

Before the Securities and Exchange Commission  
**Concept Release: Business and Financial Disclosure Required by Regulation S-K**  
Release No. 33-10064; 34-77599; File No. S7-06-16  
RIN 3235-AL-78

**Comments of Warren G. Lavey**

**I. Introduction**

I file comments as an individual with relevant expertise. I am an adjunct professor at the University of Illinois, teaching environmental law and policy; retired partner from Skadden, Arps, Slate, Meagher & Flom LLP; author of an article on securities disclosures to reflect buyers' environmental standards that are material to certain suppliers;<sup>1</sup> and advisory board member for the Sustainable Purchasing Leadership Council.

As the Commission observed in paragraph 218 of the Concept Release, some registrants choose to provide some sustainability information outside of their Commission filings. The Commission asks why companies make these disclosures and whether they are sufficient to meet investors' needs. These comments also respond to questions in paragraphs 216 (material sustainability issues for required disclosure), 219 (sustainability reporting frameworks), 220 (consistency of sustainability disclosure with Commission's mission to protect investors), and 223 (insufficiency of current climate change-related disclosures).

As described below, some registrants publicly acknowledge that certain information on purchasers' environmental standards is material to their earnings, financial position, operations, ability to compete,

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<sup>1</sup> Lavey, "Buying into Securities Filings", 33 The Environmental Forum 25 (2016), also available at <https://nextgenenvironmentallaw.wordpress.com/2016/02/25/green-purchasing-and-securities-disclosure/>.

Cynthia Williams and Sean Reynolds provided helpful comments for this submission.

and prospects. In competing for significant buyers, these registrants often communicate their environmental commitments and certifications in flexible, unregulated media outside of their Commission filings. In many cases, registrants' Commission filings fail to disclose for investors such material buying practices and environmental performance. When some investors find pieces of this information outside of Commission filings, they lack the benefit of management discussion and analysis (MD&A) and statements of risks. Moreover, the information disclosed outside of Commission filings may evade regulatory and private liability safeguards for truthfulness and completeness, and lack comparability and consistency of presentation, making these sources inadequate for investors.

To protect investors, these conditions demand new Commission guidance, comments in the filing review process, and enforcement action, as mandated by the provisions and policy of Regulation S-K.

## **II. Materiality of Buyers' Environmental Standards**

Large buyers as well as significant segments of small buyers apply environmental standards as part of their procurement practices, which materially influence many registrants' financial position and operations. Environmental purchasing practices have emerged as market forces that are already material to many investors, and are growing in breadth and strength. This section provides examples of buyers' environmental standards deserving greater Commission attention.

### **A. Forceful Emergence of Environmental Standards in Purchasing Decisions**

Federal, state and local governments are major buyers for the products and services sold by many registrants. Large public entities often subject suppliers to environmental standards, influencing registrants' sales, pricing, product design and operations.

1. Federal Agencies. Federal Executive Order 13693 (Planning for Federal Sustainability in the Next Decade, issued March 19, 2015) requires that federal agencies apply certain environmental performance

and sustainability criteria in purchasing products and services.<sup>2</sup> These standards apply to such varied acquisitions as facilities' electricity (from renewable power systems), vehicles (zero emission and plug-in hybrid), electronics products (ENERGY STAR), plumbing fixtures (WaterSense), cleaning chemicals (SNAP), trucking services (SmartWay), and copier paper (30% or more recycled content).<sup>3</sup> With almost \$450 billion in annual spending on basic goods and services,<sup>4</sup> federal agencies account for a large portion of sales for many registrants and a major force shaping competition in many markets. In FY2013, the federal government spent about \$72 billion on facilities and construction, \$47 billion on information technology, and \$34 billion on transportation and logistics services.<sup>5</sup>

2. State Governments. State governments have enacted various environmental purchasing programs. To illustrate, New York State mandates purchases of products that are less harmful to the environment. The 2005 New York State Green Cleaning Law requires all public and nonpublic elementary and secondary schools in the state to use of environmentally-sensitive cleaning and maintenance products; accordingly, the New York State Office of General Services published a list of approved green cleaning products, naming the manufacturers/vendors which satisfy the standard.<sup>6</sup> Suppliers not named on the list lose potential sales to the schools. Additionally, two executive orders provide for the development of other green procurement lists for use by the state agencies; along with requirements for buying bio-based fuels for vehicles and buildings as well as 100% recycled content paper, the New York State

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<sup>2</sup> Executive Order 13693 furthers the practices mandated earlier, including Executive Order 13423 (Strengthening Federal Environmental, Energy, and Transportation Management, 2007) and Executive Order 13514 (Federal Leadership in Environmental, Energy, and Economic Performance, 2009).

<sup>3</sup> The White House, Executive Order 13693, Sec. 3; The White House Council on Environmental Quality, "Implementing Instructions for Executive Order 13693" (June 15, 2015).

<sup>4</sup> The White House, "A Major Step Forward in Category Management: Announcing New Government-wide Category Leaders" (Feb. 25, 2016).

<sup>5</sup> The White House, "Taking Category Management Government-Wide" (Jan. 7, 2015).

<sup>6</sup> Ch. 584 of the NY Laws of 2005; New York State Office of General Services, "New York's Green Cleaning Program".

Interagency Committee on Sustainability and Green Procurement has promulgated environmental specifications for more than thirty product types.<sup>7</sup>

3. County and Municipal Governments. Many local governments have acted like the City of Minneapolis, which resolved in 2008 that “environmental considerations should be a part of normal purchasing decisions.”<sup>8</sup> For example, Alameda County, California, applied environmental performance standards and certifications in purchasing carpet (must contain recycled content and minimize off-gassing), lighting, printing devices, leased space in commercial buildings, janitorial cleaning and paper products, diesel particulate filters, office paper, and other supplies.<sup>9</sup>

Along with sustainable purchasing initiatives by governments, companies in many markets impose environmental standards on their suppliers. Three examples of major environmental certifications and commitments show the material impacts of such environmental purchasing on earnings, operations and risks of potential suppliers as well as buyers.

1. Certified Palm Oil. Companies committed to buying products certified by the Roundtable on Sustainable Palm Oil (a not-for-profit association) include Archer Daniels Midland, Avon Products, Burger King, Cargill, Coca-Cola, Colgate-Palmolive, ConAgra Foods, Costco, Domino’s Pizza, General Mills, Hershey, McDonald’s, Procter & Gamble, PepsiCo, Safeway, Target, Wal-Mart, and Wendy’s. About 21% of palm oil globally is certified by this organization, meaning that the remaining suppliers are or soon will

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<sup>7</sup> NY Executive Order No. 4, “Establishing a State Green Procurement and Agency Sustainability Program” (2008); NY Executive Order No. 142, “Directing State Agencies and Authorities to Diversify Transportation Fuel and Heating Oil Supplies Through the Use of Bio-Fuels in State Vehicles and Buildings” (2005); Responsible Purchasing Network, “Green Purchasing State Profile: State of New York” (undated).

<sup>8</sup> City of Minneapolis, “Adopting an Environmental Purchasing Policy”, Resolution 2008R-432.

<sup>9</sup> Alameda County Sustainability, “Success Stories in Purchasing”.

be unable to sell to these large buyers. These buyers' commitments also mean that they have fewer potential suppliers, which could affect their operations, costs and risks.<sup>10</sup>

2. Certified Electronics. Many large companies specify EPEAT certification ("Electronic Product Environmental Assessment Tool", managed by the Green Electronics Council, a non-profit organization) as a purchasing requirement for various types of electronics products. EPEAT tracks more than 4,400 products from over 60 manufacturers. Participating manufacturers and purchasers include Apple, Canon, Dell, Epson, Ford, HP, Kaiser Permanente, KPMG, LG, Marriott, Samsung, Toshiba, and Xerox.<sup>11</sup> The Green Electronics Council touts the competitive advantage conferred by participating in EPEAT:<sup>12</sup>

Don't lose a sale for lack of green electronics credentials. Maximize your competitive advantage and pursue the greener purchasing market with EPEAT.

As the definitive rating system for greener electronics, EPEAT helps you sell to the growing group of customers motivated by sustainability.

EPEAT launched in 2006 and today is an official resource for more than \$65 billion in procurement contracts—and counting. The demand for environmentally superior IT products and systems continues to grow. The U.S. government already stipulates that 95% of electronics procurements be EPEAT-registered. Companies are following suit. In a recent IDC survey, more than 60% of U.S. companies are looking for products that conform to industry standards such as EPEAT. (emphasis added)

3. Commitments to End Deforestation. In 2014 at the United Nation's Climate Summit, many large companies committed to take actions to end deforestation by 2030, endorsing the New York Declaration on Forests (Cargill, General Mills, Johnson & Johnson, Kellogg's, McDonald's, Procter & Gamble, SC Johnson, Wal-Mart, and others).<sup>13</sup> To illustrate these actions, McDonald's Corporation announced in 2015 its Commitment on Deforestation applicable to all its raw material supply chains, extending to

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<sup>10</sup> Roundtable on Sustainable Palm Oil website; McDonald's, "Our Supply Chain: Six Priority Products for Sustainable Sourcing" ("In 2014, the Company came close to achieving its goal of having 100% of palm oil used for restaurant cooking or by McDonald's suppliers to par-fry chicken and potato products be RSPO-certified sustainable or covered by GreenPalm Book and Claim certificates by 2015.").

<sup>11</sup> [www.epeat.net](http://www.epeat.net).

<sup>12</sup> Green Electronics Council, "Make the Most of Being an EPEAT Partner" 1 (2011) (footnote omitted).

<sup>13</sup> UN Climate Summit, "New York Declaration on Forests, Action Statements and Action Plans" (2014).

more than 3,100 direct suppliers and a complex network of indirect suppliers.<sup>14</sup> Also, World Wildlife Fund's report "Profitability & Sustainability in Responsible Forestry" promotes the economic benefits to companies of Forest Stewardship Council (FSC) certification in terms of "gaining market advantage, such as brand recognition, price premiums and market access."<sup>15</sup>

#### B. Outside Commission Filings, Some Registrants Publicly Acknowledge the Materiality of Environmental Purchasing Standards

Along with addressing investors' criteria, companies issue corporate sustainability reports and other environmental performance information in response to pressures from buyers. Portraying their sustainability leadership helps suppliers show that they satisfy buyers' environmental standards and contribute to buyers' initiatives to reduce their total (including supply chain) greenhouse gas (GHG) emissions and other measures of environmental footprint.

Some registrants' public statements outside Commission filings acknowledge material impacts of environmental purchasing standards on their financial and operating position. As the Commission recently observed in proposing modernization of property disclosures for mining registrants, a factor in determining whether certain operations are material could be "public disclosure by the registrant discussing the importance to its operations (e.g., from an operational or competitive standpoint) of a particular property or properties".<sup>16</sup> A few examples follow.

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<sup>14</sup> McDonald's Corp., "McDonald's Corporation's Commitment on Deforestation" and "Supporting Addendum" (Apr. 21, 2015); McDonald's, "Our Supply Chain: Six Priority Products for Sustainable Sourcing" (includes 2020 Aspirational Goal for 100% of fiber-based packaging from certified or recycled sources). See also DeBiase (McDonald's Chief Supply Chain and Sustainability Officer), "Working together to address climate change" (2015) ("For McDonald's, these actions are not merely 'nice to dos.' They are fundamental to how we do business and our long-term commitment to making progress on those things that matter most to our customers") (emphasis added).

<sup>15</sup> World Wildlife Fund, "Profitability & Sustainability in Responsible Forestry" at 4 (2015).

<sup>16</sup> SEC, "Modernization of Property Disclosures for Mining Registrants" at 18 (Release Nos. 33-10098, 34-78086) (2016) ("Mining Registrants").

1. As part of a series called “The Sustainability Edge”, Lockheed Martin posted on its website a publication entitled “Aligning with Customer Sustainability Goals”. The introduction states:<sup>17</sup>

Lockheed Martin’s customers are at the forefront of sustainability initiatives, recognizing that global security is highly impacted by the availability of natural resources, reliance on fossil fuels and imported oil, and impacts of climate change. U.S. Executive Orders from the White House related to sustainability mandate Federal agencies to “lead by example” and usher in a “clean energy economy.”

The U.K.’s Ministry of Defence is leading the way in sustainability, with the U.S. Department of Defense (DoD) following closely behind. With 85 percent of Lockheed Martin’s business coming from the U.S. Government – approximately 60 percent with the DoD alone – and with our goal to expand to 20 percent of total sales to international customers, it is imperative that we recognize the sustainability goals of our customers and align our business practices to assist in achieving their mission. Just as importantly, sustainability initiatives are integral to improving our own long-term operational, product and service costs, quality and performance.

What can you do?

- Partner with your customers to understand their sustainability needs
- Educate customers on what we are doing internally and how we align with their initiatives
- Inform your staff that our customers are looking to us to help them become more sustainable; from material selection to power use to end of life considerations

We are in a key position to help influence and shape the future requirements of our customers, and to help them meet one of their most challenging goals – to lead by example in a sustainable manner. (emphasis added)

Three months after the President issued Executive Order 13693 (in March 2015, establishing the federal government’s environmental procurement standards), Lockheed Martin released a one-page scorecard showing the alignment between the Executive Order’s goals and the company’s environmental sustainability goals and performance.<sup>18</sup> Another major defense contractor, Northrop Grumman, also

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<sup>17</sup> Lockheed Martin, “Aligning with Customer Sustainability Goals” at 2 (undated). This document cited two Executive Orders preceding Executive Order 13693 -- Executive Orders 13423 (2007) and 13514 (2009). Lockheed Martin had \$32 billion in U.S. government contracts in FY2014. Council on Environmental Quality, “Federal Supplier Greenhouse Gas Management Scorecard” (“CEQ Scorecard”).

<sup>18</sup> Lockheed Martin, “Lockheed Martin’s Alignment with U.S. Executive Order 13693: Planning for Federal Sustainability in the Next Decade” (June 2015).

noted on its Environmental Sustainability webpage the goals in Executive Order 13693, and stated that it shares its customers' priorities and supports their strategic objectives.<sup>19</sup>

2. Apple withdrew from EPEAT in 2012. Within days, customers that required EPEAT certification for their computer purchases contacted Apple. In particular, the City of San Francisco had a policy that its computers, laptops and monitors must be EPEAT "gold" rated. According to an article in The Guardian:<sup>20</sup>

Apple's move last week looked as though it could lead to a domino effect in which companies and government contractors might stop buying its products due to lack of EPEAT certification... Although Apple's corporate sales are far smaller than rivals such as HP and Dell, such contracts are still important both for reputation and long-term stability.

Apple quickly rejoined EPEAT. Apple's senior vice-president of hardware engineering wrote an open letter stating that it recently heard from many disappointed Apple customers, the move was a "mistake", its "commitment to protecting the environment has never changed," and it "makes the most environmentally responsible products in our industry."<sup>21</sup>

3. Several companies describe environmental sustainability as part of their corporate DNA, driving their product designs, sourcing of materials, marketing, manufacturing and other operations. In sustainability reports and other documents posted on their websites, some registrants highlight their strategy of applying environmental purchasing standards in terms of its importance for their brand reputation and control of risks and costs; these companies also point to the resources they devote to screening, monitoring and collaborating with suppliers to achieve environmental targets.

For example, Kimberly-Clark explains on its Sustainability webpage: "Sustainability is embedded into everything we do. Kimberly-Clark Corporation currently sources 100% of our wood fiber from third-party

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<sup>19</sup> Northrop Grumman, "Environmental Sustainability (greeNG)". Northrop Grumman had \$10 billion in U.S. government contracts in FY2014. CEQ Scorecard.

<sup>20</sup> Arthur, "Apple rejoins EPEAT environmental ratings system," The Guardian (July 16, 2012).

<sup>21</sup> Lowensohn, "Apple reverses course, re-ups with EPEAT green standard," CNET (July 13, 2012).



certified suppliers. We are committed to continuing to invest in responsible forest management.”<sup>22</sup> A guide for suppliers on this registrant’s website explains:<sup>23</sup>

K-C believes that the success of our mission depends in large part on how well we manage the environmental impacts of our businesses. It is the policy of Kimberly-Clark to design, manufacture and deliver its products and to operate its business in a way that protects the biosphere and promotes the sustainable use of natural resources upon which our businesses and stakeholders depend, including forests, water supplies and energy resources.... It is the intent of our policy to promote sustainable forest management practices by the Corporation’s wood fiber suppliers that are economically viable, environmentally responsible and socially beneficial by considering supplier performance in the selection process. (emphasis added)

Other registrants in various industries stress – in sustainability reports and other such unregulated documents – the critical role of environmental purchasing in their strategies, market position and operations, including:

- Office Depot – “[W]e take sustainability very seriously. We don't just look at our own operations - we work together with partners, suppliers and customers to ensure that our entire supply chain operates as 'sustainably' as possible”; defined the “Office Depot GreenerOffice™ Rating System” and reports annually product sales by “light green”, “mid green” and “dark green” categories as well as copy paper sold with FSC virgin fibers and recycled fibers; provides customers with its Greener Purchasing Program to help them reduce their environmental footprints<sup>24</sup>
- Baxter – “sustainability is a core element of Baxter’s vision to build a truly great company”; uses environmental provisions in its requests for proposals and supplier agreements globally, with reporting of vendors’ environmental performance and initiatives; reports and works to reduce the GHG emissions from upstream and downstream transportation of its products worldwide, including by requiring its U.S. carriers to participate in EPA’s SmartWay program<sup>25</sup>
- Domtar – logo is “the sustainable pulp, paper and personal care company”; environmental goals for its supply chain include by 2020 procuring 20% of fiber used from FSC certified sources, and reducing total direct and indirect GHG emissions from purchased energy at pulp and paper mills by 15%; annually reports purchases of certified wood by region<sup>26</sup>

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<sup>22</sup> Kimberly-Clark, “Sustainability, Certifications”.

<sup>23</sup> Kimberly-Clark, “Sustainability at Kimberly-Clark: Guide for Suppliers” at 4-5 (2012).

<sup>24</sup> Office Depot, “Corporate sustainability”, “Tell Green: Long-standing commitment to transparency and accuracy”, “Greener Purchasing Program”.

<sup>25</sup> Baxter, “2014 Sustainability Report” 5, 86-90.

<sup>26</sup> Domtar, “Sustainability”.

- KB Home – “an industry leader in sustainability, building innovative and highly energy- and water-efficient new homes”; reports number of EPA ENERGY STAR and WaterSense certified homes built, including number of installed certified appliances and plumbing fixtures<sup>27</sup>

### III. **Applying Regulation S-K to Material Environmental Purchasing Conditions**

#### A. **Three Provisions of Regulation S-K**

For some registrants, at least three provisions of Regulation S-K apply to the types of environmental purchasing conditions described in the preceding section. In the SEC’s review of registrants’ filings for compliance with these rules, general statements about business conditions and risks often draw comments from SEC staff requesting more specifics (granular discussion) to provide more meaningful disclosure to investors.<sup>28</sup>

First, Item 101(c) requires a registrant to describe its business, including describing where material the sources and availability of raw materials, competitive conditions in the business, and material effects of compliance with federal, state, and local environmental provisions. As for material information on sources and availability of raw materials, environmental commitments on forests, palm oil, water and natural resources have emerged to constrain or create major opportunities for suppliers and buyers. Regarding competitive conditions, the regulation directs the registrant to identify and explain the principal methods of competition (e.g., price, service, warranty or product performance), and positive and negative factors pertaining to its competitive position. Environmental performance has emerged as a major competitive factor in buying decisions. Also, the types of environmental purchasing laws, executive orders, regulations and government policies described in Section II.A above fall within Item

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<sup>27</sup> KB Home, “2015 Sustainability Report” 2, 33.

<sup>28</sup> EY, “SEC Comments and Trends: An Analysis of Current Reporting Issues” 6, 31 (2014).

101(c)(xii) as federal, state or local government “provisions” enacted or adopted “relating to the protection of the environment”.<sup>29</sup>

In Item 101(c)(xii), the term “provisions” encompasses a broad range of governmental actions, not limited to statutes like the Clean Air Act or the Clean Water Act. In 2010, the Commission observed that this section of Regulation S-K could apply to regulatory, legislative and other developments that result in greater regulation of GHG emissions, including cap-and-trade legislation.<sup>30</sup> As the President stated in Executive Order 13693, environmental operating and purchasing standards for government entities serve to protect the environment.<sup>31</sup>

It therefore continues to be the policy of the United States that agencies shall increase efficiency and improve their environmental performance. Improved environmental performance will help us protect our planet for future generations .... Employing this strategy for the next decade calls for expanded and updated Federal environmental performance goals with a clear overarching objective of reducing greenhouse gas emissions across Federal operations and the Federal supply chain. (emphasis added)

Next, Item 303 requires MD&A 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.<sup>32</sup> As the Commission observed on MD&A descriptions in its 2010 Guidance regarding disclosures related to climate change:<sup>33</sup>

Over the years, the flexible nature of this requirement has resulted in disclosures that keep pace with the evolving nature of business trends without the need to continuously amend the text of the rule. Nevertheless, we and our staff continue to have to remind registrants, through comments issued in the filing review process, public statements by staff and Commissioners and otherwise, that the disclosure provided in response to this requirement should be clear and

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<sup>29</sup> 17 CFR 229.101 (c) (iii),(ix), (xii). Pursuant to Item 101(c)(xii), the disclosure should address the material effects that federal, state and local “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 and its subsidiaries.”

<sup>30</sup> SEC, “Commission Guidance Regarding Disclosure Related to Climate Change” 13 (Release Nos. 33-9106; 34-61469; FR-82) (2010) (“Guidance Related to Climate Change”).

<sup>31</sup> E.O. 13693, Sec. 1.

<sup>32</sup> 17 CFR 229.303.

<sup>33</sup> Guidance Related to Climate Change at 16.

communicate to shareholders management's view of the company's financial condition and prospects.

That guidance noted that a registrant's MD&A may need to disclose indirect consequences of climate change regulation or business trends, such as decreased demand for goods that produce significant GHG emissions, and increased demand for goods that produce lower emissions than competing offerings.<sup>34</sup> In adopting and applying environmental purchasing standards, decisions by some large buyers to eliminate potential suppliers that fail to satisfy them are events reasonably likely to result in favorable or unfavorable material effects on the operating results of the eliminated vendors and, in some cases, on the qualifying vendors and buyers. Moreover, the expansion of environmental purchasing criteria and the growing number of buyers applying them are trends in several markets reasonably likely to result in material effects on some registrants' operating results.

Third, 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.<sup>35</sup> The 2010 Guidance on climate change observed that the disclosure of risk factors may have to include indirect effects of regulation or business trends, including damage to a registrant's reputation from the public's response to information showing that it is a laggard in practices to protect the environment:<sup>36</sup>

Depending on the nature of a registrant's business and its sensitivity to public 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.

The increased use in purchasing of environmental performance data, ratings, standards, toolkits for buyers, and other resources are driving changes to the competitive landscape and business conditions

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<sup>34</sup> Id. at 25.

<sup>35</sup> 17 CFR 229.503(c).

<sup>36</sup> Guidance Related to Climate Change at 26.

that risk materially damaging some registrants' financial performance. In turn, these developments should drive increased risk disclosures in Commission filings.<sup>37</sup>

The Commission's guidance is that "a discussion of risk in purely generic terms does not indicate how a risk may affect an investment in a particular registrant."<sup>38</sup> The Concept Release asks: "How could we modify our rules to require or encourage registrants to describe risks with greater specificity and context?"<sup>39</sup> As shown in the next section, some registrants' general statements about environmental concerns and meeting customers' requirements do little to inform investors on the development, effects and risks of material environmental purchasing standards. Specificity is particularly important when dealing with business conditions and risks associated with emerging material factors that are not familiar to many investors, such as environmental purchasing standards.

#### **B. Disclosures in Some Registrants' Commission Filings**

A recent review by this author of some illustrative Form 10-K filings strongly suggests that there would be benefits from new Commission guidance and reminders to registrants on disclosing material information regarding environmental purchasing standards. In several cases, statements on company websites indicate the materiality of events or trends in such purchasing practices, but the Commission filings do not convey this information to investors. Furthermore, investors reading the Commission filings are deprived of MD&A and risk factors addressing **with sufficient comparability, consistency and specificity** how environmental purchasing developments affect the registrants' earnings, operations and prospects.

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<sup>37</sup> Williams, "The Securities and Exchange Commission and Corporate Social Transparency," 112 Harv. L. Rev. 1197 (1999); Smith, "Sustainability Data Are Driving Disclosure," 33 The Environmental Forum 27 (2016).

<sup>38</sup> Concept Release at 150.

<sup>39</sup> Id. at 152.

1. As described above, Executive Order 13693 applies new environmental standards to hundreds of billions of dollars in annual acquisitions by federal agencies. The President's order in March 2015 led some large suppliers to the federal agencies to post on their websites documents describing their alignment with these criteria and goals. As further evidence of materiality, the largest contractor to the federal government, Lockheed Martin, posted on its website that recognizing the government's sustainability goals was "imperative" for its business practices, and that its sustainability initiatives also were "integral" to improving its costs, quality and performance. Yet, this Executive Order (as well as the two preceding executive orders on sustainability factors in federal procurements) is not noted or described for investors in the 2015 Form 10-Ks filed by the top five federal suppliers, each with over \$10 billion in U.S. government contracts in FY2014.<sup>40</sup> A scattered few vague general statements in these Commission filings may be applicable to this market condition, and two of these five registrants noted their corporate sustainability programs in their Form 10-K filings.<sup>41</sup> However, these statements give

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<sup>40</sup> CEQ Scorecard.

<sup>41</sup> Lockheed Martin 2015 Form 10-K: "We have an ongoing comprehensive sustainability program to reduce the effects of our operations on the environment." (p. 19); "We must comply with, and are affected by, laws and regulations relating to the formation, administration and performance of U.S. Government and other contracts." (p. 9)

Boeing 2015 Form 10-K: "We are subject to various federal, state, local and non-U.S. laws and regulations relating to environmental protection, including the discharge, treatment, storage, disposal and remediation of hazardous substances and wastes." (p. 5); "Our sales to the U.S. government are subject to extensive procurement regulations, and changes to those regulations could increase our costs." (p. 9)

General Dynamics 2015 Form 10-K: "We are subject to a variety of federal, state, local and foreign environmental laws and regulations." (p. 15); "Our revenue is concentrated with the U.S. government. This customer relationship involves some specific risks." (p. 16)

Raytheon 2015 Form 10-K: "Our operations are subject to and affected by a variety of international, federal, state and local environmental protection laws and regulations." (p. 12); "changes in the U.S. government procurement environment may limit certain future market opportunities for us" (p. 16); "Among the causes for debarment are violations of various statutes, including those related to procurement integrity, export control, U.S. government security regulations, employment practices, protection of the environment, accuracy of records and the recording of costs, and foreign corruption." (p. 17)

Northrop Grumman 2015 Form 10-K: "In 2015, we announced our 2020 environmental sustainability goals: to reduce absolute greenhouse gas emissions by 30 percent from 2010 levels; to reduce potable water use by 20 percent from 2014 levels; and achieve a 70 percent solid waste diversion rate (from landfills). We have recorded

investors little or no sense of the specific contents of or change in federal acquisition standards and the potential impacts on the registrants' earnings, operations, competitive position and prospects.

2. Several environmental certifications appear to have material influence on some suppliers and buyers.

As described above, Apple withdrew from the Green Electronics Council's EPEAT certification in 2012, and quickly re-entered this standard after a strong, well-publicized reaction by customers; Apple's open letter then touted what Apple described as its industry-leading environmental program. Yet, Apple's Form 10-K covering this period in 2012 (as well as its Form 10-K filings for 2013, 2014 and 2015) does not mention EPEAT or the Green Electronics Council, ENERGY STAR, other environmental certification, or a company environmental responsibility or sustainability program. While HP also fails to mention EPEAT or ENERGY STAR in its 2015 Form 10-K, it does make disclosures on requirements related to energy consumption affecting its products and procurements, the company's environmental programs, and government agencies' procurement requirements.<sup>42</sup>

3. International environmental initiatives to conserve forests and other natural resources led many registrants to commit to changing their suppliers and operations, as noted in Section II.A above. In some cases, the companies' well-publicized announcements and multi-year phase-in of the changes signal materiality.

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liabilities and have incurred and expect to continue to incur capital and operating costs to comply with applicable environmental laws and regulations and to achieve our environmental sustainability commitments." (p. 7)

<sup>42</sup> HP 2015 Form 10-K: "Some of our products also are, or may in the future be, subject to requirements applicable to their energy consumption. In addition, we face increasing complexity in our product design and procurement operations as we adjust to new and future requirements relating to the chemical and materials composition of our products, their safe use, and their energy efficiency, including requirements relating to climate change." (p. 14); "We are committed to maintaining compliance with all environmental laws applicable to our operations, products and services and to reducing our environmental impact across all aspects of our business. We meet this commitment with a comprehensive environmental, health and safety policy, strict environmental management of our operations and worldwide environmental programs and services." (p. 15); "our contracts with federal, state, provincial and local governmental customers are subject to various procurement regulations, contract provisions and other requirements relating to their formation, administration and performance" (p. 32)

McDonald's 2015 Form 10-K does not specifically mention the commitment on deforestation it made that year; investors are not informed on the content, risks or impact on its business of that commitment. Nevertheless, this Commission filing does have a paragraph in the risk factors on the need to manage (in its own operations as well as its supply chain) general pressures to make commitments on environmental sustainability matters, including deforestation.<sup>43</sup> This registrant also discussed in its Form 10-K its efforts to improve its environmental practices, describing the risk from new government initiatives on environmental matters (particularly in the area of climate change),<sup>44</sup> the risk to its brand reputation related to sustainability initiatives,<sup>45</sup> and its efforts toward more energy efficiency and more sustainable sourcing practices.<sup>46</sup>

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<sup>43</sup> McDonald's 2015 Form 10-K: "Additionally, we are keenly aware of and working to manage the risks and costs to us, our franchisees and our supply chain of the effects of climate change, greenhouse gases, energy and water resources. The increased public focus, including by governmental and nongovernmental organizations, on these and other environmental sustainability matters (e.g., packaging and waste, animal health and welfare, deforestation and land use) and the increased pressure to make commitments, set targets or establish additional goals and take actions to meet them, could expose us to market, operational and execution costs or risks. If we are unable to effectively manage the risks associated with our complex regulatory environment, it could have a material adverse effect on our business and financial condition." (p. 6)

<sup>44</sup> Id.: "Increased focus by U.S. and overseas governmental authorities on environmental matters is likely to lead to new governmental initiatives, particularly in the area of climate change. While we cannot predict the precise nature of these initiatives, we expect that they may impact our business both directly and indirectly. Although the impact would likely vary by world region and/or market, we believe that adoption of new regulations may increase costs for the Company. Also, there is a possibility that governmental initiatives, or actual or perceived effects of changes in weather patterns, climate, or water resources could have a direct impact on the operations of the System in ways which we cannot predict at this time." (p. 2)

<sup>45</sup> Id.: "[T]he ongoing relevance of our brand may depend on the success of our sustainability initiatives to support our brand ambition of good food, good people and good neighbor, which will require Systemwide coordination and alignment. If we are not effective in achieving our stated sustainability goals and addressing these and other matters of social responsibility in a way that inspires trust and confidence, trust in our brand could suffer." (p. 4); "Enhancements to the quality of McDonald's menu, more local sourcing of ingredients, and commitments around sustainability efforts are all designed to improve consumer confidence in the Brand." (p. 14)

<sup>46</sup> Id.: "At this time, the Company has already begun to undertake its own initiatives relating to preservation of the environment, including the implementation of more energy efficient equipment and management of energy use and more sustainable sourcing practices in many of its markets." (p. 2)



With less disclosure, Kimberly-Clark's 2015 Form 10-K does not notify investors of the company's policy of promoting sustainable forest management practices, including by sourcing 100% of its wood fiber from third-party certified sources. This registrant does inform investors generally of the risk to its business if it fails to satisfy retail trade customers' environmental standards,<sup>47</sup> as well as the risk to its operations from governmental regulatory requirements or nongovernmental voluntary actions in response to global climate change or other concerns.<sup>48</sup>

4. Finally, Section II.B.3 above considered four other registrants' website documents embracing their sustainability programs as fundamental strategies guiding their operations, marketing and competitive position. In the 2015 Form 10-K filed by each of these companies, investors are informed on the environmental initiatives in some detail and their significance to business strategies and operations:

- Office Depot states its environmental vision; explains that it includes environmental sensitivity in its packaging, operations and sales offerings; notes that it has been commended for environmental leadership; and provides further details on its environmental practices for paper products<sup>49</sup>

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<sup>47</sup> Kimberly-Clark 2015 10-K: "We may also be negatively affected by changes in the policies of our retail trade customers, such as inventory de-stocking, limitations on access to shelf space, delisting of our products, additional requirements related to safety, environmental, social and other sustainability issues, and other conditions." (p. 4)

<sup>48</sup> *Id.*: "Our ability to manufacture, distribute and sell products is critical to our operations. These activities are subject to inherent risks such as ... governmental regulatory requirements or nongovernmental voluntary actions in response to global climate change or other concerns regarding the sustainability of our business...." (p. 6)

<sup>49</sup> Office Depot 2015 Form 10-K: "As both a significant user and seller of paper products, we have developed environmental practices that are values-based and market-driven. Our environmental initiatives center on three guiding principles: (1) recycling and pollution reduction; (2) sustainable forest management; and (3) issue awareness and market development for environmentally preferable products. We offer thousands of different products containing recycled content and technology recycling services. Office Depot continues to implement environmental programs in line with our stated environmental vision to "increasingly buy green, be green and sell green" — including environmental sensitivity in our packaging, operations and sales offerings. Operations in the US and internationally have been commended for our leadership position for our facility design, recycling efforts, and 'green' product offerings." (p. 8)

- Baxter describes its “comprehensive sustainability program”, including environmental stewardship across the product life cycle; notes its water and energy saving strategies<sup>50</sup>
- Domtar points to environmental responsibility and sustainability as a key business objective and operating philosophy; notes its application of certified sustainable forest management practices<sup>51</sup>
- KB Home describes its commitment to “become a leading national company in environmental sustainability”, some specific actions promoting resource conservation in its offerings, and the company’s view of the impact of its sustainability program on its competitive position<sup>52</sup>

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<sup>50</sup> Baxter 2015 Form 10-K: “The company strives for continued growth and profitability, while furthering its focus on acting as a responsible corporate citizen. At Baxter, sustainability means creating lasting social, environmental and economic value by addressing the needs of the company’s wide-ranging stakeholder base. Baxter’s comprehensive sustainability program is focused on areas where the company is uniquely positioned to make a positive impact. Priorities include ... driving environmental performance across the product life cycle including development, manufacturing and transport.... Throughout 2015 the company continued to implement a range of water conservation strategies and facility-based energy saving initiatives. In the area of product stewardship and life cycle management, Baxter is pursuing efforts such as sustainable design and reduced packaging. Baxter is also responding to the challenges of climate change through innovative greenhouse gas emissions-reduction programs, such as shifting to less carbon-intensive energy sources in manufacturing and transport. Additionally, the company developed new long-term goals to drive continued environmental stewardship while creating healthier, more sustainable communities where Baxter employees work and live.” (p. 24)

<sup>51</sup> Domtar 2015 Form 10-K: “To further bolster our position and drive enhanced value for our shareholders, Domtar is focused on four key business objectives ... (4) operating with a focus on environmental responsibility and sustainability.... We strive to provide these assurances by certifying our distribution and manufacturing operations and measuring our performance against internationally recognized benchmarks. We are committed to the responsible use of forest resources across our operations and we are enrolled in programs and initiatives to encourage landowners engaged towards certification to improve their market access and increase their revenue opportunities.” (pp. 11-12): “We manage over 16 million acres of forestlands, directly and indirectly licensed or owned in Canada and the United States, through efficient management and the application of certified sustainable forest management practices such that a continuous supply of wood is available for future needs.” (p. 23)

<sup>52</sup> KB Home 2015 Form 10-K: “We have made a dedicated effort to further differentiate ourselves from other homebuilders and resale homes through our ongoing commitment to become a leading national company in environmental sustainability. We continually seek out and utilize innovative technologies and systems to further improve the energy and water efficiency of our homes, as well as engage in campaigns and other educational efforts, sometimes together with other companies, organizations and groups, to increase consumer awareness of the importance and impact of sustainability in selecting a home and the products within a home. Under our commitment to sustainability, we, among other things:

- build energy- and water-efficient new homes;
- developed an Energy Performance Guide<sup>®</sup>, or EPG<sup>®</sup>, that informs our homebuyers of the relative energy efficiency and the related estimated monthly energy costs of each of our homes as designed, compared to typical new and existing homes; and
- created and are adding more net-zero energy and zero freshwater design options, under a program called Double ZeroHouse™ 3.0, that are available in select markets....

We intend to continue to research, evaluate and utilize new or improved products and construction and business practices consistent with our commitment and believe our sustainability initiatives can help put us in a better position, compared to resale homes and homebuilders with less-developed programs, to comply with evolving

### **C. Lessons from Small Survey of Commission Filings**

This small survey showed that several registrants found clear, concise ways in their Commission filings to tell investors with reasonable specificity that environmental purchasing has material financial and operational impacts on those companies. In contrast, there are troubling omissions and inconsistencies in some other registrants' Form 10-K disclosures on environmental purchasing programs which appear – based on those companies' own sustainability reports and other documents -- to be material. This survey indicates that investors would benefit from Commission actions to make, where material, disclosures of market conditions in this area truthful and complete, with statements of risk factors along with MD&A.

As illustrations, we have seen that (1) a registrant observed that “it is imperative that we recognize the sustainability goals of our customers and align our business practices to assist in achieving their mission”, yet failed to describe in its Form 10-K those customers' application of environmental purchasing, let alone any of those standards, adoption and risks of new criteria, or impacts on the registrant's financial or operational results; (2) a registrant experienced a strong customer reaction when it lost an environmental certification and claimed that it “makes the most environmentally responsible products in our industry”, yet omitted any mention in its Form 10-K of an environmental certification or environmental program at the company; (3) a registrant committed to engage thousands of direct suppliers and a complex network of indirect suppliers in a multi-year program to end deforestation practices, yet did not mention this initiative and its impacts to investors in its Form 10-K; and (4) a registrant proclaimed that “sustainability is embedded into everything we do”, yet did not

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local, state and federal rules and regulations intended to protect natural resources and to address climate change and similar environmental concerns.” (pp. 8-9)

embed sustainability into its Form 10-K's disclosures on risks (limiting suppliers based on third-party certifications), business strategy, financial results, or operations.

Section II above demonstrated that outside of Commission filings some companies went a long way to highlight how such purchasing strongly influences their sales, sourcing of materials, operations, reputation, and competitive position. The analysis did not attempt to show that environmental purchasing is material for all registrants. It is not. Where not material to a registrant, discussion of environmental purchasing should not clutter Commission filings.

#### **IV. Recommendations for Commission Action to Encourage Disclosures of Material Environmental Purchasing Programs**

Environmental purchasing programs have emerged with material force on the financial and operational performance of some registrants. Even for registrants recognizing the materiality of environmental purchasing developments on their websites, these companies take inconsistent approaches to disclosures in Commission filings. Current practices with regard to this sustainability factor give investors incomplete information about some companies' risks and prospects, and little to no data by which to compare companies within an industry. Investors need more protection through Commission action in this area. As the Commission recently observed for mining registrants, requiring disclosures of report summaries on material operations in SEC filings in a consistent manner, rather than in other public reports, "should enable investors to assess better the value of the registrant's material properties."<sup>53</sup>

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<sup>53</sup> Mining Registrants at 36 {"[W]e believe that the proposed requirement that a registrant file a copy of the technical report summary for each material property as an exhibit to the SEC filing would enhance investor understanding of a registrant's material properties. Specifically, it would provide investors with a summary of the scientific and technical information that is the basis for the registrant's disclosure of mineral resources, mineral reserves and material exploration results, which should enable investors to assess better the value of the registrant's material properties."}.

The Commission needs to be more sensitive to the material impacts from environmental purchasing that already exist for some registrants and are growing for many others. Greater Commission attention to this issue would help protect investors through disclosures in more registrants' regulated filings, with relevant risk factors and MD&A. Many investors are unaware of the existence or material impacts on some registrants of environmental purchasing programs. In fact, allowing registrants to ignore in Commission filings these financial and operational impacts undermines the significance to investors of data and descriptions tucked into sustainability sections on companies' websites. Additionally, investors are harmed because companies usually publish sustainability data or reports without explaining the managements' views on how they relate to the companies' financial and operational performance. Even for investors willing to dive into companies' sustainability reports and marketing materials, disclosures in Commission filings are made in a liability framework that provides investors with greater assurance of truthfulness.

The Commission's observation on MD&A in its 2010 Guidance on Climate Change also applies to disclosures of material environmental purchasing programs: registrants need reminding "through comments issued in the filing review process, public statements by staff and Commissioners and otherwise" that the MD&A "should be clear and communicate to shareholders management's view of the company's financial condition and prospects".<sup>54</sup> The same recommendations apply to risk factors.

The steps in applying the existing Regulation S-K provisions and policy to material environmental purchasing practices should be fairly easy for the Commission. In addition to issuing guidance and making public statements, the Commission should look particularly closely in reviewing filings at registrants that have (a) federal, state or local governments as major customers; or (b) endorsed

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<sup>54</sup> Guidance Related to Climate Change at 16.

environmental commitments on sourcing materials, other certifications, or reducing GHG emissions and other environmental impacts in their operations and supply chains. The Commission could draw on readily available compilations of the companies more likely to be candidates for disclosures of material environmental purchasing practices. For example, the federal Council on Environmental Quality's "Federal Supplier Greenhouse Gas Management Scorecard" listed 43 companies with total U.S. government contracts in FY2014 exceeding \$1 billion; the New York Declaration on Forests named endorsements by 53 companies globally; EPEAT identifies more than 50 participating manufacturers and 23 participating enterprise purchasers; and the White House listed 154 companies participating in the American Business Act on Climate Pledge.<sup>55</sup> There are many overlaps in companies on these lists, so these indicators are quite manageable for the Commission.

Finally, the Commission should take advantage of work on industry-specific guidance for disclosures developed by the Sustainable Accounting Standards Board and other compilations of environmental indicators for corporations in developing specific line-item disclosure requirements to take account of this trend in procurements.

Respectfully submitted,

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<sup>55</sup> The White House, "White House Announces Additional Commitments to The American Business Act on Climate Pledge" (Dec. 1, 2015).