# Board Oversight of Sustainability

Alan S. Gutterman
Founding Director, Sustainable Entrepreneurship Project

## §1 Introduction

The role of corporations and other business organizations in society has become a hotly debated issue that has attracted the attention of numerous participants in the political arena; however, until recently board members generally showed little interest in the debate and remained focused on their traditional role of maximizing shareholder value. It is now becoming clear that questions regarding the role of business are tied to essential strategic and operational sustainability-related issues that are critical to the discharge of directors' responsibilities with respect to setting the long-term strategy of their companies and which have attracted the attention of investors, consumers and other stakeholders upon which companies depend for their survival.

According to studies conducted by the Conference Board and the Boston Consulting Group board oversight is one of the top drivers of a company's attention to sustainability, a result that is not surprising given that the board is uniquely situation within the organizational hierarchy to ensure that sustainability is integrated into the long-term business strategy and that due consideration is given to social and environmental trends that will impact the company's operations and the markets in which it operates.[1] The board is the only organizational body that can seamlessly integrate sustainability into decisions and actions that fall within the board's core functions including oversight of risk management, compliance and the recruitment and remuneration of the CEO. Moreover, board commitment and leadership on sustainability is highly visible and sends a strong signal about prioritization of sustainability to employees and external stakeholders such as investors. Finally, while CEOs may come and go, and short-term pressures will inevitably batter all companies at some point, the board can offer long-term leadership continuity on sustainability through its strategic planning decisions and succession planning for the CEO and other senior executives.

For KPMG, the critical sustainability-related issues fell under the broad rubric of environmental, social and governance, popularly referred to as "ESG", and included topics such as[2]:

- Climate change impacts
- Water and waste management
- Natural resource scarcity

[1] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 6.
[2] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 1. The terms "sustainability", "corporate social responsibility", "CSR" and "ESG" are sometimes used interchangeably in this chapter depending on the terms selected and used by different researchers and commentators.

- Product and worker safety
- Supply chain management
- Workplace diversity and inclusion
- Talent management
- Employee relations
- Human rights
- Health
- Labor practices
- Executive compensation
- Political contributions
- Board independence, composition and renewal

While board members and senior executives generally understand the issues involved with ESG, corporate social responsibility ("CSR") and the strategic value of implementing ESG and CSR strategies, studies have shown that board oversight of environmental and social issues is often deficient. Many larger companies with publicly-traded securities have established committees of the board to exercise some level of oversight of ESG and CSR programs; however, the activities of these committees often do not extend to assessing the environmental and social impact of strategic business decisions and/or monitoring and providing recommendations on ESG and CSR trends and developments. Many ESG and CSR board committees spend most of their time on compliance activities in relation to existing laws and industry standards and fail to move beyond that level of involvement to brainstorming about stakeholder engagement.

KPMG noted that the evidence is mounting as to a strong positive connection between a company's ability to identify and incorporate these issues into their long-term strategies to achieve a competitive advantage and the company's return on investment. Companies that continue to ignore ESG and CSR issues are vulnerable to environmental, legal and reputational risks while companies with strong ESG and CSR performance tend to have a more stable and loyal investor base, lower cost of capital and realize benefits in terms of employee engagement and customer purchaser behavior. In spite of all this, however, directors continue to struggle with how to make ESG and CSR a priority in the boardroom. According to KPMG, directors must overcome a number of challenges[3]:

- Short-term pressures caused by the need to meet quarterly earnings expectations and maintain the strength of investment vehicles that are valued daily or monthly cause companies to ignore addressing ESG and CSR issues, which by their very nature, are more long-term oriented.
- Directors are often confused by the language and nomenclature that surrounds ESG and CSR issues and which includes definitions and concepts such as CSR, "corporate responsibility", "shared value", "conscious capitalism", "impact investing", "triple bottom line", "responsible business", "corporate citizenship" and "sustainability".

[3] Id. at 1 and 5.

- Some of the issues associated with ESG and CSR have traditionally been viewed as “soft” brand/marketing topics rather than strategic issues. While many companies did make their initial forays into environmental and social responsibility as a marketing tool and relied heavily on philanthropic acts, this approach will no longer do and may even expose the company to negative feedback as being mere “greenwashing”. Directors need to change their own mindsets and those of many within their organizations: attentiveness to ESG, CSR and sustainability can be good for branding, but it needs to be more fully integrated into strategy.
- There is no “cookie cutter” approach to ESG and CSR: every company faces different issues and circumstances will change as their operating environment evolves, all of which means that directors must continuously access all of the relevant issues and adjust the company’s strategy and operational activities.
- Standards and tools for addressing many of the ESG and CSR issues are still evolving, many in just their earliest stage, and directors often have to act with clear guidelines of the type that have developed in areas where laws, regulations and related interpretations have been in place for extended periods of time. Sustainability reporting and stakeholder engagement are just two areas, each extremely important, where directors are being tasked to develop sufficient expertise to make critical decisions about communications with investors and other stakeholders on ESG and CSR issues including what is “material” and thus mandates disclosure and in what form should those disclosures be made.
- ESG and CSR issues are not something that can be treated and addressed as an afterthought, instead directors and members of the executive team need to accept a radical redefinition of their focus and activities in order to connect and embed ESG and CSR into the company’s core business activities and processes (i.e., strategy, operations, risk management and corporate culture) and demonstrate strong leadership and commitment in interactions with internal and external stakeholders in order to secure “buy in” to long-term strategic initiatives.

Support for ESG and CSR programs by the board of directors is an important element of the requisite “tone at the top” for increasing the chances of success for CSR. Board members must understand that ESG and CSR programs are consistent with their traditional role and duty to effectively manage the legal, financial and reputational risks to the company that arise from the environmental and social impacts of the company’s activities. Board members must insist that ESG and CSR be integrated into the company’s strategic decision making and performance management and assessment systems, a priority which includes allocating sufficient resources to ensure that personnel are able to efficiently engage with the company’s stakeholders. In addition, board members must push for creating and maintaining systems that provide them with the information that they need in order to understand and evaluate the company’s ESG and CSR programs.

Ceres, a non-profit organization advocating for sustainability leadership (www.ceres.org), has developed and disseminated its Ceres Roadmap as a resource to help companies re-engineer themselves to confront and overcome environmental and social challenges and as a guide toward corporate sustainability leadership.[4] In the area of governance for sustainability, Ceres stated the overall vision for companies is having sustainability embedded from the boardroom to the copy room and managing their entire value chain for sustainability. Specific expectations regarding governance were as follows:

- G1 – Board Oversight: Corporate boards will provide formal oversight for corporate sustainability strategy and long-term performance. Sustainability considerations will be integrated into board discussions on strategy, risk and revenue.
- G2 – Management Accountability: The CEO and company management—from C-Suite executives to business unit and functional heads—will be explicitly accountable for achieving sustainability goals.
- G3 – Executive and Employee Compensation: Sustainability performance results will be a core component of compensation packages and incentive plans for all executives and employees across the business. Companies will include sustainability criteria in all employee performance assessments.
- G4 – Corporate Policies and Management Systems: Companies will embed sustainability considerations into corporate policies and risk management systems to guide day-to-day decision-making.
- G5 – Public Policy: Companies will clearly state their position on relevant sustainability public policy issues. Any lobbying will be done transparently and in a manner consistent with the company's sustainability commitments and strategies.

One of the most significant drivers of enhanced board oversight of sustainability has been the changing expectations of institutional investors, a trend which is discussed in detail below. In addition, directors have become keenly aware of the expectations of other stakeholders regarding the role and purpose of corporations in society and the need for corporations, through their boards and senior executives, to forge a strategy that takes into account the environmental and social impact of operations as well as traditional financial performance objectives. Consumers are demanding that companies integrate sustainability into their products and services and employees are seeking to work for companies that aim to "make a difference" as well as profits. Lawmakers are imposing additional sustainability-related legal and regulatory compliance requirements on corporations, thus causing directors to make appropriate changes to their enterprise risk management processes. Finally, traditional notions of directors' fiduciary duties, which assumed primacy of shareholders' interests and maximizing shareholder value, are giving way to a model of directors' duties that gives due weight to the interests of stakeholders.

## §2 Investors' expectations for board oversight of sustainability

Customers, employees and corporate activists, including socially conscious investors, have been focusing on issues now commonly associated with CSR and corporate sustainability for several decades, particularly in the areas of environmental protection and human rights; however, CSR has taken on a new urgency for corporate directors and executives as institutional investors, including large public pension funds, have become

[4] Ceres, The Ceres Roadmap for Sustainability (www.ceres.org/ceresroadmap)

more interested in, and concerned about, environmental protection, human rights, health and safety and diversity and have shown greater appreciation for the benefits of pursuing corporate sustainability as opposed to only rewarding short-term profitability.[5] The submission by the BT Governance Advisory Service to the Australian Parliamentary Joint Committee on Corporations and Financial Services in 2006 provided an illustration of how and why institutional investors seek out companies that understand the need for a longer term approach to risk:

> "Long term investors expect organizational decision makers to have a regard for the interests of stakeholders other than shareowners when those stakeholder interests have the capacity to influence shareowners' interests. We believe that companies that manage their stakeholders' interests are managing their shareowners' interests, especially over the long-term. This arises from the fact that risks to companies arise not just from typical financial risks but also from regulatory, community and litigation risks."[6]

The consensus today among institutional investors is that "corporate sustainability" is no longer limited to the environmental practices of the company, but should be broadly construed to include all of the challenges that should be overcome--economic, environmental and social--and all of the actions that should be taken in order for the corporation's business model to survive and thrive currently and into the future. The President and CEO of State Street Global Advisors ("SSGA") has informed the directors of SSGA's portfolio companies that SSGA defines sustainability "as encompassing a broad range of environmental, social and governance issues that include, for example, effective independent board leadership and board composition, diversity and talent development, safety issues, and climate change."[7] Pronouncements regarding the importance of CSR by institutional investors are tremendously impactful on the decisions made by management since those investors are among the largest shareholders of the companies they follow. Directors and CEOs must be mindful of surveys showing that CSR issues play a pivotal role in investment decisions for 90% of investors.[8] Large institutional investors, such BlackRock and State Street Global Advisors ("SSGA"), have put the directors of their portfolio companies on notice that they would be expected to consider sustainability of operations, environmental factors that affect the business and the company's role as a member of the community, and that the investors believe that CSR issues can have a material impact on a company's ability to generate revenues over the long term and will consider whether the companies clearly communicate their approach to sustainability and its influence on strategy when making their investment

[5] For detailed discussion of investor interest in corporate social responsibility and sustainability, see "Corporate Governance and Sustainability" in "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
[6] Parliamentary Joint Committee on Corporations and Financial Services, Corporate responsibility: Managing risk and creating value (2006), 68.
[7] Letter from Ronald P. O'Hanley, President and CEO, SSGA, to Board Members, 1-2 (January 26, 2017), available at ssga.com.
[8] Tomorrow's Investment Rules: Global Survey of Institutional Investors on Non-Financial Performance, 5 (Ernst & Young, 2014).

decisions.[9] SSGA has announced that it would consider the following issues when evaluating companies' CSR and corporate sustainability efforts and the actions of board members in overseeing and management and setting long-term strategy[10]:

- The company has identified the sustainability issues material to the business.
- The company has analyzed and incorporated sustainability issues, where relevant, into its long-term strategy.
- The company considers long-term sustainability trends in capital allocation decisions.
- The board is equipped to adequately evaluate and oversee the sustainability aspects of the company's long-term strategy.
- The company's reporting clearly articulates the influence of sustainability issues on strategy.
- The board incorporates key sustainability drivers into performance evaluation and compensation programs.

A discussion paper on board adoption and oversight of corporate sustainability prepared by The Global Compact LEAD included the following observation[11]:

> "Sustainability is increasingly recognized as a strategic imperative for businesses globally. Far more than when the Global Compact was launched in 1999, companies recognize that their sustainability performance affects their strategy, financial performance, resilience, access to essential resources, reputation, and license to operate. Peter Senge, noted strategy theorist and faculty member at the Sloan School of Business at MIT wrote in 2009 that "people are starting to suspect that these are really strategic issues that will shape the future of our businesses." And as sustainability is being recognized more and more as a strategic business question, Boards are increasingly considering sustainability as part of their core responsibility of guiding and overseeing corporate activities."

The paper also noted that: "more and more investors are looking for corporate boards to steward corporate sustainability in order to both adequately manage risks and maximize business opportunities related to sustainability. Indeed, engagement activities are on the rise in many quarters, and like- minded investors are increasingly pooling resources to create a stronger and more representative shareholder voice and to ensure that company engagement becomes more effective.[12]

## A Corporate Governance Framework for U.S. Listed Companies

[9] See, e.g., Annual Letter from Larry Fink, Chairman and CEO, BlackRock, to CEOs (January 24, 2017), available at blackrock.com; and Letter from Ronald P. O'Hanley, President and CEO, SSGA, to Board Members, 1-2 (January 26, 2017), available at ssga.com..

[10] SSGA, Incorporating Sustainability Into Long-Term Strategy (January 23, 2017), available at ssga.com.

[11] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.

[12] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.

Important insights on what directors should know about what institutional investors will expect with respect to the governance practices of their portfolio companies can be derived from the following six principles in the Corporate Governance Framework for U.S. Listed Companies announced by the Investor Stewardship Group (www.isgframework.org):

**Principle 1: Boards are accountable to shareholders.**

1.1 It is a fundamental right of shareholders to elect directors whom they believe are best suited to represent their interests and the long-term interests of the company. Directors are accountable to shareholders, and their performance is evaluated through the company's overall long-term performance, financial and otherwise.
1.2 Requiring directors to stand for election annually helps increase their accountability to shareholders. Classified boards can reduce the accountability of companies and directors to their shareholders. With classified boards, a minority of directors stand for elections in a given year, thereby preventing shareholders from voting on all directors in a timely manner.
1.3 Individual directors who fail to receive a majority of the votes cast in an uncontested election should tender their resignation. The board should accept the resignation or provide a timely, robust, written rationale for not accepting the resignation. In the absence of an explicit explanation by the board, a director who has failed to receive a majority of shareholder votes should not be allowed to remain on the board.
1.4 As a means of enhancing board accountability, shareholders who own a meaningful stake in the company and have owned such stake for a sufficient period of time should have, in the form of proxy access, the ability to nominate directors to appear on the management ballot at shareholder meetings.
1.5 Anti-takeover measures adopted by companies can reduce board accountability and can prevent shareholders from realizing maximum value for their shares. If a board adopts such measures, directors should explain to shareholders why adopting these measures are in the best long-term interest of the company.
1.6 In order to enhance the board's accountability to shareholders, directors should encourage companies to disclose sufficient information about their corporate governance and board practices.

**Principle 2: Shareholders should be entitled to voting rights in proportion to their economic interest.**

2.1 Companies should adopt a one-share, one-vote standard and avoid adopting share structures that create unequal voting rights among their shareholders.
2.2 Boards of companies that already have dual or multiple class share structures are expected to review these structures on a regular basis or as company circumstances change, and establish mechanisms to end or phase out controlling structures at the appropriate time, while minimizing costs to shareholders.

**Principle 3: Boards should be responsive to shareholders and be proactive in order to understand their perspectives.**

3.1 Boards should respond to a shareholder proposal that receives significant shareholder support by implementing the proposed change(s) or by providing an explanation to shareholders why the actions they have taken or not taken are in the best long-term interests of the company.
3.2 Boards should seek to understand the reasons for and respond to significant shareholder opposition to management proposals.
3.3 The appropriate independent directors should be available to engage in dialogue with shareholders on matters of significance, in order to understand shareholders' views.
3.4 Shareholders expect responsive boards to work for their benefit and in the best interest of the company. It is reasonable for shareholders to oppose the re-election of directors when they have persistently failed to respond to feedback from their shareholders.

**Principle 4: Boards should have a strong, independent leadership structure.**

4.1 Independent leadership of the board is essential to good governance. One of the primary functions of the board is to oversee and guide management. In turn, management is responsible for managing the

business. Independent leadership of the board is necessary to oversee a company's strategy, assess management's performance, ensure board and board committee effectiveness and provide a voice independent from management that is accountable directly to shareholders and other stakeholders.
4.2 There are two common structures for independent board leadership in the U.S.: 1) an independent chairperson; or 2) a lead independent director. Some investor signatories believe that independent board leadership requires an independent chairperson, while others believe a credible independent lead director also achieves this objective.
4.3 The role of the independent board leader should be clearly defined and sufficiently robust to ensure effective and constructive leadership. The responsibilities of the independent board leader and the executive chairperson (if present) should be agreed upon by the board, clearly established in writing and disclosed to shareholders. Further, boards should periodically review the structure and explain how, in their view, the division of responsibilities between the two roles is intended to maintain the integrity of the oversight function of the board.

**Principle 5: Boards should adopt structures and practices that enhance their effectiveness.**

5.1 Boards should be composed of directors having a mix of direct industry expertise and experience and skills relevant to the company's current and future strategy. In addition, a well-composed board should also embody and encourage diversity, including diversity of thought and background.
5.2 A majority of directors on the board should be independent. A board with a majority of independent directors is well positioned to effectively monitor management, provide guidance and perform the oversight functions necessary to protect all shareholder interests.
5.3 Boards should establish committees to which they delegate certain tasks to fulfill their oversight responsibilities. At a minimum, these committees should include fully independent audit, executive compensation, and nominating and/or governance committees.
5.4 The responsibilities of a public company director are complex and demanding. Directors need to make the substantial time commitment required to fulfill their responsibilities and duties to the company and its shareholders. When considering the nomination of both new and continuing directors, the nominating committee should assess a candidate's ability to dedicate sufficient time to the company in the context of their relevant outside commitments.
5.5 Attending board and committee meetings is a prerequisite for a director to be engaged and able to represent and protect shareholder interests; attendance is integral to a director's oversight responsibilities. Directors should aim to attend all board meetings, including the annual meeting, and poor attendance should be explained to shareholders.
5.6 Boards should ensure that there is a mechanism for individual directors to receive the information they seek regarding any aspect of the business or activities undertaken or proposed by management. Directors should seek access to information from a variety of sources relevant to their role as a director (including for example, outside auditors and mid-level management) and not rely solely on information provided to them by executive management.
5.7 Boards should disclose mechanisms to ensure there is appropriate board refreshment. Such mechanisms should include a regular and robust evaluation process, as well as an evaluation of policies relating to term limits and/or retirement ages.

**Principle 6: Boards should develop management incentive structures that are aligned with the long-term strategy of the company.**

6.1 As part of their oversight responsibility, the board or its compensation committee should identify short- and long-term performance goals that underpin the company's long-term strategy. These goals should be incorporated into the management incentive plans and serve as significant drivers of incentive awards. Boards should clearly communicate these drivers to shareholders and demonstrate how they establish a clear link to the company's long-term strategy and sustainable economic value creation. All extraordinary pay decisions for the named executive officers should be explained to shareholders.
6.2 A change in the company's long-term strategy should necessitate a re-evaluation of management incentive structures in order to determine whether they continue to incentivize management to achieve the goals of the new strategy.

**Source:** https://www.isgframework.org/corporate-governance-principles/



Calvert Asset Management, in its 2010 survey of board oversight of environmental and social issues in North America, explained the rationale for the board's role as follows:

> "The question of whether boards of directors should have responsibility for corporate sustainability matters is sometimes debated. Some critics of the idea argue that social and environmental issues are by their nature managerial and operational issues which makes them inefficient for the board to address. However, many investors have come to believe that these issues have implication for capital investments, corporate strategy, brand and reputation. From this perspective, boards of directors are the appropriate bodies to provide long-term perspective and guidance on these matters, and the absence of board responsibility can raise questions about whether a company is managing these factors appropriately. Conversely, board-level oversight of corporate responsibility can set a meaningful "tone at the top" and provide investors and other stakeholders with a deeper understanding of how the company assesses its challenges and prioritizes issues relevant to its success."[13]

Identifying, acknowledging and addressing corporate sustainability issues create new and significant challenges for directors and the management team that range from setting high-level goals and adopting strategies to achieve those goals to extensive changes in day-to-day operational activities. Directors must not only ensure that their companies are conducting full assessments of the entire lifecycle of their products and services but must also provide the resources and incentives to collect, analyze and report information relating to the progress of the company's corporate sustainability initiatives. Institutional investors and other stakeholders will not be satisfied with vague promises and aspirational principles from their companies, nor will companies be able to simply continue to adopt a reactive approach to ESG-related concerns (i.e., waiting until a shareholder proposal on an ESG-topic is imminent before engaging with the shareholder to resolve the concern). In fact, directors should expect that stakeholders demand that companies demonstrate a proactive approach to developing and implementing sustainability strategies, allocating capital to sustainability-related initiatives and managing the risks associated with failure to respond to ESG issues.

Much of the guidance from institutional investors to companies regarding CSR and corporate sustainability has been publicly directed at the CEOs of those companies and the other members of the management team of those companies and this makes sense given that they are the persons most directly involved in the day-to-day operations and thus best situated to execute CSR and corporate sustainability commitments and programs. For example, surveys, such as one completed by Boyden in 2017 among

[13] Board Oversight of Environmental and Social Issues: An Analysis of Current North American Practice (Calvert Asset Capital Management Inc. and The Corporate Library, 2010), 8.

adults in the United Kingdom, repeatedly confirm that the public strongly believes that the CEO must play an active role in the CSR activities of his or her company and act as a spokesperson for those activities.[14] Participation and engagement by employees throughout the organization is essential for effective CSR implementation and the CEO is the only person in a position to communicate and demonstrate the values associated with CSR in a way that will integrate CSR into the corporate culture and the way that employees work on a day-to-day basis. It should be noted that CSR has become a significant driver of employee engagement, particularly among Millennials who are more willing to accept lower wages in exchange for working with a company committed to sustainability, and that the CEOs efforts to engage employees in this area will improve the company's ability to attract and retain talented workers. CEOs must also develop the soft skills necessary to communicate and engage with multiple stakeholders, each of which has different values and attitudes about how society should function and the role that the firm should play. CEOs must be able to engage in civil dialogue, approach the problems and challenges that are raised by stakeholders with an open mind and a focus on identifying and implementing innovative solutions and developing tools that will help measure and demonstrate the effectiveness and value of the company's CSR initiatives.

However, while the CEO is inevitably the high profile "face of the company", it is the members of the board of directors who retain oversight responsibility over the activities of the CEO and other officers, including those related to CSR and corporate sustainability, and clearly have a unique and essential role to play in this area. Most importantly, directors can and must provide the long-term perspective needed in order for consideration of CSR and corporate sustainability to be integrated into the company's values, strategies and processes for identifying and mitigating risks that can challenge the stability and longevity of the company. In addition, CSR and corporate sustainability commitments and programs will not be effective unless they are embraced and continuously communicated by the board to each of the company's stakeholder constituencies. Finally, the directors, through their roles in setting compensation and other incentives for the CEO and other executives and reviewing their performance, have the leverage to ensure that sufficient attention and resources are devoted to CSR and corporate sustainability.

The board cannot be passive when failure to act can have significant adverse consequences for the company and the world in which it operates including harm to the environment, damage to the company's reputation and brand, unstable supply chains, employee dissatisfaction or work stoppages, consumer boycotts, product recalls, management and board distraction, divestment by certain investors and increased attention from activist investors.[15] However, directors must also be respectful of the experience and knowledge of the CEO and the other members of the senior management team and seek to develop and maintain a collegial relationship in which all parties

[14] CEOs and the New CSR Priority (Boyden Executive Monitor, September 2017), https://www.boyden.com/media/ceos-and-the-new-csr-priority-2909935/index.html

[15] H. Gregory, "Corporate Social Responsibility, Corporate Sustainability and the Role of the Board", Practical Law Company (July 1, 2017), 3.

understand and appreciate the role of the directors as strategic partners and monitors.[16]

As for the specific CSR and corporate sustainability issues that are most important to investors, and which should therefore be priorities for directors and members of the executive team, reference can be made to surveys of CSR-related shareholder proposals compiled by organizations such as the Institutional Shareholder Services Inc. ("ISS") Governance Analytics Database. In 2016 and early 2017, for example, the most popular topics among shareholder activists included lobbying disclosure, climate change reporting, political contributions disclosure, gender pay gap disclosure and sustainability reporting[17] Average support for those proposals that were voted upon was around 20%; however, nine proposals focusing on the following topics received majority support: board diversity, political contributions disclosure, methane emissions management, sustainability reporting, animal welfare, prohibition of sexual orientation and gender identity discrimination and gender pay gap disclosure.

In addition, institutional investors have identified long-term corporate strategy and aligning compensation and management incentives to promote long-termism as key topics for engagement with their portfolio companies. For example, over 100 companies from around the world have signed on to the "Compact for Responsive and Responsible Leadership A Roadmap for Sustainable Long-Term Growth and Opportunity", which has been sponsored by the International Business Council of the World Economic Forum as a means for corporations, their chief executive officers and boards of directors, as well as leading investors and asset managers to create a corporate governance framework with a focus on the long-term sustainability of corporations and the long-term goals of society.[18] Similarly, the corporate governance principles for US listed companies endorsed by the Investor Stewardship Group include guidance that boards should develop management incentive structures that are aligned with the long-term strategy of the company.[19]

## §3 Directors' adoption and oversight of corporate sustainability

CSR and corporate sustainability are like any other important management initiatives and require proactive leadership from the top of the organization. In fact, it is clear that the "tone at the top" is an important factor in the success or failure of any CSR or corporate sustainability initiative and the directors and senior executives of the corporation are uniquely positioned to act as external and internal champions of CSR and corporate sustainability and proactively communicate with everyone involved with the organization

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[16] M. Lipton, S. Rosenblum, K. Cain, S. Niles, V. Chanani and K. Iannone, "Some Thoughts for Boards of Directors in 2018" (Wachtell, Lipton, Rosen & Katz, November 30, 2017), accessible at http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25823.17.pdf.

[17] H. Gregory, "Corporate Social Responsibility, Corporate Sustainability and the Role of the Board", Practical Law Company (July 1, 2017), 5-6 (citing Institutional Shareholder Services Inc., United States 2016: Proxy Season Review—Environmental and Social Issues (October 26, 2016), available at isscorporatesolutions.com (subscription required)).

[18] http://www3.weforum.org/docs/Media/AM17/The_Compact_for_Responsive_and_Responsible_Leadership_09.01.2017.pdf

[19] https://www.isgframework.org/corporate-governance-principles/

on a daily basis about the impact of new environmental and socially responsible products and services. The directors and senior executives must also commit to investing the time and effort necessary to explain the corporation's CSR and corporate sustainability initiatives to customers and other stakeholders and develop and implement metrics for tracking and reporting progress. While environmental and social responsibility certainly extends "beyond the law", directors and officers must be mindful of their fiduciary duties and understand how laws, regulations and standard contract provisions are rapidly evolving to incorporate environmental and social responsibility standards. Among the issues and activities that will need to be considered in establishing and maintaining effective governance and management processes for CSR and corporate sustainability implementation are the following:

- Understanding the drivers of enhanced board oversight of sustainability including investors' expectations as to the role and responsibilities of directors and changing societal beliefs regarding the political and social roles of corporations
- Understanding how CSR and corporate sustainability is changing the traditional fiduciary duties of directors and officers including the ascendance of the stakeholder-focused model and the introduction of alternative legal architectures for sustainability-oriented businesses
- Working with the board of directors to integrate environmental and social responsibility into the governance structure and the traditional roles and responsibilities of directors
- Assisting the board of directors on the design and implementation of an effective framework for board oversight of CSR and corporate sustainability
- Counseling the board of directors and senior management on the development and implementation of CSR and corporate sustainability commitments and instruments
- Incorporating reports on CSR corporate sustainability initiatives into board meetings and understanding how to create effective environmental and social responsibility committees and integrate sustainability into the activities of other board committees
- Developing job responsibilities for the senior social responsibility officer and designing effective internal organizational structures and systems for managing CSR and corporate sustainability initiatives and programs and supporting CSR and corporate sustainability commitments and expectations such as preparation and distribution of sustainability reports and stakeholder engagement
- Implementing formal management systems relating to sustainability-related issues and topics based appropriate standards issued by the International Organization for Standardization (e.g., ISO 14001 (environment); ISO 26000 (social responsibility) and ISO 28000 (supply chain security))
- Reviewing and modifying job responsibilities and compensation arrangements of executive team members, particularly the chief executive officer, to incorporate CSR and corporate sustainability commitments and attainment of CSR- and sustainability-related performance goals
- Providing education and training to directors and executive team members on sustainability issues including the creation and management of stakeholder advisor groups and teams of external experts

- Assisting directors, executive team members and managers and employees within the internal sustainability group with key CSR- and sustainability-related activities such as transparency and disclosure and stakeholder engagement
- Identifying and counseling directors and officers on ethical issues that will arise as they discharge their duties and responsibilities with respect to CSR and sustainability

A discussion paper prepared by Global Compact LEAD on the role of boards in overseeing corporate sustainability and implementing the Global Compact principles cited a 2010 survey by the Global Compact that found that 39% of the 1,300 respondents to the survey had boards that routinely addressed corporate sustainability issues and that the most frequently used models for structuring sustainability at the board level included tasking the entire board with oversight, creating new committees dedicated exclusively to sustainability and using of existing committees that assume responsibility for sustainability as one aspect of their activities.[20] The paper cited studies showing that when existing committees are selected to oversee sustainability the most common choices have been the risk, governance, strategy and audit committees. Committees charged with sustainability responsibilities are expected to interact with the full board, meet anywhere from one to four times annually and often include the lead executive in discussions. Specific activities included developing an appropriate definition of "sustainability" and related goals and commitments; reviewing policies, practices and positions; reviewing performance against sustainability goals; reviewing of developments and trends in legislation, regulation and public debate; and regular audit- style reviews of strategy, commitments, performance and goal setting and sustainability reporting.

A March 2014 study of board oversight of sustainability issues among S&P 500 companies commissioned by the IRRC Institute and authored by the Sustainable Investments Institute found that just a little over half of the companies had implemented board oversight of sustainability issues, with the level of implementation being even higher among companies that formally measured their sustainability performance and issued sustainability reports based on recognized sustainability reporting frameworks such as the Global Reporting Initiative or the International Integrated Reporting Framework.[21] Other key findings described in the study included the following:

- Companies with oversight of environmental and/or social issues most often chose the corporate governance/nominating committee to undertake this task, while a close

[20] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.

[21] P. DeSimone, Board Oversight of Sustainability Issues: A Study of the S&P 500 (IRRC Institute, March 2014), 1-2. Among companies that had been targets of shareholder proposals calling for board oversight of sustainability, a much higher percentage (80%) had implemented board oversight of sustainability issues, an indication that companies were influenced by shareholder activism in this area even if the proposals failed to achieve the requisite support for passage (support for sustainability-related proposal has increased dramatically since they first began appearing in the early 1990s). See also a similar survey of board oversight of environmental and social issues in North America that included Russell 3000 companies: Board Oversight of Environmental and Social Issues: An Analysis of Current North American Practices (Calvert Asset Management Company and The Corporate Library, 2010).

second was the practice of having a standalone sustainability-related committee assigned with oversight followed by other (e.g., technology, science or product innovation, operations or compensation), audit and risk committees in declining order of likelihood. Only 10% of the companies that had voluntarily undertaken board oversight of sustainability elected to reserve responsibility to the "board-at-large", while all of the others delegated responsibility to one or more committees.[22]

- Based on reviews of committee charters and references in sustainability reports to board oversight of environmental and social issues, social issues were more often covered by board oversight structures and policies than environmental topics.
- Political spending, which has long been the most popular interest among shareholder activists when developing their proposals for shareholder votes, was the most frequently mentioned subtopic in committee charters and sustainability reports, followed by health and safety, workplace diversity, human rights and climate change. Other social subtopics included community investment, data privacy and employee relations. Subtopics specific to particular business activities, such as animal testing, were also mentioned.
- Companies' committee charter text explaining oversight duties covering sustainability issues varied widely from very concise and high level to extremely detailed.
- Most companies with board oversight of sustainability issues have established independence standards for the composition of those committees and permitted them to hire outside counsel, advisors and experts at their discretion to fulfill duties; however, only 5% had set explicit sustainability expertise standards (outside of financial expertise) for members of these committees.
- The paper and forestry, healthcare services, oil and gas, utilities and aerospace and defense industries were the most likely to have board oversight of sustainability issues, while the real estate, construction and engineering, technology hardware, retail, industrials and media sectors were the least likely.
- There was a very strong correlation between company size, as measured by revenue and net income, and rates of board oversight of sustainability issues: top quintile companies by revenue were more than three times more likely to have board oversight of environmental and/or social issues than those in the bottom quintile.

The sustainability executives surveyed in a report released by The Conference Board in June 2016 found that 55% of the respondents said that their boards of their companies met only once a year or never on sustainability issues and 69% of the respondents said that their boards spend four hours or less per year on sustainability issues.[23] While it may be that a substantial percentage of directors do not believe that spending additional time on sustainability is necessary or feasible, another way to interpret the lack of engagement among the boards of so many companies is that the directors of those companies simply

[22] A small, yet significant, number of companies spread responsibility for board oversight of sustainability issues over several committees, typically the audit, nominating and governance and social responsibility committees. Id. at 10.

[23] The Seven Pillars of Sustainability Leadership: CEO Business Implications (The Conference Board, June 2016), 4 (as cited and discussed in V. Harper Ho, Director Notes: Sustainability in the Mainstream--Why Investors Care and What It Means for Corporate Boards (The Conference Board, November 2017), 15, electronic copy available at: https://ssrn.com/abstract=3080033).

do not have a good idea of where to start. Fortunately, there is no lack of advice on the steps that directors should consider in adopting and overseeing sustainability.

Global Compact LEAD suggested there were five key dimensions central to the intersection of sustainability and governance: board roles and responsibilities; board structure; board composition; board engagement with investors; and sustainability education for board members.[24] KPMG recommended that directors follow a framework for board oversight of ESG issues and related strategy that includes the following parts or elements: agreeing on a definition of ESG and its importance to the company and a common language that can be used throughout the organization; conducting an assessment to identify ESG risks and opportunities and determine which are of strategic significance to the company; encouraging integration of the most strategically significant ESG issues identified in the assessment into the company's long-term business strategy and helping to ensure alignment and buy-in across the enterprise through the right culture and incentives; shaping the company's key ESG messages, its "ESG story", to investors and other stakeholders in the context of strategy and long-term value creation; and ensuring the board has the right composition, skills, structure, information and processes to oversee ESG in the context of strategy and long-term value creation.[25]

Ceres recommended that directors should ensure that sustainability issues are considered systematically in the course of the company's standard governance processes by integrating sustainability into board systems and processes, which means focusing on company-specific "material" sustainability that significantly impact operations and revenues; embedding sustainability in committee charters; regularly and continuous discussing strategy, risks and incentives; recruiting diverse candidates with expertise and backgrounds on key sustainability issues and offering sustainability training; and involving key staff responsible for enterprise profit and loss in board deliberations on sustainability.[26] Ceres also called on directors to take advantage of opportunities for action relating to sustainability including embedding sustainability and longer-term thinking into strategic planning; integrating sustainability in risk oversight; engaging with external stakeholders; establishing stronger linkages between executive compensation and sustainability goals; and disclosing the role of the board and its oversight in prioritizing sustainability in the company's reporting and communications programs.

**Directors' Questions for Management on CSR Strategies and Policies**

Holly Gregory, an experienced corporate governance counselor, has recommended that directors should consider the following questions in discussing CSR strategies and policies with management as part of the board's oversight of sustainability:

[24] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.
[25] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 2-3, 20.
[26] View from the Top: How Corporate Boards Can Engage on Sustainability Performance (Ceres: 2015) (as cited and included in R. Sainty, "Engaging boards of directors at the interface of corporate sustainability and corporate governance", Governance Directions (March 2016), 85, 87).

- **CSR strategy.** What is the company's CSR strategy and how does it relate to corporate strategy generally? What is the business case for the CSR strategy?
- **Risk management.** How does the company's CSR strategy relate to risk management? What are the most significant CSR issues and risks associated with corporate strategy and operations?
- **Leadership commitment.** How does the CEO exhibit leadership commitment to CSR issues that are important to the company? Does the CEO drive CSR sensitivity within the company through regular internal communications?
- **Management responsibility.** Who is the corporate manager with responsibility for the company's CSR program (including stakeholder engagement) and reporting? How often does that manager report to the board (or relevant board committee)?
- **CSR reporting.** How does CSR responsibility and reporting relate to responsibility for risk management and compliance? Is the company appropriately positioned to assess and manage CSR risk?
- **Peer comparison.** Is the company lagging, following or leading industry and peer standards on CSR, including voluntary codes and standards?
- **Incentives and training.** How does the company encourage and incentivize appropriate consideration of CSR issues in decision-making, and how does it measure success? Is there a link to compensation? What types of training programs are in place? How else does the company assure that executives and other employees are mindful of the potential CSR impact of decisions?
- **Stakeholder engagement.** How does the company engage with key stakeholders on CSR issues? What issues have stakeholders raised in the past three years? How are those issues changing over time?
- **Board expectations and oversight.** Has the board clearly defined its expectations about the company's approach to CSR, as well as the board's role in oversight? Is appropriate oversight supported by regular information flow to the board? Do committee structures and charters support the company's CSR approach?
- **Monitoring third parties.** How does the company ensure that it understands and monitors the CSR approach and commitment of its suppliers and other business partners?

**Source:** H. Gregory, Corporate Social Responsibility, practicallaw.com (April 2014)

In 2014 the National Association of Corporate Directors ("NACD") offered the following recommendations for boards and directors as they considered how best to engage with management on sustainability-related issues: directors should understand the company's definition of sustainability in the context of the company's strategy and specific circumstances; the board and management should align on the sustainability message and information the company chooses to report publicly; boards should clarify roles for oversight responsibility of sustainability activities, including external reporting; and directors need to establish parameters for sustainability reporting to the board regarding the information required to support robust discussions with management.[27] In its handbook for directors on oversight of corporate sustainability, the NACD also provided the following useful insight from one director on how his board carried out its sustainability oversight responsibilities:

> "Much of our value-added comes from our sponsorship of, and visible support for, the various programs being pursued by the company. Knowing that the board is focused on sustainability helps mobilize [management's] efforts and maintain

[27] The Director's Handbook on Oversight of Corporate Sustainability (National Association of Corporate Directors, 2014), 4.

> momentum in the face of competing priorities. We provide encouragement and recognition for the company's accomplishments—both large and small—and help ensure that the programs are well-coordinated among the business units and geographies. We also complement the company's enterprise risk management program by monitoring the risks and opportunities related to sustainability and climate change, and identifying steps to protect and enhance the company's reputation and brand image."[28]

The recommendations above form the basis for the topics and issues described below that have been recommended for inclusion on the directors' oversight agenda; however, before proceeding it is important to return to a fundamental question that needs to be answered in order for the board to establish ESG and sustainability commitments, set and monitor long-term strategy, develop effective stakeholder communications tools and establish sustainability commitments that can be embraced throughout the enterprise. The question seems, quite simple, but often presents a sizable hurdle for directors: what does the term "ESG" mean for the company or, if the board is focusing on CSR, what does that mean for the company and which of the large and diverse topics with ESG and/or CSR are the most relevant for the company at any point in time?

As discussed above, the term "ESG" is frequently used to cover a broad range of environmental, social, and governance issues. The problem is that each of these issues can mean different things to different people and that while it is reasonable to assume that all of those issues are important at some level to all companies it is impractical to expect that a company can provide the same level of attention to each of the issues. In fact, with limited resources even for the biggest of companies, choices must be made and reflected in a company's specific definition of ESG, which should include only those issues that are most important to the company, its long-term strategy and its stakeholders (see the discussion of assessment below for guidelines on determining which ESG risks and opportunities are of strategic significance to the company). KPMG recommends that directors and senior executives move away from picking a handful of issues from the list and instead frame issues in understandable business terms. For example, KPMG pointed out that "climate change" might be better framed as "a discussion about the risks water shortages and droughts pose to a beverage company's manufacturing operations, the potential financial impact these risks pose, and how the company might mitigate these risks in a way that improves bottom-line performance". The advantage of this approach, according to KPMG, is that it "can help short-circuit preconceptions, politics, and personal views while setting the discussion on the right course at the outset".[29] Agreeing on a definition of ESG and CSR also allows the directors and executives to define a clear "corporate purpose" for the organization that can serve as the foundation for establishing and disseminating values and organizational culture elements that will bind everyone in the organization together and make them more motivated and committed to the company's long-term goals and performance. Having a common purpose facilitates the development of a common language about the company's ESG and CSR issues, risks and

[28] Id.
[29] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 4.

opportunities and allows employees from all parts of the organization to communicate and collaborate efficiently.[30]

## Sustainability in the Boardroom: Ideas for Sustainable Entrepreneurs

Sandra Taylor, who consulted with major brands include Starbucks and Eastman Kodak on the development and implementation of global corporate social responsibility ("CSR") strategies, laid out seven steps that companies preparing for listing on public securities exchanges should take when implementing board oversight of corporate sustainability efforts. Using her framework and recommendations as a foundation, the following ideas should be used by sustainable entrepreneurs as they assemble their boards of directors and advisors and build out their management team:

- ***Start at the beginning and determine materiality.*** One of the most important decisions that any sustainable entrepreneur has to make is "what sustainability means for my company". Sustainability has many definitions and can reasonably be associated with a wide range of environmental, social and governance issues, each of which has its own unique set of risks and opportunities. In order to make the right decision, sustainable entrepreneurs should reach out to qualified and experienced directors and advisors to thoughtfully and truthfully determine what issues will be material to the company's operations, the environment and communities. In this way, the sustainable entrepreneur can not only identify risks to his or her business model, but also uncover opportunities for creating and maintaining a competitive advantage. The goal of the assessment process should be to develop the company's long-term strategy and integrate sustainability into all aspects of that strategy, identify the risks that need to be addressed and monitored, determine the stakeholder relationships necessary for success and the means for effectively communicating with stakeholders and identifying features that need to be embedded in the design of the company's products and services. While the sustainable entrepreneur may believe that he or she has sufficient knowledge and breadth of perspective to reach conclusions on these topics on his or her own, it is imperative for him or her to bring together a group of directors and advisors at the very outset to test assumptions and prevent the sustainable entrepreneur from failing to see the forest for the trees and wasting time and other resources on immaterial matters.
- ***Focus on the supply chain.*** Entrepreneurs are often so focused on the design and development of their initial products, and making sure that development occurs quickly, that they fail to pay close attention to the long-term impact of supply chain decisions on the sustainability of their businesses. Sustainable entrepreneurs must practice "ethical sourcing" from the outset, which means ensuring that the inputs for their products, including intangible inputs such as the code in software used to operate the products, are, in Taylor's words, "created in safe facilities or under safe conditions where workers who are treated well and paid fair wages to work legal hours" and in a manner that "respects the environment during the production and manufacture of the products". Ethical sourcing is often the centerpiece of a sustainable entrepreneur's business model and he or she needs to develop personal relationships with all key suppliers to verify the way in which they conduct their businesses. Board members and advisors should also be proactively involved in vetting of potential suppliers. Supply chain management for the sustainable entrepreneur should be defined broadly and he or she should also seek out service providers, including attorneys and other consultants, that will provide inputs into decision making that are based on an understanding of the entrepreneur's sustainability focus.
- ***Be innovative.*** Sustainable entrepreneurs should seek out directors who have experience in product design and development and who can assist the entrepreneur in creating and integrating a "sustainability lens" into all aspects of product development and other key decisions during the important launch phase. As Taylor explained: "Rather than approving projects and then asking how the product, feature or service can be developed and delivered more sustainably, the board should add a sustainability lens (through scorecards, lifecycle analysis and indices) at decision-making points, ensuring sustainability is factored in before any go/no-go decision". Just as important is making sure that the values and goals of the company with respect to environmental sustainability and social responsibility are explicitly discussed during every major decision making process spanning senior

[30] Id. at 12.

hiring decisions establishing the enterprise risk management and approving capital projects, new business lines, mergers and acquisitions, new product launches and expansion into new geographic markets.

- ***Be the impetus.*** Sustainable entrepreneurs need to recruit board members who understand and embrace the important role of directors in setting the appropriate "tone at the top" and ensuring that environmental sustainability and social responsibility are embedded into every part of the business, including planning, strategy, operations, marketing and human resources. One of the direct steps that board members can take include ensuring the company's sustainability goals and priorities are taken into account when recruiting members of the executive team and setting their remuneration arrangements. Board members should also allocate resources to developing the infrastructure necessary to monitor the company's sustainability initiatives including the appointment of a chief sustainability officer who would be part of the executive team and work with board members to ensure that they have the information necessary to fulfill their oversight responsibilities with respect to sustainability. When interviewing and/or receiving presentations from members of the executive team overseeing different functional areas, the directors should probe to determine the level and quality of collaboration across the organizational structure on sustainability initiatives.
- ***Measure outcomes.*** One of the key traditional roles for the board is measuring the company's progress toward its stated financial goals and building a sustainable business means that the board must apply this same discipline to identifying major performance aspects of short- and long-term sustainability goals and then establish relevant objectives, select specific indicators and metrics, and commit to achieving specific targets. Taylor recommended that boards establish internal performance, communication, incentive and measurement systems for all sustainability goals; conduct quarterly business reviews; and ensure that the company's sustainability strategy and performance is communicated at annual meetings and presentations to existing and prospective investors.
- ***Be transparent.*** Many sustainable entrepreneurs fret about how to fulfill the financial and non-financial reporting requirements that will accompany the launch and expansion of their business, generally due to concerns about the costs associated with engaging outside auditors and collecting and verifying operational and performance information. While the details relating to reporting are important, sustainable entrepreneurs and their directors should start by committing the company to "transparency", which Taylor described as "reliable indicators of sustainability progress and honest communication with various stakeholders about policies, practices and progress, including formal external reporting". Reporting is an essential communications tool in the company's relationships with its key stakeholders and while startups may not have the resources and expertise to implement full-blown CSR reporting in line with the guidelines of the Global Reporting Initiative or similar standard-setting organizations, the sustainable entrepreneur and his or her directors can and should commit to creating and issuing reports that satisfy the initial expectations of the company's stakeholders. Taylor mentioned that companies can choose from among a variety of formats for presentation such as delivering a CSR report directed at consumers and community groups, or simply communicating progress on its website. Whatever approach is taken, the goal is to establish trust and support ongoing dialogue with stakeholders that are central to the success of the company. Directors should be actively involved in the reporting and disclosure process and should prepare for expanding reporting as the scope and reach of the company's business expands.
- ***Align board structure and composition.*** At the very beginning of the company's existence, oversight of sustainability should be the responsibility of all of the board members, not only because the board is generally not large enough for committees but also because it is so important to get the basics right from the outset and to ensure that each board member has the requisite "sustainability mindset". As time goes by, consideration can be given to delegating oversight of some of the CSR-related issues and activities to a committee of the board, be it the governance committee or a separate CSR committee; however, the full board must nonetheless maintain responsibility for overall oversight of issues such as climate change, human rights, sustainable supply chain management, health and safety, as well as sustainable products and services, and all directors should be provided with ongoing sustainability training and education. Taylor also recommended that recruiting efforts for new directors focus on candidates with relevant knowledge and expertise, including executives from corporations with a sustainability track record or topical experts coming from specialized positions in business. In addition, the composition of the board should reflect gender balance and diversity and members who

can objectively contribute to discussion of issues by providing stakeholder perspectives.

**Source:** S. Taylor, Seven Steps to Implementing Board Oversight of Sustainability (February 21, 2017), https://listingcenter.nasdaq.com/ClearinghouseArticle/Seven-Steps-to-Implementing-Board-Oversight-of-Sustainability-by-Sandra-E-Taylor-1324. At the time the article was written, Ms. Taylor was the CEO of Sustainable Business International LLC.

## §4 --Directors' roles and responsibilities

The focus on sustainability has extended the traditional roles and responsibilities of directors and created new ones.[31] Many agree that CSR principles are typically embedded into governance practices such as disclosure and reporting, risk management oversight, board composition and diversity and compensation. Disclosure and reporting on social, environmental and ethical issues has become commonplace among larger companies and has expanded to include specific details on policy implementation and stakeholder engagement. In addition, the main standards developed for non-financial reporting, such as the Global Reporting Initiative, have incorporated several disclosure items relating to the internal governance framework including the independence and expertise of directors; board-level processes for overseeing the identification and management of economic, environmental and social risks and opportunities, and the linkage between executive compensation and achievement of financial and non-financial goals. Risk management is a fundamental duty of the board and CSR encourages directors to take a broad view of the challenges that their companies face in maintaining performance and surviving in the marketplace. The growing emphasis on CSR also means that boards need to be able to draw on the skills, knowledge and experiences of a more diverse group of members, a requirement that is consistent with calls for better gender and ethnicity diversity in the boardroom. Finally, boards need to develop new compensation and rewards systems that take CSR into account and prioritize metrics and success indicators that are broadly defined from a longer-term perspective.[32] All in all, as boardroom focus on sustainability has increased, directors are expected to become more involved in integration of strategy and sustainability; paying attention to stakeholder perspectives and engagement; overseeing the production of, and approving, sustainability reports; and ensuring that management is appropriately accountable for sustainability performance, and compensated properly in light of that performance.[33]

Harper Ho suggested that investor activism around ESG issues and investors' growing demand growing demand for investment-grade ESG information has had important implications for how directors should approach corporate governance, investor

[31] For further discussion of roles and responsibilities of directors, see "Directors' Rights, Duties and Liabilities" in "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
[32] C. Strandberg, The Convergence of Corporate Governance and Corporate Social Responsibility: Thought-Leaders Study (Canadian Co-operative Association, March 2005), 9-10.
[33] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.

engagement, compliance and disclosure practices.[34] First of all, the broadened scope of risks that directors must consider in light of ESG activism means that boards must have new capacities to support oversight of ESG risk. Second, investors want their companies to integrate ESG performance metrics and long-term benchmarks into executive compensation. Third, directors need to ensure that investor engagement encourages dialogue and learning and confirm that senior management and investor relations personnel are aware of the increasing overlap between corporate governance and environmental and social concerns. Finally, directors need to improve the quality and formatting of their sustainability-related reporting and ensure that ESG materiality is being considered as part of their company's financial reporting process. According to Harper Ho, companies that can improve their practices in these areas are likely to see improved financial and operational performance, improved focus on long-term risk and return, better access to "patient capital" (i.e., investors that are less fixated on quarterly earnings and more supportive of R&D and other investments in the company's future) and be able to identify and exploit new sources of value for the company and keep ahead of emerging risks and opportunities.[35]

A discussion paper prepared by Global Compact LEAD on the role of boards in overseeing corporate sustainability and implementing the Global Compact principles noted that the it was no longer appropriate to distill directors' duties to a bilateral (shareholder-board) relationship and that directors must now be responsible to multiple stakeholders, all of whom are integral to the success of the business.[36] The paper suggested that the responsibilities of the board of directors for sustainability could be categories as follows:

- Traditional duties, often spelled out by legal requirements, adapted for a world in which sustainability is even more important: Directors should expect to continue to be responsible for overseeing business strategy; selecting and overseeing the chief executive and determining executive compensation, ensuring and legal compliance, fulfilling fiduciary responsibilities to shareholders and assisting management in anticipating material changes to the operating environment in order to ensure resilient business strategies. However, the emerging importance of sustainability has added new topics to be considered as boards discharge their traditional duties: human rights and climate change; the views of civil society, which have become more impactful due to new communication technologies such as social media; the impact of social and environmental issues on a company's legal license to operate; and the erosion of the primacy of shareholder value.
- Explicit responsibilities for activities related to sustainability performance including (1) integration of strategy and sustainability; (2) attention to stakeholder perspectives

[34] V. Harper Ho, Director Notes: Sustainability in the Mainstream--Why Investors Care and What It Means for Corporate Boards (The Conference Board, November 2017), 13-14, electronic copy available at: https://ssrn.com/abstract=3080033 (based on information available at UNPRI, Signatories, https://www.unpri.org/signatory-directory/).
[35] Id. at 15.
[36] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.

and engagement; (3) approval of sustainability reports; and (4) ensuring that management is appropriately accountable for sustainability performance, and compensated properly in light of that performance. Key to each of these activities is access to new forms of information that directors can use to measure environmental and social performance and issue “integrated reports” to stakeholders. Performance metrics supported by reliable information is also necessary in order to modify existing compensation and reward systems.

- Implicit responsibilities related to prioritization and agenda-setting: Directors have an implicit duty to set agendas, raise questions, shape mindsets and anticipate public reaction as they act as good stewards of corporate assets to ensure that management considers all relevant risks and opportunities arising from new technologies and business process and entry into new markets. Directors also need to understand the impact of “externalities” on business success and avoid overlooking environmental and social costs of new initiatives, as has occurred in the past with respect to the development of certain forms of energy and the outsourcing of jobs and manufacturing activities from developed to developing countries.

Another angle on the relationship between the duties of directors and sustainability is to characterize them as an obligation to oversee the “governance of responsibility”, which has been defined as “[t]he formal processes established by the board of a company to ensure the governance and oversight of the company’s responsibilities for its Social, Environmental and Economic impacts; and for any specific sustainability commitments that a company has made”.[37] Perhaps the best way to start on governance of responsibility is to identify how these additional duties might be fulfilled by extending the following traditional roles of directors[38]:

- Directors need to extend their role in approving the company’s strategy to include identifying and managing the company’s material social, environmental and economic impacts. The board needs to engage with senior management and the company’s stakeholders to articulate what corporate sustainability means for the business and how improving the CSR and sustainability performance of their business will enhance the drivers of long-term value-creation by reducing risks and identifying opportunities to create innovative products and services that address social and environmental issues.
- Once the strategy has been agreed upon, the directors need to continuously check on implementation by regularly examining the most material sustainability risks to strategy and ensuring effective risk-mitigation. The ongoing discussions of the risks confronting the company need to be expanded to include potential environmental and social impacts of business activities and processes need to be established to monitor internal management and audit of environmental and social risks.
- The traditional, and often controversial role, or directors with respect to establishing compensation and incentive programs for the CEO and other members of the senior

[37] D. Grayson and A. Kakabadse, Towards a Sustainability Mindset: How Boards Organize Oversight and Governance of Corporate Responsibility (London: Business in the Community, 2012), 5.
[38] Id. at 5-6.

management team must be adjusted to ensure that progress towards, and achievement of, material sustainability targets are taken into account. This is not an easy matter since the parties must adopt a long-term perspective, given that the results of specific sustainability initiatives may not be known for several years, and attempt to establish performance metrics with respect to activities that difficult to objectively quantify in the same way as financial results.

- The board as a whole, and its nominating and governance committee in particular, will need to incorporate sustainability-related skills and mindset into the criteria applied to identify candidates to serve on the board in the future and to move up into positions on the company's senior management team. The essence of corporate sustainability is a long-term commitment to positively address the environmental and social impacts of the business and this can only be done if successive generations of leaders have the requisite focus on sustainability and commitment to the company's sustainability objectives. The board should ensure that talent management programs within the company include training in the skills needed to define and implement the company's sustainability strategies.
- Since corporate sustainability is often conceptualized as concern for environmental, social and governance issues, directors need to keep their eye on ensuring that they observe "best practices" with respect to all aspects of corporate governance such as effective risk management, inclusion, fairness, transparency and self-evaluation. Directors should public endorse and adopt recognized principles of good governance and include them in the published policies and procedures of the board.

**Global Compact Guidance on Directors' Sustainability Duties and Responsibilities**

A Global Compact publication recommended that the roles of the entire board and individual directors with respect to sustainability be integrated into various policies and statements of the duties and responsibility of the board and directors as follows:

- In statements referring to the requirement to adhere to ethics, prudence and statutory obligations, include requirement to act in accordance with the company's sustainability and social responsibility standards, values or policies
- Within the fiduciary duty to act honestly, prudently and in good faith, add reference to acting in a socially responsible manner
- Require that directors understand their sustainability roles in addition to their statutory and fiduciary roles
- Add compliance with the company's sustainability policy alongside references to complying with articles and bylaws, e.g. include a duty to ensure compliance with the company's sustainability policies
- Within references to following sound governance practices, add following socially responsible governance practices
- Specify that the chairperson of the board, the board as a whole and each of the individual directors are responsible for setting the "tone at the top" in adhering to the company's sustainability policies, values and commitments
- Within monitoring duties, add monitoring sustainability performance, impacts and policy compliance (in addition to monitoring financial and operational performance)
- Within descriptions of the board's strategic planning duties, specify sustainability as a component of strategic planning and make reference to the need to take stakeholder considerations into account in strategic planning; reference the board's responsibility to provide oversight and advice on how the company reduces negative and enhances positive social and environmental performance and impacts

which take into account stakeholder considerations
- Include responsibility for ensuring the corporate strategy includes long-term and annual sustainability goals, targets and metrics
- Include responsibility to consider sustainability risks, opportunities and other implications that could affect the future performance of the firm when setting strategy, undertaking mergers, acquisitions, divestitures, joint ventures, major capital projects and approving major decisions
- Within requirements to ensure financial results are reported fairly and in accordance with generally accepted accounting principles, include reference to ensuring sustainability results are reported fairly and in accordance with generally accepted sustainability reporting principles
- Include requirement that directors become generally knowledgeable of the company's stakeholder interests, sustainability impacts, risks, opportunities, dependencies and performance and the sustainability trends impacting its industry and the company's employees, customers, suppliers, business partners and operating context
- Include requirement to review and approve the sustainability report content and format and ensure all material aspects are covered; specify that the board is responsible for ensuring the integrity of non-financial reporting
- Include duties to ensure the safe and sustainable operation of the company and to foster a corporate culture that promotes ethical, socially responsible and sustainable practices and decisions
- Include a board role to ensure subsidiaries adopt sustainability strategies and are in compliance with the company's sustainability policy; specify that the board monitors sustainability performance of subsidiaries
- Reference that the lead sustainability executive has a direct reporting relationship to the board
- Specify that the board is responsible to ensure the organization has identified its key stakeholders, to consider the legitimate interests held by stakeholders and to monitor the overall quality of stakeholder relations
- Consider appointing a stakeholder advisory panel or expert sustainability advisory panel to the board to keep the board abreast of emerging stakeholder and sustainability trends and expectations

**Source:** The Essential Role of the Corporate Secretary to Enhance Board Sustainability Oversight: A Best Practices Guide (United Nations Global Compact, September 2016).

## §5 --Directors' fiduciary duties

The primacy of shareholder interests has been the dominant theme of corporate governance, at least in the US, for decades, and this has complicated efforts of directors to authorize sustainability initiatives that, by their very nature, are intended to create benefits for stakeholders other than stockholders that may well adversely impact stockholder value, at least in the short term, and deprive stockholders of distributions of surplus profits.[39] However, as time has gone by, support has developed and increased for what Hart and Zingales referred to as the "constituency theory" of governance, which would expand the beneficiaries of the directors' fiduciary duties beyond shareholders to other constituencies, or stakeholders, such as employees, customers, members of the local communities in which the corporation operates and society as a whole.[40] While

[39] For further discussion of fiduciary duties of directors, see "Directors' Rights, Duties and Liabilities" in "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
[40] O. Hart and L. Zingales, "Should a Company Pursue Shareholder Value?" (October 2016), available at https://www8.gsb.columbia.edu/leadership/sites/leadership/files/Zingales-Hart--Share_value.pdf For further discussion, see "Governance and Sustainability" in "Governance: A Library of Resources for

sentiment for encouraging long-termism and promoting a broader range of stakeholder interests has been around in some form for decades, the attacks on the primacy of shareholder value creation have never been as strident and are likely to accelerate in the future and become a permanent fixture among governance issues. Given the growing consensus that the support and goodwill of a variety of stakeholders—employees, customers, suppliers, regulators and local communities in which the company operates—is critical to the long-term success of the company, giving – is critical to the long-term success of the company, there is a compelling argument to be made that paying due consideration of the interests and concerns of the company's most important stakeholders is consistent with directors' fiduciary duties to enhance the company's long-term value.[41]

Compelling evidence of the desire to free directors of historical constraints, and thus promote more aggressive and entrepreneurial sustainability efforts, has been the decision of politicians in a majority of the states and the District of Columbia to endorse and formalize the constituency theory by adopting statutes that permit the formation of "benefit corporations", a new form of for-profit corporation that explicitly expands the fiduciary duties of directors beyond maximizing shareholder value, which is still one of the primary goals of a corporation, to include consideration of whether or not the corporation's activities have an overall positive impact on society, their workers, the communities in which they operate and the environment.[42] While the rate of adoption of benefit corporation status has been slow, particularly among public companies, the recognition of benefit corporations has contributed to sharpened focus on the separate interests of non-shareholder stakeholders and created a host of new issues and challenges for directors of all types of corporations such as how to measure and compare non-financial performance aspects of corporate activities; how to hold corporations accountable to stakeholders who do not have the rights to vote that are held by shareholders; and how to structure incentive packages for executives and managers tied to complex multi-stakeholder goals and commitments.[43]

## §6 --Assessment of sustainability risks and opportunities

In order for directors to understand the scope of their responsibilities with respect to overseeing sustainability and determine how to best focus their energies, an assessment must be conducted of the issues, risks and opportunities that are material to the

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Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

[41] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 6.

[42] By 2016, over 30 states and the District of Columbia had either adopted legislation authorizing the creation of a benefit corporation or were seriously considering such legislation M. Loewenstein, Benefit Corporation Law (September 16, 2016), 1. Available at SSRN: https://ssrn.com/abstract=2840003 or http://dx.doi.org/10.2139/ssrn.2840003

[43] For further discussion of the roles and responsibilities with respect to sustainability and the management of the interest of multiple stakeholders, see "Board Oversight of Sustainability" in "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

company's operations, environment and communities.[44] KPMG called on boards to conduct assessments, but conceded that identifying the strategically significant ESG risks and opportunities for a company is complex, as they vary by industry and sector, and even within industries, and that there is no standard approach that companies can take.[45] However, KPMG recommended a two-step process described in the following paragraphs that most companies could easily use as guiding principles during the assessment stage. The first step would be to identify and assess all the ESG and CSR issues that are material to the business and/or its stakeholders. The second part—"material to stakeholders"—is important because it will assist the board in anticipating and understanding questions and pressures that the company may receive from the environment in which it is operating. Admittedly, the list of potential issues is long and should generally start with the following:

- Climate change impacts
- Waste generation and management
- Water and other natural resource scarcity
- Environmental degradation
- Product and worker safety
- Supply chain management
- Workplace diversity and inclusion
- Labor practices, talent management and employee relations
- Health and human rights
- Executive compensation
- Political contributions
- Board independence, composition and renewal

When assessing each issue, the company needs to analyze the likelihood and magnitude of the associated risks and opportunities and realize that weights and measures may change as time goes by and that assessment has to be a continuous process and not a one-time exercise. In order to align the assessment with strategy, reference should be made to the issues that peer companies have cited in their sustainability reporting and to feedback from stakeholders collected during the assessment process. While the directors do not have the time or skills to do the assessment on their own, they should nonetheless understand the steps that management is taking and use the process as a means for improving their own awareness of key economic, social and environmental sustainability issues that are engaging governments, businesses, other organizations and individuals in the worlds in which the company is operating.

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[44] S. Taylor, Seven Steps to Implementing Board Oversight of Sustainability (February 21, 2017).

[45] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 8-9. KPMG recommended that the provisional sustainability standards developed by the Sustainability Accounting Standards Board, which cover a broad range of industries in numerous sectors, can provide a reference point for identifying industry-specific sustainability factors that are reasonably likely to have material impacts.

The second step acknowledges that companies, regardless of their size and available resources, do best when they focus their attention on issues, risks and opportunities that are "strategically significant". While it is common for the initial assessment process to generate a list of six to eight issues that could affect the operating efficiency of the company, KPMG recommended that the directors themselves select and concentrate on just two or three issues that will fundamentally affect the company's ability to remain competitive and which customers, suppliers and other stakeholders agree will be key to the company's long-term success. Selection is often difficult and choices will vary depending on factors such as the company's principal basis for competing in the marketplace. For example, a company dependent on strong branding needs to focus on issues that might adversely impact the company's reputation and a company competing on price will be interested in initiatives that have the potential to further decrease the cost structure or provide protection from unexpected price increases in inputs.

While identifying risks is an important part of the assessment process, and many companies conduct the assessment under the broader umbrella of their enterprise risk management systems, KPMG admonished directors to make sure that management also takes into account opportunities that may lie within ESG and CSR issues and which can be leveraged by the company to compete in the future on the basis of innovation and disruption. A few of the examples mentioned by KPMG included solutions that would thrive in a low carbon world such as products that facilitate energy storage and efficient energy use; services that support greater access to education, affordable housing and financial products that reduce income inequality; products and services that promote health and well-being and healthy lifestyle choices; and technology that accelerates the sharing economy.

Once the board has selected the most strategically significant issues, it needs to work with management to create specific goals and "commitments", a process described further below, and establish metrics and key performance indicators that the board can use to measure progress. The directors should also be sure that these issues are highlighted in communications to stakeholders that demonstrate how the company is integrating them into its long-term strategy for overall value creation. Finally, the board should be sure that management is prioritizing the issues when making decisions about allocation of resources and that information regarding the issues is being disseminated throughout the organization so that different functions can develop their own systems and practices to make the best contribution to the new product and services that may be necessary in order to create a competitive advantage.

It is important to emphasize that KPMG and others recommend that boards focus on just two or three issues because directors have limited time and their attention needs to be carefully managed so that they can have the biggest impact. This does not mean that management should adhere to the same limitations and, in fact, the board should task management with continuously monitoring a wider range of material issues using internal and external resources allocated by the board for that purpose. Directors should expect regular reports from management on the evolving portfolio of ESG and CSR issues, risks and opportunities so that the board can, if necessary, make changes in how it goes about exercising oversight in this area. Material, although not strategically significant at the present time, issues also need to be managed as part of the company's enterprise risk management system and will need to be discussed and disclosed in reports to regulators such as the Securities and Exchange Commission and in stakeholder communications.

### §7 --Integration of sustainability into business strategy

Identifying the most strategically significant ESG and CSR issues and deciding upon commitments and initiatives for each of those issues is important; however, the ability of the company to successfully address those issues and the accompanying risks and opportunities depends on making sure that the issues are embedded, or integrated, into the company's strategy and the way in which directors, executives, employees and other stakeholders think about the company's long-term performance.[46] According to KPMG, one of the best ways for the directors to oversee integration efforts is to focus on two areas: employee selection and behavior and organizational processes and routines.[47]

With regard to employee selection and behavior, KPMG recommended that directors engage with management to understand the answers, and associated policies with respect to, the following questions:

- Are we hiring the right talent and is our selection process compatible with building an inclusive and talented workforce that reflects our business needs?
- Do we tie compensation and promotion decisions to the metrics that advance performance on the critical ESG and CSR issues that we face?
- Are we empowering people and giving decision rights to teams that can make decisions by taking into account ESG and CSR information reflecting local knowledge?
- Is our culture promoting employee behaviors that are consistent with our priorities rather than providing perverse incentives that could actually deter employees from exhibiting the behavior management and the board hope to see?

With regard to organizational processes and routines, the following questions need to be discussed and addressed:

- Do we have the right ESG and CSR metrics to monitor performance, set targets, and incentivize action?
- Are the metrics reliable, comparable over time, and credible for decision making? What are the mechanisms to help ensure these qualities?
- Have we integrated these metrics into capital allocation decisions to help determine which projects to invest in?
- Are corporate functions considering ESG and CSR issues when making marketing, procurement, recruiting and hiring, financing, and investment decisions? Are business unit leaders aligned with the corporate vision?

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[46] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 11-12.
[47] Id.

- How are we achieving harmonization of ESG and CSR practices across a diverse set of geographies while at the same time adapting to local culture and laws?

Another approach to framing and understanding integration efforts comes from the following series of questions regarding sustainability that Ceres suggested that directors be asking of themselves and members of the management team[48]:

- **Materiality:** What are our sustainability priorities and how were they identified? Are these priorities financially relevant to investors in the short- and long-term? Were stakeholders engaged in identifying these priorities?
- **Strategy and risk management:** How have the sustainability priorities been factored into the strategic plan and risk management process? How are emerging issues being identified?
- **Disclosure:** Have sustainability priorities and their impacts on the strategic plan been disclosed to stakeholders in a complete, comprehensive and credible manner?
- **Performance:** What goals have we set to improve our performance on our sustainability priorities? How do these compare with the goals set by our peers? Do these goals set us up for leadership in our industry?
- **Scope:** Do the sustainability goals cover our significant impact areas, including operations, supply chains and products?
- **Employees:** What is our strategy to build our employee base to meet our sustainability priorities?
- **Compensation:** Do we have the right incentives in place for management to meet sustainability priorities and goals?
- **Governance:** Have we established a governance structure that allows the board to oversee the management of sustainability issues and their integration throughout the enterprise?

Each of the questions posed above should be considered and addressed by the board of directors in the course of exercise their oversight responsibilities and appropriate goals and metrics should be established in each instance. For example, with respect to governance the board, or the committee of the board established to focus on sustainability matters, should be sure that vetting of all significant projects should include consideration of sustainability impacts and that all significant sustainability-focused projects are clearly connected to the company's overall strategy. Environmental and social factors should be taken into account when analyzing capital expenditure proposals, selection of key supply chain partners, investments and proposed mergers and acquisitions. The board must also ensure that executive compensation is linked to the company's sustainability performance and that the company's disclosures should include discussions of how sustainability projects have impacted the financial performance of the company's businesses.

As the directors are collecting information from the management team, the board also

[48] View from the Top: How Corporate Boards Can Engage on Sustainability Performance (Ceres: 2015) (as cited and included in R. Sainty, "Engaging boards of directors at the interface of corporate sustainability and corporate governance", Governance Directions (March 2016), 85, 88).

needs to ensure that all of the company's executives and senior managers understand the importance of ESG and CSR to the company's strategy and long-term performance and that they are focused on finding and implementing the best ways for their specific functional areas to contribute to the goals that the board has established for ESG and CSR. This will require regular meetings with not only the CEO, but also the CFO, chief operating officer, chief sustainability officer and heads of marketing, risk management, human resources, investor relations and manufacturing regarding the impacts of ESG and CSR issues on their activities in order to facilitate, as the members of Nike's Corporate Responsibility and Sustainability Committee are required to do, "the integration of these impacts into Nike's business including innovation, product design, manufacturing and sourcing, and operations".[49]

## §8 --Developing CSR and corporate sustainability commitments and targets

Oversight of CSR and corporate sustainability activities by the board of directors begins with establishing formal commitments to operating in an environmentally and socially responsible manner and then ensuring that those commitments are tightly and transparently integrated into the company's strategy and business development initiatives, organizational culture and structure and the reporting mechanisms that the company uses to measure performance and report to its stakeholders. While certain elements of the CSR and corporate sustainability framework, such as stakeholder engagement and reporting, have become universal, the specifics for any particular company will depend on its unique situational factors such as size, geographic scope of operations, industry, the content and impact of regulatory requirements and the CSR and corporate sustainability risks and opportunities associated with its strategy and day-to-day operations.

There are a number of sources that directors can turn to for ideas regarding CSR and corporate sustainability commitments. Williams noted that since the late 1990s there has been a proliferation of transnational, voluntary standards for what constitutes responsible corporate action, including standards have been developed by states; public/private partnerships; multi-stakeholder negotiation processes; industries and companies; institutional investors; functional groups such as accountancy firms and social assurance consulting groups; NGOs; and non-financial ratings agencies.[50] Notable multi-sector standards initiatives have included Social Accountability 8000 and the Ethical Trading Institute, and influential multilateral initiatives have included the OECD's Guidelines for Multinational Enterprises, the ISO 26000 Corporate Responsibility standards, the UN Global Compact and the "Protect, Respect and Remedy" framework in the UN's Guiding Principles on Business and Human Rights that articulates the human rights responsibilities of states and companies.[51]

[49] Id. at 12.
[50] C. Williams, "Corporate Social Responsibility and Corporate Governance" in J. Gordon and G. Ringe (Eds.), Oxford Handbook of Corporate Law and Governance (Oxford: Oxford University Press, 2016), 7, available at http://digitalcommons.osgoode.yorku.ca/scholarly_works/1784.
[51] Id. at 8-9.

According to Williams, most of the corporate responsibility standards are voluntary, although India passed legislation in 2014 that required companies to establish a corporate responsibility committee at the board level and contribute 2% of net profits to corporate responsibility initiatives.[52] It should not be forgotten, however, that many of the topics generally included within the general subject of CSR have been addressed to some degree in domestic regulations covering labor rights, environmental and consumer protection, anti-discrimination and anti-bribery. Countries vary in the degree to which regulatory standards relating to corporate responsibility are relied upon and Williams noted that empirical evidence suggested that the underlying regulatory standards effectively shape the sustainability culture within countries, and have both a strong effect on how companies handle corporate responsibility issues and a strong effect on the sustainability.[53] For example, Williams pointed out that Matten and Moon have argued that "in countries with stakeholder corporate governance systems and more expansive social welfare arrangements, corporate responsibility is 'implicit' in doing business according to law, so companies do not need to be as "explicit" about taking on social responsibilities, as do leading companies in more shareholder-oriented countries".[54]

One of the most interesting stakeholder-focused standards for corporate governance has been developed by the Caux Round Table ("CRT") (www.cauxroundtable.org), which describes itself as an international network of principled business leaders working to promote a moral capitalism. The CRT believes that the world business community should play an important role in improving economic and social conditions and, to that end, has developed the CRT Principles for Business to embody the aspiration of principled business leadership. The CRT Principles include the following General Principles, which are intended to serve as a foundation for dialogue and action by business leaders in search of business responsibility and a means implementing moral values into business decision making:

- Principle 1. The responsibilities of businesses extend beyond shareholders toward stakeholders
- Principle 2. The economic and social impact of business should be focused on innovation, justice and world community.
- Principle 3. Business behavior should extend beyond the letter of the law toward a spirit of trust
- Principle 4. Respect for rules
- Principle 5. Support for multilateral trade
- Principle 6. Respect for the environment
- Principle 7. Avoidance of illicit operations

[52] C. Williams, "Corporate Social Responsibility and Corporate Governance" in J. Gordon and G. Ringe (Eds.), Oxford Handbook of Corporate Law and Governance (Oxford: Oxford University Press, 2016), 13, available at http://digitalcommons.osgoode.yorku.ca/scholarly_works/1784.
[53] Id.
[54] Id. (citing D. Matten and J. Moon, "Implicit" and "explicit" CSR: A conceptual framework for a comparative understanding of corporate social responsibility", Academy of Management Review, 33:2 (2008), 404).

Of particular interest are the various Stakeholder Principles in Section 3 of the CRT Principles:

- **Customers:** We believe in treating all customers with dignity, irrespective of whether they purchase our products and services directly from us or otherwise acquire them in the market. We therefore have a responsibility to provide our customers with the highest quality products and services consistent with their requirements; treat our customers fairly in all aspects of our business transactions, including a high level of service and remedies for their dissatisfaction; make every effort to ensure that the health and safety of our customers, as well as the quality of their environment, will be sustained or enhanced by our products and services; assure respect for human dignity in products offered, marketing, and advertising; and respect the integrity of the culture of our customers.
- **Employees:** We believe in the dignity of every employee and in taking employee interests seriously. We therefore have a responsibility to provide jobs and compensation that improve workers' living conditions; provide working conditions that respect each employee's health and dignity; be honest in communications with employees and open in sharing information, limited only by legal and competitive constraints; listen to and, where possible, act on employee suggestions, ideas, requests and complaints; engage in good faith negotiations when conflict arises; avoid discriminatory practices and guarantee equal treatment and opportunity in areas such as gender, age, race, and religion; promote in the business itself the employment of differently abled people in places of work where they can be genuinely useful; protect employees from avoidable injury and illness in the workplace; encourage and assist employees in developing relevant and transferable skills and knowledge; and be sensitive to the serious unemployment problems frequently associated with business decisions, and work with governments, employee groups, other agencies and each other in addressing these dislocations.
- **Owners/Investors:** We believe in honoring the trust our investors place in us. We therefore have a responsibility to apply professional and diligent management in order to secure a fair and competitive return on our owners' investment; disclose relevant information to owners/investors subject to legal requirements and competitive constraints; conserve, protect, and increase the owners/investors' assets; and respect owners/investors' requests, suggestions, complaints, and formal resolutions.
- **Suppliers:** Our relationship with suppliers and subcontractors must be based on mutual respect. We therefore have a responsibility to seek fairness and truthfulness in all our activities, including pricing, licensing, and rights to sell; ensure that our business activities are free from coercion and unnecessary litigation; foster long-term stability in the supplier relationship in return for value, quality, competitiveness and reliability; share information with suppliers and integrate them into our planning processes; pay suppliers on time and in accordance with agreed terms of trade; and seek, encourage and prefer suppliers and subcontractors whose employment practices respect human dignity.

- **Competitors:** We believe that fair economic competition is one of the basic requirements for increasing the wealth of nations and ultimately for making possible the just distribution of goods and services. We therefore have a responsibility to foster open markets for trade and investment; promote competitive behavior that is socially and environmentally beneficial and demonstrates mutual respect among competitors; refrain from either seeking or participating in questionable payments or favors to secure competitive advantages; respect both tangible and intellectual property rights; and refuse to acquire commercial information by dishonest or unethical means, such as industrial espionage.
- **Communities:** We believe that as global corporate citizens we can contribute to such forces of reform and human rights as are at work in the communities in which we operate. We therefore have a responsibility in those communities to respect human rights and democratic institutions, and promote them wherever practicable; recognize government's legitimate obligation to the society at large and support public policies and practices that promote human development through harmonious relations between business and other segments of society; collaborate with those forces in the community dedicated to raising standards of health, education, workplace safety and economic well-being; promote and stimulate sustainable development and play a leading role in preserving and enhancing the physical environment and conserving the earth's resources; support peace, security, diversity and social integration; respect the integrity of local cultures; and be a good corporate citizen through charitable donations, educational and cultural contributions, and employee participation in community and civic affairs.

While the CRT Principles address most of the significant stakeholder topics, directors must also consider and establish environmental responsibility commitments. Commitments in this area will depend heavily on the special operational activities of the business, as well as applicable laws and regulations in the jurisdictions in which the company is operating. In general, environmental commitments can be broken out into materials; energy; water; biodiversity; emissions; effluents and waste; products and services; compliance and transport, and the board should establish goals, policies, organizational responsibilities and training programs for each of these aspects and be prepared to report on such activities using recognized frameworks such as the Global Reporting Initiative.[55]

Finally, sustainability-related commitments established by the board should also include developing and maintaining a corporate culture that is based on ethical management and integrity in relationships with stakeholders. Internal incentives should be structured in a way that drive managers and employees to engage in appropriate behaviors and base their decisions on whether or not they are consistent with the company’s overall sustainability commitments. Global Compact LEAD has recommended that behaving in an ethical manner and with integrity should be rewarded with status and career progression and that

[55] A useful resource is the 300 series of the Global Reporting Initiative Standards, which include topic-specific Standards used to report information on an organization’s material impacts related to environmental topics (www.globalreporting.org).

a "culture of integrity" can also be established by emphasizing communications about sustainability and have the board and members of the executive team publicly endorse international standards and voluntary initiatives like the UN Global Compact.[56]

Sustainability-related commitments should be integrated into the company's governance codes, policies and instruments that are published and disseminated among the company's stakeholders. For example, a Global Compact publication recommended that the company's sustainable purpose should be referenced in the statement of corporate purpose, company charter, corporate mission, vision and values and should include a reference to fostering long-term success of the company and the company's definition of sustainability.[57] In addition, a reference to operating according to sustainability standards, values or policies should be referenced in the company's code of conduct, alongside statements that the company operates in accordance with applicable laws and regulations, and to the highest ethical and moral standards.

Commitments should be operationalized through actual targets established by the board in the same way that it sets revenue targets and monitors the company's progress toward achieving those targets. Sustainability targets should be both long- and short-term and should be aligned with the specific sustainability issues and commits that the board has selected (i.e., the issues that have the greatest strategic significance to the company). Directors may look to standard criteria used in well-known sustainability performance indexes such as the Dow Jones Sustainability Index; however, it is important that the board set targets that measure how well the company is doing against its own specific strategic priorities. Global Compact LEAD observed that some companies elect to establish sustainability targets at two different levels–both for the sustainability performance (e.g., carbon emissions reduction or health and safety improvements) and for the impact of sustainability activities on the financial bottom line (e.g., cost savings and increased revenue).[58] For example, Unilever set the following sustainability-related strategic goals and targets: cutting water use associated with its product use by 50 percent from 2010 to 2020; 100% sustainable sourcing of agricultural raw materials; and 50% reduction in waste associated with consumer product disposal and an even greater cut in manufacturing waste.[59]

## §9 --Framework for board oversight of CSR and corporate sustainability

[56] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 9-10.

[57] The Essential Role of the Corporate Secretary to Enhance Board Sustainability Oversight: A Best Practices Guide (United Nations Global Compact, September 2016).

[58] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 7-8.

[59] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 13 (citing Unilever's Press Release of May 18, 2017 "Unilever's Sustainable Living brands continue to drive higher rates of growth", which also include a claim by Unilever's CEO Paul Polman that the company's "sustainable living" brands, which Polman has famously celebrated for their strong purpose and social mission, had grown 50% faster than the rest of the company's business and accounted for 60% of the company's growth).

CSR and corporate sustainability are broad and challenging topics and the directors must carefully consider how the board's duties and responsibilities will be discharged and allocated among board members. According to KPMG, the structure and processes a board creates to oversee CSR and corporate sustainability will vary based on a number of factors, such as the size and complexity of the company's operations (including its supply chain and whether operations are international), its industry, the magnitude of the company's CSR risks and opportunities, the degree to which CSR issues are central to the company's strategy, and the level of director expertise regarding relevant CSR issues.[60] One well-known corporate governance advisor has counseled that directors should begin the process of developing an oversight framework for CSR and corporate sustainability by asking and answering the following questions[61]:

- How should concerns regarding CSR and corporate sustainability be integrated into the board's discussions on strategy and risk oversight? Strategy and risk oversight are two topics that all board members should be working on and actively discussing during each board meeting and investors are looking to see whether CSR and corporate sustainability have been formalized as priorities in the board's governance guidelines and overall goals.
- To what extent should CSR and corporate sustainability topics be included as standalone agenda items for board meetings?
- What information should be provided to directors (e.g., data on how the company's efforts compare to those of its peer companies, leading industry standards, and the CSR-related priorities of key shareholders and proxy advisory firms)?
- Which metrics should the board and members of the executive team focus on in considering progress against CSR and corporate sustainability goals (e.g., goals involving reduction of water usage and emissions, reducing on-the-job injuries and employee turnover, or improving workforce diversity and employee retention)?
- What process should be used for drafting and reviewing public disclosures about the company's CSR and corporate sustainability efforts?

In addition, the board should also consider how the company's current efforts and activities with respect to CSR and corporate sustainability compare to its peers, how investors and other stakeholders perceive the company's engagement with and disclosure of CSR and corporate sustainability and whether or not the company has been effectively communicating its CSR and corporate sustainability strategies, goals and actions to investors and other stakeholders.[62]

The entire board also needs to consider whether it has the full team and resources necessary to effectively and credibly carry out its oversight responsibilities. For example,

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[60] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 18.
[61] H. Gregory, "Corporate Social Responsibility, Corporate Sustainability and the Role of the Board", Practical Law Company (July 1, 2017), 3.
[62] D. Kuprionis and P. Styles, "Translating Sustainability into a Language Your Board Understands", The Corporate Governance Advisor, 25(5) (September/October 2017), 13, 15.

consideration needs to be given to the following issues and questions[63]:

- Does the board have a sufficient number of members to staff the requisite standing and special committees and to meet expectations of investors and other stakeholders with respect to diversity and ability to effectively engage with stakeholders? Institutional investors have expectations regarding director age, diversity and periodic refreshment that need to be understood and respected and the CSR and corporate sustainability pronouncements from the board will not be seen as credible unless board composition demonstrates a commitment to diversity and stakeholder representation.
- Does the board include directors who have knowledge of, and experience with, the company's businesses? While there has been a substantial wave toward including "independent" directors on boards in recent years, and this remains good advice, boards should consider adding more than one director who is not "independent" when and if that person can provide the outside directors with insight into the day-to-day operations of the business. Given that the CEO is already a member of the board, other inside directors, typically drawn from the senior executive team, must have the experience, reputation and confidence to provide views that may differ from those offered by the CEO.
- Are all of the directors able to devote sufficient time to preparing for and attending board and committee meetings? Being an effective director requires a substantial commitment of time and physical and mental resources and each director must be able to fully participate and engage in the difficult debates that continuously occur at full board meeting and during committee meetings. Boards can no longer afford to have ceremonial directors appointed for public relations purposes, particularly when the institutional investors and other stakeholders are closely monitoring reports on director attendance and participation. Also important to consider is the time expected of each director to participate in stakeholder engagement and relationship building and education and training (see below).
- Does the board have processes in place to ensure that directors receive all of the data, presented in a clear and objective manner, which is critical for them to be able to make sound decisions on strategy, compensation and capital allocation? Directors cannot rely solely on reports prepared by the CEO to make their decisions as fiduciaries for investors and other stakeholders, but must instead ensure that objective data is collected and analyzed through the company's internal controls and made available to directors well in advance of meetings. Data requirements should be sorted out in advance between directors and management when discussing and adopting key performance indicators for each CSR initiative and program.
- Does the board have procedures in place to ensure that directors receive continuous training and education on the rapidly expanding list of topics that will appear on the board's agenda? Directors should ensure that they are provided with regular tutorials by internal and external experts as part of expanded director education and the

[63] Adapted from M. Lipton, S. Rosenblum, K. Cain, S. Niles, V. Chanani and K. Iannone, "Some Thoughts for Boards of Directors in 2018" (Wachtell, Lipton, Rosen & Katz, November 30, 2017), accessible at http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.25823.17.pdf.

curriculum must cover each of the key topics that must be addressed from a CSR and corporate sustainability perspective including issues such as climate change and supply chain management and processes such as stakeholder engagement and disclosure/reporting.

An interesting 2012 analysis of large UK-headquartered companies, companies included in the FTSE 100 and Corporate Responsibility Index top performing companies, allowed researchers to identify the following different models for oversight and governance of corporate responsibility and sustainability[64]:

- A formal dedicated corporate responsibility and sustainability or similarly titled committee of the board of directors where all of the members are board members (sometimes including executives of the company if they are also board members). Formation of a dedicated committee sends a clear signal to both internal and external stakeholders that the company and the board takes sustainability seriously; however, such a structure does come with risks of reinforcing a silo mentality.
- A “mixed” corporate responsibility and sustainability committee including at least one board member, generally a non-executive (i.e., independent) member, and senior executives who are not board members. This structure can be helpful in creating an effective link between strategy and implementation; however, it may lead to confusion between the roles of the board and executive members of the committee.
- An explicit statement that issues of corporate responsibility and sustainability are reserved for, and are to be addressed by, the board as a whole, and there is no delegation to a board committee. If the board is not sufficiently experience in identifying and managing issues associated with environmental and social responsibility this approach may be inadequate; however, over time having the full board maintain responsibility is the best way to ensure a holistic approach to the subject and makes sense when and if the entire board is experienced and properly trained in corporate responsibility and sustainability and consciously considers corporate responsibility and sustainability dimensions in every discussion of strategy and operations in the boardroom.
- A board member (usually a non-executive (i.e., independent director) is publicly designated as the lead director for corporate responsibility and sustainability. A variation of this approach was to have several board members designated as lead directors for particular issues or topics such as climate change or health and wellbeing. This approach offers a focal point for corporate responsibility and sustainability on the board; however, success depends on the authority and credibility of the lead director(s).
- A “below the board” corporate responsibility and sustainability committee consisting of only non-board members such as the CEO and other executives that reports back into the board through the chair, CEO or lead non-executive (i.e., independent) director. This approach ensures operational awareness; however, it does carry the danger of divorcing the board too much from consideration of the relevant issues.

[64] D. Grayson and A. Kakabadse, Towards a Sustainability Mindset: How Boards Organize Oversight and Governance of Corporate Responsibility (London: Business in the Community, 2012), 6-9.

- An explicit extension of the remit of an existing board committee (e.g., the audit or governance committee), all of the members of which are board members (sometimes including executives of the company if they are also board members). This approach ensures greater coordination and collaboration in developing and implementing strategy and corporate responsibility and sustainability initiatives; however, those topics may suffer for attention in the face of the alternative well-established agendas of other committees and their existing heavy workloads, particularly in the case of audit committees.

A small number of companies failed to make any explicit statement regarding oversight of corporate responsibility and sustainability, which could have meant either that they did not understand or acknowledge the potential serious impact of issues in those areas or that they believed that such issues were already being adequately considered in boardroom discussions. In light of the risks and opportunities associated with corporate responsibility and sustainability, and the intense scrutiny that companies are under with respect to those issues and how they are being addressed from corporate governance perspective, failing to have some specific structure in place is arguably short-sided and will likely raise serious questions among stakeholders. In addition, failure to formally integrate corporate responsibility and sustainability into the board's agenda will likely cause the company to miss risks and opportunities, which will ultimately have a negative impact on overall corporate performance. Moreover, when the board does not make a point of considering corporate responsibility and sustainability in some manner, issues in those areas will not be adequately addressed in annual meetings and reports and performance with respect to such issues will not be measured.

The researchers noted that, in practice, the models described above were not generally mutually exclusive and that some companies employed several of them at one time or transitioned from one to another as their needs changed or board members became more comfortable with certain issues. The researchers argued that while structure is important and can help boards focus their attention, the long-term goal should be to develop and maintain the appropriate "sustainability mindset" across the entire board such that corporate responsibility and sustainability considerations are seamlessly and automatically included in all important boardroom deliberations on strategy and the overall purpose of the company. At that point there might no longer be a need for specialized committees; however, board members would continue to benefit from inputs from the company's internal sustainability groups and external advisors and experts. In fact, the researchers found that a significant number of the companies had chosen to supplement their board structures with formal, standing or ad-hoc, stakeholder-engagement mechanisms including stakeholder and/or external sustainability expert panels to advise the board and/or members of the executive team.

**§10 ----Board committees**

While the entire board should consider the questions posed above, and CSR and corporate sustainability will need to have an important place on the agenda for full board meetings, larger companies typically rely on one or more committees when it comes to allocating specific tasks and tapping into specialized resources and expertise. Surveys have found that boards generally choose from among three models for formal structures relating to consideration of sustainability issues: (1) tasking the entire board with oversight, (2) creating new committees dedicated exclusively to sustainability, and (3) using existing committees to assume responsibility for sustainability as one aspect of their overall activities.[65] A March 2014 study of board oversight of sustainability issues among S&P 500 companies commissioned by the IRRC Institute and authored by the Sustainable Investments Institute found that among the companies that had implemented board oversight of sustainability issues, 32% of them had elected to dedicate responsibility for oversight to a committee principally focused on these tasks.[66]

The EY Center for Board Matters issued a report in December 2016 on how board committees among S&P 500 companies have evolved to address new challenges including heightened regulatory requirements, shifting investor expectations and transformative global changes.[67] EY found five significant trends that emerged between 2013 and 2016 for these larger companies:

- More boards were adding additional committees due to changing board priorities and pressures, boardroom needs and company circumstances.
- Executive committees, which tended to handle certain board-level responsibilities when the board is not in session, were the most common type of additional committee, and finance, compliance and risk committees were also growing more common.[68]
- Cyber, digital transformation and information technology were not only for the audit committee and companies were assigning various aspects of these topics to a variety of other committees including the compliance, risk, finance and technology committees.
- Compliance, risk and technology committees saw the most growth, a trend that might be explained by the likelihood that boards realized the need for greater breadth and depth of focus in these complex business areas.

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[65] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012),

[66] P. DeSimone, Board Oversight of Sustainability Issues: A Study of the S&P 500 (IRRC Institute, March 2014), 9. The committees used a variety of terms in their names including "public policy", "public affairs", "regulatory compliance", "environment" or "environmental", "health" and/or "safety", "corporate responsibility" or "corporate social responsibility", and/or "sustainability" or "sustainable". When the analysis is limited to committees assigned responsibility for CSR and/or ESG specifically, the percentages are a bit lower (e.g., a Bloomberg LP survey of S&P 500 companies in 2015 found that 123 of them (24.6%) had assigned responsibility for oversight of ESG/CSR to a board committee). What does seem to be true regardless of how it is measured is that companies are turning more and more to separate committees to handle significant parts of the board's sustainability oversight duties.

[67] http://www.ey.com/Publication/vwLUAssets/EY-board-committees-evolve-to-address-new-challenges/$FILE/EY-board-committees-evolve-to-address-new-challenges.pdf

[68] The most common functions of additional committees, ranked by the percentage of companies adding such committees, were as follows: Executive 37%, Finance 31%, Compliance 12%, Risk 11%, Corporate Social Responsibility 7%, Technology 6%, Public Policy and Regulatory Affairs 5%, Strategy and Planning 5%, Research and Development 3% and Mergers and Acquisitions 2%.

- Sector matters when it comes to additional committees and in six of ten industry sectors surveyed over 75% of the companies had at least one additional committee, presumably in response to certain unique compliance, risk and operational challenges in those sectors. Utilities companies were the higher user of additional committees, followed by financial services at a distant second.

Among smaller companies included in the S&P SmallCap 600 46% of them had at least one additional board committee, with most popular choices being executive, risk, finance, strategy and compliance. The EY report urged directors to consider whether their committee structure was appropriate for the current priorities of the board and the specific needs of the company. When conducting their assessment, directors should understand how peer companies are addressing board oversight responsibilities and identify possible pressure points that might be resolved with changes in committee structure. Relevant factors that should be considered when deciding whether to delegate oversight of CSR activities to a new committee and/or one or more existing committees include the type and magnitude of the CSR issues selected as being strategically significant by the entire board, the available bandwidth of the existing committees and the culture of the board.[69] While details of the CSR initiative, such as managing stakeholder engagement, may be delegated to committees, the entire board remains responsible for determining which CSR issues are most important and monitoring the actions of management against the performance metrics established by the entire board for each of those issues.

One approach that is growing in popularity is the creation of public policy/CSR, social and cultural responsibility and/or environmental responsibility, health, safety and technology committees composed of a sub-group of the entire board that is charged with focusing more time and effort on sustainability generally and important topics within sustainability. An analysis of all committee charters at S&P 100 firms conducted by Calvert Asset Management in 2010 found that 65% of those companies provided for sustainability oversight through at least one committee, with high-impact sectors more likely to have such committees, and that such committees typically focused on sustainability, corporate responsibility, corporate citizenship, environment, human rights, safety, health, social and the community.[70] Establishing a standalone committee at the board level focusing on sustainability significantly increases the amount of time that board members can dedicate to these discussions and increases the visibility of the board's commitment, thus sending an important signal to both internal and external stakeholders; however, boards need to be careful that relying on a separate committee reduces the uptake of sustainability by all of the directors and hampers integration into other functional committees. As time goes by the role of the committee will evolve to that of a "coordinator", with strategies, commitments and targets being set by the entire board and the committee providing support with the assistance of an internal

[69] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 19.
[70] Board Oversight of Environmental and Social Issues: An Analysis of Current North American Practice (Calvert Asset Capital Management Inc. and The Corporate Library, 2010).

sustainability office.[71]

In addition, other committees may be asked to provide support relating to specific CSR and corporate sustainability topics that are closely related to their regular activities, although it is important to avoid too much dilution of effort by making sure that the actions and activities of all committees are coordinated and the results reported upward to the entire board during the portion of the board meetings allocated to the consideration of CSR and corporate sustainability:

- ***Nominating Committee:*** In discharging its responsibilities with respect to identifying and recruiting new directors who can broaden the range of experience and expertise available to the full board and its committees, the nominating committee should pay specific attention to identifying candidates with experience in evaluating and overseeing CSR and corporate sustainability initiatives, such as CEOs of other companies that have achieved positive recognition for their sustainability efforts. The nominating committee can also contribute to the socially responsible profile of the company be ensuring that the board is diverse and represents all the company's key constituencies and that members have skills and experience necessary to engage effectively with stakeholders regarding CSR, corporate sustainability and identify and manage risks. The committee should integrate sustainability criteria into its processes for identifying director candidates and evaluating director performance.
- ***Governance Committee:*** While some companies allocate responsibility for director training and education to the nominating committee of the board, the governance committee is generally responsible for those activities and should ensure that CSR, corporate sustainability and the specific issues and topics included therein are given a place on board's education agenda.[72] For example, the governance committee should ensure that all directors are adequately versed in the sustainability-related topics of most interest to investors such as climate change and identifying and mitigating the risks associated with climate change. Education and training should also cover emerging trends in the sustainability area. The governance committee will also often be tasked with reviewing corporate policies on sustainability.
- ***Audit Committee:*** Many commentators focus on how CSR and corporate sustainability initiatives help companies manage and reduce risks. As such the audit committee of the board, which is generally the committee responsible for risk assessment and management, should include CSR and corporate sustainability on its agenda and work with the company's external and internal auditors to ensure that the sustainability topics are covered in audit activities and internal controls and that financial reporting procedures take into account emerging requirements for sustainability-related reporting. The audit committee should also understand the risks

[71] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 14. For detailed discussion of sustainability-focused committees, see "Social and Cultural Responsibility Committee" in "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

[72] Many companies combine the activities of nominating and governance into a single committee called the Nominating and Governance Committee and some even include the term "Responsibility" in the committee name.

and opportunities relating to reporting the sustainability performance of the company, ensure the quality and timeframe of sustainability and other corporate disclosures, monitor research and development on sustainability and ensure compliance with new regulations and non-binding standards on sustainability along with other committees formed to focus specifically on compliance activities.[73]

- ***Compensation and Organizational Development Committee:*** The compensation and organizational development committee should carefully review the compensation and incentive programs, and accompanying evaluation procedures, established for the company's senior executives to ensure that they are consistent with the company's CSR and corporate sustainability initiatives and performance targets. Executive compensation has often been criticized as being tied too closely to short-term performance and weighting financial performance too heavily will dissuade executives from investing in sustainability initiatives that may be more difficult to objectively assess for value (e.g., improving energy efficiency, reducing greenhouse gas emissions, meeting health and safety targets, or improving leadership diversity).[74] The compensation committee should be proactively engaged in dialogue with the company's investors regarding sustainability and executive compensation.[75] The committee should also oversee the company's human resources development programs to ensure that they include CSR and corporate sustainability topics.
- ***Disclosure and Reporting Committee:*** One of the fundamental principles of CSR and corporate sustainability is more transparency by companies with respect to their operational activities and their actual and potential impact on stakeholders beyond investors. As such, it is important for the board to recognize the importance of disclosure and reporting by establishing a separate committee on the topic and ensuring that sufficient resources are assigned to understanding and complying with mandatory reporting requirements and creating effective sustainability reports that comply with the emerging guidelines such as those developed by the Global Reporting Initiative. In particular, the committee needs to ensure appropriate funding and support for the more comprehensive internal reporting processes required for CSR and corporate sustainability analysis and reporting.
- ***Risk Management and Compliance Committee:*** The risk management and compliance committee, which is often is separated into two committees, should expand its traditional role and responsibilities to include oversight of management of risks relating to sustainability issues and compliance with sustainability-related laws and regulations. When engaging in compliance oversight the committee should be prepared to coordinate with other board committees such as the audit committee, which brings its expertise in assessing compliances with specified standards, and committees focused on specific regulated issues such as the environment and health and safety.

[73] R. Sainty, "Engaging boards of directors at the interface of corporate sustainability and corporate governance", Governance Directions (March 2016), 85, 87.
[74] For further discussion, see Glass Lewis, In-Depth: Linking Compensation to Sustainability (March 2016), available at glasslewis.com.
[75] R. Sainty, "Engaging boards of directors at the interface of corporate sustainability and corporate governance", Governance Directions (March 2016), 85, 87.

Each member of the board should be mindful of the role that he or she is expected to play with respect to CSR and corporate sustainability oversight and it is important to be clear which committees each board member will serve on and to be sure that the skills of each director are properly aligned with the internal organizational of the board.

**§11 ----Board composition**

Along with finding the appropriate structure for oversight of sustainability, boards must address the composition of the director team to ensure that it both demonstrates certain key values associated with social responsibility and includes members with the appropriate sustainability mindset and skills required to execute on sustainability commitments. Important issues and characteristics for board composition relative to sustainability are independence (i.e., separating the chief executive and chairperson positions and recruiting external directors), diversity (i.e., gender diversity, which has led to imposition of quotas to remedy under-representation of women on corporate boards, and including representatives of key foreign markets as companies globalize their operations), stakeholder representation (i.e., a director elected to the board specifically to represent the interests and perspectives of non-investor stakeholders, a concept that admittedly has yet to be widely adopted apart from a handful of jurisdictions with "dual board" corporate governance structures), cultures, age and viewpoints, each of which has a clear relationship to sustainability.[76]

A discussion paper prepared by Global Compact LEAD on the role of boards in overseeing corporate sustainability and implementing the Global Compact principles suggested four possible futures for board composition[77]:

- Maintaining the "status quo", which means a slow but steady effort to increase board diversity, focusing primarily on gender and globalization, but little change to existing governance models
- Inclusion of "new voices", which means that while governance models will remain similar to those traditionally used there will be a rapid diversification of board composition to include directors, including "stakeholder directors", chosen in whole or in part because of their knowledge, networks and perspectives on material sustainability issues
- Formalization of external advisory panels on sustainability, which are discussed below, as parallel bodies to the board of directors that enable maintenance of existing governance models with a formal channel to expertise that would enrich directors' abilities to anticipate and manage key sustainability questions
- Transition to a bi- cameral corporate governance model similar to what is used in Germany and some other jurisdictions that is based on a dual board structure that formally and explicitly balances shareholder and stakeholder interests

[76] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 12.
[77] Discussion Paper: Board Adoption and Oversight of Corporate Sustainability (Global Compact LEAD).

A March 2014 study of board oversight of sustainability issues among S&P 500 companies commissioned by the IRRC Institute and authored by the Sustainable Investments Institute found that 9% of the companies had implemented some form of board oversight of the company's positions and policies on workplace diversity and inclusion issues, in most cases allocating responsibility to one of the board committees such as corporate social responsibility or nominating and governance.[78] Directors should not underestimate the important of diversity in the boardroom to institutional investors, many of which, such as BlackRock have made it clear that they intend to engage with their portfolio companies to better understand their progress on improving gender balance and hold the nominating and/or governance committees of the boards of those companies responsible for any apparent lack of commitment to board effectiveness.[79]

KPMG noted that another important issue with respect to board composition is making sure that the directors have the relevant experience and expertise to identify and understand CSR risks and opportunities and to intelligently and effectively oversee management's handling of these issues. Companies have begun recruiting directors with specific expertise and experience on topics that will likely be most important to the company from a strategic perspective, such as "climate change", and realize that having a board with strong CSR expertise sends a signal to investors and other stakeholders that CSR issues are a priority in the boardroom. The entire board, through its nominating and governance committee, should add relevant CSR expertise to the criteria used to identify and select future candidates; however, a CSR skill set should be just one of several tools that a candidate brings to the board. For example, while a director may have extensive experience in working on a particular social issue, he or she needed to be familiar and comfortable with the financial analysis tools that will be used to develop a business case for a particular CSR initiative and the associated performance metrics. In addition, steps should be taken to educate all members of the board on CSR issues, especially those directors who lack background in the area.[80]

**§12 ----External advisory panels**

A discussion paper prepared by Global Compact LEAD on the role of boards in overseeing corporate sustainability and implementing the Global Compact principles suggested that boards supplement formal "hard governance" mechanisms for sustainability (i.e., board committees) with external advisory panels that are comprised of experts either on sustainability in general, or on specific topics of particular interest to the company such as health, nutrition or renewal energy.[81] When these panels have a direct line of the entire board they can enhance the efforts of directors to understand sustainability issues and help the board with collecting and assessing stakeholder opinions regarding the company's sustainability strategy and performance.

[78] P. DeSimone, Board Oversight of Sustainability Issues: A Study of the S&P 500 (IRRC Institute, March 2014), 1, 15.
[79] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 6.
[80] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 18.
[81] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.

A 2012 analysis of large UK-headquartered companies, companies included in the FTSE 100 and Corporate Responsibility Index top performing companies to identify models for oversight and governance of corporate responsibility and sustainability found that a significant number of companies supplemented board structures with stakeholder and/or external sustainability expert panels.[82] The report defined "stakeholder advisory groups" as "[w]here representatives of one or more stakeholder groups are consulted by the company either on a specific topic or on a variety of issues facing the business" and mentioned that companies generally deployed stakeholder advisory groups or panels consisting solely of external stakeholders or joint management-stakeholder committees. Expert panels were described in the report as being composed of a mix of individuals that might include people with broad sustainability experiences and/or members that bring experience and expertise with respect to specific industries or sustainability issues. Panels of this type generally met two to four times a year and would also be available for ad-hoc consultations with the board and/or senior management.

## Critical Success Factors for Expert Groups

As part of an extensive survey of board oversight and governance of corporate responsibility and sustainability among large UK-headquartered companies, companies included in the FTSE 100 and Corporate Responsibility Index top performing companies, a group of experienced members of experts' panels and corporate advisory groups with respect to sustainability offered the following set of "critical success factors" for ensuring the effectiveness and value-added contribution of such panel for companies:

**Basic "Terms of Engagement"**

- There is a good chemistry between the panel members.
- The discussions are chaired by someone who has gained the trust of the panelists from either internal or external encounters.
- Non-disclosure agreements are signed by panel members, at least in some cases, but members are not rigidly "sworn to silence". External conversations regarding topics covered in panel meetings can provide useful testing of evolving thinking within the group, not just a wider set of communication channels.
- Membership terms are agreed at the outset, and certainly should not be open-ended, but equally members have enough time to build up a good understanding of the business of the panel over time.

**Communication and Access**

- The panel has direct access to, and regular contact with, the CEO and senior management (including those other than the "usual suspects" for corporate responsibility, such as the finance and marketing directors) and members of the board. The panel is trusted by them and listened to as a "critical friend". It can be helpful to identify panel members with specific stakeholder relationships in order to deepen understanding of particular issues.
- There are at least occasional briefings by younger/less senior people from the company, and there are visits to relevant parts of the business, particularly where the company is a global player.
- The panel is free, and encouraged, to give its advice on any aspect of the business and may do without waiting to be asked its opinion.
- Panel members have the option to have sessions on their own, with no involvement from the company.

[82] D. Grayson and A. Kakabadse, Towards a Sustainability Mindset: How Boards Organize Oversight and Governance of Corporate Responsibility (London: Business in the Community, 2012), 10.

**Sustainability at the Heart of Business Management**

- The panel treats the purposes and values of the company as a key point of reference for its work, and where necessary, challenges the board of the company if these are not clearly or consistently stated.
- The panel resists all attempts to treat responsibility and sustainability as separate compartments and constantly checks to ensure that it is contributing to the "mainstreaming" of these issues.
- The panel is supplied with benchmark data on competitors in relevant areas of their performance.
- The panel is briefed regularly by the CEO and senior management on business performance and on the critical issues facing the business. The more "upfront" the briefings can be, the better it is. If all a panel gets is a briefing about something that is already completely done and dusted, then it is far less valuable than being part of a discussion before decisions have been taken.
- The panel is engaged with both short term and longer-term strategic issues, it helps for individual panel members to concentrate on one or two "hobby-horses" that they push with the company very hard. Some panels have their noses too much to the grindstone of the daily preoccupations and don't spend enough time looking ahead.

**Expert Advice Provided and Respected**

- The panel gives relevant, timely, substantive and well-informed advice which is recognized as leading edge and highly relevant to the business by the senior management and members of the board.
- The panels advice regularly (obviously not always) followed by the board.
- In all cases, there is transparency and accountability in the process—in other words, what was it that the panel did which led onto a decision, one way or the other, so that one can actually see how the process works through in practice.

**Source:** D. Grayson and A. Kakabadse, Towards a Sustainability Mindset: How Boards Organize Oversight and Governance of Corporate Responsibility (London: Business in the Community, 2012), 11 (see note 13 for the names of the experts participating in compilation of the list).

## §13 --Integrating sustainability into governance policies and processes

Companies often designate a corporate secretary or another person to oversee administrative matters relating to governance processes. Someone in this position would normally be expected to maintain relevant governance processes and structures through regular reviews and updates to the board manual and other governance documents; keep current on evolving practices in corporate governance and advise the board and the board's governance committee; serve as chief expert and advisor on all corporate governance matters for directors and employees; serve as executive liaison to the governance committee; and administer the corporate code of conduct and other board policies.[83] With respect to sustainability, a Global Compact publication recommended that the aforementioned traditional duties be supplemented to include monitoring the external environment to remain fully informed of corporate sustainability governance trends, emerging issues and best practices, especially those of relevance to the sector or key issues; informing the governance committee on trends and changes in best practice corporate sustainability governance and regulator expectations; determining and implementing amendments to governing documents, processes and structures to

[83] The Essential Role of the Corporate Secretary to Enhance Board Sustainability Oversight: A Best Practices Guide (United Nations Global Compact, September 2016).

incorporate sustainability oversight roles for the board; ensuring that executives and key employees understand the emerging trends in corporate sustainability governance; and, along with members of the executive team, ensuring that the board regularly reviews, updates, and monitors compliance with corporate sustainability policies.

Additional specific actions that should be taken with respect to corporate sustainability governance include the following[84]:

- Ensuring the "sustainability oversight" is included the formal record of the roles and responsibilities of the board and individual directors
- Informing the chairperson of the board and the chairperson of the relevant board committee about trends and best practices in corporate sustainability governance
- Support management's relationship with the board by informing the CEO and chief sustainability officer, if any, of trends and best practices in corporate sustainability governance and assisting management with bringing sustainability risks and opportunities to the board's attention
- When assisting the chairperson of the board and the CEO in preparation of board agendas making sure that there is sufficient time for sustainability discussions in relation to all matters coming before the board to which sustainability is relevant and reports from the sustainability committee and ensuring that meeting packages include sufficient information of sustainability impacts, risks and opportunities, including stakeholder considerations, for the board to make informed decisions
- Ensuring that board discussions of sustainability and stakeholder consideration are included in minutes of meetings of the full board and relevant board committees
- When supporting the board in developing and implementing recruitment criteria for new directors (i.e., skills, experience, attributes, diversity etc.) making sure that diversity is included as a board composition factor and focusing on increasing the number of women on the board and diversifying the composition of the board with respect to skills, ethnicity, cultural background and age (e.g., recommending that sustainability be included in the skills matrix and that at least one director have skills/experience in corporate sustainability including executives with a successful track record on sustainability or topic experts)
- Including sustainability within the new director orientation, including an overview of sustainability risks, opportunities, strategy, performance, standards, policies and key stakeholders and their priorities, etc.; and sessions with sustainability leaders in the organization. Include a copy of the company's most recent sustainability report in the orientation manual
- With respect to board and director training, securing time during board and committee meetings for education and in-depth review of sustainability risks, opportunities, impacts, trends and dependencies, including stakeholders and their key issues, to ensure that directors have the proper information and knowledge; including sustainability education sessions in the board calendar; and identifying sustainability education opportunities for directors

[84] Id.

- Ensuring that the board's evaluation processes assess board and director sustainability skills, experience and contribution (e.g. do directors feel informed about sustainability trends and issues as they impact the company, its value chain, industry and operating context; effectiveness of the Board's role in monitoring the company's sustainability performance; whether the board demonstrates a commitment to sustainability in its decisions and actions; whether the director demonstrates knowledge of the sustainability policy and strategy and their application to the business, the degree to which sustainability is considered in board decisions, etc.) and that results are used to inform training, procedures or recruitment
- Including disclosure on corporate sustainability governance practice and sustainability results in annual and sustainability reports following internationally accepted reporting standards (e.g., Global Reporting Initiative Guidelines) and in shareholder communications and ensuring effective board-stakeholder relations (e.g., through the establishment of an expert sustainability or stakeholder advisory committee to the board)

## §14 --Sustainability education and training for board members

In addition to seeking out board members with specific experience and skills relevant to sustainability, companies must ensure that all of their directors are continuously educated on sustainability in general as well as the subtopics of sustainability that are the foundation of the company's goals and commitments. Director education and training in sustainability is important for several reasons. First, directors who are unable to recognize and respond to sustainability issues are derelict in their duties with respect to risk management since those issues pose a substantial risk to the company's reputation, brand and license- to- operate. Second, directors need to understand sustainability in order to properly select and oversee senior leadership to ensure that a "culture of sustainability" is created and maintained from the very top of the organization. Finally, directors are responsible for the long-term strategy and direction of the company and in discharging those duties and making leadership decisions they need to understand how strategic management of sustainability and innovation can improve business performance.[85] Sustainability training is often assigned to the board's nominating and governance committee which will be responsible for determining the curriculum and identifying internal faculty members and external training providers such as universities with expertise in various sustainability issues.

A Global Compact publication recommended that all board members should have generic sustainability skills and knowledge such as basic awareness of sustainability and how it affects the organization; basic understanding of what is corporate sustainability; ability to identify at a high level the most material sustainability impacts of and on the organization, its value chain, industry and operating context; knowledge of key stakeholders and their priorities and issues; understanding of how poor sustainability performance can create reputational and other risks; ability to articulate how

[85] The Global Compact LEAD, Discussion Paper: Board Adoption and Oversight of Corporate Sustainability.

sustainability relates to the purpose and strategy of the organization; understanding of sustainability trends generally and as they affect the industry and their impact on the company; and knowledge of the company's business case for sustainability, including how sustainability can contribute to long-term value creation such as the ability to attract and retain talent and stimulate innovation.[86]

The education process should begin with the orientation of new directors, which should include meetings and discussion with senior management responsible for sustainability and site and facility visits including sustainability information. The orientation binder should include the company's sustainability policies and reports, a stakeholder map and stakeholder engagement policies and strategy and the company's definition of sustainability and related business case. Director training and education needs and interests relating to sustainability knowledge should be continuously surveyed and directors should be provided with a list of relevant, tailored sustainability education opportunities. Sustainability and stakeholder issues should be included on a regular basis on the board's meeting agenda and education calendar.[87]

## §15 --Competencies and remuneration of the executive team

Selecting the CEO and other members of the executive team, and setting the right performance criteria and incentives with respect to pursuit and achievement of the company's sustainability commitments and targets, is a unique and important responsibility of the board of directors. At the very beginning, during the recruitment process, Global Compact LEAD calls on directors to include in their selection criteria that candidates have the ability to demonstrate solid understanding of the complex sustainability issues that affect the business environment; commit to operate in accordance with the highest social, environmental and ethical standards; and provide a track record of producing excellent financial results with due consideration for the interests and concerns of different stakeholders.[88]

Once candidates for CEO and the other spots on the executive team have been selected, incentives must be put in place in their compensation arrangements that reward long-term performance and that are aligned with the sustainability priorities and targets established by the board. Not only does this impact the decisions that the executive team make but it also sends a strong message to employees and external stakeholders about how sustainability is valued and taken seriously at the top of the organization. Global Compact LEAD suggested that two ways to incentivize good sustainability performance might be linking part of executive pay to stocks, bonds or escrow that are only released

[86] The Essential Role of the Corporate Secretary to Enhance Board Sustainability Oversight: A Best Practices Guide (United Nations Global Compact, September 2016).
[87] Id.
[88] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 8.

after 10 or 15 years and making a portion of the performance-based salary dependent on the realization of the short-term sustainability objectives of a company.[89]

When setting "sustainability objectives" for which performance will be measured and compensation determined, emphasis should be on the specific issues and priorities that are material to the company such as the chosen targets for carbon emissions, health and safety incidents, gender diversity or sales of certain categories of sustainable products.[90] Performance measurement with respect to sustainability indicators can be challenging given the lack of necessary data and the need for some level of discretion to be used when objective information is not easily available. When discretion is used, it is important for it to be verifiable and based on an independent process. Sustainability incentives must also be meaningful in the broader context of the executive's entire compensation package.[91]

The directors need to be sure that the CEO is "on board" with the board's role in overseeing responsibility and the various pressures that directors are likely to exert on the CEO and other members of the executive team to ensure that sustainability is a central concept in their activities. In addition, the CEO and the other members of the executive team should have the ability to think strategically about the issues and communicate clearly and persuasively; possess sound business knowledge and judgment; have the ability to develop trusting relationships with a variety of company constituents before an issue becomes a problem; and have a strong grounding in a wide range of environmental processes, procedures, and technologies, social issues, and governance requirements at the local, state, regional, federal, and international levels. Finally, the board must monitor function-specific awareness of sustainability risks and opportunities among members of the executive team (e.g., does the chief financial officer incorporate sustainability factors into financial analyses and does the chief human resources officer understand the importance of human capital management).[92]

## Recommendations on Raising Organizational Sustainability Awareness

The National Association of Corporate Directors provided the following list of recommendation to directors seeking to make sustainability a higher priority at the executive level of their organizations:

**Involve leadership, i.e., tone from the top:** Embedding sustainability in a corporate culture requires leadership support from the outset, and the sustainability perspective must be consistently communicated throughout the organization by an engaged leadership team that understands the importance of sustainability to the long-term success of the company, is involved in setting goals, and is held accountable for company performance.

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[89] Id. While the discussion in this section focuses on compensation and sustainability incentives for the CEO and other senior executives, the board should also ensure that incentives and related performance indicators and measurement systems are in place for all employees with responsibilities that link to the sustainability performance of the company and such incentives are aligned with those that have been established for senior executives. Id. at 9.

[90] Id. There is also the option of providing, as is the case in certain extractive industries and the pharmaceutical industry, of using "negative criteria" that is embedded in bonus rules that provide that no bonuses will be paid when incidents of a certain magnitude have occurred. Id. at 8-9.

[91] Id. at 9.

[92] For detailed discussion of the role of the CEO in CSR initiatives, see "Sustainability Governance and Management" in "Corporate Social Responsibility: A Library of Resources for Sustainable Entrepreneurs", both prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

**Include sustainability in the corporate strategy:** Consider integrating sustainability into the core of the company's strategy and processes throughout its value chain and in essential corporate agendas such as innovation, quality, safety, public policy, and human resource initiatives.
**Employee engagement:** A skilled and motivated workforce is a sustainable workforce and involving employees in the development and implementation of the corporate sustainability program can be motivating, educational, and instill a sense of pride in the company.
**Engage external stakeholders:** Stakeholders across the value chain—from suppliers to customers as well as shareholders and members of the community in which you live—are important sources of sustainability engagement and can each provide context and ideas that help enhance the company's sustainability journey.
**Identify and assess the materiality of risks and opportunities:** In order to prioritize sustainability issues and allocate resources efficiently, employ a systematic approach to determine which environmental, social, and governance issues have the greatest impact on the business and the greatest influence on stakeholder decisions about the company.
**Look for quick wins:** Demonstrating early results helps to accelerate an organization's sustainability journey by encouraging support from stakeholders and illustrating to investors that sustainability is a strategic priority for the company.
**Set goals and monitor performance:** An organization must think strategically about setting sustainability goals and developing an appropriate set of criteria and non-traditional performance metrics to continuously monitor and report on company performance on environmental and social issues such as energy efficiency, water usage, health and safety, and the reduction of carbon emissions.
**Communicate progress internally and externally:** The company should adopt an open and transparent approach toward reporting progress on sustainability-related goals in order to reinforce the importance of environmental and social issues and enhance the company's brand.

**Source:** The Director's Handbook on Oversight of Corporate Sustainability (National Association of Corporate Directors, 2014), 6 (adapted from Ernst & Young LLP and Miami University, COSO (Committee of Sponsoring Organizations of the Treadway Commission), Demystifying Sustainability Risk (New York NY: EY, May 2013).

## §16 --Investor and stakeholder engagement

Publicly acknowledging the value and importance of multiple stakeholders and proactively supporting stakeholder engagement is an important element of the board's responsibilities for shaping the company's framework for accountability, control, and risk management and directors should take steps to embed stakeholder engagement in the company's overall governance framework.[93] Among the key steps that directors should take in this area are the following[94]:

- Define stakeholder engagement, transparency, integrity and ethical relationships with stakeholders as core values of the company
- Identify, discuss and prioritize key risks associated with changing societal expectations about the roles of business in general and the company in particular

[93] For detailed discussion of stakeholder engagement, see "Stakeholder Engagement" in "Corporate Social Responsibility: A Library of Resources for Sustainable Entrepreneurs", both prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
[94] Adapted from Stakeholder Engagement and the Board: Integrating Best Governance Practices (International Finance Corporation and Global Corporate Governance Forum, 2009), 16-17.

- Determine the board's financial and non-financial information needs for decision-making, management oversight, and monitoring key stakeholder relationships associated with generating value and wealth
- Discuss and approve key performance indicators for social, environmental and financial performance with input from investors and other internal and external stakeholders
- Approve a policy for external reporting to all stakeholders of financial and non-financial results from the company's activities and the governance processes that the board and senior management have created to ensure that sustainability is integrated into long-term strategic planning
- Proactively integrate discussion of stakeholder issues into annual meetings of shareholders rather than reacting to sustainability-focused proposals initiated by activists
- Discuss the risks and impacts of projects and operations and provide transparent disclosure information to shareowners and other key stakeholder groups
- Convene stakeholder forums and invite key stakeholder representatives to address board meetings and participate in permanent stakeholder panels formed to provide continuous input to directors and senior management

When engaging with stakeholders, directors should see the dialogue as an opportunity to gather different perspectives on the risks confronting the company, information that directors can use to improve the company's risk management systems and proactively address issues, problems and opportunities that may not have been apparent when the focus at the board level was limited to maximizing shareholder value. Stakeholder engagement is also the best way for directors to gain a better understanding of what important groups, such as employees, customers and suppliers, expect from their relationships with the company and what might be necessary in order to maintain and improve those relationships and thus promote stability and corporate sustainability. Some boards have supplemented proactive dialogue with stakeholders with grievance mechanisms that allow people external to the company, such as customers, suppliers and community members, to anonymously channel their criticism of the company's behavior and sustainability initiatives directly to the board.[95]

Certain of the directors, along with members of the executive team, should be assigned responsibility for engaging with investors and other key stakeholders of the company with respect to specific CSR and corporate sustainability issues. If one accepts the arguments of governance scholars such as Hart and Zingales, who have proposed that the primary goal of corporations should be increasing shareholder welfare by engaging in activities that shareholders cannot do on their own and which lead to satisfaction not necessarily limited to greater wealth, then directors cannot assume that shareholders only care about wealth maximization and must proactively engage with the largest shareholders of the corporation on a regular basis to understand their specific goals and objectives and the financial and non-financial criteria they are using to make decisions

[95] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 12.

regarding allocation of capital to the corporation.[96] Investor engagement is important since institutional investors have made it clear that they will support certain shareholder proposals that are intended to prod boards and company executives to provide more information and disclosures regarding sustainability issues and take consider sustainability in making long-term strategic decisions, managing operational activities and setting executive compensation.

Recognition of the importance of stakeholders in corporate governance calls on directors and managers of corporations to develop new skills in order to integrate the values and expectations of external and internal stakeholders into the overall strategic management process. Digman et al. pointed that strategic management is "inseparable from the strategic management of relationships" and Masuku advised: "A strategy should be in place for each stakeholder group their key issues and willingness to expend resources helping or hurting the organization on those issues must be understood. For each major stakeholder, managers responsible for that stakeholder relationship must identify the strategic issues that affect the stakeholder and must understand how to formulate, implement and monitor strategies for dealing with that group."[97]

When engaging with stakeholders, directors should have the appropriate level of knowledge of the issues that are most important to a particularly stakeholder and be able to explain to the stakeholder how those issues are being addressed in the context of the company's operational and risk management activities. It is common for the independent chairperson of the board to team with the company's chief executive officer to engage with the company's largest institutional shareholders. Engaging and building relationships with major institutional investors is also a helpful strategy in combatting the risk of unwanted attacks by activist hedge funds and other investors that are only interested in maximizing short-term gains and will almost certainly oppose any effort by directors and management to integrate long-termism into their strategies for the company.

**Investor Engagement on Human Capital Management**

BlackRock, a leading global investment manager, provided an illustration of the steps and questions that might be part of institutional investor engagement on an important social issue: "human capital management" ("HCM"). In his 2018 annual letter to CEOs, the Chairman and CEO of BlackRock wrote that:

> "Companies must ask themselves: What role do we play in the community? Are we working to create a diverse workforce? Are we adapting to technological change? Are we providing the retraining and opportunities that our employees and our business will need to adjust to an increasingly automated world?"

[96] O. Hart and L. Zingales, "Should a Company Pursue Shareholder Value?" (October 2016), available at https://www8.gsb.columbia.edu/leadership/sites/leadership/files/Zingales-Hart--Share_value.pdf
[97] C. Masuku, Corporate Social Responsibility Literature Review and Theoretical Framework, available at https://www.academia.edu/2172462/CORPORATE_SOCIAL_RESPONSIBILITY_LITERATURE_REVIEW_AND_THEORETICAL_FRAMEWORK (citing L. Digman, Strategic management: concepts, decisions, cases (Homewood IL: BPI/Irwin, 1990).

BlackRock and other institutional investors have taken note of the importance of recruiting and retaining talented works as a primary factor in the financial performance of companies and investors realize that business continuity and success is tied to the company's approach to HCM, a broad topic that includes employee development, diversity and a commitment to equal employment opportunity, health and safety, labor relations, supply chain labor standards and continuously adapting the workplace to taken into account rapidly changing technologies.

While traditional human resources activities have often been pigeonholed as a management issue, institutional investors expect directors to be proactively involved in HCM as a natural extension of their duties to oversee the company's strategy and define the company's purpose. Among other things, directors should be prepared to monitor HCM initiatives to ensure that they are aligned with overall strategy and that employees are fully engaged and supportive of the company, its business and goals. The board should also treat HCM in the same way as other sustainability-related topics, which means constantly looking for risks and opportunities and developing appropriate responses. Management's role in HCM is obviously more operational and focused on executing the strategies and initiatives approved at the board level; however, working to bring out the best in the company's people is arguably the most important of any manager's day-to-day activities and senior executives should be proactively involved in developing and presenting innovative HCM ideas to the directors and should be forging relationships with employees throughout the organization to demonstrate the company's commitment to their current contributions and long-term wellbeing. Directors and managers should all be familiar with, and use, the expanding set of recognized qualitative and quantitative human capital management metrics that are now available to assist companies in gauging the effectiveness of their efforts to positively engage with their employees and disclosure the results of those efforts to investors and other stakeholders.

BlackRock made it clear that it intended to back up its public statements on HCM with constructive engagement with directors and executives of its portfolio companies with the goal of building mutual understanding, probing questions and issues to develop effective solutions and sharing information on best practices. BlackRock's proposed agenda for discussions with directors on HCM included:

- Oversight of policies meant to protect employees (e.g., whistleblowing, codes of conduct, EEO policies) and the level of reporting the board receives from management to assess their implementation
- Processes to oversee that the many components of a company's HCM strategy align themselves to create a healthy culture and prevent unwanted behaviors
- Reporting to the board on the integration of HCM risks into risk management processes
- Current board and employee composition as it relates to diversity
- Consideration of linking HCM performance to executive compensation to promote board accountability
- Board member visits to establishments or factories to independently assess the culture and operations of the company

When engaging with management teams, BlackRock suggested that the following topics would be an appropriate starting point:

- Policies to encourage employee engagement outcomes and key drivers (e.g., wellness programs, support of employee networks, training and development programs, and stock participation programs)
- Processes for ensuring employee health and safety and complying with occupational health and safety policies
- Voluntary and involuntary turnover on various dimensions (e.g., seniority of roles, tenure, gender, and ethnicity)
- Statistics on gender and other diversity characteristics as well as promotion rates for and compensation gaps across different employee demographics
- Programs to engage organized labor and their representatives, where relevant
- Systems to oversee matters related to the supply chain (including contingent workers, contractors and subcontractors)

While the recommendations above were intended primarily for engagement between large institutional investors and directors and senior executives of companies with securities traded in public securities markets, they can also serve as a foundation for continuous discussions between sustainable entrepreneurs and their key early-stage investors, some of which may actually have a representative on the board and others will allow the founders to serve as the only directors but will want to be able to monitor their activities with respect to HCM in the boardroom and on the office floor. HCM oversight is particularly important when the success or failure of a startup often turns on the "talent" that can be brought to bear on solving a particular problem and developing and launching the solution, be it a product, service or combination of both. Outside oversight of HCM practices is challenging for startups given that lines of authority are blurred and the founders are often so focused on completing a mission critical project that they are unable to step back and consider their actions in the context of creating the appropriate workplace culture and modeling acceptable behaviors.

One of the worthiest calls for sustainable entrepreneurs is launching and building an organization in which all participants feel a "sense of purpose", which was the central theme of the BlackRock Chairman's 2018 CEO letter referred to above. To achieve this goal, sustainable entrepreneurs must act purposefully with an eye on improving the skills and overall wellbeing of their employees. A purposeful organizational does not come about on its own, it must be nurturing by its leaders. As such, sustainable entrepreneurs should be prepared to consider the following questions, and take the following actions, when engaging with their investors:

- Has the sustainable entrepreneur taken the lead in creating a healthy organizational culture in which all employees feel protected from unwanted behaviors of others, particularly those persons who exercise supervisory responsibilities over them? All employees need to feel free to express their opinions and the workplace should be free of harassment and discrimination and compliant with applicable health and safety standards.
- Has the sustainable entrepreneur proactively launched programs and activities to engage with employees and build loyalty and commitment throughout the workforce? Even the smallest companies can implement wellness programs, providing training and development opportunities and allow employees to assume an ownership stake in the business through stock/profit participation programs.
- Has the sustainable entrepreneur integrated of HCM issues into the company's risk management processes? Talent is a scarce resource, particularly during the startup stage, and careful consideration has to be given to the consequences of being unable to recruit and retain the right people and the potential costs associated with mistakes in the hiring process. The sustainable entrepreneur needs to be able to explain the reasons for voluntary and involuntary turnover with the pool of initial employees and take steps to remediate any problems that may be adversely impacting team building.
- Has the sustainable entrepreneur explicitly integrated diversity goals into the company's plans for future recruitment of employees, executives, advisors and directors? Diversity is one of the fundamental tenants of sustainability and effective HCM and goals should be set from the outset and progress continuously checked. If goals are not being attained, an assessment should be made to identify the reasons and make appropriate changes in recruiting strategies.
- Have HCM issues been included as explicit criteria for compensation of the sustainable entrepreneur and each of the senior executives and key managers of the company? While traditional financial goals and objectives should remain part of the assessment process, each organizational leader should expect that a significant portion of his or her contingent compensation will be based on success against mutually agreed HCM metrics that are within his or her control.
- Has the sustainable entrepreneur established career paths for each of the employees in anticipation of future growth of the company including objective criteria for promotions and upward adjustments in compensation and is the sustainable entrepreneur committed to "equal pay for equal work" and equal opportunities for advancement.
- Has the sustainable entrepreneur established procedures for employees to safely convey their complaints about the workplace to organizational leaders? As noted above, employees should feel free to propose ideas for improving the workplace; however, there should also be ways for employees to

report, without fear of retribution or retaliation, activities that appear to be illegal, unethical or otherwise not in line with company culture and expectations and those reports need to be taken seriously.

- Has the sustainable entrepreneur taken steps to ensure effective oversight of contingent workers and contractors? Many companies, particularly startups, rely heavily on non-employees, such as interns, contractors and outside consultants, and organizational leaders need to monitor the activities of these workers to ensure that they do not disrupt organizational culture and that the expected contributions to the business are being made.
- Is the sustainable entrepreneur prepared to allow major investors to visit the company's facilities to assess for themselves the organizational culture and the manner in which day-to-day operations of the company are conducted? If the major investor is a director of the company, board meetings should always be onsite and should include tours of the work spaces and interviews and meetings with managers and employees from different parts of the organization.

If the major investor is a director, each of the questions above should be covered at each board meeting and during briefer meetings or calls at regular intervals between meetings. For their part, investors electing to serve on the board need to realize they are accepting important and substantial additional oversight responsibility with respect to HCM and should be prepared to invest the appropriate amount of time in fulfilling those duties. Non-director investors should not be "passive" and leave HCM to the board and the sustainable entrepreneurs. Instead they should insist on regular meetings with board members and the executive team to go over the above questions and assess whether or not the investors' choice for director is acting as a proper steward of the company's human capital.

**Sources:** BlackRock, "BlackRock Investment Stewardship's approach to engagement on human capital management", available at https://www.blackrock.com/corporate/literature/publication/blk-commentary-engagement-on-human-capital-march2018.pdf. The BlackRock Chairman's 2018 annual letter to CEOs is available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

In his 2005 survey of international thought leaders on their assessment of the convergence of CSR and corporate governance, Strandberg found that the further one got from shareholders and employees, the less widely accepted stakeholder engagement was as a pillar of governance, except perhaps as a derivative of the risks and strategic opportunities faced by a company.[98] Among the thought leaders who preferred a values-based governance model there was more consideration of stakeholder engagement given the importance of measuring the impact of operational activities on society and the environment; however, at that point in time few boards were known to have a robust stakeholder relations policy. The dominant view of the thought leaders at that time was summed in the following quote provided by Strandberg: "Companies are driven by one thing: share price. If doing something nice to stakeholders improves share price, they are all for it. If those stakeholders can damage share price the company will manage the stakeholders and if this means paying lip service or doing something more fundamental they will do it."[99]

Masuku noted that while many organizations have had some success in building relationships with a single stakeholder group, such as customers, few organizations have built the processes necessary to effectively engage with multiple stakeholders and their

[98] C. Strandberg, The Convergence of Corporate Governance and Corporate Social Responsibility: Thought-Leaders Study (Canadian Co-operative Association, March 2005), 11.
[99] Id. at 12.

issues. One of the problems is the complex political, moral and ethical environment in which corporations must operates and the long list of issues they must confront. Each of the stakeholders has their own special concerns and it is impossible for any corporation regardless of size, to give full and proper attention to each of these concerns. Moreover, certain stakeholders are more important than others to the corporation at any given point in time and thus command more attention from the directors and management. Corporations must develop the capacity to manage stakeholders and create and implement policies and processes for prioritizing stakeholder issues and communicating with each stakeholder group in order to create reasonable expectations. This is particularly important when a strategy or action in relation to one stakeholder group may adversely impact the perceived interests of another group (e.g., shutting down an old facility in one community and building a new eco-efficient facility in another community, which improves the company's environmental impact and creates jobs in the new community but eliminates jobs in the old community).

**Advice for Directors on Meeting Stakeholder Expectations Regarding Sustainability**

Kuprionis and Styles suggested that directors ask "How prepared is my company to respond to increased sustainability expectations from investors, customers and employees? and then be prepared to do each of the following seven things:

- Add sustainability discussions to the board agenda.
- Focus on what sustainability means for the company.
- Ask for briefs on industry developments, both in substance and in governance.
- Engage with the company's chief sustainability officer and investor relations officer.
- Establish an effective board oversight approach.
- Look for balanced perspectives among differing constituencies and stakeholders.
- Consider the appropriate sustainability disclosures for the company.

**Source:** D. Kuprionis and P. Styles, "Translating Sustainability into a Language Your Board Understands", The Corporate Governance Advisor, 25(5) (September/October 2017), 13, 17.

Stakeholder engagement and management is an important part of a firm's efforts to strategically manage long-term projects that involve potentially adverse social or environmental impacts. In those instances, directors and managers must be prepared to engage with the stakeholders most likely to be affected and build relationships with those groups to ensure that each side is able to achieve what it wants in relation to the project. In the example above regarding the construction of a new facility in a different community, the company should engage with the workers and their families in the old community to develop programs to mitigate the loss of jobs by providing training and outsourcing services. While these types of programs will not completely alleviate the economic pain and personal stress of the people in the old community, they are tangible signs of a firm that carries out strategies in a socially responsible manner.

Some companies take on issues that require a commitment to real social change. Examples of changes from which large segments of society benefit today, many of which were driven by activist organizations, include child labor laws, fair trade products, wage and hour reforms, workplace safety, gender equality, civil rights, health care reforms, anti-poverty and income disparities, access to educational opportunities, support for public parks and libraries and initiatives to protect the environment and preserve natural resources. When social change is the objective, corporations must be prepared to influence governmental policies and advocate solutions that do not prioritize benefits to business over the rights and needs of other stakeholders. Participation in these efforts may be unpopular among certain groups within society and the director and managers, through their communications and stakeholder engagement activities, must be prepared to explain the rationale for participation and make the case as to how the initiative will contribute to the sustainability of the enterprise.

**Opportunities from Engaging with NGOs**

Governments and multi-lateral organizations such as the United Nations have struggled to respond to the enormous environmental and social challenges that have developed around the world and more pressure has been exerted on businesses, particularly multinational corporations, to play a larger role. The drumbeat for corporate responsibility has been fueled by social media and the reality that many of the larger global companies have substantial financial resources under their control. While businesses are generally willing to provide support for environmental and social responsibility initiatives, they want their resources to be deployed in ways that are consistent with their values and their strategies and in a manner that is efficient and objectively impactful. In many cases, this requires extensive development experience, which is something many companies do not have and cannot easily acquire.

The solution, according to a September 2017 article in *The Economist*, may be engaging with NGOs to create and execute sustainability initiatives. According to the article, NGOs can assist businesses in developing more cost-effective and impactful corporate sustainability programs by contributing their deep knowledge of issues like environmental conservation, human rights, and economic development and their technical expertise in practical solutions such as project planning and implementation, monitoring and evaluation, and social marketing. NGOs can also help companies with reconceiving their goods and services to meet the needs of those at the "base of the economic pyramid", not only improving the lives of millions of poor people but also gaining access to a market estimated to be worth $5 trillion. Similarly, NGOs can provide experience and contacts for companies interested in entering new markets, particularly frontier markets, and developing communities. Finally, NGOs with experience working on difficult issues such as climate change adaptation programs and peace and conflict resolution can help businesses strength their supply chains and their relationships in local communities.

**Source:** J. Cramer-Montes, "Sustainability: A New Path to Corporate and NGO Collaborations", The Economist (March 24, 2017), http://www.economist.com/node/10491124

## §17 --Internal organizational structure

In addition to the steps needed to integrate CSR and corporate sustainability at the board level, including allocating various responsibilities and activities among board committees, the directors need to ensure that the company has an effective internal organizational structure.[100] Many companies are creating an additional position among

[100] For detailed discussion of transparency and disclosure, see "Sustainability Governance and Management" in "Corporate Social Responsibility: A Library of Resources for Sustainable Entrepreneurs", both prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

the members of the senior executive team that is specifically focused on corporate sustainability. Appointing these "chief sustainability officers" demonstrates a high level of commitment to the area by the directors and also helps everyone inside and outside the company to identify the person who will likely be the company's spokesperson on corporate sustainability issues and responsible for managing the resources provided by the board to implement sustainability strategies and satisfy the company's disclosure obligations. The chief sustainability officer must be prepared to support the board as it considers CSR and corporate sustainability issues, engage with the company's stakeholders and, not unimportantly, effectively coordinate the efforts of all of the various departments within the company that should be involved in sustainability initiatives (e.g., investor relations, legal, operating heads and risk management).[101]

**§18 --Transparency and disclosure**

As interest in CSR and corporate sustainability has grown, companies have found that they are subject to heightened scrutiny and that the traditional disclosure practices that focused primarily, if not exclusively, on financial information and performance and related risks are no longer adequate. Companies must now be prepared to provide disclosures that address the specific concerns and expectations of multiple stakeholders beyond investors including customers, employees, business partners, regulators and activists. This means that the board of directors must understand existing and emerging disclosure requirements and ensure that the company has the necessary resources to collect and analyze the required information and present it in a manner that is clear and understandable. At the same time, however, the directors need to be mindful of the risks of expanded disclosure include the possibility of providing too much strategic information, exposing the company to heightened risk of litigation from stakeholders that believe the company has not vigorously pursued its promised CSR and corporate sustainability goals and the need to invest additional time and resources in creating and maintaining the internal reporting process necessary to support CSR and corporate sustainability disclosures.[102]

While certain CSR and corporate sustainability disclosures have now become minimum legal requirements in some jurisdictions, in general such disclosures are still a voluntary matter and directors have some leeway as to the scope of the disclosure made by their companies and how they are presented to investors and other stakeholders.[103] Some

[101] D. Kuprionis and P. Styles, "Translating Sustainability into a Language Your Board Understands", The Corporate Governance Advisor, 25(5) (September/October 2017), 13, 16.

[102] For detailed discussion of transparency and disclosure, see "Corporate Governance and Sustainability" in "Governance: A Library of Resources for Sustainable Entrepreneurs" and "Sustainability Reporting and Auditing" in "Corporate Social Responsibility: A Library of Resources for Sustainable Entrepreneurs", both prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

[103] Williams noted that to the extent that governments have regulated corporate responsibility *per se*, such regulation has focused on disclosure and during the period 2000-2015 over 20 countries enacted legislation to require public companies to issue reports including environmental and/or social information. Many of these countries are in Europe and the EU has implemented a directive that requires approximately 6,000 large companies and "public interest organizations," such as banks and insurance companies, to "prepare a nonfinancial statement containing information relating to at least environmental matters, social and

companies continue to limit their disclosures to those are specifically required by regulators; however, most companies have realized that they need to pay attention to the issues raised by institutional investors and other key stakeholders and make sure that they are covered in the disclosure program. At the other extreme, there are companies that have embraced sustainability as integral to their brands and have elected to demonstrate their commitment by preparing and disseminating additional disclosures that illustrate how they have woven sustainability into their long-term strategies and day-to-day operational activities. These companies understand that not only are investors paying more attention but that more and more people everywhere are considering ESG performance when deciding whether to buy a company's products and/or work for a particular company and that it is therefore essential to lay out their specific CSR and corporate sustainability goals and the metrics used to track performance and provide regular reports to all of the company's stakeholders on how well they are doing against those goals.[104]

Proposals from shareholder activists often help create the list of CSR and corporate sustainability topics that garner the most attention from companies and trigger movement toward greater transparency and disclosure. In recent years, companies have frequently been required to respond to call for changes in corporate policies and activities with respect to political and lobbying activity, sustainability reporting, gender pay gap reporting, and child labor issues.[105] In many cases, companies have been able to calm the concerns of activists, sometimes getting them to withdraw their proposals, by promising to provide fuller disclosure; however, once a commitment is made to expanded disclosure the company needs to fulfill its promises and allocate sufficient resources to the effort since activists will be watching closely to ensure that their expectations are satisfied. When formulating voluntary CSR-related disclosures it is important to engage with activists to ensure that they understand the approach that the company is willing to take and the company's need to balance disclosure against the need to protect sensitive and strategically important information.

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employee-related matters, respect for human rights, anti-corruption and bribery matters." In addition, several stock exchanges around the world require social and/or environmental disclosure as part of their listing requirements and pension funds in a number of developed countries are required to disclose the extent to which the fund incorporates social and environmental information into their investment decisions. All things considered, surveys show that more and more jurisdictions are implementing mandatory ESG disclosure requirements and that "there is a clear trend towards an increasing number of environmental and social disclosure requirements around the world". See C. Williams, "Corporate Social Responsibility and Corporate Governance" in J. Gordon and G. Ringe (Eds.), Oxford Handbook of Corporate Law and Governance (Oxford: Oxford University Press, 2016), 15-16, 19, available at http://digitalcommons.osgoode.yorku.ca/scholarly_works/1784.

[104] As mentioned above, expansive disclosure of this type increases the risk of litigation and/or adverse market reaction in the event that the company fails to meet its stated CSR and corporate sustainability goals, even if the disclosures are accompanied by appropriate disclaimers and are not included in regulatory filings that typically are covered by anti-fraud standards. Disclosure of actual or potential links between CSR and corporate sustainability goals and compensation must also be handled carefully, similar to links between short-term financial goals and compensation.

[105] H. Gregory, "Corporate Social Responsibility, Corporate Sustainability and the Role of the Board", Practical Law Company (July 1, 2017), 4.

When companies were first attempting to provide voluntary disclosures relating to their CSR and corporate sustainability initiatives they often struggled with the format and depth of their reporting. Fortunately, as time went by, a consensus began to emerge about the benchmarks that companies should use for guidance in preparing their CSR and corporate sustainability reports. Of particular note is the Global Reporting Initiative ("GRI") (www.globalreporting.org), which is a multi-stakeholder developed international independent organization that helps businesses, governments and other organizations understand and communicate the impact of business on critical sustainability issues such as climate change, human rights, corruption and many others. The Global Sustainability Standards Board ("GSSB") issues and maintains the GRI Standards for organizations to use in their "sustainability reporting", described by the GSSB as "an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions–positive or negative–towards the goal of sustainable development".[106] GRI has pioneered sustainability reporting since the late 1990s, transforming it from a niche practice to one now adopted by a growing majority of organizations. The GRI Standards are the world's most widely used standards on sustainability reporting and disclosure and available for use by public agencies, firms and other organizations wishing to understand and communicate aspects of their economic, environmental and social performance.[107]

The International Integrated Reporting Council, or "IIRC" (integratedreporting.org), which was founded in August 2010, released its International Integrated Reporting Framework in December 2013 as a guide that companies could use to describe how their governance structure creates value in the short, medium and long term; supports decision making that takes into account risks and includes mechanisms for addressing ethical issues; exceeds legal requirements; and ensures that the culture, ethics and values of the company are reflected in its use of and effects on the company's "capitals" (described to include financial, manufactured, intellectual, human, social and relationship, and natural (i.e., the environment and natural resources) forms of value) and stakeholder relationships.[108] Guiding principles for preparation of integrated reports include strategic focus and future orientation, connectivity of information, stakeholder relationships, materiality, conciseness, reliability and completeness and consistency and comparability, and integrated reports prepared using the Framework are expected to include the following common elements[109]:

- Organizational overview and external environment: What does the organization do

[106] GRI 101: Foundation 2016 (Amsterdam: Stichting Global Reporting Initiative, 2016), 3.
[107] For detailed discussion of the GRI Standards, see "Sustainability Reporting and Auditing" in "Corporate Social Responsibility: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
[108] P. DeSimone, Board Oversight of Sustainability Issues: A Study of the S&P 500 (IRRC Institute, March 2014), 7.
[109] The International <IR> Framework (London: The International Integrated Reporting Council, December 2013), 5. For detailed discussion of the International Integrated Reporting Framework, see "Sustainability Reporting and Auditing" in "Corporate Social Responsibility: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

and what are the circumstances under which it operates?

- Governance: How does the organization's governance structure support its ability to create value in the short, medium and long term?
- Business model: What is the organization's business model?
- Risks and opportunities: What are the specific risks and opportunities that affect the organization's ability to create value over the short, medium and long term, and how is the organization dealing with them?
- Strategy and resource allocation: Where does the organization want to go and how does it intend to get there?
- Performance: To what extent has the organization achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?
- Outlook: What challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?
- Basis of presentation: How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?

Other helpful resources are available from the Sustainability Accounting Standards Board, or "SASB" (www.sasb.org), which publishes the SASB Implementation Guide for Companies that provides the structure and the key considerations for companies seeking to implement sustainability accounting standards within their existing business functions and processes.[110] The Guide helps companies to select sustainability topics; assess the current state of disclosure and management; embed SASB standards into financial reporting and management processes; support disclosure and management with internal control; and present information for disclosure. The SASB's online resource library also includes annual reports on the state of disclosure, industry briefs and standards and guidance on stakeholder engagement. Companies should monitor CSR disclosures by their peers and the SASB library has examples of disclosures made by companies in annual reports filed with the SEC on Form 10-K. Companies can also follow the reporting practices of competitors by reviewing sustainability reports that have been registered with the GRI.

As for the board's specific roles with respect to reporting and communications, directors should take responsibility for the company's communications to stakeholders regarding sustainability, whether in a separate sustainability report or integrated into financial reporting, and should formally approve the company's sustainability report before publication.[111] KPMG noted that directors should be focused on ensuring that the company's disclosures, regardless of the form in which they are made, proactively tell the company's story regarding ESG and CSR in a manner that is consistent with the language of portfolio managers: finance, efficiency, risk, strategy and long-term performance. In

[110] For detailed discussion of the activities of the SASB, see "Sustainability Reporting and Auditing" in "Corporate Social Responsibility: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
[111] A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 10.

addition, the board needs to be sure that it understands the often differing information needs of all of the company's stakeholders and satisfies those needs with both appropriate data and additional information to provide the requisite context. The board should also work with management to create the appropriate portfolio of ESG and CSR reports and disclosures including mandated regulatory filings, annual sustainability reports, integrated reports with both financial and non-financial information, information on the company's website and presentations at community meetings and professional conferences. Finally, the entire board, or perhaps a committee of the board dedicated to reporting and disclosure, should understand the process that management uses to determine the information regarding ESG and CSR that will be disclosed and verify the accuracy of such information, particularly since standards have yet to emerge for assessing non-financial information in the same way that financial information is subject to independent audit.[112]

While the efforts of the GRI, IIRC and the SASB indicate that some progress has been made regarding the development of measurement and disclosure frameworks relating to corporate sustainability and ESG practices, companies and their stakeholders are not yet able to rely on universally accepted guidelines. Hurdles that still much be overcome, and which may never be totally resolved, include variations in ESG rating methodologies and a lack of uniformity in disclosure expectations and requirement across jurisdictions. For the time being, the most effective approach for directors and their companies may be engaging with their own key investors and other stakeholders to understand how those parties view and prioritize ESG issues and their preferences regarding measurement and disclosure with respect to the initiatives taken by the company relating to those issues. Such an approach not only reduces the likelihood of misunderstanding between the company and its primary stakeholders but will also contribute to the improvement of measurement and disclosure tools and the development of best practices that can be widely disseminated.

In the meantime, work continues among corporate governance groups and consulting to develop performance measurement tools and disclosure frameworks that integrate traditional measures of financial value with new metrics that afford proper weight to projects launched primarily to pursue and achieve long-term value creation. For companies, the stakes are high and the demand for data among analysts is continuously intensifying. Directors must understand that failure to provide clear information about the company's ESG and CSR activities, including metrics and a discussion of the context of performance and the sustainability factors that might have a material impact on the company's performance can have real world consequences for the company. For example, if incomplete or inaccurate report causes analysts to give a company a low

[112] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 15. Some companies are using third party reviewers to "audit" ESG and CSR activities and independent accountants are gradually expanding their services to include limited assurances on such activities. Another challenge for companies with respect to determining what to report and disclose is the lack of experience in identifying what might be "material", although many of the organizations working on reporting standards are attempting to provide clarity on that issue. See, e.g., the efforts of the SASB, referred to above, to identify industry-specific sustainability factors reasonably likely to have material impacts. Id. at 16.

"ESG score" the company may be disqualified from bidding on certain projects that require minimum ESG scores, the company may not be access funding from a growing number of funds that have adopted restrictions on investing in companies with low scores, the board and management may find that the company needs to contend with stockholder proposals regarding reporting and other sustainability issues and the company may be facing higher costs when looking to obtain commercial loans and/or insurance coverage.[113]

## §19 Assessing directors' performance of sustainability oversight responsibilities

Boards of public companies must, as a matter of good practice and in accordance with specific legal and regulatory requirements, conduct regular evaluations of the performance of the board as a whole and the performance of specific committees of the board and each of the individual directors.[114] Board evaluation is a relatively new phenomenon and standards are still emerging on the right questions to ask and how assessments should be conducted. Moreover, in order for the evaluation and assessment to be meaningful there needs to be some understanding as to just what is meant by the term "effective board". One report on board evaluation advised that in order for the board to be effective it must have the right people, the right culture, the right issues, the right information, the right process and the right follow-through.[115]

Boards of public companies typically delegate the evaluation and assessment process to an independent committee, generally the nominating/governance committee, and the process should focus on assessing sustainability knowledge and effectiveness and ensuring that gaps are addressed. According to a Global Impact publication, topics to be covered in the assessment process should include awareness of sustainability risks, opportunities, trends, impacts and dependencies related to the company, its value chain, industry and operating context; knowledge of the sustainability policy, strategy, best practices and their application to the business; awareness of stakeholder issues and quality of stakeholder relationships; effectiveness and adequacy of sustainability decisions, discussions, tone at the top; and effectiveness of the board's role in monitoring the company's sustainability performance.[116]

The members of that committee should be versed in the methods and tools that have been developed to make the assessment process more efficient and objective including the use of questionnaires and interviews.[117] Individual evaluation of directors can be carried out

[113] ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 16.

[114] For detailed discussion of assessing the performance of the board and individual directors, see "Board Structure and Operations" in "Governance: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

[115] See Report of the NACD Blue Ribbon Commission on Board Evaluation: Improving Director Effectiveness (2001/2005).

[116] The Essential Role of the Corporate Secretary to Enhance Board Sustainability Oversight: A Best Practices Guide (United Nations Global Compact, September 2016).

[117] See Report of the NACD Blue Ribbon Commission on Board Evaluation: Improving Director Effectiveness (2001/2005) for examples of sample forms that can be used for board evaluation and the evaluation of individual directors.

in a variety of ways including self-evaluation, peer evaluation, a combination of self-evaluation and peer evaluation, evaluation by the nominating/governance committee and evaluation by an outside consultant. Hopefully one of the byproducts of the evaluation and assessment process is that the directors gain a fuller appreciation of their value to the company and the important role that they can play in setting and executing company strategy and supporting the activities of the management team that they are overseeing.

A number of assessment tools that boards and individual directors can use with respect to oversight of sustainability have been created in recent years. One example provided by Canadian Business for Social Responsibility included the following questions[118]:

- Has the board developed a common understanding of the business case for sustainability and is that business case reviewed on a regular basis, no less frequently than annually?
- Has the board and management reached agreement on a common definition of CSR and has the company's commitment to CSR as so defined been explicitly communicated among the company's stakeholders?
- Has the board and management developed a CSR vision for the company and incorporate CSR into the company's overall mission and values and the company's code of conduct and ethics?
- Is the board aware of the significant CSR-related issues that are relevant to the company's business and the industries in which the company operates and are those issues incorporated into the company's long-term strategies?
- Has the board established a formal framework for conducting its oversight of sustainability including designation of committees with responsibility for CSR and appointment of an executive officer for CSR activities with a reporting relationship to the board?
- Does the board regularly review progress on the company's performance with respect to CSR goals, objectives and targets?
- Is CSR included as a factor in recruitment of the CEO and other executive officers and is compensation of the executive linked to performance on CSR goals and targets?
- Has the board ensured that materials CSR risks are considered with the company's enterprise risk management program?
- Does the board have a means to identify the CSR impacts of its decisions and are CSR impacts, issues and opportunities explicitly considered when approving major decisions?
- Does the board review its own practices to reduce the social and environmental impacts of board meetings?
- Does the board receive unfiltered information on stakeholder issues and concerns?
- Has the board implemented auditing procedures to assess the extent to which the company's CSR commitments are adhered to across the company and within the company's supply chain?

[118] CSR Governance Guidelines (Canadian Business for Social Responsibility, 2010).

- Is the board's composition and skill set consistent with a strong commitment to sustainability, meaning that the membership of the board reflects the cultural and gender diversity of the marketplace and candidates for directorship are required to have CSR skills, knowledge and experience?
- Does the board's new director orientation process and ongoing professional development program include CSR-related skills?
- Has the board ensured that the company's has a formal external reporting program that covers material CSR issues and is the board actively involved in management's assessment of which such issues should be reported and how?
- Does the board approve the company's CSR reporting to stakeholders and do those reports include a message from the chairperson of the board?

**Directors' Questions for Assessing Board Oversight of Sustainability**

An extensive survey of board oversight and governance of corporate responsibility and sustainability among large UK-headquartered companies, companies included in the FTSE 100 and Corporate Responsibility Index top performing companies, allowed the authors to generate the following questions that directors can use to assess and improve their contribution to effective board oversight and governance of corporate responsibility and sustainability:

- Have we made a public commitment to sustainability and if so, what is this?
- Have we linked our commitment to sustainability to our business purpose and strategy, and is this reflected in executive compensation and bonus criteria?
- Is sustainability embedded within corporate values and culture?
- Are senior executives committed to sustainability, and comfortable and credible in leading on that commitment?
- Do we have effective board oversight of sustainability?
- Does the company recruit, induct, train, appraise, reward, promote and take difficult decisions using the corporate values?
- Does the company's enterprise risk management system incorporate risks and opportunities associated with social and environmental and economic impacts?
- Does the board regularly assess the company's environmental and economic impacts?
- Does the company have a process regularly to review emerging sustainability issues and surface them at board level?
- When did the board last have an open forward discussion about Responsible Business and Sustainability issues and the implications for its business?
- Does the company have clear targets on sustainability and is it clear who has direct accountability for each target?
- Is there a "big, hairy audacious goal" of the type described by Collins and Porras in "Built to Last" for corporate responsibility and sustainability such as Unilever's Sustainable Living Plan, carbon or water neutrality or "cradle-to-cradle" manufacturing?
- Is board discussion of sustainability already aligned with board discussion of its annual business performance review and its own key performance indicators?
- When did the board last discuss the company's talent development strategy and is capacity to understand and deliver on Responsible Business and Sustainability an integral part of that strategy?
- Does the company publish a sustainability report and, if so, did the board and the CEO sign off on it?
- Is the company's sustainability reporting linked to a recognized standard such as Integrated Reporting or the Global Reporting Initiative?
- Does understanding of Responsible Business and Sustainability figure on the list of desired skills /areas of expertise for prospective directors?
- Is corporate responsibility and sustainability included within induction of new board members?

- Is corporate responsibility and sustainability part of continuing professional development for board members?
- Does board effectiveness on corporate responsibility and sustainability feature explicitly in annual board appraisals (individual and collective)?

**Source:** D. Grayson and A. Kakabadse, Towards a Sustainability Mindset: How Boards Organize Oversight and Governance of Corporate Responsibility (London: Business in the Community, 2012), 17 (listed adapted from A. Kakabadse and D. Grayson, "Embedding the governance of responsibility in the business of the board", in Cranfield on Corporate Sustainability (London: Greenleaf Publishing, 2012), Chapter 4).

Assessments should also be done for individual member of the board and should begin with evaluating whether the director has developed the requisite "sustainability mindset" and the skills necessary to contribute to discussions of sustainability issues that may come up during the board's deliberations. If a director is not comfortable with sustainability, he or she needs to embark on a self-improvement program that would include additional training and education and regular meetings with stakeholder representatives to understand their specific concerns with respect to the company's sustainability commitments. Interactions with managers and employees involved in sustainability initiatives would also be helpful and companies often seek to provide support to directors by tapping outside experts to provide skills training.

## Questions for Collective Assessment of Board Oversight of Sustainability

A Checklist for Company Secretaries included in the extensive survey of board oversight and governance of corporate responsibility and sustainability among large UK-headquartered companies, companies included in the FTSE 100 and Corporate Responsibility Index top performing companies, provides the basis for the following questions for collective assessment of board oversight and governance of corporate responsibility and sustainability, a process which should be conducted on a regular basis:

- How effective overall, on a scale of 1 to 5, is the board's oversight and governance of corporate responsibility and sustainability?
- Does the board collectively, and each individual director, have a "sustainability mindset" when considering issues that come before the board for debate and decision, particularly issues relating to overall strategy?
- If the board and director do not have the necessary "sustainability mindset", what are the hurdles and what can be done to overcome them?
- How would the skills and will of each director with respect to corporate responsibility and sustainability be rated on a scale of 1 to 5?
- What are the best tools and tactics to improve the skills and will of lower performing directors?
- Are there specific questions in the annual board appraisals designed to elicit insights into board effectiveness for oversight and governance of corporate responsibility and sustainability?
- Would a sustainability experts group to advise the board and senior management team be useful and acceptable?
- Can directors take advantage of memberships in director professional development organizations to help improve board understanding and effectiveness?
- On a scale of 1 to 5, how effective are discussions among directors about corporate responsibility and sustainability (i.e., frequency, length and depth), and the corporate responsibility and sustainability implications of any decision?
- Where are the blockages to effective debate and how can these best be tackled?

- What is the quality of board briefings about corporate responsibility and sustainability?
- How can induction and continuing training and education of directors be more effective in raising skill/will on corporate responsibility and sustainability?
- Does the board need to update its skills matrix for the board collectively and each individual director?

**Source:** D. Grayson and A. Kakabadse, Towards a Sustainability Mindset: How Boards Organize Oversight and Governance of Corporate Responsibility (London: Business in the Community, 2012), 18.

Assessment of board performance should also include an audit of the steps that the management team have taken in order to integrate CSR into day-to-day operational activities. Once again, questions for management recommended by Canadian Business for Social Responsibility can be used as the basis for this portion of the assessment[119]:

- Enterprise Risk Management: To what degree are social and environmental risks and opportunities identified, quantified and managed in our operations? In our supply chain?
- CSR Trends: What are the key social and environmental issues that could affect our long term success? What are our competitors doing on CSR and how are they benefiting from this approach?
- Stakeholder Perception: What are stakeholder expectations for a company in our industry? Are we perceived to be meeting those expectations? What are the risks if we are not?
- Decision Impacts: Have we considered the social or environmental impacts of this decision? Does this decision align with our CSR commitments?
- Financial Investments: Does our investment/asset management policy incorporate environmental, social and governance factors?
- Operations: Have we taken advantage of opportunities to reduce our environmental footprint in order to generate operational efficiencies and cost-savings?
- Products and Services: Do our products and services advance social or environmental benefits? Are there social or environmental risks associated with the life cycle of our products that need to be managed, from design and production to use and disposal?
- Human Resources: Does our human resources strategy reflect CSR? For example, is CSR incorporated into staff training and compensation?
- Impact Measurement: How are we measuring the social/environmental impacts of this area of our business?
- Integration: How is the management of social and environmental matters integrated into our core business processes, such as performance management, internal assurance and business planning?
- Brand and Market Development: Does our company and product brand include sustainability features aligned to our customers' values? How can this help us advance market share?

[119] CSR Governance Guidelines (Canadian Business for Social Responsibility, 2010).

**About the Author**

Dr. Alan S. Gutterman is the Founding Director of the Sustainable Entrepreneurship Project (www.seproject.org). In addition, Alan's prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, *Business Transactions Solution*, is on online-only product available and featured on Thomson Reuters' Westlaw, the world's largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 40 books on sustainable entrepreneurship, management, business law and transactions, international law business and technology management for a number of publishers including Thomson Reuters, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, CCH and BNA. Alan has over three decades of experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Boalt Hall, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on a diverse range of topics including corporate finance, venture capital, corporate law, Japanese business law and law and economic development, He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan, his publications or the Sustainable Entrepreneurship Project, please contact him directly at alangutterman@gmail.com, and follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/).

**About the Project**

The Sustainable Entrepreneurship Project (www.seproject.org) engages in and promotes research, education and training activities relating to entrepreneurial ventures launched with the aspiration to create sustainable enterprises that achieve significant growth in scale and value creation through the development of innovative products or services which form the basis for a successful international business. In furtherance of its mission the Project is involved in the preparation and distribution of Libraries of Resources for Sustainable Entrepreneurs covering Entrepreneurship, Leadership, Management, Organizational Design, Organizational Culture, Strategic Planning, Governance, Corporate Social Responsibility, Compliance and Risk Management, Finance, Human Resources, Product Development and Commercialization, Technology Management, Globalization, and Managing Growth and Change. Each of the Libraries include various Project publications such as handbooks, guides, briefings, articles, checklists, forms, forms, videos and audio works and other resources; management tools such as checklists and questionnaires, forms and training materials; books; chapters or articles in books; articles in journals, newspapers and magazines; theses and dissertations; papers; government and other public domain publications; online articles and databases; blogs; websites; and webinars and podcasts.

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