

# **CORPORATE DISCLOSURE POLICIES**

## **ASSURING EQUAL ACCESS FOR ALL MARKET PARTICIPANTS**

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**April, 1998**

SOL:231856-1

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## **Introduction**

Directors and senior management of Canadian public companies have a duty to provide fair and equal access to material corporate information to all investor constituents, including analysts, institutional investors and the retail investing public. Such disclosure is necessary both to ensure legal compliance with formal statutory requirements and exchange policies and to protect the corporate reputation for integrity and credibility in its disclosure practices.

The likely imposition of statutory civil liability for continuous disclosure documents and statements by Canadian securities regulators will result in an increased emphasis by issuers on the establishment and implementation of formal corporate disclosure policies and guidelines. Both The Toronto Stock Exchange (the "TSE") and the Canadian Investor Relations Institute ("CIRI") have recommended that all listed issuers implement such formal disclosure policies.<sup>1</sup>

This paper reviews recent developments and provides practical suggestions as to appropriate corporate policies and procedures to assure the timely and accurate disclosure of material, non-public corporate information, on a non-selective, non-discriminatory basis in accordance with applicable regulatory requirements. Problems of selective disclosure are emphasized, as this concern is particularly acute in the area of informal, typically oral, disclosure where one-on-one meetings with analysts are common.

Formal communications such as prospectuses and proxy circulars are carefully vetted by the corporation and its professional advisors and are made available to the investing public, both through filing and through distribution, on an equitable basis. In contrast, oral communications, such as executive speeches, interviews with the press and oral communications with securities analysts and institutional investors are informal and are inherently subject to a greater risk of selective disclosure of material non-public information.

## **The TSE Committee Report on Corporate Disclosure**

The release in Canada of the Final Report of the TSE Committee on Corporate Disclosure (the "Allen Report"), issued in March 1997, has encouraged an enhanced awareness of the need for formal corporate disclosure policies and of the corporate responsibility of reporting issuers to ensure equal access to information for all market participants. In its report, the TSE Committee recommended the establishment of limited statutory civil liability for misrepresentations and omissions in continuous disclosure to investors in secondary markets. Liability would extend not only to issuers, but also to responsible persons such as directors, participating officers, controlling shareholders, promoters and experts.

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<sup>1</sup> See the TSE, "Policy Statement on Timely Disclosure and Related Guidelines" (1997) 20 OSCB 2905, and the Canadian Investor Relations Institute, "Standards and Guidance for Disclosure" (February, 1978). See also, the American Society of Corporate Secretaries, Inc., "Suggested Guidelines for Public Disclosure and Dealing with the Investment Community", 1997.

A due diligence defence would be available in respect of disclosures in core documents such as annual information forms, financial statements, management discussion and analysis and proxy information circulars. Outside directors would be subject to a lower "not knowingly or grossly negligent" test in respect of quarterly financials and material change reports.

Non-core documents such as press releases and oral statements, such as statements to analysts, would be subject to a gross negligence test and forward-looking information would be subject to a requirement of appropriate cautionary language and a reasonable basis test. Liability for each issuer would be further limited to a maximum of \$1 million or 5% of market capitalization and liability would be allocated proportionately rather than jointly and severally, to responsible parties.

The British Columbia, Alberta, Ontario and Quebec members of the Canadian Securities Administrators (the "CSA") have adopted the Allen Report recommendations and have submitted a joint recommendation to their respective governments proposing that provincial securities legislation be amended to provide a limited statutory right to action to investors in the secondary market for misrepresentation in disclosure documents and oral statements issued or on behalf of issuers and other responsible persons.<sup>2</sup>

Coupled with the existence of effective class action legislation in British Columbia, Ontario and Quebec and the likely revision of the definition of "material fact" and "material change" to align Canadian disclosure standards with the test prevalent in the United States and in Quebec (which focuses on whether the information would be substantially likely to influence a reasonable investor in making an investment decision rather than on an ex-post examination of the effect of the disclosure in market price), such legislation will create a real risk of civil liability for defective or selective disclosure.

With respect to selective disclosure in oral communications, the Allen Report encouraged group analysts meetings and the use of telephone conference calls and other technology to disseminate information more widely. In a parallel U.S. development, Arthur Levitt Jr., Chairman of the U.S. Securities and Exchange Commission, focussed in a recent (February 27, 1998) speech on the obligation of companies to "more evenly communicate with investors" warning that a company's conference call to equity research analysts before issuing a press release can lead to insider trading charges when the analysts or their firms trade in information learned during the call.

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<sup>2</sup> (1997) 20 OSCB 2145. For a discussion, see Susan Wolburgh Jenah, "Following up on the Allen Committee Report: Civil Liability for Continuous Disclosure", Canadian Institute.

## Applicable Securities Laws and Exchange Policies

### *Canadian Disclosure Standards*

Canadian public issuers listed on the TSE are required to immediately disclose all material information<sup>3</sup>. The term "material information" is defined by the CSA in National Policy Statement No. 40 (and in the TSE Timely Disclosure Policy) to mean:

"any information relating to the business and affairs of a company that result 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".

This disclosure standard is more expansive than that imposed by applicable securities legislation which, strictly applied, requires only that a public company disclose "material changes" in its affairs. The term "material change" is defined as:

"a change in the business, operations or capital of an 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 and includes a decision to implement such a change made by the board of directors of the issuer or by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable".

Under the TSE Policy, a company may choose to delay disclosure if disclosure would be unduly detrimental to the interests of the company. The TSE has warned, however, that this confidentiality privilege may be used only infrequently and can only be justified where the potential harm to the company from disclosure may reasonably be considered to outweigh the consequences of delayed disclosure. Under provincial securities laws, a company may also request confidential treatment of a material change report where its directors have yet to accept or reject a management decision to implement a change.

Examples of situations where immediate disclosure may be unduly detrimental include the following:

- (a) release of information which would prejudice the ability of the company to pursue specific and limited objectives or to complete a transaction such as the purchase of a significant asset (e.g., because disclosure would increase the cost of making the acquisition);

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<sup>3</sup> For a survey discussion of Canadian law, see Joan C. Smart and Patricia L. Olasker, "Disclosure Standards in Canada", a paper prepared for the International Bar Association, International Securities Law Committees of the Section on Business Law in September, 1995, (1996) 19 OSCB 221.

- (b) disclosure of the information would provide competitors with confidential corporate information that would be of significant benefit to them. Examples are a decision to release a new product, or details on the features of a new product;
- (c) disclosure of information concerning the status of ongoing negotiations which would prejudice the successful completion of those negotiations.

If disclosure of material information is delayed, confidentiality must be scrupulously maintained. The company should disclose the information to its own employees only on a need to know basis and should monitor its stock for unusual market activity. If rumours or leaks arise, immediate disclosure must be made.

### *Statutory Liability for Selective Disclosure*

Canadian law imposes stricter standards respecting selective disclosure than United States law. In the United States, the decision of the U.S. Supreme Court in *Dirks v. SEC*<sup>4</sup> severely restricted the applicability of insider trading laws in cases of selective disclosure by holding that a corporate insider can be held liable for selective disclosures to analysts only if the insider obtains a personal, objective, economic benefit from tipping the information.

In contrast, applicable Canadian securities laws typically provide an express statutory prohibition against selective disclosure of material non-public information<sup>5</sup>.

For example, Section 76(2) of the *Securities Act* (Ontario) prescribes an offence of "selective disclosure" in the following terms:

"No reporting issuer and no person or company in a special relationship with a reporting issuer shall inform, other than in the necessary course of business, another person or company of a material fact or material change with respect to the reporting issuer before the material fact or material change has been generally disclosed."

Similarly, the TSE, in its Timely Disclosure Policy, states that "it is a cornerstone policy of the Exchange that all persons investing in securities listed on the Exchange have equal access to information that may effect their investment decisions". The TSE encourages listed companies to develop consistent procedures for determining what information is material and how it is disclosed and disseminated, and offers the following guidelines for avoiding selective disclosure:

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<sup>4</sup> 463 U.S. 646 (1983).

<sup>5</sup> For a detailed discussion, see Joseph Groia and Lara Edwards, "Selective Disclosure in Canada and the United States. The Achilles Heel of Insider Trader?", Canadian Institute.

"Make sure that there is no selective disclosure of confidential information to third parties, for example in a meeting with an analyst. This is *tipping*, which is prohibited under securities law ... In the event that selective disclosure of confidential information inadvertently occurs, the company must immediately disclose the information publicly by issuing a press release."

The tipping offense under Canadian securities legislation is in the same category of seriousness as insider trading and is subject to stringent penalties under, for example, Sections 122(1)(c) and 122(4) of the *Securities Act* (Ontario) of monetary fines of not more than \$1,000,000 or imprisonment of not more than two years, or to both, or to damages in an amount equal to triple the profit made by such person by reason of the contravention. Under Section 134(2), a tippee may also be liable to compensate a person who suffers damage as a result of purchasing securities from or selling securities to the tippee.

There are four principal defences available under the *Securities Act* (Ontario) to an allegation of selective disclosure:

1. A reasonable belief that the material fact or material change has been generally disclosed. In this regard, Section 76(4) provides that:

"No person or company shall be found to have contravened subsection (1), (2), or (3) if the person or company proves that the person or company reasonably believed that the material fact or material change had been generally disclosed"; or

2. The person or company reasonably believes that the fact is not material; or
3. The disclosure was in the "necessary course of business". This exception is contained within Section 76(2) and will, presumably, protect necessary selective disclosures where reasonable protections are taken respecting the scope of information being made available and the recipient is advised of the confidential nature of the information disclosed. It is highly unlikely, however, that it could be used to justify selective disclosure to give an institutional investor or analyst a trading advantage; or
4. The existence of corporate disclosure policies and procedures is relevant in defending against selective disclosure allegation. Regulation 175(3) states that:

"in determining whether a person or company has sustained the burden of proof under subsection (1), it shall be relevant whether and to what extent the person or company has implemented and maintained reasonable policies and procedures to prevent ... transmissions of information concerning a material fact or material change contrary to subsection 76(2) or (3) of the Act".

## **Recent Issues in Corporate Disclosure**

Two recent regulatory developments have emphasized the need for a disciplined and thorough approach to continuous disclosure in formal disclosure documentation: the recent CICA pronouncement on segmented financial reporting<sup>6</sup> and the recent CSA pronouncement on Year 2000 disclosure<sup>7</sup>.

As a result of the former, there will be a considerably increased emphasis on more detailed narrative analysis of segmented results in next year's annual reports. The latter development is a good example of the range of issues which securities regulators expect to see discussed in forward-looking MD&A and the depth of detail in which they expect material risks and contingencies to be discussed.

The relevance of these examples is even more significant when one considers that staff of the OSC is on record in stating that their approach to regulating the sufficiency of MD&A disclosure will become stricter once National Policy 47 (the POP Policy) and Ontario Local Policy 5.10 (the MD&A Policy) have been codified as rules pursuant to the OSC's general rule making initiative.

Specifically, in a notice published in September, 1995<sup>8</sup> respecting the 1995 Financial Statement and MD&A Review Program, OSC staff stated as follows:

"Policy reformulation will result in the MD&A requirement becoming a rule. Once adopted, this will clarify and enhance staff's ability to take action on deficient MD&A. Given that the current requirements are in a policy, there has been some hesitation in the past two years on the point of staff to require anything other than prospective amendments to MD&A."

In other words, it appears that staff of the OSC intends to become more willing to impose immediate corrective action on issuers with defective MD&A rather than limit their enforcement activities to recommending prospective improvements in disclosure.

### ***Segmented MD&A Disclosure***

The recent CICA pronouncement on "Segment Disclosure" is the result of a joint project with the Financial Accounting Standards Board and requires public companies, in fiscal years ended in 1998, to disclose more detailed and disaggregated information for each material operating segment, the products and services of such operating segments, the geographic areas in which they operate and

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<sup>6</sup> CICA Handbook, Section 17.01.

<sup>7</sup> Staff Notice 41-301 and 51-302, January 30, 1998.

<sup>8</sup> (1995) 18 OSCB 4596.

their major customers. The purpose of the new accounting rules is to provide information about the different types of business activities a company engages in and the different economic environments in which its different operating divisions operate.

These new accounting rules imply a similarly increased emphasis on segmented disclosure in the narrative MD&A analysis accompanying audited financial statements in annual reports as well as a heightened concern by issuers for the inherent tension between more detailed disclosure and competitive concerns; eg., the concern that disclosure of the profitability of each of a company's core businesses will provide sensitive information to competitors.

**(i) *Reportable Segments***

The new requirements call for disclosure of financial information for each "operating segment" of a Company which exceeds certain quantitative thresholds. Operating segments are defined as components of a company which engage in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the company's chief operating decision makers to assess performance and in making decisions regarding resource allocation, and for which discrete financial information is available from the company's internal reporting systems. Where two or more segments have essentially the same business activity, they may be aggregated together.

**(ii) *Required Disclosures***

There are three broad categories of required disclosure under the new accounting rules applicable to reportable segments: general information; information about reported segmented profit or loss, assets, and the basis of measurement; and reconciliations of the totals of significant segmented items to corresponding company amounts.

As general information, the company is required to discuss the factors used to identify the Company's reportable segments and the types of products and services from which each reportable segment derives its revenues. For each such segment, the issuer must disclose information about profit or loss and assets including operating profit or loss and details of the line items contributing to such profit or loss including revenues, both internal and external, interest revenue and expense, amortization of capital assets and goodwill and other significant non-cash items, abnormal and extraordinary items, net income of investees accounted for on the equity basis, and income tax expense or benefit as well as total assets for each segment, including amount of investment in investees subject to significant influence, and total expenditures for additions to capital assets and goodwill.

In addition, there is a requirement to reconcile reported segment information to total company information, and to provide a description of applicable allocation policies. As a consequence, income and costs not specifically allocated to a reportable segment will be highlighted. In a multi-divisional company, this may include long term indebtedness, income taxes (current and deferred), goodwill amounts and deferred expenses which have not been pushed down to divisions.

### *Year 2000 Disclosure*

The Canadian Securities Administrators have issued a staff notice dated January 30, 1998 (the "Staff Notice"), suggesting that the "Year 2000" date code problem (the "Year 2000 Issue") gives rise to sufficiently significant potential uncertainties that virtually all reporting issuers will be obliged to discuss such risks and uncertainties in MD&A sections of annual reports currently being prepared for fiscal 1997.<sup>9</sup>

The Staff Notice suggests that the requisite MD&A disclosure should include a description of the activities undertaken by the issuer to evaluate the extent of its own internal Year 2000 problems and the state of readiness of its suppliers and customers. The disclosure should include a description of the issuer's action plan to minimize risk exposure and an assessment of the availability of resources, both internal and external to implement necessary remedial action.

The Staff Notice further suggests that the extent of required disclosure will depend on the scope of the issuer's action plan in relation to the degree of its dependence on information technology, the complexity of its systems and the extent of its interaction with third parties. The amount of disclosure necessary will also depend on the degree of the issuer's current state of readiness, the scope of the issuer's activities to date to evaluate the extent of potential problems arising in its own operating and information systems and equipment, and the extent of its vulnerability to the state of readiness of its suppliers, customers and other third parties.

The CSA Staff Notice is only one of a number of recent developments requiring issuers to make disclosure of the state of their Year 2000 readiness and giving impetus to the developing of formal Year 2000 action plans.

These other developments include the following:

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<sup>9</sup> The CICA has released two publications, "Guidance for Directors - The Millennium Bug" and "Assurance Guidelines on Audit Planning". A brief discussion of the Year 2000 responsibilities of management and auditors was included in the December, 1997 issue of Risk Alert and was followed by a special edition of Risk Alert in January, 1998 devoted to audit planning and practice management considerations. Task Force Year 2000 maintains a Year 2000 information site at [strategis.ic.gc.ca/sos2000](http://strategis.ic.gc.ca/sos2000). The Canadian Bar Association has posted an "Outline of Year 2000 Legal Issues" at [www.algonquin.on.ca/cba](http://www.algonquin.on.ca/cba) and intends to post a full discussion paper reviewing Year 2000 legal issues, tentatively entitled "Countdown to Year 2000: Risks and Rewards - The Legal Issues" in May, 1998. The SEC maintains a Year 2000 website at <http://www.sec.gov/news/home2000.htm>

1. The Canadian Institute of Chartered Accountants is finalizing and intends to publish two Year 2000 guidelines, one outlining the required disclosure in financial statements of pertinent Year 2000 issues and the second outlining additional audit considerations, including guidance on addressing the fair presentation of such disclosures.
2. Canadian chartered banks are beginning to incorporate Year 2000 criteria into standard risk assessments for loans. We are already seeing lending institutions representations respecting a borrower's preparedness for Year 2000 as a condition precedent to advancing loans and loan renewals.
3. It is anticipated insurance companies will begin to make the issuance/renewal of insurance policies contingent upon the availability of formal action plans; and that endorsement wording will exclude coverage under certain types of policies.
4. Both business precedence and securities law and accounting requirements dictate that issuers confirm the Year 2000 readiness of their major suppliers and customers. Consequently, it can be anticipated that issuers will receive frequent requests throughout 1998 from their major trade partners seeking confirmation of the issuer's state of readiness including formal action plans and progress reports.

## **The Responsibility of Corporate Directors for Maintaining the Integrity of Corporate Disclosures**

### ***The Standard Trustco Decision***

Directors of public companies have a clear responsibility, beyond merely establishing and monitoring their company's continuous disclosure policies and practices, to ensure the adequacy of corporate disclosures. This principal is abundantly clear, both from the decision of the OSC in the matter of *Standard Trustco Limited*<sup>10</sup> and the recent administrative ruling of the SEC in the matter of *W.R. Grace*<sup>11</sup>.

In the *Standard Trustco* decision, which dealt with the release of financial statements that failed to disclose serious concerns raised by financial institution regulators regarding the financial condition of the issuers regulated subsidiary and, in particular, its loan loss provisions, interest accrual policy and asset variation. The directors of the company argued as a defence that it was appropriate for them to rely on the company's management and on independent legal and accounting advice obtained by management in assessing the adequacy of financial statement disclosure. The OSC rejected this argument and, in particular, stated:

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<sup>10</sup> (1992) 15 OSCB 4322.

<sup>11</sup> Securities Exchange Act of 19934 Release No. 39157 (September 30, 1997).

"... the responsibility ... to make timely and accurate financial disclosure ultimately rests with the directors of those companies... The public has a right to expect that when a reporting issuer releases financial information to the public, the directors and officers ... will have met certain standards of care [about the] integrity of the information and that the information is accurate, complete and presents a fair picture of the financial condition of the company. The whole continuous disclosure system demands this from all directors and officers of reporting issuers ...".

The OSC further expressed the view that directors have a positive obligation to look behind information received from management to ensure that the company has complied with its disclosure obligations in circumstances where the directors have reason to question management. On the facts of the *Standard Trustco* case, the OSC determined that the directors failed to exercise the appropriate level of prudence and due diligence:

"It was not appropriate in the circumstances for the directors to have placed as much reliance on management as they did ... directors should not rely on management unquestionably where they have reason to be concerned about the integrity or ability of management where they have notice of a particular problem ... it is incumbent upon all the directors to make a number of inquiries ... to obtain the necessary information and advice in order to satisfy themselves about the integrity of the interim financial statements before [approving and issuing] the financial statements".

### *The W.R. Grace Decision*

The SEC's recent investigative report involved the proxy statement and annual report of W.R. Grace & Co. and concerned the adequacy of the due diligence of directors and officers of W.R. Grace respecting corporate disclosure respecting the retirement benefits received by J.P. Grace, the company's retiring CEO and of a possible related party transaction involving the potential acquisition of one of the company's subsidiary, by his son, Peter. The SEC's administrative decision emphasized both the strict application by regulatory authorities of line item disclosure obligations in formal continuous disclosure documents and the affirmative responsibilities of directors and officers of public companies to ensure that their companies fully comply with all disclosure requirements.

The terms of Grace's retirement benefits were included in a letter agreement which extended through Grace's retirement all benefits and arrangements provided to him as CEO. The company's proxy circular referred to the fact that Grace would continue to receive certain other benefits but did not provide details. In reality, the benefits were substantial, though clearly not material in the context of the company as a whole, and included continued use of a \$3 million company-owned and maintained apartment, with services of a chef; use of a company limousine and chauffeur on a 24-hour basis; full time secretarial and administrative services; use of the company jet for personal and business travel (a perk with an attributed value of \$2.7 million); and home nursing and security services.

The key point emerging from the *Grace* decision is that directors and officers with actual knowledge of information which must be disclosed have a disclosure duty "to go beyond the established procedures to enquire into the reasons for non-disclosure of information of which they were aware". Management reliance on a standardized disclosure review process, including circulation of the draft circular, distribution of a director and officer questionnaire and legal review is insufficient in these circumstances.

With respect to legal review, the directors and officers involved in the *Grace* case were not entitled to assume that outside legal counsel who had prepared the original letter agreement and who had reviewed the proxy circular had fully considered the adequacy of the disclosure. Rather, knowing Mr. Grace's substantial influence on the corporate culture, they should have been more attentive to the quality and details of the disclosure and should have sought the specific and fully informal advice of counsel. Merely assuming that disclosure counsel has reviewed the disclosure is inadequate. Steps must be taken to confirm the adequacy of the disclosure.

As a conclusion, the SEC report articulated the following standard for a director's review of the company's required public disclosures:

"If an officer or director knows or should know that his or her company's statements concerning particular issues are inadequate or incomplete, he or she has an obligation to correct that failure. An officer or director may rely on the company's procedures for determining what disclosure is required only if he or she has a reasonable basis for believing those procedures have resulted in full consideration of those issues."

Under the *Grace* test, it is clear that a director with specific knowledge of a potential disclosure issue must ensure that disclosure on the point receives full consideration and cannot rely on the existence of corporate disclosure procedures, including legal review, as a defence against a finding of a securities law violation.

The significance and impact of the SEC's decision in *Grace* and the legal standard that it articulates is best assessed by reference to the strong dissent of Commissioner Steven Wallman in the decision. In Mr. Wallman's view, absent red flags, the directors and officers were entitled to assume that the company's system in place for vetting securities documents was working properly. This system included circulation of the draft circular and a directors' and officers' questionnaire, review by senior management and the board and review by external disclosure counsel. The two questioned disclosures both turned on fine line legal interpretations of SEC line item disclosure requirements and involved judgment calls as to mixed questions of law and fact that the directors and officers should not have been required to second guess. In Wallman's view, it was the responsibility of disclosure counsel to ask the appropriate questions and the directors had every right to rely on the system in place to produce appropriate disclosure.

## **Corporate Disclosure Policy and Recommended Procedures**

In view of recent developments, including the likely imposition of limited statutory liability for continuous disclosures and the clear imposition on directors of responsibility for the integrity of corporate disclosure, it is incumbent on boards of Canadian public companies to formulate and implement formal corporate disclosure policies and procedures to ensure that timely and accurate disclosure of material information is disseminated fairly to all participants in the market for the company's stock.

### ***The TSE Recommendation***

The TSE has recommended that each listed company establish a clear written policy to help its directors and officers to comply with disclosure obligations. Such a policy should describe the procedure to be followed and spell out the consequences of violations. The policy should be updated periodically and be brought to the attention of employees regularly.

The disclosure policy should give specific guidance as to disclosing material information, maintaining the confidentiality of information and restricting employee trading. Specifically, it should:

- (i) include provisions to assist management in determining:
  - if information is material and must therefore be disclosed;
  - when and how material information is to be disclosed;
  - the content of the press release disclosing the material information;
- (ii) Assign specific corporate officers with responsibility for disclosing material information. These officers should:
  - be completely familiar with the company's operations;
  - be kept up to date on any pending material developments;
  - have a sufficient understanding of the TSE rules to be able to decide whether or not a piece of information is material; and
  - have back-ups assigned, in case they are unavailable.

### *The CIRI Recommendation*

Similarly, the Canadian Investor Relations Institute ("CIRI") has recently published "Standards and Guidance for Disclosure" and has recommended that each public company adopt written disclosure policies to raise awareness among its senior management and the board of directors of the need for a commitment to the timely, orderly, consistent, fair and credible dissemination of information, in keeping with legal and regulatory requirements and to enable orderly behaviour in the market for the company's securities.

In the view of CIRI, any written policy should include the following elements:

- designation of a disclosure policy committee, consisting at a minimum of the general counsel or outside counsel, chief financial officer and/or treasurer, chief investor relations officer and chief corporate communications officer;
- designation of a limited number of authorized company spokespersons (and backups) who are responsible for communications with the media, investors and analysts and who have a sufficient understanding of disclosure rules to be able to decide whether particular information is material;
- commitment to keep authorized spokespersons fully apprised of company developments;
- provisions to assist management in determining when information is material and must therefore be disclosed, how disclosure is to be made and the content of press releases;
- instruction to all employees who are not authorized spokespersons to refer calls to the authorized spokespersons;
- policy on maintaining confidentiality of corporate information and corporate documents until information is ready to be publicly disseminated;
- policy on reviewing analyst reports;
- policy on responding to market rumours;
- policy of commenting on analyst earnings estimates;
- policy on providing fair distribution and access to corporate information and prohibiting selective disclosure of material information;
- policy on the conduct of analyst meetings and conference calls (e.g., who can participate in Q&A; who can participate in a listening mode only);

- policy regarding media participation in analysts' meetings and conference calls;
- policy on employees trading in company securities that sets trading windows when designated employees cannot trade in the company's securities because of their knowledge of undisclosed material information or scheduled or unscheduled corporate announcements, trading windows when all employees are free to trade in the company's securities, and contact persons who will handle employee inquiries regarding whether they may trade company securities; and
- consequences for non-compliance with the company's written policy.

### **Appropriate Corporate Disclosure Policies**

The following are appropriate elements of a formal corporate disclosure policy:

#### **1. *Guidance in Assessing Materiality***

Assessing materiality in accordance with applicable statutory definitions and regulatory standards is a difficult and somewhat subjective task. In the final analysis, the company is in the best position to apply the prescribed definitions of material information to its own unique circumstances.

The following are, however, provided by the TSE as examples of developments likely to require prompt disclosure: (a) changes in share ownership that may affect control of the company, (b) changes in corporate structure, such as reorganizations and amalgamations, (c) take-over bids or issuer bids, (d) major corporate acquisitions or dispositions, (e) changes in capital structure, (f) significant borrowings, (g) public or private issuances of additional securities, (h) development of new products and developments affecting the company's resources, technology, products or market, (i) significant discoveries by resource companies, (j) entering into or loss of significant contracts, (k) firm evidence of significant increases or decreases in near-term earnings prospects, (l) changes in capital investment plans or corporate objectives, (m) significant changes in management, (n) significant litigation, (o) major labour disputes or disputes with contractors or suppliers, (p) events of default under financing or other agreements, (q) any other developments relating to the business and affairs of the company that would reasonably be expected to significantly affect the market price or value of any of the company's securities or that would reasonably be expected to have a significant influence on a reasonable investor's investment decisions.

#### **2. *Ensuring Accuracy***

Members of management responsible for continuous disclosure should continually ensure that they are seeking information from all relevant sources in the corporation and should question these sources to verify how the information was derived and to independently assess whether the information has a reasonable basis and is both accurate and complete.

Formal disclosure documents should be subjected to a disciplined review process involving, at minimum, the following steps and procedures to ensure compliance: (a) circulation of draft documents among senior management for their review and comment; (b) review by the company officials most knowledgeable about the particular matter; and (c) review by disclosure counsel.

Unfavourable information should be disseminated as quickly as favourable information and care should be taken to ensure that press releases are balanced and do not contain promotional hype.

Forward-looking information should be accompanied by meaningful, cautionary statements identifying important factors that could cause actual results to differ materially, from projected. Particular care should be taken to avoid selective disclosure of forecast information because of its extreme price sensitivity.

If a company subsequently discovers that a press release was factually and materially incorrect at the time disclosed, it must publicly announce and correct the error once it is discovered.

Variations between a proposed disclosure and line item requirements should be brought to the boards' attention immediately and, if it is determined that individual directors or officers have direct knowledge of specific transactions or conditions, care must be taken to confirm that these individuals have carefully reviewed the related disclosures. Corporate counsel or the corporate secretary should report to the board about disclosure preparation.

### **3. *Dealing with Difficult Disclosure Issues***

Difficult issues arise in the "grey area" involving subjective determinations of materiality. Considered judgment is required on a case by case basis in assessing whether certain events constitute "material information" requiring disclosure. Where the difficulty in assessing materiality arises from lack of completeness or certainty of the information, disclosure should be delayed until management is certain as to the accuracy of the information.

The task of assessing whether particular events constitute "material information" is made more difficult given that information which may not be reasonably expected to affect *market price* might nevertheless be construed under the TSE policy as affecting underlying or intrinsic *value* of the securities. In some circumstances, even non-price sensitive information might reasonably be expected to have a significant influence on investors' investment decisions and therefore be regarded as material since it significantly affects the total mix of information available to investors.

In such circumstances, two alternative approaches are available. Clearly, the cautious approach, both with respect to legal compliance and with respect to protecting the company's reputation for disclosure integrity in the market, is to make disclosure. This ensures that the issuer's public disclosure records contain a complete record of all significant events.

Alternatively, if a decision is made not to disclose, it is good corporate practise to clearly document both the conclusion that the event in question does not constitute material information and the process by which such determination has been arrived at. In difficult situations, it would also be prudent to discuss the materiality of the event with the Market Surveillance personnel of the TSE. In the event that the event does subsequently impact the market price, and managements' judgment is second-guessed with the benefit of hindsight, it will be invaluable to be able to demonstrate that the materiality assessment was made on a principled basis in the course of a thorough process of review and consideration.

#### **4. *Designated Spokesperson***

It is easier to avoid selective disclosure if only designated spokespersons speak to analysts or the press. Therefore, every issuer should select a limited number of authorized spokespersons (and backups) responsible for communicating with analysts, the media and investors. The authorized spokesperson should be kept fully appraised of all company developments and all employees should be instructed to refer all enquiries to the designated spokesperson.

Channelling communications through a single spokesperson who is aware of the company's disclosure obligations and the legal and regulatory requirements makes it easier to avoid selective disclosure problems. To promote consistency and to monitor disclosures, other employees should be prohibited from communicating information about the company.

#### **5. *Analysts' Meetings***

##### **(i) *The Role of Analysts' Meetings***

Most sophisticated public issuers hold periodic information sessions with their major institutional investors and analysts from the brokerage houses covering their stock. These meetings may consist of one-on-one or group meetings and today frequently take the form of telephone conference calls.

Analysts provide a valuable, constructive and legitimate service to issuers and their investors by gathering, analyzing and interpreting all available information about an issuer, its competitors and the markets in which they compete. Analysts help the market to understand and evaluate the company by applying their special expertise to produce earnings forecasts, industry comparable analysis and buy/sell recommendations.

Properly utilized, analysts' meetings give an issuer's chief financial officer the opportunity to interact with investors and analysts and to provide supplemental information relating to the issuer's strategies, performance and prospects. Such meetings may, for example, permit management to elaborate on information already in the public domain, to convey its views on trends in the company's business and to

provide more detailed information and explanations about financial and operating results, including segmented information and more detailed explanations of operational, tactical or strategic decisions.

Of equal importance, analysts' meetings provide analysts and institutional investors with the opportunity to maintain a dialogue with management, to ask questions, to test the legitimacy of their earnings forecasts and to assess the company's management on a face to face basis.

(ii) ***Group Meetings and Conference Calls***

A 1997 survey of CIRI members indicated that 65% of companies surveyed use conference calls to communicate with analysts and institutional investors. Such conference calls are typically held immediately after the release of quarterly earnings results, as well as on an 'ad hoc' basis after other major announcements.

Conference calls provide a forum for the company to elaborate on corporate announcements initially disseminated by press releases. Care should be taken, however, not to divulge any new material information in the conference call, or to materially modify or expand upon information contained in the press release. If further material information is inadvertently disclosed, a supplemental press release must be immediately disseminated.

All market participants should be provided with equal access to the information provided in the conference call if it could potentially affect investment decisions. This can be achieved by, for example, publishing an 800 number which will permit interested parties not specifically invited to participate in a two-way communications mode to participate in a listening mode only. Alternatives include recording the conference call and making it available for playback or to invite a media representative to attend. The more liberal the access provided to the information disseminated in the conference call, the less risk the company faces regarding allegations of selective disclosure.

The conference call should be carefully scripted to promote order and efficiency. The call should be conducted by a senior corporate officer who is aware of what information is already on the public record and who is attuned to the sensitivities of handling undisclosed material information. The designated spokesperson should be accessible, well informed and empowered to discuss corporate matters.

Standard procedures for analysts' meetings should include a debriefing session held immediately after the meeting to review what information was discussed, and to confirm that no material information was disclosed. In the event that material information has

been inadvertently disclosed on a selective basis, the company should issue a general corrective press release immediately.

The company should consider permitting a media reporter to attend analysts' meetings and conference calls to disseminate information to retail investors. The availability of and the method of access to additional information should be publicized in reports to shareholders.

Meetings with analysts should be used to explain or elaborate on information already in the public domain and to discuss trends impacting on the issuer. Company officials should decline to answer an analyst's questions where the answers, individually or cumulatively, would provide price sensitive information. The designate spokesperson should cut off questions regarding sensitive subjects early in the discussion by indicating up front that the company is not willing to discuss certain specific issues. "No comment" is often the safest answer.

**(iii) *One-on-One Meetings***

Face-to-face meetings are a fact of life for issuers in their dealings with analysts. They are an indispensable way for analysts to meet personally with corporate officers and give such officers the opportunity to build good will and to make the company more approachable to analysts. They permit analysts to assess directly the competency, integrity and frankness of corporate officers and to ask legitimate questions about the company and its strategies, performance and prospects.

One-on-one analysts' meetings obviously and necessarily entail the selective disclosure of information and comment that has not been publicly disclosed. In this context, extreme care must be taken to discuss only legally disclosable information; i.e., care must be taken to guard against the unauthorized, careless or selective disclosure of information regarded as "material" for purposes of applicable securities legislation. "Tipping" of undisclosed material information constitutes a violation of securities laws and imposes an obligation on an analyst or institutional investor who knowingly receives such information to refrain from trading.

Material non-public information which cannot be selectively disclosed includes all information that would have, or which would reasonably be expected to have, a significant impact on the market price or value of the issuer's securities. In practice, this is a difficult definition to apply since individual non-material bits of non-public information, when inter-woven into a 'mosaic' of other information by a skilled analyst, will often assume a heightened significance. The release of details at an analysts' meeting can cast previously disclosed information in a different light so that participants

in the meeting get a different picture of the impact of the information than would readers of the original public news release.

#### **6. *Commenting on Analysts' Reports***

Companies should take special precautions to avoid liability when they are invited to review or comment upon draft analysts' reports or models. The company should limit its comments to a review of factual information or underlying assumptions and should not embrace the soft information or conclusions, but should limit their conclusions to historical fact. The company should document the guidance given so that it can later demonstrate that the guidance was given in good faith and with a reasonable basis in fact. Special care should be taken when commenting on drafts of reports that make significant changes in earnings predictions or investment ratings.

Companies should refrain from commenting on analysts' earnings forecasts, particularly where there is any chance that they may become "entangled" in the report and thereby regarded as having assumed a duty to ensure the forecast's accuracy. There is a risk that confirming, or attempting to influence, an analyst's opinions or conclusions will be construed as the company adopting the analyst's conclusions.

#### **7. *Distributing or Referring to Analysts Reports***

Companies should exercise caution when distributing or referring to analysts' reports to guard against potential legal problems. Analysts' reports are proprietary and may therefore be distributed only with the consent of the analyst's firm. In addition, by distributing or commenting on an analysts' report, the company may be seen to embrace or endorse the report and will be construed as having accepted legal responsibility for the accuracy of the contents and conclusions of the report.

In one U.S. case, for example, a court held the issuer to be "entangled" where it had supplied analysts with underlying non-public information, had reviewed and responded to draft reports and had disseminated them to prospective stock buyers. Further, recent U.S. cases appear to have extended this liability under the doctrine of "post-publication ratification" which holds that the simple act of recirculating an analyst's report by an issuer may be construed as an implicit representation by the issuer that the report is accurate, and is "ratified" by the issuer.

In any event, where an issuer becomes aware that an analyst's forecast contains concrete, factual errors which are serious and significant and which could lead to a widespread and serious misapprehension in the market (as may be the case, for example, where the issuer is a small high-tech company), the company should draw attention to the correct information in the public domain and, in some cases, should issue a corrective statement.

In cases where an issuer wishes to accept the risk and recirculate an analyst's report, the safest course for it to adopt is to follow the requirements of the "safe harbour" in U.S. securities laws for forward

looking information to make clear that the issuer does not endorse the report. Such an approach could provide that the issuer attach a covering letter to the report setting out essentially the following: undue reliance should not be placed on the forward-looking information included in the analysts' report; the forward-looking information is subject to substantial uncertainty and should be read in conjunction with the issuer's other statutory filings; the report is provided as a courtesy only, and the issuer expressly disclaims any involvement in the preparation therein and does not in any way confirm the accuracy of its contents; the issuer does not undertake to publish any corrective information regarding statements made in the report; and, if applicable, management of the issuer is of the view that certain projections in the report are overly optimistic.

A more cautious approach is for the company to limit its involvement to providing interested persons with a list of analysts covering the company and referring requests for reports to the analysts' respective firms.

#### **8. *Commenting on Analysts' Earnings Estimates***

Companies are frequently asked to respond to enquiries about possible deviations of earnings have consensus street estimates. A 1995 survey of corporate disclosure practices by the National Investor Relationship Institute indicated that 69% of those surveyed indicated that they always or usually provide guidance to analysts with respect to earnings estimates.

Generally, companies are under no obligation to respond to queries respecting earnings estimates except where there will be a significant increase or decrease in earnings in the near future, in which case the company should make a general disclosure of the fact.

Once a company comments on earnings estimates, however, it assumes an updating obligation and must continue to assess whether future updates or corrections are necessary. It must respond to future enquiries and rumours and must update or correct earlier earnings projections. If the response contains material information, it must be generally disseminated by press release.

Some companies impose a quiet period for an interval of several days to a month prior to the release of quarterly earnings results during which time management is prohibited from commenting on analysts' enquiries respecting earnings estimates. A quiet period shields the company that normally provides earnings guidance from having to comment during a period in which it may know what earnings will be.

#### **9. *Taking Analysts Over the Wall***

Extreme care should be taken in permitting an issuer's financial advisors to bring analysts "over the wall" to permit them to participate in investment banking projects. In normal circumstances, investment dealers will maintain a Chinese wall between their analysts and their investment banking departments. This separation permits investment bankers to consult freely with their issuing clients

about their financing needs, acquisition strategies and earnings prospects without tainting analysts in the same firm with inside information about the issuer.

At times, however, it may be deemed desirable to bring an analyst "over the wall" to assist in an investment banking project, to assist in due diligence investigations, to support sales and marketing efforts or to help to generate earnings estimates for use in forecasts or projections. Such involvement may be critical to the success of a project, such as an initial public offering of a bio-technology issuer, where an analyst's specialized knowledge of the industry may be indispensable in providing the expertise necessary to complete the project.

Issuers should be aware that in such circumstances, the analyst will be "tainted" and will be prohibited from issuing research reports or otherwise advising with respect to the issuer's securities while in the possession of material non-publicly disclosed information.

#### **10. *Responding to Market Rumours***

A company does not have a general duty to monitor and to correct or verify rumours in the market unless those rumours can be attributed to the company or a stock exchange requests disclosure when the rumour is causing unusual activity in the company's securities.

Generally, the company should adopt a "no comment" policy with respect to rumours that are not attributable to the company; ie., by stating "it is the company's policy to neither confirm nor deny rumours". Statements such as "there are no significant corporate developments at this time" should be avoided as they can signal the market and defeat the purpose of the policy. The company should only take precautions to ensure that it is not the source of rumours. In circumstances where the company is required to vary from its policy of not commenting on rumours, the announcement should promptly clarify or deny the rumour and should make clear that the company is varying from its usual policy.

If the rumour is about a material change in the company's business, operations or capital which the company has withheld from the market under its confidentiality privilege, and the rumour is influencing trading, this triggers an immediate obligation to disclose the relevant material information.

#### **11. *Earnings Warnings***

It has become common practice for companies to make a full pre-emptive public release when they become aware that earnings will be significantly outside the range of street expectations.

## **12. *Promoting Equal Access***

Companies should promote the equitable dissemination of material information by promptly responding, without discrimination, to all legitimate requests for information. Information should be made equally available to large and small investors and equally buy-side and sell-order analysts.

## **13. *Electronic Access to Data***

Corporate information should be made available electronically, for example through a corporate web site accessible via the Internet. Such new modes of corporate communication are gaining increased investor recognition. Issuers should be cautioned, however, that the use of electronic media will suffice in fulfilling legal disclosure obligations only where it provides dissemination of and access to information at least equivalent to traditional media.

Care should be taken to ensure that information can be accessed electronically with the same ease as print media; that it can be retrieved, down loaded and stored to the same degree and that it is updated in the same fashion. A corporate home page should not provide access to analysts' reviews if this would give the impression that the issuer is adopting or confirming the analysts' views.

## **14. *Corporate Fact Books***

The type of detailed information traditionally sought by analysts should be made directly available on request to all analysts and shareholders by way of supplementary data books.

Such corporate fact books will often contain, where appropriate, major background data, including for example, as many as ten years of historical financial and operating data, as well as segmented financial and operating data, often on a quarterly basis and disaggregated by lines of business and geographic area.

## **15. *Plant Tours***

In tours of plant facilities, access to operating personnel should be strictly controlled to ensure that analysts do not elicit confidential information in discussions with staff and employees.

## **Conclusions**

The increasing interaction between issuers and their analysts and institutional shareholders presents both opportunities and added risks to the issuer. While such interaction can strengthen the relationship between a company and its major shareholders and assist the markets in understanding the company's businesses, officers of the company responsible for such meetings must ensure that communication between the company and analysts and institutional shareholders is carefully managed.

A risk management approach to the dissemination of corporate information will ensure that issuers avoid the risk of selectively disclosing material inside information by instituting policies and procedures for the conduct of analysts' meetings and by making available to all market participants the contents of such meetings through the use of effective communications media.