

BULLETIN

April 1, 2008

OSC Staff Notice 51-716

Environmental disclosure must be improved says the Ontario Securities Commission

By Eric Belli-Bivar and Lana Finney*

Reporting issuers must improve their disclosure of known and contingent environmental liabilities in continuous disclosure documents. That is the message of the Ontario Securities Commission's Staff Notice 51-716 on Environmental Reporting (the "Staff Notice"), released February 27, 2008. The Ontario Securities Commission (the "OSC") typically issues such Staff Notices as a first volley when attempting to improve compliance with a particular aspect of securities regulation. Non-compliant reporting issuers in Ontario can expect OSC enforcement actions, and the shareholder litigation they trigger, to follow. Reporting issuers outside of Ontario should also take note of the Staff Notice as regulators in other provinces often take their lead from the OSC and because some of the comments are relevant to any TSX-listed issuer.

The Staff Report is the result of a survey conducted by OSC staff of 35 reporting issuers (22 of which were listed on the TSX; 13 were venture issuers). The issuers operate in a variety of sectors, including environmental services, industrial products, mining, oil and gas, steel, transportation, and utilities. While these sectors tend to be more environmentally sensitive, the comments in the Staff Notice are directed at reporting issuers in all sectors. Environmental disclosure by the majority of the companies surveyed was found to be wanting. Specifically, the Staff Notice stated that boilerplate disclosure is insufficient and that disclosure must include more quantitative analysis and detailed discussion.

National Instrument 51-102 Continuous Disclosure Obligations requires reporting issuers to disclose information about environmental matters in their continuous disclosure documents. This requirement is not a new one. However, the scope of the required disclosure has not been tested to date. The Staff Notice is intended to clarify exactly what type of disclosure the OSC expects to see in financial statements, management discussion and analysis (MD&A), and annual information forms (AIF).

As a general rule, continuous disclosure documents must include "material information." Information is material if a reasonable investor's decision whether to buy, sell or hold the issuer's securities would likely be affected if the information was omitted or misstated. The Staff Notice makes it clear that issuers must consider both quantitative and qualitative factors when deciding whether information is material. Furthermore, the Staff Notice emphasizes that both known and contingent environmental liabilities must be disclosed if they are material.

The Staff Notice made several specific comments about the type of disclosure the OSC believes is required:

- Where financial statements include account estimates for the costs of known and contingent environmental liabilities, the issuer should discuss the estimates in detail, provide quantitative support for the estimates, and quantify any uncertainty;
- Where quantifying a contingent liability is deemed to be impossible and estimates are therefore not included in the financial statements, the issuer should nevertheless discuss the liability in the MD&A;
- Where the issuer has asset retirement obligations, the issuer should include quantified estimates of the obligations in the financial statements and should discuss the obligations

* Prepared with the assistance of Andrew Lord, Student-at-Law

in detail in the MD&A. For TSX-listed issuers, if the asset retirement obligations constitute material long-term obligations, they must be included in the applicable summary table of contractual obligations;

- Where the issuer expects to undertake environmental protection measures, it should disclose quantitative and qualitative detail about the effects of such measures on capital expenditures, earnings and competitive position;
- Where the issuer has environmental policies that are fundamental to its operations, it must disclose the quantitative and qualitative impact of implementing these policies;
- Where environmental risks might be expected to have a material effect on the issuer's financial and operational performance, those risks should be discussed in the AIF or MD&A;
- Where the issuer is subject to environmental laws (in Canada or abroad), it should discuss the applicable laws in detail and provide quantitative information about the cost of complying with them.

The biggest challenge for issuers will likely be quantifying contingent liabilities. Borrowing from the Canadian Institute of Chartered Accountants Handbook, the OSC defines a contingency as an existing condition or situation involving uncertainty as to possible gain or loss to an issuer that will ultimately be resolved when one or more future events occur or fail to occur. Quantifying contingent liabilities therefore requires the issuer to estimate both the probability that the future events will occur and the magnitude of the effect each event could have on the liability. The Staff Notice characterizes this type of prognostication as “a matter of judgment” for those preparing disclosure documents and requires that estimates be produced where quantitative information is “reasonably available.” The soundness of a person's judgment and the reasonable availability of information are both elastic concepts. It is possible that these concepts will be tested in both OSC enforcement actions and shareholder litigation triggered by insufficient environmental disclosure.

It is also possible that such proceedings could reach past the corporation to attach liability for insufficient disclosure to certain directors and officers. The Staff Notice reminds issuers that certifying officers must certify that continuous disclosure documents present a fair picture of an issuer's financial condition and that a meaningful discussion of environmental matters is required to present a fair picture in all material respects. Presumably a certifying officer who certifies a disclosure document that has inadequate environmental disclosure could be held liable. Similarly, the Staff Notice reminds issuers that their audit committees play an important role in ensuring that procedures are in place for preparing adequate financial information and in conducting final reviews of continuous disclosure documents. The Staff Notice emphasizes that overseeing the adequacy of environmental disclosure was an important part of the audit committee's role.

The Staff Notice is very likely to be only the beginning of the OSC's effort to improve environmental disclosure by reporting issuers in Canada. Clients are encouraged to contact their legal and accounting professional advisors for specific guidance on how to comply with the clarified environmental disclosure requirements.



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For more information, please contact:

Eric Belli-Bivar

Securities & Corporate Finance Group
416.941.5396
ebelli-bivar@davis.ca

Lana Finney

Environmental Law Group
416.941.5409
lfinney@davis.ca

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