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Staff Accounting Bulletin 92: A Paradigmatic Shift in Disclosure Standards

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NOTES

STAFF ACCOUNTING BULLETIN 92: A PARADIGMATIC SHIFT IN DISCLOSURE STANDARDS

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Environmental regulations implemented by federal and state regulatory agencies over the past twenty-five years have dramatically altered corporate behavior.[1] In the corporate world,

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1. The federal environmental regulatory framework imposes various effluent, emission, release limitations, record keeping, monitoring, and reporting requirements under various statutes including the Clean Air Act ("CAA"), Pub. L. No. 101-549, 104 Stat. 2399 (codified in scattered sections of 42 U.S.C. §§ 7401-7671 (1988 & Supp. V 1993)) (regulation of stationary and other sources of air pollution); the Clean Water Act ("CWA"), 33 U.S.C. §§ 1251-1387 (1988 & Supp. V 1993) (regulation of pollutant discharges into the waters of the United States from "point sources" and of discharge of dredged or fill materials into navigable waters, and reporting requirements); the Resource Conservation and Recovery Act of 1976 ("RCRA"), 42 U.S.C. §§ 6901-6992 (1988 & Supp. V 1993) (regulation of owners and operators of hazardous waste treatment, storage, and disposal facilities as well as generators and transporters of hazardous waste); the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), 42 U.S.C. §§ 9601-9675 (1988 & Supp. V 1993), *as amended by* Superfund Amendments and Reauthorization Act of 1986 ("SARA"), 42 U.S.C. §§ 9621-9675 note 9675 (1988 & Supp. V 1993) (dealing with remediation related to releases and threatened releases of hazardous substances); the Emergency Planning and Community Right-to-Know Act ("EPCRA"), 42 U.S.C. §§ 11,001-11,049 (1988 & Supp. V 1993) (requiring emergency planning and reporting by owners and operators of facilities that use, store or manufacture hazardous chemicals); and the Toxic Substances Control Act ("TSCA"), 15 U.S.C. §§ 2601-2692 (1994)(regulation of manufacturers, processors, and distributors of chemical substances and mixtures). *See generally* James G. Archer et al., *SEC Reporting of Environmental Liabilities*, 20 Envtl. L. Rep. (Envtl. L. Inst.) 10,105 (Mar. 1990).

the penalties imposed for non-compliance with these regulations[2] can have a material impact on a company's operations and, ultimately, its profitability.[3] Perhaps the most potent weapon the United States Environmental Protection Agency ("EPA") wields is the Comprehensive Environmental Response, Compensation and Liability Act of 1980,[4] which courts have consistently held to impose strict, and retroactive, as well as, joint and several liability on parties to clean up inactive waste sites.[5] A recent study estimated that the nationwide aggregate cost to all corporations subject to Superfund site remediation exceeds over $750 billion.[6]

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2. Penalties for non-compliance with environmental statutes can be substantial. They include administrative enforcement actions, civil enforcement penalties, criminal penalties, and injunctive relief. Some of the larger penalties include RCRA, 42 U.S.C. §§ 6928(a)(3),(c) (1988) (subjecting a violator to a compliance order or civil action for injunctive or civil penalties of $25,000 per day and suspension or revocation of permit); CWA, 33 U.S.C. § 1319(g)(2)(B) (1988) (subjecting a violator to possible fines of up to $10,000 per day not to exceed $125,000); and EPCRA, 42 U.S.C. § 11,045(b) (1988) (subjecting violators to penalties of not more than $25,000 per violation per day for violations of emergency notification and reporting requirements, increasing to $75,000 per day for second and subsequent violations).

3. Recent examples of costly penalties for the violation of environmental statutes include the following: Allied-Signal Inc. "expect[ed] actual environmental outlays of thirty million to forty million in [1989 and 1990]" and this did not include 100 sites that may result in unstated future liabilities; Bofors Nobel Inc. was forced to liquidate because the clean-up cost at a single plant site was $60 million, more than twice its annual sales; Bethlehem Steel will spend approximately $92 million over five years for new controls on air emissions for its Sparrows Point, Maryland coke ovens pursuant to an administrative consent order; Rockwell International told its shareholders that it faced as much as $130 million in liability for environmental cleanups in anticipation of SEC enforcement of Staff Accounting Bulletin 92 ("SAB 92"); Exxon reserved $850 million in quarterly earnings to finance clean up of oil from the Exxon Valdez spill, reducing its second quarter of fiscal 1989 earnings from $1.01 billion to $160 million. Amal K. Naj, *See No Evil: Can $100 Billion Have "No Material Effect" on Balance Sheets?*, WALL ST. J., May 11, 1988, at A1.

4. 42 U.S.C. §§ 9601-9675.

5. *See, e.g.*, United States v. Monsanto Co., 858 F.2d 160 (4th Cir. 1988), *cert. denied*, 490 U.S. 1106 (1989); New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985); United States v. Bliss, 667 F. Supp. 1298 (E.D. Mo. 1987); United States v. Chem-Dyne Corp., 572 F. Supp. 802 (S.D. Ohio 1983).

6. *Roberts Predicts Widespread Concern With Disclosing Environmental*

The astronomical cost of environmental remediation has alarmed the Securities and Exchange Commission ("SEC").[7] As authorized by the Securities Exchange Act of 1934 ("the Exchange Act"),[8] the SEC promulgates rules governing corporate disclosures.[9] Only in the last twenty-five years has the SEC focused on the need for environmental liability disclosures ("ELDs").[10] The growing number of "ethical investors," individuals and institutions seeking to merge investment decisions with moral principles, has heightened the need for environmental liability disclosures by United States corporations.[11]

The SEC has sought to balance the needs of ethical investors against the burden placed upon corporations in two ways.[12] First,

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Liabilities, 25 Sec. Reg. & L. Rep. (BNA) 1620 (Dec. 3, 1993). In an address to the Environment, Energy, and Natural Resources Section of the District of Columbia Bar, SEC Commissioner Richard Roberts said that a majority of estimated cleanup costs, amounting to as high as $750 billion, had yet to be reflected in corporate financial statements. *Id.*

7. *Id.* Roberts told the Bar that the "vigorous enforcement of environmental laws likely to occur in the decade to come have made [concerns of] environmental liability of grow[in] prominence . . . ." *Id.*

8. 15 U.S.C. §§ 78a-78*ll* (1994).

9. *Id.* §§ 77g, 77j(c). These sections require disclosure of such other information "as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors." *Id.* The SEC's general regulatory power is provided in § 19(a) of the Securities Act of 1933 ("the Securities Act"), which authorizes the Securities and Exchange Commission to promulgate such rules "as may be necessary to carry out the provisions of this subchapter. . . . " *Id.* § 77s(a). Section 23(a) of the Securities Act grants the SEC power "as may be necessary to implement the provisions of this chapter for which [it is] responsible or for the execution of the functions vested in [it] by this chapter. . . . " *Id.* § 78w(a). In addition, the Securities Act gives the SEC rulemaking authority. *Id.* Section 12(b) provides that the SEC may require in securities registration applications such information respecting the issuer's organization, financial structure, nature of business, and financial statements as it deems "necessary or appropriate in the public interest or for the protection of investors. . . . " *Id.* § 78l(b)(1).

10. *See infra* part I; Natural Resources Defense Council v. SEC, 606 F.2d 1031, 1036-37 (D.C. Cir. 1979) [hereinafter *NRDC III*]; Natural Resources Defense Council v. SEC, 389 F. Supp. 689, 692-93 (D.D.C. 1974) [hereinafter *NRDC I*].

11. *NRDC I*, 389 F. Supp. at 693, *aff'd*, 432 F. Supp. 1190 (D.D.C. 1977) [hereinafter *NRDC II*], *rev'd*, *NRDC III*, 606 F.2d 1031.

12. For over twenty years, "the SEC has attempted to clarify the extent of the

the SEC has attempted to enforce ELD regulations via Rule 10b-5.[13] Secondly, the SEC has increased disclosure requirements to encourage corporate adoption of more responsible environmental policies.[14] An early result of the SEC's attempt to balance conflicting needs was Securities Act Release Number 5170, which mandates the disclosure of current environmental compliance costs.[15]

Inconsistencies within or inadequacies of company disclosures of environmental liabilities revealed by subsequent media attention, however, soon made it apparent that clarification of ELD requirements was necessary.[16] The SEC attempted to meet this need in a variety of ways. Two prominent examples are the SEC Forms 10-K (annual) and 10-Q (quarterly) reporting require-

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ethical investor interest in environmental disclosure." Elizabeth A. Glass Geltman, *The Pendulum Swings Back: Why the SEC Should Rethink Its Policies on Disclosure of Environmental Liabilities*, 5 VILL. ENVTL. L.J. 323, 325 (1994).

13. 17 C.F.R. § 240.10b-5 (1995) [hereinafter "Rule 10b-5"]. The Rule provides:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

14. *See, e.g.*, Adoption of Amendments, Securities Exchange Act Release No. 10,116, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,342 (Apr. 20, 1973) [hereinafter "Release 10,116"]; Disclosures Pertaining to Matters Involving the Environment and Civil Rights, Securities Exchange Act Release No. 9252, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,150 (July 19, 1971) [hereinafter "Release 9252"]. The above-referenced releases will be discussed *infra* Part I.

15. Disclosures Pertaining to Matters Involving the Environment and Civil Rights, Securities Exchange Act Release No. 5170, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,150 (July 19, 1971). The SEC defined current environmental compliance costs as consisting of "material compliance costs" and "legal proceedings." *Id.*

16. Glass Geltman, *supra* note 12, at 326-27 & n.18.

ments.[17] Failure to make necessary, complete and accurate disclosure on these forms can result in civil and criminal liability under federal securities laws.[18] In theory, the reporting rules required concise disclosure of liability data.[19] In practice, however, the scope of "necessary, complete and accurate"[20] disclosure remained ambiguous, resulting in excessive burdens upon reporting companies and, paradoxically, in decreased ELD quality.[21] The

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17. 17 C.F.R. §§ 240.13a-13 (1995). It states in relevant part:

> [e]xcept as provided in paragraphs (b) and (c) of this section, every issuer that has securities registered pursuant to section 12 of the Act and is required to file annual reports pursuant to section 13 of the Act, and has filed or intends to file such reports on Form 10-K and Form 10-KSB (§249.310 of this chapter) or U5S (§259.5s of this chapter) shall file a quarterly report on Form 10-Q and Form 10-QSB (§249.308a of this chapter) within the period specified in General Instruction A.1. to that form for each of the first three quarters of each fiscal year of the issuer, commencing with the first fiscal quarter following the most recent fiscal year for which full financial statements were included in the registration statement . . . .

Id.

18. *See generally* Archer et. al., *supra* note 1; *see infra*, part I.

19. *See* 15 U.S.C. § 78m. Section 78 states in relevant part:

> (a) [e]very issuer of a security registered pursuant to section 781 of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security—
>
> > (1) such information and documents (and such copies thereof) as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration statement filed pursuant to section 781 of this title. . . .
> >
> > (2) such annual reports (and such copies thereof), certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (and such copies thereof), as the Commission may prescribe.

Id.

20. *Id.* § 77g.

21. *See* Glass Geltman, *supra* note 12, at 329. While reporting requirements increased, the confusion generated by many of the releases resulted in incomplete or inaccurate disclosures. *Id.* at 331.

release of Staff Accounting Bulletin Number 92 ("SAB 92"),[22] is the most recent attempt by the SEC to curtail ELD shortcomings.[23] SAB 92 clarifies accounting principles at the heart of the full disclosure philosophy of federal securities laws.[24]

This Note examines the SEC's effort to balance ethical investors' needs against excessive corporate reporting requirements under SAB 92. Part I of this Note examines past SEC attempts to compel compliance with corporate environmental disclosure obligations. Part II traces the evolution of Rule 10b-5 case law and how it can be applied to a claim that a registrant should disclose its non-compliance with environmental laws. Part III describes SAB 92 and its projected impact upon investors and companies. This Note concludes by asserting that SAB 92 will encourage responsible corporate disclosure of environmental liabilities, will lead to better-informed investors, and in the long run, will benefit both investors and disclosing corporations.

I. A HISTORY OF PRE-SAB 92 ENVIRONMENTAL DISCLOSURE REQUIREMENTS

Federal securities laws consist of six separate statutes and corresponding implementing regulations enacted between 1933 and 1940.[25] The Congress enacted these laws primarily to serve two

22. 58 Fed. Reg. 32,843 (1993).

23. Glass Geltman, *supra* note 12, at 361-63. Currently, the SEC is "sharing data with the EPA and has vowed to increase enforcement for failure to disclose contingent environmental liabilities." *Id.* at 362.

24. *Id.* at 362-63. The goal of SAB 92 is to promote recognition and disclosure of environmental liabilities through stricter accounting guidelines. *Id.* SAB 92 provides a clear indication that S-K corporation disclosure and accounting of environmental loss contingencies will be subject to stricter standards for timely and comprehensive disclosure of environmental liabilities. *Id.* at 367. *See* Casey Bukro, *Facing Costs of Cleanup; SEC Tells Firms to Book Liability*, CHI. TRIB., Feb. 7, 1994, at A1.

25. The six acts are: the Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (1994); the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78*ll* (1994); the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79–79z(6) (1994); the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–77bbb (1994); the Investment Company Act of 1940, 15 U.S.C. §§ 80a(1)–80a(64) (1994); and the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b(1)–80b(21) (1994). *See* Elizabeth A. Glass Geltman, *Disclosure of Contingent Environmental Liabilities by*

distinct goals: (1) to allow for intelligent investment decisions by requiring sufficient disclosure of information, and (2) to control fraud and market manipulation in securities trading.[26] The Congress imposed disclosure obligations upon issuers of publicly-traded securities under the Securities Act[27] and the Exchange Act.[28] The legislative philosophy underlying the Exchange Act was to ensure honest markets through public scrutiny.[29] Accordingly, the Exchange Act established reporting requirements for publicly held companies.[30]

In the early 1970s, an increasingly concerned public focused its attention on the lack of company disclosure regarding environmental liabilities.[31] Companies faced liability and compliance obligations under federal environmental laws and regulations as well as under traditional common law principles.[32]

Public Companies Under the Federal Securities Laws, 16 HARV. ENVTL. L. REV. 129, 129 (1992).

26. Glass Geltman, *supra* note 12, at 330 (citing SEC v. Southwest Coal & Energy Co., 624 F.2d 1312, 1318 (5th Cir. 1980)).

27. 15 U.S.C. §§ 77a–77aa (1988). The Securities Act regulates public offerings.

28. *Id.* §§ 78a–78*ll* (1988). The Exchange Act governs periodic and annual reporting by public companies.

29. Basic Inc. v. Levinson, 485 U.S. 224, 230 (citing S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934)); Glass Geltman, *supra* note 12, at 331 n.42 (citing S. REP. NO. 792, 73d Cong., 2d Sess. 1-5 (1934) and H.R. REP. NO. 1383, 73d Cong., 2d Sess. 11 (1934)).

30. For instance, corporations registered under Section 12 of the Exchange Act must file periodic reports disclosing certain categories of material events and financial conditions. 15 U.S.C. § 781 (1994).

31. In a message to the Congress, President Nixon stated, "[a]s concern with the condition of our physical environment has intensified, it has become increasingly clear that we need to know more about the environment. [T]he present government structure for dealing with environmental pollution often defies effective and concerted action." Reorg. Plan No. 3 of 1970, 35 Fed. Reg. 15,623 (1970).

32. Philip B. Schwartz, *Disclosure Requirements for Environmental Liabilities Under Federal Securities Law*, at 295, 298 (ALI-ABA Course of Study Materials, No. C903, Feb. 24, 1994). Liability under common law often resulted in "toxic tort" litigation. *Id.* Significant federal environmental laws affecting public company disclosure include: CERCLA, 42 U.S.C. §§ 9601–9675 (1988 & Supp. V 1993); RCRA, 42 U.S.C. §§ 6901–6992 (1988 & Supp. V 1993); CAA, 42 U.S.C. §§ 7401–7671 (1988 & Supp. V 1993); CWA, 33 U.S.C. §§ 1251–1387

A. *A History of SEC Interpretive Releases*

Following the passage of the National Environmental Policy Act of 1969 ("NEPA"),[33] the SEC issued an interpretive release[34] alerting businesses that SEC regulations mandate the reporting of current environmental compliance costs.[35] The SEC also warned of forthcoming legal proceedings against non-complying companies.[36] Inconsistent and sporadic reporting in response to Release No. 9252 led the SEC to issue a superseding release in 1973.[37] Release No. 10,116 underscored key elements of Release No. 9252: the reporting of legal proceedings and costs arising from material compliance.[38] In addition, Release No. 10,116 expanded

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(1988 & Supp. V 1993); TSCA, 15 U.S.C. §§ 2601-2692 (1994).

33. 42 U.S.C. §§ 4321-4370 (1988 & Supp. III 1991). NEPA mandates that the federal government use "all practicable means and measures" to protect environmental values when administering federal programs. *Id.* § 4331(a). *See also* Exec. Order No. 12,114, 3 C.F.R. 356 (1980), *reprinted in* 42 U.S.C. § 4321 (1988) (establishing that "the Department of State and Council on Environmental Quality, in collaboration with other interested Federal agencies and other nations," shall exchange information concerning the environment in order to heighten international awareness of environmental concerns).

34. Release 9252, *supra* note 14.

35. The SEC examined five environmental disclosure alternatives that were proposed in its public proceeding: (1) comprehensive disclosure of the environmental effects of corporate activities; (2) disclosure of corporate noncompliance with applicable environmental standards; (3) disclosure of all pending environmental litigation; (4) disclosure of general corporate environmental policy; and (5) disclosure of all capital expenditures and expenses for environmental purposes. The SEC rejected alternatives (1), (3), (4), and (5), but decided to adopt alternative (2). 40 Fed. Reg. at 51,662. The SEC required that companies report compliance costs under statutory requirements when compliance "may necessitate significant capital outlays, may materially affect the earning power of the business, or cause material changes in registrant's business done or intended to be done." Release 9252, *supra* note 14, at 80,488.

36. Release 9252, *supra* note 14. The SEC further requested that registrants furnish supplemental information on any proceedings omitted from disclosure on the ground that it is not material. *Id.*

37. Release 10,116, *supra* note 14. The SEC sought "more meaningful disclosure of certain items pertaining to business and litigation, and particularly as to the effect upon the issuer's business of compliance with Federal, State and local laws and regulations relating to the protection of the environment." *Id.* at 83,029.

38. Release 10,116, *supra* note 14.

registrants' disclosure obligations to include disclosure of present and future compliance costs,[39] as well as all administrative or judicial proceedings initiated by a governmental authority, regardless of materiality.[40] Release No. 10,116 indicated that administrative or judicial proceedings regulating materials discharged into the environment could not be treated as ordinary litigation incidental to company business.[41] As a result, these proceedings had to be reported.[42] More importantly, proceedings involving governmental entities, regardless of their significance, were deemed material.[43]

Release No. 10,116 set the materiality threshold for these claims at ten percent of the assets of reporting companies and their subsidiaries, on a consolidated basis.[44] The release allowed reporting companies to group together similar proceedings if they were material in the aggregate (with the exception of proceedings involving governmental entities).[45] Multiple proceedings involving potential aggregate claims for damages exceeding ten percent of a reporting company's current assets had to be individually described.[46]

Following Release 10,116 in 1973, public interest organizations brought action in an attempt to compel the SEC to promulgate even more stringent ELD rules.[47] These groups sought a rule requiring every Section 12 company[48] to disclose the entire effect of its

39. *Id.*

40. *Id.* This disclosure requirement extended broadly to all "material legal proceedings 'known to be contemplated by governmental authorities.'" Compliance with Environmental Requirements, Securities Exchange Act Release No. 34-10,116 and 33-5386, Fed. Sec. L. Rep. (CCH) ¶ 23,507A(II)(A) (Apr. 20, 1973).

41. Environmental Disclosure Requirements, Securities Exchange Act Release No. 33-6130 and 34-16,224, Fed. Sec. L. Rep. (CCH) ¶ 23,507B(B)(1) (Sept. 27, 1979).

42. *Id.* at 23,507B(B)(2).

43. *Id.* The SEC specifically recognized in its release that its description of proceedings required to be disclosed was very broad. *Id.*

44. This disclosure requirement extended broadly to all "material legal proceedings 'known to be contemplated by governmental authorities.'" Compliance with Environmental Requirements, Securities Exchange Act Release No. 34-10,116 and 33-5386, *supra* note 40, at 23,507A(II)(C)-(D).

45. *Id.* at 23,507A(II)(E)(D).

46. *Id.*

47. *NRDC I*, 389 F. Supp. 689, 696 (D.D.C. 1974).

48. Section 12 of the Exchange Act, 15 U.S.C. § 78(l)(g), states in relevant

corporate activities on the environment.[49] The public interest groups argued that existing corporate environmental disclosure requirements were insufficient to provide investors with the necessary information required to make "socially responsible" and financially sound investment decisions.[50]

These judicial proceedings, while ultimately unsuccessful,[51] led the SEC to undertake further rule-making and to refine its existing environmental disclosure policies.[52] In 1976, the SEC added the

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part:

> (1) every issuer which is engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce . . .
>
> (2) the provisions of this subsection shall not apply in respect of—
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> (A) any security listed and registered on a national securities exchange.
>
> (B) any security issued by an investment company registered pursuant to section 80a-8 of this title . . .
>
> (G) any security issued by an insurance company . . . .

Id.

49. *NRDC I*, 389 F. Supp. at 692.

50. *Id.* at 694. Plaintiffs also argued that insufficient disclosure requirements stymied the mandate of NEPA to interpret the securities laws to the fullest extent possible in accordance with the environmental policy adopted in NEPA. *Id.*

51. The Court of Appeals for the District of Columbia held that "[a]lthough Congress in NEPA, made environmental considerations part of the SEC's substantive mission, we do not believe that NEPA goes so far as to *require* the SEC to promulgate specific rules." *NRDC III*, 606 F.2d 1031, 1045 (D.C. Cir. 1979).

52. Notice of Commission Conclusions and Final Action on the Rulemaking Proposals Announced in Securities Exchange Act Release No. 5627 (Oct. 14, 1975) Relating to Environmental Disclosure, Securities Exchange Act Release No. 12,414 [1975–76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,495 (May 6, 1976) [hereinafter "Release 12,414"]. The SEC stated that:

> [b]y requiring a description of all [governmental] litigation, regardless of whether the amount of money involved is itself material, the [SEC] believes it has given recognition to both the importance of the national environmental policy and to the far-reaching effects, both financial and environmental, of violations of environmental laws. Further, the fact that legal action, both pending and known to be contemplated, must be disclosed serves to foreshadow potentially serious environmental problems facing [companies].

requirement that reporting companies must "disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year, the succeeding fiscal year, and such further periods as deemed material."[53]

In 1979, the SEC issued a subsequent interpretive release that elaborated its existing environmental disclosure requirements.[54] The release was a three-pronged attempt by the SEC to disseminate its policies with respect to environmental disclosure.[55] In addressing these issues, the SEC stressed that specific environmental disclosure rules were to be construed liberally.[56]

First, the SEC determined that the disclosure obligation "is triggered whenever governmental authority is a party to any adminis-

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Id.; *see* Glass Geltman, *supra* note 12, at 341.

53. Release 12,414, *supra* note 52. In the same release, the SEC admonished reporting companies to disclose Notices of Violation in the nature of cease and desist orders issued by the EPA. *Id.*

54. Environmental Disclosure Requirements, Securities Exchange Act Release No. 16,224, Fed. Sec. L. Rep. (CCH) ¶ 23,507(B) (Sept. 27, 1979). This release was part of a settlement order, issued on the same day as the release, entered into between the SEC and United States Steel Corporation ("USSC"). In the Matter of United States Steel Corp., Securities Exchange Act Release No. 16,223 [1979–1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,319 (Sept. 27, 1979).

In *United States Steel Corp.*, the dependent corporation failed to report estimates of material capital expenditures beyond the subsequent two to three years as required. *Id.* at ¶ 82,334. Additionally, USSC failed to disclose other pending environmental proceedings and administrative orders. *Id.* Finally, USSC failed to disclose any Notices of Violation or less formal communications indicating that government authorities were considering an environmental enforcement action that would have required material capital expenditures. *Id.*

55. In the Matter of United States Steel Corp., Securities Exchange Act Release No. 16,223, *supra* note 54, at 82,383. The release addressed the following issues:

> (i) when must a corporation disclose, in addition to its planned environmental expenditures for the next two fiscal years, the total costs of compliance with environmental statutes;
> (ii) what disclosures must be made concerning administrative proceedings involving environmental matters that are contemplated by governmental authorities and what is an administrative proceeding; and
> (iii) when is a company required to disclose its policies concerning, or approach toward, compliance with environmental laws.

Id.

56. *Id.*

trative proceeding."[57] In other words, whenever a registrant is involved with an administrative proceeding, it must disclose whether in fact it or the government initiated the proceeding. Second, the SEC addressed types of administrative proceedings which result in required disclosure, limiting them to those proceedings which entail environmental matters.[58]

The final issue addressed in the 1979 release concerned the circumstances under which public companies must disclose their policies or approaches concerning environmental compliance.[59] The SEC did not require corporations to disclose their general environmental policy, because such a requirement "would result in subjective disclosures, largely incapable of verification."[60] Notwithstanding, the SEC mandated the disclosure of environmental policy in two instances. First, whenever corporations make voluntary disclosures of environmental policies, those disclosures must be both accurate and sufficient so as to prevent misleading disclosures.[61] Secondly, if a public corporation has an environmental policy

> which is reasonably likely to result in substantial fines, penalties, or other significant effects on the corporation, it may be necessary for the registrant to disclose the likelihood and magnitude of such fines, penalties, and other material effects in order to prevent from being misleading required disclosures with respect to such matters as descriptions of the corporation's business, financial statements . . . , capital expenditures for environmental compliance or legal proceedings.[62]

After administering these guidelines for environmental disclosure for several years, the SEC began to question its departure from the traditional economic materiality standard, as well as its disclosure requirement for all environmental proceedings involving a governmental authority regardless of the proceeding's nature or magnitude.[63] These expansive disclosure requirements resulted in filings

57. *Id.* at 82,383.
58. *Id.* at 82,384.
59. *Id.*
60. *Id.* at 82,384.
61. *Id.*
62. *Id.*
63. *See* Stephen W. Hamilton, *Environmental Disclosure Requirements of the Securities Exchange Commission, in* ENVIRONMENTAL AUDITING HANDBOOK: A

of many economically inconsequential environmental events, and tended to obscure more significant environmental matters.[64] While the SEC never agreed to revert entirely to a traditional materiality standard for environmental disclosures, in 1982 the Commission adopted a compromise approach as part of its integrated disclosure system embodied in Regulation S–K.[65]

B. *Integration of Environmental Disclosure Requirements Under Regulation S-K*

SEC Regulation S-K, one of the most important disclosure requirement regulations, requires all publicly held companies to make disclosures relating to potential environmental liability under federal, state, or local laws.[66] In 1982, the SEC adopted Regulation S–K as part of a system of disclosure regulations designed to integrate and simplify the numerous and complicated disclosures required under the Exchange Act and the Securities Act.[67] The integrated disclosure system was intended to revise or eliminate overlapping or unnecessary disclosure and dissemination requirements.[68] In particular, Regulation S–K governs disclosure requirements for public companies.[69] Ultimately, Regulation S–K was intended to reduce the burdens on registrants while at the same time ensuring that security holders, investors, and the marketplace

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GUIDE TO CORPORATE AND ENVIRONMENTAL RISK MANAGEMENT 2–109, 2-109 to 2-110 (1995).

64. *Id.*

65. Regulation S-K, 17 C.F.R. § 229 (1991).

66. *Id.*

67. Adoption of Integrated Disclosure System, Securities Exchange Act Release No. 33-6383, SEC Docket No. 1262 (Mar. 3, 1982) (codified as 17 C.F.R. § 229 (1991)).

68. *Id.*

69. *Id.* Regulation S-K states in pertinent part:

> A publicly held company is defined under the federal securities law as including (1) a company which has securities listed on a national securities exchange, (2) a company with total assets exceeding $1 million and 500 or more stockholders, or (3) a company whose registration statement became effective under the 1933 Act and which has 300 or more stockholders.

Id.

were provided with meaningful information upon which to base investment decisions.[70] To achieve this goal in the environmental arena, the SEC set out two specific rules under Regulation S-K which directly govern environmental reporting requirements: Item 101 and Item 103.[71]

1. Item 101 Disclosure

The first express reference to environmental disclosure is contained in Item 101 of Regulation S-K, which specifically requires disclosure

> [of] the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries.[72]

The registrant must also disclose "any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material."[73] This provision essentially codified the rules adopted by the SEC in its 1979 release.[74]

2. Item 103 Disclosure

The second express reference to environmental disclosure is contained in Item 103 of Regulation S-K, which requires a description of "any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their proper-

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70. *Id.*

71. Regulation S-K, Item 101, ¶ (c)(1)(xii), 17 C.F.R. § 229.101 (1991) [hereinafter "Item 101"]; Regulation S-K, Item 103, Instruction 5, 17 C.F.R. § 229.103 (1991) [hereinafter "Item 103"].

72. Item 101, *supra* note 71.

73. *Id.*

74. *See* Environmental Disclosure Requirements, Securities Exchange Act Release No. 33-6130 and 34-1622, Fed. Sec. L. Rep. (CCH) ¶ 23,507B (Sept. 27, 1979).

ty is the subject."[75] Item 103 modified prior disclosure requirements by establishing objective thresholds for disclosing environmental proceedings including those in which the government is seeking "monetary sanction."[76]

The question of what constitutes a "sanction" remains the subject of much debate.[77] In a 1989 no-action letter, the SEC took the position that "costs incurred pursuant to a remedial agreement entered into in the normal course of negotiation with the EPA will not be viewed as a sanction."[78] The SEC staff pointed out, however, that although these costs may not be reportable as "sanctions," they may be reportable under Item 101 or Item 103, if it is reasonably likely that these costs will be material.[79]

The SEC also has taken the position that "designation as a potentially responsible party (PRP) under CERCLA does not in and of itself trigger disclosure under Item 103 because PRP status alone does not provide knowledge that a governmental agency is contemplating a proceeding."[80] It is worthwhile to note, however, that this SEC release added that a reporting company's "particular circumstances," in combination with PRP status, may provide knowledge of a contemplated proceeding.[81]

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75. 17 C.F.R. § 229.103 (1991).

76. Specifically, Item 103 requires disclosure of environmental proceedings when (1) the proceeding (whether governmental or not) is material to the business or financial condition of the company; (2) the proceeding involves a potential monetary loss exceeding ten percent of current assets of the company; or (3) the proceeding is brought by the government seeking a monetary sanction, unless the company reasonably believes that the proceeding will result in fines of less than $100,000. *Id.*

77. Mary O. Hylton, *Socially Responsible Investing: Doing Good Versus Doing Well in an Inefficient Market*, 42 AM. U. L. REV. 1, 2 (1992); John Holusha, *Environmentalists Assess Corporate Pollution Records*, N.Y. TIMES, Dec. 9, 1991, at D1; Barbara Benham, *SEC Intensifies Focus on Review of Firms Environmental Liability*, INVESTORS DAILY, Sept. 24, 1990, at 28; Glass Geltman, *supra* note 12, at 339.

78. Sidley & Austin, SEC No-Action Letters, Fed. Sec. L. Rep. (CCH) ¶ 78,962 (Mar. 29, 1989).

79. *Id.* at 78,815.

80. Management's Discussion and Analysis of Financial Condition and Results of Operations: Certain Investment Company Disclosure, Securities Exchange Act Release No. 26,831, Fed. Sec. L. Rep. (CCH) ¶ 62,844 n.17 (June 7, 1989).

81. *Id.*

Questions such as what constitutes a sanction, what is material, and what the appropriate scope is for disclosure of environmental liabilities have, not surprisingly, resulted in legal battles. Neither the SEC regulations nor releases discussed previously provide a private right of action. Accordingly, much of the litigation surrounding ELD's has taken place under Rule 10b-5.[82]

II. RULE 10B–5 CASE LAW

A primary purpose of the federal securities laws is to promote disclosure of the nature and quality of securities to investors.[83] Prior to the enactment of comprehensive environmental legislation, federal securities laws did not expressly provide guidance for the disclosure of contingent environmental liabilities. The Exchange Act prohibited public registrants from making fraudulent statements or from omitting material facts.[84] Accordingly, in certain instances, public registrants that failed to adequately disclose contingent environmental liabilities were subject to liability under the Securities Laws.

Once the necessary elements of a Rule 10b–5[85] cause of action are established, parties may be held liable for misrepresentation or omission of a material fact.[86] Over the years, a body of case law has defined the scope of Rule 10b–5 and, in the process, has created a potentially effective weapon for private as well as public enforcement of environmental disclosure standards.[87] Although appli-

82. Rule 10b-5, *supra* note 13.

83. *See generally* Isquith v. Middle South Utilities, Inc., 847 F.2d 186 (5th Cir. 1988); Lipton v. Documation, Inc., 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985); *In re* LTV Securities Litigation, 88 F.R.D. 134, 144 (N.D. Tex. 1980).

84. 15 U.S.C. §§ 78a-78*ll*.

85. Rule 10b-5, *supra* note 13. Rule 10b-5 sets out the following necessary elements for a private cause of action: (1) a material misrepresentation, omission, deception, or manipulation; (2) scienter; (3) intent to deceive, manipulate, or defraud the plaintiff; and (4) causation. *Id.*

86. *See, e.g.*, Aaron v. SEC, 446 U.S. 680 (1980); Chiarella v. United States, 445 U.S. 222, 235 (1980) (The Supreme Court stated that parties may be held liable for misrepresenting or omitting a material fact.); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033 (7th Cir. 1977); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974); SEC v. Musella, 578 F. Supp. 425 (S.D.N.Y. 1984).

87. *See generally* Perry E. Wallace, *Disclosure of Environmental Liabilities*

cation of Rule 10b-5 to securities disclosure issues has fueled great debate among commentators, there have been very few SEC administrative proceedings or cases concerning the enforcement of the environmental disclosure requirements.[88] Thus, the courts have only begun to develop clear standards for determining when a corporation may be liable for securities fraud based upon its failure to disclose environmental liabilities.[89]

A. *Evolution of 10b-5 Case Law*

In *Kardon v. National Gypsum Co.*, the Eastern District Court of Pennsylvania held that Rule 10b–5 afforded injured parties an implied private right of action.[90] The court in *Kardon* also pronounced that instances of securities fraud involving private as well as public companies may be included in the scope of Rule 10b–5.[91] Following the *Kardon* decision, private litigants employed Rule 10b-5 to avail themselves of its expansive scope and jurisdictional advantages.[92] Beginning in the mid–1970s, however, the

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Under the Securities Laws: The Potential of Securities–Market–Based Incentives for Pollution Control, 50 WASH. & LEE L. REV. 1093 (1993); Note, *Recklessness and the Rule 10b-5 Scienter Standard After Hochfelder*, FORDHAM L. REV. 817 (1980); Elaine E. Bucklo, *The Supreme Court Attempts to Define Scienter Under Rule 10b-5: Ernst & Ernst v. Hochfelder*, 29 STAN. L. REV. 213 (1977).

88. *See, e.g., In re Occidental Petroleum Corp.*, Securities Exchange Act Release No. 16,950 [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) §§ 82,622, 83,347-348 (July 2, 1980). For a case interpreting the application of Rule 10b-5 to environmental disclosure, see Levine v. NL Industries, 926 F.2d 199 (2d Cir. 1991) (holding no duty to disclose because registrant was not exposed to potential environmental liabilities). The use of Rule 10b-5 to enforce ELDs is discussed further *infra* part II.B.

89. *See* Note, *Environmental Disclosures and SEC Reporting Requirements*, 17 DEL. J. CORP. L. 483 (1992).

90. 73 F. Supp. 798, 800-02 (1947) (derivative action by shareholders to recover damages from officers for fraudulently conspiring to induce plaintiffs to sell their stock in two corporations for less than its true value).

91. *See generally Kardon*, 73 F. Supp. 798 (discussing the closely held corporation whose stock was at the source of the controversy).

92. *See, e.g.*, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970); St. Louis Union Trust Co. v. Merrill Lynch, Inc., 562 F.2d 1040 (8th Cir. 1977), *cert. denied*, 469 U.S. 925 (1978); Fridrich v. Bradford, 542 F.2d 307 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977); Schlick v. Penn-Dixie Cement Corp., 507

Supreme Court began a process of narrowing Rule 10b–5's applicability.[93] Its rationale for this shift was largely due to the "danger of vexatiousness" that accompanies litigation under Rule 10b–5.[94]

One common–law fraud element that has been incorporated into Rule 10b–5 actions is the concept of materiality. Because materiality, in some form or another, is often critical in deciding whether there is a duty to disclose under the securities laws, its precise definition is of great importance.[95] Simply put, materiality refers to that point at which information becomes so significant that it will be considered legally ripe for disclosure.[96]

In March 1988, the Supreme Court issued a unanimous decision in *Basic, Inc. v. Levinson*,[97] that adopted a general test for determining the materiality of merger negotiations in actions brought

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F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975).

93. *See* Santa Fe Indus. v. Green, 430 U.S. 462, 473-74 (1977) (expanding *Ernst & Ernst* by requiring that plaintiffs seeking redress under Rule 10b–5 must allege "manipulative or deceptive" facts or transactions); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193–94 n.12 (1976) (further limiting Rule 10b–5's scope by imposing a scienter requirement which was defined as a "mental state embracing intent to deceive, manipulate or defraud"); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 749 (1975) (holding that only plaintiffs who had purchased or sold the securities in question during the period of the alleged fraud could assert claims for damages based on Rule 10b–5); Lipton v. Documation, Inc., 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985); Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981), *cert. denied*, 594 U.S. 1102 (1983).

94. *Blue Chip Stamps*, 421 U.S. at 739-40. The Court feared that private litigants would take advantage of Rule 10b-5's permissive scope and force companies into endless litigation battles. *Id.*

95. *See generally* Andrew L. Merritt, *A Consistent Model of Loss Causation in Securities Fraud Litigation: Suiting the Remedy to the Wrong*, 66 TEX. L. REV. 469 (1988); Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 HARV. L. REV. 584 (1975); Note, *Reliance Under Rule 10b-5: Is the "Reasonable Investor" Reasonable?*, 72 COLUM. L. REV. 562 (1972).

96. *See, e.g.*, Flynn v. Bass Bros. Enterprises, Inc., 744 F.2d 978, 984 (3d Cir. 1984) ("[w]here a duty to speak exists, . . . federal securities law requires the disclosure of any material fact . . . ."). This quote emphasizes the importance of identifying when a person is under a duty to speak and what information is material and therefore must be included in the statement once the duty to speak has been triggered. *Id.*

97. 485 U.S. 224 (1988). Three justices — Rehnquist, Scalia and Kennedy — did not participate in the decision.

under Rule 10b–5. The test applied by the Court requires consideration of the "probability" that the merger will occur in the light of the potential "significance" or "magnitude" of the occurrence.[98] Although the test does not specifically deal with environmental disclosure, the Court's opinion provides important insight into the meaning and application of its test to the environmental arena.

In *Basic*, representatives from a competing firm, Combustion Engineering, initiated a series of meetings and conversations with the officers and directors of the defendant concerning the possibility of a merger in September 1976.[99] Over two years later, the discussions proved fruitful.[100] On December 18, 1978, Basic requested a trading halt from the New York Stock Exchange ("NYSE") and announced it had been approached by another company concerning a merger.[101] Prior to this announcement, Basic denied on numerous occasions that negotiations were taking place.[102] On December 20, Basic's board announced it had endorsed a tender offer by Combustion for all of Basic's outstanding common stock at forty-six dollars per share.[103]

Certain shareholders brought a class action against Basic and its board of directors for alleged violations of Rule 10b-5.[104] The shareholders had sold Basic stock, prior to the December 1978 announcement, under the impression that no merger negotiations were taking place.[105] Plaintiffs charged that three statements issued by Basic between October 21, 1977 and November 6, 1978 were false and misleading.[106] The district court certified the class

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98. *Id.* at 239-40. The Court remanded for a determination of whether summary judgment, which had been granted to the petitioners by the district court, was appropriate in light of this test. *Id.*

99. *Id.* at 227.

100. *Id.* at 227-28.

101. *Id.* at 228.

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.* The first statement, published on October 21, 1977, in a local newspaper denied that any negotiations for a merger were occurring. *Id.* The second statement, issued September 25, 1978, responding to a New York Stock Exchange request, denied any pending company merger. *Id.* The third statement, issued in the shareholder report on November 6, 1978, was a typical "no corpo-

action,[107] but granted summary judgment for the defendants, holding that as a matter of law the three statements at issue were not false or misleading since the corporate events preceding them were immaterial.[108]

The Court of Appeals for the Sixth Circuit affirmed the class certification but reversed the grant of summary judgment, finding that all three statements were misleading.[109] As to whether the statements were materially misleading, and thus actionable, the court held that a statement denying the existence of discussions renders otherwise immaterial discussions material because such other discussions cause the statement of denial to be "untrue."[110] This standard set by the Sixth Circuit was at odds with the materiality standard previously adopted by the Third and Seventh Circuits. Under the materiality standard in the Third and Seventh Circuits, merger discussions were not material until an "agreement-in-principle" had been reached.[111] Based on this conflict, the Supreme Court granted certiorari to decide the legal standard for determining the materiality threshold for merger discussions under Rule 10b-5.[112]

The petitioner, Basic, asked the Court to adopt the agreement-in-principle test followed by the Third and Seventh Cir-

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rate developments" statements. *Id. See also* Bruce A. Hiler, *Basic, Inc. v. Levinson: The Supreme Court's Opinion on Disclosure of Merger Discussions in Theory and Practice*, at 1051, 1052 (PLI Course Handbook Series No. 613, 1988).

107. *Basic*, 485 U.S. at 228 n.17.

108. *Id.* at 229; Levinson v. Basic, Inc., New Court Decisions, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,801, at 90,028, 90,042-044 (Aug. 3, 1984). The district court found that the events preceding the first statement were not even preliminary merger negotiations and that, in fact, "merger negotiations" occurred only beginning on December 15, 1978. *Id.* at 90,028.

109. Levinson v. Basic, Inc., 786 F.2d 741 (6th Cir. 1986).

110. *Id.* at 749.

111. *See* Flamm v. Eberstadt, 814 F.2d 1169, 1174 (7th Cir. 1987) (adopting agreement-in-principle test and requiring agreement on "price and structure"); Greenfield v. Heublein, Inc., 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985); Staffin v. Greenberg, 672 F.2d 1196, 1207 (3d Cir. 1982) (holding that the duty to disclose the existence of merger negotiations is triggered when agreement-in-principle is reached).

112. Basic, Inc. v. Levinson, 485 U.S. 224 (1988).

cuits.[113] Instead of following either the Sixth Circuit or the Third and Seventh Circuits' standards, the Court opted for the general standard enunciated in *TSC Industries, Inc. v. Northway*.[114] The *TSC Industries* standard is used to determine whether the omission of a fact from proxy materials is material and thereby violates Rule 14a–9 of the Exchange Act,[115] which prohibits false or misleading statements in a proxy contest.[116] In *TSC Industries*, the Court held that an omitted fact is material under Rule 14a–9, "if there [is] a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[117]

When the Court accepted this standard as the basis for judging the materiality of merger discussions under Rule 10b-5 in *Basic*, only an aberrational reading of *TSC Industries* could have allowed the adoption of the agreement–in–principle test.[118] Ultimately, the

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113. *Id.* at 232-33. Three policy arguments were advanced to support such a bright–line test: (1) earlier disclosure of necessarily uncertain merger discussions could mislead investors by fostering false optimism; (2) earlier disclosure could not adequately preserve the confidentiality in such discussions and may jeopardize the negotiations; and (3) the agreement–in–principle test provides certainty for management, which otherwise would be forced to make difficult disclosure judgments, often times subjecting it to enormous civil liability for inaccurate or incomplete disclosure. *Id.* at 233.

114. 426 U.S. 438 (1976).

115. 17 C.F.R. § 240.14a–9 (1995) [hereinafter "Rule 14a–9"].

116. Rule 14a–9 provides, in relevant part:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form or proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

Id.

117. *TSC Industries*, 426 U.S. at 449.

118. Hiler, *supra* note 106, at 1051. Because the *TSC Industries* standard of materiality is grounded on the reasonable investor's view of the total information, it would be stilted to claim that a reasonable investor would or could only be

TSC Industries standard hinges on the eyes of the "reasonable investor," without a doubt an investor-oriented standard.[119] This type of analysis requires fact-specific review of all the information available to determine whether the excluded information would significantly alter the reasonable investor's decision-making process. On its face, the rigid agreement-in-principle test advanced by the petitioner would not allow such a fact-sensitive analysis.[120]

The *Basic* Court's unequivocal acceptance of the rationale of *TSC Industries* allowed for easy disposal of the agreement-in-principle test. The reasonable investor test necessitates a case-by-case analysis of "the probability that the transaction will be consummated, and its significance to the issuer of the securities."[121] The role of the materiality requirement, however, is not to "'attribute to investors a child-like simplicity, an inability to grasp the probabilistic significance of negotiations' but to filter out" insignificant information that an investor would ultimately disregard in making an investment decision.[122] This language serves to underscore one of the foremost objectives of the securities regulatory system, that of

influenced at the point of "agreement-in-principle."

119. *TSC Industries*, 426 U.S. at 449. "The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor." *Id.* at 445.

120. *Id.* The *TSC Industries* standard adopted by the Court in *Basic* was based upon the policies of the Exchange Act to "protect investors against manipulation of stock prices," to promote "honest publicity" and "honest markets" and to implement the "full disclosure" policy of the Act. Basic, Inc. v. Levinson, 485 U.S. 224, 230 (1988). *See also* Hiler, *supra* note 106, at 1051.

121. *Basic*, 485 U.S. at 225. This test is virtually identical to the test outlined by the Second Circuit in the *Texas Gulf Sulphur* case, where it considered the materiality of a contingent event in the context of an insider trading scheme. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied sub. nom.* Coates v. SEC, 394 U.S. 976 (1969). The Second Circuit held that when dealing with future-oriented information, materiality requires a balancing of the "indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Id.* at 849; *see also* SEC v. Davis [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,696 (S.D. Ohio 1988) (*Basic* test requires a "balancing of the indicated probability that the merger will occur and the anticipated magnitude of the merger in light of the totality of the company activity.").

122. *Basic*, 485 U.S. at 234 (quoting Flamm v. Eberstandt, 814 F.2d 1169, 1175 (7th Cir. 1987)).

the fully knowledgeable investor.[123]

Given that environmental liabilities are usually "contingent or speculative in nature,"[124] the examination of the probability and the magnitude of the materiality appears to be particularly applicable to environmental disclosure cases. Environmental cases frequently involve assessing the probability of environmental harm as well as examining the magnitude of environmental liabilities and corresponding obligations.[125] The probability/magnitude test adopted in *Basic* enables Rule 10b–5 to be used as a weapon against securities fraud involving inadequate environmental disclosure. It further appears that the probability/magnitude test may require very little in the way of probability before merger discussions become material.[126] Thus, similarly, an environmental liability need not be exceedingly probable before materiality is triggered and disclosure required.

B. *Uses of Rule 10b-5 for Environmental Liability Disclosures*

At present a dearth of cases have invoked Rule 10b-5 for misleading statements made on environmental matters, but the material nature of environmental issues seems naturally inclined to yield fertile grounds for attack.[127] The leading case in the field is *Levine v. NL Industries*,[128] in which the plaintiff, Levine, brought a class action against NL Industries, Inc. ("NL"), a NYSE listed public company, alleging the defendant's violation of Rule 10b–5.[129] Levine claimed that NL failed to disclose in its SEC reports that its wholly owned subsidiary was operating in violation of state and federal environmental laws.[130] Consequently, NL was subject to significant liability.[131] Levine argued that NL had a du-

123. *See* Hiler, *supra* note 106, at 1054.

124. *Id.*

125. *See* Wallace, *supra* note 87, at 1118.

126. *See* Hiler, *supra* note 106, at 1057.

127. *Id.* at 1057-58.

128. 717 F. Supp. 252 (S.D.N.Y. 1989), *aff'd*, 926 F.2d 199 (2d Cir. 1991) (holding that because NL was indemnified for all expenses under its operating agreement with the Department of Energy, its failure to disclose environmental violations was immaterial).

129. *Id.* at 252.

130. *Id.* at 253.

131. *Id.* The NL subsidiary operated a uranium processing plant that was

ty to disclose the alleged failure to comply with environmental laws under the specific disclosure requirements relating to environmental matters and that the failure to disclose rendered other statements in NL's SEC filing misleading.[132] NL claimed that it made specific disclosures required on the Annual Form 10-K and that any omissions were immaterial.[133]

In granting NL's motion for summary judgment,[134] instead of applying Rule 10b-5 the court determined that neither of the S-K regulations, Item 101 nor Item 103, by their terms mandated disclosure that the NL subsidiary was operating the processing plant in violation of applicable laws.[135] The defendant's position in this case was bolstered substantially because it operated a government plant on a cost–reimbursement basis and the subsidiary was only a small part of NL's overall operations.[136] The court's reasoning

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owned by the Department of Energy ("DOE"). The subsidiary's performance of the contract with the DOE was guaranteed by NL. Revenues from the subsidiary's operations were never more than .2% of NL's annual gross revenue. Within the class period for this litigation, there was an accidental emission of uranium dust at the plant. Consequently, surrounding landowners and residents brought an action for damages. In addition, the state brought an action seeking costs, damages and penalties for alleged environmental violations. *Id.*

132. *Id.*

133. *Id.* at 254.

134. *Id.* at 253. The court characterized the action as a fraudulent omission claim. *Id.*

135. *Id.* at 254-55. Additionally, the court found an Item 101 disclosure inapplicable in NL's situation because its subsidiary's contract with the government provided for reimbursement of all expenses that the subsidiary would incur in complying with environmental laws. As a result, NL's capital expenditures or earning could not be materially affected by compliance with environmental laws. The court further found Item 101 inapplicable because it dealt with the effect that environmental compliance had on a company's capital expenditures, earning and competitive position, not the effect of the noncompliance. *Id.* at 255. Item 103 was inapplicable because it is only triggered upon a pending legal proceedings, which there was not at the time of the disclosures at issue. For a discussion of the S-K regulations, Item 101 and Item 103, see *supra* part I.

136. *Levine*, 717 F. Supp. at 255. While a subsidiary may only be a small part of the consolidated operations, the penalties and damages arising from non-compliance with environmental laws can very quickly become material, assuming that there is no government indemnification on a cost-reimbursement basis as there was in the case of NL. *Id.*

confirms the difficulty of stretching specific disclosure requirements to accommodate an attack on a generalized disclosure.[137]

Both the specific and implied disclosure requirements discussed above require a fact-intensive analysis of a particular matter before a company can determine if disclosure of an existing or potential environmental liability is required. The magnitude of a company's potential exposure from environmental matters, particularly under Superfund, will require companies making materiality determinations to focus carefully on the probability of environmental liability when determining disclosures in light of the *Basic* reasonable investor and probability/magnitude standards.[138] With contingent environmental liabilities, a public company can be faced with the unappealing alternatives of not disclosing a liability, thereby potentially subjecting itself to securities law claims, or making disclosures which result in previously unasserted environmental liabilities. How the SEC responds to the enforcement of SAB 92 may provide an answer to this dilemma.

III. SAB 92

Past uncertainty over the best way to characterize the wide range of possible liability exposures have led companies not to provide or, at best, to provide vague estimates of their potential environmental liability.[139] In a 1993 Price Waterhouse survey, sixty-two percent of 523 companies surveyed indicated that they did not record known environmental exposures in their financial statements.[140] Concern over this lack of disclosure prompted the SEC to require more detailed and comprehensive reporting of corporations' existing or potential environmental liabilities.[141] These efforts focused upon the related issues of Regulation S–K corporation disclosure and the accounting of environmental liabil-

137. *Id.*

138. *See supra* note 121 and accompanying text.

139. Lee Berton, *SEC Rule Forces More Disclosure*, WALL ST. J., Dec. 13, 1993, at B1.

140. *Id.*

141. Jay K. Wright, *Quantifying Environmental Exposure: Another Battleground For Accountant's Liability?*, *in* Accountants' Liability 1994, at 241 (PLI Litig. & Admin. Practice Course Handbook Series No. H4–5203, 1994).

ities.[142] Accordingly, the SEC moved to require that S–K corporations substantially broaden current environmental disclosure and accounting practices.

SAB 92,[143] published by the SEC in August 1993, provides a clear indication that S–K corporation disclosure and accounting of environmental loss contingencies will be subject to stricter standards for the timely and comprehensive disclosure of environmental liabilities.[144] Implicit in the SEC's SAB 92 accounting and disclosure requirements is the view that

> [e]nvironmental liabilities typically are of such significance that detailed disclosures regarding the judgments and assumptions underlying the recognition and measurement of these liabilities are necessary to prevent a reporting company's financial statements from being misleading and to inform readers fully regarding the range of reasonably possible outcomes that could have a material effect on the registrant's financial condition, results of operations, or liquidity.[145]

A. *SAB 92's Specific Holdings*

Generally, SAB 92 presents SEC views in three areas: (1) what constitutes proper disclosure of contingent liabilities and related assets representing claims for recovery within financial statements; (2) what is the proper discount rate to be applied in reflecting the time value of money of a contingent liability presented at its pres-

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142. *Id.*

143. 58 Fed. Reg. 32,843 (1993).

144. *Id.* at 32,845. For example, SAB 92 requires disclosure if:

> A registrant believes it may be obligated to pay material amounts as a result of . . . environmental liability. These amounts may relate to, for example, damages attributed to the registrant's products or processes, clean–up of hazardous wastes, reclamation costs, fines, and litigation costs. The registrant may seek to recover a portion or all of these amounts by filing a claim against an insurance carrier or other third parties.

Id. at 32,843. *See also infra* part III.A.

145. SAB 92, *supra* note 143, at 32,845. *But cf.* Schwartz, *supra* note 32, at 316 (discussing disclosure of actual and contingent environmental liabilities by publicly reporting companies and concluding that there are no bright line tests respecting disclosure of environmental liabilities).

ent value; and (3) which disclosures are likely to be of particular significance to investors assessing these contingencies.[146] Specifically, SAB 92 asks and provides answers to eight questions regarding environmental liability reporting on S–K corporation balance sheets.[147]

The first question asks whether it is appropriate to offset a claim for recovery that will probably be realized against a probable contingent liability, resulting in a single net amount to be reported on the balance sheet.[148] The SEC response is that generally such a consolidation of figures is inappropriate.[149] SAB 92 notes that the significant uncertainties regarding both the timing and the ultimate realization of claims, as well as a general proscription of the offsetting of assets and liabilities except where a right of set-off exists, militate against the netting of these figures.[150]

The second question posits a situation in which a corporation is jointly and severally liable as a potentially responsible party ("PRP") under CERCLA and asks whether, given a reasonable basis for apportionment of costs among all PRPs involved in the site, the registrant must recognize a liability with respect to costs apportioned to other PRPs.[151] The SEC's reply is a qualified "no."[152] The SEC staff noted that if it were probable that other PRPs would not fully pay their apportioned share of costs, the registrant should not offset its recognized liability by amounts apportioned to other PRPs and should reflect all additional costs the registrant expects to pay.[153] In addition, the staff's commentary on question two suggests that the registrant's disclosure statement should discuss uncertainties affecting the ultimate liabilities and additional losses that are reasonably possible.[154]

The third question addresses disparities between estimates of

146. *See* Wright, *supra* note 141, at 246.
147. *See generally* SAB 92, *supra* note 143.
148. *Id.* at 32,844.
149. *Id.*
150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*

liability, related costs and the actual figure.[155] The SEC staff stated that registrants should base estimates "on currently available facts, existing technology, and presently enacted laws and regulations."[156] In addition, registrants should consider the likely effects of inflation and societal and economic factors.[157] SAB 92 expressly prohibits corporations from delaying recognition of contingent liabilities until a single amount can be reasonably estimated.[158] Under SAB 92, if the registrant can only determine a range within which its liability will fall, it should disclose the minimum amount of the range.[159] Interestingly, the SEC acknowledged the difficulty that corporations face in making an estimate before the full range of the problem is known.[160] The SEC suggested that "registrant[s] consider available evidence including the registrant's prior experience in remediation of contaminated sites, other companies' clean-up experiences, and data released by the EPA or other organizations."[161]

The fourth question addresses environmental liability discounting to reflect the "time value of money."[162] SAB 92 states that if the aggregate amount of the obligation and the time and amount of payments are fixed or reliably determinable for a specific site, dis-

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155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.* The efficacy of the SEC's specific prohibition against this delay was demonstrated in an October 2, 1994, letter to the editor of the New York Times Financial Desk. Evelyn Berezin, *The Importance of Being Open*, N.Y. TIMES, Oct. 2, 1994, at C9. Ms. Berezin discussed her struggle, while on the board of directors of Koppers Company, a manufacturer of coal-tar derivatives, to provide shareholders with information about the company's substantial environmental obligations. She wrote that she was consistently overruled on the grounds that "until we [Koppers] had really investigated and had hard estimates of the cost to clean up each site, it was not an acceptable accounting practice to make such information public." *Id.* Ms. Berezin concluded that the corporation subsequently underwent a hostile takeover. The overtaking corporation was itself subsequently purchased, a fact that Ms. Berezin attributed in large part to the environmental liabilities which Koppers faced. *Id.*

159. SAB 92, *supra* note 143, at 32,844.

160. *Id.*

161. *Id.*

162. *Id.*

counting is appropriate.[163] The SEC also states that the discount rate should be the rate that will produce an amount at which the environmental liability could be settled in an arm's-length transaction with a third party.[164]

The fifth question outlines the financial statement disclosures that corporations should furnish regarding recorded and unrecorded environmental liabilities.[165] SAB 92 expresses the staff's belief that environmental liabilities are typically of such great significance that detailed disclosures regarding judgments and assumptions underlying recognition and measurement of liabilities would be required to prevent financial statements from being misleading.[166] Further, these disclosures are necessary to fully inform readers regarding the range of reasonably possible outcomes that could have a material effect on the corporation's financial condition, the results of operations, or its liquidity.[167] SAB 92 then presents eight examples of necessary disclosures:

> 1. Circumstances affecting the reliability and precision of loss estimates.
> 2. The extent to which unasserted claims are reflected in any accrual or may affect the magnitude of the contingency.
> 3. Uncertainties with respect to joint and several liability that may affect the magnitude of the contingency, including disclosure of the aggregate expected cost to remediate particular sites that are individually material if the likelihood of contribution by the other significant parties has not been established.
> 4. Disclosure of the nature and terms of cost-sharing arrangements with other [PRPs].
> 5. The extent to which disclosed but unrecognized contingent losses are expected to be recoverable through insurance, indemnification arrangements, or other sources, with disclosure of any material limitations of that recovery.
> 6. Uncertainties regarding the legal sufficiency of insurance claims or solvency of insurance carriers.
> 7. The time frame over which the accrued or presently unrecog-

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163. *Id.* at 32,845.

164. *Id.* at 32,844–845.

165. *Id.* at 32,845.

166. *Id.*; *see also* Stephen C. Blowers and Sharon Z. Chevalier, *Accounting Disclosures Relating to Loss Contingencies*, INSIGHTS, Dec. 1993, at 31.

167. SAB 92, *supra* note 143, at 32,845.

nized amounts may be paid out.
8. Material components of the accruals and significant assumptions underlying estimates.[168]

The staff's response to question five is particularly noteworthy for its delineation of disclosures protected or unprotected by a "safe harbor" provision within the Securities Act.[169] Civil liability arising from false or misleading statements is governed, in part, by section 77(k) of the Securities Act.[170] Section 77(k) indicates that the standard of reasonableness "shall be that required of a prudent man in the management of his own property."[171] The Securities Act's reasonableness standard places qualified disclosures within a "safe harbor."[172] SAB 92 curtails the application of the "safe harbor" provision to environmental liability disclosures.[173]

Question six discusses the disclosure of loss contingencies that may be necessary outside of the financial statements previously discussed. Regarding this subject, the SEC staff directed registrants to other SEC regulations and interpretive releases.[174] SAB 92 also

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168. *Id.*
169. *Id.*; 15 U.S.C. §§ 77a-aa.
170. *Id.* § 77k.
171. *Id.* § 77k(c).
172. 17 C.F.R. § 230.175(a) (1992) [hereinafter "Rule 175(a)"]. Rule 175(a) was promulgated pursuant to the Securities Act and reads in pertinent part:

> A statement within the coverage of paragraph (b) of this section which is made by or on behalf of an issuer or by an outside reviewer retained by the issuer shall be deemed not to be a fraudulent statement (as defined in paragraph (d) of this section), unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

Id.; *see* Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 512–13 (7th Cir. 1989). In *Wielgos*, the Seventh Circuit affirmed a district court's ruling that an electrical utility's incorporation of erroneous statements into prospectus fell within a "safe harbor" rule for "forward–looking statements" thereby precluding a finding of securities fraud liability. The electric utility's statements dealt with the estimated cost and start-up times of nuclear reactors. *Id.*
173. The SEC's response to the fifth question is noteworthy for its specificity in discussing situations which fall outside of the Rule 175(a) "safe harbor". Prior to SAB 92, because the limits of the "safe harbor" were not clearly delineated, corporations often delayed disclosure of specific environmental liability figures until a highly reliable figure could be reported.
174. SAB 92, *supra* note 143, at 32,845.

suggested that disclosures made pursuant to these provisions should be specific enough to enable registrants to understand the scope of the contingency, including recurring hazardous substance management and pollution costs, capital expenditures to limit or monitor pollutants and hazardous substances, mandated expenditures to remediate previously contaminated sites, and anticipated non-recurring or infrequent clean-up expenditures (but which are not presently required).[175]

Question seven deals with disclosures regarding site restoration or other environmental exit costs.[176] SAB 92 indicates that registrants should disclose material liabilities that occur due to the sale, disposal, or abandonment of a property in the notes to the financial statements.[177] It further states that appropriate disclosure will generally "include the nature of the costs involved, the total anticipated cost, the total costs accrued to date, the balance sheet classification of accrued amounts, and the range or amount of reasonably possible additional losses."[178] Disclosure of expenditures required for remediation of a site before development, before sale, subsequent to a sale, or as a condition of sale should be made in a note to the financial statements unless the likelihood of a material unfavorable outcome is remote.[179]

The eighth and final question addresses a situation in which site restoration costs, post-closure costs, monitoring costs, or other environmental exit costs are anticipated at the end of the useful life of an asset.[180] SAB 92 indicates that these costs may be accrued over the useful life of the asset provided that the criteria in paragraph eight of Staff Financial Accounting Standards No. 5 ("SFAS 5") are met.[181]

SAB 92 expressly requires that registrants quantify future lia-

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175. *Id.*

176. *Id.* at 32,845-846.

177. *Id.* at 32,846.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.* Paragraph 8 of SFAS 5 states that an estimated loss from a loss contingency shall be accrued by a charge to income if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Staff Financial Accounting Standards No. 5, 1993 WL 194317, at *1.

bilities.[182] Previously, companies justified their failure to recognize "probable" liability by claiming such liability was not "reasonably estimable." The SEC hopes to close this loophole through the practices outlined in SAB 92. If a loss is probable, a company is expected to accumulate sufficient reliable information in making an estimate to recognize and disclose its minimum best estimate of the loss.[183]

For example, disclosure of a registrant's historical and anticipated environmental expenditures should separately describe the following material: (1) recurring costs associated with managing hazardous substances and pollution on ongoing operations; (2) capital expenditures to limit or monitor hazardous substances or pollutants; (3) mandated expenditures to remediate previously contaminated sites; and (4) other infrequent or non-recurring clean-up expenditures that can be anticipated but which are not required in the present circumstances.[184]

These additional disclosure requirements should prevent companies from taking a wait-and-see approach with their environmental problems and force some real soul-searching regarding the reporting of future environmental liabilities. Furthermore, SAB 92 prohibits the use of possible claims of recovery to offset liabilities.[185] In other words, the two should be listed separately as a gross liability and a claim for recovery.[186] SAB 92 will also generally stop companies from discounting liabilities to a smaller amount. Such discounting is achieved by calculating how much money, invested to yield a predicted amount, would be needed today to pay a considerably larger environmental obligation in the future. SAB 92's disallowance of this discounting practice for ELDs has been referred to by corporate executives as "balance sheet poison."[187]

182. SAB 92, *supra* note 143, at 32,844.
183. *Id.*
184. Blowers and Chevalier, *supra* note 166, at 33-34.
185. SAB 92, *supra* note 143, at 32,844.
186. *Id.*
187. Berton, *supra* note 139.

B. *Corporate Responses to SAB 92*

Market expectations of unlimited indemnity can have the effect of discouraging sales of at–risk properties or, alternatively, of discouraging investment in at–risk corporations.[188] Prior to SAB 92, amorphously delineated disclosure standards allowed great variation in disclosures of environmental liabilities and thereby avoided the potential market-related problems. With the release of SAB 92, the SEC demonstrated greater interest in illuminating the question of what constitutes adequate disclosure of environmental liabilities.[189] Given the estimated billions of dollars in under-reported or non-reported environmental liabilities, the implications for corporations, the parties that invest in them, and commerce in general are enormous.

In the past, investors often were surprised by revelations of environmental liabilities faced by companies in which they invested.[190] An example is Hanson PLC's experience stemming from its 1991 acquisition of Beazer, a British construction company.[191] Prior to the takeover, Beazer acquired Koppers Company, a Pennsylvania based producer of wood treatment chemicals, in a $1.8 billion hostile takeover.[192] Following the acquisition, in 1992, Hanson PLC set aside £734 million (approximately seventy-five percent of its 1992 profits) in anticipation of previously undisclosed environmental liability claims from the Beazer/Koppers acquisition.[193]

Based on situations like that encountered by Hanson PLC, there clearly existed a need for more detailed disclosures of environmental liabilities. Initial company reaction to SAB 92, however, has

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188. Tom Andreoli, *SEC Rule: It Trashes Balance Sheets-Firms Now Must Book Liability For Pollution*, CRAIN'S CHI. BUS., Dec. 19, 1994, at 3 ("The worst kind of news is bad news waiting to happen, but that's exactly the kind of news public companies now must provide shareholders by disclosing potential future environmental liabilities.").

189. *Id.*

190. *See* Mike Clancy, *AETNA Results Surprise Analysts, Stock Falls*, REUTERS, July 29, 1994, *available in* LEXIS, CURNWS File (discussing analyst surprise and stock price fall of approximately 8 percent on news of AETNA's addition of $64 million to its environmental indemnity-related reserves).

191. *Id.*

192. *Id.*

193. *Id.*

been less than enthusiastic, with some companies arguing that the SEC's standards are at best unrealistic and at worst unattainable.[194] These protests are based on the difficulty of estimating environmental liabilities early in the remediation process. Although preliminary liability studies can only approximate the amount of pollution at a site, companies must now provide a best guess estimate of liabilities.[195] Reflecting inherent uncertainties in the scale of an environmental liability and its remediation cost, ultimate liabilities can vary greatly from these initial estimates.[196] Companies and investors must now grapple with these uncertainties, as environmental liabilities can no longer be dismissed out of hand or expressed as an afterthought in a footnote.

How companies will specifically be affected by the SEC's stricter disclosure standards remains to be seen. There is no doubt, however, that changes in disclosure practices will be required. For example, "increased disclosure requirements will particularly affect companies that don't disclose the extent of environmental liabilities because they believe they [are not] 'material' [liabilities]" under Rule 10b-5.[197] Under pre-SAB 92 accounting standards, liabilities were "material" only if they amounted to more than five percent of a company's profits or assets.[198] SAB 92, however, requires that companies disclose many environmental liabilities even if they fall below the five percent threshold.[199] In many cases, these disclosures will surprise investors as previously invisible liabilities suddenly appear.

An example of things to come can be found in Rockwell International's ("Rockwell") recent experience in Colorado. In a

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194. Bukro, *supra* note 24 ("Many corporations are now engaging in some real soul-searching to estimate what the costs are. A lot of them are saying [that] what the SEC wants simply can't be done.").

195. *Id.*

196. *Id.*

197. Berton, *supra* note 139.

198. Regulation S-K, 17 C.F.R. § 229 (1991). *See* Notice of Adoption of Amendments to Registration and Report Forms to Require Disclosure With Respect to Compliance With Environmental Requirements and Other Matters, Securities Exchange Act Release No. 5386, 20 Fed. Reg. 12,100 (1973).

199. Richard Y. Roberts & Kurt R. Hohl, *Environmental Liability Disclosure and Staff Accounting Bulletin No. 92*, 50 BUS. LAW 1, 11 (1994).

voluntary report issued along with its normal annual report, Rockwell told its shareholders that it faced as much as $130 million in liability for environmental cleanups and fines.[200] Rockwell made this disclosure in anticipation of the SEC's enforcement of SAB 92.[201] The liability was reported as $45 million in costs stemming from Rockwell's designation as a potentially liable party at thirty-four EPA Superfund cleanup sites.[202] The additional $85 million derived "mostly [from] cleanup costs associated with businesses that were sold in the 1980's."[203] Rockwell also disclosed that it had already accrued $72.4 million in anticipation of these liabilities.[204] Taken together, these amounts were far higher than Rockwell had disclosed in previous years[205] suggesting that stricter disclosure standards will make for interesting corporate revelations in coming years. Interestingly, one year before this disclosure in 1992, Rockwell paid $18.5 million, the largest environmental fine in its history, to settle government lawsuits alleging mismanagement of nuclear wastes at the Rocky Flats, Colorado nuclear weapons plant it managed for the Department of Energy.[206]

For many corporations, even when estimates of environmental liabilities have not required dramatic revision, attitudes towards what should be disclosed to shareholders have required reexamination.[207] SAB 92 means that companies will have to work harder to meet SEC disclosure requirements.[208] It also means an increase in the quantity and quality of information provided to shareholders and potential investors, allowing them to make better informed

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200. Dean Takahashi, *Rockwell Gives Extra Report on Cleanup Costs Investing: O.C.–Based Company Says the Action Was Taken In Part Because of An SEC Inquiry and the Fact That Such Information Will Soon Be Required*, L.A. TIMES, Dec. 14, 1993, at D1.

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. *Id.*

207. *See* Andreoli, *supra* note 188.

208. Richard Y. Roberts, *Remarks at the Corporate Council Conference at the New Jersey Institute for Continuing Legal Education* (May 5, 1995), *available in* 1995 WL 275552, at *3.

investment decisions.[209] As overall investor confidence in the companies increases, there will be a corresponding benefit to companies, shareholders, and investors.[210] At the same time, stricter SEC disclosure requirements, as well as increased cooperation between the SEC and the EPA, make it clear that companies that continue to neglect environmental liabilities in their financial disclosure statements will find themselves paying for their intransigence.[211]

CONCLUSION

Through the augmented disclosure standards outlined in SAB 92, the SEC has taken an incremental step towards eliminating overly general environmental liability disclosures. The release of SAB 92 places corporations under greater pressure to provide concrete figures for ambiguously defined environmental liabilities by delineating the boundaries of the equally ambiguous Regulation S-K environmental liability disclosure requirements. In the long run, more comprehensive reporting will lead to greater investor confidence, benefiting both investors and corporations. In the short term, investors should not react in haste to augmented disclosures. Instead, investors should use the information to make better investment decisions, rewarding companies who handle environmental liabilities responsibly and increasing the accountability of those who do not.

209. *Id.*
210. *Id.*
211. Schwartz, *supra* note 32, at 316.