

January 19, 2004

Ontario Securities Commission  
20 Queens Street West  
Suite 1900, Box 55  
Toronto, Ontario M5H 3S8

Alberta Securities Commission  
300 Fifth Avenue S.W.  
Suite 400  
Calgary, Alberta T2P 3C4

**Attention: Ilana Singer**  
Legal Counsel  
Corporate Finance  
[isinger@osc.gov.on.ca](mailto:isinger@osc.gov.on.ca)

**Attention: Marsha Manolescu:**  
Deputy Director  
Legislation  
[marsha.manolescu@seccom.ab.ca](mailto:marsha.manolescu@seccom.ab.ca)

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

**Attention: Denise Brosseau**  
Secretary  
[consultation-en-cours@cvmq.com](mailto:consultation-en-cours@cvmq.com)

Dear Sirs/Madames:

**Request for Comments-Proposed National Policy 41-201 Income Trusts and Other Indirect Offerings (the “Policy”)**

Thank you for the opportunity to provide our comments.

**Congratulations!**

We applaud your recognition of the fact that investors may have difficulty comparing income trusts. We know that many of our clients certainly do. These are institutional investors who are very knowledgeable and sophisticated. If they have difficulty, we are certain that investors generally will be even more challenged. We agree, income trusts have unique attributes and investors need sufficient information to make an informed investment decision having regard to those attributes.

## **Our Response to Your Request for Comments**

### **Questions under “D.”**

The comments that follow address your questions under D. with respect to oil and gas income trusts only:

- Do stability ratings offer an appropriate and effective means of comparison of income trusts?
- Is there a more appropriate or effective method?

In our opinion, stability ratings, as contemplated, do not offer an appropriate and effective means of comparison. There is a more appropriate and effective method.

### **Problems With Stability Ratings**

As contemplated, the stability ratings deal with sustainability and variability. Using combined numerical ratings to express this very complex information is, we believe, dangerous oversimplification. Other respondents also commented on the shortcomings of the stability ratings being considered.

### **A More Appropriate and Effective Method**

We recommend a more complete approach that includes a technical understanding of the oil and gas industry and incorporates more qualitative considerations that reflect the oil and gas industry’s operating practices and how investment decisions are made every day.

### **Methodology**

Reserves and Future Net Revenue are as important, or more important, than revenue, income, current cash flow or similar measures in the oil and gas industry. NI 51-101 recognizes this and the resulting required disclosure would form an important part of our proposed approach. Historical financial measures and current financial position would supplement and complement reserves and related information. In addition, our methodology and report would include a very useful description of the trust’s actual oil and gas properties, their underlying characteristics and specific risks.

Sustainability of current cash flow is a key to investment decisions. Reserves are a depleting resource. This depletion is assessed and estimated year-by-year for the life of the reserves, excluding future exploration or acquisition reserve additions from this part of the sustainability estimate. This answers the first part of the sustainability question. That is, if the issuer does nothing but produce-out existing reserves, this is a reasonably reliable estimate of future cash flows, assuming future prices used are reasonable. Since future prices are one of the main sources of variability, a sensitivity analysis can be provided that allows the investor to better assess the implications of different pricing assumptions.

The second and most difficult part of the sustainability question, is to predict what reserves are to be discovered through exploration or, in the case of most oil and gas income trusts, to estimate the reserves to be purchased from others and further developed, and at what costs. Ross Smith has assembled an extensive proprietary database of reserves and related information. With this extensive knowledge of the properties, the reserves and production, we can provide an informed view of what results could be attained from further development of existing and acquired properties. If the issuer has a reasonable estimate of future cash flows from the production of existing reserves, non-discretionary future cash payments can be deducted, resulting in cash flows available for purchase and development of reserves, with the balance being available for distributions to unit holders. This is exactly the process followed in our evaluation process and applied to the oil and gas income trusts.

Estimates of the effects of the above variables can be shown in relatively simple, concise tables so the investor can much better understand the current estimated value of existing and anticipated reserves, cash flows and distributions. Broadly consistent comparisons can be made for numerous trusts.

Comparisons would include:

- Discounted Future Net Revenue with sensitivity analysis
- Discretionary Cash Flow by Year
- Cash Flow dedicated to acquisitions and related development by year
- Resulting new reserves and Cash Flow
- Net Asset Value obtained by substituting Discounted Future Net Revenue for book costs and accrued abandonment and reclamation costs
- Net Asset Value compared to total quoted market value
- Related premium
- Historical statistics such as reserves replacement, finding and development costs, production, reserves revisions, etc.
- Statistics as to “return of” vs. “return on” investment

As well, applicable qualitative commentary would be provided by expert specialists in the evaluation of oil and gas properties and issuers including engineers, former investment dealers, marketers, economists, financial and investment analysts. Such commentary would be based on the above data.

While we dislike single point ratings, we could include rating ranges for the above factors.

We would anticipate evaluating at least ten issuers, each of which would pay us. Our report would compare the ten or more. We would thereby remain independent and objective. The report could be updated annually or more frequently. New issuers could be added.

### **Some Advantages of the Above Approach**

1. Driven by how the oil and gas industry and its investors operate.
2. Much of the required information is readily available for analysis using our proprietary database.
3. Includes factors that are covered by bond rating services, but recognizes that those factors are secondary for income trusts.
4. Avoids criticism of respondents that bond-rating services are not applicable and that “stability ratings perpetuate the myth that Income Funds are similar to bonds and further confuse retail investors.”
5. Avoids the criticism that “Rating agencies...have no professional accreditation, and make their subjective assessments without particular accountability.” NI 51-101 requires accreditation including compliance with the COGE Handbook.
6. Avoids single point ratings and criticism that users might use such ratings inappropriately.
7. We are independent and do not directly or indirectly underwrite issues or manage public market investments. We are recognized as the only truly independent source for oil and gas research in North America.
8. Avoids criticism that, because of regulatory restrictions on future oriented financial information, “return on vs. return of investment” information can’t be given. That restriction does not apply to reserves and future net revenue.
9. Recognizes that, while distributable cash is an important factor, it is far from the only factor that should be considered by an investor.
10. Satisfies your concern that investors may have difficulty comparing trusts.

### **Ross Smith Energy Group Ltd.**

- Provides independent investment research, to institutional investors, with respect to selected North American oil and gas issuers on a subscription basis.
- Provides independent specialized analysis and views related to selected oil and gas topics.
- Clients include many of the major institutional investors in Canada and the US.
- Clients have also included individual issuers for special oil and gas studies.
- We do not provide investment banking or any underwriting services. We maintain strict independence.
- We have provided these services for approximately six years.
- We have 21 professional and support staff on site in Calgary with extensive experience in virtually all aspects of the oil and gas industry and financial markets.
- We use over 150 independent consultants located throughout the world.
- As appropriate, we engage outside, independent experts for special projects.
- Have carried out in-depth studies of oil and gas income trusts.

## **Recommendation**

- **Keep the concept of encouraging or requiring ratings and the necessity of disclosing when, and why, ratings are not presented.**
- **Don't limit ratings to prospectuses; make them part of continuous disclosure as well.**
- **State that ratings, other than those from the example rating agencies, will be acceptable, provided they are from independent, reputable, competent entities, that have demonstrated success in their field of expertise and with respect to the specific industry and to income trusts generally.**

## **Further Information**

We would be pleased to provide further information and answer any questions or concerns you may have. Examples of the unique process we follow to evaluate oil and gas income trusts could also be provided. We would welcome the opportunity to meet with you at your convenience.

Please call:

Allan Ross      (403) 294-6482  
Jim Jarrell      (403) 294-6487

Yours truly,

ROSS SMITH ENERGY GROUP LTD.

Allan J. Ross  
Chief Executive Officer and Director

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