

# Legal Update

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## *Mining Disclosure: The New Responsibilities of Engineers and Geoscientists*

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*The Instrument assigns to QPs a significant role in the disclosure process*

When National Instrument 43-101 *Standards of Disclosure for Mineral Projects* (the Instrument) becomes effective on February 1, 2001 all disclosure of scientific or technical information by mining companies must be based on information prepared by, or under the supervision of, a qualified person (QP). This represents a significant change in the role of the engineers and geoscientists who will act as QPs in the disclosure process. Our *Legal Update* of December 2000 reviewed the increased disclosure obligations that will be imposed on issuers by the Instrument. This *Update* examines some of the increased responsibilities and potential liabilities of QPs in assisting an issuer in discharging those obligations.

### ***The Role of the QP***

The Instrument assigns to QPs a significant role in the disclosure process. This involvement by QPs was one of the principal recommendations in the report of the Mining Standards Task Force and the concept has been refined through the various drafts of the Instrument. While the engineering/geoscience community has been supportive of this increased role for its members, it expressed concern from the outset that the Instrument could

impose substantially increased liability on QPs. The Instrument is sensitive to this concern and accordingly prefaces each disclosure obligation with the phrase “the issuer shall ensure” to make it clear that it is the mining company, not the QP, that has the obligation to ensure that disclosure complies with the Instrument.

In addition, Companion Policy 43-101 CP (the Companion Policy), which provides guidance on the interpretation and application of the Instrument, indicates that while the QP is responsible for preparing technical reports and providing scientific and technical information in accordance with applicable professional standards, the issuer and its directors and officers remain responsible for:

- the proper use of technical reports or other information provided by the QP; and
- ensuring that public disclosure is consistent with such reports or other information.

The Companion Policy strongly urges issuers to have the QP review any disclosure that summarizes or restates the technical report or other information provided by the QP to ensure that the

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disclosure accurately reflects the QP's work. As well, the Companion Policy emphasizes that while the QP is responsible for preparing technical reports, it is the issuer that is responsible for filing technical reports and accordingly it is the issuer that will be in breach of securities legislation, and subject to sanctions, if the report does not meet the requirements of the Instrument.

### **Potential Liability of the QP**

While the Instrument and Companion Policy thus do not make QPs responsible for disclosure, QPs nevertheless have significant responsibilities, and potential liability, in carrying out their role under the Instrument. One potential source of liability arises from the contractual relationship (express or implied) between the QP and the issuer under which the QP may be viewed as having an obligation to the issuer to ensure that the technical report or other information provided to the issuer, and on which the issuer will base its disclosure, complies with the Instrument. The extent of this obligation, and resulting potential liability, will depend on the terms of the relationship between the QP and the issuer. For this reason, it is strongly recommended that this relationship be reflected in a written engagement letter or agreement that clearly sets out the expectations and responsibilities of both the QP and the issuer in connection with each assignment for which the QP is retained.

A QP could also face potential liability where a technical report is filed with securities administrators. The Instrument requires such filing in numerous circumstances, including in connection with a prospectus, offering memorandum, annual information form and securities exchange take-over bid circular. In these situations, the technical report becomes part of the public record, and portions of it are also summarized or quoted in the particular disclosure document. The QP could face

potential liability to investors who trade in securities of the issuer in reliance on the report if the report is misrepresented in the disclosure document or if the report is deficient and it can be shown that that the misrepresentation or deficiency is attributable to the QP and resulted in or contributed to the investors' loss.

The foregoing responsibilities and potential liabilities of the QP may arise in numerous circumstances when providing services to issuers in connection with the Instrument. This *Update* will review three areas which can be particularly troublesome:

- the preparation of the technical report itself;
- ensuring that requirements concerning the professional qualifications and, in certain circumstances, the independence of the QP are satisfied; and
- providing the required certification by the QP of any technical report that is to be filed with the securities administrators.

### **QP's Obligations in Preparing a Technical Report General Requirements**

The Instrument requires that all technical reports be prepared by or under the supervision of one or more QPs in accordance with the Instrument and Form 43-101 F1, *Technical Reports* (the Form). The report must be prepared on the basis of all available factual data that is relevant to the disclosure which it supports as of the date on which it is filed. The Companion Policy confirms that a report may be prepared considerably before the filing date, provided the information in the report remains accurate and reflects all material information on the property as of the filing date. At least one of the QPs preparing the report must visit the property.

## Exercise of Professional Judgement

While much of the information required by the Form to be included in a technical report is factual, there are some compulsory procedures and analysis that are required to be performed, and certain opinions and conclusions that are required to be expressed by the QP in the report. For example:

- the QP must express an opinion on the adequacy of sampling and sample preparation, security and analytical procedures;
- the report must discuss the adequacy of data density and reliability and any uncertainty of the data;
- a technical report concerning exploration information must include the conclusions of the QP and a discussion of whether the completed project met its original objectives;
- a technical report that recommends expenditures on exploration or development work must include a statement that in the QP's opinion the property is of sufficient merit to justify the program recommended; and
- the choice of methods and procedures to be used in estimating mineral resources and reserves are the responsibility of the QP preparing the estimate.

It is in these areas, where the exercise of professional judgement is required in choosing procedures and expressing opinions and conclusions, that the QP could be exposed to potential liability if such judgement is exercised inappropriately or other than in accordance with sound professional practice and relevant industry standards and guidelines.

The Companion Policy provides guidelines for reporting on resources and reserves of industrial minerals and encourages the use of standards established by the Geological Survey of Canada for reporting on resources

and reserves of coal and the guidelines published by the Association of Professional Engineers, Geologists and Geophysicists of the Northwest Territories for reporting on resources and reserves of diamonds. The Companion Policy also requires that exploration programs be carried out and reported on in accordance with the Mineral Exploration Best Practices Guidelines developed by a committee of industry professionals and regulators which were adopted and published by CIM in the summer of 2000. Other than in respect of these particular matters the Instrument generally leaves the question of what constitutes appropriate professional practice to be answered by the industry associations which govern QPs, recognizing explicitly in the Companion Policy that mining industry practice and professional standards are continually evolving.

Accordingly it is important that QPs have continuing professional development programs to ensure that they are constantly up to date on evolving industry practice and professional standards and guidelines. In addition, staffing should be considered at the commencement of each retainer to ensure that, having regard for the scope and nature of the particular report to be produced, the appropriate level of professional experience and expertise is available to provide the applicable opinions, conclusions and recommendations.

## Reliance on Expertise of Other Professions

Another area which may give rise to potential liability relates to matters which are required by the Form to be specifically addressed in a technical report, but which may be outside the professional experience or expertise of a particular QP or may overlap with the expertise of other professions. For example, the Form requires that a technical report describe:

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*The Form permits the QP to rely on reports, opinions or statements of legal or other non-QP experts with respect to information concerning legal, environmental, political or other issues relevant to the technical report, and to include in the report a disclaimer of responsibility for those sections in respect of which the QP has relied on such other experts*

- the nature and extent of the issuer's interest in the property and the prior ownership history;
- the date on which any claims, licenses or other property rights expire;
- the obligations (such as statutory work commitments) that must be met to retain the property and the terms of any back-in rights, royalties or other payment obligations, agreements or encumbrances relating to the property;
- environmental liabilities relating to the property; and
- permits required to conduct the work proposed for the property.

If the report contains an estimate of resources or reserves, it must also include a general discussion of the extent to which these estimates may be materially affected by environmental, permitting, legal, title, taxation, socio-economic, marketing, political or other relevant issues. A technical report on a development or production stage property must include a discussion of the market for the commodity produced, whether the terms of any mining, concentrating, smelting, refining, transportation, or sales contracts (including forward sales or hedging arrangements) are within market parameters, a discussion of environmental bonding, remediation and reclamation obligations and a description of the nature and rates of taxes, royalties and other government levies or interests applicable to the project.

Given the broad scope of these issues and the diversity of disciplines that may be required to adequately address them, it may be necessary that more than one QP be involved in preparing a technical report, in order to ensure that the appropriate professional expertise and experience is available to properly address these matters. The Instrument contemplates this by permitting a report to be signed and certified by more than one QP, in which case the required certificate must identify the

specific areas of the report for which each particular QP has responsibility.

However a number of these issues, such as title matters, statutory or contractual work commitments, permitting, environmental requirements, tax burdens, social factors and political risks are beyond the scope of professional expertise of a QP (which by definition is limited to the engineering and geoscience professions) and will require input from legal and other professionals. To accommodate this, the Form permits the QP to rely on reports, opinions or statements of legal or other non-QP experts with respect to information concerning legal, environmental, political or other issues relevant to the technical report, and to include in the report a disclaimer of responsibility for those sections in respect of which the QP has relied on such other experts.

In order to be in a position to rely on this disclaimer mechanism, QPs should ensure that they identify early in the process those areas where legal or other specialized input will be required so that appropriate experts can be retained on a timely basis to provide reports or opinions on these matters and that as a standard practise, the QP develop and include an appropriate disclaimer for these matters in all reports. To be effective, the disclaimer should identify the report or opinion relied upon, its author, the extent of reliance and specifically identify the portions of the technical report to which the disclaimer applies.

### ***Ensuring the QP is Qualified***

The Companion Policy provides that it is the responsibility of the issuer and its directors and officers to ensure that the QP has the appropriate experience and competence. This is a critical question as it goes to the heart of whether the person retained to prepare a report is in fact a QP. The significant questions in making that

determination include the scope, extent and relevance of the QP's experience, membership in a recognised professional body and, in certain circumstances, the independence of the QP. These questions should be reviewed as soon as it is recognized that a technical report may be required, as discovery later in the process that the person retained does not satisfy these requirements could result in increased costs and significant delay in the preparation and filing of the report.

### **Required Experience**

The QP must have at least five years experience in mineral exploration, mine development or operation or mineral project assessment. The experience must also be relevant to the subject matter of the mineral project and technical report. Thus, for example, a geologist whose experience is limited to exploration could not be a QP for those sections of a report dealing with development or operations, and an engineer whose experience is solely in development or operations could not be the QP for sections dealing with exploration.

### **Membership in a Statutory Association**

The QP must be a member of a statutorily recognized self-regulatory association of engineers or geoscientists. The Instrument 'grandfathers' Canadian geoscientists for up to two years while legislation is enacted to recognize their professional associations in various provinces. No such grandfathering however has been provided for non-Canadian associations. This may be a concern to issuers with properties outside Canada if they have historically used a foreign engineer or geoscientist in respect of activities on those properties. If that person does not belong to an appropriate professional association, an application may be made for an exemption from the requirement for the involvement of a QP

and the acceptance of such person instead, provided that person's competence and qualification to prepare the report or other information can be demonstrated as being equivalent to a QP, despite the fact that the person is not a member of a recognized professional association. Such issuers, as well as foreign geoscience professionals wishing to provide services under the Instrument, should be mindful of the time required to obtain such an exemption and start that process sufficiently early so that it does not delay the filing of the report.

The Canadian Securities Administrators have established a committee of industry professionals to advise on the evaluations of foreign professional organizations in connection with the recognition of their members as QPs for purposes of the Instrument.

### **Independence of the QP**

The Instrument requires that a technical report filed in connection with a long form prospectus, a valuation or on an issuer becoming a reporting issuer in Canada for the first time be prepared or supervised by an *independent* QP. A company that is not a producing issuer for purposes of the Instrument (meaning it did not have gross revenue from mining operations of at least \$30 million for its most recent year and at least \$90 million in the aggregate for its most recent three years) is required to file independent reports in a number of other circumstances.

Where the QP is required to be independent, a detailed review of the QP's past involvement with the issuer and the property or project that is the subject of the report will need to be carried out to determine whether the QP is in fact independent for purposes of the Instrument. A QP will not be considered to be independent, for example, if:

*These questions should be reviewed as soon as it is recognized that a technical report may be required, as discovery later in the process that the person retained does not satisfy these requirements could result in increased costs and significant delay in the preparation and filing of the report*

*In giving this certificate, the QP will need to have an appropriate understanding of the legal meaning of a number of the terms in the certificate which are defined either in the Instrument or in securities legislation and related case law*

- the QP or an affiliate is or expects to become an employee, associate, insider or affiliate of the issuer or its insiders or affiliates;
- the QP or any affiliate owns or expects to receive any securities of the issuer or its affiliates;
- the QP or its affiliates owns or expects to receive any interest in the property that is the subject of the report or any property within two kilometres of that property or is or expects to become an insider, affiliate or partner of any person having an interest in a property within two kilometres of the property; or
- a majority of the income of the QP or its affiliates during the preceding three years was received from the issuer or its affiliates or insiders.

Unfortunately the definition in the Instrument of the numerous circumstances in which a QP will be considered *not* to be independent is very broad and rather convoluted and requires an understanding of the legal meaning of a number of terms, including “affiliate”, “associate” and “insider”. Accordingly the assistance and advice of legal counsel in making this determination should be obtained. In any event, the determination of whether an independent report is required, and if so whether the proposed QP is in fact independent, should be made at the outset of the retainer, as identifying problems in this area later in the process may lead to significant delays and increased costs.

### ***Certification of the Report***

A technical report must be accompanied by a certificate and consent from each QP who had primary responsibility for preparing any portion of the report. The certificate must identify the sections of the report for which the QP was responsible, the date and duration of the most recent site visit by the QP and any prior involvement of the QP with the property. It must also set out the

QP’s qualifications, including relevant experience and professional affiliations, confirm that the person is a QP for purposes of the Instrument and state whether the QP is independent of the issuer. Of particular concern with respect to potential liability, the QP must certify that:

- the QP has read, and the technical report has been prepared in compliance with, the Instrument and the Form;
- the QP is not aware of the omission of any material fact or change in the subject matter of the report which makes the report misleading; and
- the QP has read the disclosure in connection with which the report is being filed (i.e. the annual information form, prospectus, take-over bid circular, etc.) and has no reason to believe that there is any misrepresentation in the information derived from, or any misrepresentation of any information contained in, the technical report.

In giving this certificate, the QP will need to have an appropriate understanding of the legal meaning of a number of the terms in the certificate which are defined either in the Instrument or in securities legislation and related case law. These include an understanding of the circumstances discussed above in which a QP will not be considered independent, as well as an understanding the legal meaning of “material fact”, “material change” and “misrepresentation”.

### ***Conclusions***

The Instrument, Companion Policy and Form themselves are not intended to impose liability for mining company disclosure on QPs but rather make it clear that responsibility for disclosure rests with the issuer and its directors and officers. However, the significant involvement of QPs in providing technical reports and other information on which such disclosure is

based, the requirements for QPs to reach conclusions, express opinions and make recommendations in technical reports, the requirement that QPs review disclosure that is based on a technical report and certify, in effect, that it is accurate and materially complete and the fact that the report forms part of the public file raise some significant issues of professional responsibility, and potential liability, for QPs.

The starting point for addressing these issues is in a written engagement agreement between the QP and the issuer that clearly sets out the scope of the retainer, the respective obligations of the parties and an appropriate allocation of risks through the reasonable limitation of the liabilities of the QP, supported by corresponding indemnities from the issuer. However, even the best crafted indemnities in a comprehensive engagement agreement provide only imperfect protection for the QP, as indemnities can be very cold comfort in situations, like Bre-X, where the issuer's assets may long since have been depleted by the time the QP may wish to enforce an indemnity.

Accordingly the best protection for both the QP and the issuer will be afforded by ensuring that the QP has in place, and consistently follows, appropriate written policies and procedures covering the entire report preparation process from retainer to filing. These policies and procedures should include:

- a compulsory educational program, with appropriate legal input, to ensure that all QPs are fully aware of the responsibilities imposed on them by the Instrument, Companion Policy, Form and related securities legislation and case law and the potential liabilities to which they may be exposed;
- a review of the proposed staffing at the outset of each retainer to ensure that

the appropriate level and mix of professional experience and expertise is engaged to adequately address the opinions, conclusions and recommendations that will be required by the assignment;

- where diverse areas of expertise may be required, consider whether more than one QP should have responsibility for the report;
- early identification of areas such as title, taxation, permitting, environmental and socio-political matters where legal or other non-QP expertise will be required, ensure that these experts are retained on a timely basis to provide their input and include in the technical report an appropriate disclaimer of responsibility for those sections of the report that are based on this non-QP input;
- identify whether the QP is required to be independent and if so carry out appropriate review to ensure independence within meaning of the Instrument;
- prohibit QPs from owning shares in or acting as directors of mining companies or holding any interest in mining properties so as to limit the potential situations where a QP could be found not to be independent;
- an effective program of ongoing professional development to ensure that QPs are always up to date with evolving industry and professional guidelines and standards;
- provision for peer review of all reports prior to delivery to ensure that the requirements of the Instrument, Companion Policy and Form and the applicable professional guidelines and industry standards have been followed; and
- certifying the report and consenting to its filing only after a careful review of the related disclosure document to ensure that no material information concerning the subject matter of the

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report has changed or been omitted and that the disclosure document does not misrepresent information in the report.

The Instrument represents a substantial change in the role, responsibilities and potential liability of QPs. The proper interpretation and application of the Instrument requires an appropriate understanding of the legal meaning of a number of its terms as well as related securities legislation and case law. Given that the law relating to liability in securities disclosure matters is rapidly

evolving, and considering the increasing prevalence of class action law suits in this area, QPs should obtain legal advice in drafting an appropriate form of retainer agreement and in developing their internal policies and procedures aimed at ensuring compliance with the Instrument.

*Every effort has been made to ensure the accuracy and timeliness of this publication, but the comments are necessarily of a general nature. Clients are urged to seek specific advice on matters of concern and not to rely solely on the text of this publication.*

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