Bank Shareholders Sue Over "Inadequate" Disclosure of Climate Change Risks', *The Guardian*, 8 August 2017, available at: https://www.theguardian.com/australia-news/2017/aug/08/commonwealth-bank-shareholders-sue-over-inadequate-disclosure-of-climate-change-risks. Inadequate climate risk reporting may also give rise to NGO interventions. For example, in 2016 ClientEarth filed regulatory complaints against Cairn Energy plc and SOCO International plc alleging inadequate climate risk reporting: ClientEarth, 'ClientEarth Triggers Review of Companies' Climate Disclosures', 22 August 2016, available at: https://www.clientearth.org/clientearth-triggers-review-companies-climate-disclosures/. This type of liability is also discussed in this paper.

[19] TCFD, 'Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures', June 2017, 26-7, available at: https://www.fsb-tcfd.org/publications/final-recommendations-report/.

[20] Thomas Clarke, 'The Widening Scope of Directors' Duties: The Increasing Impact of Corporate Social and Environmental Responsibility' (2016) 39 *Seattle University Law Review* 531, 576.

[21] de Wit and Vilagosh, above n 6, 7. For this reason, the TCFD recommendations, which are discussed below, apply to all companies, not just those most obviously exposed.

[22] Rory Sullivan, 'Introduction', in Rory Sullivan (ed), *Corporate Responses to Climate Change* (2008) 2, 3, cited in Perry E Wallace, 'Climate Change, Corporate Strategy, and Corporate Law Duties' (2009) 44 *Wake Forest Law Review* 757, 757.

[23] Clarke, above n 20, 576.

[24] William TJ de la Mare, 'Locality of Harm: Insurance and Climate Change in the 21st Century' (2013) 20(1) *Connecticut Insurance Law Journal* 189, 227-8.

in oil and gas for the first time, attributable to a sustained period of low oil prices and 'technological progress which is reducing investment costs'.[25]

In light of the financial risks (and opportunities) associated with climate change for business, and the potential impact of climate change on the global economy, the G20 Financial Stability Board (FSB) established the Task Force on Climate-related Financial Disclosures (TCFD) in 2015. The TCFD considered what information market participants want companies to disclose about climate risk to enable them to measure and respond to this risk in their financial decision-making. In June 2017, the TCFD released its final recommendations.[26] The recommendations provide a framework for voluntary disclosures of climate-related financial risks and are intended to enhance market awareness of links between climate-related risks (and opportunities) on the one hand, and financial impacts on the other. They apply to all corporate and financial entities, including companies, banks, insurance firms, investors and asset managers and their intermediaries, such as ratings agencies.

The widespread industry support for the TCFD recommendations is a clear reflection of the evolution of climate change from being considered an environmental concern to today's recognition that it presents a material financial risk to business. Investors, banks, insurers and companies themselves – including carbon majors – have expressed support for the recommendations. For example, Aviva Investors has warned more than 1,000 companies globally that it will vote against their annual reports and accounts if they fail to comply with the TCFD recommendations.[27] Similarly, in March 2017, BlackRock published its 2017-18 Engagement Priorities, which includes climate risk disclosure and a warning that BlackRock will vote against management – and the re-election of directors – if they do not constructively engage with the issue of climate risk.[28] In addition, eleven major banks representing more than $7tr in capital have committed to implement the TCFD recommendations, including ANZ, Barclays, Citi, Royal Bank of Canada, Santander and UBS.[29] Insurers have also endorsed the recommendations, with the Sustainable Insurance Forum – of which the Bank of England is a founding member – stating that '[c]limate change is one of the most serious long-term challenges for the insurance sector and the wider financial system'.[30] Finally, companies themselves have embraced the TCFD recommendations, including oil and gas majors such as Royal Dutch Shell, ENGIE Group and Eni.[31]

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[25] Bate Felix, 'Electricity Investment Overtakes Oil, Gas for First Time ever in 2016: IEA', Reuters, 11 July 2017: https://www.reuters.com/article/us-energy-investment-iea-idUSKBN19W0IQ.
[26] TCFD, above n 19.
[27] Financial Times, 'Aviva Investors Demand Greater Climate Change Disclosure', 19 July 2017, available at: https://www.ft.com/content/69daf7c6-67e3-11e7-9a66-93fb352ba1fe.
[28] BlackRock, 'Our Engagement Priorities for 2017-2018', available at: https://www.blackrock.com/corporate/en-us/about-us/investment-stewardship/engagement-priorities.
[29] Melanie Cuff, 'Eleven Leading Banks Announce Plans to Pilot FSB Climate Risk Guidelines', businessGreen, 11 July 2017, available at: https://www.businessgreen.com/bg/news/3013567/eleven-leading-banks-announce-plans-to-pilot-fsb-climate-risk-guidelines.
[30] Sustainable Insurance Forum, 'Leading Insurance Supervisors Support Adoption of Climate Risk Disclosure Recommendations' (July 2017), available at: http://unepinquiry.org/wp-content/uploads/2017/07/SIF_TCFD_Statement_July_2017.pdf. See also Bank of England, 'Quarterly Bulletin: The Bank of England's Response to Climate Change', 2017 Q2, 106.
[31] Over one hundred companies with a combined market capitalisation of $3trn (and investors responsible for assets of around $25trn, including major pension investors) have signed a letter supporting the TCFD recommendations. Signatories include fossil fuel majors such as Royal Dutch Shell, ENGIE Group and Eni. See: Hamza Ali, 'Investors with $25trn of AUM back Climate Disclosures', Wealth Manager, 29 June 2017, available at: http://citywire.co.uk/wealth-manager/news/investors-with-25trn-of-aum-back-climate-disclosures/a1029476#i=1.

In light of this increasing recognition that climate change presents a material financial risk to many, if not most, companies, the following sections consider the extent to which two key legal duties owed by directors to their company might require them to consider and manage climate risk: the duty to promote the success of the company; and the duty to exercise reasonable care, skill and diligence. First, an overview of the fiduciary precepts underlying directors' duties is provided to frame the analysis.

b) Relevant fiduciary precepts

UK law has long recognised that directors owe fiduciary duties to their company, as well as a duty of care.[32] The leading case on English fiduciary duties is *Bristol and West Building Society v Mothew*.[33] In that case, Millett LJ defined a fiduciary as 'someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence'.[34] Millett LJ further states that the 'obligation of loyalty' is the distinguishing, 'core' obligation of a fiduciary: '[t]he principal is entitled to the single-minded loyalty of his fiduciary'.[35]

Directors historically owed duties to their company under common law. However, in 2006, directors' 'general duties' were codified in the Companies Act 2006 (the Act).[36] There are seven such duties: duty to act within powers (s 171); duty to promote the success of the company (s 172); duty to exercise independent judgement (s 173); duty to exercise reasonable care, skill and diligence (s 174); duty to avoid conflicts of interest (s 175); duty not to accept benefits from third parties (s 176); and duty to declare an interest in a proposed transaction or arrangement (s 177).

Six of the seven codified duties are fiduciary.[37] In *Bristol*, Millett LJ stated that breach of fiduciary duty 'connotes disloyalty or infidelity' and that '[m]ere incompetence is not enough'.[38] As such, the duty to exercise reasonable care, skill and diligence (i.e. duties of competence) is a non-fiduciary duty.[39] Of six fiduciary duties, the duty to promote the success of the company has been described as the 'principal duty' reflecting the 'core' duty of loyalty described by Millett LJ in *Bristol*.[40] Conceptually, the other five fiduciary duties, although they may apply in factually distinct scenarios, can be traced back to this central obligation. As such, directors' duties under UK law — as in most common and civil law jurisdictions — can broadly be divided into two categories: (fiduciary) duties of **trust and loyalty**, and the (non-fiduciary) duties of **competence**.

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[32] Companies Act 2006, ss 170(1), 171-7.
[33] [1998] Ch 1 ('*Bristol*'). See also *Regal Hastings v Gulliver* [1967] 2 AC 134; Rosemary Teele Langford, 'The Duty of Directors to Act Bona Fide in the Interests of the Company: A Positive Fiduciary Duty? Australia and the UK Compared' (2011) 11(1) *Journal of Corporate Law* Studies' 215, 233.
[34] *Bristol and West Building Society v Mothew* [1998] Ch 1, 16.
[35] Ibid.
[36] Companies Act 2006, Part 2, Chapter 10.
[37] *Maidment v Attwood & Ors* [2012] EWCA Civ 998, [22].
[38] [1998] Ch 1, 18. See also Langford, above n 33, 234.
[39] See Langford, above n 33, 234. Whether the duty of reasonable care, skill and diligence is a fiduciary duty has been the topic of much academic debate: see Parker Hood, 'Directors' Duties Under the Companies Act 2006: Clarity or Confusion?' (2013) 13(1) *Journal of Corporate Law Studies* 1, 8, fn 49. However, the Companies Act makes clear that it is not: see s 178(2) which explicitly excludes s 174, but provides that all other general duties are enforceable 'in the same way as any other fiduciary duty owed to a company by its directors'. See also Langford, above n 33, 222, fn 31.
[40] The Rt Hon Lady Justice Arden DBE, 'Regulating the Conduct of Directors' (2010) 10(1) *Journal of Corporate Law Studies* 1, 7; Langford, above n 33, 215, 220. See also Paul Davies and Jonathan Rickford, 'An Introduction to the New UK Companies Act: Part 1' (2008) 1 *European Company and Financial Law Review* 48, 65.

The Act provides that 'more than one of the general duties may apply in any given case'.[41] As such, a director may breach two or more duties in a specific factual scenario.[42] For example, a director's failure to promote the success of the company may also to give rise to a claim for failure to exercise reasonable care, skill and diligence.[43]

The duties contained in the Act are flexible, as are fiduciary principles more generally. As stated in a recent UN report, fiduciary duties are 'organic, not static'.[44] As such, the scope of the duties and the extent to which they require directors to address climate risk will evolve to reflect increasing awareness of climate change and its potential impact on business. As Wallace observes, '[a]s the state of knowledge about climate change evolves, so do the related discourse, debate, and responses'.[45]

The 'general duties' apply to directors of both private and public companies.[46] The Act provides that a director is 'any person occupying the position of director by whatever name called'.[47] As such, no legal distinction exists between executive directors and non-executive directors (NEDs) and directors' duties and potential liabilities equally apply to NEDs.[48] The general duties also apply to shadow directors 'where and to the extent they are capable of so applying'.[49]

c) Relationship between statutory and common law duties

The Act provides that the 'general duties' codified in the Act 'have effect in place' of the common law rules and equitable principles on which they are based.[50] This means that any claim for breach of a director's duty must now be based on one of the seven duties specified in the Act.[51] However, the Act preserves existing case law on directors' duties by providing that the statutory duties 'shall be interpreted and applied in the same way as the common law rules or equitable principles'.[52]

[41] Companies Act 2006, s 179 ('except as otherwise provided').
[42] Hood, above n 39, 6. See, e.g., *Bhullar v Bhullar & Ors* [2017] EWHC 407 (Ch).
[43] John Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap through Efficient Disclosure' (2009) 68(3) *Cambridge Law Journal* 607, 612; Langford, above n 33, 222. See, e.g., *Secretary of state for Business, Innovation & Skills v Pawson* [2015] EWHC 2626 (Ch).
[44] United Nations Global Compact et al, 'Fiduciary Duty in the 21st Century' (2015), quoting Paul Watchman (Honorary Professor, School of Law, University of Glasgow), 13. See also Olszynski, Mascher and Doelle, above n 16, 7
[45] Perry Wallace, 'Climate Change, Fiduciary Duty, and Corporate Disclosure: Are Things Heating Up in the Board Room' (2008) 26 *Virginia Environmental Law Journal* 293, 293.
[46] See ACCA, 'A Guide to Directors' Responsibilities under the Companies Act 2006', [6.67], available at: http://www.accaglobal.com/content/dam/acca/global/PDF-technical/business-law/tech-tp-cdd.pdf.
[47] Companies Act 2006, s 250.
[48] This reflects the position pre-codification: see *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498; *Re Continental Assurance Co of London plc* [2007] 2 BCLC 287. Note, however, that while there is no legal distinction between directors and NEDs, a director's functional role may affect how a duty applies to that director. For example, what is required to satisfy the duty of duty care, skill and diligence will depend on the director's specific role in managing the company: Joffe et al, above n 2, 22, [1.52].
[49] Companies Act 2006, 170(5). The Act defines a shadow director as 'a person in accordance with whose directions or instructions the directors of a company are accustomed to act': s 251(1).
[50] Section 170(3)
[51] Except to the extent that the Act preserves any common law duties, as it does regarding creditors' interests: see Davies and Rickford, above n 40, 62. See also Lowry, above n 43, 613.
[52] Companies Act 2006, s 170(4). See also Langford, above n 33, 224.

Furthermore, ‘regard shall be had’ to these rules and principles ‘in interpreting and applying the general duties’.[53]

It is therefore important to understand any differences between the pre-existing common law duties and the codified duties to determine the extent to which pre-codification case law is still relevant.[54] While the codified duties mostly reflect the common law duties, certain aspects of the duties were reformed or clarified.[55] For example, s 174 clarifies that the standard of care that applies to directors in relation to their duties of competence includes both objective and subjective components.[56]

[53] Companies Act 2006, s 170(4).
[54] Davies and Rickford, above n 40, 63.
[55] Ibid 62-3.
[56] Ibid 66-7.

2. Duties of trust and loyalty

a) Overview of duty to promote the success of the company

Directors' duty to promote the success of their company is the fiduciary duty most obviously engaged in the context of climate risk management.[57] Section 172 of the Act provides that a director must act in the way that 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**.[58] For commercial companies, 'success' has been understood to mean 'long-term increase in value'.[59] Lady Justice Arden therefore describes the duty as 'extend[ing]' the 'time horizons for decision-making'.[60] However, while long-term factors must be considered under s 172, the Explanatory Notes to the Act provide that what constitutes 'success' is a matter for the 'good faith judgment' of directors, and s 172 does not categorically require directors to pursue long-term increase in shareholder value.[61]

In acting to promote the success of the company, directors must 'have regard to' a non-exhaustive list of matters, including the likely consequences of the decision in the long-term; the impact of the company's operations on the community and the environment; and the need to act fairly as between members of the company.[62] The requirement to consider such matters (but not necessarily act upon them) reflects an 'enlightened shareholder value' model of corporate governance, whereby shareholders' financial interests remain the primary focus, but there is an understanding that those interests may best be served by also considering stakeholder interests.[63] In a Ministerial Statement, Rt Hon Margaret Hodge stated that '[t]he words "have regard to" mean "think about"; they are absolute not just about ticking boxes. If "thinking about" leads to the conclusion, as we believe it will in many cases, that the proper course is to act positively to achieve the objectives in the clause, that will be what the director's duty is'.[64] Directors' analysis of these factors may therefore require them to take positive steps to protect the company's best interests, for example, by preventing a transaction or settlement from going ahead.[65]

Whether a director has fulfilled the s 172 duty is generally assessed according to the director's subjective state of mind (i.e. whether the director has acted 'in good faith').[66] Directors therefore will usually satisfy the duty where they act in a way that they *honestly believe* will most likely promote the success of the company, even if they are mistaken and their decisions fail to achieve commercial

[57] Companies Act 2006, s 172.
[58] Companies Act 2006, s 172(1). An exception applies under 172(2) for companies whose purpose is not only to benefit its members. In addition, s 172(3) provides that the duty to promote the success of the company is subject to any laws (as currently exist at common law) requiring directors to consider or act in the interests of creditors. See Joffe et al, above n 2, 19, [1.41].
[59] Hood, above n 39, 17, citing Lord Goldsmith QC, Ministerial Statements, Lords Grand Committee, Hansard, 6 February 2006, vol 678, p 100, Columns GC255-6. See also Arden, above n 40, 2, 8.
[60] Arden, above n 40, 2.
[61] Explanatory Memorandum, [327].
[62] Companies Act 2006, s 172(2)
[63] Davies and Rickford, above n 40, 65-6.
[64] Rt Hon Margaret Hodge, Minister of State for Industry and the Regions, Ministerial Statements, Commons Report, 17 October 2006, Column 789.
[65] Langford, above n 33, 220; Joffe et al, above n 2, 15, [1.28]. See, e.g., *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd* [2003] BCC 885.
[66] *Birdi v Specsavers Optical Group Ltd* [2015] EWHC 2870 (Ch), [61]; *Secretary of state for Business, Innovation & Skills v Pawson* [2015] EWHC 2626 (Ch), [182].

success.[67] While this affords considerable leeway to directors to exercise their own business judgement, breach of duty may nevertheless occur if the court considers that 'no reasonable director could have bona fide considered a particular decision to be in the interests of the company'.[68]

In addition, the subjective standard that usually applies may be replaced by an objective standard where there is no evidence 'of actual consideration of the best interests of the company' – in other words, where directors fail to actively 'consider' whether a particular action is likely to promote the success of the company, as required by s 172.[69] In such circumstances, a line of authority suggests that 'the proper test is objective, namely whether an intelligent and honest man in the position of a director of the company concerned, could, in the circumstances, have reasonably believed the transaction [or other act or omission] was for the benefit of the company.'[70] However, as Joffe et al note, one might expect that total failure to consider the best interests of the company would result in breach in and of itself.[71] Indeed, the authors suggest that this line of authority should be treated with caution and that breach in these circumstances could occur even if the director's actions are objectively defensible.[72]

More generally, the application of s 172 will continue to evolve in response to ongoing developments in the corporate governance space. For example, in November 2016, the Government released a green paper on corporate governance reform, which generated much discussion and debate regarding the practical application of s 172.[73] In response to consultations, the Government has invited the GC100 – the Association of General Counsel and Company Secretaries working in FTSE 100 companies – 'to prepare and publish new advice and guidance on the practical interpretation of the directors' duty in section 172'.[74]

b) Application of duty to promote success of the company in climate risk context

Where climate risk poses a foreseeable and material financial risk to a company, directors could expose themselves to liability under s 172 if they fail to consider that risk, or to consider it adequately

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[67] *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd* [2003] BCC 885, 908. See also Hood, above n 39, 17, 21.
[68] Joffe et al, above n 2, 13 [1.22], citing *Re a Company, ex p Burr* [1992] BCLC 724, 731. See also *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244, [44]; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598, [90]. Joffe et al note that certain authorities also suggest that breach will occur where directors acted honestly but in a way that no reasonable director could have believed would promote the best interests of the company: 13, [1.22].
[69] *Re HLC Environmental Projects Ltd, Hellard v Carvalho* [2013] EWHC 2876 (Ch), [92], citing *Charterbridge Corpn Ltd v Lloyds Bank Ltd* [1970] Ch 62 at 74E-F, obiter, per Pennycuick J; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 at [138] per Mr Jonathan Crow.
[70] *Re HLC Environmental Projects Ltd, Hellard v Carvalho* [2013] EWHC 2876 (Ch), [92], citing *Charterbridge Corpn Ltd v Lloyds Bank Ltd* [1970] Ch 62 at 74E-F, obiter, per Pennycuick J; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 at [138] per Mr Jonathan Crow. See also *Secretary of state for Business, Innovation & Skills v Pawson* [2015] EWHC 2626 (Ch), [183].
[71] See Joffe et al, above n 2, 13, [1.23].
[72] Joffe et al, above n 2, 15, [1.27]; 18, [1.37]. See also *Bhullar v Bhullar & Ors* [2017] EWHC 407 (Ch).
[73] UK Government, 'Corporate Governance Reform: Green Paper', November 2016, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf.
[74] UK Government, Department for Business, Energy & Industrial Strategy, 'Corporate Governance Reform: The Government Response to the Green Paper Consultation', August 2017, Action 9, 35, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/640631/corporate-governance-reform-government-response.pdf.

– for example, where they take some steps towards climate risk assessment but fail to conduct robust scenario-testing, or obtain expert advice where appropriate. Liability could also arise where directors fully assess climate risk, but then unreasonably fail to act in accordance with that assessment. Whether climate risk poses a foreseeable and material financial risk to the company are questions of fact to be determined in the specific circumstances. However, as discussed above, it is increasingly accepted that climate risk does pose a foreseeable and material financial risk to many, if not most, companies.[75]

There are four key ways in which liability could arise under s 172 in relation to climate risk management: (1) where a director **acts in bad faith**, for example by ignoring climate risk in order to pursue an extraneous interest; (2) where a director **overlooks climate risk** for 'honest' reasons – for example, genuine ignorance of climate risk, or the director's political beliefs regarding climate change; (3) where a director **fails to obtain expert advice** about climate risk where appropriate, or fails to adequately consider that advice; and (4) where there is a **defect in directors' decision-making process**, in particular where directors fail to 'have regard to' the factors listed in s 172(1). These four scenarios are not necessarily mutually exclusive. For example, over-looking climate risk could also result in a defect in the director's decision-making process. Conversely, a defect in the decision-making process may be the result of a director acting in bad faith.

i. Acting in bad faith

In a climate risk context, liability under s 172 most obviously arises where directors fail to consider climate risk (or to act upon an assessment of that risk) because they are acting in bad faith – i.e. to pursue an extraneous interest or motivation, rather than the long-term success of the company. For example, in *Secretary of state for Business, Innovation & Skills v Pawson*, a director was found to have breached s 172 in circumstances where his 'over-riding concern' was to obtain a certain level of remuneration for himself, rather than the company's best interests.[76] Similarly, in *Richards & Anor v IP Solutions Group Ltd*, the directors allegedly breached their fiduciary duties by pursuing short-term sales with immediate upfront payments, which increased the directors' bonus payments but undermined the company's long-term success.[77] While the latter claim failed on the evidence, the case suggests that analogous factual scenarios in a climate risk context could result in breach of s 172.[78] For example, where directors ignore climate change because they wish to pursue short-term profits in order to increase their bonus payments, or due to pressure from certain shareholders seeking high returns in the short-term.

Directors could also breach s 172 by acting in bad faith in circumstances where they have considered and/or assessed climate risk (including any relevant expert advice), but then fail to act upon that assessment or interfere with the assessment process. Current lawsuits in the United States (US) and Europe provide examples of the types of factual scenarios in which this might arise. For example, a case against ExxonMobil in the US alleges that the company conducted a climate risk analysis but then failed to conduct its affairs accordingly, including by not revealing the full extent of the analysis in

[75] The question of materiality and other evidentiary issues are discussed in section 6 below.
[76] [2015] EWHC 2626 (Ch).
[77] [2016] EWHC 1835 (QB), [61].
[78] See also *Wey Education plc & Anor v Atkins* [2016] EWHC 1663 (Ch), where the claimants alleged that the director breached s 172 by acting to 'deliberately harm the claimant companies and promote her own interests at their expense': at [1].

its public filings.[79] In addition, the Volkswagen case in Germany is an example of how technical assessments can be interfered with in order to manipulate results for short-term advantage.[80] Such conduct could also give rise to criminal proceedings.

Finally, breach of s 172 could occur where the court finds that no reasonable director could bona fide have considered a particular action to be in the interests of the company, regardless of the director's purported subjective belief. Arguably only particularly 'egregious' cases will fall into this category.[81] However, climate risk cases could increasingly do so. Where climate change posed a foreseeable and material financial risk to a company, and a director took action that disregarded or was inconsistent with that risk, such that the company suffered loss, a court could find that no reasonable director could have considered the action to be in the company's interests. This will of course depend on the circumstances of the case, including the materiality of the risk for the particular company. However, liability in such circumstances is certainly possible, and increasingly probable – for example, where directors of a company that is already highly exposed to climate risk (such as a carbon major) act to increase that exposure (e.g., by purchasing additional carbon-intensive energy reserves), and the company suffers loss as a result (e.g., due to assets becoming stranded).

ii. Overlooking climate risk for honest reasons

Directors might also breach s 172 where they have failed to consider climate risk for honest, 'good faith' reasons, including honest ignorance, or their own political views regarding climate change. A 2014 global study of nearly 3,800 senior managers and executives found that common barriers to engagement with sustainability issues include unclear financial impact; lack of sustainability expertise among board members; sustainability issues not being seen as a priority for stakeholders; and short-termism.[82] Failure to consider climate risk for these 'honest' reasons could also result in breach of s 172.[83] This is because s 172 imposes a duty on directors to consciously and proactively evaluate the likely long-term effect on the company of any action or strategy taken. Directors must act in a way they '*consider*', in good faith, would most likely 'promote the success of the company'.[84] However, if directors have not even turned their mind to whether a particular action or strategy is in the long-term interests of the company – for example, by disregarding climate risk – they may fail to satisfy this.
For example, in *Bhullar v Bhullar & Ors*,[85] the court found that although a director had not acted dishonestly, he had breached his fiduciary duty to the company by giving 'no thought' to whether certain lending activities were in the best interests of the companies.[86] He also appeared to have given

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[79] See Sophie Marjanac, 'Executive Perspective: Latest New York Filing Asks if Exxon is Still Lying to Investors about How it Manage Climate Risk', Sustainability, 14 June 2017, available at: http://sustainability.thomsonreuters.com/2017/06/14/executive-perspective-latest-new-york-filing-asks-if-exxon-is-still-lying-to-investors-about-how-it-manages-carbon-risk/.
[80] The Guardian, 'The Volkswagen Emissions Scandal Explained', 23 September 2015, available at: https://www.theguardian.com/business/ng-interactive/2015/sep/23/volkswagen-emissions-scandal-explained-diesel-cars.
[81] PL Davies and S Worthington, *Gower and Davies Principles of Modern Company Law* (Sweet & Maxwell, 2012) 543.
[82] Rosemary Sainty, 'Engaging Boards of Directors at the Interface of Corporate Sustainability and Corporate Governance', *Governance Directions* (March 2016) 86, citing a 2014 study by MIT Sloan Management Review, Boston Consulting Group and UN Global Compact.
[83] It could also give rise to a claim under s 174 (duty to exercise reasonable care, skill and diligence). See discussion below in Part 3.
[84] Companies Act 2006, s 172(1) (emphasis added).
[85] [2017] EWHC 407 (Ch).
[86] *Bhullar v Bhullar & Ors* [2017] EWHC 407 (Ch), [122]-[123], [134]. Note that this decision appears to be consistent with Joffe et al's observation (discussed above) that outright failure to consider the best interests of the company may in and of

'no thought to the financial risk' to the companies in relation to a particular property development.[87] While failure to consider climate risk may not mean that a director has given no consideration at all to a company's long-term interests, such failure could nevertheless indicate that the long-term success of the company was sufficiently ignored to result in breach of fiduciary duty.

iii. Failure to consider expert advice

Directors could also expose themselves to liability under s 172 where they fail to obtain expert advice where appropriate, or fail to adequately consider such advice. For example, in *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd*, the directors failed to consider legal advice obtained by the company before passing a resolution to accept a settlement offer.[88] One director failed to inform himself of the case entirely, which amounted to 'wilful blindness in considering the company's interests'.[89] A second director was aware of the legal advice but placed little reliance on it.[90] While no dishonesty was alleged, the court held that in failing to consider the legal advice, the directors breached their fiduciary duties to the company. Similarly, in *Bhullar v Bhullar & Ors*, a director breached his fiduciary duties in circumstances where he did not act dishonestly but 'completely ignored' cautionary advice provided by an accountant, on the basis that such advice was not 'attractive or agreeable' to him.[91]

In a climate risk context, directors could similarly breach s 172 by failing to obtain expert advice regarding the impact of climate change on the company (for example, to enable robust scenario-testing); failing to consider or interrogate any advice received; or unreasonably failing act in accordance with it.[92]

iv. Defect in decision-making process

Finally, liability under s 172 could stem from a defect in the directors' decision-making process – in particular, from their failure to 'have regard to' the factors listed in s 172(1), where such factors impact on the interests of the company.[93] For example, failure to consider climate risk (where material) may indicate that directors did not 'have regard to' the significant long-term consequences of a particular strategy or action on the company's profitability.[94] In addition, where climate risk poses a long-term financial risk to the company, it may disproportionately affect those shareholders seeking sustained investment returns over the longer term. Failure to consider climate risk may therefore indicate that directors have not had regard to 'the need to act fairly between different groups of shareholders', despite the fact that the course of action that they have pursued has disproportionately affected a certain group or groups or shareholders.[95]

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itself constitute breach of s 172 (rather than such failure displacing the subjective test, and requiring courts to consider whether a person in the director's position could reasonably have considered the action to be in the company's interests).

[87] *Bhullar v Bhullar & Ors* [2017] EWHC 407 (Ch), [122]-[123].

[88] [2003] BCC 885, 908-9.

[89] at [82].

[90] [2003] BCC 885, 907.

[91] *Bhullar v Bhullar & Ors* [2017] EWHC 407 (Ch), [36], [122].

[92] Again, conduct of this kind could also give rise to a claim under s 174. See discussion below in Part 3.

[93] Companies Act 2006, s 172(1). See also Joffe et al, above n 2, 18, [1.37].

[94] See Arden, above n 40, 7.

[95] As Langford notes, to act fairly between different groups of shareholders, directors must consider the effect of a particular strategy or decision on different groups of shareholders: above n 33, 221. See also *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155, 251.

Section 172 also requires directors to promote the success of the company 'for the benefit of its members as a whole'[96] – failure to consider climate risk may therefore also fail to satisfy this component of the duty. A decision that has differential effects on different groups of shareholders will not in and of itself constitute a breach of duty but these effects must be 'justifiable by reference to the promotion of some non-collateral, non-sectional aim'.[97] Directors who fail to consider climate risk may be unable to provide such a justification if they have not have even turned their mind to these differential effects.

c) Conclusion on duty to promote success of the company

Where climate risk poses a foreseeable and material financial risk to a company, directors could breach s 172 if they fail to consider that risk, or if they fail to do so adequately. Liability could also arise where directors assess climate risk, or obtain advice about it, but then unreasonably fail to act in accordance with that assessment or advice.

Directors who act in bad faith and fail to consider climate risk in order to pursue an extraneous interest will plainly breach their fiduciary duty of loyalty to the company. However, liability may also arise where dishonesty is not a factor. This is because section 172 requires directors to take positive steps to promote the success of the company for the benefit of all shareholders – the duty is 'not merely a passive constraint' on conduct that directors might otherwise engage in.[98] Directors must proactively assess the long-term impact on the company of any proposed action or strategy. Breach of s 172 may therefore also arise where climate risk has not been considered for 'honest' reasons, such as genuine ignorance, directors' political beliefs, failure to obtain or consider expert advice, or where there is a defect in the decision-making process because directors have not had 'regard to' the factors listed in s 172(1).

A recent UN report on fiduciary duties argues that '[f]ailing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty'.[99] UK Courts have not yet considered whether failure to assess and manage climate risk would similarly breach directors' fiduciary duty under s 172. However, breach in these circumstances is increasingly likely. Climate risk poses a foreseeable and material financial risk to many, if not most, companies, as reflected by the fact that investors, insurers and banks are increasingly calling on companies to assess and disclose this risk. Directors' duties are flexible enough to respond to evolving business norms and market dynamics such as these, which will inform courts' views on how a reasonable director would act and redefine the boundary between acceptable and unacceptable conduct.

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[96] For example, the success of the company cannot be promoted for the benefit of majority shareholders: see Lowry, above n 43, 614.
[97] Joffe et al, above n 2, 17, [1.33].
[98] Ibid 15, [1.28].
[99] United Nations Global Compact et al, above n 44, 9.

3. Duties of competence (reasonable care, skill and diligence)

a) Overview of duties of competence

Directors' duties of 'competence' are contained in s 174 of the Act, which requires directors to exercise 'reasonable care, skill and diligence' when performing their functions.[100] The standard of care against which directors are assessed includes a subjective and an objective limb.[101] The objective limb imposes a standard of care that all directors must meet, independent of their individual capabilities – they must exercise 'the care, skill and diligence that would be exercised by a reasonably diligent person' who has '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'.[102] The subjective limb can then operate to increase (but never decrease) the level of care expected of an individual director by also taking into account 'the general knowledge, skill and experience that the director has'.[103]

The particular circumstances of the company and the decision-making context will necessarily inform how the standard applies in practice. For example, the 'scope, scale and probability' of a particular risk will determine the extent to which a director must consider and address that that risk in order to fulfil the s 174 duty.[104] In *Re Barings plc (No 5)*,[105] Parker J outlined three general principles relevant to directors' competence duties:

1. Directors have 'a continuing duty to **acquire and maintain a sufficient knowledge and understanding of the company's business** to enable them to properly discharge their duties' to the company.
2. Although directors may delegate certain functions to executives below them, and trust the executives' competence and integrity to a reasonable extent, delegation 'does not absolve a director from the **duty to supervise the discharge of the delegated functions**'.
3. There is no general rule in relation to the duty to supervise the discharge of delegated functions – whether directors have satisfied the duty will depend on the facts of the case, including the directors' specific role in managing the company.[106]

As with s 172, the first principle imposes 'expectations of proactive inquiry'.[107] Directors therefore have a responsibility 'to seek adequate advice on material issues where it is not otherwise provided', and to

[100] Companies Act 2006, s 174(1).
[101] Arden, above n 40, 11; Roman Tomasic, 'Company Law Modernisation and Corporate Governance in the UK – Some Recent Issues and Debates' (2011) 1 *Victoria Law School Journal* 43, 48.
[102] Companies Act 2006, s 174(2(a). See also, Tomasic, above n 101, 48.
[103] Companies Act 2006, s 174(2)(b); *Brumder v Motornet Service and Repairs Ltd* [2013] EWCA Civ 195, [45]-[46] (per Lord Justice Beatson). See also Joffe et al, above n 2, 22, [1.50].
[104] Sarah Barker, 'Lifting the Corporate Veil: An Introduction to Directors' Liability Exposures For Stranded Asset Risks', in Ben Caldecott (ed), *Stranded Assets and the Environment: Risk, Resilience, and Opportunity*, Chapter 9, Routledge (forthcoming, Autumn 2018).
[105] [1999] 1 BCLC 433.
[106] [1999] 1 BCLC 433, 489 (emphasis added).
[107] Barker, above n 104.

do so on an ongoing basis.[108] The second principle requires directors at all times to oversee the discharge of any functions they have delegated.[109] In practice, this means that directors must implement an oversight system to enable adequate monitoring of senior management.[110] This principle also requires directors to 'maintain an engaged and critical attitude to advice received'.[111] As such, directors' reliance on professional advisers, experts, employees and other directors will not necessarily insulate directors from breach of duty where directors have followed the advice blindly, or failed to adequately interrogate or assess it.[112]

As can be seen, the focus of s 174 is on directors' decision-making *process*, rather than the *outcome* of their decisions – the duty does not require directors to achieve a commercially advantageous result.[113] However, in arriving at any decision, directors must demonstrate that they proactively sought relevant information; interrogated and evaluated that information, including any professional advice; and monitored any activities delegated to those below them in the management chain.

Finally, there is a link between the duty of care, skill and diligence and the duty to promote the success of the company: as Lady Arden notes, s 174 requires directors to 'choose the appropriate factors to take into account for the purpose of the success duty'.[114] Similarly, Hood argues that 'the application of the factors listed in s 172(1) is a matter that comes within a director's [s 174 duty]'.[115] As such, directors not only have to manage risks and apportion appropriate weight to them (as part of their s 172 duty) but also 'identify the right risks' as part of their s 174 duty.[116] Breach of one of these duties may therefore also result in breach of the other.[117]

b) Application of duties of competence in climate risk context

In the context of climate risk assessment and management, breach of s 174 may occur in similar circumstances to those discussed in relation to s 172: namely, where climate risk poses a foreseeable and material financial risk to the company and directors have not considered that risk, or have failed to do so adequately. Directors may also breach s 174 where they have assessed climate risk but then fail to exercise reasonable care, skill and diligence in managing it. As discussed above, such failures could occur for various 'honest' reasons. However, unlike s 172, the s 174 duty is not concerned with directors' state of mind and whether they have acted honestly and loyally to the company. Rather, the focus in on directors' competence in performing their functions and the quality of their decision-making processes.

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[108] *Secretary of State for Trade and Industry v Baker (No 5) (Re Barings) (No 5)* [1999] 1 BCLC 433, 489.
[109] Joffe et al, above n 2, 22, [1.52].
[110] Arden, above n 40, 11.
[111] Joffe et al, above n 2, 22, [1.52]. See also *Re Bradcrown Ltd* [2001] 1 BCLC 547, [57]-[58]; *Green v Walkling* [2008] 2 BCLC 332, [34]-[37].
[112] Joffe et al, above n 2, 22, [1.52].
[113] In *Re Continental Assurance Company of London plc* [2007] 2 BCLC 287 Park J stated that: 'The duty is not to ensure that the company gets everything right. The duty is to exercise the reasonable care and skill up to the standard which the law expects of a director of the sort of company concerned, and also up to the standard capable of being achieved by the particular director concerned': at [399].
[114] Arden, above n 40, 11.
[115] Hood, above n 39, 18.
[116] Arden, above n 40 12.
[117] See, e.g., *Re Bradcrown Ltd* [2002] BCC 428, 439 (where the director was found to have breached both his fiduciary duty and duty of care to the company); and *Secretary of state for Business, Innovation & Skills v Pawson* [2015] EWHC 2626 (Ch), where the claimant alleged that both ss 172 and 174 were breached.

Case law indicates three key circumstances in which breach of s 174 could occur in a climate risk context: where directors (1) overlook or mismanage climate risk due to ignorance or incompetence; (2) fail to adequately supervise delegated responsibilities regarding climate risk; and (3) blindly rely on advice provided by professional advisers, or other persons, such as employees or co-directors.

i. Overlooking climate risk

The case of *Brumder v Motornet Service and Repairs Ltd* demonstrates that liability under s 174 could arise where directors overlook climate risk due to ignorance or incompetence.[118] Lord Justice Beatson's reasoning suggests that where a director pays 'no attention whatsoever' to a relevant issue, and thereby effectively 'abrogate[s] his responsibilities' as a director in relation to that issue, 'he will be in breach of his duty *qua* director under s 174(2)(a)'.[119] In that case, the director was unaware of the company's obligations under health and safety regulations and therefore effectively abrogated his responsibility to ensure compliance with the regulations. As a result, the car repair company committed regulatory breaches. In these circumstances, the Court held that the director breached his duty of care to the company.[120] Lord Justice Beatson found it was irrelevant that there may have been others more involved in setting up the workshop, or better skilled at operating it.[121]

In a climate risk context, a director could similarly breach s 174 where the director is unaware that climate change presents a material financial risk to the company, or believes there are others better equipped to consider the issue, and therefore effectively abrogates responsibility for assessing or managing that risk. As noted above, what s 174 requires of directors regarding climate risk assessment and management will depend on the decision-making context and the foreseeability and materiality of that risk to the company.[122] However, as Australian commercial barrister Noel Nutley SC has explained, there came a point in time when ignorant directors became liable for asbestos-related risks on the basis that a reasonable person would have known of such risk – and, in the relation to climate change, 'the science has been ventilated with sufficient publicity to deduce that this point has already passed…'[123]

ii. Failing to supervise delegated climate risk responsibilities

Breach of s 174 may also occur where directors are aware of climate risks and have delegated responsibility for assessing and managing this risk to senior management (or where NEDs delegate to executive directors) but then fail to implement a robust monitoring system to ensure that the delegated responsibilities are adequately performed. For example, in *Equitable Life v Bowry*, former NEDs breached their duty of care to the company by failing to exercise adequate supervisory control over the company's executive directors, whose actions caused loss to the company.[124] The court held that although the extent to which a NED may reasonably rely on the executive directors (and other professionals) to perform their duties will depend on the specific facts of the case, it is 'plainly arguable'

[118] *Brumder v Motornet Service and Repairs Ltd* [2013] EWCA Civ 195.
[119] Ibid [47] (per Lord Justice Beatson).
[120] Ibid.
[121] Ibid.
[122] This is discussed further below in section 6.
[123] Noel Hutley SC and Sebastian Hartford-Davis, 'Climate Change and Directors' Duties', Legal Opinion, 7 October 2016, available at: https://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf.
[124] [2003] EWHC 2263.

that 'a company may reasonably at least look to NEDs for independence of judgement and supervision of the executive management.'[125]

iii. Blind reliance on advice

Breach of s 174 could also occur where a director has discussed climate risk with an adviser, employee or other board member, or has received expert advice, but blindly accepts the other person's position or fails to interrogate the advice received. For example, in *Re Bradcrown Ltd*, the Court found that a director breached his duty of care to the company after he followed instructions from his co-directors and professional advisers and failed to 'take steps to satisfy himself as to the reasons for and effect of the transactions' and whether they were in the company's interests.[126] The Court found that the director 'exercised no independent judgment on the effect or utility of the transactions' in question and 'played no part in the decision making process'.[127] In these circumstances, his reliance on professional advice provided no defence.[128]

Similarly, in *Weavering Capital (UK) Ltd v Dabhia and Platt*, the Court of Appeal upheld the finding that a director breached his duty of care to the company by failing to interrogate information provided to him by another director in relation to fraudulent swap transactions and misrepresentations to investors.[129] The trial judge had found that the director 'should have realised that something was seriously amiss with the swaps … and that the swaps were being concealed from investors'.[130] The Court of Appeal accepted the trial judge's finding that had the director 'probed the information' given to him by the other director, he would have seen that that director's explanations were deficient. As such, liability under s 174 could arise where another board member adopts a position or provides advice regarding climate risk, and the director blindly accepts that position or advice without further probing or analysis.

iv. Evolving standard of care

More generally, liability under s 174 for failing to consider and manage climate risk is increasingly likely to arise because the objective limb of the standard of care provides scope for courts to consider industry norms and 'best practice' when determining whether a director fell short of the standard in a specific case.[131] Industry norms and practice regarding climate risk – often reflected in 'soft laws' such as the TCFD recommendations – demonstrate that the market increasingly expects directors to robustly assess, manage and disclose climate risk and that many are already doing so. Courts will likely consider these developments when applying the standard of care under s 174, in the same way that non-statutory accounting standards have been used to determine the standard of care expected of accountants and auditors.[132]

As climate risk awareness continues to increase and best practice solidifies, the standard of care expected of directors will likely become more stringent. For example, if the TCFD recommendations

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[125] *Equitable Life v Bowry* [2003] EWHC 2263.
[126] [2002] BCC 428, 429.
[127] *Re Bradcrown Ltd* [2002] BCC 428, 429, 436.
[128] However, the court suggested that had the director reasonably relied on the advice, he may not have breached his duty, even if the advice was wrong: at 429.
[129] *Weavering Capital (UK) Ltd v Dabhia and Platt* [2015] BCC 741, 749-50.
[130] Ibid 749.
[131] Davies and Rickford, above n 40, 67. See also Baker McKenzie and Principles for Responsible Investment, above n 4, 3.
[132] Davies and Rickford, above n 40, 67.

set the industry benchmark for climate risk assessment and reporting, it is conceivable that failure to comply with key aspects of the recommendations (such as scenario-testing) could expose directors to liability under s 174. A recent report by Baker McKenzie and PRI states that 'even the minimum standard of diligence will increasingly require more detailed and reliable information on climate risks'.[133]

In addition, the Financial Reporting Council (FRC) is currently reviewing its 2014 Guidance on the Strategic Report, which directors of listed and larger companies must produce annually under the Act.[134] The FRC has proposed a number of amendments to 'improve the effectiveness of section 172', including various references to climate change.[135] For example, the amendments provide that companies: 'should consider the risks and opportunities arising from factors such as climate change and the environment, and where material, discuss the effect of these trends on the entity's future business model and strategy.'[136] While not yet implemented, the proposed amendments demonstrate that climate risk-related soft laws are proliferating and that '[c]orporate governance inaction on climate change is increasingly likely to breach the directors' duty of due care and diligence'.[137]

c) Duties of competence conclusion

Section 174 requires directors to exercise 'reasonable care, skill and diligence' in performing their functions, including by proactively seeking information about matters relevant to the company's business. As such, where climate change poses a foreseeable and material financial risk to a company, directors will expose themselves to under s 174 in similar circumstances to those discussed in relation to s 172: where they have not considered that risk at all or have failed to do so adequately, or where they fail to adequately manage climate risk. In particular, case law indicates that breach of s 174 may occur where directors: overlook or disregard climate risk due to ignorance or incompetence, fail to adequately supervise delegated climate risk responsibilities, or unquestioningly accept others' views or rely on their advice.

Liability will not attach simply because directors' assessment of a particular matter ultimately proves to be 'wrong', and the company suffers financially as a result. Instead, the focus of s 174 is on directors' decision-making process. Directors will protect themselves from liability where they proactively seek information about climate risk (including by obtaining professional advice where appropriate); probe and interrogate any advice received; and implement robust oversight mechanisms to ensure that delegated climate risk responsibilities are appropriately discharged. Prudent directors will appreciate the increasing importance of such steps, as recent soft law developments (such as the FRC's proposed amendments to the Guidance on the Strategic Report) and evolving industry practice (as

[133] Baker McKenzie and Principles for Responsible Investment, above n 4, 4.
[134] Companies Act 2006, Chapter 4A. The Guidance is being amended to give effect to the new regulations for non-financial reporting, effective 1 January 2017. The FRC is recently consulted on its proposed amendments, with comments due on 24 October 2017. See FRC, 'FRC Consults on Non-financial Reporting Guidance', 15 August 2017, available at: https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/August/FRC-consults-on-non-financial-reporting-guidance.aspx.
[135] See FRC, 'FRC Consults on Non-financial Reporting Guidance', 15 August 2017, available at: https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/August/FRC-consults-on-non-financial-reporting-guidance.aspx.
[136] FRC, 'Draft Amendments to Guidance on the Strategic Report: Non-financial Reporting' (August 2017) 24, [17], available at: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Invitation-to-comment-Draft-Amendments-to-Strateg.pdf.
[137] Sainty, above n 82, 86.

reflected by the widespread support for the TCFD recommendations) suggest that an increasingly stringent standard of care will apply to directors' assessment and management of climate risk.

4. Duty of disclosure

The importance of accurate disclosure of a company's financial position and the risks and opportunities it faces is a 'universal cornerstone of commercial law'.[138] The absence of this information can lead to inefficient allocation of capital because insurers are unable to make fully informed financial decisions.[139] In particular, failure to disclose climate risk may mean that 'investors cannot manage risks and opportunities associated with an energy transition'.[140] For example, it has been argued that if ExxonMobil had integrated climate risk into its assessments of the company's financial position it may have reported its reserves differently in 2016 and, in turn, 'investors might have taken another view of the company's future trajectory'.[141] The financial decision-making of other key financial sector stakeholders, including banks and insurers, will also be impacted by inadequate climate risk reporting.

This paper primarily focuses on the general duties owed by directors to their company and how relevant duties could be breached in the context of climate risk assessment and management. However, corporate reporting and disclosure laws have a strong link to directors' duties because disclosures (or lack thereof) can reveal the extent to which directors have complied with their general duties – for example, by demonstrating whether (and how thoroughly) directors have considered climate risk in accordance with their duties under sections 172 and 174. The following section therefore considers key corporate disclosure laws relevant to climate risk. It also considers separate sources of liability for directors where climate risk reporting (or the absence thereof) is misleading or fraudulent because it fails to present a true and fair picture of the company's performance, risk profile or long-term business viability. Scenarios in which such liability might arise are also discussed.

a) *Key corporate disclosure laws relevant to climate risk*

Companies' corporate disclosure obligations most relevant to climate risk are contained in the Act, which includes a number of provisions to make financial and non-financial information about companies available to the market and to ensure the 'quality and reliability' of this information.[142] 'Soft laws', including codes and guidances, assist companies to interpret and comply with these obligations.[143] Industry norms and best practice – including the TCFD recommendations – may also inform the interpretation of disclosure obligations, including materiality assessments.[144] Some of these disclosure obligations and soft laws are discussed below.

i. Strategic Report

The reporting obligation particularly relevant to climate risk is the 'duty' of directors of all companies (except those entitled to the small companies exemption) to prepare a Strategic Report for each financial year.[145] The Strategic Report must contain 'a fair review of the company's business' and describe the 'principal risks and uncertainties facing the company'.[146] This review must provide a

[138] Barker, above n 104.
[139] de Wit and Vilagosh, above n 6, 78.
[140] Baker McKenzie and Principles for Responsible Investment, above n 4, 1.
[141] Elisabeth Jeffries, 'ESG: The Climate Conundrum', IPE, July / August 2017.
[142] Rickford and Davies, Part 2, 240.
[143] Baker McKenzie and Principles for Responsible Investment, above n 4, 2.
[144] Ibid.
[145] Companies Act 2006, ss 414A-B.
[146] Companies Act 2006, s 414C(2).

'balanced and comprehensive analysis' of the 'development and performance of the company's business' during the relevant financial year and the position of the company at the end of the year.[147] Listed companies must also:

- report the 'main trends and factors likely to affect the future development, performance and position of the company's business', as well as information about other matters, including 'environmental matters' (or explain why it has not included such information);[148]
- include a description of the company's strategy and business model;[149] and
- provide a 'non-financial information statement' in their Strategic Report (this requirement also applies to banks and certain insurance firms).[150] This must include information about the impact of the company's activity in relation to various matters, including the environment, and 'a brief description of the company's business model' and 'the principal risks' in relation to these matters.[151]

Although directors are not expressly required to report on climate risk in the Strategic Report, the above requirements – in particular, to report 'principal risks and uncertainties', 'key trends' and other factors likely to impact the company's business model and future prospects – may indirectly require disclosure of climate risk where it poses a material financial risk to the company.[152] In these circumstances, directors who fail to do so could be criminally liable. Directors commit a criminal offence where they approve a Strategic Report, and knew that it was non-compliant with the requirements under the Act, or were reckless as to whether it was compliant.[153] Directors will also be criminally liable where they fail to take reasonable steps to secure compliance, or prevent non-compliance.[154]

Failure to (adequately) disclose climate risk in the Strategic Report may also indicate that directors' have not complied with their general duties to the company, which would include assessing and managing that risk.[155] For example, the Report may only cursorily acknowledge climate risk or fail to outline clear strategies for managing it.[156] Indeed, the Act provides that the very purpose of the Strategic Report is 'to inform members of the company and help them assess how the directors have performed their duty under s 172'.[157]

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[147] Companies Act 2006, s 414C(3).
[148] Companies Act 2006, s 414C(7).
[149] Companies Act 2006, s 414(8)(a)-(b).
[150] Companies Act 2006, ss 414CA and 414CB.
[151] Companies Act 2006, s 414CB(1)-(2).
[152] Baker McKenzie and Principles for Responsible Investment, above n 4, 3.
[153] Companies Act 2006, s 414D(2)(a).
[154] Companies Act 2006, s 414D(2)(b). More generally, directors also commit an offence where they 'failed to take all reasonable steps for securing compliance' with the duty to prepare the Strategic Report: Companies Act 2006, s 414A(5).
[155] Failure to comply may also result in regulatory complaints: see ClientEarth, 'ClientEarth Triggers Review of Companies' Climate Disclosures', 22 August 2016, available at: https://www.clientearth.org/clientearth-triggers-review-companies-climate-disclosures/.
[156] Baker McKenzie and Principles for Responsible Investment, above n 4, 4-5. The report states that 'even the minimum standard of diligence will increasingly require more detailed and reliable info on climate risks': at 4.
[157] Companies Act 2006, s 414C(1).

In addition, as discussed above, the FRC has proposed a number of amendments to its Guidance on the Strategic Report, some of which would have important implications for climate risk reporting and its relationship to directors' duties.[158] For example, the proposed amendments provide that companies 'should consider the risks and opportunities arising from factors such as climate change and the environment, and where material, discuss the effect of these trends on the entity's future business model and strategy.'[159]

ii. Corporate Governance Code

The UK's Corporate Governance Code ('the Code') is a 'soft law' instrument that 'sets good practice on board leadership and effectiveness' to help achieve long-term success for companies.[160] While the Code is generally voluntary, companies with a Premium Listing of equity shares in the UK are required to report on their compliance with the Code, or explain why the company has not complied with any of its provisions.[161]

As with the Strategic Report, the Code does not expressly mention climate risk. However, a number of Code provisions may be highly relevant to climate risk. For example:

- The Code provides that boards should to include a 'Viability Statement' in their Strategic Report, to enable investors to assess the company's long-term viability.[162]
- The Code's Risk Management and Internal Control principle states that boards should identify, assess and monitor key risks facing the company and that this information should be contained in the annual report.[163]
- The Code provides that: 'directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company'.[164]

In light of these provisions, where climate change presents a material financial risk to the company, compliance with the Code would require companies to disclose this risk and its implications for the company in the long-term. A company's failure to (adequately) do so – or a company's failure to comply with the Code at all – could indicate that directors have also failed to comply with their general duties. As such, though largely voluntary, the Code may help elicit evidence to ground a claim for breach of directors' duties for failure to adequately assess and manage climate risk.

[158] See FRC, 'FRC Consults on Non-financial Reporting Guidance', 15 August 2017, available at: https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/August/FRC-consults-on-non-financial-reporting-guidance.aspx.
[159] FRC, 'Draft Amendments to Guidance on the Strategic Report: Non-financial Reporting' (August 2017), 24, [17], available at: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Invitation-to-comment-Draft-Amendments-to-Strateg.pdf.
[160] Baker McKenzie and Principles for Responsible Investment, above n 4, 5.
[161] Ibid. The FCA Listing Rules are available at: https://www.handbook.fca.org.uk/handbook/LR/.
[162] Principle C.2.2. See also Georgina Tsagas, 'Section 172 of the Companies Act 2006: Desperate Times Call for Soft Law Measures', Social Sciences Research Network, Draft Working Paper (July 2017) 12.
[163] Principle C.2. See Tsagas, above n 162, 12.
[164] Provision 1.2.

iii. Additional sources of liability for false and misleading disclosures

Directors' liability might also arise where climate risk reporting results in false or misleading disclosures. This could occur in the context of mandatory disclosures, or where climate risk is discussed in, or omitted from various other documents, including, issue documents, investor briefings, sustainability reports and CEO press statements. In some jurisdictions, directors have a *duty* to ensure their company does not make misleading disclosures – such a duty is incidental to their other core duties.[165] While such an incidental duty does not exist under UK law, directors' civil and/or criminal liability may nevertheless arise under various other provisions, including the following:

- The **Financial Services Act 2012** provides that in certain circumstances, a person may commit a criminal offence where they make a statement that they know to be false or misleading in a material respect (or where they are reckless as to whether the statement is false or misleading), or where the person 'dishonestly conceals any material facts' in connection with a statement.[166] For example, a person will be criminally liable for such conduct where they intended to influence another person's decision to enter into a relevant agreement or to exercise any rights conferred by a relevant investment.[167]
- The **Financial Services and Markets Act 2000** establishes a civil liability regime for securities issuers to compensate shareholders for losses arising from misleading statements and dishonest omissions made in any information published on a recognised information service, including the London Stock Exchange's RNS.[168]
- The **Theft Act 1968** provides that a director commits a criminal offence where the director 'publishes or concurs in publishing a written statement or account which to his knowledge is or may be misleading, false or deceptive in a material particular', with intent to deceive members or creditors about the company's affairs.[169]

These provisions invariably provide that liability will only arise where the false or misleading statements are 'material' or relate to 'material' facts. 'Materiality' is determined in the context of the specific factual scenario. For example, for the purposes of the Strategic Report, the FRC Guidance provides that: '[i]nformation is material if its omission or misrepresentation could influence the economic decisions shareholders take on the basis of the annual report as a whole.'[170] The Guidance further states that '[m]ateriality in the context of the strategic report will depend on the nature of the matter and magnitude of its effect, judged in the particular circumstances of the case.'[171]

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[165] Barker, above n 104. For example, under Delaware law, directors have a 'duty to disclose' as part of their duties of loyalty and care to the company.
[166] Financial Services Act 2012, s 89. See *R(Young) v Central Criminal Court* [2002] EWCA Crim 548.
[167] Financial Services Act 2012, s 89(2).
[168] Financial Services and Markets Act 2000, s 90A, Schedule 10A. These provisions are directly enforceable by investors against the company. Company liability arises where directors knew, or were reckless as to whether a statement was true or misleading, or knew that an omission was a dishonest concealment of a material fact. While directors are not personally liable, company liability in these circumstances would provide strong evidence of breach of directors' general duties.
[169] Theft Act 1968, s 19. See *R v Davenport & Ors* [2005] EWHC 2828 (QB).
[170] FRC, Guidance on the Strategic Report (June 2014), 15 [5.1], available at: https://www.frc.org.uk/getattachment/2168919d-398a-41f1-b493-0749cf6f63e8/Guidance-on-the-Strategic-Report.pdf.
[171] Ibid 15 [5.4]. Materiality is discussed further in section 6 below.

The Bank of England recently warned that misleading disclosure claims may be the 'quickest to evolve' in relation to climate risk. Indeed, the first case of this kind was commenced in Australia in July 2017, with Commonwealth Bank shareholders alleging that the bank failed to properly disclose climate risk in its annual report.[172]

iv. Scenarios in which liability for false or misleading disclosures could arise

Directors' liability for false or misleading disclosures is most likely to arise where shareholders allege that they have suffered financial loss by purchasing shares at an artificially inflated price due to reliance on inaccurate climate risk reporting (or the absence thereof).[173] This may occur where there are quantitative and/or qualitative inaccuracies regarding climate risk, or where disclosures contain omissions of material climate-related information. For example, where:[174]

- **Assets are overvalued, or liability is undervalued**. For example, shareholders allege that ExxonMobil's annual reports inaccurately conveyed the extent to which climate risk was likely to impact the company, and overstated the value of its proven oil reserves. A shareholder class action was commenced in November 2016 against a number of ExxonMobil directors alleging fraudulent misrepresentation regarding climate risk.[175]
- **Climate risk is not mentioned, only cursorily discussed or obscured** amidst other information, thereby downplaying the risk or suggesting that it is not material.[176] In addition, high level or boilerplate language is 'increasingly recognised as potentially presenting a misleading picture of a company's financial position'.[177] The widespread endorsement of the TCFD recommendations by key stakeholders demonstrates that the market increasingly expects robust, company-specific analysis of the likely impact of climate risk.
- **Climate risk is understated, or the extent to which it can be managed is overstated.** For example, this may occur where the company's internal assessments of the risk are inconsistent with the (lower) level of risk reported. For example, in 2015-6, ExxonMobil was investigated in the US for allegedly committing fraud by reporting that climate risks are inherently uncertain, despite having conducted internal assessments which produced clear scientific conclusions.[178]
- **Selective disclosure** – where scenario-testing is undertaken but only positive projections are reported. For example, in the US, Peabody Energy contravened New York laws regarding false

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[172] See Slezak, above n 18.
[173] Barker, above n 104.
[174] These examples are all taken from Barker, above n 104.
[175] See 'Robbins Geller Rudman & Dowd LLP Files Class Action Suit against ExxonMobil Corporation', PR Newswire, 7 November 2016.
[176] For example, in August 2016, ClientEarth filed regulatory complaints against Cairn Energy plc and SOCO International plc alleging inadequate climate risk reporting: ClientEarth, 'ClientEarth Triggers Review of Companies' Climate Disclosures', 22 August 2016, available at: https://www.clientearth.org/clientearth-triggers-review-companies-climate-disclosures/. While such complaints were against the company and not the directors personally, the complaints may suggest that the directors failed to adequately discharge their general duties to the company.
[177] Barker, above n 104.
[178] See Barrett, Paul and Matthew Philips, 'Can ExxonMobil be Found Liable for Misleading the Public on Climate Change', Bloomberg Businessweek, 7 September 2016.

and misleading statements by only citing favourable International Energy Agency projections in its annual report.[179]

[179] See New York Attorney-General (NYAG) (2016), 'AG Schneiderman Secures Unprecedented Agreement with Peabody Energy to End Misleading Statements and Disclose Risks Arising From Climate Change' Press Release, 9 November 2016, < https://ag.ny.gov/press-release/ag-schneiderman-secures-unprecedented-agreement-peabody-energy-end-misleading>.

5. Duties applicable to other categories of directors

a) Specific categories of directors

Directors of certain financial services system participant companies may owe additional or alternative duties under UK or EU law. This section briefly considers the relevance of climate risk to corporate trustees of pension funds, banks and insurance firms, and how the duties owed by directors of these companies are engaged (and could be breached) in this context.[180] It is beyond the scope of this paper to consider the rules applicable to these directors in any detail, and this overview is intended to highlight key points of difference only.

i. Directors of corporate trustees of pension funds

Climate risk is a material consideration for pension funds because failure to consider this risk when making investment decisions could result in pension funds experiencing lower returns and valuation losses over the longer term.[181] Such losses could, in turn, give rise to liability for the pension fund's trustees for breach of the trustees' legal duties. Trustees' duties to their trust include: duty to act in accordance with the trust deed; duty to act prudently, responsibly and honestly in making investments (including seeking advice where necessary); and duty to act in the best interests of the beneficiaries. There is therefore considerable overlap between these duties and the general duties owed by directors to their companies. Trustees' liability in relation to climate risk assessment and management could therefore arise in similar circumstances to company directors, albeit from an investment perspective.[182]

Trustees can be individuals or companies.[183] Where the trustee is a company, the directors of that company will owe general duties to the company, while the trustee company will owe statutory and common law trustee duties to the trust. The principal liability threat to directors of a trustee company arises where those directors expose the company to liability for breach of its trustee duties. For example, the s 174 duty of due care may require directors of trustee companies to take reasonable steps to ensure the company does not breach its duties to the trust.

In addition, pension funds' management of climate risk has important public policy implications because shortfalls in returns could have significant implications for national welfare systems.[184] It is therefore conceivable that where mismanagement of climate risk results in significant losses for pension funds, governments may seek to recoup any resultant public costs, creating another source of potential liability for trustees (and therefore also for directors of corporate trustees).[185]

[180] Although the functions of banking, insurance and securities were historically distinct, today many large financial institutions combine more than one of these functions: KJ Hopt, 'Corporate Governance of Banks and Other Financial Institutions after the Financial Crisis' (2013) 13(2) *Journal of Corporate Law Studies* 219, 240.
[181] EU High-Level Expert Group on Sustainable Finance, above n 13, 35.
[182] See The Pensions Regulator, 'Roles and Responsibilities', http://www.thepensionsregulator.gov.uk/trustees/role-trustee.aspx
[183] Ibid.
[184] EU High-Level Expert Group on Sustainable Finance, above n 13, 35.
[185] In a somewhat analogous case, in July 2017 three local governments in California filed lawsuits against 37 carbon majors, seeking compensation for costs associated with adapting to sea level rises linked to climate change: Laura Paddison, 'Exxon, Shell and Other Carbon Producers Sued for Sea Level Rises in California', The Guardian, 26 July 2017, available at: https://www.theguardian.com/sustainable-business/2017/jul/26/california-communities-lawsuit-exxon-shell-climate-change-carbon-majors-sea-level-rises. Such cases are predicted to increase, as the future of costs of climate change 'become

ii. Directors of banks

Climate risk is relevant to banks in their investment and asset management capacity but also in relation to their financing function, when lending to companies or projects that are exposed to climate risk.[186] Some banks are already adjusting their lending policies in response to climate change. For example, Société Générale has stated that it is 'committed to limit the coal-fuelled part of its financed energy mix (installed MW) at 19% at the end of 2020, in consistency with the IEA 2°C scenario'.[187] Furthermore, a July 2017 report ranked bank practice around financing projects exposed to climate risk, and found that bank financing of 'extreme fossil fuels' had dropped significantly from the previous year.[188] However, it nevertheless found that 'many banks are falling short of restricting financing in these areas to the extent required to reach climate stability.'[189]

While banks' commitment to reducing financing of carbon-intensive projects may primarily be aimed at accelerating the transition to a low carbon economy, such action also indicates that banks are aware of the need to manage their own exposure to climate risk. This is reflected in the banking sector's support for the TCFD recommendations.[190] Shayne Elliott, chief executive of ANZ has stated that implementing the recommendations will not only improve the banks' own disclosure practices, but also signal to customers to expect heightened scrutiny of their climate-related risks.[191] In this sense, banks play a 'meta-regulatory' role by overseeing the climate risk governance of the companies to which they are a creditor.[192]

Directors' general duties under the Act also apply to bank directors. In addition, the Senior Managers Regime ('SMR') applies to senior managers of UK banks, including directors.[193] The SMR commenced in March 2016 and aims to 'improve genuine accountability in firms by removing ambiguity and clarifying individual responsibilities.'[194] It also aims to ensure that '[s]enior managers can be held accountable for misconduct that falls within their area of responsibility'.[195] As part of this new regime, a

exponentially higher' and governments seek contributions from those responsible: Olszynski, Mascher and Doelle, above n 16, 36.

[186] For example, coal mining, coal power and liquefied natural gas projects.

[187] Societe Generale, 'Societe Generale Commits to the Fight against Climate Change', 18 November 2015, available at: https://www.societegenerale.com/en/content/societe-generale-commits-fight-against-climate-change-0.

[188] Fiona Harvey, 'Top Global Banks Still Lend Billions to Extract Fossil Fuels', *The Guardian*, 21 June 2017, available at: https://www.theguardian.com/environment/2017/jun/21/top-global-banks-still-lend-billions-extract-fossil-fuels.

[189] Rainforest Action Network, BankTrack, Sierra Club and Oilchange International, 'Banking on Climate Change' (July 2017), available at: https://d3n8a8pro7vhmx.cloudfront.net/rainforestactionnetwork/pages/17788/attachments/original/1498083347/RAN_Banking_On_Climate_Change_2017-v3.pdf?1498083347. The UK's HSBC and Barclays scored above average for good practice on coal mining but achieved only a 'D' rating and below on unconventional oil and LNG exports: see Harvey, above n 188.

[190] Cuff, above n 29.

[191] Ibid.

[192] Vijaya Nagarajan, 'Banks as Regulators of Corporate Governance: The Possibilities and Challenges' (2014) 30 *Law Context: A Socio-Legal Journal* 171, 172.

[193] Baker McKenzie, 'Extending the Senior Managers Regime', 7 June 2017, 7, available at: http://www.bakermckenzie.com/en/insight/publications/2017/06/extending-senior-managers-regime/. The SMR also currently applies to building societies, large investment firms and credit unions. The Bank of England Financial Services Act 2016 ('2016 Act') extended the SMR to extends the SMR to all firms authorised under Part 4A of the Financial Services and Management Act 2000, with expected implementation in 2018.

[194] FCA, 'Strengthening Accountability in Banking: Senior Managers & Certification Regime', available at: https://www.fca.org.uk/publication/documents/strengthening-accountability-in-banking-slides.pdf.

[195] Ibid.

Code of Conduct applies to all banking staff (except those in ancillary roles), which imposes a number of duties relevant to climate risk. For example, Rule 1 states that individuals 'must act with integrity', which means that directors must not mislead clients about the risks of an investment or mislead others within the firm about a borrower's credit-worthiness.[196] Rule 2 provides that individuals must 'act with due skill, care and diligence'.[197] The SMR and the Code of Conduct provide an additional source of risk management accountability for directors of banks, thereby potentially increasing their exposure to liability in relation to climate risk management.[198] In addition, documents such as the 'Statements of Responsibilities' that map delegation, reliance and responsibility within a regulated company's senior management could inform an analysis of, for example, delegation and supervision for the purposes of an allegation of breach of s 174.

Finally, European Union laws and regulations harmonise the corporate governance of banks and may provide additional sources of responsibility and/or liability for directors of UK banks. For example, the Capital Requirements Directive IV (CRD IV) provides prudential, transparency and disclosure rules for banks, which supersede domestic corporate disclosure laws.[199] Further developments regarding banks' role in addressing and managing climate risk are forthcoming: the Bank of England is currently conducting an internal review of the impact of climate change on PRA-regulated banking institutions.[200]

iii. Directors of insurance companies

Climate risk is relevant to insurance companies in both their investment and underwriting capacities.[201] The Bank of England examined the impact of climate change on the insurance sector in its seminal 2015 report.[202] In addition, the Sustainable Insurance Forum – a network of insurance supervisors and regulators working across a variety of countries, including Australia, France, the UK and the US – recently acknowledged the significant impact of climate risk for insurers and the financial system more broadly. Nevertheless, a recent survey conducted by the Asset Owners Disclosure Project found that insurance firms are largely 'bystanders when it comes to managing climate change risk in their investment portfolios'.[203]

There are various ways in which insurance firms can actively manage climate risk. In the context of underwriting, for example, D&O insurers could carve out certain behaviour from coverage (such as

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[196] COCON, 4.1.1G.
[197] Ibid.
[198] Banks must notify the Prudential Regulation Authority of any suspected breaches of the Code, and of any disciplinary action taken. The SMR also introduces a new criminal offence where a senior manager makes or fails to make decisions, leading to the failure of a financial institution.
[199] Hopt, above n 180, 224. The CRD IV gives effect to the Basel III agreement in the EU and includes the Capital Requirements Directive (2013/36/EU) and the Capital Requirements Regulation (575/2013). See Bank of England, Prudential Regulation Authority, 'Capital Requirements Directive IV', available at: http://www.bankofengland.co.uk/pra/Pages/crdiv/default.aspx. See also the European Banking Authority's Guidelines on internal governance of banks (September 2011).
[200] Bank of England, above n 30, 104.
[201] See Bank of England Prudential Regulation Authority, above n 9. See also de la Mare, above n 24, 197.
[202] Bank of England Prudential Regulation Authority, above n 9.
[203] Asset Owners Disclosure Project, 'Global Climate Index 2017: Rating the World's Investors on Climate Related Financial Risk', available at: http://aodproject.net/wp-content/uploads/2017/04/AODP-GLOBAL-INDEX-REPORT-2017_FINAL_VIEW.pdf. See also Environmental Finance, 'Insurers are Bystanders on Climate Change Risk Management', 20 June 2017.

mismanagement of climate risk), make coverage condition on adequate monitoring of senior management, or require ongoing provision of information to the insurer requiring climate risk assessments.[204] An insurer could also require improvements to the company's risk management strategy, for example through the appointment of an audit committee or NEDs.[205]

Directors' general duties apply to directors of insurance firms. As such, failure to (adequately) consider and manage climate risk may give rise to liability on this basis. In addition, the Senior Insurance Managers Regime (SIMR) applies to senior managers with UK insurance and reinsurance firms.[206] The SIMR is similar to the SMR discussed above and may provide another source of liability for directors in relation to climate risk assessment and management. Furthermore, as with banks, insurance firms are subject to additional corporate governance rules under EU law, which may provide additional sources of responsibility and/or liability. This includes the Solvency II Directive, which has been described as 'the most advanced, comprehensive and complex framework for risk management'.[207] While Solvency II does not expressly require insurance companies to report on climate risk, such risk could (and arguably should) be included in their general risk assessments.[208]

[204] Vanessa Finch, 'Personal Accountability and Corporate Control: The Role of Directors' and Officers' Liability Insurance' (1994) 57 *Modern Law Review* 880, 888-9
[205] Ibid 888.
[206] FCA, 'Senior Insurance Managers Regime', https://www.fca.org.uk/firms/senior-insurance-managers-regime.
[207] EU High-Level Expert Group on Sustainable Finance, above n 13.
[208] Ibid 34.

6. Establishing liability

a) *Evidentiary requirements*

There are three key evidentiary hurdles to overcome in cases alleging breach of directors' duties for failure to adequately assess and manage climate risk. Evidence is needed to establish that: (1) the loss complained of is attributable to a foreseeable and material climate-related risk; (2) directors breached their duties in the manner in which they dealt with, or failed to deal with, that risk; and (3) that breach caused the loss complained of.

i. Foreseeable and material climate-related risk

It is becoming increasingly clear that climate risk does pose a material and foreseeable risk to many, if not most, companies. This is demonstrated by the ever-increasing appetite for climate risk disclosures from shareholders and investors, and the widespread support for the TCFD recommendations from key stakeholders across the corporate and financial sectors, who clearly view climate risk as a material concern in their financial decision-making. Nevertheless, the foreseeability and materiality of precise impacts of climate change on a company may be less clear. For example, Peel explains how 'gaps or uncertainties in relevant climate science' can be problematic for cases seeking to attribute a particular entity's GHG emissions to 'specific impacts'.[209] She further notes that in general, less attention has been directed at how climate change might manifest at the local level, as opposed to global or regional impacts, and that defendants exploit such gaps in knowledge to deny their contribution to climate change impacts.[210]

Similar evidentiary gaps could undermine a claim for breach of directors' duty in the context of climate risk assessment and management. For example, directors might argue that while there is scientific consensus on climate change and even the financial risk it poses to companies, the specific impact this has or is likely to have on a particular company if less certain. However, any assessment of the materiality and foreseeability of a particular climate-related risk (and whether any loss can be attributed to such risk) will very much depend on the specific circumstances of the case, and this is not necessarily an evidentiary barrier that is impossible, or even difficult, to overcome. In addition, materiality will largely be driven by market conceptions. As Andrew Vesey, CEO of AGL Ltd has stated, '[I]t's irrelevant what I believe. If markets believe it, if customers believe it, if investors believe it, if government is making policy, then what I have is a significant risk in my portfolio that I have to mitigate.'[211]

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[209] Jacqueline Peel, 'Issues in Climate Change Litigation' (2011) 1 *Carbon & Climate Law Review* 15, 18-19. Cf Sophie Marjanac, Lindene Patton and James Thornton, 'Acts of God, Human Influence and Litigation' (September 2017) 10 *Nature Geoscience* 616, available at: https://www.nature.com/articles/ngeo3019.epdf?author_access_token=OJyOF8biyt7xV-JsaU6a7NRgN0jAjWel9jnR3ZoTv0PM6YSPpYVStdF73lrDnowLWi-vlbDKpkHtU4Y5_VPnMsIQHd4aIu7mPTAlc_5BXz7EhlGqpReudxFw6skRewY4. This article discusses how recent developments in attribution science are improving the ability to attribute human influence to extreme weather events, which in turn has implications for legal duties to manage foreseeable climate-related harms.

[210] Ibid 19.

[211] Andrew Vesey, CEO, AGL Ltd, quoted in Michael Slezak and Martin Farrer, 'AGL Boss: Regardless of Climate Science, It's Time to Drop the "Emissions Business"', *Guardian Australia*, 24 February 2016, available at: https://www.theguardian.com/australia-news/2016/feb/24/agl-boss-regardless-of-climate-science-its-time-to-drop-the-emissions-business.

ii. Breach of duty

Even if it is clear that climate risk was a foreseeable and material risk, a claimant must establish that the directors breached their duty in assessing or managing that risk. As noted above, underperformance or company loss is not in and of itself sufficient to constitute breach of duty.[212] Rather, directors' decision-making processes and the robustness of the information-seeking and analysis will be scrutinised.[213] However, information that reveals the directors' decision-making processes is notoriously difficult to access,[214] and English case law 'confers on shareholders only scant corporate rights to "internal" company documents'.[215] Keay attributes this to the 'information asymmetry' that exists as a result of the separation between management and ownership.[216] Shareholders generally cannot access board papers unless authorised expressly by the directors or an ordinary resolution of the company – there is no clear right to this information under the Act. Furthermore, even where information regarding directors' decision-making processes is obtained, assessing this information may be difficult in the absence of (costly) professional advice.[217]

In the context of derivative proceedings (discussed below), after a claimant has satisfied the first stage of the permission process, courts may require the production of certain evidence to assist in making an informed decision at the second permission stage.[218] Claimants can also seek pre-action discovery of documents under the Civil Procedure Rules, however only where the applicant is likely to be a party to a prospective substantive claim (e.g. a derivative action, s 994 petition or a personal claim), and such disclosure is ordinarily provided at the expense of the applicant.[219] In addition, Keay notes that courts are 'wary of fishing expeditions'.[220] The case of *Franbar* provides an example of evidentiary difficulties in this regard.[221] In that case, the application for a derivative claim failed because although the court held that there was some substance to the complaints, there was insufficient evidence to establish a 'clear claim of breach'.[222] An application for pre-action discovery is most likely to be successful where critical documents can be identified in advance with some accuracy, and where there are clear grounds indicating that the claim is not simply speculative.

A further issue, quite separate to the issue of whether legal avenues exist for accessing documents, is whether documents of evidentiary value exist in the first place. For example, Guidance on board

[212] *Re Continental Assurance Company of London plc* [2007] 2 BCLC 287, [300]: 'The duty is not to ensure that the company gets everything right. The duty is to exercise the reasonable care and skill up to the standard which the law expects of a director of the sort of company concerned, and also up to the standard capable of being achieved by the particular director concerned'. See also *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 832.
[213] See *Overend, Gurney & Co v Gibb and Gibb* (1872) LR 5 HL 480, 487, 495; *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392, 435; *Re National Bank of Wales Ltd* [1899] 2 Ch 629, CA; *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.
[214] Andrew Keay, 'The Ultimate Objective of the Company and the Enforcement of the Entity Maximisation and Sustainability Model' (2010) 10(1) *Journal of Corporate Law Studies* 35, 59.
[215] Arad Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (inaction)' (2009) 2(3) *European Company and Financial Review* 219, 235.
[216] Andrew Keay, 'An Assessment of Private Enforcement Actions for Directors' Breaches of Duty' (2014) 33(1) *Civil Justice Quarterly* 76, 89.
[217] Ibid.
[218] Companies Act 2006, s 261(3). See also Andrew Keay, 'Assessing and Rethinking the Statutory Scheme for Derviative Actions under the Companies Act 2006' (2016) 16(1) *Journal of Corporate Law Studies* 39, 54.
[219] Civil Procedure Rules, r 31.16.
[220] See also Keay, above n 214, 63.
[221] *Franbar Holdings Ltd v Patel and Ors* [2008] EWHC 1534 (Ch) ('*Franbar*').
[222] Reisberg, above n 215, 234.

minutes produced by GC100 (a body representing general counsel and senior legal officers from FTSE 100 companies) recommends that:

> … board minutes should not be used as the main medium for recording the extent to which each of the factors of the Companies Act were discussed. Board minutes do not, after all, do so today insofar as either the common law or statutory duties require directors to consider particular factors. The minimum requirement for minutes should only be that they clearly state the decision reached.[223]

As such, obtaining evidencing the directors' decision-making processes may involve a more complex exercise of assembling contextual documents from which the directors' decision-making processes can be inferred. For example, it may be necessary to obtain a forensic analysis of contemporaneous emails or accounts from those directly or indirectly involved in the decision-making process.

However, relevantly to a climate risk claim, commentators have suggested that the evidentiary difficulties associated with proving breach may be easiest to overcome where shareholders favouring a longer-term strategic approach bring a claim against directors for instead pursuing short-term profitability. In these circumstances, breach of s 172 could be established using 'the same kinds of long-term performance benchmarks as directors adopting an inclusive long-term view might [use]'.[224] Courts could consider expert evidence on such benchmarks and financial data or modelling.[225] In addition, 'insider' information provided by a whistle-blower or lead could play a central role in establishing a viable claim.

iii. Causation

Finally, a claimant must establish that that 'the breach of duty asserted caused the loss alleged'.[226] If the alleged breach concerns an omission – such as failure to consider climate risk – then the claimant must demonstrate that compliance would have prevented the damage.[227] This may be difficult to establish. For example, in *Franbar*, the court dismissed the claim, holding that 'it is not always possible to see from either the pleadings or the evidence a clear causal link between what would, if established, be plainly unacceptable conduct and any recoverable loss'.[228] However, a definitive link between the conduct and the loss is not required. In *Lexi Holdings Plc v Luqman*, the court stated that in determining this question, the court must construct 'a necessarily hypothetical edifice so as to ascertain what would *probably* have happened if the relevant duties had been performed'.[229]

[223] GC100, 'Companies Act 2006 – Directors' duties', 7 February 2007, 6.3(f).
[224] Joan Loughrey, Andrew Keay and Luca Cerioni, 'Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8(1) *Journal of Corporate Law Studies* 79, 107. See also Lowry, above n 43, 622.
[225] Loughrey, Keay and Cerioni, above n 224, 108.
[226] *Weavering Capital (UK) Ltd v Dabhia and Platt* [2015] BCC 741, 752.
[227] *Bishopsgate Investment Management Ltd v Maxwell* [1993] B.C.C. 120, 139 (per Hoffmann LJ).
[228] *Franbar Holdings Ltd v Patel and Ors* [2008] EWHC 1534 (Ch), [21].
[229] *Lexi Holdings Plc v Luqman* [2008] EWHC 1639 (Ch), [28] (emphasis added).

b) Possible defences to a claim for breach of duty

i. 'Business judgment rule'

There is no express 'business judgment rule' in the UK, as exists in comparable jurisdictions, including Australia and South Africa.[230] However, where directors acted in good faith, courts are nevertheless reluctant to intervene in business misjudgements and as such, commentators observe that 'virtually the same result has been achieved'.[231] For example, in *R (on the application of People and Planet) v HM Treasury*, People and Planet challenged UK Financial Investment Ltd's (UKFI) environmental policy in the context of UKFI's management of the Royal Bank of Scotland plc (RBS).[232] People and Planet argued that RBS was providing more loans to environmentally unsound projects than other banks. Sales J held that while UKFI could try to influence the RBS board's consideration of environmental and human rights, it was ultimately for the RBS board to determine what approach it believed would best promote the company's success, because management decisions are a 'matters for the judgment of' the directors.[233] This approach is consistent with the Explanatory Notes to the Act, which provide that 'business decisions', including in relation to 'strategy and tactics are for the directors, and not subject to decision by the courts, subject to good faith'.[234]

In the context of derivative claims, courts' deferral to business judgments also prevents some cases from ever proceeding to trial.[235] At the permission stage in *Iesini v Westrip Holdings Ltd*, Lewison J considered – as required by the Act – whether a hypothetical director would continue the claim. The judge listed a number of relevant factors, including the size and strength of the claim; the cost of the proceedings (and the company's ability to fund these); the ability of the defendant directors to satisfy any judgment against them and the impact on the company in terms of disruption and reputation.[236] His Honour held that 'the weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case'.[237] Keay argues that this demonstrates that even at the permission stage, courts' focus is on directors' commercial judgement and the business case for the claim, rather than on the 'enlightened decision-making aspect of it'.[238]

Some commentators argue that this approach is desirable because courts should not step into the shoes of directors and evaluate their business decisions.[239] However, this position in its extreme renders it impossible to pursue claims for breach of duty.[240] Furthermore, as Keay notes, the objective components of certain duties (most obviously in relation to the duty of reasonable care, skill and diligence) arguably oblige courts review directors' decisions. It does appear that over past two decades, a more objective approach has gained traction. There are 'indications that many judges no

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[230] Arden, above n 40, 11.
[231] Loughrey, Keay and Cerioni, above n 224, 108, fn 137; Barker, above n 104. See also *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 82, PC; and *Regentcrest plc v Cohen* [2001] 2 BCLC 80, [120]. See also Joffe et al, above n 2, 12, [1.20].
[232] [2009] EWHC 3020 (Admin).
[233] [2009] EWHC 3020 (Admin), [35] (discussed in Hood, above n 39, 18-20). See also *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 82, PC; and *Regentcrest plc v Cohen* [2001] 2 BCLC 80.
[234] Explanatory Notes, [327].
[235] Keay, above n 218, 53.
[236] Tsagas, above n 162, 10.
[237] Cited in Keay, above n 218, 53.
[238] Tsagas, above n 162, 10.
[239] See, e.g., Keay, above n 214, 65-6.
[240] Ibid 66.

longer see the boardroom as sacrosanct and have not resiled from assessing decisions of management',[241] particularly relation to breach of duty of care cases.[242] As such, the UK's unofficial 'business judgment rule' will not guarantee directors a 'defence' against claims for breach of sections 172 and 174.

ii. Decision-making paper trail

The success of any claim for breach of duty under sections 172 and 174 will depend on the content and quality of board meeting minutes, not only because such information is needed to positively establish the allegations but also because such information may provide a defence for directors. This is because sections 172 and 174 duties are focused on directors' decision-making processes, rather than the outcome of their decisions. For example, directors may be protected from liability under s 172 where there is evidence that the board did discuss the negative long-term impacts of a particular action on the company, but decided to proceed on the basis of other factors.[243] In addition, a defence will be easier to establish where there is evidence that the board considered the factors stipulated in s 172(1), such as the long-term consequences of the decision, and/or reasonably relied on professional advice.[244] Case law demonstrates that maintaining an engaged and critical attitude to professional advice, and acting appropriately in accordance with it, will provide a defence against liability, even if the advice subsequently turns out to have been wrong.[245]

iii. Power of court to grant relief

Finally, a 'catch all' defence is provided by s 1157 of the Act which gives the court the power to 'grant relief in certain circumstances' – either wholly or in part – where the court considers that the director 'may be liable but that he acted honestly and reasonably' and having regard to all the circumstances of the case, 'ought fairly to be excused'. For example, reliance on professional advice may provide grounds for excusing a director from liability under s 1157. The Court may grant such relief on 'such terms as it thinks fit'. A director may also pre-emptively apply for relief, where he 'has reason to apprehend' that a claim will be made against him for breach of duty. However, case law suggests that an application for relief under s 1157 is rarely successful, particularly where the company has become insolvent,[246] or where the director has obtained a personal benefit, even if it is 'relatively trivial'.[247]

c) Personal liability and availability of directors' and officers' insurance

i. Availability of D&O insurance

The Act prohibits any releases from directors' duties, however, it does permit companies to purchase directors' and officers' (D&O) insurance to protect directors from the consequences of any such

[241] Ibid 66, fn 168.
[242] See, e.g., *Re AG (Manchester) Ltd* [2008] EWHC 64 (Ch), [2008] 1 BCLC 321; *Lexi Holdings Ltd (in administration) v Luqman* [2008] EWHC 1639 (Ch).
[243] Loughrey, Keay and Cerioni, above n 224, 106.
[244] Ibid. See also John Kong Shan Ho, '"Director's Duty to Promote the Success of the Company": Should Hong Kong Implement a Similar Provisions?' (2010) 10(1) *Journal of Corporate Law Studies* 17, 23.
[245] See *Re Bradcrown Ltd* [2001] 1 BCLC 547, [57]-[58]; *Green v Walkling* [2008] 2 BCLC 332, [34]-[37].
[246] See, e.g., *Re Marini Ltd* [2003] EWHC 334 (Ch), [2004] BCC 172, [57].
[247] See, e.g, *IT Human Resources plc v Land* [2014] EWHC 3812 (Ch), [127]-[129]; *Northampton Borough Council v Cardoza & Ors* [2017] EWHC 504 (Ch); *Gillespie Investments Ltd v Gillespie* [2010] CSOH 113, [53]-[54]; *McGivney Construction Ltd v Kaminski & Anor* [2015] ScotCS CSOH 107 [60]-[64]; *Towers* v *Premier Waste Management Ltd* CA [2012] BCC 72; *Re In a Flap Envelope Co Ltd (in liq)* [2003] BCC 487, [64].

breach.[248] Directors may also be indemnified against liability incurred by the director to a third party (but not to the company itself), with certain exceptions in relation to criminal liability and regulatory fines.[249] For example, a director cannot be indemnified for fines imposed in criminal proceedings, or for the costs of defending any criminal proceedings where the director is convicted.[250]

Superficially, the availability of D&O insurance may appear to insulate directors from any real risks associated with personal liability by protecting their personal assets.[251] The terms of D&O insurance policies vary significantly and may be 'tailor-made' for specific clients.[252] However, a typical D&O policy will cover directors for all acts, errors or omissions in the course of performing their functions as directors, which in theory, would include their management of climate risk.[253]

However, a number of typical exclusions may operate to significantly limit coverage in relation to climate risk assessment and management.[254] First, although the Act permits insurance for directors' liability to the company, D&O policies may only cover 'third party losses' – such as those suffered by a customer or supplier – as a result of a director's wrongful conduct.[255] As such, a director may not be covered for costs associated with a derivative claim against them for breach of their duties to the company.[256] In addition, coverall exclusions for 'prior known matters' may prevent coverage where climate risk was foreseeable, or in cases of fraud or dishonesty.[257] Simic also notes that it is common for exclusions to apply where there has been 'wilful violation' or breach of a law or a duty imposed by such a law.[258] Given the increased recognition of the financial risk associated with climate change, total failure to consider such risk could conceivably constitute such wilful violation. Finally, D&O insurers – increasingly aware of the financial risks associated with climate change and directors' liability in this context – may specifically exclude coverage, for example, where 'boards fail to demonstrate a prudent and diligent approach to climate risk governance'.[259]

A separate, more fundamental issue is whether D&O insurers will be able provide coverage for directors' management of climate risk, should climate change risks materialise on a significant scale.[260] Individual policies may impose caps, such that coverage, even where available, is not co-extensive with loss.[261] However, questions also arise regarding the systemic capabilities of the

[248] Companies Act 2006, ss 232-3.
[249] Companies Act 2006, s 234.
[250] Companies Act 2006, ss 234(3)(a)(i), 234(3)(b)(i). See also Davies and Rickford, above n 40, 69.
[251] See Avryl Lattin, Yvonne Lam and Jack Hunt, 'Identifying and Managing Emerging Risks for Directors and Officers', *Governance Directions* (June 2017), 304; Melita Simic, 'Climate Change on the Corporate Governance Landscape', *Governance Directions* (December 2016), 650. For example, the Bank of England has noted that liability risks associated with climate change are particularly relevant to insurance firms, which assumes that D&O insurance will cover directors for climate change related claims: Bank of England, above n 30.
[252] Finch, above n 204, 898.
[253] Simic, above n 251 650.
[254] de la Mare, above n 24, 206. Simic notes that because D&O insurance emerged in the 1930s, well before the advent of climate change, these gaps in coverage may not necessarily be intentional – climate change impacts may simply not fit within existing definitions or may fall within historical exclusions: above n 251, 650.
[255] Simic, above n 251, 652.
[256] Ibid.
[257] Ibid 651.
[258] Ibid 652.
[259] Ibid.
[260] de la Mare, above n 24, 198.
[261] Lattin, Yam and Hunt, above n 251, 305.

insurance sector. De la Mare argues that 'we are sailing towards a perfect storm', whereby D&O insurers will either become insolvent (due to not being permitted to charge the premiums required to cover the risk), or, they will exit the market because companies will be 'unable to afford the actuarially-true premiums'.[262]

An example of such a D&O insurance 'crisis' occurred in the US and Canada in the mid-1980s, where affordable and effective D&O coverage became unavailable.[263] For certain firms (such as those producing hazardous substances), coverage was simply denied, while for other firms, levels of coverage decreased and excesses increased.[264] Premiums also increased dramatically – between 211 and 2,076 per cent between 1984-7.[265] Contributing to this crisis were several factors, including the 'inherent difficulty in predicting the risks involved in "D&O" insurance' (due to 'random' factors such as individual behaviour; high variety of risks; wide ranges for damages quantum).[266] Of particular relevance to climate risk, the increased liability of directors in the US (as a result of substantive changes to the law) was also as a key factor contributing to the crisis.[267] Finch argues that such changes to the law created 'nervousness' in the D&O insurance industry, which 'is highly vulnerable to shocks'.[268]

Writing in 1994, Finch suggested that changing directors' duty of care to impose an objective test (in contrast to the common law subjective test that applied at that time) could similarly impact the D&O market in the UK.[269] Precisely this change occurred with codification in 2006 (although an objective standard had begun to be imposed under the common law prior to this). While there has not yet been a D&O insurance crisis in the UK comparable to the US crisis described by Finch, such a shock is certainly conceivable as directors' potential liability for climate risk assessment and management is increasingly recognised – particularly if one such a case is successful, or even just commenced. This means that D&O insurance cannot be taken for granted either by directors hoping to avoid personally paying for company loss associated with their climate risk mismanagement, or by would-be claimants, in circumstances where directors might be impecunious.

d) Plausible scenarios for how liability risk might emerge

In the above analysis, various scenarios were discussed as potentially giving rise to directors' liability for breach of their general duties in a climate risk context – for example, failure to obtain or properly consider expert advice regarding the likely impact of climate change on the company. This section provides examples of more specific conduct, as well as general strategic approaches that could also give rise to liability.

[262] de la Mare, above n 24, 235-6.
[263] Finch, above n 204, 892.
[264] Ibid 893.
[265] Ibid.
[266] Ibid 894.
[267] Ibid.
[268] Ibid 896.
[269] Ibid 903. Although Finch acknowledged that the difficulty of establishing a derivative claim may counter this. Derivative claims are discussed further in section 7.

i. Conduct that may breach directors' duties

A recent report by the Bank of England and others describes risk management as a three-stage process:[270]

1. **risk-identification** – for example, strategic reviews using forward-looking models.
2. **risk assessment** – this includes basic estimation of exposure to detailed analysis of risks, including via stress-testing, scenario analysis and modelling techniques; and
3. **risk management** – activities undertaken to reduce risk exposure.

Liability could arise in relation to directors' conduct at each of these three stages. At the most basic level, directors may expose themselves to liability where they fail to equip themselves to properly complete each stage. For example, in relation to risk identification, breach of duty may occur where directors of a financial institution fail to consider which climate change related factors pose risks to the institution's financial assets and liabilities – for example, a natural disaster insurance policy could be a risk to liability, if the event probability is underestimated.[271] In relation to risk assessment, breach of duty could occur where directors fail to translate these risk factors into quantitative measures of financial risk that can, in turn, inform risk management and investment decisions.[272]

Liability could also arise at the risk-identification and assessment stages where directors fail to invest in technology or ensure there is sufficient internal expertise to identify the impact of climate change on company assets and business operations.[273] Breach may also occur where internal risk assessments are conducted but external 'expertise assurance' is not used to test the data obtained.[274]

Regarding risk management, breach could occur where strategic approaches are taken which ignore or increase climate risk exposure. For example, a recent E3G paper identifies five plausible strategies that oil and gas majors could take in response to the transition to a low carbon economy.[275] For example, the 'planned transformation' strategy involves diversifying out of oil into gas and/or clean energy, which is arguably consistent with directors' duty to pursue the company's long-term viability.[276] However, certain other approaches may result in breach of duty – for example, the 'ostrich' approach, where the company ignores the transition and fails to 'take a proactive approach to managing its fortunes'.[277]

Finally, failure to implement a clear disclosure strategy that is useable and relevant could result in breach of disclosure obligations and also provide evidence for breach of directors' duties in relation to

[270] Bank of England, the UN Environment Inquiry and the University of Cambridge Institute for Sustainability Leadership 'Enhancing Environmental Risk Assessment in Financial Decision-Making' (July 2017) 7.
[271] Ibid 5.
[272] Ibid.
[273] Nava Subramaniam, 'Climate Change Risk Disclosure: A Challenging Frontier', *Governance Directions* (November 2016), 600.
[274] Ibid.
[275] Ingrid Holmes, 'Pathways to 1.5/2oC-Compatible Oil: Is Managed Decline the Only Way?, E3G (February 2017), available at: https://www.environmental-finance.com/assets/files/research/E3G_Briefing_Future_pathways_2degC_oil_FEB2017.pdf.
[276] Ibid 3.
[277] Ibid.

any or all of the risk management categories. It could also result in a claim for fraudulent or misleading corporate reporting.[278]

[278] Subramaniam, above n 273, 600.

7. Procedural considerations

a) Standing and derivative actions

The Act provides that directors owe their general duties to the company.[279] As such, the duties are enforceable by the company only, with certain exceptions. As a result, there are four key categories of claim that can be brought for breach of directors' duties, each discussed below.[280] However, enforcement of directors' duties via these avenues has been historically difficult.[281] It should also be noted that unlike comparable jurisdictions, such as Australia and the US, there is no regulator in the UK that can enforce breaches of directors' duties. The disqualification regime for directors under the Company Directors' Disqualification Act 1985 is, with the exception of criminal proceedings, the only public intervention for errant directors.[282]

i. Action by the company

Power to bring proceedings on behalf of the company is generally vested with the board of directors by virtue of the Articles of Association granting the board the power to manage the company's affairs.[283] However, boards may be reluctant to bring claim against directors, particularly where the board itself are the wrongdoers, or if there is a close connection between the impugned director/s and the board.[284]

ii. Action by administrators or liquidators

Administrators and liquidators can bring a claim against former directors for breach of their general duties.[285] While it is rare for administrators to do so, liquidators have brought such proceedings in the past.[286] However, it may be difficult for liquidators to obtain evidence of breach if the breach occurred long before the liquidator was appointed.[287]

iii. Derivative claims by shareholders

Part 11 of the Act outlines the circumstances in which directors' duties may be enforced by a shareholder on behalf of the company via a 'derivative claim'. Derivative claims are the primary means through which breach of directors' duties are enforced.[288] They may be made against current or former directors and shadow directors.[289] It is irrelevant whether the shareholder was a member of the

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[279] Companies Act 2006, s 170(1).
[280] For full explanation of this taxonomy, see Keay, above n 216. See also Arden, above n 40, 9.
[281] Keay, above n 216, 77.
[282] Directors can be disqualified for up to 15 years where the Secretary of State believes there are sufficient grounds. However, action under this regime is rarely taken for misconduct (as opposed to criminal conduct): Andrew Keay and Michelle Welsh, 'Enforcing Breaches of Directors' Duties by A Public Body and Antipodean Experiences' (2015) 15(2) *Journal of Corporate Law Studies* 255, 278-9. Note, however, that NGO complaints may be made: Cairn and SOCO.
[283] Keay, above n 216, 79; Keay and Welsh, above n 282, 256. However, this could also occur via a majority of shareholders: Lowry, above n 43, 618.
[284] Keay, above n 216, 79; Keay and Welsh, above n 282, 256.
[285] Keay, above n 216, 80; Insolvency Act 1986, ss 165(3), 167(1)(a), Sch 4 para 4.
[286] See, e.g., *Roberts v Frohlich* [2011] EWHC 257 (Ch); *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch).
[287] Keay, above n 216, 80.
[288] Keay and Welsh, above n 282, 256. Derivative actions can also be brought by shareholders of the company's parent company: see *Waddingon Ltd v Chan Chun Hoo Thomas* [2008] HKCU 1381; *Universal Project Management Services Ltd v Fort Gilkicker Ltd & Ors* [2013] EWHC 348 (Ch), [44]-[49]. See also Clare Stanley, 'The Personal Liability of Directors to Third Parties and Shareholders' (2013) 19(5) *Trusts & Trustees* 388, 405-6.
[289] Companies Act 2006, s 260(5).

company at the time that the cause of action arose.[290] Derivative claims can be pursued to prevent 'proposed' acts or omissions, as well as to remedy those that have already occurred.[291] This may be important in a climate risk context, where shareholders may wish to pre-emptively challenge directors' conduct to prevent them from increasing the company's exposure to climate risk, or to compel them to adequately manage this risk – for example, shareholders may wish to prevent the purchase of additional carbon-intensive assets, where directors have made a bid for the assets.[292]

However, there have been very few derivative claims since the Act was introduced in 2006.[293] This is largely attributable to the strict permission process, which must be overcome before the claim can proceed.[294] The permission process involves two stages – first, the court must be satisfied that there is a prima facie case for permission to be granted; if so, the matter will proceed to hearing to determine the permission application (although the two stages may be combined).[295] The court must consider a number of factors when deciding whether to grant permission.[296] This includes whether a hypothetical director acting in accordance with s 172 would continue the claim – if they would not, then permission must be refused. Permission must also be refused if the directors' actions or omissions were ratified by a general meeting of members, or might have been ratified, had the cause of action not been commenced.[297] This could arise, for example, where the majority of members do not think there is merit in pursuing litigation, given costs and uncertainty of outcome.

Other factors are discretionary, and although courts must consider them, they are not determinative of the application.[298] For example, the importance that a hypothetical director would attach to the claim and whether the shareholder is acting in good faith by pursuing it.[299] A further consideration is whether the shareholder could instead pursue an action in his or her own right.[300] For example, in *Mission Capital*, one of the reasons the claim was dismissed was because nothing could be recovered via derivative action that could not be recovered via an unfair prejudice claim (discussed below).[301]

The requirement for courts to consider whether a hypothetical director would pursue the claim (and how much importance they place on it) is particularly prohibitive, as it means that an application is unlikely to be successful where pursuing the claim is not in the financial interests of the company – in other words, the business case for the claim is very much the focus.[302] For example, in *Franbar*, the court considered that a hypothetical director would consider various factors, including the likelihood of

[290] Companies Act 2006, s 260(4).
[291] Companies Act 2006, s 260(3).
[292] Companies Act 2006, s 260(4).
[293] As of September 2015, only 22 derivative actions had been initiated in England, Wales and Northern Ireland since the introduction of the Act in 2006, averaging 2.75 cases a year: Keay, above n 218, 41. See also Keay and Welsh, above n 282, 257.
[294] Companies Act 2006, s 261. See also Arden, above n 40, 13; Keay, above n 214, 40.
[295] Companies Act 2006, ss 261-2; Civil Procedure Rules, r 19.9(a); *Mission Capital Plc v Sinclair & Anor* [2008] EWHC 1339 (Ch), [36] ('*Mission Capital*').
[296] Companies Act 2006, s 263.
[297] Companies Act 2006, ss 263(2)(c), 263(3)(c).
[298] Companies Act 2006, s 263(3).
[299] Companies Act 2006, s 263(a)-(b).
[300] Companies Act 2006, s 263(3)(f).
[301] *Mission Capital Plc v Sinclair & Anor* [2008] EWHC 1339 (Ch), [46]. See also *Franbar Holdings Ltd v Patel and Ors* [2008] EWHC 1534 (Ch), [49]-[54]. Cf *Cullen Investments Ltd v Brown* [2015] EWHC 473 (Ch) [61] (per Norris J).
[302] Tsagas, above n 162, 10.

the company being able to recover any damages awarded, the proceedings' disruption to business, the costs of proceedings, and damage to the company's reputation, should the proceedings fail.[303] In *Mission Capital*, an application for a derivative claim against directors for breach of duty was unsuccessful because Floyd J held that a director acting in accordance with s 172 would simply replace the rogue directors, rather than pursue a claim against them.[304]

This focus on the hypothetical director and commercial considerations may undermine derivative claims where activist shareholders are seeking to pursue the claim largely for public interest or symbolic reasons – case law suggests that substantial loss (or potential loss) to the company is required. However, in a climate risk context, substantial loss to the company as a result of climate risk mismanagement is a real possibility. It is therefore conceivable that such claims would surmount the stringent requirements of the permission process.

Quite apart from the strict permission stage, there are additional barriers to commencing derivative claims, which manifest as disincentives, rather than legal hurdles.[305] This includes potentially prohibitive costs; fear of free-riding; lack of information; damage to company reputation; and relative lack of benefit.[306] The latter issue may arise because personal losses cannot be pursued via derivative action and even if the amount awarded to the company is significant, an individual shareholder may receive only a fraction of this.[307]

In light of all these barriers, both legal and non-legal, most derivative actions involve private companies, as it is more difficult for these shareholders to transfer shares and they may feel the impact of any diminution share value more acutely.[308] Indeed, Keay describes there being a 'dearth' of cases involving derivative actions by shareholders of public companies.[309] Overall, academic opinion is that derivative actions are 'not effective as instruments of corporate governance'.[310] However, in this does not mean that a derivative claim cannot ever be effective in this regard. In particular, commentators have argued that where directors pursue short term profits contrary to shareholders' preference for long-term, sustainable success, breach of s 172 could form the basis of a derivative claim.[311] There is therefore certainly some scope for derivative claims based on climate risk management to proceed beyond the permission stage and be litigated fully.

iv. Private action by shareholders for unfair prejudice

Directors' duties are owed to the company and can therefore only be enforced by shareholders derivatively. However, there may be circumstances where a shareholder can make an 'unfair prejudice' claim against a director on the basis of breach of the director's duties to the company.[312] Such a claim alleges that the company's affairs were conducted in a manner that was unfairly prejudicial to the shareholder. This cause of action is also known as the 'oppression remedy'. Although the oppression

[303] *Franbar Holdings Ltd v Patel and Ors* [2008] EWHC 1534 (Ch), [36].
[304] *Mission Capital Plc v Sinclair & Anor* [2008] EWHC 1339 (Ch), [43]. See also Arden, above n 40, 14.
[305] Keay, above n 216.
[306] See ibid, where these disincentives are outlined and discussed in detail.
[307] Ibid 88.
[308] Ibid 85.
[309] Ibid 85.
[310] Ibid 91.
[311] Loughrey, Keay and Cerioni, above n 224, 106.
[312] Companies Act 2006, s 994.

remedy is almost always used in private companies, it is possible to bring an unfair prejudice claim against a public company.[313]

Because of the strict permission process associated with derivative claims, unfair prejudice claims are a more common cause of action.[314] The oppression remedy may also be more appealing for claimants because any remedy awarded will flow to the shareholder directly.[315] However, there is a very fine distinction between the circumstances in which a derivative action is appropriate (and therefore available), and when the oppression remedy should instead be pursued (and vice versa).[316] In *Re Charnley Davies Ltd (No2)*, Millett J explained the distinction. His Honour stated that the same facts could found either action, but the nature of the complaint and the relief sought will be different – if the shareholder's essential complaint is the unlawfulness of the director's conduct, with the result that any order made would be for restitution, then a derivative action is appropriate.[317] However, if the unlawful conduct is alleged to be evidence of the manner in which the director conducted the company's affairs in a way that disregarded the shareholder's interests (and the shareholder wishes to have their shares purchased on that basis), then the oppression remedy is appropriate.[318]

As such, the oppression remedy 'tends to personalise the effects of the board's wrongful action'.[319] While derivative claims focus on 'corporate-regarding behaviour' and 'collective outcomes', the oppression remedy focuses on 'personal rights' and 'purely personal benefits'.[320] A shareholder wishing to pursue an unfair prejudice claim on the basis of breach of duty must therefore demonstrate that the breach occurred in the course of prejudicial conduct directed at them personally, not just towards the company. However, a decrease in share value can count as 'prejudice' for the purposes of s 944 – in other words, it is not fatal to a claim by certain members that they have been unfairly prejudiced that all members have suffered a loss.[321]

It is well established that misuse of directors' powers for ulterior purposes, in breach of their fiduciary duties, involves those directors 'step[ping] outside the terms of the bargain between the shareholders and the company', such to found an unfair prejudice claim.[322] However, unfair prejudice may be difficult to establish in relation to climate risk mismanagement in breach of s 174.[323] For example, in *Re Elgindata Ltd*, the court stated that shareholders consciously take the risk when investing that management may not be of high quality – the court was therefore hesitant in finding that a member has a right to expect that a reasonable standard of care will be exercised by directors.[324] A court may be so willing where there is 'persistent and serious' mismanagement, as in *Re Macro (Ispwich) Ltd*.[325]

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[313] See *Clark v Cutland* [2003] EWCA Civ 810.
[314] Keay, above n 216, 84.
[315] Keay, above n 218, 61.
[316] Ibid 60.
[317] [1990] BCLC 760.
[318] Cited in Keay, above n 218, 64.
[319] Keay, above n 214, 54.
[320] Ibid 56.
[321] In *Re Sam Weller & Sons Ltd* [1990] Ch 682, 691E-692D.
[322] *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14, 18c.
[323] See *Re EAP Securities Ltd* [2010] EWHC 2421, [41].
[324] Keay, above n 216, 81.
[325] Ibid 82.

However, in general, while many unfair prejudice claims are based on breach of directors' duties, these usually involve directors who have engaged in misconduct, rather than mismanagement.[326]

Despite this hurdle, there is still some scope for an unfair prejudice claim to be pursued in the context climate risk mismanagement, particularly in relation to a breach of s 172, and where a derivative action is not possible (for example, because a majority of members have approved the errant directors' action or refused to commence proceedings).[327] For example, such a claim could be based on breach of s 172 for failure to consider climate risk, which, although affecting the company as a whole, arguably unfairly prejudiced shareholders expected to obtain returns over the longer term, and who invested on the basis that the directors would pursue the long-term success of the company. While such a claim may appear novel, the unfair prejudice remedy is very flexible 'as a matter of statutory design'.[328] It has also been described as 'one of the most important measures for the protection of minority shareholders in the common law world' because despite its personal nature, its lack of clarity regarding its parameters means it may effectively permit 'the vindication of corporate claims'.[329]

b) Remedies

The Act does not codify remedies for breach of directors' general duties. However, it outlines the 'civil consequences' for breach (or threatened breach) and provides that those consequences are 'the same as would apply if the corresponding common law rule or equitable principle applied'.[330] It further provides that equitable remedies are therefore available for breach of those duties that are fiduciary (i.e. all duties with the exception of s 174).[331]
Breach of fiduciary duty may give rise to a variety of equitable remedies, including the following:

- constructive trust;
- an account of profits;
- equitable compensation; and
- rescission, with an injunction.[332]

The general rule is that the remedy for breach of a director's duty of reasonable care, skill and diligence is compensation for the harm that the director's conduct has caused the company.[333]

Where there has been a decrease in share price as a result of decrease in value in the company (as a result of climate risk mismanagement), the likely claim – whether based on breach of section 172 or 174 – would be for compensation. Where a claim for breach of directors' duties is brought derivatively

[326] Koh, 'Reconstructing the Reflective Loss Principle', 387; Hannigan, 614. See Re London School of Electronics (director misappropriated company's assets); Dalby v Bodilly (director allotted himself an additional 900 shares). See also Maidment v Attwood re breach of fiduciary duty (cited in Keay, above n 216, 82.)
[327] Cf Joyce Lee Suet Lin, 557, who argues that after the case of Johnson, it will be very difficult for shareholders to bring a personal action to recover diminution in share value as a result of a wrong committed against the company.
[328] Alan K Koh, 'Reconstructing the Reflective Loss Principle' (20106) 16(2) *Journal of Corporate Law Studies* 373, 388. See Companies Act 2006, s 996.
[329] Pearlie Koh, 'The Oppression Remedy – Clarifications on Boundaries' (2015) 15(2) *Journal of Corporate Law Studies* 407, 407.
[330] Companies Act 2006, s 178(1).
[331] Companies Act 2006, s 178(2).
[332] Hood, above n 39, 7; Langford, above n 33, 234.
[333] *Brumder v Motornet Service and Repairs Ltd* [2013] EWCA Civ 195, [49] (per Lord Justice Beatson).

by shareholders, any remedies will be awarded to the company itself. For example, compensatory damages would not be awarded to shareholders.

With respect to anticipated breaches of the s 172 and s 174 duties, declaratory or injunctive relief may be available against a company's directors.[334] The party directly entitled to enforce those duties is the company itself. For example, a derivative claim could be brought (with the support of a majority of members) where constraints of time or organisation would make it difficult to mobilise the majority to alter the directors' course of action before it occurred.

For unfair prejudice claims, the Act outlines five types of relief which may be granted.[335] For example, the court may regulate the future conduct of the company's affairs; require the company to undertake (or refrain from undertaking) a specific action; or provide for the purchase of shares from a member by other members or the company itself.[336] The most common remedy sought is a buyout order, whereby shares are purchased from the shareholder at a price determined by the court.[337] As with derivative claims for breach of s 172 or 174, unfair prejudice claims could also, in theory, be founded on directors' anticipated acts.[338]

c) *Costs, collective action and litigation funding*

The potential costs of bringing an action against directors can be prohibitive for shareholders. Where the claim is unsuccessful, the shareholder may have to pay their own and the directors' legal fees.[339] With respect to derivative claims, the court can require the company to indemnify the shareholder for legal costs associated with the claim, but such an order will be granted only after the shareholder has passed the permission stage and the indemnity may be capped.[340] The court may also order the company to indemnify the claimant for costs incurred during the permissions stage but is unlikely to order the company to pay the shareholder's legal fees where the application is unsuccessful.[341] Furthermore, no indemnities will be available to shareholders where they are pursuing an unfair prejudice claims, as such a claim is not made on the company's behalf.[342]

The issue of costs not only affects minority shareholders – institutional investors may also be unwilling to bear the potential costs of an unsuccessful case, as these costs cannot be passed onto the client.[343] Shareholders of all types may also be discouraged by the prospect of having to contribute all the resources and bear all the financial risk associated with litigation, when, if successful, other shareholders will benefit by 'free-riding'.[344]

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[334] Companies Act 2006, s 260(3).
[335] Companies Act 2006, s 996(2).
[336] Companies Act 2006, ss 996(2)(a), 996(2)(b), 996(2)(e).
[337] Koh, above n 328, 387. See, e.g., *Scottish Co-Operative Wholesale Society Ltd v Meyer* [1959] AC 324, where the House of Lords held that the shares were to be purchased at the value they would have had, had the oppressive conduct not occurred.
[338] Companies Act 2006, s 994(1)(b).
[339] James Kirkbride, Steve Letza and Clive Smallman, 'Minority Shareholders and Corporate Governance: Reflections on the Derivative Action in the UK, the USA and in China' (2009) 51(4) *International Journal of Law and Management* 206, 209. See also Keay, above n 216, 86-7.
[340] Keay, above n 216, 87.
[341] Civil Procedure Rules, r 19.9E; Reisberg, above n 215, 224.
[342] Joffe et al, above n 2, 496, [7.156].
[343] Kirkbride, Letza and Smallman, above n 339, 209.
[344] Ibid.

Some of the above issues may be overcome through conditional free agreements and third party litigation funding (TPLF), which is steadily growing as an industry in Europe, particularly in the UK.[345] TPLF has also made it easier for liquidators to pursue claims against directors for breach of fiduciary duty to the company.[346] A recent example of TPLF is the funding provided by Bentham Europe (BE) for a shareholder claim against Volkswagen in Germany, in relation to the emissions scandal.[347] BE agreed to cover all legal costs in return for 18-24% of any award granted by the court.[348] BE has also funded the collective action against Tesco in London.[349]

TPLF will not always be possible to obtain – availability of funding will depend on the nature and quantum of the claim.[350] For example, in relation to derivative actions, it may be difficult for shareholders to secure conditional fee arrangements or TPLF due to the difficulty getting past the permission stage.[351] In addition, TPLF may not protect shareholders from all financial risks associated with the clam. For example, concerns have been expressed about a provision contained in UK Association of Litigation Funders' voluntary code, which provides that litigation funders may withdraw funding where the funder 'reasonably believes that the dispute is no longer commercially viable', thereby potentially exposing claimants to unexpected financial risk.[352]

However, it is clear that in recent years, shareholder class actions have been recognised as a significant business opportunity for litigation funders.[353] At the same time, 'collective investor actions' have been described as 'one of the most important current developments in the world of directors and officers liability'.[354] Together, these two developments significantly increase directors' liability exposure, both with respect to climate risk mismanagement and more generally.

d) Limitation periods

A claim for compensation against a director for a historic climate risk mismanagement in breach of ss 172 and/or 174 will be subject to a primary limitation period of 6 years, running from the point at which the relevant cause of action accrues.[355] A cause of action under s 172 will likely accrue when the

[345] US Chamber Institute for Legal Reform, 'The Growth of Collective Redress in the EU: a Survey of Developments in 10 member States' (March 2017) 29, available at: http://www.instituteforlegalreform.com/uploads/sites/1/The_Growth_of_Collective_Redress_in_the_EU_A_Survey_of_Developments_in_10_Member_States_April_2017.pdf; Kevin LaCroix, 'The Top Ten D&O Stories of 2016', *The D&O Diary*, 3 January 2017, available at: http://www.dandodiary.com/2017/01/articles/director-and-officer-liability/top-ten-stories-2016/.
[346] Keay, above n 216, 80.
[347] US Chamber Institute for Legal Reform, above n 345. Conditional fee agreements are permitted under the Courts and Legal Services Act 1990, ss 58 and 58A; and Conditional Fee Agreements Order 2000, SI 2000/823.
[348] US Chamber Institute for Legal Reform, above n 345.
[349] Ibid.
[350] See Keay, above n 216, 80.
[351] Ibid 86-7.
[352] UK Ministry of Justice, Civil Justice Council, 'The Code of Conduct for Litigation Funders (November 2011), section 11.2, available at: http://associationoflitigationfunders.com/code-of-conduct/ (cited in US Chamber Institute for Legal Reform, 'The Growth of Collective Redress in the EU: a Survey of Developments in 10 member States', March 2017, 32, available at: http://www.instituteforlegalreform.com/uploads/sites/1/The_Growth_of_Collective_Redress_in_the_EU_A_Survey_of_Developments_in_10_Member_States_April_2017.pdf).
[353] See Lattin, Lam and Hunt, above n 251, 304.
[354] Kevin LaCroix, 'The Steep Rise of Collective Actions in Europe', *The D&O Diary*, 19 April 2017, available at: http://www.dandodiary.com/2017/04/articles/international-d-o/steep-rise-collective-actions-europe/.
[355] *Burnden Holdings (UK) Ltd v Fielding* [2017] 1 WLR 39, [31]; *Cia Imperio v Heath Ltd* [2001] 1 WLR 112.

breach of duty occurs, while the cause of action under s 174 will not accrue until the loss is actually incurred.[356] This could be at the same time at which the breach is committed, or at the point when loss crystallises, or at some point in between (though is likely to be when the breach occurs and has been acted on).

Where loss crystallises more than 6 years after a breach of s 172 occurred, an extended limitation period, an extension may be possible under s 32 of the Limitation Act 1980, which provides for extensions for actions involving fraud, deliberate concealment and deliberate commission of a breach of duty in circumstances where it is unlikely to be discovered for some time.[357] 'Deliberate concealment' could occur where the breach is followed by deliberate failures in reporting that are designed to cover up the breach. The extension for a deliberate commission of a breach of duty may apply where directors deliberately failed to consider the company's best interests (or one of the other s 172 factors) in circumstances where the detail of their subjective deliberations was unlikely to come to light (for example, due to lack of documentation). The same such extension may be available where breach of s 174 is alleged. For example, the extension for deliberate commission of a breach of duty could apply where directors deliberately failed to exercise reasonable care or diligence in exercising their functions, in circumstances where the extent of their efforts was unlikely to come to light.

[356] See *Cohen v Selby* [2001] 1 BCLC 176, 183c-e. This is because s 178 of the Act provides that the consequences of breach of ss 172 and 174 are the same as would apply if the corresponding equitable principle or common law rule applied.
[357] Limitation Act 1980, s 32.

8. Conclusion

Directors' liability for climate risk mismanagement is a new frontier of climate change litigation and the arguments presented in this paper have not yet been tested by courts. In particular, courts have not yet considered whether and in what circumstances failure to assess and manage climate risk would breach directors' duties under ss 172 and 174 of the Act. However, the novelty of these arguments belies the fact that directors' liability in a climate risk context is increasingly likely to arise. As Wallace notes, litigation is steadily becoming 'a more credible threat'.[358] This is because it is now clear that climate risk poses a foreseeable and material financial risk to many, if not most, companies.[359] It is also clear that the market increasingly expects directors to consider and manage this risk.[360] Furthermore, 'soft law' developments – such as the TCFD recommendations – are contributing to behavioural changes from companies, particularly in relation to increased disclosure of climate risk.[361] Because directors' duties are broadly framed and designed to respond to evolving business norms and market dynamics, these developments in climate risk awareness and reporting will inform courts' views on how a reasonable director would act. This, in turn, will redefine the boundary between legally acceptable and unacceptable conduct.

Furthermore, contemporary trends in climate litigation – and international developments more broadly[362] – are normalising corporate liability for foreseeable climate change related loss and/or loss suffered as result of misleading disclosures. This includes the ExxonMobil[363] and Peabody Energy[364] cases in the US; the Volkswagen litigation in Europe;[365] and the recent shareholder action against Commonwealth Bank in Australia.[366] It was recently noted that '[l]egal action relating to some aspect of climate change mitigation, adaptation or loss and damage have been brought in over 18 countries on six continents, with hundreds of cases in the United States alone'.[367] While many of these cases do not involve boards or directors (most are against governments), such cases are a 'salutary warning… to be alert to the very real hazards [directors] will face with the onset of climate change if they neglect their social and environmental duties'.[368] Indeed, litigation strategies are increasingly 'focusing on the

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[358] Wallace, above n 22, 757. See also Simic, above n 251, 650.
[359] The question of materiality and other evidentiary issues is discussed in section 6 below.
[360] Governance Directions, 'Investors Put Directors on Notice on Climate Change Risk', October 2016, 516.
[361] Sulette Lombard and Tronel Joubert, 'The Legislative Response to the Shareholders V Stakeholders Debate: A Comparative Overview' (2014) 14(1) *Journal of Corporate Law Studies* 211, 236.
[362] For example, the UNFCCC Warsaw Agreement includes support for measures to address loss and damage resulting from climate change: Report of the Conference of the Parties on its Nineteenth Session' (31 January 2014).
[363] Marjanac, above n 79.
[364] See New York Attorney-General (NYAG), 'AG Schneiderman Secures Unprecedented Agreement with Peabody Energy to End Misleading Statements and Disclose Risks Arising From Climate Change' Press Release, 9 November 2016, available at: https://ag.ny.gov/press-release/ag-schneiderman-secures-unprecedented-agreement-peabody-energy-end-misleading.
[365] The Guardian, 'The Volkswagen Emissions Scandal Explained', 23 September 2015, available at: https://www.theguardian.com/business/ng-interactive/2015/sep/23/volkswagen-emissions-scandal-explained-diesel-cars.
[366] Slezak, above n 18.
[367] Olszynski, Mascher and Doelle, above n 16, 15, citing J Peel and H Osofsky, Climate Change Litigation: *Regulatory Pathways to Cleaner Energy* (Cambridge University Press, 2015) 1-2. In addition, Columbia Law School Sabin Center for Climate Change Law, maintains climate litigation databases. US Litigation Database available at: http://columbiaclimatelaw.com/resources/u-s-litigation-database/); non-US Litigation Database available at: http://wordpress2.ei.columbia.edu/climate-change-litigation/non-us-climate-change-litigation/.
[368] Clarke, above n 20, 575.

fossil fuel industries' responsibility in relation to climate change', which has been described as 'the first wave of civil climate change litigation'.[369] Regardless of the success of these cases individually, they contribute to a broader movement towards increased awareness (and expectation) of corporate liability for climate change related loss. This in turn creates a legal climate in which courts are more likely to accept that directors' duties laws require, for example, positive action by directors to assess and manage climate risk.

However, despite this ever-increasing 'spectre of liability', the significant challenges associated with bringing a claim against UK directors for climate risk mismanagement must also be acknowledged. This paper has attempted to provide a balanced assessment of directors' liability risk by identifying throughout the analysis the various barriers (both legal and practical) to bringing a claim. In particular, claims for breach of s 172 will be especially difficult to bring, given the largely subjective nature of the test that applies under that section. As Loughrey, Keay and Cerioni have noted, 'it is very difficult to show that the directors have breached this duty of good faith, except in egregious cases or cases where the directors have, obligingly, left a clear record of their thought processes leading up to the challenged decision'.[370] The subjective nature of the s 172 test presents a particularly formidable legal hurdle, while other practical barriers may also undermine litigation attempts, both in relation to ss 172 and 174. These barriers include the difficulty accessing documentation to support the claim (if such documentation even exists), prohibitive costs and limitation periods.[371]

Overall, the key message for directors is that the current trajectory suggests they will be held to ever more stringent standards in relation to their assessment and management climate risk. While the UK may not be the jurisdiction in which directors are most at risk of litigation for alleged climate risk mismanagement,[372] such litigation is a real possibility (and in certain cases, may even be probable). Prudent directors will take note of this increasing liability risk and ensure that they have adequate systems in place to assess and manage climate change where it poses a material financial risk to their company.

[369] Olszynski, Mascher and Doelle, above n 16, 16.
[370] Davies and Worthington, above n 81, 543.
[371] Loughrey, Keay and Cerioni, above n 224, 109.
[372] The CCLI's forthcoming comparative report will compare the law and director's liability risk in relation to climate risk mismanagement in Australia, Canada, South Africa and the UK.

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