COMMENTS

SEC DISCLOSURE REQUIREMENTS FOR ENVIRONMENTAL LIABILITIES

I. INTRODUCTION

The Securities and Exchange Commission (SEC) is intensifying its effort to require disclosure of actual and contingent environmental liabilities by publicly traded companies.[1] Over the last few years, the SEC's commissioners and staff members have issued warnings to public companies regarding the impending enforcement actions against those companies that do not adequately disclose actual or expected environmental liabilities in their financial statements.[2] Furthermore, a cooperative effort between the SEC and the Environmental Protection Agency (EPA) to exchange information on companies that violate

1. *See* Barbara Franklin, *Environmental Liability, SEC's New Battleground: Reporting Future Costs*, N.Y.L.J., Apr. 15, 1993, at 5. SEC Commissioner Richard Roberts stressed that the mounting costs of environmental cleanup have increased the pressure on the SEC to insure that companies are reporting their share of the costs. *Id.*

2. *See SEC*, *EPA Warn Firms to Report Potential Environmental Liabilities*, CHEMICAL ENGINEERING, February 1990, at 27. SEC corporate finance attorney Paul Edwards advised companies to estimate expected environmental liabilities in their financial statements. *Id.*

environmental laws and fail to disclose those violations in their corporate documents has bolstered enforcement efforts.[3]

This Comment discusses the issue of disclosure of actual and contingent liabilities by public companies. Part II traces the development of the SEC's environmental liability disclosure requirements under federal securities laws. Part III examines the effect of Regulation S-K, the SEC's comprehensive disclosure system which established the reporting requirements presently applicable to public companies. Part IV addresses the treatment of loss contingencies under Financial Accounting Standard No. 5. Part V considers the SEC's guidelines regarding the accounting and disclosure of environmental loss contingencies contained in Staff Accounting Bulletin No. 92, published by the SEC in August 1993. Part VI discusses the anti-fraud provisions of Rule 10b-5 promulgated under section 10(b) of the Securities Exchange Act of 1934 (1934 Act).[4] Finally, this Comment concludes that the SEC must provide reporting companies with adequate guidance regarding the determination of their disclosure obligations.

The difficulty in determining required disclosures, combined with the potentially devastating penalties for misleading financial statements, encourages companies to report worst case estimates using boilerplate language. Premature and overinclusive disclosure burdens the investing public by increasing the cost of investments and negatively impacting investor confidence.

II. DEVELOPMENT AND EVOLUTION OF ENVIRONMENTAL DISCLOSURE REQUIREMENTS

Congress imposed disclosure requirements upon issuers of publicly traded securities in the Securities Act of 1933 (1933 Act)[5] and in the 1934 Act.[6] The 1933 Act regulates the registration and sale of securities, and the 1934 Act governs the annual and periodic reporting

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3. Elizabeth Ann Glass Geltman, *Disclosure of Contingent Environmental Liabilities by Public Companies Under the Federal Securities Laws*, 16 HARV. ENVTL. L. REV. 129, 131 (1992). *See also SEC and EPA Team Up in Tracking Corporate Environmental Liability*, SECURITIES WK., Sept. 24, 1990, at 10; Franklin, *supra* note 1. Roberts detailed the cooperation between the EPA and SEC, including EPA training of SEC staff, and its sharing of target companies with the SEC. *Id.*

4. 15 U.S.C. §§ 78a-78ll (1988).

5. 15 U.S.C. §§ 77a-77aa (1988).

6. 15 U.S.C. §§ 78a-78ll (1988).

requirements of public companies. Congress' purpose in enacting these statutes was to ensure that investors would have access to material information in order to promote informed investment decisions.[7]

Prior to the enactment of comprehensive environmental legislation, the securities laws had no express provisions regarding the disclosure of registrants' environmental policies or contingent environmental liabilities.[8] The enactment of the National Environmental Policy Act (NEPA)[9] in 1969 required the SEC to re-examine its rules in light of NEPA's requirement that government agencies consider environmental protection in the interpretation and administration of their policies and regulations.[10] Generally, disclosure of information was required if a reasonable investor would find the information important to his or her investment decisions.[11] The 1934 Act's provisions prohibiting misleading statements or omissions of material facts in the disclosures of publicly traded companies implied an obligation to disclose environmental liability that might materially affect the financial condition of a public company.[12] In 1971, the SEC issued an interpretive release stating that the existing general disclosure laws required that public companies disclose any "material" proceedings arising from compliance with environmental laws.[13] While the release made no changes to the

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7. 15 U.S.C. §§ 77a-77aa, §§ 78a-78ll (1988). *See also* Marisa C. Caputo, *SEC Environmental Disclosure Rules and CERCLA Liability*, 4 MD. J. CONTEMP. LEGAL ISSUES 97, 98 (1992-93).

8. *See* Geltman, *supra* note 3, at 133. *See also* Risa Vetri Ferman, Note, *Environmental Disclosures and SEC Reporting Requirements*, 17 DEL. J. CORP. LAW 483, 491 (1992).

9. 42 U.S.C. §§ 4321-4370a (1988).

10. 42 U.S.C. § 4332(1), requires federal agencies to see that "to the fullest extent possible . . . the policies, regulations and public laws of the United States shall be interpreted and administered in accordance with the policies set forth in [NEPA]." NEPA mandates that the federal government use "all practical means and measures" to protect environmental values. 42 U.S.C. § 4331(a)(1988).

11. Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (citing TSC Industries, Inc. v. Northway Inc., 426 U.S. 438, 449 (1976)).

> [A]n omitted fact is material, if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote . . . . [T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.

Id. The Court expressly adopted the *TSC Industries* standard of materiality. *Id.* at 232.

12. Geltman, *supra* note 3, at 133.

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

reporting requirements, the SEC drew attention to the fact that existing disclosure requirements were applicable to environmental matters.[14]

The 1971 Release was superseded in 1973 when the SEC issued its first express requirements for disclosure.[15] According to the 1973 Release, reporting companies were required to make disclosure of all "material effects" arising from compliance with environmental laws and regulations.[16] In addition, the 1973 Release required disclosure of future effects of environmental regulations where there exists "a reasonable basis to believe that future . . . compliance [will] have a material effect on . . . expenditures."[17]

Following the 1971 Release, several public interest groups brought an action to require the SEC to set forth additional environmental disclosure rules for reporting companies.[18] The groups sought to establish a rule that would require every reporting company to disclose the entire effect of its corporate activities on the environment.[19] The crux of the plaintiffs' complaint was that the existing corporate environmental disclosure requirements were insufficient to provide investors with the information required to make "socially responsible" and "financially sound" investment decisions.[20] Although the proceedings were ultimately unsuccessful,[21] they led the SEC to re-evaluate its rules regarding environmental disclosure and to add disclosure requirements to its existing environmental compliance regulations.[22] For example, in

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Ferman, *supra* note 8, at 492 (citing Exchange Act Release Nos. 33-5170, 34-9252 (July 19, 1971), 36 Fed. Reg. 13,989 (1971)).

14. *See* Philip B. Schwartz, *Disclosure Requirements for Environmental Liabilities Under Federal Securities Law*, C903 ALI-ABA 295, 299 (Feb. 24, 1994). *See also* Ferman, *supra* note 8, at 492.

15. Compliance with Environmental Requirements, Exchange Act Release No. 10116, 3 Fed. Sec. L. Rep. (CCH) ¶ 23,507A (Apr. 20, 1973).

16. *Id.* at 17,202.

17. *Id.*

18. National Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689 (D.D.C. 1974) *rev'd*, 606 F.2d 1031 (D.C. Cir. 1979).

19. *Id.* at 694. *See also* Ferman, *supra* note 8, at 493. Plaintiffs wanted every reporting company to be required to submit a detailed report for every product or activity in which they were engaged. *Id.* at n.67 (citing *National Resources Defense Council*, 389 F. Supp. 689, 694 (D.D.C. 1974)).

20. *National Resources Defense Council*, 389 F. Supp. at 694.

21. The D.C. Circuit Court of Appeals held that NEPA merely required the SEC to make "environmental considerations part of the SEC's substantive mission, . . . [and did not] require the SEC to promulgate specific rules." *National Resources Defense Council,* 606 F.2d at 1045.

22. Notice of Commission Conclusions and Final Action on the Rulemaking Proposals Amended in Securities Act Release No. 5627 (Oct. 14, 1975), Relating to Environmental

1976, the SEC added the requirement that registrants "disclose any material estimated capital expenditures for environmental control facilities for the remainder of the current fiscal year, the succeeding fiscal year, and such further periods as are deemed material."[23] In the same release, the Commission warned that the receipt of a cease and desist order from the EPA would be sufficient to constitute a contemplated governmental action, thereby triggering the disclosure obligation.[24]

In 1979, the SEC issued an interpretive release clarifying its existing environmental disclosure requirements.[25] The release addressed three issues: (1) the requirement that public companies disclose total estimated expenses for compliance with environmental regulations beyond two years into the future;[26] (2) the requirement to disclose administrative proceedings;[27] and (3) "the circumstances under which public companies must disclose their policies or approaches concerning environmental compliance."[28] With respect to environmental compliance costs, this release clarified that a corporation is required to disclose all expected or estimated material capital expenditures for current and future fiscal years.[29] When reporting administrative

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Disclosure, Securities Act Release No. 5704 [1975-1976 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 80,495 (May 6, 1976).

23. *Id.* at 86,291-92. The SEC reiterated its requirement that reporting companies disclose all environmental litigation initiated by a governmental authority pursuant to "federal, state or local provisions." *Id.* at 86,295.

24. *Id.* at 86,297 n.22. For a more detailed discussion of this release, *See* Robert J. Lewis, Note, *"Shh! Maybe in My Backyard!" An Equity and Efficiency-Based Critique of SEC Environmental Disclosure Rules and Extraterritorial Environmental Matters*, 78 MINN. L. REV. 1045, 1052-1054 & nn.39-46 (1994).

25. *In re* United States Steel Corp., Exchange Act Release No. 16,223 [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,319 (Sept. 27, 1979). *See also* Environmental Disclosure Requirements, Securities Act Release No. 6130, 3 Fed. Sec. L. Rep. (CCH) ¶ 23,507B (Sept. 27, 1979). This release was part of a settlement order, entered into with United States Steel Company (USSC) issued on the same day as the release. In that case, USSC failed to report estimates of $1.8 billion in material capital expenditures required to comply with environmental regulations for the period 1979-1983. *Id.* at 82,380. The SEC held that USSC should have disclosed the estimates. While they were not required to divulge estimated expenses beyond two years, the SEC stated that once the material information became available, it had to be disclosed. *Id.* at 82,383-84.

26. Environmental Disclosure Requirements, Securities Exchange Act Release Nos. 33-6130 and 34-16224, 3 Fed. Sec. L. Rep. (CCH) ¶ 23,507B, at 17,203-4 (Sept. 27, 1979).

27. *Id.* at 17,203-6.

28. *Id.* at 17,203-3.

29. *Id.* at 17,203-4 n.11, 17,203-5. Furthermore, a registrant's reasonable expectation that costs of compliance in future years will be materially higher than those disclosed for the required two-year period may result in an obligation on the part of the registrant to develop estimates for such costs and to describe the source of its estimates, the methods used to reach those estimates, and

proceedings, a company must disclose any and all environmental proceedings initiated by either the government or the registrant and provide the amount of relief sought by the government, if material.[30] With respect to disclosure of environmental policy, the SEC regulates such disclosure in situations when voluntary disclosures regarding policy are made, and when the public company has an environmental compliance policy.[31]

In 1980, the SEC adopted the provisions of the Management's Discussion and Analysis (MD&A) as an additional requirement.[32] The provisions were flexible in their approach to required disclosures because they recognized that different standards might be required for different situations.[33] While environmental liability was not specifically addressed, the provisions have been interpreted to require disclosure of environmental matters. Therefore, in accordance with the general scheme of the MD&A requirement, management must disclose foreseeable environmental liability, along with estimates of the costs of such liability.

III. REGULATION S-K

In an effort to streamline its regulatory scheme, the SEC promulgated Regulation S-K,[34] which established the uniform disclosure requirements presently applicable to public companies. The rules under the system are divided into three categories. Regulation C sets forth SEC procedures; Regulation S-X governs the SEC accounting rules and

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the extent of uncertainty associated with the occurrence of those costs. *Id.* at 17,203-5. *See also* Geltman, *supra* note 3, at 147.

30. *Id.* at 17,203-6. The Commission stated "[t]he obligation to disclose is triggered whenever a governmental authority is a party to any administrative proceeding." *Id.*

31. *Id.* at 17,203-6. The SEC has described two situations under which it regulates disclosure. *Id.* First, any voluntary disclosures regarding environmental policy must be accurate and an obligation to make additional disclosures is imposed on the corporation to avoid being misleading. *Id.* Second, disclosure of a company's environmental compliance policy is required if the company has a policy "which is reasonably likely to result in substantial fines, penalties, or other significant effects on the corporation," and may require disclosure of "the likelihood and magnitude of such fines, penalties, and other material effects." *Id.* at 17,203-6 to 17,203-7. *See also* Geltman, *supra* note 3, at 147-49.

32. The new provisions required statements to include audited financial statements, financial data necessary for trend analysis, and a "meaningful description of the registrant's business and financial condition." Ferman, *supra* note 8, at 497 (citing 45 Fed. Reg. 63,630, 63,631 (1980)).

33. *Id.* (citing 45 Fed. Reg. 63,630, 63,631-32 (1980)).

34. 17 C.F.R. § 229.10-.802 (1994).

requirements regarding the form and content of financial statements; and Regulation S-K governs the disclosure requirements for public companies.[35] Regulation S-K contains several provisions which directly address disclosure of environmental liabilities. The provisions are: (1) Item 101,[36] which relates to the disclosure of estimated and actual capital expenditures associated with environmental compliance; (2) Item 103,[37] which sets forth the SEC's requirements concerning the disclosure of legal proceedings; and (3) Item 303,[38] which addresses Management's Discussion and Analysis of Financial Condition and Results of Operations in SEC filings.

A. Item 101 of Regulation S-K

With respect to environmental matters, Item 101 requires the disclosure of:

> the material effects that compliance with Federal, State, and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. 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[].[39]

This provision essentially adopted the rules contained in the 1979 release.[40] As a result, Item 101 necessitates the disclosure of any information needed to ensure that the primary disclosures are not misleading. Commentators have suggested that Item 101 can present significant complications for registrants in view of the fact that changes in

35. Geltman, *supra* note 3, at 150 (citing Adoption of Integrated Disclosure System, Securities Act Release No. 6383, SEC Docket 1262 (Mar. 3, 1982) (codified at 17 C.F.R. § 229 (1991)).

36. 17 C.F.R. § 229.101 (1994).

37. 17 C.F.R. § 229.103 (1994).

38. 17 C.F.R. § 229.303 (1994).

39. 17 C.F.R. § 229.101(c)(1)(xii) (1994). In *Levine v. NL Industries, Inc.*, the Second Circuit interpreted, in dictum, this section as requiring disclosure of potential costs for violation of environmental laws, if material. 926 F.2d 199, 203 (1991).

40. Geltman, *supra* note 3, at 151.

the applicable environmental laws are constantly expanding their obligations.[41] Under these circumstances, companies will be forced to develop worst case estimates for compliance costs in order to avoid allegations of concealment.[42] The disclosure of potentially overinclusive worst case estimates is not helpful to investors. Arguably, such disclosure may cause undue concern and negatively impact investor confidence. In effect, this disclosure requirement may defeat the SEC's stated purpose of providing full disclosure of material facts to investors.

B. *Item 103 of Regulation S-K*

Item 103 requires a public company to report "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 subject."[43] Instruction 5 to Item 103 provides the threshold for disclosure of environmental proceedings. Specifically, Instruction 5 requires a public company to describe a proceeding if: (1) the proceeding is material[44] to the business or financial condition of the registrant;[45] (2) the proceeding involves a claim in excess of 10 percent of the current consolidated assets of the registrant;[46] or (3) the proceeding involves a governmental authority, unless the registrant reasonably believes that monetary sanctions, if imposed, will not exceed $100,000.[47] In effect, Instruction 5 qualifies

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41. *See* Perry E. Wallace, *Disclosure of Environmental Liabilities Under the Securities Laws: The Potential of Securities-Market-Based Incentives For Pollution Control*, 50 WASH. & LEE L. REV. 1093, 1107 (1993). "Especially troublesome is the requirement that 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.'" *Id.* (citing 17 C.F.R. § 229.101(c)(1)(xii)). *See also* Geltman, *supra* note 3, at 151. Registrants subject to the Clean Air Act are in an awkward position because the changes in federal air law require them to upgrade emissions control technologies in accordance with a statutorily mandated schedule. These registrants know that compliance with the new law will result in material effects, but because no implementing regulations have been promulgated, the registrants are unable to predict either the cost of compliance, or the probable effect the compliance will have on capital expenditures, earnings, and market standing. *Id.*

42. For a discussion of the risks of misleading disclosure and boilerplate language, see Geltman, *supra* note 3, at 167-69.

43. 17 C.F.R. § 229.103(1994).

44. *See infra* notes 142-43 and accompanying text for a discussion of materiality within the meaning of Regulation S-K.

45. 17 C.F.R. § 229.103, Instruction 5(A)(1994).

46. 17 C.F.R. § 229.103, Instruction 5(B)(1994).

47. 17 C.F.R. § 229.103, Instruction 5(C)(1994).

prior disclosure requirements by establishing objective thresholds for disclosing environmental proceedings that were not previously in existence.[48]

Item 103 disclosure has raised concern among public companies who have been designated by the EPA as potentially responsible parties (PRPs) under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or Superfund).[49] The Superfund statutes impose liability for the costs of cleaning up abandoned hazardous waste sites on those persons defined as responsible parties.[50] This raised the question of whether potential liability for remedial action under CERCLA constitutes a "sanction" within the meaning of Item 103, Instruction 5(C). In a 1989 no-action letter, the SEC took the position that "costs incurred pursuant to a remedial agreement entered into in the normal course of negotiation with EPA will not be viewed as 'sanctions' within the meaning of Item 103, Instruction 5(C)."[51]

The SEC has taken the position that designation as a PRP under CERCLA does not by itself trigger disclosure under Item 103, Instruction 5(C), because PRP designation alone does not provide the requisite knowledge that a governmental agency is contemplating a proceeding.[52] However, the Commission cautioned that disclosure under Item 103 would depend on the reporting company's particular circumstances, since such circumstances, in combination with PRP status, may provide knowledge of a contemplated proceeding.[53] Practitioners have noted that in light of the liability that could potentially result from PRP status,

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48. *See* Geltman, *supra* note 3, at 151-52 (citing Adoption of Integrated Disclosure System, Securities Act Release No. 6383, SEC Docket 1262 (Mar. 3, 1982) (codified at 17 C.F.R. § 229 (1991) at 1277-78)).

49. 42 U.S.C. §§ 9601-9675 (1988).

50. *See* Geltman, *supra* note 3, at 152-53.

51. Thomas A. Cole, SEC No-Action Letter,[1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,962 at 78,814 (Jan. 17, 1989). The SEC staff went on to say, "However, where it is reasonably likely that these costs will be material," the disclosure requirements of Item 101(c)(1)(xii) or Item 103, Instruction 5(A) or (B) may be triggered. *Id.* at 78,815.

52. Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosure, Exchange Act Release No. 26,831 (May 18, 1989), 54 Fed. Reg. 22,427 at 22,430 n.30 [hereinafter MD&A Release].

53. *Id.*

designation alone will most likely necessitate disclosure in the PRP's financial statements and SEC reports.[54]

C. Item 303 of Regulation S-K

Item 303 requires reporting companies to provide an historical and prospective analysis of the company's financial condition and results of operations.[55] While Item 303 makes no specific reference to environmental matters, the SEC issued an interpretive release in 1989 that established that MD&A requirements include disclosure of contingent environmental liabilities.[56]

The 1989 Release focused on changes within Item 303 and clarified the disclosure obligations of a registrant under the rule.[57] The Release provides that "a disclosure duty 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 . . . ."[58] According to the SEC, this requires management to make two determinations.[59] First, management must conclude the likelihood of occurrence of the known trend, demand, commitment, event or uncertainty.[60] If management is unable to make such a determination, it must then objectively evaluate the consequences of the known trend, demand, commitment, event or uncertainty on the assumption that it will occur.[61] Disclosure is required "unless management determines that a material effect on the registrant's financial

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54. Schwartz, *supra* note 14, at 308 (citing C. Stephen Howard, Payne L. Templeton and Elisabeth Hunt, *Accountants' Duties Concerning Clients' Disclosures of Potential Environmental Liabilities*, 467 PLI/Lit 107 (July-August 1993)).

55. MD&A Release, *supra* note 52, at 22,428.

56. *See* Letter from Linda Quinn, Director of Division of Corporation Finance, to Joseph Sciarrino of the Financial Executives Institute (Jan. 17, 1989), *reprinted in* Janet D. Smith, *Environmental Disclosures Required by Federal Securities Laws, in* Impact of Environmental Regulations on Business Transactions 1989, at 105, 129 (PLI Real Estate Law & Practice Course Handbook Series No. 342, 1989). The SEC stated that where clean up costs will be material, a known uncertainty within the meaning of Item 303 exists and disclosure is required. *Id.* The letter further stated that for similar reasons, "the disclosure requirements of Item 101(c)(1)(xii) and Item 103, Instruction 5(A) or (B) also may be triggered." *Id.*

57. Exchange Act Release Nos. 33-6835, 34-26,831 (May 18, 1989), 54 Fed. Reg. 22,427 (1989).

58. *Id.* at 22,429.

59. *Id.* at 22,430.

60. *Id.*

61. *Id.*

condition or results of operations is not reasonably likely to occur."[62] The SEC stated that all final determinations made by management must be "objectively reasonable, viewed as of the time the determination is made."[63]

The SEC illustrated the application of the two-part test of Item 303 with a hypothetical involving a company properly designated as a PRP[64] under CERCLA.[65] According to the facts, a preliminary investigation had been initiated, but there was no indication that the government had contemplated any action.[66] The SEC analyzed the information given in order to determine the necessity of disclosure, and the extent to which such disclosure would be required.[67] While the SEC specifically noted that designation as a PRP alone would not trigger disclosure,[68] the release concluded that MD&A disclosure of a reasonable quantification of the effects of the PRP status would be expected under these circumstances.[69]

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62. *Id.*

63. *Id.*

64. Potentially responsible parties include: (1) the present owner or operator of a hazardous waste site; (2) the owner or operator at the time of disposal, of a facility where hazardous waste was disposed; (3) persons who contracted for the disposal or treatment of waste removed from the site; (4) any person who transported hazardous waste to disposal or treatment facilities. 42 U.S.C. § 9607(a) (1988). For a discussion of the problems surrounding reporting of PRP status under Item 303, Regulation S-K, see Geltman, *supra* note 3, at 158-69.

65. 42 U.S.C. § 9601-9675 (1988 & Supp. V 1993). "CERCLA, also called the Superfund law, was enacted in an effort to clean up hazardous contaminants at closed or abandoned hazardous waste sites. Under CERCLA, a wide range of PRPs can be held jointly and severally liable for site cleanup costs where hazardous substances have been released." Schwartz, *supra* note 14, at 307.

66. The hypothetical was as follows:

> A registrant has been correctly designated a PRP by the EPA with respect to cleanup of hazardous waste at three sites. No statutory defenses are available. The registrant is in the process of preliminary investigations of the sites to determine the nature of its potential liability and the amount of remedial costs necessary to clean up the sites. Other PRPs also have been designated, but the ability to obtain contribution is unclear, as is the extent of insurance coverage, if any. Management is unable to determine that a material effect on future financial condition or results of operations is not reasonably likely to occur.

Exchange Act Release Nos. 33-6835, 34-26,831 (May 18, 1989), 54 Fed. Reg. 22,427, at 22,430 (1989).

67. *Id.*

68. *Id.* at 22,430 n.30.

69. *Id.* at 22,430. In addition, if a public company is designated as a PRP, and if the particular circumstances are such that the company knows or should know that the government is contemplating a proceeding, disclosure would then be required under Item 103. *See* MD&A Release, *supra* note 52 and accompanying text.

In a footnote to the MD&A Release,[70] the SEC cautioned that the disclosure standard of Item 303 is a significant departure from the probability/magnitude test approved by the Supreme Court in *Basic v. Levinson*.[71] The revised standard of Item 303 requires disclosure of a public company's PRP status unless the company can demonstrate that the designation is not likely to have a material effect. Under the *Basic* probability/magnitude test, disclosure is not required unless management determines that the PRP designation will have a material effect.[72] Under the revised standard, registrants disclose their PRP status earlier than they presumably would under the *Basic* standard.

The SEC's revised standard arguably encourages premature disclosure. One commentator suggests that the MD&A disclosure standard may "unintentionally subvert the SEC's mandated purpose of ensuring the full disclosure of material facts to investors."[73] Since the revised standard necessitates disclosure in the face of uncertainty, companies will be forced to report worst case estimates using boilerplate language, neither of which is useful to investors.[74] The argument for early disclosure is that it puts investors on notice of a potential problem. However, the information is also potentially misleading because premature disclosure or overdisclosure may cause undue concern and may obscure significant environmental disclosure.[75] If the SEC employs the traditional probability/magnitude test, disclosure would not be required until the registrants determine that the data is material. This

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70. MD&A Release, *supra* note 52, at 22,430 n.27. The probability/magnitude test for materiality is inapposite to Item 303 disclosure. *Id.*

71. Basic, Inc. v. Levinson, 485 U.S. 224 (1988). Materiality depends "'upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'" *Id.* at 238 (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (1968)).

72. "Thus under the revised MD&A mandate, a registrant must disclose contingent Superfund liability while management is still in the preliminary states of investigation, because the registrant cannot yet prove a negative—namely, that the designation will not have a material effect." Geltman, *supra* note 3, at 161. The result is that Item 303 prevents the reporting company from failing to disclose pending an investigation. *Id.* Consequently, Item 303 disclosure to stockholders may result in conditional (and potentially misleading) disclosure. *Id.* at 162.

73. *See* Geltman, *supra* note 3, at 167.

74. *Id.*

75. *Id.* at 169. The regulation "underestimates the difficulty of quantifying potential liability without detailed investigation into the availability of contribution, insurance coverage, and legal defenses" and it "overlooks the potential for misleading disclosure statements in situations where registrants are forced to make disclosures based on uncertainties." *Id.* at 171.

seems to be more consistent with the goals of MD&A disclosure set forth in Item 303.[76]

D. *Regulation S-X*

In addition to the required disclosure under Regulation S-K, SEC-regulated companies may need to address environmental liabilities in financial statements included with their SEC disclosure documents. Regulation S-X governs the registrant's accounting presentations and filings made with the SEC.[77] The obligation of SEC-regulated companies to include financial statements with their filings was reiterated by the federal district court in *Arthur Anderson & Co. v. SEC.*[78] In that case, the court stated that the plaintiff was required to observe Regulation S-X in all filings which are administered and enforced by the SEC.[79]

Although the SEC has rulemaking authority with regard to the accounting principles for disclosure documents, that authority has been delegated to the accounting profession.[80] According to its Accounting Series Release in 1973, the SEC promoted adherence to the standards and practices promulgated by the Financial Accounting Standards Board (FASB).[81] As such, statements not prepared in accordance with Generally Accepted Accounting Principles (GAAP) and FASB practices receive a negative presumption of inaccuracy.[82] A registrant with a known environmental-related exposure must therefore scrutinize disclosure in the financial statements to ensure compliance with FASB and GAAP, as well as the disclosure requirements of Regulation S-K.

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76. *Id.* at 168.

77. 17 C.F.R. §§ 210.1-01 to 210.12-30 (1994). Regulation S-X sets forth the form and content of financial statements filed as part of registration statements under the 1933 Act, and registration statements, annual reports, proxy and information statements under the 1934 Act. 17 C.F.R. §§ 210.1-01(a)(1), (a)(2) (1994).

78. Arthur Anderson & Co. v. SEC, Fed. Sec. L. Rep. (CCH) ¶ 95,720, at 90,484 (N.D. Ill. Sept. 3, 1976). The court stated that companies subject to the jurisdiction of the SEC are required to include financial statements and independent audit reports thereon and filings under the Acts administered and enforced by the SEC. *Id.* at 90,485.

79. *Id.* at 90,485 (opinion from the bench by Judge Prentice Marshall).

80. *See* Wallace, *supra* note 41, at 1121.

81. Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards, Accounting Series Release No. 150 (1973).

82. *See* Wallace, *supra* note 41, at 1120.

IV. FINANCIAL ACCOUNTING STANDARD NO. 5

Under certain circumstances, a company may incur a liability resulting from some past activity which may not be paid until some time in the future. For example, an oil spill occurs, resulting in injury to employees of the company and local citizens, and causing property damage. Although a claim has yet to be filed, it is probable that there will be lawsuits forthcoming. Accounting for loss contingencies is founded on the concept that the estimated future costs of the event should be reflected in the financial statements as of the period in which it occurred.

The FASB Statement of Financial Accounting Standards No. 5 (FASB-5), *Accounting for Contingencies*,[83] governs the disclosure of contingent liabilities in financial statements. FASB-5 applies to environmental liabilities in the same manner as it does to other contingent liabilities.[84] Paragraph 8 of FASB-5 sets forth the standard for determination of whether or not a company must reduce its earnings, as reflected in its financial statements, based on a contingency.[85] Under the standard, disclosure as an accrual against income is required where *both* of the following conditions are met:

> (a) Information available prior to issuance of the financial statements indicates that it is probable that . . . 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.[86]
>
> (b) The amount of the loss can reasonably be estimated.[87]

Paragraph 8 of FASB-5 indicates that both conditions must be satisfied before a charge against earnings is required. However, even if one or both of these conditions are not met, the reporting company must determine whether there "is at least a reasonable possibility that a loss or

83. Accounting for Contingencies, Statement of Financial Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975).

84. *See* Schwartz, *supra* note 14, at 308.

85. Accounting for Contingencies, Statement of Financial Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975) ¶ 8.

86. When a loss contingency exists, the likelihood of loss incurrence ranges from probable to remote. *Id.* at ¶ 8 n.4.

87. *Id.* "The date of the financial statements means the end of the most recent accounting period for which financial statements are being presented." *Id.* at ¶ 8 n.4.

additional loss may have been incurred."[88] If there is a reasonable possibility that a loss will be incurred, disclosure of the contingent liability is required.[89] Furthermore, the disclosure must indicate the nature of the contingency and an estimation of the loss or range of loss (or a statement that the loss cannot be estimated).[90]

The application of FASB-5 to environmental matters is supported by the examples of loss contingencies contained in paragraph 4.[91] Under FASB-5, unasserted claims must also be disclosed if it is probable that a future claim will be asserted and if there is a reasonable probability that the outcome will be unfavorable.[92] As a result, when a company receives information that it has violated environmental laws or regulations, it must determine the likelihood that the government or other parties will assert a claim.[93]

The FASB-5 requirement to disclose contingent liabilities is contrary to the Item 303 requirement. Generally accepted accounting principles require disclosure where a company is reasonably sure that a liability has been incurred. Disclosure requirements under federal securities laws require disclosure unless the reporting company is able to reach some level of assurance that a liability will not be incurred. As a practical matter, reporting companies will most likely disclose contingent environmental liabilities in their financial statements if disclosure is required in their SEC reports, regardless of whether the accounting rules require this disclosure.[94]

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88. *Id.* at ¶ 10.

89. *Id.*

90. *Id.*

91. *Id.* at ¶ 4. "Examples of loss contingencies include: . . . pending or threatened litigation . . . actual or possible claims and assessments . . . ." *Id.*

92. *Id.* at ¶ 38.

93. *See* Schwartz, *supra* note 14, at 309. "However, the accounting literature indicates that in light of the government's focus on environmental issues, a determination that the government is unlikely to bring a claim may be suspect." *Id.* The increasing level of penalties being asserted for violations of environmental regulations should be considered by reporting companies when making determinations as to their obligation to disclose. *Id.* (citing Stephen Howard, Payne L. Templeton and Elisabeth Hunt, Accountants' Duties Concerning Clients' Disclosures of Potential Environmental Liabilities, 467 PLI/Lit 107 (July-August 1993)).

94. *See* Schwartz, *supra* note 14, at 309. *See also* James G. Archer et al., *SEC Reporting of Environmental Liabilities,* 20 ENVTL. L. REP. (Envtl. L. Inst.) 10105, 10107 (1990); Stephen Howard, Payne L. Templeton and Elisabeth Hunt, Accountants' Duties Concerning Clients' Disclosures of Potential Environmental Liabilities, 467 PLI/Lit 107 (July-August 1993).

V. STAFF ACCOUNTING BULLETIN NO. 92 (SAB-92)

In August 1993, the SEC published SAB-92 which provides guidance regarding the accounting and disclosures relating to environmental loss contingencies.[95] SAB-92 provides detailed insights to date regarding SEC disclosure requirements through a series of questions regarding contingent environmental liabilities.[96] The questions relate to the following hypothetical:

> A registrant believes it may be obligated to pay material amounts as a result of . . . environmental liability. These amounts may relate to, for example, damages attributed to the registrant's . . . processes, clean-up of hazardous wastes, reclamation costs, fines, and litigation costs. The registrant may seek to recover a portion or all of these amounts by filing a claim against an insurance carrier or other third parties.[97]

The first question focuses on the issue of whether it is appropriate to offset a claim for recovery against a contingent liability and report the two as a net amount in the reporting company's balance sheet.[98] The SEC responded that ordinarily, separate presentation of the gross liability and the claim for recovery is preferred.[99] The Commission pointed out that there are significant uncertainties regarding both the timing and ultimate realization of claims made to insurance companies for recovery.[100] In addition, the risks and uncertainties associated with a registrant's contingent liability are separate and distinct from those associated with its claim for recovery from third parties.[101]

Question two deals with a situation in which a reporting company is jointly and severally liable as a PRP, but there is a reasonable basis to apportion the costs among the responsible parties.[102] In a qualified

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95. Staff Accounting Bulletin No. 92—Accounting and Disclosures Relating to Loss Contingencies, 58 Fed. Reg. 32,843 (1993) [hereinafter § SAB-92]

96. *Id.* at 32,844-46.

97. *Id.* at 32,843.

98. *Id.* at 32,844.

99. *Id.*

100. *Id.* The timing and realization of any recovery is too uncertain to net against a probable loss. *Id.*

101. *Id.* The Commission requires that reporting companies ensure that notes to the financial statements include material uncertainties affecting the calculation of the liability and the realization of any recovery. *Id.*

102. *Id.*

response, the SEC stated that a reporting company is not required to recognize the costs apportioned to the other parties unless it is probable that other parties may not fully pay their costs.[103] In that case, the reporting company should include the entire liability, even though some part of this amount may be apportioned to other PRPs.[104]

The third question addresses the reality that estimates regarding the extent of liability and amount of related costs are frequently different from the actual outcome.[105] The SEC responded that estimates should be based on "currently available facts, existing technology, and presently enacted laws and regulations."[106] In addition, the effects of inflation, and other societal and economic factors should be considered.[107] If management is only able to determine a range within which the liability will fall, the reporting company should recognize the lower limit of the range.[108] The SEC staff recognized the difficulty in calculating estimates before the company has fully investigated the matter. It was recommended that reporting companies use evidence obtained from prior experience, other companies' clean-up experiences and data released by the EPA and other organizations in calculating its estimates.[109]

Commentators have noted that companies who are required to make SEC filings ought to be aware that the SEC and EPA share information.[110] Given this fact, reporting companies should avoid making inconsistent filings. Moreover, companies must consider the information provided to the EPA with respect to clean-up cost estimates when stating in their SEC disclosure that they are unable to estimate their CERCLA liability.[111]

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103. *Id.*

104. *Id.* If the solvency of one of the parties is uncertain, or responsibility for the site is in dispute, a note to the financial statements is required and should describe any additional loss that is reasonably possible. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.* The Commission believes that recognition of a loss equal to the lower limit of the range is necessary, even if the upper limit is uncertain, pursuant to Financial Accounting Standards Board Interpretation No. 14, "Reasonable Estimate of the Amount of a Loss." *Id.*

109. *Id.* The SEC further stated that as additional information becomes available, changes in the estimates of liability should be reported in the period that those changes occur. *Id.*

110. *See* Schwartz, *supra* note 14, at 311.

111. *Id.*

Question 4 concerns recognizing environmental liabilities on a discount basis to reflect the time value of money.[112] The SEC stated that this method is acceptable if the aggregate amount of the liability and the time and amount of payments are fixed or can be reliably determined.[113]

Question 5 details the disclosure required with respect to recorded and unrecorded environmental liabilities.[114] The SEC responded that environmental liabilities are significant such "that detailed disclosure of any judgments and assumptions underlying the recognition and measurement of the liabilities are necessary to prevent the financial statements from being misleading."[115] Examples of disclosures that may be necessary include:

> (1) Circumstances affecting the reliability and precision of loss estimates;
> (2) The extent to which unasserted claims are reflected in any accrual or may affect the magnitude of the contingency;
> (3) Uncertainties with respect to joint and several liability that may affect the magnitude of the contingency . . . ;
> (4) Disclosure of the nature and terms of cost-sharing arrangements with other [PRPs];
> (5) The extent to which disclosed but unrecognized contingent losses are expected to be recoverable through insurance, indemnification arrangements, or other sources, with disclosure of any material limitation of that recovery;
> (6) Uncertainties regarding the legal sufficiency of insurance claims or solvency of insurance carriers;
> (7) The time frame over which the accrued or presently unrecognized amounts may be paid out; [and]
> (8) Material components of the accruals and significant assumptions underlying estimates.[116]

Question 6 addresses the disclosures regarding loss contingencies that may be required outside of the financial statements.[117] The SEC

112. SAB-92, *supra* note 95, at 32,844.
113. *Id.* at 32,845. For a discussion of the appropriate discount rate, see *id.*
114. *Id.*
115. *Id.*
116. *Id.*

refers to Regulation S-K Items 101, 103 and 303, and the 1979[118] and 1989[119] interpretive releases.[120] Further, the response indicates that disclosures made pursuant to these provisions should be sufficiently specific to enable a reader to understand the scope of the contingency.[121] This includes:

> (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 clean-up expenditures that can be anticipated but which are not required in the present circumstances.[122]

The remaining two questions concern site restoration costs and other environmental exit costs, both during and at the end of the useful life of the asset. The Commission indicates that "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."[123] The disclosures should include the nature of the costs involved, the total estimated cost, the total costs accrued to date, the balance sheet classification of accrued amounts, and the range or amount of reasonably possible additional losses.[124] Furthermore, disclosure of expenditures required to remediate an asset should be made in the notes of the financial statements.[125] In addition, if the reporting company may be liable for remediation of environmental damage to a previously disposed asset, disclosure should be made in the financial statements unless the

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117. *Id.*
118. *See* Exchange Act Release No. 33-6130 and 34-16224 3 Fed. Sec. L. Rep. (CCH) ¶ 23,507B (Sept. 27, 1979).
119. *See* MD&A Release*, supra* note 52.
120. SAB-92, *supra* note 95, at 32,845.
121. *Id.*
122. *Id.*
123. *Id.* at 32,846.
124. *Id.*
125. *Id.*

likelihood of liability is remote.[126] Finally, where a reporting company expects to incur site restoration costs, post-closure and monitoring costs, or other environmental exits costs at the end of an asset's useful life, such costs may be accrued over the useful life of the asset.[127]

VI. RULE 10B-5

Even when none of the mandatory disclosure provisions of the 1933 and 1934 Acts that draw upon Regulation S-K apply, Rule 10b-5[128] may create a duty of disclosure.[129] Under Rule 10b-5, a public company has no general duty to disclose, apart from those responsibilities arising under Regulation S-K.[130] However, when the requisite elements of a Rule 10b-5 cause of action have been pleaded and proved, the defendant in such an action may be held liable for material misstatements or omissions made in connection with the purchase or sale of a security.[131] The development of case law has clarified both the features of Rule 10b-5 and the elements of a Rule 10b-5 cause of action. In order to prevail on a Rule 10b-5 claim, a plaintiff[132] must prove that the defendant company knowingly[133] made a false statement or omission of material fact,[134]

126. *Id.*

127. *Id.*

128. 17 C.F.R. § 240.10b-5 (1994). The rule provides as follows:

> 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 a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) 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.

Id.

129. *See* Wallace, *supra* note 41, at 1115.

130. *See* Geltman, *supra* note 3, at 136 (citing Steven A. Fishman, *Duty to Disclose Under Rule 10b-5 in Face-to-Face Transactions*, 12 J. CORP. L. 251, 287-93 (1987)).

131. *See* Wallace, *supra* note 41, at 1115.

132. *See* David M. Bovi, *Rule 10b-5 Liability for Front-Running: Adding a New Dimension to the "Money Game,"* 7 ST. THOMAS L. REV. 103, 115 (1994). The SEC, unlike a private plaintiff, need not prove all the required elements under Rule 10b-5. *Id.* In addition, a relaxed standard for some of the elements is acceptable. *Id.*

133. *See* Aaron v. SEC, 446 U.S. 680, (1980); Bruschi v. Brown, 876 F.2d 1526, 1528 (11th Cir. 1989); Myers v. Finkle, 950 F.2d 165 (4th Cir. 1991); Akin v. Q-L Investments, Inc., 959 F.2d 521 (5th Cir. 1992). Severe recklessness can satisfy the scienter requirements for a primary violation under Rule 10(b). *Id.* at 525-26. *See also* Broad v. Rockwell Int'l Corp., 642 F.2d 929,

upon which the plaintiff justifiably relied[135] and which proximately caused the plaintiff's damages.[136]

Under Rule 10b-5, reporting companies have a duty to disclose material information.[137] As previously discussed, the definition of materiality was finally resolved by the Supreme Court in *Basic, Inc. v. Levinson*.[138] With respect to contingent or speculative liability, the *Basic* Court adopted the probability/magnitude balancing approach to materiality set forth in *SEC v. Texas Gulf Sulfur.*[139] One commentator has noted that the "probability/magnitude test of materiality appears to be particularly applicable to environmental cases, given that environmental liabilities are usually 'contingent or speculative in nature'[140] and thus invite the kind of analysis contemplated in *Basic, Inc. v. Levinson*."[141] However, whether this standard would be applied in other contexts is uncertain. In *Basic,* the Court specifically noted that it was not

961-62 (5th Cir.) (en banc), *cert. denied,* 454 U.S. 965 (1981). *See generally* Elizabeth Ann Glass Geltman, *Disclosure of Contingent Environmental Liabilities by Public Companies Under the Federal Securities Laws*, 16 HARV. ENVTL. L. REV. 129 (1992); Jeanne P. Bolger, Note, *Recklessness and the Rule 10b-5 Scienter Standard After* Hochfelder, 48 FORDHAM L. REV. 817 (1980). *See also* Wallace, *supra* note 41, at 1116-17. "Extensive monitoring, reporting, and recordkeeping requirements in many modern environmental statutes give rise to an abundance of facts to support prosecutorial allegations that environmental violations were intentional, or at least reckless." *Id.* It follows, therefore, that liberal interpretations of scienter can only make prospects more bleak for the defendant in environmental cases. *Id.*

134. *See* Basic, Inc. v. Levinson, 485 U.S. 224 (1988). *See generally* Arnold S. Jacobs, *What is a Misleading Statement or Omission Under Rule 10b-5?,* 42 FORDHAM L. REV. 243 (1973).

135. *See Bruschi*, 876 F.2d 1526; Ockerman v. May Zima & Company, 27 F.3d 1151 (6th Cir. 1994). "We see no justification for reading reliance out of Rule 10b-5 . . . ." *Id.* at 1162. *See also Basic*, 485 U.S. 224. "Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Id.* at 243. For a discussion of the continued vitality of the reliance requirement, see generally Recent Cases, *Securities Laws—Rule 10b-5—Seventh Circuit Holds That Causation Can Be Established Without Reliance*—Eckstein v. Balcor Film Investors, 8 F.3d 1121 (7th Cir. 1993), 107 HARV. L. REV. 1170 (1994).

136. *See* Commercial Union Assurance Co. v. Milken, 17 F.3d 608 (2d Cir. 1994); Rosen v. Cascade International, Inc., 21 F.3d 1520 (11th Cir. 1994); Meyers v. Finkle, 950 F.2d 165 (4th Cir. 1991). *See also* Geltman, *supra* note 3, at 135 n.41 (citing 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)).

137. 17 C.F.R. § 240.10b-5 (1994).

138. *See supra* note 11.

139. *See supra* note 72.

140. Wallace, *supra* note 41, at 1118 (citing *Basic*, 485 U.S. at 224, 232).

141. *Id.* (citing Elizabeth Ann Glass Geltman, *Disclosure of Contingent Environmental Liabilities by Public Companies Under the Federal Securities Laws*, 16 HARV. ENVTL. L. Rev. 129, 139 (1992)).

addressing disclosure of any other contingent information.[142] Furthermore, the SEC has expressly stated that in the context of whether a PRP must disclose its status and the effect thereof, the *Basic* test is not the appropriate standard.[143]

The SEC has not directly answered the question of materiality for purposes of Regulation S-K. In explaining the scope of Regulation S-K, the SEC referred to the definition of "material" in Rule 405[144] of the 1933 Act and Rule 12b-2[145] of the 1934 Act. According to Rule 405: "The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."[146]

There is very little case law involving the SEC's environmental disclosure rules.[147] In *Levine v. NL Industries*, the court dismissed a class action suit under Rule 10b-5 alleging that the company failed to disclose environmental violations of its subsidiary. The plaintiffs claimed all purchasers of NL stock paid an inflated price because of the company's failure to disclose this information.[148] The trial court granted summary judgment because the plaintiff failed to show that the registrant had a duty to disclose the information.[149] The Second Circuit affirmed the dismissal, reasoning that the defendant had no duty to disclose because NL Industries was contractually indemnified by the Department of Energy (DOE) in the event of liability or loss arising out of any such violation.[150] Since the shareholders would not suffer any financial impact from the violations, the court concluded that a reasonable investor

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142. *Basic*, 485 U.S. at 232 n.9. "We do not address here any other kinds of contingent or speculative information, such as earnings, forecasts, or projective." *Id.*

143. *See,* MD&A Release, *supra* note 52, at 22,430 n.27.

144. 17 C.F.R. § 240.405 (1994).

145. 17 C.F.R. § 240.12b-2 (1994).

146. 17 C.F.R. § 240.405 (1994).

147. *See*, *e.g.*, Levine v. NL Industries, 717 F. Supp. 252 (S.D.N.Y. 1989), *aff'd.,* 926 F.2d 199 (2d Cir. 1991); Grossman v. Waste Management, Inc., 589 F. Supp. 395 (N.D. Ill. 1984); Endo v. Albertine, 863 F. Supp. 708 (N.D. Ill. 1994).

148. *Levine,* 717 F.Supp. at 252-53.

149. *Id.*

150. Levine v. NL Industries, Inc., 926 F.2d 199, 203 (2d Cir. 1991). NL's alleged failure to disclose environmental violations was deemed immaterial because the DOE agreed to indemnify NL for any losses or liabilities resulting from such violations. *Id.* In addition, the DOE agreed to assume all future compliance costs necessary to bring the facility up to standard. *Id.*

would not attach any importance to the information in making an investment decision.[151]

In *Grossman v. Waste Management, Inc.*,[152] shareholders brought a class action alleging nondisclosure of material information regarding potential unasserted claims for noncompliance with environmental regulations.[153] The court denied Waste Management's motion for summary judgment. The defendant relied on disclosures made in SEC filings that the company was a party to environmental proceedings and that these risks were inherent in the nature of the company's business, as were the costs to control such risks.[154] The court held that the disclosure was inadequate because it did not address the fact that Waste Management could potentially be fined or that the company was disposing of hazardous wastes in violation of environmental laws.[155] The court ruled that Waste Management had "an affirmative duty to disclose matters relating to pending and contemplated environmental regulatory proceedings and the effects of environmental regulations upon the company's finances."[156]

In a more recent case, *Endo v. Albertine*,[157] shareholders brought an action against a reporting company and its independent accountant, alleging that the defendant corporation's registration statement and prospectus failed to disclose material information and were, therefore, false and misleading.[158] The plaintiffs claimed that the defendants failed to adequately disclose the contingent liabilities retained by the company arising from the operations of its former subsidiary.[159] The defendant company disclosed in its prospectus, that it and its subsidiaries were parties to certain legal proceedings and had retained certain liabilities with respect to the sale of certain discontinued operations, including Superfund and other environmental liabilities.[160] Further, the company declared its belief that these matters were not material.[161]

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151. *Id.*
152. 589 F. Supp. 395 (N.D. Ill. 1984).
153. *Id.*
154. *Id.* at 408.
155. *Id.*
156. *Id.* at 412.
157. Endo v. Albertine, 863 F. Supp. 708 (N.D. Ill. 1994).
158. *Id.* at 713.
159. *Id.* at 714.
160. *Id.* at 714-15.
161. *Id.*

Plaintiffs argued that these statements were not reflective of the true extent of the defendant company's potential liability.[162] Furthermore, the plaintiffs' evidence raised the inference that the defendant's statement in the prospectus, that the contingent environmental liabilities would be immaterial, was made in bad faith and lacked a reasonable basis in fact.[163] The court found that the mere reference to Superfund was inadequate disclosure.[164] In addition, the court held that because reasonable minds can differ on the question of materiality of failing to disclose the details regarding the contingent liability, defendant's motion for summary judgment was denied.[165]

VII. CONCLUSION

Although much of the recent environmental liability disclosure discussion has focused on actual and contingent liabilities under CERCLA, other areas of potential exposure exist. The major environmental statutes that may affect public company disclosure, in addition to CERCLA, include the Clean Air Act,[166] the Clean Water Act,[167] the Toxic Substance Control Act,[168] and the Resource Conservation and Recovery Act (RCRA).[169] Companies who violate the provisions of these statutes may face stiff criminal penalties and civil fines, and may incur significant cleanup liabilities under CERCLA or RCRA.

In light of these severe penalties, the SEC's current disclosure requirements for environmental liabilities require serious consideration by reporting companies. It is essential that reporting companies consider the SEC's recent focus on environmental disclosure as well as society's interest in monitoring the behavior of public companies through this disclosure.

The SEC's disclosure requirements for environmental liabilities are difficult for companies to interpret. What is clear, though, is that the SEC has interpreted these requirements (as noted in SAB-92) to reflect its

162. *Id.* at 720.
163. *Id.*
164. *Id.*
165. *Id.* at 733.
166. 42 U.S.C. §§ 7401-7671q.
167. 33 U.S.C. §§ 1251-1387.
168. 15 U.S.C. §§ 2601 et seq.
169. 42 U.S.C. §§ 6901-6987.

opinion that actual and contingent environmental liabilities are significant and that detailed disclosure regarding the nature and measurement of these liabilities is required to prevent the registrant's financial statements from being misleading. Moreover, such disclosure is necessary to inform investors of the full extent of the impact of these liabilities to the company's financial condition, results of operations and liquidity.

Commentators have observed that the current environmental regulations and rigorous securities disclosure regulations have created an atmosphere in which failures of compliance or lax compliance can be hazardous, and perhaps terminal for businesses.[170] Practitioners have suggested that in order to protect themselves, reporting companies will be forced to institute policies and procedures regarding the treatment and disclosure of environmental liabilities.[171] Consequently, companies will be forced to devote additional time and capital in an effort to ensure compliance with these requirements, beyond the time expended currently on compliance with environmental laws and regulations.

The issue of disclosure of actual and contingent liabilities is a serious one. Reporting companies should be aware that the regulations of the SEC may require them to provide more detailed disclosure of potential liabilities than might be required under GAAP. Registrants are left with inadequate guidance as to when and how to disclose the effects of environmental contingencies on their financial conditions. When making determinations about disclosure of environmental liabilities, companies should acknowledge the increasing aggressiveness of the EPA and the SEC, and the increasing levels of penalties being assessed against companies that violate environmental laws and regulations. To be safe, this may require companies to include information that management would otherwise deem immaterial. The investing public will ultimately be burdened with overinclusive disclosure and meaningless boilerplate language. In order to make disclosure more meaningful, the SEC and the Courts must articulate an effective approach to interpretation and enforcement of all applicable disclosure provisions.

Until then, these disclosure requirements will simply make investments more costly and negatively impact investor confidence.

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170. *See* Wallace, *supra* note 41, at 1124.

171. *See* Schwartz, *supra* note 14, at 316. In addition, companies will need to keep detailed documentation of their disclosure determinations. Internal mechanisms to ensure accuracy and consistency in handling environmental disclosure must be established. *Id.*

TRACY SOEHLE