

9/20/02

Mr. Jonathan G. Katz, Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549

**Revised Petition**  
**SEC File # 4-463**

Re: Petition for rulemaking

Dear Mr. Katz,

Pursuant to Rule 192 of the Securities and Exchange Commission's (the "Commission") Rules of Practice, the Rose Foundation for Communities and the Environment hereby submits a revised version of our previous petition (dated 8/21/02, SEC file # 4-463). Consistent with the original petition, we ask the Commission to promulgate two new rules to clarify the intent of the Commission's material disclosure requirements with respect to financially significant environmental liabilities and help ensure compliance with existing material financial disclosure requirements. The proposed rules are based on the American Society for Testing and Materials International (ASTM) 2001 Standard Guide for Disclosure of Environmental Liabilities [E 2173-01] and 2001 Standard Guide for Estimating Monetary Costs and Liability for Environmental Matters [E 2137-01].

In submitting this revised petition, we stress that it is identical to the original petition in all material aspects. However, in respect to the American Society for Testing and Material's request, we have altered the text of the petition to refer to their 2001 Standard Guide for Disclosure of Environmental Liabilities [E 2173-01] and 2001 Standard Guide for Estimating Monetary Costs and Liability for Environmental Matters [E 2137-01] by reference rather than including the actual text of the guidelines in our petition. Our understanding is that ASTM has already transmitted a copy of the full text of the guidelines to you. Therefore, rather than restate the lengthy guidelines herein, we simply summarize their intent and incorporate them by reference *in toto*. We appreciate your consideration in accepting this revised petition in order to comply with ASTM's understandable need to protect their copyrighted documents.

The Rose Foundation is a 501(c)(3) non-profit public interest organization, dedicated to advancing positive intersections of the environment and the economy. The Rose Foundation has just completed a review of the financial literature summarized in the attached paper ("The Environmental Fiduciary") that demonstrated that substantial evidence exists to show that financial performance correlates positively with environmental performance.

In submitting this petition, we note that many investors and organizations, including but not limited to the Social Investment Forum, Shareholder Action Network, Friends of the Earth, World Resources Institute, United Steelworkers of America, Health Care Without Harm, Trillium Asset Management, Calvert Group, Domini Social Investments, Walden Asset Management and Citizens Funds have all previously communicated with the Commission urging increased attention to social and environmental disclosure. We believe that crafting specific environmental disclosure rules around the ASTM guidelines would help the Commission respond to this previous and widespread community input that has been registered in written comments, past petitions, and meetings with Commission staff. Letters evidencing specific support for this petition from several of these organizations, including brokerage firms representing combined assets of over \$13 billion, a representative of the United Steelworkers of America, and more than 28 charitable foundations representing well over \$3 billion in combined assets, including the Rockefeller Family Fund, Surdna and San Francisco Foundations, and the Educational Foundation of America were submitted to the Commission with the original petition and are incorporated herein by reference. Furthermore, we are aware that several other institutions, including the Turner Foundation, have also registered their support for this petition. We ask that, as these institutions and investors contact the Commission in support of the petition, all communication related to the petition be consolidated in the Commission's files under the same file number.

## **THE NEED FOR THE PROPOSED RULE**

In 1998, the EPA's Office of Enforcement and Compliance Assurance completed a study that found that *74 percent of companies failed to report in their 10-Ks cases where environmentally related legal proceedings could result in monetary sanctions over \$100,000.*<sup>1</sup> The EPA study also found that only 26 percent of civil and administrative proceedings involving penalties were correctly disclosed in the company 10-K reports. Even worse, only 16 percent of proceedings involving court-ordered Supplemental Environmental Projects ("SEPs") and just 4 percent of proceedings involving Resource Conservation and Recovery Act ("RCRA") corrective actions were correctly disclosed. The result is that investors who relied on these inaccurate 10-Ks for an assessment of pending liabilities were left in the dark<sup>2</sup> and at a distinct disadvantage because they could not otherwise fully assess a corporation's assets and liabilities.

In 1993, a few years before the EPA study, the General Accounting Office ("GAO") had already flagged the problem in a report entitled *Environmental Liability: Property and Casualty Insurer Disclosure of Environmental Liabilities*, which found that insurance company disclosure of Superfund toxic cleanup liabilities was very poor and put investors at risk. The report reviewed the annual reports of the top sixteen publicly held property and casualty insurance companies. Only two of the sixteen disclosed dollar amounts related to environmental claims in their annual reports for 1990. Only three of the sixteen disclosed dollar amounts related to environmental claims in their annual reports for 1991. However, five of the same insurance

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<sup>1</sup> U.S. EPA, *Guidance on Distributing the Notice of SEC Registrants' Duty to Disclose Environmental Legal Proceedings in EPA Enforcement Actions*, March 2001 presentation to the American Bar Association Conference on Environmental Law.

<sup>2</sup> *Ibid*, p. 14

companies in 1990 and eight in 1991 had stated that they were involved in potentially costly litigation over environmental claims which might have had a negative financial impact on the company. Upon further inquiry by the SEC, several more firms disclosed environmental costs and expenses related to the claims.

The GAO report identified two potential structural reasons for this under reporting.

- 1) The insurance companies claimed that they *could not estimate* the incurred environmental claims costs or limitation expenses because "uncertainties" prevented the companies from estimating or reporting these liabilities. These "uncertainties" were due to evolving judicial interpretations of, and inconsistent conclusions about, legal liability for environmental cleanup.
- 2) The GAO interpreted SEC rules to require that each claim only needed to be reported if it individually exceeded 10 percent of the company's assets. Unless all claims against a company were voluntarily aggregated together, a company might *avoid disclosure* even if the sum of claims exceeded ten percent of the company's assets. (*Note: 10% of assets is a commonly used benchmark, but not the only basis for determining materiality. It is entirely possible for liabilities to be material even if they do not exceed this threshold.*)

In its report the GAO summarized the problem:

At present, no one claim in litigation may be material to any one company. The SEC regulation requiring that material legal proceedings be disclosed applies to one claim or set of related claims for damages that exceed 10 percent of a company's assets. A set of related environmental claims would be those claims associated with the same physical property or site and/or the same pollution event. However, the ultimate cleanup costs associated with thousands of pollution claims, coupled with costs to litigate the coverage issues, could be significant to individual insurance companies as well as to the property and casualty insurance industry as a whole.<sup>3</sup>

The GAO speculated that the insurance company underreporting *may reflect piecemeal accounting of individual claims by large insured corporations to evade reporting requirements* – even if the total of all the claims would have exceeded reporting thresholds.

These studies demonstrate that,

- (1) accurate disclosure of environmental risks and liabilities will not occur under the current rules and
- (2) that companies need clear standards by which they can estimate monetary costs and liabilities for environmental matters.

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<sup>3</sup> GAO, *Environmental Liability: Property and Casualty Insurer's Disclosure of Environmental Liabilities* (1993), p. 8.

This paucity of disclosed information concerning the financial significance of environmental liabilities was also recognized by the insurance industry and led the industry to initiate an ASTM guideline development process. The results of that seven-year, full-consensus process are the 2001 Standard Guide for Disclosure of Environmental Liabilities [E 2173-01] and the 2001 Standard Guide for Estimating Monetary Costs and Liability for Environmental Matters [E 2137-01] which these proposed rules are based on.

Without clearly articulated methods for estimating costs and liabilities and without full and accurate disclosure, significant underreporting and inaccurate reporting will continue. As a consequence, investors will not be able to accurately assess the value of the equities in their portfolios. However, estimation and disclosure consistent with the ASTM standards would provide investors with standardized, improved information critical to their evaluation of the financial risk associated with a company's environmental liabilities.

## **THE PROPOSED RULES**

We propose that the SEC promulgate new rules that directly reference the ASTM 2001 Standard Guide for Disclosure of Environmental Liabilities [E 2173-01] and 2001 Standard Guide for Estimating Monetary Costs and Liability for Environmental Matters [E 2137-01] with the following changes:

- The proposed rules would change all of the precatory language of the guidelines into mandatory language. For example, section 6.2.1 of E 2173 - 01 reads "Disclosure should be made when an entity believes its environmental liability for an individual circumstance or its environmental liability in the aggregate is material." The proposed rule would read "Disclosure shall be made when an entity believes its environmental liability for an individual circumstance or its environmental liability in the aggregate is material."
- Add the following sentence at the beginning of Section 5.4.1.1 of E 2137-01: "The expected value is the preferred method of estimation."

## **JUSTIFICATION FOR THE PROPOSED RULES**

In order to clarify the intent of the SEC's material disclosure requirements with respect to financially significant environmental liabilities and help ensure compliance with existing material financial disclosure requirements, we urge the Commission to adopt the proposed rules. Estimation and disclosure consistent with the proposed rules would provide investors with standardized, improved information critical to their evaluation of the financial risk associated with a company's environmental liabilities.

The proposed rules establish how corporations can appropriately estimate the costs and liabilities of environmental matters such as compliance with environmental laws, response actions, defense and legal fees, and damages arising from ecological damage, property damage, business interruption and tort claims. The proposed rules describe four known cost estimation methods and how to use them. The four methods are:

- expected value
- most likely value
- range of values
- known minimum value

The proposed rules articulate a preference for the expected value method because it provides the most robust and comprehensive estimate. However, the rules recognize that expected value is not always practicable or appropriate so it allows the use of the most likely value and range of values methods. This system is an improvement over the current system because it requires, in almost all circumstances, an estimate greater than that arrived at under the known minimum value method and thereby provides investors with the information they need to evaluate the financial risk associated with a company's environmental liabilities.

The proposed rules also establish the conditions warranting disclosure and *instructs corporations to aggregate all environmental liabilities* and report them in the company 10-K. This would close one of the biggest loopholes in reporting today – piecemeal accounting of environmental liabilities. Furthermore, the use of this standardized methodology will allow side-by-side comparison of different companies' liabilities and costs in the same industry sector.

It should be stressed that the proposed rule is based on guidelines developed by ASTM. The 2001 Standard Guide for Disclosure of Environmental Liabilities [E 2173-01] and the 2001 Standard Guide for Estimating Monetary Costs and Liability for Environmental Matters [E2137-01] were developed by a consensus process conducted by one of our nation's leading voluntary standard development organizations. These standards, originally initiated by the insurance industry, in response to the paucity of disclosed information concerning the financial significance of environmental liabilities, were developed over a seven-year, full-consensus process. Under ASTM standard-development guidelines, the standards were developed and approved (through an affirmative vote of over 90%) by a fair and unbiased group representing the diverse interests of those who would produce and use the environmental estimates and disclosures: industry, insurers, banks, environmental consultants, accountants, lawyers, academics, actuaries, and government agencies.

We appreciate the opportunity to present these issues to you for your consideration. If you have any questions, please call Tim Little, Rose Foundation Executive Director, (510)658-0702.

Sincerely,

Jill Ratner, President  
Rose Foundation for Communities and the Environment