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Disclosing Expenses and Liabilities under the Clean Air Act Amendments of 1990 in Securities Filings

Mark A. Stach

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1994]

**DISCLOSING EXPENSES AND LIABILITIES UNDER THE
CLEAN AIR ACT AMENDMENTS OF 1990 IN
SECURITIES FILINGS**

MARK A. STACH†

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The views expressed herein are those of the author and should not be attributed to, or construed to be those of, his employer.

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I. INTRODUCTION

THE Clean Air Act Amendments of 1990 ("1990 Amendments")¹ represent one of the most sweeping pieces of legislation in history.² The costs of implementing the changes required by, and complying with, the regulations enacted by the 1990 Amendments will run into the hundreds of billions of dollars.³ Major shakeouts are expected in certain industries as companies will be unable to meet the required expenditures and thus will be forced to close.⁴ In short, the 1990 Amendments "will require significant changes in the manner in which American business conducts its operations and meets its environmental obligations."⁵

The expenditures necessary to meet the requirements of the 1990 Amendments, and their consequent effect on the businesses incurring such expenditures, are of great interest and importance to the investing public. As such, they are a proper subject for disclosure under the federal securities laws.⁶ Thus, affected companies must not only plan for and incur the expenditures anticipated to meet the requirements of the 1990 Amendments, but they must also disclose the anticipated affects of such expenditures to their shareholders and the investing public.⁷

1. Clean Air Act Amendments, Pub. L. No. 101-549, 104 Stat. 2399 (1990) codified in various sections at 42 U.S.C. §§ 7401-7642 (1988 & Supp. IV 1992).

2. See, e.g., Louis S. Richman, *Report Card on Busheconomics*, *FORTUNE*, Nov. 4, 1991, at 105 (describing nearly 1,000 pages of regulations under 1990 Amendments and noting that page count could reach millions by time that all standards required to be set forth in 1990 Amendments are enacted).

3. See *infra* part II.B.2.

4. See *infra* part II.B.2.

5. See *1990: The Year In Review*, 1991 A.B.A. Sec. Nat. Resources, Energy & Envtl. L., at 149-50 [hereinafter *Year In Review*].

6. See *infra* part II.B.2.

7. See *infra* part III.

II. THE FEDERAL SECURITIES LAWS

A. Philosophy

The basic philosophy underlying the federal securities laws⁸ is that an informed investor is a protected investor.⁹ The securities laws and the regulations promulgated thereunder advance this philosophy by requiring sellers of securities, and those companies whose securities are publicly-traded, to disclose certain information about themselves.¹⁰ An argument can be made that the more information an investor has at his or her disposal, the better prepared he or she will be to make an intelligent decision with respect to the purchase or sale of a security.¹¹ While there is no doubt that some degree of disclosure regarding the business of the issuer or company is desirable, a countervailing consideration is the effect that overdisclosure might have on the ability of the investor to make an intelligent decision with regard to the purchase or sale of a security.¹² The investor can not reasonably be expected to absorb every

8. This Article will be concerned exclusively with the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988) [hereinafter Securities Act] and the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988) [hereinafter Exchange Act].

9. This proposition has been put forth more eloquently by a number of courts. *See, e.g.,* *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 563 (E.D.N.Y. 1971) ("The 1933 Act is almost exclusively preoccupied with accurate disclosure of facts, favorable and unfavorable."); *Basic, Inc. v. Levinson*, 485 U.S. 224, 230 (1988) ("Underlying the adoption of extensive disclosure requirements [of the 1934 Act] was a legislative philosophy: 'There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.'") (citing H.R. REP. NO. 1383, 73d Cong., 2d Sess. 11 (1934)).

10. *See infra* part III.B.1.

11. *See, e.g.,* H.R. REP. NO. 1383, at 11.

No investor, no speculator can safely buy and sell securities . . . without forming an intelligent basis for his judgment as to the value of the securities he buys or sells. . . . Just as artificial manipulation tends to upset the true function of an open market, so the hiding or secreting of important information obstructs the operation of the markets as indices of real value. There cannot be honest markets without honest publicity.

Id.

12. *See Notice of Commission Conclusions and Rule-making Proposals in the Public Proceeding Announced in Securities Act Release No. 5569*, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,706, at 85,712 (Oct. 14, 1975).

Whether particular disclosure requirements are necessary to permit the Commission to discharge its obligations under the Securities Act and the Securities Exchange Act or are necessary or appropriate in the public interest or for the protection of investors involves a balancing of competing factors. As a practical matter, it is impossible to provide every item of information that might be of interest to some investor in making investment decisions . . . [since] participants in the proceeding suggested more than 100 topics concerning which they desired disclosure. A disclosure document which incorporated each of these suggestions would consist of excessive and possibly confusing detail, whether provided directly to in-

piece of information relating to the registrant and its operations.¹³ Nor can a company be expected to provide this type of detail to the public marketplace.¹⁴ Thus, the securities laws do not deal in minutia. The limiting aspect of these laws and regulations is their applicability to exclusive information which is considered "material." "Material" information is generally deemed to be information regarding "those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities."¹⁵

B. Regulations Implementing this Philosophy and Potential Applicability to Clean Air Act-Related Disclosures

1. Statutory Scheme

Unless an exemption from registration exists, prior to an issuer selling securities to the public, it must file with the Securities and Exchange Commission ("SEC" or "Commission") a registration statement setting forth certain facts about the securities and the issuer.¹⁶ Companies which are "publicly-held" must file quarterly reports with the SEC which contain certain financial and other information with respect to the company's operations.¹⁷ The information which is required to be contained in these reports is set forth in the forms which are prescribed by the SEC for reporting this information.¹⁸ The SEC has promulgated Regulation S-K, which sets out standardized disclosure provisions with respect to in-

vestors or filed with the Commission for inspection by interested persons. Thus, certain types of disclosure might be so voluminous as to render disclosure documents as a whole significantly less readable and, thus, less useful to investors generally. In addition, disclosure to serve the needs or desires of limited segments of the investing public, even if otherwise desirable, may be inappropriate, since the cost to registrants, which must ultimately be borne by their shareholders, would be likely to outweigh the resulting benefits to most investors.

Id. (footnote omitted).

13. *Id.*

14. *Id.*

15. See 17 C.F.R. § 240.12b-2 (1993); see also 17 C.F.R. § 230.405 (1993).

16. Securities Act, 15 U.S.C. § 77e(c).

17. Publicly-held companies are those which have: (i) registered their securities under the Securities Act; (ii) securities registered on a national exchange (i.e., the New York Stock Exchange, the American Stock Exchange or the NASDAQ); or, (iii) 500 or more shareholders and total assets exceeding \$5,000,000. See Exchange Act, 15 U.S.C. § 78l(g); 17 C.F.R. § 12g-1 (1993). Such companies are hereinafter referred to as "registrants."

18. See, e.g., 5 Fed. Sec. L. Rep. (CCH) ¶ 27,001, at 27,047, 31,101 (1993) (Form 10-K under Exchange Act); 2 Fed. Sec. L. Rep. (CCH) ¶ 6001, at 6022, 7141-46 (1993) (Form S-1 under Securities Act).

formation which is required to be included in registration statements and periodic filings.¹⁹ Certain of these standardized disclosure provisions either explicitly address, or have been interpreted by the Commission to require, disclosure of environmentally-related liabilities and expenditures. These provisions are:

- (1) Item 101 of Regulation S-K,²⁰ which requires a description of the company's business, including, among other things, disclosure of material capital expenditures related to environmental compliance;
- (2) Item 103,²¹ which requires a description of material pending legal proceedings including those arising under environmental laws; and,
- (3) Item 303,²² Management's Discussion and Analysis ("MD&A"), which requires a narrative discussion of the company's financial condition, changes in financial condition and results of operation. Item 303 requires as part of the MD&A, a discussion of material events, trends, uncertainties, demands and commitments.²³

Information with respect to Items 103 and 303 is required to be included in both the Form 10-Q, which is required under the Exchange Act to be filed three times a year,²⁴ and the Form 10-K, which is required under the Exchange Act to be filed annually.²⁵ Information disclosed with respect to Item 101 must be set forth on an annual basis in the Form 10-K.²⁶ The information required to be disclosed under these items is also required to be included in

19. 17 C.F.R. §§ 229.10-915 (1993). Regulation S-K has been described as "a . . . complete compendium of disclosure requirements applicable to Securities Act and Exchange Act filings." *Adoption of Integrated Disclosure System*, 24 SEC Dkt. (CCH) 1275 (March 3, 1982).

20. 17 C.F.R. § 229.101 (1993); see Form 10-K of Exchange Act, *supra* note 8, at Part I, Item 1. For a detailed description of Item 101, see *infra* part III.A.

21. 17 C.F.R. § 229.103 (1993). For a detailed description of Item 103, see *infra* part III.C.

22. 17 C.F.R. § 229.303 (1993). For a detailed description of Item 303, see *infra* part III.B.

23. 17 C.F.R. § 229.303 (1993); see *infra* part III.B.

24. 17 C.F.R. § 240.13a-13 (1993); 17 C.F.R. § 240.15d-13 (1993); 5 Fed. Sec. L. Rep. (CCH) ¶ 27,045A, at 31,031 (1993) (Form 10-Q of Exchange Act). The Form 10-Q is a quarterly filing. It is only required three times per year as the last quarter is covered by the registrant's annual filing for Form 10-K.

25. 17 C.F.R. § 240.13a-1 (1993); 17 C.F.R. § 240.15d-1 (1993); Form 10-K of Exchange Act, *supra* note 19, at Part I, Item 3 and Part II, Item 7.

26. 17 C.F.R. § 240.13a-1; 17 C.F.R. § 240.15d-1; Form 10-K of Exchange Act, *supra* note 19, at Part I, Item 3 and Part II, Item 7.

certain registration statements filed under the Securities Act.²⁷ Disclosure of information under each of these regulations is predicated upon such information being material. The registrant's advisors must therefore consider whether information pertaining to the registrant's Clean Air Act ("CAA")-related expenditures and liabilities is material.

A company which fails to meet these requirements may be subjected to substantial fines.²⁸ Additionally, the SEC may order compliance with the disclosure requirements, seek injunctions or issue cease and desist orders.²⁹

2. *Potential Materiality of Expenditures Relating to 1990 Amendments*

The costs of implementing the 1990 Amendments³⁰ have been estimated to run from \$20 billion to \$100 billion a year.³¹ Annual compliance costs under the CAA have been estimated to be in the range of \$30 billion a year,³² with fees for state permit programs alone costing \$330 million per year.³³ It is predicted that annual compliance costs may rise to as much as \$44 billion by the year 2006.³⁴ The potential impact on the nation's economy is huge. One study has estimated that the U.S. gross national product will be reduced by four-tenths of a percentage point by the year 2005 as a result of the 1990 Amendments, with this figure rising to a half of a percent of the gross national product by the year 2020, when the impact of the 1990 Amendments on the economy will be complete.³⁵ The legislation will affect certain industries to a much greater extent than others. The chemical industry, petroleum refiners, steel and other heavy metal producers, electric utilities and

27. See, e.g., 2 Fed. Sec. L. Rep. (CCH) ¶ 6023, at 7151 (1993) (Form S-3 of Securities Act).

28. See Securities Act, 15 U.S.C. § 77x, Exchange Act, 15 U.S.C. § 78u-1.

29. See Securities Act, 15 U.S.C. § 77t, Exchange Act, 15 U.S.C. §§ 78u(c)-(e).

30. Clean Air Act, 42 U.S.C. §§ 7401-7642 (1988 & Supp. IV 1992).

31. See *The Year in Review*, supra note 5, at 149.

32. See James J. Maiwurm, *Annual Disclosure in a Declining Economy - Some Year-End Reminders*, 5 INSIGHTS 1, 5-6 (Jan. 1991) (citing *A Decade's Acrimony Lifted in the Glow of Clean Air*, 48 CONG. Q. 3587 (Oct. 27, 1990)).

33. See *Critics Threatening Lawsuits as EPA Issues Long-Delayed Air Permit Rule*, 5 Air Toxics Rep. 7 (July 1992).

34. *Environmental Compliance Costs May Harm Credit of U.S. Companies*, 23 Sec. Reg. & L. Rep. (BNA) 20, 770 (May 17, 1991) [hereinafter *Environmental Compliance Costs*].

35. Dale W. Jorgenson & Peter J. Wilcoxon, *The Economic Impact of the Clean Air Act Amendments of 1990*, 14 ENERGY J. 1, 159 (Jan. 1993).

the auto industry are among those industries which will feel the greatest impact from the 1990 Amendments.³⁶

The business community is well aware of the potential impact of the 1990 Amendments. The president of a large chemical company, citing the 1990 Amendments in particular, predicted that as many as one third of the 190 members of the Chemical Manufacturers Association could be driven out of business by environmental costs.³⁷ Similarly, it has been reported that refineries representing close to ten percent of the domestic refining capacity have been closed or are facing shutdown due to environmental costs.³⁸ Furthermore, Moody's Investor Service, which assigns ratings to the debt of major corporations, has said that corporations faced with material environmental compliance costs may see their credit ratings downgraded.³⁹

In light of numbers such as those noted above and public statements concerning the potential impact of the 1990 Amendments, the potential materiality of the effects of the 1990 Amendments upon industries most likely to be impacted, becomes apparent.

C. SEC's Recent Emphasis on Disclosure of Environmentally-Related Matters

The material nature of the financial impact of environmental regulations has recently been the subject of great emphasis by the SEC. In 1989, the SEC issued an interpretive release ("MD&A Release") dealing with the MD&A portion of such periodic filings.⁴⁰ The MD&A Release contained the SEC's interpretation of the disclosures required by the MD&A.⁴¹ The MD&A Release provides guidance as to the prospective nature of the disclosures required under the MD&A and focuses on, among other things, the disclosure which may be required of a registrant who has been named as

36. See *Environmental Compliance Costs*, *supra* note 34, at 770; see also *Chevron to Spend \$950 Million to Comply with Clean Gas Laws*, Associated Press, Sept. 9, 1993, available in LEXIS, NEWS Library, CURRNT File (reporting that major U.S. oil producer will spend \$950 million at two California refineries to produce reformulated gas mandated by 1990 Amendments).

37. See *A Question of Margins; Industry Overview Chemicals '92*, 241 Chem. Marketing Rep. 1, at SR3 (Jan. 6, 1992).

38. See George Lobsenz, *Environmental Laws Threaten 10 Percent of U.S. Refining Capacity*, ENERGY DAILY (May 22, 1992) (noting, in particular, effect of 1990 Amendments).

39. See *Environmental Compliance Costs*, *supra* note 34, at 770.

40. Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, 54 Fed. Reg. 22,427 (1989) [hereinafter MD&A Release].

41. *Id.*

a potentially responsible party under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA" or "Superfund").⁴² While the guidance offered by the MD&A Release did not specifically address what disclosures might be required with respect to CAA compliance (note that the MD&A Release was issued more than a year before the adoption of the 1990 Amendments), it did alert the business community to the fact that the Commission was cognizant of the increasing financial impact that environmental regulations were having on the operations of regulated companies.

Further, the SEC and the Environmental Protection Agency ("EPA") reached an agreement under which EPA is providing the SEC with certain information which may indicate that particular companies have significant environmentally-related liabilities.⁴³ Among other items, EPA provides the SEC with a list of all facilities barred from government work under the CAA.⁴⁴ Another indication of the emphasis that the SEC is placing upon the disclosure of environmental liabilities is the recent issuance of Staff Accounting Bulletin No. 92 ("SAB No. 92").⁴⁵ SAB No. 92 expresses the view of the staff of the SEC's division of Corporate Finance with respect to accounting and disclosures relating to loss contingencies in general, and environmental liabilities in particular.⁴⁶ SAB No. 92 does

42. See 42 U.S.C. §§ 9601-9675 (1988 & Supp. IV 1992).

43. Roger D. Wiegley, *Reporting of Environmental Liabilities - New SEC Initiatives*, 90-96 SEC TODAY 1 (May 17, 1990).

44. *Id.* The Clean Air Act ("CAA") bars entities which have violated its provisions from contracting with the government. CAA § 306, 42 U.S.C. § 7606. The other information provided by SEC to EPA is:

- (1) A list of all cases brought under CERCLA and RCRA;
- (2) The names of all parties receiving letters under CERCLA which identify them as potentially responsible parties (PRPs);
- (3) Lists of all recently concluded civil cases and criminal cases brought under the federal environmental laws;
- (4) A list of all facilities barred from government work under the Clean Water Act; and
- (5) A list of all facilities subject to cleanup under RCRA.

See Wiegley, *supra* note 43, at 1.

45. Staff Accounting Bulletin No. 92, 58 Fed. Reg. 32,843 (1993) [hereinafter SAB No. 92]. Staff Accounting Bulletins represent the interpretations and practices of the Division of Corporation Finance and the Office of the Chief Accountant of the SEC in administering the securities laws' disclosure requirements. *Id.*

46. *Id.* It should be noted that Staff Accounting Bulletins are published with a disclaimer stating that the views contained therein are not SEC's rules or interpretations and they are not published as bearing the SEC's official approval. One commentator has said, however, that "[t]hese interpretations [Staff Accounting Bulletins], while not rules or interpretations of, and not officially approved by, [] SEC, for all practical purposes have the force of law." Richard H. Rowe, *The Role of the Lawyer Advising on SEC Accounting Requirements*, 5 INSIGHTS 8, 20 (Aug. 1991).

not specifically refer to the 1990 Amendments and is geared more toward how to disclose loss contingencies rather than anticipated expenditures, but it does again point out the importance the SEC has placed on the disclosure of the financial impact of environmental matters.

Despite the lack of official pronouncements by the SEC specifically dealing with disclosure relating to the 1990 Amendments, the recent emphasis on the need for companies to completely and accurately disclose their environmentally-related liabilities cautions advisors to publicly-held companies to pay attention to, and consider disclosure of, expenses and liabilities relating to the 1990 Amendments. Further, in a speech, a Commissioner of the SEC placed particular emphasis on the need for disclosure with respect to CAA compliance costs, noting that it was his opinion that the "Commission staff should scrutinize carefully the adequacy of disclosures by issuers in the area of CAA compliance costs."⁴⁷

III. APPLICATION OF SPECIFIC DISCLOSURE REQUIREMENTS OF FEDERAL SECURITIES LAWS TO DISCLOSURE OF COSTS RELATING TO 1990 AMENDMENTS

Having established the potential materiality of the effects of complying with the 1990 Amendments, the particular disclosure requirements of the securities laws which may mandate disclosure *vis-a-vis* the costs of complying with the 1990 Amendments must be examined in greater detail.

A. Disclosure of Expenditures Relating to Compliance with 1990 Amendments Under Item 101(c)(1)(xii) of Regulation S-K

1. Requirements of Item 101(c)(1)(xii)

Item 101 of Regulation S-K is a description of the registrant's business which is required to be included annually in the registrant's Form 10-K and in certain registration forms.⁴⁸ Item 101 re-

47. Richard Y. Roberts, SEC Commissioner, on Recent Trends in Environmental Disclosure, Remarks Before the Environmental Group of Organization Resources Counselors (Oct. 14, 1992).

48. 17 C.F.R. § 229.101; see Form 10-K of the Exchange Act, *supra* note 8, at Part I, Item 1 (As information with respect to Item 1 is not required to be included in Form 10-Q, information sought by this Item need not be disclosed on quarterly basis.); Form S-1 of the Securities Act, *supra* note 8, Part I, Item 11(a); 2 Fed. Sec. L. Rep. (CCH) ¶ 6022, at 7141 (1993) (Form S-2 of Securities Act, Part I, Item 11(b)(3)) (requiring disclosure under certain subparts of Item 101 if registrant does not deliver its latest annual report in connection with registration statement).

quires the registrant to describe the general development of its business during the preceding five years, to set forth certain financial information about the registrant's industry segments and to describe narratively the registrant's business.⁴⁹ Item 101(c)(1)(xii) is one of the items which must be included in the narrative description of the business required under Item 101(c).⁵⁰ Item 101(c)(1)(xii) provides:

Appropriate disclosure . . . shall be made as to 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 on the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall 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 materials [sic].⁵¹

The disclosure required pursuant to the first sentence of Item 101(c)(1)(xii) is forward-looking in that it requires registrants to estimate the effects that compliance with the law will have on future capital expenditures, earnings and competitive position.⁵² The predictive element of Item 101(c)(1)(xii) means that it is closely intertwined with the MD&A.⁵³ The second sentence to what is now Item 101(c)(1)(xii) was added to the predecessor of Item(c)(1)(xii) three years after it was first adopted.⁵⁴ It requires, at a minimum, disclosure regarding the effects of environmental compliance on

49. 17 C.F.R. § 229.101(a)-(c).

50. See 17 C.F.R. § 229.101(c)(1)(xii).

51. *Id.*

52. SEC, when it adopted the first sentence to what is now Item 101(c)(1)(xii), said that it was aware that there is no specified time period in the future to be described. *Notice of Adoption of Amendments to Registration and Report Forms to Require Disclosure with Respect to Compliance with Environmental Requirements and Other Matters*, [1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,029, at 83,029 (May 1, 1973). According to the SEC, no time period was specified because "environmental compliance programs for different industries may involve substantially differing lead times." *Id.*

53. 17 C.F.R. § 229.303; see *infra* part III.B.

54. *Notice of Commission Conclusions and Final Action on the Rulemaking Proposals Announced in Securities Act Release No. 5627 (Oct. 14, 1975) Relating to Environmental Disclosure*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,291, at 86,291 (May 6, 1976).

anticipated capital expenditures during the succeeding two years, but does not limit expenditure exposure to a certain period, saying only that disclosure of material estimated capital expenditures is required for "such further period as the registrant may deem material."⁵⁵ In both the first and second sentence of Item 101(c)(1)(xii), disclosure is predicated upon materiality.⁵⁶ In this instance, material information is defined as information as to which "there is a substantial likelihood that a reasonable investor would attach importance" in making an investment decision.⁵⁷

While materiality forms the basis for determining whether disclosure is required under this Item, it is not enough to disclose that compliance with the environmental laws will have material effects on the capital expenditures, earnings and competitive position of the registrant and its subsidiaries.⁵⁸ Were this all that is required under this Item, the disclosure would be a simple one for the companies that are significantly affected by the 1990 Amendments. The second sentence of Item 101(c)(1)(xii), however, requires more than this; it requires the disclosure of estimated capital expenditures for environmental compliance.⁵⁹ This requires the registrant to both research and disclose cost estimates associated with complying with the 1990 Amendments.

2. *Item 101(c)(1)(xii) Disclosure Challenges Posed by 1990 Amendments*

Because of the nature of the CAA's statutory scheme, and the impact of the 1990 Amendments on this scheme, developing estimates of compliance costs may be problematic for some registrants. For example, one of the many areas addressed by the 1990 Amendments was the problem of "nonattainment".⁶⁰ Prior to the 1990 Amendments, EPA developed national ambient air quality standards ("NAAQS") for six "criteria pollutants".⁶¹ Each state then developed a state implementation plan ("SIP") which set emissions

55. 17 C.F.R. § 229.101(c)(1)(xii).

56. *See id.*

57. 17 C.F.R. § 230.405, 240.12b-2 (1993); *see Disclosures Pertaining to Matters Involving the Environment and Civil Rights*, [1970-71 Transfer Binder] Fed. Sec. L. Rep. (CGH) ¶ 80,487 (July 19, 1971). This release contained language which formed the basis for the predecessor of the first sentence of Item 101(c)(1)(xii).

58. 17 C.F.R. § 229.101(c)(1)(xii).

59. *Id.*

60. *See infra* text accompanying notes 61-67.

61. CAA, 42 U.S.C. § 7409. The criteria pollutants are: sulfur dioxide, particulate matter, carbon monoxide, ozone, nitrogen dioxide and lead. *See* 40 C.F.R. §§ 50.4-50.6, 50.8-50.12 (1992).

standards for the criteria pollutants within the state and was designed to bring that state's ambient air quality within the NAAQS.⁶² Under the CAA, after the state promulgates the SIP, EPA reviews the SIP and approves or disapproves all or part of it.⁶³

One of the primary purposes of the 1990 Amendments was to address areas of the country which have failed to meet NAAQS, i.e., "nonattainment" areas.⁶⁴ The 1990 Amendments attempt to deal with the issue of nonattainment by dividing the states into various areas and classifying such areas as attainment, nonattainment, or unclassifiable.⁶⁵ Nonattainment areas must modify their SIPs to provide for, among other things, the adoption of reasonably available control technology ("RACT") for stationary sources of air pollutants (i.e., industrial facilities).⁶⁶ These stationary sources and the industrial concerns which operate them will not know what the RACT is until the revised SIP has been adopted and approved by EPA. Invariably, delays occur in the adoption, review and implementation of SIPs, which, in turn, postpone the effectiveness of the regulations thereunder.⁶⁷ Yet, registrants whose operations may be affected by these regulations are required to estimate and disclose the costs of complying with them if such costs are material.⁶⁸ This has led one commentator to note:

Item 101 disclosure currently presents a challenge to registrants affected by the [1990 Amendments]. Changes in the federal air law require numerous registrants to upgrade

62. CAA, 42 U.S.C. § 7410(a)(2).

63. *Id.*

64. Theodore L. Garrett & Sonya D. Winner, *A Clean Air Act Primer: Part I*, 22 *Env'tl. L. Rep. (Env'tl. L. Inst.)* 10159, 10174 (March 1992).

65. CAA, 42 U.S.C. § 7407(d).

66. CAA, 42 U.S.C. § 7502(c).

67. Garrett & Winner, *supra* note 64, at 10182 & n.115. In light of fact that EPA was taking 30 months to review State Implementation Plans ("SIPs") prior to the adoption of the 1990 Amendments, and since the new regulations will require EPA to review substantially more SIPs, EPA will be hard pressed to meet 12 month deadline for review of revised SIPs under CAA 42 U.S.C. § 7410(k)(2). The authors observed that "as a practical matter, it seems likely that Congress' ambitious new scheme for dealing with nonattainment will bog down under the burden of its own administrative complexity."

68. The material set forth in this Article is not designed to give a comprehensive overview of the working of the nonattainment or other provisions of the 1990 Amendments. Rather, it is designed to illustrate the role that the uncertainties associated with such provisions play in the disclosure process. It is important to keep in mind in this regard that the provisions discussed herein are just a few of the many elements of the complex regulatory scheme enacted by the 1990 Amendments and that similar uncertainties may well be associated with other parts of the 1990 Amendments. Other uncertainties will likely play a similar role, *vis-a-vis* disclosing the costs associated with compliance, as those discussed above.

emissions control technologies according to a statutorily mandated schedule. Implementing regulations for many of these new programs are, however, only now being developed. Thus, many registrants subject to the [CAA] are in an awkward position. They know that there likely will be material effects of compliance with the new law, but, because no implementing regulations have been promulgated, the registrants are unable to predict either the cost of compliance or the effect compliance is likely to have on capital expenditures, earnings, and competitive position.⁶⁹

This position has apparently failed to engender much sympathy from at least one SEC official, who said:

A common question asked by issuers is how companies can make compliance cost estimates when regulations to be promulgated pursuant to the [1990 Amendments] have not yet been issued. The Amendments require certain emissions to be reduced to specified levels or to be completely phased out over specified time periods and also require companies within particular industries to install the best available technology to reduce pollution. According to representations from EPA staff to the Commission staff, companies are aware of this best available technology, including its cost. Moreover, EPA apparently has estimated the cost of compliance with the Amendments for each major industry. Therefore, it appears that EPA staff is of the opinion that companies are presently able to estimate, at least on a worst case basis, the cost of complying with the Amendments, except in one instance. With respect to toxic pollutants, it is my understanding that the timing, but not the magnitude, of costs may be uncertain until the relevant regulations are in fact issued.⁷⁰

Commissioner Roberts' reference to air toxics refers to the portion of the Amendments that requires EPA to adopt national standards for regulation of 189 air pollutants.⁷¹ Prior to the adoption of the 1990 Amendments, the standards known as national emission standards for hazardous air pollutants ("NESHAPs"), had only been

69. Elizabeth Ann Glass Geltman, *Disclosure of Contingent Environmental Liabilities by Public Companies Under the Federal Securities Laws*, 16 HARV. ENVTL. L. REV. 129, 151 (1992) (footnotes omitted).

70. See Remarks of Richard Y. Roberts, *supra* note 47.

71. CAA, 42 U.S.C. § 7412(b)(1).

adopted for seven pollutants.⁷² Under the 1990 Amendments one of the ways in which these pollutants (air toxics) will be regulated is through the adoption of emissions standards based on the employment of maximum achievable control technology ("MACT") by sources of such pollutants.⁷³ Certain standards are not required to be promulgated until ten years after enactment of the 1990 Amendments.⁷⁴ Thus, the registrant is left with the daunting task of attempting to estimate the cost of the MACT required to comply with the regulations, when it may not be determined for a number of years precisely what MACT requires of the emitter.

Many registrants that are significantly impacted by the 1990 Amendments are major industrial companies. These companies typically have human and other resources devoted to a planning function. This planning function provides the company information regarding estimated future capital expenditures needed to meet environmental requirements and the effect that such expenditures will have on earnings. This information usually constitutes part of a company's business plan and is therefore available to management. The information so developed is based on certain assumptions.

A possible solution to the problem of disclosing the estimated compliance costs associated with the 1990 Amendments is to develop estimates based on certain assumptions and then to disclose both the estimates and the assumptions upon which they are based. Disclosure of this sort has been sanctioned by SEC in an interpretative release issued in 1979.⁷⁵ In that release, SEC said:

Further, if the registrant reasonably expects that these costs [capital expenditures necessary to comply with environmental requirements] for any future year will be materially higher than the costs disclosed for the mandatory two-year period, the registrant may, if it has not already done so, be obligated to develop estimates with respect to such costs. Disclosure of such estimates may be required It may also be necessary for the registrant to set forth the source of its estimates, the assumptions and methods used in reaching the estimates, and the extent of uncer-

72. Theodore J. Garrett & Sonya D. Winner, *A Clean Air Act Primer: Part II*, 22 *Envtl. L. Rep. (Envtl. L. Inst.)* 10235, 10245 (Apr. 1992).

73. CAA, 42 U.S.C. §§ 7412(c)(2), 7412(d)(2).

74. CAA, 42 U.S.C. § 7412(e)(1)(E).

75. *Environmental Disclosure*, 18 SEC Docket (CCH) 453 (Oct. 10, 1979).

tainty that . . . [such] future costs may occur in order for the disclosure made not to be misleading.⁷⁶

Thus, with respect to the disclosure of estimated capital expenditures under Item 101(c)(1)(xii), the best course is to develop such estimates based on the best available information and to disclose such estimates and the information and assumptions upon which they are based.⁷⁷

Item 101(c)(1)(xii) also calls for disclosure with regard to the effects that environmental compliance will have on earnings and competitive position.⁷⁸ The timing issues alluded to above will play a role in the disclosure of the effects of compliance costs on earnings.⁷⁹ The registrant's earnings could be materially affected during the periods in which the expenditures required to comply with 1990 Amendments are incurred. To the extent that the registrant is uncertain of the timing of the expenditures, it should disclose this fact and state that earnings during some future period may be materially affected by compliance costs.⁸⁰ The disclosure made in this regard should recite the registrant's knowledge regarding the timing of the development and implementation of the regulations which will require the expenditures.⁸¹ As to the disclosure of the effects that complying with 1990 Amendments will have on competitive position, the 1990 Amendments affect entire industries, and as such, may well have a neutral effect on competitive position; if this is the case, the disclosure should state as much. However, the registrant or a competitor may be uniquely positioned to respond to the 1990 Amendments, or an international competitor may be exempt from the regulation entirety; if this the case, disclosure of this fact should be made.

The forward-looking element of the second sentence of Item 101(c)(1)(xii), which mandates that estimated material capital expenditures for periods beyond the mandatory two year period be disclosed, is not to be taken lightly. In an enforcement release, SEC cited United States Steel Corporation ("U.S. Steel") for, among

76. *Id.* at 455-56.

77. *Id.*

78. See 17 C.F.R. § 229.101(c)(1)(xii).

79. See *supra* text accompanying notes 69-74.

80. *Environmental Disclosure, supra* note 75, at 455-56. This release says that a discussion with regard to the uncertainty as to *whether* such future costs may occur may be required in order to prevent the disclosure from being misleading. *Id.* Similarly, it may be necessary to discuss the uncertainty with respect to *when* known future costs may occur.

81. *Id.*

other things, its failure to disclose estimates of its expected expenditures to meet the requirements of the CAA and the Clean Water Act for periods beyond the two-year required period.⁸²

The U.S. Steel release is instructive regarding both how major industrial companies estimate compliance costs and what the SEC expects in terms of disclosure of such costs. In 1971, U.S. Steel began estimating the anticipated costs of complying with the then newly enacted CAA and the proposed Clean Water Act.⁸³ The release, in a footnote, says that the estimates were based "both on requirements as then currently defined to meet criteria then being actively enforced, and on projected estimates . . . based on then existing trends in legislative and enforcement activity."⁸⁴ The estimates also took into account "various technological alternatives and regulatory requirements."⁸⁵ Between 1971 and 1978, these estimates were revised as more information regarding the requirements, under the CAA and the Clean Water Act, and the technology required to meet such requirements became available.⁸⁶ By early 1978, U.S. Steel estimated its compliance costs to be between \$1.02 and \$1.36 billion for the period from 1978 to 1982.⁸⁷ In its filings for the years 1973 to 1976, U. S. Steel disclosed what it spent in the past and what it had authorized or expected to spend in the next two or three years for environmental compliance.⁸⁸ It did not, however, disclose the estimates discussed above with respect to amounts it anticipated spending to meet environmental regulations in following years, even though the differences between such amounts were material.⁸⁹ The SEC found U.S. Steel's reports for 1973 through 1979 to be deficient, even though the second sentence to what is now Item 101(c)(1)(xii), which explicitly requires disclosure for periods beyond the mandatory two years if expenditures are expected to be material, was not adopted until 1976.⁹⁰

82. *Id. re* United States Steel Corp., [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,376, 82,381 (Sept. 27, 1979).

83. *Id.* at 82,379.

84. *Id.* at 82,379 n.11.

85. *Id.* at 82,379.

86. *In re* United States Steel Corp., [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 82,379-380.

87. *Id.* at 82,380.

88. *Id.*

89. *Id.* at 82,381. For example, according to U.S. Steel's estimates, it would be required to spend \$135 million for compliance costs in 1978 and between \$1.035 and \$1.8 billion average per year from 1979-1983. *Id.* at 82,380 n.15.

90. *In re* United States Steel Corp., [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 82,384. With respect to the fact that disclosure was required,

B. Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")

1. Regulatory Scheme

The MD&A, as required by Item 303 of Regulation S-K, is a narrative discussion of the company's financial condition, changes in financial condition, and results of operation.⁹¹ The MD&A is required to be included in all annual⁹² and quarterly⁹³ reports filed under the Exchange Act and in certain registration statements filed under the Securities Act.⁹⁴

The MD&A, like Item 101(c)(1)(xii), requires registrants to look forward and make some future-oriented disclosure of potentially material information.⁹⁵ The MD&A, however, requires more than merely estimating and disclosing future capital expenditures. As the name indicates, the MD&A requires the registrant to analyze its financial condition and results of operations. The SEC, in its interpretations of this requirement, has made it abundantly clear that this requirement is designed to be more than a narrative discussion of the numbers in the financial statements.⁹⁶ According to the SEC,

MD&A is intended to give the investor an opportunity to look at the company through the eyes of management by

notwithstanding that the second sentence to Item 101(c)(1)(xii) was not adopted until 1976, the Commission said:

However, where a registrant expected that additional material capital expenditures would have to be authorized to achieve compliance for the periods beyond that for which information was given, and had in fact developed or received estimates with respect thereto, such estimates were required to be disclosed in order to make the disclosures made not misleading. These principals were not changed in 1976, when, to achieve uniformity, the Commission prescribed disclosure of estimated capital expenditures for minimum periods.

Id. at 82,383.

91. 17 C.F.R. § 229.303.

92. *Id.* § 229.303(a) (discussion of annual reports); see Form 10-K of Exchange Act, Part II, Item 7.

93. 17 C.F.R. § 229.303(b) (discussion of interim statements); see Form 10-K of Exchange Act, Part I, Item 2.

94. 17 C.F.R. § 229.303(a); see Form S-1 of the Securities Act, Part I, Item 11(h); Form S-4 of the Securities Act, Part 1, Item 14.

95. See *infra* text accompanying notes 98-100. Instruction 3 to Item 303 gives some flavor of the prospective nature of the disclosure sought by the MD&A. Instruction 3 states that the MD&A "shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition." 17 C.F.R. § 229.303, Instruction 3 (emphasis added).

96. MD&A Release, *supra* note 40, at 22,428.

providing both a short and long term analysis of the business of the company. The Item asks management to discuss the dynamics of the business and to analyze the financials.⁹⁷

Applying this broad standard to the disclosure of the effects of the 1990 Amendments results in a formulation of what is required under the MD&A: If the 1990 Amendments will have a material financial effect on the business, explain why and discuss and analyze the specifics of the effect.⁹⁸ Although such a formula is simply stated, it is difficult to satisfy.

The specifics required are: (1) an identification of "known trends or any known demands, commitments, events or uncertainties that will result in or *are reasonably likely to result in* the registrant's liquidity increasing or decreasing in any material way;"⁹⁹ (2) a description of "the material commitments for capital expenditures as of the end of the latest fiscal period;"¹⁰⁰ and (3) description of "any known material trends, favorable or unfavorable, in the registrant's capital resources;"¹⁰¹ and (4) a disclosure of "any known trends or uncertainties that have had or *that the registrant reasonably expects will have* a material favorable or unfavorable impact on net sales or revenues from continuing operations."¹⁰²

To determine whether disclosure of a known trend, demand, commitment, or uncertainty is required, the registrant must first determine whether such trend, demand, commitment, event or un-

97. *Id.* (citing Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, 52 Fed. Reg. 13,715, 13,717 (1987)).

98. As one set of commentators have said:

MD&A, which is required in all prospectuses and reports on forms 10-K and 10-Q, is one of the most carefully read sections of disclosure documents, since in it the issuer is required to explain its recent financial performance, compare such performance against prior periods, and identify trends that could have a material effect on future financial results. MD&A is also the only section in which predictive or future-oriented information is not only encouraged, but in certain instances, mandated. In essence, in MD&A the issuer is required to compare its most recent against previous financial performances and explain any significant differences between them, as well as identify any known trends and uncertainties that may affect the issuer's business.

See Justin P. Klein & Gerald J. Guarcini, *Through the Eyes of Management*, 25 Rev. Sec. & Commodities Reg. (Standard & Poor's Corp.), Sept. 23, 1992, at 177 (footnote omitted).

99. 17 C.F.R. § 229.303(a)(1) (emphasis added). "Liquidity" is defined as "the ability of an enterprise to generate adequate amounts of cash to meet the enterprise's needs for cash." *Id.* at Instruction 5.

100. *Id.* § 229.303(2)(i).

101. *Id.* § 229.303(2)(ii).

102. *Id.* § 229.303(3)(ii) (emphasis added).

certainty is likely to come to fruition.¹⁰³ If the registrant is unable to determine that such a happening is not reasonably likely to occur, it then must determine if a material effect on the registrant's financial condition from such happening is reasonably likely to occur.¹⁰⁴ If the registrant cannot determine that a material effect is "not reasonably likely to occur", then disclosure is required.¹⁰⁵

Applying the MD&A standards to the disclosure of information relating to compliance with, or other effects of, the 1990 Amendments will typically result in disclosure by the affected company in the MD&A. Given the enormity of the costs associated with bringing facilities into compliance with the 1990 Amendments, a registrant will not typically be able to conclude that a material effect on financial condition is "not reasonably likely" to occur, notwithstanding that the specific regulations implementing the provisions of the 1990 Amendments may not have yet been promulgated.¹⁰⁶ A registrant may be more likely to conclude that results of operations for a particular period are "not reasonably likely" to be impacted by the 1990 Amendments until such time as the implementing regulations are enacted and the standards set forth therein are known. At some point, however, the results of operations for a particular period may be affected as the effects of the 1990 Amendments become reality.¹⁰⁷

103. MD&A Release, *supra* note 40, at 22,430.

104. *Id.*

105. *Id.* The test for determining whether disclosure is required with respect to an occurrence, the "not reasonably likely" test, is a different test than the test usually applied to determine whether disclosure is warranted for an occurrence, which may be material, but whose outcome is unknown. *Id.* at 22,430 n.27. The Supreme Court has stated that assessing the importance to investors of information relating to a contingent event is "a fact specific inquiry" requiring "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in the totality of the company activity." *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988). SEC rejected the probability/magnitude test for evaluating the materiality of forward-looking information in the context of the MD&A describing the probability/magnitude test as being "inapposite" to the "not reasonably likely to occur" test. MD&A Release, *supra* note 40, at 22,430 n. 27.

106. *See supra* text accompanying notes 67-77.

107. Registrants are required to disclose "trends or uncertainties . . . that the registrant *reasonably expects will have* a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(a)(3)(ii) (emphasis added); *see also* 17 C.F.R. § 303, Instruction 3.

The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (A) matters that would have an impact on future operations and have not had an impact in the past, and (B) matters that have had an impact

2. *MD&A Disclosure Relating to Acid Rain Provisions of 1990 Amendments*

The principles described above can best be illustrated by considering the disclosure of the effects of the Acid Rain provisions of the 1990 Amendments¹⁰⁸ by certain registrants impacted thereby. The Acid Rain program is codified as Title IV to the CAA ("Title IV"). The primary purpose of Title IV is to reduce sulfur dioxide emissions from electric utilities.¹⁰⁹ The 1990 Amendments achieve this goal of reduced emissions by using an allowance program which limits the amount of sulfur dioxide that a utility may emit.¹¹⁰ Each allowance permits a plant to emit one ton of sulfur dioxide per year into the air.¹¹¹ In Phase I of the allowance program, which lasts from 1995 through 1999, allowances will be allocated to utilities based upon past usage of fuel.¹¹² In Phase II of the program, beginning in the year 2000, allowances will be reduced on the basis of a formula set forth in the statute.¹¹³

One way electric power plants may reduce sulfur dioxide emissions to conform with the allowance limits is by burning low-sulfur coal.¹¹⁴ Increased demand for low-sulfur coal is a trend impacting the coal companies. Those coal companies having large supplies of such coal can predict that their results of operations will be favorably impacted by this increased demand. Such predictions should become a part of the MD&A disclosure because the MD&A requires disclosure of "known trends . . . that registrant reasonably expects will have a material favorable or unfavorable impact on net sales or

on reported operations and are not expected to have an impact upon future operations.

Id.

108. CAA, 42 U.S.C. § 7651 (Supp. II 1990) (setting forth Title IV to Clean Air Act) [hereinafter Title IV].

109. *Id.* § 7651(b); see also Arnold W. Reitze, Jr., *A Century of Air Pollution Control Law: What's Worked; What's Failed; What Might Work*, 21 ENVTL. L. 1549, 1611 (1991) (noting Title IV primarily concerned with reducing sulfur dioxide emissions from electric power plants); Hon. Henry A. Waxman, *An Overview of the Clean Air Act Amendments of 1990*, 21 ENVTL. L. 1721, 1791 n.325 (1991) (noting that utilities produce 70% of sulfur dioxide emissions nationwide, with older coal-fired plants creating 90% of emissions).

110. CAA, 42 U.S.C. § 7651(b).

111. *Id.* § 7651b(a)(1).

112. *Id.* § 7651c(a), Table A.

113. *Id.* § 7651d(a)(2).

114. See Larry B. Parker, et al., *Clean Air Act Allowance Trading*, 21 ENVTL. L. 2021, 2044 (1991) (stating that nationwide sulfur dioxide reductions during Phase I are projected to be between 3.4 million and 4.0 million tons annually and noting that "[T]hese reductions would be accomplished primarily through switching power plants from high-sulfur to medium- or low-sulfur coals.")

revenues or income from continuing operations.”¹¹⁵ Those coal companies whose coal reserves are primarily composed of high-sulfur content coal can likewise predict that demand for their product may decrease. The companies should analyze the effect that such reduced demand will have on their financial condition, and on short and long-term results of operations.¹¹⁶

Another way in which electric utilities can reduce their sulfur dioxide emissions is to install “qualifying Phase I technology,” commonly known as “scrubbers,” which reduce the emissions caused by the burning of high-sulfur coal.¹¹⁷ Those utilities which install scrubbers receive additional allowances and may delay Phase I compliance for two years.¹¹⁸ These bonus allowances, which provide utilities with an incentive to install scrubbers, were apparently designed to preserve demand for high-sulfur coal.¹¹⁹ To the extent that a utility has decided to install scrubbing technology, and the effects of the installation are material, the utility should deal with these issues in its MD&A. For example, one utility in its MD&A specifically cross-referenced the “Environmental Matters” section of its annual report, in which it said:

The [1990 Amendments], among other things, require an annual reduction in total utility emissions within the United States of 10 million tons of sulfur dioxide and two

115. 17 C.F.R. § 229.303(a)(3)(ii); *see, e.g.*, THE PITTSBON CO., 1992 FORM 10-K 25 (1993) (“The spot market for steam coal in the United States remains very weak. However, some eastern utilities that currently burn high sulfur coal are expected to switch some of their coal requirements to eastern low sulfur coal to meet new, more stringent clean air standards. This should help improve prices of low sulfur steam coal of which the coal operations have abundant reserves.”); CYPRUS MINERALS CO., 1992 ANNUAL REPORT 25 (1993) (“Decisions by utilities to purchase more low sulfur coal as part of their Clean Air Act compliance programs could improve Cyprus’ longer term competitive position, as Cyprus’ reserves consist of relatively low sulfur coal.”).

116. 17 C.F.R. § 229.303(a)(3)(ii); *see, e.g.*, MAPCO INC., 1992 ANNUAL REPORT 19 (1993) (“The Clean Air Act is expected to alter the pattern of U.S. coal consumption, especially in 1994 and beyond, resulting in a general decrease of demand for lower sulfur coals. Legislation of this type is not expected to materially impact the Coal segment’s future operating results primarily because MAPCO’s higher sulfur coals are sold to customers with scrubbers, or who have indicated their intentions to install scrubbers, combined with the anticipated favorable impact on the marketability and pricing for low sulfur and compliance coal.”).

117. *See* CAA, 42 U.S.C. § 7651a(19) (defining “qualifying Phase I technology” to be “a technological system of continuous emission reduction which achieves a 90 percent reduction in emissions of sulfur dioxide from the emissions that would have resulted from the use of fuels that were not subject to treatment prior to combustion.”).

118. *See id.* § 7651c(d)(1).

119. Waxman, *supra* note 109, at 1795.

million tons of nitrogen oxides from 1980 emission levels, to be completed in two phases. . . . It is expected that the installation of scrubbers at [one of the company's plants] in Phase I (1995) and, subject to continuing studies, possibly scrubbers at [another of the company's plants] will be the strategy undertaken by the subsidiaries to meet the required sulfur dioxide emission reductions. If compliance with the proposed nitrogen oxide emission reductions can be achieved with burner modifications at various power stations and continuous emission monitoring equipment now being installed meets the [1990 Amendments] requirements, System capital expenditures of approximately \$1.4 billion through the year 2000 will be required. Studies to evaluate cost-effective options to comply with the CAAA, including those which may be available from an emission allowance trading market, are continuing. In addition, since no regulations are final and some are not yet even published, governmental interpretations different from those assumed could substantially change compliance requirements and the cost thereof. One of the features of the CAA is to create allowances. An allowance is defined as an authorization for an owner to emit one ton of sulfur dioxide into the atmosphere. Subject to regulatory supervision, allowances (including bonus and extension allowances) not used by an owner for its own compliance may be sold or "banked" for future use or sale. It is anticipated that the subsidiaries will have a substantial number of excess allowances available, but the precise number cannot now be determined. As a result, the benefit, if any, to the subsidiaries of such allowances is unknown.¹²⁰

120. ALLEGHENY POWER SYS., INC., 1992 ANNUAL REPORT 8-9 (1993); *see also* PENNSYLVANIA POWER & LIGHT CO., 1992 ANNUAL REPORT 20 (1993).

In November 1990, federal clean air legislation was enacted that deals, in part, with acid rain, attainment of federal ambient ozone standards and toxic air emissions. The acid rain provisions, which are contained in Title IV of the legislation, specify Phase I sulfur dioxide emission limits on about 55% of the Company's coal-fired generating capacity by January 1, 1995, and more stringent Phase II sulfur dioxide emission limits for all of the Company's fossil-fired generating units by January 1, 2000.

The Company expects to meet the Phase I sulfur dioxide standards by the use of lower sulfur coal, additional processing of coal through cleaning plants, and the installation of scrubbers at [one of its plants], in which it has an 11.39% ownership interest. The Company may also choose to limit the generation at certain units and to bank or trade emis-

3. *MD&A Disclosure Relating to Effects of 1990 Amendments' Requirements Concerning Reformulated Gasoline and Oxygenated Fuels*

The 1990 Amendments to Title II of the CAA also present a disclosure challenge for affected companies. As with the coal companies, producers of gasoline will, because of the 1990 Amendments, face increased demand for certain kinds of fuel which will be required by users to meet emissions limitations set forth in the 1990 Amendments. The gasoline producers face a challenge in this regard beyond that faced by the coal companies in that to meet this increased demand, they must make substantial modifications to existing facilities.¹²¹ Thus, the MD&A disclosure must not only address the increased demand and its potential consequences, but must also deal with the consequences associated with expenditures relating to the changes necessary to meet such increased demand.

The 1990 Amendments require EPA to order: the greatest reduction in emissions of ozone forming volatile organic compounds (during the high ozone season) and emissions of toxic air pollutants (during the entire year) achieving through the reformulation of conventional gasoline, taking into consideration the cost of achieving such emission reductions, any nonair-quality and other air-quality related health and environmental impacts and energy requirements.¹²²

The reformulated gasoline must meet minimum specifications.¹²³ Beginning on January 1, 1995, only reformulated gasoline can be sold in nine areas of the country representing approximately 20% of the U. S. gasoline market.¹²⁴ Further, only reformulated gasoline may be sold in any area whose ozone nonattainment level is reclassified as "severe" one year after the date of such reclassifica-

sion allowances among its units or with other utilities, to the extent permitted by the legislation.

Id.

121. *See infra* notes 129-30.

122. 42 U.S.C. § 7545(k)(1).

123. *Id.* § 7545(k)(2)(B)-(D).

124. *Id.* § 7545(k)(5). The nine areas are the areas of population of 250,000 or more and having the highest ozone levels as of the date of enactment of the 1990 Amendments. 42 U.S.C. § 7545(k)(10)(D). These areas are: Los Angeles, New York, Chicago, Houston, Milwaukee, Baltimore, Philadelphia, San Diego and Muskegon. Rep. John Dingell, Comm. on Energy and Commerce, Clean Air Act Amendments of 1990, Report Together with Additional, Supplemental, and Dissenting Views, H.R. REP. NO. 490, 101st Cong., 2d Sess., pt.1, at 230 (1990).

tion.¹²⁵ Any ozone nonattainment area not otherwise covered may "opt in" to the reformulated gasoline program upon the Governor of the State filing an application with EPA.¹²⁶

The 1990 Amendments also added a provision to Title II which requires States in carbon monoxide nonattainment areas to revise their SIPs so that only oxygenated fuels (a minimum of 2.7 percent oxygen by weight) can be sold during the "portion of the year in which the area is prone to high ambient concentrations of carbon monoxide" (i.e., the winter months).¹²⁷ The covered areas represent many of the major metropolitan areas of the country, and again, comprise a good portion of the U.S. gasoline market.¹²⁸

Gasoline producers will be forced to meet the demand for these new fuels. The demand will be substantial in light of the size of the markets which make up the covered areas. It is no easy matter for refiners to change their processes to produce gasoline which complies with the new standards.¹²⁹ The expenditures required to make these changes in the process are substantial. The gasoline producers, thus, should discuss in their MD&As the effects that these expenditures will have on their financial condition and results of operations.¹³⁰ The MD&A should also take into consider-

125. 42 U.S.C. § 7545(k)(10)(D).

126. *Id.* § 7545(k)(6)(A).

127. *Id.* § 7545(m)(2).

128. See Garrett & Winner, *supra* note 72, at 10,261-62 (citing 56 Fed. Reg. 31,153 (July 9, 1991)).

129. See *DOE Council Says CAA Compliance to Cost More than Refineries Value*, AIR WATER POLLUTION REP. (Business Publishers, Inc., Silver Spring, MD), Sept. 6, 1993 available in LEXIS, News Library, ALLNWS File (refinery modifications to meet requirements of Clean Air Act will cost \$36.3 billion (calculated in 1993 dollars) through 2010, book value of all U.S. refineries is \$31 billion, and cost of meeting the reformulated gasoline and ultra-low sulfur diesel fuel requirements of 1990 Amendments will be \$13.7 billion); Susie T. Parker, *Many Small Refiners to Close Doors as Environmental Costs Mount*, (Kidder, Peabody and Co. Report), OIL DAILY, July 1, 1992, at 5 (quoting report issued by Kidder, Peabody & Co. predicting many smaller refineries will be unable to make investment necessary to make reformulated gasoline and desulfurized diesel fuel and thus will be forced to close); *EPA's Ethanol Move Deserves Suspicion*, OIL & GAS J., Jan. 4, 1994, at 17, available in LEXIS, NEXIS Library, ALLNWS File (describing costs that refiners face to meet 1990 Amendments reformulated gasoline and oxygenated fuels requirements as "stratospheric"); *Air Act's Oxygenate Limits for Gasoline Could be Hard to Meet*, Industry Report Says, 22 Env't Rep. (BNA) 557 (July 5, 1991) (noting that because of 1990 Amendments, petroleum industry faces difficult time meeting demand for oxygenated fuels).

130. *Id.* For example, one gasoline producer said in its MD&A:

The 1990 amendments to the Clean Air Act required a significant increase in the oxygen content of gasoline sold in certain U.S. markets beginning in November 1992 and will require further significant reformulation of gasoline for nine major metropolitan markets by January 1995. This legislation requires major capital expenditures for the in-

tion the implications that a market for the new fuels will have on the business of the registrant.¹³¹

C. Disclosure of Legal Proceedings Brought Under 1990 Amendments

1. *Civil Penalties*

a. *Government Enforcement*

Prior to the 1990 Amendments, EPA's primary means of enforcing the CAA was to bring a civil suit against those persons who violated its provisions.¹³² A civil suit can lead to an injunction or a penalty of up to \$25,000 per day of violation.¹³³ The 1990 Amendments added a provision which allows EPA to assess administrative penalties for the same violations which may form the basis for a civil

dustry and may, ultimately, result in higher retail gasoline prices for consumers. The Company's capital expenditures related to air quality were over \$270 million in 1992. Current estimates are it will spend about \$2 billion over the next five years to meet federal and state clean-air regulations for its products and facilities. This is an addition to the ongoing costs of complying with other environmental regulations.

CHEVRON CORP., 1992 ANNUAL REPORT 31-32 (1993). Another company discussed in its MD&A the particulars of efforts to meet 1990 Amendments requirements as follows:

The Corporation is also taking steps to produce gasolines that meet the requirements for oxygenated and reformulated gasolines under the Clean Air Act of 1990. At its Port Reading facility, the Corporation has a methyl tertiary butyl ether (MTBE) unit with the capacity to produce 1,700 barrels of MTBE per day. As part of the major upgrading project at the Virgin Islands refinery, the Corporation is constructing a MTBE unit and a tertiary amyl methyl ether (TAME) unit. MTBE and TAME are blending components for oxygenated and reformulated gasolines.

AMERADA HESS CORP., 1992 ANNUAL REPORT 20 (1993).

131. See *supra* text accompanying note 95. With respect to the effects of the 1990 Amendments in this regard, one company has said:

In the next several years, total environmental expenditures are expected to approximate 1992 levels or increase as Shell Oil complies with requirements under existing law, as well as with regulations yet to be promulgated or finalized. The federal Clean Air Act and related state laws such as the California air emission standards . . . are expected to have a pronounced, but as yet not yet fully understood, effect on all areas of Shell Oil's operations over the next decade as we and those with whom we do business strive to adapt to such evolving requirements. Compliance with such laws, such as the 1992 requirements to add oxygenates to fuels will add to the cost of doing business.

SHELL OIL COMPANY, 1992 Annual Report 25 (1993).

132. 42 U.S.C. § 7413(b). The suits may be brought for violations of most of the Titles of the Clean Air Act, regulations thereunder and violations of compliance orders issued by the EPA under Section 113(a)(1) of the Clean Air Act. *Id.* § 7413(a)(1).

133. *Id.*

suit.¹³⁴ The daily limit on administrative penalties, like civil penalties, is \$25,000 per day of violation.¹³⁵ The maximum amount of an administrative penalty is \$200,000.¹³⁶ The administrative action must be initiated within twelve months of the first date of violation.¹³⁷

With the increased chance of civil penalties, especially penalties of the magnitude of those contemplated by these provisions, the chance that a CAA-related proceeding will be disclosable also increases.¹³⁸ Item 103 of Regulation S-K requires registrants to disclose on a quarterly basis material legal proceedings which are not "ordinary routine litigation incidental to the business."¹³⁹ Instruction 5 to Item 103 deems environmental proceedings not be "ordinary routine litigation incidental to the business" if:

A. Such proceeding is material to the business or financial condition of the registrant;

B. Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds [ten] percent of the current assets of the registrant on a current basis; or

C. A governmental authority is a party to such proceeding and such proceeding involves monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions or in monetary sanctions, exclusive of interest and costs, of less than

134. 42 U.S.C. § 7413(d).

135. *Id.*

136. *Id.*

137. *Id.* The Attorney General and EPA Administrator may jointly determine that the penalty amount may exceed \$200,000 or a longer period of violation is appropriate. *Id.*

138. Another provision added by the 1990 Amendments allows the EPA to issue field citations in amounts up to \$5,000 per day. Because the limit on these penalties, they will not ordinarily be disclosable. See *infra* text accompanying notes 140-49.

139. 17 C.F.R. § 229.103 (1993). Item 103 states:

Describe briefly 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 property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities.

Id.

\$100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically.¹⁴⁰

Given the potential for fines in excess of \$100,000 to be levied by EPA under the 1990 Amendments, Instruction 5(C) to Item 103 may, in the future, play a prominent role in the disclosure of CAA-related legal proceedings. EPA has, in fact, exercised its administrative authority under the 1990 Amendments to levy fines in excess of \$100,000.¹⁴¹ Thus, it is necessary to examine this provision in some detail.

As EPA is a government authority, the first question is whether the administrative penalty involves a "proceeding." An administrative penalty can be assessed "by an order made after opportunity for a hearing on the record."¹⁴² Additionally, the SEC has interpreted the term "proceeding," as it is used in Item 103, broadly, especially in the context of environmental laws.¹⁴³ The SEC interpreted the forbearer of Item 103 to require the disclosure of "all administrative orders, whether or not these orders literally follow a 'proceeding.'"¹⁴⁴ Given that a hearing is a prerequisite for an EPA administrative penalty and the liberal reading given to the term "proceeding" by the SEC, there is no doubt that such a penalty would be disclosable pursuant to Instruction 5(C) of Item 103, provided the other prerequisites for disclosure had been met. Instruction 5(C) applies only when "sanctions" in excess of \$100,000 may be involved.¹⁴⁵ An administrative penalty will constitute a "sanc-

140. *Id.* at Instruction 5(A)-(C).

141. *See Record Air Pollution Fine Levied in Washington*, 23 *Env't Rep.* (BNA) 2733 (Feb. 19, 1993) (reporting what was termed at that time to be highest administrative penalty collected by EPA since 1990 Amendments, a fine of \$138,620 collected from Reynolds Metals Co. for violations at Longview, Washington plant). The company against which the fine was levied reported the following in its Form 10-K for the fiscal quarter in which the administrative action was initiated:

On July 29, 1992, Region 10 of the U.S. Environmental Protection Agency (the "Agency") filed an administrative complaint against the Registrant alleging opacity violations of the federal Clean Air Act and state air pollution regulations at the Registrant's Longview, Washington primary aluminum production plant (the "Longview Plant"). The Agency seeks \$154,000 in civil penalties. The registrant is negotiating a consent agreement with the Agency to settle the matter.

REYNOLDS METAL CO., FORM 10-Q (1992).

142. 42 U.S.C. § 7413(d)(2)(A).

143. *See Environmental Disclosure*, *supra* note 75, at 457.

144. *Id.* The Commission said that in this regard, the consequences of a judicial or administrative consent order could be just as significant as those of a fully litigated proceeding. *Id.*

145. 17 C.F.R. § 229.103, Instruction 5(C).

tion" for purposes of Item 103, Instruction 5(C).¹⁴⁶ As EPA is authorized to levy administrative penalties of up to \$25,000 per day, the \$100,000 disclosure threshold could be surpassed by one incident if the violation resulting therefrom continues for four or more days. A registrant may exclude proceedings leading to sanctions from its Item 103 disclosure so long as it "reasonably believes" that the sanctions, exclusive of interest and costs, will not exceed \$100,000.¹⁴⁷ Since the administrative penalty is assessed by an order issued after a hearing, a registrant has little grounds, other than a successful appeal of the order, for a "reasonable belief" that sanctions will be less than \$100,000 if fines in excess of this amount are a part of the order.¹⁴⁸

The discussion in the preceding paragraphs focused on EPA administrative penalties because they are a feature of the 1990 Amendments. Instruction 5(C) to Item 103, however, is equally applicable to the civil penalties which may still be imposed after the 1990 Amendments. For example, in 1993, Louisiana-Pacific Corporation agreed to pay a \$11.1 million civil fine to settle charges of violating the CAA by failing to obtain permits at some facilities and falsifying the information necessary to obtain other permits.¹⁴⁹ The fine was the largest ever levied under the CAA.¹⁵⁰ The government did not pursue criminal sanctions against the Company because

146. See *Proposed Amendments to Item 5 of Regulation S-K Regarding Disclosure of Certain Environmental Proceedings*, 22 SEC Docket (CCH) 946, 950 (May 19, 1981) [hereinafter *Proposing Release*] (noting that disclosure is not required if registrant reasonably believes that "fines" will be less than \$100,000); *id.* at 951 (referring to "\$100,000 fine threshold") (emphasis added).

147. 17 C.F.R. § 229.103, Instruction 5(C) (1993). The SEC has said that the "reasonable belief" must exist at the time the disclosure document is filed and must be reevaluated as the circumstances surrounding the proceeding change. *Proposing Release*, *supra* note 146, at 951.

148. 42 U.S.C. § 7413(d)(2)(A). The administrative penalty may be appealed to federal district court within 30 days after it becomes final. *Id.* § 7413(d)(4). The federal district court "shall not set aside or remand such order . . . unless there is not substantial evidence in the record, taken as a whole, to support the finding of a violation or unless the order . . . constitutes an abuse of discretion." *Id.* In light of the standard of review, it will not be often that a registrant will be able to form a reasonable belief that the appeal will result in sanctions of less than \$100,000, if sanctions in excess of this amount were contained in the order. Item 103 calls for disclosure of proceedings "known to be contemplated by government authorities." 17 C.F.R. § 229.103. It may be possible that the registrant will know that the EPA is contemplating a proceeding involving an administrative penalty, but "reasonably believes" that the administrative penalty will be less than \$100,000. This is another instance where the reasonable belief exception would come into play with respect to the disclosure of EPA administrative penalties.

149. See *Louisiana-Pacific to Pay \$11 Million to Settle Charges of Clean Air Violations*, 24 Env't Rep. (BNA) 179 (May 28, 1993).

150. *Id.*

many of the violations occurred before the criminal provisions of the CAA were strengthened by the 1990 Amendments.¹⁵¹ In addition to the fine, Louisiana-Pacific agreed to install \$70 million dollars worth of pollution abatement equipment at certain of its facilities during a two year period.¹⁵² Before the litigation was settled, Louisiana-Pacific included the following description of the litigation in its Form 10-Q:

On April 14, 1993, the United States Environmental Protection Agency issued Notices of Violation ("NOVs") against the registrant and its wholly owned subsidiary, Kirby Forest Industries ("Kirby"). These NOVs allege that the registrant and Kirby are in violation of the [CAA] at ten oriented strand board plants, three fiberboard plants, and a particleboard plant. The April 14, 1993 NOVs supersede prior NOVs that alleged violations at nine of such oriented strand board plants and one of such fiberboard plants. The alleged violations include failure to obtain permits in accordance with Prevention of Significant Deterioration ("PSD") regulations under the Act prior to construction of certain of the facilities, various violations of PSD regulations, and state permits and certain violations of the information submission requirements of the Act. Potential costs resulting from an enforcement action could result in penalties and substantial capital expenditures but are not expected to have a material adverse effect on the registrant. Management's estimates of the penalties have substantially been accrued for. The superseded NOVs were reported in Item 3 of the registrant's Form 10-K report for 1992.¹⁵³

Assuming that the government had not pursued civil fines against Louisiana-Pacific, but instead had concentrated solely on requiring the Company to install the \$70 million worth of pollution abatement equipment, information regarding the litigation may still have been required to be disclosed under Item 103 in light of the material capital expenditures that Louisiana-Pacific was obligated to incur as a result thereof.¹⁵⁴

151. *Id.* For a discussion of the 1990 Amendments strengthening of the CAA's criminal provisions, see *infra* text accompanying notes 166-75.

152. *Id.*

153. LOUISIANA-PACIFIC CORP., FORM 10-Q, 4 (1993).

154. 17 C.F.R. § 229.103, Instruction 5(A).

b. *Citizen Suits*

Citizens may bring civil actions under the CAA to enforce its provisions. Prior to the 1990 Amendments, this allowed citizens to bring suit for violations of "emission standards" or "emission limitations" or for violations of EPA orders with respect thereto.¹⁵⁵ The relief under such suits was limited to injunctive relief and no penalties could be had.¹⁵⁶ Prior to the adoption of the 1990 Amendments, use of this mechanism was "relatively rare."¹⁵⁷ Thus, there was little potential for a disclosable citizen suit under the CAA.

The 1990 Amendments, however, made a number of changes to the citizen suit provision which may increase the number of citizen suits filed, and thus present disclosure issues for registrants faced with such suits.¹⁵⁸ The 1990 Amendments strengthened the citizen suit provisions of the CAA by, among other things: (1) enabling citizens to enforce more classes of violations;¹⁵⁹ (2) explicitly allowing citizens to bring suits for past violations "if there is evidence that the alleged violation has been repeated";¹⁶⁰ and (3) allowing courts to assess civil penalties.¹⁶¹ Because of the increased potential for suits as a result of the provision which allows citizens to collect penalties, it has been termed the most important feature of the 1990 Amendments to the citizen suit provisions of the CAA.¹⁶² Despite the increased potential for such suits, there have been no reported citizen suits against corporate stationary sources since the adoption of the 1990 Amendments.¹⁶³

155. 42 U.S.C. § 7604(a)(1).

156. *Id.*

157. Theodore L. Garrett & Sonya D. Winner, *A Clean Air Act Primer: Part III*, 22 *Envl. L. Rep. (Envl. L. Inst.)* 10,301, 10,310 (May 1992).

158. *Id.*; see also David T. Buente, *Citizen Suits and the Clean Air Act Amendments of 1990: Closing the Enforcement Loop*, 21 *Envl. L.* 2233, 2251 (1991) ("1990 Amendments create powerful new citizen enforcement tools for that will probably increase citizen suits under the CAA").

159. 42 U.S.C. § 7604(f) (1990 Amendments' provision allowing citizen suits to enforce 1990 Amendments' permit scheme or any EPA approved SIP, which were not among classes of violations which citizens could bring suit to enforce prior to 1990 Amendments); see also 42 U.S.C. § 7412(r) (1990 Amendments extended the definitions of "emission limitations" and "emission standard," violations of which citizens were authorized to bring suits for prior to 1990 Amendments so that citizen suits could be brought to enforce CAA equipment, design, work practice or operating standards).

160. 42 U.S.C. § 7602(k).

161. *Id.* § 7604(a).

162. Garrett & Winner, *supra* note 157, at 10,310.

163. This may be due in part to the fact that the provision which allows citizen suits to be brought for past violations is not effective until a suit is brought "two years after the enactment" of the 1990 Amendments. *Id.* § 7604(g).

Given the increased potential for such suits, however, registrants should be prepared to face disclosure issues relating thereto. As such suits do not involve a government authority,¹⁶⁴ Instruction 5(C) to Item 103 is not applicable and such suits are disclosable only if they are either: (1) material; or (2) make a claim for in excess of ten percent of the registrants current assets.¹⁶⁵

2. Criminal Penalties

The 1990 Amendments also increased both the chance that a corporation might be convicted of a crime under the CAA and the possibility that disclosure will be required should a conviction occur.¹⁶⁶ The 1990 Amendments raised the penalties for certain violations of the CAA from misdemeanors to felonies.¹⁶⁷ With this rise comes a rise in the potential fine, which increases the chance that the \$100,000 threshold for disclosure will be met.¹⁶⁸ The 1990 Amendments also created a new crime for "knowing endangerment" violations of the CAA.¹⁶⁹ Organizations convicted of this crime may be fined up to \$1 million.¹⁷⁰ Another new crime added by the 1990 Amendments is a "negligent endangerment" offense for negligent releases that cause an imminent danger of death or

164. Citizens are precluded from bringing an enforcement action if the government is pursuing such an action. *Id.* § 7604(b)(1)(B).

165. 17 C.F.R. § 229.103, Instructions 5(A)-(C).

166. See generally Comment, *The Clean Air Act Amendments of 1990: Enhanced Criminal Liability*, 3 VILL. ENVTL. L.J. 181 (1992).

167. 42 U.S.C. § 7413(c)(1).

168. Fines for violations of CAA by organizations may be levied under Section 18 of the U.S. Code. 42 U.S.C. §§ 7413(c)(1)-(5). Organizational fines for Class A misdemeanors not resulting in death may be for amounts up to \$200,000 (the fine for a misdemeanor resulting in death may be in an amount of up to \$500,000) and fines for felonies committed by organizations may be for amounts of up to \$500,000. 18 U.S.C. §§ 3571(c)(3)-(5) (Supp. II 1990). Additionally, the alternate fines provisions may be invoked to fine the violator in an amount of up to twice the gain derived from, or the losses caused to third parties by, the violation. *Id.*

169. 42 U.S.C. § 7413(c)(5)(A) ("Any person who knowingly releases into the ambient air any hazardous air pollutant . . . or any extremely hazardous substance . . . and who knows at the time that he thereby places another person in imminent danger of death or serious bodily injury shall, upon conviction, be punished by a fine under Title 18, or by imprisonment of not more than 15 years, or both."). "Person" is defined to include both corporations and the "responsible" officers thereof. *Id.* §§ 7413(c)(6), 7602(e).

170. *Id.*

serious bodily injury.¹⁷¹ The “negligent endangerment” offense is a misdemeanor.¹⁷²

While the enhanced criminal sanctions provided by the 1990 Amendments have not yet been used by the government against a major corporation, it may only be a matter of time before an action of this sort is brought.¹⁷³ In recent years, enormous criminal fines for violations of environmental laws have become more frequent.¹⁷⁴ Given the combination of these factors, the registrant should be aware of the possibility that it may face the need to make disclosure under Item 103 of Regulation S-K with respect to criminal fines for CAA violations.¹⁷⁵

IV. ANTIFRAUD PROVISIONS

Federal securities laws contain a number of antifraud provisions making it illegal to make material misstatements or omit to state a material fact.¹⁷⁶ These provisions are applicable to publicly-

171. *Id.* § 7413(c)(4) (“Any person who negligently releases into the ambient air any hazardous air pollutant . . . or any extremely hazardous substance . . . and who at the time negligently places another person in imminent danger of death or serious bodily injury shall, upon conviction, be punished by a fine under Title 18, or by imprisonment of not more than 1 years, or both.”).

172. *Id.*

173. The government received some criticism in the Louisiana-Pacific case for not pursuing criminal sanctions against Louisiana-Pacific. The government countered this criticism by noting that the violations at issue occurred prior to the enactment of the 1990 Amendments, implying that post-1990 Amendments violations of a similar nature will be met with criminal sanctions. *See supra* text accompanying notes 149-54. In what was described as “the nation’s first criminal prosecution of a company for violating State Implementation Plan provisions governing emissions of volatile organic compounds,” a manufacturer of adhesive tape was fined \$100,000 and sentenced to five years of probation during which it will perform environmental tasks estimated to cost at least \$200,000. *See Pennsylvania Company Placed on Probation, Ordered to Perform Projects for VOC Violation*, 24 Env’t Rep. (BNA) 1998 (Mar. 25, 1994).

174. Joseph G. Block, *Environmental Criminal Enforcement in the 1990s*, 3 VILL. ENVTL. L.J. 33, 38 (1992).

175. Instruction 5(C) to Item 103 should again be considered as a government authority will be involved if criminal sanctions are sought. 17 C.F.R. § 229.103, Instruction 5(C). Unless the registrant “reasonably believes” that fines will be less than \$100,000, disclosure would be required. *Id.*; *see supra* text accompanying notes 140-148.

176. *See* 15 U.S.C. § 77k (Section 11 of Securities Act dealing with material misstatements or omissions in registration statements); 15 U.S.C. § 77l(2) (Section 12(2) of Securities Act prohibiting material misstatements or omissions in prospectus or oral communication used in sale of securities); 15 U.S.C. § 77q(a) (Section 17 of Securities Act proscribing use of material misstatements or omissions in connection with sale of securities on primary market); 15 U.S.C. § 78j(b) & 17 C.F.R. § 240.10b-5 (Section 10(b) of Securities Act and Rule 10b-5 of Exchange Act prohibiting use of false and misleading statements in connection with purchase or sale of security on secondary market); 15 U.S.C. § 78n(e) (Section 14 of Exchange

held companies.¹⁷⁷ The antifraud provisions may be enforced by private plaintiffs or the SEC.¹⁷⁸ Plaintiffs may base their fraud claims on omissions or misstatements with respect to the information required to be disclosed under one of the Items of Regulation S-K.¹⁷⁹ This makes correctly disclosing the information required under these Items all the more important in that the damages available to private plaintiffs under these provisions have been described as being "huge."¹⁸⁰

V. CONCLUSION

The 1990 Amendments, because of their structure and magnitude of the associated expenditures, present profound challenges in terms of disclosing compliance costs which may be required thereunder and potential liabilities which may be incurred as a result thereof. To the extent that such information is material, disclosure is required. The primary problem that registrants may face is in determining, for purposes of disclosure under Items 101 and 303, the materiality of the information associated with costs of compliance when the standards for compliance have not yet been clearly established. However, in light of the anticipated magnitude of such costs, and preeminent position that such costs have begun to take in the minds of the SEC, investors and the business community, it may be in the best interest of the registrants significantly affected by the 1990 Amendments to begin the disclosure analysis by assuming that such expenditures are material. While care should be taken to avoid including trivial information in the re-

Act prohibiting use of false or misleading statements in connection with solicitation of proxy); 15 U.S.C. § 78r(a) (Section 18 of Exchange Act establishing liability for false or misleading statements with respect to material facts included in documents filed with SEC). The potential materiality of the costs associated with complying with the 1990 Amendments discussed in part II *supra* is equally applicable in this context.

177. *Id.*

178. *Id.* There is a split of authority as to whether there is a remedy which may be implied for violations of Section 17(a). See ROBERT J. HAFT, LIABILITY OF ATTORNEYS AND ACCOUNTANTS FOR SECURITIES TRANSACTIONS § 4.01, at 4-1. (1993-94 ed.).

179. See, e.g., *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989); *Levine v. NL Industries Inc.*, 926 F.2d 199 (2d Cir. 1991).

180. David S. Ruder et al., *Disclosure of Environmental Problems*, 47 *Env'tl. Counselor* 18, 19 (July 15, 1992) ("Damage awards in private actions can be huge, since they are typically based upon the number of shares purchased or sold multiplied by the amount the stock price was affected by the misrepresentation or omission."). Additionally, the SEC's power to sanction companies for inadequate disclosure of costs and liabilities relating to compliance with the 1990 Amendments is by no means insignificant. See *supra* text accompanying notes 28-29.

quired disclosure, it is probably in the registrant's best interest to err on the side of providing too much, rather than too little, information with respect to compliance costs and potential liabilities associated with the 1990 Amendments. The registrant's advisors should marshal all the relevant facts necessary to formulate the disclosure and sift through such information to determine which of such information would be important to a reasonable investor and disclose this information.

Despite the difficulties inherent in making disclosures of this type, it is imperative that the registrant make the effort to gather and disclose the required information with respect to the impact of the 1990 Amendments on its operations and financial results and conditions. The registrant's shareholders and the public are entitled to this information and the failure to make the required disclosure could result in severe consequences to the registrant, and ultimately, its shareholders.