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CASE NOTES

Shell and the Climate Case: Is the Shell Group the "Cheapest Cost Avoider"?

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Abstract

The Hague District Court in the Netherlands faced a novel tort law issue in 2021 in *Milieudefensie et al v Royal Dutch Shell plc* – namely, whether Shell is liable in tort for the reduction costs of carbon dioxide produced in the end use of energy-carrying Shell products. The civil lawsuit aims to make Shell (re)search for adequate substitutes so as to enable Shell's customers to reduce their consumption of energy-carrying Shell products. It is argued here that Shell's liability should be assessed within Guido Calabresi's "cheapest cost avoider" framework.

Keywords: Cheapest cost avoider; Climate Case against Shell; Coase theorem; Guido Calabresi

I. Introduction

Is Shell plc, a private-sector energy firm, (partly) liable in tort for the reduction costs of carbon dioxide emissions produced when customers, business relations and other end users combust energy-carrying Shell products? That novel tort law issue was at the heart of the much-publicised climate change lawsuit brought by Milieudefensie et al, a Dutch environmental organisation, in April 2019 against Shell plc ("Shell") at the Hague District Court in the Netherlands ("the district court").[1] In May 2021, the district court found in favour of the plaintiffs and, accordingly, the injunction sought was awarded. Shell was ordered to reduce its carbon dioxide emissions. In effect, Shell must bear not just the reduction costs of the carbon dioxide emissions for which the company and its suppliers are directly responsible but also, crucially, (partly) bear the reduction costs of the carbon dioxide emissions produced in the end use of energy-carrying Shell products. Shell has appealed the ruling to The Hague Appellate Court, whose rulings are in turn reviewable by the Dutch Supreme Court.

The court case suggests many issues for analysis. Environmental and human rights lawyers may want to consider the implications of the case for the corporate responsibility to respect environmental and human rights. Likewise, tort lawyers may want to examine the use of climate science and human rights instruments as informing climate-related standards of care for tort liability. Tort lawyers may also want to examine the type of liability. This Case Note is about the applicable accountability standard (type of liability) to assign liability in tort. In the present case, Shell's liability was not based on fault nor, for that matter, product liability (strict or negligent). Instead, liability was based on a cause for

[1] *Milieudefensie et al v Royal Dutch Shell plc*, The Hague District Court (The Netherlands), Judgment of 26 May 2021. An English version of the court ruling is available at ECLI:NL:RBDHA:2021:5339, Rechtbank Den Haag, C/09/571932/HA ZA 19-379 (engelse versie) <https://uitspraken.rechtspraak.nl/details?id=ECLI:NL:RBDHA:2021:5339>.

which the company was accountable "by virtue of generally accepted principles" (common opinion) prevailing in the Netherlands. The district court recognized that Shell is able to determine its energy package, and the composition thereof, produced and sold by the Shell group. This recognition was a decisive ground on which the judges held Shell accountable for breaching the court-established climate-related duty of care. It is, however, a matter of (legal) debate whether the mere circumstance that Shell has "control and influence" over the carbon dioxide emissions released by the end users of energy-carrying Shell products can, in and of itself, be an argument for assigning liability to Shell.

It is argued here that Shell's liability should be reassessed within Guido Calabresi's "cheapest cost avoider" framework. Whoever can prevent the damage at the least cost, which Calabresi dubbed the *cheapest cost avoider*, shall be the one party liable in tort. The judges clearly did not apply the conventional polluter pays principle, as is evident from the district court's acknowledgment (in paragraph 4.4.37) that Shell – apart from its own limited carbon dioxide emissions – did not actually by itself cause the carbon dioxide emissions of the business relations of the Shell group, including the end users. However, the judges did not explicitly embrace a cheapest cost avoider argument either. From a tort law perspective, in case the Hague Appellate Court is able to identify Shell as the cheapest cost avoider, this would provide a sounder (theoretical) grounding for holding Shell accountable for breaching the court-established climate-related duty of care. Here, cheapest cost avoider reasoning is not included in the standard of care for tort liability; rather, once the relevant standard of care is established, it is a part of the accountability standard to assign liability in tort. In the present case, the question of which party can prevent the damage at the least cost is especially relevant as the civil lawsuit aims to make Shell (re)search for adequate substitutes so as to enable Shell's customers to reduce their consumption of energy-carrying Shell products in order to curtail their own carbon dioxide emissions.

The Case Note will proceed as follows: to begin with, Section II presents a summary of the case, setting out the main elements of the court's decision.[2] In Section III, the court case will be analysed with reference to the Coase theorem.[3] The analysis points to the *cheapest cost avoider* as the one party who shall be liable in tort. This doctrine is a derived outcome of the Coase theorem. Lastly, in Section IV, the main conclusions are summarised.

II. Court's decision

States and companies, such as the Shell group, have an obligation to bring the composition of their energy supply in line with the carbon dioxide reduction required to combat global warming. This was the central message of the district court in the court ruling rendered on 26 May 2021.

To that end, the court ordered Shell (in paragraph 4.1.4) to reduce its net carbon dioxide emissions in 2030 by 45% relative to 2019 levels, in line with the global emissions pathway for meeting the 1.5°C temperature goal contained in the Paris accord of 2015. In this regard, the district court further ruled (also in paragraph 4.1.4) that Shell has a(n):

[2] It goes beyond the scope of this Case Note to provide a full overview of all recent climate change litigation. For global trends in climate change litigation, the reader is referred to the websites of the Sabin Center for Climate Change Law in New York and the Grantham Research Institute on Climate Change and the Environment in London. See also, eg, G Ganguly, J Setzer and V Heyvaert, "If at First You Don't Succeed: Suing Corporations for Climate Change" (2018) 38 Oxford Journal of Legal Studies 841–68.

[3] For example, Deryugina et al discuss the Coase theorem *in extenso*, with a focus on practical applications in environmental policy. T Deryugina, F Moore and RSJ Tol, "Environmental applications of the Coase Theorem" (2021) 120 Environmental Science and Policy 81–88.

(1) "Obligation of result" for the activities of the Shell group itself – this entails that Shell must ensure that its group companies achieve emissions reductions to the level as specified by the court; and
(2) "Significant best-efforts obligation" with respect to the business relations of the Shell group, including end users – this entails taking the necessary steps to remove or prevent the serious risks ensuing from the carbon dioxide emissions generated by Shell's business relations and using its influence to limit any lasting consequences of such emissions to the best of its abilities.

The district court derived this (twin) emissions reduction obligation from the "tortious act" provision in Article 162(2), Book 6 of the Dutch Civil Code,[4] which imposes a duty not to act in conflict with what has to be regarded as "proper social conduct" in Dutch society in view of current informal (unwritten) rules and norms of behaviour. This is to say that, as a matter of Dutch tort law, the courts are charged with the task of keeping tort law abreast of current informal (unwritten) rules and norms of behaviour. The climate-related duty of care thus refers to an implied individual responsibility that Shell owes to Dutch residents and the inhabitants of the Wadden region (the islands and body of water near the North Sea), reflecting the internationally propagated and endorsed need for companies to genuinely take responsibility for carbon dioxide emissions produced by their business relations (see paragraph 4.4.19).

To determine the relevant standard of care for tort liability, amongst many considerations, the district court took account of the internationally recognized UN Guiding Principles on Business and Human Rights ("UNGP"). In effect, the standard of care was inferred from UNGP 13 under b (see paragraph 4.4.17)[5]: "The responsibility to respect human rights requires that business enterprises: (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts." In short, the serious and irreversible negative consequences of dangerous climate change in the Netherlands and the Wadden region for the human rights of Dutch residents and the inhabitants of the Wadden region (see paragraph 4.4.10), coupled with the knowledge that companies, such as the Shell group, can reasonably be expected to have about the grave consequences of carbon dioxide emissions and the risks of climate change to Dutch citizens and the inhabitants of the Wadden region (see paragraph 4.4.20), led the district court to apply this more stringent duty of care standard.

As a matter of Dutch tort law, Shell's breach of the relevant standard of care is not sufficient, by itself, to assign liability in tort. Shell's liability arising from the tortious act also required that Shell could be held accountable for breaching the court-established climate-related duty of care (cf. Article 162(3), Book 6 of the Dutch Civil Code). In the present case, Shell's liability was not based on fault nor, for that matter, product liability

[4] Art 162, Book 6, Dutch Civil Code (Definition of a "tortious act") reads as follows:

–1. A person who commits a tortious act (unlawful act) against another person that can be attributed to him, must repair the damage that this other person has suffered as a result thereof.
–2. As a tortious act is regarded a violation of someone else's right (entitlement) and an act or omission in violation of a duty imposed by law or of what according to unwritten law has to be regarded as proper social conduct, always as far as there was no justification for this behaviour.
–3. A tortious act can be attributed to the tortfeasor [the person committing the tortious act] if it results from his fault or from a cause for which he is accountable by virtue of law or generally accepted principles (common opinion).

[5] See also OHCHR | Climate Change and the UNGPs: "The UN Guiding Principles on Business and Human Rights (UNGPs) do not address climate change explicitly. Nevertheless, the UNGPs are relevant to climate mitigation efforts on the part of States, businesses, and other stakeholders." <https://www.ohchr.org/en/special-procedures/wg-business/climate-change-and-ungps>.

(strict or negligent). Instead, liability was based on a cause for which the company was accountable "by virtue of generally accepted principles" (common opinion) prevailing in the Netherlands. One of the most contentious issues between the parties in the lawsuit, according to the district court (in paragraph 4.4.25), was the control and influence that Shell exerts over the carbon dioxide emissions released by end users. Shell did not contest that it could exert *that* control and influence through its energy package, and the composition thereof, produced and sold by the Shell group (see paragraph 4.4.25). The district court recognised that Shell is able to determine its energy package, and the composition thereof, produced and sold by the Shell group. This recognition was a decisive ground on which the judges held Shell accountable for breaching the court-established climate-related duty of care. In effect, the district court inferred the applicable accountability test from UNGP 19 under b sub ii (see paragraph 4.4.21): "Appropriate action [by a business enterprise] will vary according to: the extent of its leverage in addressing the adverse impact."

Lastly, the district court assessed the consequences for Shell of incurring liability in tort by reference to the (imminent) environmental damage sustained by Dutch residents and the inhabitants of the Wadden region. In the court's view, there was nothing unfairly onerous or manifestly disproportionate in Shell's emissions reduction obligation. As the judges considered (in paragraphs 4.4.53 and 4.4.54): "However, the [general] interest served with the reduction obligation outweighs the Shell group's commercial interests, which for their part are served with an uncurtailed preservation or even growth of these activities. Due to the serious threats and risks to the human rights of Dutch residents and the inhabitants of the Wadden region, private companies such as RDS [Royal Dutch Shell] may also be required to take drastic measures and make financial sacrifices to limit CO_2 emissions to prevent dangerous climate change." From this consideration, it is clear that the issue of Shell's liability did not "degenerate"[6] into attempts at balancing the costs of the (imminent) environmental damage incurred by Dutch residents and the inhabitants of the Wadden region against the costs Shell would have to incur to reduce the carbon dioxide emissions produced in the end use of energy-carrying Shell products. The issue becomes not *whether* the reduction of carbon dioxide produced in the end use of energy-carrying Shell products is worth it, but whether Shell is in a better position, *relative* to the end users themselves, to reduce the carbon dioxide produced in the end use of energy-carrying Shell products. This is the topic of the next section.

III. Coase and the district court

The work of Ronald Coase provides a helpful framework for analysing the court case under consideration. His classic "The Problem of Social Cost"[7] (the "Coase theorem") is an article dealing with the economic problem of negative externalities and the proper role of government in restoring market perfection. The Coase theorem is an approach to internalising the social costs of negative externalities in the price mechanism. Prototypical examples of negative externalities are environmental pollution and dangerous climate change. In his article, Coase drew from several English civil court cases on tort liability for nuisance ("nuisance claims"). Liability rules are typically used in the context of negative (environmental) externalities. Like the cases cited by Coase, the lawsuit Milieudefensie filed against Shell in civil court is a classic tort case, and the judges in the case dismissed

[6] See, cf., G Calabresi and JT Hirschoff, "Toward a Test for Strict Liability in Torts" (1972) 81 Yale Law Journal 1056.

[7] RH Coase, "The Problem of Social Cost" (1960) in RH Coase, *The Firm, The Market, and the Law* (Chicago, IL, University of Chicago Press 1988) pp 95–156.

Shell's complaint (in paragraph 4.1.3) that the claims of Milieudefensie required decisions that would cross the proper boundaries of judicial decision-making.[8]

I will analyse the court case in reference to the Coase theorem. In "The Problem of Social Cost", it is not predetermined that whoever caused the damage shall be the one party liable in tort. In fact, in the Coase theorem, there is no one party who caused the damage. The court's decision sits comfortably within the Coaseian approach. The requisite weighing of the parties' interests (considering the relevant facts and circumstances of the individual case) came out in favour of Milieudefensie, although the district court acknowledged (in paragraph 4.4.37) that Shell – apart from its own limited carbon dioxide emissions – did not actually by itself cause the carbon dioxide emissions of the business relations of the Shell group, including the end users. This is to say that the judges clearly did not apply the conventional polluter pays principle. Moreover, as observed in the previous section, the requisite weighing of the parties' interests (see paragraphs 4.4.53 and 4.4.54) did not "degenerate" into attempts at balancing the costs of the (imminent) environmental damage incurred by Dutch residents and the inhabitants of the Wadden region against the costs Shell would have to incur to reduce the carbon dioxide emissions produced in the end use of energy-carrying Shell products. The issue becomes not *whether* the reduction of carbon dioxide produced in the end use of energy-carrying Shell products is worth it, but whether Shell is in a better position, *relative* to the end users themselves, to reduce the carbon dioxide produced in the end use of energy-carrying Shell products. Whoever can prevent the damage at the least cost, which Guido Calabresi dubbed the *cheapest cost avoider*,[9] shall be the one party liable in tort. This doctrine is a derived outcome of the Coase theorem.[10]

In the present case, the question of which party can prevent the damage at the least cost is especially relevant as the (Dutch) customers and end users of energy-carrying Shell products, in the opinion of the district court (in paragraph 4.4.24), still have an individual responsibility to curtail their own carbon dioxide emissions. The cheapest cost avoider analysis requires some assessment and consideration as to whether Shell can achieve the intended carbon dioxide reduction targets at lower marginal costs than end users of energy-carrying Shell products themselves. However, the judges did not explicitly embrace such a cheapest cost avoider argument. Sure enough, the judges recognised (in paragraph 4.4.25) that Shell is able to determine its energy package, and the composition thereof, produced and sold by the Shell group. And this recognition was a decisive ground on which the judges held Shell accountable for breaching the court-established climate-related duty of care. But it cannot be inferred, from the mere circumstance that Shell has control and influence over the carbon dioxide emissions released by end users through its energy package, and the composition thereof, produced and sold by the Shell group, that therefore Shell is the cheapest cost avoider.

In view of this, it is argued here that the judges should have engaged with this issue in their reasoning for holding Shell accountable for breaching the court-established climate-related duty of care. Is the Shell group the "cheapest cost avoider"? Calabresi and

[8] As an aside, it is worth noting that the district court's ruling in para 4.1.3 is in line with the intent of Art 22 (Civil Liability) of the proposal for an EU Directive on Corporate Sustainability Due Diligence (CSDD Directive) and Section 3.2.6 (Civil action) of the proposal for a Dutch (revised) Bill on Responsible and Sustainable International Business Conduct (RSIBC Bill).

[9] G Calabresi, *The Costs of Accidents: A Legal and Economic Analysis* (New Haven, CT, Yale University Press 1970) p 155. ("[T]he search for the cheapest avoider of accident costs is the search for that activity which has most readily available a substitute activity that is substantially safer. It is a search for that degree of alteration or reduction in activities which will bring about primary accident cost reduction most cheaply.")

[10] See, eg, H-B Schäfer and A Schönenberger, "Strict Liability versus Negligence" in B Bouckaert and G De Geest (eds), *Encyclopedia of Law and Economics*, vol. II (Cheltenham, Edward Elgar Publishing 2000).

Hirschoff[11] point out that considerations of knowledge, availability of alternatives to the product and category levels are implicit in the search for the cheapest cost avoider.[12] The authors provide two instructive examples pertaining to the relevance of alternatives to the product and the use to which the product is put[13]: "If the product is a cosmetic with many reasonably close substitutes, identifying and clearly warning the risky group will very likely put the user in the best position to choose. If instead the product is a medicine, the use of which is the only way of saving the user's life, identifying and warning the risky users probably would not suffice to make the users the better choosers." In the second example, the authors' proposed test imposes liability on the manufacturer because they represent the party who is best suited, *relative* to the users, through the (re)search for adequate substitutes, to reduce the current, known medical risk. By way of analogy, in the present case, the availability of alternatives to the energy-carrying Shell products and the use to which the Shell products are put are only two factors relevant to the basic question of whether Shell is in a better position, *relative* to end users of energy-carrying Shell products, to remove or prevent the serious climate risks associated with the carbon dioxide emissions produced by Shell's business relations, including the end users. And consideration of the knowledge that companies, such as the Shell group, can reasonably be expected to have about the grave dangers of carbon dioxide emissions and the risks of climate change (to Dutch citizens and the inhabitants of the Wadden region) is another important factor in the search for the cheapest cost avoider.

IV. Concluding remarks

From a tort law perspective, in case the Hague Appellate Court is able to identify Shell as the cheapest cost avoider, this would provide a sounder (theoretical) grounding for holding Shell accountable for breaching the court-established climate-related duty of care. I do not mean to suggest that the basic purpose of Shell's liability in tort necessarily is, or should be, the creation of additional incentives towards (re)search for adequate substitutes to the energy-carrying Shell products entailing fewer risks to the climate and the environment.[14] In this regard, it is well to re-emphasise the relational nature of the proposed accountability test.[15] As said, the tort law issue is not *whether* the reduction of carbon dioxide produced in the end use of energy-carrying Shell products is worth it, but whether Shell is in a better position, *relative* to the end users themselves, through the (re)search for adequate alternatives entailing fewer risks to the climate and the environment, to reduce the carbon dioxide produced in the end use of energy-carrying Shell products. Here, cheapest cost avoider reasoning is not included in the standard of care for tort liability; rather, once the relevant standard of care is established, it is a part of the accountability standard to assign liability in tort.

In sum, in the appeal proceedings, the Hague Appellate Court should draw from Guido Calabresi's "cheapest cost avoider" theory and reassess Shell's liability in tort under that theory. The analysis depends, amongst other factors, on (1) the availability of alternatives

[11] Calabresi and Hirschoff, supra, note 6.

[12] See also G Calabresi, "Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr." (1975) 43 University of Chicago Law Review 84. ("[T]he chosen loss bearer must have better knowledge of the risks involved and of ways of avoiding them than alternate bearers; he must be in a better position to use that knowledge efficiently to choose the cheaper alternative; and finally he must be better placed to induce modifications in the behavior of others where such modification is the cheapest way to reduce the sum of accident and safety costs. The party who in practice best combines these not infrequently divergent attributes is the 'cheapest cost avoider' of an accident who would be held responsible for the accident costs under the market deterrence standard.")

[13] Calabresi and Hirschoff, supra, note 6, 1063.

[14] See, cf., Calabresi and Hirschoff, supra, note 6, 1071, footnote 57.

[15] See, cf., ibid, 1071.

to the energy-carrying Shell products, (2) the use to which the Shell products are put and (3) the knowledge that companies, such as the Shell group, can reasonably be expected to have about the dangerous consequences of carbon dioxide emissions and the risks of climate change to Dutch citizens and the inhabitants of the Wadden region. It provides a presumption of proof, for Shell to disapprove, that Shell is in a better position, *relative* to the end users, to use that knowledge efficiently, developing adequate alternatives to the energy-carrying Shell products entailing fewer risks to the climate and the environment. To conclude: the Hague Appellate Court – and the Dutch Supreme Court, for that matter – should explicitly apply the cheapest cost avoider doctrine to assign liability in tort, as it would be one of the animating justifications for holding Shell accountable for breaching the court-established climate-related duty of care.

Disclaimer. This contribution is written in a personal capacity and reflects the opinion of the author and is an extended version of a two-page paper in the Dutch law journal WPNR (2022) 7380, pp 557–58.

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