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CANADIAN SECURITIES ADMINISTRATORS RELEASE NEW GUIDELINES FOR ENVIRONMENTAL REPORTING

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The Canadian Securities Administrators have released *Staff Notice 51-333 Environmental Reporting Guidance*. As anticipated in the Davis LLP bulletin of May 2010, this new CSA Staff Notice provides clarification on the continuous disclosure responsibilities of reporting issuers with regard to environmental matters. While the CSA Staff Notice does not impose any new legal obligations on issuers, it does provide greater detail regarding what material environmental information issuers will be expected to disclose, including information specifically related to greenhouse gas emissions and climate change related matters. The guidance in the CSA Staff Notice will be particularly relevant to reporting issuers who are exposed to environmental risks and opportunities.

Background

The CSA Staff Notice is the product of a multi-year ongoing effort by the CSA, including the Ontario Securities Commission, to clarify the disclosure obligations of reporting issuers regarding environmental matters, including climate change. An April 2008 Davis bulletin on the earlier OSC *Staff Notice 51-716* provided an overview of the OSC's review of the climate change disclosure of 35 reporting issuers, which was found to be wanting. The OSC subsequently undertook consultations regarding appropriate guidance for the disclosure of contingent environmental risks.

Shortly before the consultations drew to a close in the summer of 2010, the U.S. Securities and Exchange Commission released its own interpretive guidance on existing SEC disclosure requirements relating to climate change, which was discussed in the May 2010 Davis LLP bulletin.

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The CSA Staff Notice and SEC guidance emphasize that the established principle of materiality still governs and that the new guidance is only intended to help issuers understand what type of environmental and climate change related information should be considered to be material. While the SEC interpretive guidance is focused on climate change, the CSA Staff Notice addresses a broader array of contingent environmental liabilities and opportunities.

This bulletin summarizes some of the highlights of the CSA Staff Notice regarding the requirements for disclosing environmental information and the governance structures that may be required to ensure environmental disclosure requirements are met. Reporting issuers and their advisors are invited to contact Davis LLP for legal advice on any specific disclosure concerns.

Disclosure of Environmental Information

In response to the growing appreciation of the potential materiality of environmental issues, the CSA Staff Notice discusses expectations with respect to what environmental information should be disclosed.

General Principles for Assessing Materiality

Contingent environmental liabilities and opportunities are by definition subject to uncertainty about events that have yet to occur. One of the main goals of the CSA Staff Notice is therefore to provide guidance on how to determine if a given piece of information that is subject to uncertainty is material and should therefore be disclosed.

The CSA Staff Notice reiterates that there is no brightline test for materiality and the key question is whether a piece of information would likely influence a "reasonable investor's decision whether or not to buy, sell or hold securities of the issuer".

The materiality of information regarding any known trend, demand, commitment, event or uncertainty will depend on both the probability of continuance, and the anticipated magnitude of the effect. If there is uncertainty regarding the materiality of a particular piece of information, the Staff Notice encourages issuers to err on the side of inclusion.

Timing and context are two of the most critical factors influencing whether a particular piece of information is considered material. Timing considerations may encourage early reporting in the case of information regarding trends that are expected to grow. With regard to context, the Staff Notice encourages issuers to be mindful of the aggregate impact of multiple discrete pieces of information that alone may not appear material, but considered together necessitate disclosure.

Environmental Risks and Other Information

The CSA Staff Notice directs issuers to assess the materiality of environmental information under five key disclosure requirements in National Instrument 51-102 *Continuous Disclosure Obligations.*

1) Environmental Risks

In assessing and describing contingent environmental risks, issuers should address:

- potential litigation;
- physical risks to processes and supply chains;
- regulatory risks and compliance costs;
- reputational risks; and
- risks and opportunities for the current business model of the issuer.

When disclosing environmental risks, the CSA Staff Notice promotes a move away from the use of boilerplate language by encouraging issuers to provide specific quantitative and qualitative information about each identified risk.

2) Trends and Uncertainties

Even where material trends and uncertainties are difficult to quantify, issuers should endeavour to address them in their Management's Discussion and Analysis. The CSA Staff Notice recommends disclosing material information not otherwise found in financial statements relating to an assessment of whether trends and uncertainties will have, or are reasonably likely to have, a material impact on the issuer's liquidity, capital resources or results of operations.

3) Environmental Liabilities

Issuers should also disclose material environmental liabilities. Such liabilities include any legal obligation to make a future expenditure due to the past or ongoing manufacture, use, release or threatened release of a particular substance, or other activities that adversely impact the environment, must be disclosed if material.

The CSA Staff Notice groups such liabilities into two categories: those included on financial statements and those not included on financial statements. For those included on the financial statements, the CSA Staff Notice describes the critical accounting estimates that should be applied.

The timing and context considerations described above will be particularly important for assessing whether environmental liabilities are material. The long-term or contingent nature of information may make it difficult to determine the specific nature or extent of a given liability. Further, this is one of the areas where it is more likely that information immaterial on its own may be material when considered together. Nevertheless, the CSA Staff Notice clarifies that even potential material liabilities should be disclosed, even if the liability has not yet been accrued.

4) Asset Retirement Obligations

AROs are defined in the CSA Staff Notice as any requirement to perform a certain procedure in order to retire an asset. AROs may include meeting environmental remediation or other environmental regulatory obligations. Any information relating to AROs that includes material commitments, events or uncertainties that are reasonably likely to affect the issuer's business may need to be disclosed. In particular, any existing obligations in contracts or permits relating to AROs should be disclosed.

5) Financial and Operational Effects

Evolving environmental protection requirements may have a material effect on the issuer's capital expenditures, earnings and competitive position in the current financial year and the expected effect in future years. The expected impact (including the quantification of same to the extent possible) should therefore be assessed for disclosure.

Company Environmental Policies

The CSA Staff Notice emphasizes investors rights both to know what policies a company has in place to address environmental issues and to understand the governance mechanisms (e.g., board mandate, audit committees, etc.) that have been implemented to oversee and manage such policies. The CSA Staff Notice clarifies that 'policy' should be liberally interpreted and may relate to sustainable development, community relations, the use and disposal of hazardous materials, spills prevention, recycling, water management, and reduction of greenhouse gas emissions. Both the content and actual operational impact of environmental policies should be disclosed.

International Financial Reporting Standards

As of January 1, 2011, International Financial Reporting Standards became the new governing regime for financial reporting. The Staff Notice highlights that IFRS may require issuers to accrue more environmental liabilities, at higher amounts, and provide more disclosure regarding these liabilities than is required under Canadian GAAP.

Forward Looking Information

The Staff Notice cautions that environmental goals and targets publicized by companies, even if not included in mandatory securities filings, may constitute forward looking information and be considered material. The general requirements for disclosure of FLI in National Instrument 51-102 will apply to such disclosure.

Voluntary Disclosure

The CSA Staff Notice notes that information disclosed voluntarily (e.g., on websites, in response to surveys like the Carbon Disclosure Project, etc.) should be accurate and may be material (and thus subject to inclusion in mandatory disclosure filings). Issuers should therefore ensure that any material environmental information that is voluntarily disclosed is consistent with information released under continuous disclosure requirements.

Sample Disclosure

To assist reporting issuers in preparing disclosure documents, the CSA Staff Notice includes an appendix that provides a non-exhaustive list of examples of what disclosure could be appropriate in certain circumstances. Among other matters, the examples provided in the appendix highlight how anticipated climate change regulations, as well as the repercussions of a changing climate itself, may be material and could constitute forward looking information.

Corporate Governance Structures

To ensure that reporting issuers properly identify and disclose material environmental information, the CSA Staff Notice emphasizes that an issuer's environmental disclosure should be subject to three levels of oversight:

- review by the audit committee (under National Instrument 52-110);
- approval by the board of directors (under National Instrument 51-102); and
- certification by the CEO and CFO (under National Instrument 52-109).

Issuers should implement procedures and controls to ensure that reliable and timely environmental information is made available both for management analysis and decision-making and for disclosure to investors, regulators and other stakeholders.

Conclusion

In light of the guidance provided in the CSA Staff Notice, issuers should consider reviewing their existing disclosure policies and corporate governance structure to make certain that all information relating to contingent environmental risks and opportunities is appropriately assessed and disclosed if found to be material.

If you have any questions concerning the content of this bulletin, please contact the authors or your usual lawyer at Davis LLP.

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