

Much has been written in recent years on the subject of the U.S. Securities and Exchange Commission's (SEC) requirements for environmental disclosure by publicly traded companies and how the general provisions of Regulation S-K¹ (plus a number of environment-specific guidances and interpretations from the SEC and others) affect the inclusion of environmental factors in corporate financial disclosure documents. Less attention seems to have been paid, however, to the way in which these securities laws and markets have led to a noticeable evolution in corporate reporting as evidenced by dramatically broader corporate environmental-, sustainability-, and social responsibility-related disclosures—both in required SEC filings and in voluntary reports—even in the absence of dramatic changes in the underlying environmental statutes or in Regulation S-K itself.

Recent trends reflect that publicly traded companies are producing noticeably expanded environmental disclosures in their mandatory SEC reports while, in tandem, producing additional voluntary reports—variously styled as corporate sustainability, environmental, or social responsibility reports—relating to environmental and other social effects of corporate activity that are targeted at the investing public and other communities relevant to a company's reputation and success. This article discusses how stakeholder influence and other changes in the securities laws and markets have real potential to be a significant driver for transparency and innovation in the sustainability and environmental arenas.

ENVIRONMENTAL DISCLOSURE

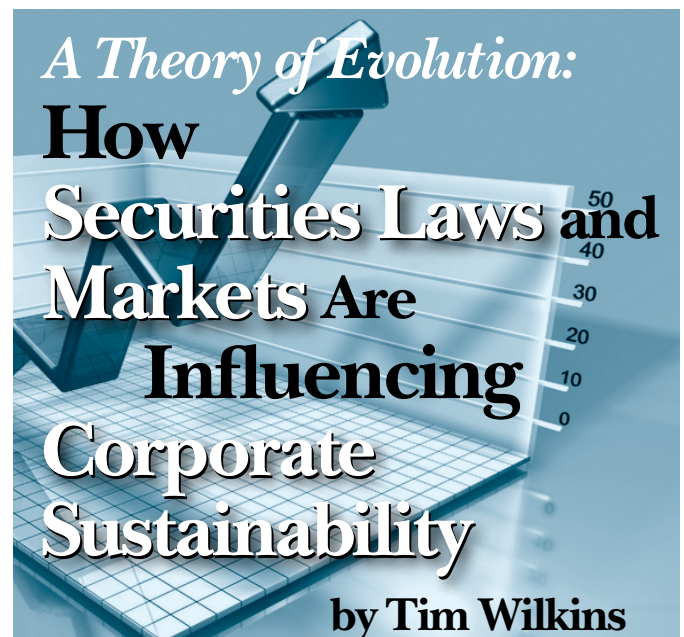
The following is a brief primer on SEC environmental disclosure requirements.

Regulation S-K

Regulation S-K¹ contains three principal elements that compel discussion of corporate environmental performance in the SEC filings of publicly traded companies: Item 101, which requires discussion of material costs and consequences of compliance with laws, including environmental laws, in terms of the company's capital expenditures, earnings, and competitive position; Item 103, which directs companies to describe material pending legal proceedings, including, without limitation, significant environmental penalty actions (which are expressly deemed material if expected to result in monetary sanctions of US\$100,000 or more) or material cleanup actions; and Item 303, which focuses on the reporting of "management's discussion and analysis" about known trends and uncertainties that are reasonably anticipated to be material. This disclosure framework motivates publicly traded companies to worry about environmental results because they have to report on those results to institutional investors, the media, and the investing public.

Interpretive Guidance

The black letter rules of Regulation S-K on what must be disclosed in corporate SEC filings have also received



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additional interpretive gloss from instructions that are included as appendices to the regulation, from subsequent releases issued by SEC staff and by the Financial Accounting Standards Board (FASB), and from influential third-party organizations, including ASTM International and the American Institute of Certified Public Accountants. These documents clarify the breadth and depth of Regulation S-K by arguably widening the issues and activities companies must consider, narrowing the window of excuses for not reporting, and providing additional direction on how uncertainties should be reported or uncertain costs calculated.

These interpretations seemed geared toward capturing in mandatory filings items that traditionally might have been omitted from many corporate financial reports because either they were not fully manifested or calculating their potential materiality with any certainty would be difficult. While a diversity remains in the approaches companies use to discuss environmental costs and consequences in their SEC filings—and while the above-referenced guidances and interpretations by no means eliminate uncertainty about what the SEC requires—by expanding the topics expressly required to be covered and by narrowing the available reasons companies might use to not report on certain issues, these efforts by the SEC, FASB, and others appear calculated to broaden environmental disclosure and transparency in companies' mandatory SEC filings.

Sarbanes-Oxley

The adoption of the Sarbanes-Oxley Act in 2002 announced a broad effort to enhance the accuracy of corporate financial disclosure by tightening certain standards, requiring

additional certifications, and sharply increasing the penalties corporate officers face for inaccuracies. Like Regulation S-K, Sarbanes-Oxley did not contain express environmental requirements, although the broader reporting and responsibility scheme, added certifications, and enhanced penalties provided by the act undoubtedly increased the seriousness with which many companies viewed their SEC filings. Sarbanes-Oxley also has at least indirectly influenced the use of environmental management systems (EMSs) because of the act's emphasis on adequate internal controls and more formal systems of management and internal oversight. At least in theory, EMSs can provide a systematic set of controls in the environmental arena that are both formal and demonstrable, not to mention independently certifiable pursuant to standards like ISO 14000. A formal EMS, especially one based on or certified to a recognized international standard, is one way to help ensure that a company is managing its risks and pursuing greater internal integrity, consistency, communication, and transparency in its handling of environmental issues. As I have written elsewhere,² however, EMSs are replete with legal pitfalls; holding an EMS out as support for claims made in closely watched securities filings would seem likely to further complicate those risks.

Ultimately, Regulation S-K, its interpretive clarifications, enforcement attention from the SEC, and the hammer of Sarbanes-Oxley together seem calculated to broaden and deepen corporate environmental disclosure.

INVESTOR-DRIVEN INITIATIVES

This evolution of environmental disclosure has not occurred in a vacuum. Outside of the two-sided relationship between regulator and regulated under the securities laws, numerous private actors are exerting influence both directly and indirectly on the SEC and on publicly traded companies. Most directly, environmental advocacy and green watchdog groups have encouraged the SEC to tighten its rules on environmental disclosure^{3,4} or petitioned the SEC to pursue enforcement actions against particular companies that in their view failed to make required disclosures.⁵ Meanwhile, environmentalists and others who have invested in publicly traded companies have taken the opportunity to present resolutions at shareholder meetings, encouraging companies to disclose broader environmental and sustainability information or to change their approach to particular environmental issues.^{6,9} And with the advent of "green" investment funds, there are now significant investment dollars deliberately chasing the stock of companies that reduce their environmental footprint and report broadly and transparently on their environmental impacts and sustainability efforts.^{6,8,10,11}

Less directly, organizations and programs like Ceres (www.ceres.org) and the Global Reporting Initiative (www.globalreporting.org) have been preparing studies about environmental disclosure practices¹²⁻¹⁴ and offering suggested standards for corporate environmental sustainability and social responsibility reporting¹⁵ to help further these goals. All of these influences have the potential to spur corporate

behavior toward visible and demonstrable environmental innovations and improvements and toward clearer and more detailed reporting. They also serve to pressure the SEC to maintain its policy and enforcement focus on the transparency, thoroughness, and accuracy of corporate filings to a degree that it otherwise might not. And as some companies provide SEC filings containing greater breadth and detail on environmental issues in their SEC filings, similarly situated companies that do not are likely to face pressure—or at least pointed questions—both from the SEC and the investing public.

MANDATORY FINANCIAL REPORTING

A confluence of many factors has led major companies to broaden and deepen the environmental disclosures found in their SEC filings over time. As an anecdotal test of this theory, I conducted a detailed review of the 1995 and 2005 annual reports of several major "household name" companies from different heavy industries. Without exception, this review revealed a marked increase in the amount and depth of text devoted to environmental issues, trends, and risk factors. This evolution is entirely consistent with my experience (as well as the experience of many colleagues) and is reflected in the hundreds of environmental disclosures I have reviewed in connection with securities, transactional, and other environmental work across many industry sectors over the same period. Discussions of individual state environmental enforcement actions, concerns about the availability and cost of emissions allowances under the Clean Air Interstate Rule, disclosure of potential liabilities at the early stages of the Superfund process, and the potential effects of climate change and carbon regulation in contemporary filings reflect a level of emphasis and detail far greater than was typical a decade ago.

Some of this evolution in disclosure practices arises from improvements in corporate environmental programs, which now identify and manifest more issues than they may once have, not to mention genuine corporate buy-in to the notion that greener business can often be good business.^{16,17} Some is attributable to the toughening of penalties and requirements for internal controls resulting from the Sarbanes-Oxley Act, and the more formalized outputs of corporate management systems that have become increasingly popular. Some of this trend can be attributed to policy clarifications from the SEC and accounting standards organizations regarding expectations and standards for mandatory disclosure. But a significant influence appears to have come from green investment funds, institutional investors concerned about big picture environmental trends, and environmental advocacy groups that develop reports, pursue petitions, and facilitate shareholder resolutions.

Also, a substantial contribution to the broadening of environmental disclosure is resulting from the evolving public state of environmental issues generally. Using climate change as an example, it is becoming much harder for companies that are heavily engaged in greenhouse gas (GHG)-emitting activities to not provide some disclosure about the likely impacts of global warming or carbon

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regulation on their business, seeing that scientists and the media have proclaimed with increasing certainty (and increasing volume) that climate change is quite real and is being influenced by human activity, including fossil fuel consumption,¹⁸ policy-makers at the federal and state levels begin to undertake carbon regulation more seriously than in the past,¹⁹ and several sizeable lawsuits allege massive potential corporate liabilities associated with GHG emissions as a cause of global warming.²⁰ In a real sense, even if companies have significant arguments to contest allegations that they have liability for the potential costs of climate change or that the potential for carbon regulation is not yet a trend they have determined is likely to cause material corporate losses, there is undoubtedly some risk in not providing such disclosure where perceptions of the issue's seriousness and materiality appear to be growing. Companies obviously are paying heed to these influences. A recent Friends of the Earth survey of climate change disclosures reflects that 49% of publicly traded companies in GHG-intensive sectors like oil and gas, electric power, and auto manufacturing included some discussion of climate change in their 2005 SEC filings, compared to 26% in 2000.²¹

VOLUNTARY DISCLOSURE

Environmental disclosures in mandatory securities filings afford publicly traded companies a limited opportunity to report on "good news," where, for example, a company has reduced its costs or liabilities through environmental improvements,

has arguments that potential liabilities are mitigated by certain circumstances, or where its competitive position on particular environmental issues is superior to other companies. Many companies, however, have recognized that some investors, customers, environmental groups, agencies, and others may not get the full picture of their corporate environmental performance or broader social responsibility from their SEC filings alone. And indeed, in some circumstances, investors and environmentalists have demanded through shareholder resolutions or otherwise that particular companies perform a full accounting of their environmental footprint (or, more broadly, its sustainability or even its overall social responsibility) and then report on that accounting publicly.⁸

Sustainability reports touch on many of the same issues as voluntary environmental reports, but with the additional layers of meaning conveyed by the term "sustainability"—the concept that a company's activities will ultimately be renewable and enduring in all respects and reflect good stewardship of all relevant resources—which go beyond the pollution-related issues that tend to dominate environmental-focused reporting. Corporate social responsibility reporting conceptually goes even further, focusing not just on whether a set of corporate practices and activities can physically endure, but on issues such as ethics, workforce diversity and nondiscrimination, fair trade, health care, and literacy efforts. In any event, these forms of voluntary reports purport to provide information that some institutions, investors, and activists have been vocal in seeking through shareholder resolutions and through socially responsible investment initiatives and funds. Companies' accession to these requests—reflected in a sharply growing number of companies preparing these reports—suggests that the securities markets have influenced the evolution of these types of reporting. As reporting broadens and more companies report on their progress on sustainability, those companies will face heightened incentives to pursue environmentally-beneficial efforts that are calculated to produce such "good news."

Reporting on environmental performance, sustainability, and social responsibility introduces additional levels of risk for the reporting companies. Companies need to be mindful of the risks associated with such reporting and with the language and the information they use. Obviously, mandatory reporting is mandatory, regardless of any legal risk that may result. But significant caution is warranted in the development and drafting of those disclosures in light of the potential legal consequences. Reporting companies need to ensure that they have effectively identified

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and accurately depicted the costs, proceedings, liabilities, trends, and uncertainties that are required to be disclosed pursuant to Regulation S-K and its progeny. For example, the cease-and-desist order from the SEC in November 2006, complaining that Ashland Inc. reduced its environmental remediation reserves without a reasonable, documented basis for such reductions underscores the need for vigorous review of the facts underlying corporate disclosures and reminded the corporate community that SEC remains interested in environmental disclosure issues and in the internal controls companies use to address environmental matters.²²

As to voluntary reporting, companies will want to carefully consider whether and how they will undertake such efforts for much the same reason. Voluntary reports that understate a company's environmental exposure or that otherwise contain potentially misleading statements can easily arise from well-meaning efforts to explain mitigating circumstances respecting particular risks, to make claims about positive environmental performance, or to highlight a company's favorable competitive position on environmental matters. Although the latter issues have the potential to arise in the context of mandatory SEC filings, risks associated with reporting on companies' "good news" (or that minimize candid discussion of the bad news) are virtually inherent in voluntary environmental, sustainability, or corporate social responsibility reporting, which is often calculated to offer a broader, but generally positive, environmental or social message about a company. While potentially subject to less automatic scrutiny by the SEC and the investing public than companies' mandatory filings, they are arguably subject to the securities laws and to SEC review and enforcement if they contain material statements judged to be fraudulent. There may also be state law risks arising from corporate public statements—as reflected in the now-settled Kasky lawsuit against Nike Inc., which complained of misstatements in the company's public relations efforts about worldwide labor practices as actionable under California state law, as well as in the state fraud statutes like those used by former New York Attorney General Eliot Spitzer to such significant effect against a variety of Wall Street powers.²³ Accordingly, great care in the preparation and presentation of such statements is warranted.

SUMMARY

Evolving trends in the SEC filings and the voluntary environmental, sustainability, and corporate social responsibility reporting of major companies reflect a growing awareness of the heightened importance of these factors to their continued success, as well as to regulators, activists, and the investing public. These types of public disclosure certainly appear to be on the rise, at least partly in response to these multi-faceted categories of demand. And, of course, as companies face expanded mandatory and voluntary disclosure demands, a commensurate incentive to seek improvements in these areas may well arise. As companies pursue such disclosures, however, great caution on whether and how to report is warranted given the very real risks under federal and state laws that are calculated to prevent and punish securities fraud and other forms of misleading public statements. **em**

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