MESSAGE FROM THE CHAIR
Kevin J. Klesh

It has been an exciting year for the Environmental Disclosure Committee as emerging issues on the water resources, hydraulic fracturing, and sustainability fronts have brought environmental disclosure into the spotlight. In September, we sponsored a Quick Teleconference on water disclosure. The following month, we coordinated a program on environmental disclosures related to hydraulic fracturing at the 20th Section Fall Meeting in Austin, Texas. Just a few weeks ago, we hosted an engaging committee call discussion about sustainability disclosure standards that are being developed and proposed for public filers, particularly by the recently formed Sustainability Accounting Standards Board (SASB). I would like to express my sincere thanks to our Programs vice chair, Rebecca Leamon, in coordinating these excellent and informative events.

On the topic of sustainability, our first article by Betty Moy Huber provides an overview of growing investor and public interest in environmental, social, and governance (ESG) disclosure that has led various groups to propose ESG disclosure standards for public filers, certain stock exchanges to express support for sustainability disclosure listing standards, and investors to launch proxies seeking more robust environmental disclosure. Our second article by Peter Gioello analyzes the origin and original intent of the requirement under Item 103 of Regulation S-K to disclose environmental government sanctions greater than $100,000 and explores whether such is still a helpful tool for investors or an outdated relic that requires revision. Finally, our third article by Kurt Herman examines environmental response cost estimation under CERCLA and the assistance offered by environmental accounting and disclosure guidance in analyzing and determining such costs. I would like to express my sincere appreciation to the authors and our vice chair for Newsletters, David Roth, on their hard work in making this newsletter possible.

I hope that you enjoy these insightful articles and the continuing opportunities for discussion that the committee offers regarding emerging trends in environmental disclosure. The committee always welcomes your input on any particular topics you would like to see covered going forward and your participation in the ongoing dialogue about the future of environmental disclosure.
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David A. Roth, Editor

In this issue:

Message from the Chair
Kevin J. Klesh ........................................ 1

Sustainability Disclosure in Public Company Annual Reports and Proxy Statements—State of Play and the Future
Betty Moy Huber..................................... 3

Looking Back at the Origin and Purpose of the $100,000 Environmental Disclosure Threshold Under Regulation S-K and Its Relevance Today
Peter J. Gioello, Jr. ................................. 6

Bridging the GAAP: Turning to Environmental Accounting Guidance to Interpret What Constitutes a CERCLA Response Cost
Kurt Herman, M. Eng., P.G. ...................... 12

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Introduction

Public interest groups and socially responsive investors have been for decades pushing for increased sustainability (also known as environmental, social, and governance or ESG) disclosure by public companies. Surprisingly, many mainstream investors (in the United States and worldwide) are now joining the call for better and more uniform sustainability disclosure, arguing that such disclosure is required for them to be able to make informed investment decisions. Some global stock exchanges have also thrown their support behind this campaign and the U.S. Securities and Exchange Commission (SEC) appears to be listening, too.

Shareholder activism, specifically submitting shareholder proposals to U.S. public companies for inclusion in such companies’ annual proxy statements on form DEF 14A was one of the original tools of public interest groups to compel companies to disclose and consider sustainability matters. This strategy had manifold benefits to the public interest groups, including forcing companies to focus on their sustainability issues, generating helpful written statements from the SEC in response to company no-further action letter requests to exclude these proposals from their proxies, and gaining media attention for the cause. This activism proved to be a fertile training ground for the interest groups who continue to submit various sustainability shareholder proposals, but are now focusing their sights on the next frontier, i.e., binding sustainability disclosure requirements.

This article discusses the key binding ESG disclosure frameworks currently being proposed, the groups behind them, and why they should be of interest to all public companies and those who advise them. The article then discusses some noteworthy sustainability shareholder proposals submitted in the 2012 and 2013 proxy seasons and some important SEC decisions made in connection therewith.

Global ESG Disclosure Initiatives

Various ESG interest groups, such as the newly formed Sustainability Accounting Standards Board (SASB), as well as the Investor Network on Climate Risk (INCR), an affiliate of Ceres, a long-standing leader in sustainability issues, have been working in parallel with regulators to adopt binding standards by which publicly traded companies would be required to disclose their ESG issues. ESG issues include (1) environmental issues (such as climate change and natural resource scarcity issues); (2) social issues (such as human rights, diversity, and stakeholder relationship issues); and (3) governance issues (such as management structure and executive compensation). As stated by the California Public Employees Retirement System (CalPERS), the largest public pension fund in the United States with approximately $261 billion in assets and a standards council member of SASB, if CalPERS were to close its doors today, it would still be required to make payments for the next 80 years, and investments in companies that focus solely on short-term profits may not do the trick. Seen in this light, ESG disclosure has as much to do with economic sustainability as it does with environmental or social sustainability. Importantly, Meyer “Sandy” Frucher, the vice chairman of the NASDAQ OMX Group (NASDAQ OMX), stated publicly in April 2013 that “nonfinancial [ESG disclosure] is essential for investors to make a decision” and that there is a need for a “uniform standard.” He noted that the New York Stock Exchange has joined NASDAQ OMX in this goal and together will advance ESG disclosure requirements before the World Federation of Exchanges in October 2013. In addition, companies like Bloomberg have begun to publish corporate ESG data for over 5000 companies, with more than 120 ESG indicators on display.

INCR

In April 2013, the INCR Listing Standards Drafting Committee released its consultation paper titled “Proposed Sustainability Disclosure Listing Standard...
NASDAQ OMX, among other exchanges, has publicly expressed support for INCR’s initiative and, according to INCR, this consultation paper is in response to such exchange interest, and aims to develop “a unified sustainability disclosure listing standard that could be adopted by all stock exchanges,” as a prerequisite to being listed. The consultation paper’s main requirement is for all listed companies to disclose sustainability risks pursuant to the Global Reporting Initiative (known as GRI). GRI, as most readers are aware, would require significant disclosure of sustainability issues above and beyond what is ordinarily deemed material under U.S. securities law. While ambitious, it is unlikely that NASDAQ OMX will adopt these standards unless its competitor exchanges do so, to avoid “forum shopping” by public companies. The consultation paper’s public comment period ended on May 1, 2013.

INCR’s Listing Standards Drafting Committee includes such prominent entities as Rockefeller & Co, BlackRock, AFL-CIO Office of Investment, as well as ESG institutional investors such as Boston Common Asset Management (see “ESG Proxy Matters,” below) and Domini Social Investments (which readers may recall as being one of the entities, with Ceres, strategic in convincing the SEC to adopt its February 2010 “Commission Guidance Regarding Disclosure Related to Climate Change”).

SASB
Relatedly, but in contrast, SASB (which despite its name is not affiliated with the Financial Accounting Standards Board (FASB) or the International Accounting Standards Board (IASB)) is also creating and disseminating sustainability accounting standards pursuant to which U.S. public companies and foreign private issuers must disclose “material” (as defined by the U.S. securities laws) sustainability issues in the Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) sections of their annual reports on forms 10-K and 20-F, respectively. Through this disclosure, SASB’s goal is to enable peer-to-peer benchmarking of sustainability issues. A standards setting organization accredited by the American National Standards Institute, SASB meets with the SEC chairman as well as the director of the SEC’s Division for Corporation Finance on a quarterly basis to brief the SEC on its progress. At one such meeting, the SEC apparently informed SASB that it would not consider a line item requirement for ESG disclosure because what may be “material” varies from sector to sector. As a result, SASB has begun drafting through multi-stakeholder industry working groups and expects to adopt, by the second quarter 2015, ESG disclosure standards for 88 different industries in the following ten sectors: (1) health care; (2) financials; (3) technology and communication; (4) non-renewable resources; (5) transportation; (6) services; (vii) resource transformation; (8) consumption; (9) renewable resources and alternative energy; and (10) infrastructure. Companies in these ten sectors are welcome (and may wish) to join SASB’s industry working groups, other than the health care and financials working groups that are now closed, so that they can have a voice in the standards setting process.

Once released, SASB will request that the SEC adopt these standards, likely in the form of SEC interpretive guidance similar to the 2010 SEC climate change disclosure guidance referred to above. It should be noted that as the current SEC chair’s term is set to expire in June 2014, it remains to be seen whether the then-SEC chair (which could continue to be Mary Jo White if Congress votes to extend her term as President Obama has requested) and the newly appointed director of the SEC’s Division for Corporation Finance, Keith Higgins, will be amenable to adopting these various standards.

SASB is working with the Public Company Accounting Oversight Board to devise standards for external auditing or other assurance of sustainability disclosure so that this disclosure could ultimately appear and be audited as part of a company’s audited financial statements (in addition to or ultimately in lieu of MD&A).

SASB, like the INCR, is backed by numerous high-profile individuals. Its advisory council is comprised of over 100 individuals affiliated with various banks, institutional investors, academics, public interest groups and other interested professionals, such as BlackRock,

**Other Initiatives**
In addition to INCR and SASB’s efforts, there are a number of other global ESG disclosure initiatives including:

- The CDP (formerly known as the Carbon Disclosure Project);
- Global Initiative for Sustainability Ratings;
- The International Integrated Reporting Council (IIRC);
- The Prince’s Accounting for Sustainability Project (A4S);
- Project Delphi in Europe;
- United Nations Environment Programme Finance Initiative (UNEP FI); and
- United Nations Global Compact (UNGC) (via its Communication and its Progress reporting requirements).

These standards vary in focus and substance, but are further evidence of the growing interest in ESG disclosure (as well as the current lack of uniformity for the same).

**ESG Proxy Matters**
The public interest groups advocating for sustainability matters form a community with various, and sometimes dizzying, overlap and cross-pollination. Their grassroots efforts and ability to organize and share information can be best seen in their long-standing work in shareholder activism, particularly in requiring public companies to disclose in their annual proxy statements filed with the SEC ESG shareholder proposals. Their success has been so widespread that the respected ISS, a leading organization that provides assistance and research to institutional shareholders, has instructed shareholders generally to vote “for” greenhouse gas and climate change shareholder resolutions in its January 2013 U.S. Proxy Voting Summary Guidelines. Indeed, Ceres refers to these shareholder activists as their “investor network.” Their success in sustainability shareholder proposals was quite likely the precursor to the above-described efforts for more formal and systematic disclosure requirements across the board.

**Climate Change as a Significant Policy Issue**
There were two recent ESG proposals worthy of discussion because of the SEC’s response. First, arguably the most talked about sustainability proposal this proxy season was Boston Common Asset Management’s proposal to PNC Financial Services Group Inc., a leading U.S. financial institution. The proposal would have required the bank’s board of directors to report to shareholders on the bank’s “assessment of greenhouse gas emissions resulting from its lending portfolio and its exposure to climate change risk in its lending, investing and financing activities.” Boston Common, who submitted this proposal on behalf of itself and four other shareholders (including Domini Social Investments), collaborated with Ceres and others to submit this proposal. PNC appealed to the SEC for a no-further action letter to exclude such proposal from its 2013 proxy, but the SEC responded that “climate change is a significant policy issue” that required PNC to include the proposal in its proxy. PNC’s annual meeting to vote on the proposal, held in late April 2013, ended after only 20 minutes due in part to the disturbance caused by Boston Common supporters in attendance. While the proposal failed to pass (garnering only 22.8 percent of the vote), financial institutions should be prepared to see the language of Boston Common’s proposal be submitted, verbatim, during next year’s proxy season.

**Sustainability as a Significant Policy Issue**
Calvert Investment Management and the Green Century Equity Fund, two well-known ESG shareholder proponents, submitted during the 2012 proxy season a sustainability proxy proposal to Cleco Corporation, a power services provider with holdings in fossil fuel-fired electric utilities. The proposal called for the company to issue a sustainability report including a comprehensive discussion of its sustainability risk and opportunities, as well as an
sustainability risk and opportunities, as well as an analysis of material water-related risks. Cleco, like PNC, submitted a no-action letter request to the SEC, which request included detailed arguments as to why the proposal did not focus on a “significant policy issue” and thus could be excluded from its proxy statement. In January 2012, the SEC disagreed, affirmatively noting that the proposal “focuses on the significant policy issue of sustainability.” The proposal just missed adoption, gaining 45.6 percent of the shareholder vote.

Conclusion
It is said that law reflects society’s economic, moral, and social values. If so, we may well see binding ESG disclosure standards applicable to public companies in the not too distant future.

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Environmental transactional attorneys have the unique task of advising clients of environmental risks in the context of corporate deals. In this hybrid role, such environmental attorneys must be knowledgeable of both environmental laws and federal securities regulations, as well as where the two areas intersect. For example, registrants have specific duties to disclose certain environmental judicial or administrative proceedings pursuant to Item 103 of Regulation S-K of the Securities Act of 1933 (Securities Act). Generally, Item 103 requires that registrants disclose:

... any material pending legal proceedings, other than ordinary routine litigation incidental to the business... [including] a description of the factual basis alleged to underlie the proceeding and the relief sought... [and] any such proceedings known to be contemplated by governmental authorities.1

The instructions to Item 103 offer some guidance as to whether a proceeding is “material” and whether the particular proceeding is or is not “ordinary routine litigation.” For example, the instructions provide a formula to guide registrants in determining whether to disclose a particular proceeding (other than an environmental proceeding):

No information need be given with respect to any proceeding that involves primarily a claim for damages if the amount involved, exclusive of interest and costs, does not exceed 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis.2...

For environmental proceedings, registrants must look to instruction 5 for guidance as to what is material and whether or not there is a disclosure obligation.
Specifically, instruction 5 to Item 103 of Regulation S-K provides that:

Notwithstanding the [general disclosure requirements for legal proceedings], an administrative or judicial proceeding . . . arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment shall not be deemed “ordinary routine litigation incidental to the business” and shall be described if:

A. Such proceeding is material to the business or financial condition of the registrant;

B. Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or

C. A governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000. . . .

Of particular interest to many environmental transactional attorneys are the origin and the purpose of the $100,000 threshold (clause C), originally proposed in 1981 (adopted in 1982) and whether this figure is still relevant.

**Origin and Purpose of the $100,000 Threshold in Environmental Disclosure**

Both registrants and transactional attorneys covering regulatory areas other than environmental (i.e., tax, benefits and labor, intellectual property) might be confused as to why there are special disclosure rules for environmental proceedings that differ from the disclosure obligations for other regulatory proceedings.

As noted below, the basis for the adoption of the specific environmental disclosure obligations originally arose from requirements under the National Environmental Policy Act (NEPA), which requires federal agencies to consider the environment in its policies and rulemaking.

In the early days of evolving federal environmental law, the Securities and Exchange Commission (SEC) made it clear in 1971 that the “forms and rules under the Securities Act of 1933 . . . and the Securities and Exchange Act of 1934 . . . “ require disclosure of material legal proceedings arising under environmental laws, pointing to the definition of “material” applicable to all proceedings at that time. In 1972, the SEC went a step further and proposed specific rules that would “require disclosure of the effect on the issuer’s business of compliance with Federal, State and local laws and regulations relating to the protection of the environment,” which includes “pending governmental or private legal or administrative enforcement proceedings arising under environmental laws or regulations and any such proceedings known to be contemplated by governmental authorities.” The SEC stated that its action of issuing the proposed rules and its ultimate adoption of the proposed rules in 1973 (1973 amendments) were being taken pursuant to NEPA. The SEC later confirmed its basis for these amendments, stating that certain actions, including the adoption of specific environmental disclosure obligations, are “based on the Commission’s recognition of the importance of environmental information to informed investment and voting decisions, and the unique mandate to consider the environment which was imposed on all federal agencies by NEPA.”

With a few notable differences, the adopted 1973 amendments are similar to today’s requirements set forth in instruction 5 to section 103 of Regulation S-K:
shall be described if such proceeding is material to the business or financial condition of the registrant or if it involves primarily a claim for damages and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis. Any such [environmental] proceedings by governmental authorities shall be deemed material and shall be described whether or not the amount of any claim for damages involved exceeds 10 percent of current assets on a consolidated basis and whether or not such proceedings are considered “ordinary routine litigation incidental to the business” . . .

Compare this to the current instruction 5 to Item 103 of Regulation S-K:

. . . an administrative or judicial proceeding . . . arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment shall not be deemed “ordinary routine litigation incidental to the business” and shall be described if:
A. Such proceeding is material to the business or financial condition of the registrant;
B. Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or
C. A governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000. . . .

Clearly, one major difference between the 1973 amendments and today’s requirements is that in the 1973 amendments, all environmental proceedings to which a governmental authority was a party were required to be disclosed. According to a later release that discusses the 1973 amendments, “[T]his disclosure standard for governmental proceedings differs from, and is broader than, the standard applicable to other types of environmental proceedings, which are subject to disclosure thresholds” and “the Commission [at the time] believed that requiring disclosure of all governmental proceedings was an effective method to inform investors and to promote environmental goal[s]” since the “disclosure of fines by governmental authorities may be of particular importance in assessing a registrant’s environmental compliance problems.”

Eight years after the adoption of the 1973 amendments, however, the SEC realized that the requirement to disclose all environmental proceedings regardless of “materiality” led to “numerous instances in which disclosures of more significant environmental proceedings [were being] obscured by lengthy disclosures of relatively inconsequential governmental proceedings, particularly proceedings which involve small fines . . . .” The SEC stated further that “the overwhelming amount of information which often is elicited by the current environmental provisions results in less readable disclosure documents and makes it more difficult to identify significant environmental proceedings,” which “impedes the Commission’s ability to fulfill its obligation . . . of ensuring that investors and shareholders receive full and fair disclosure of all material information necessary for informed decision-making.” Thinking better of it, the SEC felt the requirement to disclose all environmental proceedings to which a governmental authority was a party regardless of materiality “may hinder informed evaluations by investors and shareholders” and believed both (1) that “it could more fully satisfy its responsibilities under the federal securities laws if environmental disclosures were focused on significant environmental proceedings” and (2) “that clarity and comprehensibility of environmental disclosure effectively promotes goals of NEPA. . . .” As such, the SEC proposed adding “a new threshold for disclosure of governmental proceedings”—the $100,000 threshold set forth in instruction 5 to Item 103 of Regulation S-K—which would ultimately “allow the omission of disclosure about immaterial governmental proceedings” and “reduce burdens on registrants.”
Although the discussion is a bit unclear, it appears that the SEC decided on a fixed dollar amount for the threshold rather than a percentage of the registrant’s assets because the SEC believed that the significance of a governmental fine or penalty goes beyond the financial impact that such a fine or penalty will have on the registrant. See Release No. 33-6315, 46 Fed. Reg. 25,638, 25,639–41 (May 8, 1981) (footnote omitted) (emphasis added). 17 C.F.R. § 229.103, Instruction 5 (2013). The SEC “believes that disclosure of fines by governmental authorities may be of particular importance in assessing a registrant’s compliance problems” and “may be more indicative of possible illegality and conduct contrary to public policy.”12 In other words, the SEC believed that disclosure of governmental fines would give a potential investor a better understanding of the registrant’s environmental compliance status, irrespective of the financial effect such fines would have on the registrant. Ultimately, the SEC and several of the commentators on the rule proposal agreed that the $100,000 threshold amount would “require disclosure of governmental proceedings which . . . are important in evaluating the issuer’s environmental compliance and its impact on the issuer’s operations.”

Taking a Closer Look at the $100,000 Threshold Amount and Relevant Data from Around 1981

The SEC arrived at the $100,000 figure, in part, by reviewing the fines and penalties actually assessed in environmental proceedings around the time of the 1981 proposal. Release No. 33-6383, 47 Fed. Reg. 11,380, 11,381–82 (Mar. 16, 1982). It was not possible, at this time, to retrieve the specific data from 1981 used by the SEC in proposing that $100,000 was an appropriate threshold amount. However, a breakdown of the number of proceedings per specific dollar threshold was available for certain EPA programs during the period from 1985 to 1987 and for 1988, including the Clean Water Act (CWA), air penalties against stationary air sources under applicable regulations and under the Resource Conservation and Recovery Act of 1976 (RCRA). Overview of EPA Federal Penalty Practices FY 1988 [EPA 1988 Report], U.S. Environmental Protection Agency Compliance Policy and Planning Branch, Office of Enforcement and Compliance Monitoring (May 1989).13 Given that a primary basis for adopting the $100,000 threshold was to promote the disclosure of the more “significant” proceedings, a breakdown of the number of proceedings per specific dollar threshold is useful to help identify what the SEC might have viewed as significant during that time period—assuming, for purposes of this discussion, that the more “significant” enforcement cases represent those cases with higher fines or penalties.14 From 1985 to 1987, approximately 165 proceedings under the CWA resulted in penalties. EPA 1988 Report at 17. Of the 165 proceedings, approximately 122 resulted in fines or penalties of less than $100,000 (approximately 74 percent), 41 resulted in civil penalties between $100,000 and $1 million and two resulted in penalties of more than $1 million.15 During the same period, approximately 140 proceedings resulting in penalties related to air violations by stationary sources.16 Of the 140 proceedings, approximately 111 resulted in fines or penalties of less than $100,000 (approximately 79 percent), 27 resulted in penalties between $100,000 and $1 million and two resulted in penalties of more than $1 million.17 Under RCRA, approximately 483 proceedings resulted in penalties. Of the 483 proceedings, 479 resulted in penalties of less than $100,000 (approximately 99 percent), three resulted in fines or penalties between $100,000 and $1 million and one resulted in a penalty amount of more than $1 million. As you can see, a significant majority of the proceedings under these three programs during the 1985–1987 time period resulted in penalties of less than $100,000, which would support the SEC’s earlier determination that $100,000 is an appropriate threshold amount since it would limit disclosure to the more “significant” items.18

In order to consider whether the $100,000 threshold is still a relevant figure to “limit disclosure about immaterial governmental proceedings,” it is helpful to compare the above data from 1985 to 1987 to somewhat similar data from 2012.19 According to an inquiry using EPA’s Enforcement & Compliance History Online (“ECHO”) database, approximately 1378 enforcement cases under the CWA that resulted in a penalty either had a “settlement entered” or a “final
order issued” during the 2010–2012 time period. Of these approximately 1378 cases, 1266 resulted in penalties of less than $100,000 (approximately 92 percent). Using the same parameters except under the Clean Air Act, 1129 out of 1358 enforcement cases (approximately 83 percent) resulted in penalties of less than $100,000. Under RCRA, 1029 of 1098 enforcement cases (approximately 94 percent) resulted in penalties of less than $100,000. Surprisingly, the majority of enforcement cases result in penalties of less than $100,000, even in 2012, which would indicate that the $100,000 threshold might still be a useful tool to limit disclosure to the more significant proceedings—again, assuming that the higher the penalty, the more significant the proceeding.

Putting this data aside, some experts and some industry representatives have noted that the $100,000 threshold amount is outdated and needs to be revised. Using an online inflation calculator from the U.S. Department of Labor, Bureau of Labor Statistics, one can see that $100,000 in 1981 equals approximately $256,000 in today’s dollars. In 2004, the Governmental Accountability Office (GAO) published a report to Congress that outlined several observations and recommendations regarding public environmental disclosure, including, among other things, concerns about “[t]he adequacy of SEC’s efforts to monitor and enforce compliance with environmental disclosure requirements” and providing “suggestions for increasing and improving environmental disclosure.” Specifically, the GAO cited experts who participated in a GAO-sponsored survey who believed that “the threshold for monetary sanctions [for disclosure of legal proceedings] should be updated or abolished altogether.” Additionally, “[c]ompany representatives . . . thought that the fixed thresholds for disclosures related to legal proceedings were outdated,” suggesting “that the $100,000 threshold for monetary sanctions should be raised to $1 million to reflect increases in penalty amounts since the regulation was promulgated over 20 years ago.”

While there is definitely an argument that the $100,000 threshold might be outdated simply due to the passage of time, it is important to remember that a primary basis for adopting the $100,000 threshold was to limit disclosure to the more significant items. Given the 2010–2012 data discussed above, the $100,000 threshold might still be relevant today since many enforcement cases result in penalties of less than $100,000. In any event, the SEC, using all available data, should consider whether the $100,000 disclosure threshold remains relevant today, and whether (1) this threshold puts a burden on registrants and whether (2) current disclosure triggered by the $100,000 threshold is useful to investors in making investment decisions.

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Endnotes

1 17 C.F.R § 229.103 (2013) (emphasis added).
3 17 C.F.R. § 228.103, Instruction 5 (2013).

13 http://nepis.epa.gov/Exe/ZyNET.exe/20014EL2.TXT?ZyActionD=ZyDocument&Client=EPA&Index=1986+Thru+1990&Docs=&Query=&Time=&EndTime=&SearchMethod=1&TocRestrict=n&Toc=&TocEntry=&QField=QFieldYear=QFieldMonth=QFieldDay=IntQFieldOp=0&ExtQFieldOp=0&XmQuery=&File=D%3A%5Czyfiles%5CIndex%20Data%5C86thru90%5CTxt%5C00000015%5C20014EL2.txt&User=ANONYMOUS&P


15 Id.

16 Id.

17 Id.


19 Id.


21 Id. at 32.

22 Id.
Introduction
This article focuses on a narrow, but important, topic for potentially responsible party (PRP) cost recovery under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). Although CERCLA defines what constitutes a “response,” it fails to define precisely what types of costs may be recoverable as “necessary costs of response consistent with the National Contingency Plan” (NCP). This can be a thorny issue for CERCLA cost recovery that is subject to interpretation by the courts. While not binding, accounting guidance pertaining to environmental liability estimation and disclosure (such as that published by the American Society for Testing and Materials (ASTM), U.S. Environmental Protection Agency and Army Corps of Engineers (EPA/ACE), and American Institute of Certified Public Accountants (AICPA)) plays a potentially important role by more precisely defining what costs should be considered for inclusion within the scope of an environmental liability estimate, and may provide a proxy for evaluating what types of costs qualify as “necessary costs of response” under CERCLA.

CERCLA and the NCP—Statutory Language
Under section 107(a) of CERCLA, responsible parties may be liable for certain response costs incurred by others:

- “all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan” (107(a)(4)(A)); and
- “any other necessary costs of response incurred by any other person consistent with the national contingency plan” [107(a)(4)(B)].

The language of CERCLA section 107(a) is echoed in section 300.700 of the NCP, which states that:

- “Responsible parties shall be liable for all response costs incurred by the United States government or a state or an Indian tribe not inconsistent with the NCP” (300.700(c)(1)); and
- “Responsible parties shall be liable for necessary costs of response actions to releases of hazardous substances incurred by any other person consistent with the NCP” (300.700(c)(2)).

In the context of private PRP cost recovery, this raises an important question: what do CERCLA and the NCP mean by “necessary costs of response” and “necessary costs of response actions,” respectively? While neither CERCLA nor the NCP define these terms explicitly, CERCLA’s definition of the term “response action” and the related terms “removal” and “remedial action” do provide some insight. Collectively, as defined by section 101 of CERCLA, these terms encompass cleanup activities (such as site assessment and remediation) that address actual or potential threats to human health and the environment. (Note, however, that there are several important distinctions between removal and remedial actions, such as statute of limitations, that can affect potential PRP cost recovery.) These definitions also include certain discrete activities, such as the installation of fencing, resident relocation, and monitoring activities. Since these definitions are intended to define the response action terms and not their costs, the question still remains: for a given response, which costs are “necessary” and which are not? For example, under what circumstances are legal fees and consultant costs potentially recoverable?

Court Interpretation
Given this scant CERCLA statutory language, courts have been left to interpret these terms in decisions for PRP cost recovery cases. These decisions have a common thread in that “necessary response costs” often have been interpreted as costs that are solely or primarily “related to the cleanup effort”—investigation, remediation, mitigating risk. Thus, other types of costs, such as those that are incurred to avoid/shift liability; do not directly benefit or advance the cleanup process;
and/or are in excess of that which is required to satisfy
cleanup requirements to mitigate risk, are typically
excluded. Interestingly, cost-effectiveness has often not
been a criterion used to evaluate whether costs were
“necessary.”

Most of the relevant court decisions have focused on
the potential recoverability of legal fees as necessary
response costs. The Supreme Court’s Key Tronic
Corp. v. United States (1994) ruling established that
costs for legal fees “closely tied to the actual cleanup”
may qualify as necessary response costs. In its decision
in that case, the Court allowed legal expenses incurred
identifying other PRPs as recoverable costs, finding
that “[t]racking down other responsible solvent
polluters increases the probability that a cleanup will be
effective and get paid for” and “significantly benefited
the entire cleanup effort.” Other legal costs that were
incurred for remedy negotiation and cost recovery
litigation were not allowed; the Court deemed that the
primary purpose of that work was to protect the
client’s interests as opposed to advancing the cleanup.

The Court thus determined that only the legal costs
incrementally related to the cleanup were potentially
recoverable. Although this decision addressed legal
fees, presumably this reasoning would also extend to
other types of costs. Other court decisions expressed
similar logic to the Key Tronic decision in that they
focused on the issue of whether the work advanced the
site cleanup, although most of these decisions resulted
in an “all or nothing” approach rather than a true
incremental cost analysis. For example:

- In Champion Labs., Inc. v. Metex Corp.
  (2009), the court ruled that costs incurred to
  shift liability to other PRPs were not
  recoverable as CERCLA response costs.
- In BNSF Ry. v. Cal. (2009), the court ruled
  that legal fees related to PRP search efforts did
  not qualify as response costs because they did
  not advance the cleanup. Interestingly, the
court cited Key Tronic yet excluded the same
type of costs (PRP search costs) that Key
Tronic allowed.
- In both Bonnieview Homeowners Ass’n v.
  Woodmont Builders, L.L.C. (2009) and
  Black Horse Lane Associates v. Dow
  Chemical Corp. (2000), the courts ruled that
costs for a consultant to review work
performed by others and provide expertise in
the litigation were not allowable CERCLA
response costs because they did not advance
the cleanup.
- In 500 Assocs., Inc. v. Vt. Am. Corp. (2011),
  the court ruled that costs for an environmental
  investigation that did not advance the cleanup
  were not recoverable response costs.
- In Carson Harbor Village, Ltd. v. Unocal
  Corp. (2001), the court focused on the
  following test: “In determining whether
  response costs are ‘necessary,’ we focus not
  on whether a party has a business or other
  motive in cleaning up the property, but on
  whether there is a threat to human health or the
  environment and whether the response action
  is addressed to that threat.”

Guidance Pertaining to Environmental
Liability Estimation and Disclosure

Guidance pertaining to environmental cost and liability
estimation is consistent with the Supreme Court’s Key
Tronic decision in that it generally advises to include
costs that are “closely tied to the cleanup” within the
scope of a liability estimate. However, this guidance is
more comprehensive, considers a broader spectrum of
potential costs than legal fees, and hones in more
precisely on the economic concept of incremental
costs—inclusion of environmental liability costs that are
incrementally (not solely, exclusively, or primarily)
related to the environmental liability. This is stated
clearly in AICPA’s “Statement of Position (SOP) 96-1:
Environmental Remediation Liabilities” (AICPA 1996):

an accrual for environmental liabilities should include . . .
. Incremental direct costs of the remediation effort, as
defined. Costs of compensation and benefits for those
employees who are expected to devote a significant
amount of time directly to the remediation effort, to the
extent of the time expected to be spent directly on the
remediation effort.
SOP 96-1 also provides specific examples of incremental costs that should be considered (chart 1), while ASTM’s “Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters” (ASTM 2001; 2006) provides similar guidelines (see chart 2). Both the AICPA and ASTM guidance advocate for the consideration of a wide variety of costs that are potentially related to the liability and inclusion of costs that are incrementally related to the response within the scope of the liability estimate.

Arguably, consistent with the court’s finding in Daigle v. Shell Oil Co. (1992), the last bullet would be excluded as CERCLA response costs because they did not meet the statutory definitions for “response,” “removal,” or “remedial action.”

**Chart 1: AICPA Recommendations—Incremental Costs to Be Considered Within the Scope of a Liability Estimate**
- Legal costs “related to determining” extent and type of remedial actions or PRP cost allocation
- Excluding “. . . litigation costs involved with potential recoveries are not part of the remediation effort . . .”
- Site/Remedial Investigation (RI) costs
- Feasibility Study (FS) costs
- Consultant costs
- Engineering and consulting firms for investigation, planning, and design
- Contractor costs for performing remediation
- Government oversight and past costs
- Costs for “machinery and equipment that are dedicated to the remedial actions and that do not have an alternative use”
- Operations & Maintenance (O&M) costs
- “Costs of compensation and benefits for those employees who are expected to devote a significant amount of time directly to the remediation effort . . .”
- Internal legal staff
- Technical employees

**Chart 2: ASTM Recommendations—Incremental Costs to Be Considered Within the Scope of a Liability Estimate**
- Studies
- Response action
- Environmental compliance
- Defense and legal fees
- Fines and penalties
- Agency oversight
- Natural resource damage (NRD), property damage, business interruption, bodily injury, tort claims
EPA/ACE’s joint guidance (2000) document, “A Guide to Developing and Documenting Cost Estimates During the Feasibility Study,” elaborates on the types of costs that should be considered for inclusion within the scope of a remediation cost estimate. This guidance focuses on a holistic assessment of costs that may potentially be incurred throughout the project life cycle, from pre-remedy studies to post-remediation system decommissioning (see examples in chart 3), expanding on the concepts raised in the AICPA and ASTM guidance. This 2000 guidance supersedes EPA’s prior guidance on remedial cost estimation that was included in its 1988 guidance document on conducting RI/FSs at CERCLA sites.

**Conclusion**
The concept of incremental cost analysis, as interpreted by the courts and guidance pertaining to environmental liability estimation and disclosure, provides a practical and powerful tool for interpreting what constitutes a bona fide “necessary cost of response” for PRP cost recovery under CERCLA. While each case and site are unique, this guidance provides a systematic methodology for evaluating what types of costs are potentially recoverable under CERCLA, and may provide useful context for courts to consider in their decision making.

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**References**
- Guidance

<table>
<thead>
<tr>
<th>Chart 3: EPA/ACE Guidance Recommendations on Types of Costs to Be Considered Within the Scope of a Remediation Cost Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost Categories to Evaluate</strong></td>
</tr>
<tr>
<td>• Studies and investigations</td>
</tr>
<tr>
<td>• Remediation capital costs</td>
</tr>
<tr>
<td>• Annual O&amp;M cost elements</td>
</tr>
<tr>
<td>• Periodic cost elements (e.g., remediation system decommissioning)</td>
</tr>
<tr>
<td>• Reporting</td>
</tr>
<tr>
<td>• Treatment and disposal</td>
</tr>
<tr>
<td>• Professional/technical services</td>
</tr>
<tr>
<td>• Project management</td>
</tr>
<tr>
<td>• Field Work—Oversight, sample collection</td>
</tr>
<tr>
<td>• Technical support (e.g., regulatory communication/interaction, permits, access)</td>
</tr>
</tbody>
</table>

Environmental Disclosure Committee, July 2013


- Decisions
  - Black Horse Lane Associates v. Dow Chemical Corp. (2000), 228 F.3d 275, 31 ELR 20148 (3d Cir. 2000).
  - Carson Harbor Village, Ltd. v. Unocal Corp. (2001), 270 F.3d 863, 32 ELR 20180 (9th Cir. 2001).

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Thursday’s plenary sessions will focus on the Administration’s expected priorities over the coming months and recent changes in leadership in the agencies and on the Hill. Given our location in Baltimore, we will have a breakout session examining EPA’s recent efforts to regulate nutrients and stormwater going into the Chesapeake Bay and whether those efforts are likely to provide a model for other parts of the country. Other breakout sessions will bring you up-to-date on recent developments under the primary environmental statutes, including Clean Air, Clean Water, CERCLA, and RCRA, as well as on renewable energy and fracking issues. We will have additional breakout sessions focused on legal issues associated with superstorms and natural disasters, as well as panels on environmental law, environmental litigation, and environmental markets.

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