SEC Disclosure Requirements for Contingent Environmental Liability

Gerard A. Caron
SEC DISCLOSURE REQUIREMENTS FOR CONTINGENT ENVIRONMENTAL LIABILITY

Gerard A. Caron*

I. INTRODUCTION

The Securities and Exchange Commission (SEC) imposes disclosure obligations on all publicly held companies regarding their contingent liability arising under federal, state, and local environmental control laws.1 These obligations emerge out of specific SEC rules,2 as well as general materiality principles3 under the Securities Act of 19334 and the Securities Exchange Act of 1934.5 Violations of these disclosure requirements may result in civil or criminal liability under the federal securities laws.6 The SEC may bring enforcement actions in appropriate cases,7 and these proceedings may be supplemented

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The disclosure requirements under discussion apply not only to the ongoing reports of publicly held companies (publicly held companies include companies that have greater than $5 million in assets and at least 500 shareholders, companies that engaged in a public offering under the Securities Act of 1933 and have at least 300 shareholders, and companies that have securities listed on a national securities exchange) filed under the Securities Exchange Act of 1934, but also apply where a company files a registration statement pursuant to section 5 of the Securities Act of 1933. The specific rules and the general materiality principles discussed herein apply in both instances.


3 See, e.g., 15 U.S.C. § 77k(a) (1982); see also infra notes 20–26 and accompanying text.


6 Hamilton, supra note 1, at 2–109.

by private civil actions by aggrieved members of the investing pub-
lic. 8

The environmental disclosure requirements are of particular im-
portance because the potential for corporate liability based on en-
vironmental damage is substantial. 9 For example, criminal and civil
liability may result from corporate violations of the following legis-
lative pronouncements: the Clean Air Act, 10 the Clean Water Act, 11
the Resource Conservation and Recovery Act, 12 the Comprehensive
Environmental Response, Compensation, and Liability Act of 1980, 13
and the Toxic Substances Control Act. 14 Not only are the dollar
amounts that corporations must pay for violating these statutes high
in comparison with non-environmental civil penalty provisions, 15 but
these costs may also escalate if corporations do not discover or
correct violations in a timely manner. 16 Furthermore, although the
political climate in this country has changed since federal and state
legislatures enacted the bulk of environmental legislation, 17 it is not
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This Comment examines the history and current status of SEC disclosure requirements regarding corporate contingent liability for environmental damage. The first section discusses the development of these requirements in the 1970's and early 1980's, especially as this development reveals the intent of its framers. The second section then explains the existing requirements in the area of environmental litigation disclosure by looking at relevant SEC releases and enforcement proceedings. The final section focuses on current disclosure obligations as they relate to unasserted claims for corporate environmental damage. This Comment ultimately explores and proposes remedies for the two-fold problem that arises regarding disclosure of unasserted claims: the ambiguous standard used to determine materiality in this area, and the unreality of expecting a corporation to "turn itself in," with respect to its environmental misconduct that has thus far been undiscovered by parties outside the company.

II. THE DEVELOPMENT OF SEC ENVIRONMENTAL DISCLOSURE REQUIREMENTS

The central goal of the federal securities laws is to ensure that buyers and sellers of securities will be adequately informed of material information affecting the value of the securities traded. The general materiality standard applicable under these laws limits disclosable information to "those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered." Corporations must report information that satisfies this standard in various public filings, including quarterly and annual reports filed with the SEC.

would be disruptive, and would require a major political effort for which no support appears likely, after the brief effort at change early in the Reagan Administration. Id. The implication is that the present body of environmental laws (including its relatively tough civil penalty provisions) is in place for a while.

20 17 C.F.R. § 240.12b-2 (1986). See also TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (materiality requires "a showing of a substantial likelihood that . . . the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder").
21 Section 11 of the Securities Exchange Act requires every issuer that has securities registered under section 12 to file periodic and other reports with the SEC, that must comply with its general and special disclosure requirements.
It is well-accepted in the securities practice that material facts include not only "information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company . . . ." Thus, a publicly held corporation is required to disclose, for instance, legal proceedings instituted against it when there is a substantial likelihood that reasonable investors would attach importance to that information in making their investment decisions. The general materiality standard may also mandate disclosure even where a claim has only been threatened against a corporation. Furthermore, this standard of disclosure may be satisfied where a corporation has violated the law, and knows it is thereby subject to yet unasserted legal claims. In sum, whenever a reasonable investor, in deciding whether to buy or sell a company's securities, would want to know about the corporation's exposure to potential liability, these general materiality principles will trigger the corporation's duty to disclose.

Although the materiality standard would apply by implication to legal claims arising under environmental laws, the SEC issued a release in 1971 expressly stating this application. The release provided that "the Commission's disclosure requirements relating to legal proceedings call for disclosure, where material, of proceedings arising . . . [under] statutes, federal, state or local, regulating the discharge of materials into the environment, or otherwise specifically relating to the protection of the environment."
The 1971 release indicates that the SEC's environmental disclosure requirements regarding corporate liability originally coincided with most of the SEC's other regulations mandating disclosure of material information relating to the business operations and financial condition of publicly held corporations.\textsuperscript{29} Although the Commission later adopted specific environmental disclosure regulations, disclosure obligations under general materiality principles continue to apply to legal proceedings arising under environmental laws.\textsuperscript{30} As the Commission has explained, its general reporting rules "require disclosure of any additional material information, beyond that for which disclosure is required by specific Commission rule, necessary to make required statements not misleading."\textsuperscript{31} This requirement becomes particularly apparent when dealing with the issue of unasserted legal claims.\textsuperscript{32}

\textbf{A. The NEPA Mandate}

A question might legitimately be raised as to why the SEC issued the 1971 release if the release primarily articulated what was already apparent under the SEC's general reporting rules.\textsuperscript{33} It seems likely that the release was prompted at least in part by Congress' then-recent enactment of the National Environmental Policy Act (NEPA).\textsuperscript{34}

Among other things, NEPA instituted the mandate that all federal agencies in their rulemaking activities must consider the protection of the environment.\textsuperscript{35} All federal agencies would be required to "identify and develop methods and procedures . . . which will ensure that presently unquantified environmental amenities and values may be given appropriate consideration in decisionmaking along with economic and technical considerations . . . ."\textsuperscript{36} Furthermore, §102(1) of NEPA directs that "to the fullest extent possible . . . the policies, regulations, and public laws of the United States should be inter-
interpreted and administered in accordance with the policies set forth in [NEPA] . . . ."\(^{37}\) In issuing the 1971 release, the SEC, then, possibly sought to reiterate registrants' disclosure obligations regarding potential liability for environmental damage in order to exhibit its compliance with NEPA.

**B. The NRDC v. SEC Controversy**

Another factor that may have prompted the SEC to address environmental matters in the 1971 release was a petition filed by the Natural Resources Defense Council (NRDC).\(^{38}\) The NRDC is a non-profit organization, comprised of lawyers, scientists, and other private citizens, that seeks protection of the country's natural resources.\(^{39}\) Not long before the SEC issued the 1971 release,\(^{40}\) the NRDC filed a rulemaking petition requesting the SEC to adopt certain detailed environmental disclosure rules.\(^{41}\) This petition marked the beginning of the NRDC's exertion of pressure on the Commission to adopt comprehensive environmental disclosure rules.\(^{42}\) This pressure continued throughout the 1970's.\(^{43}\)

The purpose of the NRDC's 1981 petition was "to request that the Commission implement its new environmental mandate under NEPA in the corporate disclosure area."\(^{44}\) The NRDC took the position that NEPA required the SEC to promulgate comprehensive disclosure rules that would bring to light the "environmental impact" of corporate registrants.\(^{45}\) The petition contained proposals for specific rules that would help achieve this result.\(^{46}\)

\(^{37}\) *Id.* at § 4332(1).


\(^{39}\) *Id.* at 693.


\(^{41}\) NRDC v. SEC, 389 F. Supp. at 694.


\(^{43}\) *Id.*

\(^{44}\) NRDC v. SEC, 389 F. Supp. at 694.

\(^{45}\) *Id.*

\(^{46}\) *Id.* The NRDC's petition proposed:

that companies which file with the SEC be required to describe with respect to each major activity or product, *inter alia*: (1) the nature and extent (quantified to the extent feasible) of the resulting pollution or injury to natural areas and resources, and (2) the feasibility of, and plans for, correcting the same. The petition also requested that the SEC require disclosure of whether the registered company has
The environmental disclosure requirements mentioned in the SEC's 1971 release, emerging from the traditional materiality threshold, were a far cry from the NRDC's comprehensive disclosure proposals. A few months after the SEC issued the release, the Commission formally denied the NRDC's petition. The letter denning the petition indicated that the Commission was in the process of reviewing the environmental disclosures that had resulted from the 1971 release. The Commission further expressed that it would "actively consider amendments" to its rules in the near future. Thus, although the SEC denied the NRDC's petition, it left open the possibility that other environmental disclosure rules might be proposed soon.

In 1972, the year after the SEC denied the NRDC's petition, the SEC announced its proposals for special disclosure rules regarding environmental matters. The SEC intended these new requirements to supplement, not replace, the existing obligations in this area. The special rules were adopted with some variations one year later, in 1973, after the Commission considered public comments concerning the rule proposals.

changed company products, projects, production methods, policies, investments or advertising to advance environmental values.

Id. This kind of comprehensive environmental disclosure in public filings, and its use in compelling compliance with environmental laws is the topic of discussion in Pitt and Sonde, Utilizing the Federal Securities Laws to "Clean the Air! Clear the Sky! Wash the Wind!", 16 How. L.J. 831 (1971). The authors state, for example,

We do suggest, however, that the Commission can, and should, require corporate entities to disclose what they are doing to the environment and whether or not they are in compliance with legally imposed environmental standards. Such disclosure could thus be used as an additional weapon in the federal arsenal directed at environmental problems . . . .

Id. at 849-50.

*47 See supra note 28 and accompanying text.
*48 See supra note 20.
*49 See supra note 46.
*50 See Release No. 5704, supra note 8, at 86,293, n.8, citing SEC File No. 4-179.
*51 Id. at 86,293.
*52 Id.
*53 Id.
*56 Notice of Adoption of Amendments, Securities Act Release No. 5386, [1973–1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,342 (April 20, 1973). One notable variation between the proposals and the amendments as adopted involved the treatment of environmentally-related administrative or judicial proceedings by governmental authorities. Under the proposals, all such proceedings would have to be discussed in detail, whereas under the final amendments registrants would be allowed to group similar proceedings and provide generic
Under these 1973 regulations, the SEC required publicly held corporations to disclose all environmental administrative or judicial proceedings instituted by governmental authorities, regardless of whether the proceedings were "material" to a company's business. Consequently, multibillion-dollar corporations, under no obligation to disclose non-environmental litigation potentially involving hundreds of thousands of dollars, were obliged to disclose governmental proceedings for environmental damage involving only hundreds of dollars.

The new regulations provided, however, that detailed disclosure of each of these governmental enforcement proceedings was unnecessary:

Instead, issuers may set forth groupings of similar proceedings specifying the number of such proceedings in each group, giving generic descriptions thereof, stating the issues generally involved, and if such proceedings in the aggregate are material to the business or financial condition of the issuer, describing the effect of such proceedings on the issuer.

In spite of this option for providing generic descriptions whenever similar proceedings were involved, registrants would have to describe similar proceedings individually where any single proceeding involved a claim for damages in excess of ten percent of the issuer's current assets on a consolidated basis, or where any proceeding otherwise may have been material.

The 1973 rules also eliminated a prior loophole in the SEC's litigation disclosure requirements, as applied to litigation arising under environmental laws. General instructions in the securities regulations for assessing which legal proceedings publicly held companies must disclose provide that even though a legal proceeding involves damages in an amount meeting the standard for economic materiality, information need not be given if the proceeding is considered

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descriptions thereof. This option would be unavailable, however, whenever any one proceeding would itself be deemed "material."

57 Id. at 83,030–83,031. In Air-Products and Chemicals, Inc., SEC No-Action Letter, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,429 at 83,229 (June 11, 1973), the SEC rendered its opinion that the disclosure of these governmental proceedings is intended to be limited to those instituted by governmental entities within the United States. To the extent any foreign environmental provisions may have a material impact upon the company's financial condition or business, however, such matters should be disclosed.

58 Hamilton, supra note 1, at 2-110.


60 Id. at 83,031.

61 Id.

62 Id. at 83,030.
“ordinary routine litigation incidental to the business.”63 On the other hand, the 1973 regulations stated that “administrative or judicial proceedings arising under any Federal, State or local provision regulating the discharge of materials into the environment”64 could no longer be considered “ordinary routine litigation.”65 Thus, the SEC closed the loophole as it related to environmental litigation.66

Along with the special 1973 environmental disclosure rules, the SEC also adopted an amendment to its general litigation disclosure rules.67 The amendment would require a description of the factual basis of all material legal proceedings.68 This requirement would apply to both environmental and non-environmental pending litigation and litigation “known to be contemplated by governmental authorities.”69 In addition to requiring a description of the factual basis of the proceeding, the SEC would also require registrants to disclose the relief sought therein.70

Although it adopted special environmental disclosure rules to supplement general materiality principles in this area, the SEC declined to adopt the rules advocated by the NRDC.71 As a challenge to the Commission’s failure to propose the full disclosure rules it sought, the NRDC instituted an action in federal district court shortly before the 1973 rules were adopted.72 The NRDC challenged the SEC’s proposed rules (alleging the rules were inadequate under NEPA),73 and attacked the denial of the NRDC’s rulemaking petition (on the grounds of procedurally unsoundness).74 The district court was persuaded by the NRDC’s position, and held that the SEC’s proceedings failed to satisfy the Administrative Procedure Act75 and NEPA.76

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63 See 17 C.F.R. § 229.103 (1986).
64 Release No. 5386, supra note 56, at 83,030.
65 Id.
66 This special exception to the “ordinary routine litigation” out continues to exist in the SEC’s current rules for environmental litigation disclosures. See 17 C.F.R. § 229.103 (1986).
67 Id.
68 17 C.F.R. § 229.103 (1986).
69 Id.
70 Id.
71 See supra note 46.
73 Release No. 5704, supra note 37, at 86,293.
74 Id.
   When the SEC reconsiders its rules in accordance with this opinion, it should develop a record and resolve two overriding factual issues. The first is the extent of “ethical
The court remanded the matter to the Commission, and ordered it "to undertake further rulemaking action to bring [its] corporate disclosure regulations into full compliance with the letter and spirit of NEPA."\textsuperscript{77}

On remand, the SEC issued a release to provide notice of its renewed proceedings to fulfill the district court's instructions.\textsuperscript{78} The release provided:

[T]he Commission seeks to obtain the views of the public concerning whether, and to what extent, information that does not necessarily have direct and immediate economic significance might nevertheless be the type of information that a reasonable investor would wish to have in making an investment decision or giving a proxy.\textsuperscript{79}

After issuing the release, the SEC conducted public hearings for nineteen days.\textsuperscript{80} There was substantial public interest in these proceedings.\textsuperscript{81} The file generated by the proceedings is in excess of ten thousand pages, comprised of letters of comment, transcripts of testimony, and exhibits presented in the course of testimony.\textsuperscript{82} After the proceedings, the Commission concluded that no showing had been made that it should require expansive disclosure of information about corporate environmental practices of all registrants.\textsuperscript{83} Furthermore, the Commission announced that it would not adopt the rules advocated by the NRDC, and correspondingly issued lengthy explanatory statements.\textsuperscript{84}

Following the SEC's rejection of the NRDC proposals, the parties cross-moved for summary judgment in the district court.\textsuperscript{85} The court

\textsuperscript{77}NRDC v. SEC, 389 F. Supp. at 693.
\textsuperscript{79}Id. at 85,110.
\textsuperscript{81}Id.
\textsuperscript{82}Id.
\textsuperscript{83}Id. at 85,707.
\textsuperscript{84}Id. at 85,706–85,728. See infra notes 102–105 and accompanying text.
granted the NRDC's motion, finding the Commission's action "arbitrary and capricious," and ordered the Commission to undertake further rulemaking in accordance with the court's opinion, to be completed within six months. The Commission appealed the district court's decision to the United States Court of Appeals for the District of Columbia. That court reversed the lower court's opinion in Natural Resources Defense Council v. Securities & Exchange Commission, thus supporting the Commission's defiant position regarding the NRDC's disclosure proposals. The court ruled that the SEC's determination not to require comprehensive environmental disclosure statements from corporate registrants, made on the basis of informed rulemaking proceedings, was reasonable and satisfied the SEC's obligations under NEPA.

One factor that persuaded the appellate court to rule in the SEC's favor was its belief that Congress had vested the Commission with broad discretionary powers to promulgate disclosure rules. Another key factor in the court's decision was its interpretation that NEPA does not require the SEC to promulgate specific rules. Also, the court determined that the SEC's rulemaking proceedings were bona fide and "in accordance with all canons of procedural fairness." As a result of this favorable appellate court judgment, the SEC was allowed to rest with its relatively moderate environmental disclosure rules after years of being under fire by the NRDC to adopt its full disclosure proposals.

By persistently and emphatically refusing to adopt the NRDC's broad proposals, the SEC had revealed its motive in promulgating the existing environmental disclosure regulations. The SEC intended foremost to promote informed investment decisions, rather than to regulate corporate conduct regarding environmental compliance. The Commission believed that although the Securities Act granted

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86 Id. at 1212.
87 Id. At the time of this decision, the NRDC v. SEC proceeding had been ongoing for over four years.
88 NRDC v. SEC, 606 F.2d at 1035.
89 Id. at 1062.
90 Id.
91 Id. at 1054–56.
92 Id. at 1045.
93 Id.
94 Id. at 1056.
95 See supra note 42.
96 See Release No. 5627, supra note 80, at 85,713.
it broad discretion to require disclosure, its exercise of authority was limited to the objectives of the federal securities laws. In one of its releases, the Commission explained:

Specifically, insofar as it is relevant here, the Commission may require disclosure . . . if it believes that the information would be necessary or appropriate for the protection of investors or the furtherance of fair orderly and informed securities markets or for fair opportunity for corporate suffrage. Although disclosure requirements may have some indirect effect on corporate conduct, the Commission may not require disclosure solely for this purpose.

Although the Commission had adopted limited disclosure regulations pursuant to NEPA, NEPA basically did not alter the disclosure scheme that the Commission believed was appropriate. NEPA authorized and required the Commission to consider the promotion of environmental protection, but “along with other considerations.”

When it reviewed its environmental disclosure rules under court mandate, the SEC had taken into account some of those “other considerations.” For instance, the Commission considered the basic decision of Congress that, as far as investing is concerned, the primary interest of investors is economic. To ensure that meaningful and careful disclosure documents would be attained without unreasonable costs to registrants and their shareholders, the Commission also kept in mind the cost-benefit implications of alternative proposals. The Commission also included in its determinative balance the administrative burdens involved in the proposed disclosure. In the end, it concluded that the NRDC’s proposals were adverse to these “other considerations” and, as a result, refused to adopt major changes in its relevant rules.

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97 Id.
98 Id.
100 Release No. 5627, supra note 80, at 85,716. See also Calvert Cliffs’ Coordinating Committee v. Atomic Energy Commission, 449 F.2d 1109, 1112 (D.C. Cir. 1971).
101 Id.
102 Id. at ¶ 85,721. The Commission explained:
After all, the principal, if not the only reason why people invest their money in securities is to obtain a return. A variety of other motives are probably present in the investment decisions of numerous investors but the only common thread is the hope for a satisfactory return, and it is to this that a disclosure scheme intended to be useful to all must be primarily addressed.
Id.
103 Id. at 85,712–85,713.
104 Id. at 85,717.
105 Id.
C. The 1981 Proposed Amendments

In 1981, just over two years after receiving the favorable appellate court judgment, however, the SEC published for comment amendments that would significantly alter its environmental disclosure rules. Yet, instead of expanding disclosure requirements in this area, as the NRDC had hoped, the proposed amendments cut back on the disclosure requirements. The relevant release was met with notable silence by the NRDC contingency. The Commission explained that it was making the proposals subsequent to a review of environmental litigation disclosures generated by the existing provisions, and after receipt of comments by the public. The most significant change contemplated by the proposals was to replace the disclosure requirement of all environmental proceedings involving a domestic governmental authority with a $100,000 threshold. Pursuant to the proposed amendments, registrants would be required to disclose governmental proceedings involving potential fines unless the registrant "reasonably believes such proceedings will result in fines of less than $100,000." The Commission

107 Id. at 84,288-84,291.
108 Obviously, both sides had not forgotten that Judge McGowan's opinion paid substantial deference to the Commission's discretion in promulgating disclosure regulations. See NRDC v. SEC, 606 F.2d at 1035-62.
109 Release No. 6315, supra note 106, at 84,287. Perhaps the SEC's proposals were also prompted to some extent by President Reagan's Executive Order No. 12,291, signed on February 17, 1981. The Order provides in part: "In promulgating new regulations, reviewing existing regulations, and developing legislative proposals concerning regulation, all agencies to the extent permitted by law, shall adhere to the following ... (b) Regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society[.]" 5 U.S.C. § 601 app. at 431–34, 432 (1982). The SEC had earlier acknowledged its responsibilities to weigh with care the costs and benefits that result from its rules, and had decided the NRDC proposals failed this test. See Release No. 5627, supra note 80, at 85,717 and 85,727.
110 In Air Products and Chemicals, Inc., SEC No-Action Letter, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,429 (June 11, 1973), the Commission stated: "While . . . nothing in the forms delineates as between domestic and foreign environmental provisions, it is our view that to the extent any foreign provisions may have a material impact upon the company's financial condition or business that such matters should be disclosed. To the extent that certain provisions of the amendments render governmental proceedings "material" apart from any standard of economic materiality, it is our interpretation that the disclosure of such governmental proceedings is intended to be limited to those instituted by governmental entities within the United States. Id. at 83,229 (emphasis added)."
111 Release No. 6315, supra note 106, at 84,287.
112 Id.
justified this proposal by observing that, despite the provision for grouping descriptions on a generic basis,\textsuperscript{113} the disclosures of environmental proceedings involving governmental authorities were often excessively lengthy and detailed, tending to obscure disclosures of the more significant proceedings.\textsuperscript{114} The $100,000 threshold would, the Commission argued, alleviate the problem of cumbersome, relatively unimportant disclosures.\textsuperscript{115} The threshold would thereby improve the effectiveness and readability of environmental litigation disclosures for investors and shareholders.\textsuperscript{116} The SEC believed that this result would promote the goals of NEPA.\textsuperscript{117}

It could be argued that in publishing these 1981 proposals, the Commission again indicated that its intent behind the special disclosure regulations was to promote informed investment decisionmaking, rather than the regulation of corporate conduct.\textsuperscript{118} The amendments' effect would be to lower a corporation's disclosure burden regarding environmental litigation, because corporations would no longer have to report a number of governmental proceedings in public filings.\textsuperscript{119} At the same time, disclosure documents would become more useful to investors in assessing a registrant's exposure to contingent environmental liability.\textsuperscript{120} These amendments were later adopted by the SEC,\textsuperscript{121} incorporated into the body of relevant law, and continue to reflect the law in this area.\textsuperscript{122}

### III. Current SEC Disclosure Requirements for Contingent Environmental Liability

Regulation S-K is the repository for the uniform disclosure regulations of documents filed by publicly held corporations with the SEC under the Securities Act and the Securities Exchange Act.\textsuperscript{123}

\begin{itemize}
  \item \textsuperscript{113} See text accompanying notes 59–61.
  \item \textsuperscript{114} Release No. 6315, supra note 106, at 84,287. The Commission asserted its awareness of "numerous instances in which disclosures of more significant environmental proceedings have been obscured by lengthy disclosures of relatively inconsequential governmental proceedings, particularly proceedings which involve small fines or relatively small capital expenditures." \textit{Id.} (footnote omitted).
  \item \textsuperscript{115} \textit{Id.}
  \item \textsuperscript{116} \textit{Id.} at 84,287 n.24.
  \item \textsuperscript{117} \textit{Id.}
  \item \textsuperscript{118} See supra notes 96–98 and accompanying text.
  \item \textsuperscript{119} See supra notes 111–112 and accompanying text.
  \item \textsuperscript{120} See supra notes 114–116 and accompanying text.
  \item \textsuperscript{121} Adoption of Integrated Disclosure System, Securities Act Release No. 6383 (LEXIS, Fedsec library, Secret file) (Mar. 3, 1982).
  \item \textsuperscript{122} See 17 C.F.R. § 229.103 (1986).
  \item \textsuperscript{123} 17 C.F.R. § 229 (1986).
\end{itemize}
struction 5 to Item 103 of Regulation S-K reflects the adoption of the environmental disclosure amendments proposed in May of 1981. The SEC adopted Instruction 5 in its current form in March, 1983, as part of the expansion and reorganization of Regulation S-K.

The SEC's other specific disclosure rule directly applicable to environmental matters appears in Item 101(a)(1)(xii) of the same Regulation. Commentators consider this provision, which requires disclosure of the material effects that compliance with federal, state, and local environmental legislation may have on a corporation's capital expenditures, earnings, and competitive position, relatively non-controversial. This rule presents a related but separate issue from that of disclosable corporate contingent liability for environmental damage.

In addition to examining reporting requirements in connection with Item 103, one must also examine general materiality principles to gain a thorough understanding of SEC disclosure obligations regarding corporate contingent environmental liability. The problem of the unasserted claim and its corresponding disclosure duty that shows up in this area is the primary focus of discussion in the next section.

A. Instruction 5 to Item 103 of Regulation S-K

Instruction 5 to Item 103 of Regulation S-K lists three thresholds for determining when a corporation must report an administrative or judicial proceeding "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 . . . .”132 The three thresholds are: the general materiality test,133 the ten percent of current assets test,134 and the $100,000 test.135 If an environmental proceeding satisfies any one or more of the tests, the disclosure duty is triggered.136 In this event, the corporate registrant must provide complete information about the particular proceeding(s), including the name of the court or agency in which the proceeding is pending, the date instituted, the principal parties involved, a description of the factual basis alleged, and the relief sought.137 Registrants must report similar information for any such proceedings “known to be contemplated by” governmental authorities.138

The first disclosure threshold states a general materiality test: any pending legal proceeding (and proceedings known to be contemplated by governmental authorities) must be disclosed if “material to the business or financial condition of the registrant.”139 As mentioned earlier, the term “material” 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 buy or sell the registered securities.140 The SEC, then, expects corporate management and counsel to wear the robe of the reasonable investor in assessing the economic significance of environmental litigation facing a corporation.

The second threshold located in Instruction 5 is the ten percent of current assets test.141 Clause (b) requires disclosure of damage actions or governmental proceedings in which the total of “potential monetary sanctions, capital expenditures, deferred charges or

132 17 C.F.R. § 229.103 (1986). Before the adoption of the 1983 amendments, several commentators had argued that “the increasing number of legislative and regulatory provisions which arguably relate to environmental matters” made it difficult to determine whether disclosure was required because the Instruction referred to proceedings arising under provisions “otherwise relating to the protection of the environment.” Release No. 6383, supra note 121. To eliminate any ambiguity in this language, the Commission substituted the phrase “or primarily for the purpose of protecting the environment” as part of the 1983 amendments. Id.
133 Id. at clause (a) of Instruction 5.
134 Id. at clause (b) of Instruction 5.
135 Id. at clause (c) of Instruction 5.
137 17 C.F.R. § 229.103 (1986).
138 Id.
139 Id. at clause (a).
141 17 C.F.R. § 229.103 (1986), clause (b) of Instruction 5.
charges to income and the amount involved, exclusive of interest and costs, exceeds 10% of the current assets of the registrant and its subsidiaries on a consolidated basis . . . ."\textsuperscript{142} The SEC also employs this economic materiality test under Item 103 for non-environmental legal proceedings.\textsuperscript{143} Regarding Instruction 5, however, it is significant that federal statutes authorize unusually high fines and remedial costs in environmental enforcement actions.\textsuperscript{144} An environmental enforcement proceeding, then, is generally more likely to trigger this economic materiality standard than is a non-environmental proceeding. For instance, a Superfund action against a corporation could easily imply potential response and clean-up costs exceeding ten percent of the company’s consolidated assets, especially considering judicial receptiveness to the imposition of joint and several liability under CERCLA.\textsuperscript{145}

An important feature of these two threshold tests is that registrants must aggregate proceedings that present, in large degree, the same factual and legal issues.\textsuperscript{146} Hence, assuming that governmental and private enforcement proceedings were instituted against a corporation based on similar environmental damage allegations, the corporation would have to consider these proceedings together for disclosure consequences under the first two tests.\textsuperscript{147} In other words, whether the threshold is met is determined by reference to the alleged conduct giving rise to the multiple proceedings, rather than to any single proceeding. This aggregation requirement has the effect of lowering the disclosure threshold regarding single proceedings, because a corporation may have to disclose proceedings that do not individually meet either of the two thresholds.\textsuperscript{148}

The third threshold in Instruction 5 applies only to governmental proceedings.\textsuperscript{149} It states that corporations must disclose governmental proceedings involving potential monetary sanctions “unless the registrant reasonably believes that such proceeding will result in no

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{142} Id.
\item \textsuperscript{143} Id. at Instruction 2.
\item \textsuperscript{144} See supra note 15.
\item \textsuperscript{146} 17 C.F.R. § 229.103 (1986), Instruction 2.
\item \textsuperscript{147} Release No. 6315, supra note 106, at 84,288 n.25.
\item \textsuperscript{148} Id.
\item \textsuperscript{149} 17 C.F.R. § 229.103 (1986), clause (c) of Instruction 5.
\end{enumerate}
\end{footnotesize}
monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000 . . ."150 This provision does not require aggregation of similar proceedings.151

Once the third threshold is met, proceedings that are similar in nature may be grouped and described generically.152 The SEC reports that its earlier proposal to delete this generic description provision was met with "extensive adverse reaction,"153 presumably by registrants. The SEC has retained this option because it believes that generic descriptions reduce registrants' disclosure burden, and often result in more intelligible disclosure documents for the benefit of shareholders and investors.154

Due to the inclusion of a "reasonable belief" standard, this third threshold test does not automatically require disclosure of any proceeding in which the possible maximum fine is $100,000 or more.155 Rather, this threshold allows companies "to consider both the amount of any potential fine and the probability that this maximum penalty, as opposed to a lesser fine, actually will be imposed."156 The

150 Id. The 1981 proposed amendments to the environmental disclosure rules referred to governmental proceedings involving potential "fines." Release No. 6315, supra note 106, at 84,288. The amendments as adopted, however, refer to governmental proceedings involving potential "monetary sanctions." Release No. 6383, supra note 121. The Commission makes no mention in the latter release to explain the different choice of words. In the 1981 release, the Commission does explain why it is distinguishing between governmental proceedings involving potential fines and other governmental proceedings:

The Commission believes that disclosure of fines by governmental authorities may be of particular importance in assessing a registrant's environmental compliance problems. Proceedings involving fines (as opposed, for example, to proceedings involving capital expenditures necessary to obtain regulatory permits) may be more indicative of possible illegality and conduct contrary to public policy. Accordingly, the Commission does not view a disclosure threshold related solely to a percentage of assets as appropriate in this context. Release No. 6315, supra note 106, at 84,289.

151 Release No. 6383, supra note 121. The Commission explained:

Several commentators believed that a burdensome data collection and evaluation effort would be required in order to determine whether the potential fines likely to be imposed in similar proceedings would meet the $100,000 threshold of clause (c). In response to this concern, the definition of "proceeding" is revised to clarify that aggregation of similar proceedings is not required for purposes of clause (c).

Id.

152 17 C.F.R. § 229.103 (1986), clause (c). "Generic" descriptions are when a registrant is allowed to provide groupings of similar proceedings, stating the issues generally involved, and providing a description of each group of proceedings, rather than each proceeding individually.

153 Release No. 6383, supra note 121.

154 Id.


156 Id.
Commission has warned, however, that if a corporation fails to disclose a proceeding on the grounds of reasonable belief as to the improbability of a minimum $100,000 sanction being imposed, the registrant's reasonable belief must exist at the time the public filing is made. Further, the registrant must re-evaluate its reasonable belief in connection with future filings if there is a change in circumstances.

In forming a reasonable belief as to the financial outcome of a particular governmental proceeding, companies may want to consider their prior dealings with governmental authorities, and also the outcomes of governmental proceedings involving similar allegations brought against other companies. This is especially true given that a good faith judgment, if deemed unreasonable by the SEC, would not provide the registrant with a defense to a disclosure violation under this test.

The $100,000 threshold is probably the most controversial of the special environmental disclosure rules. It is controversial because it departs somewhat from the economic materiality standard. Correspondingly, it is also the provision in Instruction 5 that diverges the most from the disclosure instructions for non-environmental legal proceedings. This divergence is a result of the test's origins. The clause (c) provision is all that remains of the 1973 amendment to the litigation disclosure rules that required disclosure of all governmental proceedings against a company for environmental damage. The SEC had adopted that amendment to its rules when under fire by the NRDC to institute full environmental disclosure requirements.

As a result of its deviation from the economic materiality standard and the other litigation disclosure rules, this third provision appears to be pro-environmental. Whether the SEC has maintained this

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157 Id.
158 Id.
159 Hamilton, supra note 1, at 2-114.
160 A good faith, but unreasonable, judgment would not constitute a defense for the registrant because the applicable standard of reasonableness is of course an objective one—would the reasonable registrant believe the threshold would not be met in that instance? The test is also a subjective one to the extent that the registrant must actually believe that the $100,000 threshold will not be met.
161 17 C.F.R. § 229.103 (1986), clause (c)
162 Hamilton, supra note 1, at 2-114.
163 See 17 C.F.R. § 229.103 (1986).
164 See Release No. 5386, supra note 56, at 83,030.
165 See supra notes 44-46 and accompanying text.
166 Hamilton comments: "This provision in some respects appears to be directed more toward requiring a public disclosure of possible environmental sins than at providing information
rule out of a sense of obligation under NEPA, or to avoid any further litigation with the NRDC or other public interest groups, is unclear. Nonetheless, it is clear that the Commission intends to enforce this rule, as well as the other disclosure requirements for contingent environmental liability, and plans to construe these special rules "broadly and liberally."

Noncompliance with the environmental disclosure requirements by corporations may result in enforcement action by the Commission, as well as private claims under the federal securities laws, such as section 11 of the Securities Act or Rule 10b-5. The Commission has explained:

In appropriate cases, the Commission may commence an enforcement action, and investors who believe they have been, or are being, injured by non-disclosure of specific information have judicial remedies available to them. As the Supreme Court has recognized, these remedies constitute a necessary supplement to the Commission's own enforcement activities.

The SEC, therefore, expects registrants to familiarize themselves with the nuances of the environmental disclosure obligations and to comply with those obligations in completing their public filings.

**B. The SEC's Expectations for Disclosure of Contingent Environmental Liability**

The SEC has warned against certain types of reporting practice as constituting inadequate, and hence actionable, environmental disclosures. One such practice is providing overly-general related information in lieu of disclosable facts and required estimates. For

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167 Id.
168 Release No. 6130, supra note 7.
169 Id.
173 Release No. 5627, supra note 80, at 85,707.
174 See infra notes 175-194 and accompanying text.
175 See, e.g., Release No. 16,950, supra note 7, at 83,351.
example, in its 1980 enforcement action against Occidental Petroleum Corporation (Oxy), the Commission found that Oxy had not specifically disclosed the amount, or described the nature or extent, of the potential liabilities of a subsidiary, arising from its discharge of substantial amounts of wastes.\textsuperscript{176} Oxy had disclosed in various documents filed with the SEC, including its Annual Report on form 10-K for the period ending December 31, 1977, that: "[i]n light of the expansion of corporate liability in the environmental area in recent years . . ., there can be no assurance that Occidental will not incur material liabilities in the future as a consequence of the impact of its operations upon the environment."\textsuperscript{177} The SEC deemed this general disclosure insufficient under federal securities law.\textsuperscript{178} For this and other reasons, Oxy ultimately submitted an offer of settlement to the Commission.\textsuperscript{179}

Similarly, in its 1979 action against United States Steel Corporation (U.S. Steel), the SEC found mere disclosure that "the government seeks to compel new pollution control efforts"\textsuperscript{180} inadequate as a description of the relief sought in an environmental proceeding.\textsuperscript{181} The disclosure rules mandate specificity, then, as to the factual basis of material claims (and material potential claims) and the dollar amounts involved therein.\textsuperscript{182} Thus, the hedging element afforded by vagueness or generalities regarding environmental litigation disclosures in SEC filings may be attractive to companies, but may also expose them to liability for non-disclosure of material facts.

Another related reporting practice that may constitute a violation of federal securities laws is attempting to minimize the importance

\textsuperscript{176} Id.
\textsuperscript{177} Id.
\textsuperscript{178} Id. at 83,356. The Commission provided: "Under the circumstances involved, the Commission believes Oxy should timely have disclosed these potential liabilities and reasonably ascertainable amounts of potential exposure and costs associated therewith and other facts in several of Oxy's filings with the Commission." Id.
\textsuperscript{179} Id. at 83,356–83,357. The offer of settlement provided, in part, that: 1) Oxy would designate a director, satisfactory to the Commission, who would be responsible for preparing an environmental report which would recommend to Oxy's Board of Directors procedures to ensure future compliance with the federal securities laws; 2) the Commission may consult with the director and be provided access to documents received, used or generated in the preparation of the report; and 3) the director would use Oxy's recently elected senior environmental official and an outside consulting firm to help develop and prepare information for the report.
\textsuperscript{180} Release No. 16,223, supra note 30, at 82,384.
\textsuperscript{181} Id. The Release states: "[T]he Commission's regulations contemplate that an estimate of the level of expenditures required to install the pollution control equipment sought by the governmental authority be provided if such expenditures are likely to be material." Id.
\textsuperscript{182} See supra notes 175–181 and accompanying text.
of material information by placing it in an obscure location within the financial report. The Commission has stated that “disclosure about significant proceedings should be readily identifiable, and should not be obscured by, or buried within, general discussions . . . .” Moreover, in Blue Chip Stamps v. Manor Drug Stores, the Supreme Court explained: “The SEC, in accord with the congressional purposes, specifically requires prominent emphasis be given in filed registration statements and prospectuses to material adverse contingencies.” A company may be held liable under the “buried facts” doctrine where material facts are disclosed in a place that obscures their significance. Therefore, not only must registrants report specific facts and estimates, they must also report them in a prominent location.

In addition to satisfying these requirements respecting sufficient specificity and prominence of location, registrants are expected to emphasize timeliness in providing litigation disclosures. The timing of disclosures can be crucial, especially when dealing with negative financial information. A corporation’s delay in reporting potential liability for environmental damage may constitute a violation of disclosure obligations comparable to a complete failure to disclose material information. In an analogous situation, the Tenth Circuit in Financial Industrial Fund, Inc. v. McDonnell Douglas Corp. stated: “It is equally obvious that an undue delay not in good faith, in revealing facts, can be deceptive, misleading, or a device to defraud under Rule 10b-5.” Furthermore, under section 11 of the

184 Id. The Commission recommends that registrants “improve the effectiveness and readability of their environmental disclosures by using separate paragraphs or headings to distinguish general environmental information, such as broad descriptions of various legal requirements and standards, from information relating to specific environmental proceedings.” Id.
186 Id. at 753 (citation omitted).
188 See id.
191 Both the special rules, 17 C.F.R. § 229.103 (1986), and the general materiality standard, 17 C.F.R. § 240.12b-2 (1986), anticipate that corporations will disclose information from the time it meets the relevant standard.
192 474 F.2d 514 (10th Cir.), cert denied, 414 U.S. 874 (1973).
193 Id. at 519.
Securities Act, the issuer might even be liable for a good faith delay, and the underwriter and accountant may be liable for being negligent as to the issuer’s good faith delay. The timeliness requirement also means that registrants must update their filings as circumstances change, so that the disclosed information continues to be an accurate account of the company’s financial condition.

Timely environmental litigation disclosures are more attainable where corporations have instituted audit programs to furnish management with reliable, up-to-date information about the company’s environmental activities and problems. Yet, the burden imposed by the SEC on corporations regarding the timing issue would, in certain circumstances, continue to be tremendous. Under general materiality principles, the potential assertion of a claim may be disclosable even before the corporation has been threatened with any such claim. That is, if a corporation violates the law, the possibility then exists that either governmental or private claims will be asserted against it. This possibility may make the violation and its financial implications material even before parties outside the company know of the violation.

The issue of disclosure obligations respecting unasserted claims against a corporation for environmental damage is an important one that arises under general materiality principles. The SEC has made some attempt to explain what it expects of publicly held corporations in this area. So far, it appears that these expectations impose a substantial disclosure burden on corporate registrants. Part of this burden is the difficulty of figuring out exactly what standard a corporation has to meet before the disclosure duty is triggered. Popular compliance with these requirements seems unlikely to occur, unless the SEC reduces the relevant disclosure duty, or at least clarifies it, for the benefit of both corporations and investors.

IV. THE DUTY TO DISCLOSE UNASSERTED CLAIMS FOR ENVIRONMENTAL DAMAGE

The SEC’s special environmental disclosure rules apply to all pending legal proceedings and those “known to be contemplated” by

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194 See Nicholas, supra note 171, at 7.
196 See Hamilton, supra note 1, at 2-117.
197 See infra notes 248–256 and accompanying text.
199 Id.
Disclosure obligations as to potential, unasserted claims arise not under the special rules, but rather, under general materiality principles. The SEC has again and again stated that compliance with the special environmental disclosure rules "does not necessarily constitute full compliance with the disclosure requirements of the federal securities laws." Although the duty to disclose the possibility of material, unasserted claims arising under environmental laws is not the subject of a special rule, it is still important. Indeed, this duty becomes crucial insofar as its relevance might get overlooked or underestimated in SEC filings.

In addition to complying with the special disclosure rules promulgated by the SEC, a corporation's public filings must also satisfy general disclosure rules under the federal securities laws. In a 1980 release, the Commission explained:

The Commission's general reporting rules require disclosure of any additional material information, beyond that for which disclosure is required by specific Commission rule, necessary to make required statements not misleading. In the context of its environmental releases, the Commission has interpreted these rules as requiring disclosure of all other environmental information of which the average prudent investor might reasonably be informed.

The perennial question that registrants must ask, then, regarding both environmental and non-environmental information, is: "Have we told investors all that is material and wearisome about the company's business and financial condition?" Attempting to answer
this question cautiously might well be regarded as a greater challenge than complying with the numerous specific disclosure requirements that apply to ongoing public filings. Moreover, unasserted claim disclosure obligations in the environmental area represent part of that challenge, as evidenced by various SEC enforcement actions.208

A. Enforcement Actions

The SEC's requirement that publicly held corporations report material unasserted legal claims was of primary importance in the SEC's 1977 enforcement action against Allied Chemical Corporation (Allied).209 In its complaint,210 the Commission charged that Allied was subject to material contingent liability due to its alleged dumping of kepone into the James River in Virginia.211 The complaint read in part:

Allied was exposed to material potential financial liabilities from companies, individuals and state and local governments to significant amounts of kepone. Allied failed to disclose such potential material financial exposure in its reports to shareholders and the investing public in violation of the antifraud and reporting provisions of the securities laws.212

Without admitting or denying the SEC's charges, Allied consented to the entry of a permanent injunction.213 The court enjoined Allied from violating the disclosure and reporting requirements of the federal securities laws.214 Under the terms of the consent injunction, Allied also agreed “to maintain, review, modify and provide information to the Commission with respect to its current policies, practices and procedures to apprise management of material environmental risk areas and uncertainties in connection with its business.”215

The Commission's emphasis in the Allied proceeding was not that claims had already been asserted or even threatened against the corporation at the time of the non-disclosure. The Commission's
position was, rather, that the company, during the period in question, had allegedly violated environmental laws and knew that the implications of the violation might be serious. The violation of environmental laws coupled with an awareness of its high risk factor apparently was enough to trigger the disclosure duty under the traditional materiality test. The implication, then, is that Allied was under an obligation to disclose the possibility of claims being asserted against it, even before outside parties became aware of its alleged dumping of pollutants.

Another example of the potential for corporate liability based on unasserted claims occurred in 1979, involving U.S. Steel Corporation (U.S. Steel). In 1979, U.S. Steel consented to the entry of an order finding that the company had failed to make adequate disclosure of environmental matters in its ongoing reports filed under the Exchange Act. The Commission charged U.S. Steel with violations of the special environmental disclosure rules as well as general materiality principles. Moreover, the Commission restated its warning that compliance with the specific environmental disclosure rules may constitute only partial compliance with the federal securities laws.

The Commission determined, inter alia, that U.S. Steel breached general disclosure duties when it failed to report that its policy towards environmental compliance exposed the company to material contingent liability. The Commission explained that U.S. Steel "pursued an environmental policy of actively resisting environmental requirements which it maintained were unreasonable . . . [t]hereby exposing itself to certain risks including the possibility of substantial civil and criminal penalties."

Though the Commission does not require all companies to disclose their general environmental policy, a company would have related disclosure obligations in two situations. First, where a company voluntarily discloses certain information about its environmental

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216 Id. The Commission argued that the company “knew that animal and marine life that ingested kepone suffered adverse effects.” Id.

217 Id.

218 Id. The Commission’s complaint focused on Allied’s knowledge of the alleged dumping and its potential hazard, not such knowledge by other parties.

219 Release No. 16,223, supra note 30, at 82,386.

220 Id. at 82,382–82,384.

221 Id. at 82,382.

222 Id. at 82,384.

223 Id. at 82,384.

224 Id. at 82,380–82,381.

225 Id. at 82,384.
compliance policy, that information cannot contain misleading statements or omissions.\(^{225}\) Second, if a company "has a policy or approach toward compliance with environmental regulations which is reasonably likely to result in substantial fines, penalties, or other significant effects on the corporation, it may be necessary for the registrant to disclose the likelihood and magnitude of such fines, penalties and other material effects . . . ."\(^{226}\) In the case of U.S. Steel, the environmental regulations that were of principal importance\(^{227}\) were the Clean Air Act\(^{228}\) and the Clean Water Act.\(^{229}\)

Based on this latter SEC interpretation of disclosure obligations under the federal securities laws, a corporation may have to report company policy resistant to environmental compliance, aside from actual environmental law violations. Thus, the *U.S. Steel* action adds to our understanding of disclosure duties respecting unasserted claims that such duties do not ripen merely upon incidents of non-compliance with environmental laws or the assertion of legal claims against a registrant. Pursuing corporate policy resistant to compliance with environmental laws may be enough to trigger disclosure obligations in this area.\(^{230}\)

As part of its settlement with the Commission, U.S. Steel agreed to appoint a task force to review its prior environmental disclosures, and to submit a report to the audit committee of the company's board of directors, outlining procedures to provide for timely and complete disclosure in the future.\(^{231}\) Here again, the Commission demonstrated its determination that claims need not have been asserted against a company before their potential financial consequences must be disclosed.

After the *U.S. Steel* action, we can picture an SEC mandatory disclosure continuum regarding contingent environmental liability beginning at the earliest stage with corporate policy resistant to environmental compliance. Next would be a corporation's environmental law violations, whether or not outside parties are aware of

\(^{225}\) *Id.*

\(^{226}\) *Id.*

\(^{227}\) *Id.* at 82,377.


\(^{230}\) It is debatable, however, whether the SEC would attempt to enforce this obligation before a concrete violation has occurred. It might be the SEC's intention to enforce this obligation primarily as a means of extending back in time the period for which the corporation is liable for nondisclosure where actual violations are located, in addition to company policy resistant to compliance with environmental laws.

\(^{231}\) *Id.* at 82,384–82,286.
them. Then would follow environmental proceedings "known to be contemplated" by governmental authorities, and finally, pending legal claims instituted against a corporation (either by private parties or governmental authorities), arising under environmental laws.

Another SEC enforcement proceeding that illustrates the scope of the mandatory disclosure continuum is In the Matter of Occidental Petroleum Corp. In 1980, the Commission accepted an offer of settlement from Oxy, after charging that company with failure to disclose matters involving environmental protection and compliance. The Commission found that Oxy had failed to disclose the extent of legal proceedings instituted against Hooker Chemical (a wholly-owned subsidiary of Oxy), for illegally discharging materials into the environment, and the effects of compliance with environmental regulations on its corporate earnings and expenditures. Furthermore, Oxy had not disclosed certain potential liabilities resulting from the leaching of wastes into the environment from various of its chemical disposal sites.

The last finding amounted to a violation of the Commission's general reporting rules, whereas the previous two violations constituted special environmental disclosure breaches. As in Allied Chemical, the Commission expressed its view that the corporation "should timely have disclosed" its exposure to substantial financial risk, independent of whether any claims had yet been asserted against it for environmental damage. Under the general disclosure rules, therefore, the registrant cannot expect to wait until proceedings are pending, or even known to be contemplated, before that risk factor might have to be disclosed. The bare potentiality of the proceedings may itself be considered material, and a failure to disclose it may result in a violation of the federal securities laws. Whereas the U.S. Steel proceeding involved a violation of general reporting rules arising from a failure to disclose company policy, the Allied Chemical

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233 Id. at 83,356.
234 Id. at 83,348–83,353.
235 Id. at 83,348.
236 Id.
237 Id. The release provided: "The Commission's general reporting rules require disclosure of any additional material information, beyond that for which disclosure is required by specific Commission rule, necessary to make required statements not misleading." Id. (footnote omitted). The release further provided that the SEC has interpreted the general reporting rules as requiring disclosure of "all other environmental information of which the average prudent investor might reasonably be informed." Id. quoting Release No. 5170, supra note 27.
action involved a similar violation arising from a failure to disclose corporate conduct regarding noncompliance with environmental regulations.

Similarly, a corporation's duty to include information in its public filings about potential, unasserted claims for environmental damage was a central issue in *Grossman v. Waste Management, Inc.* The United States District Court for the Northern District of Illinois explained that the plaintiff's Rule 10b-5 action based on the defendant corporation's failure to disclose violations of environmental laws was not dependent on actual sanctions by environmental authorities. The court stated: "If Waste Management indeed violated the law, there existed the possibility that sanctions would be imposed. Such a possibility would make these violations material." The court denied the defendant's motion to stay the securities action until the conclusion of the environmental proceedings. If Waste Management had failed to disclose the violations, the court reasoned, then the securities violation would already have occurred, regardless of whether sanctions had yet been imposed on the company by environmental authorities.

The underlying theory of liability in *Grossman* was based on the plaintiff's assertion that the reasonable investor would have found it significant in making his investment decision that Waste Management risked liability by violating environmental laws. The expectation, then, was that if Grossman were involved in material illegal...
dumping, the company should have reported this fact from the start in its filings with the SEC.\textsuperscript{245} By doing so, its shareholders and other investors would have been better informed as to the comprehensive financial condition of the company.\textsuperscript{246}

\textbf{B. Problems With the Current Duty to Disclose Unasserted Claims for Environmental Damage}

The implications of this disclosure expectation present in \textit{Grossman} and in the earlier actions mentioned\textsuperscript{247} result in a substantial burden for corporate registrants. Although the SEC's disclosure rules do not specifically require a corporation to turn itself in by reporting violations before they are otherwise discovered,\textsuperscript{248} the general materiality principles essentially do just that. That is, registrants must disclose environmental violations in a timely manner where they create material financial exposure, regardless of whether the violations in question have become known to outside parties.\textsuperscript{249} The practical effect of this requirement would be to make the corporation "raise a red flag" for governmental authorities and private litigants regarding particular incidents of noncompliance. Furthermore, there is presently no stipulation that such corporate disclosures cannot be used as direct evidence of environmental violations. Given the likely outcome attached to this requirement,\textsuperscript{250} it is not difficult to imagine why registrants have resisted complying with this obligation.

If publicly held corporations are obliged to disclose environmental violations in SEC filings virtually from the time of their occurrence, then registrants may be denied the opportunity to address the environmental problem more directly and efficiently than would be possible after such disclosure. Early reporting of noncompliance to shareholders will most likely lead to complications in resolving the

\textsuperscript{245} Id.
\textsuperscript{246} See id.
\textsuperscript{247} See supra notes 207–246 and accompanying text.
\textsuperscript{248} Hamilton, supra note 1, at 2-114.
\textsuperscript{249} In these related enforcement actions, the event that generally triggers disclosure obligations is the material environmental violation itself, rather than knowledge of such corporate misconduct by outside parties or governmental authorities. See, e.g., Release No. 16,950, supra note 7, at 83,356.
\textsuperscript{250} The likely outcome is that a corporation would be exposing itself to a spate of enforcement proceedings, both governmental and private, very early on, and possibly before it would have time to take sufficient remedial action on its own initiative.
disputes. For instance, such disclosure will invariably cause bad relations between corporate management and shareholders, adding to the difficulties of taking efficient remedial measures. Moreover, investors may be unduly dissuaded from giving a corporation serious consideration as an investment opportunity upon its report of these violations, possibly before the company has had sufficient time to propose an effective response to the problem.251

There is also the unattractive risk of the "self-fulfilling prophecy" attached to the expectation that corporations will disclose their environmental violations and their corresponding material financial exposure.252 If a corporation reports that it is subject to potential liability of an estimated dollar amount on yet unasserted claims, based on a particular violation, the company could be advertising these lucrative claims to the advantage of potential litigants. Once claims have been instituted, or at least threatened against a company,253 mandatory disclosure of contingent liability becomes more defensible. While no claims have yet been asserted,254 however, it is harder to justify requiring a corporation to report areas ripe for litigation.255 This is particularly true regarding environmental matters, because the potential for liability is immense.256

The SEC’s interpretation of the general materiality principles in the area of unasserted claims for environmental damage imposes, then, an ominous burden on publicly held corporations. The harshness of this disclosure obligation characterized the kind of full disclosure proposals that were the subject of the NRDC–SEC battle in the 1970’s.257 At that time, the SEC emphasized that its primary objective was to make available useful information to investors,

251 Detriment to the financial condition of a corporation is, by extension, harm incurred by its shareholders. Thus, overly burdensome SEC disclosure requirements may have adverse financial consequences for a corporation's shareholders. This potential cost must be weighed against the potential benefits of having such disclosure requirements in this area.

252 See Block, Barton and Garfield, supra note 190, at 1259.

253 See generally 17 C.F.R. § 229.103. Item 103 special instructions for preparing litigation disclosures expressly apply to pending litigation and litigation known to be contemplated by governmental authorities.

254 See supra notes 201–205 and accompanying text.

255 One possible adverse effect of this requirement is that companies may be faced with a greater number of spurious claims. Reporting specific conduct that has exposed the company to potential liability, so far unasserted, may cost the company increased legal fees in defending itself against spurious claims.

256 See supra notes 9–16 and accompanying text.

257 See supra notes 38–43 and accompanying text.
rather than to regulate corporate conduct in social areas. Accordingly, it fought hard to resist the NRDC's proposals.

In articulating and enforcing registrants' reporting obligations regarding environmentally related legal claims yet to be asserted, the SEC seems to have given up some ground to the NRDC contingency. Although we have moved into a new area (the general reporting rules instead of special environmental rules) the conflict again involves highly burdensome disclosure requirements versus more moderate and investor-oriented disclosures. The current law here seems to favor the long-standing NRDC position in support of comprehensive disclosure rules.

In Release No. 5704, issued in 1976, the SEC clarified its resistance to the NRDC's full disclosure proposals:

Many of the proposals which have been suggested seem to be premised upon the assumption that the Commission has the principal responsibility for substantive regulation of environmental practices. The Commission cannot, itself, undertake to regulate corporate conduct which affects the environment. Congress and the states have created government authorities specifically to perform this function. We must presume that these government authorities are responsibly performing their duties and our disclosure requirements are necessarily premised, in part, upon this assumption.

It is helpful to keep this clarification in mind in determining what kind of disclosure requirements are appropriate to the SEC's function. As the Commission's statement implies, the regulation of corporate conduct regarding environmental compliance is an important function, but it is more appropriate to other federal and state agencies, than it is to the Commission. If the Commission's disclosure authority and responsibility under the federal securities laws is related to the dissemination of economically significant information about corporations, then the disclosure requirements should be designed primarily to serve that purpose.

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258 See supra notes 96–98 and accompanying text.
259 See supra note 42.
260 See supra notes 47–51 and accompanying text.
261 See supra notes 38–46 and accompanying text.
262 Release No. 57,044, supra note 8.
263 Id. at 86,292.
264 Release No. 5627, supra note 80, at 85,709–85,711.
C. The Ambiguity of the Disclosure Threshold for Unasserted Claims

The duty to disclose material unasserted legal claims against a corporation for environmental damage places another significant burden on corporations. The test for determining when the possibility of unasserted claims against a corporation is "material" is very unclear, and hence affords minimal predictability and uniformity. The test is ambiguous as to whether the relevant standard is a probability of the event occurring, or merely a reasonable likelihood standard.

In Grossman, the court cited Securities & Exchange Commission v. Texas Gulf Sulphur Co.265 to support the proposition that the possibility of an event occurring may be material.266 The test advanced in Texas Gulf for determining whether a contingency is material is to balance "both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity."267 This and other relevant language in the Texas Gulf opinion268 suggests that registrants should apply a probability standard similar to that recommended by the Financial Accounting Standards Board.269 In FASB No. 5, disclosure of a loss contingency involving an unasserted claim is not required of companies "unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable."270

There is some indication, however, that the appropriate test involves applying not a probability standard, but rather a reasonable likelihood standard.271 In U.S. Steel, the SEC stated that a corporation's compliance policy may trigger the corporation's disclosure duty if it is "reasonably likely" to result in substantial fines, penalties, or other significant effects on the corporation.272 Similarly, in Securities & Exchange Commission v. Mize,273 the court applied a
reasonable likelihood standard regarding disclosure of contingent events. This standard is notably less advantageous to registrants than the probability standard suggested by Texas Gulf, and is generally used by accountants to distinguish which asserted claims a corporation must disclose. Because of the ambiguity in the applicable legal standard, corporations may have difficulty in determining exactly what their disclosure duty is respecting unasserted claims.

D. Recommendations for Change

In light of the heavy burden it places on registrants in this area, the SEC should reconsider whether the benefits of unasserted claim disclosure justify the costs of such disclosure. The SEC has in the past acknowledged its responsibility to weigh with care the costs and benefits that result from its rules. Moreover, President Reagan's Executive Order No. 12,291 requires this type of analysis from federal agencies in reviewing their existing regulations.

As the Commission reviews the environmental disclosure obligations it places on corporate registrants, it should consider lowering the burden associated with unasserted claims. One way of accomplishing this would be to interpret the disclosure duty as being inapplicable to claims that have not at least been threatened against a corporation. Another method of moderating the disclosure burden here would be to limit the information that corporations must provide about material unasserted claims not to include specific facts about the violations in question. Furthermore, the Commission could stipulate that disclosure of environmental violations before claims are threatened or asserted against a company, would not be available to government authorities or private plaintiffs to serve as

274 Id. at 1051. See also Sonesta International Hotels Corp. v. Wellington Assoc., 483 F.2d 247, 251 (2d Cir. 1973) (a statement relating to a contingent event may be material provided there is a "reasonable likelihood" of its future occurrence).
275 FASB No. 5, supra note 269.
276 See infra note 283.
277 Release No. 5627, supra note 8, at 85,727.
278 E.O. No. 12,291, supra note 109.
279 The SEC's position regarding unasserted claims would become more defensible in that the "costs" to registrants would not be so high, in comparison to the questionable value such information has in the hands of investors.
280 This interpretation would lessen the amount of guesswork registrants would face in predicting their potential financial exposure for environmental noncompliance.
281 Such a limitation would curb the "open the floodgate of liability" problem that might result from the corporation's spelling out lucrative claims for the plaintiffs' bar.
direct evidence of the particular violations.\textsuperscript{282} Along with decreasing the relevant disclosure burden, such a stipulation would make popular compliance with these disclosure requirements more realistic.

The Commission should at least attempt to clarify exactly what standard applies in determining the materiality of these contingencies so that like cases will be treated alike and registrants will know what their rights are.\textsuperscript{283} The likely result of both easing and clarifying the disclosure burden as to unasserted claims is that more corporations would comply with the law, because the consequences of compliance would become less ominous to them.

V. CONCLUSION

Both special rules and general materiality principles under the federal securities laws give rise to disclosure obligations for contingent environmental liability. This body of law developed in the early 1970's as a response to the enactment of NEPA, and pressure exerted on the SEC by the NRDC to adopt full disclosure rules in this area. Throughout the 1970's, the Commission expressed that its primary objective in promulgating environmental disclosure rules was to promote informed investment decisions, rather than to regulate corporate conduct in environmental affairs. The Commission also indicated in various releases and enforcement actions its expectation that environmental disclosures will provide specific facts and estimates, placed in a prominent location, for the sake of effectiveness and readability. The Commission further emphasized timeliness of disclosures, to the extent that a corporation might be obliged to disclose environmental violations and their potential financial implications even before claims are asserted or threatened against a company. In adopting and enforcing this requirement under general materiality principles, the Commission may have lost sight of its duty to weigh carefully the costs and benefits of its rules. The resulting burden imposed on registrants is not only severe, but it is also ambiguous, and makes popular compliance with this rule very unlikely. As it reviews its current rules, the SEC should consider reformulating, at least for purposes of clarification, its relevant environmental disclosure laws.

\textsuperscript{282} This stipulation would alleviate the self-incrimination problem to which registrants are presently exposed.

\textsuperscript{283} Ambiguity in the law is unfair to parties because they are not put on sufficient notice as to exactly what behavior will expose them to liability. Furthermore, where ambiguity in the law exists, different judges will likely arrive at very different results in similar situations, thus making the law appear arbitrary.