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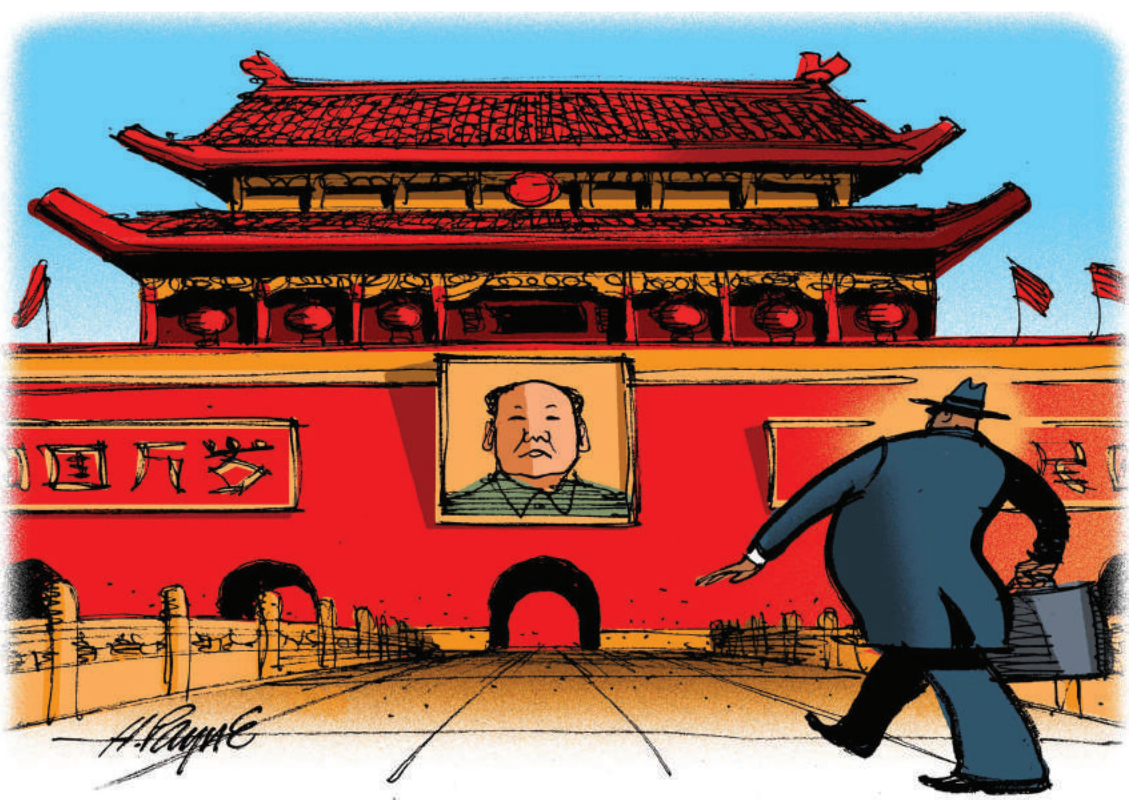

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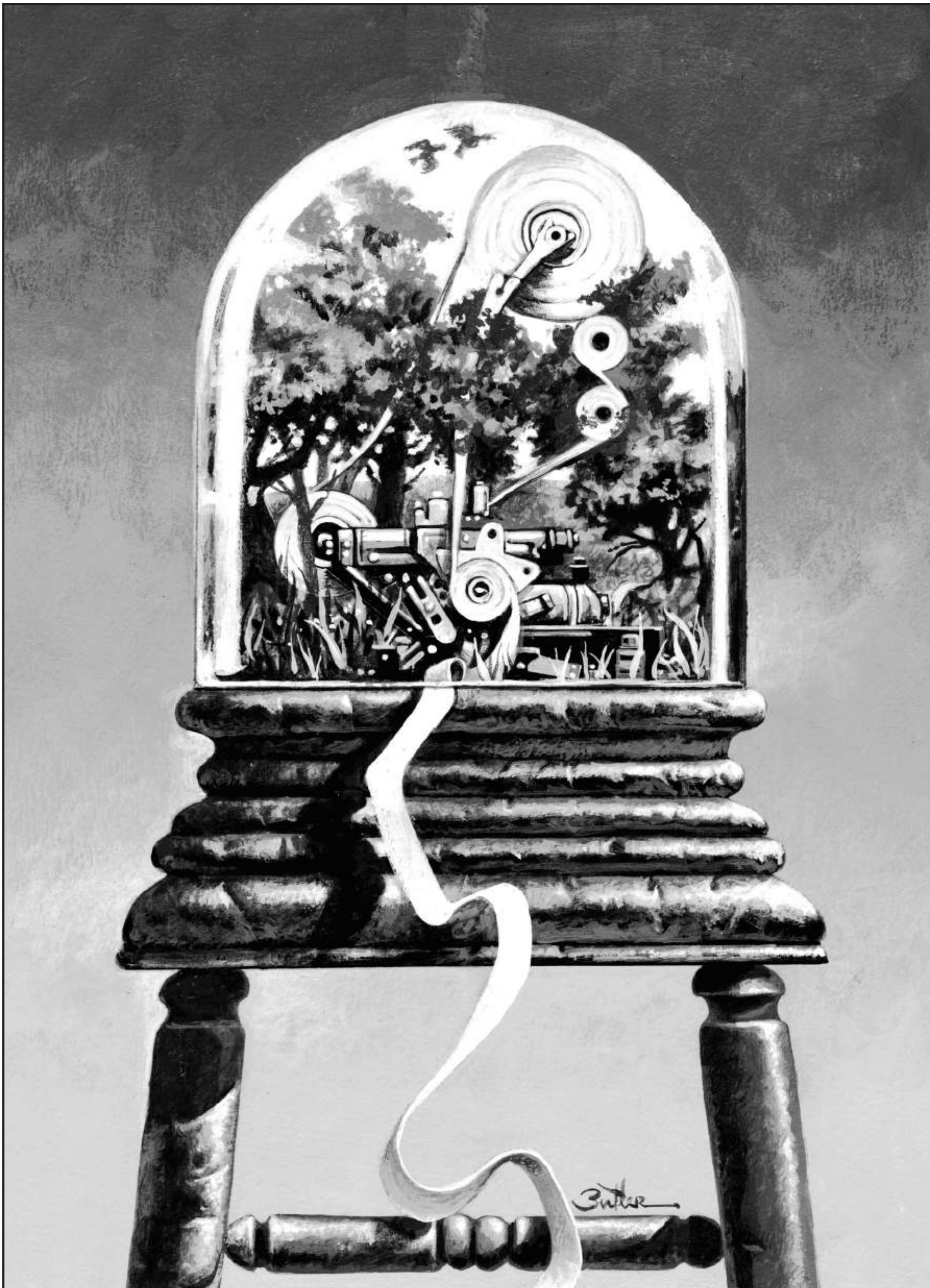

Buying Into Securities Filings

Purchasers of products and services increasingly value the ecological impacts of suppliers. Securities filings should disclose that environmentally motivated purchases materially affect some corporate earnings, prospects, and business operations

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While U.S. securities laws require publicly held companies to disclose material threats to earnings, firms generally fail to describe in their filings important aspects of their environmental footprints significantly influencing purchasers. Securities and Exchange Commission filings should reveal more of corporations' strengths and weaknesses with regard to the major environmental certifications and metrics which move purchasers. Such disclosures would inform investors and purchasers alike, improve the trustworthiness of environmental indicators, and incentivize companies to lighten their ecosystem impacts.

Environmental purchasing preferences favor lower emissions and sustainable uses of natural resources. Mobilizing purchasers supplements environmental legislation and regulations. To illustrate, several large food retailers and processors require fish and agricultural producers to achieve certifications of sustainable operations, which go beyond compliance with U.S. Department of Agriculture and Food and Drug Administration regulations. Next, over 400 global consumer-goods companies, representing 60 percent of palm oil trade, made zero-deforestation commitments at the United Nations' 2014 climate summit. Similarly, Illinois's procurement of delivery services required participation in an EPA program and assigned 20 percent of the evaluation points on the bidders' carbon dioxide emissions from vehicles, actions to reduce fuel consumption, and uses of non-petroleum fuels and recyclable packaging. When the federal General Services Administration required bidders to participate in an EPA program and monetized the social costs of their greenhouse gas emissions, it observed: "Approximately 90 percent of federal agencies' carbon footprint lies in the products and services they purchase."

Three key elements of environmental purchasing are information on vendors' and products' impacts; buyers' willingness, to some significant extent, to pay more or reform buying practices to reduce environmental costs; and pressuring suppliers to improve their footprints. Several public boycotts mobilized buyers in reaction to ecological crises, such as targeting BP after the Deepwater Horizon oil spill or naming firms for rain forest destruction. Buyers along with investors pressured companies to restore wetlands and forests. Going beyond headlines, many buyers compare vendors on their energy and water intensity, achievements and plans in cutting fossil fuels and landfill waste, methods of harvesting natural resources, and safeguards in sensitive habitats.

Leading companies voluntarily disclose environmental indicators through corporate sustainability reports and databases, responding to large investors and rating organizations. Some have made substantial progress in disseminating environmental information. However, many companies do not publicly disclose aspects of their environmental performance that purchasers find important. Also, the coverage, methods, and metrics of such disclosures differ.

The U.S. federal government and other organizations are addressing the marketplace information deficits in several ways helpful to purchasers. For example, EPA, the Department of Energy, and USDA administer efficiency certifications and publish standardized measures for electrical products, chemically intensive products, water-using products, vehicles, and bio-based products. Additionally, private-sector organizations have extensive experience with sector-specific sustainability standards, such as Forest Stewardship Council International and other organizations for forest products, Green Electronics Council for electronic products, U.S. Green Building Council for commercial offices and other buildings, and Green Seal for cleaning products. Other organizations like the Global Reporting Initiative and Sustainable Purchasing Leadership Council provide guidance, methodologies, indicators, and rankings.

In the past, purchasers — even those motivated to apply environmental preferences — spent trillions of dollars annually without information to guide them on vendors' and products' ecological footprints. This market condition is changing, with growing availability of information to buyers, analytic tools, and commitments to apply preferences. These changes raise the likelihood that companies' environmental performance affects their earnings, prospects, and business operations.

Turning now to the Securities Act of 1933 and the Securities Exchange Act of 1934, publicly held companies must disclose information that is "material" to potential investors and existing shareholders. Information is classified as material based on its relevance to understanding the past, current, and future value and performance of their securities. Companies must avoid misstatements or omissions of material information. SEC filings are subject to certification by executives, independent audits, and agency staff review. Companies face liability for their disclosures in criminal, agency, and private actions.

Securities filings have long addressed environmental issues such as liability for cleanups, financial and operational exposure in complying with regulations, risks of fines and other penalties for violating laws, and business opportunities from regulations. However, under existing SEC regulations, the scope of required disclosures should be expanding as customers as well as investors and communities apply environmental preferences.

Parts of SEC Regulation S-K and Rule 10b-5 deserve description here. Regulation S-K provides instructions for disclosures in company registration statements (for new securities), periodic reports, reports of extraordinary occurrences, and proxy statements. In describing its business pursuant to Item 101(c), the company must discuss its principal products and services; the dependence of a business segment on one or a few customers; competitive conditions in the business; and material effects of compliance with federal, state, and local environmental provisions.

Regarding competitive conditions, the regulation directs the company to identify and explain whether one or a small number of competitors is dominant in the industry, the principal methods of competition (e.g., price, service, warranty or product performance), and positive and negative factors pertaining to the competitive position of the company. Also, regarding compliance with environmental provisions, the disclosure should address the material effects "provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant."

Two other provisions of Regulation S-K pertain to purchasing preferences. Item 303 requires management description and analysis of any known trends, events, or uncertainties that will or are "reasonably likely" to result in favorable or unfavorable material effects on the company's liquidity, capital resources, or operating results. Item 503(c) requires a concise statement of risk factors, often including changes in the competitive landscape or market demand, and other variations in business conditions that may damage capital formation or financial performance.

Under Rule 10b-5, it is unlawful for any person directly or indirectly to "make any untrue statement of a material fact or to omit to state a material fact." The Supreme Court held that materiality depends on the significance that the reasonable investor would place on the item in light of the total mix of information available. A misstatement or omission may be material even if it has less than a 5 percent impact on earnings, if it is probable that the judgment of a reasonable person relying on the report would have been changed by the inclusion or correction of the item.

In 2010 guidance on climate change, the SEC pointed to disclosure obligations when a company's environmental footprint damages its reputation. After discussing potential direct business impacts of climate change, the agency addressed disclosing indirect consequences: "Depending on the nature of a registrant's business and its sensitivity to public

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Sidebar

Sustainability Data Are Driving Disclosure

Environmental law now sits at the busy intersection of "we manage what we measure" and "sunlight is the best disinfectant." These are the directional signs for the task of directing businesses and conserving the Earth's resources through sustainability.

Participants in the global capital markets, the vehicle through which significant private, semi-public, and government money will be allocated, have already begun to engineer, and then label, the way that companies with leading, comprehensive sustainability strategies can be recognized and rewarded. Inevitably, part of this effort entails massive, and pioneering, data gathering and disclosure, of the type championed by the Global Reporting Initiative.

More recently, it has inspired the transparent and collaborative efforts of the Sustainability Accounting Standards Board, which has created industry-specific metrics tied to the SEC-driven definition of materiality — information whose omission or disclosure would have been viewed by a reasonable investor as having significantly altered the total mix of information available in decisionmaking.

The related banking and investment management infrastructure has also proliferated. There are over 1,400 signatories to the sustainability-driven U.N. Principles for Responsible Investment, and over 700 asset management firms incorporate some elements of sustainability into their decisionmaking and portfolio mix. New entities such as Cornerstone Capital make sustainability the explicit focus of their investment, money management, and research activities. Dynamic benchmarking firms such as eRevalue allow instant evaluative access to the disclosure practices and histories of companies throughout global markets. And dozens of sophisticated niche funds, such as Generate Capital and Sustainable America, focus on small-scale energy, food, and water-related investments that do more with less resources for which supplies are constrained or for which the true cost of externalities has yet to be incorporated in the product.

More broadly, the pivot toward sustainability has given rise to listing requirements adopted by multiple international stock exchanges. Almost inevitably this will lead to collaboration among all exchanges on universal standards relating to sustainability as a ticket to market entry.

Jeff Smith

More broadly still, so-called "integrated reporting," in which sustainability data will be disclosed on an equal footing with more familiar financial information, will continue to mature and gain traction. Institutionally, long-term investors such as CalPERS and other global pension funds have become vigilant watchdogs and advocates for increased transparency and, on occasion, plaintiffs in securities-law cases, when financial harm can be linked to contradictory corporate messages on sustainability issues.

In the global supply chain, multinational companies such as Unilever, the Tata Group, Wal-Mart, Nike, and GE have manufacturing, raw material, and workforce needs and markets throughout the world, as well as connections to both the last mile of demand from local companies and to consumer needs and preferences in those markets. They have begun to surround the old command-and-control regulatory enforcement and standard-setting mechanisms with a growing network of decisions and investments made for reasons other than regulatory compulsion. Entrepreneurial companies such as Coclear create the analytic power and facility for sustainability-driven business decisionmaking across both geographic and corporate boundaries that were previously insurmountable.

If you want to reduce the carbon footprint of the chocolate chip cookies you make for the EU market, for example, full life-cycle and product-cycle analyses clearly presented in real time will let you do that. Similarly, for a company considering siting a facility in a region in which water may be scarce, Trucost plc can provide data analytics on current and future water pricing and likely competitors for that resource that will inform their decision.

This multifaceted evolution will lead both to standards that are recognizable, reliable, and accessible — the sustainability equivalent of the Good Housekeeping Seal — and to a nuanced and readily available drop-down menu of sustainability metrics that will satisfy the emerging demands of the 21st century reasonable investor.

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opinion, a registrant may have to consider whether the public's perception of any publicly available data relating to its greenhouse gas emissions could expose it to potential adverse consequences to its business operations or financial condition resulting from reputational damage."

As customers prioritize products' environmental impacts in selecting vendors, the link between companies' footprints and their earnings strengthens. The growing magnitude of this link increases the grounds for environmental disclosures under the securities laws. Consider three scenarios which may warrant disclosures in SEC filings in light of environmentally motivated purchasers.

First, a leading buyer or group of buyers requires, or strongly prefers, suppliers to achieve certain environmental certifications. To illustrate, Executive Order 13693 ("Planning for Federal Sustainability in the Next Decade," 2015) directs federal agencies — large customers for many businesses — to include certain "environmental performance and sustainability factors . . . to the maximum extent practicable for all procurements." The preferences include products designated by EPA for recycled content; energy and water efficiency (Energy Star qualified or WaterSense certified); alternatives to ozone-depleting substances (Significant New Alternative Policy designated); chemically safer ingredients (Safer Choice labeled); and fuel-efficient trucks (SmartWay Transport partners). The order's acquisition standards also apply to products designated by USDA as BioPreferred and bio-based, and products identified by DOE's Federal Energy Management Program.

Similarly, suppliers to many state, county, and municipal governments face environmental purchasing preferences. Examples include government entities applying the Green Electronics Council's EPEAT standard in selecting computer hardware products. Also, vendors to many large corporations must achieve environmental certifications. Companies committed to buying products certified by the Roundtable on Sustainable Palm Oil include Johnson & Johnson, H J Heinz, Hershey, ConAgra, General Mills, Mars, Wal-Mart, McDonald's, PepsiCo, Procter & Gamble, and Colgate-Palmolive. Hewlett-Packard, Lowe's, and Home Depot (each moving goods over half a billion miles annually) selected high-performing EPA SmartWay carriers for 98 percent of their shipments. Kimberly-Clark announced a goal of by 2025 sourcing 90 percent of all fiber from "environmentally preferable sources," such as FSC-certified or recycled fiber. Target committed to purchasing 100 percent sustainable, traceable seafood based on the Monterey Bay Aquarium's Seafood Watch Program certification. And McKesson adopted EPEAT registration in selecting personal computers.

Vendors may have SEC disclosure obligations to describe large purchasers' environmental preferences. Governments' environmental purchasing standards or preferences (in legislation, regulations, executive orders, or other means) may fall within the section of Regulation S-K, Item 101(c), addressing material effects on a company of compliance with federal, state, and local environmental provisions — "provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment." More generally, large purchasers' standards may significantly influence the earnings of their current suppliers as well as companies vying to sell to them. Vendors lacking the applicable certification may lose the business, or have to achieve the certification by incurring higher capital and operating costs. In contrast, such announcements may lead qualified vendors to expect decreased price competition and stronger demand.

As a second scenario, one or more leading competitors in a market segment improve their attractiveness to environmentally motivated buyers by announcing they achieved, or are committed to achieving, a certification. Such environmental indicators may significantly affect the earnings of the holder (positively) as well as its uncertified competitors (negatively).

Vendors obtain and promote environmental certifications in many markets: 18 percent of global palm oil production was RSPO certified as of October 2014. More than 20,000 building projects worldwide representing 2.9 billion square feet of space were certified by the USGBC's Leadership in Energy and Environmental Design standards in 2013. And EPA SmartWay carriers accounted for 22 percent of U.S. trucking miles in 2014. Some certifications identify market segment leaders; for example, FSC leadership awards in 2014 highlighted one or two companies in forest land managing, paper manufacturing, wood product manufacturing, tissue products manufacturing, and lumber retailing.

Under Regulation S-K, an environmental certification may emerge as a significant method of competition, as a factor affecting the competitive position of companies, or as a trend reasonably likely to affect operating results. One or more competitors that are likely to benefit materially from such status may need to inform investors of the criteria for such certification, likely effects on buyers, how distinctive its achievement is likely to remain, and costs of maintaining the certification. In making such disclosures, potential securities liability encourages companies to submit truthful information to certifying organizations. From the opposite perspective, a company lacking a certification held by some of its competitors may have to inform investors of such a market condition, likely effects on buyers, and any plans it has to achieve such status along with major impacts on operations and costs.

Another reason for securities disclosures to address environmental certifications deals with investors who see marketing information or news coverage highlighting a company's environmental credentials. In deciding whether to buy a stock, how much weight should investors give to an environmental certification held by one company but not by a competitor? What are the likely impacts on earnings and risks? Securities disclosures are intended to give investors analyses by companies' managers covering important competitive factors. As environmental purchasing grows, so too should SEC disclosures. Additionally, SEC disclosures are subject to standards and penalties tougher than those applicable to corporate sustainability reports, marketing materials, or press releases. Reflecting environmental claims in SEC filings would raise the reliability of such information. Currently, many environmental claims are not subject to independent, third-party verification, rigorous monitoring systems, or attention from senior company executives. Moreover, the claims may be misleading or present an incomplete picture.

Third, influential organizations (including EPA, USGBC, Green Seal, and GRI) announce from time to time new certification standards, ratings, or reporting requests. To sort through the proliferation of developments in environmental certifications and reports, the relevant threshold is likelihood of affecting reasonable investors, such as a material impact on companies' earnings. A new certification or rating likely to significantly affect customers' purchases would warrant SEC disclosure. Similarly, changing an environmental rating that is an important factor in competitive positioning would make an SEC disclosure reasonable.

For governments and environmental organizations, inclusion in securities disclosures would raise their certifications' visibility to investors and customers, spur companies to decrease their ecological impacts, and encourage companies to submit truthful data for ratings. To qualify as a material certification, ratings organizations must focus purchasers on the importance of their environmental indicators. More environmentally motivated purchasing means that certifications cause more material market impacts, leading to more securities disclosures. While the likely market response should determine which certification developments justify SEC disclosure, environmentalists' ratings must credibly and reliably weigh various attributes of products and vendors.

The preceding sections showed that purchasing standards and preferences likely make environmental certifications and metrics material for some vendors, requiring securities disclosures under existing regulations. Turning to a small sample of recent SEC annual reports (2014 Form 10-K), some companies made such disclosures; this information fit with descriptions of strategy, competition, environmental matters and risks. On the other hand, a limited sampling also found companies that described their environmental certifications and market developments only in publications not filed with the SEC. Four cases discussed below demonstrate the feasibility of securities disclosures and gaps between SEC-filed information and other information provided to investors and purchasers. There is no intention to allege any securities law violations or claim a systematic survey.

First, KB Home's SEC annual report described the strategy of differentiating this homebuilder from competitors through its ongoing commitment to become a national leader in environmental sustainability. This securities filing pointed to the company's commitments to meet EPA Energy Star and Watersense standards for homes and fixtures, to reduce construction and office waste, and to increase consumer awareness of the importance of sustainability in selecting a home and products. Outside of its securities filings, KB Home issued annual sustainability reports and press releases providing further details relevant to environmentally preferred purchasing, including measures of energy and water savings of its new homes compared to typical resale homes, and earning highest EPA recognitions for energy efficiency and water conservation achievements. The company's sustainability report, but not its SEC filing, showed GRI indicators of environmental performance.

In SEC disclosures on strategy and competition, paper manufacturer Domtar referred to its forest sustainability certifications: "We seek product differentiation through an extensive offering of high quality FSC-certified paper products [and] through the certification of our pulp mills to the FSC chain-of-custody standard and the procurement of FSC-certified virgin fiber." This description did not go as far as the ecological goals and actions stated in the company's annual sustainability report, including increasing FSC-certified fiber procured for its mills from 16 percent in 2010 to 20 percent by 2020, seeking to procure 100 percent of fiber from FSC-certified sources, reducing GHG emissions by 15 percent over this period, and cutting landfill waste by 40 percent over 2013-20.

In another variation on mixed disclosures, Office Depot's SEC report states in the section on environmental matters its vision to "increasingly buy green, be green, and sell green." This section briefly lists several initiatives: recycling and pollution reduction; sustainable forest management; and issue awareness and market development for environmentally preferable products. It notes: "Operations in the US and internationally have been commended for our leadership position for our facility design, recycling efforts, and 'Green' product offerings." The SEC filing provides links to two company websites detailing its achievements and green product offerings, including key environmental awards and GRI indicators.

Finally, Lockheed Martin was the largest supplier to the U.S. government in 2014, with $32 billion in contracts; its SEC filing stated that 79 percent of its consolidated net sales were to the U.S. government. Five years ago, Lockheed Martin issued a report, "Aligning with Customer Sustainability Goals," which highlighted the ecological mandates for procurement by the U.S. agencies and the U.K.'s Ministry of Defense: "It is imperative that we recognize the sustainability goals of our customers and align our business practices to assist in achieving their mission." Two months after release of Executive Order 13693, Lockheed Martin issued a chart depicting the alignment between the federal agencies' sustainability goals and the company's environmental sustainability goals and performance. Moreover, the company's annual sustainability report details a range of environmental performance indicators, results, goals, and recognitions. Along with this "imperative," the firm's business is affected by a large number of non-environmental conditions. In Lockheed Martin's SEC filing, only a general statement of a risk appears to encompass environmentally preferred purchasing as well as other conditions: "We must comply with and are affected by laws and regulations relating to the award, administration, and performance of U.S. government contracts." As for environmental matters, the filing addresses remediation liabilities and general compliance with environmental protection laws and regulations.

This small sample shows that, to varying degrees, some SEC filings inform investors of the forms and competitive impacts of environmentally preferred purchasing. Additionally, these SEC filings only partially reflect the companies' environmental attributes which are important enough to purchasers, investors and communities for the companies to engage in extensive non-SEC reporting.

Environmental advocates and securities lawyers should recognize the two-way relationship between environmentally preferred purchasing and disclosures in securities filings. One direction involves the effects of environmental information and motivated buyers on regulated filing obligations. Under existing securities laws and regulations, environmental attributes of vendors and products likely to have a material impact on companies' earnings warrant disclosures. Because of the growth of environmentally preferred purchasing, ecological certifications and metrics can significantly affect companies' business and competitive conditions. The materiality of market impacts is determined by the extent of customers' preferences for environmental performance and suppliers' use of ecological attributes in marketing and bidding. Material environmental attributes and purchasing preferences should be described in securities filings.

In the other direction, securities disclosures improve environmental information and purchasing preferences. Securities laws would increase the truthfulness of companies' environmental statements, applying higher standards of verification and completeness than pertain to marketing material and sustainability reports. Along with the visibility of descriptions in securities filings, this legal framework enhances the influences of governmental and non-governmental environmental certifications. Investors, securities analysts, and rating companies are more likely to react to disclosures in securities offerings than in databases of or reports by environmental organizations. Customers and conservation organizations can use such disclosures to expand environmentally preferred purchasing and thereby encourage lighter footprints.

The growth in environmentally preferred purchasing should raise the awareness of companies, regulators, and lawyers to disclose more ecological attributes in securities filings. Conservationists are identifying best practices in actions by suppliers and purchasers, guiding purchasers toward applying environmental standards and preferences. Purchasers increasingly recognize that some vendors lead in conserving ecosystems while others waste such assets. Furthermore, purchasers are grasping their power to channel toward conservation trillions of dollars annually. In fulfilling their traditional role of protecting investors, more securities disclosures of environmental attributes would also further the Executive Branch's efforts to promote sustainable practices and fight climate change. **TEF**