

Shareholder Safeguards: A Practical Guide to Derivative Claims in UK Corporate Law

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Although relatively rare, when they do unfold, derivative claims can be likened to a David vs Goliath battle. For example, in 2023, Client Earth, a small shareholder in Shell, sought permission from the court to bring a derivative claim against the might of Shell's board of directors. This article will consider the implications of this case, alongside broader points about the basis and process for bringing a derivative claim and the key take-away messages for both individual shareholders and directors.

What is a Derivative Claim?

A derivative claim is a type of legal action brought by a shareholder against a director(s) on behalf of a company. Governed by sections 260-264 of the Companies Act 2006 (the Act), this formalised what was previously a complex area of common law. These claims should not be confused with Unfair Prejudice Petitions, which are claims brought by shareholders in their personal capacity, under section 994 of the Act, for further detail see: [A practical guide to unfair prejudice petitions](#).

The Act provides that a shareholder may bring a statutory derivative claim against a director for any of the following reasons:

- Negligence of a director i.e. a breach of a director's professional duty of care to the company;
- Default / failure of a director to perform their obligations under the Act;
- Breach of a contractual, tortious, or fiduciary duty of a director to the company; or
- Breach of trust by a director to the company.

Examples of behaviours where derivative claims have been brought are directors transferring company funds to a personal account, failing to disclose a conflict of interest and a failure to act in the company's best interest, thus breaching the director's statutory duties. Since the wrong is to the company, any remedy recovered from the claim benefits the company as a whole, not the individual shareholder bringing the action. In a previous article ([Directors' Disqualification Under the Company Directors Disqualification Act 1986: What UK Directors Need to Know](#)), we emphasised that shadow directors can be caught too; in this case, derivative claims can also be

brought against former and shadow directors, as well as third parties who are accessories in the relevant breach.

It should be noted that whilst it is usually a minority shareholder who brings a derivative claim, the process is also open to anyone to whom shares have been transferred but not yet formally registered and where shares have been transmitted by an operation of law, for example, to a personal representative of a deceased shareholder or to a trustee in bankruptcy.

What Is the Legal Process for Bringing a Derivative Claim?

Bringing a derivative claim involves a two-stage process:

Stage One: Obtaining Court Permission to Continue a Derivative Claim

The shareholder must first obtain permission from the court to continue the claim. At this preliminary stage (at which point the shareholder must also notify the company of the claim), the court considers whether the application discloses a prima facie case. If not, the court will refuse permission. This serves as a filter, preventing unnecessary or vexatious claims. If the shareholder is not granted permission, they have seven days to request an oral hearing where they can ask the court to re-consider the decision.

Stage Two: Substantive Hearing of a Derivative Claim

If the case passes the initial hurdle, a more detailed permission hearing takes place, with evidence usually given by both parties. The court must refuse permission for the claim to continue if it is satisfied that an individual acting in accordance with the duty to promote the success of a company would not bring a claim or if the act or omission of the director(s) has been ratified by the company. Other factors that the court must consider are:

- whether the shareholder is acting in good faith;
- whether the act or omission is likely to be authorised or ratified;
- whether the company has decided not to pursue the claim;
- whether the act or omission gives right to a cause of action which the shareholder could pursue in their own right; and
- the importance which a member acting in accordance with the duty to promote the company's success would attribute to the claim.

In addition, the court is required to give particular consideration to the views of members who have no personal interest in the matter, as they are considered objective. As well as granting or refusing permission, the Court may also grant permission subject to conditions (for example you cannot discontinue the claim without the permission of the Court) or grant limited permission to continue (for example giving permission to continue until the disclosure stage when merits have become clearer).

The legal costs of making the application to continue a derivative claim are met by the applicant shareholder if permission to continue is refused. However, if permission to continue to the substantive hearing is granted, the company will meet all the legal costs of the claim.

Double/Multiple Derivative Claims

These are common-law (rather than statutory) claims by a shareholder for a breach of duty by a company's subsidiary. This is important for accountability because many large companies operate through a network of companies further down the chain. For example, Alphabet Inc. owns a number of subsidiaries including Google and Waymo (self-driving cars).

For a double or multiple derivative claim, the shareholder will still need to demonstrate the prima facie case and the court will apply the same factors in deciding whether to grant permission to continue as for the statutory claims outlined above.

Remedies Available in Derivative Claims

At present, derivative claims are not used abundantly. However, if a derivative claim is successful, there are a number of possible remedies. These include damages payable to the company, injunctions and setting aside of transactions.

How Shareholder Activism Is Shaping Derivative Claims in the UK

The rise of shareholder activism has had a significant impact on the use of derivative claims. Activist shareholders are increasingly willing to challenge management decisions, hold directors to account, and seek remedies for misconduct or governance failures.

Returning to the case of *Client Earth v Shell*, the claim alleged that the directors had breached their duties by failing to properly manage climate change risks, jeopardising the company's long-term viability. Although ultimately the court refused permission, the case was groundbreaking in attempting to frame climate inaction as a breach of directors' duties under sections 172 and 174 of the Companies Act 2006. It highlighted the potential for derivative claims to be used creatively in the ESG (environmental, social and governance) context. This should serve as a warning to boards that failure to manage climate risks or breaches of fiduciary duty related to ethical governance may now form the basis of derivative actions, particularly as expectations of corporate responsibility evolve.

Summary and Practical Considerations for Bringing Derivative Claims

In summary, directors must be alive to the risk of shareholders bringing a claim, and shareholders should be aware of their potential ability to bring a claim to hold directors to account (either under

statutes or common law for a double/multiple derivative claim). Whilst the range of breaches (or omissions) that may give cause to a claim is wide, this article draws attention to the rise of shareholder activism, particularly with regards to ESG factors. Directors should ensure that they are not simply paying lip service to their ESG strategy but able to demonstrate their meaningful commitment to all aspects of promoting the success of the company. For shareholders bringing a claim, it is strongly suggested that they seek legal advice to ensure that they have a sufficiently robust case and do not fall at the first hurdle, failing to secure the court's permission to continue and finding themselves out of pocket as a result. Despite the relative rarity of successful derivative claims by shareholders, there seems little doubt that they provide an important means of holding directors to account, particularly when these individuals who oversee the company can stifle internal governance mechanisms.