Chapter 5

Rules and Policies

5.1.1 NP 41-201 Income Trusts and Other Indirect Offerings

NOTICE

REPLACEMENT OF
NATIONAL POLICY 41-201 INCOME TRUSTS AND OTHER INDIRECT OFFERINGS

Introduction

The Canadian Securities Administrators (CSA or we), are amending National Policy 41-201 – *Income Trusts and Other Indirect Offerings* (NP 41-201).

NP 41-201 first came into effect in December 2004. On January 5, 2007, we published our proposed amended policy for a 60-day comment period. The amended policy has been, or is expected to be, adopted in all jurisdictions and will replace the December 2004 version of the policy on July 6, 2007.

This notice provides a summary of the key changes to NP 41-201, the comments we received on the proposed amended policy and the additional changes we made to the policy as a result of those comments.

Substance and purpose

We have reorganized NP 41-201 to more clearly group our guidance in the areas of distributable cash, prospectus offerings and continuous disclosure. The following is a summary of the key changes to the policy**:**

- Part 2 now focuses the guidance specifically on distributable cash. We have added guidance on distributable cash that was previously published in CSA Staff Notice 52-306 – *Non-GAAP Financial Measures* (Staff Notice 52-306) and CSA Staff Notice 41-304 – *Income Trusts: Prospectus Disclosure of Distributable Cash*, as well as other guidance about distributable cash disclosure.

- We have noted that the guidance on distributable cash applies to all disclosure about cash available for distribution, regardless of the terminology used by the issuer.

- We have noted that the guidance on disclosure of stability ratings will not apply to unsolicited stability ratings**.**

- We have provided guidance that issuers should include in their interim and annual MD&A a comparison between the expected yield figure previously disclosed and the actual yield.

- We have provided guidance on the presentation of distributable cash figures. We believe this disclosure should accompany all disclosures of distributable cash, including those contained in sales and marketing materials.

- We have clarified the content of the undertakings we expect for insider reporting and financial information of subsidiaries and the circumstances under which we expect these undertakings to be provided.

- We have clarified our expectations of MD&A disclosure of distributed cash.

- We have clarified our guidance on the disclosure of differences between corporate law protections and those provided by an issuer's declaration of trust.

Summary of written comments

We received submissions from 12 commenters during the comment period. See Appendix A for a list of the commenters and Appendix B for a summary of their comments and our responses. We would like to thank everyone who provided us with comments.

Canadian Performance Reporting Board Interpretive Release

When we published the policy for comment, we noted that the Canadian Performance Reporting Board (CPRB) of The Canadian Institute of Chartered Accountants had published for comment a draft interpretive release to the CICA publication, *Management's Discussion and Analysis: Guidance on Preparation and Disclosure*. This release provided the CPRB's views on the measurement and disclosure of distributable cash in MD&A by income trusts and other flow-through entities. We noted that we were looking forward to discussing with the CPRB the comments that they received on their draft interpretive release. We have reviewed these comments and would like to thank the CPRB for their co-operation and input.

The distributable cash guidance in this policy is intended to promote transparent disclosure for investors with respect to presentations of distributable cash. We understand that the CPRB is considering changes to its draft guidance in response to comments received and it plans to provide guidance not only on disclosure but also on a standardized measure of distributable cash derived directly from historical financial statements prepared in accordance with GAAP.

We will evaluate the form and impact of the final CPRB guidance when it is published. However, based on our current understanding of the likely content of the CPRB guidance, we believe that presentation of the standardized measure of distributable cash defined in the guidance is consistent with the objectives of the policy. Further, additional disclosure in MD&A consistent with the framework provided in the CPRB guidance would contribute to achieving the disclosure objectives of the policy.

Additional changes to the policy

After considering the comments, we made some changes to the proposed policy that was published for comment in January 2007. We do not believe these changes are material and are not republishing the policy for a further comment period. These changes are summarized in Appendix C.

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July 6, 2007

Appendix A

List of commenters

	Commenter	Name	Date
1.	Standard & Poor's Canada	Kevin Hibbert	February 15, 2007
2.	Canadian Oil Sands Limited	Ryan M. Kubik	February 26, 2007
3.	The Canadian Institute of Chartered Accountants	Kevin Dancey	March 2, 2007
4.	Enerplus Resources Fund	Robert J. Waters	March 2, 2007
5.	Ontario Teacher's Pension Plan	Brian Gibson	March 6, 2007
6.	Canadian Coalition for Good Governance	David R. Beatty	March 6, 2007
7.	Torys LLP	James Scarlett	March 6, 2007
8.	Financial Executives International	Alister Cowan	March 6, 2007
9.	Pengrowth Corporation	Chris Webster	March 6, 2007
10.	Canadian Association of Income Funds	Margaret M. Lefebvre	March 6, 2007
11.	Global Financial Group	Robert Hudson	March 6, 2007
12.	ARC Resources Ltd.	John P. Dielwart	March 6, 2007

Appendix B

Summary of comments on the proposed amended NP 41-201

Item	Reference	Summarized comment	CSA response
1.	General	Two commenters suggested that the work of the CSA in the policy be made into a rule.	We have considered the comment and continue to believe that a principles-based policy approach to the regulation of income trusts and other indirect offering structures is the appropriate regulatory course and that there is currently no justification for turning the policy into a rule.
2.	General	Four commenters suggested that the same concerns being addressed by the policy should be equally applied to corporations.	We acknowledge the comment and note that the policy applies to indirect offering structures, including those in corporate form.
3.	General	Two commenters questioned whether the policy would apply to trusts that do not use non-GAAP measures such as “distributable cash”.	The presentation of non-GAAP measures, such as distributable cash, is optional disclosure for trusts. The distributable cash guidance in the policy only applies to trusts that present non-GAAP measures.
4.	Distributable Cash Part 2.1	Four commenters encouraged the CSA to incorporate the Canadian Performance Reporting Board’s (CPRB) draft interpretive release relating to the definition of distributable cash, in order to provide greater certainty and consistency with respect to the application of this concept.	We acknowledge the comment and, where appropriate, we have made changes to the policy to more closely align with the CPRB draft guidance.
5.	Distributable Cash – Part 2.1	Three commenters expressed their support for the CSA’s principles-based disclosure guidance for distributable cash. The commenters believed that a prescribed calculation for distributable cash may not be meaningful and would reduce the information’s usefulness. The commenters also believe that standardizing the concept of distributable cash would result in undue credibility on the amount and over-reliance by investors.	We acknowledge these comments and continue to believe that a principles-based policy approach to the regulation of income trusts and other indirect offering structures is the appropriate regulatory course.
6.	Distributable Cash – Part 2.1	One commenter suggested that distributable cash and distributable income should not be used interchangeably since cash and income have different meanings.	We acknowledge the comment and note that it is the responsibility of the issuer to ensure that it uses appropriate non-GAAP terminology to describe its cash available for distribution. As set out in the policy, we expect the guidance regarding distributable cash to apply to other non-GAAP terms used to describe the amount available for distribution to securityholders.
7.	Distributable Cash – Part 2.1	One commenter suggested that the use of discretionary adjustments would defeat the objective of comparability.	We acknowledge the comment and continue to believe that issuers should be permitted to make appropriate adjustments to

			the distributable cash reconciliation. We expect that if an issuer makes a discretionary adjustment to its distributable cash reconciliation, the guidance in Part 2.7 will apply.
8.	Distributable Cash – Parts 2.2, 2.4 and 2.5	Two commenters suggested that income trusts should not discuss "cash available for distribution", but rather only "cash distributed", and focus on key financial measures such as "net income" and "cash flow". If distributable cash is to be provided, then the calculation would be derived from and reconciled to the GAAP financial statements and combined with disclosure containing a discussion of the reasons for, and the difference between distributable cash and the actual cash distributions paid.	We agree and have recommended in Part 6.5.2 that issuers provide a summary of actual cash distributions paid as compared to net income and cash flows from operating activities. We believe that a summary of the main elements of a trust's performance will assist investors in assessing the financial condition of the trust and, in turn, the sustainability of the trust's distributions. A discussion of the reasons for the difference between distributable cash and actual distributions paid should accompany the summary.
9.	Distributable Cash – Part 2.3	One commenter suggested that income trusts should fully disclose their distribution policies, including any amount of distributable cash retained in a reserve fund for future distributions, and that there should be a commentary on how the reserve fund is maintained, how it is funded and whether there has been any past usage of the fund.	We have considered this comment and are of the view that the provisions of item 1.6 – Liquidity of Form 51-102F1 MD&A would generally require this information to be disclosed in the MD&A.
10.	Distributable Cash – Part 2.6	One commenter stated that cash flows from operating activities before non-cash working capital is a more appropriate and widely used measure for comparison with distributed cash than cash flows from operating activities including changes in non-cash working capital.	We believe a distributable cash reconciliation should begin with cash flows from operating activities; a figure that can be derived from an issuer's GAAP financial statements. "Cash flows from operating activities before non-cash working capital" is not a recognized GAAP measure.
11.	Distributable Cash – Part 2.7	One commenter suggested that the proposal to discuss the work done by the issuer to ensure the completeness and reasonableness of the disclosure may not be practical or useful.	We disagree. Disclosure about what was done to support an underlying assumption for a reconciling adjustment is important information for investors.
12.	Distributable Cash – Part 2.7	Two commenters suggested that the proposals in sections 2.6 and 2.7 which suggest that issuers provide information allowing investors to anticipate distributable cash amounts and the sustainability of distributions is akin to asking issuer to prepare a forecast. For example, the statement under section 2.7 that the determination of distributable cash uses "supportable assumptions given management's judgement about the most probable set of economic conditions" implies that management has an ability to forecast such economic	We disagree. The disclosure expectations in sections 2.6 and 2.7 of the policy are consistent with our expectations for other types of forward-looking information. We strongly believe issuers and their management are in the best position to evaluate and discuss events or conditions that are likely

		conditions. Further, a requirement to "disclose all factors, events or conditions that are likely to occur in the future that may impact the sustainability of future distributions" would be very difficult for any management team to achieve.	to occur in the future that may impact the sustainability of distributions.
13	Distributable Cash – Part 2.7	One commenter suggested that information relating to provisions that stipulate when an original vendor's entitlement to distributions ceases to be subordinated is important because these provisions affect the amount of future distributions.	We acknowledge this comment and note that this information is generally disclosed in the IPO prospectus and the material contracts filed with the IPO. We are of the view that the provisions of item 1.6 – Liquidity of Form 51-102F1 MD&A require this information to be disclosed in the MD&A.
14.	Distributable Cash – Maintenance of Productive Capacity	One commenter suggested that the concept of "maintenance of productive capacity" must take into account that the cyclical nature of commodity prices influences the investment decision process of natural resource based income trusts.	We acknowledge this comment and note that the particular variables underlying the concept of "maintenance of productive capacity" may vary from issuer to issuer. Our intent is that issuers consider their particular situation when applying this concept.
15.	Distributable Cash – Maintenance of Productive Capacity	One commenter suggested that practical limitations exist in determining a distributable cash adjustment for maintenance of productive capacity. The commenter suggested that requiring disclosure about potential commitments for replacing and maintaining capital assets is not sufficient to result in a meaningful discussion of an entity's productive capacity maintenance strategy.	We acknowledge this comment and as a result, did not prescribe how issuers should calculate their distributable cash adjustment to maintain productive capacity. We expect issuers to have extensive knowledge about the operations of their underlying entities and to be able to reasonably determine their current and future cash needs to maintain productive capacity. This determination will likely vary from trust to trust and may be based on actual capital expenditures incurred in prior periods.
16.	Material Debt Part 3 – A.	One commenter suggested that the debt disclosure would be enhanced by including disclosure of how much of the debt is secured and what assets have been pledged as security, and what entity level the debt is being issued at. On an ongoing basis, disclosure of covenants and how the trust is performing relative to each measure is important.	Details about debt are generally disclosed in the IPO prospectus and in the material contract(s) relating to the debt. We have considered the comment about ongoing covenant disclosure and are of the view that the provisions of item 1.6 – Liquidity of Form 51-102F1 MD&A generally require similar information to be disclosed in the MD&A.
17.	Material Debt Part 3 – A.	One commenter suggested that a separate category on SEDAR be included to identify material contracts.	SEDAR currently has a category for material contracts called "Other – material contract(s)".

18.	Material Debt Part 3 – A.	One commenter suggested that debt obligations also be disclosed in the annual proxy circular in situations where debt covenants are in danger of being breached.	We disagree. We believe that this information is more appropriately disclosed in the MD&A and/or in a material change report (Form 51-102F2), if applicable.
19.	Material Debt Part 3 – A.	One commenter suggested that debt agreements are normal course contracts and that they need not be filed on SEDAR. The filing of these agreements can confuse and overwhelm the reader, and these agreements often contain confidentiality conditions imposed by lenders.	We disagree. We continue to believe that, in most cases, agreements relating to the material debt that have been negotiated with a third-party lender other than the issuer will be material contracts under Rule 41-501 and NI 51-102 (or their respective successors) if terms of those agreements have a direct correlation with the anticipated cash distributions.
20.	Stability Ratings Part 3 – B.	One commenter suggested that unsolicited stability ratings be disclosed with the fact that they were unsolicited, and that the disclosure of the source of the rating may be useful. Another commenter suggested that if a poor stability rating has been received, the rating should also appear in the annual proxy circular.	We disagree. We believe that imposing an obligation on issuers to disclose unsolicited stability ratings is not currently justified. Management will not have been involved in preparing the rating and may not even know that a stability rating had been determined. We also disagree that stability ratings be disclosed in annual proxy circulars. We continue to believe that solicited stability ratings should be disclosed in prospectuses and AIFs.
21.	Executive Compensation Part 3 – C.	One commenter suggested that management contracts and incentive plans need not be filed on SEDAR if the key details are adequately disclosed elsewhere.	We continue to believe that management contracts and management incentive plans that contain terms which impact distributable cash are material contracts and should be filed on SEDAR.
22.	Executive Compensation Part 3 – C.	One commenter suggested that any management contract of the operating entity should be disclosed on SEDAR and either referenced or disclosed in the proxy circular.	We currently expect management contracts and management incentive plans that may have an impact on distributable cash to be filed on SEDAR. We also expect these plans to be disclosed in the prospectus. We note that disclosure of these contracts is also currently required by Form 51-102F5 – *Information Circular* (Item 13). We note that disclosure of provisions related to external management companies is currently required by Form 51-102F6 – *Statement of Executive Compensation* (Item 1.4(e)).

23.	Executive Compensation Part 3 – C.	One commenter suggested that the compensation of the top five paid named executive officers should be disclosed, whether or not they function at the operating or issuer level.	We believe that the existing rules about disclosure of executive compensation will require the disclosure suggested by this comment. We note that proposed amendments to Form 51-102F6 – *Statement of Executive Compensation*, which are consistent with Part 3 of the policy, are currently out for comment.
24.	Offering Specific Issues – Part 4	One commenter suggested that requiring issuers to file the full details of valuations in the context of acquisitions would put them at a competitive disadvantage relative to non-trust issuers because confidential details about earnings estimates, synergies, etc. would be required to be disclosed.	We acknowledge the comment and have removed the expectation that issuers file the valuation report on SEDAR.
25.	Offering Specific Issues – Parts 4.3, 4.4, 4.5 and 4.5.2	Two commenters stated that many income trusts are acquisitive by nature and expressed concern that the regulator might require the vendor to certify the prospectus disclosure of a trust issuer. Such a requirement would restrict the ability of trusts to make acquisitions and place them at a major competitive disadvantage.	We acknowledge this comment. Currently, vendors are required to certify the prospectus only if they would otherwise be promoters or if it is necessary in the public interest. Proposed National Instrument 41-101 *General Prospectus Requirements* (NI 41-101) includes proposals regarding certification requirements for prospectuses generally. The proposed NI 41-101 was published for comment on December 21, 2006. We do not propose changing the existing guidance in the policy at this time and have referred this comment to the CSA Committee responsible for NI 41-101. NP 41-201 may be amended to reflect the conclusions reached with respect to NI 41-101.
26.	Promoter Liability – Part 4.4	One commenter suggested that the lack of clarity of the terms “selling securityholder” and “promoter” is problematic. The concept under section 4.4 that the formation of an income trust itself constitutes the party as a promoter of the business of the income trust issuer strains the common sense understanding of “promoter” and is inconsistent with the remainder of the policy which focuses on the underlying operating entity as the business of substance. As a result of the October 31, 2006 federal government announcement on income trusts, the commenter believes that it is unlikely that any new income trusts will be created, and as a result the promoter analysis under section 4.4 will have no further application.	We acknowledge this comment. Proposed National Instrument 41-101 *General Prospectus Requirements* (NI 41-101) includes proposals regarding certification requirements for prospectuses generally. The proposed NI 41-101 was published for comment on December 21, 2006. We do not propose changing the existing guidance in the policy at this time and have referred this comment to the CSA Committee responsible for NI 41-101.

		The commenter suggested that current attempts to stretch the application of the promoter rules should be put aside in favour of developing a new and more flexible rule that addresses what might more fairly be called "selling securityholder" liability.	NP 41-201 may be amended to reflect the conclusions reached with respect to NI 41-101.
27.	Sales and Marketing Materials – Part 5	Three commenters suggested that income trusts should refrain from using the term "yield" due to its association with fixed income investments and instead use "return on capital" and "return of capital". Another commenter suggested that since yields are determined by the distributions and the market price of the security and because the market price is determined by factors that are outside the influence of the issuer, it is inappropriate for issuers to comment on their yield.	We expect trusts that use the term "yield" to comply with the guidance set out in Part 5 including supplemental disclosure distinguishing units from a fixed income security. As discussed in Part 5.1, we believe is important for the issuer to disclose whether it has made all distributions necessary to achieve the previously stated "yield" figure.
28.	Continuous Disclosure – Part 6	One commenter suggested that disclosing economic return of capital would require complex explanation of these concepts which would result in a discussion that is not meaningful or useful.	We disagree. We believe it is important for investors to be aware that a portion of distributions received may represent a repayment of their principal investment. This disclosure will assist investors in assessing the sustainability of distributions.
29.	Continuous disclosure – Maintenance Capital	One commenter suggested that the deduction of "maintenance capital" is extremely difficult to derive for energy trusts. The commenter suggested making the disclosure of "maintenance capital" voluntary for trusts that claim they have a sustainable business model.	We agree with the first comment and have made corresponding changes to Part 2.6 of the policy. We disagree with the second comment. We believe that adjustments for capital expenditures, whether to maintain productive capacity of the issuer or otherwise, should be included in an issuer's distributable cash reconciliation. We expect issuers that do not claim to have a sustainable business model to adequately disclose this fact and its implications.
30.	Continuous Disclosure – Part 6.5.2	Several commenters suggested that there should be a clear distinction made between distributions classified as "return on capital" and distributions classified as "return of capital".	We acknowledge the comment. However, we understand that there are practical limitations that may prevent trusts from making a clear distinction between distributions that are a "return on capital" or a "return of capital" for tax purposes. Despite this limitation, if an issuer's distributed cash, at the end of a period exceeds either its cash flows from operating activities or net income, it should consider whether the excess distributions represent an economic return of

			capital. When distributions paid represent an economic return of capital, we expect issuers to include disclosure stating this and to discuss the impact on future distributions.
31.	Continuous Disclosure – Part 6.5.2	One commenter suggested that including net income as one of the measures in the table in the proposal seemed inconsistent with the earlier assertion that distributable cash is more closely aligned to cash flow from operations.	We did not intend to imply that net income was a more closely aligned measure to distributable cash than cash flows from operating activities. Net income is another performance indicator that will assist investors in assessing the financial condition of the trust and, in turn, the sustainability of the trust's distributions.
32.	Continuous Disclosure – Part 6.5.2	One commenter suggested that the discussion of cash flow from operating activities compared to net income is not indicative of the productive capacity of an oil and gas trust since net income includes non-cash items such as future income tax and depletion, depreciation, amortization and accretion (DDA&A). DDA&A is based on historical costs of property, plant and equipment and not the fair market value of replacing those assets in the current environment.	The primary goal of the table in Part 6.5.2 is to show the relationship between the GAAP figures for cash flows from operating activities and net income and historical distributed cash figures. This table and the accompanying disclosure were not intended to indicate the productive capacity of an issuer. If applicable, we expect a discussion of productive capacity to be provided with the issuer's distributable cash reconciliation.
33.	Continuous Disclosure – Part 6.5.2	One commenter suggested that the concept of providing investors with "information about the sources of the distributed cash that they receive, including whether an issuer borrowed amounts to finance distributions" is an exercise in futility since the allocation of cash to specific sources is arbitrary.	Existing MD&A disclosure requirements for liquidity and capital resources under NI 51-102F1 sections 1.6 and 1.7 give the reader an understanding of the issuer's overall operating and capital requirements compared to their available sources of funding. However, we believe it is important to highlight for the reader cases where cash distributions exceed cash flow from operating activities and to explain how the distributions were funded.
34.	Continuous Disclosure – Part 6.5.2	One commenter suggested that the proposed tabular format does not provide additional useful information since all of this quantitative information can be obtained from an issuer's GAAP financial statements.	We acknowledge this comment. However, we believe providing additional prominence to specific financial indicators is useful information for investors.
35.	Corporate Governance – Part 7	One commenter suggested that information comparing the rights of unitholders of a trust to the rights of corporate shareholders should be included in the proxy	We acknowledge this comment and note that we expect disclosure to be provided in the annual

		circular.	information form under the requirements of Item 15.1 of Form 51-102F2. We also note that this information is generally available in the IPO prospectus and in the material contract filed on SEDAR, which sets out the rights of securityholders.
36.	Corporate Governance – Part 7	One commenter suggested that operating entities, in addition to issuers, disclose how they will discharge their governance responsibilities.	Part 7 of the policy contains our expectation that the issuer disclose how the issuer and the operating entity will satisfy governance responsibilities.

Appendix C

Summary of Changes

The following summarizes the changes to the policy from the version published for comment on January 5, 2007.

- *Valuation reports:* In Part 4.1 we have deleted the expectation that, if a third-party valuation is obtained in an initial public offering, the valuation report should be filed on SEDAR.

- *Capital adjustments:* In Part 2.6 we have clarified the guidance to note that an issuer that does not intend to sustain the business of its operating entity going-forward (for example, in the case of depleting assets) should clearly state this in its distributable cash reconciliation.

We further clarified the guidance in this part to note that capital adjustments may be based on actual capital expenditures.

NATIONAL POLICY 41-201
INCOME TRUSTS AND OTHER INDIRECT OFFERINGS

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NATIONAL POLICY 41-201
INCOME TRUSTS AND OTHER INDIRECT OFFERINGS

Part 1 – Introduction

1.1 What is the purpose of the policy?

It is a fundamental principle that everyone investing in securities should have access to sufficient information to make an informed investment decision. The Canadian Securities Administrators (the CSA or we) believe that there are distinct attributes of an investment in income trust units that should be clearly disclosed.

Within our securities regulatory framework, raising capital in the public markets results in certain rights and obligations attaching to issuers and investors. We believe that it would be beneficial to express our view in a policy about how the existing regulatory framework applies to non-corporate issuers (such as income trusts) and to indirect offering structures in order to minimize inconsistent interpretations and to better ensure that the principles underlying the requirements are preserved. Our concerns relate to the quality and nature of prospectus and continuous disclosure, accountability for prospectus disclosure and liability for insider trading. We have drafted a policy rather than a rule because we believe that the existing regulatory requirements capture the necessary regulatory outcomes relating to income trusts and other indirect offering structures. Our goal is to provide guidance and recommendations about how income trusts and other indirect offering structures fit within the existing regulatory requirements rather than create new regulatory requirements for income trusts and other indirect offering structures. We also identify factors that relate to the exercise of the regulator's discretion in a prospectus offering.

This policy provides guidance and clarification by all jurisdictions represented by the CSA. The guidance generally relates to the requirements of National Instrument 51-102 *Continuous Disclosure Obligations* and the prospectus requirements in each jurisdiction. Although the primary focus of this policy is on income trusts, we believe that much of the guidance and clarification that we provide is useful for other indirect offering structures. As well, the guidance may apply more generally to issuers that offer securities which entitle holders of those securities to net cash flow generated by the issuer's business or its properties. We provide guidance about prospectus disclosure and prospectus liability to minimize situations where staff might recommend against issuance of a receipt for a prospectus where it would appear that the offering may be contrary to the public interest due to insufficient disclosure, the structure of the offering, or other factors.

Although the focus of this policy is on the income trust structure in the context of offerings by way of prospectus, these principles also apply to income trust structures in other contexts, such as the reorganization of a corporate entity into a trust. Although an offering document is not prepared in a reorganization, we expect that the information circular provided to relevant security holders, and that contains prospectus-level disclosure, will follow the principles set out in this policy. In addition when we are determining whether to grant exemptive relief to an income trust issuer in connection with a reorganization or other similar transaction, we will consider the principles described in Part 3 of this policy.

This policy may also apply to income trusts in the fulfillment of their continuous disclosure obligations.

1.2 What do we mean when we refer to an income trust in this policy?

When we refer to an income trust or issuer in this policy, we are referring to a trust or other entity (including corporate and non-corporate entities) that issues securities which provide for participation by the holder in net cash flows generated by: (i) an underlying business owned by the trust or other entity, or (ii) the income-producing properties owned by the trust or other entity. This includes business income trusts, real estate investment trusts and royalty trusts. In our view, this does not include an entity that falls within the definition of "investment fund" contained in National Instrument 81-106 *Investment Fund Continuous Disclosure*, or an entity that issues asset-backed securities or capital trust securities.

1.3 What is an operating entity?

In the most basic income trust structure, the operating entity is: (i) a subsidiary of the income trust with an underlying business, or (ii) income-producing properties owned directly by the income trust. In more complex structures, there may be a number of intervening entities above the operating entity. Generally, the operating entity is the first entity in the structure that has an underlying business that generates cash flows. There may be more than one operating entity in the income trust structure.

In addition to identifying the operating entity, it is also important to understand the operating entity's business. In some cases, its business is to own, operate and produce revenues from its assets. In other cases, its business is to own an interest in a joint venture or to derive a revenue stream from holding a portfolio of investments or financial instruments.

1.4 How is an income trust structured?

Typically, an income trust holds a combination of debt and equity or royalty interests in an entity owning or operating a business. Net cash flows generated by the operating entity's business are distributed to the income trust. The income trust then distributes some or all of that cash flow to its investors (referred to as unitholders or investors).

1.5 What is an income trust offering?

In a typical income trust offering, an income trust is created to distribute units to the public. The income trust then uses the proceeds from the offering to acquire debt and equity or royalty interests in the operating entity, or interests in income producing properties. We view the income trust offering as a form of indirect offering. Instead of offering their securities directly to the public, the vendors sell their interests in the operating entity to the income trust. The income trust purchases those interests with proceeds that it raises through its offering of units to the public. The interests in the operating entity that the income trust acquires are thus indirectly offered to the public. Through their direct investment in units of the income trust, unitholders hold an indirect interest in the operating entity.

By issuing units under a prospectus, the income trust becomes a reporting issuer (or equivalent) under applicable securities laws. The operating entity typically remains a non-reporting issuer.

1.6 How does an indirect offering differ from a direct offering?

In a conventional direct offering, interests in the operating entity are offered to the public through a public distribution of the operating entity's securities. By contrast, in an indirect offering, interests in the operating entity are not offered directly to the public but are instead acquired by a separate entity (for example, an income trust or its subsidiary). The securities of this separate entity, such as units of a trust, are offered to the public under a prospectus. The issuer applies the proceeds of the offering to satisfy the purchase price of the interests in the operating entity.

In a direct initial public offering, an issuer may choose to finance the acquisition of another business with proceeds raised under the offering. In that scenario, the issuer and the vendors of the business are generally arm's length parties. This differs from the structure of an indirect offering, such as the initial public offering by most income trusts, where the income trust and the vendors of the business are not arm's length parties.

In an indirect offering, the vendors negotiate the terms of the purchase of the business by the income trust, and are also involved in the negotiation of the terms of the public offering with the underwriter(s).

If vendors initiate or are involved in the initial public offering process, we believe that they are effectively accessing the capital markets themselves. We consider them to be non-arm's length vendors. This fact gives rise to the concerns that we describe in Part 4. Non-arm's length vendors that are involved in a follow-on offering are also effectively accessing the capital markets through an indirect offering, and the concerns that we describe in Part 4 are equally applicable.

Part 2 – Distributable cash

2.1 What is distributable cash?

Distributable cash is a non-GAAP measure that generally refers to the net cash generated by the income trust's businesses or assets that is available for distribution, at the discretion of the income trust, to the income trust's unitholders. Some issuers have referred to this net cash available for distribution by a non-GAAP term other than distributable cash. In this policy the guidance about "distributable cash" also applies to such other non-GAAP terms used to describe the amount available for distribution to an income trust's or other indirect offering structure's securityholders (e.g. distributable income).

The cash that is available to an income trust for distribution per unit varies with the operating performance of the income trust's business or assets, its capital requirements, debt obligations and the number of units outstanding.

Income trust distributions are, for Canadian tax purposes, composed of different types of payments that are referred to as "returns on capital" or "returns of capital." These terms are also used more generally, to make an economic rather than a tax-driven distinction. The underlying concern is that the amount of cash distributed by an income trust may sometimes be greater than what it can safely distribute without eroding its productive capacity and threatening the sustainability of its distributions. In this situation, the "excess" amount of the distribution may be regarded as an economic "return of capital." We are concerned that disclosure by income trusts has not always been sufficiently plain to allow an investor to assess whether a possible concern exists in this respect.

Please refer to subsection 6.5.2 for guidance on how issuers can address these concerns.

2.2 Do income trusts provide investors with a consistent rate of return?

No. In many ways, investing in an income trust is more like an investment in an equity security rather than in a debt security. 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. In other words, it has the ability to reduce or suspend distributions if circumstances warrant (see section 2.3 below for further details). In contrast to a traditional fixed-income security, the trust's ability to consistently make distributions to unitholders is closely tied to the operations of the operating entity or the performance of the income trust's assets. The performance of the operating entity may fluctuate from period to period, which might impact both the distributions paid and value of the issuer's units.

Unlike an issuer of a fixed-income security, an income trust does not promise to return the initial purchase price of the unit bought by the investor on a certain date in the future. Investors who choose to liquidate their holdings would generally do so by selling their unit(s) in the market at the prevailing market price.

In addition, unlike interest payments on an interest-bearing debt security, income trust cash distributions are, for Canadian tax purposes, composed of different types of payments (portions of which may be fully or partially taxable or may constitute tax-deferred returns of capital). The composition for tax purposes of those distributions may change over time, thus affecting the after-tax return to investors. Therefore, a unitholder's rate of return over a defined period may not be comparable to the rate of return on a fixed-income security that provides a "return on capital" over the same period. This is because a unitholder in an income trust may receive distributions that constitute a "return of capital" to some extent during the period. Returns on capital are generally taxed as ordinary income or as dividends in the hands of a unitholder. Returns of capital are generally tax-deferred (and reduce the unitholder's cost base in the unit for tax purposes).

2.3 How do the distribution policies of the income trust and the operating entity affect an investor's rate of return?

The distribution policy of the income trust generally stipulates that payments that the income trust receives from the operating entity (such as interest payments on the debt and dividends paid to common shareholders) will be distributed to unitholders. The distribution policy of the operating entity will generally stipulate that distributions to the income trust will be restricted if the operating entity breaches its covenants with third-party lenders (such as covenants requiring the operating entity to maintain specified financial ratios or to satisfy its interest and other expense obligations). Other operating entity obligations such as funding employee incentive plans or funding capital expenditures will frequently rank in priority to the operating entity's obligations to the income trust. In addition, the operating entity, or the income trust, might retain a portion of available distributable cash as a reserve. Funds in this reserve may be drawn upon to fund future distributions if distributable cash generated is below targeted amounts in any period.

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

To ensure that the information described in sections 2.1, 2.2 and 2.3 is adequately communicated to investors, we recommend that issuers consider including language substantively similar to the following on the prospectus cover page:

> A return on your investment in ● is not comparable to the return on an investment in a fixed-income security. The recovery of your initial investment is at risk, and the anticipated return on your investment is based on many performance assumptions. Although the income trust intends to make distributions of its available cash to you, these cash distributions may be reduced or suspended. The actual amount distributed will depend on numerous factors including: [insert a discussion of the principal factors particular to this specific offering that could affect the predictability of cash flow to unitholders]. In addition, the market value of the units may decline if the income trust is unable to meet its cash distribution targets in the future, and that decline may be significant.
>
> It is important for you to consider the particular risk factors that may affect the industry in which you are investing, and therefore the stability of the distributions that you receive. See, for example, ***, under the section "Risk Factors" [insert specific cross-reference to principal factors that could affect the predictability of cash flow to unitholders]. That section also describes the issuer's assessment of those risk factors, as well as the potential consequences to you if a risk should occur.
>
> The after-tax return from an investment in units to unitholders subject to Canadian income tax can be made up of both a return on and a return of capital. That composition may change over time, thus affecting your after-tax return. [If a forecast has been prepared, include specific disclosure about the estimated portion of the investment that will be taxed as a return on capital and the estimated portion that will be taxed as return of capital. If the issuer cannot estimate the portion that will be a return of capital, state that it is unable to reasonably estimate the return of capital on anticipated distributions, and that this amount might vary materially from period to period.] Returns on capital are generally taxed as ordinary income or as dividends in the hands of a unitholder. Returns of capital are generally tax-deferred (and reduce the unitholder's cost base in the unit for tax purposes).

2.5 What disclosure do we expect about non-GAAP financial measures such as distributable cash?

Under GAAP, an income trust must disclose the cash distributed to unitholders in its financial statements. In addition to GAAP disclosure, income trusts generally also include disclosure about historical distributable cash figures in continuous disclosure documents and estimated distributable cash in their prospectuses. Because distributable cash is a non-GAAP financial measure, an income trust's distributable cash disclosure should include a reconciliation to the most directly comparable measure calculated in accordance with GAAP.

We have concluded that distributable cash is a cash flow measure, not an income measure. Therefore, distributable cash is fairly presented only when reconciled to cash flows from operating activities as presented in the income trust's financial statements. For clarity, cash flows from operating activities includes changes during the period in non-cash working capital balances.

Issuers should define any non-GAAP financial measure and explain its relevance to ensure it does not mislead investors. Issuers presenting non-GAAP financial measures should present those measures on a consistent basis from period to period. Specifically, in respect of distributable cash, income trusts should:

(i) state explicitly that distributable cash does not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other issuers;

(ii) present cash flows from operating activities with equal or greater prominence than distributable cash;

(iii) explain why distributable cash provides useful information to investors and how management uses distributable cash as a financial measure;

(iv) provide a clear quantitative reconciliation from distributable cash to cash flows from operating activities, and refer to the reconciliation where distributable cash first appears in the disclosure document; and

(v) explain any changes in the composition of distributable cash when compared to previously disclosed measures.

2.6 What are our expectations about the format of the distributable cash reconciliation?

When presenting a reconciliation of distributable cash, income trusts should discuss any adjustments included in the reconciliation and these adjustments should be grouped separately based on the nature of the adjustment. In addition, income trusts should avoid the use of non-GAAP income measures in the reconciliation of distributable cash. For example, it is inappropriate to include non-GAAP measures such as EBITDA, Adjusted EBITDA, and Pro Forma Net Income in the distributable cash reconciliation.

An issuer might group adjustments to cash flows from operating activities included in a reconciliation of distributable cash as follows:

a. Capital adjustments – Adjustments for capital expenditures, whether to maintain productive capacity of the issuer or otherwise, should be included here and may be based on actual capital expenditures. An issuer that does not intend to maintain productive capacity (for example, in the case of depleting assets) should clearly state this in its distributable cash reconciliation.

   Other examples of adjustments that might be included in this section include provisions for maintaining or replacing mineral reserves.

   An issuer may include within this grouping a sub-total of cash flows from operating activities after deducting capital expenditures incurred during the period.

b. Non-recurring adjustments – Generally, an item is considered non-recurring if a similar charge or gain is not reasonably likely to occur within the next two years or if it has not occurred during the prior two years. An example of a non-recurring item is a payment in connection with litigation or a penalty that was levied in the current year and is not expected to be incurred going forward.

c. Other adjustments including discretionary items – We recognize that, in limited circumstances, certain adjustments may not properly be classified as non-recurring or capital adjustments. Some examples of such adjustments include amounts for asset retirement obligations or external restrictions imposed on the issuer that limit their ability to pay distributions. Where an adjustment is discretionary in nature, we expect income trusts to clearly explain the basis for inclusion of the adjustment and any underlying assumptions which are being relied upon.

2.7 What disclosure do we expect about the adjustments and assumptions underlying distributable cash?

Income trusts should consider how best to provide transparency about the presentation of each adjusting item included in a reconciliation of distributable cash, including a discussion of the work that was done by the issuer to ensure the completeness and reasonableness of the information.

Generally, to achieve acceptable transparency, the reconciliation of distributable cash to cash flows from operating activities should be accompanied by detailed disclosure that:

(i) explains the purpose and relevance of the distributable cash information;

(ii) describes the extent to which actual financial results are incorporated into the reconciliation;

(iii) explicitly states that the reconciliation has been prepared using reasonable and supportable assumptions, all of which reflect the income trust's planned courses of action given management's judgment about the most probable set of economic conditions; and

(iv) cautions investors that actual results may vary, perhaps materially, from the forward-looking adjustments.

Further adjustments made in the reconciliation of distributable cash to cash flows from operating activities should be supported by:

(i) a detailed discussion of the nature of the adjustments;

(ii) a description of the underlying assumptions used in preparing each element of the forward-looking information and the forward-looking information as a whole, including how those assumptions are supported; and

(iii) a discussion of the specific risks and uncertainties that may affect each individual assumption and that may cause actual results to differ materially from the distributable cash figure.

For assumptions to be supportable, they should take into account the past performance of the underlying operating entity, the performance of other entities engaged in similar activities, and any other sources that provide objective corroboration of the assumptions used. Further, for assumptions to be considered reasonable, we believe that they should be consistent with the anticipated plans of the income trust.

In some circumstances, assumptions may be consistent with the issuer's anticipated plans but may not provide an adequate level of transparency about the sustainability of distributable cash. It is important for income trusts to disclose all factors, events or conditions that are likely to occur in the future that may impact the sustainability of future distributions.

For example, capital expenditures to replace productive capacity may be relatively low in initial years but may rise significantly in later years. In these instances, adequate disclosure of the adjustment for estimated future capital maintenance expenditures might include a discussion of the time period over which the income trust anticipates incurring capital maintenance expenditures at the level disclosed and any expected long-term plans to replace productive capacity. A clear and complete explanation should be provided of the reasons why these provisions will be adequate to cover future capital requirements and why these amounts vary from historical amounts, if applicable.

Another example of providing adequate transparency about the sustainability of distributable cash relates to instances where an issuer makes prior arrangements with investors. For example, for some income trusts, the original vendors' entitlement to cash distributions based on their continuing interest is subordinated to that of other investors. The original vendors will not receive cash distributions for a defined period of time if the estimated level of distributable cash disclosed in the prospectus is not achieved. Distributable cash available for distribution to other investors may be higher in the short term while cash distributions are not paid to the original vendors, but may decrease once the subordination conditions are satisfied. In these instances, the key terms and impact of these arrangements should be summarized in proximity to the distributable cash information.

2.8 When should the estimate of distributable cash be derived from a forecast?

If estimated distributable cash information contained in a prospectus includes forward-looking adjustments that are based on significant assumptions, as defined in the CICA Handbook, and those adjustments materially affect estimated distributable cash, the quantitative reconciliation should begin with cash flows from operating activities derived from a forecast prepared in accordance with CICA Handbook section 4250 – *Future-Oriented Financial Information* (S.4250 forecast). These forward-looking adjustments should be integrated into the S.4250 forecast, and the S.4250 forecast should be included in the prospectus.

A S.4250 forecast may not be necessary if the adjusting items are derived from historical amounts and the adjusting items can be adequately explained by alternative disclosures. Alternative disclosures may include:

(i) historical financial statements that support the adjustments. In some cases, a recent acquisition may not be considered significant under the significant acquisition tests set out in OSC Rule 41-501 *General Prospectus Requirements* (Rule 41-501) (or its successor) or the equivalent rule in the applicable jurisdiction for purposes of providing financial statements of the acquired entity. However, the acquisition's anticipated impact on distributable cash may be material. In these cases, income trusts may choose to provide financial statements of the acquired entity in the prospectus in addition to those required by Rule 41-501, and, when appropriate, to incorporate these financial statements into pro forma financial statements of the issuer; or

(ii) other historical financial information that supports the calculation of the adjustments.

In some cases, distributable cash disclosure may contain adjusting items that are based on recent contracts or agreements for which historical financial statements or other historical financial information is not available. In these cases, issuers may instead disclose a detailed description of the contract or agreement including the relevant terms and conditions of the contractual commitment and any other financial information that supports the amount of the adjusting item.

Part 3 – Other disclosure issues

A. Material debt

3.1 Why are we concerned about material debt?

We are concerned about debt obligations that are incurred by the operating entity or other entity that rank before unitholders' entitlement to receive cash distributions. Although many non-income trust issuers have similar, or less conservative, capital structures, we are particularly concerned about the sensitivity of income trusts to cash flows. Specifically, we are concerned about reductions in distributions that might arise from increases in interest charges on floating-rate debt, a breach of financial covenants, a refinancing on less advantageous terms, or a failure to refinance.

3.2 What disclosure do we expect about material debt?

The principal terms of the material debt should be included in an income trust prospectus and in the income trust's Annual Information Form (AIF) filed under National Instrument 51-102 *Continuous Disclosure Obligations*, or its successor (NI 51-102). This would include the following information about the debt:

(i) the principal amount and the anticipated amount to be outstanding when the offering is closed,

(ii) the term and interest rate (including whether the rate is fixed or floating),

(iii) the terms on which the debt is renewable, and the extent to which those terms could have an impact on the ability to distribute cash,

(iv) the priority of the debt relative to the securities of the operating entity held by the income trust,

(v) any security granted by the income trust to the lender over the operating entity's assets, and

(vi) any other covenant(s) that could restrict the ability to distribute cash.

3.3 Are agreements relating to the material debt considered to be material contracts of the income trust?

We consider that in most cases, agreements relating to material debt that have been negotiated with a lender other than the income trust, will be material contracts pursuant to Rule 41-501 and NI-51-102 (or their respective successors) if those agreements have a direct correlation with the anticipated cash distributions. For example, distributions from the operating entity to the income trust may be restricted if the operating entity fails to maintain certain covenants under a credit agreement. If the agreement contains terms that have a direct correlation with the anticipated cash distributions, and will be entered into on or about closing, it should be listed as a material contract in the prospectus and AIF. We also expect a copy of the material agreement and any amendments to be filed on SEDAR.

3.4 Do we expect the income trust to include a separate risk factor about the material debt?

Yes. We expect the income trust to include a separate risk factor about the material debt in the income trust's prospectus and AIF. A full and complete discussion of this risk factor would usually include the following:

(i) the need for the borrower to refinance the debt when the term of that debt expires,

(ii) the potential negative impact on the ability of the issuer and/or its subsidiaries to make distributions if the debt is replaced by new debt that has less favourable terms,

(iii) the impact on distributable cash if the borrower cannot refinance the debt, and

(iv) the fact that the ability of the operating entity to make distributions, directly or indirectly, to the income trust may be restricted if the borrower fails to maintain certain covenants under the credit agreement (such as a failure to maintain certain customary financial ratios).

B. Stability ratings

3.5 What is a stability rating?

A stability rating is an opinion of an independent rating agency about the relative stability and sustainability of an income trust's cash distribution stream. Standard & Poor's (S&P's) and Dominion Bond Rating Services (DBRS) currently provide stability ratings on Canadian income trusts. A stability rating reflects the rating agency's assessment of an income trust's underlying business model, and the sustainability and variability in cash flow generation in the medium to long-term. The objective of these stability ratings is to compare the stability of rated Canadian income trusts with one another within a particular sector or industry.

3.6 Does an income trust need to obtain a stability rating?

No. However, the CSA believes that stability ratings by rating agencies, such as S&P's and DBRS, can provide useful information to investors.

Some investors who choose to invest in income trust units may base that decision primarily on the cash flow generated by the operating entity. Distributable cash is often presented as a measure of the issuer's potential to generate cash for distribution. Stability ratings can supplement the presentation of distributable cash to provide an independent opinion on the ability of an income trust to meet its distributable cash targets consistently over a period of time relative to other rated Canadian income trusts within a particular sector or industry.

3.7 What disclosure do we expect about an income trust's stability rating?

If an income trust has asked for and received a stability rating, the rating should be described on the cover page of the prospectus and in the income trust's AIF. The income trust should include disclosure about the rating in accordance with section 10.8 of Ontario Securities Commission Form 41-501F1 Information Required in a Prospectus (or its successor), section 10.8 of Schedule 1 Information Required in a Prospectus to Quebec's Regulation Q-28 respecting General Prospectus Requirements (or its successor), section 7.9 of Form 44-101F1 Short Form Prospectus (or its successor) or item 7.3 of Form 51-102F2 (or its successor). This disclosure should explain that a rating measures an income trust's stability relative to other rated Canadian income trusts within a particular sector or industry. Issuers are required to make timely disclosure of any material change in their affairs, which we believe would include any change in a stability rating that constitutes a material change.

We understand that some stability ratings are provided to income trusts on an unsolicited basis. These ratings are not based on discussions with the income trust but, rather, on publicly available information. Our disclosure expectations do not extend to unsolicited stability ratings.

C. Executive compensation

3.8 What disclosure do we expect the income trust to provide about executive compensation for the operating entity?

We believe that the executive compensation of the operating entity's executives is important information for investors. The income trust should provide that information in its prospectus and information circular as if the operating entity were a subsidiary of the income trust.

3.9 What disclosure do we expect about the income trust's management contracts and management incentive plans?

We believe that the material terms of management contracts and management incentive plans are relevant information for investors if the terms of those contracts or plans have an impact on distributable cash. For example, if the term "distributable cash" is defined in a unique way in a management contract, we expect that term of the contract to be described. A further

example would be information about why an issuer has decided to use an external management company rather than retain an internal management structure or, conversely, why an issuer has internalized management. Adequate information about those contracts and plans should be included in applicable disclosure documents. Even if those contracts and plans have not been finalized prior to the filing of an initial public offering (final) prospectus, the anticipated material terms should still be described in the prospectus.

3.10 Do we expect management contracts and management incentive plans to be filed on SEDAR?

We expect the material contracts and plans referred to in section 3.9 to be filed on SEDAR. If those material contracts and plans have not been finalized before filing a prospectus, we expect the income trust to provide an undertaking from the income trust and the operating entity to securities regulatory authorities that those contracts and plans will be filed as soon as practicable after execution.

D. Risk factors

3.11 General

Income trusts are required to disclose all material risk factors relating to the offering pursuant to a prospectus. A complete discussion of risk factors for an income trust should include the principal factors related to the specific offering that could affect the predictability of cash flow distributions to unitholders. It would also include an assessment of the likelihood of a risk occurring as well as the potential consequences to a unitholder if a risk should occur. Relevant risk factors may include risks relating to the operating entity business, the potential inapplicability to unitholders of certain corporate law rights and remedies, the potential inapplicability of insolvency and restructuring legislation in the trust context, and other factors relevant to income trusts and other indirect offerings that we have described in this policy. For income trusts, risk factor disclosure is also required on an ongoing basis in the issuer's AIF in accordance with Item 5.2 of Form 51-102F2 (or its successor).

Part 4 – Offering-specific issues

A. Determination of offering price

4.1 What disclosure do we expect about the determination of the price of an income trust's units?

We do not require that income trusts obtain a third-party valuation of the operating entity interests to be acquired (unless that valuation is otherwise required under securities legislation). However, if a third-party valuation is obtained in connection with an initial public offering, the income trust should describe the valuation in the prospectus. The description should identify the parties involved, the principal variables and assumptions used in the valuation (particularly those which could, if adversely altered, cause a deterioration in the value of the issuer's investment). If no third-party valuation is obtained, the prospectus should disclose that fact and state that the price of the issuer's units was determined solely through negotiation between the operating entity security holders and the underwriter(s).

B. Prospectus liability

4.2 What is the regulatory framework?

The central element of the prospectus system is the requirement that disclosure of all material facts relating to the offered securities and the issuer be provided so that investors can make informed investment decisions.

Although the prospectus serves a role in marketing securities, from a regulatory perspective it is also a disclosure document that can give rise to regulatory and civil liability. To provide discipline on prospectus disclosure, and to protect the integrity of the Canadian public markets, securities legislation prohibits certain persons involved in a public offering from making a misrepresentation (as defined in applicable securities legislation) in a prospectus. Where a prospectus contains a misrepresentation, investors may have the right to either rescind their purchases or to claim damages from the issuer or selling security holder, every director of the issuer, any promoters of the issuer, the underwriter(s) and certain other parties. Each of those parties (including each selling security holder) is jointly and severally liable for the damages suffered by investors as a result of the misrepresentation(s). Although "selling security holder" is not defined under applicable securities laws, the term is generally considered to mean persons who are selling securities of the class being distributed under the prospectus.

4.3 How does the regulatory framework related to prospectus liability apply to indirect offerings?

In an indirect offering, the issuer uses the proceeds to acquire a business (and perhaps to repay indebtedness), and the disclosure (including financial disclosure) in the prospectus describes both the acquired business and the issuer. The proceeds are not retained by the issuer, and any prospectus misrepresentation that adversely affects the value of the acquired business may diminish the issuer's ability to satisfy a damages claim.

An underwriter's statutory liability in an indirect offering is the same as it is in a conventional direct offering. Underwriters sign a certificate about the disclosure contained in the issuer's prospectus and are potentially liable for a misrepresentation in the prospectus.

In an indirect offering, the former owners of the operating entity (referred to as vendors) who sell their ownership interests in the operating entity to the issuer and who are effectively accessing the public markets to liquidate their holdings, are not generally considered to be "selling security holders" within the meaning of securities legislation, as they are not selling the securities being offered under the prospectus. As a result, vendors who indirectly receive part of the proceeds of the offering in exchange for their operating entity interests do not (unless they qualify as promoters, see below) have statutory liability for a misrepresentation in a prospectus as they would if their interest in the operating entity had been distributed directly to the public. Vendors of businesses to conventional issuers undertaking a direct offering would also not be considered "selling security holders" although they indirectly receive offering proceeds. However, as noted above, we believe those circumstances differ from an indirect offering because access to the public markets is being initiated primarily not by those vendors but by the conventional issuer.

4.4 Promoter liability

4.4.1 What is the meaning of promoter?

Persons that are promoters of an issuer within the meaning of securities legislation are required to sign the issuer's prospectus in that capacity. As a consequence, those persons assume joint and several liability for prospectus misrepresentations up to a maximum amount equal to the gross proceeds of the offering. The term "promoter" is defined differently in provincial securities legislation across the CSA jurisdictions. It is not defined in the Securities Act (Québec), and a broad approach is taken in Québec with respect to examining those persons who would be considered promoters. We believe that a vendor that receives, directly or indirectly, a significant portion of the offering proceeds as consideration for services or property in connection with the founding or organizing of the business of an income trust issuer, is a promoter and should sign the prospectus in that capacity.

4.4.2 What constitutes the "business" of the income trust?

In the context of indirect offerings, there appears to be uncertainty about whether the "business of an issuer", as that phrase is used in the definition of "promoter" in some of the CSA jurisdictions, refers to the business of the issuer (the income trust) or to the business of the operating entity. More specifically, the question is whether the test depends on a person's involvement in the founding, organization or substantial reorganization of the operating entity's business, or whether involvement in the founding, organization, or substantial reorganization of the income trust itself will make a person a promoter.

We believe that in most cases, the business of the income trust issuer is primarily to complete the public offering and to acquire the interest in the operating entity. Therefore, we generally focus on a person's involvement in the founding, organization, or substantial reorganization of the income trust itself.

We also believe that any person who initiated or took part in the formation, organization or substantial reorganization (as those terms are often used in the definition of "promoter") of the operating entity would not cease to be a promoter under the offering solely due to use of an indirect offering structure. The relationship between the income trust and the operating entity is not sufficiently at arm's length to support this result. The question of whether a person takes part in the founding, organizing or substantial reorganizing of the income trust's business and of the operating entity's business is one of fact. Therefore, this determination should be made by the income trust and the underwriter(s) after reviewing the relevant facts.

4.4.3 What disclosure do we expect about the implications of the operating entity being identified as a promoter?

Where the operating entity signs the prospectus as promoter but the vendors are retaining no interest, or only a nominal interest, in the operating entity upon closing of the offering, the right to claim damages from the operating entity for misrepresentations offers limited or no additional benefit to investors. This is because all or a substantial majority of the interests in the operating entity are acquired by the income trust. Therefore, the prospectus should explain that, despite the operating entity's statutory liability for a misrepresentation in the prospectus, there will be little or no practical benefit to investors who choose to exercise those rights against the operating entity. This is because a successful judgment would result in a deterioration of the operating entity's value (frequently the sole asset of the income trust) and a resulting decline in the value of the investor's securities of the income trust. It is also likely that the operating entity would have a limited ability to satisfy such a claim.

We believe this type of disclosure would be helpful to investors who may not understand the implications of the operating entity being identified as a promoter of the income trust, as is often the case.

Conversely, where the vendors retain a meaningful interest in the operating entity, the characterization of the operating entity as a promoter will offer an additional benefit because the value in the operating entity held by vendors as their retained interest

would be potentially available to contribute to satisfying a damages claim without investors suffering a corresponding decline in the value of their securities of the income trust.

4.5 Contractual accountability

4.5.1 What accountability for prospectus disclosure is typically assumed by vendors through contractual arrangements?

Our review of indirect offering prospectuses indicates that in situations where vendors have not signed the prospectus, they typically assume, by contract, responsibility for matters relating to the operating entity's business. Vendors typically provide representations and warranties about the operating entity and its business to the issuer under the acquisition agreement pursuant to which the vendors sell, and the issuer acquires, the operating entity interests. As well, in several indirect offerings, the vendors have provided a representation in the acquisition agreement about the absence of any misrepresentation in the prospectus (a prospectus representation).

4.5.2 What are our concerns about the application of the regulatory requirements to indirect offerings?

We are concerned that:

(i) investors in indirect offering structures may not appreciate that there is not always a statutory right of action against the vendors as there would be in a direct offering if the vendors were considered "selling security holders",

(ii) prospectus representations may not be given by vendors in circumstances where we would consider those representations to be appropriate,

(iii) prospectus disclosure of the vendors' representations and warranties, and limitations, in the acquisition agreement may not be sufficiently detailed or clearly set out to permit investors to understand the vendors' contractual accountability, and

(iv) the vendors' representations and warranties may not adequately address the potential loss of rights and remedies that securities legislation would provide to investors in a direct offering.

4.5.3 What disclosure do we expect about the accountability of the vendors?

To address the concerns described in subsection 4.5.2, prospectuses relating to indirect offerings, where part of the proceeds are being paid to vendors, should:

(i) include a clear statement that investors may not have a direct statutory right of action against each vendor for a misrepresentation in the prospectus unless that vendor is a promoter or director of the issuer, or is otherwise required to sign the prospectus,

(ii) include a detailed description of the vendors' representations, warranties and indemnities contained in the acquisition agreement (and any significant related limitations) and details about the negotiations (including the parties involved), together with a summary of these items in the summary section of the prospectus,

(iii) identify the acquisition agreement as a material contract and provide disclosure advising investors to review the terms of the acquisition agreement for a complete description of the vendors' representations, warranties and indemnities, and related limitations, and

(iv) identify what measures have been implemented to provide investors with rights and remedies against the vendors in lieu of those afforded by securities legislation in a direct offering.

The summary of the relevant acquisition agreement provisions should include clear disclosure about the following:

(i) the aggregate cash proceeds being paid to the vendors for the sale of their operating entity interests,

(ii) the nature of the representations and warranties provided by the vendors, including any significant qualifications, and specifically whether a prospectus representation is provided,

(iii) the period of time that the representations and warranties will survive after closing,

(iv) any monetary limits on the vendors' indemnity obligations, and

(v) any other limitations on, or qualifications to, the vendors' indemnity obligations.

The summary of the acquisition agreement provisions should provide investors with a clear description of the extent to which the vendors are supporting, with meaningful indemnities, the representations and warranties in favour of the issuer.

CSA staff may consider recommending against the issuance of a receipt for a prospectus if vendors receive cash proceeds from an indirect offering by selling their operating entity interests and do not take appropriate responsibility (directly or indirectly) for the information provided in the prospectus through the acquisition agreement, or as a result of signing the prospectus, or otherwise.

4.5.4 What are our concerns about the nature and extent of the representations, warranties and indemnities provided by vendors in the acquisition agreement?

Circumstances, including the nature of the operating entity and its business and the nature and extent of the vendors' interests (individually and in the aggregate) and their involvement in the operating entity, will affect the types of representations, warranties and indemnities that can reasonably be expected to be provided to the issuer by vendors in the context of an indirect offering.

Examples of circumstances where we have had concerns about vendors not taking appropriate responsibility in the context of indirect offerings have included situations where:

(i) certain vendors, who we refer to as active vendors, such as:

- vendors that affect materially the control of the operating entity prior to the offering, and who are involved in the offering process and/or the management or supervision of management of the operating entity prior to the offering,
- vendors that influence (whether alone or in conjunction with others) the offering process, and
- members of senior management of the operating entity,

sell a substantial portion of their interest in the operating entity to the issuer on closing but do not

a. sign the prospectus as promoter, or

b. provide a prospectus representation in the acquisition agreement;

(ii) a vendor's obligation to indemnify the issuer if the prospectus contains a misrepresentation is limited to an amount less than the proceeds received by the vendor from the sale of the vendor's interest in the operating entity or is subject to a deductible or other threshold that precludes claims against the vendor that are not, individually or in the aggregate, above a certain value; and

(iii) the vendor's responsibility for the information on which the offering is based is reduced unduly, having regard to the nature of the vendor's investment, as a result of the period during which claims may be asserted against the vendor for a prospectus misrepresentation being significantly shorter than the period in which claims may be asserted against the issuer for a prospectus misrepresentation.

If an active vendor's liability for a misrepresentation in the acquisition agreement is conditional on the active vendor having knowledge of the misrepresentation, we expect that the active vendor would generally have a corresponding obligation to take reasonable steps to confirm the accuracy of the representation. For example, a non-management active vendor should make appropriate inquiries of management of the operating entity.

The CSA acknowledges that there may be constraints on the indemnities that certain vendors can provide and the survival period of those indemnities. In assessing whether the vendors have taken appropriate responsibility (directly or indirectly) for the information provided as a basis for the offering, we will generally assess the entire framework of representations, warranties and indemnities provided by the vendors as a group, as opposed to assessing each component or vendor individually. We believe this approach is consistent with the commercial realities within which the parties to these transactions allocate the risks and rewards of the transactions.

Part 5 – Sales and marketing materials

5.1 What are our concerns about sales and marketing materials?

Registrants often solicit interest from potential investors during the "waiting period" between the issuance of a receipt for a preliminary prospectus and the issuance of a receipt for the prospectus, and in the period following the receipt for the prospectus until the primary distribution is completed. Along with the distribution of the preliminary prospectus (or prospectus, if then available) to potential investors, that process often involves the preparation and distribution of materials (such as green sheets) for the benefit of registered salespersons and banking group members. The information included in these materials is typically a simplified summary version of the disclosure in the prospectus, and should be limited to information included in, or directly derivable from, the prospectus (the exceptions are information about the basic terms of comparable offerings and general market information not specific to the issuer).

Marketing materials used in the context of income trust offerings often include prominent reference to "yield". We are concerned that expressions of "yield" in these marketing materials may not be clearly understood, both because the term itself may have connotations or common usages that are not consistent with the attributes of income trust units and because the relationship between the "yield" described in the marketing materials and the information in the prospectus may not be clear.

"Yield" is generally used in the context of income trust offerings to refer to the return 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. In connection with their ongoing approach to disclosure, issuers should carefully consider yield expectations previously communicated to investors through sales and marketing materials or otherwise. Whether and to what extent those yield expectations are met are important aspects of overall disclosure of performance. Issuers should include in their interim and annual MD&A, where applicable, a comparison between the expected yield figure previously communicated and the actual yield.

5.2 What information do we expect the green sheets to contain?

We are concerned that use of the term "yield" in these marketing materials may imply that the entitlement of unitholders to distributions is fixed. We expect expressions of yield to be accompanied by disclosure that, unlike fixed-income securities, there is no obligation of the income trust to distribute to unitholders any fixed amount, and reductions in, or suspensions of, cash distributions may occur that would reduce yield based on the offering price.

A related concern is that disclosure of a yield in marketing materials may cause confusion because yield is not typically disclosed in the prospectus. If marketing materials contain an expression of yield, we expect the statement to be tied to the disclosure in the prospectus on which the marketing is based (including, in particular, the pro forma presentation of distributable cash in the prospectus). Specifically, expressions of yield in income trust offering marketing materials should be accompanied by disclosure indicating the proportion of the pro forma distributable cash (as set out in the prospectus) that the stated yield would represent. Guidance for the disclosure about distributable cash in the green sheets is set out in subsection 6.5.2 of this policy.

In addition, if reference is made to tax efficiencies that may be realized on distributions (such as returns of capital to investors), we expect that disclosure to be clear and, to the extent practical, quantified. For example, the estimated tax-deferred portion of distributions for the foreseeable period, and the tax implications, should be clearly stated or cross-referenced.

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

Yes. Income trust issuers should provide copies of all green sheets to the securities regulatory authorities when filing the preliminary prospectus, together with separate documentation providing a clear and concise explanation of how the yield figure (if contained in the green sheet) is derived from the prospectus disclosure. In addition, we may request that additional sales and marketing materials used in connection with an income trust offering be provided.

Part 6 – Continuous disclosure-specific issues

6.1 What continuous disclosure do we expect about the operating entity?

An income trust's performance and prospects depend primarily on the performance and operations of the operating entity. To make an informed decision about investing in an income trust's units, an investor generally needs comprehensive information about the operating entity, including: (i) the operating entity's interim and annual financial statements together with corresponding MD&A for the relevant periods, (ii) complete business disclosure about the operating entity of the scope expected in an annual information form, and (iii) press releases and material change reports about any material changes in the business, operations or capital of the operating entity.

If a business acquisition report (a BAR) is filed for the acquisition by the income trust of the operating entity, in accordance with Part 8 of NI 51-102 (or its successor), the income trust must include within the BAR updated financial information about the operating entity.

To the extent the securities laws in some CSA jurisdictions are ambiguous about whether the disclosure described above about the operating entity is required by a reporting issuer that is an income trust or other non-corporate entity, the income trust issuer should file one or more undertakings with the regulatory authorities prior to receiving a receipt for a prospectus, completing a plan of arrangement involving an operating entity or otherwise acquiring a direct or indirect interest in an operating entity. The following is an example of an undertaking that we would expect:

(A) in complying with its reporting issuer obligations, the income trust will treat the operating entity as a subsidiary of the income trust; however, if generally accepted accounting principles (GAAP) used by the income trust prohibit the consolidation of financial information of the operating entity and the income trust, then for as long as the operating entity (including any of its significant business interests) represents a significant asset of the income trust, the income trust will provide unitholders with separate audited annual financial statements and interim financial statements, prepared in accordance with the same GAAP as the income trust's financial statements, and related management's discussion and analysis, prepared in accordance with National Instrument 51-102 – *Continuous Disclosure Obligations* or its successor, for the operating entity (including information about any of its significant business interests), and

(B) the income trust will annually certify that it has complied with this undertaking, and file the certificate on SEDAR concurrently with the filing of its annual financial statements.

We recognize that there may be circumstances where the income trust does not have direct access to the operating entity's financial information. For example, in situations where the income trust holds less than a 50% interest in an operating entity, it may be difficult for the income trust to have direct access to that operating entity's financial information. If so, the income trust should ensure that it can follow the guidance described in this section 6.1 either through the terms of the acquisition agreement or otherwise.

6.2 Comparative financial information

Most income trusts are the continuation of an existing business that was previously operated under a different legal form (for example, a corporation). We believe that the change in legal form does not alter the substance of the business operations and therefore does not prevent an income trust from presenting comparative financial information for the underlying business during its initial interim and annual periods including the interim period during which the trust came into existence.

For those acquisitions accounted for by the purchase method, income trusts should provide comparative financial information for the predecessor business in their interim and annual MD&A. For trusts that are created on a date within a given interim period, the trust's first interim MD&A should include both financial information about the predecessor business (from the beginning of the applicable interim period to the date of the creation of the trust) and financial information about the trust (beginning as of the date of its creation). Examples of relevant comparative information would include, but would not be limited to, the following:

- revenues/sales,
- cost of sales,
- gross margin,
- general and administrative expenses, and
- net income.

In situations where the transfer of the operating business into an income trust is accounted for at carrying amounts, we expect the income trust to provide complete financial statements with comparative figures that also reflect the operations of the business under the previous legal entity.

Where an issuer believes that providing comparative information would not be appropriate, such as where the income trust is formed as a result of multiple acquisitions, we encourage the issuer to discuss the circumstances with the relevant securities regulatory authority(ies) prior to filing the applicable continuous disclosure document(s).

6.3 Recognition of intangible assets

GAAP requires the appropriate recognition of all intangible assets acquired in business combinations. In addition, the intangible assets acquired must be assigned a portion of the total cost of the purchase based on their fair values at the date of acquisition. To assist investors in understanding the valuation process and the cost assigned to the intangible assets, income trusts should provide in the offering document a description of the method(s) used to value the intangible assets.

6.4 Are "insiders" of the operating entity also insiders of the income trust for purposes of insider reporting obligations?

Consistent with our view that the performance and prospects of an income trust depend on the performance and prospects of the operating entity, we believe each person who would be an "insider" (as that term is defined in applicable securities legislation) of the operating entity if the operating entity were a reporting issuer should comply with insider reporting requirements as if that person were also an insider of the income trust.

To the extent securities laws in certain CSA jurisdictions are ambiguous about whether insiders of the operating entity are also insiders of the income trust or other non-corporate entity, that issuer is expected to file an undertaking with the regulatory authorities prior to receiving a receipt for a prospectus, completing a plan of arrangement involving an operating entity or otherwise acquiring a direct or indirect interest in an operating entity. We expect the undertaking to provide that for so long as the income trust is a reporting issuer, the income trust will take the appropriate measures to require each person who would be an insider of the operating entity or a person or company in a special relationship with the operating entity if the operating entity were a reporting issuer to: (i) file insider reports about trades in units of the income trust (including securities which are exchangeable into units of the income trust), and (ii) comply with statutory prohibitions against insider trading. We expect the income trust to annually certify in the certificate described in section 6.1(B) above that it has complied with this undertaking.

We are concerned that additional persons that may possess material undisclosed information about the income trust may: (i) not fall within the definition of "insider" (as that term is defined in applicable securities legislation) or (ii) not be caught by the undertaking. As a result, there may be situations where we will require that additional undertakings be provided. The income trust will need to obtain the relevant contractual commitments from these persons and entities in order to comply with the undertakings referred to above.

Recent amendments to securities legislation in Alberta deem insiders of operating entities and management companies to be insiders of the income trust. The CSA is in the process of developing a proposed national rule that would harmonize and streamline the requirements for insiders of reporting issuers to file insider reports. We expect that the proposed national rule will include harmonized requirements for insiders of operating companies and management companies to file insider reports about their transactions involving securities of the income trust. Pending the implementation of the proposed national insider reporting rule, we will continue to require income trusts to provide the undertaking described above.

6.5 MD&A

6.5.1 Risks and uncertainties

Under Form 51-102F1, an income trust must discuss important trends and risks that have affected the operating entity's financial statements, and trends and risks that are reasonably likely to affect them in the future. Although the instructions in Form 51-102F1 do not specifically state it, to meet the requirement to disclose risks, income trusts should provide a detailed risk factor discussion about the potential commitment to replace and maintain capital assets, including a quantitative discussion about expected annual capital maintenance expenditure levels relative to current levels, and the expected effect on distributions.

6.5.2 Discussion of distributed cash

Although most income trusts intend to make distributions of their available cash to unitholders, these cash distributions are not assured. The actual amount distributed depends on numerous factors, including the operating entity's financial performance, debt covenants and obligations, working capital requirements and future capital requirements. It is important for unitholders to have information about the source(s) of the distributed cash that they receive, including whether the issuer borrowed amounts to finance distributions, and whether distributions include amounts that are not properly classified as a return on capital. Although the instructions in Form 51-102F1 do not specifically state it, to meet the disclosure requirements for liquidity in Form 51-102F1, income trusts should provide sufficient disclosure about their sources of funding relating to current and future cash distributions so that unitholders can understand what portion, if any, of the distributions they receive were funded by non-operating cash flows. Also, income trusts should quantify these amounts and discuss the impact on the trust's long-term ability to sustain distributions if non-operating cash flows are being used to fund distributions.

An income trust can overcome the concerns noted in section 2.1 and in this subsection by providing information in its interim and annual MD&A that summarizes the main elements of its performance that are necessary to assess the sustainability of its cash distributions. One way to summarize this information is by using a table similar to the following:

		For the most recently completed quarter	Accumulated for the current fiscal year (Year 1)	Previously completed fiscal years	
				(Year 2)	(Year 3)
A.	Cash flows from operating activities*	$ XX	$ XX	$ XX	$ XX
B.	Net Income (loss)	$ XX	$ XX	$ XX	$ XX
C.	Actual cash distributions paid or payable relating to the period **	$ XX	$ XX	$ XX	$ XX
D.	**Excess (shortfall) of cash flows from operating activities over cash distributions paid** **(A) – (C)** ***	**$ XX**	**$ XX**	**$ XX**	**$ XX**
E.	**Excess (shortfall) of net income over cash distributions paid** **(B) – (C)** ***	**$ XX**	**$ XX**	**$ XX**	**$ XX**

* Takes into account changes in non-cash working capital balances

** Includes distributions paid or payable on all classes of units and any special distributions paid or payable during the period

*** Income trusts might choose to present the excess (shortfall) in lines D and/or E in the form of a ratio or percentage. In these instances, we expect this ratio or percentage to be determined based solely on amounts included in lines A, B, and C, as applicable, from the above table.

The above table provides clear disclosure about the relationship between cash flows from operating activities and net income (loss), and historical distributed cash amounts.

When cash distributions are greater than either net income (loss) or cash flow from operating activities, creating a shortfall in any of the columns in the above table, disclosure of the following, as applicable, will help to provide a balanced discussion of the issuer's results of operations and financial condition:

(i) why the trust has chosen to make distributions partly representing an economic return of capital, or, alternatively, why it does not believe that any portion of those distributions should be regarded as an economic return of capital,

(ii) a quantification and description of the sources of cash used to fund the shortfall,

(iii) the obligations of the issuer or its subsidiaries in connection with the sources of cash used to fund the shortfall, including repayment terms and interest payable,

(iv) whether any material contract was amended in connection with the funding of the shortfall and whether any waivers or consents were obtained,

(v) whether the issuer expects that cash distributions will continue, for the foreseeable future, to exceed net income and/or cash flow from operations. If so, the trust should specifically address what implications this has for the sustainability of distributions. If not, the issuer should explain the reasons why it does not expect the situation to continue, and

(vi) whether the issuer anticipates that cash distributions may be suspended in the foreseeable future.

If cash distributions paid do not equal distributable cash, the issuer should also discuss the reasons for the difference between the two amounts. If cash distributions paid materially exceed distributable cash, the disclosure of distributable cash should include a detailed explanation of how the additional distributions were financed as this impacts the issuer's liquidity. Generic boiler-plate language about the issuer's sources of available capital or financing or simply pointing the reader to the cash flow statement for further information is not sufficient. When distributions paid are materially less than distributable cash, the disclosure of the amounts distributed should include an explanation of why distributable cash was not fully distributed.

In order to meet the requirements for MD&A, disclosure of an issuer's distributable cash for a period should be accompanied by the information referred to in sections 2.5, 2.6, 2.7 and 2.8, as applicable, as well as the above table and accompanying narrative. Issuers should also refer to the guidance in sections 2.5, 2.6, 2.7, 2.8 and subsection 6.5.2 of this policy when considering how to present disclosure of an issuer's distributable cash, including disclosure contained in annual and interim MD&A, news releases and sales and marketing materials such as green sheets. See also Part 5 of this policy.

Part 7 – Corporate governance

7.1 CEO/CFO certification, audit committees, and effective corporate governance

How each of the issuer and the operating entity will discharge their governance responsibilities is important information for investors. Issuers should provide prospectus disclosure about how each of the issuer and the operating entity will satisfy governance responsibilities including how they will comply with the following instruments or their successors as applicable in each jurisdiction:

(a) Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (MI 52-109),

(b) Multilateral Instrument 52-110 *Audit Committees* or BCI 52-509 *Audit Committees*, as applicable, and

(c) National Instrument 58-101 *Disclosure of Corporate Governance Practices*.

For example, the issuer should consider disclosing which persons will be signing as chief executive officer and/or chief financial officer to meet the requirements of MI 52-109.

In particular, income trusts should refer to the following sections of the above-noted instruments or the related companion policies for specific guidance about income trusts and other similar structures:

(a) part 4 of Companion Policy 52-109CP to Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*,

(b) section 1.2 of Companion Policy 52-110CP to Multilateral Instrument 52-110 *Audit Committees*, and

(c) section 1.2 of National Policy 58-201 *Corporate Governance Guidelines*.

7.2 Broader corporate law concerns

Corporations are governed by corporate statutes regulating their key obligations and the rights afforded to their shareholders. There is no equivalent statutory regime governing non-corporate entities like income trusts. Investors must look to the declaration of trust of each trust to determine the key obligations of the trust and unitholder rights and protections. It is important that unitholders understand that the provisions of the declarations of trust may differ from the minimum standards required under applicable corporate statutes and among various income trusts.

To facilitate unitholders' understanding of these differences, issuers should compare the rights and obligations generally available to corporate shareholders under applicable corporate statutes with those provided in the declaration of trust, highlighting any material differences. For example, under corporate law a corporation is required to hold an annual meeting enabling shareholders to exercise the right to elect directors to the board. If the declaration of trust does not enable unitholders to elect the directors to the board of the income trust, this fact should be clearly identified.

Because we are concerned that a unitholder may not be afforded the same protections, rights and remedies as a shareholder in a corporation, issuers should also provide the following disclosure in the issuer's AIF (if an AIF is filed) and any prospectus filed by the issuer:

> A unitholder in the income trust has all of the material protections, rights and remedies a shareholder would have under the *Canada Business Corporations Act*. These protections, rights and remedies are contained in the [trust indenture, dated ***].
>
> OR
>
> A unitholder in the income trust has all of the material protections, rights and remedies a shareholder would have under the CBCA, except for the following: [list protections, rights and remedies that are not available to a unitholder.] The protections, rights and remedies available to a unitholder are contained in the [trust indenture, dated ***].

Some corporate legislation such as section 21 of the Canada Business Corporations Act provides a mechanism for persons to request a shareholder list for the purpose of making an offer to acquire securities of a corporation. An income trust that refuses to provide a unitholders' list should refer to National Policy 62-202 – *Take-Over Bids – Defensive Tactics* or in Québec Notice 62-202 *Relating to Take-Over Bids – Defensive Tactics* in the case of a potential offeror requesting a unitholders' list. If refusal to provide such a list is likely to deny or severely limit the ability of unitholders to receive or respond to a take-over bid or a competing bid, Canadian securities regulatory authorities may take action.

Part 8 – Other issues

8.1 Income trust names

As discussed above in section 1.2, this policy is intended to address income trusts, not "investment funds" as defined in National Instrument 81-106 *Investment Fund Continuous Disclosure*, or an entity that issues asset-backed securities or capital trust securities. On its initial formation an income trust should exercise caution to ensure that its disclosure makes it clear to investors that it is not an investment fund or mutual fund. Income trusts should avoid adopting a name that may mislead investors as to the nature of the issuer's structure or business purpose. By using terms such as 'equity fund' or 'income growth' in the name, an issuer may be inadvertently suggesting that it is an investment fund or mutual fund. Investors should be provided with a clear understanding of the structure of the issuer and the nature of the securities that they are investing in.