



1994

The Pendulum Swings Back: Why the SEC Should Rethink Its Policies on Disclosure of Environmental Liabilities

Elizabeth Glass Geltman

Follow this and additional works at: <https://digitalcommons.law.villanova.edu/elj>



Part of the [Environmental Law Commons](#), and the [Secured Transactions Commons](#)

Recommended Citation

Elizabeth G. Geltman, *The Pendulum Swings Back: Why the SEC Should Rethink Its Policies on Disclosure of Environmental Liabilities*, 5 Vill. Evtl. L.J. 323 (1994).

Available at: <https://digitalcommons.law.villanova.edu/elj/vol5/iss2/3>

This Symposia is brought to you for free and open access by Villanova University Charles Widger School of Law Digital Repository. It has been accepted for inclusion in Villanova Environmental Law Journal by an authorized editor of Villanova University Charles Widger School of Law Digital Repository.

1994]

THE PENDULUM SWINGS BACK: WHY THE SEC SHOULD
 RETHINK ITS POLICIES ON DISCLOSURE OF
 ENVIRONMENTAL LIABILITIES

ELIZABETH GLASS GELTMAN†

TABLE OF CONTENTS

I. INTRODUCTION	323
II. GOAL OF SECURITIES DISCLOSURE: FULL & FAIR DISCLOSURE	330
III. EVOLUTION OF SEC ENVIRONMENTAL DISCLOSURE RULES	337
IV. REGULATION S-K	351
V. MANAGEMENT DISCUSSION AND ANALYSIS	357
VI. SEC-EPA DATA EXCHANGE	361
VII. STAFF ACCOUNTING BULLETIN CONCERNING DISCLOSURE OF ENVIRONMENTAL CONTINGENCIES	362
VIII. CURRENT DISCLOSURE TRENDS	370
IX. CONCLUSION	376
Appendix A	379
Appendix B.....	381
Appendix C	386
Appendix D	393

I. INTRODUCTION

During the period of the Great Depression, the nation faced an unparalleled economic crisis. As part of its attempt to abate the crisis, Congress passed the Securities Act of 1933 (the "1933 Act")¹ and the Securities Exchange Act of 1934 (the "1934 Act")² with the view that regulation of the securities markets was an urgent national concern. Under the Acts, Congress delegated very broad regulatory powers to the SEC. One of the most important authorities delegated to the SEC was the broad discretion to promulgate rules governing corporate disclosures.³

† Associate Professor, National Law Center, George Washington University, Washington, D.C.; Of Counsel, Squire, Sanders & Dempsey, Washington, D.C.; Member, Maryland and District of Columbia bars.

1. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988).

2. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988).

3. *Natural Resource Defense Council v. SEC*, 606 F.2d 1031, 1050 & 1050 n.26 (D.C. Cir. 1979) [hereinafter *NRDC III*]. "The degree of discretion accorded the

In exercising this discretion, the SEC has developed rules and regulations requiring extensive disclosures by those companies subject to SEC regulation, including environmental disclosures. The importance of environmental disclosures by U.S. corporations is magnified by the growing number of "ethical investors," those "individuals and institutions such as . . . universities and foundations which have large funds to invest and need [environmental disclosures] in order to make investment and voting decisions in accordance with their high principles and societal interests."⁴

SEC is evident from the language in the various statutory grants of rulemaking authority." *Id.* at 1150. For example, in § 7 of the 1933 Act, certain types of information must be disclosed in registration statements. 15 U.S.C. § 77g. Section 10(c) of the 1934 Act similarly applies to disclosures in a prospectus. 15 U.S.C. § 77j(c). Furthermore, these sections, in identical wording, 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." 15 U.S.C. §§ 77g, 77j(c).

The SEC's general regulatory power is provided in § 19(a) of the 1933 Act, which authorizes the SEC to promulgate such rules "as may be necessary to carry out the provisions of this subchapter." 15 U.S.C. § 77s(a). Section 23(a) of the 1934 Act grants the SEC power "as may be necessary or appropriate 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 . . ." 15 U.S.C. § 78w(a).

In addition, the 1934 Act gives the SEC rulemaking authority. Section 12(b) of the 1934 Act 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." 15 U.S.C. § 78l(b).

The 1934 Act also grants the SEC additional regulatory power by granting periodic reporting power and regulation of proxy solicitation provisions to the SEC. Section 13(a) mandates issuers of securities registered under § 12 to update the information in its application or registration statement and to file periodic reports under SEC guidelines. 15 U.S.C. §§ 78m(a), 78m(a)(1)-(2). Section 14(a) gives the SEC regulatory power in the solicitation of proxies "as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78n(a).

4. *Natural Resources Defense Council v. SEC*, 389 F. Supp. 689, 693 (D.D.C. 1974) [hereinafter *NRDC I*] (citing J. SIMON ET AL., *THE ETHICAL INVESTOR: UNIVERSITIES AND CORPORATE RESPONSIBILITIES* (1972)), *rev'd* 606 F.2d 1031 (D.C. Cir. 1979) (*NRDC III*); *see also NRDC III*, 606 F.2d at 1037.

A CNN television broadcast similarly proclaimed:

HIGHLIGHT: Socially-responsible funds have become the new trend in investing, which means no tobacco, alcohol, defense and weapons contractors, gambling or known polluters . . .

STUART VARNEY, Anchor: For investors trying to bolster their earnings without compromising their politics, shall we say, socially responsible investing may be the path to many happy returns.

Your Money: New Trend Rising in Socially Responsible Investments (CNN television broadcast, Feb. 6, 1993) [hereinafter *Your Money*].

An "ethical investor" might engage in socially responsible investing ("SRI"). Mary O'Brien Hylton, "Socially Responsible" Investing: Doing Good Versus Doing Well in an Inefficient Market, 42 AM. U. L. REV. 1, 7, 11 (1992). Two very different approaches to SRI have been suggested. The simplest method is portfolio screening or investor boycott. This method requires that a potential investor first identify various social, ethical, or political concerns and then research the activities of po-

For over two decades, the SEC has attempted to clarify the extent of ethical investor interest in environmental disclosure.⁵ In an effort to quantify it, the SEC evaluated the burden corporations were likely to bear as a result of complying with enhanced environmental disclosure rules and the potentially confusing and misleading effect the added amount of information would have on the average investor. In addition, the SEC looked at the likelihood that increased disclosure would actually facilitate more environmentally sound policies.⁶ The SEC initially concluded that investors, including ethical investors,⁷ were "typically uninterested" in such comprehensive disclosure.⁸ The SEC further concluded that if extensive environmental disclosure was required, the "sheer bulk of [the] disclosure documents [would confuse the] average investor and would tend to obscure important information."⁹

In 1977, the District Court for the District of Columbia noted that "[i]t is of considerable significance whether the Commission compels the disclosure of information by deeming such specific information 'material,' . . . or whether it promulgates rules requiring the disclosure of identical information 'as necessary or appropriate in the public interest or for the protection of investors.'"¹⁰ If the SEC deems information such as environmental disclosure matters "material," registrants would be exposed to potential civil suits by

tential investments to determine which investments are incompatible with these concerns. *Id.* at 7.

The second form is the activist shareholder approach. This technique was popularized by Ralph Nader in his campaigns to improve General Motors' safety record. Rather than avoid investments incompatible with the investor's ethical and moral concerns, this method requires the investor to object to such behavior by attempting to change the company from within. *Id.* at 11.

5. *NRDC III*, 606 F.2d at 1052; *NRDC I*, 389 F. Supp. at 692-93.

6. *NRDC III*, 606 F.2d at 1052; *see NRDC I*, 389 F. Supp. at 710-11 (incorporating Securities Act Release No. 5386 (April 20, 1973), Exchange Act Release No. 10,116 (April 20, 1973)).

7. One article notes a project of the Council on Economic Priorities: The council's reports are part of a growing effort by public interest and environmental groups to examine and publish analyses of the vast amounts of environmental data that the Government has required companies to file in recent years. Early next year, the Investor Responsibility Research Center, a Washington-based organization that conducts investment research for university endowments and pension funds, will publish statistical summaries of the environmental performance of all 500 companies in the Standard & Poor's index.

John Holusha, *Environmentalists Assess Corporate Pollution Records*, N.Y. TIMES, Dec. 9, 1991, at D1.

8. *NRDC III*, 606 F.2d at 1054 (citing 40 Fed. Reg. 51,662).

9. *Id.* (citing 40 Fed. Reg. 51,660 & n.27).

10. *Natural Resources Defense Council v. SEC*, 432 F. Supp. 1190, 1200 n.26 (D.D.C. 1977) [hereinafter *NRDC II*].

investors.¹¹ Registrants who fail to provide required information which is not deemed "material" would merely be subject to SEC enforcement.¹²

In determining whether it could require environmental disclosure for the sole purpose of furthering environmental protection, outside the purposes behind the disclosures required by the 1933 and 1934 Acts, the SEC analyzed the problem under the National Environmental Policy Act ("NEPA").¹³ The SEC concluded that disclosure under NEPA was not limited solely to environmental purposes.¹⁴ This conclusion was based on the fact that the language used in certain statutory provisions of the 1933 and 1934 Acts that give the SEC its disclosure authority¹⁵ was not explicitly used in NEPA.¹⁶ The Commission further concluded that NEPA authorized and required the weighing of environmental protection and other considerations when determining the necessity for affirmative disclosures by registrants under the securities laws.¹⁷ Until recently, this philosophy governed environmental disclosure, but as the SEC began to look closer at what companies were actually disclosing, it began to "clarify" what environmental disclosures were required under the current laws.¹⁸

11. *Id.* Liability would be pursuant to 15 U.S.C. §§ 77k, 77l (of the 1933 Act), and 15 U.S.C. §§ 78n, 78r (of the 1934 Act). *Id.*; see also *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964) (private right of action exists under § 78n for false and misleading proxy solicitation).

12. *NRDC II* 432 F. Supp. at 1200 n.26 (citing 15 U.S.C. §§ 77t, 78u). "Thus, while . . . considering the advisability of deeming information 'material,' [the SEC assessed] the costs and benefits of potentially exposing registrants to substantial civil liability." *Id.* Cf. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976) (discussing rationale for materiality requirement).

13. 42 U.S.C. §§ 4321-4370 (1982).

14. *NRDC II*, 432 F. Supp. at 1201.

15. *Id.* at 1195 & n.11, 1201 n.27 (examining language of 1933 and 1934 Acts).

16. *Id.* at 1201 & n.28 (citing 40 Fed. Reg. at 51,661).

17. *NRDC II*, 432 F. Supp. at 1201 (citing 40 Fed. Reg. at 51,662).

After reaching the[se] conclusions . . . , 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).

Id.

18. These "clarifications" first arose in response to a May 1988 lead story in the *Wall Street Journal*. Amal Kumar Naj, *See No Evil: Can \$100 Billion Have "No Material Effect" on Balance Sheets? Huge Toxic-Waste Cleanup Will Burden Many Firms*, WALL ST. J., May 11, 1988, at A1. The article stated that certain SEC staffers had

One of the most important and demanding disclosure requirement regulations is SEC Regulation S-K which requires all publicly held companies to make disclosures relating to potential environmental liability under federal, state, or local laws.¹⁹ These disclosures must be made in the various documents prepared by public companies for filing with the SEC. Two examples are the annual report on SEC Form 10-K and the quarterly report on SEC Form 10-Q.²⁰ Failure to make necessary disclosure or complete and accurate disclosure may result in civil and criminal liability under federal securities laws.²¹

noticed the failure of numerous corporations to disclose contingent Superfund liabilities. *Id.*; see also Elizabeth Ann Glass Geltman, *Disclosure of Contingent Environmental Liabilities by Public Companies Under the Federal Securities Laws*, 16 HARV. ENVTL. L. REV. 129, 130 (1992) (discussing same problems). These articles criticize a lack of an imminent SEC crack down.

19. See Regulation S-K, 17 C.F.R. § 229 (1991). "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." Geltman, *supra* note 18, at 130 n.11.

The actual cost of these disclosure requirements has long been debated, especially by the American Institute of Certified Public Accountants ("AICPA"). AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, *THE MEASUREMENT OF CORPORATE SOCIAL PERFORMANCE* (1977). In time, the AICPA study may be regarded as a harbinger of improved methods of social performance measurement and disclosure. However, its conclusion "is simultaneously optimistic and pessimistic. It is pessimistic about expectations that a social information system with even the relative purity of financial accounting systems will be developed in the foreseeable future, if ever. It is optimistic that much can be accomplished and that it will be useful." *Id.* at 11.

20. Publicly held companies must file their annual reports on Form 10-K within 90 days after the company's fiscal year. See generally Klaus Eppler & Elizabeth Schoor, *Drafting the Form 10-K*, in *PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS* 1989, 545 (Practising Law Institute 1989). A properly completed Form 10-K must include extensive financial statements and the narrative disclosure required by Regulation S-K. *Id.* Form 10-K requires disclosure related to a number of items of Regulation S-K which Form 10-Q does not require. *Id.* For example, Form 10-K requires disclosure under Item 101 (description of business), while Form 10-Q does not. *Id.*

The 1934 Act requires publicly held companies to file periodic reports with the SEC, including quarterly reports. See 15 U.S.C. § 78k. These reports are completed on Form 10-Q after each of the companies' first three fiscal quarters. *Id.* The Form 10-Q must include a balance sheet, statement of income, and a statement of changes in financial condition, as well as a narrative description required by Regulation S-K. *Id.*

21. *NRDC II*, 432 F. Supp 1190, 1200 & n.26 (D.D.C. 1977). See generally James G. Archer et al., *SEC Reporting of Environmental Liabilities*, 20 *Envtl. L. Rep.* (Envtl. L. Inst.) 10,105, 10,110 (March 1990); Mark A. Stach, *Disclosure of Existing and Contingent Superfund Liability Under the Reporting Requirements of the Federal Securities Laws*, 18 U. DAYTON L. REV. 355 (1993).

In 1989, in an attempt to force companies to provide shareholders with a more accurate report of environmental costs, the SEC issued new guidelines concerning environmental disclosure under Item 303 of Regulation S-K (concerning management discussion and analysis or "MD&A").²² The release sought to clarify what disclosure was required when a registrant receives a Superfund PRP letter from EPA. In so doing, the SEC rejected the Rule 10b-5 "materiality" analysis and elected to require disclosure of PRP status unless the registrant demonstrated that "a material effect on the registrant's financial condition . . . is not reasonably likely to occur" due to PRP status.²³

On June 14, 1993, the SEC staff issued an accounting bulletin further clarifying a registrants' obligation to disclose contingent environmental liabilities.²⁴ These guidelines apparently attempted to formalize what the staff described as "the SEC's long-standing policies on accounting and disclosure on environmental liabilities."²⁵

22. Securities Act Release No. 6835 (May 18, 1989), 54 Fed. Reg. 22,427, 22,430 n.30 (1989) [hereinafter 1989 Release]. For a discussion of this release, see David E. Dearing, *SEC Disclosure Requirements for PRPs*, 18 CHEM WASTE LITIG. REP. (Computer Law Reporter, Inc., Washington D.C.), Aug. 1989, at 422.

23. 1989 Release, *supra* note 22, at 22,430. The SEC's analysis in the release demonstrates a profound ignorance of Superfund jurisprudence. Specifically, the release ignores four important factors. First, EPA's designation of a registrant as a PRP is not a conclusive affirmation of the presence of environmental violation. Second, even if a PRP knows that contribution is likely to be available, it is very difficult to quantify the potential liability of any PRP without a detailed investigation. Third, it takes a very long time to gather appropriate information concerning potential liability of the registrant relative to the other PRPs and an even longer time to negotiate a settlement.

The SEC resolves the issue of timing of disclosure "by departing from traditional materiality analysis as espoused in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), instead promulgating an enhanced disclosure standard which requires MD&A disclosure . . . unless the registrant can determine that [PRP] status is not reasonably likely to have a material effect." Geltman, *supra* note 18, at 171. While certainly "an easy solution to the problem of when to disclose PRP status, this enhanced disclosure standard is inapposite to the spirit of the securities laws . . ." *Id.* The securities laws' sole purpose is to provide adequate disclosure such that a reasonable investor can make a reasonable investment decision. *Id.*

Applying traditional materiality analysis under Rule 10b-5 would require public registrants to balance the probability of an event occurring against the magnitude of the liability. Traditional Regulation S-K analysis would only require disclosure if the potential liability was likely to exceed ten percent of the registrant's assets. These analyses allow companies to practically assess the settlement negotiation process and disclose what management projects is most likely to occur.

24. *Staff Gives Guidance on Accounting for Loss Contingencies* 25 Sec. Reg. & L. Rep. (BNA) No. 23, at 837 (June 11, 1993).

25. *Id.* After its release, Commissioner Richard Y. Roberts announced that the recent SEC "Staff Accounting Bulletin on Disclosure of Loss Contingencies 'will assist practitioners in the environmental liability accounting area' and is 'consistent with current accounting literature.'" *Roberts Says Loss Contingencies SAB Will Help Environmental Practitioners*, 25 Sec. Reg. & L. Rep. (BNA) No. 37, at 1293

These heightened disclosure requirements force companies to disclose the worst case scenario in such cases, which is not very useful or informative to the investing public.

SEC Chairman Richard Y. Roberts has repeatedly identified environmental costs as an issue critical to businesses today, yet one that many public registrants fail to address. According to Roberts, a 1992 survey showed that sixty-two percent of responding companies knew of environmental liability exposures which they did not report in their financial statements.²⁶ Roberts acknowledged that although the SEC's concerns over environmental disclosures began in the 1970s, they have dramatically heightened since the passage of Superfund in 1980.²⁷

Roberts predicted that accurate reflection of environmental costs and liabilities in financial statements "will become a concern for virtually all securities market participants."²⁸ However, certain industries are more affected by environmental issues. Obviously, the insurance, energy, chemicals, manufacturing, primary metals, and pulp and paper industries may be more heavily affected.²⁹

Companies are responding to the "clarification" of SEC policies in various ways, some more boldly than others.³⁰ This Article

(Sept. 24, 1993) (quoting Roberts' remarks) [hereinafter *Roberts Says*]. However, Roberts also stated that SAB "is intended to address . . . deficiencies in current accounting practices." *Id.* at 1294.

26. *SEC Commissioner Warns ABA Attorneys to Disclose Environmental Liabilities*, 61 Banking Rep. (BNA) 298 (Aug. 23, 1993) (referring to 1992 Price Waterhouse survey) [hereinafter *Commissioner Warns*]. It should be noted that the survey did not address whether contingent environmental liabilities not disclosed would have been considered material under the *Basic* probability/magnitude test.

27. David E. Dearing, *supra* note 22, at 423.

28. *Roberts Predicts Widespread Concern With Disclosing Environmental 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, Roberts said that a majority of estimated cleanup costs, may be as high as \$750 billion, have yet to be reflected in corporate financial statements. *Id.* Roberts told the Bar: "The standard for disclosing environmental costs and liabilities is the company's 'best estimate,' which must consider both qualitative and quantitative aspects of any liability estimate. 'Most parties ignore the qualitative side,' which is a 'slippery evaluation to say the least.'" *Id.*

According to Roberts, the SEC staff is now turning its attention to the qualitative aspect of this type of disclosure. Roberts recommended that companies treat the MD&A disclosure requirements "very seriously." *Id.*

29. *SEC Commissioner Warns, supra* note 26, at 298. Furthermore, he anticipates a continued increase in the scrutiny given to issuers of securities in industries significantly affected by environmental risks. *Id.*

30. See Barbara Benham, *Companies Tackle Environmental Disclosures*, INVESTOR'S DAILY, May 30, 1990, at 2 (reporting that General Motors corporate spokesperson says company overdiscloses); Amy D. Marcus, *Firms Ordered to Come Clean About Pollution*, WALL ST. J., Nov. 16, 1989, at B1, B8 (quoting General Electric Co.'s general counsel that company's periodic reports included immaterial information).

begins with an examination of the goal of federal securities disclosure rules and how they relate to environmental disclosure issues. Part III of this Article examines the evolution of the SEC disclosure rules and the roles these rules have played in satisfying the interests of the ethical investor.³¹ Part IV of this Article explores Regulation S-K and its dictates which require disclosure of environmental concerns. Part V examines environmental disclosure required in MD&A. Part VI briefly discusses the maturation of the SEC-EPA data exchange and the resulting refinements in the SEC staff's interpretation of environmental disclosure requirements. Part VII assesses in detail the SEC staff's recent "clarification" of these rules and the potential problems these clarifications may cause public registrants. Part VIII explores the developing trends in environmental disclosure by examining the filings of public registrants who filed forms 10-K or 10-Q in the first quarter of 1994.³²

The Article concludes that the pendulum has once again swung back to requiring registrants to disclose all environmental data, whether or not it is material.³³ The SEC abandoned this rationale in 1973³⁴ and this Article argues that the SEC should once again abandon the policy of requiring disclosure of all environmental matters and return to the *Basic* probability/magnitude test³⁵ for all securities disclosures required under Regulation S-K,³⁶ including environmental disclosures made under Item 303.³⁷

II. GOAL OF SECURITIES DISCLOSURE: FULL & FAIR DISCLOSURE

The federal securities laws were enacted primarily to serve two distinct goals: (1) the promotion of sufficient disclosure of information to allow for intelligent investment decisions in securities markets; and (2) the control of fraud and manipulation in securities trading.³⁸ These laws were designed to protect prospective buyers and sellers equally.³⁹ One of the most effective ways of meeting

31. For a discussion of the "ethical investor," see *supra* note 4 and accompanying text.

32. For purposes of this paper, the first quarter shall consist of all filings made between January 1 and March 11, 1994, the date upon which research for this paper was completed.

33. See *infra* notes 271-77 and accompanying text.

34. See *infra* notes 75-80 and accompanying text.

35. See *infra* notes 185-90 and accompanying text.

36. See *infra* notes 132-70 and accompanying text.

37. See *infra* notes 139-57 and accompanying text.

38. SEC v. Southwest Coal & Energy Co., 624 F.2d 1312, 1318 (5th Cir. 1980).

39. See *id.* at 1318-19.

these goals is to insure that the investing public has sufficient information available to adequately evaluate potential investments.

One such source of information for potential investors is a company's prospectus. However, the objective of a prospectus is to solicit investment by the general public. Therefore, mandatory registration of such materials is intended to ensure that the factors entering into prudent investment decisions are depicted in a standardized, comprehensible, and accurate manner. The intended audience is extremely broad, encompassing both sophisticated financial analysts and untutored lay persons. Since the principal goal of the Securities Act is disclosure, close questions will generally be resolved in favor of inclusion of information.

Given these factors, disclosures in a prospectus "must steer a middle course, neither submerging a material fact in a flood of collateral data, nor slighting its importance through seemingly cavalier treatment."⁴⁰ The significance of this disclosure must be "capable of being perceived as material" and "susceptible to common understanding."⁴¹

In formulating the language of the 1934 Act, Congress expressly relied on the premise that securities markets are affected by information when acting to facilitate an investor's reliance on the information in those markets. Specifically, the legislation reads as follows:

No investor, no speculator, can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings [sic] about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value.⁴²

40. *Isquith v. Middle South Util., Inc.*, 847 F.2d 186, 202 (5th Cir. 1988) (quoting *Greenapple v. Detroit Edison Co.*, 618 F.2d 198, 210 (2d Cir. 1980)).

41. *Id.*

42. *Basic v. Levinson*, 485 U.S. 224, 230 (1988) (citing H.R. REP. NO. 1383, 73d Cong., 2d Sess. 11 (1934)); see also *Lipton v. Documation, Inc.*, 734 F.2d 740, 748 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985) ("The theory thus actually facilitates Congress' intent in enacting the federal securities law by enabling a purchaser to rely on an expectation that the securities market is free from fraud.").

Empirical studies tend to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information.⁴³ The Supreme Court has noted that "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?"⁴⁴ Most courts that have considered the proposition have concluded that reliance by plaintiffs on the integrity of the market price may be presumed when materially misleading statements have been made;⁴⁵ however, the information disclosed must be reasonably objective at the time of the disclosure.⁴⁶

43. See *In re LTV Securities Litigation*, 88 F.R.D. 134, 144 (N.D. Tex. 1980) (citations omitted); Roger J. Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, 25 WM. & MARY L. REV. 373, 374 n.1, 374-381 (1984) (discussing efficient-capital-market theory); Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW. 1, 4 n.9 (1982) (citations omitted).

44. *Basic*, 485 U.S. at 247 (quoting *Schlanger v. Four-Phase Systems Inc.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982)).

45. *Id.* at 241. For cases presuming such reliance, see: *Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986); *Harris v. Union Elec. Co.*, 787 F.2d 355, 367, 367 n.9 (8th Cir.), *cert. denied*, 479 U.S. 823 (1986); *Lipton v. Documentation, Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985); *T. J. Raney & Sons, Inc. v. Fort Cobb Irrigation Fuel Auth.*, 717 F.2d 1330, 1332-33 (10th Cir. 1983), *cert. denied sub nom. Linde, Thomson, Fairchild, Langworthy, Kohn & Van Dyke v. T. J. Raney & Sons, Inc.*, 465 U.S. 1026 (1984); *Ross v. A. H. Robins Co.*, 607 F.2d 545, 553 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Blackie v. Barrack*, 524 F.2d 891, 905-08 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

Commentators generally have applauded the adoption of one variation or another of the fraud-on-the-market theory. *Basic*, 485 U.S. at 992. An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action. For a discussion of this theory, see generally Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance, Requirements in Certain Open Market Transactions*, 62 N.C. L. REV. 435 (1984); Note, *The Fraud-on-the-Market Theory*, 95 HARV. L. REV. 1143 (1982); Michael A. Lynn, Note, *Fraud on the Market: An Emerging Theory of Recovery Under SEC Rule 10b-5*, 50 GEO. WASH. L. REV. 627 (1982).

46. *Donovan v. Bierwirth*, 754 F.2d 1049, 1057 (2d Cir. 1985). "Courts have allowed recovery only of profits earned up to a reasonable time after the information has been made public, on the theory that upon disclosure, the defrauded seller could have replaced the securities and himself earned the additional profits." *Id.*

Once the material information is made public and the market returns to normal, the defendant's action in retaining the stock is a new act, unrelated to the initial fraud. *SEC v. MacDonald*, 699 F.2d 47, 53-54 (1st Cir. 1983). The profit earned subsequent to discovery of the fraud is "purely new matter." *Id.* at 54; see also *Nye v. Blyth Eastman Dillon & Co.*, 588 F.2d 1189, 1198 (8th Cir. 1978) (trial court erred in awarding damages for sales which occurred after information was public).

Disclosure should be neither overly optimistic, nor overly pessimistic. In an attempt to provide total disclosure, disclosures may be so "full" as to become buried "in legalese."⁴⁷ To be totally accurate, facts should be simply stated in plain English and their possible consequences made known. When copious amounts of information are given it is difficult to distinguish significant information from that which is not.

Before the enactment of comprehensive environmental legislation, the securities laws had no provisions expressly relating to disclosure of either the registrants' environmental policies or contingent environmental liabilities. In 1934, Congress enacted a prohibition against fraudulent statements or omissions of material fact by public registrants. So the obligation to either disclose that environmental data or refrain from trading in securities has existed since 1934 if the environmental matters at issue impact the company's financial well-being. Accordingly, under certain circumstances, public registrants that fail to adequately disclose contingent environmental liabilities may be subject to liability under Section 10(b) of the 1934 Act and rules promulgated thereunder.⁴⁸

It is now well established that violation of Rule 10b-5 will give rise to a private cause of action.⁴⁹ Although the elements are not

47. *Reliance Ins. Co. v. Barron's*, 442 F. Supp. 1341, 1345 (S.D.N.Y. 1977).

48. 15 U.S.C. § 78(b); 17 C.F.R. § 240.10b-5. For a discussion of this liability, see generally Michael L. Hickock & Janet S. Hoffman, *Section 10b-5 Claims for Non-Disclosure of Contingent Cleanup Liabilities*, *Toxics L. REP.* (BNA) 315 (Aug. 3, 1989); Amal K. Naj, *supra* note 18, at 1, 11.

Rule 10b-5 states:

It shall be unlawful for any person, directly or indirectly . . .

(b) To 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

17 C.F.R. § 240.10b-5 (1987).

49. The essential elements of a private cause of action under § 10(b) or Rule 10b-5 are: (1) a material misrepresentation, omission, deception, or manipulation; (2) scienter; (3) intent to deceive, manipulate, or defraud the plaintiff; and (4) causation. *Issen v. GSC Enterprises, Inc.*, 508 F. Supp. 1278, 1287 (N.D. Ill. 1981). The causation element is usually established by the showing that the plaintiff relied on the misrepresentation or omission. *Id.*

Rule 10b-5 was promulgated pursuant to § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1976). The rule provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme or artifice to defraud,

(b) To make any untrue statement of material fact or to omit the statements made, in the light of the circumstances under which they were made, not misleading, or

specifically set forth in Rule 10b-5 itself, case law dictates that in order to prevail on a Rule 10b-5 claim, a plaintiff must demonstrate that the defendant registrant knowingly⁵⁰ used interstate commerce⁵¹ to fraudulently breach its fiduciary or statutory duty⁵² by making a material misrepresentation⁵³ or omission⁵⁴ in connection with the sale of a security.⁵⁵ The fraudulent misrepresentation or omission of the registrant must cause damages that are related to the material misstatement or omission.⁵⁶ Finally, the

(c) to 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.

17 C.F.R. § 240.10b-5 (1991).

50. See, e.g., *Aaron v. SEC*, 446 U.S. 680 (1980); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033 (7th Cir. 1977), *cert. denied sub nom. Meers v. Sundstrand Corp.*, 434 U.S. 875 (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). See generally Marc I. Steinberg & Samuel H. Gruenbaum, *Variations of Recklessness After Hochfelder and Aaron*, 8 SEC. REG. L.J. (1980); Jeanne P. Bolger, Note, *Recklessness and the Rule 10b-5 Scienter Standard After Hochfelder*, 48 FORDHAM L. REVIEW 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); James M. Lurie, Note, *Recklessness Under Section 10(b); Weathering the Hochfelder Storm*, 8 RUT.-CAM. L.J. 325 (1977); D. Craig Martin, Note, *Scienter's Scope and Application in Rule 10b-5 Actions: An Analysis in Light of Hochfelder*, 52 NOTRE DAME L. REV. 925 (1977); Craig M. Walker, *Accountants Liability — the Scienter Standard Under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934*, 63 MARQ. L. REV. 218 (1977).

51. 17 C.F.R. § 240.10b-5.

52. For an explanation of this duty, see J. Robert Brown, *Corporate Communications and the Federal Securities Laws*, 53 GEO. WASH. L. REV. 741, 750-71 (1985).

53. A material misrepresentation claim arises, for example, when an insider knows of material information but misrepresents that information - such as telling a prospective buyer that the company will reap a substantial profit because of alleged purchase orders, which are, in fact, only conditional. See, e.g., *Mottoros v. Abrams*, 524 F. Supp. 254 (N.D. Ill. 1981). In misrepresentation cases, the courts generally require the plaintiff to show detrimental reliance upon the alleged misrepresentation. See *Mottoros, supra*, at 258. See generally *Wright v. Heizer Corp.*, 560 F.2d 236 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978); *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973). The plaintiff must show that "the misrepresentation is a substantial factor in determining the course of conduct which results in [the investor's] loss." *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 102 (10th Cir.), *cert. denied*, 382 U.S. 811 (1965).

54. See generally Arnold S. Jacobs, *What is a Misleading Statement or Omission Under Rule 10b-5?*, 42 FORDHAM L. REVIEW 243 (1973).

55. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

56. See, e.g., *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970); *St. Louis Union Trust Co. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 562 F.2d 1040 (8th Cir. 1977), *cert. denied*, 435 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 F.2d 377 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975). 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).

plaintiff must show that he or she relied⁵⁷ on the veracity of the

57. Although Rule 10b-5 says nothing about reliance, the courts have traditionally required reliance because it provides the causal nexus between the defendant's conduct and the plaintiff's injury. Without such a reliance requirement, there was a fear that Rule 10b-5 could become a "scheme of investor's insurance." *List v. Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir. 1965), *cert. denied*, 382 U.S. 811 (1965).

The legal requirements for establishing reliance under 10b-5 have varied depending upon whether the defendant has materially misrepresented facts or has instead simply failed to disclose material facts. Recently, a third avenue for establishing reliance has emerged which permits the investor to rely on the integrity and price of the stock as set by the market.

In nondisclosure cases, the burden of disproving reliance shifts to the defendant once it is shown the nondisclosure was material. This rule emerged because it is difficult for any plaintiff to prove that he would have acted differently had a certain disclosure been made.

In *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), the Supreme Court held that reliance could be presumed. The Court stated that when there is an obligation to disclose, withholding material information establishes the element of causation in fact. *Id.* at 153-54 (citations omitted). The Court in *Affiliated Ute* stated that "[u]nder the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery." *Id.* at 153. Lower courts have interpreted this statement as limiting the *Affiliated Ute* presumption to nondisclosure cases. *See, e.g.*, *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 238 (2d Cir. 1974); *Rochez Bros. v. Rhoades*, 491 F.2d 402, 410 (3d Cir. 1973).

The *Affiliated Ute* presumption acts as a deterrent by easing the plaintiff's burden in private actions under Rule 10b-5. In *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976), wherein the Court stated that a requirement of direct proof "threatens to defeat valid claims — implicit in *Affiliated Ute* is a rejection of the burden because it leads to underinclusive recoveries and thereby threatens the enforcement of the securities laws." *Id.* at 908.

Lower courts have also determined that the *Affiliated Ute* presumption can be rebutted. *See, e.g.*, *Rifkin v. Crow*, 574 F.2d 256 (5th Cir. 1975); *Rochez*, 491 F.2d at 410; *Carras v. Burns*, 526 F.2d 251, 257 (4th Cir. 1975); *Panter v. Marshall Field Co.*, 646 F.2d 271, 284 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981). Yet, the standard the defendant must meet to rebut the presumption is not altogether clear. The Third Circuit in *Rochez* held that: "[i]f the defendant is able to demonstrate that there was clearly no reliance, that is, that even if the material facts had been disclosed, plaintiff's decision as to the transaction would not have been different from what it was, then the nondisclosure cannot be said to have caused the subsequent loss and . . . recovery should be denied." *Rochez*, 491 F.2d at 410. The *Rochez* standard was subsequently adopted by the Fifth Circuit in *Rifkin*.

The standard as interpreted by the Seventh Circuit contains a subtle variation. In *Mottoros v. Abrams*, 524 F.Supp. 254 (N.D. Ill. 1981), the court stated: "Other ways of rebutting the presumption of reliance are similar to those found in regular "omission" cases, where reliance is also presumed: the defendant may show that an investor would have purchased the stock even if he had known of the misstatements or omissions." *Id.* at 259 (citing *Rifkin* and *Blackie*).

The "fraud on the market" theory is based on the assumption that a purchaser on the stock exchange relies on the belief that the market price is validly set and that no unsuspected manipulation has affected the price. Thus, if the price of the stock is artificially inflated by deception, the investor will have been injured by relying on a market price which he believed was validly set. *Blackie*, 524 F.2d at 906-07.

registrant's statements.⁵⁸

Although application 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.⁵⁹ Thus, the courts have only begun to develop clear standards for determining when a corporation may be liable for securities fraud

58. See, e.g., *Lipton v. Documentation, 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*, 495 U.S. 1102 (1983); *Panzierer v. Wolf*, 663 F.2d 365 (2d Cir. 1981). See generally 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).

The viability of any Rule 10b-5 cause of action will, of course, turn on the facts and circumstances of the particular case in controversy. *Levinson v. Basic*, 485 U.S. 224, 240. In *Basic*, the Court said that the "fact specific inquiry" it endorsed was consistent with the approval of a number of courts. *Id.* (citing *SEC v. Shapiro*, 494 F.2d 1301, 1306-1307 (2d Cir. 1974)).

59. See, e.g., *In re Occidental Petroleum Corp.*, Exchange Act Release No. 16,950 [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶¶ 82,622, 83,347-348 (July 2, 1980). For cases interpreting the application of Rule 10b-5 to environmental disclosure, see *Levine v. NL Indus., Inc.*, 926 F.2d 199 (2d Cir. 1991) (holding no duty to disclose because registrant was not exposed to potential environmental liabilities); *Professional Serv. Indus. v. Kimbrell*, 834 F. Supp. 1289 (D. Kan. 1993) (rejecting Rule 10b-5 suit brought by shareholders). Cf. *Goldsmith v. Rawl*, 755 F. Supp. 96 (S.D.N.Y. 1991) (applying Rule 14a-9 to environmental disclosure). In *Levine* the Second Circuit found that NL's alleged failure to disclose its violations of environmental laws was immaterial because the Department of Energy ("DOE") agreed to indemnify NL for any losses or liability resulting from such violations and DOE agreed to assume all future costs of compliance associated with bringing the facility up to standard. In such a situation, the court held that "a reasonable investor would not consider NL's asserted violations of environmental law important information significantly altering the total mix of information made available to the investor." *Levine*, 926 F.2d at 203.

In *SEC v. Allied Chemical Corp.*, No. 77-373 (D.D.C. filed Mar. 4, 1977), the SEC alleged that Allied Chemical ("Allied") committed securities violations by failing to disclose potential liability for discharging pollutants. That case was settled by a consent injunction, under which Allied, without admitting or denying the allegations, agreed to the entry of a permanent injunction. In the consent injunction, Allied agreed to: (1) refrain from future violations of SEC reporting and disclosure requirements; (2) initiate investigations into other environmental abuses; (3) maintain, review, and provide information to the SEC regarding its environmental policies and practices; and (4) disclose all material environmental risks and uncertainties known to its officers, directors, or division presidents. Excerpted in 396 Sec. Reg. & L. Rep. (BNA) A-17-A-18 (Mar. 9, 1977). The SEC focused on the fact that Allied allegedly violated environmental laws and knew of the potentially serious adverse impact on the environment. *Id.* At that time, no proceedings against Allied were pending, nor had any ever been threatened, for nondisclosure. *Id.* The duty to disclose, according to the SEC, was triggered by "[t]he violation of environmental laws coupled with an awareness of its high risk factor." Gerard A. Caron, *SEC Disclosure Requirements for Contingent Environmental Liability*, 14 B.C. ENVTL. AFF. L. REV. 729, 754 (1986-87). Under such a standard, a company could be subject to a duty to disclose "the possibility of claims being brought against it" before the illegal conduct is detected. *Id.*

based upon its failure to disclose environmental liabilities.⁶⁰

III. EVOLUTION OF SEC ENVIRONMENTAL DISCLOSURE RULES

Although issues of corporate disclosure generally pertain to financial matters, public concern about the environment has led to an increased interest in the disclosure of environmental matters by public companies.⁶¹ These environmental disclosure issues differ from traditional disclosure issues because of their potential social and health impact on the public, rather than simply their monetary impact on the individual investor.⁶²

The SEC developed a specific interest in these disclosures in the early 1970's when environmental activity began to increase.⁶³ Initially, the SEC attempted to regulate environmental disclosure through its existing disclosure rules and regulations.⁶⁴ In 1971, the

60. See Caron, *supra* note 59, at 758-59 (criticizing the SEC's reliance on general materiality principles as a basis for liability for nondisclosure of contingent environmental liabilities as creating "an ominous burden" for corporate registrants, without "stipulation that such corporate disclosures cannot be used as direct evidence of environmental violations."). To support this criticism, Caron cited the negative effects of early reporting of noncompliance, including: (1) the creation of friction between shareholders and management; (2) the loss of investors before the company has had the opportunity to correct the violations; and (3) the risk of "self-fulfilling prophecy." *Id.* at 759. Caron suggests that, if the SEC's goal is solely to provide information to investors, the environmental disclosure requirements are faulty. However, if the SEC has the additional objective of regulating corporate conduct in the area of environmental compliance, then broad reporting obligations may bolster corporate compliance with environmental laws. See Risa Veth Ferman, Note, *Environmental Disclosures and SEC Reporting Requirements*, 17 DEL. J. CORP. L. 483 (Spring 1992). Ferman notes that "[b]y applying the traditional materiality/reasonable investor test to environmental disclosures, courts have created a mechanism to enforce environmental laws through the federal securities laws." *Id.* at 486.

61. See generally David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1 (1979-80) (discussing desirability of forgoing profits in favor of social needs); Leo Herzl & Richard Shepro, *Setting the Boundaries for Disclosure*, 16 SEC. REG. L.J. 179 (1988) (noting costs associated with disclosure); Thomas J. Schoenbaum, *The Relationship Between Corporate Disclosure and Corporate Responsibility*, 40 FORDHAM L. REVIEW 565 (1972) (noting ethical and moral aspects of disclosure may interest investor and rules afford investor the opportunity to ensure corporate responsibility).

62. See, e.g., *In re Union Carbide Corp.*, 634 F. Supp. 842 (S.D.N.Y. 1986) (toxic chemical leak caused death of at least 2,100 people and injured over 200,000); *In re Union Carbide Class Action Sec. Litig.*, 648 F. Supp. 1322 (S.D.N.Y. 1986) (securities fraud class action arising out of Bhopal tragedy dismissed because omissions in Union Carbide's statements did not render other statements misleading).

63. See Theodore Sonde & Harvey L. Pitt, *Utilizing the Federal Securities Laws to "Clean the Air! Clean the Sky! Wash the Wind!"*, 16 How. L.J. 831, 842-60 (1971).

64. Various provisions of the securities laws authorize the SEC to engage in rulemaking concerning environmental disclosure. Sections 7 and 10 of the 1933 Act prescribe certain types of information that must be disclosed in registration

SEC issued an interpretive release informing public companies that existing securities laws required disclosure of all economically material environmental information.⁶⁵ Such information included: (1) the existence and nature of pending environmental litigation and (2) circumstances in which compliance with environmental laws "may necessitate significant capital outlays, may materially affect the earning power of the business, or cause material changes in the registrant's business done or intended to be done."⁶⁶

In 1972, the SEC reconsidered its position on environmental disclosure.⁶⁷ As a result, it adopted specific environmental disclo-

statements and prospectuses, respectively. 15 U.S.C. §§ 77g, 77j. In addition, these sections authorize the Commission to require disclosure of other information as it "may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors." *Id.* Similarly, § 14(a) of the 1934 Act authorizes the Commission to require disclosure in connection with proxy solicitations "as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78n(a). In addition, § 19(a) of the 1933 Act and § 23(a) of the 1934 Act vest in the Commission general authority to promulgate such rules and regulations "as may be necessary" in administering the securities laws. 15 U.S.C. §§ 77s(a), 78w(a).

Section 12(b) of the 1934 Act authorizes the SEC to require applications for registration of securities to include such information respecting the issuer's organization, financial structure, nature of business, and financial statements as the Commission deems "necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78l(b). Section 13(a) of the 1934 Act authorizes SEC to require issuers of registered stock to keep current the information in the application or registration statement and to file periodic reports containing such information as the Commission deems "necessary or appropriate for the proper protection of investors and to insure fair trading in the security." 15 U.S.C. § 78m(a). For a further discussion of the SEC's general regulatory power, see *supra* notes 1-5 and accompanying text.

65. Disclosures Pertaining to Matters Involving the Environment and Civil Rights, Securities Act Release No. 5170, Exchange Act Release No. 9252, 3 Fed. Sec. L. Rep. (CCH) ¶ 23,507 (July 19, 1971).

66. *Id.*

67. See Notice of Proposed Amendments to Registration and Report Forms to Require Disclosure with Respect to Compliance with Environmental Requirements, Securities Act Release No. 5235, Exchange Act Release No. 9498, Feb. 16, 1972 available in LEXIS, "Fedsec" library, "Secret" file. The notice stated:

[T]he proposed amendments would require as a part of the description of an issuer's business appropriate disclosure with respect to the material effects which compliance with environmental laws and regulations may have upon the capital expenditures, earnings and competitive position of the issuer and its subsidiaries. In addition, information would be required as to pending governmental or private legal or administrative enforcement proceedings arising under environmental laws or regulations and any such proceedings known to be contemplated by governmental authorities.

The above proposals emphasize the effect of environmental statutes and regulations, and enforcement proceedings thereunder, which may be felt in the future by the issuer and specify certain information to be furnished in connection with the description of the business. This item requires information with respect to the business done and intended to be done

sure provisions that expanded disclosure obligations in 1973.⁶⁸ These rules required: (1) disclosure of the material effects that compliance with federal, state and local laws may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries; and (2) disclosure of any administrative or judicial proceeding known to be contemplated by governmental authorities and arising under federal, state, or local environmental laws.⁶⁹ Any proceeding brought by a governmental authority was deemed material.⁷⁰ Thus, the 1973 rules required disclosure not only of economically material information, but of environmental information which may have social or ethical importance to certain social constituents.⁷¹ By broadening the 1973 rules to include non-economic considerations, SEC required disclosure of a far greater amount of information than had been required under existing securities laws.⁷²

and the development of the business during the past five years. The amendments would serve to specify more precisely the disclosure referred to in Securities Act Release 5170 in regard to environmental matters and would, as to the forms proposed to be amended, supersede that release.

Id.

68. Notice of Adoption of Amendments to Registration and Report Forms to Require Disclosure with Respect to Compliance with Environmental Requirements and Other Matters, Securities Act Release No. 5386, Exchange Act Release No. 10,116, 3 Fed. Sec. L. Rep. 23,507A (Apr. 20, 1973)[hereinafter Notice of Adoption].

69. *Id.* The 1973 rules affected disclosures made in: (i) Securities Act registration Form S-1, Items 9(a) & 12, Instructions 4 & 5, 17 C.F.R. § 239.11; (ii) Form S-7, Items 5(a) and 5(c), 17 C.F.R. § 239.26; (iii) Form S-9, Item 3(c), 17 C.F.R. § 239.22; (iv) Securities Exchange Act registration Form 10, Items 1(b) & 10, Instructions G and 4, 17 C.F.R. § 249.210; (v) periodic Form 10-K, Items 1(b)(7) & 5, 17 C.F.R. § 249.310; and (vi) Form 8-K, Item 3, Instruction 4, 17 C.F.R. § 249.308.

70. Notice of Adoption, *supra* note 68, at 23,507A.

71. *Id.* The traditional analysis of materiality under the federal securities laws focused only upon economics.

72. In *United States v. SCRAP*, 412 U.S. 669, 711 n.7 (1973) (Douglas, J., dissenting), Justice Douglas noted that:

Some federal agencies are taking affirmative action to promote the purposes of § 105. Thus the Securities and Exchange Commission recently adopted amendments to its registration and reporting forms to require more meaningful disclosure of certain items pertaining to the effect on the issuer's business of compliance with federal, state, and local laws and regulations relating to the protection of the environment. The amendments will require as a part of the description of the issuer's business, appropriate disclosures with respect to the material effects which compliance with environmental laws and regulations may have upon the capital expenditures, earnings, and competitive position of the issuer and its subsidiaries. Other amendments describe the extent to which litigation disclosures should contain specific descriptions of environmental proceedings.

Id.

Not satisfied with the 1973 rules, the Natural Resources Defense Council ("NRDC") brought an action⁷³ in the District court for the District of Columbia against the SEC seeking to require it to promulgate even further environmental disclosure regulations.⁷⁴ The NRDC asserted that the SEC had not developed comprehensive disclosure rules to the extent required under the National Environmental Policy Act ("NEPA"). NEPA proposed that the SEC require companies to disclose with respect to each major production activity:

73. *NRDC I*, 389 F. Supp. 689 (D.D.C. 1974), *rev'd* 606 F.2d 1031 (D.C. Cir. 1979). The original petitioners and plaintiffs in district court were the Natural Resources Defense Council, Inc. ("NRDC"), the Project on Corporate Responsibility, Inc., and the Center on Corporate Responsibility, Inc. *Id.* By order in September 1976, additional plaintiffs were joined. *NRDC II*, 432 F. Supp. 1190, 1197 n.17 (D.D.C.1977). These organizations have been described as

dedicated to inducing more responsive attitudes among American corporations towards the problems of environmental degradation and inequality of employment opportunity. To this end they participate in so-called "corporate responsibility campaigns," which typically involve proposals to corporate management and shareholders, demands for disclosure, media campaigns, lobbying, educational efforts and litigation.

NRDC III, 606 F.2d 1031, 1036 (D.C. Cir. 1979).

74. *NRDC I*, 389 F. Supp. 689. On appeal the court of appeals discussed the groups' rationale:

Appellees believe that such campaigns have achieved positive results in some cases, but that their usefulness is currently limited by a shortage of information available to stockholders and an imbalance in the information that is distributed. Stockholders receive considerable lobbying by management through annual reports, selective disclosure, image advertising, and other mechanisms involving large corporate expenditures. In contrast, groups such as appellees find it expensive to compile and disseminate information even when managements are cooperative, and often difficult or impossible when managements are not. Institutional investors in particular, so it is claimed, are naturally reluctant to vote against management in the absence of full and balanced information, whatever their position would be if they were fully informed.

Appellees believe that this impediment to corporate responsibility campaigns could be considerably reduced if corporations were forced to disclose comprehensive information about their environmental and equal employment policies. They expect, further, that such disclosure would aid the public in making sound investments and would deter corporations from taking actions likely to result in significant public disapproval. With these goals in mind, appellees naturally turned to the SEC, which is, of course, the agency charged with administering the federal statutes mandating disclosure of corporate information.

NRDC III, 606 F.2d at 1036.

The NRDC unsuccessfully petitioned the SEC for over three years. According to one commentator, the SEC's refusal to adopt the NRDC's disclosure regulations indicated that the SEC thought the proper role of environmental disclosure was to provide investors with information and not to regulate corporate conduct with respect to the environment. Caron, *supra* note 59, at 739.

(1) the nature and extent (quantified to the extent feasible) of the resulting pollution or injury to natural areas and resources, and (2) the feasibility of, and plans for, correcting the same. The Petition also requested that the SEC require disclosure of whether the registered company has changed company products, projects, production methods, policies, investments or advertising to advance environmental values.⁷⁵

The District of Columbia District Court recognized without much discussion that there was some merit to NRDC's position that more stringent rules were required under NEPA.⁷⁶ The court's rejection of the rules, however, was based on procedural and not substantive inadequacy.⁷⁷ The court directed the SEC to reconsider its rules, develop a record, and resolve two overriding factual issues. The first issue was the extent of an "ethical investor's" interest in the type of information which the NRDC requested. The second issue concerned the avenues of action available to ethical investors to pursue the elimination of corporate practices that are inimical to the environment.⁷⁸

In October 1975 and May 1976, the SEC reiterated that its broad discretion to adopt particular disclosure requirements involved a balancing of interests.⁷⁹ This "balancing" involved a comparison of the incremental value of the proposed disclosure with potential confusion to investors and increased costs to registrants. The SEC acknowledged that its discretion was limited by the objectives of the federal securities laws.⁸⁰ In view, the federal securities

75. *NRDC I*, 389 F. Supp. at 694.

76. *Id.* at 702.

77. *Id.* One procedural inadequacy was the failure to provide a complete "general statement." *Id.* The court stated that the revised general statement should illustrate: (1) SEC's concept of the extent of its statutory obligation to the public under the Securities Acts and NEPA; (2) the alternatives considered; and (3) the reasons for rejecting substantial alternatives. *Id.*

78. *Id.*

79. Notice of Commission Conclusions and Rulemaking Proposals in the Public Proceeding Announced in Securities Act Release No. 5569, Securities Act Release No. 5627, Exchange Act Release No. 11,733 (Oct. 16, 1975), 40 Fed. Reg. 51,656 (1975) [hereinafter Rulemaking Release]; Notice of Commission Conclusions and Final Action of the Rulemaking Proposals Announced in Securities Act Release No. 5627, Securities Act Release No. 5704, Exchange Act Release No. 12,414 (May 6, 1976), 41 Fed. Reg. 21,632 (1976) [hereinafter Final Action Release].

80. On February 11, 1975, the SEC announced a proceeding to consider further rulemaking. Notice of Public Proceeding Regarding Such Further Disclosure, if any, of Environmental Matters in Registration Statements, Reports and Other Documents, Securities Act Release No. 5569, Exchange Act Release No. 11,236

laws were designed to require disclosure of financial information in only the narrow sense.⁸¹

In considering its obligations under NEPA, the SEC concluded NEPA's environmental mandate did not authorize the SEC to promulgate disclosure rules unrelated to its responsibilities under its organic statutes. NEPA required the SEC to consider the promotion of environmental protection and other considerations in determining whether to require affirmative disclosures under the 1933 Act and the 1934 Act.

The SEC eventually addressed the inquiries posed by the district court in *Natural Resources Defenses Council v. SEC* ("NRDC I").⁸² It found indications of investor interest in the type of information that the NRDC wanted disclosed. However, the SEC concluded that the main concern of investors with respect to such information was in determining how to vote their proxies and how to influence management policies, rather than in making investment decisions.⁸³ The SEC concluded that the disclosures requested by NRDC would probably have some environmentally beneficial effect on corporate behavior.⁸⁴

(Feb. 11, 1975), 40 Fed. Reg. 7013 (1975) [hereinafter Release No. 5569]. In 1974 and 1975, the SEC received 54 oral representations and 353 written comments. In October 1975, the SEC proposed for comment "rules which would make available to interested investors information regarding the extent to which corporations have failed to satisfy environmental standards under federal law." Rulemaking Release, *supra* note 79, at 51,657. The Commission determined, however, that it would not be appropriate to propose either alternative environmental disclosure requirements or specific disclosure requirements regarding corporate equal employment and other practices. *Id.*

The Commission received approximately 210 letters of comment concerning its proposed rules on disclosure of corporate noncompliance with federal environmental laws. On the basis of these comments, and after extended consideration, the Commission announced on May 6, 1976, that it would not adopt the proposed rules regarding noncompliance. *Id.*

81. Final Action Release, *supra* note 79, at 21,634. The one partial exception to this principle, according to the Commission, was § 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a), under which the "primacy of economic matters . . . is somewhat less" because the purpose of that provision is to require fair opportunity for corporate suffrage. Rulemaking Release, *supra* note 79, at 51,659.

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

83. Rulemaking Release, *supra* note 79, at 51,664.

84. *Id.* at 51,665. The Commission stated:

It seems clear that investors do not at present have ready access to objective information concerning the environmental practices of corporations. And although the relevant compliance reports are reasonably accessible to inhabitants of the localities most directly affected by such practices, there is presently no single governmental source to which an investor can look for the environmental reports filed by a company. Given the fact that there is a degree of interest among some investors in information regarding corporate environmental practices, we conclude that the availa-

In determining the best way to fulfill its duties under NEPA, the SEC considered and rejected five alternatives proposed during the proceedings: (1) comprehensive disclosures of the environmental effects of corporate activities; (2) disclosure of corporate non-compliance 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.⁸⁵

bility of such information may result in some investor or shareholder action. Participants in the proceeding pointed out that the submission of and voting on socially-oriented shareholder proposals has often caused a corporation to alter its behavior even though the proposals are defeated by a wide margin. Many participants also believe that disclosure requirements would serve to focus management attention on environmental issues and result in clearer recognition of the future costs and legal problems associated with environmental degradation.

Id. at 51,667.

The Commission argued that existing disclosure provisions which included rules explicitly requiring disclosure of certain economically material equal employment information were sufficient to satisfy the primarily economic concerns of participants in the rulemaking proceeding. *Id.* at 51,665-66. Further, it observed:

In the instant proceeding, over 100 different "social matters" were submitted in which "ethical" investors were said to be interested. As against this bewildering array of special causes, it has been suggested that investors are at least entitled to information regarding matters which embody fundamental national social principles as reflected in federal legislation or court decisions. We believe that persuasive arguments can be made, however, [that a] substantial amount of federal legislation to some extent embodies fundamental national social principles and, accordingly, many topics of social concern would remain. Thus, there is no distinguishing feature which would justify the singling out of equal employment from among the myriad of other social matters in which investors may be interested in the absence of a specific mandate comparable to that of NEPA. Disclosure of comparable non-material information regarding each of these would in the aggregate make disclosure documents wholly unmanageable and would significantly increase the costs to all involved without, in our view, corresponding benefits to investors generally.

Id. at 51,666 (footnote omitted).

85. *Id.* at 51,662. From the summary of the record prepared by the SEC's staff, it appears that the SEC believed that alternatives (3), (4), and (5) had widespread support among commentators. However, the record reveals that there was never much organized or documented support for those alternatives. The appellees in *NRDC III* and the District Court did not treat them as significant. *NRDC III*, 606 F.2d 1031 (D.C.Cir. 1979). Alternative (2) was the early suggestion of Theodore Sonde and Harvey L. Pitt in their article *Utilizing the Federal Securities Laws to "Clean the Air! Clean the Sky! Wash the Wind!"*. See Sonde & Pitt, *supra* note 63, at 860. It received serious consideration but, after further comments, was rejected in the Final Action Release. See Final Action Release, *supra* note 79, at 21,632. Alternative (1) was the proposal of the NRDC. The Commission rejected it for the following reasons:

First, the interest among investors that may exist appears to be primarily in whether corporations are acting in an environmentally unacceptable manner, rather than in whether, and to what extent, corporations have gone beyond what is expected of them in this area. Second, unless ex-

Following the SEC's rejection of the proposals, the NRDC sought review in district court of the SEC's refusal to compel additional disclosures.⁸⁶ In *NRDC II*, the district court granted the NRDC's motion for summary judgment, finding the SEC's action to be arbitrary and capricious on three principal grounds.⁸⁷ First, and most importantly, the court found it arbitrary that the Commission failed to consider the possibility of requiring disclosure of environmental information to shareholders solely in connection with proxy solicitations and information statements.⁸⁸ This option, the court noted, would promote "fair opportunity for the operation of corporate suffrage" without imposing the burden of having to disclose the information in registration statements and prospectuses.⁸⁹

Second, the district court found that the SEC's assessment of the cost to corporations and administrative bodies was unsubstantiated.⁹⁰ Third, the court rejected the SEC's position that other agencies with the necessary expertise should initiate environmental disclosure requirements. The court viewed NEPA as requiring the SEC to either develop the necessary expertise or to work in conjunction with agencies such as EPA or Counsel on Environmental Quality to carry out its mission.⁹¹

The SEC appealed the ruling of the district court in *NRDC II*.⁹² All but one appellee alleged that either they or their members owned corporate shares and would like to vote in a financially prudent and ethically sound manner.⁹³ The United States Court of

isting environmental standards may be used as a reference point, both the costs to registrants and the administrative burdens involved in the proposed disclosure would be excessive. There appears to be no established, uniform method by which the environmental effects of corporate practices may be comprehensively described. Nor does there appear to be scientific agreement as to the harmfulness to the environment of many activities. It appears, therefore, that the proposed disclosures would be extremely voluminous, subjective and costly to all concerned. They also would not lend themselves to comparisons of different companies, which is of great importance to investors since investment decisions essentially involve a choice between competing investment alternatives.

Id.

86. *NRDC II*, 432 F. Supp. 1190 (D.D.C. 1977).

87. *Id.* at 1212.

88. *Id.* at 1205. Information statements are provided to shareholders in connection with annual or other meetings.

89. *Id.*

90. *NRDC II*, 432 F. Supp. at 1206.

91. *Id.* at 1207 (citing *Flint Ridge Dev't Co. v. Scenic Rivers Ass'n*, 426 U.S. 776, 787 (1976)).

92. *NRDC III*, 606 F.2d 1031 (D.C. Cir. 1979).

93. One appellee, Center on Corporate Responsibility, did not allege share ownership. Its claim to standing was based on an institutional interest in inform-

Appeals for the District of Columbia held that this allegation was sufficient to establish their standing to bring suit.⁹⁴ The court found that the appellees, as corporate shareholders concerned about environmental quality, were within the zones of interest protected by NEPA and securities acts.⁹⁵

Rather than adjudicate the matter, the SEC preemptively changed its existing regulation concerning disclosure of environmental compliance matters by public corporations.⁹⁶ The changed regulation stated: "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 such further periods as the registrant may deem material."⁹⁷

In the same release, the SEC warned public companies that regulations requiring disclosure of pending proceedings encompassed a requirement to disclose all notices of violations in the nature of cease and desist orders issued by EPA.⁹⁸

ing and educating the public about matters of social concern. *Id.* at 1042 n.6. Because the position of the Center was identical to that of the other appellees, the court found it unnecessary to determine whether it would have had standing had it been the sole plaintiff. *Id.*; see *Sierra Club v. Andrus*, 581 F.2d 895, 900 n.16 (D.C. Cir. 1978), *rev'd* 442 U.S. 347 (1979) (discussing the complexity and difficulty of "informational standing"); *Scientists' Inst. for Pub. Info. v. AEC*, 481 F.2d 1079, 1087 n.29 (D.C. Cir.1973).

94. *NRDC III*, 606 F.2d at 1036.

95. *Id.*

96. On remand, the SEC issued a release giving notice of renewed proceedings to fulfill the district court's instructions. Release No. 5569, *supra* note 79. The interest of the public in these proceedings was considerable. In nineteen days of public hearings, fifty-four oral presentations were made and three hundred fifty-three written comments were received, creating a record over ten thousand pages long. Release No. 5627, *supra* note 87, at 51,657-58. The comments favoring the proposals generally declared that greater disclosure of information by corporations was essential both to sound voting on corporate policies and to informed consideration of corporate financial positions. On the other hand, hundreds of corporations submitted comments opposing the disclosure proposals on the grounds that the cost of gathering the required information would be inordinately high, that shareholders were not seriously interested in the information, and that the benefits would be small.

97. Final Action Release, *supra* note 79, at 21,632.

98. *Id.* at 13 n.22. In *NRDC III*, the court said:

Our third reason for not requiring the Commission to consider proxy disclosure is the fact that, several months after the District Court took the summary judgment motions in this case under advisement, the SEC announced a new set of proceedings. The record does not show that these proceedings were brought to the attention of the District Court, but on appeal the SEC made a representation concerning them. . . . By its announcement of these new proceedings, the SEC has successfully invoked a principle, founded in administrative law generally and in the Supreme Court's NEPA decisions particularly, that it is not the judicial province to upset agency structuring of proceedings.

An SEC complaint filed against Allied Chemical Corporation provides an example of the application of the environmental disclosure rules existing in 1977.⁹⁹ In that complaint, the SEC alleged that Allied failed

to state in public announcements and in filings with the Commission that Allied was subject to material potential financial exposure resulting, in part, from directly and indirectly discharging toxic chemicals into the environment [specifically, discharging Kepone into the James River in Virginia] from its own facilities and from the facilities of others.¹⁰⁰

The complaint charged that by omitting such disclosure, Allied had violated sections 10(b) and 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13.¹⁰¹ Without admitting or denying the allegations in the complaint, Allied consented to a permanent injunction restraining it from "making or disseminating false or misleading financial statements, reports and other material information concerning, among other things, Allied's potential material

NRDC III, 606 F.2d at 1055.

Prior to the court's opinion in *NRDC III*, the Commission announced that it would hold public hearings concerning shareholder communications, shareholder participation in corporate electoral process, and corporate governance. Re-Examination of Rules Relating to Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 13,482 (Apr. 28, 1977), 42 Fed.Reg. 23,901 (May 11, 1977).

Three critical issues were being addressed by the SEC at these meetings. First "what types of socially significant matters, if any, are material (within the meaning of Rule 14a-9) to shareholders in making informed voting decisions? In this regard, is there a difference between information necessary to an informed voting decision and information necessary to an informed investment decision?" Securities Exchange Act Release No. 13,901 (Aug. 29, 1977), 1977 SEC LEXIS 958, at *5. Second, "whether or not information relating to socially significant matters including matters relating to the environment and employment practices, is material within the meaning of Rule 14a-9, would it be appropriate for the Commission to exercise its rulemaking authority under section 14(a) to require disclosure of such information in proxy statements and/or annual reports to shareholders?" *Id.* at *6. Third, "what would be the costs and benefits of (the above)? Can these costs and benefits be quantified? If not, why?" *Id.* at *8.

The Commission announced that, at the conclusion of these hearings, it would determine "whether it is necessary or appropriate in the public interest or for the protection of investors to propose amendments to Regulation 14A, to propose amendments to other applicable rules or to recommend legislation to Congress." *Id.* at *3.

99. *NRDC II*, 432 F. Supp. at 1196 n.12 (citing SEC Compliant ¶ 7 of SEC v. Allied Chemical Corp., No. 77-373 (D.D.C. filed Mar. 4, 1977)).

100. *Id.*

101. 17 C.F.R. §§ 240.13a-1, 240.13a-11, 240.13a-13 (1991).

financial exposure resulting from its pollution activities."¹⁰²

The second phase of SEC disclosure rules required three categories of environmental information to be disclosed. First, the registrant must disclose all "material" information, which an average prudent investor should reasonably know.¹⁰³ Second, information relating to all litigation, commenced or known to be contemplated, against a registrant by a governmental authority pursuant to environmental laws, must be revealed.¹⁰⁴ Third, all additional "material" information necessary to make the registrant's statements neither false nor misleading must be listed.¹⁰⁵ Despite its consideration of various additional disclosure requirements, the SEC decided not to adopt any other requirements.¹⁰⁶ The SEC believed that the existing disclosure requirements would "elicit the type of environmental information in which investors appear to be interested and are more than sufficient to discharge the Commission's

102. *NRDC II*, 432 F. Supp. at 1196 n.12 (citing SEC Compliant ¶ 7 of SEC v. Allied Chemical Corp., No. 77-373 (D.D.C. filed Mar. 4, 1977)).

103. Notice of Adoption, *supra* note 68, at 12,100. For the definition of "material," see 17 C.F.R. §§ 210.1-02(n), 230.405(1), 240.12b-2(j). Specifically it required the disclosure of the "material" effects that compliance with federal, state, and local environmental laws may have on capital expenditures, earnings, and competitive position. Notice of Adoption, *supra* note 68, at 12,100.

104. Notice of Adoption, *supra* note 68, at 12,101-02. Thus, Item 12 of Form S-1 and Item 10 of Form 10 were amended in 1973 to state that

administrative or judicial proceedings arising under any Federal, State or 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, shall not be deemed "ordinary routine litigation incidental to business" and shall be described if such proceeding is material to the business or financial condition of the registrant or if it involves primarily a claim for damages and the amount involved, exclusive of interest and costs, exceeds 10 per cent of the current assets of the registrant and its subsidiaries on a consolidated basis. Any such proceedings by governmental authorities shall be deemed material and shall be described. . . ; provided, however, that such proceedings which are similar in nature may be grouped and described generically . . .

Id.

Significantly, in adopting this amendment, the Commission specifically rejected requiring registrants to describe generally any environmentally-related judicial or administrative proceeding brought by a governmental authority. Instead, the Commission permitted "generic" descriptions of such proceedings because the descriptions would be "excessively detailed without commensurate benefit to average investors." *Id.* at 12,102.

105. 17 C.F.R. §§ 210.3-06, 230.408, 240.12b-20, 240.14a-3(b)(2), 240.14a-9(a), 240.14c-6 (1973).

106. The SEC did adopt a rule concerning the disclosure of "material" capital expenditures for environmental purposes. Final Action Release, *supra* note 79 at 21,632. However, the Commission itself viewed this as a mere clarification of its pre-existing disclosure requirement to ensure uniformity in reporting. Rulemaking Release, *supra* note 79, at 51,656.

NEPA obligations.”¹⁰⁷

In 1979, the SEC issued an interpretive release addressing the issues of whether public companies were required to disclose: (1) total estimated expenditures for environmental compliance beyond two years in the future; (2) particular types of environmental proceedings; and (3) the circumstances under which public companies must disclose their policies or approaches concerning environmental compliance.¹⁰⁸

With regard to total estimated expenditures for environmental compliance, the SEC stated that the principle underlying the two year provision was to compel public companies to indicate the material economic effects of environmental compliance on capital expenditures and earnings. The two year disclosure rule was not intended to act as a statute of limitation beyond which no disclosure was necessary. To the contrary, disclosure beyond two years would be appropriate, and indeed required, where a public company reasonably expected that the costs of compliance in future years would be materially higher than the costs listed for the two year mandatory disclosure period.¹⁰⁹ In such circumstances, the public company may “be obligated to develop and disclose estimates with respect to such costs in order to describe adequately the material effects of complying with environmental regulations and in order to prevent misleading the public on the mandatory disclosures on capital expenditures and earnings for the minimum two year period.”¹¹⁰ Moreover, it may also be necessary to reveal the source of its estimates, its methodology, and the degree of certainty of such estimates.¹¹¹ In the SEC’s opinion, such information aids shareholders and the investing public in evaluating the registrant’s conclusions concerning contingent environmental liabilities.

107. Final Action Release, *supra* note 79, at 21,635.

108. Environmental Disclosure, Securities Act, Release No. 6130, Exchange Act Release No. 16,224, 1979 LEXIS 621, at *1. (Sept. 27, 1979) [hereinafter Release No. 6130]. This release was issued, in part, as a response to *In re United States Steel Corp.*, Exchange Act Release No. 16,223 Sept. 27, 1979, available in LEXIS “Fedsec” library, “Secret” file (Sept. 27, 1979).

109. Release No. 6130, *supra* note 108, at *8. The SEC explained:

If the registrant has estimates suggesting that after the two-year period there will nevertheless remain material capital expenditures necessary to comply with such requirements, or material penalties or fines for non-compliance are reasonably likely to be imposed if compliance is not achieved, disclosure of such additional known or estimated costs, penalties or fines may be necessary to prevent the mandatory disclosure from being misleading.

Id.

110. *Id.* at *9.

111. *Id.*

With regard to disclosures of administrative proceedings, the SEC interpreted its rules broadly. It determined that disclosure is required whenever governmental authority is a party to any administrative hearing.¹¹² The SEC also interpreted its rules as requiring disclosure of administrative orders even if they were not the result of an official "proceeding."¹¹³ An example of this is when a corporation either directly consents to the entry of an order or has negotiated for one.¹¹⁴ In the SEC's opinion, the consequences of an administrative order are often as significant as the consequences of a litigated proceeding. For this reason, the SEC did not want to "hinge . . . disclosure requirements on the technical issue of whether a registrant chooses to contest the entry of an order."¹¹⁵ Therefore, the SEC extended the duty to disclose to all administrative orders concerning environmental matters, whether or not those orders are literally the result of a proceeding.

Finally, the duty to disclose pending proceedings encompassed disclosure of the relief sought by the government when the government was the complainant.¹¹⁶ Mere disclosure that the government seeks to compel a company to comply with pollution control criterion is insufficient.¹¹⁷ Instead, registrants must disclose estimated expenditures necessary to establish the level of environmental compliance mandated and sought in the suit.¹¹⁸

With regard to disclosure of corporate environmental policies, the SEC did not set forth a blanket rule because of the difficulty to verify such claims.¹¹⁹ The SEC did describe two specific situations in which disclosure of environmental policy was necessary. First, voluntary disclosures concerning a corporation's environmental policy must be accurate. The corporation must disclose enough additional information to make the voluntary disclosure not misleading.¹²⁰ Second, if a public corporation has an environmental compliance policy reasonably likely to lead to substantial fines or penalties, the corporation must disclose the likelihood and magnitude of such fines and penalties.¹²¹

112. *Id.* at *10.

113. Release No. 6130, *supra* note 108, at *10.

114. *Id.* at *11.

115. *Id.* at *13.

116. *Id.*

117. Release No. 6130, *supra* note 108, at *13.

118. *Id.*

119. *Id.* at *14.

120. *Id.*

121. Release No. 6130, *supra* note 108, at *14.

After administering its environmental disclosure rules for several years, the SEC began to question its decision to depart from the traditional economic materiality standard for all environmental proceedings involving a governmental authority.¹²² The SEC's more expansive disclosure requirement often resulted in lengthy discussions of economically inconsequential matters such as routine permit proceedings and often obscured more significant environmental matters. In short, the requirement to disclose all environmental proceedings involving governmental entities had two negative effects. It placed excessive burdens on reporting companies and lessened the quality of environmental disclosure to the investing public.¹²³

Despite concerns over excessive environmental reporting requirements, the SEC never agreed to return entirely to a traditional materiality standard for environmental disclosures. Instead, in 1982 the SEC adopted a compromise approach to environmental disclosure as part of its integrated disclosure system in Regulation S-K.¹²⁴

122. See Hamilton, "Environmental Disclosure Requirements of the Securities and Exchange Commission," in The McGraw Hill *Environmental Auditing Handbook* at 2-110 (L. Harrison ed., 1984).

123. Deference to the SEC's decision to consider environmental disclosure was appropriate. In *NRDC III*, the court said:

Our discussion of the scope of review of agency rulemaking shows that the quasi-legislative nature of rulemaking requires even greater agency freedom to manage and structure decisionmaking than is required in licensing or adjudication. Moreover, the record of this case shows that from 1971 to 1977, the SEC repeatedly stated intentions to continue its investigations and proceedings further— e.g., when it sought dismissal of premature petitions for review in this court, when it abided by the District Court's first remand order, and when it sought extensions of time from the District Court to carry on its rulemaking. Each time, the SEC conducted further rulemaking proceedings which were more than *bona fide*. In our view, those renewed SEC proceedings were searching, intensive, productive of valuable new information and insight, and in accordance with all canons of procedural fairness. As the District Court observed, to this proceeding was devoted 'a substantial, and perhaps even an unprecedented, amount of the Commission's time'

The Commission's task has been a peculiarly difficult one, requiring it to find a path between the views of the parties to the rulemaking polarized in support of the broadest disclosure or in opposition to any disclosure, to interpret novel statutory commands, and to make decisions against the background of rapidly changing conditions in the realm of shareholder proposals. This court is mindful of the difficulty of agency decisionmaking in such contexts, and when an agency indicates a need for a further opportunity to study or act, in circumstances like this, we will generally accord its position considerable deference.

NRDC III, 606 F.2d 1031, 1056-57 (D.C. Cir. 1979).

124. Adoption of Integrated Disclosure System, Securities Act Release No. 6383, Exchange Act Release No. 18,524, 47 Fed. Reg. 11,380 (Mar. 3, 1982) [herein-

IV. REGULATION S-K

For almost fifty years, the SEC viewed disclosure under the 1933 and 1934 Acts as serving very different functions. The 1933 Act focussed on protecting offerees in public distributions of securities, while the 1934 Act was directed at policing secondary market trading. These separate goals created an impediment to common disclosure requirements.

In 1982, the SEC promulgated an integrated disclosure system, designed to integrate and simplify disclosure requirements under both acts.¹²⁵ The goal was to reduce the burden on registrants while at the same time ensuring the investing public was provided with meaningful, nonduplicative information which they could utilize to reach reasonable investment decisions.¹²⁶

The SEC's integrated disclosure system rules are divided into three categories. Regulation C sets out SEC procedures; Regulation S-X outlines SEC's accounting rules and requirements for the form and content of financial statements; and Regulation S-K governs current disclosure requirements for public companies.¹²⁷

In addition to the general disclosure requirements, the SEC set out two specific rules under Regulation S-K, which directly relate to environmental reporting requirements.

The first specific disclosure requirement, Item 101 of Regulation S-K, requires appropriate disclosure of the material effects of compliance with federal, state and local environmental laws on capital expenditures, earnings, and competitive position.¹²⁸ In ad-

after Integrated Disclosure System]. For discussions of the environmental aspects of Regulation S-K, see generally Ferman, *supra* note 60; Geltman, *supra* note 18; Archer, *supra* note 21; Milch & McCoy, *The Financial Reporting of Superfund Exposure* at 11-13, 15-16 (Paper presented to Executive Enterprises April 1989); Lathrop & Lambert, *Evaluating and Reporting Environmental Exposures for Financial Statements and Securities Law Compliance*, at 26-30 (Paper presented to Executive Enterprises April 1989); Caron, *supra*, note 59.

125. Integrated Disclosure System, *supra* note 124, at 11,380. The new rules attempted to unify and simplify disclosure requirements. *Id.* Under the 1933 Act, three registration forms were adopted. *Id.* Under the 1934 Act, Regulation S-K was reorganized and expanded to encompass all of the reporting requirements thereunder. *Id.* at 11,381.

126. See JAMES D. COX, FINANCIAL INFORMATION, ACCOUNTING, AND THE LAW: CASES AND MATERIALS 48 (1980) (setting forth objective of integrated disclosure program).

127. See generally Integrated Disclosure System, *supra* note 124.

128. Item 101, paragraph (c)(1)(xii) of Regulation S-K provides: Appropriate disclosure also 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

dition, it requires that material capital expenditures on environmental control facilities for the current and succeeding fiscal years be disclosed.¹²⁹

The next disclosure requirement, Item 103 of Regulation S-K, concerns the disclosure of legal proceedings.¹³⁰ Instruction 5 to Item 103 modified prior disclosure requirements by establishing objective thresholds for disclosing environmental proceedings for the first time.¹³¹ Under Regulation S-K, disclosure of environmental proceedings is required when the proceeding is material to the business or financial condition of the company; the proceeding or damage action involves a potential monetary loss exceeding ten percent of the company's current assets; or, the proceeding is brought by the government seeking monetary sanction, unless the company reasonably believes that the proceeding will result in no monetary sanctions or fines of less than \$100,000.¹³²

Item 103 disclosure has caused considerable concern among registrants who have been named as potentially responsible parties ("PRPs") by EPA under the Comprehensive Environmental Re-

have upon 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 material.

17 C.F.R. § 229 (1991).

129. *Id.* This provision essentially codified the SEC's position taken in its 1979 release. Release No. 6130, *supra* note 108. The enactment of the Clean Air Act Amendments of 1990, which require regulated entities to install additional control technologies according to a statutory time-table, has recently caused numerous registrants to disclose environmental compliance costs.

130. Item 103 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 property is the subject." 17 C.F.R. § 229. Instruction 5 to Item 103 requires disclosure 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 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or

C. A governmental authority is a party to such proceeding and such proceeding involves potential 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 \$100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically.

17 C.F.R. § 229.103.

131. Integrated Disclosure System, *supra* note 124, at 11,388-89.

132. *Id.*

sponse, Compensation, and Liability Act of 1980 ("CERCLA") and its reauthorizing act, the Superfund Amendment and Reauthorization Act of 1986 ("SARA")¹³³ (together "Superfund"). These statutes have been interpreted to impose strict,¹³⁴ retroactive,¹³⁵ and joint and several liability¹³⁶ for the cleanup costs of abandoned hazardous waste sites on those persons defined as "responsible parties" under CERCLA.¹³⁷ A person may be held liable under Superfund if he falls into one of four classes of persons: (i) the present owner and operator of the hazardous waste site;¹³⁸ (ii) any owner or operator who owned or operated the site at the time in which the haz-

133. CERCLA §§ 101-175, 42 U.S.C. §§ 9601-9675 (1988 & Supp. IV 1992).

134. *See, e.g.*, *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1042 (2d Cir. 1985); *United States v. Conservation Chem.*, 619 F. Supp. 162, 186-91 (W.D. Mo. 1985); *Bulk Distrib. Centers, Inc. v. Monsanto Co.*, 589 F. Supp. 1437, 1442 (S.D. Fla. 1984); *Pinole Point Properties, Inc. v. Bethlehem Steel Corp.*, 596 F. Supp. 283, 289 (N.D. Cal. 1984); *United States v. Conservation Chem. Co.*, 589 F. Supp. 59, 62 (W.D. Mo. 1984); *United States v. Northeastern Pharmaceutical & Chem. Co.*, 579 F. Supp. 823, 827 (W.D. Mo. 1984), *cert. denied*, 484 U.S. 848 (1987) [hereinafter *NEPACCO I*]; *United States v. Price*, 577 F. Supp. 1103, 1114 (D.N.J. 1983); *Ohio ex rel. Brown v. Georgeoff*, 562 F. Supp. 1300, 1305 (N.D. Ohio 1983). Congress has implicitly approved of the judicial interpretation that CERCLA imposes strict liability. *See* H.R. REP. NO. 253, 99th Cong., 2nd Sess., pt. 1, *reprinted in*, 1986 U.S.C.C.A.N. 2835, 2856.

135. *See, e.g.*, *United States v. Shell Oil Co.*, 605 F. Supp. 1064, 1083-84 (D. Colo. 1985); *Artesian Water Co. v. Government of New Castle County*, 605 F. Supp. 1348, 1356 (D. Del. 1985); *Jones v. Inmont Corp.*, 584 F. Supp. 1425, 1429 (S.D. Ohio 1984); *NEPACCO I*, 579 F. Supp. at 840-42; *United States v. Stringfellow*, 14 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,388 (C.D. Cal. Apr. 9, 1984); *United States v. Wade*, 577 F. Supp. 1326 (E.D. Pa. 1983); *Ohio ex rel. Brown*, 562 F. Supp. at 1314; *Price*, 523 F. Supp. at 1070-72. *See generally* Amy Blaymore, *Retroactive Application of Superfund: Can Old Dogs Be Taught New Tricks?*, 12 B.C. ENVTL. AFF. L. REV. 1 (1985). For a critical discussion of the retroactive application of joint and several liability, see *Superfund Improvement Act of 1985: Hearings on S. 51 Before the Senate Comm. on the Judiciary*, 99th Cong., 1st Sess. 165-72, 216-20 (1985) (statement of George Clemon Freeman, Jr.).

136. *See, e.g.*, *Shore Realty*, 759 F.2d at 1044; *United States v. New Castle County*, 642 F. Supp. 1258, 1266; *United States v. Medley*, 17 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,297 (D.S.C. 1986); *Bulk Distribution Centers*, 589 F. Supp. at 1443; *Conservation Chemical*, 589 F. Supp. at 63; *NEPACCO I*, 579 F. Supp. at 844; *United States v. A & F Materials Co., Inc.*, 578 F. Supp. 1249, 1256 (S.D. Ill. 1984); *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 807-08 (S.D. Ohio 1983); *Wade*, 577 F. Supp. at 1337.

137. *See* notes 138-41 *infra* and accompanying text.

138. CERCLA § 107(a)(1), 42 U.S.C. § 9607(a)(1); *see also Shore Realty*, 759 F.2d at 1042-44 (owner of property and its officer and principal shareholder held liable as current owners); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 577-81 (D. Md. 1986) (foreclosing bank held liable as current owner). *See generally* Jeff Civins, *Environmental Law Concerns in Real Estate Transactions*, 43 Sw. L.J. 819 (1990); Elliott H. Levitas & John Vance Hughes, *Hazardous Waste Issues in Real Estate Transactions*, 38 MERCER L. REV. 581 (1987); J.B. Ruhl, *The Third-Party Defense to Hazardous Waste Liability: Narrowing The Contractual Relationship Exception*, 29 S. TEX. L. REV. 291 (1988); Michael A. Bell, Note, *The Effect of Superfund Liability on "Owners"*, 92 W. VA. L. REV. 125 (1989).

ardous substance was dumped;¹³⁹ (iii) any person who arranged by contract for the disposal or treatment of the waste taken from a site;¹⁴⁰ or (iv) any person who transports or in the past transported the hazardous waste.¹⁴¹

Since the cost of a Superfund cleanup can be great,¹⁴² many registrants named by EPA as PRPs became concerned whether potential liability for remedial action at a Superfund site constituted a "sanction" within the meaning of Instruction 5(c) of Item 103 of Regulation S-K. Through a series of interpretive letters, the SEC Division of Corporation Finance took the position that costs incurred pursuant to a remedial agreement with EPA will not be viewed as sanctions.¹⁴³

The SEC elaborated briefly on this position in a May 1989 re-

139. CERCLA § 107(a)(2), 42 U.S.C. § 9607(a)(2). See generally Elizabeth Ann Glass, *The Modern Snake in the Grass: An Examination of Real Estate and Commercial Liability Under Superfund and SARA and Suggested Guidelines for the Practitioner*, 14 B.C. ENVTL. AFF. L. REV. 381 (1987); Peter B. Kelly, Comment, *Changes in the Ownership of Hazardous Waste Disposal Sites: Original and Successor Liability*, 67 MARQ. L. REV. 691 (1984).

140. CERCLA § 107(a)(3), 42 U.S.C. § 9607(a)(3); see also United States v. Monsanto Co., 858 F.2d 160, 168-71 (4th Cir. 1988); United States v. Ward, 618 F. Supp. 884 (E.D.N.C. 1985). See generally Baskin & Reed, *Arranging for Disposal Under CERCLA: When Is a Generator Liable?*, 15 Envtl. L. Rep. (Envtl. L. Inst.) 10,274 (1985); Douglas F. Brennan, *Joint & Several Liability for Generators under Superfund: a Federal Formula for Cost Recovery*, 5 U.C.L.A. J. ENVTL. L. POL'Y 101 (1986); Joseph DiBenedetto, *Generator Liability Under the Common Law and Federal and State Statutes*, 39 BUS. LAW 611 (1984); Jeffrey H. Howard & Linda E. Benfield, *CERCLA Liability For Hazardous "Generators": How Far Does Liability Extend?*, 9 TEMP. ENVTL. L. & TECH. J. 33 (1990); Kenneth C. Moore & Kathiann M. Kowalski, *When Is One Generator Liable for Another's Waste?*, 33 CLEV. ST. L. REV. 93 (1984-85); Sanjay Bhambhani, Note, *The Imposition of Vicarious Strict Liability on Off-site Generators of Hazardous Waste*, 40 RUTGERS L. J. 569 (1988); Note, *Generator Liability Under Superfund For Clean-Up of Abandoned Hazardous Waste Dumpsites*, 130 U. PA. L. REV. 1229 (1982); James W. Moorman & Laurence S. Kirsch, Comment, *A Response to "Arranging for Disposal" Under CERCLA*, 15 Envtl. L. Rep. (Envtl. L. Inst.) 10,274 (1985).

141. CERCLA § 107(a)(4), 42 U.S.C. § 9607(a)(4). See generally Ronald M. Eddy & Diana Terry Riendl, *Transporter Liability Under CERCLA*, 16 Envtl. L. Rep. (Envtl. L. Inst.) 10,244 (Sept. 1986); Elizabeth Ann Glass, *Superfund & SARA: Are There Any Defenses Left?*, 12 HARV. ENVTL. L. REV. 385 (1988); James F. Vernon & Patrick W. Dennis, *Hazardous-Substance Generator, Transporter and Disposer Liability Under the Federal and California Superfunds*, 2 U.C.L.A. J. ENVTL. L. & POL'Y 67 (1981).

142. See, e.g., Naj, *supra* note 18, at 1, 11 (discussing expenses involved in Superfund cleanups).

143. See Letter from Linda Quinn, Director of Division of Corporation Finance, to Joseph Sciarrino of the Financial Executives Institute (Jan. 17, 1989). The SEC Division of Corporation Finance stated that

[w]hile there are many ways a PRP can become subject to potential monetary sanctions, including triggering the stipulated penalty clause in a remedial agreement, the costs anticipated to be incurred under Superfund, pursuant to a remedial agreement entered into in the normal course of

lease.¹⁴⁴ In that release the SEC maintained that PRP designation would not necessarily trigger disclosure under Item 103, and Instruction 5 disclosure was required for other purposes. This is so because status as a PRP alone does not afford knowledge that a government agency is considering initiating a proceeding.¹⁴⁵ The SEC implied that disclosure under Item 103 would depend upon the registrant's particular circumstances, since those circumstances "when coupled with PRP status, may provide that knowledge."¹⁴⁶ The SEC re-emphasized that costs to be incurred under Superfund pursuant to a remedial agreement with EPA generally are not "sanctions" within either Instruction 5(B) or (C) to Item 103.¹⁴⁷ Rather, remedial costs would normally constitute charges to income or, in some cases, capital expenditures. Following this analysis, "[t]he availability of insurance, indemnification or contribution may be relevant under Instruction 5(A) or (B) in determining whether the criteria for disclosure have been met."¹⁴⁸

Few cases have been decided concerning disclosure of environmental violations and contingent liabilities under Items 101 and 103. In 1989, the United States District Court for the Southern District of New York dismissed a class action suit alleging fraudulent omissions by a registrant concerning environmental violation of its subsidiary in *Levine v. NL Industries, Inc.*¹⁴⁹ In *Levine*, purchasers of the registrant's stock claimed that they paid an inflated price as a result of nondisclosure and misrepresentation.¹⁵⁰ On a motion for summary judgment, the court concluded that Items 101 and 103 did not require disclosure of the contingent environmental liabilities of the registrant's subsidiary.¹⁵¹ The court also determined that certain statements appearing in the registrant's 1981-84 Form 10-Ks were not misleading, because they pertained to the registrant and not to its subsidiary.¹⁵² The court granted summary judgment in favor of the defendant holding that the plaintiff failed to show the

negotiation with the EPA generally are not 'sanctions' within either Instruction 5(B) or (C) to Item 103.

1989 Release, *supra* note 25, at 22,430 n.30.

144. *Id.*

145. *Id.*

146. *Id.*

147. 1989 Release, *supra* note 22, at 22,430 n.30.

148. *Id.*

149. 717 F. Supp. 252, 257 (S.D.N.Y. 1989), *aff'd*, 926 F.2d 199 (2d Cir. 1991).

150. *Id.* at 253.

151. *Id.* at 254-57.

152. *Id.* at 255-56. A portion of the relevant disclosure read as follows:

1. The Company believes its plants are all in good operating condition

....

existence of a duty to disclose the omitted information which is essential element to a section 10(b), Rule 10b-5 claim.¹⁵³

In 1991, the Second Circuit Court of Appeals affirmed the district court's holding in *Levine*.¹⁵⁴ However, the Second Circuit did not address the registrant's duty to disclose a subsidiary's contingent environmental liability in a 10-K Form because the court concluded that the plaintiff's allegations "did not satisfy the requirement of materiality."¹⁵⁵ The court explained that the registrant's failure to disclose the subsidiary's environmental violations was not material because the U.S. Department of Energy ("DOE") had agreed to indemnify the subsidiary and the registrant in the event of liability or loss.¹⁵⁶ Since financial loss from the subsidiary's alleged violations was indemnified, the court concluded that a reasonable investor would deem the subsidiary's alleged environmental violations unimportant.¹⁵⁷

The Second Circuit also rejected the district court's interpretation of Item 101(c)(1)(xii) in dicta.¹⁵⁸ The district court's inter-

2. NL has continued to implement an environmental control program designed to ensure compliance with governmental requirements with respect to workplace environment, atmospheric emissions, effluent discharge and waste disposal. . . .

4. From time to time, one or more of NL's plants is subject to local or state environmental regulatory enforcement. The issues raised in such matters are generally resolved in discussions with the appropriate authorities, and occasionally involve the establishment of compliance programs proposed by NL and/or the payment of penalties which do not have a material effect on NL's sales and profits.

5. The precise nature of future regulations, or the costs that may be required in meeting them, and the environmental problems which may arise in the future cannot be predicted at this time. However, NL does not believe that there will be significant curtailment or interruption of any of its important operations as a result of any failure to comply with present or future environmental laws and regulations.

Id. at 256.

153. *Id.* at 257.

154. *Levine*, 926 F.2d 199. The court held that "[p]laintiff ha[d] failed to make a showing sufficient to establish that [the registrant] had a duty to disclose that [the subsidiary] was operating the facility in violation of the law." *Id.*

155. *Id.* at 202.

156. *Id.* at 203.

157. *Id.*

158. *Levine*, 926 F.2d at 203-04. Section 101(c)(1)(xii) provides, in pertinent part, as follows:

Appropriate disclosure . . . shall be made as to the material effects that compliance with the 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. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for

pretation that Item 101(c)(1)(xii) requires disclosure of only environmental compliance costs but not the costs associated with failure to comply with them.¹⁵⁹ The Second Circuit made clear that disclosure of potentially material costs for violations of environmental laws is ordinarily required.¹⁶⁰ However, the court held that "although the cost of failing to comply with environmental regulations must be disclosed, there is no duty of disclosure in this case because of the indemnification provided by the contract between [the registrant] and DOE."¹⁶¹

V. MANAGEMENT DISCUSSION AND ANALYSIS

Item 303 of Regulation S-K requires public reporting companies to provide a narrative analysis of their financial statements and their financial condition.¹⁶² This narrative is termed the "Management Discussion and Analysis of Financial Condition and Results of Operation" ("MD&A"). Although the MD&A does not expressly order environmental disclosure, for years the securities bar speculated that the MD&A requirement to identify various items would include environmental liabilities.¹⁶³

the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material.
17 C.F.R. § 229.101(c)(1)(xii) (1990).

159. *Levine*, 926 F.2d at 203.

160. *Id.* at 203-04 (citing *In re United States Steel Corp.*, Exchange Act Release No. 16,223 [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,319 at 82,384 (Sept. 27, 1979)).

161. *Levine*, 926 F.2d at 204. Compare *Koppers Co. v. American Express Co.*, 689 F. Supp. 1417 (W.D. Pa. 1988) (addressing environmental disclosure in tender offer) with *United Paperworkers Int'l Union v. International Paper Co.*, No. 92 Civ. 2941, 1992 WL 198430 (S.D.N.Y. Aug. 17, 1992) (addressing environmental disclosure under proxy rules).

162. 17 C.F.R. § 229.303; see also Amendments to Annual Report Form, Related Forms, Rules, Regulations, and Guides; Integration of Exchange Act Disclosure Systems, Securities Act Release Nos. 6231, 17,114, 45 Fed. Reg. 63,630 (Sept. 25, 1980). The revisions to the MD&A were made in connection with amendments to Form 10-K. *Id.* at 63,636. Changes were made to the MD&A because the SEC felt that the existing guidelines were not fulfilling their original objectives and that their focus was too narrow because they did not produce narrative discussion which focused on the "financial condition of the enterprise as a whole." *Id.* For a discussion of the historical development of the Management Discussion and Analysis, see Concept Release on MD&A of Financial Condition and Operations, Exchange Act Release Nos. 6711, 24,356, 52 Fed. Reg. 13,715 (Apr. 24, 1987) [hereinafter Concept Release].

163. These include known trends, events or uncertainties that will result or are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way, affect capital resources, or materially impact net sales, revenues or income from continuing operations.

The instructions to Item 303 also emphasize the need for prospective disclosure in the MD&A, stating that it "shall focus specifically on material events and

This speculation was confirmed by interpretive letters issued by SEC's Division of Corporation Finance, which maintained that when cleanup costs are likely to be material, a known uncertainty within the ambit of Item 303 exists and must be disclosed.¹⁶⁴ The SEC stated, however, that in view of the potential joint and several liability for site cleanup and general liability insurance coverage for such costs, the netting of insurance and contributions in determining materiality for Item 101 and 303 purposes must be treated on a case-by-case basis.¹⁶⁵

In May 1989, the SEC issued a release clarifying its position on disclosure of contingent environmental liabilities in the MD&A of public registrants.¹⁶⁶ The SEC prefaced its release by explaining

uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or future financial condition." 17 C.F.R. § 229.303(a), Instruction 3. There are two types of forward-looking disclosures contemplated by the MD&A. Item 303(a)(1) requires the disclosure of any known trends, demands, commitments, events, or uncertainties which are material. Instruction 7 to Item 303 on the other hand encourages, but does not require, the disclosure of certain types of forward-looking information. 17 C.F.R. § 229.303(a), Instruction 7. The MD&A's relationship to forward-looking information has been described as its "most misunderstood aspect." Concept Release, *supra* note 162, at 13,717. The SEC has distinguished the two types of forward-looking disclosure under Item 303 on the basis of the prediction required. *Id.* Instruction 3 requires the disclosure of currently known trends, events, and uncertainties which are reasonably expected to have material effects, while non-mandatory disclosure under Instruction 7 "involves anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty." *Id.*

164. The letter stated that where it is reasonably likely that cleanup costs will be material, a known uncertainty of the type contemplated by Item 303 is present and should be disclosed. The letter also stated that, "for similar reasons," the disclosure requirements of Item 101(c)(1)(xii) or Item 103, Instruction 5(A) or (B) also may be triggered.

165. The SEC has classified cleanup costs as an uncertainty. Thomas A. Cole, SEC No-Action Letter, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 78,962, at 78,813-15 (Jan. 17, 1989). Increasing expenditures to comply with environmental laws may also be indicative of a trend which requires disclosure. 17 C.F.R. § 229.303(a)(3)(ii).

166. 1989 Release, *supra* note 22, at 22,427.

This 1989 Release followed a "Concept Release" issued by the SEC in 1987 to request comments on the possible revision of disclosure rules. See Concept Release, *supra* note 162. Coopers & Lybrand issued a request for a more specific approach to requiring disclosure of business risks and uncertainties. *Id.* at 13,717. This request was accompanied by a joint recommendation from seven major accounting firms calling for increased disclosure. *Id.* The seven firms were Arthur Andersen & Co.; Arthur Young; Coopers & Lybrand; Deloitte Haskins & Sells; Ernst & Whinney; Peat, Marwick, Mitchell & Co.; and Touche Ross & Co. *Id.* at 13,717 n.18. The Coopers & Lybrand proposal calls for restructuring of Item 303 into three distinct sections: (1) an analysis of historical financial information; (2) assessment of risk factors, future financial condition, and results of operations; and (3) management's representations. *Id.* at 13,717. The stated purpose of the MD&A would be furthered by the suggested changes:

that the MD&A requirements are aimed at providing a material historical and prospective textual disclosure which allows investors and other users to assess the financial condition and results of operations of the registrant, and specifically the registrant's prospects for the future.¹⁶⁷ The duty to make MD&A disclosure exists "where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operation."¹⁶⁸ As such, the SEC cautioned that registrants preparing MD&A disclosures should carefully review what trends, demands, commitments, events or uncertainties, including those relating to environmental matters, are known to management.¹⁶⁹

Where any trend, demand, commitment, event or uncertainty is known, management must make two assessments. First, management must determine whether the known trend, demand, commitment, event or uncertainty is likely to come to fruition.¹⁷⁰ According to the SEC: "If management determines that it is not

The Commission has long recognized the need for narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance. MD&A is intended to give the investor an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company.

Id. After evaluating the proposals received in response to the 1987 Concept Release, the SEC issued an interpretive release in May 1989. 1989 Release, *supra* note 22, at 22,428. This release provided interpretive guidance when prospective or forward-looking information was required in MD&A disclosures. *Id.* Other issues addressed in the release included the disclosure of long-term and short-term liquidity, capital-resources analysis, material changes in financial statement line items, interim period disclosures, high-yield financing, highly-leveraged transactions or non-investment grade loans, effects of federal financial assistance, and preliminary merger negotiations. *Id.* at 22,427. Requirements for the disclosure of prospective information directly affect environmental disclosures; the other issues have only peripheral effects on environmental disclosures. *See generally* Ferman, *supra* note 60.

167. 1989 Release, *supra* note 22, at 22,428. As such, the SEC said that "[t]he MD&A should contain discussion of all the material impacts upon the registrant's financial condition or results of operations, including those arising from disclosure provided elsewhere in the filing." *Id.* at 22,428 n.14.

168. *Id.* at 22,429. Such disclosure is considered "required forward-looking disclosure." *Id.* at 22,429 n.20; *see also* 17 C.F.R. § 229.303(a). This disclosure is contrasted with what the SEC considers "optional forward-looking disclosure," which involves "anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty." 1989 Release, *supra* note 22, at 22,429.

169. *Id.*

170. 1989 Release, *supra* note 22, at 22,430.

reasonably likely to occur, no disclosure is required."¹⁷¹ If management is unable to calculate the likelihood that the event will come to fruition, then management must objectively assess the future consequences under the assumption that the event will occur.¹⁷² Disclosure would be required unless management determines that a material effect on their financial condition or results of operations is not reasonably likely to transpire.¹⁷³ Additionally, all assessments made by management must be objectively reasonable at the time the determination is made.¹⁷⁴

The SEC cautioned that MD&A specifies its own disclosure standard: "reasonably likely to have a material effect."¹⁷⁵ The SEC expressly stated that the Supreme Court's probability/magnitude test for materiality in *Basic, Inc. v. Levinson*,¹⁷⁶ is not applicable to Item 303 disclosure.¹⁷⁷ The SEC standard requires management to assume the existence of the circumstance, even though management is not able to determine the likelihood of the circumstance. Management must then proceed to disclose and objectively evaluate the consequences of the matter, unless that undeterminable occurrence is "not reasonably likely to have a material effect."

Many commentators have criticized this policy.¹⁷⁸ The MD&A requirements are the most complex of all the pertinent provisions. In light of this, commentators urge that the SEC and the courts

171. *Id.*

172. *Id.*

173. *Id.*

174. 1989 Release, *supra* note 22, at 22,430 n.28. To this extent, the SEC stated that "[w]here a material change in a registrant's financial condition . . . or results of operations appears in a reporting period and the likelihood of such change was not discussed in prior reports, the Commission staff . . . will inquire as to the circumstances existing at the time of the earlier filings to determine whether the registrant failed to discuss a known trend, demand, commitment, event or uncertainty as required by Item 303." *Id.*

175. *Id.* at 22,430 n.27.

176. 485 U.S. 224 (1988)

177. 1989 Release, *supra* note 22, at 22,430 n.27. *Basic* required that a registrant evaluate the probability of an event occurring and the magnitude of its effect to determine the "materiality" of the effect. *Basic*, 485 U.S. at 238-41.

178. *See, e.g.,* Geltman, *supra* note 18, at 130; Wallace, *supra* note 6, at 1111. *See also* Marcus, *supra* note 30, at B1, B8 (noting that environmental disclosure causes "special problems, particularly in estimating liabilities accurately."); *Environmental Issues Seen as Having Widening Impact on Corporate America*, 22 Sec. Reg. & L. Rep. (BNA) No. 26, at 975 (June 29, 1990) (quoting Richard Hays, secretary and assistant general counsel of USX Corp., as saying that environmental liabilities are hard to quantify) (hereinafter *Environmental Issues*); Barbara Benham, *SEC, EPA Team Up to Go After Polluters*, *INVESTOR'S DAILY*, May 29, 1990, at 1 (commenting that liabilities under CERCLA and RCRA are difficult to quantify, creating difficulty in making the materiality determination) [hereinafter *Polluters*].

provide an effective approach to interpretation and enforcement of Item 303 and all other applicable disclosure provisions.

VI. SEC-EPA DATA EXCHANGE

Shortly after the MD&A release, the SEC and EPA agreed to exchange data to enforce proper disclosure of environmental problems.¹⁷⁹ Toward that end, EPA has provided to the SEC, on a quarterly basis since May 1989, the following information: (1) the names of all parties designated by EPA as PRPs under Superfund; (2) a list of all cases filed by EPA under the Resource Conservation and Recovery Act ("RCRA")¹⁸⁰ and Superfund; (3) civil environmental cases listed on the Consolidated Enforcement Docket; (4) criminal federal environmental cases filed on the Criminal Enforcement Docket; (5) a list of all facilities barred from government contracts under the Clean Air Act ("CAA")¹⁸¹ and Clean Water Act ("CWA")¹⁸²; and (6) a list of all RCRA facilities subject to cleanup requirements from the Corrective Action Reporting Systems. The SEC staff uses this data to verify disclosure statements filed with the SEC.¹⁸³ A standard SEC form is sent to registrants appearing on EPA's PRP lists, inquiring why disclosure of their PRP status was not made. The SEC staff has also sought EPA assistance in reviewing the technical accuracy of SEC disclosure documents containing significant environmental discussions.

179. Caleb Solomon, *In the Takeover Game, Hidden Waste Dumps Haunt Buyer and Seller*, WALL ST. J., April 2, 1990 at A1.

180. Resource Conservation and Recovery Act ("RCRA"), § 3001-5006, 42 U.S.C. §§ 6921-6956 (1988 & Supp. IV 1992).

181. CAA §§ 101-618, 42 U.S.C. §§ 7401-7671 (1988).

182. CWA §§ 101-167, 33 U.S.C. §§ 1251-1376 (1988).

183. According to SEC Commissioner Richard Y. Roberts:

As society strives to maintain and to improve our environment, costs are imposed that may need to be disclosed to investors under our federal securities laws. Compliance costs associated with regulations restricting development and limiting harmful emissions can have a material effect on the operating expenses of a company. Moreover, environmental laws can impose large liabilities, particularly with respect to past generators of waste materials.

....

The potential for large losses attributable to environmental problems is an important concern that many investors will factor into their investment decision. . . . Indeed, vigorous enforcement of environmental laws likely to occur in the decade to come have made environmental liability a matter of growing prominence for lenders, rating agencies, and acquisition-minded companies, among others.

Wallace, *supra* note 6, at 1099 (quoting Richard Y. Roberts, Developments Concerning Environmental Disclosure, Remarks Before the Dallas Bar Association, 1-6 (May 28, 1992)).

Conversely, EPA has used data supplied by SEC in connection with its enforcement efforts. In particular, it has sought information concerning corporate ownership to determine whether to bring an enforcement action against a parent or subsidiary corporation. Additionally, EPA often researches financial information concerning a corporation and any associated corporations when negotiating settlements with polluters. Although the SEC and EPA continue to exchange information, they have yet to develop a formalized memorandum of understanding.

VII. STAFF ACCOUNTING BULLETIN CONCERNING DISCLOSURE OF ENVIRONMENTAL CONTINGENCIES

The SEC is currently sharing data with EPA¹⁸⁴ and has vowed to increase enforcement for failure to disclose contingent environmental liabilities.¹⁸⁵ The staff of the SEC addressed such questions concerning the disclosure of contingent environmental liabilities in Staff Accounting Bulletin No. 92 ("SAB 92").¹⁸⁶ SAB 92 detailed

184. Cooperation between securities and environmental enforcement authorities dates back to the early 1970s. See *NRDC III*, 606 F.2d 1031, 1059 (D.C. Cir. 1979).

The value of SEC consultation with CEQ [Council on Environmental Quality] is evident. To take a hypothetical example, Congress has recently passed new legislation concerning toxic substances, . . . and EPA has commenced several far-reaching regulatory programs with respect to air and water discharges of such substances. CEQ would be in a position to know if these legislative and administrative initiatives foreshadow a period in which corporations may not be in compliance with the law, or in which compliance with toxics regulation will have a significant economic impact on corporations, or in which action on toxics may be a controversial policy issue on which corporate managements can expect shareholder proposals. It would therefore be able to advise whether disclosure in such limited contexts is especially timely, and could supply drafts of proposed disclosure requirements.

Id.

In their present informal relationship, the SEC and EPA share such basic information as: statistics on environmental cleanup sites, parties to agency proceedings and those parties' reports to the agencies. *Roberts Predicts*, *supra* note 28. Roberts also stated that SEC Chairman Arthur Levitt is currently considering the possibility of formalizing the relationship between the agencies. *Id.*

185. For further discussion, see *supra* notes 179-84 and accompanying text. Roberts explained that under the federal securities laws, registered companies must disclose material estimated environmental costs. *Id.*; see also *Polluters*, *supra* note 196, at 1; see generally Roger D. Wiegley, *Reporting of Environmental Liabilities - New SEC Initiatives*, SEC Today, Vol. 90-96 (May 17, 1990); *Clients Need to be Counseled Regarding Environmental Disclosure*, 23 Sec. Reg. & L. Rep. (BNA) No. 39, at 1437 (Oct. 4, 1991). According to Commissioner the information provided by the EPA is designed to "enhance disclosure in this area," and is used in the review process for disclosure violations. *Id.*

186. 58 Fed. Reg. 32,843 (1993) [hereinafter Staff Bulletin No. 92]. The goal of the bulletin was to promote recognition and disclosure of environmental liabilities

accounting guidelines for public companies selling securities to the public.¹⁸⁷ Its primary purpose was to clarify both the SEC accounting rules¹⁸⁸ and the disclosure rules expanded in the 1989 release.

ties. The bulletin also included a discussion of diversity in reporting of and accounting for such liability. *Id.* See generally Casey Bukro, CHICAGO TRIBUNE, *Facing Costs of Cleanup; SEC Tells Firms to Book Liability*, Feb. 7, 1994, at A1. This document went into effect January 1, 1994, applying to end-of-1993 financial statements.

187. There have been two recent developments in the environmental liability disclosure area: Staff Accounting Bulletin No. 92 and a General Accounting Office report (GAO/RCED-93-108) on environmental liability disclosure by property and casualty insurers. See *Commissioner Warns*, *supra* note 26.

188. The most recent accounting rule is the FASB Statement of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies, Statement of Financial Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975) [hereinafter SFAS No. 5], which addresses "loss contingencies," for which a certain likelihood exists that a "future event or events will confirm the loss or impairment of an asset or the incurrence of a liability." *Id.* at 3. Paragraph 8 of SFAS No. 5 is the heart of the rule; it sets forth the standard by which a company must judge whether it must reduce its earnings, as reflected in its financial statements, based on a contingency:

An estimated loss from a loss contingency . . . shall be accrued by a charge to income if *both* of the following conditions are met:

- (a) Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- (b) The amount of loss can be reasonably estimated.

SFAS No. 5 ¶ 8. "Probable" is the highest level of likelihood of occurrence under SFAS No. 5. When a future event that "will confirm the loss or impairment of an asset or the incurrence of a liability," is likely to occur, it is "probably" under the rule. *Id.* ¶ 3. "Remote" means the "chance of the future event or events occurring is slight," while "reasonably possible" lies somewhere between "probable" and "remote." *Id.* "For purposes of this section, a *contingency* is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain . . . or loss . . . to an enterprise that will ultimately be resolved when one or more events occur or fail to occur." SFAS No.5 ¶ 1.

As SFAS No. 5, paragraph 8 indicates, both of its conditions must be met before a charge to earnings is required. But even when the conditions are not met or if an exposure loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, "disclosure of the contingency [in the notes to the financial statements] shall be made when there is at least a reasonable possibility that a loss or an additional loss may have incurred." *Id.* ¶ 10. "The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made." *Id.* Further, FASB Interpretation No. 14 requires accrual of the most likely estimate of the loss. Karen M. Doren, *Hazardous Waste Treatment Costs Emerge as a Significant Accounting Issue*, INSIGHTS, Apr. 1990, at 35.

Note that the SEC rules take precedence over the accounting rules. See Accounting Series Release No. 150, which announced that:

Principles, standards and practices promulgated by the [Financial Accounting Standards Board, the principal independent accounting standards rulemaking body] will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support.

Initial corporate reaction to SAB 92 was that the SEC demands were impossible to meet.¹⁸⁹ Preliminary studies attempt to chart the extent of pollution at a site, but companies have difficulty gauging what future governmental decisions will be.¹⁹⁰

SAB 92 set out ten key principles. First, with respect to accounting disclosures relating to loss contingencies, losses arising from environmental liability should be accounted for if the claim will probably be realized.¹⁹¹

The second principle related to projecting potential insurance recoveries. The SEC staff said it was not ordinarily appropriate to offset in the balance sheet a claim for recovery probable of realization against a probable contingent liability.¹⁹²

Third, the staff addressed liability with respect to costs apportioned to other responsible parties. If a registrant is jointly and severally liable for a contaminated site, but there is a reasonable basis for apportionment of costs among responsible parties, the registrant does not need to recognize a liability for costs apportioned to other responsible parties.¹⁹³

Fourth, since estimates and assumptions regarding the extent of environmental or product liability, methods of remedy, and amounts of related costs frequently prove to be different from the ultimate outcome, SAB 92 stated "measurement of the liability should be based on currently available facts, existing technology, and presently enacted laws and regulations."¹⁹⁴ Disclosure should

Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards, Accounting Series Release No. 150, Fed. Sec. L. Rep. (CCH) para. 72,172 (Dec. 20, 1973).

189. Bukro, *supra* note 186, at A1.

190. *Id.*

191. Staff Bulletin No. 92, *supra* note 186, at 32,843. "Discounting an environmental liability for a specific clean-up site to reflect the time value of money is appropriate only if the aggregate amount of the obligation and the amount and timing of the cash payments are fixed or reliably determinable for that site." *Id.* "Any asset that is recognized as relating to a claim for recovery of a liability on a discounted basis also should be discounted to reflect the time value of money." *Id.*

192. *Id.* ¶ 6. "[S]eparate presentation of the gross liability and related claim for recovery in the balance sheet most fairly presents the potential consequences of the contingent claim on the company's resources and is the preferable method of display." *Id.*

193. Staff Bulletin No. 92, *supra* note 186, at 32,844. However, the staff said: Discussion of uncertainties affecting the registrant's ultimate obligation may be necessary if, for example, the solvency of one or more parties is in doubt or responsibility for the site is disputed by a party. A note to the financial statements should describe any additional loss that is reasonably possible.

Id.

194. *Id.*

take into consideration the likely effects of inflation and other societal and economic factors.¹⁹⁵

When management determines a range for the amount of the liability but no specific number can be determined, the registrant should recognize the minimum amount of the range pursuant to Financial Accounting Standards Board Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss" ("FIN 14").¹⁹⁶ Recognition of a loss equal to the lower limit of the range is necessary even if the upper limit of the range is uncertain.¹⁹⁷

Fifth, with regard to which discount rate should be applied, the SEC staff said: "The rate used to discount the cash payments should be the rate that will produce an amount at which the environmental or product liability could be settled in an arm's-length transaction with a third party."¹⁹⁸ If that rate is not readily determinable, the discount rate used should not exceed the interest rate on essentially risk free monetary assets and have maturities comparable to that of the environmental or product liabilities.¹⁹⁹

To comply with SEC rules, statements should state "the discount rate used, the expected aggregate undiscounted amount, expected payments for each of the five succeeding years and the aggregate amount thereafter, and a reconciliation of the expected aggregate undiscounted amount to amounts recognized in the statements of financial position."²⁰⁰

195. *Id.* "Notwithstanding significant uncertainties, management may not delay recognition of a contingent liability until only a single amount can be reasonably estimated." *Id.*

196. *Staff Bulletin*, *supra* note 186, at 32,844.

197. *Id.* The staff explained:

In measuring its environmental liability, a registrant should consider available evidence including the registrant's prior experience in remediation of contaminated sites, other companies' clean-up experience, and data released by the Environmental Protection Agency or other organizations. Information necessary to support a reasonable estimate or range of loss may be available prior to the performance of any detailed remediation study. Even in situations in which the registrant has not determined the specific strategy for remediation, estimates of the costs associated with the various alternative remediation strategies considered for a site may be available or reasonably estimable. While the range of costs associated with the alternatives may be broad, the minimum clean-up cost is unlikely to be zero. As additional information becomes available, changes in estimates of the liability should be reported in the period that those changes occur in accordance with paragraphs 31-33 of Accounting Principles Board Opinion No. 20, "Accounting Changes."

Id.

198. *Id.*

199. *Staff Bulletin* No. 92, *supra* note 186, at 32,844.

200. *Id.* at 32,845.

Sixth, regarding financial statement disclosures furnished for recorded and unrecorded product or environmental liabilities, detailed disclosures regarding the judgments and assumptions underlying the recognition and measurement of the liabilities are required.²⁰¹

The staff said examples of disclosures that may be necessary include: (1) "Circumstances affecting the reliability and precision of loss estimates;"²⁰² (2) "The extent to which unasserted claims are reflected in any accrual or may affect the magnitude of the contingency;"²⁰³ (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;"²⁰⁴ (4) "Disclosure of the nature and terms of cost-sharing arrangements with other potentially responsible parties;"²⁰⁵ (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;"²⁰⁶ (6) "Uncertainties regarding the legal sufficiency of insurance claims or solvency of insurance carriers;"²⁰⁷ (7) "The time frame over which the accrued or presently unrecognized

201. *Id.* They are also necessary "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." *Id.*

202. Staff Bulletin No. 92, *supra* note 186, at 32,845.

203. *Id.* Note that SFAS No. 5 addresses the registrant's accrual or disclosure obligations in instances of litigation, claims and assessments. Paragraph 33 of the rules provides that:

The following factors . . . must be considered in determining whether accrual and disclosure, or both, is required with respect to pending or threatened litigation and are actual or possible claims and assessments:

(a) The period in which the underlying cause . . . of the pending or threatened litigation or of the actual or possible claim or assessment occurred.

(b) The degree of probability of an unfavorable outcome.

(c) The ability to make a reasonable estimate of the amount of loss.

Id. at para. 33.

204. *Id.*

205. *Id.*

206. Staff Bulletin No. 92, *supra* note 198, at 32,845.

207. *Id.* The staff said that it believes "there is a rebuttable presumption that no asset should be recognized for a claim for recovery from a party that is asserting that it is not liable to indemnify the registrant. Registrants that overcome that presumption should disclose the amount of recorded recoveries that are being contested and discuss the reasons for concluding that the amounts are probable of recovery."

amounts may be paid out;"²⁰⁸ and (8) "Material components of the accruals and significant assumptions underlying estimates."²⁰⁹

Seventh, calculations of loss contingencies should include consideration of when claims may be realized, the probability of the claims being contested, and the financial condition of third parties from which recovery is expected.²¹⁰ Disclosures should be "sufficiently specific to enable a reader to understand the scope of the contingencies affecting the registrant."²¹¹ For example: a registrant's discussion of historical and anticipated environmental expenditures should describe separately (a) recurring costs associated with managing hazardous substances and pollution in on-going operations, (b) capital expenditures to limit or monitor hazardous substances or pollutants, (c) mandated expenditures to remediate previously contaminated sites, and (d) other infrequent or non-recurring cleanup expenditures that can be anticipated but which are not required in the present circumstances.²¹² If management's investigation of potential liability and remediation cost is at different stages with respect to individual sites, the consequences of this should be discussed.

Eighth, site restoration costs or other environmental exit costs, material liabilities for site restoration, post-closure and monitoring commitments, or other exit costs that may occur on the sale, disposal, or abandonment of a property should be disclosed in the notes to the financial statements.²¹³ 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 amount of reasonably possible additional losses should also be disclosed.

If an asset held for sale or development will require remediation prior to development, sale, or as a condition of sale, a note to the financial statements should describe how the necessary expend-

208. *Id.*

209. Staff Bulletin No. 92, *supra* note 186, at 32,845.

"[A] statement that the contingency is not expected to be material does not satisfy the requirements of SFAS 5 if there is at least a reasonable possibility that a loss exceeding amounts already recognized may have been incurred and the amount of that additional loss would be material to a decision to buy or sell the registrant's securities. In that case, the staff said the registrant must either (a) disclose the estimated additional loss, or range of loss, that is reasonably possible, or (b) state that such estimate cannot be made."

Id.

210. *Id.*

211. *Id.*

212. *Id.*

213. Staff Bulletin No. 92, *supra* note 186, at 32,846.

itures are considered in the assessment of the asset's net realizable value.²¹⁴ If the registrant may be liable for remediation of environmental damage relating to assets or businesses previously disposed of, disclosure should be made unless there is only a remote chance of an unfavorable outcome.²¹⁵

Ninth, concerning disclosure of site restoration costs and other environmental exit costs at the end of the useful life of the asset, a registrant can accrue the exit costs over the useful life of the asset, as this is an established accounting practice in some industries.²¹⁶ In other industries, the SEC staff raises no objection to that accounting provided that the criteria in paragraph 8 of SFAS 5 are met.²¹⁷ In some circumstances the use of the asset in operations gives rise to growing exit costs that represent a probable liability.²¹⁸

Tenth, with regard to loss contingencies assumed in a business combination, in accordance with Accounting Principles Board Opinion No. 16, "Business Combinations," the acquiring company should allocate the cost of an acquired company to the assets acquired and liabilities assumed based on their fair values at the date of acquisition.²¹⁹ With respect to contingencies for which a fair value is not determinable at the date of acquisition, the guidance of Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" and Financial Accounting Standards Board Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss" should be applied.²²⁰

MD&A should include appropriate disclosure regarding any unrecognized preacquisition contingency and its reasonably likely effects on operating results, liquidity, and financial condition.²²¹ The allocation period should not extend beyond the minimum rea-

214. *Id.*

215. *Id.*

216. *Id.*

217. Staff Bulletin No. 92, *supra* note 186, at 32,846.

218. *Id.* The accrual of the liability should be recognized as an expense in accordance with the consensus on EITF Issue 90-8, "Capitalization of Costs to Treat Environmental Contamination." *Id.*

219. *Id.*

220. Staff Bulletin No. 92, *supra* note 186, at 32,846.

If the registrant is awaiting additional information that it has arranged to obtain for the measurement of a contingency during the allocation period specified by Statement of Financial Accounting Standards No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises," the registrant should disclose that the purchase price allocation is preliminary. In that circumstance, "the registrant should describe the nature of the contingency and furnish other available information that will enable a reader to understand its potential effects on the final allocation and on post-acquisition operating results." *Id.*

221. *Id.*

sonable period necessary to gather the information that the registrant has arranged to obtain for purposes of the estimate. Since an allocation period usually should not exceed one year, registrants believing that they will require a longer period are encouraged to discuss their circumstances with the staff. If it is unlikely that the liability can be estimated at the time of the initial purchase price allocation, the allocation period should not be extended with respect to that liability. An adjustment to the contingent liability after the expiration of the allocation period would be recognized as an element of net income.

A controversial aspect of SAB 92 is likely to be the staff's view "that for the vast majority of situations, contingent liabilities should be displayed on the face of the balance sheet separately from amounts of claims for recovery from insurance carriers or other third parties."²²² In this connection, SEC Commissioner Roberts explained that many issuers recognize the liability net of the insurance claim—a practice he termed "equivalent to offsetting the insurance receivable against the contingent liability."²²³ Roberts conceded that current requirements permit liabilities to be offset by probable insurance recoveries.²²⁴

A second issue of great significance is the ability to recognize an estimated liability at its present value rather than at the gross amount expected to be payable. Because the ultimate settlement of environmental liability may not occur for many years, the effect of discounting the liability to reflect the time value of money may be quite important. The staff's view on this issue is that balance sheet presentation of the gross amount of liability, rather than net, most accurately shows the potential effects of environmental liability on a company's assets. Offsetting the components of liability and probable recovery "may leave investors unaware of the magnitude of the liability and may lull them into a less rigorous consideration of the legal sufficiency of the issuer's claims for recovery and the creditworthiness of the party from whom recovery is anticipated."²²⁵

Although SAB 92 applies to public companies, certain commentators predict that it will also force private companies to think

222. Staff Bulletin No. 92, *supra* note 186, at 32,846.

223. *Roberts Says*, *supra* note 25, at 1293.

224. *Id.* "However," he emphasized, "most insurance claims are heavily litigated, and no litigation outcome pattern has yet been established. Thus," he reasoned, "in most of these situations, the recovery is not probable of realization." *Id.*

225. *Id.*

about environmental problems too.²²⁶ SAB 92 is important because the SEC is alerting companies, both public and private, of the importance of this issue.

VIII. CURRENT DISCLOSURE TRENDS

A review of the SEC filings by public registrants in the first quarter of 1994 reveals that a growing number of companies are making statements concerning their environmental liabilities. Do these disclosure statements add to the "total mix of available" information and aid the reasonable investor in his or her decisions or does the addition of increased environmental disclosure by all public registrants obscure those registrants with significant environmental problems? One commentator has said that the disclosure is beneficial, explaining:

The overall effect here is a beneficial one: Investors are not defrauded by being induced to purchase securities priced at a higher value than would be assigned under circumstances of full environmental disclosure. Those investors are also in a better position to make an informed decision regarding whether to buy the securities (or hold, as the case may be). And, finally, the reductions in the value of securities as a result of these market dynamics may be so substantial that they create . . . an economic disincentive to the issuers of those securities to continue methods of production that generate large environmental liabilities. Correspondingly, as to environmental obligations, such as legal requirements to acquire and maintain certain pollution control technology, the issuer may have an incentive to acquire or develop the most economical version of that obligation.²²⁷

This conclusion presumes that the investor will be able to distinguish between routine proceedings and significant ones. It also presumes that securityholders will understand that although a registrant theoretically could be held liable for the entire cleanup costs at a site, the registrant is likely to pay only a pro rata share of these costs. Thus, those who argue that the SEC policies are beneficial

226. Staff Bulletin No. 92 sets forth the SEC staff's interpretation of Generally Accepted Accounting Principles regarding contingent liability and will effect in particular issuers that may have incurred environmental liabilities.

227. See Wallace, *supra* note 6, at 1131.

overlook the effect of including overly pessimistic information in a public filing.

They also incorrectly presume that changing the disclosure behavior of a corporation will change the environmental compliance behavior of the corporation.²²⁸ With regard to CERCLA liabilities, this presumption is completely fallacious. Liability for Superfund can arise for past disposal of hazardous wastes even though the conduct was both legal and perhaps permitted when undertaken. Superfund liability is strict and can apply to events that may have occurred fifty years ago or longer and that were completely beyond the control of the registrant.²²⁹ Thus, in some circumstances, early disclosure of Superfund liability is likely to have no effect on Superfund compliance.

In addition, the disclosure of upgrade technologies required under the Clean Air Act Amendments of 1990, is similarly unlikely to change registrants' behavior. In contrast to CERCLA liability, technology upgrade requirements are prospective in nature. The problem presented is that companies that wish to comply are now on notice that they must make certain changes to their plants by statutorily mandated deadlines, but have not yet been directed by EPA or compliance standards on how to do so. Most corporations resolve this problem by making a best guess and disclosing what their reserves will be, if any. The disclosure in SEC filings is unlikely to affect installation of the control technologies, for companies will likely wait until EPA promulgates implementing regulations.

A trend in disclosure has begun among companies that do not believe that they have significant environmental problems but are

228. *See, e.g.,* Wallace, *supra* note 6, at 1131-32.

The SEC's current emphasis on environmental disclosure has generated incentives for both environmental protection and securities market integrity. The foundation of this phenomenon is the required transmission of important information on environmental matters to securityholders and to the markets about public companies. If adverse information relating to environmental liabilities and obligations will have the effect of moving securities prices down in efficient, developed public markets, a company may have an incentive to ameliorate its environmental problems (or make its handling of environmental concerns more efficient in the case of obligations) in order to preserve the value of its securities as priced by those public markets. Completing this dynamic are the "millions of decentralized decision makers" participating in the public markets. Whether their investment objectives are economic or social in nature, owners of securities are indeed key players in creating incentives for adoption of more enlightened environmental policies by public companies.

Id. (citations omitted).

229. CERCLA § 107(a), 42 U.S.C. § 9607(a).

subject to environmental regulation. Many companies have begun to disclose that they are subject to environmental regulation but believe that the regulation will not have any material effect on the corporation. These companies probably would not have made any disclosure concerning environmental compliance under the *Basic* probability/magnitude test.

MD&A regulations provide that a registrant must disclose only information available "without undue effort or expense."²³⁰ This standard implies that a reasonable effort and expense are affirmatively required. If a registrant receives a PRP letter or other notice of environmental noncompliance just before an SEC filing is due, the registrant may not be able to generate a cost estimate before making its filing. The registrant may have no knowledge of the environmental problem from the PRP letter or notice of noncompliance. Thus, the registrant may be unable to make a reasonable projection without significant investigation. In order to make a reasonable projection, the registrant will need to determine whether it has been properly designated as a PRP or in noncompliance, the cost of cleanup or coming into compliance, and the availability of insurance and contribution. Under such a scenario the registrant would be required to disclose its status as a PRP or alleged environmental violator, since it cannot determine such status will *not* have a material effect.

Under the SEC's 1989 Release, the registrant would be advised to disclose that it has just been named as a PRP or received a notice of noncompliance, but that it is unable to determine whether the potential liability is likely to have a material effect due to the lack of an opportunity to investigate.

The problem with such limited disclosure is that it may unnecessarily provoke inquiry from the public, the SEC and the registrant's auditors. Failure to disclose the receipt of a PRP letter or other letter of noncompliance is, however, likely to prove even more problematic. Unless the facts prove that the registrant has been improperly named as a PRP, the registrant would have a difficult time justifying its failure to disclose receipt of a PRP letter. The imposition of strict and joint and several liability on PRPs for all cleanup costs makes it difficult to establish "on an objectively reasonable basis" that the liability was not reasonably likely to have a material effect.²³¹ Several examples of these types of filings are in-

230. 1989 Release, *supra* note 22, at 22,428.

231. Shell Oil Co. and its insurers spent \$40 million defending cleanup liability on a Denver pesticide plant site. The Royal Dutch Petroleum is obligated to pay

cluded in Appendix A.

A second trend that an increasing number of corporations are following is to state that environmental regulation may have a future effect, but they are unable to quantify that effect because the relevant implementing agency has failed to promulgate the compliance regulations. The Clean Air Act Amendments of 1990 have produced a great deal of this type of disclosure, since the amendments require technological upgrades to be made even though EPA has not yet produced implementing regulations.²³² This means that a large number of registrants have had to account for and reserve for control technology upgrades when they have no idea what those upgrades will be or how much they will cost because the implementation process has not yet begun or is currently in its infancy.

Similar problems also arise concerning early disclosure of PRP status at Superfund sites. At the early stages of the process, it is often impossible for the PRP to disclose any estimate of the cleanup costs without detailed examination of the site or potential parties to implead for contribution. The SEC release²³³ requires disclosure of PRP status "quantified to the extent reasonably practicable" unless the registrant can show PRP status is not likely to have a material effect. PRPs in the early stages of Superfund litigation are generally not able to definitively state that the event will not be material, since Superfund could theoretically impose joint and several liability for cleanup of any given site. Thus, a registrant that has been designated as a PRP will be unable to definitively state that it will not be materially affected, even if the registrant is experienced in Superfund litigation and believes it is unlikely to be materially af-

\$320 million of the first \$700 million and 20% of the cost above \$320 million for the one Denver site. See Naj, *supra* note 18, at 1, 11. "[In 1989], six big oil firms — Exxon Corp., Mobil Oil Corp., Chevron Corp., Texaco Inc., Amoco Corp. and Shell Oil Co. — reported costs of about \$2.8 billion related to oil spills and writedown for environmental sensitivity drilling projects off the California coast." Susan Zeidler, *Oil Companies Face Huge Superfund Site Costs*, Reuter Bus. Rep. (March 28, 1990).

232. See Wallace, *supra* note 6, at 1133.

[W]hether the subject of disclosure relates to (1) future required capital expenditures for Clean Air Act pollution control under Regulation S-K, Rule 101; (2) designation as a Superfund Potentially Responsible Party in certain instances, in advance of litigation and judgment, under Regulation S-K, Rule 103; (3) future financial implications of present environment-related activities and trends under Regulation S-K, Rule 303 (MD&A); (4) material environment-related information under Rule 10b-5; or (5) accrual of an environmental liability under SEC and GAAP principles, the securities laws often require advance disclosure.

Id.

233. *Oil/Chemical Firms Face Huge Hazardous Waste Costs*, REUTERS BUS. REP. (March 14, 1990)

fect. Despite this actuality, the registrant will be unable to say for sure that it will not be material.

Although mere receipt of a PRP letter is not an event triggering disclosure, under this new test disclosure will almost always be required.²³⁴ Parties receiving a PRP letter are almost never in a position to determine categorically, without detailed investigation, that PRP status is not reasonably likely to have a material effect.²³⁵ For example, insurance coverage for cleanup of Superfund sites is almost always litigated and the outcome of litigation is difficult to predict.²³⁶ As such, counsel are not likely to opine on the availability of insurance coverage for environmental claims. This uncertainty prevents the registrant from making the determination that PRP status is not likely to have a material effect, even if insurance coverage is ultimately found.

Similarly, the availability of contribution from other PRPs is a matter obscuring the analysis of the effect of PRP status on a registrant. Generator and transporter PRPs are not likely to know what other parties may be liable for contribution without exhaustive investigations.²³⁷ Even after investigations have produced a list of PRPs potentially liable for contribution, further inquiry will be necessary to determine which, if any, potential joint tortfeasors are solvent. Finally, the PRP will have to initiate suit against the other PRPs for contribution. Such suits are extremely expensive and the outcomes are uncertain.

For that reason, in order to avoid being misleading, any cost estimates should be caveated with (i) the source of the estimate, (ii) the assumptions and methods used in reaching the estimates and (iii) the possibility of related future costs arising.²³⁸ "Worst-case"

234. For example, the SEC told a *de minimis* contributor to the Lowry landfill site that it must list on its 10K its total potential cleanup liability. See PUBLIC SERVICE COMPANY OF COLORADO 10-K (Filing Date: Apr. 15, 1991; Document Date: Dec. 31, 1990) at 23; TOSCO CORP. 10-K (Filing Date: Apr. 17, 1991; Document Date: Dec. 31, 1990), at 8.

235. See, e.g., Statement of Paul Edwards at Government Institute entitled, "Financial Reporting of Environmental Exposures" (April 24, 1990) at 56 (determining how much a cleanup will cost "will depend upon a number of important factors" and is a "complex, perplexing and frustrating question."); see also Statement of Norton F. Tennille before the Environmental Law Institute Seminar entitled, "Environmental Disclosure Requirements" (Jan. 16, 1991).

236. Statement of Paul Edwards, Special Counsel, Corporate Finances, SEC, before the Environmental Law Institute Seminar, entitled, "Environmental Disclosure Requirements" (Jan. 16, 1990); see also Statement of Paul Edwards, *supra* note 235 ("uncertainty in law of insurance makes it dangerous to say there are no materially adverse results due to insurance coverage").

237. See, e.g., Lathrop & Lambert, *supra* note 124, at 21-23.

238. 1989 Release, *supra* note 22, at 22,427.

cost estimates, if available, should be revealed only cautiously since investors can be just as misled by unduly negative information as they can be by nondisclosure or overly optimistic data. Rather than present such pessimistic materials, many registrants include statements describing their requirement to disclose environmental matters which otherwise would not be considered financially material. For examples of these types of filings, see Appedix B.

This second trend undermines the articulated goal of the SEC staff of preventing MD&A from becoming a repository for boiler plate language.²³⁹ Unfortunately, the SEC release has not aided the PRP or the registrant subject to requirements under the Clean Air Act in determining appropriate disclosure. The SEC requires disclosure where there has been proper designation of a PRP but investigations are not advanced enough to determine the availability of insurance or contribution.²⁴⁰ Similar requirements exist with regard to control technology upgrades whose expense can not yet be quantified. Such disclosure is required because the PRP or registrant subject to environmental statutes cannot demonstrate that the effect of these laws is not "reasonably likely to have a material effect."²⁴¹

The SEC stated that such disclosure should be "quantified to the extent reasonably practicable."²⁴² However, this new disclosure requirement is an absurdity when the registrant is in the preliminary stages of a Superfund investigation.²⁴³ It is even more absurd when the PRP is investigating the validity of its designation as a PRP. Similarly, the requirement to project the effect of future environmental regulations not yet in the comment stage of implementation creates disclosure which is unlikely to aid the reasonable investor in his or her investment decision. Rather than clarifying disclosure obligations, the Commission release and staff guidelines have further clouded the mire of Superfund and other environmental disclosure issues.

A third trend that has developed is the "dump truck" or "garbage" approach to disclosure. Under this approach, registrants dis-

239. See, e.g., Statement of Paul Edwards, *supra* note 235.

240. See 1989 Release, *supra* note 22, at 22,430. See also Zeidler, *supra* note 231 ("The SEC is pushing for greater disclosure, but the accounting fraternity says it runs aground on the issue of specificity' of total costs, said W. Bruce Jones, an analyst for Moody's Investors Service.").

241. 1989 Release, *supra* note 22, at 22,430.

242. *Id.*

243. See Ziedler, *supra* note 249 ("Despite the push for more disclosure, industry officials think the uncertainty will limit how much is reported.").

close every environmental event that could conceivably effect the registrant without filtering out routine events. The approach often obscures important environmental information by including it among extremely routine proceedings.

This type of disclosure often goes on for pages and pages and may be a significant percentage of the total information included in the registrant's filing.²⁴⁴ For an example of this approach, see Appendix C.

A final trend that has developed is the direct appeal by public companies to the "ethical investor" by including information that explains the important environmental goals and attitudes of the registrant. These sometimes include disclosure of voluntary environmental efforts by the company, awards or acknowledgements by EPA, or the adoption of a new corporate philosophy. For examples of this approach, see Appendix D.

IX. CONCLUSION

Although the antifraud provisions in section 10(b) and Rule 10b-5 required disclosure of material information concerning the environmental practices of public registrants, the SEC developed a specific interest in environmental disclosure rules in the early 1970's, following the enactment of NEPA, the Clean Water Act and the Clean Air Act. Initially, the SEC's environmental disclosure requirements focused on the cost corporations would incur for environmental permits required under these new laws. Over the years, however, the SEC expanded its interest to include requiring disclosure of all economically material environmental information.

In developing these rules, the SEC expanded and contracted its disclosure requirements concerning environmental information such as litigation, learning from institutional mistakes. Thus, the SEC retracted its 1973 rules requiring disclosure of *all* information concerning the environment which may be considered socially or ethically important to social constituents, when the rule proved to result in over disclosure, obscuring material information.

In 1982, the SEC introduced Regulation S-K as part of its integrated disclosure rules. In addition to the general requirement of making full and fair disclosure, Regulation S-K contains two specific rules concerning environmental reporting obligations. Item 101, paragraph (c)(1)(xii) requires disclosure as to the material effects of compliance with environmental laws. Instruction 5 to Item 103

244. *Id.*

requires disclosure of any pending environmental litigation if it is material, involves a potential monetary loss exceeding ten percent of the corporation's assets, or is brought by the government seeking a monetary sanction which will likely result in a fine exceeding \$100,000. The SEC changed its disclosure requirements in response to judicial decisions,²⁴⁵ legislative enactments,²⁴⁶ and recommendations from professionals.²⁴⁷ It has also issued interpretive releases to remind issuers of existing requirements at appropriate times²⁴⁸ and to clarify questions raised by issuers.²⁴⁹

Through nearly ten years of experience, the environmental bar and the SEC have come to strike an understanding as to when environmental disclosure is appropriate. Great debate remains, however, concerning disclosure of contingent Superfund liabilities²⁵⁰ and Clean Air Act expenditures for upgrading control technologies in conformity with the 1990 Clean Air Act Amendments

The SEC does not want MD&A to become a repository for boiler plate language. By adopting an enhanced MD&A disclosure requirement, however, the SEC has begun to get many different types of boiler plate disclosure. In order to protect themselves from potential liability under the federal securities laws, disclosure documents now include long discussions of the implications of Superfund and other environmental jurisprudence which reveal very little about the impact of potential environmental liability on the particular registrant.

Moreover, the 1989 Commission release and the 1993 SEC staff guidance document mark a disturbing return to once-abandoned SEC policies like those espoused in 1973 requiring companies to disclose *all* environmental information which may be considered socially important. The 1973 SEC rules resulted in pages of text concerning routine environmental proceedings and matters which were not necessarily material. The result was that truly important environmental information was often lost in the "dump truck" approach of disclosure by registrants. Requiring corporations to disclose PRP status or other environmental contingencies unless they

245. See, e.g., *NRDC II*, 432 F. Supp. 1190.

246. See, e.g., 42 U.S.C. § 4321 (1988) (National Environmental Policy Act of 1969).

247. 1989 Release, *supra* note 25, 22,430.

248. See, e.g., Release No. 6130, *supra* note 115.

249. Letter from SEC to Thomas Cole, Esq., Sidley & Austin, (Jan. 17, 1989) (1989 SEC No-Action Letter LEXIS 203).

250. This concern arises due to the potential (but often theoretical) application of joint and several liability.

can prove a negative (that the contingent Superfund or other environmental liability is not reasonably likely to have a material effect) has also begun to result in pages of superfluous information.

For these reasons, the SEC should abandon its current position on MD&A disclosure of PRP status and other contingent environmental liabilities. The SEC never stated why it rejected the *Basic* probability/magnitude materiality test in favor of a standard which requires the registrant to disclose unless it can prove that PRP status is not “reasonably likely to have a material effect.” Perhaps this is because there is no rational reason for its abandonment.

The requirement to disclose PRP status unless the registrant can “prove a negative” is a novel concept in securities law—a concept with no grounding in traditional jurisprudence under Regulation S-K or Rule 10b-5. To be safe, registrants are now forced to include pages of information detailing Superfund and other environmental jurisprudence in order to explain why the registrant is disclosing otherwise immaterial information. Therefore, MD&A disclosure is beginning to result in exactly what the SEC does not want: a repository of boiler-plate language so conditioned that the investing public is unlikely to be able to evaluate the effects on the public company.

The *Basic* probability/magnitude test allowed management to evaluate the import of data as it became available. This new standard requires disclosure before management has ever had an opportunity to make a meaningful evaluation. Proponents of the efficient market hypothesis will recognize that the danger of disclosing overly pessimistic, “worst-case” data is equally dangerous as disclosing overly optimistic data. In the environmental arena, the SEC has now mandated, as a matter of policy, that registrants err on the side of presenting overly pessimistic data.

The pendulum has once again swung back to the requirements of the early 1970s that registrants disclose all environmental data, whether or not it is material—a rationale abandoned by the SEC as unworkable in 1973. While enforcement of materially misleading environmental information should certainly be vigorously prosecuted, this can be done without creating a separate disclosure standard for environmental matters. The SEC should once again abandon the policy of requiring disclosure of all environmental matters. The SEC should return to the *Basic* probability/magnitude test for all securities disclosure under Regulation S-K, including environmental disclosure made under Item 303.

APPENDIX A

Example 1

ENVIRONMENTAL MATTERS

In 1990, certain Clean Air Act Amendments were adopted by Congress which require the Environmental Protection Agency (the "EPA") to study emissions from off-road engines and equipment, including virtually all of the equipment manufactured by the Company. If the EPA determines such emissions contribute to air quality problems, the EPA is required to promulgate regulations containing standards applicable to such emissions. The EPA may promulgate such regulations sometime during 1994. Although at this time management cannot assess the impact that such regulations (if promulgated) would have upon the Company, management does not believe that it is likely to be material.

The Company has been designated a potentially responsible party (PRP), in conjunction with other parties, in certain government actions associated with hazardous waste sites. As a PRP, the Company has been and will be required to pay a portion of the costs of evaluation and cleanup of these sites. Management does not expect that these matters will have a material adverse effect on the consolidated financial position or operating results of the Company.

DEERE & CO, 10-K 11 (filing date: Jan. 28, 1994; document date: Oct. 31, 1993).

Example 2

The company is subject to federal, state and local environmental laws and regulations concerning, among other matters, waste water effluents, air emissions and furnace dust disposal. As such, the Company is from time to time involved in administrative and judicial proceedings and administrative inquiries related to environmental matters.

As with other similar mills in the industry, the Company's mini-mills are classified as generating hazardous waste because they produce certain types of dust which contain lead and cadmium. Dust generated by the Company's steel operations is currently collected and disposed

of through contracts with a company which reclaims certain materials and disposes of the remainder as a non-hazardous solid waste. The Company also has on its property at Newport a permitted hazardous waste disposal facility. Reference is made to Note 11 contained herein for information regarding the disposal of radiation contaminated dust at Newport.

The Company believes that it is currently in compliance with all known material and applicable environmental regulations.

Regulations under the 1990 Amendments to the Clean Air Act that will pertain to the Company's operations are currently not expected to be promulgated until 1997 or later. The Company believes that the Clean Air Act will not have a material impact on the Company's business or consolidated financial position for the foreseeable future.

Capital expenditures for the succeeding fiscal year relating to environmental control facilities are not expected to be material, however, such expenditures could be influenced by new and revised environmental regulations and laws.

NS GROUP INC., 1993 ANNUAL REPORT 25 (1994).

Example 3

Environmental Matters. By the nature of its operations, the Company's manufacturing facilities are subject to various federal, state and local environmental laws and regulations, including the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act and the Comprehensive Environmental Response, Compensation and Liability Act. Although the Company occasionally has been subject to proceedings and orders pertaining to emissions into the environment, the Company believes that it is in substantial compliance with existing environmental laws and regulations. See "Legal Proceedings — Environmental Matters" in Item 3 of this Annual Report on Form 10-K.

FORSTMANN & CO. INC., 10-K 11 (filing date: Jan. 25, 1994; document date: Oct. 31, 1993).

APPENDIX B

*Example 1***Governmental Regulation**

The Corporation is subject to various Federal, state and local environmental laws and regulations limiting the discharge, storage, handling and disposal of a variety of substances, particularly the Federal Water Pollution Control Act, the Federal Clean Air Act (as amended in 1990), the Resource Conservation and Recovery Act (including amendments relating to underground tanks) and the Federal "Superfund" program. The Corporation is presently engaged in a number of environmental remediation plans and has reported dispositions of waste which could result in future remediation obligations. The Corporation cannot with certainty assess at this time the impact of the future emission standards and enforcement practices under the 1990 Clean Air Act upon its operations or capital expenditure requirements.

BURLINGTON INDUSTRIES EQUITY INC., 10-K 9-10 (filing date: Jan. 10, 1994; document date: Oct. 2, 1993).

*Example 2***OTHER MATTERS _____****ENVIRONMENTAL MATTERS**

The company's facilities and products are subject to extensive environmental laws and regulations. Research, engineering, and operating expenses relating to environmental protection totaled approximately \$126 million in 1993, and are expected to remain relatively constant for 1994. Such expenses include depreciation expenses of approximately \$10 million, but exclude reserves described hereinafter. Capital expenditures for pollution abatement and control for 1993 were approximately \$11 million, approximately 2.5% of total capital expenditures. For 1994, the company estimates that such capital expenditures will approximate \$17 million.

It is expected that these expenditure levels will continue and may increase over time. However, the ultimate cost of future compliance is uncertain due to a number of factors such as the evolving nature and interpretation of

environmental laws and regulations, the extent of remediation which may be required at sites identified by the Environmental Protection Agency (EPA), or comparable state authorities, and evolving technologies. The 1990 Amendments to the Clean Air Act provide, among other things, for more stringent air emission standards which may require significant expenditures to bring the company's facilities into compliance and to redesign certain of the company's products. The 1990 Amendments are scheduled to be implemented throughout the 1990s and the first decade of the 21st century. However, a large number of the regulations which will be required to achieve that implementation have not yet been proposed or promulgated. In 1993, capital and operating expenditures attributed to compliance with the 1990 Amendments were approximately \$15 million. Expenditures for 1994 are expected to be approximately \$19 million.

Based on a preliminary environmental assessment, during 1992 Solar Turbines Incorporated (Solar), a subsidiary of Caterpillar Inc. since 1981, estimated that assessment, remediation, and preventative expenditures for contamination of its Harbor Drive facility in San Diego, California, will be approximately \$30 to \$50 million expended over the next 25 years, a significant portion of which will be capital expenditures. The contamination of Harbor Drive, a manufacturing facility for over 60 years, involves cleaning solvents, petroleum products, and metal products, which have been found in both soil and groundwater samples. Solar has been working closely with state and local agencies on this issue. While subject to further analysis, Solar believes that a substantial portion of the expenditures may be recoverable from third parties who previously conducted manufacturing or other operations on or adjacent to the site. A reserve of \$13 million was recorded in the third quarter of 1992 with respect to this matter. Remediation expenses with respect to Harbor Drive were \$3 million for 1993.

Also in 1992, a reserve of \$5 million was recorded with respect to estimated costs of remediation of soil and groundwater contamination at locations at other company facilities. This reserve includes \$4 million for estimated costs to remediate potential groundwater contamination

at a former Caterpillar facility located in San Leandro, California. Remediation efforts have been ongoing, and the company has been working closely with the California Department of Toxic Substances Control in its remediation efforts. Remediation expenses with respect to San Leandro were less than \$1 million for 1993.

As of December 31, 1993, the company, in conjunction with numerous other parties, has been identified as a potentially responsible party (PRP) at 18 active sites identified by the EPA, or similar state authorities for remediation under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), or comparable federal or state statutes (CERCLA sites). Lawsuits and claims involving additional environmental matters are likely to arise from time to time.

CERCLA and facility sites are in varying stages of investigation and remediation. As a result, management's assessment of potential liability and remediation costs have been based on currently available facts, the stage of the proceedings, the number of PRPs identified, documentation available, currently anticipated and reasonably identifiable remediation costs, amounts contributed by the company on a pro-rata basis toward investigation and remediation costs, existing technology, presently enacted laws and regulations, and other factors. While the company may have rights of contribution or reimbursement under insurance policies, such issues are not factors in management's estimation of liability.

Based on the foregoing factors, management believes that it is unlikely that any identified matters, either individually or in the aggregate, will have a material adverse effect on the company's consolidated financial position, results of operations or capital expenditures. Remediation and monitoring expenses actually incurred in 1993 in respect of CERCLA sites and soil and groundwater contamination at company facilities (including Harbor Drive and San Leandro sites noted above) were approximately \$4 million.

CATERPILLAR INC., Proxy Statement A-32 (filing date: Feb. 24, 1994; document date: Feb. 25, 1994).

Example 3

The Environment

Proposed EPA Regulations

The company will incur capital expenditures, in addition to those set forth in the company's Annual Report on Form 10-K for the fiscal year ended December 31, 1992 (the "1992 Form 10-K"), to meet the requirements of the federal Clean Air Act Amendments of 1990 (the "Clean Air Act") and state air toxics regulations as well as the federal Water Pollution Control Act (the "Clean Water Act") (collectively, the "Acts"). On October 31, 1993, the United States Environmental Protection Agency proposed implementing regulations pursuant to the Acts, with certain additional Clean Air Act implementing regulations expected to be issued in 1994. All of the regulations are expected to become final in 1995, with compliance required by 1998.

With respect to the Clean Water Act, the proposed regulations provide for oxygen delignification and chlorine dioxide substitution as the preferred technology to reduce the potential for the formation of dioxin in the pulp bleaching process. The company has implemented and is continuing to implement this technology at its bleached kraft mills. If the final regulations continue to designate oxygen delignification and chlorine dioxide substitution as the preferred technology, the company presently anticipates that it will incur capital expenditures to meet the requirements of the Clean Water Act, additional to those set forth in its 1992 Form 10-K, of approximately \$25 million over the period of approximately 1995 to 1998.

Assuming that the Clean Air Act regulations to be proposed in 1994 use a range of standards currently expected by the company and that all of the regulations pursuant to the Clean Air Act are adopted as proposed, the company presently anticipates that it will incur capital expenditures to meet the requirements of the Clean Air Act and state air toxics regulations, additional to those set forth in its 1992 Form 10-K, of \$100 million to \$200 million over the period of approximately 1995 to 1998.

CHAMPION INT'L CORP., 10-Q, Amendment 1, 9 (filing date: Jan. 26, 1994; document date: Sept. 30, 1993).

Example 4

Under the Clean Air Act Amendments of 1990 many states will be required to implement alternative fuel programs for fleet vehicles operating in certain nonattainment areas. As states begin to implement their clean fuel fleet programs, the Company anticipates acquiring new delivery vehicles or modifying its existing delivery vehicles in order to comply with the regulations. Additionally, facility modifications may be required to accommodate the use of alternative fuels at the Company's stations and ramps. The Company believes these new alternative fuel programs will impose additional expenditures on the Company, however, the magnitude of the impact has not yet been determined nor has the Company decided what steps, if any, to take to counteract it.

FEDERAL EXPRESS CORP., 10-Q 19 (filing date: Jan. 14, 1994; document date: Nov. 30, 1993).

APPENDIX C

ENVIRONMENTAL REGULATION

The National Environmental Policy Act requires that detailed statements of the environmental effect of the Company's facilities be prepared in connection with the issuance of various federal permits and licenses, some of which are described below. Federal agencies are required by that Act to make an independent environmental evaluation of the facilities as part of their actions during proceedings with respect to these permits and licenses.

The federal Clean Water Act requires permits for discharges of effluents into navigable waters and requires that all discharges of pollutants comply with federally approved state water quality standards. The Connecticut Department of Environmental Protection ("DEP") has adopted, and the federal government has approved, water quality standards for receiving waters in Connecticut. A joint federal and state permit system, administered by the DEP, has been established to assure that applicable effluent limitations and water quality standards are met in connection with the construction and operation of facilities that affect or discharge into these waters. The current discharge permit for New Haven Harbor Station was issued by the DEP on September 30, 1991. The discharge permits for Bridgeport Harbor, English and Steel Point Stations expired on February 25, 1992, May 15, 1992 and March 16, 1992, respectively. Applications for renewal of these permits were filed on August 23, 1991, November 14, 1991 and September 13, 1991, respectively, and, although new permits have not yet been issued, the Company has not been advised by the DEP that any of these facilities has a permitting problem. While the renewal applications are pending, the terms of the expired permits continue in effect. The DEP has determined that the thermal component of the discharges at each of the Company's stations will not result in a violation of state water quality standards and that the location, design, construction and capacity of the cooling water intake structures reflect the best technology available, as defined by the federal Environmental Protection Agency ("EPA"). All discharge permits may be reopened and amended to in-

corporate more stringent standards and effluent limitations that may be adopted by federal and state authorities. Compliance with this permit system has necessitated substantial capital and operational expenditures by [the Company], and it is expected that such expenditures will continue to be required in the future. Although the magnitude of future expenditures cannot now be estimated accurately, the Company presently anticipates spending several million dollars during the next several years to consolidate and improve the wastewater collection and treatment system at Bridgeport Harbor Station.

Under the federal Clean Air Act, the EPA has promulgated national primary and secondary air quality standards for certain air pollutants, including sulfur oxides, particulate matter and nitrogen oxides. The DEP has adopted regulations for the attainment, maintenance and enforcement of these standards. In order to comply with these regulations, the Company is required to burn fuel oil with a sulfur content not in excess of 1%, and Bridgeport Harbor Unit 3 is required to burn a low-sulfur, low-ash content coal, the sulfur dioxide (SO₂) emissions from which are not to exceed 1.1 pounds of SO₂ per million BTU of heat input. Current air pollution regulations also include other air quality standards, emission performance standards and monitoring, testing and reporting requirements that are applicable to the Company's generating stations and further restrict the construction of new sources of air pollution or the modification of existing sources by requiring that both construction and operating permits be obtained and that a new or modified source will not result in the violation of the EPA's national air quality standards or its regulations for the prevention of significant deterioration of air quality.

Amendments to the Clean Air Act in 1990 will require a significant reduction in nationwide SO₂ emissions by fossil fuel-fired generating units to a permanent total emissions cap in the year 2000. This reduction is to be achieved by the allotment of allowances to emit SO₂, measured in tons per year, to each owner of a unit, and requiring the owner to hold sufficient allowances each year to cover the emissions of SO₂ from the unit during that year. Allowances are transferable and able to be bought and

sold. The Company believes that, under the allowances allocation formula, it will hold more than sufficient allowances to permit continued operation of its existing generating units without incurring substantial expenditures for additional SO₂ controls. The Company is marketing its surplus allowances, and has sold to a midwestern utility company an option to purchase a quantity of the Company's surplus allowances commencing in the year 2000. This sale has not had a significant impact on the Company's earnings.

The same 1990 Clean Air Act amendments also contain major new requirements for the control of nitrogen oxides that will be applicable to generating units located in or near areas, such as [the Company's] service territory, where air quality standards for nitrogen oxides and/or photochemical oxidants have not been attained. These amendments will also require the installation and/or modification of continuous emission monitoring systems, and require all existing generating units to obtain operating permits. During 1993, the Company expended approximately \$12.3 million for nitrogen oxides controls and monitoring systems during a major overhaul of the largest generating unit at Bridgeport Harbor Station; and approximately \$1.7 million will be expended in 1994 to complete this work. However, a federally-mandated 1994 revision to Connecticut's plan for achieving compliance with air quality standards for photochemical oxidants has not yet been promulgated, and the Company is not yet able to assess accurately the applicability and impact of implementing regulations to and on its generating facilities. Compliance may require substantial additional capital and operational expenditures in the future. In addition, due to the 1990 amendments and other provisions of the Clean Air Act, future construction or modification of fossil-fired generating units and all other sources of air pollution in southwestern Connecticut will be conditioned on installing state-of-the-art nitrogen oxides controls and obtaining nitrogen oxide emission offsets—in the form of reductions in emissions from other sources—which may hinder or preclude such construction or modification programs in [the Company's] service area, depending on am-

bient pollutant levels over which the Company has no control.

The Company's generating stations in Bridgeport and New Haven comply with the air quality and emission performance standards adopted by those cities.

Under the federal Toxic Substances Control Act ("TSCA"), the EPA has issued regulations that control the use and disposal of polychlorinated biphenyls ("PCBs"). PCBs had been widely used as insulating fluids in many electric utility transformers and capacitors manufactured before TSCA prohibited any further manufacture of such PCB equipment. Fluids with a concentration of PCBs higher than 500 parts per million and materials (such as electrical capacitors) that contain such fluids must be disposed of through burning in high temperature incinerators approved by the EPA. Solid wastes containing PCBs must be disposed of in either secure chemical waste landfills or in high-efficiency incinerators. In response to EPA regulations, [the Company] has phased out the use of certain PCB capacitors and has tested all Company-owned transformers located inside customer-owned buildings and replaced all transformers found to have fluids with detectable levels of PCBs (higher than 1 part per million) with transformers that have no detectable PCBs. Presently, no transformers having fluids with levels of PCBs higher than 500 parts per million are known by [the Company] to remain in service in its system, except at one of [the Company's] generating stations. Compliance with TSCA regulations has necessitated substantial capital and operational expenditures by [the Company], and such expenditures may continue to be required in the future, although their magnitude cannot now be estimated. The Company has agreed to participate financially in the remediation of a source of PCB contamination attributed to [Company]-owned electrical equipment on property in New Haven. Although the scope of the remediation and the extent of [the Company's] participation have not yet been fully determined, the owner of the property has estimated the total remediation cost to be approximately \$346,000.

Under the federal Resource Conservation and Recovery Act ("RCRA"), the generation, transportation, treatment, storage and disposal of hazardous wastes are subject

to regulations adopted by the EPA. Connecticut has adopted state regulations that parallel RCRA regulations but are more stringent in some respects. The Company has complied with the notification and application requirements of present regulations, and the procedures by which [the Company] handles, stores, treats and disposes of hazardous waste products have been revised, where necessary, to comply with these regulations.

The Company has estimated that the cost of environmental remediation of its decommissioned Steel Point Station property in Bridgeport, which the Company intends to sell for development, will be approximately \$10.3 million, and that the value of the property following remediation will not exceed \$6 million. In its December 16, 1992 decision on [the Company's] application for retail rate increases, the DPUC provided for additional revenues to be recovered from customers in the amount of the \$4.3 million difference during the period 1993-1996, subject to true-up in the Company's next retail rate proceeding based on actual remediation costs and actual gains on sale of the property.

RCRA also regulates underground tanks storing petroleum products or hazardous substances, and Connecticut has adopted state regulations governing underground tanks storing petroleum and petroleum products that, in some respects, are more stringent than the federal requirements. The Company has 19 underground storage tanks, which are used primarily for gasoline and fuel oil, that are subject to these regulations. The Company has a testing program to detect leakage from any of its tanks, and it may incur substantial costs for future actions taken to prevent tanks from leaking, to remedy any contamination of groundwater, and to remove and replace older tanks in compliance with federal and state regulations.

In the past, the Company has disposed of residues from operations at landfills, as most other industries have done. In recent years it has been determined that such disposal practices, under certain circumstances, can cause groundwater contamination. Although the Company has no knowledge of the existence of any such contamination, if the Company or regulatory agencies determine that re-

medial actions must be taken in relation to past disposal practices, the Company may experience substantial costs.

A Connecticut statute authorizes the creation of a lien against all real estate owned by a person causing a discharge of hazardous waste, in favor of the DEP, for the costs incurred by the DEP to contain and remove or mitigate the effects of the discharge. Another Connecticut law requires a person intending to transfer ownership of an establishment that generates more than 100 kilograms per month of hazardous waste to provide the purchaser and the DEP with a declaration that no release of hazardous waste has occurred on the site, or that any wastes on the site are under control, or that the waste will be cleaned up in accordance with a schedule approved by the DEP. Failure to comply with this law entitles the transferee to recover damages from the transferor and renders the transferor strictly liable for the cleanup costs. In addition, the DEP can levy a civil penalty of up to \$100,000 for providing false information. UI does not believe that any material claims against the Company will arise under these Connecticut laws.

A Connecticut statute prohibits the commencement of construction or reconstruction of electric generation or transmission facilities without a certificate of environmental compatibility and public need from the Connecticut Siting Council ("CSC"). In certification proceedings, the CSC holds public hearings, evaluates the basis of the public need for the facility, assesses its probable environmental impact and may impose specific conditions for protection of the environment in any certificate issued. During 1993, a citizens' group appealed to the Connecticut Superior Court from a decision of the CSC declining to reopen the 1991 certification of a transmission line that has since been completed by the Company and The Connecticut Light and Power Company in Fairfield County. The Superior Court dismissed this appeal; but the citizens' group has taken an appeal from the Superior Court's decision, and the Company is unable to predict what impact, if any, the group's actions will have on the operation of the transmission facility.

In complying with existing environmental statutes and regulations and further developments in these and

other areas of environmental concern, including legislation and studies in the fields of water and air quality (particularly "air toxics" and "global warming"), hazardous waste handling and disposal, toxic substances, and electric and magnetic fields, the Company may incur substantial capital expenditures for equipment modifications and additions, monitoring equipment and recording devices, and it may incur additional operating expenses. Litigation expenditures may also increase as a result of scientific investigations, and speculation and debate, concerning the possibility of harmful health effects of electric and magnetic fields. The Company believes any additional costs are recoverable through the ratemaking process. The total amount of these expenditures is not now determinable.

UNITED ILLUMINATING CO., 10-K 13-16 (filing date: Feb. 18, 1994; document date: Dec. 31, 1993).

APPENDIX D

Protection of the Environment

Dow Corning has set a goal to reduce within the United States its toxic releases by 80% in 1995 compared to 1987. This goal is consistent with voluntary commitments made by the Company under two programs with the U.S. Environmental Protection Agency - the 33/50 Voluntary Reduction Program under which the Company has committed to reductions of all of its toxic chemical releases, and the Clean Air Act Early Reduction Credit Program under which the Company has committed to major reductions in methyl chloride releases at its largest U.S. manufacturing facilities. As a member of the Chemical Manufacturers Association, the Company is also committed to and is implementing the codes of management practices specified in Responsible Care(R).

Dow Corning expends funds consistent with its commitments to limit the discharge of materials into the environment. It is expected that Dow Corning's pollution control related expenditures will be partially offset through the recovery of raw materials in the pollution control process. These expenditures should not materially affect Dow Corning's earnings or competitive position.

The Company records a charge to earnings for environmental matters when it is probable that a liability has been incurred and the Company's costs can be reasonably estimated. For information concerning environmental liabilities, see Note 2 of Notes to Consolidated Financial Statements.

DOW CORNING CORP., 10-K 4 (filing date: Feb. 14, 1994; document date: Dec. 31, 1993).

