Expert Q&A on Trends in Corporate Social Responsibility

Recent years have seen a rise in legislation and regulation, as well as direct stakeholder action, aimed at increasing companies' accountability for the social and environmental impacts of their operations. At the same time, companies are now more aware that they can gain business advantages by skillfully managing these impacts. This often involves adopting corporate best practices that go beyond what is necessary for legal and regulatory compliance. Practical Law Corporate & Securities asked Gwendolyn Jaramillo and Sarah Altschuller of Foley Hoag LLP to discuss trends in corporate social responsibility (CSR) and steps boards and general counsel should consider to respond to the shifting legal and regulatory landscape and stakeholder demands.

GWENDOLYN WILBER JARAMILLO
COUNSEL
FOLEY HOAG LLP

Gwendolyn is counsel in the firm's Corporate Social Responsibility practice and serves as Deputy Chair of the firm's International Business practice. She advises clients in industries including the extractive sector, investment management and information and communications technologies on CSR policies and strategies, particularly on implementation and compliance techniques.

SARAH A. ALTSCHULLER
ASSOCIATE
FOLEY HOAG LLP

Sarah is an associate in the firm's Corporate Social Responsibility practice. She advises multinational companies regarding the development and implementation of CSR strategies, policies and procedures, as well as compliance with emerging legal and regulatory requirements.

What are some of the considerations that CSR is typically understood to encompass?

In our view, CSR is a strategic response to evolving stakeholder expectations regarding corporate accountability for adverse social and environmental impacts of business activities. Through CSR, companies build capacity to respond to these expectations. CSR also supports a company's ability to comply with changing legal requirements. Today's stakeholder expectations often become tomorrow's legislation and regulations.

The types of considerations a company and its stakeholders may be concerned with include:

- Human rights impacts of the company's activities, ranging from the labor practices of company suppliers to the ways a company's technology guidelines impact free expression.
- Management of scarce natural resources, including water.
- Increased demands for greater transparency regarding the company's political spending, including lobbying expenses.

Corporate stakeholders, including employees, customers, investors, policymakers and communities, expect companies to manage all of the social and environmental impacts of their operations responsibly. Individual companies, however, often focus their CSR commitments and initiatives on areas particularly relevant to their business and industry. For example, an internet company may focus on protecting users' rights to freedom of expression and privacy, while a mining company may focus on environmental concerns, the rights of indigenous peoples and the training of security forces.

Effective CSR requires:

- Setting goals and developing appropriate policies and standards.
- Having the capacity to implement policies and standards effectively.
- Engaging with stakeholders on the nature and extent of the company's efforts to manage its operations responsibly.

For example, in response to stakeholder concerns, an internet company may:

- Develop a human rights policy that sets out the company's commitment to respect rights to privacy and freedom of expression in its operations.
- Establish internal standards and guidance documents to implement its human rights policy, including guidelines for responding to law enforcement requests and due diligence questions to assess the human rights-related risks of storing data in particular countries.
- Communicate its commitments and practices to stakeholders using clear and accessible terms of use guidelines and regularly report on the company's responses to law enforcement requests in different jurisdictions.

How does CSR relate to corporate philanthropy?

A company's philanthropic initiatives reflect its approach to CSR. For example, many companies provide philanthropic support to organizations that address the social and environmental concerns that are also the focus of their CSR commitments. Both corporate philanthropy and CSR often stem from the same impulses to act responsibly and to provide benefits to communities affected by the company's operations.

Failure to distinguish between philanthropy and CSR, however, can be risky. If a company seeks to "operate responsibly" solely through philanthropic commitments, it may have little capacity to address the legal, reputational and operational risks associated with stakeholder concerns about the social and environmental impacts of the company's operations. Managing these risks requires the development of appropriate social and environmental standards and performance objectives.

What are some of the CSR legislative trends that companies should be aware of?

In recent years, we have seen several new legislative and regulatory requirements mandating that companies make public disclosures regarding their efforts to address potentially adverse human rights impacts of their operations. Recent examples in the US include:

- Section 1502 of the Dodd-Frank Act, the conflict minerals provision, which directed the SEC to issue a rule creating specific disclosure requirements for companies that use certain minerals seen as funding the ongoing conflict in the Democratic Republic of the Congo (for more information, search Conflict Minerals Diligence on our website).
- The California Transparency in Supply Chains Act, requiring certain retailers and manufacturers doing business in California to disclose their efforts, if any, to address the risk of human trafficking and slavery in their supply chains (for more information, search Corporate Social Responsibility and the Supply Chain on our website).
- The Reporting Requirements on Responsible Investment in Burma, requiring US companies with cumulative investments in Burma that exceed $500,000 to file reports with the US State Department on their processes to address certain human rights impacts in Burma.

These requirements reflect the emerging expectation that companies should be accountable for assessing and mitigating the adverse human rights impacts of their operations. This was a core expectation established by the UN's *Guiding Principles on Business and Human Rights* (Guiding Principles), published in 2011, which provide guidance to companies seeking to operate with respect for human rights. The legislative provisions discussed above reflect the expectations set by the Guiding Principles. These expectations have also been incorporated into the revised OECD Guidelines on Multinational Enterprises, which observe that "respect for human rights is the global standard of expected conduct" for companies.

Additionally, these requirements reflect a broader trend toward requiring transparency, in the form of disclosures required by law or regulation, as a mechanism to pressure companies to operate in a certain way. We are seeing new or proposed legislative requirements mandating disclosures to the SEC and other bodies on topics ranging from lobbying expenditures to efforts to eradicate the worst forms of child labor.

What types of management systems are companies developing to integrate CSR into their operations? What do you recommend as best practices?

The types of management systems that support strong CSR performance are no different from those used by companies to manage any other performance objective. Companies need:

- Strong corporate-level policies reflecting high-level support for their CSR commitments.
- Performance standards that ensure company employees and, when possible, business partners and suppliers, understand and are held accountable to the company's policies on social and environmental performance.
- Oversight mechanisms and reporting channels to track performance and ensure that performance gaps are addressed quickly.

For example, a mining company's policy on indigenous peoples must be reflected in specific corporate standards on community engagement and consultation, and the treatment of cultural heritage sites. These standards should become part of specific and appropriate performance objectives for site-level personnel, ranging from country and mine site managers to early-stage exploration teams. Performance reviews of those personnel should reflect the company's commitments to these specific standards and objectives. The company should also ensure that corporate-level personnel receive regular reports on the extent to which different sites are operating consistently with internal standards. Failures to operate consistently with corporate standards should be remedied with performance improvement plans.

What role do you recommend the board of directors have in a company's CSR initiatives?

The board of directors has a critical oversight role to play regarding a company's CSR commitments and strategies. Oversight of a company's approach to CSR is consistent with the board's obligations to ensure that the company is operating in a manner consistent with long-term value creation. A key function of the board is to oversee management's approach to:

- Risk management.
- Legal and regulatory compliance.
- Strategic planning.

The board should be concerned with the company's short- and long-term capacity to manage its operations in a socially and environmentally responsible way. For example, the board should ensure that the company's management structure includes senior-level personnel with specific expertise on the social and environmental concerns most relevant to the company's operations. We are seeing more oil, gas and mining companies establish executive-level positions with specific responsibility for sustainability. Similarly, many companies that handle large quantities of consumer or user data are establishing chief privacy officer positions.

The board should be concerned with the company's short- and long-term capacity to manage its operations in a socially and environmentally responsible way.

By raising key questions and endorsing specific priorities, the board can also ensure that key personnel receive the resources needed to respond to evolving stakeholder concerns and associated legislative and regulatory requirements. For example, a board member that raises questions about a company's capacity to manage water-related risks may help ensure:

- Management dedicates sufficient attention to assessing the emerging legal, reputational and operational risks associated with water scarcity at each of the company's operating locations.
- The commitment of appropriate financial resources to efforts to mitigate those risks.

What recent trends have influenced the extent to which boards have focused on CSR?

Companies and their boards increasingly realize that there are real risks if they fail to manage their operations responsibly. These risks can include:

- Lawsuits.
- Boycotts.
- Loss of financing.
- Breakdowns in relationships with key business partners.

Stakeholder opposition to company operations can lead to project delays or cancellations, additional conditions or costs associated with financing or insurance and diverted staff time. The overall cost of these types of impacts can be quite large. In a 2010 report to the UN Human Rights Council, the UN Special Representative on Business and Human Rights observed that, in consultations with oil, gas and mining companies, he had found that many costly project delays were the result of "stakeholder-related risks." He reported that one company may have experienced a $6.5 billion "value erosion" as a result of these non-technical risks.

The results of the 2013 proxy season also indicate that shareholders of reporting companies are increasingly demanding that boards oversee management's response to social and environmental concerns. In the 2013 season, shareholders filed more than 20 proposals for structural governance reforms relating to oversight of social and environmental issues. The proposals requested that company boards:

- Form committees on specific subjects, such as human rights.
- Identify board member nominees with relevant expertise, such as environmental expertise.

(See *Proxy Preview 2013, As You Sow, the Sustainable Investments Institute, and Proxy Impact*.)

Many reporting companies have already formed committees with CSR responsibilities. According to committee charters, the responsibilities of these committees include:

- Reviewing social, political, economic and environmental trends that may have a significant impact on the company's business activities and performance (*McDonald's Corporation*).
- Reviewing and assessing company policies and practices regarding significant CSR issues, including compliance with the company's code of conduct, product safety, environmental health and compliance, transparency, sustainability, public policy matters, corporate citizenship and charitable contributions (*Hasbro, Inc.*).
- Reviewing and making recommendations on shareholder proposals relating to CSR matters, which are then submitted for inclusion in the company's proxy statement for its annual shareholders' meeting (*Philips-Van Heusen Corporation*).

These charters reflect the significant business considerations served by CSR. Too many companies, however, have failed to recognize that CSR can be a significant component of a company's approach to both risk management and value creation or have left boards disengaged from important oversight roles regarding the management of social and environmental concerns.

What advice would you give to a general counsel or board member seeking to bolster the company's ability to respond to shifting legal requirements and stakeholder demands in this area?

Companies are at risk if they approach social and environmental concerns solely with a compliance-oriented or philanthropic mentality. While meeting current requirements and supporting local communities is important, it is also important to ensure that the company is attuned to policy trends and shifting stakeholder demands. Companies should assess the extent to which they have the capacity to operate consistently with emerging best practices, noting that these evolving performance standards may well be predictive of future compliance requirements.

A general counsel or board member should consider:

- Setting up appropriate reporting lines to executive leadership and the board regarding:
  - social and environmental performance challenges;
  - policy trends; and
  - stakeholder demands.
- Building internal expertise on voluntary CSR standards and best practices in the company's industry.
- Using cross-functional engagement to ensure that personnel responsible for assessing relevant trends are communicating with those developing operational plans.
- Evaluating whether the company has the capacity to:
  - operate consistently with industry best practices and voluntary standards; and
  - assess the legal, reputational and operational risks to the company if performance gaps exist.