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The Materiality of Climate Change and the Role of Voluntary Disclosure

Gail Henderson

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ABSTRACT

Investor groups in both Canada and the U.S. have petitioned the Ontario Securities Commission and the Securities and Exchange Commission to issue statements clarifying the application of existing disclosure requirements to climate change-related risks. Even if issuers are meeting their current obligations with respect to disclosure of climate change risks, however, the “materiality” threshold for disclosure would likely leave a gap between what issuers are required to disclose under the law and what interested investors would like to know about how issuers are responding to the challenges posed by climate change. This is due to the fact that if an issuer has determined that climate change will not have a material impact on its financial results, it is under no obligation to disclose its reasons for reaching this conclusion. Investors interested in environmentally-responsible investing, however, may want to know these reasons. It may be relevant to their investment decisions, for example, whether the reason is because the issuer has already reduced its greenhouse gas (GHG) emissions, rather than because it has purchased carbon credits on the futures market which it can use to meet any regulatory limits on emissions the government may seek to impose. But it does not necessarily follow that mandatory disclosure under securities regulation is the most appropriate way to fill this gap. A preferable approach might be for voluntary disclosure regimes, such as the Global Reporting Initiative (GRI), to fill this gap. Although take-up by corporations of the GRI standard for disclosure has been slow, environmental reporting in compliance with the standard can provide interested investors with credible and comparable information.

THE MATERIALITY OF CLIMATE CHANGE AND THE ROLE OF VOLUNTARY DISCLOSURE

BY GAIL E. HENDERSON*

I. INTRODUCTION

While North American national governments demonstrate an ongoing reluctance to pass climate change legislation, investors in Canada and the U.S. are pressing issuers and regulators for more and better disclosure on climate-change related risks.¹ Canadian investors most recently expressed their concerns to the Ontario Securities Commission (OSC) during its 2009 corporate sustainability reporting initiative.² In an earlier staff notice, the OSC expressed its own concerns regarding the level of issuer compliance with environmental disclosure obligations.³ Both the Canadian Securities Administrators and the Securities and Exchange Commission have responded to this pressure with “guidance” to issuers on their environmental reporting obligations under existing securities disclosure laws.⁴

* S.J.D. Candidate, University of Toronto, gail.henderson@utoronto.ca.

¹ Letter from E. Ellmen, SIO, to J. Matear and N. Varma (21 April 2008), online: SIO <<http://www.socialinvestment.ca/documents/OSCEnvironmentalReportingStaffNoticeApril081.pdf>>; California Public Employees’ Retirement System, et al., “Petition for Interpretive Guidance on Climate Change Disclosure” (18 September 2007), online: Investor Network on Climate Risk <<http://www.incr.com//Document.Doc?id=187>> [SEC Petition].

² Ontario Securities Commission, OSC corporate sustainability reporting initiative: Report to Minister of Finance (December 18, 2009 at 10), online: OSC, <http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20091218_51-717_mof-rpt.pdf> [OSC, “2009 Report”]. Although investors want the OSC to play a greater role in “promoting” environmental disclosure, they generally were of the opinion that this did not require “expanding existing disclosure requirements.” *Ibid.* at 10 and 15.

³ *Environmental Reporting*, O.S.C. Staff Notice 51-716 (2008) 21 OSCB 2223 (29 February 2008) at 2223 [OSC, *Environmental Reporting*]. See also OSC, “2009 Report”, *ibid.* at 15; Jason Scott Johnston, “Signalling Social Responsibility: On the Law and Economics of Market Incentives for Corporate Environmental Performance” (2005) University of Pennsylvania Law School Institute for Law and Economics Research Paper No. 05-16 at 8, online: SSRN, <<http://ssrn.com/abstract=725103>>.

⁴ *Environmental Reporting Guidance*, CSA Staff Notice 51-333 (October 27, 2010) at 5, online: OSC, <http://www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20101027_51-333_environmental-reporting.pdf> [CSA Staff Notice 51-333]; SEC, Interpretive Release: Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (February 2, 2010) at 27, online: SEC, <<http://www.sec.gov/rules/interp/2010/33-9106.pdf>>. The Canadian Performance Reporting Board of the Chartered Accountants of Canada has also attempted to clarify issuers’ responsibilities with respect to climate change disclosure: Canadian Performance Reporting Board, Discussion Brief, “MD&A Disclosure About the Financial

Even if issuers were to comply fully with their current obligations to disclose climate change-related risks, a gap would remain between what issuers are required to disclose under securities law and what some investors would like to know about how issuers are responding to the challenges posed by climate change. This is because issuers are required to disclose only “material” risks. The ongoing uncertainty around future climate change-related legislation and the timing and extent of predicted physical impacts of climate change makes it difficult for issuers to determine whether these are reasonably likely to have a material effect on their financial results. Furthermore, if an issuer has determined that climate change will *not* have a material impact on its financial results, they are under no obligation to disclose their reasons for reaching this conclusion. Environmentally-responsible investors or institutional investors concerned with long-term, economy-wide risks of climate change⁵ may want to know these reasons, however. It may be relevant to their investment decisions, for example, whether the reason is because the issuer has already taken positive actions to reduce their greenhouse gas (GHG) emissions versus protecting the company’s bottom line by purchasing carbon credits on the futures market which it can use to meet any future regulatory limits on carbon emissions, should they ever be imposed.

The materiality threshold for disclosure under securities regulation, therefore, may leave out information pertinent to some investors about a company’s environmental performance. One solution is to require all companies to report on their environmental performance. This raises

Impact of Climate Change and Other Environmental Issues” (14 October 2005), online: Chartered Accountants of Canada, <http://www.cica.ca/multimedia/Download_Library/Research_Guidance/MDandA_Business_Reporting/English/E_CPRB_Discussion_Brief_2005.pdf> [CICA Brief], updated in “Building a Better MD&A: Climate Change Disclosures”, online: Chartered Accountants of Canada, <<http://www.cica.ca/research-and-guidance/mda-and-business-reporting/mda-publications/item12846.pdf>>.

⁵ Some scholars have described large institutional investors as “universal” investors on the basis that their portfolios reflect the market as a whole and therefore they are more concerned (or ought to be) with issues that can affect the economy as a whole, such as climate change, than with individual company performance. See James P. Hawley & Andrew T. Williams, *The Rise of Fiduciary Capitalism* (Philadelphia: University of Pennsylvania Press, 2000).

important policy questions, however, as to what information companies ought to disclose, in what format and how frequently, and whether securities law is the most appropriate avenue through which to impose such a requirement.⁶ In any event, legislation mandating environmental reporting beyond the materiality threshold is unlikely to come any time soon: provincial securities regulators are currently preoccupied with the fight over the constitutionality of the proposed national securities regulator and enhanced environmental disclosure.⁷ Nor does the proposed national securities act make any mention of mandatory environmental disclosure.⁸ In the meantime, it is relevant to ask whether voluntary disclosure in accordance with an international voluntary disclosure standard, such as the Global Reporting Initiative (GRI), might fulfill some of the objectives of mandatory disclosure and fill the gap in environmental information desired by some investors left by continuous disclosure obligations under securities law. I argue that the GRI's G3 Guidelines for voluntary reporting of environmental information does both and therefore concerned investors should turn their attention to encouraging companies to disclose in accordance with this standard. This article does not delve into the well-covered debate about the role of mandatory or voluntary disclosure as a tool of environmental regulation in changing corporation's behaviour towards the natural environment, nor the possible value of disclosure provided by the GRI and CDP to the public at large.⁹

⁶ Not to mention the responsibility of corporations for the environmental impacts of their operations and the compatibility of the current profit-maximization objective of the corporation with the concept of sustainable development. These issues are the focus of my SJD dissertation.

⁷ A reference to the Supreme Court of Canada on the constitutionality of the proposed federal act was heard by the Court on April 13, 2011; the decision is pending.

⁸ Proposed Canadian Securities Act, online: Department of Finance, <<http://www.fin.gc.ca/drleg-apl/csa-lvm-eng.htm>>. Arguably this is a matter to be dealt with through regulations made under the Act: see s. 227(v) of the proposed act.

⁹ On this topic generally, see, e.g., David W Case, "Corporate Environmental Reporting as Informational Regulation: A Law and Economics Perspective" (2005) 76 U Colo L Rev 379 at 391; Bradley C Karkkainen, "Information as Environmental Regulation: TRI and Performance Benchmarking, Precursor to a New Paradigm?" (2001) 89 Geo L J 257.

Part II summarizes the current Canadian disclosure requirements under which issuers might be required to disclose climate change-related information and discusses the materiality threshold for disclosure. This summary integrates the recent guidance from the Canadian Securities Administrators (CSA) on environmental disclosure. Part III reviews the main climate-change-related risks facing issuers, examines the difficulty in applying the materiality threshold to these risks and explains the “gap” in disclosure that would remain even if all issuers were accurately determining and disclosing their material climate change-related risks. Part IV first reviews some of the emerging international voluntary disclosure standards, including the GRI and the Carbon Disclosure Project. I then evaluate these standards in light of the advantages and disadvantages of mandatory and voluntary reporting.

II. CURRENT DISCLOSURE REQUIREMENTS

In Canada, there are two mandatory continuous disclosure documents in which issuers could be required to make climate change-related disclosure: the annual information form or “AIF”; and the management discussion and analysis or “MD&A”, which must accompany all annual and interim financial statements.¹⁰

The required contents of the AIF are set out in Form 51-102F2. The AIF should contain “material information related to the issuer”, rather than to the general state of the economy.¹¹ Item 5 is a description of the business. This description must include the “effects of environmental protection”, specifically “[t]he financial and operational effects of environmental protection requirements on the capital expenditures, earnings and competitive position of [the]

¹⁰ *Continuous Disclosure Obligations*, O.S.C., NI 51-102 (4 July 2008), ss. 6.1 (AIF) and 5.1 (MD&A), online: Ontario Securities Commission <http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/rule_20080704_51-102_unofficial-cons-ni.pdf> [NI 51-102].

¹¹ David L. Johnston & Kathleen Doyle Rockwell, *Canadian Securities Regulation*, 4th ed (Markham, ON: LexisNexis Canada Inc., 2006) at 206. See NI 51-102, *ibid.*, Form 51-102F2, Part 1, (a): “Your AIF describes your company, its operations and prospects, risks and other external factors *that impact your company specifically*.” [Emphasis added.]

company in the current financial year and the expected effect in future years.”¹² The recent guidance from the CSA explains that issuers should include information on the costs associated with compliance, “anticipated trends in respect of these costs, and the potential impact of these costs on the issuer’s financial and operational results.”¹³

Issuers are also required to include a description of any social or environmental policies considered “fundamental” to the issuer’s operations.¹⁴ The recent CSA guidance on environmental disclosure instructs issuers to construe “policy” broadly to include policies on “sustainable development, community relations, the use and disposal of toxic or otherwise hazardous materials, prevention of spills, recycling, conservation of water and the reduction of greenhouse gas emissions.”¹⁵ The description “may include a quantification of the costs associated with the policies where quantitative information is reasonably available and would provide meaningful information to investors.”¹⁶ Finally, section 5.2 requires disclosure of “risk factors” and expressly mentions environmental risks.¹⁷

Disclosure of risks is also required in the MD&A. Form 51-102F1 instructs that MD&A should discuss “material information that may not be fully reflected in the financial statements” and “important trends and risks that have affected the financial statements, and trends and risks

¹² NI 51-102, *ibid.*, Form 51-102F2, s. 5.1(1)(k). This requirement also applies to long-form prospectuses: see *General Prospectus Requirements and Related Amendments (Final)*, O.S.C., NI 41-101 (2008) 31 OSCB Issue 10 (Supp-2) (7 March 2008), Form 41-101F1, Item 5 [NI 41-101]. SEC Regulation S-K, Item 101 contains a similar requirement: see Oren Perez, “Facing the Global Hydra: Ecological Transformation at the Global Financial Frontier – The Ambitious Case of the Global Reporting Initiative” (2006) Bar-Ilan University Public Law and Legal Theory Working Paper No. 06-9 at 12 (SSRN).

¹³ CSA Staff Notice 51-333, *supra* note 4 at 15.

¹⁴ NI 51-102, *supra* note 10, Form 51-102F2, s. 5.1(4). The U.K. similarly requires disclosure of environmental matters only “to the extent necessary for an understanding of the development, performance or position of the company’s business”: *Companies Act 2006*, c. 46, s. 417(5).

¹⁵ CSA Staff Notice 51-333, *supra* note 4 at 16.

¹⁶ *Ibid.*

¹⁷ This is also a required long-form prospectus item: see NI 41-101, *supra* note 12, Form 41-101F1, Item 21.

that are reasonably likely to affect them in the future”.¹⁸ Specifically, issuers are required to disclose “known trends, demands, commitments, events or uncertainties that are reasonably likely to have an effect on [the] business”¹⁹ and “commitments, events, risks or uncertainties that [the issuer] reasonably believe[s] will materially affect [the] company’s future performance”.²⁰ The recent CSA guidance notes that “[t]here is no specified future time period that must be considered in assessing the impact of a known trend or uncertainty”; rather, the time period will depend on the particularities of both the issuer and trend or uncertainty in question.²¹

All of these disclosure requirements are qualified, however, by the “materiality” threshold. The OSC has stated that “materiality is the *determining factor* for including information in [continuous disclosure] documents.”²² Forms 51-102F2 and 51-102F1 instruct issuers to focus on “material” information, and to “exercise [their] judgement” in determining whether or not information is material.²³ The definition of “material” to be applied to both the AIF and MD&A is “[w]ould a reasonable investor’s decision whether or not to buy, sell or hold securities in [the] company likely be influenced or changed if the information in question was omitted or misstated?”²⁴

Over the years, courts and securities commissions have attempted to interpret and give meaning to the “elusive” concept of materiality.²⁵ Of course, in the hands of the courts, the determination as to whether a given fact was “material” and therefore ought to have been

¹⁸ NI 51-102, *supra* note 10, Form 51-102F1, Part 1 (a). Form 51-102F1 should also include discussion of any material asset retirement obligations: CSA Staff Notice 51-333, *supra* note 4 at 14. A completed Form 51-102F1 must also be included in a long-form prospectus: see NI 41-101, *ibid.*, Form 41-101F1, Item 8. SEC Regulation S-K, Item 303 contains a similar requirement: see Perez, *supra* note 12 at 13.

¹⁹ NI 51-102, *ibid.*, Form 51-102F1, s. 1.2.

²⁰ *Ibid.*, Form 51-102F1, s. 1.4(g).

²¹ CSA Staff Notice 51-333, *supra* note 4 at 11.

²² OSC, *Environmental Reporting*, *supra* note 3 at 2223. See also CSA Staff Notice 51-333 at 5.

²³ NI 51-102, *supra* note 10, Form 51-102F2, Part 1 (d) and Form 51-102F1, Part 1 (e).

²⁴ *Ibid.*, Form 51-102F2, Part 1 (e) and Form 51-102F1, Part 1 (f). See also OSC, “2009 Report”, *supra* note 2 at 14.

²⁵ Homer Kripke, *The SEC and Corporate Disclosure: Regulation in Search of a Purpose* (New York: Law & Business, Inc., 1979) at 42.

disclosed is “an *ex post facto* judgement”.²⁶ It is much more difficult for issuers “to specify *ex ante* what types of information are [material] without engaging in overkill.”²⁷

In the *YBM* case,²⁸ the OSC noted that assessing materiality is “not a science” and “involves the exercise of judgement and common sense.”²⁹ The Commission reiterated that the proper test for materiality “is one of market impact” from the perspective of the investor as an “economic being”.³⁰ In other words, materiality is to be assessed from the point of view of an investor concerned with the “market price or value” of the security.³¹ With respect to future events, the Commission cited the decision of the U.S. Supreme Court in *Basic Inc. v. Levinson* for the proposition that the potential effect on the market price had to be discounted by the chances of it occurring.³² The Commission went on to find that even where probability cannot be determined with certainty, a fact may still meet the test for materiality “when the broader factual context suggests a risk faced by an issuer.”³³

In *Kerr v. Danier Leather Inc.*, the Supreme Court of Canada held that the “business judgement rule” has no application to disclosure requirements.³⁴ The business judgement rule is applied by courts in reviewing decisions of the board of directors and states that courts will not interfere with decisions that fall within a “range of reasonableness”.³⁵ In *Kerr*, the Court stated that “while forecasting is a matter of business judgement, disclosure is a matter of legal

²⁶ *Ibid.* at 22.

²⁷ Paul G Mahoney, “Mandatory Disclosure as a Solution to Agency Problems” (1995) 62 U Chicago L Rev 1047 at 1094.

²⁸ *In the Matter of YBM Magnex International Inc.* (2003), 26 OSCB 5285 [*YBM*].

²⁹ *Ibid.* at para. 90.

³⁰ *Ibid.* at para. 91.

³¹ *Ibid.* This is similar to the approach taken by the International Accounting Standards Board and the U.S. Supreme Court: see Perez, *supra* note 12 at 9-10.

³² *YBM, ibid.* at 92.

³³ *Ibid.* at 101.

³⁴ 2007 SCC 44, [2007] 3 S.C.R. 331 at para. 55.

³⁵ *Ibid.* at para. 54, citing *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 OR (3d) 177 (CA).

obligation.”³⁶ Determining “materiality”, however, requires an “exercise [of] judgement”³⁷ and courts likely will find themselves without the expertise to second-guess management’s materiality judgements with respect to climate change, except in those cases that fall outside the “range of reasonableness.”

There is some evidence that the type of information considered relevant by “reasonable investors” is evolving to include environmental factors. A number of large Canadian pension funds have “responsible investing” policies that discuss the relevance of a potential portfolio company’s environmental performance to their investment decision-making.³⁸ The OSC Report to the Minister on its corporate sustainability reporting initiative quotes from the CFA Institute’s 2008 paper “Environmental, Social and Governance Factors at Listed Companies: A Manual for Investors” that “[a] growing number of investors...share the view that a prudent investor ought to consider ESG [environmental, social and governance] issues in his or her analysis because these factors can have an impact on investment performance.”³⁹ Although issues of environmental performance and disclosure are attracting increasing attention in the investment community, it is not clear that this concern is affecting where the majority of investors put their money. In other words, it is not clear that a company’s overall environmental performance is currently influencing investors’ decisions to buy, sell or hold a security. This recent attention, therefore, does not appear to represent a real shift in the definition of “reasonable investor” as an

³⁶ *Ibid.* at para. 54.

³⁷ *Supra* note 29 and accompanying text.

³⁸ See, e.g., Canada Pension Plan Investment Board, “Policy on Responsible Investing”, August 2010 at 1, online: CPPIB, <http://www.cppib.ca/files/PDF/Responsible_Investing_Policy_August2010.pdf>: “Responsible corporate behaviour with respect to environmental, social and governance (ESG) factors can generally have a positive influence on long-term financial performance, recognizing that the importance of ESG factors varies across industries, geography and time”. See also Caisse, “Policy on Socially Responsible Investment” at 1, online: Caisse, <http://www.lacaisse.com/en/gouvernance/Documents/politique_investissement_responsable_en.pdf>; OMERS, Statement of Investment Policies and Procedures – Primary Plan at 6, online: OMERS, <<http://www.omers.ca/pdf/SIPandP.pdf>>. The extent to which these policies are implemented in actual investment decision-making is an issue I explore in a draft paper presented at the 14th Berlin Roundtables on Transnationality: Financialization and Everyday Life, Berlin, June 25-29, 2011.

³⁹ OSC, “2009 Report”, *supra* note 2 at 14.

“economic being”: environmental factors are taken into account only insofar as they might impact an issuer’s bottom line.⁴⁰ And so long as investors are not basing investment decisions on environmental performance environmental factors are unlikely to have a “material” effect on issuers’ financial results, except in extreme circumstances, such as the Deepwater Horizon explosion and oil spill. This is not to suggest that there are not very good reasons for investors to consider environmental factors in making investment decisions for reasons apart from their impact on expected returns, but rather that if there is a shift in investor behaviour, it may be less profound than some might hope.⁴¹ For this reason, the materiality threshold still strictly limits the environmental information that an issuer is required to disclose under existing securities law. The next section explores in more detail the limit on disclosure imposed by the materiality threshold.

III. THE MATERIALITY OF CLIMATE CHANGE

A. Application of the Materiality Threshold to the Main Categories of Risk Posed by Climate Change

There is general agreement that the climate is warming as a result of human activity.⁴² The risks posed by climate change fall broadly into two main categories: physical risks and regulatory risks.⁴³ There is also a risk that governments or environmental groups will attempt to hold large emitters liable for the effects of climate change through litigation.⁴⁴ Although it is

⁴⁰ See, e.g., CPPIB, Policy on Responsible Investing, *supra* note 38 at 1.

⁴¹ There is a small, but not insignificant market in North America for “ethical funds” that screen investments based on ethical criteria, including environmental factors. Canada’s “social responsible investing” market was estimated at over 600 billion CAD in 2008, representing 19.9% of assets under management in Canada: Social Investment Organization, “Canadian Socially Responsible Investment Review 2008” (March 2009) at 5, online: SIO, <<http://www.socialinvestment.ca/documents/caReview2008.pdf>>.

⁴² See, e.g., Nicholas Stern, Stern Review on the economics of climate change, Chapter 1 at 6-7, online: National Archives, <http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm>.

⁴³ SEC Petition, *supra* note 1 at 22.

⁴⁴ Andrew Schatz, “Regulating Greenhouse Gases by Mandatory Information Disclosure” (2008) 26 Va Env’tl LJ 335 at 362. CSA Staff Notice 51-333, *supra* note 4 at 8 also discusses “reputation” and “business model” risk. The latter includes things such as “decreased demand for goods that have a negative impact on the environment or fail to meet customer standards.”: CSA Staff Notice 51-333 at 10.

evident that climate change constitutes a trend or risk reasonably likely to affect issuers in the future,⁴⁵ determining the materiality of that risk is another matter.

The predicted effects of climate change include, among other things, the “availability of water”; the “productivity of farms, forests and fisheries”; and the “prevalence of oppressive heat and humidity” which, in turn, will impact costs related to “engineered environments” such as office buildings.⁴⁶ It is predicted that rising global temperatures will cause sea levels to rise,⁴⁷ which will “not only encroach directly on existing infrastructures but also accelerate the rates of coastal erosion, increase the damage due to storm surges, and contaminate coastal aquifers with salt water.”⁴⁸ There is also evidence that climate change will cause, or is already causing, an increased number of both floods and droughts.⁴⁹ These physical impacts pose risks to businesses’ assets, operations and markets.⁵⁰ The recent CSA guidance provides a list of specific examples of such risks, including property damage, disruptions to operations and increased insurance claims and premiums.⁵¹

Whether these predicted effects will occur, and, if so, *when*, is still uncertain. The United Nations Intergovernmental Panel on Climate Change (IPCC) is considered the authoritative voice on climate change. The IPCC has expressed “very high confidence” of increased risk of flood due to the rise in sea level, but only “medium confidence” that global warming will affect

⁴⁵ SEC Petition, *supra* note 1 at 28-29.

⁴⁶ John P. Holdren, “Global Climatic Disruption: Risks and Opportunities”, Presentation to the Investor Summit on Climate Risk (New York, 14 February 2008) at 5, online: Ceres, <<http://www.ceres.org//Document.Doc?id=282>>.

⁴⁷ *Ibid.* at 23, 30; Stern, *supra* note 42, Chapter 1 at 15-16.

⁴⁸ Vaclav Smil, *Global Catastrophes and Trends: The Next Fifty Years* (Cambridge, MA: The MIT Press, 2008) at 182.

⁴⁹ Holdren, *supra* note 46 at 17, 28; Stern, *supra* note 42, Chapter 1 at 15.

⁵⁰ Holdren, *ibid.* at 55.

⁵¹ CSA Staff Notice 51-333, *supra* note 4 at 9.

crop productivity.⁵² How much sea levels are expected to rise is also uncertain. The IPCC predicts an increase between 18 and 59 cm during the twenty-first century, but “[n]arrowing the estimates of future sea level rise is extremely difficult.”⁵³ Smil sums up the difficulties in predicting the specifics of climate change impacts this way: “even our most complex models are only elaborate speculations.”⁵⁴ It is likewise impossible for an issuer to quantify with any level of accuracy the risk of property damage, disruption or increased insurance costs due to climate change in order to determine the materiality of these risks for the purpose of disclosure. Until these risks can be quantified with more certainty, any disclosure under existing requirements would have to be so vague and general, rather than firm-specific, as to be meaningless to investors.

Even if issuers could determine with any level of accuracy the reasonably likely effects of climate change on its financial results, the question remains whether a “reasonable investor” would consider possible physical impacts 50-100 years in the future⁵⁵ “material” today? In its recent guidance, the CSA notes that the time horizon of a trend or uncertainty “may be relevant” to determining its materiality.⁵⁶ There are very good reasons for investors to take the possible impacts of climate change into account in making investment decisions, particularly for large institutional investors, such as public-sector pension funds with liabilities stretching generations into the future,⁵⁷ but it is not clear that these possible future impacts currently are affecting decisions to buy, sell or hold a particular security, having regard to the investor as an “economic

⁵² IPCC, “Climate Change 2007: Synthesis Report” at 48, online: IPCC, <http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr.pdf>. The IPCC defines “very high confidence” as 9 out of 10 and “medium confidence” as 5 out of 10: see *ibid.* at 27.

⁵³ Smil, *supra* note 48 at 182.

⁵⁴ *Ibid.* at 180.

⁵⁵ See Holdren, *supra* note 46 at 23-30; IPCC, *supra* note 52 at 21-32.

⁵⁶ CSA Staff Notice 51-333, *supra* note 4 at 11.

⁵⁷ Ontario Teachers’ Pension Plan, “Annual Report 2009” at 27, online: Teachers, <http://docs.otpp.com/AnnualReport.pdf>: “We invest with a long-term focus because the pension plan will be paying benefits to today’s young teachers 70 years or more from now.”

being” as instructed by the Commission in *YBM*.⁵⁸ In other words, it is not clear that the long-term physical impacts of climate change require disclosure under the existing definition of material.

With respect to regulatory risks, proposals to combat climate change are wide-ranging and include things that will save money in the long-term, such as improving the energy efficiency of buildings.⁵⁹ The biggest potential regulatory impact on issuers is the possibility of limits on GHG emissions and a corresponding increase in operating costs in order to comply. Such limits, however, do not appear likely in the near future. The current Canadian federal government has committed itself “to reducing Canada’s total greenhouse gas emissions by 17 per cent from 2005 levels by 2020” in accordance with the Copenhagen Accord, a non-binding international agreement.⁶⁰ The government’s plan to meet this non-binding target makes no mention of caps on GHG emissions.⁶¹ The Conservative government’s previous climate change action plan, “Turning the Corner” appears to have been abandoned.⁶² One stated reason for holding off on imposing caps on GHG emissions is to ensure that Canada’s policies are aligned with the U.S. The U.S. Congress has failed to adopt federal GHG regulations,⁶³ although many

⁵⁸ *Supra* note 28 and accompanying text.

⁵⁹ Holdren, *supra* note 46 at 49.

⁶⁰ “Canada’s Action on Climate Change”, online: Environment Canada, <<http://www.climatechange.gc.ca/default.asp?lang=En&n=72F16A84-1>>; “A Climate Change Plan for the Purposes of the *Kyoto Protocol Implementation Act*” at 3, online: Government of Canada, <http://www.climatechange.gc.ca/Content/4/0/4/4044AEA7-3ED0-4897-A73E-D11C62D954FD/COM1410_KPIA%202011_e%20-%20May%2031%20v2.pdf>.

⁶¹ The plan refers to new emission regulations for cars and light trucks, which will require automakers to meet a company-specific fleet average GHG emissions standard and new “emissions intensity” performance standards for coal-fired electricity plants: “Backgrounder: Key Features of Canada’s Passenger Automobile and Light Truck Greenhouse Gas Emission Regulations”, online: Environment Canada, <<http://www.ec.gc.ca/default.asp?lang=En&n=714D9AAE-1&news=4EF678F8-D8EE-404E-8F31-4F85289FCCC8>>; and “Backgrounder: Key Elements of Proposed Regulatory Approach”, online: Environment Canada, <<http://www.ec.gc.ca/default.asp?lang=En&n=714D9AAE-1&news=55D09108-5209-43B0-A9D1-347E1769C2A5>>

⁶² “Canada’s Action on Climate Change”, *supra* note 60.

⁶³ Carl Hulse & David M. Herszenhorn, “Democrats Call Off Effort For Climate Bill in Senate”, *New York Times*, July 23, 2010 (QL).

states and municipalities have enacted their own initiatives.⁶⁴ As a result of Congress' failure, the E.P.A. will impose limits on GHG emissions to take effect starting in mid-2011,⁶⁵ although the move is already being challenged in Congress and in the courts.⁶⁶ The only North American companies currently subject to GHG emissions limits are large emitters operating in Alberta⁶⁷ and companies operating in the European Union, which put in place a cap-and-trade regime to meet its commitments under the Kyoto Protocol.⁶⁸

The one step forward, two steps back on climate change legislation in North America has made it difficult for issuers to determine whether climate change regulation “constitutes a ‘known trend’”⁶⁹ that requires disclosure. The Conference Board of Canada has attributed the lack of disclosure on climate change at least partly to “a lack of clarity in federal regulations.”⁷⁰ With respect to the requirement to disclose the “financial and operational effects of environmental protection requirements” in the AIF, until regulation is imposed that puts a price on GHG emissions, any environmental costs of these emissions are “externalized” and do not have to be disclosed,⁷¹ precisely because they have no impact on the issuers' financial results.

B. The Remaining Gap in Climate Change-Related Disclosure

Even assuming issuers are correctly assessing the materiality of the possible impacts of climate change to their future financial results, this may leave a gap in the information desired by some investors. Writing in the corporate governance context, Anand argues that requiring issuers

⁶⁴ SEC Petition, *supra* note 1 at 23, 26, Appendix C.

⁶⁵ John M. Broder, “E.P.A. Limit on Gases to Pose Risk to Obama and Congress”, New York Times, December 30, 2010, online: NY Times, <http://www.nytimes.com/2010/12/31/science/earth/31epa.html?_r=1&hp>.

⁶⁶ John M. Broder, “Senate Rejects Bills to Limit E.P.A.’s Emissions Programs”, New York Times, April 6, 2011, online: New York Times, <<http://www.nytimes.com/2011/04/07/us/politics/07epa.html?scp=9&sq=congress%20climate%20change&st=cse>>.

⁶⁷ *Specified Gas Emitters Regulation*, Alberta Regulation 139/2007, s. 3(3). Alberta is the only province to impose limits on GHG emissions.

⁶⁸ SEC Petition, *supra* note 1 at 22-23.

⁶⁹ *Ibid.* at 28.

⁷⁰ “Poor Information Faulted” (2007) 18 Environment Policy & Law 1003 at 1003.

⁷¹ Mary G Condon, Anita I Anand & Janis P Sarra, *Securities Law in Canada: Cases & Commentary* (Toronto: Emond Montgomery Publications Limited, 2005) at 389.

to disclose which voluntary corporate governance mechanisms they have adopted and to explain *why* they have not adopted others means that investors do not have to draw inferences as to the reason for an issuer's failure to incorporate a particular corporate governance mechanism.⁷² The problem with climate change-related disclosure under current securities law requirements is that the materiality threshold forces investors to draw inferences as to why a particular issuer has failed to make any climate change-related disclosure and, unlike corporate governance, there is no handy list of climate change best practices in order to impose a similar "comply or explain" rule. The materiality threshold in current mandatory disclosure rules means that if a company has determined that a risk is not "material" it is under no obligation to explain *why* it has come to this conclusion.⁷³ Is it because, for example, the issuer has already taken action to reduce its GHG emissions or because it does not anticipate becoming the target of climate change regulation or because it has stockpiled cheap carbon credits or because it simply has not considered the issue?⁷⁴ In sum, there is no obligation on an issuer that has failed to disclose any climate change-related risks to make the statement "we do not consider climate change a material risk to our future financial results because we have already prepared for this risk in the following ways."

The materiality threshold may explain, therefore, the lack of climate change-related disclosure in many issuers' continuous disclosure documents,⁷⁵ but it does not necessarily follow

⁷² Anita I Anand, "An Analysis of Enabling vs. Mandatory Corporate Governance: Structures Post-Sarbanes Oxley" (2006) 31 Del J Corp L 229 at 249.

⁷³ As Form 41-101F1 specifically states: "negative answers to items may be omitted": see NI 41-101, *supra* note 12, General Instructions, Item (6). In the U.K., if information on environmental matters is not included in a directors' report, the report must state that such information is not contained in the report, but there is no express requirement to explain why it is not: *Companies Act, 2006*, *supra* note 14, s. 417(5).

⁷⁴ Although this last possibility would constitute a breach of the issuers' obligations regarding disclosure, it would be very difficult to detect and prove. An issuer might be required to disclose this type of information with respect to "reputation" risk: CSA Staff Notice 51-333, *supra* note 4 at 10. But, like all of the other climate-change related risks, such disclosure would be necessary only if an issuer felt that its public image with respect to climate change was "material".

⁷⁵ KPMG and United Nations Environment Programme, "Carrots and Sticks for Starters: Current Standards and Approaches in Voluntary and Mandatory Standards for Sustainability Reporting" (2006) at 8, online: KPMG <http://www.kpmg.com.au/Portals/0/Carrots_and_Sticksfinal.pdf> [KPMG, "Carrots"]. See also Steven Lydenberg,

that lowering or eliminating the materiality threshold with respect to information on issuer's environmental performance is the best way to fill this gap.⁷⁶ As Mahoney has noted, securities laws were “not designed to provide *all* value-relevant information to all market participants”⁷⁷ and “the more things a disclosure system attempts to do, the more substantial are the design problems facing its authors.”⁷⁸ At some point, requiring disclosure of more information becomes counterproductive,⁷⁹ and, post-*Sarbanes-Oxley*, companies are already disclosing more information than ever.⁸⁰ The materiality threshold is an important guard against both information overload⁸¹ and “obscuring material disclosures with unnecessary disclosures of immaterial information.”⁸²

At the same time, increased environmental reporting should be *improved* environmental reporting that avoids the pitfalls of existing mandatory disclosure documents. In its 2008 review of issuers' environmental reporting in continuous disclosure documents, the OSC noted that many of the issuers reviewed included only boilerplate discussion, even on company-specific matters, such as the issuer's environmental policies.⁸³ The next section of the paper examines whether voluntary disclosure mechanisms might fill, for now at least, the existing gap left by

Corporations and the Public Interest: Guiding the Invisible Hand (San Francisco: Berrett-Koehler Publishers, Inc, 2005) at 69: the materiality threshold may lead to “only sporadic” climate change-related disclosure.

⁷⁶ See Case, *supra* note 9 at 410. For an argument in favour of expanded mandatory disclosure under securities regulation, see Cynthia A Williams, “The Securities and Exchange Commission and Corporate Social Transparency” (1999) 112 Harv L Rev 1197.

⁷⁷ Mahoney, *supra* note 27 at 1111.

⁷⁸ *Ibid.* at 1104.

⁷⁹ Troy A Paredes, “Blinded by the Light: Information Overload and Its Consequences for Securities Regulation” (2003), 81 Wash ULQ 417 at 419, 442, 446.

⁸⁰ *Ibid.* at 418.

⁸¹ *Ibid.* at 448.

⁸² CICA Brief, *supra* note 4 at p. 9. There is also a concern that too many “negativistic warnings” will lead them to be ignored or not taken seriously by investors: Kripke, *supra* note 25 at 15. Although the GRI's G3 Guidelines, discussed below, include the notion of materiality, the threshold “is not limited only to those sustainability topics that have a significant financial impact on the organization”, but includes all impacts that could affect sustainability in the sense of meeting the needs of the present without compromising the ability of future generations to meet their own needs: see Global Reporting Initiative, “Defining Report Content: Materiality”, online: GRI <<http://www.globalreporting.org/ReportingFramework/G3Online/DefiningReportContent/>>.

⁸³ OSC, *Environmental Reporting*, *supra* note 3 at 2224 and 2226-27; CSA Staff Notice 51-333, *supra* note 4 at 4.

mandatory disclosure under securities regulation and evaluates disclosure under GRI's G3 Guidelines against the arguments in favour of mandatory disclosure.

IV. FILLING THE GAP: THE ROLE OF VOLUNTARY DISCLOSURE

A. The Global Reporting Initiative and Other Voluntary Disclosure Regimes

In the aftermath of the *Exxon-Valdez* oil spill off the coast of Alaska in 1989, the Coalition for Environmentally Responsible Economies (Ceres) came up with a corporate code of environmental conduct comprised of the ten Valdez Principles, later renamed the Ceres Principles.⁸⁴ The tenth principle requires “an annual self-evaluation” of the company’s progress in implementing the principles, and also requires the company to “support the timely creation of generally accepted environmental audit processes”.⁸⁵ To facilitate compliance with this principle, Ceres created an advisory panel to assist corporations that had endorsed the Ceres Principles report to investors in a “thorough and credible manner.”⁸⁶ Between 1990 and 1999, the panel met regularly, defining and refining its reporting format.⁸⁷

In 1997, Ceres, in partnership with the United Nations (UN) Environment Programme, established the Global Reporting Initiative (GRI), with the goal of extending the environmental reporting principles developed by Ceres to other social issues and to foster comparison of companies’ environmental performance by coming to a global consensus on reporting standards.⁸⁸ In 1999, GRI’s “Sustainability Reporting Guidelines” for “triple bottom line” – economic, environmental and social – reporting were released. The Guidelines are now in their

⁸⁴ Lydenberg, *supra* note 75 at 62-63.

⁸⁵ Ceres, “Ceres Principles”, online: Ceres, <<http://www.ceres.org/about-us/our-history/ceres-principles>>.

⁸⁶ Lydenberg, *supra* note 75 at 63.

⁸⁷ *Ibid.*

⁸⁸ *Ibid.* at 63-64. See also GRI, “History”, online: GRI, <<http://www.globalreporting.org/AboutGRI/WhatIsGRI/History/OurHistory.htm>>.

third generation, hence the name “G3 Guidelines”.⁸⁹ In 2002, GRI was spun off from Ceres into an independent organization, and in 2006, GRI partnered with the UN Global Compact,⁹⁰ a policy initiative with its own ten principles for corporate conduct in the areas of human rights, labour, environment and anti-corruption.⁹¹ The idea behind the partnership is for corporations to use the GRI reporting guidelines to report on their progress in achieving the Global Compact principles.⁹²

The G3 Guidelines contain Reporting Principles, such as stakeholder inclusiveness, balance and accuracy, “for defining report content and ensuring the quality of reported information” and “Standard Disclosures”, including numerous “Performance Indicators” for each of the three areas that make up the triple bottom line.⁹³ The Guidelines also take into account that a company’s sustainability reporting will improve over time, and provide a ranking system for the level of compliance with the Guidelines to facilitate improvement.⁹⁴

With respect to climate change specifically, the G3 Guidelines require reporting of energy consumed and energy saved through conservation efforts and efficiency improvements, and GHGs emitted and GHG emission reductions planned and achieved, as well as total

⁸⁹ GRI, “Making the Connection: The GRI Guidelines and the UNGC Communication on Progress” at 5, online: GRI, <http://www.globalreporting.org/NR/rdonlyres/A72A4645-B6FA-40B5-A1EE-A64E6F0CFBB2/0/260607_COP_MTC.PDF>.

⁹⁰ UN Global Compact, News Release, “UN Global Compact and Global Reporting Initiative Form Strategic Alliance” (6 October 2006), online: UN Global Compact, <http://www.unglobalcompact.org/NewsandEvents/news_archives/2006_10_06.html>; Lydenberg, *supra* note 74 at 65.

⁹¹ UN Global Compact, “Overview of the UN Global Compact”, online: UN Global Compact, <<http://www.unglobalcompact.org/AboutTheGC/index.html>>.

⁹² GRI, “Making the Connection”, *supra* note 88 at 3.

⁹³ *Ibid.* at 5; GRI, “The GRI Guidelines: An Executive Summary”, online: GRI, <http://www.globalreporting.org/NR/rdonlyres/D2BC0DF8-FF2C-4BAB-B2B4-27DA868C2A5F/3188/G3_Executive_Summary.pdf>. For a more detailed description of the environmental indicators, see Perez, *supra* note 12 at 19.

⁹⁴ For a fee, GRI will check a report’s level of compliance with the G3 Guidelines. The report must then display an icon indicating that it has been checked and the level of compliance: see Global Reporting Initiative, “Application Levels Check”, online: GRI, <<http://www.globalreporting.org/ReportServices/ApplicationLevelChecks/ServicesReportservicesApplicatonlevelcheck.htm>>.

environmental protection expenditures and investments.⁹⁵ The G3 Guidelines also require disclosure on what it calls “Management Approach” items, including organizational responsibility, training and awareness and monitoring and follow-up.⁹⁶

Disclosure under the G3 Guidelines therefore helps to fill the gap left by the materiality threshold by allowing investors to see the company’s vulnerability to climate change impacts, through the disclosure of energy consumed and GHGs emitted; how the company plans to address this vulnerability, through disclosure of initiatives to reduce GHG emissions; and the progress made so far, through disclosure of energy saved and GHG emission reductions achieved. In other words, voluntary disclosure using the G3 Guidelines can reveal the *why* behind an issuer’s materiality determination, and permits to some extent an independent assessment of this determination by investors.

Although the G3 Guidelines appear to be the “emerging standard” for reporting non-financial information,⁹⁷ they are just one set of voluntary disclosure standards a company could choose to follow. Specifically related to the issue of climate change is the Carbon Disclosure Project (CDP). The guiding principle behind the CDP is that “a business can only manage what it measures.”⁹⁸ To this end, the CDP, acting on behalf of 534 institutional investors,⁹⁹ sends out an annual information request form to 4,700 large corporations around the world.¹⁰⁰ The form asks

⁹⁵ GRI, “Making the Connection”, *supra* note 88 at 10-11.

⁹⁶ *Ibid.* at 10.

⁹⁷ Allan White, “The Quiet Revolution in Business Reporting” (Ceres, April 2007) at 5. Sweden, for example, requires state-owned companies to report using these guidelines: see Letter from A. Stausboll et al. to F. E. Harmon (22 October 2008) at 3, online: Ceres <<http://www.ceres.org/Document.Doc?id=376>> [“INCR Letter”].

⁹⁸ Carbon Disclosure Project & PricewaterhouseCoopers, “CDP Global 500 Report 2008” at vii, online: Carbon Disclosure Project, <https://www.cdproject.net/CDPResults/67_329_143_CDP%20Global%20500%20Report%202008.pdf> [CDP, “Report 2008”].

⁹⁹ Including the four largest Canadian public-sector pension funds, Canada Pension Plan Investment Board, Caisse de dépôt et placement du Québec, Ontario Teachers’ Pension Plan and British Columbia Investment Management Corporation.

¹⁰⁰ Carbon Disclosure Project and PricewaterhouseCoopers, 2010 Global 500 Report at 7, online: CDP, <<http://www.carbondisclosureproject.net>> [CDP, “Report 2010”].

for data on direct and indirect GHG emissions, as well as information on physical and regulatory risks and opportunities.¹⁰¹ In 2010, 3050 companies responded to the request.¹⁰² CDP then compiles and analyzes the responses and provides the data and analysis to investors in the form of various reports. CDP also publishes a “Carbon Leadership Index” of the companies in each sector that provided the most comprehensive responses to the information request.¹⁰³

Also specific to climate change is the Global Framework for Climate Risk Disclosure, released by a group of institutional investors, including CalPERS, in October 2006.¹⁰⁴ The Framework consists of four elements of disclosure: total historical, current and projected GHG emissions; the company’s climate risk and emissions strategy; assessment of physical risks; and analysis of regulatory risks. These elements are to be applied through both current mandatory disclosure requirements and voluntary regimes such as GRI, thereby complementing existing disclosure requirements under securities law and other voluntary standards.

The next two sections compare the advantages of mandatory versus voluntary environmental disclosure to determine whether voluntary disclosure might fill the gap left by disclosure made in accordance with the existing requirements under securities law. Given GRI’s position as the emerging standard, the analysis focuses primarily on GRI’s G3 Guidelines. I argue that disclosure in accordance with the GRI’s G3 Guidelines achieves many of the goals of

¹⁰¹ Carbon Disclosure Project, “CDP 2009 (CDP7) Information Request” at 2 and 4, online: Carbon Disclosure Project, <http://www.carbondisclosureproject.net/documents/CDP7_2009_Questionnaire.pdf> [CDP, “Information Request”]. For a detailed description and critique of the CDP, see Ans Kolk, David Levy & Jonathan Pinkse, “Corporate Responses in an Emerging Climate Regime: The Institutionalization and Commensuration of Carbon Disclosure” (2008) 17 European Accounting Review 719.

¹⁰² CDP, “Results: Overview”, online: CDP, <<http://www.carbondisclosureproject.net>>.

¹⁰³ Carbon Disclosure Project, “Leadership indexes and the CDP 2010 disclosure and performance scores”, online: CDP, <<https://www.cdproject.net/en-US/Results/Pages/leadership-index.aspx>>.

¹⁰⁴ Global Framework for Climate Risk Disclosure, “A statement of investor expectations for comprehensive corporate disclosure” (October 2006), online: UNEP Finance Initiative <http://www.unepfi.org/fileadmin/documents/global_framework.pdf>.

mandatory disclosure, such as comparability across companies and provides useful, credible information to investors.

B. The Advantages of Mandatory Disclosure

The primary advantage of mandatory disclosure is, not surprisingly, its mandatory nature: all issuers must disclose. Since voluntary disclosure standards “cannot compel adherence...there will be holdout problems.”¹⁰⁵ Market pressure to voluntarily disclose will be insufficient “if a firm’s competitors choose not to disclose similar information.”¹⁰⁶ Therefore, if a firm’s competitors are not disclosing their GHG emissions or climate change action plan, there is little incentive for a firm to be the first to do so.¹⁰⁷ After all, why would corporate officials voluntarily take the risk of negative investor or consumer reaction to the disclosure? This may help to explain why participants in voluntary disclosure schemes tend to be firms that already have high environmental performance standards.¹⁰⁸

Take up of the GRI has in fact been limited. In 2010, the GRI was aware of 1,397 companies who had issued sustainability reports using the G3 Guidelines.¹⁰⁹ In 2008, the companies reporting in accordance with the G3 Guidelines included one third of S&P 100 companies and 77% of the world’s 250 largest companies,¹¹⁰ but these numbers represent a very small percentage of all corporations worldwide and, in 2006, only 292 companies were reporting

¹⁰⁵ Frank H Easterbrook & Daniel R Fischel, “Mandatory Disclosure and the Protection of Investors” (1984) 70 Virginia L Rev 669 at 697. See also Lydenberg, *supra* note 75 at 65. Risk of litigation for a misrepresentation may also be a disincentive for firms to make voluntary disclosure. Voluntary disclosure may fall under the definition of “document” under s. 138.1 of the Ontario *Securities Act*, R.S.O. 1990, c. S.5, making it subject to civil liability for misrepresentation. See also CSA Staff Notice 51-333, *supra* note 3 at 24. Unless the stock price suffered as a result of correcting the misrepresentation, however, any damages would likely be nominal at best.

¹⁰⁶ Easterbrook & Fischel, *ibid.* at 697.

¹⁰⁷ On the other hand, as more companies engage in voluntary reporting, competitors have an incentive to follow: Case, *supra* note 9 at 391; Perez, *supra* note 12 at 24-26.

¹⁰⁸ Perez, *ibid.* at 27; Schatz, *supra* note 44 at 361. On the other hand, “dirty” industries, such as the chemical industry, for example, may be more sensitive to pressures from investors and others regarding their environmental performance: see Karkkainen, *supra* note 9 at 341.

¹⁰⁹ GRI, Year in Review 2009/10 at 16, online: GRI, <<http://www.globalreporting.org/NR/rdonlyres/9F9C6F28-44CA-42E6-940F-C5223543EC74/0/GRIYearInReview2010.pdf>>.

¹¹⁰ INCR Letter, *supra* note 97 at 3.

in full compliance with the guidelines.¹¹¹ The Board of the GRI itself has called on governments to make environmental, social and governance (ESG) reporting mandatory.¹¹² Making disclosure mandatory, however, does not necessarily mean that it will be complied with.¹¹³ France has experienced very low compliance rates with its mandatory social and environmental reporting requirements.¹¹⁴ As noted above, investors and regulators have expressed concern that North American issuers are not complying fully with existing environmental disclosure requirements.¹¹⁵ Companies may be more likely to comply with voluntary approaches when they are involved in developing the disclosure standards, since they are then more likely to view them as reasonable.¹¹⁶ As discussed further below, GRI develops its guidelines through extensive consultation with stakeholders.¹¹⁷

There are also countervailing forces to the disinclination to disclose, although there is likely a limit to what these forces can achieve absent mandatory disclosure rules.¹¹⁸ If investors continue to demand more and better climate change-related disclosure, issuers may choose to respond to that demand without the need for mandatory disclosure rules.¹¹⁹ Institutional investors are playing an important role in this regard. As mentioned above, CDP collects information on behalf of 534 institutional investors, representing \$64 trillion in assets¹²⁰ and the Global

¹¹¹ Perez, *supra* note 12 at 25, referring to the previous version of the guidelines. “Adherence levels” of reports registered with GRI is included in the GRI Reports List, online: GRI <<http://www.globalreporting.org/GRIReports/GRIReportsList/>>.

¹¹² GRI, Year in Review 2008/2009 at 17, online: GRI, <http://www.globalreporting.org/NR/rdonlyres/E8B6ED9E-1A29-4154-A6DA-F14E6F71A2C9/3830/GRI_Year_In_Review_241209.pdf>.

¹¹³ See Karkkainen, *supra* note 9 at 294, on problems of compliance with respect to the Toxic Releases Inventory.

¹¹⁴ KPMG, “Carrots” *supra* note 75 at 8. See also Lydenberg, *supra* note 75 at 66: 20 out of 120 companies on the SBR 120 Index did effectively no reporting and two-thirds reported on less than 40% of the prescribed indicators.

¹¹⁵ *Supra* note 3 and accompanying text. See also Case, *supra* note 9 at 410: “The SEC has a troubled record on enforcing existing environmental disclosure requirements.”

¹¹⁶ KPMG, “Carrots”, *supra* note 75 at 10.

¹¹⁷ See *infra* note 154 and accompanying text.

¹¹⁸ Karkkainen, *supra* note 9 at 367. Schatz, *supra* note 44 at 358 notes that CDP disclosure appears to have “levelled off” at 72% of Fortune 500 companies.

¹¹⁹ Easterbrook & Fischel, *supra* note 105 at 696; Kripke, *supra* note 25 at 118; Schatz, *supra* note 44 at 371.

¹²⁰ *Supra* note 100.

Framework for Climate Risk Disclosure is an institutional investor initiative.¹²¹ Under the Investor Network on Climate Risk Action Plan, another initiative of Ceres, investors representing \$1.75 trillion in assets under management¹²² have pledged to “urge companies to provide better disclosure about the financial and material risks posed by climate change and to explain how they are factoring carbon costs into operational and capital-planning decisions” using the GRI guidelines and the Global Framework on Climate Risk Disclosure.¹²³ Some institutional investors, including the Canada Pension Plan Investment Board, are voting in favour of shareholder proposals asking for better environmental disclosure.¹²⁴ Investor interest should also encourage analysts to provide analysis of environmental factors. The question is whether investors’ recent focus on environmental issues will shift during times of economic crises, such as the ongoing sovereign debt crises affecting the United States and the European Union.

Although leaving it up to issuers to judge the demand for climate change-related disclosure may slow take-up of voluntary disclosure standards like the G3 Guidelines, it also allows issuers to determine whether additional non-material disclosure is worth the expense or whether these resources would be better spent implementing other environmental initiatives.¹²⁵ Since disclosure is not costless, it is important to determine whether it will have a sufficient

¹²¹ *Supra* note 103.

¹²² Investor Network on Climate Risk, “Action Plan: Capitalizing the New Energy Future: Minimizing Climate Risks, Seizing Opportunities” (February 2008), online: United Nations, <<http://www.un.org/partnerships/Docs/Investor%20Network%20on%20Climate%20Risk%20Action%20Plan.pdf>> [INCR, “Action Plan”]. See also Investor Network on Climate Risk, “2008 Investor Summit on Climate Risk Final Report” (February 2008) at 3, online: United Nations, <<http://www.un.org/ga/president/62/ThematicDebates/gpicc/isfinalreport.pdf>>.

¹²³ INCR, “Action Plan”, *ibid.*, item 4. See also Schatz, *supra* note 44 at 371: “institutional investors will often reward companies for candid disclosure”.

¹²⁴ The Canada Pension Plan Investment Board voted in favour of 36 out of 55 shareholder proposals filed in the 2010 proxy season asking for enhanced disclosure on environmental and social risks: CPPIB, Report on Responsible Investing, July 1, 2009 – June 30, 2010 at 14, online: CPPIB, <http://www.cpib.ca/files/PDF/CPPIB_RI_Report_2010.PDF>.

¹²⁵ Lydenberg, *supra* note 75 at 67.

effect on investor and company behaviour to justify directing resources to disclosure over other possible forms of environmental regulation.¹²⁶

Another important touted advantage of mandatory disclosure rules is that they ensure “that information will be conveyed to investors in a standardized manner”,¹²⁷ thereby facilitating comparison of companies¹²⁸ and enhancing credibility.¹²⁹ The correlative criticism of voluntary disclosure in general and sustainability reports in particular is that they do not provide the standardized, credible disclosure on climate change necessary for investors to make meaningful comparisons.¹³⁰

The G3 Guidelines seek to address the problems of standardization and comparability by providing a standard format and set of indicators for companies to use in disclosing environmental performance information to investors. An investor is therefore able to compare companies adhering to the G3 Guidelines, since they will be providing the same information in the same format. The specificity of the information requested under the G3 Guidelines also facilitates comparison.¹³¹

A related criticism of voluntary disclosure is that it fails to provide clear “benchmarks” by which to measure an issuer’s performance against both other issuers and that issuer’s own performance in previous years.¹³² The G3 Guidelines, however, provide benchmarks in the form of reporting of total emissions of GHGs, ozone-depleting substances, NO_x, SO₂ and “other

¹²⁶ As noted in the Introduction, the merits of disclosure as a form of environmental regulation, but see references *supra* note 9.

¹²⁷ Anand, *supra* note 71 at 247.

¹²⁸ *Ibid.* at 248-49; Easterbrook & Fischel, *supra* note 105 at 687, 700; Karkkainen, *supra* note 9 at 291; Williams, *supra* note 76 at 1292-93; Mark R Gillen, *Securities Regulation in Canada*, 3d ed (Toronto: Thomson Carswell, 2007) at 342.

¹²⁹ Case, *supra* note 9 at 425.

¹³⁰ Johnston, *supra* note 3 at 7; Anand, *supra* note 72 at 247. This was one of the concerns expressed by investors during consultations by the OSC’s corporate sustainability reporting initiative: OSC, “2009 Report”, *supra* note 2 at 14.

¹³¹ Easterbrook & Fischel, *supra* note 105 at 701.

¹³² Schatz, *supra* note 44 at 357; Karkkainen, *supra* note 9 at 261, 291; Case, *supra* note 9 at 396.

significant air emissions” by weight.¹³³ The G3 Guidelines also provide a standard for disclosure against which to measure non-G3 Guidelines environmental reporting.

The credibility problem is particularly relevant to company “sustainability reports”, which are often viewed as mere “public relations” exercises that tend to focus on opportunities, rather than risks.¹³⁴ This perception is reinforced when sustainability reports are issued in response to negative publicity about a company’s environmental performance.¹³⁵ It would seem, however, that having gone to the expense of producing a sustainability report, an issuer would want to signal its credibility to investors. Although mandatory disclosure rules backed by penalties for misrepresentation are one way of providing credibility, adherence to a set of voluntary disclosure standards, like the G3 Guidelines, can also serve this function.¹³⁶ First, full compliance with the standard demonstrates that the company is not making selective “self-serving” disclosures.¹³⁷ Second, specific aspects of voluntary disclosure standards can assist in ensuring credibility. The G3 Guidelines’ “Management Approach” items enhance credibility through disclosure of “credibility-boosting” indicators, such as the monitoring and follow-up measures implemented to support any lofty goals.¹³⁸ Although the CDP does not verify the accuracy of responses, the information request form includes questions regarding “sources of uncertainty” in the data provided, such as assumptions or extrapolations made in calculating the quantity of GHG emissions.¹³⁹ Third, the information provided through the G3 Guidelines’ specific input and output “indicators” on, for example, the amount of a company’s GHG

¹³³ Items EN19 and EN20: GRI, “Making the Connection”, *supra* note 89 at 11.

¹³⁴ SEC Petition, *supra* note 1 at 50; Case, *supra* note 9 at 394-95.

¹³⁵ Case, *ibid.* at 389.

¹³⁶ KPMG International & SustainAbility Ltd., “Count me in: The readers’ take on sustainability reporting” (2008) at 12, online: GRI <<http://www.globalreporting.org/NR/rdonlyres/3F57ACC8-60D0-48F0-AF28-527F85A2A4B4/O/CountMeIn.pdf>> [KPMG, “Count me in”].

¹³⁷ Anand, *supra* note 72 at 248.

¹³⁸ GRI, “Making the Connection”, *supra* note 89 at 10: “Disclosure of Management Approach”.

¹³⁹ CDP, “Information Request”, *supra* note 101 at 7.

emissions, are “less susceptible to manipulation and [are] more immune to economic pressures” than reporting requirements based on broad concepts of corporate social responsibility.¹⁴⁰

Credibility also can be enhanced through auditing, or by including environmental reporting with financial reporting in the annual report.¹⁴¹ The credibility concern can also counter the disincentive to disclose negative information,¹⁴² since disclosing bad news may help to ensure that the good news is not discounted as being incomplete.¹⁴³

Finally, mandatory disclosure also provides an answer to the “free-rider” problem that arises from the “public good” component of disclosure. This problem has two aspects: the impossibility of issuers recouping the cost of developing a disclosure format from other issuers who will be able to use it¹⁴⁴ and the difficulty of analysts in recouping the full value of time spent gathering information.¹⁴⁵ Non-profit organizations, such as GRI and the CDP, can provide a solution to this problem, however: they are not concerned, as private companies or analysts would be, about going to the expense of developing a disclosure format only to have other companies “free-ride” and simply copy it¹⁴⁶ or not being able to recover the full cost of gathering information from the investors who will make use of it. Growing investor interest in this information should ensure that these organizations continue to have funding to engage in standards development and information gathering.

¹⁴⁰ Perez, *supra* note 12 at 22.

¹⁴¹ Lydenberg, *supra* note 75 at 74, citing Suncor Energy as an example of the former approach and Dofasco as an example of the latter. KPMG has noted that “Major accountancy organizations” are providing “assurance in corporate responsibility reporting”: KPMG International, “KPMG International Survey of Corporate Responsibility Reporting 2008” at 5, online: KPMG <<http://www.kpmg.com.au/Portals/0/Corporate-Responsibility-Reporting-Survey-20081120.pdf>>.

¹⁴² Anand, *supra* note 72 at p. 248; Paredes, *supra* note 79 at 422.

¹⁴³ Karkkainen, *supra* note 9 at 290; KPMG, “Count me in”, *supra* note 135 at 15-16.

¹⁴⁴ Easterbrook & Fischel, *supra* note 105 at 681, 685-86; Paredes, *supra* note 79 at 421.

¹⁴⁵ John C. Coffee, “Market Failures and the Economic Case for a Mandatory Disclosure System” (1984) 70 Virginia L Rev 717 at 725.

¹⁴⁶ Easterbrook & Fischel, *supra* note 105 at 687.

B. The Advantages of the Voluntary Disclosure under the G3 Guidelines

Apart from the low take-up rates of the GRI's G3 Guidelines among issuers, the Guidelines would seem to achieve several of the advantages of mandatory disclosure, including standardization, comparability and credibility. Use of voluntary disclosure standards such as the G3 Guidelines also has its own advantages, including allowing greater room for innovation, collaboration and flexibility, and providing "green" companies with an effective way to distinguish themselves from "dirty" ones.

The "proliferation of single issue disclosure initiatives",¹⁴⁷ such as the CDP, may impede the move towards standardization, but it also helps to ensure that voluntary disclosure standards continue to evolve and improve.¹⁴⁸ Ongoing refinement of the G3 Guidelines ensures that disclosure in accordance with this standard continues to reflect the information investors actually want.¹⁴⁹ The goal is to maintain the right balance between innovation and standardization.¹⁵⁰ This is an advantage that voluntary disclosure has over mandatory disclosure, since writing disclosure rules into law effectively stops the innovation process.¹⁵¹ There also is a significant amount of consultation among the different climate change disclosure initiatives. For example, the CDP and Ceres both sit on the World Economic Forum's Climate Disclosure Standards Board, another organization working towards the development of a standard framework for climate change-related disclosure.¹⁵² Continuing innovation also allows for ongoing consultation with various stakeholders in order to come to a true consensus on the appropriate level and

¹⁴⁷ White, *supra* note 97 at 6. See section IV.A, above.

¹⁴⁸ Kolk, Levy & Pinkse, *supra* note 101 at 742; White, *ibid.* at 4.

¹⁴⁹ GRI, "Making the Connection", *supra* note 89 at 5.

¹⁵⁰ White, *supra* note 97 at 4.

¹⁵¹ Easterbrook & Fischel, *supra* note 105 at 700: "Regulations are more failure-prone than markets, because there are few automatic forces that correct regulations gone awry." Markets are, of course, subject to their own failures, such as information asymmetry between parties, a failure that mandatory disclosure attempts to address.

¹⁵² World Economic Forum, "Climate Disclosure Standards Board (CDSB)", online: World Economic Forum <<http://www.weforum.org/en/initiatives/ghg/ClimateDisclosureStandardsBoard/index.htm>>.

content of reporting.¹⁵³ GRI uses an “open process” of collaboration with business, civil society, labour and “other professional institutions” to develop its reporting standards.¹⁵⁴

The other advantage of a voluntary approach to climate change disclosure is that even as it moves towards standardization, it maintains flexibility.¹⁵⁵ The GRI/Global Compact guidance document notes that there is no “single way to prepare a sustainability report”, but “encourages” companies to use the GRI G3 Guidelines.¹⁵⁶ Climate change-related disclosure, in particular, is not amenable to a “one size fits all” approach. Climate change will impact different companies very differently, as will regulation of GHG emissions. A mandatory disclosure rule could result in the disclosure of irrelevant, or vague, boilerplate, information by many issuers.¹⁵⁷ Flexibility also allows smaller companies to tailor their disclosure as needed.¹⁵⁸ Current mandatory disclosure requirements under securities law are frequently criticized for placing too heavy a burden on smaller companies, effectively precluding them from the public markets.¹⁵⁹ This is one reason why North American regulators might want to wait and observe companies’ experience using the G3 Guidelines for small and medium-sized companies.

Another advantage of single-issue voluntary disclosure schemes is that they are tailored to a specific area in which some investors might be particularly interested. Voluntary disclosure on a specific issue, such as climate change, allows interested investors to save time by accessing

¹⁵³ White, *supra* note 97 at 6.

¹⁵⁴ GRI “Making the Connection”, *supra* note 89 at 5. See also Lydenberg, *supra* note 75 at 64; Case, *supra* note 9 at 400-01.

¹⁵⁵ See Karkkainen, *supra* note 9 at 369 on the importance of even a mandatory environmental disclosure regime maintaining flexibility.

¹⁵⁶ GRI, “Making the Connection”, *supra* note 89 at 4.

¹⁵⁷ Gillen, *supra* note 127 at 349. This is the case with France’s mandatory corporate social responsibility reporting regime: Lydenberg, *supra* note 75 at 67.

¹⁵⁸ GRI offers reporting assistance specifically geared to small and medium-sized enterprises: see GRI, “Small and Medium Enterprise”, online: GRI <<http://www.globalreporting.org/WhoAreYou/SME/>>.

¹⁵⁹ See, e.g., Marc Morgenstern & Peter Nealis, “The Impact of Sarbanes-Oxley on Mid-Cap Issuers” (2004), online: U.S. Securities and Exchange Commission, <http://www.sec.gov/info/smallbus/mmorgensternmidcap.pdf>; Paul Rose, “Balancing Public Market Benefits and Burdens for Smaller Companies Post Sarbanes-Oxley” (2005) 41 *Williamette L Rev* 705.

efficiently the information that matters to them, rather than having to spend time searching through mandatory continuous disclosure documents.¹⁶⁰ Investors may find “comprehensive reports” “daunting” or “boring”.¹⁶¹ Disclosure focused on a single issue, such as that made in response to the CDP information request, hopefully avoids the “information overload” problem for investors and experts alike.¹⁶²

Finally, voluntary disclosure allows “good” or “green” companies to distinguish themselves from “bad” or “dirty” ones. By choosing to disclose environmental information in accordance with a voluntary standard such as GRI, a company can signal its commitment to environmental issues. This is similar to the way a company can signal its value by listing its shares on a publicly-traded stock exchange, thereby “voluntarily” agreeing to be bound by mandatory disclosure rules in securities legislation.¹⁶³ In order for signalling to be effective, however, it has to be difficult for bad companies to mimic.¹⁶⁴ The G3 Guidelines ranking system for the level of compliance with the standard and the CDP’s Carbon Leadership Index meet this requirement of an effective signalling device by providing an objective indicator of the quality of the issuer’s voluntary disclosure.¹⁶⁵

V. CONCLUSION

Although there is some evidence that the information desired by the “reasonable” investor is shifting to include information on the long-term effects of climate change, this information, in the case of many issuers, has yet to reach the point of “materiality” under existing securities law. Even if all issuers were in full compliance with their obligations to disclose

¹⁶⁰ Easterbrook & Fischel, *supra* note 105 at 709. As outlined in section II above, information related to climate change could be disclosed in various sections of the AIF or the MD&A.

¹⁶¹ Lydenberg, *supra* note 75 at 77.

¹⁶² Paredes, *supra* note 79 at 455-56.

¹⁶³ *Ibid.* at 471.

¹⁶⁴ *Ibid.*

¹⁶⁵ See *supra* note 103.

climate change-related risks under current mandatory securities disclosure rules, the materiality threshold means that a gap would remain between what issuers are mandated to disclose and the level of detailed information desired by some investors. Voluntary disclosure initiatives such as The Global Reporting Initiative's G3 Guidelines are helping to fill this gap by providing more comprehensive, specific and detailed climate-change related disclosure in a standardized manner. I do not wish to paint an overly rosy picture of voluntary disclosure – take-up of the G3 Guidelines remains low, for example – but the existence of an emerging global standard for voluntary climate change-related disclosure helps to achieve the comparability and credibility of mandatory disclosure and encouragement from institutional investors and other organizations could help to boost use of the G3 Guidelines and other voluntary disclosure standards. The GRI's G3 Guidelines also provide an example of an environmental disclosure standard, one regulators would do well to study more carefully before expanding existing disclosure requirements in order to ensure that the information disclosed by issuers is in fact useful to investors and not more unhelpful, boilerplate statements.