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ARTICLE

CORPORATE ENVIRONMENTAL ACCOUNTABILITY: EXPANDING SEC DISCLOSURES TO PROMOTE MARKET-BASED ENVIRONMENTALISM

Terra Pfund*

I. INTRODUCTION

Since the birth of modern environmental regulation in the 1970's, the United States government, the Environmental Protection Agency (EPA), and citizens alike have been struggling over the best means to curtail environmental degradation and ensure both environmental compliance and pollution control. While the current Administration has consistently cut the EPA's enforcement budget, new and innovative solutions need to be found to keep regulatory enforcement on track.

A logical, yet overlooked solution to this regulatory enforcement quandary can be found in corporate Green Management1 and market-based incentives.2 Over the past 30 years, the EPA has operated under a standards-based regulatory program.3 This command-control regulatory solution has provided dramatic improvements in the handling and disposing of toxic and hazardous materials, air quality and water quality.4 However, even though EPA's command-control regulatory program has been successful, there is growing concern that the current program "will not be able to address the most pressing environmental challenges in an efficient or cost-effective manner."5 Many environmentalists, including employees of the EPA, are now advocating a second-generation regulatory system based on performance rather than baseline standards.

Regulating the environment from a performance standard such as market-based incentives "places a greater emphasis on high quality environmental information and environmental performance indicators to drive decision-making and priority setting."6 The information disclosed is used as a tool for public awareness, allowing the investor and the consumer to make an environmentally educated investment decision or purchase. These "green investments" are a catalyst for making environmental performance indicators important in the decision-making within the corporation. When publicly traded corporations make financial disclosures about their environmental liabilities, it allows for public choice. The investor and consumer will use their investment dollars "to promote corporate attainment of national environmental goals."7 These disclosures give

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3 See generally id.


5 Franco, supra n. 2, at 2.

6 Id.

Corporations incentives to improve their environmental management, and strive for greater, more cost effective environmental compliance.\(^8\)

In 2000, the Office of Cooperative Environmental Management, under the EPA, reviewed available academic research regarding the nexus between corporate environmental performance and financial performance.\(^9\) The study concluded that there was a positive relationship. Evidence showed financial benefits to those corporations taking a proactive approach to environmental management and a demand for corporate environmental performance information from capital market participants.\(^10\)

Yet, regardless of the demand, publicly traded companies (registrants) are not disclosing environmental information as required by the SEC.\(^11\) Furthermore; studies indicate that the disclosures that are being reported are often incomplete and inaccurate.\(^12\) In order for a market-based incentive to operate as a regulatory device, adjustments within the SEC’s environmental disclosure requirements must be addressed.

This note will offer a discussion on how more rigid enforcement of environmental disclosures under the Securities and Exchange Commission will supplement current environmental regulations, foster Green Management, and provide market-based incentives to achieve national environmental policy goals. Part II explains the connections between Green Management, ethical/environmental investing, corporate environmental disclosure and the market-based incentive program. Part III offers a brief description of current environmental disclosure requirements under modern environmental statutes, how they offer supplemental help, but alone cannot sustain a market-based incentive program. Part IV discusses the Blue Sky Laws\(^13\) and the history of the Securities and Exchange Commission's environmental disclosure requirements. Part V offers suggestions to strengthen the current disclosure requirements for environmental liability and evaluates current trends in the SEC and the EPA. This article concludes that a market-based incentive program is indeed a valuable supplement to the current command-control regulatory programs currently in place. However, in order for a market-based incentive program to be successful, additional environmental disclosures—and enforcement of those disclosures—are required.

II. CORPORATE ACCOUNTABILITY AND THE ETHICAL INVESTOR

Prior to investigating the current environmental disclosure requirements under various environmental statutes and under the SEC, it is important to note the relationship between corporate responsibility and ethical or environmental investing. As previously noted, the 1970's gave birth to the American environmental revolution. Environmentalism has since become integrated into the core of American values.\(^14\) "Environmentalism has become a part of 'the American consensus,' an idea deeply fixed in the firmament of values that define America's basic political beliefs."\(^15\) Environmental values have also made their way into American corporate cultures through the concept of ethical investing.\(^16\) Shareholder concerns for the environment have begun to force companies to subscribe to Green Management and to demand increasingly

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\(^{8}\) Id.
\(^{10}\) Franco, *supra* n. 2, at 6.
\(^{11}\) Id. at 7.
\(^{12}\) Id.
\(^{13}\) See *infra* nn. 61-63.
\(^{15}\) Id. (citing Walter A. Rosenbaum, *Environmental Politics and Policy* 340 (3d ed. 1995)).
\(^{16}\) Id.
specific environmentally friendly behavior.\textsuperscript{17} The Green Management of corporations embodies the theory that "environmentally driven innovation can lead to cost savings and lower compliance costs, and create new efficiencies, thus improving corporate competitive posture."\textsuperscript{18} Substantial financial benefits may accrue to "corporations with aggressive environmental programs—and these benefits are passed along to shareholders in the form of increased earnings and corporate value."\textsuperscript{19}

Green Management not only satisfies the American investor’s desire for corporations to conform to American environmental values, it has proven to have a positive impact on corporate financial performance.\textsuperscript{20} "Economic theory holds that in the idealized, perfectly competitive economy, the self-motivated behaviors of individuals and corporations will result in efficient patterns of production and consumption. This equilibrium of production and consumption is efficient in the sense that no one person can be better off without making another person worse off."\textsuperscript{21}

Research conducted by the Rose Foundation\textsuperscript{22} points to three specific conclusions: (1) "Investors who choose the environmental leaders in an industry-balanced portfolio were found to do as well and sometimes better than choosing the environmental laggards in each industry;" (2) "Equity portfolios composed of stocks with good environmental ratings are likely to outperform the stock market while controlling for some macroeconomic trends;" and (3) "Corporations with sound environmental management systems generally have superior stock market performance."\textsuperscript{23}

Corporations with rigorous Green Management systems in place are saving money through energy efficiency, waste reduction, ecologically aware manufacturing productions, and lower compliance costs. As a result, Green Management systems are increasing their corporate competitive advantage.\textsuperscript{24} Alternatively, a corporation with significant environmental liabilities can drastically reduce profitability, earnings, and shareholder value.\textsuperscript{25}

Not only has the non-profit environmental community focused on the connection between ethical investing, Green Management, and corporate disclosure, but the EPA has as well. In a 2001 Enforcement Alert, the EPA noted that environmental information—including a corporation’s compliance history and involvement in a federal environmental enforcement action—may be used by the public to guide purchasing and investment decisions.\textsuperscript{26} The EPA went on to state that "full and fair disclosure of material information related to a firm’s environmental performance, compliance and liabilities is essential if stock markets are to accurately reflect the financial condition of publicly traded companies."\textsuperscript{27} Most importantly was EPA’s belief that "enforcement of

\textsuperscript{17} Id. at 468.
\textsuperscript{18} Goodman, supra n. 1, at 3.
\textsuperscript{19} Id.
\textsuperscript{20} See id.
\textsuperscript{21} Franco, supra n. 2, at 3.
\textsuperscript{22} The Rose Foundation is a non-profit organization located in Oakland, CA. Their mission includes: fostering community and environmental stewardship; improving communications between businesses and their neighbors; recognizing individual responsibility for the environmental consequences of personal actions; forging positive links between environmental stewardship and sustainable job creation; harnessing economic power to leverage environmental sustainability; and instilling respect for the inalienable rights protected by our nation’s constitution and the essential human rights to clean air, clean water and individual dignity. The Rose Foundation for Communities and Environment, About Us <http://www.rosefdn.org/aboutus.html> (accessed Feb. 9, 2004).
\textsuperscript{23} Goodman, supra n. 1, at 23-25.
\textsuperscript{24} Id. at 3.
\textsuperscript{25} Id.
\textsuperscript{27} Id.
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.28

In 2002, the EPA disclosed that 74 percent of the publicly traded corporations that it surveyed openly violate the SEC’s environmental financial debt accounting regulations.29 The report went on to state that "the high percentage of publicly traded corporations [are] hiding their environmental debt from shareholders and the lack of enforcement by the SEC30 for its environmental accounting filing regulation is rewarding corporate noncompliance to US environmental laws."31 In order for the EPA’s current command-control environmental regulatory program to be supplemented with a market-based incentive program, both agencies (EPA and SEC) must work together to ensure adequate disclosure and thus foster ethical investing. This cooperation can be attained through mandatory environmental disclosure and adequate enforcement of disclosure regulations (discussed in more detail in Part V below).

Whereas corporations may be willing to disclose their Green Management practices, this disclosure alone is inadequate for an effective market-based incentive program. The ethical investor not only needs to know corporate Green Management policy to make an educated investment choice, but environmental liabilities as well. Even though the SEC sets forth specific environmental disclosure requirements, what is currently mandated offers the ethical investor only a cursory review of the corporate environmental portfolio. Moreover, current disclosure requirements are not being adequately enforced.32 Investor protection is the driving force behind the SEC’s regulatory scheme. It is the SEC’s job to administer and enforce the federal securities laws in order to protect investors and to maintain fair, honest, and efficient markets. In addition to protecting investors from fraudulent securities transactions, it is imperative that investor protection should also include effective dissemination of corporate policies and liabilities.

The SEC acknowledged in a 1979 Interpretive Release that “environmental statutes could have a material economic impact on [those] corporations.”33 This acknowledgement should be articulated through stringent extensive environmental disclosure requirements and the enforcement of those requirements. While disclosure requirements do not set substantive environmental standards, they do improve the quality and quantity of information that reaches investors and community advocates.34 Mandatory disclosure requirements strengthen corporate accountability by providing investors with the tools to have a significant influence on market forces raising performance and driving corporate environmental compliance improvement.35 It is evident that corporate responsibility and ethical or environmental investing are linked to one another. Additionally it is evident that corporate environmental disclosure and environmental compliance are linked. For a market-based incentive program to be successful, these links must be fused together to form a chain which will in turn promote higher environmental standards. Before that fusion is made however, it is important to note why current disclosure requirements are insufficient alone.

28 Id.
29 A study conducted by Martin Freedman, professor of accounting at the College of Business and Economics at Townsend University in Maryland found that of the EPA’s list of 900 publicly traded potentially responsible parties listed on the National Priority List found most companies make little or no disclosure effort on environmental expense/liability reporting. Donald Southerland, EPA Reveals US Publicly Traded Corporations Hide Billions in Environmental Debt <http://www.riskworld.com/NEWS/02q2/nw02a096.htm> (last updated Apr. 9, 2002).
30 In the last 20 years the SEC has only enforced its Regulation S-K financial environmental accounting regulation once. Id.
31 Id. (emphasis added).
32 EPA Enforcement Alert, supra n. 26.
35 Id.
III. CURRENT ENVIRONMENTAL DISCLOSURE REQUIREMENTS

The United States Congress has enacted various environmental laws addressing pollution control, environmental degradation, sustainability, and liability for environmental violations. The majority of these statutes contain disclosure requirements that are predominantly used for environmental regulatory enforcement. While much of the disclosed information is shared between the EPA and the SEC, this cooperation has proven to be ineffective as a tool for a market-based incentive program. While the EPA shares its compliance actions with the SEC, SEC disclosure regulations are inadequate, often inaccurately categorizing environmental expenditures. Furthermore, the information disclosed is insufficient, and that deficiency in turn is not corrected. If the public does not have access to accurate disclosures, a market-based incentive program cannot be successful.

An overview of disclosures required by environmental statutes illustrates that these laws alone cannot foster a market-based incentive environmental program. This section will show while the applicable environmental statutes demand disclosure, they do not always promote public disclosure. Therefore the statutes only support governmental regulation and enforcement. In order to promote a performance-based system, a greater emphasis must be placed on “high quality environmental information and environmental performance indicators to drive-decision making and priority setting.” Current disclosure requirements under environmental statutes fail as market based incentives because they are not adequately focused on public access to the information disclosed.

The National Environmental Policy Act (NEPA) declares it the policy of the United States to "encourage productive and enjoyable harmony between man and his environment" and to "promote efforts which will prevent or eliminate damage to the environment." This policy is implemented by requiring federal agencies to "integrate environmental issues into their decision making processes." The influence NEPA has on corporate disclosures is limited to the requirement that the SEC consider environmental issues when regulating corporate disclosure. However, because corporations are private entities, NEPA has no substantive corporate application. There is no inherent duty for a corporation to make an assessment under NEPA of its environmental impact or environmental liabilities. Without corporate application, the public cannot utilize NEPA to foster a market-based incentive program.

The Resource Conservation and Recovery Act (RCRA) and the Comprehensive Environmental Response, Compensation and Liabilities Act (CERCLA) were passed to regulate the growing amount of toxic and hazardous materials used by industry. RCRA establishes a “cradle to grave” regulatory program to prevent present and future waste disposal from endangering public health or environment. CERCLA establishes authorities and processes to remediate contamination from past disposal, which now endangers or threatens to

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36 The EPA and the SEC staff have worked together to “increase the flow of information between the two agencies. The EPA regularly sends the SEC lists of those companies barred from government contracts under the [Clean Air Act] or the [Clean Water Act]; companies named as [potentially responsible parties] PRPs for the cleanup of hazardous waste sites; and names of those companies involved in any criminal or civil proceeding under federal environmental laws.” Bagby, supra n. 7, at 233, nn. 33-36.
37 Id.
38 See Southerland, supra n. 29.
39 Franco, supra n. 2, at 2.
41 Bagby, supra n. 7, at 234.
42 Id. at 235.
Corporations may be liable for their handling, processing, and disposing of hazardous materials under RCRA and their past site contamination under CERCLA. Although RCRA and CERCLA have had a dramatic impact on corporate environmental liability, their primary focus is on waste management, disposal, and remediation. While the explicit disclosure requirements are used to identify Potentially Responsible Parties (PRPs); amounts and types of hazardous substances found in storage, treatment, or disposal sites; and hazardous waste releases into the environment, the disclosure information that is provided is bewildering and not readily available to the public.

Additionally, disclosures under both statutes are made to the EPA and not to the public investor. While the investor may access this information through a Freedom of Information Act request to the EPA, the inability of the public to directly access this information makes both RCRA and CERCLA ineffective for disclosure under a market-based incentive program.

In 1986, Congress enacted the Emergency Planning and Community Right-To-Know Act (EPCRTKA). EPCRTKA empowers the public with access to information about chemical hazards and toxics within their community. It requires corporations to disclose their use of hazardous and toxic chemicals through the filing of Toxic Chemical Release Forms (TCRF), Material Safety Data Sheets (MSDS), and Emergency and Hazardous Chemical Inventory Forms (EHCIF). Each of these disclosure forms must be filed with the appropriate state agency and with the EPA. EPA maintains a toxic release inventory (TRI) for each chemical that a corporation used based on its TCRF disclosures. EPA must make available all TRIs to the public through computer telecommunications.

While the TRI requirement of the EPCRTKA does mandate corporate disclosures and public access, the information contains extensive scientific data, challenging for the average investor without a scientific background to understand and disseminate. The primary purpose of the Act is to ensure that the community has adequate knowledge of toxins affecting them and can develop emergency and response plans in the event of a chemical release. While TRI data is being accessed by environmental groups and the public more frequently, it is not applicable to every publicly traded corporation regulated by the SEC. Only corporations using toxics above certain threshold levels are required to submit TRI data. Therefore, EPCRTKA disclosure requirements are not applicable to the remaining corporations affecting the environment. Additionally, only members of the public who are specifically aware of the statute and the reporting requirements have ready access to the information.

44 Id. at 256.
45 Id. at 166.
47 40 C.F.R. § 265.1 et seq.
48 40 C.F.R. § 302.6.
49 "Even a brief treatment of RCRA illustrates that only someone with a fairly complete understanding of the Act would be able to find a particular corporation’s disclosure information. Certainly the information is not widely available to potential investors and stockholders; moreover, a sophisticated analysis of the available information will be required before the information can be used in the marketplace. The difficulty of accessing and processing information under RCRA prevents potential investors from making informed investment decisions. RCRA, therefore, fails as an effective market-based incentive." Bagby, supra n. 7, at 253.
50 Congress was spurred to action by a toxic release in Bohpal, India that killed thousands. Sprankling, supra n. 43, at 91.
52 42 U.S.C. § 11023(j).
53 Id.
54 Bagby, supra n. 7, at 247.
EPCRTKA provides a foundation for corporate disclosure and public empowerment and is therefore a gateway statute for implementing a market-based incentive environmental program. Still, the foundation alone is inadequate. Local governments charged with providing the information often do not have the funding for data management and therefore cannot successfully implement the program. Due to the inaccessibility of the data, investors cannot find adequate information on corporate environmental compliance and liability. Therefore, EPCRTKA alone falls short on environmental disclosure instrument for creating a market-based incentive environmental program.

Regulatory and pollution control statutes such as the Clean Water Act (CWA) and the Clean Air Act (CAA) mandate disclosure. However, the disclosures in both statutes are made through self-monitoring and self-auditing. While this self-monitoring is a mandatory disclosure, the disclosure is made only to the EPA or state agencies. As with the environmental statutes previously discussed, the public is only privy to the information through a Freedom of Information Act request. Without easier public access to the disclosure of environmental liabilities, neither the CWA nor the CAA act as a market based incentive.

As the discussion above indicates, while Congress has enacted many environmental statutes that provide for disclosure of environmental liabilities, these statutes are predominantly regulatory. They do not address the

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55 Bagby, supra n. 7, at 248. In addition to EPCRTKA, the U.S. Congress enacted the Pollution Prevention Act of 1990 (PPA). Like the TCRF requirement in EPCRTKA, the PPA requires owners and operators of facilities to file a Toxic Chemical Source Reduction and Recycling Report. Id. Data is then collected by the EPA and made available to the public. Id. at 249.

56 Mary L. Lyndon, Information Economics and Chemical Toxicity: Designing Laws to Produce and Use Data, 87 Mich. L. Rev. 1795, 1835 (1989) (“While computerized services are developing, many local emergency planning committees cannot afford to study their own needs nor establish the connections that would allow them to function. Instead, they are opting to take the data as hard copy, where it often sits in boxes unused.”).

57 For example, under the Clean Air Act, industry must comply with National Ambient Air Quality Standards (NAAQS). Emissions data is submitted to the EPA to insure the industry is operating within the NAAQS guidelines. Likewise, under the Clean Water Act, a permit holder must comply with their National Discharge Elimination System (NPDES) guidelines. Records of compliance under the CAA’s NAAQS and the CWA’s NPDES are submitted to the EPA Data Monitoring Reports (DMRs). While the submission of a DMR is a disclosure of industrial or corporate activity, it is not easily accessible to the common investor or shareholder, and only may be obtained through a FOIA request.

58 The EPA defines an environmental audit as “a systematic, documented, periodic and objective review of a facility’s operations and practices related to meeting environmental requirements.” 33 U.S.C. § 1319(d). There are two basic types of environmental audits—compliance audits and management audits. Compliance audits are an independent assessment of the corporation’s compliance with environmental statutes and regulations. Management audits examine the corporation’s systems and procedures to assure environmental compliance. Patrick J. Ennis, Student Author, Environmental Audits: Protective Shields or Smoking Guns? How to Encourage the Private Sector to Perform Environmental Audits and Still Maintain Effective Enforcement, 42 Wash. U.J. Urb. & Contemp. L. 389, 395 (1992). A successful auditing program may include (1) explicit top management support for environmental auditing and the commitment to follow up on the findings; (2) an environmental auditing function independent of audited activities; (3) adequate auditor training and staffing; (4) a process which collects and analyzes, interprets, and documents information sufficient to achieve audit results; (5) explicit audit program, objectives, scope, resources, and frequency; (6) a process which includes quality assurance procedures to verify the accuracy and thoroughness of the audit; and (7) a process which includes specific procedures to prepare promptly candid, clear, and appropriate written reports on audit findings, corrective actions, and schedules for implementation. EPA Environmental Auditing Policy Statement, 51 Fed. Reg. 25004, 25008 (July 9, 1986).

59 CAA NAAQS emissions standards, CWA NPDES permitting and DMR reports.

60 5 U.S.C. § 552. The Freedom of Information Act (FOIA) allows the public to gain access to materials and information from government agencies that may not otherwise be available. See id.

61 See Bagby, supra n. 7, at 259.
need for corporate disclosure and the breadth of corporate environmental liability in today’s technology driven world. With the growth of the hi-tech industry, corporate operations though deemed “Green” deal with highly toxic and hazardous materials that have significant impacts on air quality, groundwater, and local energy resources. In order for a market-based incentive program to be successful, corporate environmental disclosures need to be provided not only to local and federal agencies, but to the public consumer and investors as well. Without the availability of information regarding environmental liabilities, investors and community members can only make uneducated decisions. The values placed on green investments are vastly diminished because the extent of corporate liability, environmental impacts, and non-compliance are virtually unknown.

IV. THE SECURITIES AND EXCHANGE COMMISSION

After the stock market crash in 1929, the United States Congress together enacted the Securities Act of 1933 and then the Security Exchange Act of 1934, fondly known as the Blue Sky Laws. The Blue Sky Laws were enacted “to protect consumers in the financial markets against excessive speculation, misrepresentation, and exploitation involving unsound, worthless, or fraudulent securities.” The Blue Sky Laws are a disclosure-based regulatory mechanism that requires the mandatory disclosure of “material” financial and non-financial information in statements filed with the Securities and Exchange Commission (SEC).

The 1933 Act requires corporations to file a registration statement with the SEC before securities can be offered for sale to the public. “The Securities Act of 1933 is specifically intended to ‘provide full and fair disclosure of the character of securities.’” The 1934 Act is much more broad, regulating all facets of the public trading of securities. Registered corporations must disclose material information when securities are registered for trading, and companies must then file annual, quarterly, and other periodic reports with the SEC. “Disclosure is the keystone of the entire structure of federal securities legislation.” The SEC has the power to provide detailed guidance regarding the form and content of disclosures. The Commission may adopt “such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.” However, until the 1970’s, the SEC had not addressed disclosure requirements for environmental liabilities.

64 “Beginning in the late nineteenth century the eastern industrialists found fertile ground for securities in the developing American frontier. There were many questionable practices and as a result pressures arose to regulate the marketing of fraudulently valued securities. Accordingly in 1911 Kansas passed the first state security statutory regulation which is also known as a “blue sky law” because of its purpose to protect the Kansas farmers against the industrialists’ selling them a piece of the blue sky.” Robert W. Hamilton, Corporations Including Partnerships and Limited Liability Companies 331 (6th ed., West 1998) (quoting Thomas Lee Hazen, Treatise on the Law of Securities Regulation 7 (2d ed., West 1990)).
66 Id. at 228.
68 Bagby, supra n. 7, at 266 (citing The Securities Act of 1933, Preface).
70 Bagby, supra n. 7, at 265.
71 Id. at 266 (internal citation omitted).
72 Bagby, supra n. 7, at 266.
A. The Road to Environmental Disclosure

The SEC first became acquainted with environmental liabilities and disclosure requirements when former President Richard Nixon signed NEPA into law.74 NEPA dictates that federal agencies are required to review their regulations and processes to make sure that they are consistent with “the national policy for the environment.” As stated previously, NEPA’s only influence on corporate disclosure is limited to the requirement that the SEC consider environmental issues when promulgating rules to regulate corporate disclosure. President Nixon catapulted this policy into action through Executive Order 11514.76 The order mandated that “federal agencies shall initiate measures needed to direct their policies, plans and programs so as to meet environmental goals.” Regulatory programs and corrective actions from all federal agencies were required to be submitted to the Council on Environmental Quality (CEQ).78

By September 1970, the SEC had failed to submit corrective action to the CEQ. The SEC was only prompted to comply with the executive order by a rulemaking petition filed by the Natural Resources Defense Council, Inc. (NRDC).79 The SEC responded to NRDC by issuing an interpretive release in 1971 entitled Disclosures Pertaining to Matters Involving the Environment and Civil Rights.80 The release provided modest guidance to the then-current SEC disclosure requirements under Regulation S-K.81 It simply reiterated disclosure requirements under the Blue Sky Laws and included compliance with other pertinent environmental laws that would “cause material changes in [the] registrant’s business done or intended to be done.”82 Additionally, it required the disclosure of pending or contemplated litigation.83

In December 1971, the SEC promised “to actively consider amendments . . . in the near future” but declined to revise the disclosure rules as requested by NRDC.84 In March 1973, the NRDC sued to challenge the SEC’s failure to propose more stringent rules.85 The litigation prompted the SEC to adopt disclosure

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75 Bagby, supra n. 7, at 228 (citing 42 U.S.C. § 4331(a) (2000)). “The Joint Conference Report underscores this as a separate and new obligation on all federal agencies unless expressly prohibited by existing law applicable to the agency or unless the agency’s full compliance would be impossible under other applicable laws. The conferees explicitly stated that the language ‘to the fullest extent possible’ shall not be used by any Federal agency as a means of avoiding compliance... The language . . . is intended to assure that . . . no agency shall utilize an excessively narrow construction of its existing statutory authorizations to avoid compliance.” Bagby, supra n. 7, at 229 n. 11 (citing Conf. Rep. No. 765, at § 102, (Dec. 17, 1969) (reprinted in 1969 U.S.C.C.A.N. 2767, 2770)).
77 Id. at § 1.
78 Id. at §§ 1, 2(a), and 2(d).
79 Bagby supra n. 7, at 267.
80 Id. at 268.
81 Id.
83 Id.
85 Id. at 275. NRDC proposed that the SEC should promulgate rules requiring additional disclosure, including discussing major activity the corporation impacts including: (1) pollution or natural resources; (2) current feasibility for reducing such pollution; (3) the prospects for improving existing technology; (4) existing and projected expenditures for pollution abatement; (5) legal requirements, including licenses, permits, outstanding court or administrative orders; and (6) pending or threatened litigation, government and private. Other proposals included requiring disclosure of the registrant’s overall

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amendments in April 1973. The 1973 amendments require disclosure of the "material effects which compliance with environmental laws and regulations may have upon the capital expenditures, earnings and competitive position and the disclosure of material environmental litigation."\textsuperscript{86}

The SEC stated that more stringent environmental disclosure requirements were unnecessary and would require a "deluge of confusing disclosures about immaterial governmental environmental proceedings."\textsuperscript{87} Environmentalists did not warmly welcome this policy statement. NRDC continued the litigation and sought a mandatory injunction to compel the SEC to modify corporate disclosure standards to include environmental liabilities and to make those disclosures available to the public in SEC filings.\textsuperscript{88} NRDC claimed that the 1971 SEC Interpretive Release and 1973 amendments were inadequate and failed to further the environmental policy mandated by NEPA.\textsuperscript{89}

The District Court agreed with NRDC and remanded to the SEC. The remand obligated the SEC to promulgate a "general statement" to determine "(1) what the SEC views as its statutory obligation to the public under the securities laws and under NEPA; (2) what rulemaking alternatives it actually considered; and (3) the reasons for excluding any ‘substantial alternatives’ such as proposals by NRDC and other interested parties."\textsuperscript{90}

Without appealing the District Court decision, the SEC began reconsideration through participation in legislative hearings, as well as public notice and comment.\textsuperscript{91} After five months of hearings,\textsuperscript{92} "the SEC concluded that no further mandatory disclosures were necessary but proposed a few minor environmental disclosure changes in the October 1975 release, Conclusions and Proposed Environmental Disclosures."\textsuperscript{93} The SEC concluded that its broad discretion to promulgate disclosure regulations was limited "to the economic and investment market protection context of the securities laws."\textsuperscript{94} Additionally, the SEC believed that the cost of environmental disclosure requirements requested by NRDC would outweigh the benefits of such requirements.\textsuperscript{95}

The SEC then proposed that registrants provide environmental compliance reports indicating where registrants had "failed within the previous twelve months to meet an applicable environmental standard established pursuant to any federal statute."\textsuperscript{96} Nonetheless, the SEC deemed this disclosure too expansive and potentially misleading. Stating that investors would not have the environmental expertise to make meaningful

environmental policy statement and a discussion of how the registrant made changes to advance environmental values. See id. at 275, n. 267, citing Exch. Act Release 11236, 1975 WL 160462, at 2-3 (Feb. 11, 1975).

\textsuperscript{86} Bagby, supra n. 7, at 270 (internal citations omitted).

\textsuperscript{87} Id. at 271, n. 249. Because of the SEC's requirements, large corporations were required to disclose government-initiated environmental proceedings involving a small amount of money while they were not required to disclose non-environmental litigation involving much larger sums of money. See id.

\textsuperscript{88} See NRDC I, 389 F. Supp. at 692.

\textsuperscript{89} See id.

\textsuperscript{90} Bagby, supra n. 7, at 273.

\textsuperscript{91} See Exch. Act Release 11236, supra n. 85.

\textsuperscript{92} The hearing process lasted nineteen days and included fifty-four oral presentations and 353 written comments on the record, which totaled over ten thousand pages. The responses came from public environmentalist groups and private corporate interests. As predicted, the environmental side advocated more broad environmental disclosure, while the other denied the effectiveness of the disclosure. Bagby, supra n. 7, at 273, n. 274. See Exch. Act Release 11733, 1975 WL 160503, at 3 (Oct. 14, 1975). The commission gathered nearly 15,000 pages over the five year period leading to the final rulemaking. Exch. Act Release 12414, 1976 WL 160388, at 3 (May 6, 1976).

\textsuperscript{93} Bagby, supra n. 7, at 276-77.

\textsuperscript{94} Id. at 278.

\textsuperscript{95} See generally Exch. Act Release 11733, supra n. 92.

\textsuperscript{96} Bagby, supra n. 7, at 278-79.
comparisons between registrants, the proposals never made it into SEC regulations.\(^9^7\) NRDC believed this final agency action to be incomplete and again requested judicial review in NRDC II.\(^9^8\)

The court’s review in NRDC II found that the SEC’s conclusions were arbitrary and capricious because the SEC failed to consider relevant factors found in the administrative record.\(^9^9\) Like in NRDC I, the court in NRDC II remanded to the SEC “to engage in reasoned decision-making based on an adequately developed administrative record and to undertake further rulemaking.”\(^1^0^0\)

The SEC rejected the remand and appealed to the D.C. Circuit. The appellate court in NRDC III concluded that the SEC had broad discretion in rulemaking and policy making processes.\(^1^0^1\) Consequently, because the court deferred to the agency’s discretion, the SEC continued the environmental disclosure policy it had previously developed in its 1971 and 1973 Interpretive Releases. After an administrative enforcement proceeding by the SEC against United States Steel Corp.,\(^1^0^2\) the SEC issued another interpretive release, the 1979 Environmental Disclosure Requirement.\(^1^0^3\) The interpretive release stated that the “Commission’s (SEC) disclosure requirements impose significant obligations with respect to information concerning environmental protection.”\(^1^0^4\) Additionally, the SEC articulated its “longstanding concern about the adequacy of disclosure with respect to environmental protection requirements, and particularly in light of the requirements of the National Environmental Policy Act, registrants should be aware that the Commission will continue to monitor environmental disclosure as well as bring enforcement actions in appropriate cases of non-compliance.”\(^1^0^5\)

While the SEC’s interpretation of S-K disclosures seemingly takes a proactive environmental role, the agency’s enforcement history has proved otherwise.\(^1^0^6\)

The SEC again addressed environmental reporting in a 1981 rule proposal, Disclosure of Environmental Proceedings. This rule created a “three-part materiality threshold for requiring the disclosure of environmental litigation: (1) all material environmental proceedings, (2) damage actions or governmental proceedings involving charges, fines, damages, or capital expenditures exceeding ten percent of current assets, and (3) all government proceedings unless the registrant reasonably believes resulting fines will be less than $100,000.”\(^1^0^7\) These new rules provide the basis for the current SEC environmental disclosure requirements.

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\(^9^7\) Id. at 279.
\(^9^8\) Id.
\(^1^0^0\) Id., 432 F. Supp. at 1212.
\(^1^0^1\) Nat. Resources Def. Council, Inc. v. Sec. and Exch. Commn., 606 F.2d. 1031, 1031 (D.C. Cir. 1979) (hereinafter “NRDC III”).
\(^1^0^2\) SEC brought action against United States Steel Corp. for misleading disclosures. The SEC found Steel Corp.’s disclosures, while facially accurate, were misleading because “compliance with specific environmental disclosure rules does not necessarily constitute full compliance with the disclosure requirements of the federal securities laws.” Bagby, supra n. 7, at 283.
\(^1^0^3\) Exch. Act Release 16224, supra n. 33.
\(^1^0^4\) Id. at 1.
\(^1^0^5\) Id. at 5.
\(^1^0^6\) See Southerland, supra n. 29.
\(^1^0^7\) Bagby, supra n. 7, at 286.
V. CURRENT SEC ENVIRONMENTAL DISCLOSURE RULES AND PROPOSALS TO FOSTER A MARKET-BASED INCENTIVE PROGRAM

The nucleus of corporate environmental disclosure under SEC regulations is the S-K form.\(^{108}\) Regulation S-K establishes disclosure requirements under both the 1933 Act and the 1934 Act.\(^{109}\) S-K disclosures are submitted to the SEC under form 10-K.\(^{110}\) Regulation S-K contains an affirmative disclosure duty and relies on the concept of “materiality.” Materiality of information is the trigger for what has to be disclosed and what information may be withheld.\(^{111}\) While the SEC has provided a definition for “material,”\(^{112}\) it is highly subjective\(^{113}\) and the standard creates a great deal of controversy over disclosure limitations.\(^{114}\) Currently, the SEC states that “the term ‘material,’ when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.”\(^{115}\)

Regulation S-K contains three explicit tiers of environmental disclosures: Item 101,\(^{116}\) Item 103,\(^{117}\) and Item 303.\(^{118}\) Disclosures under Items 101, 103, and 303 are usually made in the form of narrative

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108 The requirements under the S-K regulation follow the 1981 rule proposal for the disclosure of environmental proceedings.


110 10-K is the general form “for annual reports of issuers subject to the Exchange Act’s registration and reporting requirements.” Id. at § 9.3.

111 Feller, supra n. 65, at 228.

112 Hazen, supra n. 109, at § 3.4[2].


114 See 17 C.F.R. § 229.101, at “Instructions to Item 101.”

115 Feller, supra n. 65, at 228.

116 Id. (citing 17 C.F.R. § 240.12b-2).

117 17 C.F.R. § 229.101(a), entitled “Description of the Business,” requires registrants to “[d]escribe the general development of the business of the registrant, its subsidiaries and any predecessor(s) during the past five years, or such shorter period as the registrant may have been engaged in business.” Id. It further requires that “[i]nformation shall be disclosed for earlier periods if material to an understanding of the general development of the business.” Id.

118 17 C.F.R. 229.103, entitled “Legal Proceedings,” requires registrants to “[d]escribe briefly any material legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is subject.” Id. It further requires them to “[i]nclude the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceeding known to be contemplated by governmental authorities.” Id.

119 17 C.F.R. § 229.303(a) (1994), entitled “Management’s Discussion and Analysis of Financial Conditions and Results of Operations (MD&A),” requires as follows:

(a) Full Fiscal Years. Discuss the registrant’s financial condition, changes in financial condition, and results of operations. The discussion shall provide information as specified in paragraphs (a)(1)[Liquidity], (2)[Capital Resources] and (3)[Results of Operations] with respect to liquidity, capital resources and results of operations and also shall provide such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations. Discussion of liquidity and capital resources may be combined whenever the two topics are interrelated. Where in the registrants judgment a discussion of segment information or of other subdivisions of the registrants business would be appropriate to an understanding of such business, the discussion shall focus on each relevant, reportable segment or other subdivision of the business and on the registrant as a whole.
discussions. The disclosure requirements must "explain rather than obscure the pertinent issues." The SEC requires the use of "plain English" in corporate disclosures so that the ordinary investor is able to understand the disclosures provided.

A. Item 101

Item 101 requires the registrant to file a general description of the business. This includes financial information about the industry and its foreign and domestic operations and exports. "Appropriate disclosures also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem necessary." The focus of Item 101 is the material impact that environmental regulations will have on the corporation's capital expenditures, corporate earnings, and general competitive position.

Item 101 is quite broad. It requires the disclosure of compliance costs, including the installation and maintenance of pollution control equipment. Despite the expansive parameters of Item 101, there are disclosure inadequacies that may inhibit a market-based incentive program.

While cost of compliance must be disclosed under Item 101, so must the cost of non-compliance, including clean-up costs under CERCLA. However, costs of non-compliance are classified merely as expenses or capital expenditures. If the clean-up costs are part of a remedial agreement with the EPA or other applicable State agency, they are still categorized as capital expenditures, not penalties. While it is important to foster a cooperative relationship between corporations and the EPA to ensure compliance and clean-up in the event of contamination, these relationships and the actions taken within them should not be veiled in the disguise of mere capital expenditures. If corporations are spending significant amounts of corporate funds on clean-up costs mandated by the EPA, this is equivalent to penalty assessment. Disclosing remediation costs as a capital expenditure implies that the corporation has complied with environmental standards, when in fact they have not. Site remediation is an expenditure that would not be required if the company had been compliant with environmental standards.

For example, Corporation X has entered into an agreement with the EPA to spend $4 million on an on-site remediation due to a toxic release prohibited under RCRA. This expense in turn is listed and disclosed under the corporations' Generally Accepted Accounting Principles (GAAP) as a capital expense. To the common investor, a capital expense is a corporate asset, i.e., a step the corporation has taken to improve its competitive edge—such as installing $4 million worth of new equipment to increase productivity. The $4 million expense for on-site remediation could have been saved and otherwise invested if the corporation had been compliant with environmental standards. This expense is, in reality, an unjustified debt, whereas facility

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120 Feller, supra n. 65, at 228-29.
121 Hazen, supra n. 109, at § 3.10.
122 Id. at § 3.10[2].
124 17 CFR § 229.101(c)(1)(xii).
125 See id.
126 Bagby, supra n. 7, at 289.
127 Id. at 289-90.
128 Id. at 290.
upgrades that increase productivity are assets. Knowing that a corporation is spending money on EPA mandates—money that it could have otherwise invested—is a material fact that an investor would attach importance to in determining whether to purchase the registered securities of that corporation. In order for a market-based incentive program to be successful, investors must have the opportunity to make an educated choice, not a choice based on disguised facts.

Issues with capital expenditures are again raised in the SEC’s coordination of requirements within the GAAP under Item 101(c).\textsuperscript{129} GAAP under Item 101\textsuperscript{130} is counterintuitive as applied to capital expenditures. Under GAAP, many contingent environmental liabilities are itemized as capital expenditures and are thus misleading to the public and investor.

For example, if a corporation incurs expenses (1) in extending the life of their property, (2) in mitigating environmental contamination, or (3) in the preparation of resale, the expenditures are exempt from being categorized as an environmental liability. On the contrary, they are merely listed as a corporate capital expenditure. These categorical exemptions create an extreme danger of investor confusion. If these exclusions are applied to CERCLA, the danger of investor confusion is highlighted. A corporation may be held liable under a remedial agreement with the EPA to clean up the contamination of one of their properties. The action is not listed as a penalty under Item 101, nor is it listed as a contingent liability; on the contrary, it is merely listed as a capital expenditure. It is obvious that capital expenditures, including environmentally related expenditures, are important to the average investor in determining a corporation’s bottom line. However, simply listing remedial clean-up as a capital expenditure disguises the environmental liability and is misleading to the ethical environmental investor. The capital expenditure exemptions within GAAP undermine the environmental disclosure requirements under Item 101 and thus are inadequate to provide a market-based incentive program.

B. Item 103

Item 103 requires that SEC registrants disclose, on at least a quarterly basis, pending proceedings, or proceedings known to be contemplated, by a governmental authority to which they are a party, and that arise under federal, state, or local provisions that have the primary purpose of protecting the environment.\textsuperscript{131} In an Item 103 disclosure, the registrant must articulate the alleged facts of the proceeding, the parties involved, the relief sought, the date the proceeding was initiated and the venue.\textsuperscript{132}

Item 103 not only embodies the general materiality threshold that the SEC applies throughout the Act’s regulation, but it creates specific materiality thresholds as applied to environmental disclosures.\textsuperscript{133} Environmental disclosures under Item 103 are triggered if at least one of three qualifiers is met: material legal proceedings, if the relief sought amounts to over ten percent of the registrants’ current assets and if government sanctions would amount to more than $100,000.

1. Legal Proceedings and Materiality

The first threshold is one of general materiality as applied to legal proceedings. A legal proceeding that is “material” to the business or financial condition of the registrant must be disclosed.\textsuperscript{134} There is no bright-line

\textsuperscript{129} 17 C.F.R. § 229.101(c)(xi) and (xii).
\textsuperscript{130} Additionally, Regulation S-X requires the preparation and formatting of quantitative financial information made to the SEC and to shareholders. See 17 C.F.R. § 210 et seq.
\textsuperscript{131} 17 CFR § 229.103.
\textsuperscript{132} Id. See supra n. 117.
\textsuperscript{133} Bagby, supra n. 7, at 292.
\textsuperscript{134} EPA Enforcement Alert, supra n. 26, at 2.
test for establishing the materiality of a disclosure. However, under Item 103's "materiality" test, there are specific instances where presumptions are made. A legal proceeding is presumed insignificant if it is "ordinary routine litigation that is incidental to the business." Greater significance is placed on material insolvency proceedings and insider litigation. Additionally, disclosures of potential or contemplated governmental proceedings are deemed material.

The SEC broadly interprets "government proceeding" to include administrative orders and Notice of Violations issued by the EPA or other authorized State agency. While only pending private actions must be disclosed, all potential government litigation (amounting to more than $100,000 in sanctions) must be disclosed. The SEC has made the assumption that governmental litigation is less frivolous than private litigation. There is, however, an inadequacy in this distinction. While the interpretation is broad, it excludes environmental citizen suits. Citizen suits that arise under environmental statutes should not be categorized as private rights of action for purposes of SEC environmental disclosures. It is apparent that citizen suit jurisdiction and standing requirements preclude them from being frivolous private rights of action. Moreover, they can result in significant penalties. Notice of Intent to Sue letters under various environmental statute citizen suit provisions should be deemed potential "government" litigation. These notice letters should be subject to mandatory disclosure for contemplated governmental litigation.

2. Aggregation of Damages

The second mandatory disclosure under Item 103 is any legal proceeding that involves primarily a claim for damages, or that involves potential monetary sanctions, capital expenditures, deferred charges, or charges to income for which the amount involved, exclusive of interests and costs, exceeds ten percent of the current assets of the registrant and its subsidiaries on a consolidated basis. This materiality threshold prohibits registrants from using the routine litigation exemption to avoid disclosure of private environmental proceedings. Private environmental litigation must only be disclosed if aggregated. When aggregated, the damage claims exceed ten percent of the registrant's current assets or multiple claims arising from the same facts are deemed material.

Within the context of Item 103, "aggregation of litigation" has three definitions: (1) combining all proceedings arising under the same facts and circumstances; (2) combining all pending or threatened litigation of all types; and (3) grouping all "similar" proceedings. Litigation may be aggregated for various purposes, including "grouping environmental or other social concern litigation to signal the registrant's commitment to such matters."

Under Item 103 there is a danger that the aggregation of litigation may inaccurately highlight the financial magnitude of the litigation, misleading investors. Additionally, the confusion regarding which claims must be aggregated and when not only leaves investors ill-informed, but exposes the registrant to additional liabilities by the SEC. These dangers could be alleviated through the promulgation of specific and detailed mandatory aggregation guidelines.

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135 17 C.F.R. § 229.103.
136 Bagby, supra n. 7, at 294.
137 Id. at 292-93.
138 EPA Enforcement Alert, supra n. 26, at 2.
139 Bagby, supra n. 7, at 293.
140 Id. at 296.
141 Id. at 297.
142 A corporation may be subject to suit by either investors or the SEC for failing to disclose all material information necessary to avoid misleading investors under Rule 10b-5. The rule states:
3. Monetary Sanctions Amounting to more than $100,000

The third mandatory disclosure is for monetary sanctions. "If a governmental authority is a party to the legal proceeding and the registrant has a reasonable belief that the proceeding will result, or has resulted in, monetary sanctions of $100,000 or more, the legal proceeding must be disclosed." It is noted that the duty to disclose the information related to these legal proceedings might exist before the actual initiation of a proceeding, so long as the registrant reasonably expects that the qualifying proceeding will be initiated.

The $100,000 threshold creates a per se materiality rule for government environmental legal proceedings. Under the per se rule, disclosure is only required if governmental regulators seek more than $100,000 in sanctions. If a registrant has a reasonable belief that the resulting sanctions will be less than $100,000, the proceeding need not be disclosed. The reasonable belief must exist when the registrant files for 10-K with the SEC and the registrant is under the duty to update, correct and monitor the progress of the litigation.

4. Per Se Materiality

The per se materiality rule under Item 103 creates the same controversy as in the capital expenditure exclusions under GAAP in Item 101 disclosures. The controversy is specifically embedded in the term "sanction." Governmental proceedings resulting in settlements, consent decrees, or administrative orders that require environmental mitigation and expenditures amounting to more than $100,000 are not deemed sanctions. If the expense is not categorized as a sanction, the $100,000 per se materiality rule is not triggered. Likewise, designation as a PRP under CERCLA—which could have astronomical economic implications—does not trigger disclosure under Item 103. Superfund clean-up costs do not constitute "sanctions" for the purpose of Item 103, but are deemed remedial costs, and thus treated as current charges to income or capital expenditures.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange:

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. 240.10b-5.
143 EPA Enforcement Alert, supra n. 26, at 2.
144 id.
145 Bagby, supra n. 7, at 293.
146 id. at 293-94.
147 id. at 294.
148 id. at 293-94.
149 id. at 294.
150 id. at 295.
151 id.
5. Disclosure Proposals

Item 103 of the Regulation S-K disclosure requirements provides a respectable starting point for a market-based incentive program. However, significant amendments must be made to address ambiguity in order for a market-based incentive program to be successful.

First, the definition of "governmental proceeding" should be expanded to include 60-day Notice of Intent to Sue letters under citizen suit litigation. While corporations often view citizen suit threats as inconsequential, the effects of these suits on the marketplace are significant. The filing of a citizen suit also has significant implications for the reputation of the business within the community and marketplace alike. Citizen suit litigation often highlights a corporation's environmental management and its interaction with the local community. Keeping investors abreast of citizen suit litigation provides them with an indication of the corporation's actions within its local community and its reputation within the community. This information gives investors the tools to manage their investments as a green investor and thus pushes the corporation towards environmental compliance and better environmental management—a market-based incentive program.

Second, the SEC should promulgate concrete aggregation standards. The subjectivity of current aggregation standards may not only leave investors in the dark regarding the financial implication of the registrant's contingent environmental liabilities, but may also subject the registrant to additional litigation under Rule 1Ob-5, the predominant antifraud prohibition designed to prevent inaccurate disclosures. Under current aggregation standards, remedial settlement costs may not be aggregated to reach the ten percent threshold. This aggregation standard may be inadequate, in essence misleading the investor. Providing investors with corporation's complete financial liability baseline maintains a heightened public scrutiny, and that is a specific deterrent to future corporate non-compliance.

Finally, under the $100,000 per se materiality rule, the term "sanction" should be interpreted more broadly. The interpretation should include settlements, consent decrees, and administrative orders that do not utilize the term "sanction" within their text. Furthermore, "sanction" should also include remedial clean-up costs, site mitigation, and designation as a PRP under CERCLA. While the disclosure of this information may seem threatening, that threat is exactly the catalyst that will spur voluntary compliance with environmental standards. Also, regardless of whether the information is threatening, if it is accurate, the investor will want to receive it.

Adversaries to expansive environmental disclosures and a market-based incentive programs may argue that this expansion would unduly confuse the investor regarding contingent environmental liabilities. However, this inference can be rebutted. An educated investor will make note of the link between environmental and financial performance. If an expansive interpretation of contingent environmental liabilities were adopted, these disclosures would provide corporations with an incentive to address the liabilities expeditiously. Raising the level of corporate awareness surrounding environmental performance and management directly addresses a market-based incentive program. Providing investors with full and fair environmental disclosure enables the investor to select the premium environmental corporation and weed out the mediocre corporations. This is the basis of a general incentive for corporations to improve their environmental performance, which is exactly what makes market-based incentive programs work.

C. Item 303

Item 303 requires environmental disclosures in the form of a Management Discussion and Analysis ("MD&A"). The MD&A contains the disclosure of environmental contingencies that may reasonably have a material impact on net sales, revenue, or income from continuing operations.\(^3\) It gives the investors the

\(^3\) EPA Enforcement Alert, supra n. 26, at 2.
opportunity "to look at the registrant through the eyes of management by providing a historical and prospective analysis." The duty of disclosure in an MD&A report is much broader than disclosure provisions in Item 103. MD&A mandates disclosure of specific forward-looking information . . . [if it is] reasonably likely to have a material effect.

Disclosures in the MD&A are made in a “plain English” narrative form and require the disclosure of management’s economic judgments and predictions. The plain English narrative form and prospective analysis of the MD&A is very flexible and therefore open to ambiguity and significant non-disclosure. Environmental disclosures are significantly impacted because the MD&A “imposes a separate duty on management to disclose its interpretation of the impact of environmental regulation on the registrant’s operations and performance.”

To alleviate the ambiguity of Item 303 and to address the considerable discretion that a registrant has regarding the MD&A disclosures, in 1989 the SEC set forth the 1989 Guidance. The Guidance provides a two-part analysis for environmental disclosure determinations under Item 303. First, the registrant must determine if a contingent event (or liability) is reasonably likely to occur. There is a presumption that the event will in fact occur unless the registrant can prove that the event is not reasonably likely to occur. If the registrant determines that the event is reasonably likely to occur, the contingent event must then be disclosed. Only if the registrant makes the determination that the “event’s occurrence is not reasonably likely to have a material effect on the company” may it avoid disclosure.

The SEC’s Guidance places the burden of proof on the registrant. Nevertheless, management still has extremely broad discretion, and significant problems arise in the context of materiality and corporate environmental disclosures. Much of the law of environmental disclosure under the Blue Sky Laws is unsettled, which results in even broader discretion. Quite simply, it is too easy for a corporation to defend a decision not to disclose.

Even though, in theory, the MD&A under Item 303 offers the investor a view from the managerial perspective, and the duty to disclose under regulation S-K is affirmative, it is subjectively based upon materiality. This subjective approach makes it too easy for the registrant to opt for nondisclosure, claiming that the information is immaterial. In order for the MD&A to be a successful tool utilized by the investor to promote a market-based incentive program, the doctrine of materiality under the SEC needs to be updated to address environmental disclosure concerns.

153 Bagby, supra n. 7, at 295.
154 Id. at 303-04.
155 Hazen, supra n. 109, at 3.10[2].
156 Bagby, supra n. 7, at 300.
157 Id.
158 Id.
160 For example, under the Clean Air Act, if the EPA proposed rules to lower baseline emission standards, the registrant must make a determination of whether or not the proposed rules would be approved and thus put into effect.
161 Feller, supra n. 65, at 233.
162 Id.
163 Id.
164 Id.
165 Id. at 234.
166 Id.
The concept of materiality is embedded in both the regulations and the securities laws themselves.\footnote{Id. at 252. (Compare 15 U.S.C. § 78j and § 78m (the statutory sources of authority for reporting environmental liabilities) with the rules promulgated thereunder in 17 C.F.R. pt. 229)} The materiality concept has found its way into environmental disclosures through the SEC’s balancing of two competing concerns: (1) protecting the investor and (2) not overburdening the disclosure requirements with information that has questionable value.\footnote{Id.}

When the concept of materiality is thrust into the realm of environmental disclosures, the regulations fail to balance the competing concerns.\footnote{Id.} Current materiality standards under environmental disclosures do not provide registrants with adequate guidelines. Registrants must make a subjective determination regarding the qualitative and quantitative values of their contingent environmental liabilities. Due to the subjective nature of this determination, disclosure is varied and ultimately unenforceable.

If the SEC, in conjunction with the EPA, developed objective standards regarding the materiality of contingent environmental liabilities, including costs and performance measures, it would address concerns over the registrant’s broad discretion in determinations about materiality.\footnote{Id. at 252-53.}

In addition to rule promulgation regarding the concept of materiality, the SEC should take a more proactive role in the enforcement of existing requirements. A 1998 EPA study found a non-reporting rate of 74 percent on the disclosure of environmental legal proceedings in registrant’s 10-K statements.\footnote{Franco, supra n. 2, at 7.} If investor protection is the primary focus of the SEC, a more active role in enforcement would bring this ideal to fruition. Environmental disclosures under Regulation S-K must be more meaningful and thus foster investor protection. In order for investors to create an environmental compliance incentive for corporations, they must have direct and adequate access to the corporation’s environmental performance.

**VI. CONCLUSIONS**

Current environmental disclosure regulations under various environmental statutes, coupled with more expansive SEC environmental disclosures and more stringent SEC disclosures, provide the information an ethical environmental investor needs to facilitate a market-based incentive program (which fosters environmental compliance). Disclosures under Regulation S-K are the basis for corporate disclosure of information regarding the impact environmental regulations, environmental litigation, and contingent environmental liabilities. While this regulation provides a building block to foster market-based incentives, in order to be successful, environmental disclosures need to be thorough and candid. Regulation S-K lacks the requisite teeth to provide adequate enforcement under the existing SEC requirements. The modification of the materiality standards is imperative to reforming SEC disclosure requirements to provide for a market-based incentive environmental program.

The SEC should promulgate new rules specifically regarding the materiality of environmental disclosures. These rules should address the SEC’s intent to require mandatory disclosure requirements for significant environmental contingencies. Additionally, rules should be promulgated to allow for the aggregation of contingent environmental liability. The aggregation of these liabilities will allow consumers, stockholders, and proxy voters to make informed decisions regarding a corporation’s green management and its future actions.
In the past, the SEC has stated that its broad discretion to promulgate disclosure regulations was "limited to the economic and investment market protection context of the securities laws." Since the SEC made that statement in the mid 1970's, it has been established that good environmental management fosters corporate competition and substantial benefits to both the corporation and the investor/shareholder. The theory of using green management as a fiduciary can function as the means to expand SEC environmental disclosure regulations. The expansion of these regulations—to allow for more expansive and coherent disclosures—would foster a market-based incentive program. Moreover, the SEC should take a more proactive role in the enforcement of corporate environmental disclosures. This enforcement is mandated due to the SEC's interpretation of their regulatory purpose—investor protection. The success of a market-based incentive program would alleviate much of the burden the EPA has had on environmental regulatory enforcement and become a vehicle for heightened environmental compliance and standards.

The enforcement of environmental disclosure requirements helps to ensure that companies complying with these obligations are not disadvantaged in the marketplace by firms that ignore the duty to disclose their environmental liabilities. The public availability of information regarding environmental performance and compliance will result in market forces that can positively influence environmental behavior.

While the EPA has a dwindling enforcement budget, new and innovative solutions should be utilized to ensure environmental compliance and pollution control. These can be implemented not only through successful Green Management of corporations, but through environmental disclosures and the enforcement of proper disclosure, giving the public a market-based solution to our growing environmental problems.

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172 Bagby, supra n. 7, at 279.
173 See Goodman, supra n. 1.
174 EPA Enforcement Alert, supra n. 26, at 1.
175 Id.