

Environmental Disclosure in Securities Law

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Rick Moscone, Partner



Charles Birchall, Partner

The recently concluded United Nations Climate Change Conference, held in Copenhagen, was moderately successful in advancing a global initiative to reduce climate change. As this global initiative becomes more advanced, the environmental disclosure requirements under securities law will likely become more pronounced. The following is a summary of the current environmental disclosure requirements under securities law in Canada.

National Instrument 51-102 *Continuous Disclosure Obligations* ("NI 51-102") requires that reporting issuers disclose material information about environmental matters in their continuous disclosure documents.

Ontario Securities Commission ("OSC") Staff has reminded reporting issuers to disclose material information regarding known and contingent environmental matters, and ensure that disclosure complies with securities legislation and supplies investors with meaningful information for making investment decisions.

Staff Notice 51-716 – Environmental Reporting ("SN 51-716"), issued by OSC Staff on February 29, 2008, directs reporting issuers, including those listed on the Toronto Stock Exchange ("TSX") and the TSX Venture Exchange ("TSXV"), to improve their environmental disclosure practices. SN 51-716 outlines the results of a targeted review of 35 reporting issuers. The OSC Staff raised two general and re-occurring issues in the notice:

- i. **Improve *Qualitative Environmental Disclosure*:** Issuers often fail to discuss specific environmental risks and liabilities, rather they provide boilerplate discussions of environmental issues. These are insufficient because they do "not provide meaningful information to investors"; and

- ii. **Improve *Quantitative Environmental Disclosure*:** Issuers often fail to fully discuss and quantify the costs associated with environmental liabilities, obligations, protection requirements, policies and risks.

SN 51-716 contains no specific reference to climate change, however, as regulations for climate change are adopted in Canada and internationally, it is expected that these matters will be covered by SN 51-716.

The Canadian Performance Reporting Board of the Canadian Institute of Chartered Accountants ("CICA"), on the other hand, prepared a report titled *Building a Better MD&A: Climate Change Disclosures* (the "CICA Report") to provide further guidance about Management Discussion & Analysis ("MD&A") disclosures specifically in regards to climate change.

Below is an overview of SN 51-716 and the CICA Report as well as a brief discussion of their implications.

Scope of the Reports

The compliance review reported in SN 51-716 was performed to assess the satisfaction by issuers of environmental disclosure obligations imposed by NI 51-102. The OSC Staff examined continuous disclosure documents and the web sites of 22 TSX-listed issuers and 13 TSXV-listed issuers (within the meaning of NI 51-102). Each issuer operated in one of the following industries: environmental services, industrial products, mining, oil and gas, steel, transportation services, or utilities. The OSC Staff noted that the notice may be relevant to issuers operating in other industries.

The CICA Report considered a number of important developments within the regulatory field and obtained input from institutional investors, as well as MD&A preparers, about the types of disclosures that would be most appropriate.

Materiality

The focus of the OSC Staff inquiry and the CICA Report was on the disclosure of *material information* as required by the *Securities Act* (Ontario), and more particularly NI 51-102. Materiality is the determining factor in deciding whether to include information about environmental matters in continuous disclosure documents, such as in issuers' financial statements, MD&A and Annual Information Forms ("AIFs").

In SN 51-716 the OSC states that information relating to environmental matters is material "if a reasonable investor's decision whether or not to buy, sell or hold securities of the issuer would likely be influenced or changed if the information was omitted or misstated." The OSC Staff is of the view that issuers must consider both quantitative and qualitative factors in determining materiality generally, as well as in relation to environmental matters.

The CICA Report held materiality as "an overriding principle" and stated that in considering materiality, management should consider whether the impact of a climate change issue might reasonably be expected to grow over time. In this case, early disclosure of the matter may be material to long-term investors.

Results of the Compliance Review reported in SN 51-716

The OSC reviewed the following areas, and required improved disclosure to shareholders in all of these areas:

- financial liabilities related to the environment (environmental liabilities);
- asset retirement obligations;
- financial and operational effects of environmental protection requirements;
- environmental policies fundamental to operations; and
- environmental risks.

Financial Liabilities

Issuers should generate quantitative accounting estimates of their financial liabilities if quantitative data is reasonably available and such information is material to investors. This is the case even if liabilities are contingent. OSC Staff is of the view that materially contingent liabilities must be discussed in an Issuer's MD&A and AIF whether or not they have accrued or have been disclosed in the financial statements. Liabilities that are not individually material must be disclosed if collectively they reflect a material trend or underlying risk.

Asset Retirement Obligations

Environmental matters can affect the useful life of an asset and as such, may materially affect asset retirement obligations. The financial statements must include asset retirement obligations as soon as a reasonable estimate can be generated. If an asset retirement obligation is material to an issuer, the issuer should strive to supplement the disclosure in its MD&A. The supplement should include a "comprehensive discussion of material commitments, events or uncertainties, including AROs, that are reasonably likely to have an effect on the issuer's business." If asset retirement obligations are material and long-term, issuers should include them in the summary contractual obligations table in their MD&A.

Environmental Protection Requirements

Issuers should quantify the costs of compliance with environmental legislation. Issuers should perform a more detailed analysis of environmental risks in respect of relevant environmental laws, and assess the potential impact of compliance on the issuer's finances or operations. As an example, issuers with commercial industrial real estate holdings should be assessing the impact, if any, of recent amendments to Ontario's "Brownfields" legislation.

Environmental Risks

An issuer should consider disclosing environmental risk factors in its AIF, or if not required to file an AIF, in its MD&A. Material risks relating to environmental legislation, whether domestic or international, should be included. This analysis "may include whether or not the issuer is in compliance with these laws and any costs of compliance."

CICA Report

The CICA Report notes that climate change issues will impact some industries and companies more than others. However, it argues that in time climate change will affect, either directly or

indirectly, the business operations and financial performance of many Canadian companies, large and small, in most sectors. Disclosure of the carbon footprint for certain large emitters is a first step. See (iii) immediately below.

The CICA Report outlines five specific areas where institutional investors generally seek climate change information, which are: (i) business strategy (including competitive threats and opportunities), (ii) risks, (iii) greenhouse gas emissions, (iv) financial impacts and (v) governance processes.

In order to furnish them with this information, the CICA Report suggests that it is likely sufficient to provide MD&A disclosures about climate change on an annual basis, with only material changes to information reported in annual MD&As being reported in interim MD&As. Disclosing information deemed necessary for a MD&A should not be included by way of cross-reference to information in other documents or locations, including annual information forms, sustainability reports, or corporate websites.

The CICA Report advises that in addition to considering securities regulators' requirements and financial statement disclosures, management may find it useful to review other sources to identify potential material disclosures including but not limited to industry-sector research papers, sustainability reports and strategic statements and plans.

Implications for Reporting Issuers

No New Disclosure Obligations, But...

While these reports do not impose new disclosure obligations, they do provide guidance from OSC Staff and the CICA on what they consider sufficient disclosure of environmental issues as required by NI 51-102. This guidance was given because investors increasingly seek information to help them assess the impact of climate change, and investors and the OSC staff alike have expressed dissatisfaction with existing disclosures by companies with respect to climate change and other environmental issues. Issuers should therefore review their environmental disclosure and consult with their advisors to ensure that their practices are in line with current disclosure obligations and the guidance provided by OSC Staff and the CICA.

The CICA has suggested three principal options for presenting climate change information within an MD&A:

- present a separate climate change section;
- present as a subheading within the risk section; or
- intersperse a discussion of climate change issues within various sections of the MD&A, to reflect the linkages between climate change and other aspects of the company's business, such as corporate strategy, capital resources, liquidity, key performance drivers and outlook.

Officer and Audit Committee Responsibilities

Management is responsible for MD&A disclosures, including those about environmental matters and climate change issues. Directors, however, are responsible for reviewing and approving all MD&A disclosures. The CICA Report recommends some general questions to be asked to ensure the adequacy of proposed MD&A disclosures, including:

- How have we determined which climate change issues are material and therefore require disclosure in the MD&A?
- Have we assessed materiality in qualitative as well as quantitative terms?
- Have we focused on the potential impact of climate change issues on longer term financial condition, results of operations and cash flows as well as shorter term performance?
- From period to period, is there comparability and consistency in MD&A disclosures about climate change issues?
- Have we ensured consistency of MD&A climate change disclosures with those in other public reports?

SN 51-716 contained a reminder to issuers that chief financial officers and audit committees are personally responsible for ensuring financial statements, MD&A and AIFs adequately quantify and disclose material environmental issues. These responsibilities are derived from *Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings* and *Multilateral Instrument 52-110 – Audit Committees*. Certifying officers and audit committees must be satisfied that these items contain a meaningful discussion of material environmental matters and fairly represent the issuer's financial situation. Issuers should therefore ensure that adequate procedures are in place for proper review and oversight regarding the disclosure of material environmental matters.

Environmental Enforcement Act

There are recent legislative changes that may create new disclosure obligations for corporations, including those that are reporting issuers. The new federal *Environmental Enforcement Act* ("EEA") received royal assent on June 18, 2009 and is to come into effect by an order of the Governor-in-Council. The EEA creates higher fines and amends other enforcement measures of certain federal environmentally-related statutes.

From a disclosure perspective, the EEA provides that when a corporation is convicted of an offence under these amended statutes, the court must order the corporation to notify its shareholders of the facts of the offence and punishment imposed. Therefore, the EEA creates additional disclosure requirements for reporting issuer corporations convicted of such offences.

This shareholder notification provision is divergent from the overriding securities law principle of materiality which is discussed in SN 51-716 and in the CICA Report. Since the court *must* order the corporation to notify shareholders, even so-called "paper" offences and related fines still have to be reported to shareholders regardless of their materiality.

The EEA leaves it to the discretion of the court how this information is to be disclosed to shareholders. However, if shareholder notice is ordered through channels that traditionally advise shareholders of material changes, such as through a press release, then these notices could muddy the waters between material and non-material disclosure. Investors advised of a conviction of a "paper" offence, for example, could be led to think that this is a "material" disclosure by the corporation.

While it is unclear whether the shareholder notice provisions under EEA will add value to investor decision making, reporting issuers should be aware of these new disclosure provisions.

Conclusions

There is a growing emphasis on climate change and environmental disclosure requirements, as well as the enforcement of disclosure requirements. Managers and directors of issuers should be diligent in considering and attempting to quantify (on a qualitative and quantitative basis) the impact of any material risks and liabilities associated with global climate change on their operations and financial statements. This will not only protect issuers from the risk of non-disclosure, but also help direct the issuer efforts amidst a changing environmental landscape.

Rick Moscone is a Partner at Fogler, Rubinoff LLP in the Securities and Business Law Group. He can be reached at (416) 941-8858 or rmoscone@foglers.com.

Charles Birchall is a Partner at Fogler, Rubinoff LLP and specializes in environmental law, both the regulatory and transactional aspects thereof. He can be reached at (613) 842-7440 or cbirchall@foglers.com.

For further information, please contact Rick or Charles or your usual Fogler, Rubinoff LLP contact.

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