Harvest Energy Trust
Proposed National Policy 41-201 – Comments

SPECIFIC REQUESTS AND GENERAL COMMENTS:

Part 1 - Introduction

- *Agree that scope of proposed policy is appropriate?*

There is a fundamental premise throughout the policy that implies that there are distinct differences between the business processes of income trusts and conventional equity issuers. We believe the scope of the policy amplifies these distinctions to an inappropriate level. Fundamentally, we feel income trust structures can be treated in much the same as any other publicly traded entity. Making the distinction between indirect and direct issuers is in most cases at best theoretical. We feel these distinctions could result in appropriate differentiation in the capital markets that could likely lead to a misallocation of available capital and confusion of some investors.

For example, at a fundamental level, we would argue that many so called "direct issuers" employ complex and layered structures that implicitly make them fundamentally indirect issuers. We refer to structures like partnerships, which have become popular, and the multi-layered international corporate structures that are designed for tax efficiency or risk limitation.

- *Discussion of indirect offerings is clear?*

We accept the definition of "indirect offerings", but as we stated above, the distinction is theoretical, when only applied to income trusts. We would argue that many public issuers use indirect structures to organize their assets for a variety of reasons. It is our feeling that the true distinction should be "non-arm's length" or "arm's length", which we feel the markets and regulators have already done well to distinguish. Perhaps this should be the issue of consideration rather than "indirect" vs. "direct" offering, which at best is only applicable in a theoretical sense.

- *Comments on the form of the policy as drafted.*

The basic structure, as five parts, is clear and the topics are also clear. However, in some instances we had some difficulty moving through it and found the issues to be confusing in how they were organized. For example, as a specific comment, the issue of indirect offering is introduced in Part 1, but not dealt with in application until Part 4. If this is a fundamental issue, we recommend bringing out all the aspects clearly and independently. Perhaps a definition section would be the best way to deal with this.

Part 2 - Prospectus Disclosure

- *Appropriateness of guidance provided in respect of direction as to risk factors disclosed in relation to the operating entity?*

We feel that generally existing prospectus risk disclosure requirements for all entities already provides the necessary guidance. However, in the case of areas of specific distinction for income trusts, such as the potential for unlimited liabilities and the fact that income trusts potentially distribute a significant portion of their cash flow, there may be a need for mandated disclosure. Our feeling, however, is that these specific issues are generally well handled by the issuers.

- *Agree with prospectus cover page disclosure of “return on” vs “return of” capital?*

We are concerned that this requirement may call for the preparation of a “forecast”. Preparation of a forecast is time consuming, costly and will call for disclosure of various assumptions thus impairing the achievement of “plain” disclosure (i.e. prospectus information is more complex and the amount of information is increased). In addition, this may only lead to additional costs to income trust to maintain, update, reconcile and report forecast changes on a continuous basis.

The percentage of return of capital versus the return of income is reasonable for disclosure at the appropriate time in an income tax analysis. But to report return of capital versus return of income in the earnings regime calls for some very substantial and perhaps arbitrary assumptions on the "going concern" nature of an entity's assets and business plan and could lead to misrepresentation of performance. This type of analysis is the domain, in our view, of the equity analyst and the capital market.

- *Additional disclosure on Distributable Cash?*

The emphasis on improving the disclosure on Distributable Cash is understandable, but the application of improvements will be impractical. It is true that current rates of distribution are factors in defining market price, but to draw a direct linkage between Distributable Cash and unit price is too simplistic. Pricing is defined by all of expected Distributable Cash over time, asset value, cash flow volatility, quality of management and business plan and many other more subtle factors. Trust units are equity units, carrying all the same risk as common shares with perhaps a few unique risks such as the potential for limited liability (which is very theoretical). Investors must be informed of this reality - and it is our belief that the market is broadly aware of this reality. Disclosure on this analysis is more the domain of the equity analyst than additional corporate disclosure.

Nevertheless, Distributable Cash definitions should comply with NP 52-303. Perhaps better accounting treatment of Distributable Cash could be achieved through better application of NP 52-303.

Lastly, the additional disclosure contemplated by the policy for the cover page of the prospectus is perhaps inappropriate. The additional disclosure could make the prospectus more complex and therefore, less "plain" in the context of "full, plain and true".

- *Additional disclosure on Short-Term Debt?*

There is no arguing the importance of the potential implications of short-term debt on Distributable Cash. However, short-term debt can have significant impact on any operating entity that is capital intensive. The idea of mandating the full disclosure of debt agreements on SEDAR is too aggressive. Debt arrangements are competitive documents for both the entity issuing the debt and the lender. Both of these entities would be suffer a negative economic impact if forced to disclose all the terms of the agreement. (i.e. lenders will move to more standard type arrangements and limit borrowers from unique and favourable). As such; disclosure of such documents may negatively impact strategic opportunities of the reporting issuer. Perhaps a compromise is a series of mandated details of a debt agreement.

- *Stability ratings valuable to investors?*

Certain income trusts may be suitable candidates for stability rating but many are not due to the volatile and complex nature of their operations. Investors should rely upon their own due diligence, their investment advisors due diligence and equity analyst reports. Most rating agencies are not capable of evaluating the complexities of the equity structure of an entity and therefore would not be capable of developing sound judgement on the potential opportunities or risks of an entity. Inclusion of stability ratings may not be as reliable on

unique or unusual business models or structures. Generally no interaction takes place between the rating agency and the income trust; thus there is no method to exchange, review and verify information as well as educating the rating agency. The cost may also be a concern.

- *Stability ratings as an appropriate and effective means of comparison; is there a more appropriate or effective method?*

Stability ratings, while interesting, are likely to be a less appropriate and effective means than an investment advisor's due diligence and equity analyst reports. Furthermore, in a manner similar to the way in which securities laws and regulations utilize distinctions between entities in different business areas for defining disclosure, this policy should consider the practical aspects of specifying certain policy requirements for specific industries. For example, the concept of a stability rating may be applicable for, perhaps, REITs, but a mandatory application of stability rating for, say, an oil and gas royalty trust seems impractical.

- *Executive compensation.*

In our view, the largest issue is the inconsistency in disclosure of the typical compensation terms between income trusts. We have observed that some trusts argue that since their officers are employed by the operating entity, they are prevented from having to provide this disclosure. This is unacceptable. Using the argument that income trusts fundamentally behave in the same manner as other entities, they should be mandated to disclose in the same manner.

As for management contrasts, it is our belief that a distinction must be made between the business contracts (that were prevalent with oil and gas royalty trusts until recently) and employment contract with individual officers. We feel the management contracts should be disclosed because they have potentially broad business impacts. However, individual employment contracts are typically personal documents and should only require summary disclosure.

Part 3 - Continuous Disclosure

- *Continuous disclosure in situations where expected Distributable Cash was presented, to require the issuer to compare the forecast in an annual update to the Distributable Cash, distributed cash and tax attribute allocation, compared to the original forecast?*

These recommendations seem reasonable, given the need for investors to understand the difference between actual performance and the forecasted performance, reconciliation between the differences and income tax effects. However, it should not be mandated that issuers offer forecasts of Distributable Cash. Furthermore, this issue is not unique to income trusts. Many entities forecast the cash flow from operations associated with their structure. Similar policy requirements should be assigned to this group. It was interesting, the specific aspects of Distributable Cash, as described in the "Request for Comments" were not evident in the policy.

- *Insiders of Operating Entities.*

The undertakings and annual certification contemplated by the policy should be applied to all public entities not just income trusts. Insider reporting is the responsibility of the individual not the entity. The entity should not be held responsible for actions of individuals who it has no authority over. The best an entity could accomplish is the notification of these "outside" individual, but even this is not definitive. The policy as drafted expects the income trust will enter into separate contractual commitments with external persons not covered by the

insider" rules but have material undisclosed information – this approach will certainly be impractical to administer.

Part 4 - Prospectus Liability

- *Promoter Liability.*

The definition of a promoter is very clear, in our view. As such, whether it is an income trust or a common share equity issuer, the concept of a vendor, as a promoter is in our view identical. If this vendor gains the full economic benefit from an issue without the commensurate liability and it is apparent that management is not in a position to execute its requisite due diligence without a conflict of interest we feel regulations are required. However, this is only likely to occur in an IPO.

However, it is not supportable that the vendor in a so-called indirect offering is always a promoter. In follow-up offerings, where an income trust (or any other issuing entity) is raising funds to finance an acquisition, it seems unreasonable to unilaterally always label such a vendor as a promoter. The entity is already in existence. As such, its management should executing their due diligent role to protecting the interests of existing and future stakeholders. It seems that the real issue is one of whether management is able to perform its due diligence role when it comes to acquisitions and follow-up financing, not whether the vendor is a promoter and should be required to sign the prospectus.

The largest concern that we see with the policy as drafted is the ongoing potential requirement for vendors to sign prospectuses or the undue requirement to disclose potentially sensitive purchase and sale information concerning a transaction. These requirements will impair many organizations' competitive position with respect to vendors and impair their ability to complete value creating acquisitions.

Disclosure attributable to vendors in an indirect offering, 4.4.3(i) and (iii) seem reasonable; while "detailed" description of vendor reps, warranties, indemnities, and negotiations go beyond "plain" disclosure.

In respect of the acquisition agreement, we feel it is inappropriate for CSA staff to judge the adequacy of a transaction and have sufficient power to delay an issue should the CSA staff member be unsatisfied with the amount of responsibility being assumed by the vendor. This is a commercial issue that should be left to the management of the business entities.

Part 5 - Sales and Marketing Materials.

- *Green Sheets.*

Green sheets are the responsibility of the underwriters, and regulated under applicable securities regulations. It is our feeling that the reporting issuer should not be held responsible for a document over which it has limited control.

The use of the term "yield" has evolved significantly in the past 7 years with the increase in the market for income trusts. We do not feel there is any confusion with the use of "cash-on-cash yield" or the like. Investors understand that it is not "yield" in the context of bond returns. Again, as with the preparation of the green sheet, nomenclature is more the domain of the underwriters and the investment advisors, not the issuer.