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December 23, 2003

**VIA E-MAIL**

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

c/o Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, ON M5H 3S8

**Attention: Ilana Singer, Legal Counsel, Corporate Finance**

c/o Commission des valeurs mobilières du Québec  
800, Square Victoria, 22<sup>nd</sup> Floor  
Tour de la Bourse  
P.O. Box 246  
Montréal, PQ H4Z 1G3

**Attention: Denise Brosseau, Secretary**

Dear Sirs/Madams:

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

This letter is in response to the Request for Comments relating to Proposed National Policy 41-201 – *Income Trusts and Other Indirect Offerings* (the “Proposed Policy”) published by the Canadian Securities Administrators (the “CSA”) on October 24, 2003. Defined terms used in the Proposed Policy will be used in this comment letter. We are pleased to have this opportunity to provide our comments on the Proposed Policy.

We begin by acknowledging the objective of the Proposed Policy, being the enhancement of the nature and quality of disclosure of income trusts and other indirect offering structures, both in prospectuses and on an ongoing basis to ensure adequate protection of investors.

We recognize the recent increase in the number of income trusts and other indirect offerings structures and agree that existing rules may not adequately address the disclosure and

liability issues that such entities raise. Moreover, we agree these rules may need to be clarified to ensure that investors have access to sufficient information to make an informed investment decision.

However, such rules should not put income trusts and other indirect offering structures at a competitive disadvantage compared to other issuers. We believe that income trusts and other indirect offering structures which are akin to regular share corporations should be treated in the same way as regular share corporations.

Our comments on the specific aspects of the Proposed Policy follow. We have used the section headings and numbers adopted in the Proposed Policy.

## **Part 1 – Introduction**

As a general comment, we are concerned that the Proposed Policy is not framed as a rule. We believe this may lead to inconsistent enforcement and uncertainty in the market as to compliance.

### **1.1 What is the purpose of the policy?**

The stated purpose of the Proposed Policy is to clarify how the existing regulatory structure applies to non-corporate structures such as income trusts and to indirect offerings. Particular areas of concern are the quality and nature of prospectus disclosure and continuous disclosure records, accountability for prospectus disclosure and liability for insider trading. The CSA note that many of the principles outlined in the Proposed Policy are equally applicable to direct offering structures.

If there are aspects of the Proposed Policy that may properly apply to issuers with a direct offering structure, in our view, a general statement does not provide sufficient guidance to issuers that operate through such a structure as to what specific requirements such issuers will have to comply with. Without references to specific requirements, we are unsure how the Proposed Policy will be enforced against such issuers. If issuers other than those with an indirect offering structure are expected to comply with specific aspects of the Proposed Policy, we believe that it would be preferable to specify the relevant requirements.

## **Part 2 – Prospectus Disclosure**

### **2.4 What cover page disclosure do we expect about distributable cash?**

The Proposed Policy recommends income trusts disclose on the cover page of a prospectus the estimated portion of an investor's investment that will be taxed as a return on capital as well as the estimated portion that will be taxed as a return of capital. We believe that such a requirement will impose a significant burden on income trusts, both in terms of actual costs as well as the time it takes for an income trust to go to market, as they will be required to develop detailed forecasts of expected financial information to determine these values.

Further, such information cannot be provided without the use of future oriented financial information which is subject to significant regulatory restrictions.

In addition, the Proposed Policy does not state for what period such disclosure will be required or how it shall be determined.

As a practical matter, we note that the Proposed Policy recommends the inclusion of a considerable amount of disclosure on the face page of a prospectus. We believe this recommendation is too broad and should be reconsidered with a view to prioritizing and reducing the volume of such cover page disclosure.

## **2.8 Are agreements relating to the operating entity's short term debt material contracts of the income trust?**

We are concerned with the statement in the Proposed Policy that agreements relating to short term debt are, in most cases, material contracts and should be filed on SEDAR. We note that corporations are not required to file similar agreements on SEDAR. Public disclosure of such agreements may adversely affect the competitive position of an income trust. We note that the Proposed Policy requires an income trust to disclose in its prospectus the principal terms of any short term debt as well as include a separate risk factor about the operating entity's short term debt. We believe that these requirements provide sufficient disclosure about the sensitivity of an income trust to the cash flow of the operating entity and, consequently, that the public disclosure of agreements relating to short term debt is not necessary.

## **2.10 Stability Ratings**

The Proposed Policy states that "a fundamental characteristic that distinguishes income trust units from traditional fixed-income securities is that the income trust does not have a fixed obligation to make payments to investors". We are therefore concerned with the apparent emphasis in the Proposed Policy on stability ratings, which are issued by bond rating agencies. In our view, such emphasis will perpetuate the myth that an income trust investment of is more like debt security that provides a consistent rate of return to an investor. Although the Proposed Policy does not impose a requirement on income trusts to obtain a stability rating, we believe that the disclosure expectations contained in the Proposed Policy (i.e. the reasons for an income trust not obtaining a stability rating and the cover page disclosure) may over emphasize stability ratings in the minds of investors. We submit that rather than relying on stability ratings, investors should be able to assess an investment in units of an income trust on the same basis as they would assess an investment in the securities of a regular share corporation. Currently, the capital markets effectively require certain types of income trusts to obtain ratings. We believe the use of a rating should be governed by the requirements of the markets.

## **Part 3 – Continuous Disclosure**

### **3.1 What continuous disclosure do we expect about the operating entity?**

We believe financial reporting should be governed by GAAP (as is the case for corporate reporting issuers). We do not believe that any features of an income trust are so unique as to require such a material difference in reporting requirements. We are also of the view that the proposed certification requirements should be reconsidered. We believe such requirements could be eliminated entirely provided that continuous disclosure documents are adequate. Alternatively, such certifications could be part of the management proxy circular or AIF or other annual disclosure document instead of yet another stand alone filing.

### **3.2 Comparative financial information**

The Proposed Policy states that most income trusts are the continuation of an existing business that was previously operated under a different legal form. Therefore, the Proposed Policy suggests that the entity should be able to provide comparative financial information for the underlying business for the initial interim and annual periods following the initial public offering (the “IPO”). We are concerned that it may not always be appropriate to assume that such a comparison can be reflected adequately in financial statements. Preparing comparative information for periods prior to an income trust’s IPO can be problematic and may not be particularly helpful when presented together with information from post-IPO periods since often the operating business has not just operated in a different form but rather may have been operated as a division of a larger enterprise or the operating business itself may consist of assets and businesses previously owned and conducted in whole or in part by a variety of legal entities. Moreover, the pre-IPO period will likely differ from the post-IPO period as it relates to many financial statement items. We believe that the provision by an income trust of a full set of financial statements of a prior period will add to the complexity of the information presented and render some financial statements almost incomprehensible. In addition, we suggest that making such financial statements comparable may require several material pro-forma adjustments. To reduce confusion to investors, we believe that the Proposed Policy should recommend the provision of meaningful and understandable comparable information with specific inclusions and exclusions.

## **Part 4 – Prospectus Liability**

### **4.3.1 What is the Meaning of Promoter**

If the CSA propose to expand the definition of promoter we believe that the words “significant portion” in respect of the offering proceeds are not precise enough.

#### **4.4 Contractual Accountability**

The Proposed Policy specifies that that vendors of an operating business to an income trust must take appropriate responsibility for disclosure in the income trust's prospectus through signing the prospectus, the agreement through which the income trust acquires the operating business or otherwise.

The Proposed Policy notes that CSA staff may recommend against the issuance of a receipt for an income trust's prospectus if the vendors of the operating entity receive cash proceeds from an indirect offering by selling their operating entity interests and do not take appropriate responsibility for the information provided in the prospectus. While we understand that CSA staff will look at the entire framework of representations, warranties and indemnities provided by the vendors as a group in assessing whether the vendors have taken appropriate responsibility (directly or indirectly) for the information provided as a basis for the offering, we are concerned that CSA staff may be put in the position of passing on the appropriateness of the terms of an acquisition agreement. This is of particular concern in fully arm's length transactions.

While we understand the desire for proper disclosure of the terms of relevant acquisition agreements, we are concerned with the implied requirement that such agreements contain "meaningful indemnities". First, we are unsure as to what the CSA may consider to be "meaningful" in a given transaction. Second, as we note in the preceding paragraph, we are concerned that the CSA may be passing on the appropriateness of the terms of an acquisition agreement.

### **Part 5 – Sales and Marketing Materials**

#### **5.1 What are our concerns about sales and marketing materials?**

We note that in the Proposed Policy, the term "yield" is defined to mean the return (other than a return of capital) that would be generated over a one-year period, as a percentage of the offering price of the units, if the amounts intended to be distributed by the income trust according to its distribution policy are so distributed. However, the term "yield" is usually used to mean the total amount to be distributed by an issuer divided by market price of the particular share or unit, expressed as a percentage. In addition, we are uncertain as to why returns on capital are excluded from "yield".

#### **5.3 Do we expect income trusts to provide us with copies of their green sheets?**

We do not believe that income trusts should be required to file green sheets when they file a preliminary prospectus since other issuers are not subject to such a requirement.

Thank you for the opportunity to comment on the Proposed Policy. We would be happy to discuss any of the above with you further. If you have any questions, please do not hesitate to contact John S. Osler (Calgary) or Christopher S.L. Hoffmann or Frank A. DeLuca (Toronto).

Yours truly,

**McCarthy Tétrault LLP**



John S. Osler

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