

# Regulation Tomorrow

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United Kingdom (and EU regulation)

## ClientEarth fails in judicial review against Financial Conduct Authority



By Katie Stephen (UK) and Joe Smallshaw on June 22, 2023

Posted in ESG, Investigations and enforcement, United Kingdom

### Background

ClientEarth, an environmental charity that seeks to bring legal challenges in respect of entities that it considers have not discharged their environmental responsibilities, has failed in its attempt to judicially review a decision of the Financial Conduct Authority (FCA) to approve the prospectus of a UK oil and gas company, Ithaca Energy plc (**Ithaca**). Ithaca's flotation was the UK's largest public listing of 2022.

The registration document in relation to Ithaca's proposed IPO was approved by the FCA and published by Ithaca in October 2022. ClientEarth engaged in correspondence with the FCA following the publication of

the registration document as it considered that it contained deficiencies regarding disclosure of Ithaca's climate-related financial risks.

The FCA subsequently approved Ithaca's prospectus and it was published in November 2022. Certain amendments appear to have been made to the climate-related risk factor disclosed in the published prospectus (as compared with the registration document) but ClientEarth considered these were cosmetic in nature.

Ithaca's prospectus contained a number of climate-related disclosures which included detail relating to risks such as:

- longer term reduction in the demand for hydrocarbon products due to development of alternative energy technologies and consumer preference;
- disruption to Ithaca's operations as a result of climate change;
- litigation and challenge by climate activists;
- continued political attention to the role of human activity in climate change; and
- the impact of international agreements and regulation.

## **Relevant Requirements**

Section 87A(1) of the Financial Services and Markets Act 2000 (**FSMA**) provides that the FCA may not approve a prospectus unless it is satisfied that it contains the information required by the UK retained version of Regulation (EU) 2017/1129 (the **UK Prospectus Regulation**).

Article 6(1) of the UK Prospectus Regulation provides that a prospectus must contain the necessary information which is material to an investor for making an informed assessment of (amongst other things) the issuer's assets and liabilities, profits and losses, financial position, and its prospects. It also provides that the information to be included may vary depending on the nature of the issuer, the type of securities and the circumstances of the issuer.

Article 16(1) provides that the risk factors to be included in a prospectus shall be limited to risks which are specific to the issuer and/or to the securities and which are material for taking an informed investment decision.

## **ClientEarth's Application**

ClientEarth filed an application for permission to apply for judicial review of the FCA's decision to approve the prospectus on the basis that it was arguable that:

- the FCA had erred in law by approving Ithaca's prospectus in circumstances where the prospectus failed to disclose or describe adequately Ithaca's assessment of the materiality and specificity of its climate-related financial risks in breach of Article 16(1) of the UK Prospectus Regulation and, in particular, that whilst the risk factor in the prospectus referred broadly to the potential consequences of climate change, there was no assessment of the probability of these risks materialising or the scale of their impact on Ithaca's business in the event that they did materialise; and
- the FCA's conclusion that the prospectus contained the necessary information that was material to an investor making an informed assessment of Ithaca's financial position and prospects (as required by Article 6(1) of the UK Prospectus Regulation) was rationally unsustainable, as Ithaca did not include its assessment of the materiality of the climate-related financial risks it faces and it did not include information about the compatibility of Ithaca's business plans with an emissions trajectory aligned with the Paris Agreement

and/or the UK Government's net zero commitment, which information was material to an investor's ability to make an informed assessment of its prospects.

The application by ClientEarth was made against the FCA as defendant, but Ithaca also participated in the proceedings as an interested party. The FCA opposed the application on the merits, but also on standing and delay. In respect of the merits of the application, the FCA contended that it is not part of the function of the FCA, when approving a prospectus, to identify or decide for itself the probability or magnitude of risks relating to the issuer or the offered securities, which was the responsibility of the issuer. The FCA was of the view that its role was to ensure that the specificity and materiality of a risk factor is apparent from the disclosure of the risk factor, and that, as it was satisfied that the specificity and materiality of the climate-related risk factors set out in Ithaca's prospectus were adequately described and corroborated, its decision cannot have been irrational.

### **The Court's Decision**

The High Court refused ClientEarth's application for permission to apply for judicial review of the FCA's decision on the basis that:

- the prospectus did address risks arising out of climate-related factors and it was not arguable that the FCA had misdirected itself in law as to the meaning of Article 16(1) (the FCA's position being that, whilst there is a requirement in Article 16(1) for the specificity and materiality of a risk factor to be adequately described on the face of the prospectus, it was for Ithaca to determine the materiality and specificity of the risks to be included and not the FCA);
- against the background of the duty to be concise, the FCA's conclusion that the various risk factors were adequately and specifically described, having regard to the face of the prospectus itself, was not arguably in error in public law terms; and
- under s. 87A of FSMA, the FCA has to be satisfied that a prospectus complies with Article 16(1), including that a risk is adequately described and that the risk factors are corroborated, and therefore the FCA has a considerable margin of discretion. Coupled with the FCA's expertise in the area, this makes the irrationality standard particularly difficult to surmount. The fact that the Paris Agreement was a risk for Ithaca's business had been disclosed and it was open to the FCA to conclude that, in the context of the whole of the prospectus, Ithaca had provided investors with sufficient information to make an informed assessment of risk in accordance with Article 6(1) of the UK Prospectus Regulation. Such a conclusion was not arguably in error in public law terms.

It has been reported that ClientEarth has since indicated that it will apply for the decision to be reconsidered.

### **Comment**

The FCA's case that Ithaca's disclosures were compliant with the relevant requirements of the UK Prospectus Regulation may offer some assistance to other corporates in terms of the approach to disclosures and level of detail they are required to provide in relation to climate-related risks given the FCA's view that it is for the company to assess the specificity and materiality of relevant risks and for the FCA to ensure that the specificity and materiality of a risk factor is apparent from the disclosure. The description of risk factors must be adequate and no particular form is required.

However, third party challenges such as this judicial review application by ClientEarth and general increased prominence being given to climate-related risk factors may increase the level of scrutiny by the regulator. Corporates are also likely to face further challenges from organisations such as ClientEarth and other parties unhappy with their climate-related disclosures, including investors and customers who do not face the same procedural and evidential difficulties as an applicant seeking to judicially review the regulator. In the mean-

time, listed corporates should ensure they have in place robust and well-documented procedures and governance arrangements around the identification, assessment and disclosure of climate-related risks.

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