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July 24, 2001

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
The Manitoba Securities Commission
Ontario Securities Commission
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Department of Government Services and Lands, Newfoundland and Labrador
Registrar of Securities, Government of the Northwest Territories
Registrar of Securities, Government of the Yukon Territory
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario M5H 3S8

- and -

Denise Brosseau, Secretary
Commission des valeurs mobilières du Québec
Stock Exchange Tower
800 Victoria Square
P.O. Box 246, 22nd Floor
Montréal, Québec H4Z 1G3

Dear Sirs/Mesdames:

Re: Proposed National Policy 51-201 - Disclosure Standards

This letter is submitted in response to the request for comments contained in the notice (the “Notice”) published by the Canadian Securities Administrators (the “CSA”) regarding proposed National Policy 51-201 - Disclosure Standards (the “Proposed Policy”).

As stated in the Notice, the principal purpose of the Proposed Policy is to provide interpretive guidance to public companies on the existing timely disclosure requirements of Canadian securities legislation, particularly with a view to avoiding selective disclosure of material non-public information, and to set forth some "best disclosure" practices that can be adopted by companies to assist them in complying with their legal obligations.

Although these objectives are laudable and the proposed practices are generally helpful, one very troubling aspect of the Proposed Policy is the expression of the CSA's view that the current statutory requirements impose a "duty to update" voluntary public statements concerning an issuer's "financial outlook" (also known as "guidance") when the issuer becomes aware that its results will be materially above or below the original guidance. This view raises important issues concerning the scope of an issuer's disclosure obligations under Canadian securities laws that could have potentially far-reaching implications for the issuers that access our capital markets.

The practice of issuing financial "guidance" – by which we mean statements of management's current expectations concerning future revenues, earnings or growth rates – affects a growing number of Canadian public companies. For some of these companies, their industry peers, with whom they are compared in the competition for capital, are largely U.S. public companies who regularly provide guidance to the capital markets and who are not subject to Canadian disclosure rules.

Although the issuance of guidance is a voluntary exercise, some Canadian companies have little choice but to publicly disclose this information in order to satisfy the informational demands of the capital markets, to allow their securities to be valued by the secondary markets on the basis of the same information as their competitors, and to reduce the chances of inadvertent selective disclosure of this information in discussions with analysts, institutional investors, the media and others. We are of the view, for the reasons discussed below, that forward-looking or "soft" information, such as financial guidance, should not be subjected to the same disclosure standards as other "hard" information that has traditionally formed the basis of the "material change" disclosure obligation.

Our principal concerns with the CSA's proposed interpretation of the existing timely disclosure requirement, as it relates to updating financial guidance, are set forth below.

1. *Exceeds Statutory Requirement.* The CSA's interpretation, in our view, goes beyond the scope of the existing statutory requirement. Canadian securities legislation, such as the *Securities Act* (Ontario), defines a "material change", in relevant part, to mean "<u>a change in the business, operations or capital</u> 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" (emphasis added). The statutory requirement to disclose "material changes" does not require immediate disclosure of all market sensitive information, such as "material facts" (as defined in securities legislation), nor does it impose an obligation to disclose management's opinions or beliefs concerning an issuer's prospects or other predictive information.

Furthermore, the legislation does not provide that voluntary disclosure (by whatever means) of such predictive information creates a continuous duty to update such information for subsequent developments. If this were the case, reporting issuers would be legally obligated to monitor constantly their forward-looking statements (e.g., those contained in MD&A disclosure or an officer's oral remarks made in an analysts' conference call) and ensure that the disclosed "soft" information is continuously and immediately updated for subsequent material developments. We would suggest that such a disclosure obligation is not only onerous but practically unworkable.

The Proposed Policy cites the Ontario Securities Commission's decision in *Re Royal Trustco Limited, et al.* as support for the CSA's contention that the timely disclosure requirements might impose a "duty to update" previously disclosed forward-looking information. However, the fact situation in *Royal Trustco* was vastly different from the present context. Finding a duty to update "hard" factual information contained in a directors' circular issued in response to a take-over bid is, in our view, a far cry from imposing a duty to update financial guidance in the context of the timely disclosure requirement. Moreover, the Commission's comments in *Royal Trustco* on the existence of a "duty to update" are more supportive of the recognition of a "duty to correct" previous disclosures than a "duty to update", since the majority of the panel held that Royal Trustco's directors' circular (as updated by its CEO's subsequent letter to shareholders) failed to disclose all pertinent material information then in the possession of the directors.

Although we appreciate the policy objectives of the CSA's interpretation, we are of the view that this interpretation does not merely contextualize the general obligation to disclose "material changes" but instead goes well beyond the plain, intended and normally understood meaning of the statutory definition of "material change".

2. *Judging Guidance in Hindsight Is Inappropriate.* Due to the temporal nature of the timely disclosure requirement (i.e., material changes must be publicly disclosed "forthwith"), the CSA's interpretation will expose issuers to "Monday morning quarterback" assessments by securities regulators as to the precise time when an issuer's guidance ought to have been changed or withdrawn due to subsequent developments. Predictions of future performance or growth, however, should stand on a different legal footing from other corporate developments because they will almost always prove to be wrong (i.e., either too low or too high) in hindsight. Such predictions are matters of opinion or belief involving the exercise of management's business judgment based on many factors, including their experience, perceptions of trends, current conditions and expected future developments.

Moreover, the process of evaluating the continuing viability of an issuer's financial outlook typically is a gradual (rather than episodic) process that occurs over a span of time within the financial period to which the outlook relates. Management can always be second-guessed as to the exact moment within that time span when they ought to have revised their guidance (upward or downward) based upon a fresh look at the future. The Proposed Policy offers no assistance from the CSA as to the

standard by which management will be judged in dealing with the temporal dilemma posed by the imposition of a "duty to update" financial guidance.

3. *Guidance Disclaimers Are Ignored*. Implying a "duty to update" financial guidance through the statutory duty to make timely disclosure of material changes effectively eviscerates any publicly stated corporate policy of an issuer disclaiming responsibility for issuing updates of financial guidance. This position takes guidance out of context, stripping it of important qualifiers which an issuer may have imposed on its use. We would submit that if an issuer expressly disclaims any assumption of responsibility for updating guidance, such a disclaimer is an important and integral condition of the notional agreement under which the company has chosen to share such information with the market and cannot simply be ignored. Guidance is a "package" which includes the assumptions, cautionary statements and disclaimers which accompany its publication.

4. *Increased Litigation Exposure*. Financial guidance is based on assumptions regarding many internal and external factors that inevitably will be overtaken by future events. We are concerned that, due to the inherent uncertainty of guidance, the CSA's interpretation will expose Canadian reporting issuers to greater risks of liability for forward-looking statements and could encourage the proliferation of meritless class action lawsuits against Canadian reporting issuers both in Canada and in the United States. If an issuer's results prove to be less than predicted, buyers will sue; if results prove to be greater than predicted, sellers will sue. As the U.S. Fourth Circuit Court of Appeals has observed: "Imposing liability [for predictions of future growth] would put companies in a whipsaw, with a lawsuit almost a certainty."

In this regard, we would note that, while the CSA's proposal for a statutory civil remedy for investors in the secondary market contains a safe-harbour (akin to that contained in the U.S. *Private Securities Litigation Reform Act of 1995*) for misrepresentations in forward-looking statements at the time such statements are made, the imposition of a statutory "duty to update" such statements would expose issuers and their directors and officers to liability under the proposed civil remedy, without the benefit of a safe-harbour, for failure to make timely disclosure of a subsequent "material change" relating to such statements. This would appear to effectively remove the "liability shield" which the safe-harbour was intended to provide for forward-looking information since plaintiffs would be expected to routinely allege that a subsequent undisclosed material change had occurred.

5. *Disincentive to Disclosure*. Contrary to other recent securities law initiatives (e.g., interim MD&A disclosure), the CSA's interpretation could well discourage Canadian companies from making public statements concerning their expected future growth or performance so as to avoid the consequences of a far-reaching "duty to update". This, in turn, would reduce the amount, depth and/or quality of forward-looking information publicly available to the secondary markets and could increase the incidents of selective disclosure of such information (both advertent and inadvertent) to analysts and others. We do not believe that this regressive situation would be in the long-term best interests of the Canadian capital markets.

6. *More Onerous Than the U.S. Position*. The CSA's interpretation represents a further and unnecessary point of differentiation between the Canadian and U.S. securities regulatory regimes. Although U.S. courts have generally recognized that there is a "duty to correct" statements that were false or misleading when made, to our knowledge no U.S. federal circuit court has held that there is a duty to update simple earnings projections that were believed to be, and in fact were, correct when made, but proved to be inaccurate in light of subsequent events. While we recognize the need to preserve investor confidence in our capital markets, we believe that the CSA should consider the policy reasons underlying the jurisprudence in the United States relating to this issue and whether the imposition of a Canadian duty to update financial guidance would be a disincentive to Canadian or foreign issuers to access the Canadian capital markets.

We support the following position on the subject of financial guidance:

- From a public policy standpoint, the CSA should work to facilitate a regulatory regime which encourages reporting issuers to be forthcoming about their future financial prospects and changes in those prospects.

- Updating guidance in a timely manner to reflect subsequent significant developments should be identified by the CSA as a "good" practice which will help issuers to maintain credibility among investors and analysts.

- Reporting issuers should enjoy an effective "safe harbour" with respect to forward-looking statements and subsequent developments which may affect such statements.

- An issuer making forward-looking statements should disclose material assumptions and risks and provide a clear statement of whether the issuer is voluntarily undertaking a duty to update or revise such statements if circumstances change.

- Issuers should be reminded that, depending upon the particular circumstances, the confirmation of guidance selectively may contravene the statutory prohibition against "tipping". Some U.S. issuers, for example, in addressing this issue in the context of SEC Regulation FD, have adopted the practice of expressly assuming a "duty to update" by publicly stating that prior to the commencement of the "quiet period" before the publication of their quarterly earnings results, the public can continue to rely on the issuer's published guidance as still being management's current expectations on the matters addressed therein until the issuer publishes a notice stating otherwise.

- A significant change in management's expectations as to an issuer's ability to achieve its published guidance would constitute a "material fact" under securities legislation and, accordingly, would be subject to

the legal prohibitions against insider trading and selective disclosure or "tipping" until such information has been generally disclosed.

- The CSA can always address egregious situations through the exercise of their broad "public interest" jurisdiction in cases where an issuer's conduct is considered abusive or is likely to bring the Canadian capital markets into disrepute.

We appreciate the opportunity to comment on these important issues. Please feel free to contact the writer at (416) 216-3939 if you have any questions relating to this submission.

All of which is respectfully submitted.

Yours very truly,

Michael J. Lang

MJL/jl