NOTE

SCRUBBING THE BOOKS GREEN: A TEMPORAL EVALUATION OF CORPORATE ENVIRONMENTAL DISCLOSURE REQUIREMENTS

ABSTRACT

Through arm-twisting, the federal government has forced corporations to disclose environmental liabilities since the catastrophic mid-twentieth century collision between securities and environmental law. Though their protests were numerous, and the self-proclaimed injustices against them unparalleled, corporations have recently been shoved over a fence onto a side where the grass is certainly greener, though not in the spirit of that adage.

The 2002 promulgation of Sarbanes-Oxley has done much to elevate the paranoia of corporate management, and as publicly backed environmental regulation increases its tenacity for environmental betterment, chief executive officers and chief financial officers are starting to sweat green all over their 10-Qs and 10-Ks.

This note takes the reader on a brief tour of the past, present, and future of environmental liability disclosures, hoping to provide at least the semblance that our federal government has been employing efficient means to protect both investors' wallets and their world.

I. HISTORY OF CORPORATE ENVIRONMENTAL COMPLIANCE AND ENVIRONMENTAL DISCLOSURES

A. *Early Forms of the Corporate Duty to Disclose*

The Securities Act of 1933[1] ('33 Act) and the Securities Exchange Act of 1934[2] ('34 Act) were both promulgated to facilitate the disclosure of public corporations' financial and material nonfinancial information to the Securities and Exchange Commission (SEC), its investors, and the public in general.

B. *Early Forms of Corporate Environmental Disclosures*

The '33 Act and the '34 Act identify four types of environmentally related information that is required to be disclosed by an SEC registrant in its quarterly (10-Q) and annual (10-K) reports: (1) information tending to show

[1] 15 U.S.C. § 77 (2000); 17 C.F.R. § 230 (2000).

[2] 15 U.S.C. § 78(a) (2006); 17 C.F.R. § 240 (2006).

the material effects of environmental compliance on the registrant;[3] (2) material legal proceedings in which the registrant is involved;[4] (3) discussion and analysis of the financial condition of the registrant;[5] and (4) contingent liabilities in financial statements.[6]

1. Data Tending to Show Material Effects of Environmental Compliance on the Registrant

The expense of environmental compliance or noncompliance is said to materially affect the financial condition of a corporation when such an expense would be important to a reasonable investor in evaluating the "total mix" of information available.[7] In addition to the disclosure of material costs, corporations must also refrain from making false statements of material fact, or from omitting facts necessary to ensure statements are not misleading.[8] However, when disclosing material information, management must segregate infrastructure and equipment costs from expenses associated with noncompliance.[9]

2. Material Legal Proceedings Involving the Registrant

The financial effect of certain legal proceedings on a corporation is also important to investors.[10] Accordingly, an SEC registrant is required to disclose material, environmentally related,[11] legal proceedings that (1) are "material to

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[3] 17 C.F.R. § 229.101(c)(xii) (2005).

[4] *Id.* § 229.103.

[5] *Id.* § 229.303.

[6] *Id.* § 210.3-10.

[7] TSC Indus., Inc. v. Northway Inc., 426 U.S. 438, 449 (1976) ("[T]here must have been a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."). *See, e.g.*, United Paperworkers Int'l Union v. Int'l Paper Co., 985 F.2d 1190, 1200 (2d Cir. 1993) (holding that a company's failure to disclose its having pled guilty to felonies for its violations of environmental regulations to be a material omission when considering the total mix of information available to investors).

[8] *See generally* Basic Inc. v. Levinson, 485 U.S. 224 (1988) (applying *TSC Industries'* materiality standard to Rule 10b-5 of the Securities Exchange Act of 1934).

[9] *See* Securities Act Release No. 33-5386, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 79,342, at 83,030 (Apr. 20, 1973). Expenditures for environmental compliance, including fines, should be separated from costs associated with the purchase of equipment or the maintenance of facilities. Otherwise, investors are unable to determine when a company is responsibly allocating dollars towards compliance, or merely paying administrative or civil penalties for past environmental wrongdoing.

[10] *See* 17 C.F.R. § 229.103 ("Describe briefly any material pending 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 the subject.").

[11] *See id.* Although 17 C.F.R. § 229.103 exempts corporations from having to disclose legal

the business or financial condition of the registrant" and are not "ordinary routine litigation incidental to the business;" or (2) may result in either damages or monetary sanctions exceeding ten percent of the corporation's current assets, and, a party involved is a governmental authority, unless the company "reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions . . . less than $100,000."[12] Although the identification of which legal proceedings might be material is conjectural[13] at best, the SEC's scrutiny of materiality under this provision is typically unforgiving and post hoc.[14]

3. Discussion and Analysis of the Financial Condition of the Registrant

The SEC also rigorously scrutinizes in hindsight a corporation's disclosures of management discussions and analyses (MD&A) of financial conditions under Item 3 of Regulation S-K.[15] Although all permutations of the word "environment" are absent from the black letter requirements mandating MD&A disclosures, the SEC has nonetheless required the disclosure of material environmental concerns discussed by corporate management as a sub requirement of Item 3.[16]

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proceedings that are incidental to the corporation's business, Instruction 5 to Item 103 expressly states that "administrative or judicial proceeding[s] . . . arising under any Federal, State, or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary [sic] for the purpose of protecting the environment shall not be deemed 'ordinary routine litigation incidental to the business . . . .'" *See also* Office of Reg. Enforcement, U.S. EPA, *U.S. EPA Notifying Defendants of Securities and Exchange Commission's Environmental Disclosure Requirements*, ENFORCEMENT ALERT, Oct. 2001, *available at* http:// www.epa.gov/oeca/ore/enfalert (indicating that EPA enforcement actions fall within the SEC's definition of a legal proceeding and therefore must be disclosed when the corporation first believes that such a proceeding will be initiated).

[12]17 C.F.R § 229.103; *see also infra* note 56 (discussing the pointless exercise of labeling some information as more or less material than others).

[13]Although there is no definitive method for determining when a potential administrative proceeding becomes imminent enough to disclose, there has been at least some jurisprudence that has refused to find a corporation's mere knowledge of its violation of an environmental regulation to be insufficient to compel disclosure of that violation. *See* Levine v. N.L. Indus., 717 F. Supp. 252, 255 (S.D.N.Y. 1989) (finding that management's circulation of internal documents that revealed its knowledge of an existing, actionable violation was not sufficient to force disclosure without knowledge that the state was intending to bring suit).

[14]*See* William Walsh et al., *New Initiatives to Encourage Disclosure of Environmental Costs and Liabilities*, 34 Env't Rep. (BNA) 217, 223 (Jan. 24, 2003). In evaluating environmental trends, enforcement actions, and contingent liabilities, "management must understand that SEC enforcement decisions are often made with the benefit of 20/20 hindsight. Unfortunately, it is easy to second-guess prior disclosure efforts after a substantial loss or liability has surfaced.").

[15]17 C.F.R. § 229.303.

[16]*See generally* Securities Act Release No. 6711, *Concept Release on Management's Discussion and Analysis of Financial Condition and Operations*, 52 Fed. Reg. 13,625, 13,715-19 (Apr. 17, 1987) (identifying general types of MD&A disclosures).

4. Contingent Liabilities in Financial Statements

Most significant environmental liabilities that escape the disclosure requirements of the previous three categories are required to be disclosed pursuant to the final category: the disclosure of a corporation's contingent environmental liabilities.[17] These are environmental liabilities for which an "amount of loss can be reasonably estimated"[18] and for which the corporation knows the probability[19] of such a potential loss.[20]

II. CHANGES IN CORPORATE AND ENVIRONMENTAL REGULATIONS

A. *Adoption of Sarbanes-Oxley*

The 2002 promulgation of the Sarbanes-Oxley Act[21] increased the pressure on corporate management to ensure the disclosure of all material financial information—including material environmental liabilities[22]—to

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[17]*See* Securities Act Release No. 33-5386, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 79,342, at 83,029 (Apr. 20, 1973) ("If management has a reasonable basis to believe future environmental compliance may have a material effect on the issuer's expenditures, earnings, or competitive position in the industry, then such matters should be disclosed."). *See also* Peter Gilbertson, *Reconciling Environmental Disclosure with Environmental Exposure: A Case for Environmental Risk Oversight*, 2 A.B.A. SEC. ENV'T, ENERGY & RESOURCES SPECIAL COMM. ON ENVTL. DISCLOSURE NEWSL. 7, 11-12 (Nov. 2004) (discussing the disclosure of contingent liabilities as governed by the SEC Financial Accounting Standards Board's (FASB) Financial Accounting Standard No. 5).

[18]Gilbertson, *supra* note 17, at 11.

[19]For a contemporary exploration of the word "probability" used in this context, see Cooper Indus., Inc. v. Aviall Servs., Inc., 543 U.S. 157, 167-68 (2004) (holding "that a private party who had not been sued in [a Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)] administrative or cost recovery action could not obtain contribution from other liable parties."). "Potentially responsible parties" (PRPs), under CERCLA, can no longer count on reimbursement from other private PRPs in instances where no government enforcement action has been brought against the party seeking reimbursement. *Id.* at 160-61.

[20]*See* 17 C.F.R. § 229.303; *see also* U.S. GOV'T ACCOUNTABILITY OFFICE, ENVTL. DISCLOSURE: SEC SHOULD EXPLORE WAYS TO IMPROVE TRACKING AND TRANSPARENCY OF INFORMATION, GAO-04-808, at 10-11 (July 2004) [hereinafter GAO-04-808] (discussing disclosure of contingent liabilities including corporate management's duty to disclose its knowledge regarding probable material fluctuations in environmental liabilities). *See, e.g.*, SEC Litigation Release No. 17,435, 2002 SEC LEXIS 736 (Mar. 26, 2002) (filing of a complaint by the SEC against six top officers of a public corporation alleging, inter alia, fraudulent manipulation of accounting records to eliminate impairment of landfill assets).

[21]Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28 & 29 U.S.C.) [hereinafter Sarbanes-Oxley].

[22]*See* GAO-04-808, *supra* note 20, at 8. The potential exists for Sarbanes-Oxley to increase the quality and quantity of environmental disclosures. Indeed, such increases seem required, as a 2001 EPA Policy Memorandum revealed that seventy-four percent of registered corporations listed no known

investors in conformance with SEC requirements.[23] In addition to being subject to increased pecuniary punishment, certain corporate executives now face the possibility of prison time for failure to comply with SEC reporting regulations.[24]

Additionally, a recent trend in the federal courts is to premise corporate managers' criminal liability on mere negligence in their violation of environmental laws.[25] The lowering of the mens rea necessary to impose criminal liability on corporate management under environmental regulations, coupled with the imposition of criminal liability of corporate managers introduced by Sarbanes-Oxley,[26] creates a legal gauntlet of potential jail time for corporate managers who fail to comply with environmental laws, or who fail to ensure disclosure of material environmental information to the SEC. The converse is that successful navigation of this green gauntlet can lead to both tangible and intangible corporate benefits.

Notwithstanding the capital investments involved in bringing existing environmental practices into compliance, and the maintenance costs associated with environmentally compliant practices, a corporate manager would still appear provident to force his corporation into full compliance,[27] as it would eliminate both the possibility for civil and criminal penalties arising from environmental compliance statutes and Sarbanes-Oxley. The result is a huge benefit for investors and an even bigger one for registrants.

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environmental liabilities to be disclosed. Memorandum from Mary K. Lynch & Eric V. Schaeffer to EPA Office of Enforcement and Compliance Assurance (OECA) Office Directors, Guidance on Distributing the "Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings" in EPA Administrative Enforcement Actions (Jan. 19, 2001), http://www.epa.gov/ compliance/resources/ policies/incentives/programs/sec-guid-distributionofnotice.pdf [hereinafter EPA Policy Memo]. For a discussion involving this EPA Policy Memo, see David Monsma & John Buckley, *Non-Financial Corporate Performance: The Material Edges of Social and Environmental Disclosure*, 11 U. BALT. J. ENVTL. L. 151, 202 (2004).

[23]*See* Walsh et al., *supra* note 14, at 228. One of Sarbanes-Oxley's primary purposes is the establishment by management of information collection, and disclosure controls and procedures.

[24]*See* Sarbanes-Oxley, 18 U.S.C. §§ 1350, 1519 (2002).

[25]*See, e.g.*, United States v. Ortiz, 427 F.3d 1278, 1279, 1281 (10th Cir. 2005) (holding an operations manager criminally liable for a negligent violation of the Clean Water Act, 33 U.S.C. §§ 1311(a), 1319(c)(1)(A) (2000), and failure to obtain a National Pollutant Discharge Elimination System (NPDES) permit). Consider too that, in addition to Ortiz's twelve month jail sentence, his corporation (if it were public) would be required to disclose the cost associated with obtaining the required NPDES permit, and costs associated with altering the company's business practices to comply with that permit, if these costs were material within the meaning of 17 C.F.R. § 229.101(c)(xii).

[26]*See* Sarbanes-Oxley, 18 U.S.C. § 1350 (2002).

[27]*See* GAO-04-808, *supra* note 20, at 35 (discussing the potential benefits in corporate perception associated with corporate compliance with environmental regulations).

1. Internal Management System for Environmental Reporting

Under Sarbanes-Oxley, corporate chief executive officers (CEOs) and chief financial officers (CFOs) must now ensure that an internal process is developed for the purpose of identifying and communicating to management environmental matters that require disclosure.[28] Because this internal reporting system must be periodically evaluated for sufficiency of operation, and because CEOs and CFOs are now required to disclose any deficiencies or fraud in the reporting structure, claims by management that they were unaware of reporting process deficiencies will often fall on the SEC's deaf ears.[29]

2. Separate Reporting Duties for Attorneys

Corporate managers are not the only ones who face new challenges; corporate attorneys would be wise to brush up on their environmental law if they intend to practice before the SEC after Sarbanes-Oxley. Section 307 of Sarbanes-Oxley requires attorneys who appear before the SEC to report "evidence of a material violation of securities law" and "breach[es] of fiduciary duty" by either the corporation or its employees to head counsel or the CEO.[30] If their reports are ignored, the attorneys must report to some or all of the board of directors.[31]

3. Protection for Whistle-blowers

Of special concern, when analyzed in the context of environmental reporting, is the increased protection afforded to whistle-blowers under Sarbanes-Oxley.[32] Although protections for whistle-blowing employees already exist in specific circumstances under many other federal statutes,[33] and

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[28]*See* 15 U.S.C. § 7241 (2002) (discussing the effect of Sarbanes-Oxley on internal corporate environmental reporting systems in holding corporate officers responsible for financial reporting).

[29]*Id.* § 7241(a)(5). The officers must certify that the reports to the auditors, or auditors committee of the board of directors, include:

> (A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and (B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls . . . .

[30]*Id.* § 7245.

[31]*Id.*

[32]*See generally* Marc I. Steinberg & Seth A. Kaufman, *Minimizing Corporate Liability Exposure When the Whistle Blows in the Post Sarbanes-Oxley Era*, 30 J. CORP. L. 445 (2005); 18 U.S.C. § 1514(A).

[33]*See, e.g.*, Steinberg & Kaufman, *supra* note 32, at 445-46 (discussing whistle-blower protections under federal statutes, including the False Claims Act, 31 U.S.C. § 3729 (1986), the Energy

although state laws provide a minimal level of piecemeal protection against retaliatory discharge in general,[34] uniform federal whistle-blower protection in the corporate and securities areas did not exist prior to Sarbanes-Oxley.[35] Under Sarbanes-Oxley, corporations must establish procedures for "confidential, anonymous submission by employees . . . regarding questionable accounting or auditing matters."[36]

Employers are therefore subject not only to criminal penalties for the retaliatory discharge of employees who report their violations of, or participate in, legal proceedings brought against them under federal whistle-blower provisions,[37] but also for the retaliatory discharge of employees who report fraudulent accounting and reporting practices. Again, by approaching the retaliatory discharge issue from both an environmental angle and from a corporate and securities angle, the federal government increases its chances of furthering the notably different objectives of these regulations by creating two opportunities to discover conduct which, in many instances, will constitute violations of the whistle-blower protection provisions of the two federal statutes.[38] The reality that employers may face prosecution for the retaliatory discharge of an employee under both environmental and securities whistle-blower statutes should, ideally, result in a reduction in the frequency of environmental and securities liabilities.

Reorganization Act, 42 U.S.C. § 5851 (1974), the Toxic Substances Control Act, 15 U.S.C. § 2601 (1976), and the Clean Water Act, 33 U.S.C. § 1251 (1977)).

[34] *See* William R. McLucas & Mark M. Oh, *Whistleblowing: Protection of Corporate Officials and Employees Who Provide Evidence of Fraud Under the Sarbanes-Oxley Act of 2002*, 1411 PLI/Corp 61, 63-64 (Feb. 2004) ("All states have some type of law prohibiting retaliation against [whistle-blowers], but these laws vary widely by state in terms of the persons protected, the procedural requirements for establishing retaliation, the type of evidence required to prove retaliation, and available remedies.").

[35] *See id.* Prior to Sarbanes-Oxley, whistle-blowers were only protected in specific circumstances, and not for disclosing corporate fraud.

[36] 15 U.S.C. § 78j-1(m)(4)(B).

[37] *See* Steinberg & Kaufman, *supra* note 32, at 445-46.

[38] Imagine a scenario where a small industrial manufacturer is operating pursuant to a National Pollutant Discharge Elimination System (NPDES) permit that regulates the concentration of specific pollutants in the manufacturer's waste water discharge. For the past eight months, the CEO has been directing the corporation's facility's manager to adjust the reported levels of copper concentration to comply with the permit, or else the corporation would face monetary sanctions. Furthermore, the CEO—acting as honorary CFO—prepares two rounds of quarterly 10-Qs, failing to record any environmental liabilities for either improving the facility to reduce the copper concentration, or paying the monetary sanctions that could be imposed by the EPA. The facility's manager, who sees a copy of the 10-Qs next to the trash can, decides to report the CEO's behavior to the EPA and to the SEC. Subsequently, the facility's manager is fired. After Sarbanes-Oxley, the facility's manager could invoke the whistle-blower protections of either the Clean Water Act, or Sarbanes-Oxley in a retaliatory discharge claim.

B. *The Environmental Protection Agency's Development of New Methods for Improved Corporate Environmental Liability Disclosures*

1. Regulation by Information

Instead of merely sanctioning corporations for their environmental violations, the Environmental Protection Agency (EPA) recently instituted a new initiative to attack a corporate asset cherished even above its finances: its attractiveness to investors and to the public in general. Since 2003, the EPA has been working towards the development of an online depository (essentially an environmental hit list) of information on companies that are either currently in violation of environmental regulations or are currently being investigated pursuant to an agency enforcement action.[39] This environmental hit list is an example of governmental regulation by information,[40] which is intended to promote corporations' quasi-voluntary[41] compliance with environmental regulations while providing cost saving benefits to both regulated entities and the administrative agencies that regulate them.[42] Though the benefits of the academic template for regulation by information seem incontrovertible, commentators have raised doubts regarding the practical realization of these

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[39]Walsh et al., *supra* note 14, at 218.

[40]Regulation by information is the "government's practice of collecting and making public various types of information on private business activities with the express intent that resulting public and political pressures will force desired changes in private sector behavior." Center for Regulatory Effectiveness (CRE), *"Regulation by Information" Prompts Call for Amendment to Paperwork Reduction Act and the Implementation of a Federal Data Quality Program, available at* http://www.thecre.com/information/index.html.

[41]The term "quasi-voluntary" is used to highlight the likelihood that, even when the impetus for corporate compliance with environmental regulations is the prevention of the public disclosure of corporate non-compliance, many companies' compliance with environmental regulations is based on the minimization of sanctions or the avoidance of criminal liability; it is rarely benevolent. If not thus qualified, the term voluntary could be attenuated to describe corporate compliance with environmental regulations in general, regardless of the public's knowledge of corporate compliance.

[42]*See* Walsh et al., *supra* note 14, at 220 (identifying the regulated entities' benefit as the ability to choose its specific method of compliance with environmental regulations and the regulator's benefit of achieving the goals of its mandate in a less costly manner). *See also* Alessandra Love Simons, *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*, 17 VILL. ENVTL. L.J. 331, 354 (2006) (offering the circuitous argument in which environmental data is available, for instance, under the Clean Water Act, 33 U.S.C. § 1367, by way of the Freedom of Information Act, 5 U.S.C. § 552 (2002), but should nonetheless be disclosed in a concise format to investors to prevent their needless governmental entanglement). However, by using the Freedom of Information Act the investor can gain data in excess of that published by EPA; not only could current environmental records be obtained, but past records as well. Thus, the prudent investor could identify trends in a corporation's compliance history. With seriousness of questionable veracity, the author wonders why corporations do not eliminate their release of raw data and instead prepare surrogate Rochdale reports to eliminate investors' analysis of data altogether.

benefits. For instance, without a disinterested party monitoring the EPA's dissemination of corporate environmental information, concerns regarding the accuracy of data and of fairness to the corporation seem justified. In many cases, once environmental information is displayed on the EPA's web site, it can be taken by any adverse party and skewed, misreported, or otherwise presented in a manner that distorts its relevance to investors and to the public.[43]

Another potential concern is the usefulness of the environmental information disclosed to investors. For the investor to use information disclosed on the EPA's hit list, "the information must be accurate, complete, unbiased, fair and relevant . . . ."[44] However, even if all of these conditions are met, the utility of the information for investment analysis remains questionable.[45] One could envision even the slightest disparity regarding the legality of a corporation's environmental practices as being the deciding factor to an investor who is undecided about whether to invest in a company. This scenario is not far-fetched, and so long as it is not, information that could aid in an investor's decision-making process will be useful, albeit inundating.

2. EPA's Enforcement and Compliance History Online

An additional method to facilitate corporate disclosures of environmental and, indirectly, accounting information is the implementation in 2003 of the EPA's Enforcement and Compliance History Online (ECHO).[46] The use of this web site is yet another example of the EPA's regulation by information.[47] Though ECHO's scope of disclosures is more focused[48] than the EPA's online environmental hit list, ECHO may prove to be more useful to investors because

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[43]*See* Drew Douglas, *Florida Officials Complain of Errors Posted on Site Listing Facility Compliance Records*, State Env't Daily (BNA), at D-9 (Dec. 11, 2002). The author identifies another recent EPA attempt at online environmental compliance disclosures that resulted in the publication of errors. According to the Florida Department of Environmental Protection, "of 117 [Florida] facilities listed as in 'significant non-compliance' on the web site, 12 were reported in error, 29 were back in compliance, and 76 were under enforcement actions by the state or EPA itself." *See also* Walsh et al., *supra* note 14, at 221 (highlighting the unintentional creation of a presumption of guilt upon companies placed on EPA's environmental hit list, even when their presence on this list is merely a result of an enforcement action in which their guilt has not been proven).

[44]Walsh et al., *supra* note 14, at 221.

[45]Presumably, the term "investor" is reserved for an individual who analyzes relevant financial data to make money, and not for an individual who invests money in an environmental engineer to analyze environmental data to speculate over its financial implications.

[46]ECHO, About the Site, http://www.epa-echo.gov/echo/about_site.html.

[47]*See supra* note 40 (defining regulation by information).

[48]ECHO, *supra* note 46. ECHO publishes the compliance history of over 800,000 facilities regulated by the Clean Air Act, the Clean Water Act, the National Pollutant Discharge Elimination System and the Resource Conservation and Recovery Act.

of its more detailed reporting of a corporation's environmental compliance.[49] ECHO provides facility-specific information regarding not only present enforcement actions and penalties, but past compliance with certain regulations as well.[50] Investors can use this information to evaluate independently the financial implications of a corporation's past, present, and future environmental practices and to make more informed investment decisions. Also, through ECHO, an investor's ability to evaluate the culpability of a corporation involved in a current enforcement action by considering that corporation's past environmental practices helps eliminate any presumption of guilt arguments raised against the use of the EPA's environmental hit list.[51]

III. DEVELOPING TRENDS IN CORPORATE ENVIRONMENTAL DISCLOSURE

Recent studies reveal that the majority of environmental disclosures, both in the United States and in other countries,[52] lack depth and quality.[53] However, some financial experts, and those in charge of preparing SEC disclosure reports, say that the existing reporting flexibility is necessary given the diversity of registrants.[54] Reasons given by pro-registrant stakeholders against increasing the scope of required environmental disclosures include the fear of overlapping with current disclosures under existing environmental regulations;[55] the relative immateriality of environmental information as compared to management compensation or other purely financial matters;[56] the additional reporting burden[57] placed on registrants without any discernable

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[49]*See* Walsh et al., *supra* note 14, at 229 n.5 (comparing the depth of information published on ECHO as compared to other EPA disclosure policies).

[50]ECHO, About the Data, http://www.epa-echo.gov/echo/about_data.html.

[51]*See supra* note 43 (analyzing the potential for negative effects resulting from EPA's regulation by information initiatives).

[52]*See generally* Cynthia Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493, 511-21 (2005) (discussing the United Kingdom's struggle to address issues associated with corporate reporting of environmental and social data).

[53]*See supra* note 22.

[54]*See* GAO-04-808, *supra* note 20, at 15 (identifying arguments made by industry stakeholders that current disclosure requirements are sufficient to ensure environmental information is reported).

[55]*See* ECHO, *supra* note 46 (identifying several federal regulations that already require disclosures of environmental data).

[56]*See* GAO-04-808, *supra* note 20, at 15 ("According to financial analysts with general investment interests, environmental information is less important than other types of information, such as executive compensation or the percentage of stock owned by the Board of Directors, in assessing a company's condition and its desirability as a potential investment."). However, the author wonders why pro-registrant stakeholders should make arguments concerning relative importance of accounting information when the SEC and federal courts have specified countless times that *all* material information must be disclosed.

[57]Registrants do not want to confound investors. Suddenly, registrants are philanthropic

benefit to investors' decision making; and aggregating the uncertainties associated with the compliance costs of pending environmental regulations results in increased uncertainty, making the magnitude of the resulting environmental liability disclosure useless.[58]

A. *Quantitative Effect of Sarbanes-Oxley on Corporate Environmental Disclosures*

Settling the debate between registrants and investors over the sufficiency of existing environmental disclosures and the impact of Sarbanes-Oxley on those disclosures is difficult because of an existing inability to quantify current disclosure practices. This difficulty results from the existing flexibility in both the interpretation of SEC disclosure requirements and in the format of required SEC reports, as well as the lack of access to all of registrants' environmental records.[59] Thus, reports of nonexistent, or even negligible, environmental liabilities are not necessarily proof of compliance. Without access to the entirety of a registrant's data, it is difficult to determine whether few disclosures means few environmental violations, or whether it indicates a refusal to disclose required environmental liabilities.[60]

In addition to the lack of access to all registrants' environmental data, the inability to evaluate the adequacy of existing environmental reporting is exacerbated by the SEC's insufficient monitoring practices of registrants' reporting. The SEC's failure to review even a quarter of registrants' annual filings, to track the nature and extent of disclosure insufficiencies to identify trends, or to ensure access to all of a registrants' pertinent data, hinders any cogent review of Sarbanes-Oxley's influence on environmental disclosures.[61]

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concerning the withholding of environmental information—that is presumably already in a reportable format, having purportedly been disclosed as required by various other federal regulations—in SEC disclosure reports when it seems that the more confusing environmental information contained in a disclosure report, the more likely it is to be rubber stamped by an SEC reviewer. A more realistic evaluation might be to call the registrants' arguments pretextual; the intention being the withholding of sensitive and detrimental information pertaining to the registrants' environmental liabilities.

[58] *See* GAO-04-808, *supra* note 20, at 15.

[59] *Id.* at 16 (stating that without access to all of a registrants' environmental data, it is nearly impossible to identify which registrants are reporting all of their environmental liabilities).

[60] "Assessing companies' disclosure of environmental information is difficult, primarily because researchers have no way of knowing what environmental information is (1) potentially subject to disclosure and (2) material in the context of a company's specific circumstances, and therefore required to be reported." *Id.*

[61] *Id.* at 24-26.

B. *Ancillary Corporate Benefits for Increased Environmental Disclosure*

Along with the obvious benefits of avoiding SEC sanctions and possible criminal charges, registrants who satisfy the requirements of both the EPA and the SEC become attractive to socially responsible investors.[62] The practice of selecting companies in which to invest based on their economic and social policies seemed insignificant at its genesis, but recently the dollar amount invested by socially responsible investors has grown to about $2 trillion.[63] Several companies have already acted to cash in on this increasing market by endorsing the Coalition for Environmentally Responsible Economies (CERES) Principles, "a series of environmental protection pledges" adopted and complied with voluntarily by corporate endorsees.[64] A CERES report, which serves to document compliance with these environmental principles, is prepared yearly and released to investors to encourage trading in environmentally friendly corporations.[65] Even if the trend of socially responsible investors stalls or plateaus, the reputation of a registrant may be tarnished by environmental noncompliance, thus reducing its marketability in the eyes of socially responsible *consumers*, which ultimately may affect its attractiveness to investors.

IV. UNIFORMITY AND RELEARNING HOW TO SHARE

A. *Sharing of Information Between the SEC and EPA*

In 2001, the EPA announced its intent to share with the SEC any pending environmental enforcement actions, including information obtained from companies involved in such actions, in an effort to effectuate the SEC's S-K requirements.[66] By sharing information about environmental enforcement actions, the EPA hoped to facilitate a symbiotic relationship between

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[62]The term "socially responsible investor" refers to individuals who screen their investments based on companies' environmental, labor, or community practices. *See, e.g.*, Rob Wherry, *Ethical Investing*, SMART MONEY, Nov. 2006, at 38.

[63]*See* GAO-04-808, *supra* note 20, at 8 (reporting an estimate from the Social Investment Forum that eleven percent of the assets comprising the $19.2 trillion in professional portfolios was invested in socially screened accounts). The report is unable to conclude, however, whether the increase in investment is due to conscientious investors, or to the reality that corporations are simply beginning to comply with environmental regulations, making the percentage unrelated to investments made by socially responsible investors. *Id.*

[64]Mitchell Crusto, *Endangered Green Reports: "Cumulative Materiality" in Corporate Environmental Disclosures After Sarbanes-Oxley*, 42 HARV. J. ON LEGIS. 483, 492 (2005).

[65]*Id.*

[66]*See* Office of Reg. Enforcement, U.S. EPA, *supra* note 11, at 3.

itself and the SEC.[67] This relationship was intended to foster SEC attempts to weed out registrants that did not comply with environmental disclosure requirements and to further the SEC's goal of protecting shareholders from insufficient or misleading investment information.[68] Likewise, the increase in potential SEC actions against registrants that violate state and federal environmental laws should have promoted compliance with those laws.

In reality, the sharing of enforcement information has nearly ceased, as the EPA's method of tracking violators by facility is incompatible with the SEC's method of tracking registrants by company.[69] Some experts have argued for the streamlining of data sharing and interoperability between the EPA and SEC, but federal agency coordination is surely on a wish list with many signatories, and it may be some time before efficient data sharing techniques are implemented.[70] The SEC has belittled the need for better coordination with the EPA by claiming that the new ECHO practice has eliminated the need for the sharing of additional information.[71] Before this argument may be accepted, it is important to remember that ECHO only tracks *compliance* history. It discloses neither information pertaining to other environmental liabilities[72] nor undiscovered violations of environmental regulations.

B. *Stabilization of Corporate Environmental Disclosures*

Because current SEC reporting requirements are somewhat ambiguous, arguments have been made for the SEC's adoption of a heightened and standardized system of reporting environmental information.[73] The lead candidate for adoption appears to be a method developed by the American Society of Testing and Materials (ASTM), though registrants and industry stakeholders are actively fighting this alternative.[74]

In 2001, the ASTM created two documents regarding disclosure

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[67] *Id.* at 1 (discussing EPA's belief that enforcing disclosures would lead to market forces with a positive effect on corporate environmental behavior).

[68] GAO-04-808, *supra* note 20, at 28.

[69] *Id.*

[70] *Id.* at 33.

[71] *See id.* at 28.

[72] For instance, a corporation may invest several years and thousands of dollars in trying to obtain various permits for proposed facilities. The EPA would have detailed information pertaining to all of the proposed facilities, yet this information is not disclosed on ECHO because no compliance history exists currently. If the corporation does not disclose this information to the SEC, receiving the information from the EPA may be the only feasible alternative.

[73] Richard M. Schwartz & Donna Mussio, *Environmental Due Diligence for Securities Offerings*, 1368 PLI/Corp 509, 512-17 (May 2003).

[74] *See* GAO 04-808, *supra* note 20, at 30; Richard M. Schwartz et al., *Environmental Disclosure Requirements Under the Federal Securities Laws*, 1489 PLI/Corp 115, 154-57 (May 2005) (discussing the "Rose Petition").

practices of environmental liabilities: the Standard Guide for Disclosure of Environmental Liabilities and the Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters.[75] These documents were subsequently named in the "Rose Petition"[76] as the preferred standard to be adopted by the SEC as a mandatory reporting standard for corporate environmental disclosures. The drafters of this rulemaking petition hope to increase compliance with environmental regulations by requiring registrants to disclose more detailed environmental liability information.[77] The proposed reporting standards would primarily modify the materiality determination of environmental liabilities, making disclosure of environmental liabilities more likely to be required in all circumstances.[78] Currently, Item 101 of the SEC's S-K regulations does not require registrants to disclose environmental liabilities that are not material, even if such liabilities would be material if accounted for and reported as one liability.[79] Aggregation of liabilities would likely lead to full disclosure.

V. CONCLUSION

It is undeniable that the federal government has taken steps to improve the accuracy and depth of corporate disclosures, but the means to an end are always fair game for a debate. It seems patently obvious that those with their fingers on the pulse of corporate cash flow should be forced to prove that they have no environmental liabilities to disclose by releasing *all* environmental data to either the EPA or the SEC. If a corporation has nothing to hide, then providing records on all of its existing environmental facilities should be of no consequence. This decision seems easy, but it becomes more troublesome when you become the one pouring over thousands of records, worrying about going to jail if you do, or do not, disclose them.

Yes, the side of the fence upon which corporations are now situated is definitely greener.

And, if it is not, the SEC wants to know why.

Michael J. Viscuso

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[75] *See* E-2173-07 (2006), http://www.astm.org; E-2137-06 (2006), http://www.astm.org.

[76] *Revised Rulemaking Petition from Jill Ratner, President, Rose Foundation for Communities and the Environment, to Jonathan G. Katz, Secretary, SEC*, SEC File #4-463 (2002), *available at* http://www.sec.gov/rules/petitions/petn4-463.htm (petition for the SEC's adoption of a heightened materiality standard for determining environmental disclosures, offered by ASTM).

[77] *Id.*

[78] *Id.*

[79] 15 U.S.C. § 77 (2000).