

MATERIALITY AS IT RELATES TO THE MINING INDUSTRY

New Disclosure Rules for Mining Companies

Conference Board of Canada

December 9 and 10, 2002

Vancouver

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¹ The author would like to acknowledge the able assistance of Ms. Leslie Hayes in the preparation of this paper.



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I. INTRODUCTION

Continuous disclosure of material changes is one of the most important developing areas of securities law. Disclosure, in some shape or form, has been a part of securities and corporate legislation for some time. At least as early as the U.K. *Companies Act* of 1844,¹ disclosure was required in the form of a prospectus followed by the filing of annual reports. Similar requirements for annual information were also a part of corporate legislation in Canada. The U.S. *Securities Exchange Act of 1934*² (the “*Exchange Act*”) formed the basis for a modern continuous disclosure system with its requirements of annual and interim reports as well as proxies and their accompanying information circulars.

Continuous disclosure was the single most important reform recommended in the Kimber Report published in 1965.³ The Kimber Commission was of the opinion that public confidence in the securities industry would increase measurably with enhanced disclosure.⁴ The Kimber Commission’s mandate was primarily to look into insider trading and takeover bids. However, its mandate also included generally addressing the degree of disclosure to shareholders. The Kimber Commission recommended ongoing disclosure including the distribution of periodic financial statements, mandatory proxy solicitation and the reporting of insider trading.

Another influential report was the Merger Report of 1970.⁵ One of the primary results of this report was the enactment of the “closed system”. The key to the “closed system” is its very strong emphasis on ongoing disclosure for the purposes of secondary market trading. It allows primary and secondary trading amongst a group of exempt persons who are presumed not to need the protection afforded by the disclosure provided in prospectuses or financial statements and through the use of mandatory proxy solicitation.

¹ 1844 (U.K.), chapters 110 and 111. Under the *Directors Liability Act*, 1890, 53 and 54 Vict. c.64, directors, promoters and others who authorized the use of their name on the prospectus were liable to persons who subscribed for shares on the faith of the prospectus, if such person had sustained loss or damage by reason of any untrue statement in the prospectus.

² The *Securities Exchange Act of 1934*, 15 U.S.C.

³ Report of the Attorney General’s Committee on Securities Legislation in Ontario (Toronto: Queen’s Printer, March 1965).

⁴ The recommendations of the Kimber Report with respect to disclosure, which were adopted in securities laws throughout most of Canada, emphasizes disclosure of the type required by the *Securities Exchange Act of 1934*.

⁵ The Merger Report of 1970, “Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Combinations and Private Placements”, dealt with the need for greater disclosure in the field of private placements.

Continuous disclosure practices in Canada were most recently reviewed in the Allen Report of 1997.⁶ The purpose of this report was to review continuous disclosure by public corporations, comment on the adequacy of such disclosure and determine whether additional remedies should be available to injured investors, or to regulators, if corporations fail to observe the current continuous disclosure rules. The fundamental conclusion reached by the committee formed to prepare the report is that there is a sufficient degree of non-compliance with current continuous disclosure rules in Canada to cause concern.⁷

This paper is intended to be a general overview of the area of disclosure and materiality. It is not intended to be an exhaustive analysis of the topic. Part II will briefly examine the regulatory regime, Part III will look at some of the case law surrounding the area, and Part IV provides an analysis of what the disclosure requirements entail. Finally, Part V looks at corporate governance practices both in Canada and in comparison to other jurisdictions.

II. REGULATORY REGIME

There are three main sources of continuous disclosure requirements: federal and provincial legislation, the policy statements and rules issued by the securities regulators and the requirements of the stock exchanges. This paper will focus on the legislation found in British Columbia and Ontario and the equivalent federal legislation.

These sources cover both periodic and event-driven disclosure. Periodic disclosure involves the regular reporting from time to time through financial statements and proxy materials which are prepared by the company as required under various statutes, regulations, policy statements and exchange requirements. Event driven disclosure involves the disclosure of material information when such information necessitates its disclosure.

⁶ The Allen Report of 1997, "Responsible Corporate Disclosure Final Report: A Search for Balance", was the culmination of a two-year study of a committee formed by The Toronto Stock Exchange on the issues surrounding the continuous disclosure practices in Canada. The Toronto Stock Exchange sponsored the report in an effort to foster better disclosure in Canada and to instill greater confidence in the fairness and quality of the Canadian marketplace.

⁷ The three fundamental recommendations of the Allen Report are: (i) the creation of a limited statutory regime whereby issuers and others responsible for continuous disclosure violations may be liable in civil actions brought by injured investors to recover their damages; (ii) the development and implementation of other initiatives to improve effectiveness of the regulatory network that creates, monitors and enforces continuous disclosure rules in Canada; and, (iii) the full integration of the disclosure regime in Canada rather than the current separation into transactional disclosure and continuous disclosure.

1. Provincial Legislation

1.1 British Columbia

The main provisions governing continuous disclosure are found in the provincial securities acts. In British Columbia, the relevant provisions are found at sections 85 through 91 of the British Columbia *Securities Act*⁸ (the “BCSA”). These sections cover the disclosure of material changes (section 85), insider trading (section 86), insider reports (section 87), discretionary orders by the Commission⁹ deeming a reporting issuer to have ceased to be such (section 88), halt trading orders (section 89) and personal information forms (section 90). In addition, the Commission or the Executive Director may exempt a person from these requirements if there is a conflict with the requirements of the law of the jurisdiction in which the reporting issuer is incorporated and it would not be prejudicial to the public interest.

The *BCSA* is supplemented by the provisions of the regulations found at sections 155 through 161 of the British Columbia *Securities Rules*.¹⁰ The topics covered include insider reporting (sections 155 to 160) and the exemptions from the insider trading requirements (section 161).

1.2 Ontario

The corresponding provisions in the Ontario *Securities Act*¹¹ (the “OSA”) are found at sections 75 and 76 and sections 107 to 109. These sections cover the publication of material changes (section 75), insider trading (section 76) and insider reports (sections 107 to 109).

The *OSA* is supplemented by the provisions of the regulations found at sections 164 to 175 of the Ontario *Securities Act Regulations*¹² which deal with insider trading reports.

2. Federal

The relevant provisions of the *Canada Business Corporations Act*¹³ (the “CBCA”) are found at sections 126 to 131 which cover insider trading. The regulations supplementing these provisions are

⁸ British Columbia *Securities Act*, R.S.B.C. 1996 c. 418 as amended.

⁹ The term “Commission” refers to the Securities Commission of the various provinces.

¹⁰ British Columbia *Securities Rules*, B.C. Reg. 194/97 as amended.

¹¹ Ontario *Securities Act*, R.S.O. 1990, c. S.5 as amended.

¹² Ontario *Securities Act Regulations*, R.R.O. Reg. 1015 as amended.

¹³ *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 as amended.

found in the *Canada Business Corporations Regulations*¹⁴ in sections 29 to 31.1 which cover the regulation of insider reports.

The federal corporate statute is more encompassing than the corresponding provincial statutes as it covers areas such as insider reports and is more in depth regarding the areas of proxies and proxy solicitation. As there is no federal securities legislation, the *CBCA* incorporates some of the concepts found in the provincial securities acts.

3. National Policy 51-201 “Disclosure Standards”

National Policy 51-201 (“NP 51-201”) replaces old National Policy Statement 40 and was effective July 12, 2002.¹⁵ NP 51-201 applies to all issuers whose securities are publicly traded in Canada including reporting issuers or the equivalent in any Canadian jurisdiction. This policy supplements existing requirements in the timely disclosure of material information.

The policy addresses concerns about the practice of selective disclosure. Selective disclosure occurs when material information is disclosed to one or more individuals but not to the investing public. This creates opportunities for insider trading and can undermine investor’s confidence in the market. The policy deals with three general areas: timely disclosure, materiality and the prohibitions against selective disclosure. It also list some “best disclosure” practices that can be adopted by issuers to manage their disclosure obligations.

Issuers are required to immediately disclose a material change in their business.¹⁶ This may be done by issuing and filing a press release describing the change. An issuer must also file a material change report as soon as practicable but no later than 10 days after the change occurs. An issuer has an obligation to disclose both favorable and unfavorable news.

An issuer may delay disclosure of a material change and keep it confidential temporarily if the release of the information would be unduly detrimental to the issuer’s interest. An issuer must make a confidential filing with the Commission.¹⁷ The issuer is under a duty to maintain complete confidentiality.

¹⁴ *Canada Business Corporations Regulations*, SOR/79-316 as amended.

¹⁵ BCN 2002/30.

¹⁶ NP 51-201 at paragraph 2.1.

¹⁷ NP 51-201 at paragraph 2.2.

Securities legislation prohibits a reporting issuer and any person or issuer in a special relationship with a reporting issuer from informing, other than in the necessary course of business, anyone of a material fact or material change before that information has been generally disclosed.¹⁸ This is generally known as “tipping”. Insider trading occurs when anyone in a special relationship with knowledge of a material fact or material change that has not been generally disclosed purchases or sells securities of the reporting issuer.

The tipping and insider trading provisions apply to both material facts and material changes while the timely disclosure obligations generally only apply to material changes. If an issuer were to selectively disclose a material fact, this would be in breach of the securities legislation.

Persons in a special relationship with an issuer include insiders, directors, officers, employees, persons engaging in professional or business activities for the issuer and anyone who learns of material information from someone in a special relationship.¹⁹

NP 51-201 gives some interpretive guidance as to what “necessary course of business” entails. Some examples include communications with vendors, suppliers, lenders, legal counsel, employees, labour unions or credit rating agencies.²⁰ In addition, certain communications with controlling shareholders may be considered in the “necessary course of business”. A selective disclosure to an analyst, institutional investor or other market professional would not be permitted. Issuers are not prohibited from speaking with the media about non material information or material information that has been previously disclosed.

It is important to note that the tipping provision doesn’t require an issuer to release material information to the marketplace but rather prohibits an issuer from disclosing material information to anyone prior to that information being generally disclosed to the marketplace. Information is “generally disclosed” if the information has been disseminated in a manner calculated to effectively reach the marketplace and public investors have been given a reasonable amount of time to analyze the information. NP 51-201 lists several methods that may satisfy the generally disclosed requirement. They include news releases distributed through widely circulated news or wire services or announcements made through press conferences or conference calls. The issuer must make a conference call available for replay or transcript for a reasonable amount of time. Posting information to an issuer’s website will not, by itself, be likely to satisfy this requirement.

¹⁸ NP 51-201 at paragraph 3.1.

¹⁹ NP 51-201 at paragraph 3.2.

²⁰ NP 51-201 at paragraph 3.3(2).

As the definition of material fact and material change are based on a market impact test, it is also necessary to take into consideration the nature of the information itself, the volatility of the issuer's securities and prevailing market conditions when determining materiality.²¹ The policy gives examples of potentially material information to assist issuers in determining materiality. This includes changes in corporate structure, changes in capital structure, changes in financial results, changes in business and operations, acquisitions and dispositions and changes in credit arrangement. While issuers are generally not required to interpret the impact of political, economic and social developments, if these developments will have a direct effect on the business and affairs of the issuer, the issuer is encouraged to explain the impact on them.

This policy also stresses the importance of being aware of the risks associated with disclosure to analysts.²² Issuers should have a firm policy of providing only non-material and publicly disclosed information to analysts. In addition, issuers should be careful when circulating an analyst report as this may be seen as endorsing a report.

Finally, NP 51-201 recommends some "best disclosure" practices in the disclosure of material information.²³ This will help to contribute to the fairness and efficiency of the capital markets and investor confidence in those markets.

Establishing a corporate disclosure policy gives an issuer a process for disclosure. The focus of the policy should be on promoting consistent disclosure practices aimed at timely and broadly disseminated material information. A committee should be set up that is responsible for developing, implementing and monitoring the disclosure policy. NI 51-201 also recommends having the board of directors or audit committee review disclosure in advance of release of earnings guidance and news releases containing financial information. The "best disclosure" practices also provides guidance on analyst conference calls, analyst reports and electronic communications.

4. National Instrument 43-101 "Standards of Disclosure for Mineral Projects"

National Instrument 43-101 ("NI 43-101") is a policy developed by the Canadian Securities Administrators to establish standards for public disclosure an issuer makes of scientific and technical

²¹ NP 51-201 at Part IV.

²² NP 51-201 at Part V.

²³ NP 51-201 at Part VI.

information concerning mineral projects. Its purpose is to enhance the accuracy and integrity of disclosure in the mining sector and applies to all oral and written statements.

Under this instrument, an issuer must base all scientific and technical disclosure on information prepared by a qualified person. A qualified person is defined as an individual who is an engineer or geoscientist with at least five years experience in mineral exploration, mine development or mineral project assessment and must be a member in good standing of a professional organization.²⁴

Mineral resources and mineral reserves are defined in the instrument as having the meanings ascribed to them by the Canadian Institute of Mining, Metallurgy and Petroleum (the “CIM”) in the CIM standard definitions.²⁵ These definitions are set out in the Appendix of the Companion Policy to NI 43-101.

An objective standard of reasonableness must be applied in determining whether a statement constitutes disclosure.²⁶ It is not for an officer of an issuer or a qualified person to determine that he or she personally believes the matter is material but rather what a person acting reasonably would conclude.

Materiality should be determined in the context of the particular issuer’s overall business and financial condition. It should be determined in relation to the significance of the information to investors, analysts and other users of the information.

Any disclosure or technical reports filed must utilize only the applicable mineral resource and mineral reserve categories set out in the CIM standard definitions. Each category of mineral resource and mineral reserves must be reported separately and an issuer must not add inferred mineral resources.²⁷

A qualified person must prepare and certify the technical report. The report must include the name and the relationship to the issuer of the qualified person. All written disclosure must state whether the

²⁴ NI 43-101 at paragraph 1.2 “qualified person”.

²⁵ NI 43-101 at paragraph 1.2 “mineral resource” and “mineral reserve”.

²⁶ Companion Policy to NI 43-101 at paragraph 1.6.

²⁷ NI 43-101 at paragraph 2.2. An “inferred mineral resource” is that part of a mineral resource for which quantity and grade or quality can be estimated on the basis of geological evidence and limited sampling and reasonably assumed, but not verified, geological and grade continuity (Appendix to Companion Policy to NI 43-101).

qualified person has verified the data, describe the nature and limitations of the verification or explain any failure to verify the data.²⁸

An issuer is prohibited from making disclosure of the quantity or grade of a deposit unless the disclosure provides a statement that the quantity or grade is conceptual in nature, there has been insufficient exploration to define a mineral resource and it is uncertain if further exploration will result in the discovery of a mineral resource on the property.²⁹

An issuer is prohibited from making any disclosure of the results of an economic evaluation in a preliminary assessment unless the preliminary assessment is a material change in the affairs of the issuer and the disclosure includes a statement that the assessment is preliminary in nature, the basis for the assessment and the qualifications and assumptions of the person making it. There are also special rules for disclosure of exploration targets, historical estimates and preliminary assessments.

An issuer is required to file a technical report on its material properties together with a prospectus, information or proxy circular, offering memorandum containing scientific and technical information, rights offering circular containing scientific and technical information, annual information form or annual report, valuation, or a take-over bid circular or directors' circular that discloses a preliminary assessment or mineral resources or mineral reserves. An issuer does not have to file a technical report with an annual information form or annual report or short form prospectus if it does not contain any new material information.

5. Stock Exchange Requirements

Each stock exchange has its own rules that must be complied with if an issuer is listed on that exchange.

The TSX Venture Exchange (formerly the CDNX) has laid out its requirements in its Corporate Finance Manual Policies and Rules.³⁰ Under Policy 3.2 "Filing Requirements and Continuous Disclosure" and Policy 3.3 "Timely Disclosure", the issues of materiality, confidential disclosure and insider trading are expanded upon. Each issuer that has securities traded on an exchange must execute a listing agreement or Form 2D. The listing agreement contractually binds the issuer to adhere to certain reporting requirements.

²⁸ NI 43-101 at Part 3.

²⁹ NI 43-101 at paragraph 2.3.

³⁰ Last amended June 15, 2002.

The Toronto Stock Exchange (“TSX”) has its own requirements for disclosure. The TSX Company Manual³¹ sets out at Part IV.B the conditions for listed companies in order to remain listed on the TSX. Sections 406 to 423.14 lays out the provisions for timely disclosure and sections 437 to 454 discuss annual reports, annual financial statements and interim financial statements. The TSX also requires an issuer to enter into a listing agreement (Appendix A of the TSX Company Manual) which contractually obligates an issuer to comply with the disclosure requirement of the exchange. Appendix B of the TSX Company Manual gives additional disclosure standards for issuers engaged in mineral exploration, development and production. This calls for issuers to comply with NI 43-101, along with the requirements of the TSX, OSA and rules and policies of the securities regulatory body. A Form 7 “Mining Company/Oil & Gas Company Report” must also be filed.

The TSX has issued a Policy Statement on Timely Disclosure and Related Guidelines.³² This policy is substantially the same as old National Policy 40, which NP 51-201 replaced. It requires immediate disclosure of material information upon that information becoming known to an issuer. Although the OSA only requires disclosure of a material change, the TSX requires disclosure of material information, a broader definition.

The TSX has also issued “Electronic Communications Disclosure Guidelines”³³ to provide assistance in disclosing information using the internet. The guidelines are to be used in conjunction with the Timely Disclosure Policy Statement and the rules about disclosure in the OSA. The TSE strongly recommends that all listed companies maintain a corporate website to make investor relations available electronically, however disclosure by the internet alone will not meet an issuer’s disclosure requirements.

III. CASES

Materiality has been a concept that courts have struggled with both in Canada and in the U.S. The concept of materiality was analyzed in *SEC v. Texas Gulf Sulphur Co.*³⁴ (“*Texas Gulf*”). In this case, the employees of a mining company purchased stock in the company after the discovery of large deposits of ore. The company released ambiguous statements about the drilling and then released a detailed statement, which resulted in a substantial increase in stock value.

³¹ The TSX Company Manual is available on the TSX website at www.tse.com or available in loose-leaf form through CCH Canada Limited in the *Canadian Stock Exchanges Manual*. The TSX Company Manual is a general but not exhaustive guide to aid listed companies in fulfilling the TSX’s filing and reporting requirements.

³² Available on the TSX website at www.tse.com.

³³ Available on the TSX website at www.tse.com.

³⁴ 401 F.2d 833 (1968).

The court in *Texas Gulf* defined the test of materiality as whether a reasonable man would attach importance to the information in determining his choice of action in the transaction in question. This includes any fact which in reasonable and objective contemplation might affect the value of the corporation's stock or securities such as facts that affect the future of the company. The court at this time said that these facts do not have to be disclosed immediately, the timing of which is a matter of the business judgment of the corporate officers; however, those with the information must not trade in the corporation's securities. Finally, the case held that a factor in determining if a fact is material is the importance attached to it by those who knew about it.

The defendants in this case argued that because the information was speculative, it was not material. The court established a probability/magnitude standard for determining the materiality of speculative development:

Whether facts are material ... will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.

The court found that the drilling results were material, including the visual evaluation of the drill core. The defendants possessed undisclosed material information and traded in securities of the company, which was prohibited by law.

The 1976 U.S. case of *TSC Industries v. Northway Inc.*³⁵ ("TSC") established the definitive test for materiality. The test the court set out was that materiality depends on the objective importance to reasonable investors. However, the court went on to say that this objective standard should be taken with a view to the total mix. This view to the total mix creates the possibility that the materiality of identical facts will depend on the context surrounding those facts.

In *Re Apple Computer Securities Litigation*,³⁶ the court adopted the total mix standard of *TSC*. The case involved a number of statements made by Apple regarding one of their products. The plaintiff investors contended that the statements were misleading and the company did not disclose the negative material facts about the product but rather only presented the positive ones. The court cautioned that hindsight was not a tool to be used when examining the materiality of forecasting. Rather, the focus should be on what effect the disclosure would have on the market.

³⁵ 426 U.S. 438 (1976).

³⁶ 672 F.Supp. 1552 (1987).

When dealing with materiality, it is the case of *Basic v. Levinson*³⁷ (“*Basic*”) that sets the standard. The court expressly adopted *TSC* as the standard for materiality. A fact or an omitted fact is material if there is a substantial likelihood that its disclosure would have been considered significant by the reasonable investor in making a decision. Information doesn’t become material by a denial of the information.

Basic does note that the application of materiality is straightforward where the impact on the company is certain. However, where an event is speculative in nature, it is much more difficult to ascertain whether the reasonable investor would have considered the omitted information important at the time. In the context of mergers, the court rejected the agreement-in-principle test stating:

A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the securities act and Congress’ policy decision. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over- or underinclusive.

This confirms the fact-specific inquiry into the significance the reasonable investor would place on the withheld or misrepresented information.

Canadian securities regulators have also grappled with the concept of materiality. Justice Trainor of the British Columbia Supreme Court summarized the problems in *Trian Equities Ltd. v. Beringer Acquisitions Ltd.*³⁸ (“*Trian*”) in a quote from the unreported Ontario High Court decision of *Core-Mark International v. 162093 Canada Ltd.*:

The test, though simply stated, is not easy to apply. Materiality is a delicate assessment requiring the exercise of judgment and common sense. Matters that may be the subject of negotiation amongst individuals may be inappropriate for public disclosure. Care must be taken that the investing public is not misled. There is inevitably a certain amount of give and take in dealing with matters of this kind. Perfection is unattainable and with hindsight it is easy to be critical.

In Canada, except Quebec, the test for materiality has become known as the market impact test. This is the same as the test for a material fact as set out in the securities act under the definition of “material fact”. It is important to note that this is different from the test for a material change which is

³⁷ 485 U.S. 244 (1988).

³⁸ [1992] B.C.J. No. 2813 (B.C.S.C.).

a change in the business, operations, assets or ownership of the issuer that would reasonably be expected to have a significant effect on the market price or value of the securities of the issuer.

The statute makes it clear that there is a distinction between a material fact and a material change. Justice Nunn of the Nova Scotia Supreme Court in *Amirault v. Westminer Canada Ltd.*³⁹ acknowledged that National Policy 40 was to be applied and recognized that it imposed a higher standard of disclosure for material information, being both material changes and material facts. It is the responsibility of the issuer to determine what information is material. However, before a fact can become material, it must be established. This means that not every single thing needs to be reported. If every suspicion that could affect the market price were to be reported, it would result in market chaos. Justice Nunn stated at page 100:

In a mining exploration company, there are many facts, i.e., events, occurrences, results and the like occurring regularly and often important to the company's operation but to hold that all these, or all important things are material and must be disclosed would create not an open and fair market place but rather a chaotic one. For example, as here, if you have an expected grade which upon some initial sampling turns out to be lower that certainly is a fact and undoubtedly an important one. However, to say that it is material and required to be disclosed is another matter for within a day or week the sample grade may change upward dramatically. If both were disclosed as material information, the market could go up and down like a yo-yo and would be open to unresolvable and myriad claims of manipulation – reveal a few pessimistic facts, bring down the price of the stock, then release some favorable facts for the reverse effect.

In this case, the court felt that the facts of grade and ore reserves would become material facts when the company is satisfied as to the accuracy of the fact. This involves performing the necessary work to establish the fact.

The pivotal case in Canada as to materiality is *Pezim v. British Columbia (Superintendent of Brokers)*⁴⁰ (“*Pezim*”). In this case, the defendants were officers or directors of two companies, Prime Resources Corporation (“Prime”) and Calpine Resources Inc. (“Calpine”). There were allegations that Prime or Calpine failed to disclose all material changes of assay results before the company had granted or re-priced options. The defendants claimed that they were prevented from knowing these results due to a “Chinese Wall”.

³⁹ [1993] N.S.J. No. 129 (N.S.S.C.).

⁴⁰ [1994] S.C.J. No. 58 (S.C.C.).

The Supreme Court of Canada determined that although not all changes are material changes, a change in assay and drilling results could amount to a material change. It is not necessary for there to be a physical change for there to be a material change. Not only is there a duty to disclose under the Act, but there is an active duty on the directors to inquire if there is a material change before engaging in securities transactions. This duty is not displaced if there is a “Chinese Wall”.

The essence of materiality was summed up by Justice Iacobucci on page 27:

In the mining industry, mineral properties are constantly being assessed to determine whether there is a change in the characterization of the property. Thus, from the point of view of investors, new information relating to a mining property (which is an asset) bears significantly on the question of that properties value. Accordingly, I agree with the approach taken by the Commission, namely that a change in assay and drilling results can amount to a material change depending on the circumstances.

Therefore, a material fact, although it does not amount to a change in the business, operations, assets or ownership of an issuer may still be considered a material change if it is of significant importance to investors regarding the value of an asset.

The court also recognized the jurisdiction of the Commission to make determinations in these manner. The Commission has a degree of specialization and expertise that makes it the best entity to administer and apply the securities legislation. Therefore, the court should generally give deference to the Commission’s decisions.

Although *Pezim* set the standard for materiality in Canada, issuers are still struggling with what information is material and what is not. There have been some recent cases involving the mining industry which deal with the issue of materiality that make it clear that this is a test that is not easy to apply in every day practice.

*Inmet Mining Corp. v. Homestake Canada Inc.*⁴¹ (“*Inmet*”) dealt with the sale of a gold mine from Inmet Mining Corp. (“*Inmet*”) to Homestake Canada Inc (“*Homestake*”). Homestake alleged that Inmet made misrepresentations and did not disclose certain material facts. Inmet provided the raw results of all drill hole assays but did not disclose that it doubted the accuracy and reliability of the company that produced the results. Although the court was primarily concerned with materiality in a contract, it did review the case law on materiality in the securities legislation arena. The test for materiality must

⁴¹ [2002] B.C.J. No. 42 (B.C.S.C.).

be more objective with respect to legislated disclosure because it is aimed at the protection of the general public. “It would be impossible to know what would affect the mind of every purchaser”.⁴² This recognizes the flexible and variable nature of materiality.

In *R. v. Harper*⁴³ (“*Harper*”), the president of Golden Rule Resources Ltd. had issued a press release regarding high gold contents in some soil sample. He then became aware of subsequent soil samples that were negative. The president traded in the securities of the company without disclosing the negative samples. His defense was that he had been told by his geologist that he could ignore the negative samples because they were in error.

The trial court found that the soil samples were material information that should have been disclosed. The Court of Appeal upheld the decision and in its discussion of the case, may have established a higher threshold of materiality for the mining industry than the legislation. The court noted the expert evidence of a geologist that stated that the samples were “highly significant pieces of information to a competent geologist acting reasonably”.⁴⁴ This seems to suggest that materiality is to be viewed from a geologist's point of view.

IV. THE NATURE OF DISCLOSURE REQUIREMENTS

In order to determine what is material and needs to be disclosed, an issuer must not only look to the statutory requirements of the securities acts, but the statutory obligations also must be read in conjunction with the policy statements and rules of the Commission, the stock exchange's policies and the interpretation of materiality by the courts. This makes determining what is material one of the most important yet one of the most difficult areas of securities law.

The *BCSA* defines “material change” and “material fact” in section 1(1). A “material change” means a change in the business, operations, assets or ownership of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer. A “material fact” means a fact that significantly affects or could reasonably be expected to significantly affect the market price or value of the securities.

Section 85 of the *BCSA* and section 75 of the *OSA* requires issuers to make public disclosure of material changes in their affairs on a timely basis. As a material change must involve a change in the business, operations or ownership of the issuer, not all changes are necessarily reportable. (The

⁴² *Inmet, supra*, at paragraph 127.

⁴³ [2002] O.J. No. 8 (Ont. Sup. Ct. J.).

⁴⁴ *Harper, supra*, at paragraph 18.

OSA uses the phrase “change in business, operations or capital”.) There appears to be a distinction between an internal change and an external change. An internal change would be one the issuer would be obligated to disclose, however, an external change, such as a change to the bank rate, would probably not need to be disclosed as it is an act applicable to business generally and not unique to a particular issuer.⁴⁵ In *Pezim*, the court also noted that a drilling result could be material, even though it wasn't a change in the issuer's assets.

A change is only material where it would be reasonably be expected to have a significant effect on the market price or value of the securities of an issuer. Materiality is therefore closely linked to the investment decision process. This focus on price or value, however, may have the effect of excluding disclosure of matters as a material change that may be material to an investor in making an investment decision but does not have the effect of altering market price or value. Cases such as *Basic*, *Triam* and *Pezim* attach a standard of materiality of the reasonable man: whether a reasonable man would attach importance to the information in making an investment decision. Therefore, a simple focus on price or value is not necessarily sufficient to determine materiality.

A material change can also include a decision to implement a change even if the confirmation of that decision has not been made by the directors of the issuer. The definition of material change in both the *BCSA* and the *OSA* includes a decision to implement a change made by senior management of the issuer who believe that confirmation of the decision by the directors is probable or the directors of the issuer. It is the decision itself that is reportable under this portion of the definition, not the future change. The mere intention to implement the material change would not be reportable unless it is fully within the power of the issuer to do so. A proposed change can only become material when the Board of Directors decides to implement it or at the very least, when senior management decides to implement it and management is fairly certain that the Board of Directors will confirm that decision.

If a material change occurs in the affairs of an issuer, the issuer must file a press release as soon as practicable. In addition, the issuer must file a required report (Form BCF 53-901.F “Material change report under section 85(1) of the Act”) as soon as practicable but within 10 days after the date on which the change occurs. NP 51-201 suggests that a news release issued through a widely circulated news or wire service is sufficient to satisfy the disclosure requirements.

The TSX requires immediate disclosure of material information upon the issuer becoming aware of that information. “Material information” is defined as both material changes and material facts. This is a higher standard than is imposed by the securities legislation. NP 51-201 also uses the term

⁴⁵ Alboini, Victor P., *Securities Law and Practice*, 2nd ed. (Loose-leaf) (Toronto: Carswell) at 18-10.

“material information”. This has, to a large extent, eliminated the distinction between a “material change” and a “material fact” as it encompasses both. This broad definition could include events that are beyond the issuer’s control such as political, economic and social developments. NP 51-201 recognizes that generally, issuers are not required to disclose these external events unless they have a direct effect on the business and affairs of the issuer that is material and that effect is uncharacteristic of the effect generally experienced by other issuers.

In some circumstances, material information can be reported on a confidential basis.⁴⁶ In such cases, no press release is filed but a report marked “confidential” must be filed with the commission. Confidential reporting may be done where, in the opinion of the issuer, disclosure would be detrimental to the interests of the issuer.

V. CORPORATE GOVERNANCE PRACTICES

1. Problems from the Past

In the past decade, there have been many problems that boards of directors have faced on how to deal with materiality. In the early 1990s there were several highly publicized incidents of questionable disclosure.

Part of the problem was the inadequate role of the relevant statutory provisions. The regulations regarding disclosure and materiality fall not only under the corporate legislation but also under the securities legislation and the exchange rules. The definitions of materiality were vague, broad and subjective, which lead to uncertainty over what is material and needs to be disclosed and what is not. Some sections of the securities act only require material changes to be disclosed while others require both material changes and material facts. In addition, materiality often depends on the context in which it is viewed, which only adds to the lack of clarity regarding this matter.

Disclosure that did occur was often only positive; negative information was not viewed to be material enough to disclose. Press releases were frequently designed to promote the purchase of stock rather than disclose material information. There was a lack of statutory civil liability for inadequate disclosure. All these factors lead to both confusion and uncertainty for directors as to what was material and what needed to be disclosed.

⁴⁶ BCSA section 85(2); OSA section 75(3); NP 51-201 section 2.2.

For many years, the normal means of disclosing material information was through the prospectus, supplemented by the corporate law requirements of annual financial statements.⁴⁷ Over time, disclosure became a matter that was increasingly regulated by the securities industry and was introduced into securities legislation for the first time in 1979 in the *OSA*.

In 1994, in response to the problems facing the Canadian securities industry, the Toronto Stock Exchange Committee on Corporate Governance in Canada released its report and guidelines for improved corporate governance entitled “Where were the Directors”⁴⁸ (The Dey Report). This committee was set up to study the state of corporate governance in Canada and make recommendations as to ways to improve the efficacy of governance.

The Dey Report found that there were several instances of breakdown due to ineffective governance. Boards and shareholders together share the responsibility for ineffective governance. Corporate governance was not a high priority to boards and shareholders were passive on the issue. The report recommended that issuers create a committee of directors with the general responsibility for developing a corporation’s approach to governance issues. This committee should be independent of the management of the issuer to allow directors to freely exchange views and to effectively assess the direction of the issuer. Each issuer should describe in its annual report or information circular its system of corporate governance.⁴⁹

Five years later, a follow up report, “Five Years to the *Dey*”,⁵⁰ found that progress had been made towards achieving the goals set out in The Dey Report. However, only one in four boards gave formal attention to policy development for corporate communications. Only about one in three boards approved news releases on all material matters. On the subject of corporate governance as a whole, less than half of the boards had explicit processes to deal with corporate governance issues, stating that “good corporate governance is simply practiced, with little separate discussion”.⁵¹ This suggests that although corporate governance is an issue that is increasingly becoming more of a concern to

⁴⁷ Alboini, Victor P., *supra*, at 18-3.

⁴⁸ The Dey Report of 1994, “Where Were the Directors: Guidelines for Improved Corporate Governance in Canada” was a study done by The Toronto Stock Exchange Committee on Corporate Governance in Canada. The Toronto Stock Exchange sponsored the report to examine the state of corporate governance. It concluded that there was a need for improved governance and to increase shareholder confidence in the efficacy of the governance of Canadian corporations.

⁴⁹ The Dey Report, Part VI.

⁵⁰ The Report on Corporate Governance, 1999, “Five Years to the *Dey*” was a follow-up study to The Dey Report sponsored by The Toronto Stock Exchange and the Institute of Corporate Directors. One of the recommendations in The Dey Report was to have a successor committee monitor developments in corporate governance and evaluate the continued relevance of the recommendations.

⁵¹ Five Years to the *Dey*, page 23.

stakeholders and regulators, issuers are resistant to accepting that formalized corporate governance should be put into place. A complaint of the issuers that participated in the report was that the recommendations in The Dey Report were unrealistic and too rigid for everyday practice.

In 1995, the Toronto Stock Exchange Committee on Corporate Disclosure released its interim report on corporate disclosure called the Allen Report. The final report was released in 1997.⁵² The Committee was formed to review continuous disclosure by public corporations in Canada, to comment on the adequacy of such disclosure and to determine whether additional remedies should be available to injured investors or to regulators if corporations fail to observe the rules.

The Allen Report was focused on the practice of selective disclosure. It made recommendations designed to equalize access to information among investors. First, the authors of the report recommended the creation of a limited statutory regime whereby issuers and others who are responsible for continuous disclosure violations may be liable in civil actions by injured investors to recover their damages. Second, they recommended initiatives to improve the effectiveness of the regulatory network that creates, monitors and enforces continuous disclosure rules. This included the full integration of disclosure rather than the current separation into transactional disclosure and continuous disclosure.

The report made several recommendations regarding statutory civil liability. It proposed that any person who buys or sells a security of an issuer during the period between the date of the misleading information and the date when that information was corrected, or between the date when the information should have been disclosed and the date the information was disclosed, should have a cause of action. The issuer, each director of the issuer and each officer of the issuer who authorized, permitted or acquiesced in the misleading or non-disclosure, each controlling person, experts and each influential person should be liable.

While these recommendations have been debated, they have not yet been introduced into securities legislation. In 1998, the Canadian Securities Administrators ("CSA") reviewed and supported the Allen Report and subsequently published proposed amendments to the securities legislation (the "1998 Draft Legislation"). After receiving comments on the 1998 Draft Legislation, the CSA revised its proposals. The result was Canadian Securities Administrators Notice 53-302 "Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definitions of "Material Fact" and "Material Change". The notice proposed amendments to

⁵² The Allen Report, *supra*. In addition, in 1995 The Interim Report of the Committee on Corporate Disclosure "Towards Improved Disclosure: A Search for Balance in Corporate Disclosure" was released and presented the committee's initial conclusions for comment and debate.

securities legislation that would give investors in the secondary market the right to sue any public company and key related persons for making public misrepresentations about the company or for failing to make required timely disclosure. These proposals have not been proceeded with at this time.

The Ontario Securities Commission's Five Year Review Committee⁵³ (the "Committee") recently released a report considering whether the current disclosure standards in the *OSA* should be altered to require companies to disclose all "material information".⁵⁴ Material information is defined as "any information relating to the business and affairs of a company that results in or would reasonably be expected to result in a significant change in the market price or value of any of the company's listed securities".⁵⁵

The Committee determined that employing a material information standard would frustrate the business necessity to keep certain information confidential during negotiations or in similar circumstances, and would also impose a large administrative burden on issuers to keep investors current about all of the company's significant dealings. The Committee noted that certain exchange policy documents, such as the TSX's Timely Disclosure Policy, already require that all material information be disclosed. As a potential difficulty, the Committee noted that the TSX is only able to enforce its policies through de-listing, which punishes both issuer and investor. Despite their apprehensions regarding a material information disclosure standard, the Committee recommended that the Ontario Securities Commission's enforcement powers under the *OSA* be increased to allow the Commission to enforce exchange policies. This adjustment would allow the TSX to seek the Commission's wider scope of enforcement mechanisms in applying their material information standard.

A second issue considered by the Committee was whether the *OSA* should be revised to require a standard of materiality consistent with the U.S. focus on the reasonable investor as opposed to the current focus on market impact. Under a reasonable investor standard, a change, fact or piece of information is material if "there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision".⁵⁶ The Committee recommended that to increase

⁵³ Five Year Review Committee Draft Report: "Reviewing the Securities Act (Ontario)", (2002) 25 OSCB, chaired by Purdy Crawford, was the culmination of two years of meetings, research and deliberations concerning the current state of securities legislation in Ontario. The report was issued in draft form in order to solicit the views of the public regarding the recommendations.

⁵⁴ Five Year Review Committee Draft Report section 12.1.b.

⁵⁵ TSX Policy Statement on Timely Disclosure and Related Guidelines, p. 2.

⁵⁶ Five Year Review Committee Draft Report section 12.2.a.

consistency with U.S. standards, the current securities legislation be revised to incorporate a reasonable investor standard of materiality.

Selective disclosure is defined by the Committee as “material non-public information that is disclosed to one or more individuals or companies and not broadly to the investing public”.⁵⁷ Several problems result from selective disclosure. First and foremost, investors who are not provided the information suffer from the market actions of the inside or tipped-off traders. This leads to a lack of confidence in the operation of the market. Second, both Canadian and American regulators have noted that analysts are performing less of their own research, relying instead on information provided to them by issuers. This is significant both for the decline of independent research, and for the leverage that issuers gain with analysts who are reliant upon their sharing of information.

The Committee determined that the current provisions in the *OSA*⁵⁸ relating to tipping and insider trading were sufficient for dealing with selective disclosure issues. The Committee also noted with approval that NP 51-201 provides a set of suggested disclosure policies and guidelines for issuers to employ.

In the 2001 case of *Re Air Canada*⁵⁹ (“*Air Canada*”), the Ontario Securities Commission reached an enforcement settlement relating to selective disclosure with Air Canada. The facts of the case involved two employees of Air Canada releasing information during ‘quiet hours’ to several analysts prior to any public announcement by the company. The stock opened lower the next morning, and it was not until afternoon that Air Canada determined the cause of the movement. A statement was immediately released by Air Canada to equalize the information available in the market, but the statement was not as detailed as the earlier disclosure. Air Canada took full responsibility for the leak, and was able to negotiate a settlement agreement that involved admitted fault and discipline under section 127 of the *OSA* for contravening public interest, but no liability under section 76(2). Air Canada’s “good faith” and cooperation with the Commission were key in reaching this settlement.

The British Columbia Securities Commission has tabled several concepts relating to disclosure for discussion.⁶⁰ As a shortcoming in the current regulatory framework, the Commission identified that they “do not require issuers and registrants to take any responsibility for controlling illegal insider trading by persons who work for them and have access to inside information”.⁶¹ The Commission

⁵⁷ Five Year Review Committee Draft Report section 13.1.

⁵⁸ *OSA* section 76 or *BCSA* section 86.

⁵⁹ 24 O.S.C.B. 4899 (Ontario Securities Commission).

⁶⁰ BCN 2002/12 “New Concepts for Securities Regulation”.

⁶¹ BCN 2002/12, Concept 4.

proposes to put in place requirements on issuers to monitor and regulate members of their organizations who have access to insider information. The Commission also proposes a new regime of civil remedies for insider trading.

2. Comparison of Other Jurisdictions

As noted by the Ontario Securities Commission Five Year Review Committee,

U.S. federal securities laws impose no general duty to disclose material developments as they occur, except where:

- (a) it is necessary to correct a previous untrue statement that has become materially misleading and on which the market is still relying;
- (b) it is necessary to update forward-looking statements or projections on which the market continues to rely that were true when made, but later became materially false or misleading in the context of subsequent events; or
- (c) the issuer is in the process of buying or selling its own securities or wishes to facilitate such transactions by insiders.⁶²

The United States Securities and Exchange Commission's (the "SEC") "periodic reporting requirements, such as Form 8-K,⁶³ have instead been used to complement, rather than duplicate, the various U.S. stock exchange rules, which generally require disclosure of all material information".⁶⁴

The SEC proposes to increase the statutory requirements for disclosure through Form 8-K amendments. The SEC recently advocated the inclusion of additional events that would trigger a Form 8-K Disclosure ("Additional Form 8-K Disclosure").⁶⁵ Form 8-K requires issuers to report certain events within 15 days or five business days of the event (depending on the event).⁶⁶ There are

⁶² Five Year Review Committee Draft Report, section 12.1.c.

⁶³ Form 8-K is derived from the *Securities Exchange Act of 1934*, (1934) U.S.C. ch. 404. Form 8-K is used for current reports under section 13 or section 15(d) of the *Exchange Act* or for reports of non-public information required to be disclosed by Regulation FD (see note 74).

⁶⁴ Five Year Review Committee Draft Report, section 12.1.c.

⁶⁵ RIN 3235-A147 "Proposed Rule: Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date".

⁶⁶ Form 8-K specifies the dates required in Part B: Events to be Reported and Time for Filing of Reports. Events that must be recorded within 15 calendar days are: changes in control of registrant; acquisition or disposition of assets; bankruptcy or receivership; and changes in fiscal year. Events that must be recorded within five business days are: changes in registrant's certifying accountant and resignations of registrant's directors. Other events and Regulation FD (see note 74) disclosure must be filed in accordance with Rule 100(a) of Regulation FD. Rule 100(a) states that whenever an issuer, or person acting on its behalf,

currently nine categories of events⁶⁷ that trigger the requirement of Form 8-K reporting, ranging from the purchase or sale of significant amounts of assets to the resignation of a company director. In Additional Form 8-K Disclosure, the SEC has proposed an additional 13 categories of events that would trigger Form 8-K reporting. Included are such categories as material impairments, the termination of significant customer relationships and the entry into a material agreement not made in the ordinary course of business.⁶⁸ The SEC has also proposed that the deadline for filing reported events be shortened to two business days after the occurrence of the event.

In addition to Additional Form 8-K Disclosure, the SEC has made several other proposals related to disclosure in light of the recent control lapses in the U.S. Securities market. The most prominent of these proposals is “Certification of Disclosure in Companies’ Quarterly and Annual Reports”⁶⁹ (“Certification of Disclosure”). This proposal recommends that “a company’s principal executive

discloses material nonpublic information to certain enumerated persons (in general, securities market professionals or holders of the issuer’s securities who may well trade on the basis of the information), the issuer must make public disclosure of that same information simultaneously (for intentional disclosures) or promptly (for non-intentional disclosures) (RIN 3235-AH82 “Final Rule: Selective Disclosure and Insider Trading” section II, part B). Financial Statements and Exhibits must be filed in accordance with various sections of the *Exchange Act*.

⁶⁷ The nine categories are listed in note above.

⁶⁸ The entire proposed list of new items to be included in Form 8-K are:

- Entry into a material agreement not made in the ordinary course of business;
- Termination of a material agreement not made in the ordinary course of business;
- Termination or reduction of a business relationship with a customer that constitutes a specified amount of the company’s revenues;
- Creation of a direct or contingent financial obligation that is material to the company;
- Events triggering a direct or contingent financial obligation that is material to the company, including any default or acceleration of an obligation;
- Exit activities including material write-offs and restructuring charges;
- Any material impairment;
- A change in a rating agency decision, issuance of a credit watch or change in a company outlook;
- Movement of the company’s securities from one exchange or quotation system to another, delisting of the company’s securities from an exchange or quotation system, or a notice that a company does not comply with a listing standard;
- Conclusion or notice that security holders no longer should rely on the company’s previously issued financial statements or a related audit report; and
- Any material limitation, restriction or prohibition, including the beginning and end of lock-out periods, regarding the company’s employee benefit, retirement and stock ownership plans.

The SEC also proposes to move the following two items from other *Exchange Act* reports to Form 8-K:

- Unregistered sales of equity securities by the company; and
- Material modifications to rights of holders of the company’s securities.

⁶⁹ RIN 3235-A154 “Proposed Rule: Certification of Disclosure in Companies Quarterly and Annual Reports” was originally released for comment on June 14, 2002. On July 30, 2002, President Bush signed into law the *Sarbanes-Oxley Act of 2002* which required the SEC to adopt rules implementing specified statutory certification requirements for principal executive officers and principal financial officers. This proposal reflects those rules and will be adopted on August 29, 2002.

officer and principal financial officer ... certify that, to their knowledge, the information in the company's quarterly and annual reports is true in all important respects and that the reports contain all information about the company of which they are aware that they believe is important to a reasonable investor".⁷⁰ In a related regulatory effort, the SEC posted a list on July 29, 2002 of 947 companies whose top officials are required to file sworn statements attesting to the accuracy of their companies' most recent annual and quarterly financial reports.⁷¹

A third recent SEC proposal⁷² recommends that periodic reports disclosed by an issuer (i.e., annual and quarterly reports) should include specific discussion of all accounting estimates and uncertain projections made in the creation of financial statements. The proposal also recommends that if an issuer makes a material adjustment to its accounting policy, the issuer must explain in detail the reasons for adopting the new policy. Discussion on both these matters is to be included in the Management's Discussion and Analysis section of the report.

A final SEC disclosure proposal is entitled "Form 8-K Disclosure of Certain Management Transactions".⁷³ This proposal recommends that Form 8-K also require disclosure of any securities or loan activities between directors or executive officers and their companies.

The principal SEC document addressing selective disclosure is Regulation Fair Disclosure ("Regulation FD").⁷⁴ Regulation FD is very similar in structure and intent to the tipping and insider trading provisions contained in Canadian provincial securities legislation. Regulation FD requires that "reporting companies disclose material information through broad non-exclusionary public means and not selectively to securities analysts and other market professionals. Whenever an issuer, or any person acting on its behalf, discloses material non-public information to specified persons, the issuer

⁷⁰ Certification of Disclosure, *supra*, at page 1, Summary.

⁷¹ SEC News Release, 2002-115.

⁷² RIN 3235-AI44 "Proposed Rule: Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies" was released for comment in May 2002. The SEC proposed disclosure requirements that would enhance investor's understanding of the application of companies' critical accounting policies.

⁷³ RIN 3235-AI43 "Proposed Rule: Form 8-K Disclosure of Certain Management Transactions" was proposed in order to provide investors with prompt disclosure of directors' and executive officers' transactions in company equity securities, directors' and executive officers' arrangements for the purchase and sale of company equity securities and loans of money to a director or executive officer made or guaranteed by the company so that investors will be able to make investment and voting decisions on a better-informed and more timely basis.

⁷⁴ Regulation FD (RIN 3235-AH82) is derived from the *Securities Exchange Act of 1934* and came into force on October 23, 2000. The SEC adopted new rules to address the issues of selective disclosure by issuers of material nonpublic information, when insider trading liability arises in connection with trader's "use" or "knowing possession" of material non-public information, and when the breach of family or other non-business relationship may give rise to liability under the misappropriation theory of insider trading.

must simultaneously (for intentional disclosures) or promptly (for non-intentional disclosures) make public disclosure of that information”.⁷⁵

Regulation FD helped clarify the law relating to selective disclosure in the United States. Prior to Regulation FD, selective disclosure was addressed under general principles of fraud law.⁷⁶

The rules adopted by the U.S. securities exchanges are similar to the SEC’s rules and policies. As an example, the New York Stock Exchange (“NYSE”) has issued guidelines in its NYSE Listed Company Manual for the public release of information.⁷⁷ These guidelines are very similar to the SEC’s Regulation FD. As the NYSE noted in a letter to executives of listed companies⁷⁸ dated March 22, 2001, the only significant difference between these rules is the specific requirement in the Timely Alert Policy that disclosure occur through the use of a press conference. By contrast, Regulation FD only specifies that disclosure must be made through broad, non-exclusionary means to the public.

3. Effect of Recent Events in the Market

In 2001, Enron Corporation, one of the world’s largest energy, commodity and services companies collapsed. At the heart of the Enron collapse were issues relating to the corporate governance of the company. Investor confidence in publicly traded companies has been severely shaken and the Enron collapse has changed the way we look at the integrity of the capital markets.

The circumstances of the Enron collapse have prompted regulators and legislators in the U.S. to examine the current regulatory regime with a view to the reliability of corporate disclosure, corporate governance and auditor independence. Canadian securities regulators are scrutinizing more closely the corporate disclosure and accounting by Canadian companies.

The *Sarbanes-Oxley Act of 2002*⁷⁹ (the “*Sarbanes-Oxley Act*”) was signed into law by President Bush on July 30, 2002. It contains new requirements for public companies, accounting firms and law firms that provide services for public companies. It requires that the SEC adopt the rules on or before

⁷⁵ BCN 2001/39 “Proposed National Policy 51-201 Disclosure Standards and Rescission of National Policy 40 Timely Disclosure” discussed the initiative taken in the United States in Regulation FD.

⁷⁶ BCN 2001/39, *supra*.

⁷⁷ NYSE Listed Company Manual sections 202.05 and 202.06.

⁷⁸ This letter, dated March 22, 2001, was to the Chief Financial Officers, Corporate Secretaries and Investor Relations Professionals of Listed Companies with respect to the NYSE Timely Alert Policy (sections 202.05 and 202.06) and the SEC Regulation FD from Catherine R. Kinney, Group Executive Vice President of the NYSE.

⁷⁹ 15 U.S.C.S. (2002).

August 30, 2002. These provisions apply to U.S. public companies and to foreign issuers with reporting obligations under the *Exchange Act*.⁸⁰

The *Sarbanes-Oxley Act* requires that the principal executive officer or principal financial officer certify in each annual or quarterly report the following:

- the signing officer has reviewed the report;
- the report does not contain any untrue statement of material fact or omit to state a material fact;
- the financial information fairly presents the financial condition and results of operations of the issuer;
- the signing officers are responsible for establishing and maintaining internal controls, have designed such controls to ensure that material information is made known to them by others, have evaluated the effectiveness of the internal controls and have presented their conclusions about the effectiveness based on their evaluation;
- the signing officers have disclosed to the issuer's auditors and the audit committee all significant deficiencies in the operation of the internal controls and any fraud that involves management or other employees who have a significant role in the issuer's internal controls; and
- the signing officers have indicated whether or not there were any significant changes in internal controls or other factors that could affect internal controls.⁸¹

Each periodic report filed by an issuer pursuant to section 13(a) or 15(d) of the *Exchange Act* that contains financial statements must be accompanied by a written statement by the CEO and CFO certifying that the report fully complies with the requirements of the sections and the information contained in the report fairly presents, in all material aspects, the financial condition and results of operations of the issuer.⁸² Any CEO or CFO that certifies a report that does not conform with the certification will be criminally liable. If the CEO or CFO "knowingly" certifies the report, the fine is up to \$1,000,000 (U.S.) or imprisonment of up to 10 years or both. If the CEO or CFO "willfully" certifies a report "knowing" it does not conform, the fine is up to \$5,000,000 (U.S.) or imprisonment of up to 20 years or both.

⁸⁰ *Exchange Act, supra*, note 2.

⁸¹ *Sarbanes-Oxley Act*, section 302: Corporate Responsibility for Financial Reports.

⁸² *Sarbanes-Oxley Act*, section 906: Corporate Responsibility for Financial Reports.

For the purposes of the certification process, “issuer” includes any company with securities registered under section 12 of the *Exchange Act* and any company that is required to file reports with the SEC under section 15(d).⁸³ A number of Canadian issuers who must submit quarterly or semi annual financial statements to the SEC will need to comply with these requirements.

VI. CONCLUSION

Materiality is a difficult standard to apply, especially in the mining industry context. It is a test that defies being describes in terms that are black and white but rather can vary from incident to incident depending on the context surrounding the information. With the introduction of NI 43-101, which imposes additional standards on the mining industry, materiality will likely be an issue that continues to cause confusion and uncertainty.

The effect of NP 51-201, NI 43-101 and the recent events in the market will be to make board of directors and audit committees more diligent regarding disclosure. There is and will continue to be a greater emphasis on corporate governance, both from the regulators and from private industry. We have already seen some companies move towards the creation of corporate governance committees and disclosure committees to ensure the integrity of communications between the issuer and the stakeholders. As a failure to comply with the standards set up in the industry will continue to have greater consequences, materiality and disclosure will be an ongoing concern for directors and officers of companies, who will ultimately bear responsibility for any disclosure made.

⁸³ *Sarbanes-Oxley Act*, section 2(a)(7): Definitions.

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