ClientEarth

Investor Briefing: Milleudefensie et al. v Royal Dutch Shell – Six takeaways for business climate plans

1. Background

The Hague District Court has delivered a watershed decision against the oil and gas major Royal Dutch Shell (**Shell**), with implications for the business plans of all high-emitting businesses and their investors, financiers and advisers.

The case was filed in April 2019 by Friends of the Earth Netherlands, a group of other NGOs and 17,379 Dutch citizens. The claimants alleged that Shell was in breach of its duty of care under the Dutch Civil Code, informed by its human rights responsibilities, by failing to adequately reduce its emissions.

On 26 May 2021, the Hague District Court ordered Shell to **reduce its net carbon dioxide emissions by 45% by 2030**, in line with the global emissions pathway for meeting the 1.5°C temperature goal contained in the Paris Agreement.

This case is seminal in terms of its conclusions concerning the relevance of climate science and international climate law to corporate liability and its consideration of business impacts on human rights.

a. 'Net Zero means Net Zero'

The Court found that Shell's new climate commitments and "Energy Transition Strategy" are inadequate to discharge its legal obligations, because they fall short of a broad international consensus on what is needed to limit climate impacts on human rights.

The court's near-term emissions reduction order drew on climate science, including the IPCC's assessment that the world's carbon budget for 1.5°C would be used up by 2030 at current emissions levels. In addition to the IPCC reports, the court also considered the analysis of the International Energy Agency (**IEA**) and international practice by companies in setting science-aligned emissions reduction plans.

According to the Climate Action 100+ Benchmark, no oil and gas companies have strategies in place that are consistent with a 1.5°C future. Yet many purport to be addressing climate change or moving toward sustainability. This judgment serves as a stark warning – apart from the reputational and strategic risks, there is litigation risk for companies (and follow-on stranded asset / re-valuation risk for investors) that do not adjust their strategies and policies to align with a net zero by 2050 pathway. Even more litigation will be brought using similar arguments to this case, or in respect of greenwashing if company claims are misleading about their compatibility with a net zero future.

b. 'Risk to you, impact on me'

Ultimately, the Court found that Shell's inadequate climate policy constituted a breach of its legal duty of care towards Dutch citizens. While Shell does not have a government's direct human rights legal obligations, its human rights responsibilities shaped the court's interpretation of the company's duty of care. In particular, the court referred to the UN Guiding Principles on Business and Human Rights, a global standard consolidating existing international human rights law, which requires companies to identify, prevent, and address human rights impacts linked to their businesses.

According to the judgment, management of financial and business risks alone is not sufficient. As such, failure to act on the real-world environmental and social impacts of a company's business, irrespective of the bottom line, increases litigation risk. If courts or governments in the Netherlands and elsewhere look to international business and human rights standards, this principle would require a significant shift of mentality in many boardrooms in their climate planning.

c. 'Whole business approach'

The Court was clear that Shell's Board and ultimate parent company is responsible for setting climate policy across the whole group. As such, the court order extends to Shell's entire business, in all of the jurisdictions in which it operates.

The Court order applies to all of Shell's direct and indirect emissions throughout its value chain (the latter known as Scope 3 emissions). The Court found that Shell controls and influences the Scope 3 emissions of end-users by the products that it sells. It is therefore responsible for these emissions, and can reduce them through changes to its business. The Court emphasised that scope 3 emissions are a particularly key consideration for companies that produce and sell fossil fuels, as it comprises the majority of their emissions.

Most major 'upstream' coal, oil and gas companies have sought to distance themselves from responsibility for scope 3 emissions, or only address them on an intensity basis. As a result of the judgment, Shell is now subject to the most stringent and comprehensive 2030 scope 3 reduction targets, requiring a reduction of 45% below 2019 levels across the entire Shell group internationally. According to the Hague District Court, fossil fuel producers and sellers cannot simply place the onus on the end-users of their products to change their behaviour. As matter of Dutch law – itself informed by international standards and law – these companies have a legal obligation to set adequate targets, and ultimately change their product offerings to reduce end-use emissions.

d. 'Companies and investors lagging behind'

The Court found that Shell's existing climate policy disregarded its responsibilities. Shells' "Energy Transition Strategy", recently approved by shareholders, was found to contain vague, caveated and non-binding intentions that allowed Shell to move slower if it judged society was. To date, many oil and gas majors and other high emitting businesses have issued similarly hedged ambitions. High-profile investor engagement has been one of the driving forces behind companies increasing their climate ambition. However, progress has often been slow and incremental due to strong push back from high-emitting companies and difficulties in coalescing enough shareholder support to pass legally binding resolutions that align with climate science. As such, company commitments have for some time lagged behind social expectations and scientific developments. They now also lag behind what the law requires.

By grounding its decision on climate science and the impact on human rights, the Hague District Court has forced Shell to catch up, to move faster than its existing commitments and those of its competitors. This judgment sets a new baseline for business climate action, and shows that investors need to move rapidly to keep pace, and risk their client's capital, or their engagement efforts becoming obsolete.

e. 'Costs of inaction'

The IEA confirmed in its Net Zero by 2050 report that there can be no new oil and gas fields approved for development and no new coalmines or mine extensions in a pathway to 1.5°C. Renewable energies will need to expand at an unprecedented pace to become the largest source of energy supply by 2050, while fossil fuel use sees a "huge decline".

Under a 1.5°C pathway, many high emissions assets including coal and gas power plants must be retired early. Fossil fuel companies face an existential stranded asset risks under this pathway unless they fundamentally transform their energy offerings and align their business strategies to meet climate goals.

Companies should also consider how their auditing and financial accounts and the underlying assumptions need to change to reflect and disclose transition-related material risks to investors – including litigation risk.

The costs of delayed action are evident in the abrupt change Shell is now required to undertake. Other high-emitting businesses must consider why they are delaying change, including in light of the associated litigation risks. Action now would be considerably cheaper, and less disruptive to business, than being forced to do so in a short time frame by a court order, by rapid regulatory developments or due to delayed decision-making.

Additional risks now arise for Shell's Directors, who must comply with the judgment and also discharge their duties of care to the company itself. This decision clearly shows that a failure to adequately manage the transition exposes Directors of all high emitting companies to personal liability risks. Properly discharging those duties means aligning business plans fully with Paris, and mitigating stranded asset and related losses.

f. 'Shrinking room for manoeuvre'

The court made clear that, based on international consensus, rapid emissions reductions must happen by 2030 in order to reach net zero by 2050. However, the court left Shell some flexibility by setting a "net" target. This means that Shell will be able to use so-called 'negative emissions', carbon capture and storage (**CCS**) and/or carbon offsets, although the Court noted the scientific warnings over the risks in relying on large-scale negative emissions technologies and their deployment by 2030 is highly doubtful.

The carbon budget is dwindling rapidly. As time goes by, the room for companies to avoid adequate policy adoption and implementation will become progressively more restricted.

If Shell appeals the case all the way to the Supreme Court, a decision may not be issued for several years.[1] Even if an appeal judgment is in Shell's favour, Shell will have had to implement the target in the meantime, by which time it may be only a few years until 2030. In addition, there is also a risk that judgments from higher courts may confirm or strengthen the Hague District Court's decision, as occurred in the landmark Urgenda litigation against the Dutch government, including in view of worsening climate change and narrowing carbon budgets.

3. Conclusions

This judgment is the first to require a company to reduce their emissions in line with the Paris Agreement and climate science. It has implications for the requirements of corporate and financial law, for example the fiduciary obligations of directors and asset managers. It makes clear that compliance with legislation and weak, hedged voluntary commitments cannot absolve a company of the risk of liability. Companies may be held responsible for scope 3 emissions across their value chain.

As with the spread of climate litigation against governments following the Urgenda judgment, a similar growth globally in cases against companies is likely. The Hague District Court has set out reasoning and

[1] In Urgenda v the Netherlands, the appeal process took over 4 years.

a framework for analysing the minimum standard of corporate climate responsibility, which can in principle be readily transferred to other jurisdictions and systems of law. To manage litigation risks, business risks and financial risks – if not simply as a matter of good business –- companies should act now to ensure that their businesses are aligned with a global pathway for net zero by 2050, incorporating meaningful short-term (5-10 year) targets and plans.

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