Environmental Disclosure Requirements
Under the Federal Securities Laws

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# Environmental Disclosure Requirements
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**Introduction**

During the past two decades, U.S. companies have spent billions of dollars as a result of increased enforcement of environmental regulations. One need not look far to find illustrations of where this money has been spent. Civil penalties in the millions of dollars have been sought and obtained in federal Clean Air Act and Resource Conservation and Recovery Act enforcement actions. The cost to remediate the average Superfund site has been estimated by the U.S. Environmental Protection Agency (“EPA”) to be $25 million. People may debate the wisdom and efficacy of the current environmental regulatory scheme, but the tremendous impact it has had on the economy and corporate behavior cannot be denied.

In the early 1990s, Commissioner Richard Roberts of the U.S. Securities and Exchange Commission (“SEC”) publicly cautioned reporting companies that the SEC would apply increased scrutiny to environmental disclosure contained in public filings. His comments specifically targeted the insurance, pulp and paper and electric utilities industries, among others. Although few SEC enforcement proceedings were reported in the wake of the Commissioner’s pronouncements, the quality of environmental disclosure thereafter notably improved. The following years also saw an unprecedented growth in both U.S. and global capital markets.

The manner in which financial performance and liabilities – including environmental liabilities – are reported to the investing public continues to gain in importance. Today, in the wake of enormous global economic strains and financial uncertainties, there is once again renewed interest on the part of the SEC and the EPA as well as various stakeholders in the scope and quality of environmental disclosure. Moreover, as climate change increasingly dominates public debate, the impacts of greenhouse gas emissions are prompting growing demands for enhanced disclosure of the legal, financial and physical risks relating to climate change.
As we discuss in the following pages, public reporting companies must satisfy a host of SEC requirements regarding the recordation and disclosure of environmental costs and liabilities. Principal among these provisions is Regulation S-K, the repository for the SEC’s integrated disclosure requirements. In addition, the SEC has issued various staff accounting bulletins and other guidance documents that clarify and amplify the disclosure requirements under Regulation S-K. The following outline describes these requirements, as well as various accounting standards and guidance documents and new proposals by a range of parties for enhancing environmental disclosure and financial reporting relating to environmental liabilities.
1. Regulation S-K.

1.1 Generally.

Regulation S-K is the “repository” for the SEC’s uniform disclosure requirements under the Securities Act of 1933 (“Securities Act”) and the Securities Exchange Act of 1934 (“Exchange Act”). See Adoption of Integrated Disclosure System, 47 Fed. Reg. 11380 (1982). Its provisions are specifically applicable to the content of the non-financial statement portions of (1) registration statements under the Securities Act, and (2) registration statements, annual or other periodic reports, going private transaction statements, tender offer statements, annual reports to security holders, proxy and information statements, and any other documents required to be filed under the Exchange Act. See 17 C.F.R. 229.10(a). Regulation S-K incorporates the relevant interpretive releases under the Acts, as well as the forms under the Acts. See id. There are three principle sections of Regulation S-K that are directly relevant to the disclosure of environmental matters: Item 101, 17 C.F.R. 229.101; Item 103, 17 C.F.R. 229.103; and Item 303, 17 C.F.R. 229.303.

1.2 Item 101, Description of Business.

1.2.1 Generally.

Item 101(c)(xii) requires the disclosure of the “material”1 effects that compliance with Federal, State and local provisions . . . regulating the discharge of materials into the environment, or

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1 “Material” information is defined under the Securities Act and the Exchange Act as information “to which there is a substantial likelihood that a reasonable investor would attach importance in deciding to buy or sell the securities registered.” 17 C.F.R. 240.12b-2 (Exchange Act); see 17 C.F.R. 230.405 (Securities Act). See also Staff Accounting Bulletin (“SAB”) 99.
otherwise relating to the protection of the environment, may have
upon the capital expenditures, earnings and competitive position of
the registrant and its subsidiaries.” 17 C.F.R. 229.101(c)(xii).
Disclosure of material estimated capital expenditures for
environmental control facilities is required for the remainder of the
current fiscal year, its succeeding fiscal year, and “such further
periods as the registrant may deem material.” Id.

(a) **Contingent Effects**: Item 101(c)(xii) requires the disclosure
of effects that environmental matters may have on the
financial condition of the registrant. See id. This language
requires the disclosure of contingent effects as well as those
of which the company knows. In interpreting a precursor
to the provision, the SEC emphasized the disclosure of “the
possible future effects of environmental statutes and
regulations, and proceedings thereunder, on the issuer. . . .”
Compliance with Environmental Requirements, Securities

(b) **Foreign Environmental Provisions**. The SEC has stated
that “to the extent any foreign [environmental] provisions
may have a material impact upon the company's financial
condition or business such matters should be disclosed.”
Air Products and Chemicals, Inc., SEC No-Action Letter
(June 11, 1973) (interpreting precursor to Item 101(c)(xii)).

(c) **Small Offerings**. For years, the SEC imposed identical
requirements on disclosures relating to small offerings. See

However, effective February 4, 2008, the SEC adopted a new regulation simplifying the disclosure obligations under Regulation S-K for smaller reporting companies.\(^2\) 17 C.F.R. 229.101(h)(4)(xi). Pursuant to the new regulation, a smaller reporting company may satisfy its obligations under Item 101 by describing the development of its business during the previous three years. This description must include “[c]osts and effects of compliance with environmental laws (federal, state and local),” to the extent “material to an understanding of the smaller reporting company.” Id. Unlike Item 101(c)(xii), the new rule for smaller reporting companies appears to require disclosure of only historical (and not future) costs and effects of compliance with environmental laws.

1.2.2. **Time Period Covered by Disclosures.**

Item 101 requires the disclosure of material effects that will occur after the specified periods if the registrant deems such effects material. The SEC has emphasized that disclosure beyond the required period may be required where the disclosed costs do not adequately reflect the expenditures necessary to comply with the environmental requirements in question, or when material penalties

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\(^2\) An issuer (other than an investment company, an asset-backed issuer or a majority-owned subsidiary of a parent that is not a smaller reporting company) qualifies as a “smaller reporting company” if it (i) had a common equity float of less than $75 million, calculated as of the end of its second fiscal quarter, (ii) for an initial registration statement, had a public float of less than $75 million within 30 days of the date of filing or (iii) in the case of an issuer whose public float was zero, had annual revenue of $50 million or less in its last fiscal year. 17 C.F.R. 229.10(f)(1).
for non-compliance are reasonably likely to be imposed. See In re United States Steel Corp., Exchange Act Release No. 16223 [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,319, at 82,376 (SEC Admin. Proc., Sept. 27, 1979) (interpreting precursor to Item 101(c)(xii)). In such a situation, the SEC has warned that disclosure of effects for the additional periods may be required to prevent the mandatory disclosures from being misleading. See id.

1.2.3. Costs Associated with Non-Compliance.

Although by its terms Item 101(c)(xii) requires the disclosure of only those expenditures necessary to comply with environmental regulations, both the United States Court of Appeals for the Second Circuit and the SEC have interpreted the provision to require the disclosure of expenditures resulting from non-compliance as well. For example, in Levine v. NL Industries, 926 F.2d 199 (2d Cir. 1991) the Second Circuit, though finding no material omission, acknowledged that “[d]isclosure of potential costs for violations of environmental laws, if material, is ordinarily required [by Item 101(c)(xii)].” Levine, 926 F.2d at 203. The SEC came to a similar conclusion in a 1980 administrative proceeding against Occidental Petroleum Corporation, where it stated that Occidental was required to disclose costs associated with “possible remedial activities necessary to compensate for previous non-compliance with environmental regulations. . . .” In re Occidental Petroleum Corp., Exchange Act Release No. 16950, 20 SEC Docket 567, 570 (July 15, 1980) (interpreting precursor to Item 101(c)(xii)).
1.2.4. **Detail Required in Disclosure.**

(a) **Estimates.** In interpreting the precursor to Item 101(c)(xii), the SEC has stated that the registrant may be required to set forth “the source of its estimates, the assumptions and methods used in reaching the estimates, and the extent of uncertainty that projected future costs may occur in order for the disclosure made not to be misleading.” In re United States Steel, Fed. Sec. L. Rep. (CCH) ¶ 82,319, at 82,383.

(b) **Segregation of Costs.** Interpreting the same provision, the SEC has further stated that where expenditures are partly for environmental compliance, and partly for “the replacement, modification or addition of equipment or facilities,” the costs of environmental compliance should be segregated to the extent there is a reasonable basis to do so. Securities Act Release No. 33-5386, Fed. Sec. L. Rep. (CCH) ¶ 79,342, at 83,030.

(c) In the same release, the SEC warned that such estimates “should not be calculated or stated on an annual basis when such [sic] would diminish the apparent materiality of the expenditures or result in non-disclosure.” Id.

1.3 **Item 102, Description of Property.**

Item 102 requires a brief description of the location and general character of “materially important physical properties of the registrant and its subsidiaries.” 17 C.F.R. 229.102. The purpose of this provision is to inform investors as to the “suitability, adequacy, productive capacity and extent of utilization of the facilities by the registrant.” Id., at Instruction 1.
Neither the SEC nor the courts have addressed the issue of whether Item 102 specifically requires the disclosure of environmental matters.

1.4 Item 103, Legal Proceedings.

1.4.1. Generally.

Item 103 requires the registrant to describe any material legal proceedings, pending or known to be contemplated, “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. 229.103. The provision expressly excludes from its requirements “ordinary routine litigation incidental to the business. . . .” Id. Environmental litigation is not considered ordinary litigation under Instruction No. 5 to Item 103. See infra Section 1.4.2.

1.4.2. Instruction No. 5.

In particular, Instruction No. 5 to Item 103 states that an administrative or judicial proceeding arising under any legal provisions “that have been enacted or adopted regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment” are not ordinary routine litigation incidental to the business. The Instruction requires that such proceedings be disclosed if any one of the following three conditions exist with respect to them:

(i) Such proceeding is material to the business or financial condition of the registrant;

(ii) Such proceeding involves primarily a claim for damages, or involves potential 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

(iii) 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 interests and costs, of less than $100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically. See 17 C.F.R. 229.103 at Instruction 5.

In order to determine whether a proceeding must be disclosed under Instruction 5(A), a registrant must employ the materiality test as articulated in Basic v. Levinson, 485 U.S. 224, 229-31 (1988) (specifically adopting the materiality test of TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976), for Rule 10b-5, the general disclosure rule). Under Basic, a registrant must disclose any fact that the reasonable investor would view as significantly altering “the total mix of information made available.” Id. at 231-32.3

Under Instructions 5(B) and 5(C), environmental proceedings meeting the threshold requirements set forth in either of those instructions must be disclosed even in the absence of materiality.

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3 See also Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 516-17 (7th Cir. 1989), in which Judge Easterbrook, in dicta, defines materiality as depending “not only on the magnitude of its effect but also on its probability.”
See Mark A. Stach, DISCLOSING ENVIRONMENTAL LIABILITY UNDER THE SECURITIES LAWS, 3-23 to 3-28 (1997).

1.4.3. **Contemplated Proceedings.**

Item 103 requires the disclosure of proceedings that are pending or “known to be contemplated by governmental authorities.” 17 C.F.R. 229.103. In In re Occidental Petroleum Corp., the SEC found that a disclosure duty existed after the company's management was informed by the U.S. Attorney that a criminal action against the company for violations of environmental provisions “would be likely.” Exchange Act Release No. 16950, 20 SEC Docket at 569. Item 103 does not require the disclosure of uncharged criminal conduct, however, provided that such charges are not known to be contemplated. See United States v. Crop Growers, 954 F. Supp. 335, 347 (D.D.C. 1997) (finding no duty to disclose where registrants had no knowledge of any proceedings against them at the time of the filings). Moreover, Item 103 does not require disclosure of proceedings that are fully resolved prior to the reporting date.

(a) **Knowledge of Violation Alone.** At least one court has held that a company's mere knowledge of the existence of a violation, and that suit was a possibility, did not give rise to a disclosure duty under Item 103. See Levine v. NL Indus., 717 F. Supp. 252, 255 (S.D.N.Y. 1989), aff'd, 926 F.2d 199 (2d Cir. 1991) (company's internal documents established that it knew of violation and that state environmental authorities could bring suit, but not that state was
contemplating action). In affirming the district court’s determination, the appellate court emphasized that, since the U.S. Department of Energy had agreed to indemnify the defendant for any loss its subsidiary would suffer as a result of violations of environmental law, any such violation was immaterial. See Levine, 926 F.2d at 203.

1.4.4. “Proceedings” Broadly Defined.

The SEC has stated that for the purposes of the disclosure of environmental matters, “the meaning of an administrative proceeding has never been construed narrowly. . . .” In re United States Steel, Fed. Sec. L. Rep. (CCH) ¶ 82,319 at 82,383 (interpreting precursor to Item 103, Instruction 5).

(a) The Role of the Government. Item 103 requires the disclosure of proceedings which are “known to be contemplated by governmental authorities.” 17 C.F.R. 229.103. The SEC has broadly interpreted environmental disclosure provisions as requiring the disclosure of “administrative proceedings which are initiated by the registrant, as well as those initiated by the government.” In re United States Steel, Fed. Sec. L. Rep. (CCH) ¶ 82,319 at 82,383 (interpreting precursor to Item 103). The government need only be a party to such contemplated proceedings in order to trigger this disclosure requirement.

(b) Environmental Actions brought by a Foreign Government. The SEC staff has stated that the “[t]he reference in Instruction 5 to an administrative or judicial proceeding

(c) Administrative Orders Not Following a Proceeding. The SEC has interpreted its environmental disclosure provisions as requiring the disclosure of “all administrative orders relating to environmental matters, whether or not those orders literally follow a ’proceeding.’“ In re United States Steel, Fed. Sec. L. Rep. (CCH) ¶ 82,319 at 82,384 (interpreting precursor to 103). In so stating, the SEC gave as examples the situations where “a corporation directly consents to the entry of an order or where the order is the product of negotiation between the parties.” Id.

(d) Notices of Violation. The SEC has stated that a company's receipt of a Notice of Violation in the form of a cease and desist order from the EPA “would constitute a sufficiently concrete indication of contemplated governmental legal action to require disclosure. . . .” Securities Act Release No. 5704, Fed. Sec. L. Rep. (CCH) ¶ 80,495 at 86,297 n.22 (interpreting precursor to Item 103); see also In re United States Steel, Fed. Sec. L. Rep. (CCH) ¶ 82,319 at 82,383.

(e) Potentially Responsible Party Status. The SEC has stated that potentially responsible party (“PRP”) status in
Superfund litigation is not itself sufficient to require disclosure under Item 103. See Securities Act Release No. 6835, 54 Fed. Reg. 22427, 22430 n.30. The SEC explained that “PRP status alone does not provide knowledge that a governmental agency is contemplating a proceeding.” Id. Nonetheless, the Commission stated that PRP status is a factor in determining whether proceedings are known to be contemplated, and “when coupled with other circumstances,” may trigger Item 103’s disclosure requirements. Id.

(f) Permit Proceedings. In Wielgos v. Commonwealth Edison Co., 892 F.2d 509 (7th Cir. 1989), the Seventh Circuit suggested that Item 103 may require the disclosure of the existence of pending permit applications. In holding that the company had disclosed “all that Item 103 requires,” the court pointed out that the company had revealed that “it was building five nuclear reactors, which it could not operate without licenses from the NRC [(Nuclear Regulatory Commission)].” Id. at 517.

The SEC, however, has stated that “since clause (C) [of Instruction 5] concerns proceedings involving potential monetary sanctions, permit proceedings and requests for waivers or variances would not be disclosable pursuant to clause (C).” Securities Act Release No. 6383, Fed. Sec. L. Rep. (CCH) ¶ 72,328 at 63,004.
(g) **Environmental Compliance Reports.** The SEC has refused to require the listing of environmental compliance reports under Section 103, see Securities Act Release No. 5704, Fed. Sec. L. Rep. (CCH) ¶ 80,495 at 86,295, and has further refused to require the disclosure of governmental authorities from which such reports may be obtained. See Securities Act Release No. 6383, Fed. Sec. L. Rep. (CCH) ¶ 72,328 at 63,005.

1.4.5. **“Sanctions” for the Purposes of Instructions 5(B) and (C).**

Although the SEC has construed broadly the meaning of “sanctions” for purposes of Instructions 5(B) and (C), costs incurred pursuant to a remedial agreement under Superfund, “entered into in the normal course of negotiations with the EPA, generally are not ‘sanctions’ within either Instruction 5(B) or (C) to Item 103.” Securities Act Release No. 6835, 54 Fed. Reg. at 22430 n.30. The SEC has warned, however, that such remedial costs would constitute either charges to income or capital expenditures, and therefore may be relevant to whether disclosure is required by Instructions 5(A) or (B). *Id.*

Notwithstanding the general interpretation that costs incurred pursuant to a remedial agreement are not “sanctions,” the SEC has stated on at least two occasions that “there are many ways a PRP may become subject to potential monetary sanctions. . . .” Thomas A. Cole, Esq. SEC No-Action Letter (Jan. 17, 1989); Securities Act Release No. 6835, 54 Fed. Reg. at 22430 n.30. As an illustration of the breadth of the definition, the SEC has stated that
“triggering the stipulated penalty clause in a remedial agreement” qualifies as a sanction under this provision. Id.

(a) **Aggregation of Sanctions.** The SEC has stated that registrants are not required to aggregate potential monetary sanctions of similar proceedings when determining whether disclosure is required by Instruction 5(C). See Securities Act Release No. 6383, Fed. Sec. L. Rep. (CCH) ¶ 72,328 at 63,004. However, aggregation of sanctions in proceedings “which present in large degree the same issues” is required for purposes of Instruction 5 (A) and (B). 17 C.F.R. 229.103 at Instruction 2. See James G. Archer, et al., *SEC Reporting of Environmental Liabilities*, 20 ENVTL. L. REP. at 10106 (Mar. 1990). In proceedings involving both monetary penalties and supplemental environmental projects (“SEPs”), the amount of the monetary penalties should be aggregated with the cost of the SEP for purposes of determining whether the $100,000 threshold has been met.

1.4.6. **Availability of Insurance, Indemnification or Contribution for the Purposes of Instruction 5(A) and (B).** The SEC has stated that a PRP may consider the availability of insurance, indemnification or contribution in determining whether it has a disclosure duty under Instruction 5(A) or (B). See *Management’s Discussion and Analysis of Financial Condition and Results of Operation; Certain Investment Company Disclosure*, Securities Act Release No. 6835, 54 Fed. Reg. 22430 at 22427 (citing Thomas A. Cole, Esq., SEC
FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP


1.4.7. Detail Required in Disclosure.

Item 103 requires the disclosure of “the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought.” 17 C.F.R. 229.103.

(a) Nature of Relief. With respect to the disclosure of the nature of relief sought, the SEC has stated that it “does not consider mere disclosure that the government seeks to compel new pollution control efforts to constitute adequate disclosure of relief sought” and instead SEC regulations “contemplate that an estimate of the level of expenditures required to install the pollution control equipment sought by the governmental authority be provided if such expenditures are likely to be material.” In re United States Steel, Fed. Sec. L. Rep. (CCH) ¶ 82,319 at 82,384.

(b) Name of Court or Agency. The Seventh Circuit has held that, although Item 103 requires disclosure of the name of the court or agency in which the proceedings are pending, the Item does not require the disclosure of the specific agency tribunal before which a proceeding is to be tried. See Wielgos, 892 F.2d at 517 (holding that omission of fact that permit proceeding was before ASLB rather than some
other part of the NRC was not a violation of requirements of Item 103). The court further stated that Item 103 did not require the company to disclose the “status of the pending case.” Id.

(c) Prospective Effects. Though Item 103 does not specifically require predictions as to the effects of litigation, it is common practice to disclose whether management considers the litigation to be material.

1.4.8. EPA Disclosure Initiative. In 2001, EPA announced an environmental disclosure initiative to encourage greater compliance with SEC disclosure requirements under Item 103. To accomplish this objective, EPA created an online database, Enforcement and Compliance History Online (“ECHO”), which identifies companies’ environmental compliance history, formal enforcement actions and related penalties on a facility-specific basis. See Enforcement and Compliance History Online, available at http://www.epa.gov/echo/index.html; see also William J. Walsh, et. al., New Initiatives To Encourage Disclosure of Environmental Costs and Liabilities, 34 ENVTL. REP. BNA 217 (Jan. 24, 2003).

Furthermore, EPA requested its enforcement personnel to distribute a “Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings” (the “EPA Notice”) to companies that are parties to formal EPA-initiated administrative enforcement actions unless the enforcement personnel bringing the action reasonably believe that Item 103 does not apply. The EPA has continued to distribute the EPA Notice to parties to certain EPA-initiated enforcement. See generally EPA Compliance
The EPA Notice seeks to inform recipients that they are potentially subject to Item 103 and should themselves determine whether disclosure of the action is required. The EPA Notice system is based on the notion that increased scrutiny of corporate environmental information, particularly legal proceedings, by the public, shareholders, and investors will likely provide a deterrent to future non-compliance.

The EPA Notice must comply with the following guidelines:

- **Recipients:** Companies involved in an administrative legal proceeding taken in response to violation(s) of Federal, State or local provisions having the primary purpose of environmental protection should receive the EPA Notice, *provided that* the EPA has initiated the enforcement action and the EPA has the lead for prosecuting the case.

- **Exemptions:** The EPA Notice should *not* be distributed if: (1) the party to receive the EPA Notice

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4 The EPA also publishes an *Enforcement Alert* newsletter regarding environmental enforcement actions and SEC environmental disclosure requirements. See *EPA Civil Enforcement: 2008 Editions of Enforcement Alert Newsletters*, available at [http://www.epa.gov/compliance/resources/newsletters/civil/enfalert/index.html](http://www.epa.gov/compliance/resources/newsletters/civil/enfalert/index.html).
is a Federal, State or local governmental entity or if
(2) the case has been, or is expected to be, referred to
the Department of Justice.

- **Timing:** The EPA Notice should be distributed no
later than the initiation of any formal administrative
action brought by EPA. For the purpose of these
guidelines initiation is considered to be when a formal
administrative complaint is filed, an administrative
order is issued, or a letter demanding stipulated
penalties is sent.

See *Guidance on Distributing the “Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings” in EPA Administrative Enforcement Actions* (Jan. 19, 2001), available at

1.5 **Item 303, Management's Discussion and Analysis.**

1.5.1. **Generally.**

Item 303, titled Management's Discussion and Analysis
(“MD&A”), requires that the registrant discuss historical financial
results, as well as “known trends . . . events or uncertainties . . .
that are reasonably likely” to have a material impact on liquidity,
capital, sales, revenues or income.\(^5\) 17 C.F.R. 229.303. The
provision requires that the discussion focus specifically on events

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\(^5\) The SEC has pointed out that the MD&A would also require the disclosure of the management's decision not to incur an expenditure if the effect thereof would be a material change in a growth trend. See Securities Act Release No. 6835, 54 Fed. Reg. at 22429.
and uncertainties known to management that would cause other reported information to become misleading. 17 C.F.R. 229.303 at Instruction 3. The SEC has particularly emphasized the disclosure in the MD&A of matters relating to the registrant's prospects for the future. See id. at Instruction 3(A); Securities Act Release No. 6835, 54 Fed. Reg. 22428. At a 1994 meeting of the Organization Resources Counselors, then SEC Commissioner Richard Y. Roberts stated that he expected the SEC to intensify its review of the MD&A disclosures of environmentally sensitive companies. 


(a) **Applicability to Disclosure of Environmental Matters.** The SEC has stated that a precursor of Item 303 “would compel the disclosure of information concerning environmental compliance, impact, expenditures, plans or violations, not otherwise specifically required, of which the average prudent investor ought reasonably to be informed.” Securities Act Release No. 5704, Fed. Sec. L. Rep. (CCH) ¶ 80,495 at 86,297 (interpreting precursor to Item 303 which required disclosure of “all material information necessary to make statements [in required filings] neither false nor misleading”). Moreover, in its 1989 interpretive release on MD&A, the SEC used as an illustration of the provision's operation an example in which a company was required to disclose its PRP status under CERCLA, and effects thereof, under circumstances where management
was unable to determine that a material effect on future financial condition or results of operations was not reasonably likely to occur. See Securities Act Release No. 6835, 54 Fed. Reg. at 22429.

1.5.2. Disclosure of Contingent Events.

The MD&A may require the disclosure of contingent events and their prospective effects. In its 1989 interpretive release, the SEC put forth the following test for determining whether Item 303 requires disclosure of a particular contingent event:

(a) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.

(b) If management cannot make that determination, it must evaluate objectively the consequences of the event or uncertainty on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur. Securities Act Release No. 6835, 54 Fed. Reg. at 22430.

Registrants should note that the SEC has expressly rejected the probability/magnitude balancing test for disclosure of contingent events approved in Basic v. Levinson, 485 U.S. 224, 238 (1986), as “inapposite to Item 303 disclosure.” Securities Act Release No. 6835, 54 Fed. Reg. at 22430 n.27. That an event be reasonably likely to occur is
therefore a threshold inquiry for requiring disclosure under Item 303, and cannot be compensated for by the event having great potential consequences.6

(c) **Determination Must Be Objectively Reasonable.** The SEC has stated that a registrant's determination as to whether to disclose a contingent event in the MD&A “must be objectively reasonable, viewed as of the time the determination is made.” Id. at 22430. The Commission has further warned that if a material change in financial condition or results of operation occurs and was not discussed in prior MD&A disclosures, the SEC staff will inquire into the circumstances of the prior MD&A filings to determine whether the registrant failed to meet the requirements of Item 303. Id. at 22430 n.28.

(d) **Joint and Several Liability.** The SEC has also warned that for purposes of determining whether to disclose potential environmental liability in the MD&A, “aggregate potential cleanup costs must be considered in light of the joint and several liability to which a PRP is subject.” Securities Act Release No. 6835, 54 Fed. Reg. at 22430.

1.5.3. **Forward-Looking Information vs. “Known Uncertainties.”**

The MD&A requires the disclosure of “known uncertainties.” 17 C.F.R. 229.303(a)(1). On the other hand, the provision encourages but does not require the disclosure of “forward-looking

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6 The SEC has given no indication that the Basic test is inapplicable to either Item 101 or Item 103.
information,” and states that “[a]ny forward-looking information supplied is expressly covered by the safe harbor rule for projections.” 17 C.F.R. 229.303 at Instruction 7. Both the Securities Act and the Exchange Act establish “safe harbors” for “forward-looking statements” made with a reasonable basis and in good faith. See Securities Act Release No. 6835, 54 Fed. Reg. at 22429 and n.22 (citing Rule 175(c) under the Securities Act, 17 C.F.R. 230.175(c); Rule 3b-6(c) under the Exchange Act, 17 C.F.R. 240.3b-6). The SEC attempted to resolve this apparent contradiction in its 1987 “Concept Release” on MD&A. The SEC stated that “required disclosure” is characterized by trends or uncertainties that are “currently known” and “reasonably expected to have material effects.” Securities Act Release No. 6711, Fed. Sec. L. Rep. (CCH) ¶ 84,118, at 88,624 (Apr. 20, 1987). “In contrast,” continued the Commission, “optional forward-looking disclosure involves anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty.” Id. The distinction therefore appears to rest on the degree of predictability of the event at issue.

Harvey L. Pitt & Karl A. Groskaufmanis, *The Recently Enacted Securities Litigation Reform Act Gives Public Companies a Safe Harbor for Some Predictive Statements*, Nat’l L. J., at B4 (Jan. 15, 1996). The safe harbor provision shields material forward-looking statements that are identified as such and that are “accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.” *Id.*

(a) **Case Law on Environmental Forward-Looking Statements.**

In *Endo v. Albertine*, shareholders of Fruit of the Loom, Inc. (“FOL”) filed suit against various FOL directors, officers, accounting firms and investment banks alleging, among other things, that the defendants made false and misleading statements and failed to disclose material facts relating to environmental liabilities in a prospectus for a public stock offering. *Endo v. Albertine*, 863 F. Supp. 708 (N.D. Ill. 1994), aff’d, *Endo v. Arthur Andersen & Co.*, 163 F.3d 463 (7th Cir. 1999). The environmental liabilities at issue related to the operations of a former FOL subsidiary and were retained by FOL in the disposition of the former subsidiary. The prospectus contained boilerplate language stating that FOL had “retained certain liabilities with respect to the sale of certain discontinued operations, including ‘Superfund’ and other environmental liabilities,” but FOL believed that these liabilities were not material. *Id.* at 714-15. The FOL defendants argued that they were
entitled to the safe harbor provisions of Securities Act Rule 175, 17 C.F.R. 230.175, which provide that “forward-looking statements” will not be deemed fraudulent absent a showing that the statements were made “without a reasonable basis or disclosed other than in good faith.” Endo, 863 F. Supp. at 718. The plaintiffs argued that the Rule 175 protections should not apply because the environmental liabilities were known material facts about FOL’s condition at the time the prospectus was filed rather than projections about future performance. Id. The plaintiffs presented evidence from FOL’s prior SEC filings and media reports suggesting that FOL had retained over $60 million in potential environmental liability associated with the former subsidiary. Id. at 720. The court denied the FOL defendants’ motions for summary judgment because the plaintiffs raised the inference that the statements regarding environmental liability lacked a reasonable basis and were made in bad faith. Id. at 719. The court also held that reasonable minds could differ on the question of whether the omission of information on $60 million in potential environmental liability is material, and thus the materiality issue could not be resolved at the summary judgment stage of the case. Id. at 720.

1.5.4. Types of Contingencies Reportable Under MD&A.

(a) Effects of Proposed Regulation. Material effects of proposed environmental requirements would be reportable in the MD&A. As an example of information required to
be disclosed, the 1989 MD&A interpretive release cites a situation where “regulations have been proposed [pursuant to recently enacted legislation] which, if promulgated, would require the expenditure of [material capital resources].” Securities Act Release No. 6835, 54 Fed. Reg. 22430; cf. Exchange Act Release No. 17390, Fed. Sec. L. Rep. (CCH) ¶ 82,712 at 83,890 (Dec. 18, 1980) (stating without specific reference to MD&A that SEC rules and regulations “require the disclosure of all material information relating to the impact of proposed . . . statutes, rules, [or] regulations”).

(b) **PRP Status.** The MD&A interpretive release makes clear that PRP status may give rise to a contingency reportable in the MD&A. In illustrating the operation of Item 303, the release cites a situation in which a registrant has been designated a PRP and material costs are reasonably likely. The release concludes that the MD&A requires disclosure of the effects of the PRP status in such situations. See Securities Act Release No. 6835, 54 Fed. Reg. at 22430.

At least one commentator has noted that, with regard to PRPs, the SEC has departed from the “traditional materiality analysis as espoused in Basic 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.” Elizabeth G.

The MD&A interpretive release clarifies that, in determining whether MD&A disclosure is required, issuers must consider the “aggregate potential cleanup costs” in light of the joint and several liability to which PRPs are subject. Securities Act Release No. 6835, 54 Fed. Reg. at 22427. In making the determination of whether a material future effect is not reasonably likely to occur, issuers can take into indemnification, insurance coverage and contribution from other PRPs, but must factor into the determination “[f]acts regarding whether insurance coverage may be contested, and whether and to what extent potential sources of contribution or indemnification constitute reliable sources of recovery.” Id.

1.5.5. **Detail Required in MD&A.**

Item 303 provides that the information provided in the MD&A “need only include that which is available to the registrant without undue effort or expense and which does not clearly appear in the registrant's financial statements.” 17 C.F.R. 229.303 at Instruction 2; see Securities Act Release No. 6835, 54 Fed. Reg. at 22430 (stating that MD&A requires quantification of potential liability “to the extent reasonably practicable”). The SEC has indicated that such information need only be detailed “to the extent necessary to an understanding of the registrant’s business as a
whole.” See Securities Act Release No. 6231, 20 SEC Docket 1059, 1072 (Sept. 2, 1980). However, Item 303(a) also indicates that if in the registrant’s judgment a discussion of segment information or of other subdivisions of the registrant’s business would be appropriate to an understanding of such business, the discussion should focus both on each relevant reportable segment or other subdivision as well on the registrant as a whole.

Notwithstanding the apparent laxity of these requirements, the SEC has required the registrant to state “the amount, or describe the nature or extent of the potential [environmental] liabilities” in its disclosures. In re Occidental Petroleum Corp., Exchange Act Release No. 16950, 20 SEC Docket 567, 571 (July 15, 1980) (discussing precursor to Item 303). The SEC has further advised that even where exact calculations of potential environmental liability are not possible, the effects of such liability should be “quantified to the extent reasonably practicable.” Securities Act Release No. 6835, 54 Fed. Reg. at 22430; see Remedies Act to Be Enforced on Case-by-Case Basis, McLucas Says, 23 SEC. REG. L. REP. (BNA) 1557, 1558 (Oct. 25, 1991) (“Companies certainly ought to be able to produce a ‘reasonable range’ of the amount necessary to solve the problem.”).

1.5.6. Disclosure of Loss Contingencies Under Item 303.

(the “2006 Guidance”), which includes guidance on disclosing loss contingencies (including environmental contamination and pending and threatened litigation) under Item 303. See id. at 45.

The 2006 Guidance notes that the need to discuss loss contingencies in the MD&A may precede any requirement to recognize such contingencies pursuant to accounting requirements “when the registrant becomes aware of information that creates a reasonable likelihood of a material effect on its financial condition or results of operations, or when such information is otherwise subject to disclosure in the financial statements, as occurs when the effect of a material loss contingency becomes reasonably possible.” Id. at 45-46. The 2006 Guidance further states that “[i]f a registrant is unable to estimate the reasonably likely impact, but a range of amounts are determinable based on the facts and circumstances surrounding the contingency, it should disclose those amounts.” Id. at 46. Pursuant to the 2006 Guidance, companies should consider whether it is necessary to discuss loss contingencies on both an aggregated and disaggregated basis, as many individual loss contingencies can have characteristics and/or uncertainties that would make aggregated disclosure insufficient to provide material information necessary to understand the loss contingencies. Id.

The 2006 Guidance also advised that the discussion and analysis in the MD&A should include (i) a quantification of related accruals and adjustments, costs of legal defense, and reasonably likely exposure to addition loss, (ii) the relevant terms of indemnification obligations for discontinued operations (including the duration of
the indemnification obligation and the extent of coverage or
exposure), if management determines it is reasonably likely that
the company will incur a material liability, (iii) the assumptions
used to reflect the registrant’s exposure and the extent to which the
resulting estimates are sensitive to changes in such assumptions
(particularly when there is a material difference between the range
of reasonably possible loss and the amount accrued), and (iv) the
timing of accounting effects, including a discussion of when the
underlying event associated with the loss occurred and
developments in the intervening periods that resulted in the
establishment or adjustment of accruals. Id.

1.5.7. SEC Proposal and Guidance Regarding Critical Accounting
Estimates.

On May 10, 2002, the SEC proposed a rule concerning new
disclosure requirements in the MD&A relating to (a) critical
accounting estimates and (b) the initial adoption of critical
accounting policies that have a material impact on a company's
financial condition or results of operations. See Disclosure in
Management's Discussion and Analysis About the Application of
Critical Accounting Policies, Securities Act Release No. 8098
proposal would also require disclosure of a detailed mathematical
sensitivity analysis of critical assumptions underlying the
estimates. Because many companies' environmental reserves
typically are based on estimates, it is possible that the new MD&A
requirement, if adopted, could require enhanced disclosure of
critical environmental accounting estimates.
As proposed, every MD&A would include a separately captioned section regarding critical accounting policies and estimates. An “accounting estimate” means an approximation made by management of a financial statement element, item or account in the financial statements. An accounting estimate is “critical” and would require disclosure if (1) it requires the company to make assumptions about matters that are highly uncertain at the time of the estimate and (2) different estimates that the company reasonably could have used, or changes in the estimate that are reasonably likely to occur from period to period, would have a material impact on the presentation of the company's financial condition or results of operations.

The SEC proposal would also require disclosure regarding the initial adoption of an accounting policy that has a material impact on a company's financial condition or results of operations that may occur when events or transactions affecting the company occur for the first time, or were previously immaterial in their effect but become material, or events or transactions occur that are clearly different in substance from previous ones.

The proposed rules would potentially apply to environmental estimates. Under the proposed rules, companies could be required to describe critical environmental accounting estimates in a separately-captioned section of their MD&A in any annual report, registration statement or proxy or information statement. Such companies would also need to indicate what the environmental estimate would be if different assumptions were used. Where the
environmental contingency is so uncertain that an estimation cannot be made under FASB SFAS No. 5 (see description infra Section 2.1), the proposed disclosure requirement would probably not apply since it can be said that no estimate is made at all in such a situation.

In December 2003, the SEC provided interpretive guidance on critical accounting policy disclosure, stating that the MD&A disclosure should present a company's analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time. With respect to the latter, the SEC stated that a company should address the risk that its accounting estimates or assumptions may change. In addition, a company should analyze, to the extent material, such factors as how it arrived at an estimate, how accurate the estimate or assumption has been in the past, how much the estimate or assumption has changed in the past, and whether the estimate or assumption is reasonably likely to change in the future. See SEC Release No. 33-8350 (Dec. 19, 2003).

When the critical accounting rules were initially proposed, a member of the SEC staff stated that the SEC hoped to issue final rules in 2003. However, final critical accounting rules were never issued. Instead, the SEC withdrew the item from its agenda in 2007, but left open the possibility for considering it further at a


In the SEC’s February 2003 summary review of 2002 10-K disclosure by Fortune 500 companies, inadequate MD&A disclosure of environmental liabilities was among the items receiving SEC comment. See Summary of Significant Issues Addressed in the Review of the Periodic Reports of the Fortune 500 Companies, available at http://wwwlsec.gov/divisions/corpfin/fortune500rep.htm. The SEC noted that companies should improve disclosure required under FASB SFAS No. 5, SOP 96-1 and SAB 92 relating to the nature of loss contingencies, amounts accrued, estimates of the range of reasonably possible losses, significant assumptions underlying the accrual, and the cost of litigation. The SEC also noted that many companies had failed to adequately disclose items specifically required under SAB 92 relating to closure and post-closure costs and other site restoration expenses incurred upon the sale or abandonment of property.

1.6 Item 503(c).

Item 503(c) requires registrants to provide a discussion of the most significant factors that make a offering speculative or risky. 17 C.F.R. 229.503(c). Registrants are required to disclose the particular risks that

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7 Although the critical accounting rules were never issued, the SEC emphasized the importance of accounting assumptions and reiterated some of the requirements from the tabled rules in the 2006 Guidance, described infra at Section 1.5.6.
could affect the issuer or the securities being offered, but not risks that
generally apply to any issuer or any offering. These risk factors must also
be discussed in annual 10-K filings, and any material changes to risk
factors described in the annual report must be disclosed in quarterly 10-Q
filings. Environmental risks, though not specifically cited among the
examples of risk factors set forth in Item 503(c), must be disclosed if they
could significantly affect an issuer or offering.

1.7 **Disclosure for Foreign Private Issuers: Form 20-F.**

The annual reports and registration statements of foreign private issuers must meet the disclosure requirements set forth in Form 20-F. See Form 20-F, available at http://www.sec.gov/about/forms/form20-f.pdf. Foreign private issuers are specifically required to disclose “any environmental issues that may affect” the use of “any material tangible fixed assets, including leased properties.” Id. at 13. This provision arguably could require the disclosure of both material and non-material environmental issues at covered properties. In addition, there are several general provisions setting forth disclosure requirements for foreign private issuers that are similar to those imposed on U.S. companies by Item 101, Item 103 and Item 303 of Regulation S-K. Under these general disclosure provisions, foreign private issuers may be required to disclose environmental information relating to, among other things, government regulation, capital expenditure commitments, known trends, uncertainties, demands, commitments or events, and legal proceedings. Id.

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8 Generally, foreign private issuers are companies with foreign ownership of a majority of their voting securities and any of the following: (i) a majority of foreign directors or officers; (ii) a majority of assets located outside the U.S.; or, (iii) business that is principally administered outside the U.S. 17 C.F.R. 240.3b-4(c).
1.8 Disclosure of Environmental Liability in Tender Offers.

Regulation S-K is applicable to “any document required to be filed under the Exchange Act, to the extent provided in the forms and rules under such Act,” including specifically tender offer statements. 17 C.F.R. 229.10(a). Courts have acknowledged that registrants may be liable for material omissions of environmental liability in documents relating to a tender offer. For example, in Grumman Corp. v. LTV Corp., 527 F. Supp. 86 (E.D.N.Y. 1981), the court held that the defendant company's failure to disclose between $185 million and $240 million in future costs for environmental compliance in its Schedule 14D was an omission of a material fact. See id. at 103. The court subsequently held that the plaintiffs were entitled to a preliminary injunction under Section 14(e) of the Exchange Act, 15 U.S.C. § 78n(e) (antifraud provision applicable to tender offers), enjoining the defendant corporation from proceeding in the tender offer. Id. at 106; see also Crouse-Hinds Co. v. Internorth, Inc., 518 F. Supp. 416, 473 (N.D.N.Y. 1981) (holding that no material omission existed, but acknowledging that Section 14(e) requires the company to avoid misstating or omitting material facts regarding environmental liabilities).


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9 The Court in Crouse-Hinds stated that the SEC's requirements relating specifically to environmental disclosure, contained in Securities Act Release No. 5704, were inapposite to materials involved in a tender offer. See 518 F. Supp. at 474. However, this statement was made before the amendments to Regulation S-K making it the repository for the SEC's uniform disclosure requirements. The current version of Regulation S-K is by its own terms applicable to “any document required to be filed under the Exchange Act, to the extent provided in the forms and rules under such Act,” including tender offer statements. 17 C.F.R. 229.10(a).
the court refused to interpret the tender offer provisions as requiring the offeror to provide environmental information about the target. See id. at 1406.

2. Financial Statements and Accounting Requirements.

Accounting standards, which are used by the SEC for reviewing financial filings, may also dictate disclosure of environmental matters. Former Commissioner Richard Roberts emphasized this point: “[e]nvironmental matters may also have financial implications for issuers that must be reflected under generally accepted accounting principles. . . .” Commissioner Roberts Discusses Environmental Disclosure, 1507 Fed. Sec. L. Rep. (CCH) at 7.

2.1 FASB SFAS No. 5.10

The primary accounting standard applicable to environmental disclosure in financial statements is Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (“SFAS No. 5”), which deals with accounting for contingencies. SFAS No. 5 provides that loss contingencies must be disclosed if: (1) available information indicates that it is probable that “an asset has been impaired or a liability has been incurred at the date of the financial statements” and (2) the amount of the loss can be reasonably estimated. SFAS No. 5 at ¶ 8. If both these conditions are met, the Statement requires that the loss be disclosed as a charge to income. Id.

Paragraph 10 of SFAS No. 5 provides that even when both of the conditions for accrual in paragraph 8 are not met, narrative disclosure of

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10 The FASB is in the process of revising the reporting and disclosure requirements for loss contingencies in SFAS No. 5. This project is described infra at Section 2.1.
the loss contingency shall nonetheless be required where there is “at least a reasonable possibility” that the loss has been incurred. This is true even if “information may not indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.” SFAS No. 5 at para. 10, n.6.

This narrative disclosure is required to state the nature of the contingency, and give an estimate of the possible loss or range of loss, or state that an estimate cannot be made. Id. The registrant is further required to record the most likely amount within the range if one can be determined.

Remedies to be Enforced on Case-by-Case Basis, McLucas Says, 23 SEC. REG. & L. REP. (BNA) at 1559. If no amount within the range is a better estimate than any other amount, the registrant must accrue the minimum amount in the range. FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss; Staff Accounting Bulletin No. 92, Topic 5-Y, Accounting and Disclosures Relating to Loss Contingencies.

(a) **Immaterial Items.** SFAS No. 5 provides that it “need not be applied to immaterial items.”\(^{11}\) The FASB has not provided further guidance with respect to the materiality threshold for purposes of SFAS No. 5. However,

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\(^{11}\) On March 15, 2005, the FASB rejected a proposal by the Rose Foundation for Communities and the Environment to require present value estimation for environmental liabilities under SFAS No. 5 and to consider whether environmental liabilities should be aggregated for purposes of determining materiality. The FASB reasoned that environmental liabilities should not have special measurement attributes separate from other contingent liabilities and that the issue could be addressed in the project reconsidering generally the accounting treatment of contingent liabilities (discussed infra in Section 2.1). See Environmental Liabilities Project Rejected; FASB Staff Studying Broader Work, BNA SEC. REG. & LAW REP., Vol. 37, No. 11 (Mar. 14, 2005).
Qualitative Characteristics of Accounting Information, provides that information is material when “[t]he magnitude of an omission or misstatement of [such information], in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.”

Moreover, the SEC has issued a Staff Accounting Bulletin to provide guidance with respect to the materiality of misstatements in financial statements and emphasize its view that a company should not rely solely on quantitative benchmarks in determining whether an issue is material. See Staff Accounting Bulletin No. 99, Materiality (“SAB 99”). Instead, SAB 99 states that “an assessment of materiality requires that one view the facts in the context of the ‘surrounding circumstances,’ as the accounting literature puts it, or the ‘total mix’ of information, in the words of the Supreme Court.” SAB 99 (quoting TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976)).

Among other key factors to consider in making a materiality assessment, SAB 99 notes that companies should consider whether a misstatement affects the company’s compliance with regulatory requirements.

(b) Recording of Contribution, Indemnity, and Insurance. The SEC has stated that companies should not offset a claim for indemnification, contribution or insurance recoveries
against a related accrual for a contingent environmental liability. See Staff Accounting Bulletin No. 92, Topic 5-Y, Accounting and Disclosures Relating to Loss Contingencies (discussed infra Section 2.3). Thus, if a loss contingency meets the requirements of SFAS No. 5, a company must take an accrual, with a corresponding asset being recorded for recovery if the claim for recovery is probable of realization. According to SAB 92, separate presentation of the gross accrual and the related claim for recovery “most fairly presents the potential consequences of the contingent claim on the company’s resources.” Id. at 4; see also Remarks of Richard Y. Roberts, Commissioner of the SEC, Environmental Liability Disclosure Update, delivered at the New Jersey Institute for Continuing Legal Education on May 5, 1995 (“separate display of a claim for indemnification or contribution will lead to a more rigorous consideration of the uncertainties affecting realization of that claim”); Statement of Position 96-1 of the American Institute of Certified Public Accountants (“AICPA”) at 56 (“[t]he staff believes that separate 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”).

2.2 SOP 96-1.

In October 1996, the AICPA published Statement of Position 96-1, Environmental Remediation Liabilities (“SOP 96-1”). In issuing SOP 96-
1, the AICPA sought to improve and make more uniform the manner in which existing authoritative accounting literature is applied with regard to measuring and disclosing environmental remediation liabilities. The statement expressly excludes from its purview accounting guidance for costs associated with operational pollution control technology, site restoration triggered by the cessation of operations or voluntary site remediation not resulting from a third-party claim or litigation. Further, the guidance does not address the recognition of liabilities of insurance companies with respect to unpaid claims or asset impairment.

The statement is organized in chapters: chapters 1 through 4 provide a narrative of major federal legislation addressing pollution control and remediation; chapters 5 through 7 address the recognition, measurement and disclosure of a registrants’ remediation liabilities. Despite its great length, SOP 96-1 offers few new insights, but serves as a useful compendium of existing legislative authority and guidance. SOP 96-1 clarifies that a company should not discount an environmental remediation liability unless the aggregate amount of the liability and amount and timing of payments in connection with the liability are fixed or reliably determinable.

An instructive passage, set forth in Appendix B, is an illustrative case study analyzing appropriate accounting treatment for various stages of an environmental investigation and remediation. The passage shows how accruals for environmental remediation liability should be reevaluated and adjusted after certain “recognition benchmarks,” such as completion of a feasibility study or issuance of a record of decision.

2.2.1. EPA Environmental Accounting Project.
In 1992, the EPA created an Environmental Accounting Project to “encourage and motivate business to understand the full spectrum of their environmental costs, and integrate these costs into decision-making.” The EPA partnered with the Tellus Institute, a non-profit environmental research and consulting organization, to maintain and further develop tools and documentation on environmental accounting. In April 1992, the EPA’s Pollution Prevention Program launched the Environmental Management Accounting (“EMA”) international website, which was designed to be a comprehensive source for articles, research and education regarding environmental accounting. (www.emaweb.org, last visited Mar. 21, 2007; down for maintenance as of March 7, 2008). Though the EMA website appears to be no longer active, the EPA maintains a separate website entitled "Environmental Accounting," available at http://www.epa.gov/oppt/library/pubs/archive/acct-archive/resources.htm. In addition, the International Federation of Accountants released a guideline in August 2005 on environmental management accounting. See International Guidance Document: Environmental Management Accounting, available at http://www.ifac.org/Members/DownLoads/IFAC_Guidance_doc_on_EMA_FINAL.pdf.

2.2.2. Governmental Accounting Standards Board – Pollution Remediation Obligations.

On December 1, 2006, the Governmental Accounting Standards Board, an organization which establishes accounting standards for state and local governments, issued Statement No. 49, Accounting
and Financial Reporting for Pollution Remediation Obligations, which provides guidance to state and local governments regarding how and when to measure and report the costs associated with pollution cleanup obligations. The document is available at http://www.gasb.org/news/nr120106.html.

2.3 SAB 92.

In 1993, the SEC published Staff Accounting Bulletin No. 92, Topic 5-Y, Accounting and Disclosures Relating to Loss Contingencies (“SAB 92”). SAB 92 is an interpretation of generally accepted accounting principles (“GAAP”) with regard to contingent environmental liabilities, and “was intended to promote the timely recognition of contingent losses and to address the diversity in practice with respect to the accounting for and disclosure of contingent liabilities.” Under SAB 92, contingent environmental losses must be accrued by a charge to income if it is probable that a liability has been incurred and if the amount of the liability can be estimated.

SAB 92 is organized in a series of questions and interpretative responses, summarized as follows:

(1) Offsetting losses and recoveries should be represented on the balance sheet separately rather than netted because this “most fairly represents the potential consequences of the contingent claim on the company's resources.” SAB 92 at 4.

(2) With respect to joint and several liabilities for a contaminated site, if there is a reasonable method of apportioning the costs, and it is probable that the other PRPs will contribute, then the registrant
need only recognize the estimate of its portion of the liability. A note on the uncertainties relating to contributions by other PRPs may be necessary.

(3) Liabilities should be estimated based on present facts and existing technology, while also considering all other available information, including future circumstances such as the effects of inflation. Even before a detailed remediation study is performed, costs relating to alternative remediation strategies may be available or reasonably estimable. If management is able to determine that the amount of a liability is likely to fall within a range, and no amount within that range can be determined to be the better estimate, the registrant should recognize the minimum amount of the range.

(4) If registrants discount estimates of liabilities, the rate used to discount the expected payments should be the rate that will produce an amount at which the environmental liability could be settled in an arm’s length transaction; if that rate cannot be determined, a rate no greater than the risk-free rate should be used.

(5) Detailed disclosures regarding material environmental loss contingencies must be furnished in the notes to financial statements to prevent those financial statements from being misleading.

(6) With respect to disclosures regarding loss contingencies outside of financial statements, Items 101, 103, and 303 of Regulation S-K provide guidance.
(7) Site restoration costs or other environmental exit costs should be disclosed in the notes to financial statements.

(8) During the life of an asset, it is permissible to accrue costs that will be incurred after the useful life of the asset provided the costs are reasonably estimable.

2.4 **SOP 94-6.**

In 1994, the AICPA issued Statement of Position 94-6, *Disclosure of Significant Risks and Uncertainties* (“SOP 94-6”), which sets forth disclosure requirements relating to loss contingencies that could significantly affect the amounts reported in financial statements in the “near term” (defined as a period of time not to exceed one year from the date of the financial statement). SOP 94-6 lists environmental remediation-related obligations and litigation-related obligations as examples of loss contingencies that may be based on estimates that are particularly sensitive to change in the near term. The disclosure requirements in SOP 94-6 apply if (i) due to one or more future confirming events, it is reasonably possible that an estimate of the effect of a loss contingency that existed at the date of a financial statement will change in the near term and (ii) the change in the estimate would have a material effect on the financial statement. If these conditions are met, a company must disclose the nature of the uncertainty and the reasonable possibility that a change in estimate will occur in the near term.

2.5 **FASB Project to Revise Reporting and Disclosure Requirements for Loss Contingencies under SFAS No. 5.**
The FASB is in the process of revising reporting and disclosure requirements for loss contingencies under SFAS No. 5. At a September 2007 meeting, the FASB voted to add to its agenda a project to reconsider comprehensively the accounting for contingencies, as currently provided for in SFAS No. 5, which the FASB viewed as necessary because existing recognition criteria for contingent liabilities in SFAS No. 5 results in delayed recognition of liabilities and because the disclosure criteria in SFAS No. 5 was viewed as inadequate. The project ultimately could result in the adoption of “fair value” measurement (discussed below in Section 2.6) for all contingent liabilities. See Minutes of the September 6, 2007 Board Meeting—Accounting for Contingencies (Sept. 18, 2007), available at http://fasb.org/board_meeting_minutes/09-06-07_contingencies.pdf.

The FASB split the project into two components: (i) an interim project to expand disclosures and (ii) a long-term reconsideration of recognition and measurement of contingencies to be coordinated with the ongoing convergence of U.S. accounting standards with International Financial Accounting Standards issued by the International Accounting Standards Board (“IASB”) (discussed infra in Section 2.9).

Although the FASB has not yet proposed comprehensive changes to the recognition and measurement standards of SFAS No. 5, in June 2008, the FASB released an Exposure Draft of a proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies, which would significantly expand the quantitative and qualitative footnote disclosure requirements for loss contingencies under SFAS No. 5 and would also apply to contingent environmental liabilities. However, due to an overwhelming number of comment letters expressing concerns
regarding the potential prejudicial impact of the increased disclosure requirements on pending litigation, on September 24, 2008, the FASB decided to reconsider the June exposure draft and test an alternative model addressing the concerns raised by commentators. The FASB indicated that any final FASB statement on the topic would not be effective sooner than for fiscal years ending December 15, 2009. See FASB, Project Update: Disclosure of Certain Loss Contingencies, available at http://www.fasb.org/project/accounting_for_contingencies.shtml.

2.6 Fair Value Measurements.

In September of 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (“SFAS No. 157”), which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. See SFAS No. 157, available at http://www.fasb.org/pdf/fas157.pdf. The Statement is intended to create greater consistency and comparability in fair value measurements and to foster expanded disclosures about fair value measurements. SFAS No. 157 applies to a broad array of FASB pronouncements that utilize “fair value” as a measurement, including asset retirement obligations in accordance with FAS 143, business combinations in accordance with SFAS No. 141(R), and indemnity obligations in accordance with FASB Interpretation No. 45.12

12 FASB Interpretation No. 45, Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, clarifies that “a guarantor is required to recognize, at the inception of the guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee.”
SFAS No. 157 defines fair value generally as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a fair value analysis hierarchy that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to data that is not observable by market participants and reflects the reporting entity’s own assumptions based on the best information available to it, which might include its own data.\textsuperscript{13} Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy.\textsuperscript{14} In addition, whereas under SFAS No. 5, liabilities may be recognized at the low end of a range of estimates if no number within the range is a better estimate, under a fair value analysis, probabilities of various outcomes must be weighed and factored to arrive at the point within the range that is most representative of fair value under the circumstances. As a result, fair value estimates may often be higher than estimates that result from the application of SFAS No. 5.

SFAS No. 157 became effective for financial assets and liabilities on November 15, 2007, and for certain nonfinancial liabilities (including asset retirement obligations) on November 15, 2008. See Staff Position FAS 157-2, Effective Date of FASB Statement No. 157.

\textsuperscript{13} SFAS No. 157 provides that a company must supplement its own data with information about market participant assumptions that is reasonably available without “undue cost and effort.”

\textsuperscript{14} In January 2008, the FASB proposed guidance on the measurement of liabilities in accordance with SFAS No. 157. See FASB Staff Position FAS 157-c, Measuring Liabilities under FASB Statement No. 157. At its February 25, 2009 meeting, the FASB voted to revise the Staff Position, which relates in part to the appropriate level to categorize a liability within the fair value hierarchy, with the proposed guidance becoming effective for periods beginning after July 1, 2009.
There has been a fair amount of criticism of the application of SFAS No. 157 to nonfinancial liabilities (which include many environmental liabilities), due to the difficulties and uncertainties in calculating fair value for such liabilities. Despite the criticism, the FASB and SEC have continued to express support for fair value measurement. See FASB Chairman Robert H. Herz Testifies on Mark-To-Market Accounting, available at http://www.fasb.org/news/nr031209.shtml; Robert H. Herz and Linda A. MacDonald, Some Facts about Fair Value, FASB Understanding the Issues (May 2008), available at http://72.3.243.42/articles&reports/uti_fair_value_may_2008.pdf. In 2008, the SEC completed a study on fair value measurement, which acknowledged that there have been some difficulties applying fair value standards, but emphasized that they should not be suspended. See Office of the Chief Accountant and Div. of Corporation Finance, Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting (Dec. 30, 2008), available at http://www.sec.gov/news/studies/2008/marktomarket123008.pdf. In response to the SEC’s study, in February 2009, the FASB announced the addition of new FASB agenda projects to improve (i) the application guidance used to determine fair value and (ii) disclosure of fair value estimates. See FASB Initiates Projects to Improve Measurement and


2.7 SFAS No. 143.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations (“SFAS No. 143”). SFAS No. 143, which became effective for fiscal years beginning after June 15, 2002, affects how companies recognize and measure legal retirement obligations resulting from the acquisition, construction or normal operation of tangible, long-lived assets (such as utility plants, mines, landfills, and transformers). SFAS No. 143 requires companies to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be determined. Thus, a company that has a legal obligation to perform decontamination activities when a facility (or a portion of a facility) ceases to operate would have an asset retirement obligation that must be recognized as a liability and measured for fair value. The costs associated with the recognition of the asset retirement obligation are capitalized and depreciated over the expected life of the asset.

There is some uncertainty regarding the extent to which clean-up obligations are subject to SFAS No. 143. Remediation obligations resulting from normal, “proper” operations (e.g., disposal of telephone poles or other contaminated equipment or fixtures) are subject to SFAS No. 143. SFAS No. 143, however, does not apply to legal obligations resulting from the “improper” operation of an asset, such as an oil spill, which instead would be subject to SOP 96-1. It is debatable whether all spills result from “improper” operations (and thus would be subject to
SOP 96-1) or whether some spills result from the “proper” operation of an asset (and thus would be subject to SFAS No. 143).  

SFAS No. 143 does not apply to asset retirement obligations that are “immaterial.” The FASB has not provided further guidance with respect to this materiality threshold.

2.7.1. FIN 47.

On March 30, 2005, the FASB published an interpretation (“FIN 47”) clarifying the standards governing asset retirement. See FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143, available at http://www.fasb.org/pdf/fin%2047.pdf. FIN 47 clarifies that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of SFAS No. 143. Accordingly, FIN 47 requires companies to recognize and report future environmental liabilities upon the retirement of a related asset. The ability of a company indefinitely to defer settlement of the obligation or the ability of a company to sell the asset prior to its retirement would not relieve the company of recognizing the obligation.

FIN 47 includes several illustrative examples, including the purchase of a building containing asbestos-containing materials, for which regulations are in place requiring special handling and

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disposal of the asbestos upon renovation or demolition. According to the example, the asset retirement obligation occurs when the company purchases the building. The ability of the company to abandon the factory does not relieve the company of the obligation as “no building will last forever.” Similarly, the ability of the company to sell the factory does not relieve the company of its obligation, as the sale would transfer the obligation to another entity and that transfer would affect the selling price. Therefore, the company should recognize the asset retirement obligation upon acquisition of the factory, assuming that the fair value of the special handling and/or disposal is reasonably estimable.

FIN 47 indicates that the fair value of an asset retirement obligation can be reasonably estimated if (1) the purchase price of an asset reflects the fair value of the obligation (e.g., a negotiated purchase price reduction, or the use of indemnities or insurance to transfer environmental risk), (2) there is an active market for the transfer of the obligation, or (3) there is sufficient information to calculate the expected present value of the liability (if necessary, using a probabilistic weighted average of possible outcomes).

FIN 47 does not require immediate recognition of a liability if a fair value determination cannot be made. In such a situation, FIN 47 requires the financial statement to describe the obligation, explain that the liability has not been recognized, and provide the reason why the fair value is not presently reasonably estimable.

FIN 47 expressly requires companies to identify all asset retirement obligations and directs affected companies to take a
one-time cumulative accounting charge to net income to true up their books. FIN 47, which became effective no later than December 15, 2005 (for fiscal year companies) and December 31, 2005 (for calendar year companies), has been the subject of significant criticism from industry. Some commentators have speculated that FIN 47 creates an incentive for companies to sell-off properties that face large asset retirement obligations.

It has been noted that the effect of FIN 47 on financial statement disclosure has varied - even among companies in the same industry - with some companies recording significant charges as a result of asset retirement obligations17 and others stating that their obligations are not estimable or material.18 Recent SEC Comment Letters indicate that the SEC has been requiring companies to provide additional disclosure regarding their analysis of asset retirement obligations in light of FIN 47, in particular where

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companies have indicated that such obligations are not estimable. See, e.g., SEC Comment Letter, Alon USA Energy, Inc. (Sept. 25, 2007); SEC Comment Letter, Autocam Corp. (Nov. 29, 2006), see also http://www.advancedenvironmentaldimensions.com/sec_comments.htm (listing SEC comment letters that address conditional asset retirement obligations).

2.7.2. **FAS 143-1**.

In June 2005, the FASB issued a Staff Position under SFAS No. 143 to provide guidance on the accounting impact of electronic equipment waste disposal obligations under Directive 2002/96/EC on Waste Electrical and Electronic Equipment (the “WEEE”), adopted by the European Union in January 2003, which effectively obligates a commercial user to incur costs associated with the retirement of a specified asset that qualifies as “historical” waste equipment (i.e., products on the market on or prior to August 13, 2005). FAS 143-1 clarifies that a commercial user should apply the provisions of SFAS No. 143 to the obligation associated with historical waste and that the ability or intent of the commercial user to replace the asset and transfer the obligation does not relieve the user of its present duty or responsibility to settle the obligation. See FASB Staff Position No. FAS 143-1, *Accounting for Electronic Equipment Waste Obligations* (June 8, 2005).\(^\text{19}\)

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\(^{19}\) A related directive, *Directive on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment*, 2002/95/EC[1] (commonly referred to as “RoHS”), adopted...
2.8 **SFAS No. 141(R).**

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141, *Business Combinations (Revised 2007)* (“SFAS No. 141(R)”), which changes the requirements for how an acquirer in a business combination recognizes in its financial statements the assets acquired, the liabilities assumed, and any non-controlling interest in the target. SFAS No. 141(R) applies to all transactions in which an acquirer obtains control of a businesses, including combinations achieved without the transfer of consideration. SFAS No. 141(R) does not apply to the formation of a joint venture; an asset purchase where the assets do not constitute a “business”; a business combination between entities under common control; or transactions in which the acquirer is a not for profit organization. SFAS No. 141(R) became effective for transactions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

The prior version of the business combination rule (SFAS No. 141) permitted deferred recognition of pre-acquisition contingencies until the recognition criteria for SFAS No. 5 were met. As revised in 2007, SFAS No. 141(R) required that all contractual contingencies and all noncontractual contingencies that are “more likely than not” to give rise to an asset or liability as defined in FASB Concepts Statement No. 6.

Footnote continued from previous page

in February 2003 by the European Union and effective on July 1, 2006, restricts the use of certain hazardous materials in the manufacture of various types of electronic and electrical equipment. The revision of SFAS No. 141 was part of a joint project of the FASB and the IASB, the objective of which was to develop a single standard of accounting for business combinations. For its part, the IASB issued a revised IFRS 3. The joint project is another example of the movement toward a convergence of global accounting standards. See infra Section 2.8.
Elements of Financial Statements (Dec. 1985), be measured and recognized at their fair values as of the acquisition date. If the more-likely-than-not criterion is not met at the acquisition date, the acquirer instead accounts for the non-contractual contingencies in accordance with SFAS No. 5 and other applicable GAAP.

As a result, under SFAS No. 141(R) as issued in 2007, acquirers may have had an obligation to record contingent environmental liabilities that were not previously accounted for by sellers under SFAS No. 5. Even if previously accounted for by sellers pursuant to SFAS No. 5 (which permits recognition of a liability at the low end of a range when no amount within the range can be determined to be the better estimate), it is possible that acquirers may have been required to record higher estimates based on the fair value measurement pursuant to SFAS No. 141(R).

The 2007 version of SFAS No. 141(R) also expanded footnote disclosure requirements for liabilities arising from contingencies and required companies to disclose (i) the amounts recognized at the acquisition date (or an explanation as to why no amount was recognized), (ii) the nature of

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21 Concepts Statement No. 6 provides that assets are “probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events” and that liabilities are “probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.”

both recognized and unrecognized contingencies, and (iii) an undiscounted 
estimate of the range of outcomes for both recognized and unrecognized 
contingencies (or an explanation as to why a range cannot be estimated).

In response to concerns by auditors, preparers and lawyers regarding the 
difficulty in applying SFAS No. 141(R) to contingencies and the potential 
prejudicial effect on litigation contingencies, on February 25, 2009, the 
FASB voted to issue FASB Staff Position FAS 141(R)-a, *Accounting for 
Assets Acquired and Liabilities Assumed in a Business Combination that 
Arise from Contingencies*, which amends the provisions in SFAS No. 
141(R) related to the initial recognition and measurement, subsequent 
measurement and disclosure of assets and liabilities arising from 
contingencies in business combinations. FASB Staff Position FAS 
141(R)-a represents a significant retreat from the application of fair value 
accounting for contingencies in business combinations and reverts to 
language in the prior SFAS No. 141, which requires such contingencies be 
recognized at fair value on the acquisition date only if fair value can be 
“reasonably estimated.” If fair value cannot be reasonably estimated, a 
company should measure the asset or liability in accordance with SFAS 
No. 5 and FASB Interpretation No. 14, *Reasonable Estimation of the 
Amount of a Loss*. In addition, at the February 25, 2009 meeting, the 
FASB decided to remove the accounting guidance for assets and liabilities 
arising from contingencies from SFAS No. 141(R) and revert essentially 
to the prior guidance in SFAS No. 141. Finally, the FASB amended the 
disclosure requirements in SFAS No. 141(R) to eliminate a requirement to 
disclose an estimate of the range of outcomes of recognized contingencies 
at the acquisition date. For unrecognized contingencies, the FASB
decided that entities need only make the disclosures required by SFAS No. 5 and that those disclosures be included in the business combination footnote.

The FASB plans to issue the final FASB Staff Position FAS 141(R)-a in March 2009. The final FASB Staff Position FAS 141(R)-a will have the same effective date as SFAS No. 141(R) and will therefore be effective for all business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

2.9 Foreign Private Issuers and Convergence of Global Accounting Standards.

Foreign private issuers may prepare financial statements in accordance with either GAAP or another comprehensive body of accounting standards (such as International Accounting Standards (“IAS”)). Until recently, a foreign private issuer that used accounting standards other than GAAP was required to provide an audited reconciliation to GAAP. However, in December 2007, the SEC adopted amendments that, subject to certain conditions, permit foreign private issuers to file financial statements prepared in accordance with International Financial Accounting Standards (“IFRS”) as issued by the IASB without reconciliation to GAAP. See SEC Release No. 33-8879 (Dec. 21, 2007). IFRS are currently required or permitted to be used in more than 100 countries.

The amendments are part of recent moves by the SEC and other standard setting bodies toward a convergence of accounting standards into one global standard and reflect the increasing use of IFRS outside the U.S. In recognition of the latter, in 2007 the SEC issued a concept release seeking
input regarding the nature and extent of the public’s interest in giving U.S. issuers the option to file with the SEC financial statements prepared in accordance with IFRS as published by the IASB. See SEC Release No. 33-8831 (Sept. 13, 2007).23


However, the Roadmap requires significant improvements in IFRS and the achievement of certain milestones before the SEC would require reporting. Id. In addition, Mary Schapiro, President Obama’s newly appointed SEC Chairman, expressed concerns during her confirmation hearing about the

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23 In another move toward the adoption of a global standard, the Canadian Accounting Standards Board recently confirmed that IFRS would replace Canada’s GAAP as the required standards for listed companies and other profit-oriented enterprises that are responsible to large or diverse groups of stakeholders. The official changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. See Canadian Accounting Standards Board Confirms Changeover Date to IFRS (Feb. 13, 2008), available at http://www.acsbcanada.org/download.cfm?ci_id=43289&la_id=1&re_id=0.
mandatory use of IFRS in the United States based on both the cost to U.S. reporting companies and the principles-based nature of IFRS accounting standards. *Nomination Hearing before the S. Comm. on Banking, Housing and Urban Affairs*, 11th Cong. (2009) (testimony of Hon. Mary Schapiro). Therefore, the ultimate adoption of IFRS for U.S. reporting companies and the timing thereof remain uncertain.

2.10 **Restating Financial Information.**

An obligation to restate financial information disclosed to the SEC may arise if information was not disclosed in accordance with Regulation S-K or any applicable accounting standard. For example, in connection with due diligence undertaken in the acquisition of Millennium Chemicals Inc. ("Millennium"), it was discovered that errors had been made in recording estimated liabilities for future environmental remediation costs associated with Millennium’s existing obligations, primarily related to a single site. **See** C. Gregory Rogers, *Environmental Disclosure Due Diligence: Taking the Next Step in Environmental Due Diligence*, ABA SECTION OF ENV., ENERGY AND RESOURCES: 36TH CONFERENCE ON ENVIRONMENTAL LAW 1-2 (Mar. 8-11, 2007), available at [http://www.abanet.org/environ/programs/keystone/2007/finalcomments/Rogers.pdf](http://www.abanet.org/environ/programs/keystone/2007/finalcomments/Rogers.pdf). In 2005, the board of Millennium determined to correct the errors by increasing its recorded liabilities for environmental remediation by $59 million in a restated Form 10-K including restated financial statements for the years ended December 31, 2001 through 2003. **Id.** More recently, General Motors, as part of a restatement of its consolidated financial statements and financial information for 2002 through the third quarter of 2006, recorded adjustments to its earnings and retained earnings
for 2004 and 2005 to reflect properly obligations for ongoing environmental operation and maintenance costs for certain of its sites. See General Motors Corp. Annual Report for Fiscal Year Ended December 31, 2006 on Form 10-K, available at http://sec.gov/Archives/edgar/data/40730/000095012407001502/k11916e10vk.htm; see also http://www.advancedenvironmentaldimensions.com/restatements.htm (listing restatements reported to the SEC that concern environmental matters and/or asset retirement obligations).


In recent years, the SEC has shown increased willingness to review financial disclosure relating to environmental matters. See SEC v. James Charles Blue, Litigation Release No. 19969 (Jan. 17, 2007) (SEC alleged that senior executives of a subsidiary of ConAgra Foods Inc. engaged in improper accounting practices, including reducing legal and environmental reserves to offset losses in other areas and to boost earnings during 2000 and 2001, and thereby caused ConAgra to make false and misleading statements in its periodic filings); In re Ashland Inc. & William C. Olasin, Exchange Act Release No. 54830 (Nov. 29, 2006) (SEC issued a cease and desist order against Ashland after an Ashland executive reduced cost estimates from 1999 to 2001 for environmental remediation obligations without any reasonable basis, leading to a reduction in Ashland’s environmental reserves and an increase in its net income); SEC v. Safety-Kleen Corp., Litigation Release No. 18555, Jan. 28, 2004 (SEC announced a final judgment against former senior executives of Safety Kleen who materially overstated Safety-Kleen’s

3. The Impact of the Sarbanes-Oxley Act and CEO/CFO Certification on Environmental Disclosures.

Although the 2002 Sarbanes-Oxley Act did not expressly address environmental disclosure requirements, it may have resulted in increased or more timely and accurate environmental disclosure based on the Act’s required internal controls and procedures to ensure accuracy of disclosure and senior management certification as to the material accuracy of disclosure and financial statements. The Sarbanes-Oxley Act mandates that CEOs and CFOs make certain certifications to accompany their company's periodic and annual reports filed with the SEC under Sections 906 and 302, respectively. The Section 906 certification must state that any periodic report containing financial statements fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act and that information contained in the periodic report fairly presents, in all material

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respects, the financial condition and results of operations of the issuer. The certification as to the compliance of such periodic report with the requirements of Section 13(a) or 15(d) of the Exchange Act is not qualified as to materiality.

Section 302 and rules promulgated by the SEC pursuant to the Sarbanes-Oxley Act require the CEO and the CFO to make certain certifications in each annual and quarterly report. In general, the CEO and CFO (or persons performing similar functions) are required to certify that:

- he or she has reviewed the report being filed;
- based on his or her knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact;
- based on his or her knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition, results of operations and cash flows of the company;
- he or she is responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the company and having such disclosure and internal control systems periodically evaluated;
- the disclosure controls and procedures ensure that material information relating to the company is made known to them by others with sufficient speed to allow “timely” decisions regarding disclosure; and
- the internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

The SEC expressly required that public companies adopt and maintain controls and procedures to ensure adequate and timely SEC disclosures. See
http://www.advancedenvironmentaldimensions.com/control_deficiencies.htm
(listing control deficiencies reported to the SEC pursuant to Section 404 of the Sarbanes-Oxley Act that concern environmental matters). In In Re Ashland Inc. & William C. Olasin, Ashland Inc.'s Director of Environmental Remediation, William Olasin, reduced the cost estimates from 1999 to 2001 for remediating environmental contamination at dozens of chemical and refinery sites for which Ashland had responsibility. Ashland used those estimates to determine its environmental reserves, which Ashland disclosed in the periodic reports that it filed with the SEC. Securities Exchange Act of 1934, Release No. 54830 (Nov. 29, 2006). Olasin was found to have had no reasonable basis for reducing these cost estimates, which had been developed by a team of Ashland engineers, an outside consultant, and a computer program. The SEC issued a cease and desist order against Ashland after it concluded that Ashland's process for setting its environmental reserve did not establish adequate guidelines for, or require documentation or review of, adjustments to environmental cost estimates, and therefore, its system of internal accounting was insufficient.

The new SEC rules may encourage companies to re-examine their environmental reporting systems because senior management must now certify that (1) the environmental disclosures comply with periodic and annual disclosure requirements and (2) any environmental liabilities are appropriately reflected in the financial statements in accordance with GAAP. The potential criminal penalties for a false certification under Section 906 (a $5 million fine and up to 20 years imprisonment for a willful violation) should provide a strong incentive to ensure that there is a well-documented system to ensure the accuracy of environmental disclosures and appropriate consideration and accounting treatment of potential environmental liabilities.
The Sarbanes-Oxley Act also directed the SEC to adopt minimum federal standards of conduct for attorneys who appear and practice before the SEC, including attorneys involved in preparing SEC disclosure. 15 U.S.C. § 7245. These rules impose a duty on both outside and in-house counsel to report material violations of securities law that come to be known by counsel “up-the-ladder” to the chief legal officer, chief executive officer, audit committee or board. See SEC Release No. 33-8185. Such up-the-ladder reporting would require reporting of any material misstatements in the disclosure of environmental liabilities.

4. SEC Enforcement Actions, Shareholder Lawsuits and Shareholder Petitions Alleging Material Environmental Nondisclosure.

4.1 SEC Enforcement of Environmental Disclosure Requirements.

SEC enforcement actions relating to environmental disclosure requirements in Regulation S-K have been relatively scarce. In recent years, the SEC has stepped up its enforcement of environmental disclosure requirements and accounting standards in financial statements. See supra Section 2.11.

In 1977, the SEC filed a complaint against Allied Chemical Corporation (“Allied”) alleging violations of antifraud and filing provisions of Section 10(b) and Section 13 of the Exchange Act for failure to disclose material potential liability related to releases of a toxic chemical into the environment. SEC v. Allied Chem. Corp., Litigation Release No. 7811, 1977 SEC LEXIS 2280 (Mar. 4, 1977). The SEC found that Allied knew at the time of the releases that the chemical caused adverse effects in animals, and therefore concluded that Allied was exposed to material potential liabilities related to the releases. Id. Allied consented to a
permanent injunction from further violations of the antifraud provisions. 

In addition, Allied performed an investigation of the material environmental risks and uncertainties associated with its business and agreed to provide the Commission with information on corrective actions taken by the company to improve environmental disclosures. 

In 1979, the SEC brought an enforcement action against United States Steel Corporation (“U.S. Steel”) for failure to comply with Section 13 of the Exchange Act and applicable rules relating to environmental disclosures. In re United States Steel Corp., Exchange Act Release No. 16,223, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) 82,319, at 82,383 (Sept. 27, 1979). The SEC found that U.S. Steel had failed to disclose estimates of future environmental compliance costs, some of which involved material capital expenditures, as well as communications from government agencies indicating that enforcement actions were contemplated for Clean Air Act violations. Furthermore, the SEC found that U.S. Steel had not adequately disclosed its environmental policy of “actively resisting environmental requirements which it maintained were unreasonable” by minimizing and delaying capital expenditures for compliance. The SEC found that this environmental policy exposed U.S. Steel to “certain risks including the possibility of substantial civil and criminal penalties.” Rather than describing its active resistance policy and the associated risks, U.S. Steel stated in an annual report that it “had pledged to resolve its environmental problems as effectively and efficiently as technology, time and money permit.” In finding that this disclosure was inadequate, the SEC stated that corporations are not generally required to disclose their environmental
policies, but any voluntary disclosures must be accurate and comprehensive. Id. Moreover, companies with environmental policies that are reasonably likely to result in substantial penalties or other significant effects may need to disclose the likelihood and magnitude of such penalties and other material effects. Id. U.S. Steel agreed to comply with environmental disclosure requirements in future filings, amend its previous filings as needed and improve its internal system for evaluating environmental information. Id.

In a 1980 enforcement action against Occidental Petroleum Corporation (“Occidental”), the SEC found that Occidental failed to disclose material environmental information in violation of Section 13 of the Exchange Act. In re Occidental Petroleum Corp., Exchange Act Release No. 16,950, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,622, at 83,356, 1980 SEC LEXIS 1158 (July 2, 1980). The Commission found that Occidental did not make certain required disclosures concerning (i) pending or contemplated judicial and administrative proceedings related to contamination, (ii) potential liabilities related to specific offsite waste disposal sites, and (iii) the effects of compliance and past non-compliance with environmental laws upon capital expenditures and earnings. Id. at *37-39. In an annual report, Occidental had stated that “there can there can be no assurance that Occidental will not incur material liabilities in the future as a consequence of the impact of its operations upon the environment.” Id. at *19-20. However, the SEC found that this language did not adequately disclose material potential liabilities associated with specific offsite waste disposal sites and noted that Occidental had not disclosed the amount, nature or extent of its potential liabilities. Id.
Occidental agreed to amend its previous filings and comply with the disclosure requirements of the Exchange Act in future filings, in part by improving its internal mechanism for evaluating environmental risks associated with its business. *Id.* at *41-46.

In *In re Lee Pharmaceuticals*, 66 SEC Docket at 2133-20 (Apr. 9, 1998), the SEC issued a cease and desist order to Lee Pharmaceuticals (“Lee”), a manufacturer of dental and cosmetic products, for materially understating its “environmental responsibilities” in several annual filings. In 1988, the California Regional Water Quality Control Board (“Water Board”) ordered Lee to further investigate soil and groundwater contamination that had been identified on Lee’s property. In 1989 and 1990, Lee’s consultant conducted additional sampling and furnished Lee with an estimate of $465,200 for investigation and cleanup costs. Lee’s management, however, believed this estimate to be “unreliable” and disclosed in its 1991 10-K only that the company had identified “some potential contamination” and that the investigation was inconclusive. After further tests conducted in 1991 confirmed the contamination, the Water Board issued a “cleanup order” to Lee. Despite the Water Board’s order and a $700,000 claim that Lee was pressing against its insurance carrier in connection with the order, Lee again stated in its 1992 10-K that it had no information about the estimated cleanup costs. In addition, during 1991, Lee was named by EPA as a PRP at the San Gabriel Superfund Site. In its 1992 10-K, Lee inaccurately stated that the contamination at the San Gabriel site “was sufficiently low that the EPA was not currently requiring a cleanup.” The SEC found that Lee “materially understated its environmental responsibilities” by not disclosing that it was a PRP at the
San Gabriel site or that it had received a cleanup order from the Water Board with respect to its own site. The SEC ruled that even though its response costs had not yet been determined, Lee had a duty to disclose a reasonable estimate of such costs.

4.2 Shareholder Lawsuits.

In Grossman v. Waste Management, Inc., shareholders brought a class action, alleging that various problems defendant had encountered with environmental authorities should have been disclosed under Rule 10b-5, especially in light of the fact that Waste Management had explicitly touted its environmental record. See 589 F. Supp. 395, 409-410 (N.D. Ill. 1984). For instance, in the company’s 1981 annual report, Waste Management stated that it “set the standards for the entire industry” for environmental excellences and that the growth of the company largely resulted from “environmentally sound handling of a broad range of materials.” Id. at 410. The district court denied the defendant’s motion for summary judgment, holding that a question of fact remained as to whether the prospectuses and reports upon which plaintiffs relied had disclosed all material information regarding environmental issues. See id. at 409-412; see also United Paperworkers Int'l v. Int'l Paper Co., 985 F.2d 1190 (2d Cir. 1993) (company issued misleading statements regarding its environmental record); cf. Gannon v. Continental Insurance Co., 920 F. Supp. 566, 580 (finding that company’s failure to disclose the reasoning behind its environmental reserve policy was not material because the company did not comment on the quality of the policy, but merely described what it was); Anderson v. Abbott Lab., 140 F. Supp. 2d 894 (finding that in the absence of explicit favorable claims regarding, or in
reference to, its environmental record or regulatory issues, Abbott did not have to disclose potential FDA violations).

In In re AES Corporation Securities Litigation, shareholders brought a class action alleging that AES Corporation (“AES”) and a number of its officers, directors and underwriters made false and misleading statements in prospectuses associated with public stock offerings. In re AES Corp. Sec. Litig. 825 F. Supp. 578 (S.D.N.Y. 1993). The statements at issue generally proclaimed AES’ commitment to social responsibility, leadership in environmental compliance and emphasis on clean power production. Id. at 581-82. The plaintiffs also claimed that AES’ statements regarding operations at certain sites were materially false and misleading because of undisclosed environmental permitting and compliance issues that would have negatively affected stock prices had they been disclosed. Id. After the public stock offerings, AES disclosed that employees at one of its plants had been intentionally falsifying wastewater discharge reports to hide the plant’s non-compliance with applicable regulations. Id. at 583. The court differentiated between statements of opinion and belief that could not support the plaintiffs’ claims, and material misstatements and omissions that could establish a violation of Rule 10b-5. Id. at 585. In denying the defendants’ motion to dismiss, the court held that the plaintiffs successfully alleged omissions of material fact relating to the falsification of wastewater reports and permitting issues that established an inference of AES’ intent to defraud investors. Id. at 592.

In In re Union Carbide Class Action Securities Litigation, the court rejected the plaintiff shareholders’ allegations that the company’s failure
to disclose the risks of its production of methyl isocyanate (the chemical released in Bhopal, India) violated the general antifraud provisions of the securities laws and Rule 10b-5. In re Union Carbide Class Action Securities Litig, 648 F. Supp. 1322 (S.D.N.Y. 1986), aff’d in part and modified in part, In re Union Carbide Corp. Gas Plant Disaster at Bhopal, 809 F.2d 195 (2d Cir. 1987), cert. Denied, 484 U.S. 871 (1987). The district court held that the risks posed by the chemical were not material for purposes of federal securities laws and that disclosure would “overwhelm an investor with scientific and administrative facts” and “bury the shareholder in an avalanche of trivial information.” Id. at 1327.

In so holding, the court emphasized that the materiality determination should be made based on the facts available at the time of the transaction (an ex ante approach), rather than using 20-20 hindsight (an ex post approach). Id.

Similarly, in Levine v. NL Industries, Inc., the Second Circuit affirmed the lower court’s rejection of a shareholder’s Rule 10b-5 claim that the defendant corporation failed to disclose that its subsidiary operated a uranium processing facility on behalf of the Department of Energy in violation of environmental laws. Levine 926 F.2d 199 (2d Cir. 1991). The court held that any expenses in connection with such violation would not be material, as the Department of Energy was obligated to indemnify the subsidiary for all expenses incurred in complying with environmental laws. Under such circumstances, the court held that there was “no plausible way” that shareholders could suffer financially from the alleged environmental violations, and, therefore, a reasonable investor would not consider the alleged violations to be “important information significantly
altering the total mix of information made available to the investor.” Id. at 203.

More recently, six securities class action lawsuits were filed (and thereafter consolidated) against United States Liquids, Inc. See In re United States Liquids Securities Litigation, Case No. H-99-2785, 2002 U.S. Dist. LEXIS (S.D. Tex. June 12, 2002). The plaintiffs alleged that the company failed to disclose that the EPA and the FBI were investigating illegal disposal of PCBs into the Detroit sewer system from one of the company's most profitable facilities. After the EPA issued heavy fines and ordered a temporary shutdown of the facility, the company's stock price dropped by 50%. In August of 2004, the company filed a petition for bankruptcy and is now defunct. The plaintiffs’ claims against company were extinguished in the bankruptcy proceeding and the claims against three officers of the company were settled in May of 2006, with the defendants agreeing to pay $600,000 to a settlement fund.

4.3 Shareholder Petitions.

Since the late 1990's, investors, environmental organizations, public interest groups and unions have alleged frequent noncompliance with environmental disclosure requirements and called for stricter SEC enforcement of such requirements. These groups have filed a number of

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petitions with the SEC requesting that the agency investigate alleged environmental disclosure violations by individual companies. See, e.g., Petition of two institutional investors relating to Dow Chemical (Aug. 10, 2004) (alleging that the company made misleading statements during an annual shareholder meeting and omitted material information from SEC filings relating to the 1984 Bhopal, India explosion, dioxin contamination in Midland, Michigan and the chemical defoliant Agent Orange); Petition by nine institutional investors relating to Abbott Laboratories (June 28, 2001) (alleging that the company failed to disclose recent scientific findings relating to chemicals associated with the production of polyvinyl chloride plastic); Petition by Friends of the Earth relating to Scotts Company (Mar. 7, 2001) (alleging that the company failed to disclose trends in UK environmental regulations which the group contended were potentially material to the company's peat extraction business); Petition by two shareholders relating to Crown Central Petroleum (Aug. 25, 1999) (alleging that the company failed to disclose environmental penalty proceedings); Petition by United Steel Workers of America relating to Phelps Dodge (Nov. 5, 1998) (alleging that the company failed to

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adequately disclose environmental liabilities and cleanup costs associated with a contaminated site); and *Petition by Friends of the Earth, the Sierra Club and Citizen Action relating to Viacom* (Feb. 1997) (alleging that the company had inadequately disclosed its Superfund liabilities).

5. **Other Initiatives to Enhance Environmental Disclosure.**

5.1 **Non-Material Environmental Matters.**

5.1.1. **NRDC v. SEC.**

*Natural Resources Defense Council v. SEC*, 389 F. Supp. 689 (D.D.C. 1974), involved an action by an environmental group under 15 U.S.C. § 77g and the National Environmental Policy Act, 42 U.S.C. §§ 4321 et seq., to compel the SEC to require disclosures of certain environmental matters not having a material financial impact. See 389 F. Supp. at 694 (listing proposals rejected by SEC, which rejections plaintiffs contested). The district court held that the SEC had violated the procedural provisions of the Administrative Procedure Act, 5 U.S.C. §§ 551 et seq., in its rulemaking decisions on environmental disclosure. See id. at 701. The court ordered the SEC to reconsider its rules accordingly, and specifically directed the Commission to consider the possibility that “ethical investors” may have an interest in environmental information which does not necessarily have a material financial impact, and that this interest may require the disclosure of such information. See id.; see also *Roeder v. Alpha Indus., Inc.*, 814 F.2d 22, 25 (1st Cir. 1987) (assessing materiality of company's omission of bribes to contractors, court points out that management's willingness to engage in unlawful activity and
its decision to place the corporation at risk by doing so “may be critically important factors to investors”).

5.2 SEC Rejection of Requirement.

The SEC has refused to require the disclosure of non-material environmental information. For example, in rulemaking proceedings intended to respond to the NRDC opinion, the SEC rejected each of five proposals regarding the disclosure of non-material environmental information. See Securities Act Release No. 5627, Fed. Sec. L. Rep. (CCH) ¶ 80,310, at 85,706, 85,717-19 (Oct. 14, 1975) (rejecting proposals which would require comprehensive disclosure of environmental effects of corporate activities, disclosure of all pending environmental litigation, disclosure of general corporate environmental policy, and disclosure of all capital expenditures for environmental purposes); Securities Act Release No. 5704, Fed. Sec. L. Rep. (CCH) ¶ 80,495, at 86,295 (rejecting proposal which would require listing of environmental compliance reports).

The SEC has, however, indicated that the disclosure of a company's environmental policy will be required if either of two conditions exist. First, if the corporation voluntarily chooses to make disclosures concerning its environmental policy, it must make such additional disclosures concerning its policy as are necessary to prevent the voluntary disclosures from being misleading. See In re United States Steel, Fed. Sec. L. Rep. (CCH) ¶ 82,319, at 82,384. Furthermore, if a corporation has an environmental policy which is “reasonably likely” to result in “substantial” financial penalties for non-compliance, it may be necessary to disclose the likelihood and extent of such penalties to prevent the
required disclosures concerning the company's business from being misleading. See id.

5.3 Shareholder Proposals for Increased Disclosure Through Proxy Statements.27

Shareholders have successfully compelled the disclosure of non-material environmental matters through proxy statements. Rule 14a-8 under the Exchange Act requires that a registrant include valid “proposal[s] for action” from shareholders in its proxy statement. 17 C.F.R. 240.14a-8(a). However, there are a number of exceptions that permit registrants to exclude shareholder proposals from proxy materials. Using these exceptions, corporations have excluded environmental shareholder proposals from proxy materials pursuant to (i) Rule 14a-8(i)(3) and Rule 14a-8(i)(6) because the proposal is vague, indefinite and misleading; (ii) Rule 14a-8(i)(7) because it deals with a matter relating to the company’s ordinary business operations; and (iii) Rule 14a-8(i)(10) because it has been substantially implemented. See, e.g., Willamette Indus., Inc., 2001 SEC No-Act. Lexis 439 (Mar. 30, 2001), Mead Corp., 2001 SEC No-Act. Lexis 181 (Jan. 31, 2001), Potlatch Corp., 2001 SEC No-Act. Lexis 216 (Feb. 13, 2001).

In June 2005, the Corporate Finance Division of the SEC issued Staff Legal Bulletin No. 14C (the “Bulletin”) to provide greater guidance as to when a resolution calling for a company to address environmental risks is excludable under Rule 14a-8(i)(7). The Bulletin cites Securities Exchange

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27 For a discussion of shareholder proxy statements initiatives relating to disclosure of climate change-related risks, see infra Section 6.2.2(a).
Act Release No. 40018, which states that a proposal relating to ordinary business might not be excludable under Rule 14a-8(i) (7) if the proposal addressed a “sufficiently significant social policy [issue] . . .because the proposals would transcend the day-to-day business matters . . . .” The determination, as interpreted by the Bulletin, appears to turn on whether the risk addressed is internal or external to the Company:

“To the extent that a proposal and supporting statement focus on the company engaging in an internal assessment of the risks or liabilities that the company faces as a result of its operations that may adversely affect the environment or the public’s health, we concur with the company's view that there is a basis for it to exclude the proposal under rule 14a-8(i)(7) as relating to an evaluation of risk. To the extent that a proposal and supporting statement focus on the company minimizing or eliminating operations that may adversely affect the environment or the public's health, we do not concur with the company's view that there is a basis for it to exclude the proposal under rule 14a-8(i)(7).” Staff Legal Bulletin No. 14C (CF) (June 28, 2005), available at [http://sec.gov/interps/legal/cfslb14c.htm](http://sec.gov/interps/legal/cfslb14c.htm).

Thus, a shareholder proposed resolution calling for a company to disclose its policy with respect to environmental risks it faces may not be excludable under Rule 14a-8(i)(7) if the proposal could be viewed as


5.3.1. The “Valdez Principles.”

Using Rule 14a-8, shareholders interested in monitoring their corporation's environmental compliance have submitted proxy proposals that the corporation become a signatory to the “Valdez Principles.” The Valdez Principles, developed by the Coalition for Environmentally Responsible Economies, require the registrant to implement a broad range of measures designed to protect the environment, and further require periodic assessment and public disclosure of the success of those measures. These proposals have generally withstood challenges under Rule 14a-8(c), which provides bases on which proposals may be properly excluded from proxy statements by registrants. See also United Paperworkers, 985 F.2d at 1190 (affirming that International Paper Company violated Section 14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 promulgated thereunder in issuing misleading statements regarding the company’s environmental record in a proxy statement which recommended the rejection of a shareholder proposal to adopt the Valdez Principles).

5.3.2. The “Pure Profit” Report.
On the other hand, corporations were able to exclude shareholders
proposals for corporate reports assessing the environmental issues
raised in a report published by the World Resources Institute in
March 2000, entitled *Pure Profit: The Financial Implications of
Environmental Performance* (the “Pure Profit Report”). The Pure
Profit Report examined 13 leading companies in the pulp and
paper industry and concluded that pending environmental issues
will have material financial impacts and that financial exposures
vary considerably between the companies. In a companion report
published in October 2000, *Coming Clean: Corporate Disclosure
of Financially Significant Environmental Risks*, the authors
examined the 1998 and 1999 public disclosure of the 13 companies
and concluded that few of the companies disclosed any details
about the financial risks or potential impacts arising from “known
environmental uncertainties.” The shareholder proposals, which
were part of an organized shareholder campaign in connection with
the reports, sought information on liability projection methodology
and an assessment of other major environmental risks.

5.4 **The Rose Petition.**

On August 21, 2002, the Rose Foundation for Communities and the
Environment submitted a rulemaking petition to the SEC (the “Rose
Petition”). The Rose Petition requests that the SEC adopt new rules

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29 The Rose Foundation for Communities and the Environment is a 501(c)(3) non-profit public
interest organization dedicated to advancing positive intersections between the environment, the
economy and communities. 25 other charitable foundations and 7 investment companies joined
the petition. A revised petition was submitted on September 9, 2002. Except for altering the text
of the petition to refer to ASTM 2001 by reference (rather than including the text), it is identical to

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requiring enhanced environmental disclosures based on the American Society for Testing and Materials ("ASTM") 2001 Standards (the "ASTM Standards"), which were adopted by the ASTM in March 2002. See ASTM 2001 Standard Guide for Disclosure of Environmental Liabilities (E 2173) and ASTM 2001 Standard Guide for Estimating Monetary Costs and Liability for Environmental Matters (E 2137). The Rose Petition proposes that the SEC promulgate new rules that directly reference the ASTM Standards with the important modification that all of the precatory language of the ASTM Standards be changed to mandatory language. For example the proposed rule would read: “Disclosure shall be made when an entity believes its environmental liability for an individual circumstance or its environmental liability in the aggregate is material” as opposed to disclosure should be made as provided by the ASTM Standards.

According to the Rose Petition, disclosure consistent with the ASTM Standards will provide investors with standardized and improved information critical to their evaluation of the financial risk associated with a company's environmental liabilities. The proposed rules would require corporations to estimate the costs and liabilities of environmental matters using four known cost estimation methods, which include:

- “expected value”
- “most likely value”
- “range of values”

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The original petition in all material aspects. The Rose Petition is available at http://www.sec.gov/rules/petitions/petn4-463.htm.
• “known minimum value”

The Rose Petition argues that the proposed rules would minimize the circumstances in which disclosure can be avoided based on claims of uncertainty.

In addition, the proposed rules would require companies to consider the financial impact of all environmental liabilities insofar as they instruct companies to disclose when a company believes its environmental liability for an individual circumstance or its environmental liability in the aggregate is material. According to the Rose Petition, this would close one of the biggest loopholes in reporting today: piecemeal accounting of environmental liabilities. Finally, the proposed rules would create more detailed minimum requirements concerning the content of a company's environmental disclosures.

The petitioners claim that the existing SEC rules and enforcement policies are inadequate to compel disclosure of information sufficient for investors to make informed choices based on companies' records of environmental compliance. The Rose Petition cites an EPA study from 1998 that found that 74 percent of companies failed to report in their Form 10-Ks cases in which environmentally related legal proceedings could result in monetary sanctions over $100,000. The EPA study also found that only 26 percent of civil and administrative proceedings involving penalties were correctly disclosed in companies’ Form10-Ks. Moreover, only 16 percent of proceedings involving court-ordered Supplemental Environmental Projects (“SEPs”) and only 4 percent of RCRA corrective action proceedings were correctly disclosed. The Rose Petition also cites a 1993 General Accounting Office (“GAO”) report which found that disclosure of
Superfund cleanup liabilities by insurance companies was very poor and put investors at risk.

To date, the SEC has not taken any action with respect to the Rose Petition.

In July 2004, the Rose Foundation published a report detailing accounting strategies employed by corporations to limit disclosure of environmental risks and liabilities. After examining how companies account for environmental liabilities and subsequently disclose (or not disclose) those liabilities, the authors conclude that the SEC should implement the recommendations found in the 2002 Rose Petition. Sanford Lewis & Tim Little, *Fooling Investors and Fooling Themselves: How Aggressive Accounting Leads to Environmental Accounting Fraud*, available at http://rosefdn.org/downloads/Fooling%20Investors%20Report.pdf.

5.5 California State Treasurer Initiative.

In February 2004, California State Treasurer Phil Angelides launched an initiative calling on CalPERS and the California State Teachers’ Retirement System to (1) use their financial clout in pressing the SEC to strengthen environmental disclosure rules, (2) target private investment in environmental technologies, and (3) invest in stocks of environmentally responsible companies. In April 2004, CalPERS recommended that the SEC begin public hearings within six months on the reporting of environmental risks by public companies. See *The Green Wave Initiative*, available at http://www.treasurer.ca.gov/greenwave.

To date, the SEC has not responded to CalPERS’s request.

5.6 GAO Review.
In July 2004, the GAO released a report reviewing the effectiveness of the SEC’s environmental reporting requirements, the level of compliance with such requirements and the level of disclosure directed at shareholders. The GAO report concluded that key stakeholders disagree on whether environmental disclosure requirements provide too much flexibility or are too narrow in scope; it is difficult to determine whether varying levels of disclosure within industries reflect different risks faced by companies or differences in the extent to which companies are disclosing risks; the adequacy of the SEC’s efforts to monitor and enforce compliance with environmental disclosure requirements cannot be determined; and the SEC should take steps to improve the tracking and transparency of its reviews of filings and to improve its coordination with the EPA. In response to the report, the SEC started tracking its reviews of company filings to identify trends in environmental disclosures. The SEC also agreed to make comment letters and company responses available on its website.


6. Climate Change.

6.1 Climate Change – Application of Regulation S-K to Evolving Regulatory Requirements

In recent years, governments, regulators, businesses, public interest groups, educational institutions, foundations and consumers have devoted substantial resources to the issue of climate change and the legal, financial and physical risks associated with it. This focus has led to the adoption of
mandatory programs to limit greenhouse gas emissions and associated emission trading systems in a number of countries; regional, state and local initiatives in the U.S. to curb greenhouse gas emissions; and litigation seeking to require regulators to address climate change or seeking injunctive relief (such as the reduction of greenhouse gas emissions and/or the consideration of climate change in environmental permitting decisions) and/or damages allegedly resulting from greenhouse gas emissions. See generally Global Climate Change and U.S. Law (Michael B. Gerrard ed., ABA Section of Environment, Energy & Resources, 2007). Although climate risk may be material for some businesses and subject to mandatory disclosure under Regulation S-K, the disclosure of risks associated with climate change has been inconsistent and, to some extent, has been overshadowed by voluntary disclosure pursuant to guidelines issued by various groups of institutional investors and nonprofit organizations. See infra Section 6.2.2(b) for a discussion of such voluntary disclosure guidelines. One commentator lamented that “the climate change disclosure market has been largely privatized, and most of the best and most thorough reporting on climate change has been done outside disclosure mandated by the Securities Act and the Exchange Act, and through frameworks that the SEC did not participate in creating” and called for SEC guidance on climate change disclosure. See Jeffrey A. Smith, Disclosure of Climate Change Risks and Opportunities, THE REVIEW OF SECURITIES AND COMMODITIES REGULATION, Vol. 41, No. 1 (Jan. 2, 2008). A survey of climate change disclosures in the 2008 10-Ks of 350 companies found that only 12% of the companies made any climate-related disclosures, and these companies were primarily in the energy and utility industries. See Jane W. Sellers, et al., Climate Change Disclosure: Out with the Old; In with the New? (Jan. 15, 2009), available at http://www.mcguirewoods.com/news-resources/item.asp?item=3664; Ceres, Climate Risk Disclosure by the S&P 500 (Jan. 2007), available at http://www.ceres.org//Document.Doc?id=146. As discussed in Section 6.2.2(b) infra, a number of institutional investors and nonprofit organizations have called for SEC guidance or Congressional action to address climate change disclosure.
of the evolving regulatory requirements relating to climate change and examines the possible application of Item 101, Item 103 and Item 303 of Regulation S-K to climate change issues.32

6.1.1. Regulatory Requirements.

Regulatory requirements relating to climate change are evolving at international, federal, regional, state and local levels.

(a) The Kyoto Protocol. On the international level, the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which entered into force in 2005, sets mandatory greenhouse gas emission limits for the more than 175 developed nations (including Canada, Russia, Mexico and the European Union) that ratified it. See United Nations Framework Convention on Climate Change, available at http://www.unfccc.int; see also Status of Ratification, available at http://unfccc.int/kyoto_protocol/background/status_of_ratification/items/2613.php. In accordance with the Kyoto

Protocol, in 2005 the European Union established a cap and trade system for greenhouse gas emissions, known as the European Union Greenhouse Gas Emissions Trading Scheme. Efforts toward negotiating a post-Kyoto treaty have begun, most notably with the United Nations Climate Change Conference in Bali in December 2007, which was attended by ministers of 180 countries and resulted in the Bali Roadmap, an agreement that includes the Bali Action Plan, which charts the course for negotiations for a new treaty designed to address climate change. See *Bali Delegates Agree on ‘Road Map,’ But ‘Complex Negotiations’ Lie Ahead*, BNA ENV. REP., (Dec. 12, 2007). The United Nations Climate Change Conference in Poznań in December 2008 led to a renewed commitment to advance the Bali Action Plan and prepare for comprehensive negotiations that are to be held in Copenhagen in 2009. See *The United Nations Climate*

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33 There is currently no formal guidance addressing accounting for emissions allowances. In 2005, the IASB formally withdrew guidance on accounting for emission allowances (developed by the International Financial Reporting Interpretations Committee and known as IFRIC 3 Emission Rights) and began a project to draft a separate standard on accounting for pollution emission allowances relating to greenhouse gases. See Deloitte & Touche LLP, *Accounting for Emissions Rights* (2007), available at www.deloitte.com/dtt/cda/doc/content/us_er_Accounting%20ForEmission%20Rights_0220_2007.pdf. Similarly, in the U.S., the FASB has begun a project to provide accounting guidance for emission allowance programs. See *Emissions Trading Schemes*, available at http://72.3.243.42/project/emissions_trading_schemes.shtml. A joint IASB and FASB board meeting held on the topic in October 2008 was deemed educational and no decisions were made. FASB, *Minutes of the October 21, 2008 Joint Board Meeting: Emissions Trading Schemes*, available at http://72.3.243.42/board_meeting_minutes/10-21-08_emissions.pdf.
(b) **U.S. Legislation and Proposals.** The U.S. withdrew from Kyoto treaty negotiations in March 2001, when President Bush announced that the U.S. would not ratify the Kyoto Protocol due to concerns that compliance would have significant adverse economic effects. Since that time, a number of Congressional proposals to address climate change issues have stalled; however, as discussed below, it now appears likely that federal greenhouse gas emissions regulation in the form of a cap and trade system will be implemented under President Obama. A number of previous federal legislative proposals, such as the original version of the Lieberman-Warner bill, have included directions to the SEC to promulgate climate change disclosure requirements. S. 2191, 110th Cong. § 9002 (2007).

In the absence of federal legislation, a patchwork quilt of regional, state and local regulation of greenhouse gas emissions has developed in the U.S.\(^\text{34}\) For example, Massachusetts, Wisconsin, Oregon and New Hampshire have all adopted rules capping or requiring reductions in total CO2 emissions from power plants. In addition,

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\(^{34}\) For a comprehensive overview of regional, state and local climate change initiatives, see the website of The Pew Center on Global Climate Change, available at [http://www.pewclimate.org/what_s_being_done/in_the_states](http://www.pewclimate.org/what_s_being_done/in_the_states).

(c) **Clean Air Act Regulation.** Even in the absence of federal legislation, EPA may regulate greenhouse gas emissions under its existing Clean Air Act authority. In *Massachusetts v. EPA*, 549 U.S. 497, 532 (U.S. 2007), the U.S. Supreme Court ruled that carbon dioxide fell within the Clean Air Act’s definition of a pollutant and ordered EPA to study whether carbon dioxide should be regulated by the agency.35 With the recent change in administration,

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35 In response to the Supreme Court’s decision in *Massachusetts v. EPA*, the EPA issued an Advance Notice of Proposed Rulemaking in July 2008, detailing the complexities involved in regulating greenhouse gas emissions under the Clean Air Act. See *Advance Notice of Proposed...*
EPA is widely expected to issue an endangerment finding classifying greenhouse gases as pollutants that endanger public health and welfare, paving the way for regulatory oversight of greenhouse gas emissions under the Clean Air Act or an alternative legal framework.

(d) Greenhouse Gas Emissions Reporting. In March 2009, EPA released a draft rule entitled “Mandatory Reporting of Greenhouse Gases,” which, if enacted, would require a wide range of greenhouse gas emission sources, including fossil fuel manufacturers and suppliers, industrial facilities and utilities, to monitor greenhouse gas emissions starting in 2010 and report such emissions to EPA beginning in 2011. A pre-publication copy of this draft rule is available at http://www.epa.gov/climatechange/emissions/ghgrulemaking.html.

(e) Climate Change Litigation. On the litigation front, the climate change docket in the U.S. has become increasingly active in recent years. Many of the cases involve suits to compel environmental regulatory agencies to promulgate or strengthen regulations addressing greenhouse gas emissions. Most significantly, as noted above, in 2007, in Massachusetts v. E.P.A., the U.S. Supreme Court held that CO2 is an air pollutant under the Clean Air Act for

Footnote continued from previous page
purposes of motor vehicle emissions. 127 S. Ct. 1438 (2007). A number of cases have also been filed against major greenhouse gas emitting businesses alleging public nuisance and seeking injunctive relief (such as reduction in greenhouse gas emissions) and/or monetary damages. See, e.g., Connecticut v. American Electric Power Co., 406 F. Supp. 2d (S.D.N.Y. 2005) (appeal pending); California v. General Motors, No. C06-05755 MJJ (N.D. Cal. 2006) (appeal pending); Native Village of Kivalina v. ExxonMobil Corp., No. 08-CV-1138 (N.D. Cal. Feb. 2008). Another category of cases involves suits against private entities or governmental agencies seeking to compel them to account for the impact of climate change in environmental permitting actions. See, e.g., In re Deseret Power Electric Cooperative, PSD Appeal No. 07-03 (EPA Env. Appeals Bd. Nov. 2008); Northwest Envtl. Defense Ctr. v. Owens Corning, 434 F. Supp. 957 (D. Or. 2006). Finally, a number of climate change cases have been filed against private entities and their insurance carriers in the aftermath of Hurricane Katrina. See, e.g., Barasich v. Columbia Gulf Transmission Co., 467 F. Supp. 2d 676 (E.D. La. 2006) (dismissing lawsuits alleging that activities of oil and gas companies contributed to the destructive impact of Hurricanes Rita and Katrina for failure to state a claim); Comer v. Murphy Oil, No. 05-CV-436LG (S.D. Miss. 2005) (suit against a group of oil companies for
contribution to global warming and intensity of Hurricane Katrina dismissed in 2007 for failure to state a claim).

6.1.2. Materiality
A threshold question under Item 101, 103 and 303 is whether current or future regulation of greenhouse gas emissions or the physical risks associated with climate change will have a material impact on the registrant. As noted in Section 1.2.1 above, a fact is material “if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” See SAB 99 (quoting TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976)). A recent petition seeking SEC guidance on climate change disclosure posits that the “steadily growing demand” from investors for information relating to climate risk is evidence that “reasonable investors” consider the risk of climate change as part of the “total mix” of information necessary to make investment decisions. See Section 6.2.2(b) infra: Petition for Interpretive Guidance on Climate Risk Disclosure (Sept. 18, 2007), available at http://www.sec.gov/rules/petitions/2007/petn4-547.pdf. Even if institutional investor interest in climate change is not evidence of its materiality, before concluding that the impact of climate change will not be material (or that the impact cannot be determined), commentators are urging that a registrant should carefully consider the potential impacts of physical risks and regulatory risks relating to climate change on the registrant. See Cheng & Daly, supra note 32; Deatherage, supra note 32. In order to do so, it may be
necessary to assess the registrant’s levels of greenhouse gas emissions – particularly in industrial sectors that are significant emitters of greenhouse gases.

6.1.3. Item 101

Item 101 requires registrants to disclose the material effects of costs to comply with environmental laws and regulations. In particular, Item 101(c)(xii) requires a registrant to disclose material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and the succeeding year, as well as any further periods that the registrant deems material. For registrants in industrial sectors that have high greenhouse gas emissions (e.g., coal-burning power plants and aluminum smelters), Item 101 will require careful consideration of regulatory developments relating to climate change (e.g., mandatory cap and trade programs and reporting of greenhouse gas emissions), as well as the disclosure of material contingent capital plans. See Smith, supra note 31 at 3; but see Mounteer, et. al., supra note 32 at 13-14 (concluding that Item 101 disclosure is not yet necessary, other than perhaps for power plants operating in RGGI member states, as it would be “premature to estimate capital expenditures necessary to operate in a world of constrained or more expensive carbon dioxide emissions rights, without greater certainty about the extent of the constraint or the cost”). In addition, multinational companies with facilities both in the U.S. and in Canada and/or Europe must consider whether disclosure under Item 101 is required with respect to capital expenditures undertaken as an
alternative to purchasing emission credits in the European Union
Greenhouse Gas Emissions Trading Scheme or other greenhouse
gas emissions trading programs. See id. (citing 1973 SEC No-
Action Letter clarifying that “to the extent any foreign
environmental provisions may have a material impact upon the
company’s financial condition or business, such matters should be
disclosed”).

6.1.4. Item 103

Instruction 5(A) of Item 103 requires disclosure of material legal
proceedings that are pending or known to be contemplated to
which the registrant is a party or of which the registrant’s property
is subject.36 As noted in Section 6.1.1(e) above, the climate
change litigation docket has grown. Item 103 requires registrants
that are parties to the proceedings to disclose any such legal
proceedings that may result in material liabilities and costs (e.g.,
material costs associated with the installation of pollution control
facilities to reduce CO2 emissions or the purchase of emission
offset credits). However, non-defendant companies should also
consider disclosure of legal proceedings to the extent any

36 In addition to the requirement pursuant to Instruction 5(A) of Item 103 to disclose legal
proceedings that are material to the business or financial condition of a registrant, Instructions
5(B) and (C) require disclosure, respectively, of (i) legal proceedings involving claims for
damages or costs in excess of 10% of consolidated assets and (ii) legal proceedings to which a
governmental authority is a party and which involve monetary sanctions, unless such sanctions are
reasonably expected to be less than $100,000. At least one commentator has posited that,
although suits by state attorney generals against private emitters of greenhouse gases to date have
sought only injunctive relief (e.g., reduction of greenhouse gas emissions), future climate change
suits by state attorney generals (which are governmental authorities) could seek relief that
potentially could be considered “sanctions” within the meaning of Instruction (C) of Item 103.
See, e.g., Gerrard supra Section 6.1, at 462.
precedent established will be controlling and likely to result in material legal or regulatory consequences. As a result, “disclosure of climate change litigation, both by the parties involved and by those potentially affected by the outcomes, has been the most robust and detailed of all SEC-mandated climate disclosure to date.” See Smith, supra note 31 at 4.

6.1.5. Item 303

Item 303 requires registrants to disclose known trends, events or uncertainties that are reasonably likely to have a material impact on liquidity, capital, sales, revenues or income. Specifically, the registrant must (i) assume that the trend, event or uncertainty will occur, unless the registrant concludes that it is not reasonably likely to occur, and (ii) disclose the trend, event or uncertainty, unless the registrant can determine that it is not reasonably likely to have a material effect on the registrant’s financial condition or results of operations. In light of an emerging consensus on the science of climate change, the likely ultimate passage of federal climate change legislation and the regional, state and local initiatives mandating reductions in greenhouse gas emissions, it would be difficult to conclude under the first inquiry that regulation of climate change is a trend, event or uncertainty that is not reasonably likely to occur. Thus, disclosure will be necessary under Item 303 unless a registrant can determine that climate change impact and regulation is not reasonably likely to have a material effect on the registrant. See, e.g. Gerrard supra Section 6.1 at 466.
6.1.6. **Item 503(c)**

Item 503(c) requires registrants to disclose the most significant factors that make an offering speculative or risky in registration statements and annual reports. Registrants with substantial greenhouse gas emissions and registrants in certain business sectors more likely to be impacted by climate change have begun to describe climate change risks in the risk factors disclosed pursuant to Item 503(c). Such climate change risks that may be significant include legal, financial and physical risks, reduced demand for certain products such as coal, and greater difficulty obtaining required permits for projects with substantial greenhouse gas emissions such as power plants.

6.2 **Settlements and Initiatives to Enhance Climate Change Disclosure.**

6.2.1. **Climate Change Disclosure Settlements.** Although to date no cases have been filed seeking disclosure under Regulation S-K of climate change issues, in September 2007, New York Attorney General Andrew Cuomo issued subpoenas under New York State’s blue sky law (the Martin Act) to five energy companies seeking internal documents related to their analysis of climate change risks. In letters accompanying the subpoenas, Attorney General Cuomo expressed concern over the adequacy of climate change risk disclosures in the companies’ 2006 Form 10-Ks given that all the companies were involved with plans to build new coal-fired power plants. The letters are available at [http://www.oag.state.ny.us/media_center/2007/sep/sep17a_07.htm](http://www.oag.state.ny.us/media_center/2007/sep/sep17a_07.htm). In response to the investigation, Xcel Energy and Dynegy entered
into binding and enforceable agreements to enhance their disclosure of climate change risks in August and October 2008, respectively. The enhanced disclosure requirements include analysis of financial risks from current and anticipated climate change regulation, climate change-related litigation and the physical impacts of climate change. Additionally, the companies agreed to disclose current emissions, projected increases in emissions from planned coal-fired power plants, strategies for reducing emissions and corporate governance actions concerning climate change. The agreements are available at

http://www.oag.state.ny.us/media_center/2008/aug/xcel_aod.pdf

and


It is possible that the Xcel and Dynegy agreements could become climate change disclosure templates for companies in the power industry, as such companies seek to avoid similar enforcement actions.

6.2.2. Climate Change Disclosure Initiatives.

(a) Shareholder Campaigns.

In recent years, climate change has dominated shareholder resolutions relating to environmental matters. Companies in the automobile, utility, oil & gas and manufacturing sectors have for some time been subject to shareholder campaigns aimed at improving disclosure (and reduction) of greenhouse gas emissions due to concerns over global warming. Recent years have seen a surge in the number of global warming shareholder resolutions
filed. Over the 2003 to 2005 proxy seasons, 28 to 33 shareholder global warming resolutions were filed per season. See Ceres, Collected Press Releases available at http://www.ceres.org/Page.aspx?pid=421&srcid=552. In 2006, the number decreased to 24, but 43 resolutions were filed in 2007, including the first resolutions requesting that companies set specific greenhouse gas emissions targets. See Ceres, 2007 Proxy Season Produces Strong Results on Climate Change (2008), available at http://www.incr.com/Page.aspx?pid=893. A total of 57 climate-related shareholder proposals were filed in 2008 and a record high 62 resolutions have been filed to date in the 2009 proxy season. See Ceres, Investors Achieve Major Company Commitments on Climate Change (Aug. 20, 2008), available at http://www.ceres.org/Page.aspx?pid=928; Ceres, Southern, Massey Energy and Chevron Among Nine 'Climate Watch' Companies Targeted by Investors (Feb. 18, 2009), available at http://www.ceres.org/Page.aspx?pid=1033. The scope of the companies targeted by such campaigns has grown as well, and companies in the financial, insurance, property management, home building, airline, forestry, retail and computer sectors have been subject to proposed resolutions calling for disclosure of their plans for dealing with the risks posed by climate change. See id; see also Ceres, Power Companies and Wall Street Firms Begin To Assess Climate Risks (Oct. 31, 2006), available at


38 Although institutional investors have assumed a leading role in requesting increased disclosure of the financial impact of climate change, mutual funds have not supported the issue. In 2006, all 28 of the investment management companies responsible for the nation’s 100 largest mutual funds abstained or opposed all shareholder resolutions that sought increased corporate disclosure on the financial risks and opportunities posed by climate change. See Ceres, *U.S. Mutual Funds Critical Missing Link in Supporting Climate Change Shareholder Resolutions* (undated), available at http://www.ceres.org/Document.Doc?id=270. Many of the investment management companies associated with the largest mutual funds have proxy voting policies that require them to abstain on all environmental resolutions, and while opposition of mainstream mutual funds has decreased in recent years, the rate of abstention has increased. See Ceres, *Ceres Study Shows That Nation’s 100 Largest Mutual Funds Sitting on Sidelines on Climate Change Issue* (Jan. 26, 2006), available at http://www.ceres.org/Page.aspx?pid=549&srcid=421; Ceres, *Mutual Funds and Climate Change: Opposition to Climate Change Resolutions Begins to Thaw* (Apr. 2008) available at http://www.ceres.org/Document.Doc?id=322.


A number of companies have been successful in arguing that such resolutions should be excluded from proxy statements under Rule 14a-8(i)(7) as such matters relate to the ordinary business operations of a company. See, e.g., CONSOL Energy Inc. (NY State Common Retirement Fund), SEC No-Action Letter, WSB File No. 0302200908 (Feb. 23, 2009) (CCH) (excluding proposal to require company to report on its response to increasing public pressure to decrease greenhouse gas emissions); Alpha Natural Resources, Inc., SEC No-Action Letter, WSB File No. 0223200909 (Feb. 17, 2009) (CCH); Kansas City Southern (Recon.), SEC No-Action Letter, WSB File No. 0324200812 (Mar. 14, 2008) (CCH); ONEOK, Inc., SEC No-Action Letter, WSB File No. 0211200803 (Feb. 7, 2008) (CCH) (excluding proposal to require the company to report on its response to increasing regulatory, competitive, and public pressure to reduce greenhouse gas emissions); Wachovia Corp., SEC No-Action Letter, WSB File No. 0221200622 (Feb. 10, 2006); Arch Coal Inc., SEC No-Action Letter, WSB File No. 0122200824 (Jan.

In response to resolutions that were ultimately withdrawn in 2008, Ford Motor Co. became the first U.S. automaker to set a clear goal to cut GHG emissions from its vehicles, with a goal of reducing emissions by at least 30% by 2020; Centex announced that it would aim to increase the energy efficiency of new homes by 22% and power monitors would be installed to allow homeowners to track energy consumption; and Bank of America announced that it will include the cost of carbon emissions when evaluating electric power projects. See *Ceres Annual Report 2007-2008*, available at [http://www.ceres.org/Document.Doc?id=385](http://www.ceres.org/Document.Doc?id=385).

For example, in March 2005, the SEC declined to allow ExxonMobil to omit from its proxy materials shareholder proposals dealing with global warming and other environmental topics. The SEC declined no-action relief requested by ExxonMobil to omit proposals that (1) the board make available to its shareholders the research data relevant to the company’s position on the science of climate change; (2) the company prepare a report on the potential environmental damage that would result from drilling for oil and gas in protected areas and the implications of a policy refraining from drilling in those areas; and (3) the company prepare a report on how it will meet the GHG reduction targets in countries where it operates that have adopted the Kyoto Protocol. See BNA SEC. REG. & L. REP., Vol. 37, No. 14 (Apr. 4, 2005). ExxonMobil subsequently issued a report setting forth the data behind the company's skepticism on climate science and explaining how the company intends to comply with the Kyoto Protocol’s greenhouse gas emissions limits. See Bill Baue, Resolution Withdrawals Signal Success in Shareowner Advocacy.

(b) Institutional Investor Initiatives.

(i) Institutional Investor Guidelines for Voluntary Climate Disclosure. In the absence of clear and uniform mandatory standards for disclosure of climate change risks, institutional investors have developed voluntary disclosure frameworks intended to enhance the availability of information related to the risks that companies face from climate change and the regulation of greenhouse gas emissions.41

Carbon Disclosure Project: The Carbon Disclosure Project (“CDP”), which is comprised of 475 institutional investors with assets of more than $57 trillion, has issued information requests on greenhouse gas emissions to large global companies for the past 7 years. Companies are encouraged

40 ExxonMobil Corp. has been the target of more recent shareholder resolutions relating to climate change. For example, in 2007, a shareholder resolution requesting specific greenhouse gas emissions reductions received 31% support. However, a separate 2007 resolution seeking increased spending on renewable energy technology was granted no-action relief by the SEC under Rule 14a-8(i)(10) after the company argued that the proposal had already been substantially implemented. See Ceres, $900 Billion of Institutional Investors Pressure ExxonMobil on Global Warming (May 23, 2007), available at http://www.ceres.org/Page.aspx?pid=448&srcid=421; ExxonMobil Corp., SEC No-Action Letter, WSB File No. 0402200703 (Mar. 23, 2007) (CCH). In the 2008 proxy season, resolutions requesting the adoption of quantitative emissions reduction targets and a policy for research and development of renewable energy received 30.9% and 27.5% support, respectively. See Ceres, Investors Achieve Major Company Commitments on Climate Change (Aug. 20, 2008), available at http://www.ceres.org/Page.aspx?pid=928.

41 See Smith, supra Note 31 at 2 (noting that in the absence of SEC guidance on how traditional disclosure standards should be applied to climate change, there is “an unprecedented divergence between the scope and quality of mandatory reports on the one hand and voluntary reports on the other”).
to report their emissions data using the Greenhouse Gas Protocol, a standardized emissions reporting system developed by the World Resources Institute. The most recent information request, issued in February 2009 to over 3,000 companies, seeks disclosure of the companies’ exposure to financial risks from climate change and steps they are taking to evaluate and address that risk. The companies’ responses to the information requests issued by the CDP and related reports are available at http://www.cdproject.net/results.asp.

Global Reporting Initiative: The Global Reporting Initiative ("GRI"), a multinational group of stakeholders that includes institutional investors, has been developing and refining a sustainability disclosure framework since 1999. The sustainability disclosure framework includes reporting on greenhouse gas emissions and climate change risks. The "G3 Guidelines," the latest version of GRI’s reporting framework, is available at http://www.globalreporting.org/ReportingFramework/G3Online/.

The Climate Registry: The Climate Registry is a nonprofit collaboration among several U.S. and Mexican states and Canadian provinces and territories that provides a

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standardized greenhouse gas emissions measurement and reporting system. Corporations, government agencies and non-profit organizations submit reports using the Climate Registry’s reporting framework and the data is made publically available. See *The Climate Registry*, available at http://www.theclimateregistry.org/. The Climate Registry also offers an emissions accounting infrastructure that can support a variety of greenhouse gas emissions reduction programs, including voluntary, regulatory and market-based programs.


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43 The framework is available at http://216.235.201.250//Document.Doc?id=73 and consists of four elements of disclosure: (1) total historical, current, and projected greenhouse gas emissions; (2) strategic analysis of climate risk and emissions management; (3) assessment of physical risks of climate change; and (4) analysis of risk related to the regulation of greenhouse gas emissions.
Investors that adopt the Global Framework for Climate Risk Disclosure pledge to use the disclosure framework in engagements with companies and to encourage them to use existing climate change-related reporting mechanisms including the frameworks put forth by the Global Reporting Initiative and the Carbon Disclosure Project.\footnote{A legislative proposal in California would have required the California Controller to develop a climate change disclosure standard to provide guidance to companies that do business in the state. However, an amended version of the bill, SB 1550, was narrowly defeated in the State Senate in August 2008. See Ceres, Investors Praise California Senate Leaders for Passing Historic Climate Disclosure Bill (May 22, 2008), available at http://www.ceres.org/Page.aspx?pid=905.}


Proposed Climate Disclosure Guidelines for Auto Industry:

In March 2009, an international coalition of institutional investor groups proposed new climate disclosure guidelines for the auto industry that include enhanced disclosure of the financial implications of climate change policy, targets for vehicle emissions reductions, current and future emissions

\textsuperscript{45} Citi, JPMorgan Chase and Morgan Stanley formulated and first adopted the Carbon Principles. Subsequently, Bank of America, Credit Suisse and Wells Fargo also adopted the Carbon Principles.

\textsuperscript{46} The Carbon Principles echo the Equator Principles, which are voluntary standards for financial institutions to manage environmental and social risk in their project finance transactions. See www.equator-principles.com.

(ii) **Institutional Investor Meetings on Climate Change.** There have been several climate risk meetings organized by institutional investors. The Institutional Investor Summit on Climate Risk (“Summit”), organized by Ceres and the United Nations, first convened in 2003, when asset managers representing over $1 trillion in assets, including treasurers of 9 states (including New York and California) and managers of the nation’s two largest union pension funds, issued a 10-point call for increased disclosure of the financial impact of potential regulation resulting from global warming. The 10-point call for action includes petitioning the SEC for enforcement of environmental risk disclosure requirements, filing and supporting global warming shareholder resolutions, and forming an Investor Network on Climate Risk to follow through on their plans. See *Investor Network on Climate Risk*, available at http://www.incr.com. A similar action plan was announced at the second Summit in 2005, where investors managing more than $3 trillion of assets announced that they will require investment managers overseeing their funds to set forth their strategies for assessing financial risks associated with climate change. See Ceres, *U.S. & European

(iii) Institutional Investor Initiatives Requesting SEC Guidance/Regulation. Institutional investors have called upon the SEC to issue guidance and/or regulation regarding climate change disclosure. These requests, which have proliferated in recent years, are outlined briefly below.

April 2004 Petition: In April 2004, 13 public pension fund leaders, including eight state treasurers and comptrollers, four labor pension fund leaders, and the New York City Comptroller, called on the SEC to require companies to disclose the financial risks of global warming. The group,
collectively managing assets of nearly $800 billion, concluded that global warming poses material financial risk to many of their portfolio companies and that the SEC should require that those risks be disclosed. See Ceres, Thirteen Pension Leaders Call on SEC Chairman to Require Global Warming Risks in Corporate Disclosure (Apr. 15, 2004), available at http://www.ceres.org/Page.aspx?pid=584&srcid=421.

June 2006 Petition: In a June 2006 letter to SEC Chairman Christopher Cox, 28 institutional investors wrote that climate change poses material financial risks to many of their portfolio companies and that those risks should be disclosed as a matter of routine corporate financial reporting to the SEC. The letter called on the SEC to enforce existing disclosure requirements on material risks that are underreported, such as climate change; strengthen current disclosure requirements by providing interpretive guidance on the materiality of risks posed by climate change; and require companies to include in their proxy statements shareholder proposals asking companies to report on financial risks due to climate change. The full text of the letter is available at http://www.incr.com/Document.Doc?id=48.

March 2007 Petition: In March 2007, a large group of investors, asset managers and companies, representing $4 trillion under management, called on Congress to address their concerns regarding the risks of climate change.
Among the key action requests was a call for the SEC to clarify what companies should disclose to investors on climate change in their regular financial reporting. See Ceres, *Investors Managing $4 Trillion Call on Congress to Tackle Global Climate Change* (Mar. 19, 2007), available at http://www.ceres.org/Page.aspx?pid=451&srcid=421.


The petition outlines three categories of risks of climate change that should be assessed and, if material, disclosed:

(i) physical risks from climate change;

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47 The Free Enterprise Action Fund (“FEAF”), a relatively small fund that had $6.6 million under management as of December 31, 2008, also submitted a rulemaking petition asking the SEC to issue interpretive guidance requiring corporations to disclose the business risks posed by regulation of greenhouse gas emissions. See *Fund Petitions SEC to Require Disclosure on Risks of Climate Change Regulations*, SEC Today Online, Vol. 2007-211 (Nov. 1, 2007). To date, the SEC has not responded to the petition. In July 2008, FEAF submitted a second rulemaking petition to the SEC requesting the issuance of interpretive guidance that would warn companies against making “false and misleading” statements concerning the establishment of a scientific consensus that human activities are the cause of global warming. See FEAF, *SEC petitioned to warn companies against making false and misleading claims on global warming*, available at http://freeenterpriseactionfund.com/release072308.htm.
(ii) financial risks associated with present or probable regulation of greenhouse gas emissions; and

(iii) legal proceedings related to climate change.

Representatives of the group that submitted the petition testified before the Senate Subcommittee on Securities, Insurance and Investment (“Subcommittee”) about alleged inconsistency in the SEC’s application of Rule 14a-8(i)(7) and the need for a uniform, general set of disclosure guidelines for climate change disclosure. See Senate Subcommittee Witnesses Urge SEC To Issue Guidance on Climate Change Disclosure, SEC Today Online, Vol. 2007-214 (Nov. 6, 2007). Following the testimony, Senator Christopher Dodd, the Chairman of the Senate Committee on Banking, Housing and Urban Affairs, and Senator Jack Reed, the Chairman of the Subcommittee, sent a letter to the SEC urging the Commission to issue interpretive guidance on climate change risk disclosure. The letter is available at http://www.abanet.org/environ/committees/environdisclosures/highlights_docs/FinalCoxletteronclimaterisjdisclosureasent.pdf.

The petitioners filed a supplement to their call for greater disclosure of climate risks in June 2008 with additional evidence of the far-reaching financial impacts of current and planned climate change regulation. See Re: File No. 4-

May 2008 Petition: In May 2008, a group of 52 institutional investors representing $2.3 trillion under management issued a letter to Senate leadership calling for a national climate policy focused on reducing greenhouse gas emissions. The letter also asked Senate leaders to pressure the SEC to issue interpretive guidance on climate change risk disclosure.

September 2008 Oil Sands Petition: In September 2008, a group of environmental organizations and 19 institutional investors representing over $700 billion in assets sent a letter to the SEC calling for additional disclosure requirements for oil sands. See Ceres, Investors Call on
SEC to Expand Climate Reporting Requirements to Include Oil Sands (Sept. 9, 2008), available at http://www.ceres.org/Page.aspx?pid=941. The letter was sent in response to the SEC’s Modernization of the Oil and Gas Reporting Requirements, which proposed to expand the categories of oil and gas that could be reported to include oil sands. Modernization of the Oil and Gas Reporting Requirements, Release Nos. 33–8935; 34–58030 (July 2, 2008), 73 Fed. Reg. 132 (July 23, 2008). As oil sands development emits more greenhouse gases relative to traditional oil extraction and refining, the group asked the SEC to require additional disclosures for oil sands reserves to reflect heightened regulatory and litigation risks associated with their development. The final rule does not include the enhanced disclosures sought by the group. See Modernization of the Oil and Gas Reporting Requirements, Release Nos. 33–8995; 34–59192 (Dec. 29, 2008), 74 Fed. Reg. 9 (Jan. 14, 2009), available at http://www.sec.gov/rules/final/2009/33-8995fr.pdf.

October 2008 Petition Relating to 21st Century Disclosure Initiative: In October 2008, a group of 14 state officials and institutional investors issued a letter calling on the SEC to enhance climate-related disclosures as part of its 21st

**December 2008 Petition to President Obama:** In December 2008, a group of more than 60 institutional investors, state officials and advocacy organizations sent a letter to President Obama urging increased disclosure of environmental risks including climate change. The letter is available at [http://www.iccr.org/news/press_releases/2008/Obamaletter.pdf](http://www.iccr.org/news/press_releases/2008/Obamaletter.pdf). The letter suggests that the SEC has been overly broad in excluding shareholder initiatives under the standard put forth in Legal Bulletin No. 14C. See supra Section 5.3. The group called for a re-examination of the SEC’s application of the ordinary business exclusion to shareholder resolutions as well as the adoption of standards

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To date, the 21st Century Disclosure Initiative has consisted of a review of the SEC’s existing disclosure system and a report describing a modernized disclosure system with recommended actions for the transition to a new system. For more information on the 21st Century Disclosure Initiative, see [http://www.sec.gov/spotlight/disclosureinitiative.shtml](http://www.sec.gov/spotlight/disclosureinitiative.shtml).
for disclosing environmental issues. To date, no response to the letter has been issued.

(iv) **Institutional Investor Initiatives Aimed at Large Public Companies.** Institutional investors have on numerous occasions sent letters to large public companies seeking disclosure of the financial impact of climate change. For example, in November 2003, 95 institutional investors with assets of over $10 trillion wrote to the 500 largest publicly traded companies seeking disclosure of information concerning their greenhouse gas emissions. See Friends of the Earth, *Third Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemical, and Utilities Companies* (Jul. 2004).


In December 2005, 20 investors collectively controlling $800 billion in assets co-signed letters requesting the 30 largest publicly-held insurance companies in North America to disclose their financial exposure from climate
change and the steps they are taking to reduce those financial impacts.\textsuperscript{49} The investors made this request in light of back-to-back severe hurricane seasons in the U.S. (including the devastating effects of Hurricane Katrina). The investors requested that the climate reports be completed and shared with shareholders by August 2006. See Ceres, \textit{Institutional Investors Urge Insurance Companies To Boost Response To Financial Risks and Opportunities from Climate Change} (Dec. 1, 2005), available at http://www.ceres.org/Page.aspx?pid=466&srcid=421.

In February 2009, a coalition of institutional investors collectively controlling over $200 billion in assets named nine companies in the energy, automotive and home building industries to a Climate Watch List to highlight questions about the adequacy of their climate-related disclosures.\textsuperscript{50} See Ceres, \textit{Southern, Massey Energy and Chevron Among Nine 'Climate Watch' Companies Targeted by Investors} (Feb. 18, 2009), available at

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\textsuperscript{49} The National Association of Insurance Commissioners adopted mandatory climate change disclosure rules in March 2009 that require insurance companies with annual premiums over $500 million to provide state insurance regulators with an annual climate risk disclosure survey starting in May 2010. The disclosure survey is intended to provide information on the insurance companies' financial exposure to climate change and any actions taken to mitigate those risks. See NAIC Press Release, \textit{Insurance Regulators Adopt Climate Change Risk Disclosure} (Mar. 17, 2009).

\textsuperscript{50} The companies named to the Climate Watch List are Southern Company, Massey Energy, Consol Energy, Ultra Petroleum, ExxonMobil, Chevron, Canadian Natural Resources, General Motors and Standard Pacific.
http://www.ceres.org/Page.aspx?pid=1033. The companies named to the Climate Watch List have historically resisted climate-related shareholder resolutions, leading to concerns that their disclosures were inadequate relative to other companies in carbon-intensive industries.

(c) ASTM Climate Change Disclosure Standard. ASTM International (“ASTM”), a voluntary standards development organization, is in the process of developing climate change disclosure standards for financial statements to encourage “consistent and comprehensive disclosure of climate change exposures/risks.” See ASTM, Draft Guide for Disclosures Related to Climate Change Exposure Risks, ASTM WK21096 (Aug. 1, 2008); Gayle S. Koch, Let’s Talk About Climate Change: Disclosure is Coming, The Brattle Group Environment Newsletter, Issue 1 (2008), available at http://www.brattle.com/_documents/UploadLibrary/Upload728.pdf. Under ASTM's draft standard, companies that identify potential impacts from climate change must assess whether the impacts (i) have more than a remote likelihood; (ii) would be severe enough to disrupt financial condition, cash flows or operations; and, (iii) are near-term. If any of these criteria are applicable, the company must estimate the likelihood, timing, and magnitude of the potential climate change impacts. Potential impacts must be disclosed when aggregate financial impacts are determined to be material.