

Goodmans^{LLP} Update

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Income Funds

December 3, 2004

CSA Adopts Income Trust Policy

In our [Client Update dated October 30, 2003](#), we outlined the key elements of then proposed National Policy 41-201 - *Income Trusts and Other Indirect Offerings* (the “Draft Policy”). The Policy has now been adopted in final form (the “Final Policy”) by the Canadian Securities Administrators (CSA), with effect as of December 3, 2004.

The Final Policy is the first regulatory instrument that focuses directly on the income trust structure providing guidance and clarification to market participants by expressing the regulators’ views on how the existing securities regulatory framework should apply to income trusts and other indirect offerings.

The CSA received numerous comments from industry participants on the Draft Policy during the comment period and the Final Policy reflects several significant amendments.

Key Provisions

Vendor Liability

The Final Policy outlines the CSA’s concern that in an indirect offering structure, such as an income trust, persons involved in and benefiting from the public offering process may not be assuming appropriate responsibility for the disclosure in the prospectus. To address this the Final Policy reflects the CSA’s view that vendors who are heavily

involved in the public offering and who receive significant proceeds should have statutory prospectus liability, and that other “active” vendors should have contractual liability to the issuer (in effect for the indirect benefit of the public).

The basic principles of the Final Policy with respect to vendor Liability are unchanged from the Draft Policy. The CSA continue to express their view that the parties who receive a significant portion of the proceeds of an income trust offering qualify as “promoters” (under applicable securities laws, persons who qualify as “promoters” in respect of an offering are required to sign the prospectus and thereby assume joint and several liability for prospectus misrepresentations in an amount up to the gross proceeds of the offering).

The Final Policy also continues to reflect the view expressed in the Draft Policy that parties who receive proceeds but do not sign the prospectus as promoters are, if they are “active vendors” involved in the offering process, expected to assume (by contract) “appropriate responsibility” for the prospectus disclosure. While the Final Policy is not precise as to what constitutes “appropriate responsibility”, the CSA does indicate that examples of circumstances where they have had concerns included situations where 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 vendors that are not, individually or in the aggregate, above a certain value.

Stability Ratings

The provisions in the Final Policy concerning stability ratings, (ratings of cash flow stability published

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by independent agencies) have been significantly changed from the Draft Policy. Having received many comments on the subject, the CSA has removed the recommendation contained in the Draft Policy that an income trust that does not obtain a stability rating provide cover page disclosure explaining why it chose not to obtain a stability rating.

Distributable Cash

The Final Policy has revised some of the CSA's recommended cover page prospectus disclosure, specifically by (among other things):

(i) modifying the suggested wording concerning the non-assured nature of distributable cash (and the risks associated with investments in income trust units) to emphasize that the return on an income trust unit is not comparable to the return on an investment in a fixed-income security;

(ii) limiting the recommendation that the cover page contain the expected breakdown of distributable cash between a "return of" and a "return on" capital to an income fund's initial public offering where the income fund has prepared a forecast that facilitates the calculation of these amounts.

MD&A

The CSA provides recommendations to income trust issuers on the content of their MD&A with respect to certain distributable cash matters including: (i) the sources of funding distributions, whether by cash generated from operations, through borrowed funds or otherwise; (ii) where disclosure as to tax-deferred portions of distributions is made in the prospectus, issuers will be required to compare this to the actual composition

of distributions in their MD&A and where not included in the prospectus, because no forecast was prepared, the CSA recommends that disclosure of the tax-deferred portions of its distributions be included in the MD&A going forward; and (iii) where applicable, the issuer provide a comparison between the expected distributable cash amount disclosed in the prospectus and the actual distributed cash.

Debt Disclosure

The CSA has clarified their recommendation in the Draft Policy that an income trust provide detailed prospectus disclosure of short term debt by broadening the relevant debt in the Final Policy to include all material debt regardless of whether or not it is short term in nature. The CSA continues to expect that changes to the income trust's debt including its non-renewal or renewal on less favourable terms be included as a risk factor in the prospectus.

Corporate Governance

The Final Policy has also been amended to include reference to the recently finalized Investor Confidence Rules (summarized in our [Client Update dated January 20, 2004](#)) and the CSA recommends that income trusts describe in their prospectus how they intend to comply with these new corporate governance initiatives.

In addition, the CSA have recommended that income trust issuers now explain how the rights of unitholders may differ from the rights afforded to shareholders under applicable corporate laws.

If you would like to discuss any aspect of the Final Policy, please contact any member of Goodmans' Income Funds Group listed on the next page.

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