Environmental Disclosure by Public Companies

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1. INTRODUCTION 2

2. MATERIAL INFORMATION 3

a) Statutory Definition 3
b) Case Law 6
(i) Potential Impact 6
(ii) Excessive Disclosure 6
(iii) Company-Specific Risks 6
(iv) Time of Determination 7
(v) Indemnity Agreements 7
(vi) Statutory Violations 7
c) Environmental Information 7
d) Corporate Social Responsibility Reports 8
e) Example 9

3. FORWARD-LOOKING INFORMATION 10

a) Foreseeability 11
b) The Specific Case of Climate Change 12
c) Example 14

4. LIABILITY OF DIRECTORS AND OFFICERS 14

5. CONCLUSION 16

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1. Introduction

For many decades, public companies have had to provide information to investors on all material aspects of their activities, their financial performance and their future projects. Such continuous disclosure is done through filings and news releases describing material changes.

In 2005, the Autorité des marchés financiers du Québec adopted Regulations 51-102[1], 52-109[2] and 58-101[3] to specify the nature and scope of the information that needs to be disclosed, to make certain officers accountable for information gathering and for the accuracy of communications as well as requiring the disclosure of corporate governance practices. The Quebec *Securities Act* and Regulation 51-102 provide that a reporting issuer must file periodic reports of continuous disclosure, including the annual information form (AIF) and the management discussion and analysis form (MD&A).

As we will see below, Regulation 51-102 Forms and Policy Statement 51-102 have specified the environmental content of periodic disclosures.

However, many stakeholders are still unsatisfied with the scope and the generic nature of environmental disclosures[4]. Some authors even refer to the lack of consistency between the regulatory requirements and the disclosures filed as a "disclosure gap"[5]. These discrepancies are also observed in climate change risks disclosures[6].

In response to the pressures of various segments of society[7], financial market regulators have examined the environmental disclosures made by companies whose activities affect the environment and have severely criticized them.[8].

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1 Regulation 51-102 respecting Continuous Disclosure Obligations, Autorité des marchés financiers du Québec ("**AMF"**), in force June 1, 2005 ("**Regulation 51-102**").

2 Regulation 52-109 respecting Certification of Disclosure in Issuer's Annual and Interim Filings, AMF, in force June 1, 2005 ("**Regulation 52-109**").

3 Regulation 58-101 respecting Disclosure of Corporate Governance Practices, AMF, in force June 1, 2005.

4 Wagner, Constance, "Corporate Environmental Reporting and Climate Change Risk: The Need for Reform of Securities and Exchange Commission Disclosure Rules" (2009-2010); 11 Transactions: Tenn. J. Bus. L. 152, p. 153.

5 Report entitled "Corporate Social Reporting Initiative – Report to Minister of Finance", prepared by the Hennick Centre for Business and Law and Jantzi-Sustainalytics, in 2009 (the "**Hennick Report**"), p. 12.

6 A review of the 2009 annual reports filed by 400 public companies with the SEC revealed that only 17% of the verified reporting issuers mentioned climate change risks, in Tonello, Matteo, "Sustainability in the Boardroom", The Conference Board, No. DN-008, June 2010, in note 39 of its text; only 24 of the 1,400 reporting issuers listed on the Toronto Stock Exchange filed a report on social responsibility using the Global Reporting Initiative framework in 2009 (Hennick Report, *supra*, note 5, p. 12).

7 Through various means, stakeholders, shareholders, institutional investors and professional groups have shown their interest in having more detailed, more complete and more systematic information available to them. See: Hennick Report, *supra*, note 5, p. 12; Wagner, Constance, *supra*, note 4, p. 154; Tonello, Matteo, *supra*, note 6, p. 3.

8 For example, the Ontario and Alberta Securities Commissions have examined the corporate environmental disclosures in sectors related to the environment and concluded that the disclosures were general and inadequate. See: OSC Staff Notice 51-716 – Environmental Reporting, (2008) 31 OS CB 2223; and "Continuous Disclosure Review Program", ASC, February 2008, p. 20.

More recently, the Ontario Legislative Assembly voted unanimously to support a resolution introduced by the Honourable Laurel Broten, calling on the Province of Ontario to undertake a review of the corporate disclosure reporting requirements for financial and non-financial information and compliance therewith, to ensure that Ontario investors have access to all the material information they need. This resolution also gave the Ontario Securities Commission (the "**OSC**") the mandate to conduct a public consultation on corporate social responsibility and environmental, social and governance reporting standards[9].

It is in this evolving context that appears to be moving towards increased environmental disclosure that we shall address two issues that are inevitably raised when directors, officers and advisers of public companies consider the information gathered and identify the information that must be disclosed, namely (a) the evaluation of the threshold beyond which the disclosure of information is required (this threshold is often called "materiality") and (b) the scope of the forward-looking information to be disclosed.

We shall examine one of the possible vectors of this change, namely the responsibility of directors and officers of public companies. It seems plausible to us that financial market regulators and investors will try to reach directors and officers of public companies who do not adequately report environmental information; lawsuits against directors and officers have played a significant role in the evolution of corporate behaviour with regard to environmental management and performance in the early 1990s[10].

2. Material Information

Securities laws and regulations define material information that must be disclosed. Canadian and American courts have shed some light on the materiality threshold and on the analysis required to determine the materiality threshold in a given context.

a) Statutory Definition

In Quebec, the materiality threshold above which information must be disclosed is defined in the *Securities Act*[11] as well as in Forms 1 and 2 of Regulation 51-102[12].

The QSA provides that a reporting issuer must periodically disclose information about its business and internal affairs in accordance with the conditions determined by regulation[13].

Regulation 51-102 provides that material information must be disclosed in the annual information form ("**AIF**") and the MD&A[14].

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9 The OSC conducted a public consultation leading to the publication of the Hennick Report, *supra*, note 5.

10 The landmark decision in environmental statutory responsibility of directors and officers in Canada is *R. v. Bata* (1992) 7 C.E.L.R. (N.S.) 245 (Ontario Court of Justice, Provincial Division). The company appealed the sentence and the order preventing it from indemnifying its directors: (1993) 11 C.E.L.R. (N.S.) 209 (Ontario Court of Justice, General Division) and (1995) 25 O.R. (3d) 321 (Ontario Court of Appeal). On appeal, the penalties were reduced and the order quashed. This decision was then cited and followed on many occasions.

11 R.S.Q. c. V-1.1 (the "**QSA**").

12 *Supra*, note 1.

13 Section 73 QSA.

In the AIF, the reporting issuer must (i) describe the environmental protection requirements applicable to the company as well as their effects on capital expenditures, earnings and competitive position of the company[15]; (ii) mention environmental and social policies fundamental to operations, as well as steps taken to implement these policies[16]; (iii) disclose material environmental and public health risk factors relating to the company's operations[17]; and (iv) describe all civil and regulatory proceedings, current and contemplated[18].

The MD&A must disclose material information on the current and future activities of the corporation, including the information that complements and supplements the financial statements and that may not be fully reflected therein. It must discuss material trends and risks that could affect the financial statements or that are likely to affect them in the future.

Each AIF and MD&A must be certified by the chief executive officer and the chief financial officer as to the adequacy of the management and data collection systems and, to their knowledge, as to the accuracy of the disclosures[19]. This certification includes the collection and disclosure of information on the environmental performance and responsibilities of the company.

As we will see in section 4 of this article, the public company that fails to report material information in an AIF or in a MD&A could be subject to penal proceedings[20] by the AMF, a statutory civil action taken by investors[21] and civil liability proceedings under Section 1457 of the *Civil Code of Québec* ("**C.C.Q.**"). The AIF and the MD&A are core documents within the meaning of Section 225.3 of the QSA.

The Regulation 51-102 Forms set out the following test to determine if information is material: "*Would a reasonable investor's decision whether or not to buy, sell or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated?*"[22].

This regulatory test of what constitutes material information to be reported in periodic continuous disclosure documents, which is based on the decision of a reasonable investor, differs from the test applicable to a material fact under the QSA, which is used in public offerings of securities[23]. Assessing a material fact is based on its impact on the market,

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14 Part 4A for the MD&A and Part 6 for the AIF.

15 Section 5.1(1)(k) of Form 51-102F2.

16 Section 5.1(4) of Form 51-102F2.

17 Section 5.2 of Form 51-102F2.

18 Section 12 of Form 51-102F2. Civil proceedings do not need to be disclosed if damages claimed do not exceed 10% of the corporation's assets. Significant penalties or sanctions imposed by a court or a regulatory authority must be disclosed.

19 Regulation 52-109.

20 Sections 73, 202 and 203 of the QSA.

21 Sections 218 and Sections 225.2 and following of the QSA.

22 Part 1(e) Form 51-102F2 for the AIF and Part 1(f) of Form 51-102F1 for the MD&A. This definition is in keeping with that of the CICA Handbook governing information to be reported in financial statements.

23 A material fact also differs from a material change, which must be published immediately. See: *Kerr* v. *Danier Leather Inc.*, [2007] 3 S.C.R. 331, para. 38. ("**Danier**"), which specifies the differences between the two notions; and *In the Matter of*

meaning that the information must be disclosed if it has the potential to change the value or the price of the securities of the public company. The statutory civil actions under the QSA are based on the existence of a misrepresentation, itself defined as any misleading information on a material fact[24], and therefore likely to affect the value or the price of securities.

The Canadian definition of material information is similar to that adopted in the United States[25]. Canadian courts often refer to the more abundant American case law to establish the parameters of materiality[26]. We shall do the same in this article.

While the reasonable investor standard is an objective one, its appreciation, in practice, is based on the facts and circumstances of each case. The decision to disclose or not disclose information, must result from a rigorous analysis of all relevant facts and the potential impact of such information. This decision must also take into consideration the expectations and concerns of a reasonable investor.

In a recent ruling[27], the Ontario Securities Commission describes the assessment of the materiality of a statement as follows:

> *"Accordingly, the assessment of the materiality of a statement is a question of mixed fact and law that requires a contextual determination that takes into account all of the circumstances including the size and nature of the issuer and its business, the nature of the statement and the specific circumstances in which the statement was made. The reasonable investor standard for determining materiality articulated in TSC Industries has been accepted and applied by the Commission in a number of decisions.* "

The notion of reasonable investor is evolving and does not only include economic components. It also reflects social values and fluctuating market trends, at a given time. The person who must determine the impact of information on the decision of this virtual investor must therefore try to understand the economic expectations of investors generally, as affected by contemporary social concerns, and determine what could likely influence an investment decision.

Piergiorgio Donnini, OSC Panel, September 12, 2002, p. 34; confirmed by the Ontario Court of Appeal, 2005 CanLii 1622 ("**Donnini**").

24 Section 5 QSA.

25 In a document entitled "SEC Guidance Regarding Disclosure Related to Climate Change; Final Rule » (the "**SEC Guide**"), Federal Register/Vol. 75, No. 25, February 8, 2010, the United States *Securities Exchange Commission* (the "**SEC**") states that "*information is material if there is a likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information*", p. 6293.

26 See, for example, Donnini, *supra*, note 23, pp. 36 and following and *In the Matter of YBM Magnex International Inc.*, (2003) 26 OSCB 5285, para. 101 ("**YBM**").

27 *In the Matter of Biovail Corporation, Eugene Melnyk et al*, O.S.C. Panel, September 30, 2010 ("**Biovail"**), p. 16.

b) Case Law

The courts have set out certain principles that define the materiality threshold of information to be disclosed and that illustrate what they believe to be consistent with a reasonable investor's behaviour. Although these decisions do not address environmental information directly, they are helpful to assess materiality. We set out some of these principles below.

(i) Potential Impact

In *Kripps* v. *Touche Ross*[28], it was decided that for information to be material, it is not sufficient to establish that it "might possibly" influence the decision of a reasonable investor - it must be demonstrated that it probably would affect it.

(ii) Excessive Disclosure

In *YBM*[29], excessive disclosure which includes immaterial facts, is qualified as "counter-productive". This approach results in overwhelming the reasonable investor, watering down material information and creating confusion in the investor's mind. The court specified that judgement and common sense should prevail.

In *TSC Industries*, the judge states the following:

> "…*if the standard of materiality is unnecessarily low, not only may the corporation and its management be subject to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information – a result that is hardly conducive to informed decision-making.*"[30]

(iii) Company-Specific Risks

Continuous disclosure reports must contain information describing material risks that are specific to the company. If there are company-specific risks, it is not sufficient to mention the risks shared by the whole industry or the risks affecting all companies within a given geographical area[31]. In this decision, the information in question was a report from one of the Board committees on the corruption of certain employees who were said to have links to organized crime in Eastern Europe and a general business risk analysis for Eastern Europe.

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28 1997 CanLii 2007, (B.C.C.A.), p. 48.

29 YBM, *supra*, note 26, p. 23.

30 *TSC Industries Inc.* v. *Northway Inc.*, 426 U.S. 438 (1976) ("**TSC Industries**"), p. 448.

31 YBM, *supra*, note 26, p. 40.

(iv) Time of Determination

The determination of the materiality of information must take into consideration the information available at the time of reporting, and not after the filing of disclosure documents, when all the information becomes available[32].

(v) Indemnity Agreements

In *Levine* v. *N.L. Industries*[33], the Court decided that the reporting issuer may take into account indemnity agreements given by a solvent person, in this case the government, in the determination of the materiality of information. If the indemnity agreements are such that they exonerate from potential liability, disclosure of potential liability is not required. This case involved a uranium processing facility operated in violation of federal environmental laws by a subsidiary of the reporting issuer, and potentially resulting in significant compliance costs.

(vi) Statutory Violations

American courts have decided that existing violations of environmental laws, in the absence of litigation, could constitute material information to be disclosed[34].

c) Environmental Information

Since the 1980s, American courts and the SEC have rendered several decisions on the disclosure of environmental information.

Some of these decisions address the accounting treatment of environmental information, such as the failure to investigate, estimate and disclose in financial statements and continuous disclosure documents the costs of soil and groundwater contamination remediation[35], and the inappropriate use of reserves for site clean-ups[36].

Other decisions examine the materiality of environmental information and the necessity of disclosing it. In *SEC* v. *Allied Chemical Corporation*[37], the company had failed to disclose the discharge of soil and contaminants in the environment, despite knowledge of its impact. *In re Occidental Petroleum Corporation*[38] involved one of the worse environmental disasters in the

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32 Danier, *supra*, note 23, para. 40; *In re Union Carbide Class Action Securities Litigation*, 648 F Supp 1322.

33 926 F. 2d 199 (U.S. CA 2nd circuit), February 15, 1991 ("**Levine**"), p. 5.

34 Levine, *supra*, note 33, p. 4; *Grossman* v. *Waste Management*, 589 F. Supp. 395 (N.D. 111, 1984); *SEC* v. *Texas Gulf Sulfur Co.*, 401 F 2d 833, p. 849.

35 *In the Matter of Lee Pharmaceuticals*, Exchange Act Release No. 39843, 1998 SEC LEXIS 691 (April 9, 1998). In this case, the reserve created was deemed insufficient.

36 In *In re Ashland Inc.*, Exchange Act Release No. 54830, 2006 SEC LEXIS 2738 (November 29, 2006) and in *SEC* v. *Safety-Kleen Corp.*, Litigation Release No. 17891, 2002 SEC LEXIS 3169 (December 12, 2002), the reserve had been reduced without justification, which artificially scaled up revenues; see also *SEC* v. *ConAgra Foods, Inc.*, Litigation Release No. 20206, 2007 SEC LEXIS 1610 (July 25, 2007) and *SEC* v. *Buntrock*, Litigation Release No. 17435, 2002 SEC LEXIS 736 (March 26, 2002) addressing inappropriate capitalization of environmental expenditures.

37 *SEC* v. *Allied Chem. Corp.*, Litigation Release No. 7811, 1977 SEC LEXIS 2280 (March 4, 1977).

38 Exchange Act Release No. 16,950, 1980 SEC LEXIS 1158 (July 2, 1980).

United States, commonly called the Love Canal case. The court concluded that the company should have disclosed the leaching of chemical waste into the soil and groundwater of a residential area.

In *Endo*[39], the company disclosed that it had retained certain environmental liabilities after the sale of one of its subsidiaries, but did not believe that these liabilities were significant. This general information was deemed insufficient due to the material economic value of these liabilities, which were then assessed at $60 million.

Failure to disclose estimates of significant costs required to ensure regulatory compliance of a plant's air emissions[40] was also found inadequate.

However, it was decided that a chemical manufacturer does not have to describe general risks associated with its activities in the continuous disclosure documents, since these risks are considered common knowledge and more detailed information relating to these risks is easily accessible in other types of documents[41].

d) Corporate Social Responsibility Reports

Corporate social responsibility reports, also called sustainable development reports or triple bottom line reports, are different from continuous disclosure documents produced by a reporting issuer, in that they are voluntary and are not required by any securities law or regulation, or by any other law. They contain material information about the company's relationships with communities, treatment of its employees and the environment.

Ceres[42] has designed and initiated a project aimed at developing a set of rules governing the preparation and format of social responsibility reports, the *Global Reporting Initiative Reporting Framework* (the "**GRI**")[43].

The materiality threshold for information to be disclosed is addressed differently in the preparation of non-financial reports dealing with corporate social responsibility.

In the GRI, the threshold of material information is described as follows: "*Determining materiality for a sustainability report also includes considering economic, environmental, and social impacts that cross a threshold in affecting the ability to meet the needs of the present without compromising the needs of future generations*"[44]. To determine if information reaches this threshold and must therefore be disclosed, economic information must be considered, as must other types of information, such as corporate environmental values, matters raised by stakeholders, voluntary commitments and environmental performance indicators on energy

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39 *Endo* v. *Arthur Andersen & Company*, 163 F. 3d 463, January 4, 1999 (U.S. Court of Appeals, 7th circuit).

40 *In re U.S. Steel Corporation*, Exchange Act Release No. 16,223 [1979-1980 Transfer Binder] (Sept. 27, 1979).

41 *In re Union Carbide Class Action Securities Litigation*, *supra*, note 32.

42 An association founded in 1989, after the Exxon-Valdez oil spill, regrouping investors, environmental organizations and other stakeholders.

43 Information on the GRI is available at: http://www.globalreporting.org.

44 Document entitled "RG&FSSS-Sustainability Reporting Guidelines & Financial Services Sector Supplement", G3 Guidelines, GRI and UNEP Finance Initiative, 2008, p. 13.

consumption, contaminant emissions and biodiversity. The impact on a larger group of stakeholders, not only investors, should also be considered[45].

In spite of these differences, there are overlaps between information disclosed in continuous disclosure documents and that disclosed in social responsibility reports.

In fact, it is not impossible that, one day, the disclosure of social responsibility information will be required in continuous disclosure documents. In Canada, reporting issuers are already required to disclose environmental policies fundamental to their operations as well as the steps taken to implement them[46]. In France, Norway, Denmark and South Africa, disclosure of certain environmental and social information is now mandatory. In the United Kingdom, public companies may choose not to disclose this information, so long as they so state[47].

We can even imagine that a certain degree of harmonization will be introduced between the mandatory continuous disclosure regime and voluntary regimes.

It is interesting to note that the statutory civil liability regime for secondary market trades set out under the QSA extends to any writings filed with the AMF, of course, but also to any other writing, the content of which would reasonably be expected to affect the market price or value of the issuer's securities[48]. One could conclude that it would be possible to base such a recourse on a social responsibility report published on a reporting issuer's website.

e) Example

Consider the example of a public company operating in the manufacturing sector, which received a notice of infraction from Quebec's Ministère du Développement durable, de l'Environnement et des Parcs (MDDEP, or Department of Sustainable Development, Environment and Parks) alleging the failure to keep secondary containment structures around its outdoor chemical storage tanks at its main plant. The MDDEP has not yet initiated penal proceedings, but this is the third notice on the same subject.

The cost of installing the containment structures is $80,000. At first glance, disclosure of this information would not be required. By asking the plant manager a few questions, the corporate environment manager learns that plant activities will have to be interrupted for a period of three weeks to proceed with this work, leading to a loss of revenue and contractual penalties of $800,000. He then asks about the possible environmental consequences of the absence of these structures. The plant has been operating since 1984 and spillage of chemicals on the ground occur on a regular basis during tank filling operations. A characterization study reveals that the soil is contaminated and the estimated cost of decontamination work is of $500,000. The tanks are located close to a stream flowing into a private lake used for recreational fishing. Over the past year, the company received several complaints from citizens who noticed dead fish in the lake downstream from the plant. In summary, the absence of

[45] *Ibid*, pages 33 and following.

[46] Regulation 51-102, Form 2, Section 5.1(4).

[47] Hennick Report, *supra*, note 5, pp. 55 to 57.

[48] Sections 225.3 and 225.8 QSA.

containment structures results in corrective measure costs and short-term loss of income in the range of $880,000. The company will probably have to proceed with soil rehabilitation at an estimated cost of $500,000, at some point. There could be penal proceedings with significant fines and a civil suit for damages to the quality of the water, fauna and property value by users and owners of properties around the lake. The impacts of this practice and of environmental effects could affect the company's reputation.

Depending on the value of the company's assets and income, expenditures could be significant enough to influence the decision-making of a reasonable investor and therefore lead to the duty to disclose. Since this is a large company, the expenses are not significant. However, even if the economic value of these expenditures is not significant for the company, an investor could be influenced by a non-economic factor, such as the impact of this environmental management practice on the company's reputation. It would therefore be prudent to disclose these facts. What about potential penal and civil actions? Should this risk be disclosed? Would the possibility of penal proceedings and a class action by citizens for impact on wildlife and the environment change the decision of a reasonable investor to buy, sell or keep the securities issued by the company?

It would be defensible, in our view, not to disclose the potential actions since there is no indicator of probability or imminence of actions and no fines have been imposed. We will now turn to the disclosure of forward-looking information.

3. Forward-Looking Information

Another considerable challenge for those who prepare continuous disclosure documents is determining if they must disclose a liability or a fact that has not yet materialized, if they have knowledge of facts that could lead to its realization. Of course, they must disclose only if this forward-looking information is material, but what are the bounds of foreseeability? How far must corporate officers look into the future?

Forward-looking information is defined under Section 5 of the QSA for the purposes of disclosure in terms of possible events, situations or operating results that is based on assumptions about future economic conditions and courses of action. Forward-looking information that would have to be disclosed, if material, could come from various sources, including all documents published by the reporting issuer and made public, as well as information presented on the reporting issuer's website[49].

When forward-looking information is disclosed, it must be identified as such and worded cautiously by specifying that the results may vary from forecasts and mentioning risks that could influence these results[50]. Assumptions used and the policy for updating forward-looking information must also be stated[51]. These specifications may give rise to certain defences in the event of statutory civil actions[52].

49 Policy Statement to Regulation 51-102, Part 4A.1.

50 Regulation 51-102, Part 4A.3(a) and (b).

51 Regulation 51-102, Part 4A.3(c) and (d).

52 Section 218 for the primary market and sections 225.2 and 225.8 for the secondary market.

Forward-looking information may be divided into two categories: (i) contingent liabilities that must be disclosed in financial statements, the MD&A or the AIF[53] and (ii) forward-looking information to be disclosed in the MD&A for the purpose of providing comments and a context to the financial statements, including material trends and risks that have affected the financial statements and that are reasonably likely to affect them in the future[54].

For example, the rehabilitation costs for an industrial site on which activities will be terminated in short order and the expenditures for upgrading the effluent treatment equipment anticipated for the next three years are contingent liabilities, the disclosure of which is required if the expenses are material. On the other hand, the eventual adoption of regulatory standards requiring greenhouse gas ("**GHG**") reductions and establishing a cap-and-trade system for offsets corresponds to a trend, a prospective risk, the disclosure of which is required in the MD&A if the financial consequences of their adoption on the company are or will be significant.

a) <u>Foreseeability</u>

American case law has developed a test to determine if a fact or a future trend must be disclosed, namely the double negative standard, which has been recognized and recommended by the SEC[55].

This test reads as follows:

1) Is the fact or future trend likely to come to fruition?

2) If management cannot make that determination, it must presume that it will and make an objective evaluation of the consequences.

3) Disclosure is not required if a material effect on financial condition or results of operations in not reasonably likely to occur.

In *Danier*[56], the board of directors had approved the wording of a prospectus that was filed for a public offering of securities. After the filing of the prospectus, but prior to the closing date of the public offering, the board of directors learned that the financial results of the last quarter were lagging behind the forecasts set out in the prospectus. The Supreme Court of Canada decided that this was a material fact that, if known at the time the prospectus had been prepared, should have been disclosed. As this forward-looking fact was not foreseeable, it could not be disclosed[57].

Neither regulation nor case law establishes a time limit beyond which a reporting issuer must not question material facts or beyond which disclosure of forward-looking information is not required. In the Policy Statement to Regulation 51-102, it is specified that the reporting issuer must consider the

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53 Form 51-102F2, Part 1(f) and 51-102F1, Part 1, p. 79, Section 1.4(d).

54 Form 51-102F1, Part 1(a). Additional information and precautions that must be followed when reporting forward-looking information is listed under Part 4A.3 of Regulations 51-102.

55 See SEC Release No. 33-6853 (May 18, 1989) and SEC Guide, p. 6295.

56 *Supra*, note 23.

57 However, the Court concluded that this fact was not a material change requiring immediate disclosure.

nature of its industry and its operating cycle to determine the time period[58]. In the United States, Regulation S-K provides that a two-year period is sufficient, except where the absence of disclosure of a future fact that would happen more than two years later is misleading[59].

b) The Specific Case of Climate Change

Recognition by the scientific community of global warming and of the resulting climate and physical phenomena has led to social debates on the permanence of warming, its causes and ways to stabilize warming. The debate is mostly on the future impact of this phenomenon.

In the European Union, a regulatory regime requires the progressive reduction of GHG and permits the trading of allowances and offsets to attain reductions.

In Canada, two provinces, British Columbia and Quebec, have implemented a carbon tax. Alberta adopted a statutory regime to reduce GHG emissions based on the intensity of reductions, which while less stringent than the European rules, is the only mandatory regime in North America. There is no federal regulatory regime yet[60], except for the obligation imposed on certain large emitters to report their GHG emissions on a yearly basis[61].

Many voluntary initiatives and programs include government[62], institutional investors[63] and industrial[64] stakeholders who promote emissions reduction, the dissemination of information on emissions and the adoption of regulatory standards mandating reductions.

The Canadian Institute of Chartered Accountants ("**CICA**") has already emphasized the importance of considering the challenges related to climate change when preparing the MD&A and provided guidelines on the issues that may require disclosure[65]. The CICA listed six questions that management might consider when preparing a MD&A:

1) *"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?*

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58 Policy Statement to Regulation 51-102, Part 4A.8.

59 Davis Polk & Wardwell, "Environmental Disclosure in SEC Filings – 2009", January 21, 2009, p. 4.

60 It is interesting to note the existence in Montreal of the Climate Exchange, where futures for offsets that will eventually be created under a federal regime can be traded.

61 The duty to report GHG emissions also exists in most Canadian provinces.

62 For example, the membership of the Western Climate Initiative includes American states and Canadian provinces that intend to set up a regulatory system of emissions reduction and exchange of emission allowances and offsets starting in 2011.

63 See in particular the initiatives of the Carbon Disclosure Project and the Investor Network on Climate Risk (INCR) that seek disclosure by public companies of their GHG emissions as well as their strategies to reduce these emissions.

64 See in particular the voluntary disclosures made by companies publishing social responsibility reports in accordance with the GRI rules and filing emissions and reduction data with the Climate Registry and the Chicago Climate Exchange.

65 "Guide: CICA Disclosure Brief", published in 2005 suggesting what a MD&A should contain; and "Building a Better MD&A, Climate Change Disclosures", published in 2009, recommending the disclosure of business strategies, physical, regulatory and reputational risks, litigation, foreseeable financial impact, governance policies implemented to address this issue, direct and indirect emissions as well as reduction costs.

2) *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?*

3) *From period to period, is there comparability and consistency in MD&A disclosures about climate change issues?*

4) *Have we ensured consistency of MD&A climate change disclosures with those in other public reports (e.g. sustainability reports, responses to surveys such as the Carbon Disclosure Project, press releases)?*

5) *Have we implemented appropriate systems, procedures and controls to enable timely, complete and reliable reporting of climate change information in the MD&A?*

6) *Have we presented disclosures about climate change issues in plain language, with candour and without jargon?"*[66].

More recently still, the SEC published a guide explaining the application of existing disclosure rules to climate change issues[67]. The SEC recommends a review of facts, trends and liabilities, current and future, related to climate change that could have a material impact on a public company, in order to determine if they must be disclosed in the AIF or the MD&A[68].

Although the requirement to disclose information related to climate change is the subject of controversy[69], it would be wise to consider the current and future consequences of this issue on the financial results of a public company, if a significant part of its operations and markets are in jurisdictions where GHG emissions are already regulated.

A few American court decisions[70], as well as the settlement agreement of a criminal action initiated by the Attorney General of the State of New York against energy producers,[71] establish precedents that heighten the importance of climate change issues.

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[66] Building a Better MD&A, Climate Change Disclosure, *supra*, note 65, p. 17.

[67] The SEC guide, *supra*, note 25. The SEC gives examples of effects resulting from climate change for which disclosure could be required: costs related to regulatory compliance, the fluctuation of the demand for goods and services the manufacturing or use of which generates GHG emissions, the increase in the demand for renewable energy, the increase in fuel prices and reputational costs.

[68] *Ibid*, p. 6291.

[69] Boecher, N.M., "SEC Interpretive Guidance for Climate-Related Disclosures", 10 Sustainable Dev. L & Policy, 43 2009-2010, p. 43. A SEC Commissioner, Mrs. Kathleen L. Casey, stated that the risks of physical damage are not relevant as they are unforeseeable if they happen over decades or centuries (January 27, 2010).

[70] These court cases include *Massachusetts* v. *EPA*, 549 U.S. 497 (2007) where the Supreme Court of the United States held that the EPA has the authority to regulate CO_2 emissions under the *Clean Air Act*; *Native Village of Kivalina* v. *Exxon Mobil Corp.*, N.D. Cal., filed Feb. 2008, dismissed in September 2009, and under appeal, where a claim for damages filed by residents of an Alaskan village against oil and energy companies was dismissed due to the political nature of climate change issues; *Comer* c. *Murphy Oil USA, Inc.*, U.S. CA. (5th Circuit), #07-60756 (October 16, 2009) where residents and owners of land and property filed an action in damages against producers of fossil fuels for having contributed to the ferocity of Hurricane Katrina, which damaged their properties.

The instances and quality of environmental disclosures related to climate change have increased over the last few years[72].

c) Example

Let us go back to the example presented in the previous section of this article and add a new fictitious element.

Over the last year, the Quebec Minister of Sustainable Development, Environment and Parks publicly announced her intention to tighten enforcement by significantly increasing the number of proceedings instituted. Her department was granted an annual budget for investigations and proceedings equal to the aggregate of the last five years' budgets. Several proceedings have been initiated since.

Although no penal proceedings or investigations were initiated, these facts establish a future trend, which substantially increases the chances of proceedings being instituted. The amount of fines could reach several hundred thousand dollars and penal prosecution would also increase the chances of civil actions by citizens.

Because of this additional element, it would be prudent to include specific disclosure on potential proceedings, both for the potential economic impacts of these proceedings and their potential effect on the company's reputation.

4. Liability of Directors and Officers

Is the value of a public company's securities decreases significantly due to environmental information it should have disclosed earlier, the company could be subject to civil proceedings by investors who suffered financial losses[73], either individually or collectively, and to penal prosecution by the AMF[74].

The company could also incur administrative penalties imposed by the Bureau de décision et de révision, the payment of which would be collected by the AMF[75].

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71 See settlement agreements in *In re Xcell Energy Inc.*, Assurance of Discontinuance Pursuant to Executive Law No. 63(15), AOD #08-012 (August 26, 2008) and *In re Dynegy Inc.*, Assurance of Discontinuance Pursuant to Executive Law No. 63(15), AOD #08-132 (October 23, 2008).

72 See examples of disclosure by public companies in the United States in 2009, indexed by Carter, Ledyard & Milburn, April 22, 2010.

73 This recourse would be based on Section 1457 of the Civil Code of Quebec; see Deschamps, Pierre; "La responsabilité civile extracontractuelle, chapitre I, Les conditions générales de la responsabilité civile et du fait personnel", in Collection de droit 2009-2010, Vol. 4, Cowansville, Yvon Blais, p. 27.

74 Section 73 of the QSA provides for the obligation of a reporting issuer to provide periodic disclosure prescribed by regulation and Section 202 provides, for any violation of the act, a minimum fine equivalent to the greater of $3,000 for a legal person or an amount which is double the profit realized by reason of the offence. The maximum fine is the greater of the following amounts: $200,000 for a legal person or an amount four times the profit realized by reason of the offence. The violation of a regulation is subject to the same fines (section 203).

75 An administrative penalty for contravention to the QSA or a regulation cannot exceed $2,000,000 (Sections 273.1 and 273.2 QSA).

The affected investors could also take action against directors and officers of the reporting issuer. They could take an action in civil liability[76] by alleging a fault for having failed in their duty to act with prudence, diligence and honesty in the best interest of the company[77].

Civil recourses against directors and officers were made easier by the adoption of provisions in the QSA allowing civil liability recourses for misrepresentation in continuous disclosure documents, without having to prove causality between the information and the prejudice suffered by the investor, which is presumed[78]. Personal fault of the officer and the director does not need to be proven, only the misrepresentation.

Damages that can be obtained through this statutory civil regime are however limited by proportionate liability, as apposed to joint and several liability, by taking into account of all the authors of a fault and by a ceiling of the greater of $25,000 and 50% of the remuneration, in all forms, paid to that person by the company in the year preceding the misrepresentation[79]. Recourses must also be previously authorized by the court.

The regulatory obligation of officers, namely the certification by the CEO and CFO, to their knowledge, that disclosures found in the AIF and the MD&A are accurate, substantiate their duty of prudence and diligence[80]. In Biovail[81], the Ontario Securities Commission expresses itself on the liability of directors and officers with regards to the disclosure of material information and quotes *Re Standard Trustco*:

> "Corporate directors and officers have a central role to play in ensuring that corporate disclosure is accurate and not misleading or untrue.
>
> Directors and officers of a reporting issuer are ultimately responsible for ensuring that information disclosed by the issuer complies with the Act:
>
> [t]he responsibility of companies to make timely and accurate financial disclosure ultimately rests with directors of those companies. In practice, the responsibility is shared by the directors, audit committees, chief executive officers, chief financial officers and other management. The company itself would also be responsible.
>
> The public has a right to expect that when a reporting issuer releases financial information to the public, the directors and officers

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76 Section 1457 C.C.Q.

77 Sections 321, 322 and 2138 C.C.Q., Section 123.83 of the *Companies Act*, R.S.Q. c. C-38 ("**QCA**") and Section 122(1) of the *Canada Business Corporations Act* R.S. (1985) c. C-44 *("***CBCA***")* for directors; and Section 123.83 QCA, Section 122 CBCA and Section 2138 C.C.Q. for officers; see Martel, Paul, "Le fonctionnement interne d'une compagnie", Barreau du Québec, Collection de droit 2009-2010, Vol. 9, Cowansville, Yvon Blais, p. 221 for directors and p. 229 for officers.

78 Sections 225.2 and following QSA for the secondary market. There are equivalent provisions under sections 138.1 and following OSA.

79 *Supra*, note 77, p. 224.

80 NI 52-109.

81 *Supra*, note 27, p. 78; *Re Standard Trustco* (1992), 15 O.S.C. B. 4322, p. 4364.

> of the company will have met certain standards of care in satisfying themselves that there is no question about the integrity of the information and that the information is accurate, complete and represents a fair picture of the financial condition of the company. The whole continuous disclosure system demands this from all directors and officers of reporting issuers. »

It is important to note that the statutory civil recourse based on the existence of a misrepresentation requires demonstration of an impact on a security's price or value[82]. The mere fact, for a public company or for its directors and officers, of not having disclosed information susceptible of influencing the decision of a reasonable investor, which constitutes a violation of Regulation 51-102 and the QSA[83], would not necessarily affect the value of the security. Plaintiffs would then have to prove this effect, beyond the regulatory offence.

Directors may obtain from the company a commitment to indemnify them if they have complied with certain duties to act honestly and in good faith[84]. This undertaking may also be supplemented by a liability insurance policy contracted by the company to the benefit of directors[85].

Directors and officers may avail themselves of defence arguments[86], but they cannot justify their decisions by invoking the "business judgment rule", a principle established under American law and integrated into Canadian law, according to which business decisions made legally, in good faith and without conflict of interest are respected even if they are not deemed wise[87]. In Danier[88], the Supreme Court of Canada ruled that this principle cannot be invoked as a defence to the statutory civil action for misrepresentation.

Several Canadian securities commissions have commented on the inadequacy of environmental disclosures by public companies. The SEC specified, on numerous occasions, its expectations in this regard and, more recently, outlined the application of disclosure rules to climate change issues.

It would not be surprising, over the next few years, to witness an increase in civil and penal actions against public companies operating in environment-related sectors that only produce general disclosures, as well as against directors and officers of these companies.

5. <u>Conclusion</u>

Social pressures in North America and Europe for more precise and comprehensive disclosure of material environmental information have intensified over the last few years, including with regards to the disclosure by public companies in continuous disclosure documents.

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82 See section 2 a) of this article.

83 Section 73 QSA.

84 Sections 123.87 and following QCA and Section 124 CBCA.

85 See Martel, Paul, *supra*, note 77, p. 218.

86 Sections 225.19 and following QSA.

87 Martel, Paul, *supra*, note 77, p. 221.

88 *Supra*, note 23.

More specifically, investors are seeking a more stringent and uniform system for reporting environmental information, which would enhance the reliability of disclosed information[89]. Investment dealers are developing ethical investment fund products that require in-depth analysis of the environmental and social performance of public companies, which they can only conduct superficially if disclosures are inadequate[90].

It therefore seems to us that the expectations and the behaviour of the reasonable investor are evolving and the decision made today by such an investor to buy, sell or hold securities issued by a public company is more influenced by material environmental information, than it was a few years ago. It also appears that the reasonable investor is no longer influenced only by the economic consequences of environmental information, but also by non-financial factors, such as environmental performance and its impact on a company's reputation.

This evolution seems to align with a more global movement according to which the impact of a company's activities on society as a whole is taken into account. Indeed, the Supreme Court of Canada has broadened the scope of stakeholders and interests that directors must consider when taking a decision in the best interests of the company: these potential stakeholders and interests now include the environment. In this context, it would be logical for the reasonable investor to also consider the environmental consequences of a company's activities[91].

We believe that directors and officers of public companies should think about the exhaustiveness of their company's environment performance measurements and the value and reliability of their environmental information gathering systems. We are also of the view that the duty of prudence and diligence of directors and officers requires them to be informed about the guidelines and advice provided by the securities commissions and the CICA in matters of environmental disclosure and to examine carefully the wording of environmental disclosures in the AIF and the MD&A.

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89 Rapport Hennick, *supra*, note 5, page 20; and Dhir, Aaron A., "The Politics of Knowledge Dissemination: Corporate Reporting, Shareholder Voice, and Human Rights", 47 Osgoode Hall L.J. 47 (2009).

90 CICA, "Environmental, Social and Governance (ESG) Issues in Institutional Investor Decision Making", September 2010, p. 11.

91 *BCE Inc.* v. *1976 Debentureholders*, [2008] 3 S.C.R. 560; and Bone, Jeffrey, "Corporate Environmental Responsibility in the Wake of the Supreme Court Decision of BCE Inc. and Bell Canada", 27 Windsor Rev. Legal & Soc. 5 (2009).