



Enforcing the 'Ethical Charter'

In recent years, the damaging environmental impact of our modern way of living has become a hot topic on society's agenda and there has been a notable shift towards making choices based on their ethical consequences. If we take the fashion industry as an example, when purchasing a new item of clothing, consumers are now more interested than ever before in the supply chain that led to the creation of that item:

- Where did the raw materials, for example the cotton, come from?
- Were the raw materials grown using pesticides?
- Did the farmers get a fair price for the raw materials?
- Were the clothes manufactured in a factory producing significant emissions?
- Did the workers who made the clothing receive a good wage?

Following this trend, investors now also increasingly consider the ethical impact of the companies they are investing in, and the Environmental, Social and Governance ("ESG") criteria have become a common way for investors to evaluate a company's practices for their ethical standards.

If a company markets itself as having a clear ethical or moral stance, what would happen if, after a shareholder has made the decision to invest in a company based on its ethical practices, the founders or operators of the company sell out to a more profit focused investor who then changes an element of the company's supply chain to a cheaper option that is not as ethical but ultimately more profitable? For example, switching from an organic cotton to conventional cotton.

This article explores the options (both current and hypothetical) available for a shareholder who finds themselves in this position, and considers the question, how can the ethical charter of a company be enforced?

Types of claims currently available

Litigation regarding ESG issues is on the rise and an aggrieved shareholder who is unhappy with the changes to the ethical nature of their company, could consider pursuing one of the following claims:



Protection of the Prospectus

Before investing in the company, the shareholder is likely to have been provided with a prospectus, or listing particulars, setting out a range of information about the company in order to inform their investment decision. The shareholder could potentially make a claim under section 90 of the Financial Services and Markets Act 2000, if a statement in the prospectus is untrue or misleading, or if there is an omission of information that was required to be included in relation to the assets and liabilities, financial position, profits and losses and prospects of the company. A shareholder may claim that statements made in relation to the company's ESG criteria were misleading, if the company subsequently directly or indirectly alters them. Alternatively, a shareholder may claim that omissions regarding the ESG criteria, or the ethical practices of a company, are unlawful in circumstances where the ethical practices of a company are critical to its financial performance.



Shareholder Rights

Beyond the basic rights of a shareholder, additional rights will be company specific and are usually found in the company's articles of association, or a shareholders' agreement. For example, the shareholders may have the right to be consulted or informed before the company makes certain decisions. Therefore, a shareholder may have the right to be consulted about changes to the company's ethical practice and if they are not, the shareholder could bring a personal claim to enforce this right under the articles of association or the shareholders' agreement.



Derivative Claim

The shareholder could bring a derivative claim, being a claim brought by a shareholder on behalf of the company itself in respect of a breach of duty by a director. The wrong committed by the director must involve negligence, default breach of duty and / or breach of trust. To take the example given above, changing the company's ethical practices to those more driven by profit could be a breach of the directors' duties set out in section 172 of the Companies Act 2006 being the duty to promote the success of the company, including having regard to amongst other things, "the need to foster the company's business relationships with suppliers, customers and others" and "the impact of the company's operations on the community and the environment". Such a claim could have very serious consequences for a company whose business relies on such relationships.



Shareholder Class Action

An alternative to the derivative claim is the shareholder class action. This type of claim involves a group of shareholders, who have a common interest, bringing a claim against the company. In comparison with the US, this type of claim has not been a particularly popular cause of action in the UK. Indeed, [the first shareholder class action](#) was brought in the UK in November 2019, and was unsuccessful. If enough shareholders of the company were interested in pursuing the company for the changes to its supply chain, this could be an option but given this type of claim's track record in the UK, the chances of success may not be in the shareholder's favour.



Claim by a company with a direct interest

A third-party 'neighbour' company with a direct interest in the way the company is conducting itself could also bring a claim. For example, if the company in question has a CSR partner, depending on the nature of the contract signed, the company may have breached a clause of that contract by changing its supply chain, and the CSR partner may choose to bring a claim on this basis.

What new areas of law could potentially develop in this area?

Although there are various potential routes of redress currently available for shareholders, none is tailored specifically or solely for holding a company and / or its directors accountable absent an accompanying claim for damages or other loss. However, as it appears that investors' focus on ESG criteria will become more prevalent over the coming years, it is feasible that we could see a new branch of law or regulation develop, specifically to reflect a change in societal standards which aims to hold companies, and their directors, accountable for the ethical or moral basis on which the company is being held out as being run.

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