

ENVIRONMENTAL DUE DILIGENCE  
FOR SECURITIES OFFERINGS

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1. Why Is Environmental Due Diligence Necessary for Offerings?

- Environmental due diligence is necessary to assess a company's exposure to environmental liabilities and compliance costs that must be disclosed to comply with the Securities Act of 1933 and the Securities Exchange Act of 1934.
- There has been increased scrutiny of environmental disclosure in recent years from the SEC, Congress, EPA, shareholders and public interest groups. The ABA created a Special Committee on Environmental Disclosure in 2004.

1. SEC. The SEC has initiated several enforcement actions relating to environmental disclosure and made a series of comments indicating that it would apply increased scrutiny to environmental disclosure in public filings.
  - In 1998, the SEC issued a cease and desist order to Lee Pharmaceuticals for materially understating its environmental liabilities in several annual filings.
  - At the 2001 ABA annual meeting, the SEC announced that it would begin screening 10K's for violations in environmental disclosure requirements.
  - In 2002, the SEC sued the founder and five former officers of Waste Management Inc., alleging, in part, that the company had "established inflated environmental reserves (liabilities) in connection with acquisitions so that the excess reserves could be used to avoid recording unrelated environmental and other expenses." In 2004, one of the defendants settled and agreed to pay a civil penalty and disgorge certain bonuses. The litigation is continuing as to the five other executives.
2. Congress. In October 2002, Senators Corzine, Lieberman and Jeffords asked the General Accounting Office ("GAO") to review the effectiveness of the SEC's environmental reporting requirements and the level of compliance with those requirements and to identify changes to the requirements that would encourage greater environmental disclosure. In July 2003 and 2004, Senator Corzine convened Congressional symposia to consider the current state of disclosure of environmental risks. The results of the GAO's review, "Environmental Disclosure,

SEC Should Explore Ways to Improve Tracking and Transparency of Information,” was unveiled in the summer of 2004. 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.
  - The SEC should take steps to improve the tracking and transparency of its reviews of filings and to improve its coordination with the EPA. Toward this end, the SEC has agreed to make comment letters and company responses available on its website and has started tracking its reviews of company filings to identify trends in environmental disclosures.
3. EPA. In 2001, the EPA announced an environmental disclosure initiative to encourage greater compliance with SEC disclosure requirements. To accomplish this objective, the 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. The EPA also notifies affected companies that SEC disclosure obligations may apply to pending enforcement actions.
4. Shareholder Suits. Shareholders have filed complaints relating to environmental disclosure.
- Class actions were filed in 1999 by shareholders of U S Liquids for allegedly concealing material environmental information resulting in inflated share prices.

5. Public Interest Groups. Shareholder interest groups have pushed for enhanced disclosure and enforcement by the SEC.
- Since the late 1990's, the Corporate Sunshine Working Group (an alliance of investors, environmental organizations, including Friends of the Earth and the World Resources Institute, unions, and public interest groups) have alleged frequent noncompliance with environmental disclosure rules and called for stricter SEC enforcement of such rules.
    - In 1998, the United Steel Workers of America (a member of the Corporate Sunshine Working Group) petitioned the SEC alleging that Phelps Dodge failed adequately to disclose environmental liabilities and cleanup costs associated with a contaminated site.
    - In 1999, two shareholders petitioned the SEC to investigate Crown Central Petroleum for, in part, failing to disclose certain environmental penalty proceedings.
    - In March 2001, Friends of the Earth petitioned the SEC to investigate the Scotts Company for alleged failure to disclose trends in UK environmental regulations which the group contended were potentially material to Scotts' peat extraction business.
    - In June 2001, nine institutional investors petitioned the SEC to require Abbott Laboratories to disclose recent scientific findings relating to chemicals associated with the production of polyvinyl chloride (PVC) plastic.
    - In February 2004, California State Treasurer Phil Angelides launched an initiative calling on the California Public Employees Retirement System ("CalPERS") and the California State Teachers' Retirement System ("CalSTRS") 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.

- In August 2004, two institutional investors sought an SEC investigation of Dow Chemical's allegedly misleading statements made during an annual shareholder meeting and omissions from SEC filings relating to the 1984 Bhopal, India explosion, dioxin contamination in Midland, Michigan and the chemical defoliant Agent Orange.
- Public interest groups have published a number of reports regarding the inadequacy of environmental disclosure and proposed rules requiring enhanced disclosure.
  - In 2000, the World Resources Institute released a report alleging that the pulp and paper industry is not properly disclosing environmental risks.
  - In 2001, the World Resources Institute and the Calvert Group, a socially responsible mutual fund, requested the SEC fully to enforce regulations that require companies to disclose known environmental risks and uncertainties that are likely to affect future financial performance.
  - In 2002, Friends of the Earth, an environmental organization, published a survey concluding that publicly traded companies in the automobile manufacturing, integrated oil & gas, insurance, petrochemicals, and utilities industries are failing to report material environmental issues, such as climate change. The updated survey, published in 2003, found some improvement in disclosure, but concluded that the majority of companies in such sectors still fail to disclose risks relating to climate change.
  - In 2002, the Rose Foundation, a coalition of charitable foundations and socially responsible investment funds, submitted a rule-making petition to the SEC calling for enhanced disclosure of environmental liabilities.
  - In 2004, the Rose Foundation published a study detailing accounting strategies employed by corporations to limit disclosure of environmental risks and liabilities.

- A 2004 report authored by Robert Repetto detailed ten case studies of mining company disclosure and concluded that nine of the hard rock mining companies failed to disclose known financially material risks arising out of environmental issues.

## 2. Principal Environmental Laws

- Environmental laws can be divided into three broad categories.
  1. Laws relating to Contamination (CERCLA): The Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”) and similar state Superfund statutes impose liability on current owners and operators of a contaminated facility, former owners and operators at the time of disposal, generators who send waste to contaminated facilities, and transporters. Such liability is strict, retroactive, and joint and several.
  2. Laws relating to Compliance (e.g., Clean Water Act, Clean Air Act, the Resource Conservation and Recovery Act (“RCRA”), and OSHA). Many environmental compliance statutes authorize penalties of up to \$25,000 per day per violation and also provide for criminal liability even if the defendant did not “knowingly” violate the law. Citizen suits may also be brought under many of these statutes.
  3. Toxic Torts: Common law theories of nuisance, negligence, trespass, and strict liability for ultra-hazardous activities can be asserted in connection with exposure to hazardous substances (e.g., exposure to asbestos, toxic air emissions, contamination, and mold). Damages can include personal injury, property damage, and medical monitoring for increased risk of future injury.

## 3. Principal SEC Disclosure Requirements for Environmental Liabilities

- Item 101 (Business) of Regulation S-K: Requires disclosure of material environmental compliance costs.
- Item 103 (Litigation) of Regulation S-K: Requires disclosure of material legal proceedings, proceedings for which costs could exceed 10% of the current assets, and any enforcement proceedings that reasonably may be expected to result in sanctions of \$100,000 or more.

- Item 303 (MD&A) of Regulation S-K: Requires disclosure in MD&A of contingencies that are reasonably likely to have a material effect and requires quantification of potential liability to the extent reasonably practicable.
- FASB Statement 5: FASB Statement 5 provides that loss contingencies must be disclosed if (i) 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 (ii) *the amount of the loss can be reasonably estimated*. Under FASB Statement 5, even if both conditions cannot be met, disclosure of the loss contingency is required where there is “at least a reasonable possibility” that the loss has been incurred. This 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.
- SAB 92: Under SEC Staff Accounting Bulletin (“SAB”) No. 92, detailed disclosures regarding material environmental loss contingencies must be furnished in the notes to financial statements to prevent those financial statements from being misleading. 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. The liability must be recorded separately from any expected insurance recoveries and contribution/ indemnification rights. With respect to joint and several liabilities for a contaminated site, if there is a reasonable method of apportioning costs, and it is probable that 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.
- SOP 96-1: Provides accounting guidance with respect to environmental remediation liabilities that relate to pollution arising from historic conduct.
- FASB Statement 143 (“FAS 143”) and FASB Interpretation No. 47 (“FIN 47”): FAS 143 requires companies to record the fair value of a liability for an asset retirement obligation (i.e., legal retirement obligations resulting from the acquisition, construction or normal operation of tangible, long-lived assets, such as utility plants, mines and landfills) in the period in which it is incurred if a rea-

sonable estimate of “fair value” can be determined. FAS 143 does not apply to “immaterial” obligations or to legal obligations resulting from the improper) operation of an asset, such as a catastrophic spill. FIN 47 clarifies that an asset retirement obligation that is conditional on a future event is within the scope of FAS 143.

#### 4. Environmental Due Diligence Steps in Connection with Offerings

1. Submit environmental due diligence document request.
2. Review environmental documents at issuer’s or attorney’s offices and, if possible, make copies of significant or critical documents.
3. Conduct telephone and/or in-person interviews of some or all of the following:
  - Corporate Director of Environmental, Health & Safety
  - In-house Environmental Counsel
  - CFO and possibly the Company’s accountants (with respect to environmental accounting issues)
  - Director of Human Resources (or other person responsible for health and safety issues, if such issues do not fall within scope of responsibility of environmental director)
  - Facility Environmental Managers (to the extent that corporate environmental manager does not have information regarding facility-specific environmental issues)
  - Outside Environmental Counsel (for any potentially material environmental legal proceedings)
  - Outside Environmental Consultants (for any potentially material environmental investigations/remediations)
4. Request follow-up documentation, as necessary, based on results of interviews.
5. Retain environmental consultants, if necessary and cost-effective.
  - Typically, parties conducting environmental due diligence for offerings do not retain environmental consultants to assist in reviewing material.
  - Typically, parties conducting environmental due diligence for offerings do not request environmental consultants to perform new Phase I environmental site assessment. However, issuers

will need to have sufficient and current environmental information available and may, therefore, need to have assessments prepared.

## 5. Environmental Due Diligence Information Requests

- Generally parties conducting environmental due diligence should discuss with the issuer and/or request the issuer to provide, or make available for inspection, documents relating to some or all of the following categories of information:
  - Current and Former Properties
  - Environmental Management
  - Audits/Inspections
  - Phase I and II Environmental Site Assessments
  - Claims/Information Requests/Notices of Violation
  - Environmental permits
  - Asbestos/PCBs/Mold
  - Employee Safety and OSHA-Related Documents
  - Audit Letters by Outside Counsel
  - Divestiture /Acquisition Agreements and Agreements with Indemnification, Allocation and/or Cost Sharing Provisions
  - Budgets, Proposed Capital Projects and Other Expenditures for Environmental Matters
  - Financial Reserves for Environmental Matters
  - Insurance Information
- In addition to general requests, due diligence should be tailored to specific environmental concerns associated with specific industries (e.g., companies in the pulp and paper industry can face significant compliance costs in connection with implementation of the “Cluster Rules” under the Clean Water Act and the Clean Air Act).

- a. Due Diligence Requests Relating to Current and Former Properties
- Sample Request: Identify and describe all real property or other facilities *currently* or *formerly* owned, operated or leased, either *directly* or *indirectly* (i.e., through subsidiaries, joint ventures, operating units or other related entities). All predecessor companies, discontinued operations and formerly owned, leased or operated properties should be identified, and, where possible, the information requested below should be provided with respect to both current and former properties and operations.
  - Under CERCLA and similar state statutes, both current owners and operators and former owners and operators at the time of the disposal are potentially liable. Therefore, it is important to obtain information regarding environmental conditions at all current and former properties.
  - In addition, under CERCLA, a parent company can be held (i) indirectly liable as an owner or operator of its subsidiary's facility through traditional veil-piercing and (ii) directly liable as an operator if it manages, directs or conducts pollution-related operations at a subsidiary — i.e., operations relating to the leakage or disposal of hazardous wastes, or decisions about compliance with environmental regulations.
- b. Due Diligence Requests Relating to Environmental Management
- Sample Request: Identify and describe (i) individuals currently responsible for environmental compliance and (ii) environmental compliance programs and practices. Indicate whether facilities have achieved ISO 14001 certification.
  - A strong environmental management program helps provide comfort that environmental issues are being adequately addressed.
  - Many global companies have taken steps to achieve certification under the International Organization for Standardization (“ISO”) 14001. ISO 14001 contains voluntary standards relating to Environmental Management Systems (“EMS”). Certification under ISO 14001 requires the following:

- A policy statement committing to pollution prevention, continual improvement of the EMS and overall environmental performance, and compliance with law.
  - Identification of all of the company's activities, products and services that could significantly impact the environment.
  - Development of performance objectives to achieve the policy statement's commitments and implementation of the EMS to meet the objectives.
  - Establishment of a program to conduct periodic audits of the EMS' operation.
  - Implementation of actions to correct deviations from the EMS, including periodic evaluations of the company's compliance with law.
- c. Due Diligence Requests Relating to Environmental Audits/ Inspections/Phase I/II Site Assessments
- Sample Request: Provide copies of all (i) environmental audits, action plans, reports, impact statements, tests, site investigations or assessments, whether performed internally or by an outside consultant; (ii) reports or other documents relating to any inspection by any governmental entity concerning compliance with environmental laws; (iii) notices or filings pursuant to any environmental law; and (iv) current spill prevention, control or countermeasure plans and emergency response plans. In addition, to the extent known, identify any conditions or events which might give rise to environmental liabilities.
  - Some companies conduct routine or periodic environmental audits to assess compliance with environmental laws and regulations.
  - Audits may be performed in-house or by outside consultants.
  - EPA and many states have audit policies allowing for reduced penalties if a company conducts a voluntary audit, discloses the findings within a specified time period, and promptly implements any necessary corrective action.
  - A Phase I environmental site assessment is a review of historical and current information relating to a site and adjacent properties to determine if there are Recognized Environmental Conditions ("RECs") — problems which indicate known or potential contamination.

- Phase I's are often conducted by purchasers and/or sellers in connection with an acquisition/divestiture or by lenders in connection with financing.
  - Phase I's are rarely conducted by underwriters in the securities offering context (but review of Phase I's previously conducted is a significant part of an underwriter's document review).
  - The site assessment is used to support the argument that the owner should be considered an "innocent landowner" or a "bona fide prospective purchaser" and to assist in assessing the business risk of a transaction.
  - Phase I's occasionally will include review of compliance, liability for offsite waste disposal and former/divested facilities.
  - Phase I's do not include soil and/or groundwater sampling.
- A Phase II environmental site assessment includes soil and/or groundwater sampling to assess environmental conditions at the site.
- d. Due Diligence Requests Relating to Claims/Information Requests/Notices of Violation
- Sample Request: Provide copies of all administrative or judicial orders, injunctions, notices, records of decision, claims, complaints or correspondence discussing actual or potential liabilities, requests for information, citations or notices of violation relating in any way to environmental matters (including, without limitation, claims for cleanup costs, fines or penalties, property damage and/or personal injury, and notices of liability or potentially responsible party (PRP) status under CERCLA or state law).
  - This request is made in order to confirm compliance with Item 103 of Regulation S-K, which requires disclosure of certain environmental legal proceedings. Registrants must disclose any legal proceeding in which the government is a party if such proceeding involves potential monetary sanctions greater than \$100,000.

- Under this rule, a company with a market capitalization of billions of dollars must still disclose a \$100,000 penalty.
  - A 1998 survey by the EPA's Office of Enforcement and Compliance Assurance found that 74% of companies failed to report in their 10Ks environmentally related legal proceedings that could result in governmental monetary sanctions over \$100,000.
  - In a 2001 presentation to the ABA, the EPA reported that 96% of companies facing federally-imposed toxic clean-up expenses failed to properly disclose the liabilities to shareholders.
  - The due diligence request relating to claims includes a request for PRP notices and requests for information. Large industrial companies with a long history of operation may have been named a PRP at dozens of contaminated sites (including sites where such companies are current or former operators or sites where such companies disposed of hazardous waste).
  - The due diligence request relating to claims includes any citizen suits and claims relating to toxic torts.
  - During telephone/in-person interviews, parties conducting environmental due diligence should inquire whether there are any threatened claims relating to environmental matters.
- e. Due Diligence Requests Relating to Environmental Permits
- Sample Request: Provide copies of all environmental permits, waivers, exemptions, exclusions, variances, warnings, notices of violation, fines, communications with regulatory authorities regarding compliance with any such environmental permits, and any proposed or pending applications for issuance or renewal of any environmental permits.
  - Such information is necessary to assess a company's compliance with environmental laws and regulations.
  - During telephone/in-person interviews of relevant environmental personnel, parties conducting environmental due diligence should inquire regarding the likelihood that critical environmental permits will not be renewed, or that any renewals will contain requirements for additional pollution control measures requiring material capital expenditures.

f. Due Diligence Requests Relating to Asbestos/PCBs/Mold

- Sample Request: Provide copies of all documents relating to the presence, use, handling, storage, transportation, removal or disposal of asbestos-containing materials (“ACM”), PCBs or PCB-containing equipment, or mold, including any ACM, PCB or mold surveys or studies, and a list of any properties where any known or suspected ACM, PCBs or PCB-containing equipment, or mold is or was located.
- Potential asbestos liability includes (i) liability arising from claims alleging exposure to asbestos and (ii) costs relating to abatement and/or remediation of asbestos-containing material (“ACM”) at current facilities.
- Liability relating to asbestos claims can be significant.
  - Since 1979, over 80 companies have filed for bankruptcy protection due to liability in connection with asbestos claims.
  - Published reports put the total cost for asbestos losses at \$200 billion in the U.S., with defendant corporations paying approximately \$78 billion and insurance companies absorbing \$122 billion of the costs.
  - After years of pursuing primarily ship building companies and companies that made ACM, asbestos plaintiffs have begun routinely suing second-tier asbestos defendants, such as companies that sold or installed asbestos or products containing asbestos and companies that owned buildings containing ACM.
  - Due diligence queries relating to asbestos claims should include the following:
    - How many total claims have been filed and how many claims remain pending?
    - How many claims are filed each year?
    - How many claims are settled each year?
    - What is the average cost of settling a claim?
    - What are the annual defense costs?

- How many claims are covered by insurance? Are defense costs covered by insurance? Is there a cap on insurance liability?
- In general, liability relating to abatement and remediation of ACM at current facilities is not as significant as liability relating to asbestos exposure claims.
  - Except for certain categories of facilities (e.g., schools), there is no need to abate/remediate ACM unless such ACM is damaged and friable.
- One of the fastest growing areas of toxic tort litigation is claims arising from exposure to toxic mold. In 2001, a Texas family received a jury verdict of \$32 million (later reduced to \$15 million) for damages resulting to mold exposure. Since then, approximately 10,000 mold cases have been filed against various defendants – including land owners, real estate agents, property managers, developers, employers, contractors, architects and engineers.

g. Due Diligence Requests Relating to Employee Safety and OSHA

- Sample Request: Provide copies of all OSHA inspections, assessments, citations, warnings, notices of violation or other correspondence regarding noncompliance or fines; material safety data sheets (MSDS); studies concerning health effects upon employees in connection with occupational exposure to any substances; and documents relating to Worker’s Compensation claims and amounts paid to employees pursuant to such claims or pursuant to other actions alleging personal injury during the last 5 years.
- Typical OSHA penalties involve minor amounts (e.g., \$1,000); however, penalties can be significant if an employee is killed or seriously injured in connection with an OSHA violation.
- Companies that handle certain hazardous substances (e.g., lead) may be required to conduct air monitoring to ensure compliance with regulatory standards and medical monitoring to ensure that levels of toxic substances in employee blood are safe.
- Worker’s Compensation claims relating to exposure to hazardous substances can be costly.

h. Due Diligence Requests Relating to Audit Letters

- Sample Request: Please provide copies of all letters or other documents prepared internally or by any legal counsel in response to inquiries by any financial auditors reflecting any information relating in any way to environmental matters.
- Such audit letters often contain well-drafted summaries of potentially material environmental liabilities.
- Typically the audit letters are also requested as part of the main corporate diligence request.

i. Due Diligence Requests Relating to Agreements

- Sample Request: Provide copies of any contractual indemnity, allocation, or other cost-sharing provisions relating to environmental liabilities, including without limitation all such provisions contained in any acquisition, sale or merger agreement, or in any separate letter agreement or other document.
- Divestiture/acquisition agreements and settlement agreements may contain significant ongoing environmental indemnification obligations as well as benefits and/or contain covenants requiring the performance of costly corrective action.
  - For example, a company could be a PRP at dozens of contaminated sites based on the historic waste disposal of a predecessor. If the predecessor is financially viable and agreed to indemnify the company for liabilities relating to pre-closing waste disposal, such liabilities may not be material.
  - Conversely, a company with currently benign environmental operations could have indemnification obligations in connection with historic operations.
  - Parties conducting environmental due diligence must conduct a separate analysis as to the status and survival/limitations contained in indemnification agreements.
- Likely recoveries of costs pursuant to such agreements should not be netted out for purposes of recording an environmental liability (i.e., the liability must be recorded separately from any contribution/indemnification rights).

j. Due Diligence Requests Relating to Capital Expenditures

- Sample Request: Please provide copies of all budgets, proposed capital projects, and other estimates of capital costs and other expenditures for environmental matters.
- Item 101(xii) of Regulation S-K requires disclosure of material effects that compliance with environmental law may have on capital expenditures, earnings and competitive position.
- During telephone interviews, parties conducting environmental due diligence should explore the need for capital expenditures in connection with anticipated regulatory changes.
- If several companies in an industry sector disclose potential capital expenditures in connection with a risk or uncertainty relating to a new or proposed environmental regulation, a competitor's failure to disclose the risk may trigger closer scrutiny by the SEC, shareholders and/or public interest groups.

k. Kyoto Protocol on Climate Change

- The Kyoto Protocol requires 39 industrial nations to reduce their emissions of certain greenhouse gases linked to global warming. To become effective, the Kyoto Protocol required backing from at least 55 countries and support from nations representing at least 55 percent of carbon dioxide emissions from industrialized nations as of 1990. The Kyoto Protocol passed the second hurdle in November 2004 upon Russia's ratification and became legally binding on its participants as of February 16, 2005.
- Companies that operate in countries that have ratified the Kyoto Protocol may be required to disclose in their MD&A any material costs of compliance with the protocol.
  - The Kyoto Protocol has been ratified by more than 150 nations, including EU, Russia, Canada, Mexico, China, Norway and Japan.
  - In 2001, the US announced that it would not ratify the protocol.
- A recent survey conducted by Carbon Disclosure Project (an investor group concerned about the financial risks of global climate change) of the 500 largest global companies found that most companies consider climate change to be a legitimate financial risk that will have a growing impact on profitability.

- A 2002 Survey of Climate Change Disclosure in SEC Filings of Automobile, Insurance, Oil & Gas, Petrochemicals and Utilities Companies, prepared by Friends of the Earth, alleged that companies are failing to report material environmental issues relating to climate change. An updated survey, published in 2003, found some improvement in disclosure, but concluded that the majority of companies in such sectors still fail to disclose risks relating to climate change. Friends of the Earth released a third survey in 2004, finding the overall climate reporting rate to be relatively low at 39 percent, but with impressive reporting by the electric utilities sector.
  - In April 2004, 13 major public pension fund leaders called on the SEC to require companies to disclose the financial risks of global warming.
  - In the 2004 and 2005 proxy seasons, at least 28 and 33, respectively, global warming shareholder resolutions were filed. As a result of such shareholder pressure, a number of companies (including American Electric Power, Cinergy Corp., Southern Company, TXU, Great Plains Energy Inc., Alliant Energy, WPS Resources, MGE Energy, Ford Motor Co., General Motors, Anadarko Petroleum, The Home Depot, Lowes, Chubb, Toronto-Dominion and Simon Property Group) agreed to disclose risks related to potential future constraints on carbon dioxide and other emissions.
1. Due Diligence Requests Relating to Financial Reserves
- Sample Request: Please provide information regarding any financial reserves in connection with environmental matters, and a complete breakdown of any such reserves.
  - Various accounting obligations relating to contingent environmental liabilities can affect disclosure and, consequently, environmental due diligence inquiries. Such accounting obligations are reflected in FASB Statement 5, SAB 92, SOP 96-1, FAS 143 and FIN 47.
  - A telephone interview of the company's CFO and its accountants may be necessary to explore the company's environmental accounting policies and the implementation of those policies.

- FIN 47 will likely require companies to conduct diligence to (1) identify all of their asset retirement obligations and (2) value the identified obligations. Such valuations must be conducted without regard to any “undue cost or effort.” Environmental Data Resources has launched an initiative to help clients attain compliance with FIN 47.

m. Due Diligence Requests Relating to Insurance Information

- Sample Request: Please provide copies of all insurance claims, notices or other communications with insurance carriers relating to environmental liabilities since 1980.
- There have been many environmental insurance litigations relating to historic contamination under old Comprehensive General Liability (“CGL”) policies drafted at a time when neither party anticipated CERCLA-type environmental liability. These old CGL policies are “occurrence” policies (rather than “claims made” policies) and can provide coverage if the insured can show that contamination occurred during policy years. Coverage often depends on whether the environmental incident was “sudden and accidental.” Some companies have settled with their insurance companies for significant sums under these policies.
- Some insurance companies, like AIG and Chubb, are now offering environmental insurance products in an attempt to bridge gaps in environmental indemnities. Such insurance products include:
  - cleanup cost cap insurance (capping environmental cleanup costs in order to mitigate the uncertainty in estimating cleanup costs)
  - pollution legal liability insurance (providing coverage for losses due to pre-existing and unknown pollution conditions)
  - environmental pollution programs (combining elements of cleanup cost cap and pollution legal liability coverage)
- Some insurance companies offer environmental insurance products to address ongoing environmental risks (e.g., spills during policy period).

6. Impact of Sarbanes-Oxley Act of 2002 on Environmental Disclosure
- The Sarbanes-Oxley Act requires CEOs and CFOs to file certifications with their company's quarterly and annual SEC filings providing the following:
    - To the CEO's/CFO's knowledge, the report does not contain material omissions or misstatements.
    - To the CEO's/CFO's knowledge, the financial statements fairly present in all material respects the company's financial condition, results of operation and cash flows.
    - The CEO/CFO is responsible for establishing and maintaining, or causing to be established under his or her supervision, a system of disclosure controls and procedures designed to ensure that information required to be disclosed is reported in a timely manner; and the CEO/CFO has evaluated the effectiveness of the disclosure controls as of the end of the period covered by the report and has provided its conclusions with respect to such evaluation in the report.
    - The CEO/CFO is responsible for designing, or causing to be designed under his or her supervision, a system of internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external use in accordance with GAAP; the CEO/CFO has disclosed any change in internal control over financial reporting that occurred during the last fiscal quarter (the fourth quarter in the case of an annual report) which has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and the CEO/CFO has reported (1) any significant deficiencies or material weaknesses in the design or operation of the internal control over financial reporting and (2) any fraud, whether or not material, involving management or other employees who have a significant role in the registrant's internal control over financial reporting, to the registrant's audit committee and outside auditors.
  - The Company's environmental disclosure and the accounting treatment of environmental liabilities is therefore covered by the CEO/CFO certifications. Management should review environmental reporting and financial reporting practices and, if necessary, adopt new procedures for assessing and reporting environmental liabilities.

- The new attorney up-the-ladder reporting requirement could also require the company's counsel (internal or external) to report to the CLO, CEO, audit committee or board if the lawyer believes there is a material violation of the securities laws, including a material misstatement in the environmental disclosure.

## NOTES

## NOTES