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Environmental Disclosure Update in Securities Law

Even though recent international and domestic efforts to address climate change seem to have stalled or are seen to be moving at a snail's pace, investors are increasingly looking for more disclosure of environmental information to assess whether companies are identifying and managing the risks associated with the environment, including climate change. To this end, investors and other stakeholders consulted during the Ontario Securities Commission's corporate sustainability reporting initiative expressed the following concerns regarding the adequacy of disclosure about environmental issues as set out in CSA Staff Notice 51-333:

- material information regarding environmental issues is found in voluntary reports and not in securities regulatory filings;
- information provided is not necessarily complete, reliable or comparable among issuers, and is boilerplate disclosure that does not provide meaningful information to investors;
- if the information is not provided in securities regulatory filings, it is not necessarily provided in a timely manner since the prescribed timelines for CD documents under securities legislation do not apply to voluntary reporting; and
- environmental information is not integrated into financial reporting.

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. In addition, National Instrument 58-101 *Disclosure of Corporate Governance Practices* and National Instrument 52-110 *Audit Committees* also contain relevant disclosure requirements.

Ontario Securities Commission ("OSC") Staff have reminded reporting issuers to disclose material information regarding known and contingent environmental matters, and ensure that such disclosure supplies investors with meaningful information for making investment decisions. As set out in CSA Staff Notice 51-333, the test for materiality is objective. "Information relating to environmental matters

is likely 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".

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.

The Canadian Performance Reporting Board of the Canadian Institute of Chartered Accountants ("CICA") also prepared a report titled *Building a Better MD&A: Climate Change Disclosures* to provide guidance about Management Discussion & Analysis ("MD&A") disclosures, specifically with respect to climate change. 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 MD&A and AIFs 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. For 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 Annual Information Form ("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.

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.

Additional Guidance

Notwithstanding guidance from the OSC and the CICA, issuers have still had difficulty in applying the materiality test in the context of knowing when to disclose environmental information. In order to

further assist issuers, CSA Staff Notice 51-333 sets out the following guiding principles to consider when making materiality determinations:

- **No bright-line test** – There is no standard or uniform threshold when environmental information becomes material. The materiality of information may vary between industries and even between issuers within the same industry;
- **Context** – Materiality should be considered in the light of all facts available. An issuer should "not lose sight of the forest for the trees" by assessing individual facts by piecemeal;
- **Timing** – Determining what is material is a dynamic process that will depend on prevailing conditions at the time of reporting. An issuer should consider whether the impact of an environmental matter might reasonably be expected to grow over time, in which case early disclosure would be important to reasonable investors;
- **Trends, demands, commitments, events and uncertainties** – An issuer should consider the probability that a trend, demand, commitment, event or uncertainty will occur and the anticipated magnitude of its effect;
- **Err on the side of materiality** – If there is any doubt about whether information is material, an issuer is encouraged to err on the side of materiality and disclose the information.

The Staff Notice goes on to provide that in assessing environmental risks that may impact an issuer's business and operations they can generally be divided into five categories: litigation, physical, regulatory, reputation, and business model. Again, OSC Staff caution that as with any other type of disclosure, material risks should be disclosed in a meaningful way and to avoid the use of boilerplate disclosure.

Audit Committee, Board and Officer Responsibilities

CSA Staff Notice 51-333 comments that in fulfilling their oversight functions relating to environmental disclosure, audit committees, boards and certifying officers should consider the following questions:

- What environmental matters are reasonably likely to impact the issuer's business and operations in the foreseeable future?
- What are the magnitude, sources and nature of the issuer's current and anticipated environmental risks and liabilities?
- What has been, and is likely to be, the impact of environmental matters on revenues, expenditures and cash flows?
- What impact, if any, could environmental matters have on the issuer's financial condition and liquidity?
- What assessment has management made to investors regarding the materiality of environmental matters, and are the disclosures made in the financial statements, MD&A, and AIF consistent with this assessment?

With respect to the last question posed, CSA Staff Notice 51-333 notes that it is not sufficient for an issuer to discuss material environmental matters solely on its website or in voluntary reports or responses to surveys. Such information should also be disclosed in its continuous disclosure documents. Moreover, an issuer should also ensure that its website, voluntary reports and responses to surveys do not contain any misrepresentations respecting environmental matters. While such documents and written communications are not required to be filed with securities regulatory authorities, they may attract liability under securities legislation, including civil liability for secondary market disclosure. In any event, an issuer should ensure that all public and continuous disclosure is consistent.

Finally, SN 51-716 contains 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.

Federal Environmental Enforcement Act

There are federal legislative changes that have recently come into force that may create new disclosure obligations for corporations, including those that are reporting issuers. The federal *Environmental Enforcement Act* ("EEA") received royal assent on June 18, 2009 and came into force by an order of the Governor-in-Council on December 10, 2010. 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 the above-noted National Instrument 51-102 and Staff Notices. 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. One is also left to wonder whether a court ordered disclosure should automatically be disclosed under the continuous disclosure documents pursuant to the guidance set out in CSA Staff Notice 51-333.

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 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. In attempting to protect issuers from the risk of non-disclosure, they should have regard for the latest Staff Notice, 51-333, including its examples of entity-specific disclosure.

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