INTERVIEW

Shareholder Litigation: The Tool of Last Resort

By Aaran Fronda

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Steven Friel, CEO at Woodsford, explains why investors must actively engage with investee firms to make the downside of bad activity outweigh the upside for potential corporate wrongdoers.

In 2022, companies faced a record number of shareholder resolutions on environmental and social issues, according to **data** from Morningstar. As the volume and breadth of ESG risk exposure continues to rise, the stage is set for another momentous proxy season in 2023 – a trend that could lead to further litigation if companies ignore shareholder engagement.

According to a **new paper** from the Principles for Responsible Investment on board responsiveness to shareholder ESG proposals, investors have low experience and expectations of implementation.

"There is a growing realisation that investors need to use all the engagement tools available to them," Steven Friel, CEO at Woodsford, tells *ESG Investor*. "That primarily means voting at AGMs and generally engaging with the company, but it also includes collective, escalated engagement, up to and including litigation."

As investors become more "ESG aware", they become more cognizant of financial institutions' and corporates' ESG failures, says Friel.

"Banks engage in money laundering, retail businesses engage in supply chain labour practices that abuse workers' rights, and miners engage in corruption and bribery around the world – all that has happened and continues to happen," he says. Twenty years ago, those companies might have got a "regulatory wrap on the knuckles" but now that investors have a wider array of engagement tools at their disposal, wrongdoers are being held to account.

As a commercial litigation funder, Woodsford supports investors seeking redress from investee firms for a serious breakdown of ESG standards leading to financial loss or a decline in the shareholder value. Woodsford takes the financial risk in a third party's legal proceedings and shares in the proceeds if successful.

In one of the most shocking breakdowns of governance standards in recent years, it was discovered by the French Parquet National Financier, the UK Serious Fraud Office and the US Department of Justice that the European-headquartered aerospace company Airbus had engaged in bribery and corruption on a massive scale.

As a result, investors suffered significant losses. In January 2020, Airbus agreed to pay penalties of around US$4 billion in fines and compensation to only its US shareholders.

However, the company has not yet settled with its EU shareholders. In response, Woodsford organised investors and funded a Dutch class action brought by law firm Scott+Scott to hold Airbus accountable and provide affected European stakeholders with compensation.

"We identify the wrongdoing, we identify the loss to shareholder value that has been caused by that wrongdoing, and we identify the shareholders affected by the wrongdoing," explains Friel.

"We then bring affected shareholders together, we inform them about their rights, collect them together in a collective engagement, and assist them to engage with the investee company. If litigation is necessary, we find a law firm and fund the litigation – we aim to bring an efficiency to this part of the engagement spectrum."
There has been a "tremendous change" in the attitude of the major institutional investors in escalating engagement via litigation, says Friel. Investors have gone on a journey over the last four years, and they will now participate unless there's a good reason not to, he says.

Across the many engagements that Woodsford is engaged in with listed companies across the UK, Europe, Asia and Australia, the firm count hundreds of asset owners and managers in the global top 50 by AuM.

“These are serious, credible people, who five years ago probably would not have thought this way,” he notes. “If there’s a consensus among reputable long-term institutional investors at an investee company that something has gone wrong and that wrongdoers should be held accountable, there is a level of safety in numbers.”

Feet to the fire

Corporate wrongdoing frequently occurs. Following the international response to the Russian invasion of Ukraine, compliance with international sanctions, anti-money laundering (AML) and counter-terrorist financing (CTF) rules have become major issues for banks.

However, several **major financial institutions have failed** to operate within the rules. There are many complicated reasons why people make bad decisions, and there are many complicated reasons why investee companies engage in wrongdoing, explains Friel. Usually there are both corporate level profit and executive remuneration motives.

“If you get your remuneration structures wrong, if bankers’ bonuses are incentivised in a particular way, that increases the likelihood that they will disregard their ESG obligations for personal gain.”

But even if the amount of wrongdoing isn’t decreasing, the likelihood that it gets found and called out *is* increasing thanks to investors increased interest and awareness of corporate ESG failings.

“If Boohoo had engaged in its unethical labour practices 20 years ago – would anybody have noticed, would anybody have cared?” asks Friel. “But in today’s environment, where quite rightly, investors, regulators, and journalists among others care about these things, it’s much more likely to be found out, and therefore much more likely to give rise to ESG litigation.”

In February, news broke that the directors of oil major Shell are being sued by environmental lawyers ClimateEarth over their climate strategy, which the claimants argue is inadequate to meet net zero targets.

But Friel is quick to note litigation should always be viewed as a “tool of last resort”, adding that if investors and investee companies can resolve their differences through open dialogue and normal channels of engagement they should do so.
“If investors can amicably get compensation, amicably get accountability, and do so collectively with their fellow shareholders, that’s a positive thing,” he says. “But ultimately, the litigation, the day in court, needs to be there as a backstop threat for a company that fails to engage amicably.”

He notes that “99% of engagement is about the carrot”.
“It’s about encouraging investee companies to act properly, to attract investment in their company and develop strong investor relations,” he says. “But the carrot only works, if there’s also a stick.”

Even at the sharp end of engagement that Woodsford organises right up to litigation, the majority are often resolved before the day in court.

“The goal is of investors, litigators and regulators is to make sure that the downside of bad activity outweighs the upside for the potential bad actors,” he says.
“Companies and directors have to know that there are real, negative repercussions to their ESG failings.”