# Protecting a Company's Social License To Operate: *The board's role in oversight*

*MCC interviews* ***Robyn Bew****, director of research,* ***National Association of Corporate Directors*** *(NACD), which recently published its* Director's Handbook on Oversight of Corporate Sustainability Activities. *She can be reached at* ***resources@NACDonline.org.***

***MCC: People often think of corporate sustainability activities in terms of environmental, energy or corporate philanthropy-related issues. How does NACD define sustainability?***

***Bew:*** Broadly speaking, the terms "corporate sustainability" or "corporate social responsibility" (CSR) cover all the issues you mentioned; however, NACD's view is that companies should consider a wide range of issues, including the more traditional environmental, health and safety topics, as well as community and labor issues, reporting transparency, or diversity in the workplace, just to name a few. As a result, our perspective is that the exact definition of sustainability will differ from company to company or industry to industry.

The key point is that while sustainability remains connected with traditional environmental issues, in practice, we're hearing from directors that companies are taking a more holistic company-specific view that takes into account its full spectrum of risks and opportunities. Therefore, directors need to understand what sustainability means for their company and make that conversation with management a starting point.

In response to this need, NACD, in conjunction with EY, has published the *Director's Handbook on Oversight of Corporate Sustainability Activities* (the Handbook), which identifies key recommendations for sustainability oversight and offers practical guidance on everything from assessing if a board is "sustainability-ready" to raising organizational awareness. It also includes some resources for directors, including a board self-assessment questionnaire and a sample sustainability committee charter.

***MCC: Why is sustainability a board-level issue?***

***Bew:*** Boards have a fiduciary objective of long-term value creation. They are charged with safeguarding the company's assets, including its social license to operate. Even more fundamentally, discussions between the board and management about strategy, risk, competitive opportunities, innovation and performance are increasingly focused on the impact of major global trends that affect every company and industry – issues like population growth, resource scarcity, climate change and urbanization. Therefore, sustainability is closely tied to corporate strategy, which is at the heart of the board's responsibility.

***MCC: Do boards typically place these oversight responsibilities in a dedicated sustainability committee?***

***Bew:*** Given the various aspects of corporate governance, there is no one-size-fits-all answer. And with respect to sustainability oversight, governance practices are evolving quite actively. Let me give some statistics. In the most recent NACD public company governance survey, 62 percent of responding directors said that their boards regularly oversee activities that fall under the holistic definition of sustainability we talked about earlier, and nearly 25 percent specifically said they have board-level oversight of CSR or sustainability programs.

The percentage for large cap companies is even higher. According to a study from the Sustainable Investments Institute (Si2) in conjunction with the Investor Responsibility Resource Center Institute (IRRCi), over 50 percent of S&P 500 companies have some form of voluntary board oversight of sustainability issues. The study reports that the number of companies with a dedicated sustainability committee, while still relatively small, is growing fast. It also noted that some companies are housing sustainability responsibilities with their nominating and governance committees.

Other approaches include keeping oversight as a full-board activity, or housing some responsibilities within the audit committee, such as sustainability reporting. So it varies, and practices will likely continue to change as investors continue to ask questions and the landscape for reporting frameworks evolves.

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***MCC: What is the impact of increased investor attention to sustainability practices on company disclosures, and what are the particular implications for audit committees?***

***Bew:*** According to a study by EY, nearly half of shareholder proposals submitted during the 2014 proxy season related to environmental and social topics. Anecdotally, NACD's conversations with major institutional investors also reflect consistent messages about the desire for boards to work with a holistic definition of risk – which includes sustainability-related considerations. Those global issues like resource scarcity and demographic change affect all companies and industries. They're game changers and will play into any assessment of risk and opportunity. Investors want to know that the board is bringing a broad view into conversations with management.

In terms of disclosures, investors are looking well beyond the standard financial reports and filings to fully understand a company's valuation and competitiveness. It's not news that they're looking at social media and blogs, and in the sustainability space, there are number of indexes and third-party data providers that compare how companies are doing relative to their peers. In the sustainability context, investors want to know about the firm's regulatory compliance, the level of consumer demand for sustainability-related products and services, or its ability to attract and retain talent.

Audit committees are increasingly directing questions to the CFO and the head of internal audit about the information being reported on these issues; often it is non-financial data. Where does that data come from, and what related policies and controls are in place? Should we engage a third party to provide assurance on that data? What about our relationships with vendors and suppliers? How are we monitoring for compliance? In a nutshell, the audit committee wants to ensure that sustainability reporting meets the same investment-grade standards as the company's financial reporting.

***MCC: What information do directors want from GCs and management on sustainability matters?***

***Bew:*** Directors are asking GCs about compliance, meaning current sustainability requirements that apply to the company and how they may be evolving. As in many areas, GCs have to stay on top of regulatory and legislative developments and their impact on the company's operations or reporting obligations. It's also common for boards to ask about contracts with customers, vendors or suppliers and whether these agreements appropriately reflect the company's policies and sustainability commitments.

From the management team, boards want information about how sustainability concerns affect a broad range of issues, from capital and resource allocation, to the implications for new product or new business development, as well as the impact on employee engagement. One of the real upsides we discovered in the process of creating NACD's Handbook – based on interviews of directors who are members of sustainability committees – is that sustainability is a corporate asset in terms of recruiting and retaining great talent. People want to know that they're working for companies that are out in front in this area, and boards are asking HR to report on how sustainability efforts are affecting employee engagement.

And of course, boards want information on the company's overall performance and how it compares to competitors. They're also asking about the views of major investors and other key stakeholders on sustainability, and how those views apply to the company's situation specifically. The overriding goal is to identify critical risks/opportunities and create competitive advantage.

***MCC: Are there existing reporting frameworks that management should consult in disclosing sustainability information?***

***Bew:*** A number of frameworks are becoming increasingly common, and the Handbook discusses a few. In the U.S., the Sustainability Accounting Standards Board is making progress, as is the Global Reporting Initiative. The whole Integrated Reporting movement is engaged with the next evolution of corporate reporting, which includes

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### Wyndham: Cybersecurity

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not to bring any legal action. Certain of the shareholders that had taken part in the demand letters then brought a shareholder derivative action against the board.

Because Wyndham is a Delaware corporation, the decision of its board as to whether to bring a lawsuit is protected by the business judgment rule. Under the business judgment rule, the court presumes that the board refused the demand "on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company."[12] To win a lawsuit, the plaintiff shareholder must overcome this presumption – a difficult task under most circumstances, as courts are willing to "uphold even cursory investigations by boards."[13] And indeed, it was an insurmountable task for the Wyndham shareholder plaintiffs. The court held that the board acted reasonably, noting that before the board received the demand request, it had met 14 times to discuss the cyber breach, the board was given a presentation by Wyndham's general counsel on the situation at every quarterly board meeting, and the board's audit committee discussed the issue in at least 16 meetings. As a result, the board "had a firm grasp of Plaintiff's demand when it determined that pursuing it was not in the corporation's best interest."[14]

Nonetheless, the company faced significant legal fees defending the shareholder action, and a less reactive board might have faced liability. And it is not clear whether consumers, financial institutions or other injured parties will mount a class action against the company.

### Remedial Measures

A data-breached company not only faces the expense of complying with regulatory investigations and defending litigations, but also has to repair the leak. After the cyberattacks occurred, Wyndham initiated a series of security upgrades and hired an independent firm to review its security. Wyndham also required its franchisees execute an addendum to their franchise agreements that addressed cybersecurity. Such remedial measures can be costly.

### Lessons Learned

From the Wyndham case study, one can derive several lessons. Companies would be wise to heed these lessons learned to avoid the fate of companies like Wyndham, Target and Home Depot. While it may be nearly impossible to ensure that a data breach will never occur, companies should take all reasonable actions to prevent such a breach. And, if one occurs, companies should follow a response plan and prepare for the almost certain investigations and litigation.

## Lessons Learned from the Wyndham Cyber Breach

1 The importance of cooperation. Wyndham chose not to self-report, contested the formal order, declined settlement, and challenged the FTC's authority in court. This likely resulted in significant additional costs.

2 Data breaches are expensive. Even when the number of accounts hacked is relatively small, the costs – in time and money – of regulatory investigations and litigations can be high. Companies are better off investing in prophylactic security measures, rather than spending more in legal fees and settlements down the road.

3 A solid cyber defense program is essential to cybersecurity. The FTC's recommendations for structuring such programs[15] are significant, and they need to be supervised at the highest levels of the company. Today's directors should seek outside assistance in understanding the company's data security and compliance policies.

4 The need to reduce exposure with a formidable defense. Measures include publicizing the company's security program, limiting data collection/retention, and limiting third-party access, including employee access to personal information (it must be job-related). File-sharing programs are often entry points for hackers. The central tenet is deterrence.

5 Management must take a hands-on approach to breach incidents. The lesson from Wyndham is that derivative litigation may be averted if directors are both informed through regular board updates and engaged in remedial measures through dedicated committee oversight.

6 Have a comprehensive data breach response plan. Take immediate action to notify legal counsel and technical specialists and to comply with state notice requirements. Legal implication may extend to class actions. Home Depot reported 44 lawsuits,[16] and Target learned a similar lesson. Enforcement may come from the FTC as well as the FCC, the SEC and state attorneys general. To face this thicket, companies need strong legal and technical advice.

7 Review the company's insurance. Some D&O policies don't cover cyberattacks, though an exclusion may be more common. Exclusions are also common in general liability policies. If coverage is not available, directors and officers should ensure sufficient funding for data breach response.

To review footnotes for this article, visit: http://www.metrocorpcounsel.com/articles/31991/wyndham-case-study-cybersecurity-how-cost-relatively-small-breach-can-rival-major-h.

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sustainability themes. Then there are protocols, such as from the World Resources Institute, that cover specific issues like greenhouse gas emissions.

The board should start by asking management: what reporting requirements apply to our company, and what additional metrics or other sustainability information might we voluntarily choose to report? What is our story to investors, employees and stakeholders, and how are we going to tell it? From there, the company can make its own selection as to the most effective reporting framework to use.

While each framework is different, they all have similar goals in providing structure, comparability and a level of commonality – to enable an outside audience to look across different companies in similar industries and say, "Okay, I can see where this company currently stands and where it is on the overall journey." Sustainability is commonly envisioned as a journey.

***MCC: What other trends or emerging practices are you seeing from NACD members in the area of sustainability oversight?***

***Bew:*** We heard about one practice from a company with facilities in multiple locations globally. That board's dedicated sustainability committee asks management to report at the division level. Our member director told us that the board doesn't expect every business unit to perform at the same level on every metric or goal because each unit is dealing with very different conditions and operating environments. Therefore, the division-level goals should be customized to each unit's starting point. The board's consistent expectation is that each division should be making progress on its journey at an appropriate pace, and thus ensuring that the company, as a whole, is moving forward in the right direction.

Another common theme from boards active in this area is that sustainability and CSR have to tie into matters of strategic importance to the company. One director told us, "CSR isn't just about writing checks; it goes beyond philanthropy for philanthropy's sake. It's got to be about winning in the marketplace for the long term and keeping the company growing and profitable." Directors are saying, "We want to understand the link with strategy. It can't just be a feel-good exercise."

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***MCC: That's a powerful point. Maybe you could wrap up with more feedback from your members.***

***Bew:*** One of the directors we interviewed had a suggestion for boards who might be relatively new to sustainability oversight. A good starting point could be to choose one topic, such as supply chain and procurement, HR, community affairs or new product development. For the next board meeting, directors can ask management to present the sustainability questions and issues relevant to that topic and then discuss with the board how the company will define and measure success.

And here are some remarks that really sum it up, made by a director from a board whose sustainability charter talks about protecting the company's goodwill. We asked, "Why did the board decide to form a sustainability committee?" and the director said, "We see this as part of our fiduciary duty. Put simply, we want to leave the company in better condition than when we began our terms on the board."

In closing, I would like to invite MCC readers to access an executive summary of NACD's Oversight of Corporate Sustainability Activities Handbook at www.nacdonline.org/sustainability.