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Loopholes in Corporate Environmental Reporting and What Is Being  
Done to Close Them: A Recent GAO Study Examines the Status of  
Environmental Reporting to the SEC and Suggests Improvements

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LOOPHOLES IN CORPORATE ENVIRONMENTAL  
REPORTING AND WHAT IS BEING DONE TO CLOSE THEM:  
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I. INTRODUCTION

While the costs of compliance with environmental protection laws have reached astronomical levels, concerns have arisen surrounding the Securities and Exchange Commission's (SEC) ability to sufficiently regulate corporations' disclosure of these costs.<sup>1</sup> Corporations, arguably the greatest polluters, are scrambling for new and more reliable ways to ensure satisfactory compliance with ever-changing environmental laws.<sup>2</sup> Equally desperate to keep up, the government and the public are each striving to curb the devastation to the environment through enforcement of environmental protection and pollution laws.<sup>3</sup> One method of enforcement, which has emerged amidst cutbacks to the Environmental Protection Agency's (EPA) enforcement budget, is reliance on the SEC's disclosure requirements.<sup>4</sup> The SEC's environmental disclosure requirements traditionally have been a means of informing investors of material

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1. See Mitchell F. Crusto, *Green Business: Should We Revoke Corporate Charters for Environmental Violations?*, 63 LA. L. REV. 175, 225-26 (2003) (considering whether general corporate law promotes environmental protection and suggesting changes to ensure further protection). In the past 15 years, compliance costs for various environmental protection laws have ranged from \$24 billion for the Clean Air Act in 1990 to \$250 billion for waste control in 2000. See *id.* at 226. There are concerns that corporations are not reporting these costs accurately and in turn the SEC is unable to adequately determine this accuracy. See *id.* at 233-34; see also Sanford Lewis & Tim Little, *Fooling Investors and Fooling Themselves: How Aggressive Corporate Accounting and Asset Management Tactics Can Lead to Environmental Accounting Fraud*, THE ROSE FOUNDATION FOR COMMUNITIES AND THE ENVIRONMENT (July 2004), <http://www.rosefdn.org/fooling.pdf> (discussing SEC's inability to assess accuracy of environmental costs).

2. See David Monsma & John Buckley, *Non-Financial Corporate Performance: The Material Edges of Social and Environmental Disclosure*, 11 U. BALT. J. ENVTL. L. 151, 152-53 (2004) (noting corporate reliance on various policies and procedures to meet various legal requirements).

3. See Terra Pfund, *Corporate Environmental Accountability: Expanding SEC Disclosures to Promote Market-Based Environmentalism*, 11 MO. ENVTL. L. & POL'Y REV. 118, 119 (2004) (arguing enforcement is better attained through expansion of SEC's disclosure requirements).

4. See *id.* (noting use of these requirements traditionally took role of market-based incentives as opposed to regulatory devices to enforce environmental laws).

environmental liabilities that may affect future financial status.<sup>5</sup> Now, they are increasingly used by socially responsible investors to determine which investments are environmentally-friendly and by the government as a regulatory device to ensure compliance with environmental protection laws.<sup>6</sup> Given the new and quickly increasing importance of the disclosure requirements, attention is appropriately drawn to the ability of the SEC to adequately impose and enforce those disclosure requirements.<sup>7</sup>

Following a series of inflammatory public corporate scandals, the public, as well as the government, started to question the SEC's competency to regulate corporate America.<sup>8</sup> In addition, a 2001 EPA report revealed that seventy-four percent of public companies facing some material environmental regulatory action did not disclose these liabilities in their SEC filings as required.<sup>9</sup> Soon thereafter, Congress passed the Sarbanes-Oxley Act which changed the manner and extent to which corporations trading on U.S. exchanges report their business to the SEC.<sup>10</sup> Riding the coattails of public support for broad, sweeping changes to corporate disclosure

5. *See id.* (explaining traditional role of SEC's environmental disclosure requirements).

6. *See* Monsma & Buckley, *supra* note 2, at 157-59 (noting materiality requirement of SEC disclosure); Pfund, *supra* note 3, at 118-19 (noting use of SEC filings by investors to make "environmentally educated investment decision[s]" and use by government as regulatory tool).

7. *See* Pfund, *supra* note 3, at 118-19 (discussing reliance on "green" investor relations organization's presentation in reporting that companies are not disclosing all their environmental liabilities to SEC); Crusto, *supra* note 1, at 233 (criticizing "materiality" standard in suggesting that "federal securities laws do little to promote corporate environmental protection"); Monsma & Buckley, *supra* note 2, 152 n.3, 157 n.24 (noting concern that SEC disclosure requirements fail to inform investors of environmental liabilities and remarking that even more sophisticated investors would have difficulty sifting through SEC filings) (citing John W. Bagby, Paula C. Murray & Eric T. Andrews, *How Green Was My Balance Sheet?: Corporate Liability and Environmental Disclosure*, 14 VA. ENVTL. L.J. 225, 337-38 (1995)).

8. *See* Crusto, *supra* note 1, at 175 (noting "recent corporate abuses in financial reporting"); U.S. GOV'T ACCOUNTABILITY OFFICE, ENVIRONMENTAL DISCLOSURE: SEC SHOULD EXPLORE WAYS TO IMPROVE TRACKING AND TRANSPARENCY OF INFORMATION 1 (July 2004) [hereinafter GAO-04-808] (remarking on effect of corporate scandals in shaking investor confidence in reporting).

9. *See* Monsma & Buckley, *supra* note 2, at 202 n.189 (referencing report in context of letter to SEC Chairman, Jonathan G. Katz); Pfund, *supra* note 3, at 121 n.29 (remarking that corporations were rewarded for noncompliance because of SEC lax enforcement of requirements) (quoting Donald Sutherland, *EPA Reveals U.S. Publicly Traded Corporations Hide Billions in Environmental Debt*, RISKWORLD (2002), available at <http://www.riskworld.com/NEWS/02q2/nw02a096.htm>).

10. *See* Crusto, *supra* note 1, at 175 (noting that Sarbanes-Oxley Act was written in response to concerns over abuses in financial reporting); *see also* Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201-7266 (2005) [hereinafter Sarbanes-Oxley] (amending earlier securities acts).

laws, a group of U.S. senators and representatives requested a study by the Government Accountability Office (GAO)<sup>11</sup> examining the status of environmental disclosure in particular.<sup>12</sup> The study examined “(1) key stakeholders’ views on how well [the] SEC has defined the requirements for environmental disclosure, (2) the extent to which companies are disclosing such information in their SEC filings, (3) the adequacy of [the] SEC’s efforts to monitor and enforce compliance with the disclosure requirements, and (4) experts’ suggestions for increasing and improving environmental disclosure.”<sup>13</sup> Finally, the report made a number of recommendations to improve the transparency of environmental disclosure information and the SEC’s ability to track it.<sup>14</sup> Although the study was largely inconclusive in being able to identify “red herrings” of obfuscation, it was successful in revealing a number of areas in which corporations can circumvent environmental reporting requirements.<sup>15</sup> More importantly, the study brought together some of the world’s foremost experts to suggest possible solutions to close those loopholes.<sup>16</sup>

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11. Recently, the GAO changed its name from the General Accounting Office to the Government Accountability Office. See GAO’s Name Change and Other Provisions of the GAO Human Capital Reform Act of 2004, <http://www.gao.gov/about/namechange.html> (last visited Feb. 26, 2006).

12. See U.S. GOV’T ACCOUNTABILITY OFFICE, ENVIRONMENTAL DISCLOSURE BRIEFING 1 (Aug. 4, 2004) [hereinafter GAO-04-1019R] (noting that briefing was part of symposium on disclosure of environmental information in SEC filings sponsored by group of Senators and Representatives); GAO-04-808, *supra* note 8, at 1 (introducing report requested by sponsoring Senators James M. Jeffords, Jon S. Corzine and Joseph I. Lieberman on Committee on Environment and Public Works); see also Tasha Eichenseher, *Shareholders: Information Lacking on Corporate Environmental Disclosure*, GREENWIRE at 1 (July 16, 2004) (LEXIS, News and Business) (noting report was requested in response to accounting scandals and “questionable environmental underwriting”). The GAO is an independent nonpartisan agency that, upon the request of Congress, investigates how government spends tax-dollars. See *The Background of GAO*, <http://www.gao.gov/about/history.html> (last visited Feb. 26, 2006).

13. See GAO-04-1019R, *supra* note 12, at 1 (addressing contents of GAO report). Using the term “stakeholders” as opposed to “shareholders” is meant to expand the reference of those with an interest in a corporation’s activities. See Monsma & Buckley, *supra* note 2, at 173-74. “Stakeholders” have been defined as “those individuals or groups whose opinion or interests bear on a corporation’s reputation, and hence it’s brand value.” *Id.* Such individuals and groups might include shareholders as well as the public at large, non-governmental organizations, and various government entities. See *id.*

14. See GAO-04-808, *supra* note 8, at 29-36 (reporting on experts’ suggestions to improve current filing requirements).

15. See *generally id.* (summarizing with titles such as “Stakeholders Disagree on . . .,” “Little is Known About . . .,” and “Adequacy of . . . Cannot Be Determined”).

16. See *id.* at apps. III & IV at 46-51 (listing outside studies used in compiling reports as well as various industry, non-profit, government and academic experts). The list of experts consulted includes: large “green” investor resources such as

This Comment will examine some of those loopholes as well as some suggested solutions. Section II will cursorily review the background of the GAO report and briefly summarize the information covered therein.<sup>17</sup> Section III will cover the report's findings and explain that while they are largely inconclusive, this indecision is itself a cause for concern.<sup>18</sup> Section IV will offer an explanation and discussion of some suggested remedies to improve and increase environmental reporting.<sup>19</sup> Finally, Section V will discuss the potential impact of continued increased scrutiny on corporate environmental disclosure.<sup>20</sup>

## II. BACKGROUND: THE GAO REPORT

The SEC is responsible for protecting investors by requiring corporations to disclose all information that would be important in making sound investment decisions.<sup>21</sup> Important information includes financial reporting on the company's assets and liabilities, management's forward-looking analysis identifying known trends or uncertainties that may affect the company, information on the company's business practices, the status of the company's compliance with various government regulations, the status of any judicial and legal proceedings involving the company, and, more recently, a cer-

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The Rose Foundation; firms representing industries most affected by filing requirements such as Sidley, Austin, Brown and Wood, LLP; academics such as professors at Harvard and Vanderbilt Universities; industry leaders such as Pillsbury Winthrop; accounting firms such as Ernst & Young; and government officials responsible for prosecuting violations, such as the State of New York Office of Attorney General. *See id.* at app. IV.

17. For a brief digest of the GAO Report, see *infra* notes 21-36 and accompanying text.

18. For a critical analysis of the GAO's findings, see *infra* notes 37-124 and accompanying text.

19. For a discussion of proposed remedies, see *infra* notes 125-65 and accompanying text.

20. For an examination of the potential impact of increased scrutiny, see *infra* notes 166-75 and accompanying text.

21. *See* GAO-04-808, *supra* note 8, at 1-2 (explaining primary role of SEC as background information for report).

tification that all of this information is accurate and reliable.<sup>22</sup> This list is neither comprehensive nor exhaustive.<sup>23</sup>

For many companies, this reporting includes disclosure of various environmental risks, liabilities and concerns.<sup>24</sup> For example, the need for a company to engage in costly remediation efforts to clean-up a polluted manufacturing plant might be relevant to an inquiring investor.<sup>25</sup> A corporation may be able to reasonably predict the cost of compliance with some proposed or recently enacted regulation that may require, for instance, a substantial change in technology.<sup>26</sup> Additionally, the failure of a company to report an-

22. See *id.* at 1, 6 (noting elements that must be disclosed in annual and quarterly SEC filings); Jeffrey C. Fort, *Corporate Compliance Series: Designing an Effective Environmental Compliance Program*, in CORP. COMPL. SERIES: ENVTL. § 1:103 (West 2005) (discussing heightened interest in Management's Discussion and Analysis or "MD&A"). A company must, at the least, file a 10-K annually and a 10-Q quarterly. GAO-04-808, *supra* note 8, at 6. A more recent comprehensive regulation, the S-K, integrates the various requirements. See *id.* The Sarbanes-Oxley Act of 2002 requires management to certify the accuracy and reliability of corporate disclosures. See *id.* at 1, 8; see also Gregory Bibler & Robert H. Fitzgerald, *United States: Increased Scrutiny of Environmental Reporting Systems Warrants Carefully Calculated Response*, 2004 WLNR 12294985, \*1, MONDAQ, July 15, 2004, available at <http://www.mondaq.com/article.asp?articleid=27303&searchresults=1>; see also generally, Sarbanes-Oxley.

23. See Fort, *supra* note 22 (listing select reporting requirements). These and other reporting requirements stem mostly from the Securities Act of 1933 (1933 Act) and the Securities and Exchange Act of 1934 (1934 Act) and amendments to these Acts. See generally, Securities Act of 1933, 15 U.S.C. §§ 77a (2000) [hereinafter 1933 Act]; Securities Exchange Act of 1934, 15 U.S.C. §§ 78a (2000) [hereinafter 1934 Act]; Sarbanes-Oxley. In addition, the 1934 Act not only created the SEC, but authorized it to furnish its own rules and regulations, supplementing and interpreting the securities legislation passed by Congress. See 1934 Act, 15 U.S.C. §§ 4, 23 (establishing SEC and authorizing rulemaking ability). All in, these rules and regulations make up thousands of pages of disclosure requirements. See generally, 1933 Act; 1934 Act; Sarbanes-Oxley.

24. See GAO-04-808, *supra* note 8, at 1 (emphasizing importance of environmental disclosure in assessing investment strategies). Logic dictates that certain types of companies, such as software companies or banks, will have little if any environmental reporting. Energy companies, manufacturers and waste disposal companies, among others, will have increased environmental disclosures.

25. See *id.* (discussing relevant investor concerns). The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) is the regulation that controls the remediation of polluted property. See Amy Pilat McMorrow, *CERCLA Liability Redefined: An Analysis of the Small Business Liability Relief and Brownfields Revitalization Act and Its Impact on State Voluntary Cleanup Programs*, 20 GA. ST. U. L. REV. 1087, 1091 (2004). Accountability as a potentially responsible party (PRP) for remediation of a site under CERCLA is an often-quoted source of environmental liability that needs to be reported to the SEC. See Fort, *supra* note 22; Brent A. Olson, *Disclosure of Environmental Liability*, in 2 PUBLICLY TRADED CORPORATIONS: GOVERNANCE & REG. § 12:13 (West 2d ed. 2004); Bibler & Fitzgerald, *supra* note 22.

26. See GAO-04-808, *supra* note 8, at 1 (noting there may be substantial effects on companies' financial future if required to comply with such potential regulations). An extreme example might include a regulation requiring that all automobiles designed and manufactured for sale in the United States have some alter-

anticipated compliance costs in a manner deemed adequate by its shareholders may result in expensive litigation or proxy fights over shareholder proposals, which are themselves worthy of reporting.<sup>27</sup> The practice (and requirement) of reporting environmentally-related information to the SEC has come to be known as “environmental reporting” or “environmental disclosure,” and has drawn heightened scrutiny from the public and Congress in response to a number of reports pertaining to the extent and accuracy of such reporting.<sup>28</sup>

In response to these concerns, Senators Jim Jeffords, Jon Corzine and Joseph Lieberman requested the GAO report.<sup>29</sup> The report examined the opinions of “key stakeholders” and experts to consider various aspects of environmental disclosure and proposed methods of improving disclosure.<sup>30</sup> The first three issues in the re-

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native source of energy besides fossil fuels. Such a regulation would have a profound financial impact on the automobile industry. That impact, however, may be less on companies such as Honda, Kia and Hyundai, which have already developed and implemented such technology. See Ruth Rosselson, *The Top 10 Ethical Car Brands*, THE GUARDIAN 18, Special Reports (Nov. 27, 2004), available at <http://www.guardian.co.uk/cars/story/0,,1357774,00.html>.

27. See GAO-04-808, *supra* note 8, at 29 (discussing shareholder suits alleging inadequate environmental disclosures). Under Securities Exchange Act Rule 14a-8, shareholders may submit proposals, to be included in the annual proxy statement, phrased as a recommendation or request that management disclose specific social and environmental information. Leslie H. Lowe, *New Solutions to Environmental Problems in Real Estate Deals 2004: Corporate Disclosure of Environmental Liabilities*, at 411, 468-69 (PLI Real Estate Law & Practice, Course Handbook Series No. 511, 2004). If management does not want to include the proposal in the proxy statement, it must submit such a request to the SEC who in turn will issue a No Action Letter if it is determined that the material being requested is not “material.” See Leib M. Lerner, *Disclosing Toxic PIPEs: Why the SEC Can and Should Expand the Reporting Requirements Surrounding Private Investments in Public Equities*, 58 BUS. LAW. 655, 673 n.102 (Feb. 2003). If such a request fails, the company may instead send an opposition opinion with the proxy. See Lowe, at 469.

28. See generally GAO-04-808, *supra* note 8 (referring to “environmental disclosure”); Eichenseher, *supra* note 12, at 1 (referring to “environmental reporting”); see Olson, *supra* note 25 (noting public concern that companies may not be reporting all known environmental concerns) (internal citations omitted). Presumably, part of the impetus in requesting the GAO report is Congressional concern of the extent of environmental reporting.

29. See Eichenseher, *supra* note 12 (noting Senators requesting reports). The GAO report was also presented at a symposium, which was sponsored by the requesting Senators, minus Jeffords, as well as Senators Lautenberg, McCain and Nelson, and Representatives Blumenauer, Doggett, Markey, Michaud, Olver, Pallone, Payne and Solis. See GAO-04-1019R, *supra* note 12, at 1 (referencing letter from John B. Stephenson, Director, Natural Resources and Environment, GAO, to Senator Jon Corzine).

30. See GAO-04-808 *supra* note 8, at 39 (defining “key stakeholder” as those having “a stakeholder interest in the disclosure requirements because they (1) had a particular interest in environmental disclosure; (2) used disclosure information as investors, financial analysts or researchers; or (3) were involved in the disclosure

port addressed the current status of environmental reporting.<sup>31</sup> These issues were (1) the sufficiency of definitions in the reporting requirements; (2) the extent to which companies are correctly reporting; and (3) the adequacy of the SEC's monitoring and enforcement of the reporting requirements.<sup>32</sup> The GAO's findings in these areas were largely inconclusive.<sup>33</sup>

The final and potentially most substantial issue considered in the report was the need for and possible success of certain methods for improving environmental disclosure.<sup>34</sup> In its discussion of this issue, the GAO considered not only the opinion of the party suggesting the change, but opposing opinions as well.<sup>35</sup> Generally, representatives from various industries required to make environmental disclosures comprise the opposition.<sup>36</sup> Following is a brief summary of the first three issues considered and an explanation of why the GAO's findings were inconclusive and why this indecisiveness is itself a cause for concern.

### III. GAO REPORT'S FINDINGS

#### A. How Well Has the SEC Defined Environmental Disclosure Requirements?

The GAO report examined the imprecise definitions espoused by a variety of sources for environmental disclosure and stakeholders' opinions as to whether the requirements are too flexible or too narrowly defined.<sup>37</sup> Because the stakeholders disagreed on these issues, the report failed to come to any conclusion.<sup>38</sup>

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process as reporters or preparers of SEC filings"); *see also supra* note 13 (explaining when "stakeholder" as opposed to "shareholder" is used). While a complete list of the key stakeholders involved in the report can be found in an appendix, the list generally includes "representatives of investor organizations, including those that identify themselves as socially responsible and those with general investment interests; financial services institutions; environmental groups, attorneys and consultants; business associations; credit rating agencies; and public accounting firms." GAO-04-808, *supra* note 8, at 39.

31. *See* GAO-04-808, *supra* note 8, at 3-5 (summarizing first three areas of study).

32. *See id.* at 9-28 (reporting on results of first three areas of study).

33. For a discussion of the inconclusive nature of certain parts of the GAO study, *see supra* note 15 and accompanying text.

34. *See* GAO-04-808, *supra* note 8, at 29-36 (reporting suggested remedies).

35. *See id.*

36. *See id.* at 29, app. IV at 51 (listing "experts" that contributed to study).

37. *See id.* at 9 (summarizing findings on flexibility and scope of environmental disclosure definitions).

38. *See id.* at 36 (making general conclusions about report without mentioning disclosure definitions).

1. *How Are the Environmental Disclosure Requirements Currently Defined?*

Most of the SEC's reporting requirements are not specifically tailored to environmental information; rather, they relate generally to how a company must report to the SEC.<sup>39</sup> Since 1972, however, various regulations, statements of position, staff accounting bulletins, statements of financial accounting standards, action memos and interpretation memos have pertained to the disclosure of environmental information in SEC filings.<sup>40</sup> Three separate agencies, the SEC, the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA), have issued these regulations, standards and interpretations.<sup>41</sup> Many of these clarifications specifically address environmental disclosure, including that required in Item 103 of Regulation S-K.<sup>42</sup> Item 103 is required in all regularly submitted SEC filings as well as in most other SEC filings.<sup>43</sup>

The general requirements that are relevant to environmental disclosure fall roughly into three categories: liabilities, materiality and future risks.<sup>44</sup> An environmental liability must be reported in a company's financial statements if it is "probable" and "reasonably estimable," or mentioned in the footnotes if it is "reasonably possible."<sup>45</sup> Not only does this language give plenty of room for maneu-

39. See GAO-04-808, *supra* note 8, at 9 (noting most requirements are generally applied to all information that might need to be reported).

40. See *id.* at 44, app. II (listing principle requirements and guidance used by GAO in assessing whether requirements were sufficiently defined). The eighteen reports run from 1972 through 2003. See *id.*

41. See *id.* (listing issuing agency of requirements and guidance). Nine reports were issued by the SEC, seven by the FASB and two by the AICPA. See *id.*

42. See *id.* at 11 (noting Item 103 of Regulation S-K specifically addresses environmental disclosure as opposed to more general definitions and requirements found elsewhere).

43. See Securities Act Rules, 17 C.F.R. pt. 239.11 (2005) (requiring Item 103 in initial offering filing); Exchange Act Rules, 17 C.F.R. pt. 249.310 (2005) (requiring Item 103 in 10-K filing); Exchange Act Rules, 17 C.F.R. pt. 240.14a-101 (2005) (requiring Item 103 in certain circumstances as part of Item 13 of Schedule 14a which is necessary for proxy statement). Regulation S-K is a clearinghouse of explanations for frequently required disclosures. See generally Regulation S-K, 17 C.F.R. pts. 229.10-802 (2005). The regulation language for specific filings repeatedly references Regulation S-K, where the disclosure requirements are more thoroughly explained. See, e.g., Securities Act Rules, 17 C.F.R. pt. 239.11 (referring to S-K item in almost every line of initial public offering filing, S-1).

44. See GAO-04-808, *supra* note 8, at 12-16 (discussing stakeholders' opinions of materiality, liability and future risks reporting requirements).

45. See *id.* at 9-10 (discussing requirements for liability reporting). The report did not address what makes a liability "probable," though it did provide a definition of "reasonably estimable" based on generally accepted accounting principles. *Id.* In estimating the cost of liabilities, accounting standards not only allow, but

vering, but also certain disclosure requirements allow liabilities to be reported as capital expenditures, misleading the average investor.<sup>46</sup> For example, under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), a corporation may be required to clean-up a polluted Superfund site as part of a settlement.<sup>47</sup> While an average investor may consider the costs associated with clean-up to be a penalty for the underlying polluting, and thus, a liability, it can be reported instead as a capital expenditure.<sup>48</sup> Reporting it as a capital expenditure suggests that the corporation is complying with environmental standards, rather than some sort of penalty or wrongdoing.<sup>49</sup> Of course, the corporation would not have to clean-up if it had not polluted illegally in the first place.<sup>50</sup>

Furthermore, environmental information must be disclosed only if it is considered "material."<sup>51</sup> Information is "material" if "there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."<sup>52</sup> Examples of "material" information in the environ-

mandate that the lowest available estimate be used and that the greater estimates be mentioned in the footnotes. *See id.* In some instances, the difference between the lowest estimate and higher estimates could be in the millions. *See id.* Alternatively, the report defines "reasonably possible" as a liability having a "greater than remote chance of occurring." *Id.*

46. *See* Pfund, *supra* note 3, at 130 (noting non-compliance costs may be reported as capital expenditures).

47. *See id.* (explaining classification of remedial action taken as part of CERCLA compliance).

48. *See id.* at 130-31 (explaining that average investor considers capital expenditure as asset, whereas CERCLA remediation is actually debt).

49. *See id.* at 130 (noting misleading nature of reporting allowances).

50. *See id.* (noting remediation would not be required if company had complied with environmental standards initially).

51. *See* GAO-04-808, *supra* note 8, at 10 (reporting on materiality requirement of SEC reporting). In 1979, SEC first acknowledged that environmental statutes could create a "material" impact qualifying it for disclosure. Exch. Act Release 16224, 1979 WL 169925, \*1 (Sept. 27, 1979). What information is considered "material" has been the subject of immense litigation and volumes of judicial decisions. *See, e.g.,* TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976); Elkind v. Liggett & Meyers, Inc., 635 F.2d 156 (2d Cir. 1980). The most recent definition espoused by the Supreme Court, and that relied on by the SEC, is that information is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." Basic, Inc. v. Levinson, 485 U.S. 224, 231 (1988) (citing TSC Indus., 426 U.S. at 449). Alternatively, the FASB focuses on the reliance of any reasonable person, not just a shareholder deciding how to vote. *See* GAO-04-808, *supra* note 8, at 10; FASB Concepts Statement 2, *Qualitative Characteristics of Accounting Information* (May 1980), available at <http://www.fasb.org/pdf/con2.pdf>.

52. *See* Monsma & Buckley, *supra* note 2, at 163 (discussing materiality requirement in environmental context); *see also* 17 C.F.R. pt. 230.405 (defining materiality under 1933 Act). "Materiality" is an important element in the

mental context appear in *United Paperworks International Union v. International Paper Co.*<sup>53</sup> There, the United States Court of Appeals for the Second Circuit confirmed the lower court's finding that the International Paper Company (International Paper) had failed to disclose "material" information to its shareholders.<sup>54</sup> The undisclosed information included that International Paper had been "accused of numerous environmental offenses, had pled guilty to felonies [associated with environmental violations], had agreed to pay huge fines [in connection with environmental violations], and had been the target of numerous [state and federal environmental] administrative complaints."<sup>55</sup>

SEC regulations have been interpreted to dictate that future environmental risks must be reported in the Management's Discussion and Analysis of Financial Condition and Results of Operation (MD&A) section of SEC filings.<sup>56</sup> Among other things, this section requires the reporting of "known" circumstances that are "reasonably likely" to give rise to "material" effects on the company.<sup>57</sup> For example, if EPA notified a company that the company was a Potentially Responsible Party (PRP), consequential enforcement action might be considered a "known" future risk that is "reasonably likely" to give rise to "material" effects on the company.<sup>58</sup> Some of

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determination of a securities fraud claim. See Tina M. Carew & Andrew J. Surdykowski, *Securities Regulation*, 54 MERCER L. REV. 1637, 1647 (2003) (defining and discussing elements of securities fraud action).

53. 985 F.2d 1190 (2d Cir. 1993) (holding corporation liable for failing to disclose material information to shareholders in response to shareholder proposal concerning "Valdez Principles"). The "Valdez Principles" are a set of corporate accountability standards "which oblige[ ] corporations to . . . reduce waste matter and provide for its safe treatment, market safe products and services, and redress environmental damage." Monsma & Buckley, *supra* note 2, at 186. Developed by the Coalition for Environmentally Responsible Economies, the principles are frequently the subject of shareholder proposals requesting their adoption by a corporation's board of directors. See *id.*

54. *United Paperworkers Int'l Union*, 985 F.2d at 1193 (discussing background of International Paper's business dealings and procedural posture of case).

55. See *id.* at 1194-96 (discussing allegations of plaintiff shareholders as well as actual violations, lawsuits and remediation in which International Paper had been involved).

56. See GAO-04-808, *supra* note 8, at 6 (noting what is expected in MD&A portion of SEC reporting); Regulation S-K, 17 C.F.R. pt. 229.303 (requiring MD&A section in Registration Statement); Fort, *supra* note 22 (discussing heightened interest in MD&A).

57. See GAO-04-808, *supra* note 8, at 10-11 (discussing requirement to report future risks). The MD&A includes a discussion of "the company's liquidity, capital resources, and results of operations" in relation to any "known trends, demands, commitments, events, or uncertainties." *Id.* at 10. Although companies are encouraged to be forward-looking, the disclosure of a future risk is mandatory when it might be material. See *id.* at 11.

58. See *id.* at 11 (discussing example of potential future risk).

these vague terms, familiar in legal parlance, are further explained either in the regulations or by the courts. Still, there is substantial room for maneuvering.<sup>59</sup> As indicated in the examples above, such maneuvering may include avoiding the disclosure requirements altogether or providing misleading or half-truth disclosures.<sup>60</sup>

The AICPA and the SEC have issued some guidance specific to environmental disclosure.<sup>61</sup> The AICPA sought to more clearly define when an environmental liability must be reported, but still used terms such as “probable,” “reasonably possible,” and “remote.”<sup>62</sup> The SEC sought to more clearly define environmental materiality by creating numeric thresholds such as the potential loss of ten percent of current assets or potential monetary sanctions of \$100,000.<sup>63</sup> Again, however, the use of terms such as “potential” leaves room for the kind of creative accounting that has drawn so much attention lately.<sup>64</sup>

## 2. *Stakeholders Disagree About Whether Environmental Disclosure Requirements Are Too Flexible or Too Narrow in Scope*

The disagreement over the sufficiency of environmental disclosure definitions are divided into predictable camps.<sup>65</sup> Environmental interest groups and researchers, as well as investment analysts with an interest in socially responsible investing, found the require-

59. *See id.* at 10-11 (discussing disclosure of future risks). Item 303 of Regulation S-K specifically addresses the discussion of future risks in terms of liquidity, capital resources and the results of operations. *See id.* While “forward-looking” information is not required but “encouraged,” there can be a duty to disclose when that expected trend is currently known and reasonably expected to occur. This language leaves it to the discretion of management to decide whether something is reasonably expected to occur. *See id.*

60. For examples of how unclear disclosure requirements and definitions allow obfuscation of environmental reporting, see *supra* notes 37-59, *infra* notes 61-64 and accompanying text.

61. *See* GAO-04-808, *supra* note 8, at 11-12 (discussing environment-specific disclosure requirements issued by SEC and AICPA).

62. *See id.* (summarizing AICPA elaboration of environmental liability reporting). The AICPA Statement of Position also enumerates specific examples of when a liability is ripe for reporting. *See* AICPA, *Statement of Position 96-1: Environmental Remediation Liabilities*, J. ACCOUNTANCY, Mar. 1997, at 96.

63. *See* GAO-04-808, *supra* note 8, at 11 (summarizing SEC requirements for environmental materiality). The report noted that the creation of such numerical benchmarks is rare for the SEC. *See id.* Other conditions were included in the SEC requirements. For example, the ten percent loss must involve federal, state or local environmental laws and the \$100,000 sanction is only relevant if a government authority is a party to the proceedings. *See id.*

64. *See id.* at 1 (noting “recent scandals involving accounting practices have shaken consumer confidence”).

65. *See id.* at 9 (summarizing disagreement between investors and researchers and those who prepare or file reports).

ments inadequate.<sup>66</sup> Alternatively, reporting companies, industry representatives, independent auditors and investment analysts with more general interests found the requirements sufficient and changes unfeasible.<sup>67</sup> Both groups focus on the effect additional disclosure would have on investors' ability to make sound decisions.<sup>68</sup> Proponents for greater disclosure argue that current requirements hinder an investors' ability to make sound investment decisions.<sup>69</sup> The opposition argues that increased disclosure would not change this ability.<sup>70</sup> Both groups also disagree about whether the existing requirements are too flexible or too narrow in scope.<sup>71</sup>

The representatives of socially responsible investing assert that the requirements allow too much discretion in deciding what environmental information to disclose, and, alternatively, that the requirements too narrowly define what environmental information *must* be disclosed.<sup>72</sup> These proponents point to specific examples of problems with the current requirements.<sup>73</sup> These concerns include questions about: precisely when an environmental liability occurs; what defines the likelihood of an environmental liability; whether allowing the *lowest* estimate of the cost of a liability allows a company to evade using the *best* estimate; whether the negative impact on good will should be included in the liability calculation; and whether the distinction between known environmental liabilities versus forward-looking environmental liability projections provides too much flexibility.<sup>74</sup>

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66. *See id.* at 12 (listing stakeholders who found disclosure requirements too flexible and too narrow in scope). This group included an "others" category. *See id.*

67. *See id.* at 14 (describing stakeholders who found disclosure requirements necessary and adequate in scope). This group also included an "others" category. *See id.*

68. *See* GAO-04-808, *supra* note 8, at 12, 14 (discussing opposing views on effect that disclosure definitions have on ability for investor to make informed decisions).

69. *See id.* (discussing views of socially responsible investors as to whether disclosure requirements are adequate).

70. *See id.* (discussing views of adverse stakeholders as to whether disclosure requirements are adequate).

71. *See id.* at 9 (summarizing opponents' views on flexibility and scope of disclosure definitions).

72. *See id.* at 14-15 (summarizing view of reporting companies and similar stakeholders).

73. *See* GAO-04-808, *supra* note 8, at 15-16 (listing some expressed concerns of reporting companies and similar stakeholders).

74. *See id.* at 12-14 (explaining in detail using specific examples of concerns of stakeholders with social interests).

Conversely, representatives from reporting companies concentrate more on policy concerns involved in requiring greater disclosure.<sup>75</sup> These concerns include: the financial feasibility of disclosing more environmental information; whether additional requirements will preclude the flexibility needed to adapt rules to each circumstance; whether increased environmental disclosure may distort actual risks; whether more environmental information is relevant to investors' decisions; and whether other information is of greater importance to investors.<sup>76</sup> Some of these representatives concede that if there are actual problems with disclosure, they are a result of the SEC's failure to enforce the current requirements rather than from a need for increased requirements.<sup>77</sup> Because stakeholders do not agree on these issues, the GAO report was inconclusive as to whether the requirements are sufficiently defined.<sup>78</sup> The very fact that key players disagree on what the requirements are and what their scope is, however, suggests that additional clarification is necessary.<sup>79</sup>

#### B. To What Extent Are Companies Disclosing Environmental Information in Their SEC Filings?

In determining whether companies were disclosing all necessary environmental information, the GAO was unable to reach any firm conclusions in its report except to find that this information was too difficult to determine, but that generally, disclosure was increasing over time.<sup>80</sup> Without access to companies' records to compare with those companies' filings and because of the flexibility of the requirements, the GAO was unable to determine the current trend of compliance.<sup>81</sup> In an effort to use one sample industry as a

75. *See id.* at 14-16 (explaining concerns of reporting companies as well as adequacy of current requirements).

76. *See id.* (detailing companies' opinions that requirements are adequate in scope and necessarily flexible).

77. *See id.* at 16 (explaining SEC's responsibilities in protecting investors).

78. *See* GAO-04-808, *supra* note 8, at 9 (summarizing disagreement of stakeholders and coming to no definitive conclusion about adequacy of disclosure definitions).

79. *See id.* at 9-16 (discussing concerns of various stakeholders about disclosure definitions but failing to conclude that such disagreements suggest need for clarification).

80. *See id.* at 16 (summarizing conclusion that determining level of disclosure is extremely challenging).

81. *See id.* at 16-17 (explaining factors making determination difficult). Interestingly, an excuse cited by the report here, that the requirements are too flexible to make a determination, is essentially the conclusion that the GAO, in its report, refused to make in the previous section. *See id.* at 9-16.

model of wider practices, the GAO conducted a limited study of the utility industry's greenhouse emissions disclosure.<sup>82</sup> This study, however, was inconclusive because it only demonstrated that the level of disclosure was wide-ranging.<sup>83</sup> The GAO found that other existing studies were limited in their conclusions because of methodological limitations.<sup>84</sup> Yet, if based on available information, the GAO was unable to determine whether a corporation is adequately disclosing, one wonders whether the SEC is not in the same predicament.<sup>85</sup> Is not the wide range of disclosure levels indicative of an inconsistency that needs to be remedied?<sup>86</sup>

1. *Why Is It Difficult to Determine Whether Companies Are Complying with Their Environmental Disclosure Responsibilities?*

The GAO report lists a number of factors that make determining the level of compliance difficult.<sup>87</sup> On a practical level, the GAO has limited authority, and thus, limited access to information necessary to determine a particular company's compliance status.<sup>88</sup> Without complete access to a company's records, there is no way to assess whether that company has fully disclosed its environmental liabilities.<sup>89</sup> The report also complained that the GAO was unable to determine whether a company was adequately disclosing because the flexibility of the requirements provided so much discretion to

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82. *See id.* at 20-23, 40-41 (explaining methodology used to conduct utility industry study).

83. *See* GAO-04-808, *supra* note 8, at 20-23 (describing findings of study and range of disclosure levels).

84. *See id.* at 18-20, 39-40 (explaining methodology for selecting studies and limitations that existed in selected set). Appendix III of the report also includes a list of all the studies used in this section of analysis as well as the objective, scope and limitations of each study. *See id.* at 46.

85. *See id.* at 16-17 (discussing reasons why it is difficult to determine whether company is fully disclosing all material environmental information).

86. *See id.* at 36-37 (recommending that more efficient methods be used to electronically track and organize filings).

87. *See id.* at 16-17 (discussing factors creating difficulty in determining whether companies are fully disclosing material environmental information).

88. *See* GAO-04-808, *supra* note 8, at 16 (expressing "impossibility" of assessing extent of environmental disclosure).

89. *See id.* at 16 (noting that GAO did not have access to company records and those records are not publicly available). Again, it is interesting to note the difficulties encountered by the GAO in formulating this analysis in relation to the previous section on the sufficiency of the requirements. The GAO uses strong language in the report to express its frustration here. *See id.* "Because company records are generally not publicly available, it is virtually impossible for an external party to know what information companies should be disclosing." *Id.*

companies.<sup>90</sup> Finally, the GAO in its report concluded that it was unable to determine whether a company's low disclosure was indicative of low liabilities or low compliance.<sup>91</sup>

2. *Can the Level of Compliance be Determined Through Industry-Specific Study?*

The GAO concluded that neither independent studies nor its own sample study revealed a trend in the level of disclosure, except that the disclosure levels vary.<sup>92</sup> The GAO report considered fifteen studies that existed through 2003, which analyzed the extent of companies' environmental disclosure.<sup>93</sup> Because these reports were limited to the industries studied, the GAO concluded that no other generalizations could be drawn.<sup>94</sup> Some studies did suggest that disclosure increased over time; however, the GAO gave limited credit to any conclusions drawn from these studies due to alleged methodological difficulties.<sup>95</sup>

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90. *See id.* at 17 (explaining that use of general and interpretative terms such as "reasonably possible" or "reasonably estimable" make analyzing disclosure levels difficult). The terms identified here by the GAO as being uncertain were the same identified by socially responsible investors in the earlier section. *See supra* notes 61-77 and accompanying text.

91. *See* GAO-04-808, *supra* note 8, at 17 (describing consequence of interpretative disclosure requirements). One might expect that the problems facing the GAO in this context are similar to those facing SEC officials in deciding the adequacy of a company's filings.

92. *See id.* at 16 (summarizing review of independent studies as well as GAO's own test study in effort to determine level of compliance).

93. *See id.* at 18 (explaining that 27 studies were identified and narrowed because of time frame and major methodological limitations). Appendix I explains that 152 studies were actually initially gathered. *See id.* at 39. That list was then narrowed to those published after 1995 and consisted of original research not summaries of other's research. *See id.* Again, however, the report considered the studies to be inconclusive except in demonstrating that the extent of disclosure varies. *See id.* at 18-20. One might conclude, however, that the very fact of substantial variation in the level of disclosure is itself a problem. For example, the report points to one study suggesting that for companies that had CERCLA remediation responsibilities some did not disclose these responsibilities at all. *See id.* (citing Martin Freedman & A.J. Stagliano, *Political Research and Environmental Disclosure: The Case of EPA and the Superfund*, 4 RES. ON ACCT. ETHICS 211 (1998)). The report pointed to a number of studies that examined the disclosure of specific industries. *See id.* at 19. The GAO report explained that variations within industries, such as coal utilities, could be substantial. *See id.* Those reports found that within those industries the level of disclosure varied. *See id.*

94. *See id.* at 18 (concluding little could be garnered from existing independent studies).

95. *See id.* at 19-20 (noting that some studies suggested explanations for increase in disclosure over time). The GAO report noted that several studies drew a correlation between increased guidance on reporting requirements from the SEC and other agencies and increased disclosure. *See id.* For example, one study suggested that the increase of disclosures by PRP's for CERCLA liabilities was due to

The GAO conducted its own study on the extent of compliance of a particular industry but made no further conclusions beyond affirming that variation existed in disclosure.<sup>96</sup> The GAO's study examined the disclosure by electric utility companies regarding the companies' greenhouse gas emissions.<sup>97</sup> In particular, the study reviewed the annual and quarterly SEC filings of the twenty largest emitters of greenhouse gases.<sup>98</sup> Although such disclosures were not required under any current regulation, the report noted that some companies reported in response to public interest while others did not.<sup>99</sup> Of the companies that did report on this matter, some companies were more specific than others regarding, for example, the materiality of compliance costs for potential future legislation.<sup>100</sup> Again, varying levels of disclosure are evident from the GAO study.<sup>101</sup> The report seems reluctant to conclude that this variability is itself a problem.<sup>102</sup>

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the release of a 1993 SEC Staff Accounting Bulletin entitled *Accounting Disclosures Relating to Loss Contingencies*. Elizabeth Stanny, *Effect of Regulation on Changes in Disclosures of and Reserved Amounts for Environmental Liabilities*, J. OF FIN. STATEMENT ANALYSIS 34 (1998). If the conclusions of this and other reports drawing such a correlation are accepted as accurate, credit would be added to the socially responsible investors' assertions that the requirements should be better defined to improve disclosure.

96. See GAO-04-808, *supra* note 8, at 20-23 (describing GAO study and results, and noting alleged relationship between greenhouse gas emissions and global warming).

97. See *id.* (noting several sources have requested additional information regarding greenhouse gas emissions).

98. See *id.* at 20, 40-41 (listing these companies as AES Corp., Alleghany Energy, Inc., Ameren Corp., American Electric Power Co., Inc., CenterPoint Energy, Inc., Cinergy Corp., Dominion Resources, Inc., DTE Energy Co., Duke Energy Corp., Edison International, Entergy Corp., FirstEnergy Corp., FPL Group, Inc., Mirant Corp., PPL Corp., Inc., Progress Energy, Reliant Energy, Inc., Southern Co., TXU Corp. and Xcel Energy, Inc.).

99. See *id.* at 20-21 (noting there is no imminent threat of legislation in this area). While the Kyoto Protocol signed in 1997 may require such reporting, it has never been ratified and it is clear that the current administration does not intend to submit the agreement to the Senate for advice and consent. See *id.* at 21 n.20. It is unclear why the GAO chose to study the environmental disclosure on an issue that does not require reporting. Presumably, in order to determine the extent to why companies are complying with the disclosure requirements, it would be prudent to study the extent of compliance on a required issue. Only nine of the companies in the study reported any impact from current legislation. See *id.* at 22.

100. See *id.* at 21-23 (giving examples of type of information reported, such as whether impact of domestic legislation would be material if measurable at all).

101. See GAO-04-808, *supra* note 8, at 16 (concluding that GAO test study showed wide variance in reporting levels).

102. See *id.* at 16 (concluding only that it is difficult to determine whether companies are fully disclosing material environmental information, but not that this difficulty is itself problematic).

C. Is the SEC's Monitoring and Enforcement of Environmental Disclosures Adequate?

Deciding that the extent of SEC monitoring and enforcement of environmental disclosures could not be determined, the GAO report pointed to the lack of information on the adequacy of companies' disclosures.<sup>103</sup> The report did discuss the methodology used by the SEC to analyze filings, but concluded that without a systematic way to track filings over the years, no conclusions about the SEC's efforts could be made.<sup>104</sup> Without a tracking system, however, it seems the conclusion should be that the SEC's own ability to monitor a company's environmental disclosure is dubious.<sup>105</sup>

The report also noted the failure of the SEC and EPA to coordinate their efforts to make use of the available information more efficiently.<sup>106</sup> This last observation resulted in one of the few recommendations that the GAO made to the SEC and the report's sponsoring legislators.<sup>107</sup>

1. *How Does the SEC Monitor and Enforce Disclosure Requirements and Is There Any Way to Track or Analyze the Results of the SEC's Oversight Efforts?*

The GAO report suggested that the SEC's main source of monitoring and enforcement is the review of a company's filings.<sup>108</sup> Following a review, the SEC has a number of options available to it.<sup>109</sup> If the reviewer decides that more information is needed, the SEC will issue a comment letter to the company requesting that information.<sup>110</sup> A reviewer may issue several comment letters over several

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103. *See id.* at 23 (summarizing basis and conclusion concerning extent of SEC enforcement).

104. *See id.* (noting that "adequacy of SEC's efforts to monitor and enforce compliance with environmental disclosure requirements cannot be determined").

105. *See* Monsma & Buckley, *supra* note 2, at 202 (discussing EPA report finding that 74% of companies do not adequately disclose required environmental information); *see also* GAO-04-808, *supra* note 8, at 23 (noting that "SEC cannot . . . identify trends or set priorities").

106. *See* GAO-04-808, *supra* note 8, at 23 (discussing examination of EPA-SEC relationship).

107. *See id.* at 37 (recommending officials at each agency work together to take better advantage of available EPA data).

108. *See id.* at 24-25 (explaining review process).

109. *See id.* at 24 (noting that not all filings are reviewed and of those that are reviewed only small percentage are reviewed in their entirety). If a filing is found to adequately disclose all necessary information, including environmental disclosures, the SEC will do nothing. *See id.*

110. *See id.* at 25 (noting that comment letters are most likely action to solicit additional information). Alternatives include requests for amendments of the filings and suggestions to make disclosures in future reports. *See id.* at 25 n.23.

months before the SEC is satisfied that the filing is complete.<sup>111</sup> Despite this deliberate review process, the SEC makes no effort to track the comment letters or enforcement actions for particular companies.<sup>112</sup> For example, a company may routinely fail to disclose certain environmental information year after year, causing a comment letter to be sent on each occasion.<sup>113</sup> The reviewers, however, have no way of knowing that such letters were sent in previous years and, therefore, are unable to identify trends of obfuscation.<sup>114</sup> The report also noted that of the cases that the Division of Enforcement receives, very few are for failures to provide environmental disclosures.<sup>115</sup> Moreover, relatively few of the comment letters issued concern environmental disclosures.<sup>116</sup>

2. *To What Extent Do the SEC and EPA Coordinate Efforts to Improve Environmental Disclosure?*

Adding to the inefficiency of the SEC's enforcement efforts is the seemingly unproductive relationship with EPA.<sup>117</sup> The agencies

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While the SEC does not have the power to compel information based on the comment letter alone, it may refer the company to the Division of Enforcement for further proceedings. *See id.* at 25. According to officials at the SEC, however, most enforcement actions arise in response to an internal whistleblower or to news coverage of the wrongdoing. *See id.* at 26. The report noted that companies may decide responding to a comment letter is either too difficult or costly, both financially and to its competitive position. *See id.* at 25.

111. *See* GAO-04-808, *supra* note 8, at 25-26 (noting response to comment letters is best when approval of filing is required for transaction).

112. *See id.* at 26 (reporting SEC Division of Corporation Finance, reviewing division, does not systematically track comment letters). Despite the GAO's conclusion in its report that nothing can be assessed concerning the SEC's efforts to monitor and enforce, these observations suggest that the GAO did identify problem areas. *See id.* In the recommendation section of the report, the GAO did propose that the SEC create a database of these comment letters and/or make that database public. *See id.* at 36-37.

113. *See id.* at 26 (discussing lack of negative effects from absence of comment letter tracking system).

114. *See id.* (noting lack of tracking system makes SEC unable to identify "problem areas, analyze trends over time or within particular industries, or assess the need for additional guidance in certain areas").

115. *See id.* at 25 (noting only four enforcement cases concerning environmental disclosure failures since 1977). Furthermore, the GAO, in its report, commented that most enforcement actions result from corporate whistleblowers. *See id.* at 26. This fact may be more compelling in the coming years as the Sarbanes-Oxley Act requires a greater duty for individual corporate officers to certify their company's filings. *See* Monsma & Buckley, *supra* note 2, at 202.

116. *See* GAO-04-808, *supra* note 8, at 26-27 (noting that frequency of environmental disclosure as subject of comment letters increases when dealing with certain industries). This information comes in part from a study conducted by the SEC in 2002 surveying the extent of their reviews. *See id.*

117. *See id.* at 28 (noting "sporadic efforts" and limited extent of current information sharing).

have reached a formal agreement to facilitate information sharing; however, because the focus of the agencies differs significantly, the content and volume of their shared information make it too cumbersome for practical utility.<sup>118</sup> Examples of shared information include lists sent by EPA to the SEC of “those companies barred from government contracts under the [Clean Air Act] or the [Clean Water Act]; companies named as [PRPs] for the clean-up of hazardous waste sites; and names of those companies involved in any criminal or civil proceeding under federal environmental laws.”<sup>119</sup>

In several cases, however, this information is not in a form that the SEC can easily manipulate.<sup>120</sup> For example, EPA assesses enforcement actions on a case-by-case, or “facility-specific” basis, not on a corporation-by-corporation basis.<sup>121</sup> If a Superfund remediation case concerns a factory in Michigan with five PRPs, EPA’s file will most likely be referenced by the name of the Michigan site and somewhere within it will be listed the relative PRPs.<sup>122</sup> The SEC, by contrast, assesses a particular company’s reporting as a whole and use of EPA’s system is therefore exceptionally inefficient.<sup>123</sup> Although both agencies have committed to increased cooperation, the reluctance of SEC officials to recognize its value makes such cooperation unlikely.<sup>124</sup>

#### IV. DESPITE INCONCLUSIVE RESULTS, SUGGESTIONS FOR CHANGES AND IMPROVEMENTS

Despite the GAO report’s consistent indecision on the efficacy of the SEC’s enforcement of environmental disclosure laws, the report makes a number of suggestions for changes and improve-

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118. *See id.* (referring to comments from both agencies’ officials that “the volume and complexity of the data that EPA was providing were not useful to SEC reviewers”).

119. Pfund, *supra* note 3, at 122 n.36 (discussing extent of information sharing between SEC and EPA) (quoting Bagby et al., *supra* note 7, at 233 nn.33-36).

120. *See* GAO-04-808, *supra* note 8, at 28 (discussing EPA-SEC relationship).

121. *See id.* (explaining differences between SEC and EPA systems).

122. *See id.* (referring to facility-specific data as useful for raising “red flags” but not for general assessment of company).

123. *See id.* (quoting SEC concern that EPA system would not allow SEC to readily identify parent company of PRPs concerned).

124. *See id.* (noting SEC official’s opinion that further cooperation is unnecessary). The SEC’s opinion in this regard is of questionable standing given the 2001 EPA report that 74% of companies are not reporting their environmental liabilities appropriately to the SEC. *See* Sutherland, *supra* note 9. If EPA can reach this conclusion using its data, then it follows that the solution to the SEC’s failures in this regard is to use that same data.

ments.<sup>125</sup> These suggestions highlight the same problems that the report had refused to acknowledge earlier.<sup>126</sup> Following is an analysis of suggestions on three of the several identified issues: (1) when a liability occurs and thus a reporting obligation exists; (2) whether and/or when a company must disclose potential future liability in response to new and pending legislation; and (3) whether a company must report on less financial-based environmental performance.<sup>127</sup> The following sections will also suggest that potential solutions to these problems will have positive secondary effects on general corporate environmental policy.

#### A. When Does a Liability Accrue for Reporting Purposes?

The issue is about whether an environmental liability accrues (1) when the actual injury to the environment occurs, (2) when the company becomes aware of the violation, or (3) when a third party, including the government, initiates action against the company.<sup>128</sup> The experts consulted for the GAO report suggested that, at the very least, the issue should be clarified by either the SEC or the FASB to guide corporations toward accurate disclosure.<sup>129</sup> Beyond this, some experts disagree on whether the clarification should adopt decreased and later disclosure or increased and earlier disclosure.<sup>130</sup> The disagreements are predictably split on interested

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125. See GAO-04-808, *supra* note 8, at 29-36 (reporting on suggestions of experts in three categories); compare *supra* note 15 (noting inconclusive nature of report subtitles).

126. See GAO-04-808, *supra* note 8, at 29 (noting "concerns [that] contribute to the inadequate disclosure of environmental information" despite earlier conclusions that it was unable to conclude whether such inadequate disclosure existed). To maintain its air of consistency and impartiality, the report couches these suggestions in terms of those made by experts in the field, which the GAO in turn summarizes and endorses. See *id.*; but see *id.* at 36-37 (making "Recommendations for Executive Action"). Among the GAO's recommendations are the suggestions made by the experts in response to perceived problems, again those problems about which the GAO report is inconclusive. See *id.*

127. See *id.* at 30-36 (noting other issues such as whether SEC should limit flexibility of existing requirements, increase level of monetary sanctions before requiring reporting, aggregate liabilities before requiring reporting, extent of increased EPA and SEC cooperation and use of non-regulatory approaches including market based incentives to improve disclosure); see also Pfund, *supra* note 3 (suggesting increased use of market-based incentives to improve disclosure).

128. See GAO-04-808, *supra* note 8, at 30-31 (noting clarification is necessary in SEC and/or FASB standards in relation to this issue).

129. See *id.* at 30-31 (reporting on non-industry based expert opinion).

130. See *id.* (noting expert disagreement in resolving when environmental liability accrues).

lines between industry representatives requesting the former and investors and environmental watchdogs requesting the latter.<sup>131</sup>

An example of the problem appears in the CERCLA Superfund site identification and remediation process.<sup>132</sup> After determining a Superfund site exists, the hunt begins for the PRPs responsible for that site's remediation.<sup>133</sup> Once named a PRP, a company expects that responsibility for a costly clean-up will follow.<sup>134</sup> The SEC, however, has determined that simple identification as a PRP does not lead to the automatic assumption that the government is contemplating a legal proceeding to recover the cost of remediation.<sup>135</sup> The corporation, therefore, is not presumed to have knowledge of the action and must not yet disclose the situation to investors.<sup>136</sup>

The concern of industry representatives is that earlier disclosure would not better inform investors.<sup>137</sup> They argue that such early disclosure would be incomplete and possibly inaccurate.<sup>138</sup> "Once a third party intervenes and companies learn more about the extent of the problem, they can make and disclose better estimates."<sup>139</sup> To a certain extent, this argument goes against the spirit of the environmental protection laws which encourage affirmative action on behalf of the company to identify environmental violations and take the necessary steps to remediate the problems.<sup>140</sup>

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131. *See id.* at 31 (noting industry representatives prefer that disclosure requirements accrue after action has been initiated). Twenty-four of the thirty experts shared the concern that the lack of clear guidelines was a problem. *See id.* at app. V at 53. Twenty-five of the thirty agreed this problem contributed to inadequate environmental disclosures. *See id.*

132. *See* Bagby et al., *supra* note 7, at 294-95 (explaining CERCLA-related disclosure problem).

133. *See id.* at 242 (discussing CERCLA process).

134. *See id.* (discussing steps taken by parties in CERCLA actions).

135. *See id.* at 295 (explaining that identification as PRP is neither "material litigation" nor "sanction" under Item 103 and therefore does not trigger disclosure).

136. *See id.* (noting that identification as PRP does not provide knowledge to corporation that reportable government action is pending).

137. *See* GAO-04-808, *supra* note 8, at 31 (noting concern that such disclosure would not advance investors understanding of company's financial health).

138. *See id.* (highlighting industry representatives' issue with early disclosure).

139. *Id.* (noting specific concern with early disclosure).

140. *See* National Environmental Policy Act of 1969, 42 U.S.C. § 4321 (2000) (stating one purpose as promoting "efforts which will prevent or eliminate damage to the environment and biosphere and stimulate the health and welfare of man"); Clean Air Act, 42 U.S.C. § 7401(b)(1), (c) (2000) (noting that purposes of Clean Air Act include "to protect and enhance the quality of the Nation's air resources so as to promote the public health and welfare and the productive capacity of its population" and "to encourage or otherwise promote reasonable Federal, State, and local governmental actions, consistent with the provisions of this Act, for pol-

Instead, the companies would rather wait until they are caught with their hand in the cookie jar before having to address, and ultimately disclose, these environmental liabilities.<sup>141</sup> Yet, at least one industry commentator has suggested that clarification of the reporting guidelines will help the situation by providing corporations with an incentive to address liabilities earlier and more efficiently.<sup>142</sup> Clarification will also increase “corporate awareness surrounding environmental performance.”<sup>143</sup>

The magnitude of litigation costs and the potential for liability is so great that the need for more precise reporting requirements in this area is clear.<sup>144</sup> It is hard to conceive a situation in which early reporting, while somewhat speculative, would not be material to an investor. The fact that these requirements are not certain, and are subject to debate, speaks to the inability of the SEC to enforce them effectively and the need for better guidance.<sup>145</sup>

#### B. Must a Company Disclose the Financial Impact of New or Pending Legislation, and if So, When?

The concerns surrounding the reporting of environmental liabilities are similar to those in relation to the financial impact of new or pending legislation.<sup>146</sup> Experts cite examples such as the potential impacts from changes in regulations concerning global climate change and greenhouse gas emissions.<sup>147</sup> In particular, some suggest that companies report on the financial impact of actions that they will need to take in response to such legislative changes.<sup>148</sup>

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lution prevention”); Clean Water Act, 33 U.S.C. § 1251(a) (2000) (describing purpose of Clean Water Act as “[r]estoration and maintenance of chemical, physical and biological integrity of Nation’s waters”).

141. See GAO-04-808, *supra* note 8, at 31 (noting industry’s preference for waiting until third party initiates presumably litigious action).

142. See Pfund, *supra* note 3, at 134 (suggesting increased guidance for Item 103 disclosure requirements).

143. See *id.* (demonstrating non-investor based benefits of increased enforcement of SEC requirements).

144. See Crusto, *supra* note 1, at 226 (noting costs relating to environmental protections laws reaching \$250 billion).

145. For a discussion of GAO report findings concerning problems with disclosure definitions and enforcement, see *supra* notes 37-123 and accompanying text.

146. See GAO-04-808, *supra* note 8, at 31 (referring to experts’ opinions on disclosure of future risks).

147. See *id.* (noting two examples given in response to survey questions); *but see id.* (reporting that industry representatives believe singling out certain issues).

148. See *id.* (using climate change to illustrate how company might need to report impact of complying with future regulatory changes).

Industry representatives respond that such reporting would be “speculative” and again not helpful to investors.<sup>149</sup>

Another concern with this issue is that, more than with already accrued environmental liabilities, disclosure here only satisfies non-financial goals of certain interest groups, and does not help to present a more complete picture of a company’s financial health.<sup>150</sup> Alternatively, these costs will have to be disclosed at some point, at latest, when they are actually accrued.<sup>151</sup> If the corporation is in a position to make reasonable estimates as to what those costs are, why not disclose that information as soon as those estimates are available?<sup>152</sup> Again, the fact that the standard here is not clear and subject to argument illustrates the need for the SEC to issue clearer guidelines.<sup>153</sup> Further, as a regulatory tool, such reporting would require a corporation to address environmental liabilities at an earlier point, preferably allowing the corporation to avoid violations before they occur.<sup>154</sup>

### C. What Non-Financial Environmental Performance Information Should Be Required, if Any, in an SEC Filing?

In the spirit of increased disclosure, some experts suggest that corporations should be required to disclose certain non-financial environmental indicators.<sup>155</sup> Examples of these performance indicators include: “energy, material, and water use; greenhouse gas and other emissions; effluents and waste generation; use of hazardous materials; and recycling, pollution, waste reduction, and other

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149. *See id.* (quoting company representatives as “questioning the value of disclosing ‘speculative’ information to investors”).

150. *See id.* (suggesting that increased reporting requirements would only advance interests of particular groups).

151. *See* GAO-04-808, *supra* note 8, at 31 (describing opinion that problems will arise as to when pending legislation becomes “material”).

152. *See id.* (noting opinion that companies are aware of disclosure requirements and so do not need additional guidance in way of “forward-looking disclosure”); *but see supra* notes 37-79 and accompanying text (discussing experts’ disagreements over how well environmental disclosure requirements are defined and whether companies are clear on what is expected).

153. *See supra* notes 37-79 and accompanying text (describing problems with environmental disclosure definitions and guidance).

154. *See supra* notes 128-29 (describing purpose of environmental statutes as being preventative among other things).

155. *See* GAO-04-808, *supra* note 8, at 31-32 (noting five of thirty experts surveyed made this suggestion); *see also* Pfund, *supra* note 3, at 135-36 (suggesting such disclosure be made in MD&A section of SEC filings allowing for more general discussion).

environmental programs.”<sup>156</sup> This suggestion faces a more difficult battle than the others over whether such information would be “material” to investors in making sound investment decisions; though, the increased existence of “green” institutional investors weighs heavily in favor of adopting such suggestions.<sup>157</sup>

The other main objection by industry representatives to the disclosure of non-financial environmental indicators is that this information is often available in other forms such as on a company’s website or in other reporting forums, and is thus inappropriate for SEC filings.<sup>158</sup> For example, disclosures required under CERCLA are made to EPA and are available to the public through a Freedom of Information Act (FOIA) request.<sup>159</sup> Similarly, disclosures required under the Clean Water Act (CWA) and the Clean Air Act (CAA) are also accessible through FOIA requests.<sup>160</sup> This information, however, can be reasonably construed as financial and, in the aggregate, can also be “material;” therefore, potential investors should not have to negotiate a labyrinth of bureaucracy to discover this necessary information.<sup>161</sup> A primary purpose of the SEC is to provide *consolidated* financial information for the ease of investors.<sup>162</sup> Furthermore, compliance with other environmental regulations, such as CERCLA or CAA, involves highly scientific and technical reporting, which requires significant sophistication on the part of the average investor.<sup>163</sup> Alternatively, SEC reporting has a “plain English” requirement intended to minimize the use of “legalese” that often appears in financial statements.<sup>164</sup> Further, in

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156. See GAO-04-808, *supra* note 8, at 32 n.27 (referring to suggestion of certain experts that SEC create such reporting guidelines as outlined in The Global Reporting Initiative).

157. See Pfund, *supra* note 3, at 119-20 (defining and summarizing history and increase of “green” institutional investors); see also Monsma & Buckley, *supra* note 2, at 188-90 (remarking on importance of environmental performance information as investment criterion).

158. See GAO-04-808, *supra* note 8, at 32 (noting other sources of this information as special reports and other regulatory agencies).

159. See Pfund, *supra* note 3, at 123 (noting certain environmental compliance information is available to public in formats other than SEC filings).

160. See *id.* at 124 (noting CWA and CAA are Acts that require self-monitoring and self-auditing by complying corporations).

161. See *id.* at 129-30 (discussing difficulty of ascertaining what is “material” in context of environmental liability reporting).

162. See GAO-04-808, *supra* note 8, at 3 (describing purpose of SEC).

163. See Pfund, *supra* note 3, at 123 (noting Emergency Planning and Community Right-To-Know Act reporting requires extensive scientific data necessitating average investor to have scientific background to understand and disseminate).

164. See *id.* at 130 (noting purpose of “plain English” requirement is to “explain rather than obscure the pertinent issues”)(internal quotations omitted).

the context of environmental reporting, this "plain English" requirement has the added benefit of forcing a corporation's management, rather than the investor, to simplify scientific and technical language.<sup>165</sup> Finally, as a regulatory tool, the suggestion to disclose non-financial environmental information, more than the other suggestions, has the added benefit of being a source of ensuring compliance with various environmental regulations.

## V. CONCLUSION

The SEC needs to increase enforcement of its environmental disclosure requirements because of its growing importance in ensuring compliance with progressively complicated environmental laws.<sup>166</sup> The need for the SEC's environmental disclosure requirements has moved beyond the SEC's stated purpose of protecting investors and into a realm of ensuring compliance with the underlying laws.<sup>167</sup> As the source of the most comprehensive compilation of information on publicly traded companies, the SEC has become the forum for checking a company's environmental as well as financial condition.<sup>168</sup> Whereas environmental and financial health are often inseparable, they do stand independently and companies need to appreciate that reporting on the former is as important as reporting on the latter.<sup>169</sup>

Although the recent GAO report assessing the SEC's treatment of environmental disclosure falls short of concluding massive shortcomings, a careful reading uncovers huge and commonly used loopholes in environmental reporting.<sup>170</sup> The most forceful argument of industry representatives is that increased disclosure will not be helpful or "material" to investors.<sup>171</sup> On a purely financial note,

165. *See id.* (explaining that "plain English" requirement allows investors to understand disclosures provided).

166. *See id.* at 119 (discussing role of SEC environmental disclosure requirements in enforcement of environmental laws).

167. *See id.* at 121 (noting that "[m]andatory disclosure requirements . . . drive corporate environmental compliance improvement").

168. *See* David W. Case, *The EPA's Environmental Stewardship Initiative: Attempting to Revitalize a Floundering Regulatory Reform Agenda*, 50 EMORY L. J. 1 n.445 (2001) (noting need for SEC to expand environmental reporting to increase transparency of environmental compliance to that of financial compliance); *see also* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999).

169. *See* Williams, *supra* note 168, at 1306-07 (encouraging increased development of environmental reporting paralleling financial reporting).

170. *See* GAO-04-808, *supra* note 8, at 36 (noting lack of "compelling evidence" to excuse indecisiveness).

171. *See id.* at 12 (explaining opinion that increased reporting would not be helpful to investors).

it is hard to comprehend how spending hundreds of billions of dollars on corporate environmental responsibilities is not "material."<sup>172</sup> On a policy note, as a bastion of accurate and reliable corporate information, the SEC must protect its reputation by ensuring that companies appropriately disclose their environmental information.<sup>173</sup> The SEC should carefully consider not only the nominal "recommendations" of the report, but also the underlying findings and suggestions of experts.<sup>174</sup> These are the materials that expose the true vulnerabilities of the environmental disclosure process and suggest the needed remedies.<sup>175</sup>

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172. See Pfund, *supra* note 3, at 120-21 (noting that "enforcement of environmental disclosure requirements helps ensure that companies complying with [these] obligations are not disadvantaged in the market by firms that ignore the duty to disclose their environmental liabilities") (citing EPA Enforcement Alert, U.S. EPA Notifying Defendants of Securities and Exchange Commission's Environmental Disclosure Requirements 1 (Oct. 2001), available at <http://www.epa.gov/Compliance/resources/newsletters/civil/enfalert/sec.pdf>); see also Crusto, *supra* note 1, at 226 (discussing cost of environmental law compliance).

173. See Williams, *supra* note 168, at 1306-07 (noting integrity of SEC financial reporting).

174. See GAO-04-808, *supra* note 8, at 36 (giving "recommendations for executive action"); but see *id.* at 9-36 (reporting on general findings and suggestions by experts for change).

175. See *id.* at 9-36 (reporting on general findings and suggestions by experts for change).