Remarks Of

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"Update on Environmental Disclosure"

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Colorado Springs, CO
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*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners or the staff.

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UPDATE ON ENVIRONMENTAL DISCLOSURE

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I. INTRODUCTION

The importance of environmental disclosure is reflected in the offering documents and periodic reports filed with the Commission every day by issuers located throughout the country. I intend today to provide a brief overview of the environmental disclosure requirements applicable to companies under our federal securities laws.

II. OVERVIEW

A. Growing Awareness of Environmental Issues

As society strives to maintain and improve our environment, costs are imposed that may need to be disclosed to investors under our federal securities laws. Compliance costs associated with regulations restricting development and limiting harmful emissions can have a material affect on the operating expenses of a corporation. Moreover, government regulations and the public's concern for the environment has spawned new industries and, at the same time, rendered "non-environmentally safe" products unfashionable. Perhaps even more significant, however, are environmental laws that can impose large liabilities, particularly with respect to past generators of waste materials. Indeed, the term "environmental due diligence" has acquired a relevance to participants in business transactions that would have been unimagined only a decade ago.

B. Environmental Liability

While both federal and state environmental laws have permeated the consciousness of many businesses, particular industries, such as the pharmaceutical, petroleum, chemical, waste management, and heavy manufacturing segments, among others, must be particularly sensitive to disclosure and accounting issues presented by these laws. For example, the Resource Conservation and Recovery Act ("RCRA") is a "cradle-to-grave" law, affecting most manufacturers, that governs the generation, storage and disposal of hazardous materials. Compliance with the requirements of RCRA has been estimated by the Environmental Protection Agency ("EPA") to cost businesses in excess of $20 billion dollars per year. Similarly, the Clean Water Act and the Clean Air Act, each impose annual compliance costs estimated at more than $30 billion.

Although environmental laws may affect the operating costs of issuers, much of the recent disclosure debate has focused on issuer liability under the Comprehensive Environmental Response, Compensation and Liability Act, known as the "SuperFund" legislation or "CERCLA." Under this legislation, waste transporters and waste generators, as well as past and present owners and operators of hazardous waste sites, may be designated by the EPA as Potentially Responsible Parties ("PRP"). Unlike most fault based liability schemes, past or present owners of a hazardous waste site can be held liable without regard to whether they were responsible for the release of hazardous substances. Moreover, each PRP is "jointly and severely liable" for the cost of cleaning up the entire site. The expanding scope of environmental liability has produced a perhaps unanticipated affect on lenders and even governmental issuers of municipal conduit bonds that, through foreclosure or the offering process, acquire title to a hazardous waste site.

Currently there are some 1200 sites designated on the National Priorities List. Sixteen of these sites are located in Colorado, including some of the largest. Another 30,000 sites nationally have been submitted as candidates for the list. Clean up costs at the average SuperFund site are estimated by some to be approximately $30 million. Moreover, many sites will cost over $100 million. The U.S. Government's Office of Technology Assessment has speculated that over the next forty to fifty years the cost of cleaning up these sites may exceed $500 billion.

The potential for large losses attributable to environmental problems is an important concern that many investors will factor into their investment decision. Indeed, vigorous enforcement of environmental laws likely to occur in the decade to come have made environmental liability a matter of growing prominence for lenders, rating agencies, and acquisition-minded companies, among others. In response to these concerns, there already is a growing reluctance of traditional lenders, as well as trustees for bondholders, to exercise covenants that permit foreclosure on property securing defaulted debt. Moreover, a recent decision holding liable a county that was the nominal owner of property securing industrial development bonds may chill public involvement in this segment of the tax-exempt bond market.[1]

III. PRINCIPLE REPORTING REQUIREMENTS

A. Historical Role of the Commission

As you are aware, the federal securities laws are designed to promote full disclosure of material facts. The general antifraud provisions impose liability on persons who make false statements or omissions of material facts in connection with the purchase or sale of securities. These provisions apply to all securities transactions, including private placements and mergers of many

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1 Stevens, Environmental Liability Rears Head As Latest Terror to Municipal Bond Industry as EPA Pursues Issuers, The Bond Buyer (Nov. 1, 1990) at 3A.

businesses. In certain cases, these general antifraud provisions will require disclosure to investors of the material affect of environmental laws on an issuer.

In addition to complying with the general antifraud provisions of the federal securities laws, issuers registering public offerings of securities under the Securities Act of 1933, or filing periodic reports under the Securities Exchange Act of 1934, must comply with the applicable line-item disclosure requirements under Regulation S-K. With the increase in regulation and environmental liability since the early 1970s, the Commission has attempted to refine the disclosure obligations raised by environmental legislation, and the regulations promulgated thereunder.

In 1971, for example, the Commission first issued a release calling to the attention of issuers their disclosure responsibilities in connection with litigation and compliance costs associated with environmental requirements.[2] A series of subsequent releases over the next two decades have sought to further refine the disclosure

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[2] Securities Act Release No. 5170 (July 19, 1971).

responsibilities of issuers subject to environmental laws. In addition, several prominent enforcement actions instituted by the Commission against issuers that failed to disclose known environmental liabilities and compliance costs have highlighted the importance of accurate disclosure in this area.

B. Regulation S-K

Several provisions of Regulation S-K have particular significance for issuers that are subject to potential environmental liabilities and risks.

1. Item 101 - Description of Business

Item 101, for example, requires an issuer to provide a general description of its business. In addition, it requires specific disclosure of the material affects that compliance with federal, state and local environmental laws may have upon the capital expenditures, earnings, and competitive position of the issuer. An issuer must disclose any material estimated capital expenditures for environmental control facilities. For a specific example, in one of the enforcement actions that I alluded to earlier, United States Steel

Corporation was found to have filed false reports with the Commission because, among other things, it failed to disclose significant costs it estimated would be necessary to bring its operations into compliance with the requirements of both the Clean Air Act and the Clean Water Act.[3]

2. Item 103 - Legal Proceedings

Item 103, for another example, requires that the issuer disclose any material pending legal proceeding, including specified proceedings arising under federal or state environmental laws. Specifically, Item 103 requires disclosure of any administrative or judicial proceeding arising under environmental laws if: (a) such proceeding is material to the business or financial condition of the issuer; (b) such proceeding includes a claim for damages or costs in an amount exceeding 10% of current consolidated assets; or (c) a governmental authority is a party to the proceeding, unless any sanctions are reasonably expected to be less than $100,000. It is important to note that any such proceedings known to be

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[3] In the matter of United States Steel Corporation, Securities Exchange Act Release No. 16223 (Sept. 22, 1979).

contemplated by governmental authorities also are required to be disclosed.

3. Item 303 - Management Discussion and Analysis

Finally, the Management Discussion and Analysis ("MD&A") Item, Item 303, requires management to discuss the issuer's historical results and its future prospects. This forward-looking disclosure is triggered by any "known" trends, demands, commitments, events or uncertainties that are reasonably likely to have a material affect on the issuer's operating results or financial condition. The purpose of the MD&A is to give investors a look at the company through the eyes of management. MD&A and the related financial statements are the heart of an issuer's disclosure document.

In a 1989 interpretive release on MD&A, the Commission stated that an issuer should follow a two-step analysis in determining whether prospective information is required.[4] First, is the "known" trend, demand, commitment, event or uncertainty likely

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[4] Securities Act Release No. 6835 (May 18, 1989).

to come to fruition? If management cannot make a determination that the event "is not reasonably likely to occur," management must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur. Obviously, Item 303 would compel management to disclose the significant implications of environmental laws on future operations of the issuer.

IV. ACCOUNTING AND DISCLOSURE RELATING TO ENVIRONMENT LOSS CONTINGENCIES

Beyond these narrative discussions mandated by Regulation S-K, environmental matters also may have financial implications to issuers. Generally accepted accounting principles, specifically FASB Statement No. 5, indicate that an estimated loss from a loss contingency must be accrued by a charge to income if it is probable that a liability has been incurred and that the amount of the loss can be reasonably estimated.

It is the responsibility of management to accumulate on a timely basis sufficient relevant and reliable information to make a reasonable estimate of environmental liability. If management determines that the amount of the liability is likely to fall within a range and no amount within that range can be determined to be the better estimate, the registrant is required to record the minimum amount of the range.[5] The additional exposure to loss should be disclosed. Changes in estimates of the liability should be reported in the period that they occur.[6] The measurement of the liability should be based upon currently enacted environmental laws and upon existing technology.

The recognition and measurement of the liability must be evaluated separately from the consideration of any expected insurance recoveries. If information available prior to the issuance of the financial statements indicates that it is probable that a environmental liability had been incurred at the date of the financial statements, the amount of the company's liability should be

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[5] FASB Interpretation No. 14.

[6] APB Opinion No. 20.

recognized and recorded, if it can be estimated, regardless of whether the issuer is able to estimate the amount of recoveries from insurance carriers.

V. UNCERTAINTIES

Having described the environmental disclosure requirements, let me also confess that determining the costs of regulatory compliance, and measuring the bottom line effect of potential SuperFund liability in many cases may be difficult. The last decade has witnessed the enactment of a host of legislative and regulatory initiatives in the environmental area where the costs are yet uncertain. Environmental standards, for example, may impose on issuers the requirement to use not merely the best available technology, but technology that does not yet exist and whose costs, in some cases, cannot accurately be measured. Moreover, sudden, and perhaps unpredictable, liability arising from accidental discharges of hazardous waste, including oil spills, may have a profound effect on the balance sheet of a company. Indeed, the law in this area is still evolving. Fundamental interpretive issues affecting lenders, insurers and the role of the bankruptcy laws have yet to be clearly resolved. Moreover, further legislative refinements may add additional requirements and also may reduce the potential exposure of some persons, such as lenders.

Finally, although I can summarize for you the general accounting standards that are applicable to the contingent liabilities of any issuer, FASB No. 5 predates the SuperFund legislation, and there is a paucity of specific guidance to help management and their accountants measure environmental clean-up costs. Moreover, the Financial Accounting Standards Board is unlikely to provide additional guidance on techniques for estimating environmental costs, leaving a whole new industry composed of engineers and other professionals independently to develop such techniques.

VI. ONGOING COMMISSION REVIEW

Although a number of issues have yet to be resolved, it is clear that aggressive enforcement of environmental laws will increase in the 1990s. "Environmental due diligence" is a phrase that will grow increasingly familiar to the attorneys that represent both public issuers and investors. At the Commission, the large dollar amounts of anticipated SuperFund costs has produced increased pressure to monitor the adequacy of issuer disclosure. During the past several years, the Commission's staff has been closely looking at the adequacy of environmental disclosure in connection with its review of filings. When the staff finds material omissions or deficiencies relating to environmental matters, it will request corrective disclosure and, in egregious cases, may refer the matter to the Division of Enforcement.

In order to enhance the disclosure in this area, a dialogue has been developed between the staffs of the Commission and the Environmental Protection Agency. Through an informal understanding, the staff receives from the EPA lists of all companies that have been named as PRPs on hazardous waste sites. Information also is received concerning companies subject to the clean up requirements under RCRA; criminal cases under federal environmental laws; civil proceedings under environmental laws; and companies barred from government contracts under the

Clean Air Act and the Clean Water Act. The staff currently utilizes this information in its review process.

VI. CONCLUSION

Many issuers already are acutely aware of their responsibilities and potential liability under our environmental laws. Regardless of their sophistication, however, it is the responsibility of the business lawyers in this audience to make sure that your clients are familiar with their responsibilities to investors under our federal securities laws.

I expect that in the future many issuers will face significant losses due to environmental liability. Inevitably, the mantra of the plaintiff bar will be "what did you know and when did you know it?" In this rapidly "changing environment," I would challenge each of you to acquaint yourselves with the environmental regulations and to focus seriously on whether your clients have adequately disclosed the short-term and long-term affects of environmental laws on their operations.