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Board Oversight and Corporate Social Responsibility: Obligations and Considerations

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Boards of directors should ensure that they have the information they need to understand and respond to shifting societal expectations in the area of corporate social responsibility ("CSR"). As key corporate stakeholders demand that companies account for, and respond to, the adverse social and environmental impacts of their operations, these expectations are both relevant to current compliance considerations and predictive of future legal and regulatory requirements. An effective board should assess whether or not existing management personnel and systems are sufficiently responsive to emerging market, regulatory, and operational challenges. As one former chief executive has observed,

> [t]he job of the board is all to do with creating momentum, movement, improvement and direction. If the board is not taking the company purposely into the future, who is? It is because of boards' failure to create tomorrow's company out of today's that so many famous names in industry continue to disappear.[1]

It is thus the role of an effective board to consider how the corporation can best stay abreast of change, position itself for the future, and still achieve its stated goals, both economic and more intangible. That said, recent studies have found that board oversight of corporate social and environmental practices is lacking, and that existing oversight, when in place, is largely focused on corporate compliance with existing standards.

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A 2010 report, *Board Oversight of Environmental and Social Issues*, by Calvert Asset Management Company and The Corporate Library, reviewed committee charters at S&P 100 firms and found that only 65 of those companies have board committees with some level of responsibility for oversight of corporate responsibility concerns. More troubling, only 27 percent monitor and oversee risk management plans and review the effectiveness of corporate issue identification and management processes. Notably, less than 50 percent of the 65 companies' boards monitor and provide recommendations on CSR trends and developments.

CSR and the Duties of the Board

The duties of care and loyalty originated from concerns that directors would act in their personal interest, in the interests of management, or in anything other than the interests of the shareholders of the corporation. An important early case establishing shareholder primacy in the decisions of directors was *Dodge v. Ford Motor Co.*[2] The Michigan Supreme Court invalidated the authority of the Ford Motor Company to withhold shareholder dividends in favor of reinvestment, with what Henry Ford argued was an aim "to employ still more men; to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes." [3] The court held that directors had a certain amount of discretion, but that discretion was limited to choosing the appropriate means to maximize shareholder wealth.

Courts, and society, subsequently moved to a broader concept of the role of directors in carving a path for a corporation, and similarly a broader consideration of the possible mechanisms of wealth creation by a corporation. Rather than being measured solely by their ability to maximize immediate-term wealth

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[1] JOHN HARVEY-JONES, MAKING IT HAPPEN: REFLECTIONS ON LEADERSHIP 147 (1988), *cited in* R. MONKS AND N. MINOW, CORPORATE GOVERNANCE (2008).

[2] 170 N.W. 668 (Mich. 1919).

[3] *Id.* at 671.

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for shareholders (i.e., in the form of dividends), directors are able to consider the broader interests of the corporation and its long-term well-being. Using the business judgment rule, courts will generally presume that boards of directors have exercised their obligations in an informed and prudent manner and with the good faith belief that their decisions are in the best interests of the company.

In *Shlensky v. Wrigley*, a shareholder of a pro baseball team sued the directors of the corporation for refusing to install lights at the baseball field owned by the team, arguing that the decision resulted in lost revenue from night games.[4] The directors had declined to do so due to the impact on the surrounding community. The court defended the board's right to consider other factors, such as the long-term interest in the value of the property surrounding the field, as long as the directors could demonstrate that the decision was taken with the best interests of the corporation in mind.

The parallel evolution of the role of directors and corporations continued with the widespread adoption of constituency statutes as a reaction to the numerous hostile takeovers of the late 1980s. Delaware case law (e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[5]) established a duty for directors, at least in a takeover scenario, to obtain the best available value for the company's shareholders rather than potential long-term values that the company may achieve. Constituency statutes, first passed in the ''rustbelt'' states in an effort to protect legacy corporations and their communities from takeovers, generally permit a board to take into account the impact of the transaction on constituencies, such as employees and local communities, in addition to the impact on the corporation's shareholders, and permit the board to take into account the shareholders' long-term as well as short-term interests.

Evolving Obligations, Expectations

As with directors' obligations, CSR has evolved and broadened in scope over time along with society's understanding and expectations. If CSR is defined as voluntary commitments to stakeholders which a corporation makes, as opposed to legally required compliance efforts, it can be seen as a bellwether of the direction in which regulation is trending or areas in which heightened legal standards may be expected to emerge as a result of increased societal expectations. The role of directors in this area, as with any other area of corporate compliance and strategy, is that of faithfully assessing the best position for the corporation with respect to standard-setting and implementation of and compliance with such standards.

Thus, the traditional duties of the board are not static: their scope is informed by the ever-evolving operating environment in which new issues are continually emerging.

On a practical level, directors generally are protected by the boundaries of the business judgment rule in terms of their attention to and consideration of the specific issues that are placed before them. Nonetheless, the duties of care and loyalty in today's complex global business environment require more than mere attention to the issues that are presented for directors' consideration and review. Rather, an effective board must fundamentally maintain an issue-spotting role in order to help the corporation compete successfully, position itself in the marketplace, and maintain compliance with internal standards and external legal and regulatory requirements. Consideration and, as appropriate, adoption and implementation of CSR policies, standards, and procedures, should be considered within the scope of an effective director's responsibilities.

In assessing the company's capacity to respond to emerging legal and regulatory requirements, boards should be aware that courts have recognized the ''protean nature'' of ideal corporate governance practices, and that notions of what decisions, or omissions, are protected as within the boundaries of the business judgment rule are evolving.[6] In *In re The Walt Disney Co. Derivative Litigation*, the Delaware Court of Chancery stated that a director may violate the duty to act in good faith if they take an ''ostrich-like'' approach to corporate governance: in order to be protected by the business judgment rule, and in order to comply with the duty of good faith, directors must actually exercise their judgment through a process of assessing and responding to material issues facing the company.[7]

Thus, the traditional duties of the board are not static: their scope is informed by the ever-evolving operating environment in which new issues are continually emerging. Just as corporations are creations of state statutes, the duties of directors are creations of case law and statutory law. These duties have evolved as the views of society have evolved, and the challenges facing corporations have changed. The obligations of a director to act with respect to CSR issues are in some senses a continuation of that evolutionary process, and in other senses, coherent with even the earliest conceptions of director duties.

The duty of care can cut both ways when considering the CSR-related obligations of directors. On the one hand, directors have a responsibility to monitor the state of the industry and proactively consider how best to position the corporation for the future. For companies in the extractive, agricultural, and manufacturing sectors, stakeholders increasingly see robust CSR programs as a response to baseline expectations. In other industries, such as technology and financial services, debates about corporate obligations and stakeholder expectations are more nascent, but reflect a growing consensus that all companies have certain obligations to address the broader and potentially adverse impacts of their operations on stakeholders.

Companies face significant legal, reputational, and operational consequences for failures to meet stakeholder expectations in the area of social and environmental performance. These consequences may include: loss of access to finance; exposure to fines and lawsuits; the shutting down or slow down of facility operations; and poor employee morale. Reputational harm can impair a company's capacity to leverage relationships with key public and private stakeholders and to implement short- and long-term business strategies. Ulti-

[4] 237 N.E.2d 776 (Ill. App. 1968).
[5] 506 A.2d 173 (Del. 1986).
[6] *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 697 (Del. Ch. 2005).
[7] 825 A.2d 275, 288 (Del. Ch. 2003).

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mately, it may be the case that a failure to identify and implement CSR objectives for the company will lead to short-term reputational damage, actual loss of value for the company as a result of human-rights or environmental liabilities, and/or merely a loss of potential to be a leader in the field as baseline practices in the relevant industries evolve.

Such costs may be deemed to be an acceptable risk by directors in some cases. The key issue is whether a board considers them at all, and has an established framework for doing so. Boards of directors, especially in high-profile and high-risk industries under scrutiny from human rights or environmental advocates, may be well-advised to establish information and control systems to assess and manage the risks associated with the social and environmental impacts of company activities.

In *In re Caremark International Inc.*, the Delaware Chancery Court found that directors' obligations include a duty to attempt, in good faith, to ensure that adequate information and reporting systems exist to provide them with the information they need to monitor and oversee corporate operations effectively and ''to reach informed judgments concerning both the corporation's compliance with law and its business performance.'' [8]

In 2006, in *Stone v. Ritter*, the Delaware Supreme Court affirmed that *Caremark* provides the standard for director duties with respect to corporate compliance issues, and that the *Caremark* duty of good faith is a subset of the director duty of loyalty.[9] The court found that directors may be liable if they fail to implement a reporting or information system or controls or ''having implemented such a system or controls, consciously failed to monitor or oversee its operations, thus disabling themselves from being informed of risks or problems requiring their attention.'' [10]

A CSR Roadmap for Directors

As discussed above, the implications of CSR and its implementation within any given corporation will vary based on many factors. Nonetheless, the role of the board in evaluating and overseeing CSR commitment and functions is defined by the body of law regarding fiduciary duties, and is linked on a very practical level to the corporation's existing compliance function.

An effective CSR program is implemented through corporate-level policies and standards and supported by oversight mechanisms, training programs, and accountability measures.

Compliance with CSR may seem a nebulous concept, but it is surprisingly concrete and challenging. Once a goal is set for the corporation—whether that is a legally mandated goal such as compliance with the Foreign Corrupt Practices Act or local labor laws, or a voluntary standard such as the Voluntary Principles on Security and Human Rights or the Global Network Initiative Principles—the only added value for the corporation is in achieving and implementing that goal. Giving merely lip service to CSR goals may lead to legal, reputational, and internal morale challenges.

An effective CSR program is implemented through corporate-level policies and standards and supported by oversight mechanisms, training programs, and accountability measures. The board has an important and clearly defined role to play in ascertaining whether there is value in a CSR program, and if so, ensuring that the company adopts an appropriate program and has the management capacity to implement and benefit from it.

In thinking about how to play an appropriate role in CSR positioning and implementation, here are a few guideposts for board members to consider:

Positioning Considerations

1. How does the company currently perceive CSR? Is CSR seen as a foundation for risk management and compliance, philanthropic efforts, and/or sustainability reporting?

2. What are the major legal, operational, and reputational challenges faced by the company and its industry peers? Are the company's CSR initiatives, along with other company policies and practices, preparing the company to meet those challenges?

3. Who are the company's stakeholders? How does the company's CSR program enable the company to engage with, and assess the concerns of, those stakeholders?

4. How does the company compare with its industry peers in terms of its view and implementation of CSR? What value do industry members derive from their CSR positioning?

5. What voluntary commitments, codes, or standards have the company's industry peers signed on to? Has the company done the same? Why or why not?

6. Does company management see the company as a leader? Does management want the company to be perceived as an industry leader or as in ''the middle of the pack''? Is the company's CSR positioning appropriate given management's goals and self-perception?

7. What are potential avenues for better calibrating the company's CSR positioning with its internal and external goals?

Implementation Considerations

1. What is the company's CSR strategy? To what extent has the company implemented CSR initiatives? What is the state of awareness among company personnel of the existence and importance of these initiatives?

2. Does the board have a clearly defined role in overseeing the company's CSR strategy? If not, how can a role for the board be established? Can it be linked with existing compliance oversight functions of the board? What are the risks and benefits to the company of formalizing a role for the board with regard to CSR?

3. Is the board currently informed regarding CSR-related compliance and reputational issues? What information is regularly provided to the board regarding the social and environmental impacts of the company's operations?

4. Who is responsible for defining and overseeing CSR at the company? What oversight and accountability mechanisms reinforce the company's CSR strategy?

5. What specific resources are required to implement the company's current CSR policies and initiatives? Have those resources been effectively deployed or allocated? Have existing

[8] 698 A.2d 959, 970 (Del. Ch. 1996).
[9] 911 A.2d 362 (Del. 2006).
[10] *Id.* at 370.

compliance mechanisms been utilized to build CSR capacity, or can they be? What costs does the board perceive will be involved in implementing or augmenting a CSR strategy, and are such resources appropriately allocated to CSR at this time?

In the final analysis, the board is charged with fulfilling its duties of care and loyalty. Whether the ultimate impact of CSR lies in its ability to protect against legal, reputational, and operational risks, or its capacity to create shared value for the company and its stakeholders, the board can best fulfill these duties to the corporation, and to stakeholders, by considering CSR's value for the corporation and acting upon its conclusions.

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