

## Green in tooth and claw: Does ESG\* mean the end of capitalism?

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Two of the fundamentals of capitalism, namely the pursuit of growth and profit, are today being questioned in ways that would scarcely have seemed possible a generation ago. Recent legal developments increase the obstacles for companies seeking to prioritise shareholder returns and raise the prospect that “orthodox” capitalism is now dead in all but name. Many of these developments arise from ESG-inspired shifts in norms and values. This article considers several recent developments and questions whether the fundamentals of capitalism remain intact.

### Boards and shareholders

UK company boards have for some years been required to consider the broader impact, including the environmental and community impact,

of their decisions as part of their basic duty to “promote the success of the company”.<sup>1</sup> Whilst that in itself arguably constitutes a departure from capitalist orthodoxy because shareholder interests are no longer the sole concern of company management, changes are now being proposed which would go even further.

The Better Business Act coalition, which claims to have significant support in the UK, proposes to amend the law to require boards to “advance the purpose of the company” whilst still having regard to environmental, community and other factors.<sup>2</sup> This is intended to create parity between the interests of shareholders and others, thereby extinguishing the orthodox notion of shareholder primacy.

\* *Environmental, Social and Governance.*

1. *Section 172, Companies Act 2006.*

2. <https://betterbusinessact.org/the-bba-story>

Whilst these changes remain pending, shareholders are already taking action. In June 2021, Exxon succumbed to a U.S. shareholder coup, with three board members replaced with shareholder-backed candidates with supposedly greener agendas. Separately, almost two thirds of Chevron’s shareholders rebelled by voting through a resolution proposed by green campaigners to force the company to cut emissions.

Shareholders in public companies have a number of other tools at their disposal to further ESG-inspired objectives. In the UK, shareholders with five per cent of paid-up voting shares can requisition general meetings and table headline-grabbing resolutions. Derivative actions can be brought, in which claims are commenced by shareholders acting in the name of the company to uphold the company’s rights, typically where those in control of the company cannot or will not act. Such claims could become more common where shareholders perceive that directors give insufficient consideration to environmental or community factors when determining the company’s strategy.

Whilst in England a derivative action must obtain the Court’s permission to proceed, the approach of Courts in other jurisdictions seems to be increasingly sympathetic to environmental and social concerns.

### Approach of the Courts

In a landmark ruling in May 2021, a Court in the Netherlands ordered the parent company of the Shell group to cut the aggregate annual volume of all CO<sub>2</sub> emissions of the group, its suppliers and customers by 45% by the end of 2030 relative to 2019 levels (with respect to suppliers and customers, this was a best efforts obligation). In response to the claim brought by seven environmental associations, Shell defended its corporate agenda by arguing that it had committed to investing billions of dollars in low-carbon energy including hydrogen, renewables and biofuels, but was ultimately unsuccessful.

The Dutch Court held that Shell must observe a standard of care under Dutch law grounded in the Paris Agreement and the UN Guiding Principles on Business and Human Rights. The court also accepted that Dutch law applied to the claimants’ tort claims because the event giving rise to the damage was the parent company’s development of its group-wide policies, which occurred in its head office in the Netherlands.

The case has potentially far-reaching implications. The Dutch Court found that every CO<sub>2</sub> emission, from anywhere in the world, contributes to possible climate change in the Netherlands. Being the first of its kind to link climate



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change directly to the individual responsibility of non-state entities emitting CO<sub>2</sub>, it leaves the door open for claimants to argue the same principles should apply to other companies influencing global CO<sub>2</sub> emissions, particularly those with headquarters in the Netherlands.

Another recent decision has increased the risks for companies with operations overseas, particularly where those operations have an environmental or social impact. In *Vedanta Resources plc v Lungowe*,<sup>3</sup> claims were brought in England by Zambian citizens following alleged discharges of toxins from a copper mine into watercourses in rural Zambia. The two defendants were the UK-domiciled parent company and the Zambia-domiciled operating subsidiary. The defendants challenged the jurisdiction of the English court, arguing that the 'real' defendant was the Zambian subsidiary and that the proceedings should therefore take place in Zambia. The UK Supreme Court however rejected the jurisdiction challenge, partly because it found there was a real issue to be determined as against the UK-domiciled parent.

3. [2019] UKSC 20.



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Whilst the Supreme Court was clear that it was not extending the law of negligence to make claims against parent companies easier per se, it did find that the extent to which parent companies exercise influence and control over subsidiaries, particularly through group-wide policies and procedures, will be relevant to the existence of a duty of care. The risk of such a duty arising will increase as the parent company becomes more involved in the implementation, monitoring and enforcement of those policies, beyond simply their promulgation. As a key aspect of an ESG-led corporate agenda is improved governance through policies and procedures, it is easy to see how this increases the risk of parent company liability arising in respect of the activities of operating subsidiaries.

### The prospect for green capitalism

There is a common argument that ESG-led norms and values do not undermine capitalist ideology but rather complement it, by seeking to ensure that capitalism becomes sustainable by acting on environmental issues but without risking the fundamentals of growth and profit. In this vein, the founder of the hedge fund behind



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the June 2021 Exxon coup declared that he had been motivated to "take a long-term view to value creation" by taking environmental risks and opportunities into account. He was clearly still driven by the profit motive.

If that is correct, then it may indeed be the case that capitalism can turn "green" and continue with its key philosophy fundamentally intact in future. However, a developing viewpoint holds that "green growth" is essentially illusory and the only sustainable economic model is one where economic activity *decreases* over time because growth (and by extension, year-on-year profits) is unsustainable per se. Proponents of this view can point to the environmental impact, which is increasing dramatically, of producing batteries for electric vehicles, amongst other examples. In this scenario, it is indeed difficult to see how capitalism can survive in anything like its current form.

It seems that the fundamentals of capitalism, whilst increasingly challenged, remain intact for now. However, as continuous economic growth takes an ever bigger environmental and social toll, there are real questions as to how long the old assumptions of shareholder

profit and perpetual growth will hold good. In the meantime, it appears likely that there will be even more litigation and legal change in the years to come, spearheaded by motivated individuals who understand how to make use of existing rules to achieve ESG objectives. Companies will need to understand these risks and be able to respond quickly.

*Richard's practice is centred on complex and high value commercial litigation and arbitration, typically with an international element. He is regularly instructed to act on matters involving shareholder and corporate issues, including those relating to joint ventures and public companies. He also has experience of overseas company processes, including the Dutch Enterprise Court.*

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