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Ontario Securities Commission
Alberta Securities Commission
British Columbia Securities Commission
Commission des valeurs mobilières du Québec
Saskatchewan Financial Services Commission
The Manitoba Securities Commission

Re: Comments on Proposed National Policy 41-201 – *Income Trusts and Other Indirect Offerings*

I. INTRODUCTION

This letter responds to the request of the Canadian Securities Administrators (the "**CSA**") for comments on proposed National Policy 41-201 – *Income Trusts and Other Indirect Offerings* (the "**Policy**").

Part II – General Comments sets out our general comments on the Instrument. **Part III – Response to Specific Requests for Comments** sets out our response to the CSA's request for comments on certain specific aspects of the Proposed Policy.

II. GENERAL COMMENTS

1. Implementation.

Fasken Martineau fully supports the purpose of the Proposed Policy given that it provides needed clarity to the securities legislative framework as it applies to income trusts. Fasken Martineau has had extensive experience in a variety of income trust offerings and, in that regard, we are familiar with the issues raised in the Proposed Policy. Given the recent significant expansion in the number of income trust offerings, we feel that the Proposed Policy is both timely and useful as it provides a transparent codification of what we understand has been the CSA's developing practice to date.

2. Insider Reporting.

We are concerned with the requirement in the Proposed Policy that the income trust undertake to take "appropriate measures" to require insiders of the operating entity to file insider reports about trades in units of the income trust.

First, the Proposed Policy does not define what would constitute "appropriate measures". While this may be best left to the income trust to determine, it would appear that one of the only methods to do so would be through employment covenants; however, the income trust might then be forced to attempt to amend unilaterally, directly or indirectly, the employment contract of the insider. Should the insider fail to comply with this contractual obligation, the trustees of the income trust may be faced with the awkward position of terminating an employee for breaching an obligation that is not grounded in the relevant securities legislation.

Second, the obligation to report as an insider should rest on the insider itself if a person is an insider as defined in the applicable securities legislation. If such person is not caught by the definition of "insider", we feel it would be more appropriate to amend the legislation to address this fact.

We suggest that, if an undertaking is necessary, the income trust should be required to take appropriate measures to alert insiders of the obligation to report.

3. <u>Placement of Risk Factors</u>.

Given that the primary purchasers of income trust units tend to be retail investors who may be less sophisticated than large institutional investors, we suggest that the CSA consider adding a provision in the Proposed Policy that the prospectus give greater prominence to the disclosure of risk factors. One method of doing so would be to require that the risk factor disclosure be placed toward the beginning of the prospectus, rather than toward the end, which has been our experience.

4. <u>Lack of Insolvency Legislation</u>.

Should the CSA ultimately include guidance regarding risk factors in the prospectus, consideration should be given to including reference to a risk factor surrounding the inapplicability of insolvency and restructuring legislation in the trust context. The principal statutes traditionally used for purposes of financial restructuring are the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act* or, in some cases, the *Winding-Up and Restructuring Act*. A trust is not a legally recognized entity within the relevant definitions of these insolvency and restructuring statutes and therefore an income trust would not be able to access the remedies available thereunder in the event a restructuring is necessary. Investors should therefore be alerted to the fact that, in the event of an insolvency or restructuring, their position as unitholders of a trust may be quite different than that of holders of equity in a corporate entity.

5. **Specific Drafting Comments**.

Section 2.4 – We have proposed certain amendments to the sample cover page disclosure provided in Section 2.4. In particular, the disclosure does not contemplate that an income trust might hold income producing properties rather than an operating business. Further, we believe that the tax disclosure could be made more accurate by including the revisions we have provided. In that regard, we propose the following sample language (with changes highlighted) which incorporates these comments and certain additional drafting changes:

> The pricing of the units has been determined, in part, based on the ~~estimate~~**forecast net income and the resulting calculation** of distributable ~~cash~~**income** for the year ended •~~ on page •~~. Although the income trust intends to make distributions ~~of~~**from** its ~~available~~**distributable** ~~cash~~**income** to unitholders, these ~~cash~~ distributions are not assured. The actual amount distributed will depend on numerous factors including the operating entity's financial performance **[or the financial performance of the underlying commercial properties]**, debt covenants and obligations, working capital requirements, future capital requirements and, if applicable, the deductibility for tax purposes of interest payments on the debt of the operating entity [these details can be tailored according to the specific set of circumstances in each transaction]. The market value of the units may deteriorate if the income trust is unable to meet its ~~cash~~**distributable** ~~distribution~~**income** targets in the future, and that deterioration may be material.
>
> The after-tax return from an investment in units to unitholders subject to Canadian income tax will depend, in part, on the composition for tax purposes of distributions paid by the income trust (portions of which may be fully or partially taxable or may constitute non-taxable returns of capital). The composition for tax purposes of those distributions may change over time, thus affecting the after-tax return to unitholders. The estimated portion of ~~your~~**a unitholder's** investment that will be taxed **in [specify year]** as a return on capital is •**%** and the estimated portion that will be taxed **in [specify year]** as return of capital is •**%**. Returns on capital are generally taxed as ordinary income ~~or as dividends~~ in the hands of a unitholder. Returns of capital ~~are~~**will initially be** generally non-taxable to a unitholder (but **generally will** reduce the unitholder's **adjusted** cost base ~~in the~~ **of a** unit for **income** tax purposes). **[Include cross-reference to tax disclosure in prospectus.]**

Sections 2.4 and 2.13 – We note that the lead-in language to the sample cover-page disclosure in these two sections differs such that in the first case, reference is

made to the sample disclosure being "helpful" while in the latter case the disclosure is "expected". Given the importance of the disclosure discussed in each of these items, we believe that the CSA should use consistent lead-in language, otherwise it may lead to an interpretation that the disclosure required in one section is of lesser importance.

Sections 3.1 and 3.4 – These sections refer to filing an undertaking with "regulatory authorities". We believe that this reference should be to "securities regulatory authorities" as such term is defined in National Instrument 14-101 – *Definitions*, unless this term is to capture other regulatory entities.

Section 4.3.3 – In the last paragraph, the Proposed Policy makes reference to the fact that the retained interest of vendors who retain a meaningful interest in the operating entity *would* be available to satisfy a damages claim in the event of a claim against the operating entity who has signed the prospectus as a promoter. We believe that the reference to the term "would" should be changed to "may" as the availability of the vendor's retained interest to satisfy a damages claim will depend on the particular facts and circumstances of any claim.

III. RESPONSE TO SPECIFIC REQUESTS FOR COMMENTS

The following are our comments in response to certain of your specific requests for comments.

1. **Scope**.

In the opening section 1.1, we recommend that the CSA include an explanation that the Proposed Policy has been implemented as a policy as opposed to a rule or national instrument since it is believed that the existing regulatory framework currently captures the issues relating to income trusts and indirect offerings; the Proposed Policy is merely provided to guide issuers and their counsel in applying this framework.

2. **Format of policy**.

We believe that the Proposed Policy would be more useful to unsophisticated investors if the more substantive portions were separated from the narrative or explanatory portions. In this manner, unsophisticated investors who may consult the Proposed Policy can obtain the relevant information for their needs without having to wade through the details of sample cover page disclosure, for example. A cross reference could be made within the text of the explanatory sections to the substantive requirement that results from the concern raised by the CSA.

3. **Direction regarding risk factors**.

We believe that the Proposed Policy should only provide limited guidance on what should be included in any particular risk factor. We note that risk factor guidance is provided in section 2.9 regarding the terms of short-term debt. While this guidance is of assistance, it appears isolated within the Proposed Policy given that many other matters are discussed that will give rise to a risk factor, such as risks related to distributable cash and risks related to the fact the vendors of the operating entity may hold no interest following the offering.

If guidance is to be provided, however, it should emphasize that the guidance is not exhaustive and should only provide a checklist of non-exclusive items to consider when disclosing risk factors.

4. **"Return on" vs. "Return of" capital**.

We believe that the recommended distinction of "return on" and "return of" capital is a useful distinction to be highlighted in the prospectus. We understand in particular that unsophisticated investors today may not fully understand or appreciate the distinction. Mandating greater clarity in prospectus and continuous disclosure is one method of further educating investors on this issue.

5. **Stability ratings**.

As similar ratings are not required for corporate issuers when issuing equity securities, we do not believe that income trusts should be required to obtain a stability rating. An investment in income trust units is in essence an equity investment and, in this respect, is not different from an investment in common shares. While it is often a commercial reality that such a rating will be obtained, it should not be a specific securities law requirement that such ratings be obtained.

6. **Comparison of distributed and distributable cash to expected distributable cash figure**.

To the extent that an issuer chooses to announce expectations of distributable cash figures, we agree that issuers should provide an updated comparison of distributed and distributable cash to the expected distributable cash figure. Requiring that distributable cash figures be later compared to previously expected figures is useful given that this is the fundamental item that investors look to when assessing whether to acquire income trust units. This will allow investors to assess their investment on an ongoing basis using this important measure and will

also provide investors acquiring trust units in the secondary market with valuable information. We also support a recommendation that issuers update a breakdown of the distributed and distributable cash figure between the "return on" vs. "return of" capital. Once again, we believe that many investors may not appreciate this distinction and the significant income tax implications it may have.

IV. CONCLUSIONS

We appreciate being given the opportunity to comment on the important and worthy initiatives contained in the Proposed Policy. If you wish to discuss any of our comments, please do not hesitate to contact any of George C. Glover, Jr. in our Toronto office, Gilles Leclerc of our Montreal office or Lata Casciano of our Vancouver office. The contact particulars are set out below.

Respectfully submitted,

This is a computer-generated transmission and therefore does not contain a hand-written signature.

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