NATURAL RESOURCES DEFENSE COUNCIL, INC. v. SEC: DISCLOSURE OF ENVIRONMENTAL INFORMATION UNDER THE SECURITIES ACTS AND NEPA— THE MERITS AND JUDICIAL REVIEW*

I
INTRODUCTION

Acting under the theory that disclosure of pertinent information provides a sound basis for determining a security's value and for shareholder voting decisions, the Securities and Exchange Commission (SEC or Commission) promulgates and enforces regulations that require regulated businesses to disclose certain information to their shareholders and the public. Financial information is most frequently the target of the disclosure regulations. Certain groups, most notably the so-called "ethical investor" who is committed to certain social and political values, have called for meaningful disclosure of information pertaining to social and environmental matters. The SEC repeatedly has resisted their demands.

This Comment will focus on the controversy surrounding disclosure of environmental information. The SEC acknowledges that some environmental information, such as expenditures for violations of environmental laws, is financially important and presently requires disclosure of such information. Environmental information, however, rarely has such direct financial relevancy. Environmental information often has no financial relevancy; an example is the specific design specifications of emissions control equipment. More frequently, environmental information has indirect but substantial financial implications. A company's environmental policy, for example, is in itself of little financial importance. That policy, however, may reflect management's competency and awareness and may indicate, when evaluated in the light of past company performance, how the company will respond to future environmental regulations. The SEC has resisted efforts aimed at requiring disclosure of this kind of information, citing financial irrelevancy and the "imprecise" character of the information as justification. Proponents of environmental disclosure argue that environmental information is not financially irrelevant. To the extent that environmental information is imprecise, the decision whether to require its disclosure must be made with a full awareness of the kind of information presently subject to disclosure requirements, information which is in itself of questionable usefulness and deceptive precision.

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The most recent in a series of decisions addressing the Commission's refusal to promulgate environmental disclosure regulations is *Natural Resources Defense Council, Inc. v. SEC*[1] *(NRDC v. SEC II)*. The controversy arose in 1971 when the Natural Resources Defense Council (NRDC) and others filed a rulemaking petition with the SEC. The petition sought to change the Commission's rules to require disclosure of environmental information, a change which ostensibly would bring the SEC into compliance with the National Environmental Policy Act of 1969[2] (NEPA). The SEC rejected the rulemaking petition, but the proponents of environmental disclosure obtained an order requiring the SEC to conduct an informal rulemaking proceeding.[3] The SEC complied with the order but at the conclusion of the rulemaking proceeding refused to adopt environmental disclosure regulations. The proponents again brought suit, and the court decided in *NRDC v. SEC II* that the Commission's decision to reject various environmental disclosure requirements was not based on a consideration of relevant factors, was not rational, and was in violation of NEPA's procedural mandate. In particular, the court noted that the Commission failed to consider certain factors inherent in the distinction between the information needs of investors choosing securities and shareholders exercising the corporate franchise.

Judge Richey's decision in *NRDC v. SEC II* can be questioned on two grounds. The first is whether Judge Richey acted within his judicial authority. The scope of judicial review is analyzed in Part IV of this Comment, after the substantive issues on which its understanding depends are discussed. The second question is whether the Commission gave adequate thought to issues which, although triggered by NEPA's procedural mandate, are inherent in all areas of securities regulation. Judge Richey's reasoning only suggests the complexity of the issues. This Comment analyzes them closely, beginning with a look at the Commission's role in the regulation of securities as dictated by the Securities Acts[4] and NEPA. The characteristics of the regulated companies are discussed, and it is shown that certain kinds of environmental disclosure are not necessarily harmful to the regulated companies. Finally, the interests of the investing public are reviewed. The analysis concludes that certain investor groups such as the ethical investor have a strong interest in certain kinds of environmental disclosure which need not conflict with the interests of the regulated companies. The SEC must consider the interests of these groups as required by the Securities Acts construed in light of the congressional policies declared in NEPA. Moreover, Judge Richey was well within the proper scope of judicial review in finding that the Commission's decisionmaking process was flawed.

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1. 432 F. Supp. 1190 (D.D.C. 1977). This case is currently on appeal before the District of Columbia Circuit in Natural Resources Defense Council, Inc. v. SEC, No. 77-1761 (D.C. Cir., filed July 13, 1977).

2. 42 U.S.C. §§ 4321-4335 (1976) (congressional declaration of purpose and subchapter I).

3. Natural Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689, 693 (D.D.C. 1974).

4. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976).

II
THE *NRDC v. SEC II* DECISION

A. Background

Upon becoming effective on January 1, 1970, NEPA required all federal agencies to initiate measures needed to conform their policies, plans, and programs to national environmental goals.[5] The Commission failed to comply with this requirement by the deadline date.[6] On June 1, 1971, petitioners NRDC and the Project on Corporate Responsibility, Inc., ostensibly seeking to bring the Commission's disclosure regulations into compliance with NEPA's environmental mandate, filed a rulemaking petition with the Commission. Reacting to this petition, the Commission issued a release alerting publicly-held companies that existing regulations required disclosure of "material" information regarding environmental matters.[7] On December 21, 1971, the Commission entered an order declining to take the requested action but stating that amendments to disclosure forms would be considered in the near future.[8]

Subsequent Commission action was procedurally defective. A February 16, 1972 release solicited public comment on proposed amendments that would have required reporting companies to disclose the effects of compliance with environmental laws and regulations.[9] After the comment period the Commission announced adoption of new regulations[10] intended to satisfy the Commission's obligations under NEPA.[11] Believing the new regulations inadequate the NRDC and a co-plaintiff[12] filed suit. The court held that the Commission had not complied with certain procedural requirements in adopting its new regulations[13] and remanded.[14]

Pursuant to court order, the Commission again solicited public comment, this time pertaining to whether the new disclosure rules were adequate in view of NEPA and, if not, what further rulemaking action should be taken.[15] Two

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5. *See* 42 U.S.C. § 4333 (1976).

6. Natural Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689, 693-94 (D.D.C. 1974) (deadline date set by executive order).

7. SEC Securities Act Release No. 5170, SEC Securities Exchange Act Release No. 9252 (July 19, 1971), 36 Fed. Reg. 13,989, 13,989 (1971). The Commission emphasized that only material information need be disclosed. Information regarding compliance with statutory environmental requirements is required when compliance may materially affect the earning power of the business, necessitate significant capital outlays, or cause material changes in the registrant's business. In short, the Commission seeks only financially material information. *See id.*

8. 389 F. Supp. at 694.

9. SEC Securities Act Release No. 5235, SEC Securities Exchange Act Release No. 9498 (February 16, 1972), 37 Fed. Reg. 4365 (1972).

10. SEC Securities Act Release No. 5386, SEC Securities Exchange Act Release No. 10,116 (April 20, 1973), 38 Fed. Reg. 12,100 (1973).

11. 389 F. Supp. at 695.

12. NRDC joined with the Center on Corporate Responsibility, Inc.

13. 389 F. Supp. at 698-702.

14. *Id.* at 693.

15. SEC Securities Act Release No. 5569, SEC Securities Exchange Act Release No. 11,236 (February 14, 1975), 40 Fed. Reg. 7013, 7014 (1975) [hereinafter cited as Release No. 5569].

factual issues were emphasized: (1) the extent of "ethical investor"[16] interest in disclosure of environmental information, and (2) the availability to investors of avenues of action that tend to eliminate corporate practices inimical to the environment.[17] The release set forth disclosure requirements proposed earlier by the petitioners.[18] It requested comment on these requirements and on criteria for determining which registrants should make the proposed disclosures and which disclosures should be included in documents distributed to the public.[19]

After exhaustive public hearings,[20] the Commission declined to take further rulemaking action on all but one item, the disclosure of corporate noncompliance with applicable environmental standards.[21] According to the SEC, dis-

16. *See* text accompanying notes 124-41 *infra*.

17. Release No. 5569, *supra* note 15, at 7014.

18. The Commission set forth nine possible environmental disclosure requirements for comment in its notice of public hearing. The proposed amendments were similar to those originally requested by the petitioners in 1971 and would require that registrants describe, with respect to each major activity or product:

> (1) The nature and extent, quantified to the degree feasible, of the resulting environmental pollution or injury to natural resources;
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> (2) The feasibility of reducing such pollution or injury under existing technology, including a description of alternatives and the cost of each;
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> (3) The prospects for improving that technology;
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> (4) Existing and projected expenditures for reducing such pollution or injury;
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> (5) Legal requirements affecting the impact of the registrant's activities on the environment, including requirements for licenses and permits and outstanding court or administrative orders; and
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> (6) Pending or threatened judicial or agency proceedings, whether initiated by private or governmental bodies, challenging registrant's compliance with environmental protection standards.

Id. Three other disclosure alternatives also were proposed. These would have the SEC require:

(7) Disclosure of changes in products, projects, production methods, policies, investments, or advertising that advance environmental values and a general statement of the registrant's policy towards environmental issues and concerns;

(8) Certain disclosures only of registrants which, by reason of their size or business, are considered to have major potential for causing environmental harm; and

(9) Different information to be disclosed in prospectuses, proxy, or information statements, or annual reports to security holders than that disclosed in documents which are filed with the Commission and are available for public inspection. *Id.*

19. *Id.*

20. The public file at the end of the proceeding consisted of the following subfiles:

> S7-551-1: Written comments received in response to Release No. 5569 and certain background information as described in that Release;
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> S7-551-1A: Witnesses' prepared statements and exhibits submitted at the public hearing.
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> S7-551-1C: Correspondence in connection with the proceeding other than written comments;
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> S7-551-H: Transcripts of the public hearings.

SEC Securities Act Release No. 5627, SEC Securities Exchange Act Release No. 11,733 (October 14, 1975), 40 Fed. Reg. 51,656, 51,658 n.10 (1975) [hereinafter cited as Release No 5627]. These and other documents relating to this proceeding are available for public inspection at the Commission's Public Reference Section, 1100 L Street, N.W., Washington, D.C.

21. *Id.* at 51,662-63. Although the Commission had set forth nine proposed environmental disclosure requirements in the notice of public hearing, it reclassified them into five categories and explained its evaluation of the public comment on the basis of the five categories. Those categories

closure of "material" corporate noncompliance was already required,[22] and reporting requirements of other federal agencies were being extended to include activities that affect the environment but have no direct bearing on a company's financial status.[23] Accordingly, the Commission published proposed amendments for public comment. One of these amendments required a registrant to provide a list of its most recently filed environmental compliance reports. Another required the registrant promptly to provide investors with copies of the report listed, upon written request and payment of a fee. None of the proposed amendments survived; the Commission withdrew them after considering the comments received.[24] The Commission did adopt a rule concerning the disclosure of material capital expenditures for environmental purposes but acknowledged the rule to be no more than clarification of a preexisting disclosure requirement ensuring uniformity in reporting.[25] Having suffered a major setback before the Commission, NRDC and others[26] filed suit on July 16, 1976, seeking judicial review of the Commission's actions.[27]

B. NRDC v. SEC II

The Commission's decision was challenged on two grounds. Plaintiffs argued that NEPA requires the Commission to compel substantial corporate disclosures which will (1) deter corporate activities adversely affecting the environment and (2) provide investors with information necessary to make environmentally responsible investment and voting decisions.[28] Plaintiffs also asserted that even if NEPA does not mandate substantial additional disclosures, the Commission's decision not to exercise its authority to compel the disclosures was arbitrary and capricious.[29]

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were (1) comprehensive disclosure of the environmental effects of corporate activities; (2) disclosure of corporate noncompliance with applicable environmental standards; (3) disclosure of all pending environmental litigation; (4) disclosure of general corporate environmental policy; and (5) disclosure of all capital expenditures and expenses for environmental purposes. *Id.* at 51,662.

22. The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information to those matters of which an average prudent investor ought reasonably to be informed before purchasing the security registered. *See* text accompanying notes 50-63 *infra*.

23. Release No. 5627, *supra* note 20, at 51,662 & n.45.

24. SEC Securities Act Release No. 5704, SEC Securities Exchange Act Release No. 12,414 (May 6, 1976), 41 Fed. Reg. 21,632, 21,632 [hereinafter cited as Release No. 5704].

25. Natural Resources Defense Council, Inc. v. SEC, 432 F. Supp. 1190, 1196 n.15 (D.D.C. 1977). *See* Release No. 5704, *supra* note 24, at 21,633.

26. In addition to NRDC, the other plaintiffs in this suit are Project on Corporate Responsibility, Inc., Center for Corporate Responsibility, Inc., National Organization for Women, Unitarian Universalist Association, American Baptist Home Mission Society, and Province of St. Joseph of the Capuchin Order. 432 F. Supp. at 1197 n.17.

27. The Commission was under court directions to undertake further rulemaking action to bring its corporate disclosure regulations into full compliance with the letter and spirit of NEPA and to reconsider fully its denial of the equal employment portion of the plaintiffs' rulemaking petition. Although the *NRDC v. SEC II* court addressed both issues, this Comment will consider only the issue of corporate disclosure of environmental information.

28. 432 F. Supp. at 1197.

29. *Id.*

The court disagreed with the plaintiffs' first argument. According to the court, none of NEPA's provisions relied on by the plaintiffs require the Commission to impose substantial environmental disclosure requirements on registrants.[30] The decision to take or not to take particular action, rather, is broadly committed to agency discretion.[31] The court, however, agreed with plaintiffs' second argument, concluding that the Commission's final decision not to formulate additional disclosure requirements was arbitrary and capricious. According to the court, NEPA requires that the Commission seriously consider to the fullest extent possible environmentally beneficial alternatives to its actions.[32] The Commission may neither strike "an arbitrary balance of costs and benefits" nor give "clearly insufficient weight to environmental values."[33] In reviewing informal agency rulemaking, a court is guided by the "arbitrary or capricious" standard and may not substitute its judgment for that of the agency.[34] Nonetheless, a court may assure itself that the agency's decision is based on a consideration of the relevant factors and may exhaustively inquire into the facts for this purpose.[35]

To support his holding, Judge Richey pointed to instances in which the Commission erroneously exercised its discretion. The Commission incorrectly assumed that disclosure requirements must apply equally to filings with the Commission and communications to shareholders and the public.[36] Furthermore, the Commission improperly reached conclusions pertaining to (1) the cost and feasibility of developing environmental disclosure guidelines and standards and (2) the costs of compliance with and administration of certain of the disclosure alternatives. Neither conclusion was supported by underlying findings of fact; each stood as a bald assertion without substantial support.[37] In addition, NEPA procedural mandates were violated. The Commission did not attempt in good faith to develop appropriate guidelines and standards for disclosure.[38] Insofar as the Commission based its decision on a belief that other federal agencies were better suited to initiate environmental disclosure, it shunted aside environmental factors in the bureaucratic shuffle. An agency may not refuse to give serious consideration to environmental factors only because it believes that another agency should assume the responsibility for promoting NEPA policies.[39] Finally, the Commission's rationale in rejecting certain proposed disclosure alternatives was unsound. Statements explaining the rejection of specific proposed disclosure alternatives suggest that the Commission's assessment of these alternatives might not have been rational. At least two con-

30. *Id.* at 1197-98.
31. *Id.* at 1198.
32. *Id.* at 1198-99.
33. *Id.* at 1199.
34. *Id.*
35. *Id.* at 1199-1200.
36. *Id.* at 1205-06.
37. *Id.* at 1206-07.
38. *Id.* at 1207-08.
39. *Id.*

clusions were left unexplained[40] and another was offered without discussion of a crucial issue.[41]

III
SEC AUTHORITY AND THE NATIONAL ENVIRONMENTAL POLICY ACT

As Judge Richey recognized, a reviewing court must consider the economic and social questions raised in the environmental disclosure controversy insofar as necessary to judge whether the Commission's decision was, from a legal standpoint, arbitrary or capricious.[42] The environmental disclosure question, at the outset, calls for resolution of certain fundamental legal issues. These issues are the scope of the grant of power to the SEC in the Securities Acts and the extent to which NEPA requires the SEC to exercise that power.[43] Once the law is understood, a reviewing court must determine which factual issues are pertinent to the legal controversy and whether the SEC considered all of these factual issues as required by the Securities Acts viewed in light of NEPA. The reviewing court may not substitute its judgment on factual issues for the administrative agency's judgment. Implicit in the court's inquiry into the factual issues are concerns of fundamental social and economic importance, including the nature of the Commission's obligations to investors and the public, and the extent to which corporations should or must assume social responsibility. Many of the economic and social aspects of the environmental disclosure question, moreover, extend well beyond the scope of the Commission's proceedings to date and strike at the heart of the role of disclosure and of the SEC in a changing business and social climate.

A. The Regulator: Disclosure and the Commisson's Role

1. The Commission's Exercise of Power

The keystone of the Securities Act of 1933[44] (Securities Act), the Securities Exchange Act,[45] and the entire legislative scheme of securities regulation is disclosure.[46] The Securities Act was "designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud, and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing."[47] The Securities Exchange Act "was intended principally to protect in-

40. *Id.* at 1208.
41. *Id.*
42. *See* text accompanying notes 163-220 *infra*.
43. *See* text accompanying notes 44-114 *infra*.
44. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976).
45. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976).
46. Knauss, *A Reappraisal of the Role of Disclosure*, 62 MICH. L. REV. 607 (1964). *See* Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 563 (E.D.N.Y. 1971).
47. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976). *See generally* HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, FEDERAL SUPERVISION OF TRAFFIC IN INVESTMENT SE-

vestors against manipulation of stock prices through regulation of transactions upon securities exchanges and in over-the-counter markets, and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges."[48] Each Act contains a broad delegation of rulemaking authority to the Commission.[49]

The Commission enjoys broad discretion in expanding or contracting disclosure rules but limits its requirements to "material" information.[50] The term "material" is undefined in the Securities Act and the Securities Exchange Act. In SEC regulations, " 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters about which an *average prudent investor* ought reasonably to be *informed*."[51] This definition, although frequently applied by the Commission to securities registration and proxy solicitation, is of little practical usefulness and the courts have not adopted it.[52]

The Commission's definition of material emphasizes strictly financial information and thereby undervalues the breadth of authority granted the Commission in the Securities Acts. The legislative history of the Securities Acts reflects a predominant but by no means exclusive interest in disclosure of financial information. Congress intended the Securities Act to bring about full disclosure of every element indispensable to an accurate judgment of security value.[53] Economically material information may be indispensable, but non-economic information also may influence security value and therefore be indispensable to an accurate judgment of security value. One of the six chief provisions of the Securities Exchange Act calls for adequate and honest reporting by registered companies to securities holders.[54] A free and open public market is

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CURITIES IN INTERSTATE COMMERCE, H.R. REP. No. 85, 73d Cong., 1st Sess. 1-5 (1933) [hereinafter cited as HOUSE REPORT: SECURITIES ACT].

48. 425 U.S. at 195. *See* SENATE COMM. ON BANKING AND CURRENCY, FEDERAL SECURITIES EXCHANGE ACT OF 1934, S. REP. No. 792, 73d Cong., 2d Sess. 1-5 (1934).

49. This broad congressional grant of rulemaking, or legislative, power is explicitly conditioned upon the limitation that the Commission may prescribe rules and regulations only as necessary or appropriate in the public interest or for the protection of investors. *See, e.g.*, Securities Act of 1933, §§ 7, 10, 15 U.S.C. §§ 77g, 77i (1976) (prescribing the contents of a Securities Act registration statement and prospectus); Securities Exchange Act of 1934, §§ 12(b), 14(a), 15 U.S.C. §§ 78*l*(b), 78n(a) (1976) (prescribing the contents of a Securities Exchange Act registration statement and governing proxy solicitations). *Cf.* 15 U.S.C. §§ 77s(a), 78w(a) (1976) (Commission's general rulemaking authority under the Securities Acts, which incorporates the public interest by reference).

50. *See* Note, *Disclosure of Corporate Payments and Practice: Conduct Regulation through the Federal Securities Laws*, 43 BROOKLYN L. REV. 681, 687-99 (1977); Note, *The Ethical Investor and the SEC: Conflict Over the Proper Scope of the Shareholder's Role in the Corporation*, 2 J. CORP. L. 115, 155-58 (1976) [hereinafter cited as *Shareholder's Role*].

51. 17 C.F.R. § 210.1-02(n) (1978) (emphasis added); *Cf. id.* §§ 230.405(*l*), 240.12b-2(j) (immaterial language variation).

52. *See* text accompanying notes 59-63 *infra*.

53. HOUSE REPORT: SECURITIES ACT, *supra* note 54, at 3-4. The House noted "[t]he type of information required to be disclosed [must be] of a character comparable to that demanded by competent bankers from their borrowers . . . [and] adequate to bring into the full glare of publicity those elements of real and *unreal values* which may lie behind a security." *Id.* at 4 (emphasis added).

54. HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, SECURITIES EXCHANGE BILL OF 1934, H.R. REP. No. 1383, 73d Cong., 2d Sess. 7, 11-13 (1934).

premised on the theory "that competitive judgments of buyers and sellers as to the *fair* price of a security brings about a situation where the market price reflects as nearly as possible a *just* price."[55] Considerably more than economic factors alone influence this judgment.[56] In addition, frequent use in the Securities Act and the Securities Exchange Act of the phrase "as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors"[57] should discourage a narrow interpretation of materiality. Congress, moreover, expressly required that disclosure in proxy solicitations comprise more than economically material information. If shareholders are to understand how their interests are being served, they must be enlightened not only about matters pertaining to the financial condition of the corporation, but also about major questions of policy which are decided at stockholders' meetings.[58] Although Congress unambiguously intended that the scope of required disclosure not be constricted, its guidance as to how broad that scope ought to be was inadequate.

The Supreme Court's decision in *TSC Industries, Inc. v. Northway, Inc.*[59] undercuts the Commission's definition of materiality. The Court found that "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[60] The *Northway* materiality standard is noticeably different from the SEC standard in at least two respects. First, the emphasis shifts from an abstract principle regarding what an "average prudent investor" needs to know to be "informed" to the ostensibly more tangible test of whether a reasonable shareholder would consider the information important. The difference is crucial to those investors who consider social and ethical matters of importance in making investment and voting decisions, the so-called "ethical investors." It may be difficult to argue that environmental information is necessary to "inform" investors, if indeed the contours of that slippery word can be defined. There can be no doubt, however, that ethical investors consider environmental information important. Second, and more importantly, the Supreme Court avoids any reference to "average prudent investor" in its definition of materiality. The language of the Commission's definition firmly anchors materiality to past investor behavior

55. *Id.* at 11 (emphasis added). The distinction between "fair" and "just" is that the collective decisions of security purchasers about the values of securities approach the values that could be determined if securities valuation were a science and if securities information were perfect. As the House remarked, "[t]he disclosure of information materially important to investors may not instantaneously be reflected in market value, but despite the intricacies of security values truth does find relatively quick acceptance on the market." *Id.*

56. *See, e.g.*, text accompanying notes 124-41 *infra*.

57. *See* note 49 *supra*.

58. SENATE COMM. ON BANKING AND CURRENCY, FEDERAL SECURITIES EXCHANGE ACT OF 1934, S. REP. No. 792, 93d Cong., 2d Sess. 12 (1934).

59. 426 U.S. 438 (1976) (deciding the rule 14a-9 materiality standard).

60. *Id.* at 449. An earlier Supreme Court case, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), described materiality generally as requiring that "the defect [an omission or misstatement in a proxy statement] have a significant *propensity* to affect the voting process," *id.* at 384. The *Northway* Court considered its materiality standard to be "fully consistent" with the *Mills* general description of materiality, 426 U.S. at 449, although it downplayed other aspects of the *Mills* statement on materiality, *see id.* at 447.

rather than permitting the standard to evolve to meet contemporary problems which threaten the public interest and the interests of investors. The Court's adoption of markedly different language, "a reasonable shareholder," signals judicial acceptance of a more comprehensive and flexible materiality standard. For example, ethical investors are no less "reasonable" because they weigh social or ethical matters along with economic ones prior to voting or investment decisions. On one hand, ethical investors do represent a minority; they are not average investors.[61] Nevertheless, ethical investors do represent a cross section of the investment community[62] insofar as they seek financial return through sound portfolio management or judicious speculation.[63]

2. The Impact of NEPA on the Commission's Statutory Authority

NEPA's policies and goals supplement those set forth in existing authorizations of federal agencies.[64] When there is no conflict, a federal agency must, to the fullest extent possible, (1) interpret and administer policies, regulations, and public laws in accordance with the policies set forth in, *inter alia*, section 101 of NEPA and (2) observe the procedural requirements set forth in section 102 of NEPA.[65] The first requirement means that the federal government must "use all practicable means and measures . . . to create and maintain conditions under which man and nature can exist in productive harmony, and fulfill the social, economic, and other requirements of present and future generations . . . ."[66] In order to carry out the policies of NEPA, the federal government must "use all practicable means, consistent with other essential considerations of national policy, to improve and coordinate [federal activities to bring about] the widest range of beneficial uses of the environment without degradation, risk to health or safety, or other undesirable and unintended consequences."[67] The second requirement is intended to implement the policies of NEPA by imposing additional administrative procedures on federal agencies. Federal agencies must use a systematic, interdisciplinary approach that will combine the natural and social sciences and the environmental design arts.[68] Agencies must identify and develop methods and procedures that will insure appropriate consideration of unquantified environmental traits in addition to economic and technical matters.[69] Agencies must "make available to States, counties, municipalities, insti-

61. *See* Release No. 5627, *supra* note 20, at 51,663-64.

62. Persons who identified themselves during the SEC proceedings as investors seeking disclosure of socially significant information of a type not traditionally considered economically material represented many investor categories: individual, religious institutions, educational institutions, special interest groups, foundations, financial institutions (little direct comment from banks, traditional mutual funds, and insurance companies), and states. SEC, PUBLIC PROCEEDING REGARDING DISCLOSURE OF ENVIRONMENTAL, EQUAL EMPLOYMENT, AND OTHER SOCIALLY SIGNIFICANT MATTERS: TOPICAL ANALYSIS OF TESTIMONY AND LETTERS OF COMMENT: REL. NO. 33-5569, DOCKET S7-551, at 1-8 (1975) [hereinafter cited as SEC TOPICAL ANALYSIS].

63. *See* text accompanying notes 130-41 *infra*.

64. National Environmental Policy Act of 1969 § 105, 42 U.S.C. § 4335 (1976).

65. *Id.* § 102, 42 U.S.C. § 4332 (1976).

66. *Id.* § 101(a), 42 U.S.C. § 4331(a) (1976).

67. *Id.* § 101(b)(3), 42 U.S.C. § 4331(b)(3) (1976).

68. *Id.* § 102(2)(A), 42 U.S.C. § 4332(2)(A) (1976).

69. *Id.* § 102(2)(B), 42 U.S.C. § 4332(2)(B) (1976). The Council on Environmental Quality, es-

tutions and individuals advice and information useful in restoring, maintaining, and enhancing the quality of the environment."[70]

Federal agencies are subject to NEPA regardless of the degree to which their missions may be thought of as affecting the environment.[71] In *Concerned About Trident v. Rumsfeld*[72] the United States Court of Appeals for the District of Columbia Circuit found that all federal agencies must comply with the procedural requirements of section 102 unless a clear and unavoidable conflict in statutory authority exists.[73] In accord are guidelines established by the Council on Environmental Quality which state that each agency of the federal government "shall comply with [section 102] unless existing law applicable to

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tablished by subchapter II of NEPA as a policy advisory agency, *see* 42 U.S.C. §§ 4341-4347 (1976), has provided guidelines for the preparation of environmental impact statements. The Council recently has published for public comment proposed regulations. The Council designed these regulations to implement the procedural provisions of NEPA, and intends that they be binding on each federal agency and department. *See* 43 Fed. Reg. 25,230 (1978). The proposed regulations are considerably broader in scope than the current guidelines.

70. National Environmental Policy Act of 1969, § 102(2)(G), 42 U.S.C. § 4332(2)(G) (1976).

71. Most NEPA litigation has been directed against developmental projects in well-defined federally licensed or funded programs such as highways, water resource projects, nuclear power plants, urban development, and federal facilities. *See* Coggins, *Some Suggestions for Future Plaintiffs on Extending the Scope of the National Environmental Policy Act*, 24 KAN. L. REV. 307, 341 (1976). The typical relief sought has been an injunction against the project pending adequate evaluation. *Id.*

Instances in which NEPA has been held not to apply are infrequent. In United States v. Students Challenging Regulatory Agency Procedures (SCRAP), 412 U.S. 669 (1973), the Supreme Court reviewed the decision of a district court enjoining the Interstate Commerce Commission (ICC) from permitting, and railroads from collecting, a 2.5% interim surcharge on recyclable commodities. The district court found that NEPA implicitly conferred authority on the federal courts to enjoin any federal action taken in violation of NEPA's procedural requirements. Students Challenging Regulatory Agency Procedures (SCRAP) v. United States, 346 F. Supp. 189, 197 (D.D.C. 1972), *rev'd*, 412 U.S. 669 (1973). The Supreme Court reversed, finding from the language and history of section 15(7) of the Interstate Commerce Act, 49 U.S.C. § 15(7) (1970), that Congress had vested exclusive power in the ICC to suspend rates pending a final decision on their legality and had deliberately extinguished judicial power to grant relief. 412 U.S. at 691. The issue, then, was whether in this specific context NEPA *sub silentio* revived judicial power that had been explicitly extinguished by Congress. *Id.* at 696. The Court held that NEPA was not intended to repeal by implication any other statute, *id.* at 694, and could not revive judicial power.

Similarly, other cases holding NEPA not applicable tend to deal with relatively unique and unusual provisions and circumstances. *See, e.g.*, Flint Ridge Dev. Co. v. Scenic Rivers Ass'n, 426 U.S. 776 (1976); American Smelting and Refining Co. v. FPC, 494 F.2d 925 (D.C. Cir.), *cert. denied sub nom.* City of Willcox v. FPC, 419 U.S. 882 (1974). In *Flint Ridge*, the Court found a clear and fundamental conflict of statutory duty between NEPA environmental impact statement requirements and a 30-day deadline imposed on the Secretary of HUD. 426 U.S. at 791. In *American Smelting and Refining*, the FPC's duty under the National Gas Act to prevent discriminatory practices in the event of a shortage of natural gas called for prompt action. The language of the statute gave rise to the type of statutory conflict which alone will excuse noncompliance with NEPA. 494 F.2d at 947-49.

72. 555 F.2d 817 (D.C. Cir. 1977).

73. *Id.* at 823. *See* Flint Ridge Dev. Co. v. Scenic Rivers Ass'n, 426 U.S. 776 (1976). NEPA's mandate to all federal agencies requiring compliance " 'to the fullest extent possible' . . . is neither accidental nor hyperbolic. Rather, the phrase is a deliberate command that the duty NEPA imposes upon the agencies to consider environmental factors not be shunted aside in the bureaucratic shuffle." *Id.* at 787.

the agency's operations expressly prohibits or makes compliance impossible."[74] A leading early decision established that NEPA mandates a reordering of priorities and makes environmental protection a part of the mandate of every federal agency and department.[75]

NEPA also mandates that officials making ultimate decisions be informed of the full range of responsible opinion on all environmental effects of their actions.[76] An agency may not "sit back, like an umpire, and resolve adversary contentions at the hearing stage."[77] Agencies have a duty, which is grounded on broad principles of administrative law, to develop a full record on all issues.[78]

The case law, then, does not go so far as to conclude that NEPA fundamentally enlarges an agency's mandate. NEPA does mandate, however, that an agency consider alternatives to its actions that would reduce environmental damage. As the court noted, NEPA " 'mandates only a careful and informed decisionmaking process to enlighten the decisionmaker and the public.' "[79] The SEC, moreover, must comply to the fullest extent possible with the procedural provisions of NEPA because the history and language of the Securities Acts suggest no conflict with NEPA's policies. That legislative history reflects a predominant but by no means exclusive interest in disclosure of economically material information.[80] Although the Commission in its regulations has narrowly defined the term "material" to limit disclosure to economic information,[81] the courts have not adopted the Commission's definition. The judicial interpretations of materiality extend the subject matter of disclosure beyond economic information.[82] Hence, the SEC must give good faith and informed consid-

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74. 40 C.F.R. § 1500.4(a) (1977), *quoted in* 555 F.2d at 823 (citing 1975 edition).

75. Calvert Cliffs' Coordinating Comm., Inc. v. AEC, 449 F.2d 1109, 1112 (D.C. Cir. 1971).

76. Natural Resources Defense Council, Inc. v. NRC, 547 F.2d 633, 645 & n.34 (D.C. Cir. 1976), *rev'd on other grounds sub nom.* Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978) (quoting Comm. for Nuclear Responsibility, Inc. v. Seaborg, 463 F.2d 783, 787 (1971)). Nevertheless, the courts generally may not impose procedures beyond the statutory minimum dictated by the Administrative Procedure Act, even in the hope of forcing development of the full range of responsible opinion. *See* note 248 *infra*.

77. 449 F.2d at 1119. In the context of the "alternatives" analysis in a NEPA-mandated environmental impact statement, however, the Supreme Court recently emphasized that "cryptic and obscure" reference to matters during an administrative proceeding, without more, may not be sufficient grounds on which to vacate the agency's subsequent determination. Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 553-54 (1978).

78. Scenic Hudson Preservation Conference v. FPC, 354 F.2d 608, 620-21 (2d Cir. 1965), *cert. denied*, 384 U.S. 941 (1966).

79. 432 F. Supp. at 1198 (quoting Natural Resources Defense Council, Inc. v. NRC, 547 F.2d 633, 654 (D.C. Cir. 1976), *rev'd on other grounds sub nom.* Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978)).

80. *See* text accompanying notes 53-58 *supra*.

81. *See* text accompanying notes 50-52 *supra*.

82. *See* text accompanying notes 59-63 *supra*. While an agency's long-standing construction should be given great weight, *see, e.g.*, Federal Maritime Comm'n v. Seatrain Lines, Inc., 411 U.S. 726, 745 (1973), courts also have established the principle that an agency may not act in violation of its statutory mandate. The judiciary is the final authority on issues of statutory construction. *Id.* at 745-46. While deference to the Commission's interpretation is entirely appropriate under ordinary circumstances, in this case NEPA undercuts the administrative construction. *Cf.* Adamo

eration to proposals calling for environmental information disclosure requirements.

3. *"Soft" Information*

Critics have expressed increasing dissatisfaction with disclosure generally. Whatever implications this criticism holds for future Commission disclosure policy,[83] several of the arguments bear directly on the question of whether the Commission ought to become involved with environmental disclosure. One argument stresses that past events and threats of liability should not be emphasized if the disclosure documents produced under the Commission's direction are to guide security investment decisions.[84] The Commission's current disclosure policy, which is based in part on the unarticulated assumption that past events are a reasonable basis for predictions of future security value,[85] is not reconcilable with prevailing economic wisdom which downplays the usefulness of historic information. That disclosure policy has not protected the public from loss and fraud.[86] The Commission also is fundamentally mistaken in some of its beliefs about the investing public. It has thought the public capable of handling highly technical disclosure of accounting and other matters but has denigrated the public's common sense.[87]

To cure its flawed disclosure policies, the Commission should redirect its efforts and develop indicators of future behavior, such as forecasts, opinions, and other "soft information."[88] Soft information comprises: (1) forward-oriented statements, "such as projections, forecasts, predictions, and statements concerning plans and expectations;" (2) backward-oriented statements concerning past or present situations for which the maker lacks information to prove accuracy; (3) information reflecting subjective evaluations, such as representations about the competency or integrity of management; (4) "statements of motive, purpose, or intention;" (5) "statements involving qualifying words, such as 'excellent,' 'ingenious,' 'efficient,' and 'imaginative,' for which there

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Wrecking Co. v. United States, 434 U.S. 275, 287 & n.5 (1978) (agency construction undercut by Clean Air Act). There is room for expansion in the Commission's exercise of its statutory authority. NEPA at least compels adoption of procedure that furthers environmental protection, provided the Commission's statutory authority under the Securities Acts is not exceeded as would be true if, for example, the Commission's statutory authority conflicted with NEPA. *See* text accompanying notes 71-75 *supra*.

83. The Commission is involved in an ongoing examination of the shareholder democracy process. *See* SEC Securities Exchange Act Release No. 13,482 (April 28, 1977), 42 Fed. Reg. 23,901 (1977) (shareholder communications, shareholder participation in the corporate electoral process, and corporate governance); SEC Securities Exchange Release No. 12,999 (November 22, 1976), 41 Fed. Reg. 52,994 (1976) (relationship between ethical matters and the proxy rules).

84. Kripke, *A Search for a Meaningful Securities Disclosure Policy*, 31 BUS. LAW. 293, 316 (1975).

85. *Id.* at 294. A second flawed assumption is that the standard accounting model, which reports the past on a historic cost basis, reasonably corresponds with reality so that the resulting net income figure is useful for determining security value. *Id.*

86. *Id.* at 315.

87. *Id.* at 314.

88. *Id.* at 315-16.

are no generally accepted objective standards of measurement."[89] Most environmental information is soft information and, as most soft information, is viewed by the SEC as improper subject matter for disclosure.[90] The arguments in support of disclosure of soft information, and environmental information in particular, are developed in the following sections focusing on the characteristics of the regulated companies and the interests of the investing public. These arguments have been wholly and improperly denigrated because of the Commission's traditional antagonism toward disclosure of soft information.

B. The Regulated: Firms Subject to Registration Requirements and Shareholder Voting Regulation

Environmental disclosure is not necessarily inconsistent with our contemporary view of the corporate self-interest. The once-popular theory of American enterprise known as managerialism has given way in recent years to the "social environmental model." Developed during the 1940's and 1950's, managerialism emphasized the central role of professional managers.[91] The giant corporation was viewed as the dominant actor in an oligopolistic economy. Highly specialized and professional management was thought to run the corporation free from the influence of the unorganized stockholders or the board of directors. The classical market model of profit maximization was rejected. Managers sought security, power, and prestige for themselves through the growth of the firm.[92] Under managerialism, "a company's social involvement [was] limited only by the humanitarian propensities of its management."[93] The managerialism model, however, fails to depict and explain current realities. Large corporations in highly concentrated industries do not always behave exactly like monopolists or oligopolists, and the notion that managers behave contrary to shareholder interests often is untrue in contemporary business operations.[94]

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89. Schneider, *Nits, Grits, and Soft Information in SEC Filings*, 121 U. PA. L. REV. 254, 255 (1972). The Commission seems to be relaxing its position on certain kinds of soft information. *See, e.g.*, SEC Securities Act Release No. 15,305 (November 7, 1978), 43 Fed. Reg. 53,246 (1978) (liberalizing position on forecasts).

90. Filings with the SEC omit a vast reservoir of information that is highly relevant in predicting future developments because of the Commission's policy emphasizing "hard information." Schneider, *supra* note 89, at 254, 258-59. Hard information means statements concerning objectively verifiable historical events or situations to be reported in prospectuses, proxy statements, and SEC filings. *Id.* at 254-55. In practice, however, "hard" and "soft" are relative terms with diffuse meanings; an audited historical financial statement is accepted as hard information, but many subjective evaluations and other types of soft information are considered in its preparation. *Id.* at 256. Exceptions to the Commission's hard information policy follow a double standard; disclosure of soft information is mandatory when the information creates specific negative inferences but usually prohibited otherwise. *Id.* at 261-62, 264. Some soft information should not be disclosed. The reasons for nondisclosure should be considered only in tailoring the specifics of a new disclosure approach, however, and do not compel retention of the status quo. *Id.* at 274-76.

91. N. JACOBY, CORPORATE POWER AND SOCIAL RESPONSIBILITY 193 (1973).

92. Alternatively, the corporate executive might be considered a trustee concerned with an equitable division of corporate gains among owners, workers, suppliers, and customers. In either instance the firm's behavior is largely determined by the discretionary power of management. *Id.* at 193-94.

93. *Id.*

94. *Id.* at 194. Shareholders are reasserting their role as the ultimate arbiters of corporate policy

The social environment model is based on the tenet that an enterprise reacts to the total societal environment that influences costs, revenues, and profits.[95] Hence, an enterprise responds to such nonmarket forces as politics. Socially responsible behavior, moreover, is viewed as consistent with enlightened corporate self-interest.[96] Opponents of corporate social responsibility argue "that consideration of any factors other than profit-maximizing ones either results in a deliberate sacrifice of profits or muddies the process of corporate decisionmaking so as to impair profitability."[97] This argument suffers from a number of infirmities;[98] most notably, it focuses on the profits of an individual firm rather than the profits of the corporate sector as a whole. That focus is incorrect because it ignores reasonable shareholder behavior. As good portfolio management calls for diversified holdings, maximization of shareholder welfare requires at least that firms acknowledge all returns appropriate through the market system by the corporate sector as a whole.[99]

"[w]ith the massive institutionalization of shareownership, the rise of stockholder organizations, and the gearing of executive compensation to the profitability of companies through bonuses and stock options." *Id.*

95. *Id.* at 185-205.

96. The doctrine of enlightened self-interest is described succinctly in a study by the Committee for Economic Development:

> The self-interest of the modern corporation and the way it is pursued have diverged a great deal from the classic *laissez-faire* model. There is broad recognition today that corporate self-interest is inexorably involved in the well-being of the society of which business is an integral part, and from which it draws the basic requirements needed for it to function at all—capital, labor, customers. There is increasing understanding that the corporation is dependent on the goodwill of society, which can sustain or impair its existence through public pressures on government. And it has become clear that the essential resources and goodwill of society are not naturally forthcoming to corporations whenever needed, but must be worked for and developed.

COMMITTEE FOR ECONOMIC DEVELOPMENT, SOCIAL RESPONSIBILITIES OF BUSINESS CORPORATIONS 26-27 (1971). *See also* A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 149-54, 98 A.2d 581, 583-86, *appeal dismissed*, 346 U.S. 861 (1953). The doctrine of enlightened self-interest also is based on the proposition that corporate interests may be jeopardized if business does not accept a fair measure of responsibility for social improvement. Corporate managers may take interest in social responsibility if only to avoid direct government regulation. COMMITTEE FOR ECONOMIC DEVELOPMENT, *supra* at 28-29.

97. J. SIMON, C. POWERS, & J. GUNNEMANN, THE ETHICAL INVESTOR 27, 30 (1972) [hereinafter cited as THE ETHICAL INVESTOR].

98. *Id.* at 31-46.

99. H. Wallich & J. McGowan, *Stockholder Interest and the Corporation's Role in Social Policy*, in A NEW RATIONALE FOR CORPORATE SOCIAL POLICY 39, 50 (1970) [hereinafter cited as *Corporation's Role*]. A sector is a large portion of the economy which is separately identifiable by its characteristics. Economists divide the economy into three general sectors: consumer, corporate (also called business or industrial), and government. The corporate and consumer sectors often are collectively referred to as the private sector. "Returns appropriate through the market system by the corporate sector as a whole" refers to returns on investment accruing to the corporate sector as a whole (rather than to an individual industry or firm within the corporate sector) by operation of the market mechanism. Wallich & McGowan refer to this as the "intermediate" investment policy base. They also discuss two other possible policy bases; the narrow policy base, the classical market model approach, which takes account only of returns directly appropriable by the corporation; and the broad policy base which includes not only market appropriate returns but also returns accruing to the community not appropriable through the market by the corporate sector. *Id.* at 43.

Corporate responsibility can take several forms. At the very least, a corporation should self-regulate to avoid social injury, the "negative injunction."[100] At the other extreme is "the championing of political and moral causes unrelated to the corporation's business activities." Gifts to charity is an example.[101] Other courses of action are "affirmative action extending beyond self-regulation but falling short of the championing of causes," such as cooperation with government in the training of the unemployed; and internal reform in corporate structure that affects shareholder voting rights, management prerogatives, or information sharing.[102]

The social environment model and the environmental disclosure issue are inextricably intertwined. The SEC must acknowledge this fact if its consideration of the environmental disclosure issue is to be acceptable under the Securities Acts and NEPA. As a means to an end, environmental disclosure is no more than a constructive response to social needs which benefits the public as well as the corporate sector. The formulation of environmental disclosure requirements must depend on the form of corporate responsibility believed to be appropriate. For example, one commentator proposes five measures by which social and other variables may be incorporated into business plans along with economic and technological factors: sensory mechanisms,[103] feedback processes,[104] communications,[105] systematic records,[106] and a progress audit.[107] The extent to which a company should be required to develop these measures will depend on the extent to which its enlightened self-interest is furthered by observance of the negative injunction, the institution of internal reform in corporate structure, establishment of affirmative action programs, or the championing of causes.[108]

Two points must be stressed. First, each of the five measures is dependent for success on the effective exchange of soft information. The standard accounting model analyzes hard information on an historic cost basis to report on the past. However, the standard accounting model does not comport well with the present condition and future potential of firms,[109] and does not facilitate ex-

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100. THE ETHICAL INVESTOR, *supra* note 97, at 27.

101. *Id.*

102. *Id.*

103. "Social sensors" should be developed to identify and measure changes in public values, attitudes, and expectations that bear upon the company's performance on a wide range of subjects. They must go beyond traditional market research programs. N. JACOBY, *supra* note 91, at 202.

104. Feedback processes should be established to evaluate and act upon the information acquired. *Id.*

105. Communication channels should be established and used regularly as sources of intelligence about attitudes and values and as instruments to transmit information about the company's goals, activities, and accomplishments. *Id.*

106. A systematic record should be kept of all company outlays that are made to improve the quality of life. *Id.*

107. A social audit would measure the company's progress toward the social goals it has set for itself. A company must define goals and develop programs to achieve those goals to make the preparation of a social audit possible. *Id.* at 203.

108. *See* text accompanying notes 100-02 *supra*.

109. *See* note 90 *supra*.

change of soft information. Secondly, the cost of the measures must not be allowed to affect the competitive position of the firms within an industry. Firms will not adopt the practice of acknowledging all returns appropriate through the market system by the corporate sector as a whole unless rules regulating corporate policies apply uniformly. Uniform government regulation of all firms in an industry is preferable to other methods, including private political pressure applied only to some firms in the industry, because it facilitates uniform adjustment[110] and stabilizes the sector.[111]

The foregoing analysis is premised on environmental disclosure being a means toward achieving socially responsible corporate behavior. The sharing of environmental information as an end in itself is not prudent, socially responsible behavior. As an end in itself, the sharing of environmental information yields returns accruing to the community that are not appropriate through the market by the corporate sector as a whole. While shareholder satisfaction need not be derived solely from the expected financial return of the shareholders' wealth portfolios, shareholders *qua* shareholders receive no satisfaction from extra-sector returns. Moreover, practical experience shows that the wealthiest investors are seldom concerned in social matters.[112] Shareholders dissatisfied with corporate sector returns will tend to shift portfolios toward nonequity securities[113] which will raise the cost of capital for all corporations but leave their relative status unaffected. Individual corporations voluntarily adopting environmental disclosure as an end risk offending some shareholders and will incur an analogous, but individual, adverse impact on their cost of capital.[114]

C. The Beneficiaries of Regulation: The Public and Investors

1. Corporate Democracy

The participation of shareholders as architects of corporate policy, a role inconsistent with managerialism, is an important element of the social environment model and should influence environmental disclosure policy. The basic

110. N. JACOBY, *supra* note 91, at 201.

111. The SEC operates an extensive system for the disclosure of corporate operations, and is in the unique position of being able to impose uniform disclosure regulations on firms within industries. Piecemeal disclosure of environmental information, as under the present laws, is detrimental to development of corporate enlightened self-interest for reasons ranging from redundant and useless reporting to reporting requirements that bear disproportionately on certain industries. *See* SEC TOPICAL ANALYSIS, *supra* note 62, at 185. Regulated disclosure of environmental information is essential to encourage corporations to pursue a policy of enlightened self-interest regarding environmental matters.

112. *See Shareholders's Role, supra* note 50, at 130-42 (discussing attempts to use the corporate proxy machinery to force management to act on matters of public interest).

113. Equity is the extent of an owner's right in his property above all claims and liens against it. Security is a general term for a stock, bond, or other instrument of ownership or debt. The assets of a corporation are subject to many claims: creditors, for accounts payable; employees, for accrued wages; lenders, such as bondholders, for borrowing; and stockholders, for those assets not subject to the claims of outsiders. Stockholders are the owners of the corporation whose right in the corporate property is evidenced by an instrument of ownership, the equity security, rather than an instrument of debt such as a bond.

114. *See Corporation's Role, supra* note 99, at 46-50.

tenet behind shareholder participation, or corporate democracy, is that ownership and control of corporations should not be separate.

Corporate democracy is criticized on three grounds. The first criticism is that the shareholder has no intrinsic relationship to corporate decisionmaking and control and, consequently, is not responsible for social injury. Shareholder interests are fully protected if financial information is made available, fraud and overreaching are prevented, and a market is made in which shares may be traded. Nevertheless, shareholdership imposes a responsibility on the holder for the social effects of corporate policy because the shareholder often (1) has notice of the offensive corporate policy; (2) has power to influence social policy; and (3) is the final means by which an offensive policy may be modified. The Securities Exchange Act and the rules of the exchanges require the managements of listed companies to provide information about corporate affairs to their shareholders.[115] Although at present the information required does not necessarily include data about social impact, that information may alert shareholders to actual or potential socially injurious practices. "[N]otice—actual or 'constructive'—of social injury is at least one of the conditions for the existence of an obligation to help to correct social harm."[116] Having power to correct harm is also one of the conditions for the existence of an obligation to help correct the harm. Shareholders have such power. Only two or three percent of the vote may be required to influence policy because any one shareholder or group of shareholders generally does not control corporate policies. While the exercise of shareholder rights may not occasion sudden, drastic reform, it can alter management decisions and prevent or limit social injury.[117] Finally, the shareholder is often the last party able to correct an injurious policy which has not been adjusted by the directors or by government intervention.[118]

The second criticism, that shareholder participation in social matters is unfair, urges that to encourage shareholder participation in social matters will invite frivolous or harassing complaints and unreasonable and arbitrary demands. In practice, however, shareholder participation has proven to be responsible, and the existing regulatory system does provide safeguards.[119] Moreover, encouragement of shareholder participation will not increase the role of the large institutional investors who need no encouragement to fully exercise their power to distort the decisionmaking process. In any event, institutional shareholders, unlike individual acquiescent shareholders, commonly act as an opposing bloc to management.[120]

In support of the third criticism, that shareholders are incompetent to deal with social issues, proponents point to the commonly-held opinion that the board of directors and not the shareholders constitute the proper body for

115. The preceding argument is fully developed in THE ETHICAL INVESTOR, *supra* note 97, at 49.
116. *Id.*
117. *Id.* at 50-57.
118. *Id.* at 58-59.
119. *Id.* at 59. Safeguards include rules which bar false and misleading claims in shareholder campaigns and which excuse management from printing in its proxy materials any shareholder proposal that failed to attract a certain percentage of votes at the prior annual meeting.
120. *Id.* at 59-61.

deciding difficult questions of resource allocation. The wisdom to decide questions of social policy, however, does not uniquely reside in any one group, management or shareholders.[121] Doubts about shareholder competence sometimes are based on the belief that information about corporate policies and the impacts of these policies is too difficult to obtain and understand.[122] As to the charge of difficulty of access, institutional investors and special interest groups have established means to acquire some of the information they need.[123] That acquisition is burdened, however, by unfair cost and delay, and lack of comprehensiveness of the information. Further, the information is not available to all shareholders. This problem would seem to argue for, not against, the Commission's promulgation of environmental disclosure requirements. As to the charge of difficulty of understanding, presently disclosed financial information often requires complex analysis by security analysts in order to be meaningful. Similarly, sophisticated analysis of environmental information will become available as disclosure prompts a demand for that analysis.

2. *The Ethical Investor*

A number of investors have emerged who, due to personal preference or institutional commitment to certain social and political values, either are reluctant to hold certain securities or desire to influence the policies of firms in which they do invest.[124] These ethical investors may purchase stock against financial judgment in a corporate polluter, for example, for the purpose of forcing the company to reform. Alternatively, ethical investors may hold the stock of a corporate polluter for investment reasons yet refuse to acquiesce in the company's socially injurious policies.[125]

The most influential class of ethical investors is institutions and universities. Members of this class characteristically design their investment portfolios to maximize return but do not wish to impose social injury.[126] While the class as a whole has no coordinated investment policy, guidelines are available to one member of this class, the university investors.[127] The guidelines do not call for investment decisions that serve as the instrumentality for affirmative action to promote social goals; portfolio purchases are to be based on maximum return principles. The guidelines, however, do require a serious effort at self-regulation. If investor action involves more than the voting of proxies or communication with corporate management,[128] however, such action should not be undertaken unless the social injury appears to be grave and all methods of correcting the practice have failed or appear futile. Should the corrective process

121. *Id.* at 62-63.
122. *Id.* at 63.
123. *Id.*
124. Stevenson, *The SEC and the New Disclosure*, 62 CORNELL L. REV. 50, 60 (1976).
125. THE ETHICAL INVESTOR, *supra* note 97, at 9.
126. *Id.* at 9-10. Social injury is defined as a violation or frustration of domestic or international legal norms meant to protect against deprivations of health, safety, or basic freedoms. *Id.*
127. *See id.* at 171-78.
128. *E.g.*, litigation or the initiation of a proxy campaign.

or the correction itself reduce the stock's return so as to make it unattractive under conventional maximum return criteria, the stock is to be sold.[129]

A distinction between environmental disclosure as an end and as a means has been drawn.[130] A related distinction, with which the guidelines are consistent, must be made between ethical investors who would use disclosed social information to avoid certain purchases or to acquire token numbers of securities for the sole purpose of challenging corporate practices, and ethical investors who would use disclosed social information to manage their portfolio holdings, the "avoidance" ethical investor and the "involved" ethical investor respectively. The avoidance ethical investor seeks environmental disclosure as an end product of securities regulation, an attitude which results in returns accruing to the community not appropriable through the market by the corporate sector.[131] The Securities Acts were not intended to promote,[132] and NEPA does not compel,[133] disclosure for the purpose of the avoidance ethical investor. The involved ethical investor, however, has a legitimate interest in environmental disclosure. By analogy with environmental disclosure as a means, the interest of the involved ethical investor is consistent with corporate self-interest,[134] corporate democracy,[135] and reinterpretation of the securities acts in light of NEPA. The information needs of the involved ethical investor are entitled to consideration by the Commission.

Testimony taken during public hearings on the environmental and equal employment disclosure issues reveals the uses ethical investors make of social information. Most of those testifying who used social information indicated that it played an important role in their voting on shareholder proposals. A lesser number indicated that social information was considered in determining which securities to sell or buy. Some witnesses, particularly religious institutions, indicated that social information was used in deciding whether to commence correspondence or negotiations with management.[136] The ethical investors' motivations ranged from ethical to economic. Many witnesses argued that, ethical considerations aside, environmental information lacking direct economic impact nonetheless may be "material"[137] given current social attitudes. Environmental and social misbehavior could lead to consumer backlash or government regulation, thereby increasing corporate costs and liabilities. Disclosure that represents the corporation's ability to avoid social problems provides a good index to management's overall quality because corporate social responsibility in the long run will determine the public relations and regulatory framework within which the corporation operates.[138]

129. THE ETHICAL INVESTOR, *supra* note 97, at 10, 93-95. The authors also argue that to decline to invest in morally or socially objectionable holdings or to cleanse a portfolio through the sale of such holdings has no corrective value. *Id.* at 52-53.

130. *See* text accompanying notes 103-14 *supra*.

131. This is the broad investment policy base discussed at note 99 *supra*.

132. *See* text accompanying notes 53-58 *supra*.

133. *See* text accompanying notes 64-67 *supra*.

134. *See* text accompanying notes 95-96 *supra*.

135. *See* text accompanying notes 115-23 *supra*.

136. SEC TOPICAL ANALYSIS, *supra* note 62, at 13-17.

137. *See* text accompanying notes 59-63 *supra*.

138. SEC TOPICAL ANALYSIS, *supra* note 62, at 17-20, 107-09.

Absent compelled environmental disclosures, the ethical investor has spent time and money to secure often inadequate or incomplete information. The costs of informational analysis should be borne by the investor, but investment information should be provided by the SEC. Material currently filed with or required by the Commission contains little environmental information. Other federal agencies, notably the Environmental Protection Agency, collect environmental information,[139] but investor use of this information is often impractical. The information is not kept in a central depository; the regional offices keep information on individual plants, not on the company; and certain information simply is not available. Public interest publications provide some information, as do voluntary disclosures by some corporations.[140] Nonetheless, the SEC alone is situated to address the shortcomings inherent in the present "system" of acquiring and disseminating environmental information.[141]

IV
THE SCOPE OF JUDICIAL REVIEW

Increased federal concern with the environment has presented the courts with unique and difficult questions of policy not always amenable to satisfactory resolution by traditional legal means. Perhaps the legislature is the most suitable forum for resolution of these questions, but broad legislative delegation has been the rule rather than the exception.[142] This delegation has given rise to new controversy about the role of the courts in resolving environmental problems. Both procedural and substantive levels of judicial review are marred by tension created by the fitting of environmental law into the framework of conventional legal analysis.[143] Judicial review of administrative agency decisionmaking procedures considers the questions of which procedures are required or justified by statute and will be effective in making environmental issues more comprehensible.[144] Disagreement over the nature of procedural review was nowhere more evident than in the District of Columbia Circuit, with Chief Judge Bazelon, on one hand, advocating a procedure-based approach to environmental law and Judge Wright, on the other, cautioning against overstepping statutory bounds.[145] The term "substantive review" encompasses a wide variety of judicial involvement in the merits of the case, although most courts require only a complete articulation of the reasons underlying a deci-

139. A great deal of information, including permits, permit applications, compliance reports, license applications, and impact statements, is generated under environmental legislation which includes the Federal Water Pollution Control Act (National Pollution Discharge Elimination System); the Clean Air Act; and the Marine Pollution, Research, and Sanctuaries Act. The materials can be obtained through the Freedom of Information Act. *Id.* at 85.

140. *Id.* at 83-94.

141. *See* note 111 *supra*.

142. Oakes, *The Judicial Role in Environmental Law*, 52 N.Y.U.L. REV. 498, 503 (1977).

143. *Id.* at 505.

144. *Id.*

145. *Id.* The Supreme Court has come down squarely against Judge Bazelon on the concept of a procedure-based approach. *See* note 248 *infra*. In addition, NEPA cannot serve as the basis for a substantial revision of the procedural specifications of the APA. Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 548 (1978).

sion.[146] The courts have gone somewhat further in reviewing federal agency action having an environmental impact, "but the role remains limited to whether the agency has considered all relevant factors and has articulated the basis for its decision."[147] In retrospect, neither an extensive procedural role nor a limited substantive one has entirely succeeded in adapting normal legal tools to the problems of the environmental field.[148]

In promulgating rules and regulations under the Securities Acts to comply with NEPA's mandate, the Commission is engaged in informal rulemaking which embraces the full range and complexity of issues inherent in environmental controversies. Because the federal securities laws contain no provision for judicial review of SEC rulemaking, the provisions of the Administrative Procedure Act[149] (APA) apply.[150] Some provisions of the APA have not been adapted successfully to the problems of the environmental field and confusion remains over the proper role of judicial review, particularly regarding substantive review of informal agency action.

A. Procedure Under the APA

Congress has delegated to the Commission the authority to make rules having the force of law. The Commission is obliged to use the proper procedure to act reasonably and within the delegated powers.[151] The procedures em-

146. Oakes, *supra* note 142, at 509.

147. *Id.* at 509-10.

148. Even limited substantive judicial review restricted to evaluating the adequacy of an agency's consideration of relevant material does not overcome the problem of an agency strongly committed to a particular result. An after-the-fact court-imposed requirement could produce only pro forma, automatic reconfirmation of a contemplated plan. *See* City of Rochester v. United States Postal Service, 541 F.2d 967 (2d Cir. 1976); Oakes, *supra* note 142, at 510-11.

149. Administrative Procedure Act §§ 4, 10, 5 U.S.C. §§ 553, 706 (1976).

150. Natural Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689, 697 (D.D.C. 1974). SEC rulemaking is not reviewable by direct petition to the court of appeals under 15 U.S.C. § 78y(a) (1976) (Security Exchange Act provision for appellate review of Commission orders). *See* 389 F. Supp. at 696 (citing PBW Stock Exchange, Inc. v. SEC, 485 F.2d 718 (3d Cir. 1973), *cert. denied*, 416 U.S. 969 (1974)).

151. The Commission is authorized to promulgate legislative rules. *See* note 49 *supra*. The distinction between legislative and interpretive rules is fundamental. An agency without the power to make law through rules may promulgate interpretive rules, statements to guide staff and affected parties. Interpretive rules traditionally do not merit great judicial deference. When Congress delegates to any agency the authority to make rules having the force of law, the resulting statements are legislative rules. If the agency uses proper procedure and acts reasonably and within the delegated power, the reviewing court traditionally has no more power to substitute its judgment for that of the agency than it has power to substitute its judgment for that of Congress in determining the content of a statute. K. DAVIS, ADMINISTRATIVE LAW OF THE SEVENTIES § 29.01-1, at 257-58 (Supp. 1978).

In the absence of explicit statutory provisions in the securities laws, the Commission's informal or notice and comment rulemaking must include the procedural elements set forth in section 4 of the APA: notice of the proposed rules to a broad class of participants, an opportunity to comment on the rule, and an agency statement contemporaneous with the enactment of the rule. Notice generally includes a statement of the time, place, and nature of the proceeding; a reference to the legal authority under which the rule is proposed; the terms or substance of the proposed rule or a description of the subjects and issues involved; and a copy of the proposed rule. The agency statement should give reasons for the agency's action; in both environmental and non-environmental

ployed by the SEC in the environmental disclosure proceedings satisfied the requirement of the APA and were not at issue either in the trial court or on appeal.[152] Accordingly, the trial court could turn only to substantive review in its consideration of the Commission's rulemaking proceeding in the matter of environmental disclosure.

B. Substantive Review of Agency Action

Judge Leventhal of the United States Court of Appeals for the District of Columbia Circuit has remarked that the role of the courts is to insure coordination of all policies that a federal agency must take into account when making an administrative decision. That coordination is essential when dealing with NEPA, which requires each federal agency to consider matters often outside of its pre-NEPA interests.[153] Simply stated, the principal legal question presented by the *NRDC v. SEC II* decision is whether Judge Richey exceeded the proper scope of his review powers.

1. Standards of Judicial Review

Prior to the 1970's the law governing judicial review of agency action was thought to be established. The "clearly erroneous" standard provided the broadest scope of inquiry for the court, but that standard was applicable only to appellate review of findings of judges sitting without juries.[154] Of the two standards provided in the APA for review of agency action, the "substantial evidence" standard[155] was the more generous, the "arbitrary or capricious" standard[156] the more restrictive.[157] Moreover, by the terms of the APA the substantial evidence standard seemed to apply to matters reviewable on the record of an agency adjudication. The arbitrary or capricious standard was re-

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matters, courts have demanded a factually detailed statement of basis and purpose. The statement also should confront and distinguish critical testimony. *See* Verkuil, *Judicial Review of Informal Rulemaking*, 60 VA. L. REV. 185, 186-87, 235, 239-40 (1974). Absence of such comment stifles the court's review, Portland Cement Ass'n v. Ruckelshaus, 486 F.2d 375, 393-94 (D.C. Cir. 1973), and flaws the rulemaking action.

152. The SEC had failed to comply with the procedural requirements of section 4 of the APA early in the administrative proceedings. *See* Natural Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689 (D.D.C. 1974). Plaintiffs now admit that the Commission's subsequent rulemaking proceeding satisfied the APA's procedural requirements and that substantive judicial review was appropriately exercised by the trial court. *See* Natural Resources Defense Council, Inc. v. SEC, 432 F. Supp. 1190, 1194 (D.D.C. 1977).

153. Leventhal, *Remarks, Environmental Decision-Making: The Agencies Versus the Courts*, 7 NAT. RES. LAW. 351, 351-52 (1974) (remarks by H. Leventhal, Circuit Judge, United States Court of Appeals, District of Columbia). *See* International Harvester Co. v. Ruckelshaus, 478 F.2d 615, 647 (D.C. Cir. 1973). *See also* text accompanying notes 71-75 *supra*.

154. K. DAVIS, *supra* note 151, § 29.00, at 646 (1976) (citing District of Columbia v. Pace, 320 U.S. 698, 701-02 (1944)).

155. 5 U.S.C. § 706(2)(E) (1976). The "substantiality of evidence" must take into account whatever in the record fairly detracts from its weight. Universal Camera Corp. v. NLRB, 340 U.S. 474, 488 (1951).

156. 5 U.S.C. § 706(2)(A) (1976).

157. K. DAVIS, *supra* note 151, § 29.00, at 647 (1976) (citing Abbott Laboratories v. Gardner, 387 U.S. 136, 143 (1967)).

served for review of informal adjudicative or rulemaking action.[158] In short, an action reviewable under the arbitrary or capricious standard commanded great judicial deference, more so than an action reviewable under the substantial evidence test. In turn, substantial evidence review allowed greater deference than clearly erroneous review.[159]

Judicial review of informal agency action in this decade has not been constrained by previous interpretations of the arbitrary or capricious standard. One reason is that by statute Congress occasionally has provided for substantial evidence review of notice and comment rulemaking.[160] In addition, courts have interpreted some statutes as providing for substantial evidence review.[161] Of greatest importance to the lower courts, the Supreme Court has opened the door to judicial reinterpretation of the arbitrary or capricious standard as applied in particular to environmental controversies by upsetting the established hierarchy of judicial review standards.[162]

2. *The Arbitrary or Capricious Standard in Evolution: The Supreme Court Decisions*

The leading Supreme Court decision applying the arbitrary or capricious standard, *Citizens to Preserve Overton Park, Inc. v. Volpe*,[163] accounts for much of the unsettled law governing standards of judicial review. The particular provisions before the Court prohibited the Secretary of Transportation from authorizing the use of federal funds to finance the construction of highways through public parks if a "feasible and prudent" alternative route existed. If no such route were available, highway construction through the park could be approved only if harm to the park were minimized by careful planning.[164] Petitioners pleaded a failure of the Secretary to make formal findings and challenged the merits of the Secretary's decision.[165] Finding the Secretary's discretion to be limited,[166] the Court applied the arbitrary or capricious

158. *Id.*

159. *Id.* at 648.

160. *Id.* § 29.01-3, at 660-62 (citing Associated Indus. v. United States Dep't of Labor, 487 F.2d 342, 347-48 (2d Cir. 1973) (Occupational Safety and Health Act provides that determination by the Secretary of Labor shall be conclusive if supported by substantial evidence in the record considered as a whole)).

161. *Id.* at 662 (citing Chrysler Corp. v. Department of Transp., 472 F.2d 659 (6th Cir. 1972) (although silent on scope of judicial review, statute commanding the Secretary of Transportation to file with the court the records of notice and comment proceedings was held to require the agency's decision to be supported by substantial evidence)).

162. *See id.* § 29.00, at 648-52.

163. 401 U.S. 402 (1971).

164. *Id.* at 404-05. The provision cited is included in § 4(f) of the Department of Transportation Act of 1966, 49 U.S.C. § 1653(f) (1970), and § 18 of the Federal Aid Highway Act of 1968, 23 U.S.C. § 138 (1970).

165. 401 U.S. at 408 n.16.

166. *Id.* at 410-13. The Court addressed a preliminary issue, the agency discretion exception. Noting that the scope of the exception is very narrow, the Court pointed out that the exception applies "in those rare instances where 'statutes are drawn in such broad terms that in a given case there is no law to apply.' " *Id.* at 410 (citing S. REP. No. 752, 79th Cong., 1st Sess. 26 (1945)). The Securities Acts and NEPA provide applicable law. NEPA's mandate, which is to insure to the

standard rather than the substantial evidence standard because the hearing was a quasi-legislative proceeding not designed to produce a record adequate to serve as the basis of agency action.[167]

Overton Park is remarkable because the Court brandished an arbitrary or capricious standard that appears significantly to expand the reviewing court's powers, although the controversy involved a mere public hearing conducted by local officials for the purpose of informing the community and soliciting community views.[168] Under the arbitrary or capricious standard, stated the Court, a reviewing court is not relieved of its obligation to engage in a "substantial inquiry."[169] Once the court finds that statutory authority is granted to an agency, the court must decide whether the agency's decision is " 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' . . . To make this finding the court must consider whether the decision was based on a *consideration of the relevant factors* and whether there has been a *clear error* of judgment."[170] Professor Davis notes that the quoted phrase seems indistinguishable from the clearly erroneous standard for reviewing findings of judges sitting without juries, which traditionally has been interpreted as calling for broader review than demanded under even the substantial evidence standard. According to Davis, unless the Court intended to depart from prior law, which the opinion does not indicate, "the language about 'clear error of judgment' cannot be justified."[171] Nevertheless, some language in the opinion does suggest that some change of prior law was intended. The Court's statement pertaining to "consideration of the relevant factors" is a command to the judiciary to exercise substantive review at least insofar as necessary to determine which factors are relevant to an agency's decision and whether the agency's discussion of these factors was adequate. The Court does go on to state "[a]lthough this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency."[172] Despite the Court's caution that the ultimate standard of review is a narrow one, such language as "a searching and careful inquiry," "substantial inquiry," and "a thorough, probing, in-depth review" of agency action[173] obligates the reviewing court to do more than approve agency action that is based merely on some favorable evidence.[174]

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fullest extent possible that the policies and procedures of NEPA are considered and implemented, lends explicit meaning to the "public interest" language of the Securities Acts. *See* text accompanying notes 64-82 *supra*.

167. *Id.* at 414-15.

168. *Id.*

169. *Id.* at 415. Although an agency's decision is entitled to a presumption of regularity, that presumption is not to shield its action from a thorough, probing, in-depth review. *Id.*

170. *Id.* at 416 (emphasis added). The Court cites from L. JAFFE, JUDICIAL CONTROL OF ADMINISTRATIVE ACTION 182 (1965) for this phrase. The original language reads "a clear error of judgment in the conclusion . . . reached upon a weighing of the relevant factors." *Id.* (citing McBee v. Bomar, 296 F.2d 235, 237 (6th Cir. 1961)).

171. K. DAVIS, *supra* note 151, § 29.01-5, at 665-66 (1976).

172. 401 U.S. at 416.

173. *Id.* at 415-16.

174. K. DAVIS, *supra* note 151, § 29.01-5, at 666-67 (1976).

Subsequent Supreme Court cases shed little light on the meaning of *Overton Park*'s "clear error of judgment" language. In one case the Court inquired into the soundness of the reasoning by which an agency reached its conclusions, ascertaining only that the agency conclusions were rationally supported.[175] The opinion, however, appears to be restricted to ICC actions[176] and *Overton Park* was not cited. In another case, the Court carefully distinguished between the substantial evidence standard and the arbitrary or capricious standard, and applied the latter to review of an informal adjudicatory proceeding.[177] Although the opinion cited *Overton Park* as controlling, it avoided discussion of the "clear error of judgment" language. The "clear error of judgment" language was quoted with approval in *Bowman Transcription, Inc. v. Arkansas-Best Freight System, Inc.*,[178] but *Bowman* appears to be a throwback to pre-1970 concepts of judicial review.[179] The arbitrary or capricious standard, opined the Court, requires no more than a rational basis[180] for an agency's treatment of the evidence.[181] In partial harmony with *Overton Park*, the *Bowman* Court acknowledged that the agency must draw out and crystallize competing interests.[182] The reserved tenor of the opinion, which contrasts with the somewhat expansive language of the *Overton Park* decision, may be attributable to compelling policy arguments faced by the *Bowman* Court.[183]

The *Overton Park* decision raised the question of whether the language "a clear error of judgment" ought to be taken as equivalent to the clearly erroneous standard. Professor Davis suggests four possibilities. First, the language is "inadvertent" and changes nothing. Second, the scope of the arbitrary or capricious standard is deliberately raised to the generous scope of review afforded by the clearly erroneous standard. Third, by equating the two standards the Court advocates a compromise standard. Fourth, the refined differences are unimportant, and judges, understanding that they must refrain from substituting their judgment for that of the agency, will place emphasis on the degree to

175. United States v. Allegheny-Ludlum Steel Corp., 406 U.S. 742, 749 (1972).

176. *See id.*

177. Camp v. Pitts, 411 U.S. 138, 141-42 (1973).

178. 419 U.S. 281, 285 (1974).

179. *Cf.* K. DAVIS, *supra* note 151, § 29.00, at 651-52 (1976) (distinguishing between evidence viewed in isolation and in the context of the entire record).

180. Traditionally, the arbitrary or capricious standard was not distinguished from the "rational basis" test, which limited judicial review of informal agency rulemaking to determining whether there was a rational basis for the rule. Complete deference to the agency's rulemaking function as reflected in the rational basis test is reminiscent of the time when informal rulemaking was a less important mode of agency action. Verkuil, *supra* note 151, at 206-07.

181. 419 U.S. at 290.

182. *Id.* at 293-94.

183. *See id.* at 298-99 (citing *Overton Park*). In *Overton Park*, public policy compelled a searching and careful look at agency action. In *Bowman*, compelling public interest reasons called for deference to the agency's decision. It is unfortunate that the Supreme Court may have allowed public interest considerations to taint its treatment of judicial review standards. A standard governing judicial review should be uniform for all agency action, and the facts of the particular case should determine whether the agency action is proper under the review standard.

which the agency has been conscientious, careful, and fair.[184] Although the Supreme Court's handling of the issue is perplexing, the circuit courts have refined the arbitrary or capricious test in numerous applications to administrative action.

3. *The Arbitrary or Capricious Standard in Evolution: The Circuit Court Decisions*

Judges are in conflict over the scope of judicial review under the arbitrary or capricious standard, a conflict that has inspired thoughtful analysis. For instance, Judge Skelley Wright of the United States Court of Appeals for District of Columbia Circuit doubts that courts can avoid substantive review of rulemaking after *Overton Park*, regardless of how many procedures are imposed on the rulemaking agency.[185] Nevertheless, he believes that the APA requires only the most basic, minimal sort of rationality. Given that "weightings on conflicting evidence need be only 'reasonable' to pass the substantial evidence test, . . . they can be less than reasonable and still survive the [arbitrary or capricious standard]."[186] In drawing conclusions, the agency must have given "actual, good faith consideration to all relevant evidentiary factors." Once having done so, the weight which the agency assigns a factor "is of virtually no concern to the reviewing court."[187] On the other hand, Judge Friendly of the Second Circuit believes that while there may be cases in which an *adjudicative* determination not supported by substantial evidence would not be arbitrary or capricious, the two standards, substantial evidence and arbitrary or capricious, tend to converge in the review of informal agency rulemaking.[188]

Judge Richey cites *Ethyl Corp. v. EPA*[189] in support of his view of judicial review powers.[190] The petitioners in *Ethyl*, various manufacturers of lead additives and refiners of gasoline, claimed that the Administrator of the Environmental Protection Agency misinterpreted a statutory standard and that his application of that standard in an informal rulemaking proceeding was arbitrary and capricious.[191] In holding against petitioners, Judge Wright, writing for the court,[192] stated:

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184. K. DAVIS, *supra* note 151, § 29.00, at 649 (1976). The "clear error of judgment" verbalism may be settling into obscurity. *See id.* § 29.01-5, at 268 (Supp. 1978).

185. Wright, *The Courts and the Rulemaking Process: The Limits of Judicial Review*, 59 CORNELL L. REV. 375, 390-91 (1974). Judge Wright argues against Chief Judge Bazelon's procedure-based approach.

186. *Id.* at 392.

187. *Id.* For a critical review of Judge Wright's position, see K. DAVIS, *supra* note 151, § 29.01-5, at 667-68 (1976).

188. Associated Indus. of N.Y.S., Inc. v. United States Dep't of Labor, 487 F.2d 342, 350 (2d Cir. 1973).

189. 541 F.2d 1 (D.C. Cir.) (en banc), *cert. denied*, 426 U.S. 941 (1976).

190. Natural Resources Defense Council, Inc. v. SEC, 432 F. Supp. at 1199-1200.

191. 541 F.2d at 10-11.

192. Judges Bazelon, McGowan, Leventhal, and Robinson concurred in Judge Wright's opinion for the court. Judge McGowan joined in a concurring opinion filed by Chief Judge Bazelon. A concurring statement was filed by Judge Leventhal. On the other side of the 5-4 decision, Judge

> The close scrutiny of the evidence is intended to educate the court. . . . The enforced education into the intricacies of the problem before the agency is not designed to enable the court to become a superagency that can supplant the agency's expert decision-maker. To the contrary, the court must give due deference to the agency's ability to rely on its own developed expertise . . . . The immersion in the evidence is designed *solely* to enable the court to determine whether the agency decision was rational and based on consideration of the relevant factors [citing *Overton Park*].[193]

Chief Judge Bazelon agreed that the court severely limited judicial weighing of the evidence by construing the Administrator's decision to be a matter of legislative policy.[194] He remained convinced, however, that the Administrator should have been required to exercise rigorous procedural safeguards, even though the decision was quasi-legislative.[195] Judge Bazelon would have preferred the court to take a stronger stand in favor of imposing procedural safeguards and to forswear close analysis of the evidence in cases under the arbitrary or capricious standard. Judge Leventhal urged that Judge Bazelon's position was too extreme in its abdication of substantive review of matters outside of the usual experience of generalist judges. Congress broadly delegates legislative power because the availability of judicial review over general as well as technical matters assures that agencies exercise their power rationally, equitably, and within statutory limits.[196] In his dissent, Judge Wilkey cited much of the same authority as did the court, but with an important difference. He would not hesitate to pierce the record to find insufficient supportive evidence or clear errors in the analytical and evaluative methodology and in the logical structure of the agency's reasoning.[197]

Four overlapping formulations of the arbitrary or capricious standard emerge in *Ethyl*. Chief Judge Bazelon's approach, supported by one other judge, would provide virtually no substantive review in highly scientific and technical areas in which judicial understanding of the evidence is slight. In other areas, such as securities regulation, Judge Bazelon's argument would have somewhat less strength, although he might advocate considerable restraint in substantive review and emphasize the value of procedural safeguards. Judge Wright's interpretation of the proper scope of the standard carried the unqualified support of only one other judge. The Wright formulation allows limited substantive review but full immersion into the administrative record. Judge Leventhal advocated the Wright formulation with more emphasis on substantive review. The fourth formulation, supported by three of the dissenting judges, called for exhaustive substantive review.

MacKinnon filed a dissenting opinion, and Judge Wilkey filed a dissenting opinion in which Judges Tamm and Robb joined.

193. 541 F.2d at 36.

194. *Id.* at 67.

195. *Id.* at 66. Chief Judge Bazelon's position recently has been rejected by the Supreme Court. *See* note 248 *infra*.

196. *Id.* at 68-69.

197. *Id.* at 100.

Although leading to different conclusions, the Wright and dissent formulations are not fundamentally dissimilar. The Wright formulation does restrict the role of the courts. *Overton Park*'s troublesome language of "a clear error of judgment" is read as no more than an affirmation of the traditional standard of review; agency action will be reversed under the arbitrary or capricious standard only if the error is so clear as to deprive the agency's decision of a rational basis.[198] For there to be a rational basis, the agency must articulate a rational connection between the facts found and the choice made, although a decision of less than ideal clarity will be upheld if the agency's rationale may reasonably be discerned.[199] The court does not weigh the evidence introduced before the agency, and inquires into the soundness of the reasoning by which the agency reaches its conclusions only to ascertain whether the conclusions are rationally supported.[200] Although the court does not weigh the evidence, it will not condone patently improper administrative weighings.[201] Judge Wright noted that the primary difference between the substantial evidence and arbitrary or capricious standards is the limiting of substantial evidence review to evidence developed in formal hearings. Under the arbitrary or capricious standard, a court reviewing informal agency rulemaking may consider the agency's developed expertise and any evidence referenced by the agency or otherwise placed in the record.[202] He did not state that the primary difference between the two standards is review of administrative weighings, although the agency's balancing of the evidence would seem reviewable under the substantial evidence standard.[203] The reason for that silence may derive from the requirement that an agency's decision be rational. Insofar as an agency's balancing is fairly debatable, *Overton Park* emphasizes that the court may not substitute its judgment. On the other hand, if the agency's balancing is egregious, there will be a discernable reason. The agency may have been careless, prejudiced, or poorly informed. Defective procedure or failure to develop material factors accounts for poorly informed decisions, and the use of procedural and substantive review to uncover these defects is by now established. The focus of the disagreement would seem to be the redress of careless or prejudicial agency action through judicial review of the informal rulemaking process.

A careless or prejudiced agency "reaching" for a decision may ignore or improperly balance factors, or fail to develop essential elements of the logical progression. The *Ethyl* dissent would probe the record seeking conclusive proof that the agency has not ignored factors or improperly balanced factors, and has developed all essential elements of the logical progression. A closer look at the Wright formulation shows interest in the same questions although the "benefit of the doubt" belongs to the agency. For instance, while the Wright formula-

198. *Id.* at 35 n.74.

199. *See id.* at 34 n.73 (citing Bowman Transp. Inc. v. Arkansas-Best Freight Sys., Inc., 419 U.S. 281, 286 (1974)).

200. 541 F.2d at 37 n.78 (citing United States v. Allegheny-Ludlum Steel Corp., 406 U.S. 742, 749 (1972)). *See* 419 U.S. at 293-94.

201. *But see* text accompanying note 187 *supra*.

202. 541 F.2d at 37 n.79.

203. *See* note 153 *supra*.

tion does not question the agency's balancing, it does not entirely forego consideration of weight:

> [A]fter considering the inferences that can be drawn from the studies supporting the Administrator, and those opposing him, we must decide whether the *cumulative* effect of all of this evidence, and not the effect of any single bit of it, presents a rational basis for the . . . regulations.[204]

The question is not whether factors have been properly balanced by the agency, but rather whether the evidence taken as a whole can be rationally construed as supporting the regulations.[205]

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204. 541 F.2d at 38 (emphasis added).

205. The early District of Columbia Circuit cases do not conflict with the Wright formulation of the arbitrary or capricious standard. City of Chicago v. FPC, 458 F.2d 731 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 1074 (1972), followed closely on the heels of *Overton Park*. The *Chicago* court refused to accept the implications of Superior Oil Co. v. FPC, 322 F.2d 601 (9th Cir. 1963), *cert. denied*, 377 U.S. 922 (1964), which held that in determining the propriety of rules of general application, the reviewing court must defer completely to the agency's statement of its basis for action. 458 F.2d at 741. Two reasons justified rejection of *Superior Oil*. First, judicial review would be a "futile exercise in formalism," *id.* at 742, if no inquiry were permissible into the existence of the condition which an agency advances as the predicate for its regulatory action. Second, although rulemaking resembles legislative action, the findings of an agency exercising quasi-legislative power are not due the same deference accorded legislative findings. *Id.* The *Chicago* court also explained that the substantial evidence standard is inappropriate for judicial review of informal agency rulemaking. The agency record of the proceeding will contain information which is generalized, uncontested by cross-examination, and conclusory, and often based on data collected by special interest parties. *Id.* at 744. In addition, the substantial evidence standard is essentially a particular application of a general principle which also guides judicial review under the arbitrary or capricious standard. *Cf.* Ethyl Corp. v. EPA, 541 F.2d at 37 n.79 (standards seem to merge, but a primary difference is apparent). Judicial review serves to "determine whether a reasoned conclusion from the record as a whole could support the premise on which the [agency's] action rests." 458 F.2d at 744. Moreover, under the arbitrary or capricious standard, a reviewing court also must be aware that an agency is expected to bring to bear the full range of its knowledge and expertise when interpreting data and forming predictions. *Id.* at 747.

Another early decision, Greater Boston Television Corp. v. FCC, 444 F.2d 841 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971), concerned judicial review of Federal Communications Commission action on a license application. Although a substantial evidence case, *Greater Boston* often is cited in informal rulemaking cases as authority for in-depth review of the administrative record. *See, e.g.*, Ethyl Corp. v. EPA, 541 F.2d at 35-36; International Harvester Co. v. Ruckelshaus, 478 F.2d 615, 648 (D.C. Cir. 1973); Natural Resources Defense Council, Inc. v. SEC, 432 F. Supp. at 1199. In the words of the *Greater Boston* court:

> A court does not depart from its proper function when it undertakes a study of the record, hopefully perceptive, even as to the evidence on technical and specialized matters, for this enables the court to penetrate to the underlying decisions of the agency, to satisfy itself that the agency has exercised a reasoned discretion, with reasons that do not deviate from or ignore the ascertainable legislative intent. "The deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia."

444 F.2d at 850 (footnotes omitted).

Judge Leventhal, the author of *Greater Boston*, also wrote the court's opinion in another early decision, International Harvester Co. v. Ruckelshaus, 478 F.2d 615 (D.C. Cir. 1973). In *International Harvester*, the court used the term "reasoned decision" to mean that an agency bears the burden of adducing a reasoned presentation supporting the reliability of its methodology. *Id.* at 648.

The difference, then, between the majority and the dissent, and between the arbitrary or capricious and substantial evidence standards, lies in the discretion permitted the agency. One of the contested conclusions in *Ethyl* was that blood lead levels are elevated in a small but significant number of adult members of the general public. Judge Wright acknowledged that the studies relied on by the agency addressed blood lead levels of occupational groups but pointed out that trends in occupational groups often precede similar effects in the public at large.[206] Petitioners argued that certain studies of public blood lead levels, which the agency found to be flawed, should have outweighed the implications of the occupational group studies. Valid conclusions, answered Judge Wright, may be "obscured," but the possibility of false positive findings of elevated blood lead levels is less than the possibility of false negative findings.[207] He found a rational basis. The dissent emphasized that the subject of the studies, occupational groups exposed to unusually high quantities of automobile dust, rendered the studies too remote to be controlling.[208] The dissent thought that flaws in the rejected studies did not affect certain relevant conclusions contained therein and that the agency failed to explain why it accepted some studies and not others.[209] The dissent also called the majority's "bridge" between the occupational group blood lead levels and the public blood lead levels a *post hoc* rationalization which fills gaps in the agency's logic.[210] This criticism of the court's approach is badly founded. The dissent misperceives the relationship between the Wright and dissent positions; contrary to the dissent's belief,[211] there are important differences between the two interpretations of the arbitrary or capricious standard. The dissent allowed little deference to agency expertise[212] while the majority tolerated much more.[213] According to the majority, an agency decision that seems to have been based on improperly balanced factors may not be upset by a reviewing court if the agency has fully developed all relevant factors and if the evidence taken as a whole can be rationally construed, with due deference to agency expertise, as supporting the regulation. Also, an agency may fail to develop essential elements of the logical progression from facts to conclusions, but the court may accept the agency's conclu-

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This approach is consistent with the Wright formulation, although perhaps more receptive to greater substantive review. In characterizing his approach as central to the rule of administrative law, Judge Leventhal has written that the "scope of judicial review on the merits is a narrow one, which must repose full latitude in the agency, provided it has shown that it has taken a 'hard look' at the problems." Leventhal, *Environmental Decisionmaking and the Role of the Courts*, 122 U. PA. L. REV. 509, 540 (1974). The court will not be confined to bare formalities; whether the standard is called substantial evidence or arbitrary or capricious is not likely to be of great consequence. *Id.* at 540-41. No comparison between the Wright formulation and Judge Friendly's approach, which views the arbitrary or capricious and substantial evidence standards as convergent, could be more candid.

206. 541 F.2d at 40-41.
207. *Id.* at 41.
208. *Id.* at 102-03.
209. *Id.* at 103-04.
210. *Id.* at 104.
211. *Id.* at 100 n.139.
212. *See* text accompanying note 197 *supra*.
213. 541 F.2d at 36, 37 n.79.

sions if the evidence taken as a whole can be rationally construed as providing the missing elements.[214]

The United States Court of Appeals for the District of Columbia Circuit has followed the Wright formulation in two recent decisions of note. Its opinion in *United States Lines, Inc. v. Federal Maritime Comm'n*[215] cites to *Overton Park* for the governing principles of judicial review under the arbitrary or capricious standard, and to *Ethyl* and the recent *Home Box Office, Inc. v. FCC*[216] decisions which review those governing principles.[217] The *United States Lines* and *Home Box Office* decisions indicate that the governing principles of the arbitrary or capricious standard are well established, with the following parameters: (1) the reviewing court may not substitute its judgment for that of the agency,[218] although (2) the review must be searching and careful,[219] and (3) the agency must have (a) adequately considered all relevant factors, and (b) demonstrated a rational connection between the facts found and the choice made.[220] These principles comprise neither a deliberately generous nor a compromise standard. The traditional hierarchy is retained but with less than rigid observance of refined differences. Understanding that they must refrain from substituting their judgment for that of the agency, judges will emphasize the degree to which the agency has been conscientious, careful, and fair.

V
ANALYSIS OF THE COURT'S REVIEW OF THE COMMISSION'S ACTION

A. The Principle Issues Before the Commission

Comments offered by participants in the public hearing suggest the broad range of issues which the Commission was obliged to consider in rendering its decision. While numerous comments concerned details of specific proposed disclosure requirements, only the remarks pertaining generally to environmental disclosure are relevant to questions raised in this Comment. Those remarks framed six issues over which the participants were in sharp disagreement. The first issue, whether environmental disclosure would be excessively burdensome to the regulated companies, involved controversy over the cost and technical feasibility of generating environmental data and over the cost and volume of the disclosure document.[221] The second issue concerned the extent to which environmental disclosure would cause financing delays because of data gathering, disclosure document preparation, and challenges to data accuracy.[222] The

214. Insofar as an agency seems to ignore factors, it has not honored its obligation to explain fully its actions. The flaw is well within the scope of judicial review of agency procedure. *See* text accompanying notes 149-50 *supra*.

215. 584 F.2d 519 (D.C. Cir. 1978).

216. 567 F.2d 9 (D.C. Cir.) (per curiam), *cert. denied*, 434 U.S. 829 (1977).

217. 584 F.2d at 525-26.

218. *Id.* at 526; 567 F.2d at 35.

219. 584 F.2d at 526; 567 F.2d at 35.

220. 584 F.2d at 526; 567 F.2d at 35.

221. SEC TOPICAL ANALYSIS, *supra* note 62, at 185-87.

222. *Id.* at 187-88.

third issue concerned the usefulness to investors of environmental disclosure. Those who opposed environmental disclosure thought that much environmental information was speculative and subjective and could seriously mislead investors, while other information was highly technical and useless to the average investor. Those who favored environmental disclosure thought that meaningful and objective standards could be prepared. Environmental information beyond the understanding of the average investor could be analyzed by appropriate experts in a way not unlike the handling of currently required financial disclosures.[223] The fourth point of disagreement concerned the extent to which environmental disclosure would put issuers at a competitive disadvantage with nonpublic and foreign companies which are not subject to disclosure requirements.[224] The fifth issue concerned the Commission's competency to review the adequacy of environmental information and the extent to which involvement in the review of environmental information would compromise its present operations.[225] The sixth issue, agency coordination, involved questions pertaining to the current availability of environmental information from governmental agencies and the potential value of SEC participation in the information process.[226]

B. The Commission Erred in Assessing Benefits and Costs as though Disclosure Must Be Across-the-Board

In its review of the Commission's rulemaking action, the *NRDC v. SEC II* court identified several flaws. One such flaw was the Commission's failure to consider requiring disclosure of environmental information to shareholders in connection with proxy solicitations and information statements without requiring identical disclosure in registration statements, prospectuses, and the like.[227] Ironically, the Commission had noted that economic matters are of less primary importance under section 14(a) of the Securities Exchange Act,[228] particularly with respect to shareholder proposals, than they are under other provisions of the Securities Acts,[229] and that investors would utilize environmental information more in making voting decisions than in making investment decisions.[230] The court also found that the Commission's emphasis on intercorporate comparisons was not valid in determining costs and benefits in connection with proxy solicitations.[231]

The *NRDC v. SEC II* court was correct in finding fundamental differences between disclosure in connection with registration statements and disclosure in connection with proxy solicitations. Shareholders are responsible for the social effects of corporate policy and are in the unique position of being able to mod-

223. *Id.* at 188-89.
224. *Id.* at 190.
225. *Id.* at 190-91.
226. *Id.* at 191-93.
227. 432 F. Supp. at 1205.
228. 15 U.S.C. § 78n(a) (1976).
229. Release No. 5627, *supra* note 20, at 51,659.
230. *Id.* at 51,664.
231. 432 F. Supp. at 1206.

ify corporate social policy through voting.[232] In stark contrast, investor avoidance of morally or socially objectionable holdings has no corrective value.[233] Further, most investors interested in disclosure of social information would use environmental information in voting on shareholder proposals.[234] There would be less objection to adjusting disclosure requirements to comport with size and type of firm,[235] because inter-corporation comparison is not a reason for disclosing information to voting shareholders. In addition, the meaning of corporate social responsibility varies according to context. Environmental disclosure in proxy solicitation is a means toward achieving socially responsible corporate behavior and in principle is responsible practice.[236] On the other hand, environmental disclosure in Securities Act filings is not prudent, socially responsible behavior for a corporation to undertake.[237]

The *NRDC v. SEC II* court was well within the scope of its judicial review powers. In failing to distinguish between proxy solicitation and Security Act filings, the Commission did not exercise a reasoned discretion consistent with ascertainable legislative intent.[238] Congress emphasized that disclosure pertaining to proxy solicitations should include more than economically material information,[239] and NEPA fits within this expression of congressional intent by requiring the Commission to interpret and administer the Securities Acts in accordance with NEPA policies and procedures.[240] Insofar as Congress differentiates between the informational requirements of shareholders and investors, the Commission may do no less. Having failed to distinguish between the informational needs of these groups, the Commission neglected to consider factors necessary to reach a proper conclusion. *Overton Park* and *Ethyl* condone judicial inquiry under the arbitrary or capricious standard into whether an agency has considered all necessary and relevant factors.[241]

C. The Commission Erred in Providing Cost-Benefit Support for Some of Its Findings

The *NRDC v. SEC II* court noted a dearth of support for the Commission's conclusions with regard to the cost and feasibility of developing guidelines and standards and held that the Commission's ultimate balancing of costs and benefits was not based on a consideration of the relevant factors and was not sustainable on the administrative record.[242] Two aspects of the court's reasoning are troublesome, however. One is the extent to which the matters

232. *See* note 111 & text accompanying notes 115-23 *supra*.
233. *See* note 129 *supra*.
234. *See* text accompanying note 136 *supra*.
235. *See* SEC TOPICAL ANALYSIS, *supra* note 62, at 178-80.
236. *See* text accompanying notes 103-14 *supra*.
237. *See* text accompanying notes 112-14 *supra*.
238. See the statement of Judge Leventhal in Greater Boston Television Corp. v. FCC, 444 F.2d 841, 850 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971), quoted at note 205 *supra*.
239. *See* text accompanying note 58 *supra*.
240. *See* text accompanying notes 64-70 *supra*.
241. *See* text accompanying notes 170, 193 *supra*.
242. 432 F. Supp. at 1206-07.

before the Commission were susceptible to a cost-benefit type of analysis; the other is the extent to which the court must defer to the Commission's expertise in such matters.

With respect to the first question, the necessity for and sophistication of numerical cost-benefit analyses is influenced by the decisionmaking techniques agencies use.[243] The Army Corps of Engineers exemplifies an agency obligated to conduct and experienced in performing cost-benefit analysis. The Corps for years has used a Congressionally mandated cost-benefit analysis to evaluate the feasibility of its projects. Courts should not hesitate to require inclusion of environmental values in the Corps' quantitative framework.[244] The expert technical agencies such as the Nuclear Regulatory Commission, formerly the Atomic Energy Commission, and the Department of Transportation comprise a second category. The judiciary has required that the technical agencies perform numerical analyses.[245] In a third category are the nontechnical agencies that neither undertake construction projects requiring numerical analysis nor possess a technical staff. Placing a cost-benefit analysis requirement on these agencies will not promote better decisionmaking but will result in careless procedure and meaningless analysis.[246] The Commission falls within this third category.

With respect to the second question, the extent to which the court must defer to the Commission's expertise, the discretion of nontechnical agencies on technical matters is due less judicial deference than is the discretion of a technical agency.[247] The cases which have troubled the courts have been precisely those in which technical and scientific matters unlike those before the Commission have been involved.[248] While an agency must be expected to bring to bear

243. Note, *Environmental Law—The National Environmental Policy Act of 1969—The Influence of Agency Differences on Judicial Enforcement*, 52 TEXAS L. REV. 1227, 1238 (1974).

244. *Id.* at 1240-41.

245. *Id.* at 1241-42.

246. *Id.* at 1242.

247. *Cf.* text accompanying notes 192-97 *supra* (judicial review of agency determinations on scientific and technical matters).

248. The District of Columbia Circuit has been troubled about the appropriate degree of discretion to allow administrative agencies on scientific and technical determinations. This problem was responsible for considerable disagreement in Ethyl Corp. v. EPA, 541 F.2d 1 (D.C. Cir.) (en banc), *cert. denied*, 426 U.S. 941 (1976). *See* text accompanying notes 189-97 *supra*. The trend currently is that when questions before an agency acting in either a quasi-legislative or quasi-judicial capacity are on the frontiers of scientific or technical knowledge and sufficient data is not available to make a fully informed factual determination decisionmaking must depend to a greater extent upon policy judgments and less upon purely factual analysis. Industrial Union Dep't, AFL-CIO v. Hodgson, 499 F.2d 467, 474 (D.C. Cir. 1974). The court's duty is to insure that the reasoning supporting the judgments underlying conclusions of a technical subject and the data supporting such judgments are spread out in detail on the public record. Justification of a conclusory nature is not acceptable. Natural Resources Defense Council, Inc. v. NRC, 547 F.2d 633, 651 (D.C. Cir. 1976), *rev'd on other grounds sub nom.* Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978). Another trend in the law of the D.C. Circuit had been the imposition by courts of procedural requirements beyond the statutory minimum dictated by section 4 of the Administrative Procedure Act (APA), 5 U.S.C. § 553 (1976). In highly technical areas, in which judges are institutionally incompetent to weigh evidence for themselves, a focus on agency procedure will prove less instrusive and more likely to improve the quality of decisionmaking than judges steeping them-

the full range of its knowledge and expertise when interpreting data and forming predictions,[249] the courts tend to defer to agency expertise only when that expertise is of a highly technical nature.

Upon general principles, then, the SEC is a nontechnical agency which is not required to conduct a cost-benefit analysis. If the analysis is done, it will not merit great deference. Notably, the *NRDC v. SEC II* court did not challenge the Commission's use of a cost-benefit analysis to justify its conclusions, nor did the court impose the requirement of a rigorous cost-benefit analysis on the Commission. The court's concern was more limited and its review well within the scope of judicial power under the arbitrary or capricious standard. Once the Commission chooses to justify its rejection of various alternatives on the alleged basis of a cost-benefit analysis, it must show that its analysis was reasonably conducted. Conclusory statements will not suffice; they do not provide the factual predicate, even allowing for deference to agency expertise, to serve as a rational basis for the agency's action.[250]

D. The Commission Erred in Not Complying with NEPA's Procedural Mandate

The *NRDC v. SEC II* court also based its remand on a finding that the Commission failed to make a serious effort to develop appropriate guidelines and standards for the disclosure of environmental information.[251] Considered as a conclusion based on substantive review under the arbitrary or capricious standard, the court's decision on this point runs contrary to the announced purpose of the Commission's proceedings.[252] The point of the proceeding was to determine whether regulations were needed and which regulations were needed; to hold that the Commission did not make a serious effort to develop those regulations answers an issue not before the court.

Insofar as the court's language can be read as questioning the Commission's interpretation of the NEPA legal predicate, however, Judge Richey was

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selves in technical matters to determine whether the agency has exercised a reasoned discretion. 547 F.2d at 657 (Bazelon, C.J., separate statement). *See* 541 F.2d at 66-67 (Bazelon, C.J., concurring). The Supreme Court's decision in Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978), rejects that development. While the APA merely establishes lower procedural bounds, a court may not routinely require more than the minimum even when an agency's proposed rule addresses complex or technical factual issues or issues of great public concern. *Id.* at 545-46. Congress intended that the discretion of the agency and not that of the courts be exercised in determining when extreme procedural devices should be used. *Id.* at 546. NEPA cannot be used by a court to require procedures beyond those specified in section 4 of the APA; "the only procedural requirements imposed by NEPA are those stated in the plain language of the Act." *Id.* at 548. Now that the Court has spoken out against judicial imposition of procedural requirements beyond the APA minimum on the rulemaking activities of agencies, the reviewing courts must trust to limited substantive review to keep the agencies in line.

249. *See* text accompanying notes 193, 204-14 *supra*.

250. *See* text accompanying note 204 *supra*.

251. 432 F. Supp. 1207. The Commission was held to be in contravention of section 102(2)(B) of NEPA. *See* text accompanying note 68 *supra*.

252. "Through this proceeding the Commission seeks to determine whether its present disclosure rules are adequate in view of the provisions of [NEPA] and, if not, what further rulemaking action should be taken." Release No. 5569, *supra* note 15, at 7013.

well within judicial authority to interpret the statutory basis for administrative action.[253] The court perceived statutory misinterpretation as the reason for the Commission's mistaken belief that other agencies should assume the responsibility for promoting the policies of NEPA.[254] The better reading, then, is that the Commission's misinterpretation of NEPA's procedural mandate influenced the Commission's consideration of guideline and standards development, thereby invalidating the agency's conclusions based on that consideration.

E. Other Evidence Suggesting that the Commission's Assessment of Certain Alternatives May Not Have Been Entirely Rational

The *NRDC v. SEC II* court found the Commission's handling of three administrative findings to have been careless, suggesting that the Commission's assessment of certain alternatives may not have been entirely rational.[255] The SEC thought that certain kinds of disclosure were duplicative in content and effort,[256] but this finding cuts both ways. Some degree of duplication favors disclosure because it means that firms have already generated the information and that requiring disclosure of the information will not involve the cost of procuring the data. Regardless, if adequate information is available from other sources, nondisclosure is favored. The SEC, in failing to explain the significance of little "direct" investor interest,[257] also did not address the possibility that direct investor interest in current disclosures may be less keen than in the relatively "soft" environmental disclosures. Finally, the Commission's explanation for rejecting disclosure requirements pertaining to capital expenditures and expenses for environmental purposes was found to be wholly inadequate.[258] These flaws can best be characterized as a failure to develop adequately the essential elements of the logical progression from facts to conclusions.[259] Unpersuaded by its study of the evidence taken as a whole, the court properly refused to defer to agency judgment on these points.

VI
CONCLUSION

The complex issues before the Commission in this informal rulemaking proceeding include the effect of environmental disclosure on business resources; the role which environmental disclosure should play in responsible corporate behavior, corporate democracy, and securities transactions; and the informational needs of the general investing public and the so-called ethical in-

253. See the statement of Judge Leventhal in Greater Boston Television Corp. v. FCC, 444 F.2d 841, 850 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971), *quoted in* note 205 *supra*. *See also* note 82 & text accompanying note 170 *supra*.

254. 432 F. Supp. at 1207-08.

255. *Id.* at 1208.

256. Release No. 5627, *supra* note 20, at 51,662 n.44.

257. 432 F. Supp. at 1208.

258. *Id.*

259. *Cf.* text accompanying note 214 *supra* (evidence taken as a whole did not provide the missing elements).

vestor. Well established principles of administrative law and concern for prudent utilization of judicial resources preclude *de novo* review of the informal rulemaking process. A better course is to restrict judicial involvement to limited substantive review under the arbitrary or capricious standard and to procedural review. The traditional scope of the arbitrary or capricious standard was violently if unintentionally upset in the Supreme Court's *Overton Park* decision and remains unsettled, although most of the cases are drawing near a common resolution. The present scope of judicial review under the arbitrary or capricious standard in the United States Court of Appeals for the District of Columbia Circuit is a liberal restatement of the old rational basis test, which is that the cumulative effect of all the evidence must provide a rational basis for the administrative action. While the arbitrary or capricious standard in theory permits a more limited review than the substantial evidence standard characteristically used in review of agency action "on the record," the arbitrary or capricious standard as applied in practice gives judges considerable latitude in the review of agency decisions. This latitude is found in the extent to which judges deem deference to agency discretion appropriate. The courts, understanding that they must refrain from substituting their judgment for that of the agency, will nonetheless place emphasis on the degree to which the agency has been conscientious, careful, and fair.

Employing these principles of judicial review, the United States District Court for the District of Columbia noted serious flaws in the Commission's decisionmaking process and remanded the case. The court found that the Commission had failed to consider factors necessary to reach a proper decision, factors inherent in the distinction between the informational needs of investors choosing securities and shareholders exercising the corporate franchise. The court also found lacking a sufficient factual predicate for the Commission's cost-benefit analysis; improper interpretations of relevant law and an irreparable failure to develop adequate elements of the logical progression from facts to conclusions were egregious flaws. These findings are well within the scope of judicial review under the arbitrary or capricious standards.

Although judicial review is relatively narrow under the arbitrary or capricious standard, the court must study the record to satisfy itself that the agency has exercised a reasoned discretion consistent with the legislative intent. Under the Securities Acts, viewed in light of NEPA, the Commission must seriously consider environmentally beneficial alternatives to its present actions. This Comment has developed one view of the role of environmental disclosure in business and shareholder decisionmaking. The content of the Commission's rules and regulations must be shaped by a rigorous balancing of the benefits and costs of specific disclosure schemes, a matter well within the discretion of the agency. Nonetheless, strong evidence suggests that disclosure of "soft" information such as environmental information is required by the Commission's mandate under the Securities Acts viewed in light of NEPA and interpreted in the context of the current business and social climate. The Commission's failure to recognize these principles accounts for the flaws in its decisionmaking process.

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