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Section of Environment, Energy and Resources

Special Committee on Environmental Disclosure Newsletter

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MESSAGE FROM THE CHAIRS

Jeffrey A. Smith
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Committee Activities

We are staying busy and growing steadily. The Special Committee on Environmental Disclosure has sponsored several recent programs on the disclosure issues raised by climate change and greenhouse gases. The most recent program, a quick teleconference on March 1, was entitled "Kyoto's Ratified But Not By The United States – Now What?" A program in October, cosponsored with the Section of Environment, Energy, and Resources's Ethics Committee, dealt with the ethical issues raised by disclosure, or its absence, in SEC filings of potential greenhouse gas impacts. While climate change issues have been at the recent forefront, the committee is active across the full range of mandatory (*e.g.*, SEC, Sarbanes-Oxley) and voluntary (*e.g.*, GRI-type) disclosure matters.

The committee publishes several newsletters a year dealing with issues such as the role of institutional and investor groups in shaping disclosure and the use of insurance in balance sheet and disclosure issues.

The committee also maintains a Web site containing, among other things, a "primer" on environmental disclosure issues under SEC rules (including Sarbanes-Oxley), an analysis of the recent GAO Report on corporate environmental disclosure and a "links" page to key disclosure rules and guidance.

The committee welcomes new members. See http://www.abanet.org./environ/committees/environ disclosures.

Committee Newsletter

This newsletter, our second of this ABA year, contains articles on the increasing expectations for environmental disclosures, the potential effect of the *Aviall* decision on environmental disclosure, and the disclosure ramifications of the effect of greenhouse gases and climate change on corporate finances.

The first article focuses on new expectations that are rapidly developing for environmental disclosure and the ways that accountants, securities regulators, and the environmental and NGO communities are pushing the issue in different directions.

The second article evaluates the potential effect of the recent *Aviall* decision that disallowed certain contribution claims under the Comprehensive Environmental Response, Compensation, and Liability Act on disclosure requirements relating to environmental liabilities.

The final article reviews the recent GAO report on corporate environmental disclosure and the potential implications for companies that may be effected by greenhouse gas emissions limitations under the Kyoto Protocol and national laws.

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Scott D. Deatherage, Editor

In this issue:

This newsletter is a publication of the ABA Section of Environment, Energy, and Resources, and reports on the activities of the committee. All persons interested in joining the Section or one of its committees should contact the Section of Environment, Energy, and Resources, American Bar Association, 321 N. Clark St., Chicago, IL 60610.

CORPORATE ENVIRONMENTAL DISCLOSURES: OLD COMPLAINTS, NEW EXPECTATIONS

Kevin A. Ewing
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Introduction

Multinational companies doing business in or with the United States appear to be facing new and more differentiated expectations about the disclosure of corporate environmental liabilities, risks and effects. The challenge of first recognizing and then meeting these new expectations continues to occupy the attentions of companies, investors and government officials throughout the United States and Europe, but to varying degrees. The attention is warranted.

In summary, the authors contend that new expectations for environmental disclosures are developing rapidly after years of slow foment, catalyzed by recent corporate scandals in the United States and elsewhere. But the lines of intellectual discourse on environmental disclosures have evolved in parallel, largely uninformed by each other: the accountants have focused largely on liabilities arising from environmental incidents or required expenditures, the securities regulators largely on material risk of liabilities, and the environmental and non-governmental organization (NGO) communities on the physical effects on the environment of corporate behavior. Now is a useful time to consider convergence across these lines of discourse, especially in view of the heightened risks that may now attend incomplete, incorrect or (ironically) excessive disclosure of environmental matters.

Old Complaints, New Expectations

The corporate scandals at Enron, Arthur Andersen, Parmalat, Bankgesellschaft Berlin, WorldCom and others continue to affect the business environment in Europe and the United States. Each has helped push corporate transparency and accountability onto the international stage and into everyday discussion among businesspeople, investors and the public generally. In the United States, governmental officials (such as the attorney general of New York) have seized upon the subject of corporate disclosures the way others, in the past, focused on organized crime. For some, an uneasy feeling has crept in alongside the thought that the behavior associated with Enron and others is pandemic. These fears seem to have some foundation, as allegations of corruption have embroiled ever more companies.

While the recent corporate scandals have spurred the United States and the U.S. Congress toward reform, including the passage of the Sarbanes-Oxley Act of 2002, the reality is that corporate wrongdoing is old as the hills, and the rules governing disclosures remain as murky as ever.

Given the regulatory murk, one cannot be surprised to learn that companies disclose inconsistently, or that a host of studies of corporate disclosures have concluded over the years that not enough environmental disclosure is made to satisfy the applicable standard, whatever it is. Whether all of these studies are credible and useful is a worthwhile question, but so is the more basic observation that the existence of a significant deficit in corporate environmental disclosure, at least in securities-related filings and financial accounts, is the accepted wisdom of the times.

The most recent of these dispiriting assessments of disclosures appeared in the United Kingdom but is also representative of assessments in the United States. The study, prepared by Trucost plc for the U.K. Environment Agency, analyzed the disclosures of 570 companies.[2] The authors noted that "the vast majority lack depth, rigour or quantification"[3] in their environmental disclosures and further concluded that "few FTSE All Share companies currently report in a way which would fulfill the environmental criteria of the draft OFR regulation."[4] Moreover, "few could be described as . . . adequate for shareholders to properly assess environmental risks or opportunities."[5]

Yet not all of these studies deserve quite the recognition they have received. One oft-cited study is a survey of U.S. Securities and Exchange Commission (SEC) registrants by Price Waterhouse that found that 62 percent had not accrued known environmentally-related exposures on their financial statements.[6] In the same vein, the leading U.S. environmental enforcement agency (EPA) concluded in 1998 that registrants's 10-K filings for the years 1996 and 1997 failed to report environmental legal proceedings 74 percent of the time.[7]

Given how frequently these two American studies make the rounds in the literature, one should bear in mind that the Price Waterhouse study addressed corporate filings made more than twelve years ago, when the Soviet Union teetered on the brink and the Internet was of no consequence in business. As for the EPA study, the agency withheld it from publication for good reason: its methodology is sufficiently flawed to call into question the reliability of its findings.[8] Nevertheless, both studies are cited frequently with authority. In fact, the U.S. Environmental Protection Agency (EPA) cites the Price Waterhouse report and the EPA survey as two of three bases for its current policy of admonishing the regulated community about its environmental disclosure obligations in securities-related filings in the United States.[9] The same EPA survey is cited repeatedly by the U.K. Environment Agency in its just-published assessment of environmental disclosures by certain FTSE companies.[10]

These are not the only studies of corporate environmental disclosure that suffer serious deficiencies. The U.S. Government Accountability Office (GAO) recently identified 27 studies and papers conducted between 1995 and 2003 with original research on the topic of environmental disclosures. Twelve were eliminated either as not pertinent or for being constrained by "severe methodological limitations." The 15 remaining studies fared not much better: GAO cautioned that "all contain strong limitations," such as small sample size, inconsistent criteria for assessing adequacy of disclosure and heavy reliance on assumptions.[11]

GAO concluded that:

> Nine of the 15 studies attempted to address the extent or adequacy of companies's environmental

> disclosure in terms of meeting SEC's reporting requirements. In most of these cases, the studies concluded that environmental disclosures were inadequate. However, because the criteria used to assess the disclosures may not have been appropriate, it is impossible to validate the studies' conclusions about how well or poorly companies are meeting SEC reporting requirements. All of these studies used criteria that either included items not required by SEC or reflected the researchers' interpretations of SEC reporting requirements and related guidance. In several instances, the researchers acknowledged that their interpretation of the requirements would not necessarily be consistent with others' views.[12]

Nevertheless, these and other studies have for years supported (and perhaps helped create) the perceived wisdom about deficient corporate disclosure of environmental liabilities and risks. Setting aside their limitations or validity, what is interesting for our purposes is that, in the wake of recent corporate accounting scandals and other similar developments, this conventional wisdom has laid a foundation upon which a new set of expectations about environmental disclosures is growing, as reflected in the increased attention of those engaged in or regulating multinational businesses.

For example, corporate shareholders are expressing considerably more interest in "socially-conscious" or "environmental" investment strategies, as discussed in more detail below. Shareholders in the United States and in Europe have also become more assertive about putting environmental issues on the corporate agenda through shareholder resolutions.[13] Shareholders are not the only ones growing more attentive to such matters. In addition to its internal surveys of corporate environmental disclosures, EPA issued in January 2001 a headquarters memorandum instructing senior officials and regional offices to distribute a notice concerning the potential applicability of corporate disclosure requirements to recipients of EPA enforcement actions, under the theory that an enforcement action may constitute a legal proceeding within the ambit of the SEC's Item 103 disclosure rule.[14] The agency followed up on the memorandum with an "Enforcement Alert" later that same year alerting the regulated community to the scope of disclosure requirements.[15] The same alert pointedly noted EPA's intent to develop a centralized, publicly-available Web page that includes "recently concluded EPA enforcement actions that may be subject to SEC disclosure requirements, and a link to SEC's [electronic database of filings, EDGAR] that enables users to access annual (10-K) and quarterly (10-Q) disclosure statements. . . ."[16]

The implicit threat of EPA's "alert" hangs in the air somewhat timorously and appears to have no more resonance than the lingering echo of former SEC Commissioner Roberts's numerous admonitions regarding environmental disclosures in the early 1990s. As a practical matter, the degree of interaction and communication between EPA and the SEC remains quite limited. As GAO has reported, "Despite sporadic efforts to coordinate on improving environmental disclosure, SEC and EPA do not have a formal agreement to share relevant information."[17] That SEC staff find few reasons to be concerned with environmental disclosures does not, therefore, surprise.[18]

Lawyers have also become considerably more conscious of disclosure practices and obligations and of their role in supporting disclosure compliance. The Sarbanes-Oxley requirements for lawyers (and others) may significantly alter the parameters of discourse between lawyer and client, as will the sustained attention being paid by governmental investigators, the media and the plaintiff's bar to the role of lawyers in advising clients against whom allegations of fraud or corruption are later brought. In addition, at least in the United States (Europe, stay tuned), the lawyers's interaction with accountants has become more diffident and troubling. Law firms are receiving more penetrating inquiries from auditors of their clients's financial statements concerning the lawyers's knowledge of, not just assessment of, matters that might be or become loss contingencies.

In short, for various reasons corporate environmental disclosures have the increased attention of business leaders, shareholders, regulators, lawyers, accountants and others, who are often predisposed to believe that existing environmental disclosure practices are deficient, or at least will be deficient when measured against emerging standards. Where previously debates concerning improvements to environmental disclosure regulation and practice lacked either urgency or widespread support, current conditions suggest that new expectations are in fact taking root and are apt to develop real fruit before long. We turn next to observations about the marketplace to explore the divergence of perspectives and pronouncements in the fields of regulated and unregulated disclosures and accounting treatments.[19]

Observations of the Marketplace

Rising expectations concerning corporate disclosures (environmental and otherwise) are of little moment unless they can be enforced. Even if improvement in disclosure practices has intrinsic merit, it will not happen on any large scale absent a credible threat of correction. The law and the investment market are two powerful mechanisms for correction, and both have the close attention of corporate executives. Our focus will largely be on market-related corrections, particularly the twin trends toward environmental screening by large investors and voluntary environmental reporting by large companies. Given the potential importance of such voluntary environmental reports, we examine the form and function of such reports in some detail. Thereafter we spotlight an unusual example of legal enforcement through the imaginative (some might say questionable) use of fraud laws to ferret out wrongdoers and to discipline the market for alleged failures in transparent disclosure.

Environmental Screening Is Serious Business

As many have noted, the focus on corporate responsibility – and particularly environmental achievement – has spread to mutual funds, privately managed investment portfolios, pension funds and shareholder resolutions. Frequently, social filters are used to focus on companies that act "responsibly." Social filters are not a new phenomenon, nor is their use limited to environmental advocacy groups. Calvert Funds, which also offers a socially-conscious approach to investing, even provides a filtering tool that can be applied to any mutual fund company to determine how its investments match up against Calvert's criteria (which include criteria on environmental policies and performance).[20] Some corporations that match up well with the criteria used by socially responsible funds are turning it to their own advantage. Bristol-Myers Squibb's Web page, for example, touts the accolades the company has received from various funds and investment advisers for its environmental performance.[21]

Even shareholders have taken up the banner of socially responsible investment: shareholder votes on corporate, social and environmental responsibility are gathering more support than ever.[22] Companies such as the Southern Company and ExxonMobil have seen shareholder resolutions relating to environmental issues garner support over 20 percent.[23] Meg Voorhes, director of USPIRG's social issues services observes that, "In the 32-year history of shareholder activism on social issues only board-diversity proposals have had average support levels topping 20 percent."[24] While few would expect these types of proposals to succeed as shareholder resolutions, they appear to have become an important part of the corporate landscape.

Whether or not one agrees with the (various) premises of socially responsible investment, the financial importance of such investment and its link to corporate governance issues more generally suggest that the upward trendline warrants attention, for at least two reasons. First, it serves as an indicator of higher expectations of corporate disclosure, since disclosures (and reports from third parties, including the government) are an essential part of the database subject to investment screening. In addition, it strongly suggests that publicity concerning corporate environmental matters must be considered ever more carefully. The next section examines a related trend – the corporate environmental report – by which companies and others seek to marshal environmental facts in a format that is both informative and publicity-savvy.

Corporate Environmental Reports: The New Vogue

The last decade has shown a strong rising trend favoring the preparation of Corporate Environmental Reports (CERs). These reports, which resemble an annual review of environmental performance, vary in form from company to company – and not surprisingly so, since they are voluntary and largely unregulated. Like marketing documents, CERs have a distinctly positive air about them, since they tend to highlight environmental success stories, awards and other positive environmental news about the company. Accordingly, they invite comparison with existing forms of more disciplined disclosure under the securities rules and the accounting rules, whose strictures (such as they are) might have contributed to the ascendancy of CERs. Whether or not the trend favoring CERs reflects inadequacies in the existing environmental disclosure rules and practices, it appears that the trend creates new expectations for disclosure and new possibilities for enforcement for disclosure failings.

That CERs have caught on – also among multinational companies – is readily apparent. At various points over the past decade, KPMG has created and updated an International Survey of Corporate Sustainability Reporting that details the increasing use of CERs and "sustainability" reports.[25] In 2002, almost half of the Global Fortune 250 created sustainability reports, and the number has been increasing.[26] Among companies filing these reports, corporate and environmental reporting rates are highest in business sectors such as chemicals and synthetics, and pharmaceuticals, which KPMG reckons involve the most significant environmental impact.[27] That said, the KPMG report acknowledges that corporations in non-industrial sectors are preparing such reports as well.[28] Geographically, the highest reporting rates are in Europe and North America, but the practice is expanding beyond these regions.[29] The largest increases in sustainability reporting rates have been in countries that recently enacted mandatory reporting requirements.[30]

Independent third-party verification of CERs is also on the rise.[31] In 2002, over a quarter of the companies in the Global Fortune 250 that prepared reports had those reports independently verified.[32] This number stood at 19 percent in 1999.[33] However, while the use of independent third-party verification increases globally, such is not the case in the United States. Only 3 percent of reporting U.S. companies in the Global Fortune 250 used independent verification.[34]

The ability to vary key attributes of CERs – in particular their scope, level of detail, and subject-matter focus – makes the CER format considerably more appealing as a means for communicating about environmental issues than the standard annual company report or securities-related filing. Accordingly, CERs have grown noticeably longer and more detailed over the past few years.[35] By contrast, the level of detail and the subjects discussed in regulated disclosures submitted by companies with CERs appear to have stayed fairly constant.[36] The increasing prominence and number of CERs has persuaded some that CERs are becoming "mainstream"[37] and may soon become good business practice.[38] If so, an important new expectation will have emerged that solidifies the place of CERs as an additional forum for environmental disclosure, even if they are not legally required.

Various initiatives are under way to sculpt the format and scope of CERs, but none are anchored in existing law or in financial accounting principles per se. While CERs are commendably flexible, the correlative temptation of such flexibility is overabundant or unbalanced disclosure. The stark difference in the amount of information available in CERs on the one hand and in regulated disclosures on the other hand invites misunderstanding on issues like financial significance and the overall character of corporate operations. The implicit assumption that prospective shareholders will understand the differences and judge the disclosures accordingly is strikingly optimistic. Given the still-unsettled mechanisms for enforcing expectations about CERs, such optimism seems especially troubling. In the next section we examine efforts to develop a more systematic and authoritative format for voluntary environmental disclosures.

Corporate Environmental Reports – Form and Function

Disclosure cannot be transparent without a shared understanding of terms. This is true for traditional accounting and financial analysis, and it is true for environmental matters specifically. For financial matters, the commonality arising from uniform application of Generally Accepted Accounting Principles (GAAP) within the United States, the wide array of public venues for sophisticated discussion of financial matters, and the existence of shared curricula for professionals and the public to learn about financial analysis in the United States and elsewhere – all help to create the shared understanding necessary for meaningful evaluation of balance sheets, cash flow and the like. In the specialized area of environmental risks and liabilities, however, generally accepted principles are a distant hope,[39] public venues for informed discussion about environmental accounting and reporting are few and far between,[40] and curricula focused on environmental disclosures are a rarity.

The need for shared understanding is perhaps most acute in the area of corporate performance metrics, which is to say the measurement of environmental achievements and failures on a company-wide basis. What are the trenchant indicators of environmental performance? Familiar shibboleths include: dollars spent on environmental equipment, like scrubbers; reductions in emissions and waste; costs avoided through early detection of environmental ills; trendlines in the number of lawsuits, notices of violation and consent agreements addressing environmental issues; and the existence (or absence) of programmatic infrastructure such as corporate environmental policies and environmental management systems (EMS).

No doubt each of these indicators – and dozens more like them – can provide information useful to assessing the environmental strengths or weaknesses of an organization. Yet few observers would contend that such indicators are robust enough or comprehensive enough to describe overall environmental performance accurately.

Into this breach few have stepped with confidence. One effort, however, is worth describing in detail, since it augurs the evolution of a shared terminology and a generally accepted framework for reporting on environmental performance, particularly among multinational companies.

Global Reporting Initiative

The Global Reporting Initiative (GRI) was born in 1997 as a partnership between the United Nations Environment Programme (UNEP) and the Coalition for Environmentally Responsible Economics (CERES), and it currently works in collaboration with the United Nations's Global Compact. GRI's mission is to:

> Elevate sustainability reporting to a level as routine as financial reporting by creating a generally accepted, international *process* and *products*.[41]

Animated by these principles, the proponents of GRI convened a large stakeholder group whose principal purpose was to draft guidelines for reporting about the economic, environmental and social sustainability of an organization based upon its operations, products and services. The effort targets the "triple bottom line" of environmental, social and financial indicators and, accordingly, does not focus only on environmental matters. While treating each of the three "bottom lines" separately, GRI views its work as a milestone on the path toward total performance reporting, which would represent an integrated form of economic, social, environmental, financial and perhaps other reporting dimensions.

In 2002, after years of stakeholder discussions, GRI published its *Guidelines*, which present a "framework for reporting on an organization's economic, environmental and social performance."[42] In essence, the *Guidelines* present a coherent scheme for covering a wide of array of specific topics considered germane to and revealing of the three bottom lines. A sustainability report reflecting the *Guidelines* framework would address, for example, ten designated "aspects" of the environmental bottom line, among them Materials, Energy, Water, Biodiversity, Emissions, Suppliers and Compliance.[43] In turn, the economic and social bottom lines each have their own "aspects," numbering five and 21, respectively.[44] Each "aspect" is to be illuminated by disclosures that address specified "core" or "additional" indicators (*e.g.*, total water use), to the extent relevant to the reporting company.

GRI is careful to emphasize what the *Guidelines* are not. They are not intended as a code of conduct, nor a performance standard or management system; they are not meant to provide instruction on how a company should design its systems for data management and reporting, and they supposedly offer no methodology for preparing, monitoring or verifying reports.[45] Despite these disclaimers, the hopeful premise of the *Guidelines* is that they will find widespread acceptance and will lead to more balanced reporting in a format that improves comparisons across companies and reporting years.[46]

Companies that adhere strictly to the *Guidelines* may self-certify themselves as "in accordance" with (*i.e.*, having strictly adhered to) the *Guidelines*, but GRI recognizes that many companies will prefer to use the *Guidelines* as an informal reference, rather than a code. Those opting for the stricter "in accordance" reporting must include in the report a prescribed statement, signed by the CEO or the board, that certifies that the report is a balanced and reasonable presentation of our organization's economic, environmental, and social performance.[47]

In function, but not in substance, the certified statement resembles the certification required of registrants of securities and of auditors certifying a financial statement. However, unlike the analogous legal and accounting statements, which resonate with decades of jurisprudence and industry practice, there is no authoritative gloss on the meaning of "balanced" and "reasonable." Instead, adhering to the specified "core" and "additional" indicators is thought to ensure a report that is deeply probative of an organization's sustainability performance. As the *Guidelines* are put to use over time and deficiencies emerge, GRI anticipates refining the indicators in order to keep them probative on matters of sustainable development.[48]

Nevertheless, in a given instance, the indicators may prove insufficient to present a balanced and reasonable picture of environmental performance. Anticipating such instances, GRI requires organizations seeking "in accordance" status to confirm their report's consistency with eleven general principles, which represent the overarching goals for reporting under the *Guidelines*.[49] These principles are: Transparency, Inclusiveness, Auditability, Completeness, Relevance, Sustainability Context, Accuracy, Neutrality, Comparability, Clarity and Timeliness.[50] Each principle is elucidated by a narrative description in the *Guidelines*.[51]

None of the principles, it will be noted, is called "Materiality." Instead, the principles of Completeness, Relevance and Inclusiveness jointly intersect the traditional concept of materiality by focusing closely on what is relevant and significant from the perspective of the "information user," not the perspective of the reporting entity.[52] The *Guidelines* also do not define who the "information user" is. Instead, GRI envisions a "stakeholder" process by which the reporting entity first identifies and then engages those who have an interest in the company's environmental or sustainability performance. The stakeholders are intended to have a substantial say in matters such as "the choice of indicators, the definition of the organization's reporting boundaries, the format of the report, and the approaches taken to reinforce the credibility of the reported information."[53] As a practical matter, the reporting entity decides with whom it is willing to engage in dialogue about disclosure. In this respect the reporting entity has more discretion under the *Guidelines* than under the reporting rules of the Securities and Exchange Commission, whose focus is steadfastly upon the prospective investor.

Whether GRI's *Guidelines* will emerge as the authoritative, or at least the most pervasively used, framework for corporate reporting on environmental (and other) issues remains to be seen, but for the moment it appears it might. The current roster of adherents includes 128 organizational stakeholders whose official support of GRI and whose own application of the *Guidelines* seem to confirm the *Guidelines*'s legitimacy among multinationals.

By some measures, using GRI's *Guidelines* improves the overall merit of a corporate sustainability report. A comprehensive study and assessment of 100 corporate reports in 2002 concluded that “[t]here is a substantial difference between reports based on the GRI guidelines and others,” with the former outperforming the latter by 8 percent on average when measured against the same criteria.[54] But the news is not all positive. The same report highlighted two important and unfavorable trends in the CERs reviewed. First, environmental disclosures are decreasing as social and other disclosures increase and, second, GR’’s reliance on innumerable indicators has led to the “carpet bombing syndrome” in which the quantity of disclosures overtakes their quality and relevance.[55]

These concerns are real, and they erode the premise and promise of the *Guidelines*. Three other concerns similarly circumscribe GRI’s efforts to date. First, as GRI recognizes, the *Guidelines* perpetuate a “silo” approach, with only modest integration of economic, social and environmental issues and indicators.[56] Second, the reliance on stakeholders to define essential concepts such as materiality invites a changing standard over a company’s reporting lifetime and an inconsistent standard across companies. Third, the *Guidelines* are, and are intended to be, separate from other forms of reporting on similar topics, including “legally mandated reporting or disclosure requirements”[57] and “financial reports”[58].

Each of these observations reflects GRI’s conscious and consuming interest in the outward effects of an organization upon the environment and the social and physical communities around it. After all, it is the successes and failures of an organization’s progress toward sustainable development that the *Guidelines* are meant to illuminate, not the financial relevance of a corporate liability nor even the relative risk of an environmental incident that might be calamitous to the organization or stakeholders. Yet liability and risk, in addition to effects, are the concern of organizations as a whole and may arise from the same operations, decisions and circumstances on which the *Guidelines* throw their particular light. If there is to be any integration of these concepts in the future, as GRI states as its hope, then a measure of convergence will be needed. Moreover, in the interim lurks the potential that divergence among voluntary and regulated disclosures will provide a foundation for criticism and, perhaps, enforcement, as discussed next.

Learning from Mr. Spitzer

Eliot Spitzer may be the only state attorney general with the kind of name-recognition in the United States (and perhaps abroad[59]) that could make a national politician envious. State attorneys general do not customarily occupy more than an unlit corner of the public’s mind, yet Mr. Spitzer has become a byword among corporate chieftains in and around New York for the tenacious, sometimes clever and always serious manner in which he has sought redress for perceived egregious corporate conduct. He seems to be (and perhaps relishes being) a crusader against corporate villainy, and he has had enough success to give such a claim a gloss of credibility.[60] These days, few would choose to tangle with Mr. Spitzer.

Since taking office in late 1998, New York’s attorney general has relentlessly[61] pursued alleged fraud in the New York financial center, and he has done so on an ambitious scale. The “global settlement” obtained by New York[62] in December 2002 against leading investment banking firms was an eye-opener for many and a stimulus for New York and other authorities to continue to investigate financial fraud cases with vigor. His catalogue of prosecutorial accomplishments includes well-publicized settlements and financial recoveries from Merrill Lynch, Bank of America, FleetBoston Financial, Janus Capital Management, and many others.

A close study of the attorney general’s accomplishments and methods lies well beyond our scope of inquiry, but two ingredients have seemed essential to his efforts and may portend something important for environmental disclosure. First, New York has an unusual fraud statute[63], which supports investigations and lawsuits that might be harder to bring elsewhere; since New York is a vital marketplace (commercial and intellectual) for many multinational companies, this local law matters. Second, more generally, financial fraud involving corporate non-disclosure has been the subject of immense, sustained public attention ever since Enron’s demise, a fact that has played nicely into the hands of an ambitious and able lawyer in a state that celebrates audacity.

What is interesting for our purposes is the question whether other areas of corporate disclosure – notably environmental liabilities, risks and effects – could ever attract similar prosecutorial attention, based on the widespread existence of fraud statutes (and new insights in using them) coupled with a sustained surge of public indignation. One wonders, for example, whether a case like Love Canal, had it burst on the scene in 2002, might have raised the public's ire enough to attract the kind of attention that the New York attorney general has brought to the financial markets. Back then, it *was* sufficient to generate a new and groundbreaking federal law, now (in)famous the world over: the Superfund law.

So the question is not idle. Among environmental professionals, Mr. Spitzer is probably as well known for his *avant-garde* stance on alleged transboundary air pollution as for his financial cases.[64] More broadly, and more important than Mr. Spitzer's recent efforts, the United States and other countries have already experienced environmental events that the public has deemed both catastrophic and attributable to corporate misconduct or mismanagement. Three Mile Island (reactor safety), Chernobyl (radiation fallout), Valdez (oil spill), Seveso (chemicals release), Bhopal (gas release), Baia Mare (cyanide spill), Enschede (fireworks explosion) and other names are by now familiar entries in the worldwide environmental lexicon. Even in the absence of an accident, perceived environmental risks have lately stimulated not just discussion but outright public hostility and effective politicking: consider the fierce debate in the United States over residential siting of marine terminals for the storage and regasification of liquified natural gas (LNG).[65]

Today's focus on disclosure of risk and accountability for misconduct suggests that environmental catastrophes – or perceived risk of catastrophes – on a scale such as we have seen before could stoke the kind of public indignation that supports a much closer inspection of the culture of corporate environmental disclosure.[66] Then it becomes a question of the means by which an enforcing entity such as an attorney general might proceed. Given the legal complexities and technical underpinnings of environmental law (not to mention tricky issues like federal preemption), a righteous attorney general or other crusader could be forgiven for preferring the simple and sturdy fraud statute, as Mr. Spitzer has done.

Prosecutors in the United States and perhaps elsewhere are also making bolder use of basic legal concepts (of which fraud is only one) to address a broad range of corporate and individual statements that might previously have been ignored or discounted. For example, Martha Stewart was charged by indictment with making false statements to the press concerning her personal stock trades, in an alleged attempt to defraud investors and stem a drop in her company's share price.[67] The charge was ultimately rejected by the court for insufficient evidence – *not for failure to state a claim*.[68] The theory of the initial charge was that exculpatory personal statements by a leading shareholder and corporate executive can influence investors's opinions of the company and, therefore, can be used willfully by an executive to manipulate those opinions and thereby manipulate the company's stock price.

The theory of the Stewart charge, if it takes hold in other cases, promises considerable heartache for corporate executives caught up in criminal investigations of their personal conduct. But the theory also extends naturally to corporate executives who are themselves not under scrutiny but whose companies are targets of criminal investigations, since it is inevitable that such executives will be called upon publicly to explain and defend the company's conduct. Moreover, the Stewart charge sheds more light on what a company can say about its corporate conduct, which is a topic described but not well illuminated in a 1998 lawsuit against Nike, Inc. In that case, a private individual alleged that the company had made several false statements or material omissions of fact relating to the physical conditions under which laborers manufactured the company's products.[69] The U.S. Supreme Court initially accepted the case for review in order to address two questions, one of which was:

> whether a corporation participating in a public debate may "be subjected to liability for factual inaccuracies on the theory that its statements are 'commercial speech'

> because they might affect consumers' opinions about the business as a good corporate citizen and thereby affect their purchasing decisions."[70]

It was widely acknowledged that the answer to the question would have important ramifications on corporate efforts to become more open and disclosure-friendly, especially on topics with broader social implications. As one observer noted: "The case has become a touchstone for fierce debate over what constitutes free speech and should be protected by the Constitution. The case is vital to the SRI Community as it will decide whether corporations and corporate social responsibility reports, can be protected by the same rules of free speech as those covering their critics."[71] Another observer – namely, Justice Breyer of the U.S. Supreme Court – put it more concretely:

> This concern is not purely theoretical. Nike says without contradiction that because of this lawsuit it has decided "to restrict severely all of its communications on social issues that could reach California consumers, including speech in national and international media." It adds that it has not released its annual Corporate Responsibility Report, has decided not to pursue a listing in the Dow Jones Sustainability Index, and has refused "dozens of invitations . . . to speak on corporate responsibility issues." Numerous *amici* – including some who do not believe that Nike has fully and accurately explained its labor practices – argue that California's decision will "chill" speech and thereby limit the supply of relevant information available to those, such as journalists, who seek to keep the public informed about important public issues.[72]

Notwithstanding the concerns, the Supreme Court opted to dismiss the matter without decision on the merits, on the theory that the petition to the Court was premature and should not have been granted.[73] A few months later, the parties settled the case, leaving in mid-air the question the Supreme Court had asked but not answered.[74]

The annals of creative fraud claims such as the Stewart charge and the Kasky suit recently gained an environmental chapter. On July 21, 2004, eight state attorneys general (including the New York attorney general) brought suit against five large energy companies on a theory of "nuisance" arising from the alleged transboundary effects of air pollutants emitted from energy generating facilities.[75] By relying on the ancient common law theory of nuisance, rather than on the extensive provisions of federal and state air pollution statutes and regulations, the plaintiffs avoid statutory hurdles and present, to the public at least, a simple and straightforward message. Whether the suit succeeds remains to be seen. For now, we note that the complaint refers specifically to statements (called "admissions" in the complaint) made by one of the defendants in its voluntary environmental report.[76]

The idea that nuisance actions might end-run long-established statutory programs and enforcement options, or that exculpatory (mis)statements might be the basis for criminal prosecution of company and individual alike, has garnered considerable attention and evoked real concern among lawyers and environmental professionals. The concerns gain heft and perhaps even urgency as one surveys the ever deeper field of voluntary corporate environmental reports, discussed above. How well such reports and their many details represent the overall reality of a company's environmental performance, risk and liability remains to be seen and, perhaps, judged.

Conclusion

The foregoing observations underscore three key points. First, regulated and unregulated disclosures have diverged substantially in their scope, purpose and detail. Second, the financial marketplace is paying attention to both kinds of disclosure and is to some extent making financial decisions according to perceptions created by the disclosures and their degree of transparency. Third, divergent standards for disclosure also present a legal risk when one considers the all-around utility of fraud statutes and the increased interest in applying them to perceived public ills. Fortunately, if history is any guide, change in enforcement precepts in the area of environmental disclosure will come gradually, but come it will. Now is an excellent time to reconsider the divergent perspectives on disclosure and to seek significantly greater convergence across disciplines as well as jurisdictions.

Notes:

1. This article is a condensed version of one that originally appeared in the September 2004 edition of Business Law International, a publication of the International Bar Association. It is adapted and reprinted here with permission from BLI, which holds the copyright. For a broader discussion (with more extensive references), please see the full version of this article available at http://www.bracewellgiuliani.com/Publications/publication_listing.asp.
2. *Environmental Disclosures in the Annual Report & Accounts of Companies in the FTSE All-Share*, U.K. Environment Agency (July 2004) (hereinafter, "U.K. Environment Agency's 2004 Disclosure Report").
3. *Id*. at 4.
4. *Id*. at 63. The (forthcoming) regulation cited relates to the Operating and Financial Review portion of a company's securities-related disclosures. The OFR regulations will considerably expand the duties of auditors, *id*. at 37, and "will require companies to disclose environmental policies and performance where such information is necessary for shareholders, 'to assess the strategies adopted by the company and the potential for those strategies to succeed'." *Id*. at 11 (emphasis in original). The regulation should be read in conjunction with the forthcoming European Union Prospectus Directive and the existing European Union Modernization Directive.
5. *Id*. at 61.
6. *Accounting for Environmental Compliance: Crossroads of GAAP, Engineering, and Government* (A Survey of Corporate America's Accounting for Environmental Costs) (PriceWaterhouse, 1992) at 1.
7. This study was conducted by Abt Associates Inc., Cambridge Massachusetts, under Contract #68-W98-005, WA 1-07 and WA-2-07, but was never formally released to the public. The study is discussed in *Corporate Environmental Disclosure: Opportunities to Harness Market Forces to Improve Corporate Environmental Performance*, a paper presented by Nicholas C. Franco to the ABA Conference on Environmental Law in Keystone, Colorado (March 2001), available at http://www.corporatesunshine.org/epaaba.pdf (hereinafter, "Franco's 2001 Corporate Environmental Disclosure Paper").
8. See *Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information*, U.S. Government Accountability Office (July 2004) at 18, n.12. Available at http://www.gao.gov/new.items/d04808.pdf (hereinafter, "GAO's 2004 Environmental Disclosure Report").
9. Memorandum from Mary Kay Lynch and Eric V. Schaeffer (U.S. Environmental Protection Agency) to EPA's Regional Offices and Enforcement Coordinators, *Guidance on Distributing the "Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings" in EPA Administrative Enforcement Actions*, Jan. 19, 2001 (citing (1) A Survey of Corporate America's Accounting for Environmental Costs (PriceWaterhouse, 1992); (2) an unreleased 1998 study by the Office of Enforcement and Compliance Assurance of U.S. EPA (see *supra* note 7); and (3) *Environ- mental Disclosure by Companies Involved in Initial Public Offerings*, by Martin Freedman and A.J. Stagliano (1996)), available at http://www.epa.gov/compliance/resources/policies/incentives/programs/sec-guid-distributionofnotice.pdf (hereinafter, the "EPA's 2001 Guidance on Distributing Notice of SEC Registrant's Duty"). The limitations of the Freedman/Stagliano effort are noted in GAO's 2004 Environmental Disclosure Report at Appendix III.
10. U.K. Environment Agency's 2004, Disclosure Report at 17 and 57.
11. GAO's 2004 Environmental Disclosure Report at 18 and Appendix III.
12. *Id.* at 20 (footnote omitted).
13. *See, e.g.*, Claudia H. Deutsch, *Revolt of the Shareholders*, N.Y. Times, Feb. 23, 2003, Section 3, at 1 (noting that General Motors, Kodak, and ExxonMobil faced shareholder resolutions on environmental matters at their annual meetings); Katharine Q. Seelye, *Environmental Groups Gain As Companies Vote on Issues*, The N.Y. Times, May 29, 2003, at C1 (reporting increased levels of

support for shareholder resolutions on global warming at auto manufacturers, electric power companies and oil companies).

14. *See* EPA's 2001 Guidance on Distributing Notice of SEC Registrant's Duty.

15. *See U.S. EPA Notifying Defendants of Securities and Exchange Commission's Environmental Disclosure Requirements,* Enforcement Alert, EPA 300-N-01-008 at 3 (October, 2001), available at http://www.epa.gov/compliance/resources/newsletters/civil/enfalert/sec.pdf.

16. *See id*.

17. GAO's 2004 Environmental Disclosure Report at 4-5.

18. SEC's review of the annual filings of Fortune 500 companies in 2002 "found relatively few problems with environmental disclosure overall, compared with other types of disclosure." *Id*. at 4.

19. The lengthier article from which this one is adapted provides, as an intermediate step, a thorough review of the rules governing regulated disclosures in the United States, as well as a limited review of the accounting rules under GAAP.

20. *See* Know What You Own®, available at http://www.calvertgroup.com/sri_kwyo.asp.

21. *See* Bristol-Myers Squibb, *Economic Performance: Investors*, available at http://www.bms.com/static/ehs/perfor/data/epinves.html.

22. Claudia H. Deutsch, *Revolt of the Shareholders*, The N.Y. Times, Feb. 23, 2003, available at http://query.nytimes.com/gst/abstract.html?res=F60C1FFD38590C708EDDAB0894DB404482; Katharine Q. Seelye, *Groups Gain as Companies Vote on Issues*, The N.Y. Times, May 29, 2003, available at http://www.globalpolicy.org/socecon/envronmt/2003/0528companies.htm.

23. Katharine Q. Seeyle, *Groups Gain as Companies Vote on Issues*, The N.Y. Times, May 29, 2003, available at http://www.globalpolicy.org/socecon/envronmt/2003/0528companies.htm.

24. *Id*.

25. *See* KPMG International Survey of Corporate Sustainability Reporting 2002.

26. *Id*. at 9.

27. *Id*. at 10.

28. *Id*. at 5.

29. *Id*.

30. *Id*. at 6.

31. *Id*. at 18.

32. *Id*.

33. *Id*.

34. *Id*. at 20. It should be noted that KPMG offers these types of verification services and may be predisposed to favor CERs and CER verification.

35. *See, e.g.*, General Motors' Sustainability reports from 1999-2003. In fact, GM has created a Web page, www.gmability.com, to continuously track environmental and sustainability issues.

36. *See*, *e.g.*, companies such as Ford, Cummings Engine and Eastman Chemical. These companies's 10-K filings are quite consistent in their form and content over the past decade.

37. KPMG International Survey of Corporate Sustainability Reporting 2002 at 5.

38. *Id*. at 6.

39. See "Global Reporting Initiative" below for a discussion of one attempt at creating a shared system of accounting (conceptually) for certain kinds of environmental and social performance.

40. *Mandatory and Voluntary Environmental Disclosures in a Time of Crisis in Corporate Governance: A Perfect Storm?,* a paper presented by Jeffrey A. Smith to the ABA Conference on Environmental Law in Keystone, Colorado (March 2004). Under the auspices of the American Bar Association's Section on Environment, Energy, and Resources, Mr. Smith and Mr. Thomas M. McMahon have recently organized a special committee devoted to environmental disclosures, with useful materials posted at http://www.abanet.org/environ/committees/environdisclosures/home.html.

41. *The Power of Full Disclosure: The Global Reporting Initiative*. Presentation by Dr. Allen L. White of Global Reporting Initiative at the Conference on Finance, Environment and Development (Paris, Jan. 10, 2003) at 5 (emphasis in original). That "financial reporting" is the benchmark – at least in relation to routinization – is interesting in light of the limited concrete guidance and regulation on how environmental liabilities, risks and effects should be accounted for financially (see 'Existing Disclosure Requirements in the United States' above), and in light of the attendant variability in financial accounting for environmental matters.

42. *Sustainability Reporting Guidelines*, Global Reporting Initiative (2002) at 8, available at www.globalreporting.org.
43. *Id*. at 36.
44. *Id*.
45. *Id*. at 8.
46. *Id*.
47. *Id*. at 13.
48. *Id*. at 9.
49. *Id.* at 13.
50. *Id*. at 23.
51. *Id*. at 20-31 (Part B of the *Guidelines*).
52. *Id*. at 24-27.
53. *Id*. at 25. See esp. the discussion of the principle of Inclusiveness at 24-25.
54. *See Trust Us: The Global Reporters 2002 Survey of Corporate Sustainability Reporting* (SustainAbility Ltd. and United Nations Environment Programme, 2002) (Executive Summary) (hereinafter, "*Trust Us*"), available at www.sustainability.com/trust-us.
55. *See id* at 62-63.
56. *See id*.
57. *Sustainability Reporting Guidelines*, Global Reporting Initiative (2002) at 9, available at www.globalreporting.org.
58. *Id.* at 17. "GRI believes that both financial reporting and sustainability reporting serve parallel and essential functions that enrich each other. . . . GRI encourages the coordination of both reporting processes and expects that over time financial performance measurement increasingly will benefit from the measurement of economic, environmental, and social performance." *Id*.
59. *See, e.g.*, Kerstin Friemel, *Eliot Spitzer: Matador der Aktionaere*, Financial Times Deutschland, April 30, 2002; see also Peter Herkenhoff, *Gnadenloser Wall-Street-Jaeger Eliot Spitzer legt jetzt auf Grosskonzerne an*, Die Welt, June 4, 2004.
60. *Time* magazine named New York's attorney general "Crusader of the Year" in 2002. See Adi Ignatius, *Crusader of the Year, Wall Street's Top Cop*, Dec. 30, 2002, available at http://www.time.com/time/personoftheyear/2002/poyspitzer.html.
61. Not everyone agrees that "relentless" fits the bill. Some believe Mr. Spitzer has been co-opted by his targets: *see, e.g.*, Daniel Gross, *Eliot Spitzer, Wimp: Why the New York attorney general isn't strong-arming white-collar shysters*, May 21, 2004, available at http://slate.msn.com/id/2100951/. Others criticize his motives: *see, e.g.*, Brooke A. Masters, *Eliot Spitzer Spoils for a Fight: Opponents Blast Unusual Tactics of N.Y. Attorney General*, Washington Post, May 31, 2004, at A01 (also available at http://www.washingtonpost.com/wp-dyn/articles/A3061-2004May30.html).
62. The settlement was obtained with the cooperation and assistance of many other agencies, including the U.S. Securities and Exchange Commission (SEC), the North American Securities Administrators Association (NASAA), the National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE), and state securities regulators. Nevertheless, this deal and several others relating to financial fraud are generally considered the work or inspiration of New York's Attorney General.
63. N.Y. Gen. Bus. Law, Art. 23-A, § 352 *et seq*. (McKinney 1996) ("The Martin Act").
64. *See, e.g., A Clean Air Rule That Works*, The N.Y. Times, April 28, 2003, at A22 (editorial referring to Spitzer's "several novel legal strategies" in pursuing air-pollution claims); *see also* Brooke A. Masters, *Eliot Spitzer Spoils for a Fight: Opponents Blast Unusual Tactics of N.Y. Attorney General*, The Washington Post, May 31, 2004, at A01 (noting that Spitzer's 1999 air pollution cases were his "first big venture onto federal turf").
65. *See, e.g.*, *The Future of LNG*, Boston Globe, June 28, 2004 (editorial seeking a better process for selecting suitable sites in northeastern U.S.); John Surratt, *LNG Proposal Up For Discussion*, The Mississippi Press, July 11, 2004 (concerning possible site near Dauphin Island in Gulf of Mexico); *California Plans to Sue for LNG Permitting Authority in Dispute with FERC*, Oil & Gas Journal editors, Oil & Gas Journal, July 16, 2004 (concerning state-federal jurisdictional battle over siting authority).
66. To be sure, large-scale environmental disasters do not necessarily arise from corporate misconduct or mismanagement: as the U.S. EPA has acknowledged in its own report on the *Valdez* spill, some oil spills are probably unavoidable so long as the world expects deliveries of oil. See Samuel K. Skinner and William K. Reilly, *The Exxon Valdez Oil Spill: A Report to*

the President, Executive Summary (May, 1989). Moreover, from a legal standpoint, fraud claims may be more complicated, or at least markedly different, in the context of fairly panoramic environmental laws.
67. Count Nine of the superseding indictment in *U.S. v. Stewart*, available at http://news.findlaw.com/hdocs/docs/mstewart/usmspb10504sind.html.
68. *U.S. v. Stewart*, Order Granting Defendant's Motion for Judgment of Acquittal on Count Nine (Cedarbaum, J.), Feb. 27, 2004, available at http://news.findlaw.com/hdocs/docs/mstewart/usmspb22704opn.pdf.
69. *See Nike, Inc. v. Kasky*, 539 U.S. 654 (2003) (June 26, 2003) (Stevens, J., concurring) (certiorari dismissed as improvidently granted).
70. *Nike, Inc. v. Kasky*, 539 U.S. 654, 656-57 (2003) (June 26, 2003) (Stevens, J., concurring) (certiorari dismissed as improvidently granted).
71. *Supreme Court Will Hear Nike v Kasky*, posted to SRiMedia PLC, Jan. 10, 2003, available at http://www.srimedia.com/artman/publish/article_342.shtml. SRiMedia is a London-based online news outlet on issues of corporate governance. *See also Nike, Inc. v. Kasky*, 539 U.S. 654 (2003) (June 26, 2003) (Stevens, J., concurring) (certiorari dismissed as improvidently granted) at 2-3. (citing *amici* briefs of ExxonMobil and Pfizer and considering "of great importance" the need to protect against a "chilling effect" against those who seek to participate in public policy debates, including individual companies).
72. *Nike, Inc. v. Kasky*, 539 U.S. 654, 682-83 (per curiam) (June 26, 2003). (Breyer, J., dissenting) (certiorari dismissed as improvidently granted) (citations omitted).
73. *Nike, Inc. v. Kasky*, 539 U.S. 654 (per curiam) (June 26, 2003) (certiorari dismissed as improvidently granted).
74. Reactions to the settlement have varied. *See, e.g.*, William Baue, *The Implications of the Nike and Kasky Settlement on SCR Reporting*, CSRwire, Sept. 18, 2003, available at http://www.csrwire.com/sfarticle.cgi?id=1222.
75. See Pamela Najor, John Herzfeld, and Carolyn Whetzel, *Eight States File Public Nuisance Lawsuit Against Utilities for Carbon Dioxide Gases*, Daily Environment Report (BNA), July 22, 2004.
76. State of Connecticut's Complaint at ¶ 23, *State of Connecticut v. American Electric Power Company, Inc.*, (S.D.N.Y. 2004) (No. 1:04-cv-05669-LAP).

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THE POTENTIAL IMPACT OF THE *AVIALL* DECISION

Janet Weller

Introduction

On Dec. 13, 2004, the U.S. Supreme Court ruled in a 7-2 decision that contribution claims are not available under section 113(f)(1) of the Comprehensive Environmental Response, Compensation, and Liability Act or "Superfund." law for voluntary remediation. *Cooper Industries, Inc. v. Aviall Services, Inc.,* 543 U.S. ___, 125 S. Ct. 577 (2004). The decision applies to situations where a potentially responsible party (PRP) conducts a remediation program without having first been sued by a government enforcement agency under the "Superfund." 42 U.S.C. 9601 *et seq*. The Court declined to rule whether there is an implied right of contribution under Superfund section 107 in such circumstances.

Because the decision leaves in doubt the viability of cost recovery or contribution *claims* under Superfund for a broad range of voluntary remediation programs, evaluation of future environmental liabilities, especially when a company has undertaken such a voluntary program without agreement from others as to cost or liability allocation, has a *new* element of uncertainty. For public companies with potential site remediation liabilities, the decision presents another challenge – assessing the impact of the *Aviall* decision and subsequent lower court rulings on their disclosure obligations in public filings.

The *Aviall* Decision

In the case before the Court, Aviall Services, Inc. discovered contamination on four sites it owned, which it reported to Texas authorities (as required under state law). The state authorities directed Aviall to remediate the site and threatened to bring an enforcement action if Aviall did not voluntarily initiate remediation of the contamination. Aviall voluntarily conducted a clean-up program and incurred $5 million in costs in doing so.

Aviall then sought contribution in federal court from a prior owner of the sites, Cooper Industries, Inc., under both sections 107 and 113 of Superfund. The initial complaint was subsequently amended to combine the section 107 and 113 claims into a single claim based on section 113(f)(1). That section provides that "[a]ny person may seek contribution . . . during or following any civil action under section 9606 of this title or under section 9607(a) of this title." 42 U.S.C. § 9613(f)(1). The district court ruled that the section 113 claim was time barred because it was not brought during or after a section 106 or section 107 action. *Aviall Services Inc. v. Cooper Industries, Inc.,* 2000 WL 31730 (N.D. Tex. 2000).

The Fifth Circuit originally upheld the lower court's decision, but subsequently reversed the district court and reinstated the contribution claim after a rehearing *en banc*. *Aviall Services Inc. v. Cooper Industries, Inc.,* 263 F.3d 134 (5th Cir. 2001). The Fifth Circuit considered the legislative history of Superfund and the overall purpose of promoting prompt cleanup of contaminated sites and concluded that the ability of a private party who has not been subject to an enforcement action to seek recovery from another was not specifically limited by the "during or following any civil action" phrase.

The Supreme Court, however, held that the "clear meaning" of section 113(f)(1) prohibited Aviall from bringing an action for contribution under section 11(f)(1), as Aviall was never actually sued by the government. In doing so, the Court rejected the argument that "may" was permissive and therefore not limited by the subsequent condition of having been the subject of a civil action under sections 106 or 107. The Supreme Court noted that this permissive interpretation would have rendered superfluous not only the subsequent language in section 113(f)(1) but also that of section 113(f)(3)(B), which allows contribution actions after certain settlements.

The Supreme Court declined to address Aviall's claims that it has a statutory right to seek cost recovery under Superfund section 107(a)(4)(B) or that it has an implied right of action for contribution under section 107, leaving those issues for further consideration in the U.S. Court of Appeals for the Fifth Circuit. Aviall had relied upon further language in section 113(f)(1) that states "[n]othing in this subsection shall diminish the right of any person to bring an action for contribution in the absence of a civil action" and had argued that even if section 113(f)(1) does not give it a right of contribution, this savings clause preserved either a direct or implied cause of action under section 107. While two justices would have ruled for Aviall on those claims, the majority opinion declined to address the issue of an implied right to contribution as the issue had not been briefed.

Potential Impact on Site Remediation and Cost Recovery Practices

It has become common practice for companies to initiate site remediation programs on a voluntary basis, before being sued by enforcement agencies. Government agencies have encouraged such activities through a variety of voluntary site remediation programs. Voluntary cleanup activities have generally allowed companies to use less formal procedures and implement site remediation activities on a more timely and cost-effective basis. In addition, companies often opt to pursue voluntary action when faced with a potential state or federal enforcement action, allowing both the potentially responsible parties (PRPs) and state and federal agencies to avoid the added costs of an enforcement action.

In these circumstances, companies have typically sought to recover all or a portion of their *remediation* costs from other *PRPs. The predicate for these cost recovery initiatives, whether pursued through informal negotiation or actual litigation, has been the presumed joint and several liability exposure of all PRPs.* Superfund section 107(a) imposes strict, joint and several liability upon four classes of PRPs, including current and former owners and operators of facilities at which a release or threatened release of a hazardous substance has occurred. The heretofore-established premise of joint and several liability often facilitated site remediation and private cost allocation without resort to litigation or enforcement action.

Whether there was a right of contribution under Superfund for these remediation costs – under any circumstances – was uncertain, however, without authoritative judicial interpretation. In 1986, Congress amended Superfund by adding section 113(f)(1), the language of which the Supreme Court interpreted in the *Aviall* decision. The Court construed the amendment *to have added* a right of contribution *after* enforcement authorities commence a civil action for remediation or cost recovery, but not before.

Previously, the majority of the appellate courts, including the U.S. Courts of Appeals for the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and Tenth Circuits had construed section 113(f)(1) to allow a PRP to sue other PRPs for cost recovery regardless of whether the plaintiff PRP had been the subject of a civil enforcement action. A majority of courts had also ruled that a plaintiff PRP could not bring a cost recovery action under section 107.

In *Aviall*, the Court noted that the viability of cost recovery claims under section 107 may "depend in part on the relationship between §§ 107 and 113" and left that issue to be addressed by the Fifth Circuit and the district court in this case. *Other courts similarly will need to reassess the argument for an implied right of contribution under section 107 in light of the Court's ruling in* Aviall.

Increased Uncertainty Regarding Future Liability and Cost Recovery

In these circumstances, the common assumptions that many companies have used to project both potential liability and potential cost recovery in the context of voluntary remediation activities no longer prevail. A new element of uncertainty has been introduced to the calculus.

The significance of this uncertainty for environmental disclosure *purposes* necessarily will vary depending upon the circumstances of each company. Companies that do not have significant remediation obligations or exposure are not likely to be affected. On the other hand, public companies with significant remediation obligations or liabilities will want to review their current disclosure from several perspectives.

Companies that are presently involved in Superfund cost recovery proceedings need to evaluate the continued viability of the cost recovery claims at issue. Proceedings should be reviewed in the first instance to determine whether contribution claims are being brought "during or following a civil action" or subsequent to "an administrative or judicially approved settlement" for purposes of section 113(f)(3)(B). An assessment should be made of the potential for cost recovery to proceed on alternate bases. Overall, companies should *consider* whether the overall ability to pursue cost recovery successfully is either less certain or is more difficult to assess. This assessment can be expected to vary from one locale to another, as the courts begin to address these issues. The size of the projected financial recovery from third parties must also be evaluated.

Companies should similarly review their current and potential involvement in voluntary remediation activities that are not the subject of any proceeding. Site activities may have been initiated with a set of assumptions regarding third party cost recovery that may no longer be viable. In some instances, a company may have assumed a remediation commitment under a program that does not provide any independent basis for seeking third party contribution or cost recovery. The factual context in each case must be reviewed to evaluate whether other state or federal programs can provide a basis for cost recovery or contribution. The extent to which a PRP has assumed a *binding* obligation under a given voluntary remediation program also should be reassessed, as state programs can differ significantly in this regard.

In some instances, remediation funding for multiparty sites may have proceeded on a cooperative basis, with negotiated agreements allocating percentage liability shares to participating parties. The extent to which these agreements impose contractual obligations on PRPs for pending remediation activities should be reexamined. At least in the interim, the ability to negotiate extensions of these cost allocation agreements to future operable units may have diminished as a result of the *Aviall* decision.

Potential Significance Relative to Disclosure Obligations

Based on an assessment of these and other factors, public companies may conclude that their disclosure should be updated to reflect the new uncertainties associated with these types of proceedings and remediation activities. In each instance, the specific requirements that govern different components of disclosure, including those that establish additional requirements for environmental disclosure, must be closely reviewed and taken into account.

The primary regulations establishing specific obligations with respect to environmental disclosure are set out in Items 101, 103 and 303 of Regulation S-K, 40 C.F.R. §§ 229.101, 229.103 and 229.303. Interpretive guidance issued by the U.S. Securities and Exchange Commission (SEC) regarding the assessment and reporting of remediation liabilities also needs to be considered.

For example, companies should evaluate whether any modifications or additions may now be needed to update any disclosure of remediation litigation that may be required under Item 103 of Reg. S-K. Companies need to consider whether the potential impact of the *Aviall* decision, and its subsequent application by the lower courts, change the underlying assumptions about cost recovery in a manner that would either alter the accuracy of the prior disclosure or impact the materiality of projected expenditures. More generally, a company should consider whether uncertainty with respect to future ability to pursue cost recovery on a joint and several liability should be discussed in the context of any Management Discussion and Analysis (MD&A) discussion of remediation liabilities. In this regard, consideration should be given to the circumstances in which such disclosure generally would be required (*i.e.*, if a company concluded that "currently known trends, events and uncertainties . . . are reasonably expected to have material effects") or would instead be optional (*i.e.*, where management is anticipating "a future trend or event, or anticipating a less predictable impact of a known trend, event or uncertainty"). Release No. 6211, 52 Fed. Reg. at 13717.

Companies should also review and evaluate any potential impact on accrual and disclosure of environmental costs in financial statements pursuant FASB No. 5 and SEC Staff Accounting Bulletin No. 92 (SAB 92). The accounting guidance generally proscribes netting out of financial statements potential cost insurance recoveries or potential cost recoveries from PRPs, so a different analysis must be applied in this context of these accruals from that allowed for MD&A purposes. The validity of the assumptions underlying these accruals must be based on current law and methodology and should be revisited in light of the *Aviall* decision.

The content of the footnotes that accompany the financial statements also must be considered. Environmental liabilities are one of the categories identified as of "such significance" that "detailed disclosures regarding the judgments and assumptions underlying the recognition and measurements of the liabilities" may be necessary "to inform readers fully regarding the range of reasonably possible outcomes that could have a material effect on the registrant's financial condition, results of operations or liquidity." SAB 92. Examples of "disclosures that may be necessary" include "[u]ncertainties with respect to joint and several liabilities that may affect the magnitude of the contingency," the "[d]isclosure of the nature and terms of any cost-sharing arrangements with other potentially responsible parties," and "[t]he extent to which disclosed but unrecognized contingent losses are expected to be recoverable through insurance, indemnification arrangements, or other sources, with disclosure of any material limitations of that recovery." SAB 92. Hence, depending upon the origin and type of environmental liabilities covered in the financial statements, the actual and potential limitations on cost recovery actions addressed in the *Aviall* decision may well need to be addressed in the footnotes to the financial statements.

Over time, the impact of the *Aviall* decision will be defined through subsequent decisions. Both the Department of Justice and the U.S. Environmental Protection Agency reportedly are evaluating procedural options and enforcement tools, such as short-form model orders, that might be deployed on a relatively expedited basis to against PRPs to satisfy the statutory predicate for pursuing cost recovery claims under section 113(f) of Superfund. While action to amend the pertinent provisions of Superfund has been discussed, a legislative "quick fix" generally is viewed as a low probability. Hence, public companies will need to monitor developments, reassess the viability of section 107 cost recovery claims between PRPs, and evaluate potential impacts relative to their environmental disclosure obligations.

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Special Committee on Environmental Disclosure Newsletter

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ENHANCING CLIMATE CHANGE DISCLOSURES AFTER GAO ISSUES REPORT ON SEC DISCLOSURES

Stephen J. Humes

Following ratification of the Kyoto Protocol (Protocol) by the Russian Federation, the Protocol became international law on Feb. 16, 2005. The Protocol's major feature is that it imposes mandatory reductions on greenhouse gas emissions for the world's leading economies which have accepted it. These targets range from -8 percent to +10 percent of the countries' individual 1990 emissions levels "with a view to reducing their overall emissions of such gases by at least 5 percent below existing 1990 levels in the commitment period 2008 to 2012." Kyoto Protocol to the United Nations Framework Convention on Climate Change, adopted Dec. 10, 1997, 37 I.L.M. 22, 54-56 (the "Kyoto Protocol").

Greenhouse gas emissions include six gases, but arguably carbon dioxide is by far the most important gas in the basket because it accounted for over four-fifths of total greenhouse gas emissions from developed countries in 1995, with fuel combustion representing all but several percent of this amount. *See* United Nations Framework Convention on Climate Change, "Essential Background," http://unfccc.int/essential_background/items/2877.php. While U.S. withdrawal of support for the Kyoto Protocol makes it non-legally binding on U.S. greenhouse gas emissions, the international implementation of the Protocol gives publicly-traded companies yet another reason to consider carefully whether their public filings with the U.S. Securities and Exchange Commission (SEC) contain adequate disclosures about the degree to which individual companies' operations contribute to climate change.

Although Section 821 of the 1990 Clean Air Act Amendments mandates that Title V sources of air pollution, which include major energy facility operators, are subject to mandatory reporting of greenhouse gas emissions, including carbon dioxide, to the U.S. Environmental Protection Agency (EPA), the federal government has not enacted limitations on greenhouse gas emissions. *See* 42 USC 7651k, note on Section 821 of Pub. L. 101-549. However, a growing number of states and regions are already addressing climate change on the local and regional levels. For example, Massachusetts and New Hampshire have already enacted limitations on carbon dioxide emissions from existing power plants and the Regional Greenhouse Gas Initiative (RGGI), consisting of the six New England states, New York, New Jersey and Delaware (with Pennsylvania and Maryland observing) represent a regional effort among coordinating states to address the climate change issue. The RGGI states have already called for mandates that would require 10 percent reductions in greenhouse gas emissions from all power plants across the board for the nine states. Massachusetts calls for 10 percent reductions from six power plants – Salem Harbor, Brayton Point, Canal, Mystic, Mt. Tom and Somerset.

New Hampshire's mandate calls for a 4 percent reduction from three power plants (Schiller, Newington and Merrimack). These presumably will be rolled into the RGGI mandates when they occur in 2007. (*See* www.rggi.org for more information on RGGI, including details on participating states.)

In addition, the state of Washington enacted legislation last year (Sub. House Bill 3141, signed into law on March 31, 2004) that requires fossil-fueled power plants with a generating capacity of 25 megawatts or more to mitigate 20 percent of the carbon dioxide emissions the plant produces over 30 years. This requirement also applies to new power plants seeking site certification and existing plants that increase production of carbon dioxide emissions by 15 percent. Washington's mitigation plan is intended to reduce carbon dioxide emissions by requiring power plants to make payments to organizations or projects that reduce air pollution. The payments required by the legislation are $1.60 per ton of carbon dioxide emissions by the power plants. While power plants are the initial focus of mandated reductions of greenhouse gas emissions, it is only a matter of time before other business sectors are targeted.

In another initiative being watched closely, on July 22, 2002, California's governor signed into law AB 1493 (commonly known as the "Pavley law"), which directs the California Air Resources Board (CARB) to promulgate regulations that achieve the maximum feasible and cost-effective reduction of greenhouse gas emissions from passenger cars and light trucks sold in California. Regulations were developed during 2004 and adopted by CARB on Sept. 24, 2004. In an action filed in December in U.S. District Court in California, the automobile industry sued to block the regulations. *See Central Valley Chrysler-Jeep, Inc. v. Witherspoon*, Civ. No. F-04-6663 REC LJO, filed Dec. 7, 2004 (E.D. Ca.).

Significant from the energy practitioners' perspective is that the Government Accountability Office (GAO) report last July indicated that 19 of 20 major U.S. electric utilities and merchant power generators (whose disclosures were examined by the GAO) issued public disclosures in their filings with the SEC concerning greenhouse gas emissions, but "the amount and type of information disclosed varied widely." *See* "GAO Issues Report on Adequacy of Environmental Disclosure in SEC Filings at a Symposium Sponsored by Senators Corzine, Lieberman and McCain," *Special Committee on Environmental Disclosure Newsletter*, Vol. 2, No. 1, Nov. 2004, published by the ABA Section of Environment, Energy, and Resources. The GAO observed in its report that 1 of the 20 utilities made no mention of greenhouse gas controls in its filing and the other 19 energy companies' disclosures varied but acknowledged the impact of future greenhouse gas regulations could be "material." The 20 companies whose environmental disclosures were scrutinized by GAO are: AES Corporation; Allegheny Energy, Inc.; Ameren Corporation; American Electric Power Company, Inc.; CenterPoint Energy, Inc.; Cinergy Corporation; Dominion Resources, Inc.; DTE Energy Company; Duke Energy Corporation; Edison International; Entergy Corporation; FirstEnergy Corporation; FPL Group, Inc.; Mirant Corporation; PPL Corporation, Inc.; Progress Energy; Reliant Energy, Inc.; The Southern Company; TXU Corporation; and Xcel Energy, Inc.

While reductions of greenhouse gas emissions have not yet been mandated by EPA, socially-responsible investor groups have been pressuring public companies in recent years to disclose in SEC filings the potential financial impact of greenhouse gas emission controls that may be imposed in the future. For example, the Carbon Disclosure Project (CDP) provides a large institutional investor collaboration on the business implications of climate change. CDP serves as a clearinghouse for institutional investors to collectively sign global requests for disclosure of information on greenhouse gas emissions, which CDP sends the largest companies in the world. Hundreds of large corporations already disclose their greenhouse gas emissions through this Web site. *See* www.cdproject.net for more information.

In response to such socially-responsible and faith-based environmental pressures, the SEC recently required Exxon Mobil Corporation to include a climate change resolution in its proxy that would require the company to enhance its disclosure on the impact of greenhouse gas emission reduction initiatives on the company. *See* "Exxon May Face More Heat on Global Warming," *The Wall Street Journal*, March 28, 2005, p. A2. In addition, attorneys general from northeast states commenced litigation in the last year to try to force major sources of greenhouse gas to reduce their emissions. In announcing the litigation last July, Connecticut Attorney General Richard Blumenthal, who was joined in the action by New York City and the states of California, Iowa, New Jersey, New York, Rhode Island, Vermont and Wisconsin, said the litigation was aimed at forcing the nation's five largest emitters of carbon dioxide pollution to force reductions in their emissions of the heat-trapping gas. The suit targets American Electric Power, the Southern Company, the Tennessee Valley Authority, Xcel Energy Inc. and Cinergy Company. (*See State of Conn. et al. v. American Electric Power Co.* et. al., filed July 21, 2004 (S.D.N.Y.)).

Furthermore, in separate litigation brought by 12 states and a diverse group of environmental organizations, the U.S. Court of Appeals for the D.C. Circuit heard oral arguments on April 8, 2005 concerning litigation aimed at compelling EPA to list carbon dioxide as a criteria pollutant for purposes of setting National Ambient Air Quality Standards for carbon dioxide under section 108(a)(1) of the Clean Air Act. *See Commonwealth of Mass. Et al. v. U.S. Environmental Protection Agency*, No. 03-1361 (consolidated with Nos. 03-1362 through 03-1368). Section 108 of the Clean Air Act is codified at 42 USC § 7408. The litigation before the D.C. Circuit also challenges whether EPA is precluded from exercising its Clean Air Act authority by promulgating motor vehicle emission standards and whether EPA unlawfully and arbitrarily refused to act to regulate greenhouse gas emissions under the Clean Air Act.

Given the increasing pressures public companies face on accepting climate change as a problem that cannot be ignored, including local and regional public policy initiatives and the possible outcome in litigation that could mandate federal measures to address greenhouse gas emissions, and given the GAO's report that urges the SEC and EPA to work together to enhance environmental disclosures in public company disclosure filings, energy practitioners and others involved with major carbon dioxide emitters have to recognize that existing SEC disclosure requirements mandate that climate change not be ignored.

There are important voluntary efforts underway at many power plants that impact greenhouse gas emissions and may actually qualify as a public-company asset rather than a liability or expense. For example, a power plant owner that reduces emissions through the installation of scrubber technology or shuts a plant down as part of a settlement for New Source Review litigation may also qualify for substantial carbon dioxide emission reduction credits that may not yet have been monetized. In addition, some companies are already voluntarily reducing their carbon dioxide emissions and participating in the Chicago Climate Exchange, an ad-hoc effort that is organizing to help companies manage and trade emissions credits. Other energy companies with potentially significant carbon dioxide emission exposure have decided to address the problem, with SEC disclosure and approval, through projects that create "carbon offsets" by investments of energy companies in forestation in areas such as the Mississippi Delta.

Among the topics for public companies to take note of is the fact that the SEC indicated to GAO that it is willing to work with EPA for greater public disclosure of environmental risks and liabilities, but said that the information already available in the EPA's Enforcement and Compliance History Online (ECHO) database (*see* www.epa.gov/echo) is "sufficient for the purposes of identifying potential disclosure problems." EPA's Web site provides compliance and enforcement information for more than 800,000 regulated facilities nationwide. What is troubling for many public companies is that the EPA's Website can create the impression that public companies have environmental disclosure obligations, but fails to identify a facility owner's possible defenses, offsetting environmental projects, or the EPA's own willingness to settle claims for less than the amount that would trigger public company disclosure obligations. ECHO is also silent on greenhouse gas issues.

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The Special Committee on Environmental Disclosure's Web site provides both a place for "where to start your research" links and materials to update and explain the background and current developments in environmental disclosure responsibilities. We now have the Primer, a modified and updated "PowerPoint" and a new Links page that provides a brief explanation of what to expect to find at each of the sources/sites listed. Please send us suggestions on additional sources for information on environmental disclosure responsibilities and for tracking this developing field. We'll review them and merge them into the current structure. Similarly, suggestions on material which should be available on the site are greatly appreciated.

The list serve, ENVIRON-ENVIRON_DISCLOSURES@MAIL.ABANET.ORG, is open to members of the Special Committee on Environmental Disclosure, who are interested in engaging in discussion of the problems and issues involved in disclosure and reporting. This list serve is not open to the general public. Section members can join the Special Committee on Environmental Disclosure using the sign-up page at www.abanet.org/environ/committees/signup.html on the Section Web site or by sending a request to the Section's staff.

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