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Insights

RAISING THE STAKES IN ACTIVIST SHAREHOLDER CLAIMS

CLIENTEARTH ARE ORDERED TO PAY SHELL'S COSTS IN A DEPARTURE FROM THE DEFAULT POSITION IN DERIVATIVE PROCEEDINGS

Sep 14, 2023

SUMMARY

The High Court has ordered that ClientEarth pay Shell's costs in connection with all aspects of ClientEarth's unsuccessful application for permission to continue a derivative claim against Shell and its directors. This is a departure from the default position in derivative proceedings. Usually, the company will not be awarded any costs incurred in making submissions in opposition to, or attending any hearing of, a shareholder's application at the permission stage. This judgment therefore raises the stakes for activist shareholders who are considering bringing a derivative claim.

On 12 May 2023, the High Court refused ClientEarth's application for permission to continue a derivative claim against Shell and its directors on the grounds that it did not disclose a *prima facie* case for giving permission. Our Insight on this decision can be found here. This decision was upheld at an oral hearing with a judgment on 24 July 2023.

Shell sought an order that ClientEarth pay its costs. It submitted that it was entitled to all the costs of the action, including the application for permission to continue the derivative claim. This was despite the usual rule that prevents a company from seeking its costs of any voluntary submissions made at the permission stage.

On 31 August 2023, the High Court handed down a decision on the costs of that application.

RULES ON COSTS

The general rule on costs set out in CPR 44.2(2) is that the unsuccessful party (in this case ClientEarth) will be ordered to pay the costs of the successful party (in this case Shell), although the Court has a discretion to make a different order.

CPR PD 19A paragraph 2 sets out the following exception to this general rule at the permission stage of a derivative claim: "*if without invitation from the Court the company volunteers a submission or attendance, the company will not normally be allowed any costs of that submission or attendance*". This rule is similar to the equivalent rule concerning the costs of voluntary submissions from a respondent to an appeal that is found in CPR paragraph 8.1 of PD52B.

If the Court invites the company to attend the hearing at the permission stage, then CPR PD 19A will not apply and the usual rules allowing a successful party to recover its costs would apply.

In the case of these proceedings, Shell, without invitation from the Court, volunteered its original written submission and voluntarily chose to attend the oral renewal hearing. ClientEarth therefore argued that CPR PD 19A para 2 should apply, and ClientEarth should not be ordered to pay Shell's costs, even though Shell was the successful party.

In contrast, Shell argued that CPR PD 19A should not apply and that it should be awarded its costs given the unfounded and very serious nature of the allegations that ClientEarth had made which led to Shell incurring substantial legal costs. Shell also argued that the application had not been pursued in good faith and was devoid of any merit. Shell argued that, in the circumstances, it had no choice but to take steps to respond to and oppose ClientEarth's application.

ClientEarth responded by arguing that Shell's approach was unprecedented and would stifle future attempts to pursue board members of large well-resourced companies for breach of duty.

JUDGMENT

The Court decided not to apply CPR PD 19A para 2 and so made an order that ClientEarth pay Shell's costs of the proceedings to be assessed on the standard basis if not agreed.

The Court noted that CPR PD 19A para 2 "*operates as a filter for the protection of the company reflecting the fact that it is not expected to participate at this stage of the proceedings and that it should not do so unless there is some reason which takes the case out of the norm*". The Court, therefore, went on to consider whether there was some reason that took this case "*out of the norm*". The Court stated that the factors it took into account when deciding whether to depart from the rule in CPR PD 19A para 2 were:

- Whether the nature of the proposed application has material unusual features on which it is reasonable for costs to be incurred by the company;
- Whether those features are such that, allowing the case to proceed to a substantive application for permission will give rise to significant cost and expense;
- Whether there is a real possibility that a *prima facie* case will not be established;

- Whether the court will receive material assistance from the company in reaching a conclusion on whether or not that is the case;
- Whether these features should have been anticipated by the applicant;
- The impact on the company generally of permitting the matter to proceed to a substantive application even if the application were to prove to be ill founded;
- Whether the applicant will or should have known that was the position; and
- Where the balance of justice lies having regard to questions of proportionality and the overriding objective.

The Court reached the conclusion that this was a case which was "*far from the norm*" for many reasons.

First, ClientEarth's application was always bound to garner significant publicity, a fact of which ClientEarth was well aware. Shell was, therefore, entitled to take the view that the mere finding of a *prima facie* case would have an unusually significant adverse impact on it.

Second, the case was unusual because it made serious claims of breach of duty against all the directors of a major international company without distinction, and attacked its business strategy looking to the future rather than specific acts of corporate wrongdoing causing measurable loss.

Third, ClientEarth was the holder of such a small number of shares and, although support for its objectives was indicated by a larger body of shareholders, there was little if any support for taking the course it has elected to take.

Fourth, "*it would always have been anticipated both by Shell and ClientEarth that, given the number of defendants, the nature of the allegations and the potential impact on Shell's business if permission were to be granted, a full-blown application for permission would be unusually expensive and resource intensive. Not only did this take the case out of the norm, it also meant that attendance at the hearing and the making of submissions was a proportionate response by Shell and should have been anticipated by ClientEarth to be such*".

The Court also noted that if Shell had not chosen to voluntarily file submissions, then the Court would likely have invited it to do so in any event. The Court said that the submissions made by Shell were of "*material assistance*" to the Court. It noted that without those submissions, it could not have ruled out the possibility that the Court would have determined that a full hearing was required with the substantial additional time and costs associated with this.

Finally, the Court noted that it was always open to ClientEarth to apply for costs management such as a costs capping order, and "*it would have been the prudent course had it mattered, given that the derogation from the general rule was only the normal approach not the invariable approach*".

LOOKING AHEAD

The Court's departure from the normal rule on costs at the permission stage of a derivative action puts a marker down. Whilst much of the judge's criticism of ClientEarth and the ultimate decision that he reached turned on the specific facts of the case, the ruling demonstrates the risk that activist shareholders may face if they seek to use the derivative action process in this way. Any such shareholders may not only face difficulties meeting the test for a *prima facie* case, but they may also now be penalised in costs.

The threat of a costs order of this nature is likely to give activist shareholders pause for thought, particularly given that they may be funding their application through donations and crowd-funding, or receiving professional services on a pro-bono basis. The potential for a large adverse costs order is likely to be a significant deterrent to activist shareholders considering pursuing derivative actions.

Any activist shareholders who do pursue derivative actions are likely to apply for a costs capping order, which the Court may order if it is in the interests of justice to do so, and there is substantial risk that, without such an order, costs will be disproportionately incurred and the Court is not satisfied that the risk can be adequately controlled by case management and detailed assessment of costs.

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