

MAKING NICE, OR PLAYING IT SMART?

Is corporate social responsibility a director duty or simply good PR?

[BY EVA H. DAVIS]

CALL IT A SIGN OF THE TIMES: MORE and more corporations are choosing to make corporate social responsibility (CSR) a core part of their mission. They are responding to a broad array of societal concerns, including the environment, the well-being of their employees, and the needs of the communities in which they operate. And they are responding to the interests of a wide range of concerned stakeholders—local communities, consumers, suppliers, creditors, employees, and other members of the public sphere. Increasingly, socially responsible corporations are pursuing a triple bottom line: people, planet, and profit. And, while many attempts to import CSR values into company culture have failed so far, there is a trend in the direction of incorporating them.

Over the last year several companies announced plans to engage in socially responsible practices. Starbucks Corporation, Pfizer Inc, and Federal Express Corporation all published annual corporate social responsibility reports for 2009 and/or 2010. While these companies are in very different industry sectors, they all have some common areas of concern, such as their impact on the environment. In April, Wal-Mart Stores, Inc., provided an update on its three sustainability goals: to be supplied 100 percent by renewable energy, to create zero waste, and to sell products that sustain people and the environment. In May, Kaiser Permanente announced that it will start buying medical products based on eco-friendly criteria. By getting out in front of these issues, the companies stand to avoid legal trouble in the future.

Why is this movement taking hold now? First, the Internet has changed the world, making it more difficult to hide what corporations are doing, and easier to register an opinion about their actions. Via blogs, e-mail blasts, and



other electronic media, stakeholders can easily communicate with each other and with a corporation to press for CSR. In 2007 the Securities and Exchange Commission amended its proxy rules to allow shareholder-to-shareholder communication via Web sites and chat rooms with the goal of enhancing shareholder participation and interaction without violating proxy rules.

Second, major corporate scandals in the last decade (Enron Corporation, Tyco International Ltd., WorldCom, and Hollinger International) and the recent collapse of Wall Street have caused regulators and stakeholders to push for greater ethics, transparency, accountability, and disclosure at the corporate level. With corporations held in disrepute on issues ranging from corruption to financial pain to environmental calamity, the time for corporate image burnishing is now. In response, many corporations, particularly those with household names, now openly tout

“good corporate governance” and “best practices.” And for many, CSR is the next “best practice.”

Third, many shareholder and institutional investor groups now have guidelines that require socially responsible investing. What began as investor concern about a single key issue (such as the refusal in the 1970s and 1980s to invest in businesses that had dealings with apartheid South Africa) has evolved as the range of issues deemed connected with corporate practices widens. So CSR guidelines today take on many flavors.

For example, TIAA-CREF, one of the largest investment funds in the country, has stated that long-term value for its investors is gained through CSR in areas ranging from executive compensation and the environment to human rights in Sudan. To support these guidelines, TIAA-CREF has sponsored hundreds of shareholder resolutions on these topics at numerous annual shareholder meetings during the last few years.

Similarly, many institutional investors have adopted the United Nations Principles for Responsible Investment, a set of voluntary best practice standards that asset owners and asset managers pledge to uphold in order to incorporate environmental, social, and governance issues into their investment processes and shareholder practices.

Fourth, over time, the SEC has been more willing to allow shareholders to include CSR resolutions in a corporation’s proxy. As a matter of law, the SEC traditionally allows corporations to exclude a large number of CSR resolutions, citing rule 14a-8, which allows corporations to exclude resolutions that don’t relate to “ordinary business operations.” However, through a combination of case law and SEC interpretations, shareholder resolutions are

an exception to the ordinary business operations exclusion, allowing shareholder proposals that relate to human rights, the environment, employment discrimination, golden parachutes, and additional employment matters to be placed on their ballots.

In late 2009 the SEC advised in a staff legal bulletin that a shareholder proposal that focuses on the board's role in the oversight of a company's management of risk may transcend the day-to-day business matters of a company and raise other significant policy issues appropriate for a shareholder vote.

For example, in 2009, following significant negative publicity relating to alleged human rights violations in China and India, The Coca-Cola Company was forced to place on the ballot a resolution relating to the establishment of a board committee on human rights. The provision, like a majority of

ness community interest in the link between company image and the real-world fortunes of the corporation can only grow. CSR is another form of brand management. Strong consumer brands command premium pricing, which can translate into higher market value.

CLEARLY, CSR PROGRAMS ENHANCE the image of a company, but is CSR also definable as a director duty, or is it something more nebulous, a nice way to appear virtuous but not a key corporate concern? Company directors have a fiduciary duty to maximize value for their corporation's shareholders, but not a duty to cause a corporation to act in a socially responsible manner. Courts are reluctant to second-guess decisions that are made by directors to maximize value, particularly if the decision appears reasonable at the time made and was done following director review

the impact of larger social problems on long-term value.

So what does all this mean for corporate counsel? As with any serious issue, the board operates best when it is out in front of a problem, rather than reacting to an unexpected attack by an activist shareholder, and for this they should seek legal guidance. Which aspects of incorporating CSR into company culture qualify as core concerns from a business duty? Certainly any best practices that can prevent lawsuits in the future would qualify, and in-house counsel are in the best position to determine what those would be. Corporate counsel must understand the issues likely to be raised by the corporation's stakeholders and help prepare their boards to respond to them. This requires that counsel be informed about the corporation's business units, industry, and other constituents, including

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shareholder proposals relating to CSR, ultimately failed. Even so, shareholder activists increasingly propose these resolutions to highlight what they view to be significant social issues—often as part of a larger campaign to influence social change by the corporation.

In 2009 the SEC also proposed rule changes that would allow for shareholders to be granted access to a corporation's proxy statement to nominate candidates for the election of directors. If adopted in the future, this proposal would give shareholder activists an additional tool to promote corporate social responsibility—either by obtaining a board seat and pushing the agenda in the boardroom, or by using the possibility of a proxy fight for a board seat as leverage to push the agenda outside the boardroom. While attempts to get such a proposal into the Restoring American Financial Stability Act of 2010 recently passed by Congress proved unsuccessful, that will not be the final word on the matter.

Finally, CSR action is simply good public relations and marketing. Busi-

ness community interest in the link between company image and the real-world fortunes of the corporation can only grow. CSR is another form of brand management. Strong consumer brands command premium pricing, which can translate into higher market value.

Under certain circumstances, directors can choose to self-regulate and make CSR a fiduciary duty. In March, Intel Corporation added a corporate responsibility and sustainability performance requirement to a board committee's charter. This made CSR a fiduciary duty of company directors who serve on that committee. The new charter provision was added in response to pressure from an activist shareholder to include a resolution in Intel's upcoming proxy statement that would create a new board committee specifically to address sustainability. Some activist shareholders may view this as another step toward making CSR a fiduciary duty. (Intel's board committee charter can still be amended by the company's board to remove this charter provision.) As this link between larger social issues and the financial prospects of a corporation becomes stronger, fiduciary duties arguably require that directors consider

its shareholder base, and also the standards being adopted by their industry sector as a whole. With this information, in-house counsel can assist the board in setting a CSR agenda, and can assist the corporation in developing its communications with stakeholders to forestall any potential problems in the future.

CSR decisions are strategic corporate matters that require board oversight. In choosing whether to pursue any socially responsible agenda, the board should not simply make decisions that benefit short-term stock value, but should also weigh the costs and benefits that their strategies may have on long-term value. Socially responsible policies seemed like a frill not long ago, but going forward, they will loom large in corporations' images, and that will affect those companies' bottom lines. Legal departments have a stake in making sure that corporations get it right.

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