Welcome Note from the Chair
Jim Harbell welcomes you to the first edition of this newsletter. [VIEW](#)

Big Business on a Low-Carbon ‘Diet’?
Lindsay A. Wolter, Seyfarth Shaw LLP, Chicago IL
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WELCOME

FROM THE CHAIR

WELCOME TO THE FIRST NEWSLETTER of the Environment, Energy and Natural Resources Committee of the Business Law Section.

While it has been a long time in the planning, we are delighted with the final product. The wide array of talents and interests of our members is represented by such diverse topics as the Chicago Climate Exchange, Unilateral Administrative Orders issued by the EPA, Implications and Recommendations from Environmental Reporting arising out of Sarbanes-Oxley, Stormwater Enforcement and Issues concerning the Federal Data Quality Act. We hope that you will find these articles interesting and useful.

In addition, I want to take the opportunity to encourage you to become more involved in the Committee. This involvement can occur on a number of different levels; including speaking opportunities, future contributions to our on-going newsletter and taking positions on the Executive of the Committee.

Future speaking opportunities include our Hot Topics Program, which will be held in Nashville, TN on April 1-2, 2005 as part of the Business Law Spring Meeting. We annually present hot topics of interest to Energy and Environmental Practitioners and are currently looking for volunteers who wish to participate. As well, we intend on having a program on “all appropriate inquiry”: if that is a specialty topic of interest for you, please let us know. Finally, we have started to think about the ABA Annual Meeting in Chicago: there will be speaking opportunities available there too.

Concerning publishing opportunities, while this is the first edition of our newsletter, we have already started the process for our second edition and look forward to future contributions. If you are thinking about writing something or have recently written something that would be suitable for our publication and wish to submit it, please do so.

As well, please feel free to pass this newsletter to colleagues and friends. We encourage people to join the Committee and would be pleased to discuss the easy steps it takes to complete the membership process.

All the best for the holiday season.

Jim Harbell
Chair, Environmental, Energy and Natural Resources Committee, Business Law Section
Stikeman Elliott LLP

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**Big Business on a Low-Carbon 'Diet'?**

Lindsay A. Wolter  
*Seyfarth Shaw LLP, Chicago IL*

The effects of global warming are becoming increasingly apparent. Worldwide and global carbon dioxide emissions are expected to increase 1.7% annually in the next thirty years. It is no wonder, therefore, that people are taking action. The [Chicago Climate Exchange](http://www.chicagoclimateexchange.com) (CCX), the first North American emissions trading market, offers businesses an innovative solution to this growing problem. Since its doors opened in December of last year, CCX has attracted nearly 70 members and traded just under 1.4 million metric tons of carbon dioxide. And membership benefits don't stop with peace of mind. CCX members are beginning to realize other advantages as well.

On November 18, Russia formally acceded to the Kyoto Protocol, an international agreement setting targets to reduce greenhouse gas emissions in an effort to curb global warming. As a result, the treaty will go into effect on February 16, 2005. The [International Energy Agency](http://www.iea.org), a body committed to advancing the security of energy supplies, economic growth and environmental sustainability, has affirmed the purpose behind the protocol, stating that governments around the world will need to take measures to mitigate the growth in carbon dioxide emissions.

While the United States has not signed the Kyoto Protocol, businesses such as Ford Motor Co., DuPont, American Electric Power and Motorola have joined the exchange and are now counting carbon and building up credits on the bet that domestic regulation is inevitable. The outcome of the recent elections may make regulation less imminent, but the number of legislative proposals in recent years (over 70 bills, resolutions and amendments in the United States Congress since 2001) indicates that some form of regulation related to greenhouse gas will pass relatively soon.

The CCX is a self-regulatory exchange that administers a voluntary, legally binding program that offers its members the chance to reduce and trade greenhouse gas emissions in the most efficient way possible. The CCX trades the equivalent of metric tons of carbon dioxide. In addition to trading carbon dioxide, the CCX also trades methane, nitrous oxide and chlorofluorocarbons (CFC's), the same gases that are being phased out because of their effect on the ozone layer. Emissions of the non-carbon dioxide gases are converted to metric tons of carbon dioxide using values established by the Intergovernmental Panel on Climate Change. The CCX has also announced plans to begin trading sulfur dioxide allowances. This new market, which could attract a new range of members such as coal-powered electric power plants, could launch by years end.

Several types of memberships in the CCX are available. **Members** include corporations, municipalities and other entities that have direct greenhouse gas emissions from facilities in the U.S., Canada or Mexico. **Associate members** include entities that have little or no direct emissions and offset their indirect emissions associated with business related activities, such as universities, religious organizations and even law firms. **Participant members** are offset and liquidity providers. Entities outside North America may also participate as **exchange participants**.

Upon joining the legally binding exchange, members commit to reducing their greenhouse gas emissions by 1% each year over the coming years, resulting in net emissions of 4% by 2006. If a member exceeds its allowance, it must either use the CCX to purchase emissions from another member that has gone under its allowance or purchase offsets. If a member reduces more than 1% of its emissions, it has the option to bank the credits for future use or sell them to other CCX members. Consequently, the market system provides financial incentive to stay within or below a member's allowances.
Carbon trading not only boosts the environmental reputation of its members, but the practice may even prove to be a wise business decision for its members. In addition to being ahead of the curve if and when emissions regulations are promulgated in the United States, several members have experienced or expect to experience monetary benefits. One such member, British Petroleum, announced in 2000 a commitment to reduce its carbon emissions to 10% below its 1990 levels by 2010. By 2002, BP had achieved its goal and attributes $650 million in savings to its new energy efficiency. Another member, STMicroelectronics, plans to have zero net emissions by 2010 with a 40-fold increase in production from its 1990 rates. By the time this is accomplished, the company expects to have saved almost $1 billion.

The CCX has proven to be enormously successful. With 7,000 to 10,000 tons of carbon dioxide being traded daily, the addition of sulfur dioxide trading and an increasing membership, the CCX is expected to continue to grow.

The CCX is actively seeking members, including law firms, nationwide. Interested parties should visit CCX's website, www.chicagoclimateexchange.com for more information regarding membership. For more information about the effects of global warming on businesses, visit the Seyfarth Shaw LLP website and read our October 2004 bulletin, How Global Warming Developments Affect Business.

EPA Unilateral Administrative Orders are Unconstitutional!
Is the Star Chamber Really Dead?

Bill S. Forcade
Jenner & Block LLP, Chicago IL

Environmental statutes governing air pollution, water pollution, hazardous waste disposal and Superfund cleanups contain provisions that allow EPA to issue a Unilateral Administrative Order (UAO). The UAO will require the defendant to take specific, costly actions with no procedural protections and no appeal procedure. Recent judicial opinions question the constitutionality of this process. Until the issue is finally resolved by the Supreme Court, EPA may be more likely to issue such orders. Anyone currently involved in an environmental dispute with EPA should consider the implications of this issue.

EPA may issue a UAO based on any information, whenever EPA concludes that an environmental violation or remediation obligation exists. EPA believes the defendant has no right to examine the information EPA relied upon, no right to question the witnesses or documents, no right to a hearing, no right to provide meaningful opposing testimony or documents, and no right to judicial review. EPA sees UAO rights as similar to the rights afforded sixteenth-century English defendants in the Court of Star Chamber.

The UAO usually commands the defendant to take specific expensive corrective actions. The defendant may be held civilly or criminally liable for violating any command in the UAO, independent of whether they are liable for the underlying environment claim. Defendants who disagree with the UAO face the difficult choice of complying with an expensive, unwarranted EPA command or risking substantial civil and criminal liability simply for defiance of the UAO.

The UAO has been an important enforcement tool for EPA. Once EPA determines that a violation or remediation obligation exists, it traditionally will issue a Notice of Violation, a Finding of Violation, or a Notice of Liability letter. Many cases will be negotiated and resolved at this stage. However, these preliminary determinations are not final EPA action subject to judicial review and they do not carry a specific legal consequence independent of the underlying claim. Where the defendant disagrees with EPA's claim or is recalcitrant in negotiations, EPA wants a bigger stick to encourage defendants to take the requested action. The UAO is that bigger stick,
because it purports to carry significant civil and criminal liability simply for disregarding the UAO.

An equally important factor is information disclosure. EPA traditionally does not disclose why and how it believes the defendant has an environmental obligation during preliminary negotiations, including negotiations under the UAO. Rather, EPA requests the defendant to provide persuasive evidence that a violation has not occurred, the prove your innocence approach. For simple issues this may not be significant. For more complex issues it may be vitally important. Defendants have received a preliminary determination and a UAO while having no idea how EPA calculated, measured or otherwise determined that a violation occurred. This makes it difficult to prove your innocence. Once the matter proceeds to litigation the traditional approach prevails: EPA information is subject to discovery requests and EPA carries the burden of proving a violation.

Securing judicial review of a UAO has been problematic. Facial constitutional challenges have traditionally been denied. When defendants raise a constitutional challenge to a specific UAO at the time of issuance, EPA argues the somewhat incongruous position that the UAO is not a final reviewable EPA action, but that direct legal consequences flow from a violation of the UAO. Defendants who choose to withhold their constitutional challenge until EPA seeks to judicially enforce the UAO may have waived that challenge by failing to raise it when the UAO was issued.

Recently, judicial support has grown for the idea that a defendant may present Constitutional challenges to the UAO process, and perhaps win. The District of Columbia Court of Appeals found that defendants may present a facial challenge to the constitutionality of the UAO process under CERCLA. The Sixth Circuit held that a Clean Air Act UAO must be a final reviewable EPA decision, as the concurrence noted, to avoid a process, unenforceable as violative of constitutional due process. In TVA v. EPA, the Eleventh Circuit found the Clean Air Act language regarding the UAO process repugnant to the Due Process Clause of the Fifth Amendment. The United States Supreme Court denied certiorari.

The growing judicial concern about the constitutionality of the UAO process places EPA in a difficult position. EPA cannot secure congressional amendments for all of the underlying environmental statutes in a timely manner. EPA will not simply ignore a powerful statutory enforcement tool based on limited Appellate Court opposition. EPA's best course may be to issue many UAOs in other circuits hoping for an appeal and judicial opinion rejecting the constitutional claims. The likelihood of future Supreme Court review is increased if the constitutional issue has been developed more fully in the lower courts and there is a conflict in the circuits.

Anyone receiving a UAO now faces a procedural morass. When TVA objected to the UAO, EPA created an ad hoc scheme in which the Environmental Appeals Board was delegated the task of reconsidering the UAO by informally adjudicating the issue of liability. Since TVA rejected that approach, EPA's procedural reaction to any future UAO challenge is uncertain. This poses significant procedural pitfalls for the unwary defendant.

The likelihood that a current conflict with EPA will result in a UAO is significant. EPA regional internet web sites show a great deal of UAO activity since the TVA decision. Where defendants believe a UAO is unreasonable, they must institute a constitutional challenge or accept the risk of substantial liability for violating the UAO. Few defendants will be thrilled with the litigation costs associated with a Supreme Court constitutional challenge over what is essentially an environmental dispute.

FOOTNOTES

Administrative Reform Needed to Ensure Federal Agency Data Quality

Gerald H. Yamada
O'Connor & Hannan LLP, Washington DC

In May 2004, the Office of Management and Budget issued its first annual report to the Congress describing agency implementation of the Federal Data Quality Act (FDQA), commonly referred to as the Information Quality Act. The OMB report addressed eight perceptions associated with FDQA and summarized agency responses to Requests for Correction (RFC). In July 2004, OMB Watch issued its critique of the OMB report, opining that the OMB report is "seriously flawed: data is inaccurate, information is misleading, and overall is highly biased."

FDQA was enacted as part of the Treasury and General Government Appropriations Act, 2001, and in furtherance of the Paperwork Reduction Act. Section 515, Public Law 106-554. FDQA directed that OMB and federal agencies issue guidelines for "ensuring and maximizing the quality, objectivity, utility, and integrity of information (including statistical information) disseminated by Federal agencies." FDQA also directed federal agencies to "establish administrative mechanism allowing affected persons to seek and obtain correction of information maintained and disseminated by the agency that does not comply with the [OMB] guidelines." FDQA Section 515 (b) (2)(A) and (B). OMB's final guidelines were published in the Federal Register on February 22, 2002. 2

Whether FDQA serves a useful public purpose can be examined by evaluating agency responses to RFCs as reported in the OMB report. The three agencies that received the largest number of RFCs during the FY 2003 reporting period were the Federal Emergency Management Agency (FEMA) (24,433 RFCs); Department of Transportation (DOT) (98); and Treasury (19). OMB reported that a large volume of FEMA RFCs were for map corrections and a large volume of DOT RFCs were for incorrect reporting of individual accidents. The Treasury RFCs were all related to updating interest rates for bonds. Because these agency RFCs were limited to a very narrow range of matters, they were not helpful in assessing the usefulness of the FDQA.

The next two agencies receiving the highest number of RFCs were the Department of Labor (DOL) and Environmental Protection Agency (EPA). DOL received 18 RFCs and EPA received 13 RFCs. The DOL and EPA RFCs were for a broad range of agency matters, and the DOL and EPA responses showed a stark contrast between agencies' ability to respond to RFCs depending upon the type of federal action involved.

Out of the 18 RFCs that DOL received, DOL made corrections in 13 cases within the 60-90 day correction period. DOL committed to making corrections in 2 other cases but the corrections were delayed because a Federal Register notice was needed or a technical amendment had to be issued. In 3 cases, DOL determined that no correction was needed. No appeals were requested in the 3 cases where no corrections were made.

Out of 13 RFCs that EPA received, EPA made no correction within the 60-90 day correction period. In 6 cases, EPA stated that the RFCs would be considered as a comment to on-going or future rulemaking or update to an EPA publication. In another instance, EPA referred the RFC to the agency that "disseminated a report to which EPA appears to have substantially contributed the technical data that was the subject of the RFC."

DOL and EPA experiences with FDQA support three observations. First, the DOL experience shows that FDQA can serve a useful public purpose in providing an administrative mechanism to seek corrections to agency information within 60-90 days.

Second, 9 DOL and EPA RFCs show that FDQA corrections involving regulations, guidelines, manuals, reports, etc. cannot be addressed within a 60-90 day time frame. For the EPA RFCs, the reason is probably because environmental matters are complex and determinations as to the quality, objectivity, utility, and integrity of such
information cannot be easily made. This is likely to be a problem with all regulatory agencies.

Third, OMB and federal agencies appear to have interpreted their FDQA responsibilities to be triggered only when a RFC is filed. This is in contradiction of the language of FDQA that places an affirmative responsibility on federal agencies for "ensuring and maximizing the quality, objectivity, utility, and integrity of information (including statistical information) disseminated by Federal agencies." FDQA does not require that a RFC must be filed before a federal agency determines whether its information meets FDQA standards.

These observations support the problematic conclusion that FDQA has not been implemented to deal with complex regulatory matters in a timely manner. A solution to this problem should start with agency rulemakings by increasing the transparency of agency information used in rulemakings.

An approach to increasing transparency for rulemakings can be easily done with a minimal administrative reform in the OMB guidelines. Currently, the OMB guidelines do not provide a uniform administrative review process but allow each agency to establish its own administrative procedures. As a result, at the time a rulemaking is proposed, federal agencies do not have to assure the public that the agencies have reviewed information used in the rulemaking to ensure that the information meets FDQA standards.

The suggested administrative reform is to modify the OMB guidelines so that federal agencies (1) implement internal procedures to ensure and maximize the quality, objectivity, utility, and integrity of information that the agency is using in its proposed rulemaking by conducting a FDQA review before proposal, (2) provide the public with a summary of the FDQA review and a statement as part of the rulemaking record that the information used in the rulemaking meets or does not meet FDQA standards, and (3) inform affected persons of their right to submit a RFC.

This modification would not create different procedures or policies since federal agencies already conduct a number of statutory and Executive Order reviews. One of the statutory reviews routinely conducted is for the Paperwork Reduction Act. The suggested reform is a reasonable extension of the Paperwork Reduction Act review since Congress enacted the FDQA in furtherance of the Paperwork Reduction Act. See FDQA, Section 515. FDQA reviews can be simply added to the Paperwork Reduction Act discussions in the preambles to proposed and final rules. If this modification is adopted for rulemaking, then agencies can adopt similar procedures for their guidelines, manuals, reports, or other complex federal actions.

FOOTNOTES
1] This article was also published by the Washington Legal Foundation as a Legal Opinion Letter, Vol. 14 No. 21, October 1, 2004.


Stormwater Enforcement is on the Rise: Lessons Learned from Wal-Mart

Amy C. Erickson
National Association of Home Builders, Washington DC

Earlier this year, the U.S. Environmental Protection Agency (EPA) announced that it, along with a number of states, had reached a settlement agreement with Wal-Mart Stores, Inc. concerning its alleged violation of the Clean Water Act’s stormwater permitting requirements. Wal-Mart was ordered to pay $3.1 million, spend $250,000 on a Supplemental Environmental Project, and implement a comprehensive personnel and paper system devoted to ensuring compliance with the stormwater rules and ensuring that all contractors employed by Wal-Mart abide by the stormwater permit requirements.
The Clean Water Act, Section 402(p) requires EPA to regulate stormwater discharges from municipal and industrial sources, including construction activities. EPA's stormwater permitting program for discharges from construction sites requires operators of sites that disturb one or more acres of land (or less than one acre in a "common plan of development or sale") to obtain a permit from either EPA or the state. The most common way to satisfy the permitting requirement is to obtain coverage under a construction general permit. EPA and most state permitting agencies require the applicant to prepare a Stormwater Pollution Prevention Plan and file a Notice of Intent. The site operator must then implement the Stormwater Pollution Prevention Plan during construction, conduct inspections and keep records of these inspections, until the active construction ceases and the site meets the jurisdiction's definition of "final stabilization." Once the site is stabilized, the construction site operator files a Notice of Termination with EPA or the state permitting agency.

What does the Wal-Mart Consent Decree have to do with the rest of the construction industry? After all, this was Wal-Mart's second consent decree, after a previous investigation into Wal-Mart's stormwater control practices ended in a $1 million dollar settlement with EPA and several states. What is different about this second consent decree and why this settlement has widespread applicability to the construction industry and its clients is EPA's 2003 Stormwater Compliance and Enforcement Strategy.

The "Wal-Mart Consent Decree" signaled the beginning of a new formula for enforcement of the stormwater permitting program. It is the first "high profile" settlement under EPA's Stormwater Compliance & Enforcement Strategy. The Strategy flows from EPA's decision in 2000 to declare enforcement of the stormwater program a national enforcement priority. The stormwater permitting program has been plagued with implementation problems and reportedly low levels of compliance since its inception. The Agency claims that only 1/3 of all construction sites that need a stormwater permit are actually covered.

EPA presents two enforcement models in the Stormwater Enforcement Strategy: the "Sector Based Approach to Compliance and Enforcement for Large Scale Construction Activities" and the "Watershed Approach for Industrial Facilities in Impaired Watersheds." Wal-Mart and many large builders, developers, contractors and their customers fit into the first model. The Sector Based Approach focuses enforcement efforts on two categories of construction companies: commercial "big-box" retail stores (like Wal-Mart) and large national, residential construction companies. EPA's Sector Based Approach consists of 3 main steps:

1. Identify and prioritize companies for investigation (using inspection data and compliance history information to make the determination, in addition to the size of the company);

2. Send Section 308 letters (referring to Section 308 of the Clean Water Act, which grants EPA the authority to conduct inspections and view records) to the corporate offices of each of the large national construction firms identified for investigation. The purpose of the 308 letter is to obtain information on the firms' compliance history and to look for potential examples of noncompliance.

3. After reviewing the information, decide whether to pursue an enforcement action. EPA can issue Notice of Violation letters, assess an administrative penalty, or pursue a civil penalty and refer the case to the Department of Justice.

EPA's stormwater enforcement activities are not limited to large volume builders, however. EPA implemented the stormwater permitting program in two phases the first phase became effective in 1992, and required operators of construction sites that discharge stormwater and disturb five or more acres, or less than five acres within a common plan of development or sale, to be permitted, either under a general permit or an individual permit. In 2003, Phase II became effective, and brought construction sites disturbing one or more acres, or less than one acre in a common plan, under the jurisdiction of the permitting program.
In the Strategy, EPA distinguishes between the large construction sites (5 or more acres known also as "Phase I" sites) and the smaller construction sites (1-5 acres, often called "Phase II" sites). EPA states in the Stormwater Enforcement Strategy that it will focus compliance efforts on those new to the stormwater program. EPA will emphasize compliance assistance starting from when the Phase II program requirements came into effect in 2003 through 2005. Starting in 2005, however, EPA will begin initiating enforcement actions against permit holders in the Phase II size category.

With its use of the pilot Expedited Settlement Offer, EPA has developed a vehicle for targeting smaller, first time violators of the stormwater rules. The Expedited Settlement Offer is available to those whose sites are less than 50 acres in size, who are first-time offenders with violations not exceeding $15,000 and with no serious allegations of environmental harm. The goals of the Expedited Settlement Offer pilot program are to quickly gain compliance with the stormwater rules and to reduce costs associated with delays and the settlement process. From early reports, it appears that the Expedited Settlement Offer has shortened the time period between inspection and penalty assessment. The penalties associated with the Expedited Settlement Offer range from $500 to $15,000, with penalty assessments listed in EPA press releases ranging from $2,500 to $7,000. While these amounts are far less than the $3.1 million paid by Wal-Mart, $7,000 can feel like $3.1 million to many small businesses. Another concern plaguing the pilot program is that the settlement package sent to violators has also created the impression in some recipients that they cannot discuss the Expedited Settlement Offer with EPA without being cast into full-blown settlement talks where fines rise to $32,500 per violation per day. The pilot program just recently passed its first year of implementation, and it is likely that many of these concerns will be addressed in the evaluation and revision of the program.

What was once a topic for local planning officials and engineers is now a legal problem that requires construction lawyers and their clients to familiarize themselves with EPA's stormwater program. Compliance with all components of the stormwater permitting program is a critical, although frequently daunting, task that must be performed by nearly every builder, contractor, and developer in the country. The penalty formula presented in the Wal-Mart consent decree—a monetary fine, a Supplemental Environmental Project and the imposition of a complex recordkeeping system (with the personnel to implement and enforce the system) should be expected to be included in future civil penalty settlement offers. And as penalty amounts rise, so too does the potential for litigation.

Click here for more information on EPA's NPDES permitting program for stormwater discharges from construction activities.

Amy Ericksen is an attorney and environmental policy analyst with the National Association of Home Builders.

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*Environmental Disclosure Requirements*

http://apps.americanbar.org/buslaw/committees/CL400000pub/newsletter/200412/home.html
Disclosure obligations for environmental liabilities are not a new development. The following rules and guidelines for financial reporting of environmental liabilities have been in existence since the 1970s:

**SEC Regulation S-K, Item 101:** Description of Company's Business requires a company to identify any material effects that compliance with existing or anticipated environmental laws and regulations may have upon the capital expenditures, earnings and competitive position of the company and its subsidiaries.\(^2\)

**SEC Regulation S-K, Item 103:** Legal Proceedings requires disclosure of "any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party." Registrants are also required to disclose any matter, irrespective of materiality, if it involves a claim that exceeds ten percent of the registrant's current assets or if a governmental authority is a party to a proceeding that involves a potential monetary sanction, unless the registrant reasonably believes that such proceeding will not result in a monetary sanctions exceeding $100,000. Item 103 instructs companies to apply the standard for materiality separately to each proceeding or set of proceedings presenting "in large degree the same legal and factual issues as other proceedings pending or known to be contemplated".\(^3\)

**SEC Regulation S-K, Item 303:** Management Discussion & Analysis requires management to discuss and analyze the company's financial condition and results of operations. This includes a discussion of business trends or events likely to have a material effect on the company's financial condition. Environmental issues such as greenhouse gas emission reduction requirements, proposed hazardous substance restrictions or other regulatory constraints could qualify as "trends or events" that should be included in financial reports.\(^4\)

**Statement of Financial Accounting Standards No. 5 (FAS 5)** addresses accounting and reporting of loss contingencies such as projected costs for site clean-up or remediation. Under FAS 5, loss contingencies must be accrued only if (i) it is "probable" that an asset has been impaired or that a liability has been incurred, and (ii) the amount of the loss can be "reasonably estimated."

**SEC Staff Accounting Bulletin 92 (SAB 92)** provides guidance on accounting and disclosure obligations for contingent environmental liabilities and expands on FAS 5. SAB 92 provides that the minimum loss estimate in a range can be used for accrual purposes if no amount within a range is a better estimate than any other amount within the range.

**American Institute of Certified Public Accountants Statement of Position 96-1 (SOP 96-1)** provides guidance for recognizing, quantifying, and disclosing environmental liabilities, including benchmarks for making materiality determinations at various stages of assessment and remediation.

Existing environmental disclosure requirements turn on whether these liabilities are deemed to be "material." While the exact parameters for materiality have not been defined, SEC Guidance and a number of U.S. Supreme Court decisions have concluded that a matter is material if:

There is a substantial likelihood that a reasonable person would consider it important. An auditor must consider both "quantitative" and "qualitative" factors in assessing a matter's materiality.\(^5\)
The judgment of such person relying on a particular item would have been changed or influenced by the inclusion or correction of the item; or

There is a substantial likelihood that a fact would be viewed by a reasonable investor as significantly altering the "total mix" of the information made available.

**Sarbanes-Oxley: Implications and Recommendations for Environmental Reporting**

Sarbanes-Oxley established a system of increased responsibility and accountability for public company financial disclosures, which will affect the way that environmental information is collected, evaluated and reported. Of particular relevance for environmental reporting, the Section 404 requirement that a publicly held company have in place an "internal control program" to assure the accuracy of its financial reporting and disclosure and that its CEO and CFO certify under Section 302(a) to the effectiveness of the controls, as well as the accuracy of the financial statements, underscores the importance of good communications among the environmental, business and financial managers and the lawyers.

In designing its internal control program, a company may be able to build on programs already in place. For example, many companies already have environmental auditing or similar compliance-assurance programs, which can be used to identify current and anticipated environmental compliance costs and liabilities that must be evaluated for SEC reporting. More and more companies are now using environmental management systems, including self-assessments and management review, to track and improve environmental performance. Increasingly, companies design information flow systems to include the type of environmental information that will need to be disclosed to auditors and, potentially, to the SEC.

A number of companies developed or modified their information-gathering systems in response to the seminal 1996 *Caremark* decision, which held that corporations owe their shareholders a duty to put programs in place to ensure timely flow of information concerning operations, risks, potential liabilities and matters of similar import to the business managers and directors so as to enable responsible business decisions to be made. Even before *Caremark*, a number of companies had internal "compliance certification" programs, under which plant managers would certify to the next tier of management that all of the facilities and activities under their jurisdiction were in compliance with all applicable laws, except as specifically disclosed. These certifications then would be made up the line by the regional managers, ultimately reaching the CEO. This type of program is often supported by the legal department to help maintain a high level of compliance and can be a key component in the development and evaluation of environmental information for SEC reporting.

To the extent that programs such as these do not exist, or lack adequate comprehensiveness and rigor, the environmental lawyer can play a vital role with respect to design and effective implementation. Good models for environmental management systems include the ISO-14001 EMS standards and the companion ISO-14004 guidelines, as well as EPA's "Compliance-Focused Environmental Management System (COSO)." Enforce Agreement’s Guidance (revised August 2002).

The one framework which has been specifically recognized by the SEC for an internal control system under Sarbanes-Oxley is *Internal Control* Integrated Framework, developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In September 2004, COSO released *Enterprise Risk Management* Integrated Framework, which is expected to become a commonly accepted model for discussing and evaluating a company's risk management processes. The components of the new framework include: internal environment description, objective setting, event identification, risk assessment, risk response, control activities, information and communication, and monitoring. This principles-based framework is designed to enable companies and other organizations to identify all the aspects that should be present in an enterprise risk program and how they should be implemented.
Features that practitioners should ensure are addressed in any information-gathering system for SEC reporting include:

A process for gathering information on capital and operating costs of equipment, systems or processes expended or budgeted for compliance with any environmental legal requirements and other policy measures the company implements to protect the environment or to minimize the risks arising from environmental matters.

Guidance on an internal reporting threshold for materiality. Based on the size and nature of the business, it may be possible to determine an approximate dollar amount for disclosure to the SEC. But for internal information gathering, the number must be far lower because items of a similar nature must be aggregated, and doubts should be resolved in favor of inclusion.

Guidance on including items where the liability is likely, but the actual amount is uncertain (see FAS 5 and SAB 92 for guidance on loss contingencies and contingent environmental liabilities; ASTM's "Standard Guide For Disclosure of Environmental Liabilities" (ASTM E2173-01) and ASTM's "Standard Guide For Estimating Monetary Costs and Liabilities For Environmental Matters" (ASTM E2137-01).

Requests for environmental information should be integrated with, or at least harmonized with, the company's overall information-gathering procedures for SEC reporting.

Requests for information should be made early enough to allow time to resolve uncertainties and address information gaps.

A multi-disciplinary team should be established to review and evaluate the data. Ideally, this team should include the legal department, the budgeting and accounting offices and risk managers. Senior business managers should be available to the team as needed.

Although the full implications of Sarbanes-Oxley on environmental reporting have yet to be realized, companies must be able to demonstrate they have established reliable, validated protocols for identifying, tracking, analyzing, and judging the potential materiality of existing and contingent environmental liabilities, and that they have adhered to the letter and the spirit of Sarbanes-Oxley in their financial disclosures.

FOOTNOTES
1] 15 U.S.C. 7201 et seq
2] 17 CFR 229.101
3] 17 CFR 229.103
4] 17 CFR 229.303

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