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# Shadows and Light: Addressing Information Asymmetries through Enhanced Social Disclosure in Canadian Securities Law

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# SHADOWS AND LIGHT: ADDRESSING INFORMATION ASYMMETRIES THROUGH ENHANCED SOCIAL DISCLOSURE IN CANADIAN SECURITIES LAW

Aaron A. Dhir\*

## I. INTRODUCTION

Beginning in 2005, the Investment Dealers Association of Canada sponsored a comprehensive review of Canadian securities regulation with a view towards modernizing the legislative framework and improving the effectiveness of our capital markets. The Final Report of the “Task Force to Modernize Securities Legislation in Canada” was released in October 2006.<sup>1</sup> The 65 recommendations set forth are the product of 30 research papers prepared by international and Canadian academics and practitioners, oral and written submissions<sup>2</sup> and a series of eight stakeholder consultations.<sup>3</sup>

The Final Report of the Task Force provides the opportunity to reflect not only on its recommendations but also on issues that were not addressed.<sup>4</sup> For example, while disclosure figured prominently in

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1. The Task Force to Modernize Securities Legislation in Canada, *Canada Steps Up: Final Report* (October 2006), online: Task Force to Modernize Securities Legislation in Canada <<http://www.tfmsl.ca>> .
2. *Ibid.*, at p. 21; The Task Force to Modernize Securities Legislation in Canada, *Canada Steps Up: Written Submissions and Presentations* (October 2006), vol. 7, online: Task Force to Modernize Securities Legislation in Canada <<http://www.tfmsl.ca>> .
3. I participated in one of these consultations — a roundtable titled “Critical Issues in Enforcement”, held at the University of Toronto’s Capital Markets Institute (February 3, 2006).
4. For a discussion of the Task Force’s recommendations from the perspective of retail investors, see Paul Halpern and Poonam Puri, “Reflections on the Recommendations of the Task Force to Modernize Securities Legislation in Canada: A Retail Investor Perspective” (2008), 46 C.B.L.J. 199.

the Task Force process, the concept of mandatory social disclosure did not.<sup>5</sup> The crux of this concept is that it requires publicly traded corporations to report to investors not just the fact of revenue generation, but also on the method by which revenues are generated.<sup>6</sup> So, for example, in addition to traditional financial information, a company would report on its patterns of legal compliance and its policies, practices and business impacts as they relate to issues such as the environment, labour, human rights etc.<sup>7</sup>

To date, social disclosure has garnered little attention in the Canadian academic legal literature. The present article is one of two that attempts to fill this void and to inform current and future policy reform initiatives.<sup>8</sup> In the companion piece, I address the issues at a more conceptual level, with reference to the broader theoretical

5. Other similar terminology in the literature includes: non-financial disclosure, extra-financial reporting, triple bottom line reporting, corporate social transparency, sustainability reporting, etc.
6. Cynthia Williams, "The Securities and Exchange Commission and Corporate Social Transparency" (1999), 112 Harv. L. Rev. 1197 at p. 1201. For more on the elements of social reporting, see David Hess, "Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness" (1999), 25 J. Corp. L. 41 at p. 64 and David Hess, "Regulating Corporate Social Performance: A New Look at Corporate Social Accounting, Auditing, and Reporting" (2001), 11 Business Ethics Quarterly 307 at p. 318 (setting out possible items of relevance to various stakeholder groups).
7. Although the recommendations of the final report did not make explicit mention of social disclosure, it is both directly and indirectly referenced in some of the underlying research studies that were commissioned. See Janis Sarra, "Modernizing Disclosure in Canadian Securities Law: An Assessment of Recent Developments in Canada and Selected Jurisdictions" (paper commissioned by the Task Force to Modernize Securities Legislation in Canada, May 29, 2006) at p. 11, online: Task Force to Modernize Securities Legislation in Canada <<http://www.tfmsl.ca>> and Mary Condon and Poonam Puri, "The Role of Compliance in Securities Regulatory Enforcement" (paper commissioned by the Task Force to Modernize Securities Legislation in Canada, June 28, 2006) at p. 19, online: Task Force to Modernize Securities Legislation in Canada <<http://www.tfmsl.ca>>.
8. In particular: (1) in February 2008, the "Expert Panel on Securities Regulation" was appointed by the federal finance minister to provide "advice and recommendations to the federal Minister of Finance, and the provincial and territorial ministers responsible for securities regulation, on the best way forward to improve securities regulation in Canada." See "About Us", online: Expert Panel on Securities Regulation <<http://www.expertpanel.ca>>; and (2) under s. 143.12(1) of Ontario's Securities Act, R.S.O. 1990, c. S.5 (OSA), the Ontario government is required by May 31, 2007 to designate an advisory committee to review current legislation, regulations and rules pertaining to provincial securities law. Presumably the work of this panel will begin in due course. The last advisory committee report was released in 2003. See Five Year Review Committee, *Five Year Review Committee Final Report — Reviewing the Securities Act (Ontario)* (March 21, 2003), online: Ontario Ministry of Finance <<http://www.fin.gov.on.ca>> (Five Year Review Committee, *Final Report*).

frameworks of new governance and reflexive law.<sup>9</sup> In this paper, I turn my attention to the underlying mechanics. In section II, I review the extent to which Canadian companies have been reporting social information. In section III, I canvass the degree to which such disclosure is actually required under securities law *vis-à-vis* the continuous disclosure obligation that requires public companies to provide periodic and timely disclosure to investors. I focus on three of the key components of periodic disclosure — quarterly/annual financial statements, the management discussion and analysis (MD&A) and, most importantly, the annual information form (AIF). Although many firms are underreporting, it is clear that a sufficient legal basis exists to compel the disclosure of material social information. However, various weaknesses limit the potential of existing provisions and arguably facilitate corporate opacity. As such, in section IV I provide a set of recommendations that I hope will serve to enhance the social disclosure landscape. In section V, I offer some concluding remarks.

## II. TO WHAT EXTENT HAVE CANADIAN COMPANIES REPORTED SOCIAL INFORMATION?

The sustainability reporting landscape in Canada has been described as dim.<sup>10</sup> In a 2001 report on Canada's one hundred largest corporations, Stratos Inc. noted disappointing results in terms of environmental performance reporting, few expressions of “an integrated triple bottom line vision and strategy” and underdeveloped non-environmental social reporting generally.<sup>11</sup> In a 2005 study, the Certified General Accountants Association of Canada (CGA) sought survey data on sustainability reporting from each corporation listed on the TSX Venture Exchange and the Toronto Stock Exchange with head offices in Canada.<sup>12</sup> While there

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9. Aaron A. Dhir, “The Politics of Knowledge Dissemination: Corporate Reporting, Shareholder Voice and Human Rights”, forthcoming in (2009), 47 Osgoode Hall L.J. 1.

10. See Allan C. Hutchinson, *The Companies We Keep: Corporate Governance for a Democratic Society* (Toronto: Irwin Law, 2005), p. 301 (“In general . . . Canadian corporations have shown only a limited appetite for such social reporting”).

11. Stratos Inc., “Stepping Forward: Corporate Sustainability Reporting in Canada” (November 2001) at p. 16, online: Stratos Inc. <<http://www.stratos-sts.com>>.

12. This survey population was chosen on the assumption that it reflected most of Canada's public corporations and included the prominent Canadian regions and industrial sectors. Two hundred responses were received and the outcomes were viewed as accurate “within +/- 5.5 percentage points, 9 times out of 10.” See Certified General Accountants Association of Canada, “Measuring Up: A Study on Corporate Sustainability Reporting in Canada” (2005), Part 2 at p. 34, online:

were signs that firms are turning their attention to sustainability issues in their reporting, the report concluded that this trend “is relatively slow and gradual” and that “coverage of sustainability issues continues to rank lowest of all items reported by companies.”<sup>13</sup> This mirrors a Conference Board of Canada report which found that 68% of Canada’s largest corporations do not issue formal corporate social responsibility reports and that none provides public disclosure exceeding 60% of relevant indicators.<sup>14</sup>

In particular, the social disclosure practices of Canadian extractive companies have been called into question on various occasions.<sup>15</sup> This is of particular importance given that Canada has listed on its stock exchanges more mining firms than any other state.<sup>16</sup> Globally, these exchanges represent “the world’s largest source of equity capital for mining exploration and production both in Canada and abroad.”<sup>17</sup> In a 2001 academic study that compared the environmental reporting of U.S. and Canadian corporations, the authors noted “a number of resource-based companies who chose to

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Certified General Accountants Association of Canada <<http://www.cga-canada.org>> (CGA, “Measuring Up, Part 2”).

13. *Ibid.*, at p. 64.

14. Conference Board of Canada, *The National Corporate Social Responsibility Report: Managing Risks, Leveraging Opportunities* (June 2004) at p. 8. It should be noted that Canadian companies have not always demonstrated a willingness to participate in studies attempting to assess the reporting of social information. For example, the Climate Disclosure Project seeks to advise institutional investors on the risks associated with climate change and to advise corporate management on related investor concerns. As part of this initiative, it invites institutional investors to join an annual international request asking corporations for information pertaining to greenhouse gas emissions that is relevant to shareholder value. In the 2006 survey, participating Canadian investors represented more than \$1 trillion in total managed assets. However, less than one third of Canadian companies approached actually responded to the request for information — representing one of the lowest response rates in the global survey. See *Carbon Disclosure Project Report 2006 — Canada 280* at pp. vi, 2 and 6, online: Carbon Disclosure Project <<http://www.cdproject.net/reports.asp>>. The response rate did, however, increase in 2007. See *Carbon Disclosure Project Report 2007 — Canada 200* at p. i, online: Carbon Disclosure Project <<http://www.cdproject.net>>.

15. But see contra Janis Sarra and Vivian Kung, “Corporate Governance in the Canadian Resource and Energy Sectors” (2006), 43 *Alta. L. Rev.* 905 at paras. 63, 64, 89-91, 93, 95-99 and 101 (QL).

16. National Roundtables on Corporate Social Responsibility and the Canadian Extractive Industry in Developing Countries, *Advisory Group Report* (March 29, 2007) at p. 3, online: Foreign Affairs and International Trade Canada <<http://geo.international.gc.ca>> (citation omitted).

17. *Ibid.* My analysis in this paper focuses on publicly traded corporations that issue securities for public distribution/are the subject of securities regulation and are more likely to be implicated in problematic overseas conduct that has material relevance for investors.

disclose absolutely nothing about their effect on the environment” despite regulatory requirements.<sup>18</sup> A 2006 KPMG study surveyed the disclosure and accounting of 44 international mining firms, including 12 Canadian corporations. Of the jurisdictions reviewed, the Canadian businesses placed last in terms of detailed sustainability disclosure in annual reports.<sup>19</sup> A 2004 study conducted by Stratos Inc. for the National Roundtable on the Environment and the Economy reviewed the disclosure practices of select oil and gas, mining and financial services issuers, focusing on certain representative social responsibility-related issues. While positive signs were demonstrated, it was found that the disclosures of all three sectors were lacking in very important ways.<sup>20</sup>

A 2004 study conducted for the Yale School of Forestry & Environmental Studies inquired into the sufficiency of U.S. and

18. Nola Buhr and Martin Freedman, “Culture, Institutional Factors and Differences in Environmental Disclosure between Canada and the United States” (2001), 12 *Critical Perspectives on Accounting* 293 at p. 314.
19. KPMG, “Global Mining Reporting Survey 2006” (2006) at p. 82, online: KPMG in Canada <<http://www.kpmg.ca>>. Canadian firms were in the middle of the pack in terms of separate sustainability reports (at p. 85). See also Andy Hoffman, “Canadian Miners Go on Buying Spree”, *The Globe & Mail*, December 12, 2006, online: *Globe & Mail* <[www.theglobeandmail.com](http://www.theglobeandmail.com)> (“Canadian mining companies are aggressively boosting their mineral reserves through acquisitions . . . but are well behind other mining nations when it comes to disclosure on social and environmental issues . . .”).
20. Stratos Inc., “Corporate Disclosure and Capital Markets: Demand and Supply of Financially Relevant Corporate Responsibility Information” (December 22, 2004), online: National Roundtable on the Environment and the Economy <<http://www.nrtee-trnee.ca>> (accessed August 10, 2008). Deficiencies canvassed included the following: (1) oil and gas — “[o]verall, however, they present very different strategies for addressing climate change, and provide considerably more detail about their internal greenhouse gas . . . reduction and offsetting activities and performance than about strategic plans to assess investments or other actions relating to the potential long-term implications of a carbon-constrained future” (at vi); (2) mining — “in general, however, there is only limited disclosure of information on biodiversity risks in the public information provided by the companies. Indeed, none of them provides a detailed description of how the potential significance of biodiversity issues is assessed and managed” (at pp. vi-vii); and (3) financial services — “[h]owever, the almost complete lack of disclosure by the five reviewed banks about how they are managing social risks in their financial services and products invites the conclusion that they are not addressing [corporate responsibility] in a systematic manner” (at p. vii). A more recent study by Stratos Inc. considered the sustainability reporting of seven “recognized sustainability reporting leaders.” While this study necessarily involved positive results, weaknesses were noted with respect to environmental reporting and reporting “on the influence of companies on sustainability performance in their value chain.” See Stratos Inc., “Canadian Corporate Sustainability Reporting: Best Practices 2008” at p. 6, online: <<http://www.stratos-sts.com>>.

Canadian mining firms' environmental disclosures. The study first accounted for the occurrence of environment-related events that had a material financial impact on listed companies. It then reviewed prior, current and subsequent financial disclosures and press releases in order to determine the precise content of the firms' disclosures. Materials prepared by sources external to the companies were then reviewed with a view towards establishing what the company knew or could have known about the event during and after its occurrence (as well as what the company could have known about the likelihood of the event prior to its occurrence).<sup>21</sup> In all case studies except one, the disclosures were found to be inadequate; in particular the disclosure of environmental liabilities and risks that were known to the firm and financially material.<sup>22</sup>

In general, the global mining industry has had difficulties with proper risk management. In 2006, Ernst & Young surveyed the majority of the leading 40 international mining firms, including prominent Canadian companies. Only 39% of responding companies were mindful of the necessity of having a communications policy with significant equity-holders.<sup>23</sup> Further, 55% reported that fundamental risks were not being properly managed, including 18% who stated that environmental-related risks were being under-managed. As stated by Ernst & Young, "[w]e believe this is due to mining companies not yet sufficiently managing or responding to emerging risks such as climate change and the increased community pressure around the local environmental impact."<sup>24</sup> Finally, turning away from group studies, while industry giant Alcan Inc.<sup>25</sup> has received numerous accolades for its global sustainability practices,<sup>26</sup> a recent analysis strongly critiqued its 2007 sustainability report. After discussing the deficiencies, the author concluded that "the painful realities of Alcan's environmentally damaging industry have been unduly minimised, meaning the relevance of the report suffers."<sup>27</sup>

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21. The company would have had access to the materials examined (*i.e.* studies, reports etc.).

22. Robert Repetto, "Silence is Golden, Lead, and Copper: Disclosure of Material Environmental Information in the Hard Rock Mining Industry" (July 2004), at p. 4, online: Yale School of Forestry & Environmental Studies <<http://environment.yale.edu>>.

23. See Ernst & Young, "Exploring the Risks: Attitudes to Risk in the Global Mining Sector" (2006) at p. 11, online: Ernst & Young <<http://www.ey.com>>.

24. *Ibid.*, at p. 13.

25. Now Rio Tinto Alcan Inc.

26. See "Sustainability Awards and Recognition", online: Rio Tinto Alcan Inc. <<http://www.publications.alcan.com>>.

### III. TO WHAT EXTENT IS SOCIAL DISCLOSURE REQUIRED UNDER CANADIAN SECURITIES LAW?

A key finding of the CGA study discussed above is that regulatory requirements are the paramount determinant for corporations in considering whether to move towards the adoption of social reporting.<sup>28</sup> This raises a fundamental question: to what extent is social disclosure actually required under Canadian securities law?<sup>29</sup> As recently noted by Professor Sarra, while social disclosure-related provisions are “increasingly prevalent” in other jurisdictions, “Canada’s requirements in this respect are minimal at best . . .”<sup>30</sup> That having been said, despite the dearth of explicit terms there is — without question — sufficient legal basis to compel the reporting of this information if it is material. In addition to the prospectus document that is required when a company initially goes public or issues additional securities,<sup>31</sup> reporting issuers are subject to a continuous disclosure obligation which requires them to provide periodic and timely disclosure to investors.<sup>32</sup> The key components of periodic disclosure are: (i) quarterly/annual financial statements, (ii)

27. See Deborah Smith, “Alcan’s 2007 Sustainability Report — A Little Too Shiny” (February 26, 2008), online: Ethical Corporation <<http://www.ethicalcorp.com>>.
28. CGA, “Measuring Up, Part 2”, *supra*, footnote 12, at p. 47.
29. It should be noted that there are reporting requirements under other regimes that are of relevance. For example, Canadian banks with equity of one billion dollars or higher are required to publish an annual “public accountability statement” which is to describe “the contribution of the bank and its prescribed affiliates to the Canadian economy and society.” See Bank Act, S.C. 1991, c. 46, ss. 459.3. Also, the Canadian Environmental Protection Act, 1999 establishes the National Pollutant Release Inventory, which requires firms to report on the release of various pollutants. See Canadian Environmental Protection Act, 1999, S.C. 1999, c. 33, ss. 46 and 48. Further, at the municipal level, the city of Toronto is currently contemplating a new bylaw that would introduce an “Environmental Reporting, Disclosure and Innovation Program” under which businesses would be required to report annually on the use or release of 25 prescribed toxic substances. See “Environmental Reporting, Disclosure and Innovation Program”, online: City of Toronto <<http://www.toronto.ca>>.
30. Janis Sarra, “Disclosure as a Public Policy Instrument in Global Capital Markets” (2007), 42 *Tex. Int’l L.J.* 875 at p. 896. See also Benjamin J. Richardson, “Financing Environmental Change: A New Role for Canadian Environmental Law” (2004), 49 *McGill L.J.* 145 at p. 195 (“While Canadian companies are not currently required to routinely report in their financial statements on their environmental activities and costs, the regulatory trend in other jurisdictions is towards mandatory corporate environmental reporting”).
31. While my discussion will focus on the continuous disclosure regime, the disclosure of social information also has relevance in terms of prospectus requirements.
32. Using Ontario as an example, the term “reporting issuer” has a seven-fold definition in s. 1(1) of the OSA, *supra*, footnote 8. Most frequently, an issuer will

the MD&A, (iii) the AIF and (iv) information circulars. For the purposes of social disclosure, the first three are the most germane and will be discussed in detail; in particular in light of National Instrument 51-102 which provides elucidation on each and serves to harmonize continuous disclosure requirements in Canada.<sup>33</sup>

## 1. Financial Statements

Every Canadian reporting issuer is required to prepare and file quarterly and annual financial statements, which include a balance sheet, income statement, cash flow statement and statement of retained earnings.<sup>34</sup> The Canada Business Corporations Act (as well as provincial corporate law statutes) requires corporate directors to submit to shareholders the financial statements, any auditor's report and any other information pertaining to the corporation's financial position at each annual meeting.<sup>35</sup>

Financial statements are to be prepared in accordance with "Generally Accepted Accounting Principles" (GAAP)<sup>36</sup> which, for Canadian issuers, means in accordance with the handbook of the Canadian Institute of Chartered Accountants (CICA).<sup>37</sup> In a 2004 report, the CICA advises that ethical, social and environmental factors should be integrated into corporate financial statements in particular instances; for example, if the issue has led to transactions with third

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be considered a reporting issuer by meeting s. 1(1)(b) (*i.e.* it has filed a prospectus and been issued a receipt).

33. National Instrument 51-102, "Continuous Disclosure Obligations", online: Ontario Securities Commission <[www.osc.gov.on.ca](http://www.osc.gov.on.ca)> (Unofficial Consolidation, current to July 4, 2008) (NI 51-102 Consolidation). National Instruments are developed by provincial securities administrations in collaboration and are put forth by the Canadian Securities Administrators (CSA), the umbrella organization of all provincial regulators. The fact that an instrument has been termed "national", as opposed to "multilateral", reflects its adoption by the regulator of each province. See Mark R. Gillen, *Securities Regulation in Canada*, 3rd ed. (Toronto: Thomson, 2007), p. 101 and Jeffrey G. MacIntosh and Christopher C. Nicholls, *Securities Law* (Toronto: Irwin Law, 2002), pp. 83-84. NI 51-102 was implemented in Ontario by Ontario Securities Commission Rule 51-801, "Implementing National Instrument 51-102 Continuous Disclosure Obligations", online Ontario Securities Commission <[www.osc.gov.on.ca](http://www.osc.gov.on.ca)>.
34. NI 51-102 Consolidation, *ibid.*, at pp. 14-15, ss. 4.1 and 4.3. For a detailed explanation of each, see Christopher C. Nicholls, *Corporate Finance and Canadian Law* (Scarborough: Carswell, 2000), pp. 124-33.
35. Canada Business Corporations Act, R.S.C. 1985, c. C-44, ss. 155(1) (CBCA).
36. National Instrument 52-107, "Acceptable Accounting Principles, Auditing Standards and Reporting Currency", s. 3.1(1), online: Ontario Securities Commission <<http://www.osc.gov.on.ca>>.
37. National Instrument 14-101, "Definitions", s. 1.1(3), online: Ontario Securities Commission <<http://www.osc.gov.on.ca>>.

parties or results in present financial obligations or future obligations that are known and can be estimated (e.g. costs associated with addressing contaminated areas).<sup>38</sup> Where financial obligations cannot be quantified or approximated, the CICA suggests providing disclosure via notes to the statements if omitting the information would produce a misleading result.<sup>39</sup> In considering the importance of materiality,<sup>40</sup> CICA acknowledges that these issues “may not in themselves be material relative to the aggregate of other financial statement line items in which they are included” and thus that they may not “warrant separate disclosure in the body of the financial statements.”<sup>41</sup> However, the CICA states that in situations where such issues do not fit properly under GAAP, the issuer should contemplate providing disclosure in the MD&A.<sup>42</sup>

## 2. The MD&A

Every Canadian reporting issuer must file an MD&A that relates to interim and annual financial statements.<sup>43</sup> Each year, the issuer must send a request form to registered and beneficial holders of non-debt instrument securities which allows them to request both the annual/interim financial statements and the accompanying MD&A.<sup>44</sup> If such a request is made, the issuer must provide a copy of the MD&A without charge before the prescribed deadline.<sup>45</sup> The MD&A contains both “reflective” and “prospective” elements.<sup>46</sup> In other words, it is a narrative analysis on the part of management as to the corporation’s financial performance as reflected in the financial statements and the firm’s likely future performance.<sup>47</sup> The MD&A plays an important public function. It assists current and future shareholders in evaluating underlying value and is particularly consequential for retail investors; in particular, investors who may require assistance in

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38. CICA, “Financial Reporting Disclosures about Social, Environmental and Ethical (SEE) Issues” (November 2004) at pp. 11-12, online: National Round Table on the Environment and the Economy <<http://www.nrtee-trnee.ca>> (accessed August 10, 2008) (CICA, “Financial Reporting Disclosures”).

39. *Ibid.*, at p. 11.

40. To be discussed in more detail below.

41. See CICA, “Financial Reporting Disclosures”, *supra*, footnote 38, at p. 12.

42. *Ibid.*

43. NI 51-102 Consolidation, *supra*, footnote 33, at p. 34, ss. 5.1(1).

44. *Ibid.*, at 17-18, s. 4.6(1).

45. *Ibid.*, at p. 37, s. 5.6(1).

46. Mary G. Condon, Anita I. Anand and Janis P. Sarra, *Securities Law in Canada: Cases and Commentary* (Toronto, Emond Montgomery, 2005), p. 362.

47. Form 51-102F1, “Management’s Discussion & Analysis”, NI 51-102 Consolidation, *supra*, footnote 33, at p. 77, part 1(a) (51-102F1).

interpreting the information contained in the financial statements.<sup>48</sup>

Form 51-102F1 provides guidance on the specifics to be included in the MD&A. Part 2, s. 1(4)(d) provides as follows:

[F]or issuers that have significant projects that have not yet generated operating revenue, describe each project, including your company's plan for the project and the status of the project relative to that plan, and expenditures made and how these relate to anticipated timing and costs to take the project to the next stage of the project plan . . .<sup>49</sup>

Instruction (ii) then gives the following clarification: “[y]our discussion under paragraph 1.4(d) should include . . . any factors that have affected the value of the project(s) such as change in commodity prices, land use or *political or environmental issues*.”<sup>50</sup> While this is the only MD&A-related provision that explicitly references the reporting of social issues, these issues could easily fall within the more general provisions. Namely, issuers must also provide information on the following:

- “known trends, demands, commitments, events or uncertainties that are reasonably likely to have an effect on your company's business;”<sup>51</sup>
- “any . . . significant factors that caused changes in net sales or total revenues;”<sup>52</sup>
- “commitments, events, risks or uncertainties that you reasonably believe will materially affect your company's future performance including net sales, total revenue and income or loss before discontinued operations and extraordinary items;”<sup>53</sup> and
- “unusual or infrequent events or transactions.”<sup>54</sup>

The CICA has provided a guidance document on the preparation of effective MD&A disclosures in the form of six organizing principles and an accompanying disclosure structure. While it is not binding on Canadian companies, the four primary regulators have urged reporting issuers to employ it as a disclosure framework.<sup>55</sup> The guidance document recommends that the MD&A should set out

48. Condon, Anand and Sarra, *Securities Law in Canada*, *supra*, footnote 46, at pp. 362-63.

49. 51-102F1, *supra*, footnote 47, at p. 82, part 2, ss. 1(4)(d).

50. *Ibid.*, part 2, s. 1(4), instruction (ii) (emphasis added).

51. *Ibid.*, at p. 80, part 2, s. 1(2).

52. *Ibid.*, at p. 82, part 2, s. 1(4)(b).

53. *Ibid.*, part 2, s. 1(4)(g).

54. *Ibid.*, part 2, s. 1(4)(j).

55. CICA, “Management's Discussion and Analysis: Guidance on Preparation and Disclosure” as cited in CICA, “Financial Reporting Disclosures”, *supra*, footnote 38, at p. 15.

pivotal performance drivers and related performance measures/indicators.<sup>56</sup> The former are defined as “those activities, competencies and qualities in which superior performance and favourable results are essential for the company, core business or segment to achieve its vision and strategic goals.”<sup>57</sup> Most importantly for the present discussion, the guidance document sets out specific examples of critical performance drivers for which performance may be gauged and reported on. Such drivers expressly include social and environmental responsibility, leadership and governance and reputation.<sup>58</sup> Moreover, while not specifically mentioned under the guidance document’s section on risk-related disclosures, social issues could very well fall within the following recommended practice:

A company should disclose its principal risks and describe related risk management systems to enable MD&A report readers to understand and evaluate the company’s risks and its decisions regarding the management of such risks. Such disclosure should include:

- the principal risks and uncertainties facing the company and its core businesses and segments, as appropriate;
- the strategies and processes employed for managing these risks; and
- the potential specific impact of these risks on results and capabilities, including capital resources and liquidity.<sup>59</sup>

### 3. The AIF

With the exception of venture issuers, Canadian public companies must file an AIF.<sup>60</sup> Similar to the prospectus, the AIF is a detailed disclosure document that is intended to set out material information about the issuer, its business operations and future prospects. The AIF also describes risks the issuer is facing and other outside factors that affect the firm.<sup>61</sup> Form 51-102F2 provides guidance on the particulars to be included in the AIF. Of the key components of periodic disclosure, this document sets out the most explicit requirements of reporting social information. As such, it is of assistance to quote the relevant provisions here; specially, ss. 5.1(1)(k), 5.1(4) and 5.2 mandate the following disclosure:

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56. *Ibid.*, at p. 16.

57. *Ibid.*, at p. 17.

58. *Ibid.*

59. *Ibid.*, at pp. 17-18. In this regard, the guidance document “emphasizes and expands upon risk disclosure requirements in the MD&A and in the AIF” (at p. 18).

60. NI 51-102 Consolidation, *supra*, footnote 33, at p. 40, s. 6.1.

61. Form 51-102F2, “Annual Information Form”, NI 51-102 Consolidation, *supra*, footnote 33, at p. 98 part 1(a).

Environmental Protection — The financial and operational effects of environmental protection requirements on the capital expenditures, earnings and competitive position of your company in the current financial year and the expected effect in future years.<sup>62</sup>

.....  
 Social or Environmental Policies — If your company has implemented social or environmental policies that are fundamental to your operations, such as *policies regarding your company's relationship with the environment or with the communities in which it does business, or human rights policies*, describe them and the steps your company has taken to implement them.<sup>63</sup>

.....  
 Disclose risk factors relating to your company and its business, such as cash flow and liquidity problems, if any, experience of management, the general risks inherent in the business carried on by your company, *environmental and health risks*, reliance on key personnel, regulatory constraints, *economic or political conditions and financial history and any other matter that would be most likely to influence an investor's decision to purchase securities of your company*. If there is a risk that securityholders of your company may become liable to make an additional contribution beyond the price of the security, disclose that risk.

#### Instructions

- (i) Disclose the risks in order of seriousness from the most serious to the least serious.
- (ii) A risk factor must not be de-emphasized by including excessive caveats or conditions.<sup>64</sup>

Further, under s. 5(1)(d), (e) and (f) reporting issuers with mineral projects must report the following information:

All environmental liabilities to which the project is subject.<sup>65</sup>

The location of all known . . . existing tailing ponds, waste deposits and important natural features and improvements.<sup>66</sup>

To the extent known, the permits that must be acquired to conduct the work proposed for the project and if the permits have been obtained.<sup>67</sup>

This provision should be read in concert with National Instrument 43-101, which sets out disclosure standards that are specific to mineral projects. Of particular note, under this instrument a reporting issuer is required to file a technical report for mineral projects on properties material to the issuer.<sup>68</sup> A report that discloses mineral reserves or resources must include, *inter alia*, “a general

62. *Ibid.*, at p. 103.

63. *Ibid.*, at p. 104 (emphasis added).

64. *Ibid.* (emphasis added).

65. *Ibid.*, at p. 106.

66. *Ibid.*

67. *Ibid.*

68. National Instrument 43-101, “Standards of Disclosure for Mineral Projects”, ss. 4.1(1), online: Ontario Securities Commission <www.osc.gov.on.ca> (NI 43-101).

discussion on the extent to which the estimate of mineral resources and mineral reserves may be materially affected by any known environmental . . . legal . . . socio-economic . . . political or other relevant issues . . .”<sup>69</sup>

Finally, while not expressly referencing social disclosure, ss. 12.1(1) to (3) and 12.2(b) of the AIF could also be of relevance; for example, with respect to human rights-related litigation or environmental/labour regulatory infractions. These provisions provide as follows:

- (1) Describe any legal proceedings your company is or was a party to, or that any of its property is or was the subject of, during your company’s financial year.
- (2) Describe any such legal proceedings your company knows to be contemplated.
- (3) For each proceeding described in subsections (1) and (2), include the name of the court or agency, the date instituted, the principal parties to the proceeding, the nature of the claim, the amount claimed, if any, whether the proceeding is being contested, and the present status of the proceeding.

**INSTRUCTION**

You do not need to give information with respect to any proceeding that involves a claim for damages if the amount involved, exclusive of interest and costs, does not exceed ten per cent of the current assets of your company. However, if any proceeding presents in large degree the same legal and factual issues as other proceedings pending or known to be contemplated, you must include the amount involved in the other proceedings in computing the percentage.<sup>70</sup>

.....

Describe

(b) any other penalties or sanctions imposed by a court or regulatory body against your company that would likely be considered important to a reasonable investor in making an investment decision<sup>71</sup>

#### 4. OSC Staff Notice 51-716

In February 2008, the Ontario Securities Commission (osc) released Staff Notice 51-716.<sup>72</sup> SN 51-716 expressly notes that NI 51-102 necessitates the disclosure of environmental-related information in a reporting issuer’s continuous disclosure documents. In order to assess compliance, the osc reviewed the financial statements, MD&As and AIFs of 35 reporting issuers from seven industries, as well as information contained on each firm’s website.<sup>73</sup>

69. Form 43-101F1, “Technical Report”, in NI 43-101, *ibid.*, s. 19(g).

70. Form 51-102F2, *supra*, footnote 61, at p. 117.

71. *Ibid.*

72. osc Staff Notice 51-716, “Environmental Reporting” (2008), 31 oscB 2220, online: Ontario Securities Commission <[www.osc.gov.on.ca](http://www.osc.gov.on.ca)> (SN 51-716).

73. *Ibid.*, at p. 2220.

The results of the study were less than encouraging. For instance, the osc found that many reporting issuers simply provided a boilerplate articulation of environment liabilities in their MD&A, with little to no analysis. Others did not review environmental estimates at all.<sup>74</sup> The majority of reporting issuers that incorporated disclosure on environmental protection requirements in their AIF neglected to quantify the relevant costs or the effect/possible effect on operational and financial results.<sup>75</sup> A number of reporting issuers did not include any significant description of environmental policies fundamental to their business operations or the steps taken to execute any such policies; other issuers simply gave generic information.<sup>76</sup> In terms of environmental risks, some issuers used standard-form language and did not quantify the associated costs. For example, rather than enumerating and discussing applicable legal provisions and measuring current and future costs of compliance, one company merely acknowledged that it would sustain penalties if it breached relevant environmental laws and stated that “there was no assurance that it could comply with these laws.”<sup>77</sup>

In each of the situations described above, the osc described the boilerplate disclosure received as “insufficient.”<sup>78</sup> This echoes the findings of a recent study conducted by the Alberta Securities Commission (ASC), which reviewed the 2007 continuous disclosure filings of reporting issuers in that province. The ASC found various

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74. *Ibid.*, at p. 2221.

75. *Ibid.*, at p. 2223. Professor Richardson has found that the requirement to disclose the material results of environmental protection requirements in the AIF has been “easily discharged with a few perfunctory words.” See Richardson, “Financing Environmental Change”, *supra*, footnote 30, at p. 196 (using Shell Canada as an example).

76. SN 51-716, *ibid.*, at p. 2224.

77. *Ibid.*

78. For commentary and a sample of the reaction to SN 51-716, see Sandra Rubin, “When osc Goes Green, Lawyers See Red”, *Globe and Mail*, March 19, 2008, online: *Globe and Mail* <<https://secure.globeadvisor.com>> (“How are we going to put metrics on that? Has the osc even thought of that? This is accountants at the osc running amok”); Terence Corcoran, “Green Boilerplate from the osc: Corcoran”, *Financial Post*, February 28, 2008, online: *Financial Post Comment* <<http://network.nationalpost.com>> (“That there might be significant costs associated with sending a new batch of environmental lawyers, accountants and consultants to dig into all kinds of potentials risks — real, hypothetical or imagined by green activists — doesn’t appear in the report”); Janet McFarland, “Clean up Environmental Disclosure: osc”, *Globe and Mail*, February 28, 2008, online: *Globe and Mail* <<http://www.theglobeandmail.com>>; Peter Brieger, “Companies Not Disclosing Enough about Environmental Risks: osc”, *Financial Post*, February 27, 2008, online: *Financial Post* <<http://www.financialpost.com>> (accessed August 5, 2008) and Gloria Gonzalez, “Disclosing Environmental Risks a Growing Concern in Canada” (2008), 42 *Business Insurance* 17.

disclosure deficiencies, including inadequate risk language in the MD&A and AIF. It cited the description of environmental risk exposure, environmental protection requirements, environmental policies and the accounting of environmental liabilities as “common deficiencies.”<sup>79</sup>

#### IV. ANALYSIS OF EXISTING REQUIREMENTS/ RECOMMENDATIONS

As mentioned above, despite the paucity of provisions that expressly reference the reporting of sustainability-related disclosure, it is clear that this information must be reported if it is material.<sup>80</sup> However, various weaknesses exist and I will now offer a set of recommendations that I hope will serve to enhance the social disclosure landscape in Canada.<sup>81</sup>

##### 1. Enhancing the AIF’s Potential

First, as noted above, the AIF is of particular importance as it articulates the most explicit social reporting requirements. However, a close reading suggests that even these provisions can (and should) be strengthened. Form 51-102F2 only requires reporting on policies fundamental to operations relating to human rights, the environment or relevant communities if they have been implemented by the issuer.<sup>82</sup> If no such policies exist, the issuer is not obliged to disclose that fact or to explain the reasons for these omissions.<sup>83</sup> This is not in line with emerging best practices in other comparable jurisdictions.<sup>84</sup>

79. Alberta Securities Commission, “Continuous Disclosure Review Program 2007 Report” (February 2008) at p. 20, online: Alberta Securities Commission <[www.albertasecurities.com](http://www.albertasecurities.com)>.

80. See also Shawn H.T. Denstedt and Scott R. Miller, “Due Diligence in Disclosing Environmental Information for Securities Transactions” (1995), 33 *Alta. L. Rev.* 231 at p. 9 of the QL version (“Notwithstanding the lack of specificity in Canada, it is clear, in the authors’ view, that environmental issues fall under those items often referred to in securities legislation as ‘Other Material Facts’”). As noted previously, the concept of materiality will be discussed in more detail below.

81. The inadequate disclosure of social information described above is symptomatic of continuous disclosure deficiencies in general. See Condon, Anand and Sarra, *Securities Law in Canada*, *supra*, footnote 46, at pp. 364 and 366 (discussing studies conducted by regulators in Alberta and Quebec).

82. 51-102F2, *supra*, footnote 61, s. 5.1(4).

83. Gil Yaron, Memorandum to osc Continuous Disclosure Advisory Committee titled “Corporate Disclosure of Material Social and Environmental Information” (June 28, 2005), at p. 6, online: SHARE <<http://www.share.ca>>.

84. Professor Williams has identified the social disclosure elements of U.K./E.U. reporting regimes as reflecting emerging best practices. See Cynthia A. Williams, Memorandum to the Expert Panel on Securities Regulation in

For example, the U.K. Companies Act 2006 received Royal Assent on November 8, 2006.<sup>85</sup> Section 417, which came into force on October 1, 2007,<sup>86</sup> explicitly requires social reporting as part of the “business review” that must form part of the director’s report.<sup>87</sup> Under it, if the prescribed information is not revealed (including policies relating to environmental, labour and social/community issues), there must be an explicit statement of what has been omitted.<sup>88</sup> Further, while Form 51-102F2 asks the issuer to describe steps taken to implement any relevant social policies, it is lacking insofar as it does not require an evaluation of their success. Again, the Canadian instrument is out of step with the U.K. equivalent, which requires consideration of the policies’ effectiveness.<sup>89</sup> In that regard, the form should be revised so that reporting issuers are asked to provide disclosure even if they have not adopted such policies and to discuss the efficacy of policies that have been implemented.<sup>90</sup>

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Canada (July 15, 2008), online: Expert Panel on Securities Regulation <<http://www.expertpanel.ca>> (“Emerging best practice in both the European Union and the United Kingdom recognizes that future risks and opportunities include significant social and environmental risks and opportunities . . . For Canada to require similar information would bring its disclosure requirements in line with emerging best practice in the developed capital markets and in line with the expectations of global institutional investors”).

85. “Explanatory Notes to Companies Act 2006”, online: Office of Public Sector Information <<http://www.opsi.gov.uk>> .

86. “The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007”, ss. 2(1)(g), online: Office of Public Sector Information <<http://www.opsi.gov.uk>> .

87. Companies Act 2006 (U.K.), 2006, c. 46, s. 417 (Companies Act 2006). The “business review” replaces the former requirement that listed corporations prepare an annual Operating and Financial Review and Directors Report (OFR). For an analysis of the social reporting elements of the OFR, and the process that led to its implementation, see Charlotte Villiers, *Corporate Reporting and Company Law* (Cambridge: Cambridge University Press, 2006), pp. 205-27; Cynthia A. Williams and John M. Conley, “An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct” (2005), 38 *Cornell Int’l L.J.* 493 and Cynthia A. Williams and John M. Conley, “Triumph or Tragedy? The Curious Path of Corporate Disclosure Reform in the U.K.” (2007), 31 *Wm. & Mary Envtl. L. & Pol’y Rev.* 317. In the latter piece, the authors opine that the Companies Act 2006 “may accomplish the same substantive ends as the OFR requirements in a more effective way” (at p. 321).

88. Companies Act 2006, *ibid.*, s. 417(5)(c).

89. *Ibid.*, s. 417(5)(b).

90. Yaron recommends the following revised wording: “Describe the extent (if it all) to which your company has implemented social or environmental policies that are fundamental to your operations, such as policies regarding your company’s relationship with the environment or with the communities in which it does business, or human rights policies, and the steps your company has taken to implement them.” Yaron, *supra*, footnote 83, at p. 19. While this is a step in the right direction, it does not address the “efficacy” issue. I would suggest wording

Second, the reporting issuer is under no legal obligation to directly distribute the AIF to its shareholders.<sup>91</sup> Even though the information it contains is sometimes included in corporate annual reports, firms are under no obligation to prepare such reports.<sup>92</sup> While many, of course, do in any event (both as a way of attracting new equity investment and as a way of reporting to existing shareholders), it is by no means guaranteed that AIF-necessary information will be included.<sup>93</sup>

Third, in addition to pointing out faulty disclosure, the OSC's SN 51-716 also serves as a reminder that certifying officers and audit committees have respective roles to play in ensuring that the information contained in continuous disclosure documents is a fair representation of a firm's financial health.<sup>94</sup> Along these lines, the annual financial statements must be audited and approved by the board of directors.<sup>95</sup> The MD&A must also receive approval from the board of directors or, in the case of an interim MD&A, the board's audit committee.<sup>96</sup> However, there is no requirement that the board

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that is in harmony with ss. 417(5) of the Companies Act 2006, which provides as follows:

(5) In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include . . .

(b) information about—

(i) environmental matters (including the impact of the company's business on the environment),

(ii) the company's employees, and

(iii) social and community issues,

including information about any policies of the company in relation to those matters and the effectiveness of those policies; and

. . . .

If the review does not contain information of each kind mentioned in paragraphs (b)(i), (ii) and (iii) . . . it must state which of those kinds of information it does not contain.

91. Condon, Anand and Sarra, *Securities Law in Canada*, *supra*, footnote 46, at p. 364 ("There is no requirement to send an AIF directly to security holders . . .").
92. National Round Table on the Environment and the Economy, "Capital Markets and Sustainability: Investing in a Sustainable Future" (February 2007) at p. 15, online: National Round Table on the Environment and the Economy <<http://www.nrtee-trnee.com>> .
93. Indeed, "the AIF is not generally distributed to shareholders, is not always presented together with the financial statements and MD&A and is not required for venture issuers." See CICA, "Financial Reporting Disclosures", *supra*, footnote 38, at p. 21. Of course, for those investors who are already anticipating this information, it is publicly available online via SEDAR (System for Electronic Document Analysis and Retrieval). See Condon, Anand and Sarra, *Securities Law in Canada*, *supra*, footnote 46, at p. 364.
94. SN 51-716, *supra*, footnote 72, at p. 2225.
95. NI 51-102 Consolidation, *supra*, footnote 33, at p. 15, s. 4.1(2) and p. 17, s. 4.5(1).

approve the AIF or that the audit committee review it.<sup>97</sup> Therefore, of the primary documents employed to meet a reporting issuer's continuous disclosure requirements, the one most central to social disclosure is subject to the least rigorous review.<sup>98</sup>

This is potentially problematic at three levels: (a) it implicitly establishes a hierarchy of information where social factors are valued less. This serves to perpetuate the misconception that such information is not material to a reporting issuer's business operations (or, at least, not *as* material); (b) given that both the MD&A and the AIF require disclosure of material risks, the corporation may be more inclined to report on this information as it relates to social disclosure in the AIF;<sup>99</sup> and (c) the requirement of board approval is useful not only in terms of ensuring the adequacy of the disclosure. For issues that may not have traditionally occupied a prominent role in internal corporate discourse (human rights, the environment etc.), it is also likely that this prescription will cause directors to consider these issues more thoroughly and to make inquiries where there are ambiguities<sup>100</sup> — thus serving to eventually normalize these topics in the overall corporate culture.

In light of points (b) and (c) above, consideration should be given to obligating the disclosure of the AIF to shareholders directly and to necessitating board or audit committee approval. In the alternative, regulators should revisit the question of what is the optimal location for sustainability disclosure in securities filings. What location will best allow shareholders to see the “bigger picture” as it pertains to this disclosure in terms of contextualizing the information within the backdrop of the business' overall financial position and future direction? Given the discussion above, it may be the case that the express sustainability disclosure provisions should be transferred from the AIF to the MD&A. Or it may be the case that the best way forward is to establish a mandatory, dedicated social disclosure instrument.<sup>101</sup>

96. *Ibid.*, at p. 36, s. 5.5(1) and p. 37, s. 5.5(3).

97. As with the financial statements and the MD&A, certifying officers must attest to the adequacy of the AIF. See Multilateral Instrument 52-109, “Certification of Disclosure in Issuers' Annual and Interim Filings”, online: Ontario Securities Commission <<http://www.osc.gov.on.ca>>.

98. CICA, “Financial Reporting Disclosures”, *supra*, footnote 38, at p. 23 (“Information provided in an MD&A, therefore, is subjected to a more rigorous review process than information provided in the AIF or the information circular, neither of which is required to be reviewed by the audit committee and approved by the board of directors”).

99. *Ibid.*

100. *Ibid.*

## 2. Interpretative Guidance

Fourth, regulators must stay apprised of social-disclosure related developments in other jurisdictions (such as the relevant provisions of the U.K. Companies Act 2006 discussed above) and continuously evaluate how/if these developments can be effectively incorporated into the Canadian framework.<sup>102</sup> They must also continue/increase efforts to provide reporting issuers with interpretive guidance on social disclosure.

With SN 51-716, the OSC has taken a step in the right direction; in particular insofar as it presents illustrations of successful disclosures. For example, with respect to the disclosure of environment liabilities in the MD&A, the notice gives an example of a reporting issuer that took great pains to discuss the issue of reclamation costs (*i.e.*, the expenses associated with returning a site to its prior condition if mineralized material is not located). The issuer began by referencing the applicable laws in various jurisdictions where its mines were located. It then discussed the difficulties of approximating reclamation costs, but proceeded to deliver an itemization of estimated costs for both closed and open mines. The issuer also set out the basis for these estimated figures and the methodology used in reaching them and ended by amortizing any shifts in its approximated expenses over the duration of the open mines' operations. The dissemination of examples such as this can be of great assistance to other issuers in compiling their disclosures. It also serves to actively validate the disclosure of the issuer that is cited.<sup>103</sup> SN 51-716 is also key for its reminder of the importance of international business activity.<sup>104</sup> This is of particular salience with respect to Canadian multinational enterprises that conduct business abroad via a

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101. *Ibid.*, at p. 31.

102. For a review of sustainability reporting in other European jurisdictions (in particular, France) see Williams and Conley, "An Emerging Third Way", *supra*, footnote 8, at pp. 504-505 ("[i]t is France . . . that has been the leader in the field of required social and environmental disclosure"). See also Lucien J. Dhooge, "Beyond Voluntarism: Social Disclosure and France's Nouvelles Regulations Economiques" (2004), 21 *Arizona Journal of International & Comparative Law* 441. For a discussion and critique of Australian requirements, see Juliette Overland, "Corporate Social Responsibility in Context: The Case for Compulsory Sustainability Disclosure for Listed Public Companies in Australia?" (September 2007), online: SSRN <<http://papers.ssrn.com>>. See also Yaron, *supra*, footnote 83, at p. 11.

103. SN 51-716, *supra*, footnote 72, at p. 2221.

104. *Ibid.*, at p. 2224 ("We are of the view that if any risks relating to environmental laws are material to an issuer's operations, *whether national or international*, the issuer should include a detailed discussion of these laws") (emphasis added).

subsidiary created in the host state. In these situations, it is important that the subsidiary's conduct be accounted for. Guidance should be taken from U.S. cases such as *In the Matter of Caterpillar Inc.*, where the Securities and Exchange Commission (SEC) found that Caterpillar Inc. had failed to provide sufficient MD&A disclosure, when it neglected to discuss material aspects of a Brazilian subsidiary's operations.<sup>105</sup>

That being said, there is also room for improvement going forward. To date, Canadian regulators have provided little specific guidance on climate change disclosure, which has assumed a heightened importance. For example, in September 2007 a broad coalition of U.S. investors (representing 1.5 trillion USD in assets) submitted a petition to the SEC asking it to provide clarification to the effect that "material climate-related information must be included in corporate disclosures under existing law."<sup>106</sup> This request for clarification was reiterated in June 2008. In a supplemental letter to the SEC, the coalition highlighted an increasing body of domestic and transnational law designed to curb greenhouse gas emissions and repeated its call for interpretative guidance.<sup>107</sup>

In that regard, the CICA has produced a discussion paper<sup>108</sup> that is currently under revision and could serve as the basis for a future staff notice that would be dedicated to providing firms with detailed guidance on their climate change-related disclosures under securities law.<sup>109</sup> The content of such disclosure might include, for example: "[p]hysical risks associated with climate change that are material to the company's operations or financial condition; [fi]nancial risks and economic opportunities associated with present or probable

105. *In the Matter of Caterpillar Inc.*, 1992 WL 71907 (March 31, 1992) at p. 8 ("[Caterpillar] should have discussed the impact of [the subsidiary] on Caterpillar's overall results of operations [and] should have discussed the future uncertainties regarding [the subsidiary's] operations, the possible risk of Caterpillar having materially lower earnings as a result of that risk and, to the extent reasonably practicable, quantified the impact of such risk").

106. See "Petition for Interpretive Guidance on Climate Risk Disclosure" (September 18, 2007) at p. 9, online: SEC <<http://www.sec.gov/rules/petitions/2007/petn4-547.pdf>>.

107. See coalition letter to the SEC (June 12, 2008), online: Investor Network on Climate Risk <[www.ceres.org](http://www.ceres.org)>. For a discussion of U.S. securities law obligations as they relate to climate change-related disclosure see Perry E. Wallace, "Climate Change, Fiduciary Duty, and Corporate Disclosure: Are Things Heating up in the Boardroom?" (2008), 26 Va. Env'tl. L.J. 293.

108. Canadian Performance Reporting Board, "MD&A Disclosure about the Financial Impact of Climate Change and other Environmental Issues" (October 2005), online: Canadian Institute of Chartered Accountants <<http://www.cica.ca>>.

109. Letter of the Social Investment Organization to the Ontario Securities Commission (April 21, 2008), online: sio <<http://www.socialinvestment.ca>>.

greenhouse gas regulation; [and] [l]egal proceedings relating to climate change.”<sup>110</sup> In designing such a notice, regulators should also draw from the work of the Global Framework for Climate Risk Disclosure. Established by a group of leading institutional investors, the framework has produced a guide that provides corporations with particulars on how to best report on certain elements of climate change.<sup>111</sup> Regard should also be had for the Greenhouse Gas Protocol’s “Corporate Accounting and Reporting Standard” (which sets out advice and standards for businesses on accounting for and reporting on the six greenhouse gases addressed under the Kyoto Protocol)<sup>112</sup> and the International Organization for Standardization’s recently published standards for greenhouse gas accounting and verification (which extend guidance on the quantification and reporting of emissions and emission reductions at the project and organizational levels, as well as the validation/verification of assertions).<sup>113</sup>

Similarly, Canadian regulators have also provided little assistance on the disclosure of material risks associated with human rights and economic/political conditions. This deficiency must be remedied given the linkages increasingly made between Canadian corporate operations overseas and human rights deprivations.<sup>114</sup> As a starting point, while I have argued that human rights-related risks undoubtedly fall under the existing social disclosure provisions, for the purposes of clarity I recommend that ss. 5.2 of Form 51-102F2 be amended to specifically include them (*i.e.*, in addition to the currently enumerated “environmental and health risks,” “economic or political conditions” etc.).<sup>115</sup>

### 3. Regular Reviews of Continuous Disclosure Filings

Further (and hand in hand with the recommendation of providing more fulsome interpretative guidance), as was done by the OSC in SN

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110. See “Petition for Interpretive Guidance on Climate Risk Disclosure”, *supra*, footnote 106, at p. 9.

111. “Using the Global Framework for Climate Risk Disclosure: Guide to Disclosing Climate Risk to Investors” (October 2006), online: CalPERS Shareowner Forum <<http://www.calpers-governance.org>>.

112. Greenhouse Gas Protocol, “A Corporate Accounting and Reporting Standard” (revised edition, March 2004), online: Greenhouse Gas Protocol Initiative <<http://www.ghgprotocol.org>>.

113. “New iso 14064 Standards Provide Tools for Assessing and Supporting Greenhouse Gas Reduction and Emissions Trading” (March 3, 2006), online: International Organization for Standardization <<http://www.iso.org>>.

114. See Dhir, “The Politics of Knowledge Dissemination”, *supra*, footnote 9, at pp. 6-8.

115. Form 51-102F2, *supra*, footnote 61, at p. 104.

51-716 with respect to environmental disclosures, regulators should conduct regular reviews of continuous disclosure filings that specifically focus on human rights-related risks.<sup>116</sup> For this recommendation, I offer two comments.

To begin, regulators typically conduct periodic reviews, which were harmonized by the CSA in 2004.<sup>117</sup> After a problem with a reporting issuer's continuous disclosure is identified, it is brought to the issuer's attention via a comment letter that asks the issuer either to address the error or to submit a reply explaining why corrective action is not necessary. If a resolution cannot be reached, enforcement action will be considered.<sup>118</sup> In 2004, the U.S. Government Accountability Office recommended that all SEC comment letters, and the responses of issuers, should be made fully available to the public in the form of a searchable electronic database.<sup>119</sup> The SEC subsequently adopted this recommendation.<sup>120</sup> However, using the osc's website as a case study, only a summary of the deficiency is made available, as well as the issuer's post-correction press release.<sup>121</sup> Posting the osc's actual comment letter, and any response received, would help to ensure that investors/the public and other issuers fully understand the substance and conclusions of regulatory continuous disclosure reviews and would assist civil society and academia in

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116. Other issued-oriented reviews have been conducted in the past pertaining to executive compensation disclosure and income trusts. See CSA Staff Notice 51-304, "Report on Staff's Review of Executive Compensation Disclosure" (November 2002), online: Ontario Securities Commission <<http://www.osc.gov.on.ca>> and CSA Multilateral Staff Notice 51-310, "Report on Staff's Continuous Disclosure Review of Income Trust Issuers" (February 13, 2004), online: Ontario Securities Commission <<http://www.osc.gov.on.ca>>. Given that organisations such as the ones cited above (the CICA, the CGA, the Conference Board etc.) already have experience and established methodologies for conducting similar sorts of reviews, it may be most efficient for regulators to work in partnership with them. Further, it may be of assistance to establish linkages with, and to enlist support of, securities experts in academia.

117. CSA Staff Notice 51-312, "Harmonized Continuous Disclosure Review Program" (July 16, 2004), online: Ontario Securities Commission <[www.osc.gov.on.ca](http://www.osc.gov.on.ca)>.

118. *Ibid.*, at p. 6477.

119. United States Government Accountability Office, "Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information" (July 2004) at pp. 36-37, online: United States Government Accountability Office <<http://www.gao.gov>> (GAO, "Environmental Disclosure").

120. See "SEC Staff to Begin Publicly Releasing Comment Letters and Responses" (May 9, 2005), online: SEC <<http://www.sec.gov>>.

121. "Reporting Issuers Refilings and Errors List", online: Ontario Securities Commission <<http://www.osc.gov.on.ca>>; telephone conversation with osc Inquiries Officer Scott Murray (July 31, 2008) (confirming that comment letters and responses are not made publicly available on the osc's website).

conducting more meaningful reviews and evaluations of corporate disclosure.<sup>122</sup>

In addition, with respect to material human rights reporting, it can no longer be credibly argued that appropriate benchmarks do not exist. The Global Reporting Initiative's (GRI) "G3 Guidelines" contain a set of human rights-specific performance indicators that facilitate disclosure relating to the effects of a firm's operations on the rights of its stakeholders. Based on the United Nations international human rights framework, the indicators cover investment processes, discrimination, collective bargaining/freedom of association, forced labour, child labour, security processes and the rights of indigenous peoples.<sup>123</sup> Taking investment as an example, among other things, the reporter is asked to disclose the number of significant/material investment agreements entered into and how those agreements incorporate provisions relating to human rights or whether they have been through a process of human rights-related screening.<sup>124</sup>

The need for regulatory intervention is underscored by the fact that the CGA study discussed above found that slightly less than one-quarter of participating firms were even cognizant of the GRI and its work.<sup>125</sup> As noted by the CGA, "[t]his outcome demonstrates that the GRI is still relatively unknown amongst a majority of publicly-traded companies in Canada."<sup>126</sup> And yet approval of the GRI is considerable amongst numerous other actors. Support for the reporting framework has been expressed by the CGA,<sup>127</sup> the CICA,<sup>128</sup> Stratos

122. GAO, "Environmental Disclosure", *supra*, footnote 119, at p. 36.

123. Global Reporting Initiative, "Human Rights Performance Indicators" (2006) at pp. 1-2, online: GRI <<http://www.globalreporting.org>>.

124. *Ibid.*, at p. 3. A recent study conducted by the GRI and the Roberts Environmental Center surveyed the human rights-related reporting of 100 global corporations. Of the nine performance indicators set out in the G3 Guidelines, four were omitted completely by approximately 50% of the respondents. Further, when "strict compliance with quantitative G3 Human Rights Performance Indicators was examined, fully conforming reporting was found in only 7% of possible cases for companies who declared use of G3 Guidelines and 2% for other companies." See Global Reporting Initiative, "Reporting on Human Rights" (2008), online: GRI <<http://www.globalreporting.org>>.

125. See CGA, "Measuring Up, Part 2", *supra*, footnote 12, at p. 54.

126. *Ibid.* More recently, there are signs that a growing number of Canadian reporting issuers are using the GRI reporting framework. However, this is still limited to less than one half of issuers that actually engage in sustainability reporting. And even of these issuers, the most recent studies indicate that over 85% are not using the most recent version of the framework. See Stratos, "Canadian Corporate Sustainability Reporting", *supra*, footnote 20, at p. 4.

127. Certified General Accountants Association of Canada, "Measuring Up: A Study on Corporate Sustainability Reporting in Canada" (2005), Part 4, at p. 81, online: Certified General Accountants Association of Canada <[www.cga-canada.org](http://www.cga-canada.org)> ("the Sustainability Reporting Guidelines . . . provided by the

Inc.,<sup>129</sup> the National Round Table on the Environment and the Economy,<sup>130</sup> the Canadian social investment community<sup>131</sup> and Canadian academics.<sup>132</sup> Internationally, in 2007 Sweden became the first government to require state-owned firms to report annually on sustainability issues using the GRI framework.<sup>133</sup> Beginning in 2003, South Africa's Johannesburg Securities Exchange began requiring listed corporations to report on environmental and social issues using the GRI structure as a reference tool.<sup>134</sup>

#### 4. A Comment on Enforcement

Before proceeding to the fifth recommendation, I should comment briefly on the issue of enforcement. One possible strategy for

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- Global Reporting Initiative . . . represent the best framework for achieving necessary standardization”).
128. The CICA was a GRI founding member. See “Canada’s CAS Support Integrating Environment and Social Issues into Corporate Reporting” (February 12, 2007), online: Canadian Institute of Chartered Accountants <<http://www.cica.ca>> .
  129. Stratos, “Corporate Disclosure and Capital Markets”, *supra*, footnote 20, at p. 39 (“In their sustainability reports or integrated reports, companies should consider following the international guidelines being developed by the Global Reporting Initiative . . . In a very pronounced trend, the best sustainability reporters internationally are increasingly modeling their reports on the GRI”).
  130. National Round Table, “Capital Markets and Sustainability”, *supra*, footnote 92, at p. 32 (“Recommendation 5.3[.]: That the Canadian Securities Administrators encourage the disclosure of financially material ESG issues through publication of a guidance or interpretation statement and encourage Canadian firms to be guided by established reporting frameworks such as the Global Reporting Initiative”).
  131. Social Investment Organization, “Written Submission to the National Roundtables on Corporate Social Responsibility and the Canadian Extractive Sector in Developing Countries” (September 13, 2006) at p. 5, online: <<http://geo.international.gc.ca>> (“Provincial securities acts could be amended to require publicly listed companies to report to the GRI framework. The Canadian Securities Administrators could approve similar regulations. However, the federal government also could have a potential role to play in this by requiring . . . that all publicly listed companies chartered under the Canada Business Corporations Act . . . be required to issue annual GRI reports”).
  132. In focusing on the Canadian upstream petroleum industry, a recent study concluded that of the existing sustainability reporting frameworks the “GRI Guidelines provide the best umbrella framework and the most credible general system for reporting.” See Irene Herremans *et al.*, “Sustainability Reporting in the Upstream Petroleum Industry in Canada” (January 15, 2007) at p. 4, online: Institute for Sustainable Energy, Environment and Economy <<http://www.i-see.ca>> (stating, as well, the need for a sector supplement on the petroleum industry).
  133. “Sweden Pioneers a Global First in Sustainability Reporting” (2007), online: Global Reporting Initiative <<http://www.globalreporting.org>> .
  134. Sarah Joseph, *Corporations and Transnational Human Rights Litigation* (Oxford: Hart Publishing, 2004), p. 110.

achieving enhanced social disclosure is to insist that regulators take steps towards more robust forms of enforcement, including “initiating a high-profile enforcement action.”<sup>135</sup> Along these lines, commentators have noted that “[i]n Canada, only a single [enforcement] case involving environmental disclosure was brought by securities regulators within a period of twenty-five years” and have argued that this has had the effect of softening regulatory compliance and perpetuating the misconception that environmental/social information is not material.<sup>136</sup> While I sympathize with this argument and would certainly advocate stronger enforcement measures as a long-term strategy,<sup>137</sup> I am not convinced that this is the best way to proceed at the current juncture. For the present, I am of the view that more is to be gained by a combination of rigorous interpretative guidance and issue-specific monitoring/reviews of continuous disclosure filings that focus on human rights-related risks. Before proceeding to more austere deterrence-based measures, more needs to be done in terms of assisting issuers to understand the nature of their continuous disclosure obligations with respect to social information. This approach is in harmony with the compliance-based strategy most recently (and persuasively) recommended by Professor Condon<sup>138</sup> and the growing body of

135. CICA, “Financial Reporting Disclosures”, *supra*, footnote 38, at p. 29. See also National Round Table, “Capital Markets and Sustainability”, *supra*, footnote 92, at p. 32 (“Recommendation 5.4[:] That securities regulators . . . when required, enforce the [environmental, social and governance] disclosure requirement”).

136. Repetto, “Silence is Golden”, *supra*, footnote 22, at p. 21. See also Robert Repetto, Andrew MacSkimming and Gustavo Carvajal Isunza, “Environmental Disclosure Requirements in the Securities Regulations and Financial Accounting Standards of Canada, Mexico and the United States” (March 25, 2002), at pp. 16-19, online: Commission for Environmental Cooperation <<http://www.cec.org>> (discussing *Sheridan (Re)* (1993), 16 O.S.C.B. 6345). The argument for more robust forms of enforcement engages the systemic problems associated with capital markets enforcement in Canada. For a discussion of these issues, and accompanying recommendations, see the Hon. Peter de C. Cory and Marilyn L. Pilkington, “Critical Issues in Enforcement” (paper commissioned by the Task Force to Modernize Securities Legislation in Canada, September 2006), online: Task Force to Modernize Securities Legislation in Canada <<http://www.tfmsl.ca>>.

137. See Condon, Anand and Sarra, *Securities Law in Canada*, *supra*, footnote 46, at p. 372 (“Even with codification, there will . . . be issuers who use any malleability or lack of clarity in reporting requirements to shirk their obligations . . . Hence, enforcement . . . is essential to the integrity of the system”).

138. Mary Condon, “Rethinking Enforcement and Litigation in Ontario Securities Regulation” (2006), 32 *Queen’s L.J.* 1 at pp. 5 and 42 (“in order to be more effective, deterrence-based enforcement efforts, such as after-the-fact sanctioning, should be re-oriented towards strategies for developing ‘compliance cultures’ within market participants”; “[w]ith respect to public enforcement of securities

law and society work that questions the efficacy of enforcement motivated by deterrence aims.<sup>139</sup>

### 5. Education on the Materiality of Social Information to Firm Valuation

Fifth, and finally, securities regulators should work in collaboration with interested stakeholders (*e.g.*, both levels of government, the CICA, civil society organizations etc.) to design a program that will educate Canadian companies on the materiality of social information to firm valuation.<sup>140</sup> It is clear that a widespread connection has not yet been made by members of industry. Consider the following comments of the Canadian Bankers Association, made when NI 51-102 was in its developmental stages and feedback on the instrument was being solicited:

The proposed AIF requirements deal with disclosing an issuer's social and environmental policies. The Purpose of such disclosure is unclear . . . Since information in the AIF is generally of a financial, operational and governance nature, the requirement inappropriately expands the scope of the AIF. *Additional non-material information should not be required disclosure in a document such as the AIF . . .*<sup>141</sup>

In order to adequately advance this recommendation, it is necessary to take a step back for a moment and to consider the concept of materiality in its broader context. Materiality is central to securities regulation as it is the standard that facilitates a determination of what information must be disclosed by a public corporation.<sup>142</sup> It is broadly recognized that in order to make informed decisions regarding equity investment, investors should have available to them all material information.<sup>143</sup> Internationally, the majority of (and perhaps all) public markets are disclosure-based. This design permits the issuance and trading of securities only if the

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law by the osc, I argue that there is insufficient evidence that deterrence is an effective regulatory strategy to justify the weight that is currently placed on it in sanctioning, at both the administrative and criminal levels”).

139. See the discussion in Condon, *ibid.*, at pp. 30-34 and, in particular, note 33 (“a more specific set of regulatory requirements and/or more pervasive monitoring by regulatory agents is required to reorient the ‘culture’ of such firms”).

140. National Round Table, “Capital Markets and Sustainability”, *supra*, footnote 92, at p. 32.

141. Letter of the Canadian Bankers Association to provincial regulators (August 27, 2003), online: Ontario Securities Commission <<http://www.osc.gov.on.ca>> (emphasis added).

142. Condon, Anand and Sarra, *Securities Law in Canada*, *supra*, footnote 46, at p. 224.

143. Repetto *et al.*, “Environmental Disclosure Requirements”, *supra*, footnote 136, at p. 1.

issuing company has met transparency requirements.<sup>144</sup> The disclosure of such information is integral to shielding investors from fraud and to capital markets efficiency. Information asymmetries may result in the incorrect pricing of securities and the practice of incomplete disclosure may serve to cloak malfeasance.<sup>145</sup> Using material information, markets must be able to adequately express firm exposures as an evaluation of economic risk and value.<sup>146</sup>

Materiality — and, specifically, what should be characterized as material information, material fact and material change — has particular importance *vis-à-vis* prospectus requirements.<sup>147</sup> But it is also a foundational notion in the continuous disclosure regime, most notably in the context of a reporting issuer's obligation to disclose material changes in the affairs of its business.<sup>148</sup> Most importantly for present purposes, Forms 51-102F1 and 51-102F2 advise issuers to include in the MD&A and AIF only material information,<sup>149</sup> which is defined in both documents as follows: “[w]ould a reasonable investor's decision whether or not to buy, sell or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated? If so, the information is likely material.”<sup>150</sup>

There is no objective measure for establishing materiality — it is a social construction, shaped by socio-economic context.<sup>151</sup> In that regard, it is noteworthy that both Forms articulate a “reasonable investor test” for determining materiality (in harmony with the U.S. approach), rather than a “market impact test” which is routinely applied in provincial securities legislation outside of Quebec.<sup>152</sup> The

144. Sarra, “Disclosure as a Public Policy Instrument”, *supra*, footnote 30, at p. 876.

145. Repetto *et. al.*, “Environmental Disclosure Requirements”, *supra*, footnote 136, at p. 1.

146. Repetto, “Silence is Golden”, *supra*, footnote 22, at p. 16.

147. For a more detailed discussion of this issue, see Five Year Review Committee, *Final Report*, *supra*, footnote 8, at pp. 142ff.

148. NI 51-102 Consolidation, *supra*, footnote 33, at p. 40, s. 7.1.

149. 51-102F1, *supra*, footnote 47, at p. 82, part 1(e); Form 51-102F2, *supra*, footnote 61, at p. 98, part 1(d).

150. 51-102F1, *ibid.*, at p. 82, part 1(f); Form 51-102F2, *ibid.*, at p. 99, part 1(e). The CICA guidance document recommends that “[m]anagement should resolve any doubt about materiality in favour of disclosure”. See CICA, “Management's Discussion and Analysis: Guidance on Preparation and Disclosure” as cited in CICA, “Financial Reporting Disclosures”, *supra*, footnote 38, at p. 16.

151. Margaret V. Sachs, “Materiality and Social Change: The Case for Replacing ‘the Reasonable Investor’ with ‘the Least Sophisticated Investor’ in Inefficient Markets” (2006), 81 Tul. L. Rev. 473 at p. 483 (“Different eras have given rise to different standards of materiality”).

152. Five Year Review Committee, *Final Report*, *supra*, footnote 8, at p. 148.

latter test is exemplified by the definition of “material fact” in s. 1(1) of the OSA: “a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.”<sup>153</sup> There is, of course, the potential for significant overlap between the two tests. A reasonable investor’s decision whether or not to buy, sell or hold securities (*i.e.*, the reasonable investor test, applicable to the MD&A and AIF) will invariably be influenced by whether the relevant information will have a significant effect on the value of the security (*i.e.*, the market impact test). However, it can also be argued that the reasonable investor test is distinguishable from the market impact test because it opens the door to considering information that may not be directly linked with the security’s market value. The former test has the potential to engage the investment decision-making process outside of the traditional contours of market price — in other words, outside of the realm of rational choice theory that characterizes the neoclassical economic paradigm and into the realm of “irrational” factors that may inform an investment decision and are accounted for under a behavioral finance approach.<sup>154</sup>

It is tempting to advocate in favour of sustainability reporting as a function of the arguably more broad reasonable investor test that accompanies the MD&A and AIF. My preference, however, is to be more cautious. Even if we assume a more rigid test (*i.e.*, one that equates a reasonable investor’s decision solely with value maximization), there is a growing body of literature establishing a nexus between a firm’s social performance and its profitability, thus bringing social information under the umbrella of materiality. The reporting of social information should be viewed as an integral part of a business’ overall risk management strategy. With this information, shareholders are in a better position to assess pecuniary risks and to allocate capital to firms that are best suited to mitigate these risks. Consider environmental and human rights-related information as examples:

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153. OSA, *supra*, footnote 8, s. 1(1).

154. See, for example, John R. Nofsinger, *The Psychology of Investing*, 3rd ed. (Upper Saddle River, NJ, Pearson Prentice Hall, 2007). Over 30 years ago, Amartya Sen offered a biting critique of traditional economic theory’s reductionist account of human behavior: “The *purely* economic man is indeed close to being a social moron. Economic theory has been much preoccupied with this rational fool decked in the glory of his *one* all-purpose preference ordering. To make room for the different concepts related to his behavior we need a more elaborate structure.” See Amartya K. Sen, “Rational Fools: A Critique of the Behavioral Foundations of Economic Theory” (1977), 6 *Philosophy & Public Affairs* 317 at p. 336 (emphasis in original).

Such information is crucial for investors because the value of securities depends on the stream of future returns and their riskiness. In many industries, future returns and risks are significantly affected by environmental exposures. Because these are inadequately disclosed and analyzed, investors often suffer sudden and significant losses when those risks materialize. Most of these occurrences were the culmination of environmental exposures and risks that existed beforehand but were not disclosed and were not understood by investors, who consequently suffered serious losses.<sup>155</sup>

[C]orporations which violate human rights face higher insurance costs, lawsuits in tort and the risk of paying settlements or damages payments. Human rights abuse creates a riskier political climate which can cause rioting, leading to destruction of corporate property and the possible nationalization of business assets. Such risks are not just intolerable to individual investors; they also poison the capital market generally and discourage efficient capital formation. Companies which violate human rights laws risk investors' assets for questionable gains. They seek to externalize costs resulting in diseconomies to the detriment of the market. Given these concrete economic costs, investors have a right to know about the labor, environmental, and human rights practices of their company.<sup>156</sup>

Along these lines, two recent and relevant U.S. examples include the operations of Chevron in the Ecuadorian Amazon and those of Dow Chemical in India. Non-governmental organization Amazon Watch has accused Chevron of providing insufficient disclosure and misrepresenting material information regarding a possible \$10 billion liability that stems from oil-related environmental litigation pursued by Amazon residents in Ecuador. It has further asked the SEC to impose sanctions on the corporation.<sup>157</sup> Further, Amnesty International has alleged that Dow has not disclosed information relating to its belief that pending legal liabilities regarding the Bhopal chemical disaster are an impediment to the company's continued expansion in India.<sup>158</sup> Correspondingly, it has asked the SEC to launch an official investigation.

Returning to the substance of recommendation five, in establishing an educative program for reporting issuers on the

155. Repetto, "Silence is Golden", *supra*, footnote 22, at p. 19.

156. Eric Engle, "What You Don't Know Can Hurt You: Human Rights, Shareholder Activism and SEC Reporting Requirements" (2006), 57 Syracuse L. Rev. 63 at p. 66.

157. See "SEC Complaint Lodged against Chevron for Hiding \$10 Billion Liability in Ecuador" (March 26, 2008), online: Amazon Watch <<http://amazonwatch.org>>.

158. See "Amnesty International Seeks SEC Investigation of Dow Chemical" (April 12, 2007), online: Amnesty International USA <<http://www.amnestyusa.org>> ("Looking at these letters, it seems that Dow's refusal to address the human rights of the Bhopal survivors may be having a serious, but undisclosed, financial impact").

materiality of information that has not historically been characterized as such, it will be essential to expose issuers to compelling, persuasive research. I have canvassed some of the relevant academic literature elsewhere<sup>159</sup> and will now mention only three recent (and related) United Nations studies. In 2004, the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (UNEPFI) published a groundbreaking study titled “The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing”. Eleven reports from nine brokerage houses were produced for the study, which analyzed the materiality of environmental, social and corporate governance (ESG) factors to corporate reputation and competitiveness in seven industry sectors. Each report found that ESG considerations have an impact on long-term shareholder value, sometimes at a profound level.<sup>160</sup> Most importantly for present purposes, as a result of the findings the UNEPFI encouraged regulators to “[u]pdate their regulations of . . . financial materiality to include consideration of material environmental, social and corporate governance issues . . . [and] [u]pdate financial disclosure regulations for companies and stock exchanges to require specific disclosure of environmental, social and corporate governance criteria.”<sup>161</sup> Interestingly, no Canadian or U.S. brokerage houses agreed to participate in the study, citing, among other things, problems with

159. See Aaron A. Dhir, “Realigning the Corporate Building Blocks: Shareholder Proposals as a Vehicle for Achieving Corporate Social and Human Rights Accountability” (2006), 43 *American Business Law Journal* 365 at pp. 371-73 and Aaron A. Dhir, “Of Takeovers, Foreign Investment and Human Rights: Unpacking the Noranda-Minmetals Conundrum” (2006), 22 *Banking and Finance Law Review* 77 at pp. 96-99. See also: Conference Board of Canada, “The Role of the Board of Directors in Corporate Social Responsibility” (June 2008) at p. 11 (citation omitted) (“The CSR business case documented in the literature includes enhanced reputation, improved brand equity, minimized operational risks, improved productivity, ability to attract and retain talent, greater efficiency, enhanced customer and regulator relations, improved access to capital, broadened social licence to operate, increased innovation, and overall enhanced competitive positioning. Much research to date highlights the growing view that CSR issues are material to a company’s bottom line . . .”); the studies referenced by Herremans *et al.*, *supra*, footnote 132, at p. 9 (“up to 50 percent of a traditional company’s value . . . can be determined by assessing . . . non-financial factors”); the studies referenced in David Hess, “Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development” (2007), 2 *Va. L. & Bus. Rev.* 221 at p. 229, n. 41; and Yaron, *supra*, footnote 83, at pp. 12-13.

160. UNEPFI, “The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing” (June 2004) at p. 4, online: UNEPFI <<http://www.unepfi.org>> .

161. *Ibid.*, at p. 5.

data analysis due to barriers preventing sufficient disclosure of these factors (*i.e.*, we cannot participate in a study to address social disclosure because the information is not available due to perceived governmental/regulatory encumbrances).<sup>162</sup>

In 2005, Freshfields Bruckhaus Deringer (Freshfields) produced a report for the UNEPFI that considered the fiduciary duties of trustees with respect to institutional investment funds. Specifically, the UNEPFI asked Freshfields to consider whether incorporating ESG factors into investment decision-making (*e.g.*, portfolio construction, asset allocation, stock-picking) is “voluntarily permitted, legally required or hampered by law and regulation.”<sup>163</sup> In reviewing seven major jurisdictions (both common and civil law), the report concluded as follows:

In our view, decision-makers are required to have regard (at some level) to ESG considerations in every decision they make. This is because there is a body of credible evidence demonstrating that such considerations often have a role to play in the proper analysis of investment *value*. As such they cannot be ignored, because doing so may result in investments being given an inappropriate value.

. . . [T]he links between ESG factors and financial performance are increasingly being recognised. On that basis, integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions.<sup>164</sup>

Finally, building on the first two studies, in a 2006 report the UNEPFI further analyzed the relevance of ESG metrics to firm valuation. It found “robust evidence” that such metrics impact long and short-term shareholder value both positively and negatively and that this impact can be measured using a spectrum of valuation tools. The findings were the result of analysis conducted by “established financial analysts” and were supported by an arms-length investment consultant.<sup>165</sup>

162. *Ibid.*, at p. 8.

163. Freshfields Bruckhaus Deringer, “A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment” (October 2005) at p. 6, online: UNEPFI <<http://www.unepfi.org>>.

164. *Ibid.*, at pp. 10, 11 and 13 (emphasis in original).

165. UNEPFI, “Show Me the Money: Linking Environmental, Social and Governance Issues to Company Value” (2006) at p. 11, online: UNEPFI <<http://www.unepfi.org>>. In addition to studies establishing a correlation between social and economic performance, other bodies of literature will be a useful addition to any educative program. For example, the global not-for-profit AccountAbility has offered a framework/methodology for assisting businesses in identifying and evaluating material sustainability-related considerations. See AccountAbility, “The Materiality Report” (November 2006) at pp. 31ff, online: AccountAbility <<http://www.accountability.org>>.

Before closing this section, I should note that any educative program for reporting issuers should also involve a candid discussion of industry concerns with managing associated costs. “[D]isclosure is not costless”<sup>166</sup> and strengthening social disclosure will certainly trigger additional expenditures in terms of information production and verification. Given the literature establishing a connection between firm social and financial performance, it is increasingly difficult to argue that this disclosure will be relevant to only a small, select group of investors (and thus that the costs are not justified). Further, it should be noted that sustainability reporting has the potential to yield various financial benefits. For example, gains arising from strengthened ties with significant end purchasers, suppliers and workers; a more nuanced comprehension of possible liabilities;<sup>167</sup> decreased insurance and debt financing costs;<sup>168</sup> less share price fluctuation;<sup>169</sup> and achieving societal licence for operating practices/enhanced reputational capital. Thus, “[f]rom a corporate strategy perspective, the costs . . . may not be considered costs at all, but rather an investment with returns paid in several different forms.”<sup>170</sup> That having been said, following the U.K. approach, limits might be placed on which firms must provide such disclosure

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[www.accountability21.net](http://www.accountability21.net) > . See also Simon Zadek and Mira Merme, “Redefining Materiality: Practice and Public Policy for Effective Corporate Reporting” (July 2003), online: AccountAbility, <<http://www.accountability21.net>> (advancing four proposals for the implementation of a redefined conception of materiality). Further, in the Canadian context, Denstedt and Miller offer excellent practical advice on the process of conducting an environmental due diligence review in order to ensure that material information is not omitted. See Denstedt and Miller, *supra*, footnote 80, at p. 19ff.

166. Anita I. Anand, “An Analysis of Enabling vs. Mandatory Corporate Governance: Structures Post-Sarbanes-Oxley” (2006), 31 *Del. J. Corp. L.* 229 at p. 248.

167. Hess, “Social Reporting”, *supra*, footnote 6, at p. 81.

168. Yaron, *supra*, footnote 83, at p. 18.

169. Allen L. White, “New Wine, New Bottles: The Rise of Non-Financial Reporting” (June 20, 2005) at p. 3, online: GRI <<http://www.globalreporting.org>> (citation omitted).

170. Hess, “Social Reporting”, *supra*, footnote 6, at p. 81. For an exploration of the relationship between social disclosure and market reaction in the United Kingdom, see Alan Murray *et al.*, “Do Financial Markets Care about Social and Environmental Disclosure?” (2006), 19 *Accounting, Auditing & Accountability Journal* 228 at pp. 245-46: “The most important [result] was that, over a period of time, total social and environmental disclosure is significantly related to market returns even after adjusting for the size effect . . . we can conclude that companies . . . with consistently lower returns are likely to have consistently lower levels of total and voluntary social and environmental disclosure . . . Equally, companies with consistently higher returns are likely to have consistently higher levels of total and voluntary social and environmental disclosure . . . On the evidence . . . we cannot infer that such disclosures are wastefulness on the part of management, which are ignored or discounted by the market.”

according to size/market capitalization (*i.e.*, in order to protect smaller issuers).

## V. CONCLUDING REMARKS

Despite the lack of explicit provisions, there is undoubtedly sufficient basis to compel the reporting of material sustainability-related information under Canadian securities law. However, various weaknesses exist in the legal framework. These weaknesses, coupled with how the existing law has been interpreted, stifle the potential of existing provisions. In this paper, I have offered a set of recommendations that I hope will strengthen the legal regime. Many important questions remain. For example, when company officers go through the process of determining what information is material they are exercising their discretion, which is to be informed by legal standards. What exactly is the relationship between these decisions regarding disclosure and the business judgment rule?<sup>171</sup> Do adequate procedures exist for the external, independent verification of reported social information? While “[t]here are authoritative interpretations of accounting standards [regarding] the correct accounting treatment . . . of many environmental issues,”<sup>172</sup> accounting practices *vis-à-vis* other ethical/social issues are still evolving.<sup>173</sup> Will this development proceed in a satisfactory manner only as a result of enhanced mandatory disclosure?<sup>174</sup> Should there be a heightened role for non-governmental organizations in the auditing

171. The content and application of the business judgment rule is a somewhat nuanced issue. At a general level, it is understood as the principle that courts should afford deference to the business decisions of corporate directors and officers. See *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461 at para. 64, 244 D.L.R. (4th) 564. The Supreme Court of Canada recently stated that the business judgment rule does not apply in ascertaining whether a corporation has met its disclosure obligations under the OSA. Disclosure, it wrote, is an issue of legal obligation, not business judgment. See *Kerr v. Danier Leather Inc.*, [2007] 3 S.C.R. 331 at paras. 54-58, 286 D.L.R. (4th) 601. Arguably, however, this statement was in *obiter* as strictly speaking the court did not need to entertain this issue.

172. CICA, “Financial Reporting Disclosures”, *supra*, footnote 38, at p. 11.

173. *Ibid.*, at p. 12, n. 10. See also David L. Owen and Brendan O’Dwyer, “Corporate Social Responsibility: The Reporting and Assurance Dimension” in Andrew Crane *et al.*, eds., *The Oxford Handbook of Corporate Social Responsibility* (New York: Oxford University Press, 2008), p. 384 at pp. 403-404 (“The . . . studies considered . . . suggest that sustainability assurance practice is characterized by inconsistencies in approach [However,] [s]ome hope for improvement is offered by ongoing attempts to develop comprehensive assurance standards that combine the procedural and presentational rigor of ISAE 3000 with the emphasis on stakeholder responsiveness of AA1000 . . .”).

174. As suggested by Yaron, *supra*, footnote 83, at p. 17.

process?<sup>175</sup> Is there a risk of “informational overload,” where an overabundance of material may result in detrimental effects, including decisions of poor quality?<sup>176</sup>

These are some of the questions that will need to be further engaged as regulators progress in addressing potential information asymmetries by strengthening Canada’s disclosure regime. A recent survey of Canadian businesses suggests that firms are demonstrating a marked improvement in reporting to investors on corporate governance issues.<sup>177</sup> It is hoped that social disclosure will be the next step in this trend.

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175. As suggested, for example, by the European Coalition for Corporate Justice. See European Coalition for Corporate Justice, “Fair Law: Legal Proposals to Improve Corporate Accountability for Environmental and Human Rights Abuses” (May 29, 2008) at p. 32, online: ECCJ <<http://www.corporatejustice.org>>.

176. Paula J. Dalley, “The Use and Misuse of Disclosure as a Regulatory System” (2007), 34 Fla. St. U. L. Rev. 1089 at p. 1115.

177. Janet Mcfarland, “Business Gets Better at the Business of Disclosure”, *The Globe & Mail*, November 26, 2007, online: Globe & Mail <[www.theglobeandmail.com](http://www.theglobeandmail.com)>.