BY NEILL MAY

Living in a material world

The core concept that runs through disclosure requirements for publicly traded issuers is materiality. Executives and directors of public issuers (and their advisers), who have to immediately disclose information that is "material," repeatedly face the question of what is "material." For such an apparently simple test, however, it can be very difficult to apply and frequently interpretations of the term are at odds with the general public's understanding and expectation.

Madonna was able to capture the ubiquity of the concept when she observed that we're living in a material world. If she had been a securities lawyer, she might have been able to come up with a couple of other verses; I'll spare you my own attempts at songwriting (until the last paragraph). I am confident, though, if only I had her ability to succinctly describe complex ideas in song, I could have had a comparable career in showbiz, given my sublime dancing skills and my undervalued talent for setting legal contracts to hummable tunes.

The recent British Columbia Securities Commission decision in *Re Canaco Resources Inc.* highlights many of the issues around "materiality." In the fall of 2010, the company received results from infill drilling on its principal property, some of which were later described in a press release as "spectacular new drill results." The company's CEO forwarded some of the results to members of the board, who exchanged e-mails calling the results "spectacular," "just beautiful," and "fantastic news." Canaco (which has since changed its name) did not promptly disclose the drill results; instead, because it was in the course of raising capital, it issued three very positive press releases about the drill results over a three-week period. Before any public disclosure was made, the board approved the issuance of stock options, including to management and members of the board. The TSX Venture Exchange, on which the company is listed, eventually required Canaco to disclose all of the remaining undisclosed drill results and to re-price the options that had been issued (Canaco offered to cancel the options, but the TSX-V accepted the re-pricing).

In *Canaco,* the BCSC determined the drill results were *not* material, and there had therefore been no breach of securities laws for failing to disclose them. This may seem like an odd outcome to those not steeped in the principles of our material world, in light of the board's comments about the drill results, the communications plan to stagger disclosure of the information (presumably because it was expected to be positively received in the market), and because of the timing of the option grants. The BCSC's decision illustrates the statutory test (whether the development would reasonably be expected to have a significant impact on the market price or value of any of the issuer's securities), and the principles relied upon by regulators to assess disclosure decisions.

Of particular note, the BCSC confirmed: (i) the test for materiality is objective, so what any particular director, officer, analyst, or anyone else thought, and any business judgment that may have been applied to the decision not to disclose, is irrelevant; (ii) the test focuses on the effect disclosure would have on the price or value of the issuer's securities and not what a reasonable investor would want to know; and (iii) decisions about materiality are not held to a standard of perfection and the impact on the market price or value of the securities should not be assessed with the benefit of hindsight.

The decision was based in significant part on the fact the results were infill results that generally confirmed the results of previous drilling. More generally, however, it illustrates some common issues and questions about disclosure. For example, people often wonder why public issuers don't just disclose everything. It is important to understand that disclosure of immaterial information, or premature disclosure, can be misleading, and over-expansive disclosure may effectively define a very low disclosure standard for the issuer that can be a trap.

A further clear lesson from the case, one some executives seem slow to learn, is e-mail commentary can be potentially damaging (even if the results being "spectacular" and "beautiful" didn't make them "material," it wasn't helpful to have superlatives like that on record). Conversely, documentation of process is helpful (one of the directors was on record asking if there was any undisclosed information before approving any options, so there was record of the board having considered the materiality of the information).

Lastly, an approach often adopted by boards is to seek legal advice on disclosure questions; this is difficult, because application of the test requires familiarity with the business, and expertise on the value of securities. Lawyers are not equipped to expertly advise on these points, but the question still gets regularly posed to counsel, which simply imposes a discipline on counsel to respond properly and carefully.

And now, since I have a little space: "Some boards disclose, some boards are more closed, I think that's OK. No clear answers on 'material' means more work for May." CL

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