



# Climate Change – Securities Related Disclosure Requirements

By Ron Ezekiel & Georald Ingborg  
October 13, 2004



**Climate Change Central**

Made available through a sponsorship from  
Climate Change Central

FASKEN  
MARTINEAU 



**Climate Change Central**

<b>I. INTRODUCTION.....</b>	<b>1</b>
<b>II. SECURITIES DISCLOSURE REQUIREMENTS .....</b>	<b>3</b>
Purpose of Disclosure Requirements.....	3
Overview of Disclosure Requirements.....	3
New Implications for Failure to Disclose.....	5
<b>III. CLIMATE CHANGE RISKS .....</b>	<b>7</b>
Regulatory Risk .....	7
Tort-based Climate Change Lawsuits .....	8
Trade Risks .....	11
<b>IV. MUST CLIMATE CHANGE RISKS BE DISCLOSED? .....</b>	<b>14</b>
Regulatory Risk .....	14
Tort-based Climate Change Lawsuits .....	15
Trade Risks .....	15
A Discussion of Existing Disclosure Provisions .....	16
<b>V. CONCLUSION.....</b>	<b>18</b>

*This paper is intended to provide information on recent developments in provincial, national and international law. This paper is not a legal opinion and readers should not act on the basis of this paper without first consulting a lawyer who will provide analysis and advice on a specific matter. Fasken Martineau DuMoulin LLP is a limited liability partnership under the laws of Ontario and includes law corporations.*

## Climate Change – Securities Related Disclosure Requirements

Ron Ezekiel & Georald Ingborg<sup>1</sup>

### I. Introduction

Every company that publicly offers securities in Canada and files a prospectus, or whose securities are traded on a Canadian exchange, becomes a public company or “reporting issuer” under Canadian securities law. That imposes important disclosure obligations on the company, its directors and senior management in relation to material business risks faced by the company and other information that could impact share value. The focus of this paper is to analyse these disclosure requirements in the context of business risks arising from climate change and climate change related regulation in Canada.


This paper is divided into five parts. Part two, which follows this brief introduction, will outline and examine applicable securities disclosure requirements. This section will also describe some pending changes to the law that introduce new and more onerous penalties for non-compliance.

Part three focuses on climate change risks. More specifically, this section details three potential risks faced by companies operating in Canada:

- (a) *Regulatory Risk:* Companies may face new risks and costs associated with new regulations under consideration by Canada’s federal and provincial governments aimed at assisting Canada to meet its Kyoto Protocol commitments.
- (b) *Tort-based climate change lawsuits:* Legal scholars in the United States have recently identified a potential risk for U.S. companies in connection with tort-based lawsuits relating to environmental damage caused by climate change. That same risk might apply to Canadian companies with assets or operations in the U.S. In Canada, meanwhile, a recent Supreme Court of Canada decision has opened the door for governments, and potentially non-government plaintiffs, to sue and recover damages from companies damaging the environment. The potential for such a claim to be brought in connection with damage from climate change is discussed.

---

<sup>1</sup> The authors would like to express their appreciation to Alejandro Bustos, articulated student, for his invaluable help in preparing this paper.

- 
- (c) *Trade risks:* The Kyoto Protocol could potentially conflict with the trade rules of the World Trade Organization. In addition, aspects of the proposed Canadian federal government climate change regulatory scheme raise the specter of industrial subsidies, raising the possibility that climate change sensitive exports may become the subject of trade sanctions.

Part four applies the disclosure requirements to the identified climate change related risks and analyses whether and how those risks should be disclosed. A discussion of current disclosure language, and an assessment of their adequacy, is also included. Finally, model disclosure language is discussed.

Part five concludes with a summary of the key findings of this paper.

## II. Securities Disclosure Requirements

### Purpose of Disclosure Requirements

The purpose of disclosure requirements in Canada, including continuous disclosure requirements, is to ensure that potential investors receive all the material information that is necessary in order for the investor to be able to make an informed decision about whether to invest in a company.

Canada is a federal state where legislative power is divided between the federal government in Ottawa, the 10 provinces and three territories. Unlike the U.S., where securities and securities markets are primarily federally regulated, each province and territory in Canada has its own set of securities laws and its own securities regulator. There is a growing trend, however, towards greater co-operation among regulators, as well as the harmonization of securities rules, through mutual reliance and the adoption by regulators of national instruments and policies.

One example of this trend is National Instrument 51-102 – Continuous Disclosure Obligations (the “National Instrument”) adopted by the securities regulators in every Canadian jurisdiction earlier this year. The National Instrument provides harmonized continuous disclosure obligations applicable to all reporting issuers in Canada.

### Overview of Disclosure Requirements

Generally, there are two categories or types of disclosure requirements required under applicable Canadian securities laws: “primary offering documents” include prospectuses, offering memoranda and securities exchange take-over bid circulars; and “secondary market disclosure documents” include annual information forms (“AIFs”), press releases, material change reports, financial statements and management proxy circulars.

#### *Primary Offering Documents*

When a company offers securities to the public by way of a prospectus, the prospectus is required to contain “full, true and plain disclosure” of all “material facts” relating to the issuer and the securities being offered, including the material risks facing the company.

The term “material fact” is defined in the *Securities Act* (Ontario) as “a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.” This definition has recently changed in Ontario under the amendments described below. Formerly, the definition of a “material fact” included a “fact that significantly affected, or would reasonably be expected to have a significant effect...”. As a result, the hindsight element of the definition has been removed so that the actual effect of a fact on the market price of the security is no longer relevant for determining whether a fact is a material fact.

Companies and their directors and officers have, for many years, been subject to statutory civil liabilities to investors when a prospectus or other primary offering document contains a “misrepresentation”. Section 1(1) of the Ontario *Securities Act* defines misrepresentation as

- (a) an untrue statement of material fact, or
- (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made.”

#### *Secondary Market Disclosure Documents*

Canadian reporting issuers (other than those not listed on the Toronto Stock Exchange or certain U.S. exchanges) are also obligated to file, at least annually, an AIF, which is meant to disclose all material information about the issuer. Information is considered material if an investor’s decision to buy, sell or hold securities would likely be influenced or changed if the information was omitted or misstated. Risk factors are now considered an element of material information that is required to be included in the AIF. Risks that would be most likely to influence an investor’s decision to purchase securities of the company must be included. Generally, these risks would include risks relating to a company’s business, such as cash flow and liquidity problems, experience of management, the general risks inherent in the business carried on by the company, environmental and health risks, reliance on key personnel, regulatory constraints, economic or political conditions and financial history. Risks must be disclosed in the order of their seriousness.

In addition, Canadian reporting issuers must publicly announce and report, as soon as possible, any material change that has taken place in the business, operations or capital of the company. Section 1.1 of the National Instrument defines a “material change” as follows:

- (a) a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer; or
- (b) a decision to implement a change referred to in paragraph (a) made by the board of directors or other persons acting in a similar capacity or by senior management of the reporting issuer who believe that confirmation of the decision by the board of directors or any other persons acting in a similar capacity is probable.

Section 7.1 of the National Instrument provides that reporting issuers must report a material change in two different ways. First, they must immediately issue a press release describing the material change. Second, the issuer must submit, within 10 days of the change, a material

change report in the prescribed form. A company, however, does not have to submit a material change report if the disclosure of this information would be unduly detrimental to its interests.

These definitions raise a series of questions. For instance, is the risk of a tort-based climate change lawsuit, or the threat of environmental trade sanctions, something that can “reasonably” be expected to impact the market price of a company’s securities? Likewise, can a company be accused of misrepresentation if it fails to mention these types of risks in its secondary market disclosure documents? These questions form the background for the remaining sections of this paper, but it is important to first note some of the pending changes to securities laws in Canada and the implications of those changes.

### *New Implications for Failure to Disclose*

Statutory civil liability for misrepresentations found in a prospectus or offering memorandum or other primary offering documents have existed for many years. However, there has not been a similar statutory civil liability regime for misrepresentations made in other forms of corporate communication or secondary market disclosure. Instead, investors have historically had to rely on the common law tests or case law in order to be successful in an action for misrepresentations by a company in secondary market disclosure. This may all change with new proposed rules in certain Canadian jurisdictions. Certain Canadian jurisdictions, such as British Columbia and Ontario, are set to introduce new rules that may make it easier for investors to sue companies, their directors and officers and others who fail to disclose material risks in secondary market disclosure documents.

In the case of British Columbia, the provincial legislature passed a new *Securities Act* (British Columbia)<sup>2</sup> on May 11, 2004. This new piece of legislation is likely to come into force before the end of 2004. This new *Securities Act* (British Columbia) introduces significant changes to B.C. securities legislation. Among the more important changes are plain language disclosure requirements and increased investor remedies, in addition to statutory civil liabilities against an expanded group of potential defendants for misrepresentations in secondary market disclosure documents.

In Ontario the provincial legislature introduced an omnibus bill to help restore investor confidence in the province’s capital markets following the corporate scandals in the U.S. involving Enron, Worldcom and others.<sup>3</sup> The omnibus bill,<sup>4</sup> which amended Ontario’s *Securities Act*<sup>5</sup> as well as several other statutes, received Royal Assent on December 9, 2002. Several of

---

<sup>2</sup> Bill 38, *Securities Act*, 5<sup>th</sup> Session, 37<sup>th</sup> Leg., British Columbia, 2004.

<sup>3</sup> H. Garfield Emerson, Q.C. and Geoff A. Clarke, *Bill 198 and Ontario’s Securities Act: Giving Investors and the OSC Added Muscle*, paper presented at 3<sup>rd</sup> Annual Directors’ Governance Summit (Nov. 17-19, 2003) at 1.

<sup>4</sup> Bill 198, *An Act to Implement Budget Measures and Other Initiatives of the Government*, 3<sup>rd</sup> Session, 37<sup>th</sup> Leg., Ontario, 2002.

<sup>5</sup> R.S.O 2002, c. 22.

the amendments to the Ontario *Securities Act* were proclaimed into force on April 7, 2003. However, three key amendments have still not been proclaimed in force. The three amendments are: (a) creation of civil liability for secondary market disclosure; (b) the offence of fraud and market manipulation; and (c) the offence of misleading or untrue statements.<sup>6</sup>

Arguably the biggest reform is the proposed amendment to the Ontario *Securities Act* that creates a statutory civil liability for misrepresentations in secondary market disclosure, such as AIFs, press releases and material change reports. In addition, these provisions, as currently drafted, would also be applicable to misrepresentations in public oral statements.

If the proposed amendments are adopted in either of the above cases, there are significant implications for an issuer and its management if it has shareholders in these jurisdictions. Although a company may only have operations in one or two provinces, a company listed on the Toronto Stock Exchange will be subject to the new rules, if implemented, in Ontario, and in British Columbia if it has shareholders in that province.

Historically, one element of a common law action for misrepresentation included the investor needing to prove that they “relied” on the misrepresentation when seeking compensation for any related investment losses as a result of the misrepresentation. The new statutory civil liability provisions for secondary market disclosure effectively remove that requirement to prove reliance. Investors will no longer need to prove that they relied on the misrepresentation.

In addition, the categories of persons that could potentially be subject to statutory liability for misrepresentation in secondary market disclosure will be expanded significantly under the proposed amendments described above.<sup>7</sup> These categories include the reporting issuer, directors and officers of the reporting issuer, as well as their controlling shareholders, promoters, insiders and even the issuer’s advisors in some circumstances.

As a result, these proposed amendments will make the accuracy of all corporate communications (including even public addresses by senior officers) as important as the accuracy of information required to be contained in a prospectus. Public companies should, with the assistance of its advisors, establish a formal system of disclosure procedures and assess the other implications of these amendments.

---

<sup>6</sup> Emerson and Clarke, *supra*, note 2 at 3.

<sup>7</sup> *Ibid* at 4.

### III. Climate Change Risks

For most people, climate change is not a legal problem, it is an environmental one. A growing number of commentators, however, are identifying an increasing number of potential legal risks associated with climate change. As one paper recently noted:

In fact, there are a number of compelling legal and economic reasons that corporations would be well advised to give careful consideration to the issue of climate change – and even develop their own climate change action plan – in advance of any regulatory requirement.... [T]here is reason for genuine concern that liabilities may be lurking for those who neglect the issue now, to the later detriment of the corporation and its shareholders.<sup>8</sup>

This section outlines and discusses three potential climate change related risks: regulatory risk, tort-based climate change lawsuits and trade risks.

#### Regulatory Risk

The Canadian government is considering a new regulatory system – one aimed at assisting Canada to meet its Kyoto Protocol commitment. Under the new system energy companies, oil and gas companies and companies from other prescribed sectors could see an increase in their production and administrative costs. Though it is still too early to know the impact this new system will have on industry with certainty, it is possible to foresee some economic costs and business risks for companies engaged in activities falling within the scope of the new system.

Current federal policy guidance on the new system suggests one of its components will entail a permitting system for greenhouse gas emissions from covered activities within covered sectors. Covered sectors are expected to include oil & gas, energy generation and certain mining and manufacturing operations. Companies within these sectors are referred to as “Large Final Emitters” or “LFEs”.

The permitting system would see an “intensity target” set for each activity within each sector. The target would specify a quantity of greenhouse gas emissions that can be emitted per unit production from that activity. Targets are expected to be set, on average, on a stretch basis at approximately 15% below business as usual emission intensities.

Companies operating within the covered sectors would receive free permits based on the applicable intensity target(s) multiplied by their actual production. Companies would, for the most part, be insulated from risks associated with production variances. However, companies

---

<sup>8</sup> J. Kevin Healy and Jeffrey M. Tapick, *Climate Change: It's Not Just a Policy Issue for Corporate Counsel – it's a Legal Problem*, 29 Col. J. Envtl. L 89 at 93.

would bear significant risk with respect to the efficiency of their operations. Emitters with less efficient operations may have emission intensities that far exceed the applicable prescribed emission intensities. They would not only be required to make up the 15% permit shortfall resulting from the stretch target, but the incremental shortfall resulting from their higher actual emission intensities.

Current federal policy suggests permit shortfalls could be addressed in five ways:

- Additional permits could be purchased from other emitters with extra permits
- The emitter may be able to source “offsets” - reductions to Canada’s national greenhouse gas emissions inventory resulting from a project to reduce those emissions - from an offset vendor
- The emitter may be able to buy certain instruments provided for by the Kyoto Protocol and convert them into permits usable within the Canadian regulatory system
- Improvements could be made to the emitter’s operations to improve emissions intensities
- The emitter may be able to purchase additional permits from the Canadian government for a fixed fee. The government has suggested that these “Price Assurance Mechanism” units will be available at a cost of \$15/tonne of carbon dioxide equivalent (CO<sub>2</sub>e) emissions.

The cost of compliance using any of the first three options will be dependent on market conditions. Capital costs will dictate the cost of the fourth option, while the costs of the fifth option appear to be fixed as indicated.

The Canadian federal government, however, does not have exclusive jurisdiction over the regulation of greenhouse gas emissions. Provincial governments may also seek to regulate them, using policies that are complimentary to, or completely different from, the federal regulatory system. For instance, Alberta has passed legislation<sup>9</sup> (some of which is not yet in force) that sets different emissions targets than the proposed federal system. Each regulatory system, federal and provincial, that could impact a company’s operations, must be considered in assessing the materiality of those regulatory systems on the company’s operations.

#### Tort-based Climate Change Lawsuits

Another possible risk facing emitters is the risk of law suits claiming damages for climate change related damages. These suits would likely be negligence claims based on tort law, where the claimant would argue it has suffered damages as a result of the emitter’s negligence for

---

<sup>9</sup> *Climate Change and Emissions Management Act*, S.A. 2003, c. C-16.7.

continuing to emit greenhouse gases, even after evidence that greenhouse gas emissions were contributing to climate change came to light.

This is certainly not an easy claim to bring. Causation – the requirement that the claimant demonstrate that the defendant’s emissions (as opposed to the emissions of others) actually caused the damages in question – may be an insurmountable barrier. However, legal scholars in the United States are already discussing potential scenarios for bringing this kind of environmental lawsuit forward.<sup>10</sup> And a recent Supreme Court of Canada decision<sup>11</sup> may have opened the door for similar claims here.

Already, commentators have identified a number of possible claimants:

Coastal states, islands, the State of Alaska, and Alaskan villages all seem to be experiencing present harms from global warming. As such, they could be promising plaintiffs in any current climate change litigation. In such litigation, one of the first critical issues these plaintiffs would face is the often complicated issue of damages.<sup>12</sup>

...

The Alaskan property, buildings, and infrastructure harmed by thawing permafrost could constitute present damages. Alaska’s Department of Transportation & Public Facilities, for instance, has incurred mounting expenditures for maintaining and repairing Alaska’s roads. North of Fairbanks, thawing permafrost has already caused roads to buckle and house and telephone poles to tilt.<sup>13</sup>

This legal analysis from the United States is based on a three-step process. First, the argument postulates that greenhouse gas emitters are contributing to climate change. Second, it is further assumed that climate change is causing important changes to our environment (*e.g.* the thawing of permafrost in Alaska), and that those changes result in tangible damage (*e.g.* increased damage to Alaskan highways). Third, if a plaintiff can establish that a particular emitter has, or group of emitters have, contributed to or caused those damages, then the foundation for a negligence claim may exist.

---

<sup>10</sup> David Grossman, *Warming Up to a Not-So-Radical Idea: Tort-based Climate Change Litigation*, 28 Col. J. Envtl. L. 1; see also Healy and Tapick, *supra*, note 8.

<sup>11</sup> *British Columbia v. Canada Forest Products Ltd.*, [2004] SCC 38

<sup>12</sup> Grossman, *supra*, note 12 at 16.

<sup>13</sup> *Ibid* at 18.

In the US, the pool of potential claimants could be significant because of a peculiar law called the Alien Tort Statute, also known as the Alien Tort Claims Act (“ATCA”). This law, which was passed by the 1st Congress, first appeared in Section 9 of the Judiciary Act of 1789.<sup>14</sup> According to ATCA, U.S. district courts “...shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.”

For nearly 200 years, ATCA was largely forgotten. Then, in 1982, Dolly Filartiga, a political refugee from Paraguay living in the U.S., rediscovered the law. In an incredible turn of events, a former Paraguayan police official, who had tortured and murdered Ms. Filartiga’s brother, was found living in New York. When Ms. Filartiga learned about this, she used ATCA to successfully sue the official in U.S. courts. Since then, numerous foreigners have used ATCA to sue defendants in the U.S. for violations of international law.

The success of ATCA has led to speculation that foreign states that have been impacted by climate change could use ATCA to sue U.S.-based emitters.<sup>15</sup> A very recent decision by the U.S. Supreme Court,<sup>16</sup> however, has undermined this argument. In this decision, the U.S. Supreme Court held that ATCA, when it was first passed in the 18<sup>th</sup> century, was only meant to be used in a “modest” number of cases that involved clear violations of international law, such as piracy. What the law was not meant to do was act as a widespread legal tool for foreign plaintiffs.

Even though this decision may call into question the ability for foreign plaintiffs to sue U.S.-based emitters, it does not eliminate the risk. There is likely still a significant pool of claimants that are U.S. citizens, particularly those living in areas that are most susceptible to climate change, like Alaska.

The issue can not be ignored by Canadians, particularly Canadian emitters that have emitting assets in the U.S. They too, could be subject to this kind of claim. In addition, Canadian emitters may face a similar but not identical risk in Canadian courts. The Supreme Court of Canada, in its recent decision in *British Columbia v. Canadian Forest Products Ltd.*, held that a corporation could be sued for damaging the environment. In this case, the Crown sued a logging company that had started a forest fire. The Crown claimed damages under three headings: (a) expenditures for suppressing the fire; (b) loss of stumpage revenue; and (c) loss of trees for environmental reasons.

---

<sup>14</sup> Marcia Coyle, *Justices Weigh Alien Tort Act*, March 29, 2004, online: The National Law Journal Web Site, <<<http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1080334938936>>> Last Accessed: October 7, 2004.

<sup>15</sup> Healy and Tapick, *supra*, note 8 at 102; see also Rosemary Reed, *Rising Seas and Disappearing Islands: Can Island Inhabitants Seek Redress Under the Alien Tort Claims Act?*, 11 Pac. Rim L. & Pol’y J. 399.

<sup>16</sup> *Sosa v. Alvarez-Machain*, Docket No. 03-339, (June 29, 2004).

The Supreme Court refused to give the Crown damages under the third category, but only came to that decision because it found that the Crown had not properly quantified this particular claim. Binnie J., who wrote the majority judgement, held as follows:

¶81 It seems to me that there is no legal barrier to the Crown suing for compensation as well as injunctive relief in a proper case on account of public nuisance, or negligence causing environmental damage to public lands, and perhaps other torts such as trespass, but there are clearly important and novel policy questions raised by such actions. These include the Crown's potential liability for *inactivity* in the face of threats to the environment, ... the limits to the role and function and remedies available to governments taking action on account of activity harmful to public enjoyment of public resources, and the spectre of imposing on private interests an indeterminate liability for an indeterminate amount of money for ecological or environmental damage.

Clearly a claim along these lines would face obstacles, including the policy considerations identified by Binnie J. Nevertheless, the ability to bring a claim of this kind exists.

### Trade Risks

The main purpose of the World Trade Organization (the "WTO") is to eliminate barriers to international trade. By enforcing a series of agreements – the most important being the *General Agreement on Tariffs and Trade*,<sup>17</sup> the *General Agreement on Trade in Services*<sup>18</sup> and the *Agreement on Trade-Related Aspects of Intellectual Property Rights*<sup>19</sup> – the WTO seeks to prevent member states from engaging in protectionist trade practices.

The WTO, however, was not designed to solve environmental, labour or other non-trade problems. As a result, a tension exists between the economic goals of the WTO and multilateral environmental initiatives such as the Kyoto Protocol. The Kyoto Protocol is a results oriented treaty – it sets a goal to be achieved without specifying how it is to be achieved. For Canada, that goal is to reduce its national greenhouse gas emissions to 6% below 1990 emissions levels during the period 2008-2012. It does not specify how Canada is to go about achieving that goal.

---

<sup>17</sup> *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, 15 April 1994, 33 *International Legal Materials* (I.L.M.) 1125; Note: The original 1947 GATT agreement – 55 *United Nations Treaty Series* (UNTS) 194 – has been incorporated into the WTO.

<sup>18</sup> *Ibid*, Annex 1B, 44.

<sup>19</sup> *Ibid*, Annex 1 C, 81.

In fact, most Kyoto signatories are proposing different means of achieving their Kyoto Protocol targets. Japan's proposed regulatory system is different from Canada's, and Canada's is different from the EU's. In some cases components of these policies and other policy options, while aimed at achieving Kyoto Protocol commitments, may also be construed as protectionist trade practices. There is no specific exemption for the Kyoto Protocol in any of the WTO agreements. As a result, a country that adopts a policy to achieve its Kyoto Protocol commitments could, at the same time, find itself in breach of one or more WTO agreements if that policy also has the effect of trade protectionism.

For example, consider Article III (2) of the GATT. According to this provision, imported products cannot be subject to taxes that are in excess of those imposed on like domestic goods. Imagine a Kyoto Protocol signatory adopts an indirect carbon tax<sup>20</sup> on both imports and exports of fossil fuels as part of its regulatory system aimed at achieving its Kyoto Protocol commitments. This tax could potentially violate WTO trade rules. As one author argues:

If the domestic fuel, such as biomass fuel, contains less carbon than the imported one, such as coal, foreign producers might argue that this is a case of protection in disguise and that taxation is excessive on imports compared with taxation on like domestic products.<sup>21</sup>

The problem would be even more pronounced between trading partners, one of whom is a signatory to the Kyoto Protocol, and one of whom is not. For example, Canada and the U.S.


A systematic analysis of Canada's proposed greenhouse gas regulatory policy, and whether components of it could constitute protectionist trade practices is beyond the scope of this paper. However, there are aspects of the policy that could present a risk.

For example, consider PAMs – the Price Assurance Mechanism units that the Canadian government is proposing to introduce in order to keep its commitment to industry that industrial emitters will not have to pay more than \$15/tonne CO<sub>2</sub>e to comply with the new regulatory system. If market prices exceed this amount, Canadian emitters will be permitted to buy compliance for less than market prices. If those same Canadian emitters are producing products which are exported internationally and compete against foreign goods produced by emitters who must pay market prices for compliance units in a similar program in their countries, PAMs could be construed as a subsidy to Canadian industry. Countries where those foreign manufacturers are located may respond with trade sanctions.

---

<sup>20</sup> Indirect taxes are a tax that are levied on products as they reach consumers, *e.g.* a sales tax.

<sup>21</sup> *Climate Change and Trade Rules – harmony or conflict?* online: National Board of Trade Web Site <<[http://www.kommers.se/binaries/attachments/3431\\_Climate\\_and\\_Trade\\_Rules.pdf](http://www.kommers.se/binaries/attachments/3431_Climate_and_Trade_Rules.pdf)>> Last Accessed: October 1, 2004.



As another example, consider the very nature of emissions intensity regulation. This is the same much maligned regulatory system that the U.S. keeps proposing as an alternative to the Kyoto Protocol's firm caps. Instead of fixing a firm cap for LFEs, Canada's proposed emissions intensity regulation has the effect of passing the risk associated with increased output to the Canadian taxpayer. Because LFEs will receive permits based on the prescribed emissions intensity multiplied by their actual output, an increase in output means the LFE will be awarded more permits.

But Canada's emissions levels under Kyoto are capped. If LFEs are emitting more greenhouse gases because of an increase in output, and they are awarded more permits, the incremental emissions must be made up by the Canadian government if Canada is to meet its Kyoto Protocol commitments. Again, if LFE exports compete against foreign goods produced by emitters who must bear the full brunt of an increase in output under their regulatory system, Canada's emissions intensity regulatory system could be construed as a subsidy to Canadian industry.

#### **IV. Must Climate Change Risks Be Disclosed?**

Having identified the applicable Canadian securities disclosure requirements, and some possible climate change related risks, do the disclosure requirements necessitate disclosure of the identified risks?

The analysis turns on the materiality of the risk. Recent amendments to the Ontario *Securities Act* define a “material fact” as a fact that “...would reasonably be expected to have a significant effect on the market price or value of the securities” of the reporting issuer. So the analysis and result will vary on a company-by-company basis depending on the nature of the company’s business, the nature of its operations, the nature of its products, the efficiency of its facilities, and numerous other factors. In each case, the climate change related risk must present a material risk to that company’s share value in order for there to be a need to disclose that risk.

##### Regulatory Risk

As discussed above, a company’s climate change related regulatory risk depends on the effect that Canada’s greenhouse gas regulatory systems (both federal and provincial), once implemented, will have on the company. For the time being, the effect cannot be calculated with precision because regulatory system policy is still being developed. In addition, some of the effects of the proposed regulatory systems will depend, in large part, on the market costs of compliance instruments. Those market costs remain uncertain.

However, a range of business risks may be calculable. In some cases, companies are already in discussions with federal regulators with respect to the emission intensity targets the regulators intend to establish for regulated activities. As those targets are settled, and the direction of the Canadian regulatory system policy firms up, companies should be able to compare their actual emissions against emissions based on the prescribed emissions intensity target. Exceedances will have to be covered by way of one of the compliance options discussed above (*e.g.* with the purchase of excess permits, offsets, PAMs, etc.).

Although many of the compliance options depend on market prices, compliance by way of internal efficiency improvements and compliance through the purchase of PAMs do not depend on market prices. The former depends on the capital costs of efficiency improvements and the latter has a fixed price of \$15/tonne CO<sub>2</sub>e attached to it. An analysis of those options should generate an estimate of actual compliance costs. To the extent those costs represent expenditures that would reasonably be expected to have a significant effect on the market price of the emitters securities, the risk should be disclosed.

The authors would suggest the following disclosure be included in the “Risk Factors” section of an emitters disclosure documents either under the company’s existing section on environmental risks or under a separate heading entitled “Climate Change Risks”:

“Canada is a signatory to the Kyoto Protocol (the “Protocol”). The Protocol requires Canada to reduce its average annual national greenhouse gas emissions to 6% below 1990 level emissions during the period 2008-2012. In December 2002, the Canadian federal government ratified the Protocol. The Canadian government may elect to regulate domestic greenhouse gas emissions in a manner consistent with the Protocol or in a different manner. The Canadian government is in the process of developing regulations that could regulate the Corporation’s greenhouse gas emissions. Provincial governments may also elect to regulate greenhouse gas emissions.

Although it cannot be predicted with certainty what impact these regulations will have on the Corporation, it is possible that the Corporation will be subject to increased production and administrative costs. Based on the current policy direction, the costs of compliance will likely depend on the cost and availability of market compliance instruments, costs of internal efficiency improvements or costs associated with the purchase by the Corporation of compliance instruments from government. These costs could have a material adverse effect on the Corporation’s financial condition and results of operations.”

#### *Tort-based Climate Change Lawsuits*

Possibilities exist in both Canada and the U.S. for tort-based claims to be brought against emitters for damages caused by climate change. Although the risks of these lawsuits are the subject of much debate among commentators, there is yet little evidence that these lawsuits present a material risk to emitters. There are still considerable obstacles to these claims in both Canada and the US. Until such time as these claims prove successful, or new legislation or the common law materially change the current analysis, none of these claims likely present a real enough risk to emitters to warrant their disclosure under Canadian securities laws.

#### *Trade Risks*

The trade risks associated with Canada’s proposed greenhouse gas regulatory system discussed above are difficult to quantify. In many respects they are dependent on the international price of carbon, which is still difficult to establish, but in any event seems to be well below \$15/tonne CO<sub>2</sub>e at present.

However, many of Canada’s LFEs produce goods for export. In many respects, trade risks may be the most significant risk arising from greenhouse gas regulation in Canada for many of those companies. Although the risk is difficult to quantify, and likely could not be calculated with sufficient precision to require its disclosure on an LFE’s financial statements, the risk may be real and substantial enough for some LFEs so as to warrant its disclosure under securities law disclosure requirements. Until Canadian policy is more definite, and subject to a more detailed

analysis of the trade implications of that policy to a particular LFE's exports, a general disclosure of the risk would likely be sufficient.

Accordingly, the authors would suggest the following disclosure be included in the "Risk Factors" section of an emitters disclosure documents if the regulatory risks outlined above are not applicable to the emitter or, if regulatory risks are applicable, incorporated into that disclosure amended as appropriate:


"Canada is a signatory to the Kyoto Protocol (the "Protocol"). The Protocol requires Canada to reduce its average annual national greenhouse gas emissions to 6% below 1990 level emissions during the period 2008-2012. In December 2002, the Canadian federal government ratified the Protocol. The Canadian government may elect to regulate domestic greenhouse gas emissions in a manner consistent with the Protocol or in a different manner. The Canadian government is in the process of developing regulations that could regulate the Corporation's greenhouse gas emissions. Provincial governments may also elect to regulate greenhouse gas emissions.

Although it cannot be predicted with certainty what impact these regulations will have on the Corporation, it is possible that these regulations may conflict with international trade laws. These conflicts may result in trade sanctions that may impact the Corporation's exports, or may force the Corporation to abandon markets in which the costs to the Corporation of those trade sanctions are material. Trade sanctions could have a material adverse effect on the Corporation's financial condition and results of operations."

#### *A Discussion of Existing Disclosure Provisions*

The authors have undertaken a review of a number of the risk factors included in publicly filed documents of some of the largest oil and gas and energy producers in Canada. The documents reviewed included prospectuses, annual information forms, management discussion and analysis and certain United States SEC filings from March 2003 through September 2004. While the risk disclosure contained in all of the disclosure documents reviewed contained some form of disclosure of environmental risks, the disclosures varied considerably in terms of the depth of discussion on specific environmental risks.

Some disclosure was very minimal in terms of any specific environmental risks. The authors noted at least one example where the extent of the risk factor was to the effect that:



“Management anticipates capital expenditures and operating expenses could increase in the future as a result of the implementation of new and increasingly stringent environmental regulations. Compliance with environmental regulation can require significant expenditures and failure to comply with environmental regulation may result in the imposition of fines and penalties, liability for clean-up costs and damages and the loss of important permits.”

Other environmental risk disclosure was more extensive in terms of specific risks mentioned. Of the 10 issuers’ documents reviewed, four issuers included some form of disclosure relating to the Kyoto Protocol. The following is an example:

“It is premature to predict what impact the potential Protocol regulations will have on the Corporation’s sector, but it is possible that the Corporation would face increases in operating costs in order to comply with a GHG emissions target.”

In the view of the authors, this disclosure may not go far enough to adequately identify the potential risks associated with the potential implementation of greenhouse gas regulation in Canada.

While it is acknowledged that these emitters may have made a determination that specific risks relating to climate change have historically been sufficiently immaterial to warrant disclosure, the authors are of the view that risks relating to climate change, whether in relation to the regulatory costs of compliance or trade risks, should be reconsidered in light of recent developments and issuers should consider expanding their risk disclosure.

## **V. Conclusion**

Large Final Emitters and other Canadian greenhouse gas emitters face an array of potential risks from environmental damage caused by climate change and from Canadian greenhouse gas regulatory policy. Those risks will vary materially from emitter to emitter, as they are very dependent on the nature of the emitter's business, the efficiency of the emitter's equipment and the markets in which the emitters products are sold.

In some instances, even though the risk is indeterminate, it may be material. Risks that constitute "material facts" or similar terms under applicable securities legislation must be disclosed.

Three risks associated with climate change have been identified: regulatory risks, tort-based lawsuits and trade risks. Of those, the authors conclude that both regulatory risks and trade risks could present a risk to some emitters material enough so as to warrant disclosure.

Finally, greenhouse gas regulatory policy in Canada is still being developed. Disclosures appropriate for today's indeterminate risks may not provide adequate disclosure in the future, as policy crystallizes and is ultimately implemented. As with all securities related disclosures, regular review and revision is required to ensure the disclosure is kept current and represents full, true and plain disclosure of all material facts.

