NOTICE OF NATIONAL POLICY 41-201

INCOME TRUSTS AND OTHER INDIRECT OFFERINGS

December 3, 2004.

Notice of Policy

The Ontario Securities Commission (the Commission), together with other members of the Canadian Securities Administrators (the CSA or we), has, under section 143.8 of the *Securities Act* (Ontario) (the Act), adopted National Policy 41-201 Income Trusts and Other Indirect Offerings (the Policy).

The Policy will be adopted on December 3, 2004.

Background

On October 24, 2003, the CSA published a proposed version of the Policy for comment (the Draft Policy). During the comment period, which ended on December 23, 2003, we received 21 comment letters. We received 3 comment letters after the expiry of the comment period.

Substance and purpose of the Policy

The Policy provides guidance and clarification to market participants about income trusts and other indirect offering structures. The CSA wants to ensure that everyone investing in income trust offerings has access to sufficient information to make an informed investment decision. We believe that it is beneficial to express our view about how the existing regulatory framework applies to non-corporate issuers (such as income trusts) and to indirect offerings, in order to minimize inconsistent interpretations and better ensure that the intent of the regulatory requirements is preserved.

We note that legislative changes in Alberta relating to the concepts of insider and control, as well as unitholder liability, clarify the framework for income trusts in Alberta. Similar legislation is being considered in Ontario and British Columbia.

Summary of changes to the Draft Policy

After considering the comments received, we have made changes to the Draft Policy. As these changes are not material, we are not republishing the Policy for a further comment period. The CSA plans to revisit the Policy in approximately two years.

This section describes changes made to the Draft Policy. We have considered the comments received and thank all the commenters. The names of the commenters and a summary of their comments, together with our responses, are contained in Appendices A and B to this notice. We have attached a blacklined version of the Policy (blacklined against the Draft Policy) as Appendix C to this notice.

Introduction

We have revised section 1.1 of the Policy to clarify the reasons for drafting a policy rather than a rule.

Definition of income trust

We have deleted the reference to “substantially all” in section 1.2 to reflect situations where a unitholder is entitled to less than substantially all of the net cash flows generated by an operating entity.

We have added language to clarify that the Policy is not intended to apply to issuers of asset-backed securities or capital trust securities.

Description of direct and indirect offerings

We have made several drafting changes to make the distinction between direct and indirect offerings clearer.

Risk factors

We have added a section relating to risk factors, in which we remind issuers to disclose relevant risk factors in the prospectus.

We have added a recommendation about the risk factor relating to the potential inapplicability of insolvency and restructuring legislation in the trust context.

Distributable cash

We have replaced the term “non-taxable” with “tax-deferred”.

We have determined that the more specific breakdown between “return on” and “return of” capital is more appropriate in the context of continuous disclosure documents, such as MD&A. In the context of the initial offering document, we recommend that issuers provide that breakdown, if a forecast has been prepared. If no forecast has been prepared, we recommend that issuers provide cover page disclosure which explains to investors that the distribution will contain a breakdown of both a “return on” and “return of” capital.

Non-GAAP measures

Since publication of the Draft Policy on October 24, 2003, the CSA published CSA Staff Notice 52-306 – *Non-GAAP Financial Measures*. We have revised section 2.5 of the Policy accordingly.

Material debt

We have revised the Policy to ensure that all material debt, regardless of term length, is captured. We also clarify that only material credit agreements need to be filed.

We have revised the Policy to capture debt incurred by an entity other than the operating entity.

Stability ratings

We have removed the recommendation for issuers to include disclosure about the absence of a stability rating, and the reasons for not obtaining one.

Determination of unit offering price

We have clarified the Policy to explain that the valuation section applies in the context of an initial public offering rather than in the context of subsequent offerings and acquisitions.

Continuous disclosure

As a result of recent amendments to OSC Rule 61-501 and Autorité des marchés financiers' (AMF) regulation entitled Policy Statement Q-27, we have removed the reference to OSC Rule 61-501 and AMF's regulation entitled Policy Statement Q-27.

Management's Discussion and Analysis (MD&A)

We have added a section to the Policy relating to MD&A, specifically about our recommendations relating to MD&A disclosure about risks and uncertainties, and about distributed cash.

Comparative financial information

Section 3.2 of the Policy was revised to take into account the issuance on March 19, 2004 by the Canadian Institute of Chartered Accountants' Emerging Issues Committee (EIC) of EIC Abstract 145 - Basis of Accounting for Assets Acquired Upon the Formation of an Income Trust, applicable for transactions initiated on or after January 1, 2004.

Prospectus liability

We have clarified that we are not amending the legislative definition of promoter through the Policy. We have also elaborated upon concerns relating to the use of contractual representations and warranties in scenarios where active vendors that would be akin to selling security holders in a direct offering have not signed a prospectus certificate.

Sales and marketing materials

We have removed the exclusion of "return of capital" from the definition of "yield".

Corporate Governance

We have added a section entitled "Corporate governance" to deal specifically with governance issues in the income trust context. In particular, we have added guidance about the investor confidence initiatives, and about broader corporate law concerns.

Questions

Please refer your questions about the Policy to any of:

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Appendix A
to Notice

List of commenters on
National Policy 41-201
Income Trusts and Other Indirect Offerings

1. Canadian Association of Income Funds by letter dated Nov. 26, 2003
2. ARC Energy Trust by letter dated Dec. 7, 2003
3. Pension Investment Association of Canada by letter dated Dec.12, 2003
4. Government of Alberta, Revenue by letter dated Dec. 16, 2003
5. Canadian Oil Sands by letter dated Dec. 17, 2003
6. CIPPREC by letter dated Dec. 19, 2003
7. Gluskin Sheff + Associates Inc. by letter dated Dec. 22, 2003
8. Fasken Martineau DuMoulin LLP by letter dated Dec. 23, 2003
9. McCarthy Tétrault LLP by letter dated Dec. 23, 2003
10. Torys LLP by letter dated Dec. 23, 2003
11. Osler, Hoskin & Harcourt LLP by letter dated Dec. 23, 2003
12. Burnet, Duckworth & Palmer LLP by letter dated Dec. 23, 2003
13. Standard & Poor's by letter dated Dec. 23, 2003
14. RBC Capital Markets by letter dated Dec. 23, 2003
15. Goodman & Company by letter dated Dec. 23, 2003
16. Blake, Cassels & Graydon LLP by letter dated Dec. 23, 2003
17. Financial Executives International by letter dated Dec. 23, 2003
18. TSX Group by letter dated Dec. 23, 2003
19. Harvest Energy Trust by letter dated Dec. 23, 2003
20. Signature Funds by letter dated Dec. 19, 2003
21. William E. Hewitt, CFA by letter dated Dec. 23, 2003
22. Fraser Milner Casgrain LLP by letter dated Dec. 23, 2003*
23. Ross Smith Energy Group Ltd. by letter dated Jan. 19, 2004*
24. British Columbia Investment Management Corporation by letter dated Jan. 14, 2004*

* These comment letters were received after the expiry of the 60-day comment period.

Appendix B
to Notice

National Policy 41- 201 Income Trusts and Other Indirect Offerings (the Policy)
Comments received during 60-day comment period commencing
October 24, 2003 and ending December 23, 2003

No.	Theme	Comment	Response
1.	General support for initiative (Part 1 - General)	The majority of the commenters express general support for the initiative and the format of the Policy.	The CSA acknowledges the support of the commenters.
2.	Format of Policy (Part 1 - General)	One commenter suggests adding a summary of the core guidance, in order to allow market participants to quickly access the "required elements" without reading the entire document. Several commenters note that the separation of the descriptive portion of the Policy from other sections of the Policy might be beneficial to investors. However, the majority of commenters encourage the CSA to retain the current format of the Policy, noting that the Policy is easy to follow in its current format.	We have decided to retain the current format of the Policy because the majority of commenters support the format.
3.	Scope of Policy – acceptable and suggestion to expand (Part 1 - General)	A number of commenters express support and agreement with respect to the scope of the Policy, while a few commenters suggest expanding the scope of the Policy to include governance issues. In particular, one commenter recommends that the Policy be expanded to clarify how the existing rules regarding audit Committees and CEO/CFO certifications under Multilateral Instrument *Certification of Disclosure in Issuers' Annual and Interim Filings* (MI 52-109) and Multilateral Instrument 52-110 *Audit Committees* (MI 52-110) apply to trusts.	We appreciate the expressions of support for the scope of the Policy. We have added a section to the Policy to deal specifically with governance issues. In particular, we have added the following recommendations: 1. that issuers provide prospectus disclosure about how they intend to comply with MI 52-109, MI 52-110, proposed Multilateral Policy 58-201 *Effective Corporate Governance* (MP 58-201) and proposed Multilateral Instrument 58-101 *Disclosure of Corporate Governance Practices* (MI 58-101), where those instruments are applicable, and 2. that issuers disclose whether a unitholder has substantially the same protections, rights and remedies as a shareholder and if not, explain how those protections, rights and remedies differ.
4.	Scope of Policy - too broad (Part 1 - General)	One commenter notes that the stated scope of the Policy is overly broad because market participants may be uncertain about how the Policy may apply to a particular transaction. The same commenter recommends that specific examples be provided about what is meant by "structures in other contexts".	Section 1.1 of the Policy specifically refers to the reorganization of a corporate entity into a trust as one example of the income trust structure "in other contexts". As noted in section 1.1 of the Policy, we expect issuers to apply the principles described in the Policy to the income trust structure in other contexts such as reorganizations.
5.	Scope of Policy - policy versus rule (Part 1 - General)	A number of commenters express a concern that the Policy is framed as a policy rather than as a rule. One commenter points to specific sections within the Policy that contain "prescriptive" language. One commenter suggests that the CSA explain within	We have revised section 1.1 of the Policy to clarify the reasons for drafting a policy rather than a rule. We explain that the existing regulatory framework applies to income trusts and other indirect offering structures, and that the Policy has been drafted to guide issuers and their counsel in applying this

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		the Policy that it has been implemented as a policy rather than a rule because the CSA believes that the existing regulatory framework captures the issues relating to income trusts and other indirect offerings. One commenter suggests that more prescriptive language be used in the Policy (ie, "require" rather than "expect" or "encourage', as lead-in language).	framework. We intentionally use language that provides guidance and recommendations since we have drafted a policy rather than a rule. The purpose of a policy is to provide guidance and recommendations, based on existing legislative requirements, whereas the purpose of a rule is to provide mandatory requirements. Since we have drafted a policy rather than a rule, and based on existing case law (such as *Ainsley Financial Corp.* v. *Ontario (Securities Commission)* (1994), 21 O.R. (3d) 104), we do not consider it appropriate to make the language in the Policy more prescriptive.
6.	Republication of Policy (Part 1 - General)	One commenter suggests that the Policy be revisited after the resolution of the "unlimited liability issue" and/or the inclusion of income trusts in the S&P/TSX Composite Index.	We believe that this guidance is important to market participants at this time due to the large number of income trust offering structures in the current market. This does not preclude us from revisiting issues relating to income trusts in the future. We will continue to monitor legislative initiatives and will update the Policy to make necessary changes. We welcome commenters' continued input in this regard. We also note that legislation relating to unitholder liability has been passed in Alberta, and similar legislation relating to unitholder liability is being considered in Ontario and in British Columbia. In Québec, provisions relating to unitholder liability were enacted in 1994 and are provided for in the Civil Code of Québec.
7.	Scope of Policy - reorganizations (Section 1.1)	One commenter notes that the Policy should not apply to reorganizations of a trust and its subsidiaries unless there is an issuance to the public of securities.	In a reorganization, security holders are asked to make a decision about a proposed transaction that will affect their security holdings in the issuer. The information circular that describes the reorganization is required to contain prospectus-level disclosure. The Policy explains what information should be considered so that this standard is met.
8.	Purpose of Policy (Section 1.1)	One commenter suggests that the CSA add language to the Policy to clarify when and how issuers using a direct offering structure should follow the guidance described in the Policy.	The legislative framework applies in the context of both direct and indirect offering structures, but the Policy is intended to specifically provide guidance within the existing framework for income trusts and other indirect offering structures. Rather than adding clarifying language, and to avoid potential confusion, we have deleted the sentence that refers to direct offering structures.
9.	Definition of income trust (Section 1.2)	One commenter suggests stating that the entitlement to substantially all of the cash flow from the operating entity may be in the form of a royalty payment, interest payments, or dividends.	We have decided to retain the current language. Our intention is to have a flexible definition of distributable cash that captures different forms of cash flow.

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		We have also received suggestions from several advisory committees to delete the reference to "substantially all" in section 1.2 of the Policy.	We have deleted the reference to "substantially all" in section 1.2 to reflect situations where a unitholder is entitled to less than substantially all of the net cash flows generated by an operating entity.
10.	Definition of "operating entity" (Section 1.3)	One commenter notes that the definition of "operating entity" is broad enough to capture most special purpose issuers of asset-backed securities, although those issuers distribute debt rather than equity. The commenter suggests that there be an exemption for issuers of asset-backed securities with an approved rating, as such terms are defined in National Instrument 44-101 – *Short Form Prospectus Distributions*.	We have added language to clarify that the Policy is not intended to apply to issuers of asset-backed securities or capital trust securities.
11.	Definition of "operating entity" (Section 1.3)	One commenter suggests that clarifying language be added to the Policy to explain that only the material subsidiaries of operating entities are meant to be captured by the Policy. For example, the commenter notes that if there are subsidiary entities which constitute less than 20 per cent of the overall consolidated operations of a trust, there should not be specific disclosure (such as separate financial statements or detailed disclosure) required in relation to those smaller entities if those smaller entities comprise a different segment of the business.	The Policy does not require information about non-material subsidiaries of the operating entity. We note that section 3.1(i) of the Policy, in the context of the undertaking relating to financial statements (and where consolidation is not permitted), states that as long as the operating entity (including information about any of its significant business interests) represents a significant asset of the income trust, the income trust will provide unitholders with separate financial statements for the operating entity (and any of its significant business interests).
12.	Description of direct and indirect offerings (Section 1.6)	The majority of commenters agree that the description of direct and indirect offerings is clear. However, a number of commenters note that the distinction could be made clearer. One commenter notes that more emphasis should be placed on the broad tenet that indirect offerings, regardless of differences due to legal structures, are not different from direct offerings when it comes to the obligation of reporting requirements for public issuers.	We have made several drafting changes to make the distinction between direct and indirect offerings clearer. In particular, we have noted that although the existing regulatory framework properly captures both direct and indirect offerings, the purpose of the Policy is to provide guidance and clarification to market participants about how we believe the existing regulatory framework should be applied within the context of income trusts and other indirect offerings.
13.	Risk factors (Part 2 - General)	A number of commenters note that current prospectus requirements already provide the necessary guidance about risk factors, except in relation to unique features of income trusts such as the potential for unlimited liability and the fact that income trusts potentially distribute a significant portion of their cash flow. Several commenters agree that it is appropriate to give guidance on operating entity related risk factors. They believe that only limited guidance on particular risk factors is warranted and if given, should emphasize that the guidance is not exhaustive. Several commenters recommend giving greater prominence to the disclosure of risk factors by encouraging the placement of risk factors closer to the front, rather than at the end, of the prospectus.	We agree that it is appropriate to provide only limited guidance on risk factors. We agree that risk factors relating to the operating entity, the non-assured nature of distributable cash, and the fact that income trusts potentially distribute a significant portion of their cash flow are significant. We have decided not to encourage issuers to provide risk factor disclosure closer to the front because we believe that the summary of risk factors in the "Prospectus Summary" section provides sufficient information at the front of the

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			prospectus. We have, however, forwarded this comment to a CSA committee that is currently revisiting the prospectus requirements because we believe that this issue is not unique to income trusts.
14.	Risk factors - insolvency and restructuring legislation (Part 2 - General)	One commenter recommends the inclusion of a specific risk factor regarding the potential inapplicability of insolvency and restructuring legislation in the trust context.	We agree that there is uncertainty about whether insolvency and restructuring legislation is applicable in the trust context. We have added a recommendation about this potential risk factor within the new "Risk Factors" section.
15.	Risk factors - disclosure of all relevant risk factors (Part 2 - General)	One commenter notes that several key documents are filed after the offering has closed and is concerned that issuers may not be providing disclosure about those documents in the prospectus.	We agree that all relevant risks relating to the offering should be disclosed in the prospectus, regardless of when the executed documents are filed.
16.	Distributable cash (Sections 2.1 - 2.4)	A number of commenters suggest that sections 2.2 and 2.4 of the Policy be revised to explain that distributions classified as a return of capital reduce the cost base of the units and should be referred to as "tax-deferred" rather than "non-taxable" returns of capital. In particular, one commenter notes that this point is particularly relevant in the context of REITs because a large portion of the distributions of many REITs constitute "tax-deferred" returns of capital (such as returns sheltered by the application of capital cost allowance to buildings and equipment).	We understand that many commenters prefer the term "tax-deferred" to "non-taxable". Although both terms could be used in this context, we have replaced the term "non-taxable" with "tax-deferred".
17.	Distributable cash - cover page disclosure regarding "return on" and "return of" capital (Section 2.4)	Several commenters agree that more information on the specific breakdown of distributable cash figures is needed and should be highly visible on the cover page. They also note that disclosure of distributions and their origins should be clear and simple to understand, including any pro forma projections of distributions in the prospectus. One commenter suggests that the proposed language may not be appropriate in follow-on offerings by income trusts whose units are publicly traded. One commenter notes that the recommended distinctions are useful in both the prospectus and continuous disclosure contexts. A number of other commenters suggest that face page disclosure relating to the estimated split between taxable and tax-deferred returns of capital be eliminated or alternatively, that the time period for these estimates be limited to 12 months. The commenters note that the face page disclosure recommended in the Policy may be (a) inconsistently available for all income trust issuers, (b) misleading, (c) lacking in meaning or usefulness, (d) subject to change, and (e) time-consuming and costly to prepare. However, those that have the information should be encouraged to provide it.	We believe that information that describes the distribution as containing both a "return on" and a "return of" capital is useful information to investors, in both the initial and subsequent offerings. However, we have determined that the more specific breakdown between "return on" and "return of" capital is more appropriate in the context of continuous disclosure documents, such as MD&A. In the context of the initial offering document, we recommend that issuers provide the breakdown, if a forecast has been prepared. If no forecast has been prepared, we recommend that issuers provide cover page information which explains to investors that the distribution will contain a breakdown of both a "return on" and "return of" capital.

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		Several commenters express concern that this recommendation would call for the preparation of a forecast, which is time-consuming, costly and results in more complex disclosure for investors. One commenter notes that the disclosure suggested in section 2.4 does not contemplate that an income trust might hold income-producing properties rather than an operating business.	
18.	Distributable cash - non-GAAP measures (Section 2.5)	One commenter notes that for many investors, GAAP earnings statements are not well understood and can be manipulated.	It is not within the mandate of the CSA to change GAAP because GAAP is a standard established by the CICA rather than by the securities regulators. With respect to non-GAAP financial measures, as long as the guidance in CSA Staff Notice 52-306 – *Non-GAAP Financial Measures* (Staff Notice 52-306) is followed, the CSA does not object to the use of non-GAAP measures. We note that since the draft policy was published in October, 2003, the CSA published Staff Notice 52-306 (which replaces CSA Staff Notice 52-303), and the Policy has been revised accordingly.
19.	Cover page disclosure - general	One commenter notes that the recommended cover page disclosure may be too broad. The CSA should consider shortening the suggested cover page disclosure.	We believe that the recommended cover page disclosure is important information for investors. We have not revised this section.
20.	Short-term debt - significance of material debt (Part 2C)	Several commenters acknowledge the importance of the potential implications of short-term debt on distributable cash. Some suggest that disclosure be limited to material short-term debt, while others suggest that disclosure be expanded to include all significant debt, whether short or longer term. One commenter suggests this could be accomplished by disclosing overall debt obligations in the prospectus, financial statements or other continuous disclosure documents. One commenter notes that, in appropriate cases, an issuer should be explicitly permitted to provide disclosure regarding its different short-term debt obligations on an aggregated basis. Others express a concern that the emphasis on short-term debt in the Policy may overshadow the existence of other relevant risk factors and suggests citing examples of other relevant risk factors such as whether debt is fixed or floating rate debt, aggregate debt maturities, and the potential inapplicability of insolvency and restructuring legislation to the trust itself.	Our intention is to capture only *material* credit agreements. Since income trust offerings are sold on the basis of distributable cash, we consider all credit agreements that could have a potential impact on the ability of the trust to distribute distributable cash to its unitholders to be material contracts. For example, if a credit agreement contains a term which specifies that if the trust does not maintain specified ratios, it cannot distribute cash to unitholders, that term would be considered material since it could have a direct impact on the ability of the trust to distribute distributable cash. We agree that it is important to focus on all material debt, whether that debt is long- or short-term. We have therefore revised the Policy to clarify that disclosure of the principal terms of material credit agreements should be made. Material terms of a credit agreement would include, for example, information about the interest rate (including whether the rate is fixed or floating).
21.	Short-term debt - SEDAR filing of credit agreements (Part 2C)	Most commenters feel that the test for whether or not a contract is a material contract should be the same for all issuers. Several commenters believe that disclosure about the principal terms of the short-term debt provides adequate information about the financing arrangements of the income trust and the	Our intention is not to designate all credit agreements as material contracts. In the context of income trusts and other indirect offerings, we note that terms of credit agreements frequently have a potential impact on distributable cash. Whether or not a contract is material is a question of fact for

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		operating entity. They believe that it is unnecessary to file the agreements on SEDAR, and that the SEDAR filing puts them at a competitive disadvantage with other issuers.	issuers and filing counsel to determine. If issuers and filing counsel determine that a contract is material, that contract should be listed as a material contract and filed on SEDAR.
22.	Short-term debt - REITs (Part 2C)	One commenter notes that, in the case of REITs, issuers typically provide an aggregated mortgage chart indicating principal by maturity, by average interest rate and by percentage floating rate versus fixed rate exposure. The commenter believes that this type of consolidated disclosure is sufficient in that context.	We agree that this type of disclosure is detailed and informative. Generally speaking, the aggregated mortgage chart offers useful information to investors. However, we note that for investors to fully understand certain details relating to mortgage agreements that may differ in certain respects from information that is described in the chart, the filing of those credit agreements would offer valuable information.
23.	Short-term debt - characterization of short-term debt (Part 2C)	One commenter suggests referring to debt that has a term of five years or less, rather than to debt obligations that are "renewable" within five years or less. One commenter notes that the definition of "short-term debt" in the Policy differs from the accounting definition of that term, which may lead to confusion.	As noted above (Comment 20.), we have revised the Policy to include all debt (whether short- or long-term) that could have a potential impact on distributable cash.
24.	Short-term debt - debt incurred within overall structure (Part 2C)	One commenter suggests that we recommend disclosure of any short-term debt obligations which are owed within the overall ownership structure of the trust or any debt which would be eliminated upon consolidation, rather than uniquely short-term debt that is incurred by the operating entity. As well, the commenter notes that it is not always the operating entity that incurs the third-party debt.	We agree that the debt can be incurred at a level other than the operating entity. We have revised the Policy to capture debt incurred by an entity other than the operating entity.
25.	Executive compensation - support and suggestion for expansion	There is strong support among commenters for the executive compensation disclosure recommendations. A number of commenters suggest the inclusion of stronger wording and more robust requirements in the area of executive compensation, including specific and detailed disclosure relating to salaries and bonuses paid, options granted and other compensation awarded, as well as the underlying reasons for the payments, as this appears to be the largest area of inconsistent disclosure between income trusts.	We acknowledge the support of the commenters. We believe that the current recommendations in the Policy are sufficiently strong and robust to capture details such as salaries and bonuses paid, options granted and other compensation awarded. Section 2.15 of the Policy recommends that issuers provide information about executive compensation in the prospectus as if the operating entity is a subsidiary of the income trust at the time that a final receipt for the prospectus is issued. Under Form 51-102F6 *Statement of Executive Compensation*, issuers are required to provide detailed disclosure relating to executive compensation in connection with their continuous disclosure filings, along the lines identified by the commenters.
26.	Executive compensation - compensation agreements between employees of the trust and other parties	One commenter recommends that income trust issuers disclose compensation agreements between employees of the trust and any outside parties, including retainers, finders' fees, etc. to ensure that fees are reasonable and do not bias management to the detriment of public unitholders.	Paragraph (f) of the definition of "executive officer" in National Instrument 51-102 Continuous Disclosure Obligations includes "any other individual who performed a policy-making function in respect of the reporting issuer". Therefore, any individual that has performed a policy-making function in respect of the issuer falls within the definition of "executive officer", and will need to be considered for purposes of

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			Form 51-102F6. We believe that this would capture the arrangements described by the commenter.
27.	Executive compensation - distinction between business management contracts and employment contracts with individual officers	One commenter believes that the Policy should distinguish between business management contracts, which should be fully disclosed, and employment contracts with individual officers, for which there should be only summary disclosure.	We believe that the material terms of both types of contracts should be disclosed. If terms of either of those contracts could have a material impact on distributable cash, we believe that full disclosure is warranted.
28.	Executive compensation - material changes and filing of plans on SEDAR	One commenter recommends that the final sentence of section 2.17 be rewritten as follows: "which would include any change in executive compensation that constitutes a material change". The same commenter notes that there does not appear to be any policy basis to distinguish between the disclosure of income trust executive compensation plans and those of corporations, nor should there be a distinction in terms of the requirement to file copies of plans on SEDAR. The same commenter expresses a belief that the current prospectus disclosure requirements are sufficient. Accordingly, the commenter disagrees with the requirement that internal management incentive plans be filed on SEDAR.	We agree with the suggested clarification and we have revised the Policy accordingly. If terms of a management contract or management incentive plan could have a material impact on distributable cash, those terms should be disclosed and those contracts should be listed as material contracts and filed on SEDAR. We believe that it is more likely that terms of these contracts may be material in the context of income trusts than for other issuers. Therefore, while the test applied is the same, the results of applying that test may be that a greater number of those contracts are material.
29.	Executive compensation - disclosure about details relating to external management parties	One commenter notes that if management has decided to use an external management party, the justification and benefits of using external management should be clearly disclosed. Any formula used to compensate external management should be laid out in clear terms for investors to analyze.	We have added language to the Policy to explain that all terms relating to the compensation of external management, that could have an impact on distributable cash, should be disclosed. In this scenario, an explanation about why an issuer decided to use an external management company rather than retain an internal management structure can be important information for investors.
30.	Stability ratings (Sections 2.10 - 2.12) - potentially confusing and a possible false sense of security	Many commenters are concerned that our emphasis on disclosure of stability ratings, or the reasons why an issuer did not obtain one, may confuse investors and provide them with a false sense of security. As stability ratings are issued by bond rating agencies, some commenters believe that the ratings perpetuate a myth that income trusts are similar to bonds. Investors may be led to believe that they are investing in a fixed-income security. One commenter notes that the private enterprises that produce stability ratings are not unlike investment management firms. Both analyze income trusts in an attempt to determine whether the distributions are sustainable. The commenter notes that the individuals producing stability ratings are as prone to error as investment managers. The commenters generally believe that the most effective method of comparing income trusts is via	We acknowledge the comments of the commenters. Although we continue to believe that stability ratings provide investors with a valuable tool for comparing their investments in different income trust issuers, we have removed the recommendation that issuers provide disclosure about the absence of a stability rating. However, we continue to expect issuers to disclose the rating, if one has been obtained, consistent with the prospectus form requirements.

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		rigorous, fundamental equity research, which is similar for comparisons among regular share corporations. Rather than relying on stability ratings, investors should be able to assess an investment in units of an income trust on the same basis as they would assess an investment in the securities of a regular share corporation. Several commenters note that there is no pervasive use of stability ratings to date. Certain income trusts may be suitable candidates for stability ratings but many are not due to the volatile and complex nature of their operations. One commenter notes that the capital markets currently effectively require certain types of income trusts to obtain stability ratings. The commenter believes that use of a rating should be governed by the requirements of the markets. Several commenters are concerned that the imposition of mandated stability ratings would add increased costs to issuers, particularly smaller capitalization issuers, without adding equivalent benefit to investors. Management time and operating expense associated with obtaining a rating is not necessarily helpful to investors nor in their best economic interests.	
31.	Stability ratings (Sections 2.10 - 2.12) - recommended disclosure about change in stability rating	One commenter notes that where an income trust has a stability rating and there is a change in that rating, positive or negative, it is important to provide a reminder that such a change would constitute material information that would require immediate disclosure to the public.	We agree that this type of information would be material information that public investors should receive by way of a material change report. We believe that this requirement already exists within our current legislative framework, but we added a reminder to the Policy.
32.	Determination of unit offering price (Section 2.13)	One commenter notes that many REIT declarations of trust require an appraisal for every acquisition of real property throughout the life of the REIT. Asking for this disclosure with respect to every such valuation would result in the disclosure of much sensitive confidential information, and would also represent an unfair burden to REITs compared to traditional share corporations. The commenter believes that this requirement should be deleted.	The Policy does not recommend disclosure of every appraisal of real property throughout the life of a REIT. Our intention is to provide investors with disclosure about how the unit offering price is determined at the time of the initial public offering. This is because many investors are not aware of how that price is determined, since the process differs from the valuations that occur in a more traditional, direct initial public offering. We have clarified the Policy to explain that the valuation section applies in the context of an initial public offering rather than in the context of subsequent offerings and acquisitions.
33.	Continuous disclosure (Part 3)	Several commenters emphasize that income trust issuers must provide a suitable portrayal of the possible risks and potential adverse consequences of owning a narrowly focused business, particularly in the risk section of the prospectus and in the MD&A section of ongoing financial reports. The portrayal	We agree with this suggestion, and we have added language to the Policy to explain, in particular, our recommendation that relevant disclosure be provided in both the prospectus and in the MD&A.

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		should be thorough but comprehensible to the average retail investor.	
34.	Continuous disclosure - annual certification	A number of commenters express concern about annual certification of compliance with the undertakings provided under section 3.1 and suggest that the certification be included as an additional requirement of management information circulars, AIFs or annual reports as opposed to being a stand-alone filing.	We have decided not to remove the annual certificate recommendation in section 3.1 of the Policy. We note that we are in the process of adding a separate filing subtype to SEDAR entitled "annual certification". This will enable issuers and filing counsel to easily file the annual certificate on SEDAR. We have referred the suggestion to incorporate the annual certificate into a continuous disclosure document such as the AIF, to the continuous disclosure working group as a possible amendment to the continuous disclosure rule.
35.	Continuous disclosure - consolidation under GAAP	One commenter notes that financial reporting should be governed by GAAP (as is the case for corporate reporting issuers). The commenter does not believe that special reporting requirements are warranted for income trust issuers.	We agree that financial reporting should generally be governed by GAAP. However, we also believe that, in the case of income trust issuers, investors need financial information about the operating entity in order to have all relevant information about their investment. For this reason, we have determined that it is important for investors to receive separate financial information about the operating entity in situations where GAAP does not require consolidation. We note that we expect to receive the undertaking described in this part even in situations where a prospectus includes consolidated financial results. This will ensure that investors continue to receive necessary information about the operating entity for as long as it remains a significant asset of the income trust, if the income trust ceases to consolidate the operating entity's financial results at some point in the future. We note that we are creating a separate SEDAR filing subtype entitled "operating entity financial statements", under which the separate financial statements can be filed. In cases where consolidation is required, we do not expect that separate financial information be provided.
36.	Continuous disclosure - information about distributed and distributable cash	Several commenters note, in response to a specific request for comment, that a comparison of distributed and distributable cash to expected distributable cash increases accountability and provides investors with readily available analysis. The continuous disclosure policy should consider that a fund's distribution policy changes over time and therefore a comparison to the targets originally outlined in a prospectus may not be appropriate.	We agree with the views expressed by the commenters, and have added language to the Policy to express our expectation that issuers provide a comparison of distributed and distributable cash to expected distributable cash on a continuous basis.

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37.	Continuous Disclosure - OSC Rule 61-501 and Q-27 undertaking (Section 3.1)	One commenter submits that the undertaking with respect to Ontario Securities Commission Rule 61-501 *Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions* (Rule 61-501) and the AMF's regulation entitled Policy Statement No. Q-27 *Protection of Minority Securityholders in the Course of Certain Transactions* (Q-27) should only be required to the extent that GAAP prohibits the consolidation of financial statements of the income trust and operating entity.	We have deleted the references to Rule 61-501 and Q-27 in the undertaking due to amendments to Rule 61-501 and Q-27 that address income trusts.
38.	Continuous Disclosure - operating entity financial statements (Section 3.1)	One commenter notes that the proposed requirements for disclosing operating entity financial statements should apply to income trusts in the same manner as they apply to holding companies. The commenter also inquires into what is meant by "significant asset".	Income trusts and regular share corporations are treated equally in situations where GAAP requires consolidation. Therefore, we do not expect to see separate financial statements of the operating entity where its financial results are consolidated. However, we view the income trust offering as an indirect offering of the underlying operating entity, and the operating entity is frequently the only significant asset of the income trust. Therefore, in situations where GAAP does not require consolidation of the operating entity financial results into the income trust's financial statements, and the operating entity represents a significant asset of the income trust, we have recommended that separate financial statements of the operating entity be provided. This ensures that investors are provided with meaningful disclosure about their investment. Income trusts and their advisors should determine whether the operating entity is a significant asset of the income trust based upon their particular circumstances.
39.	Comparative financial information (Section 3.2)	One commenter notes that there may be circumstances where comparative information is not available on a basis that is relevant or not available at all, particularly if assets have been purchased from multiple parties. Several commenters note that it may not be appropriate to assume that comparative financial information can be provided. They note that preparing comparative information for periods prior to an income trust's IPO can be problematic and may not be particularly helpful when presented together with information from post-IPO periods. This is because the operating business may not have only operated in a different form but may have been operated as a division of a larger enterprise or the operating business itself may consist of assets and businesses previously owned and conducted in whole or in part by a variety of legal entities.	We agree that there may be unique situations where providing comparative information would not be appropriate. For example, this may occur in situations where the income trust is formed as a result of multiple acquisitions. In these circumstances, we would consider accepting an explanation within the notes to the financial statements or in the MD&A, as applicable.
40.	Definition of	Several commenters feel that it is inappropriate to	We are not amending the definition of insider

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	insider (Section 3.4)	amend the definition of insider through undertakings as opposed to the more appropriate mechanism of legislative amendment.	under the legislation through the undertaking suggested in the Policy. Securities legislation provides the securities regulatory authority or regulator with the discretion to refuse a receipt for a prospectus where it is in the public interest to do so. One issue that we often face with income trust prospectuses is whether it is in the public interest to issue a receipt when persons who would be insiders if the operating entity went public in a direct offering avoid the insider reporting and trading provisions of securities legislation because of the income trust structure. A practice has developed to address this issue where income trusts provide the undertaking described in the Policy. We wish to make this practice transparent through the Policy so that issuers are aware of our concern and have a suggested approach when planning their offerings. We agree that in the longer term, this concern could be addressed through legislative amendment, which is already occurring in some jurisdictions (see consequential amendments to the *Securities Act* (Alberta), in effect July 1, 2004). In the interim, however, our concern regarding insiders of an operating entity can be addressed through other means such as the undertakings described in the Policy.
41.	Undertaking relating to insiders - "appropriate measures" (Section 3.4)	One commenter notes that the Policy does not define "appropriate measures", and it would appear that one of the only methods to do so would be through employment covenants. This might prove to be impractical, and could lead to undesirable results. Another commenter points out that as insider reporting is the responsibility of the individual and not the entity, it is impractical to expect an income trust to enter into contractual commitments with external persons not covered by the insider rules but who possess material undisclosed information about the trust. The best the income trust could be expected to do would be to notify these individuals, but it should not be held responsible for the actions of persons over which it has no authority.	We acknowledge that income trusts may have to resolve some practical issues in implementing the undertakings suggested in the Policy. We do not intend to define exactly which measures are appropriate. We believe that income trusts and their advisors are in the best position to judge what measures are appropriate based upon their particular circumstances.
42.	Undertaking relating to insiders - third party managers (Section 3.4)	One commenter agrees that insiders of the operating entity should be caught by the ambit of insider trading reporting rules as if the operating entity was the reporting issuer and suggests that a similar policy concern apply to third party managers.	We agree with the commenter. The Policy provides that there may be situations when we will request that additional undertakings be provided. Note that in Alberta, recent legislative amendments deem certain persons to be insiders of an income trust, such as the operating entity and manager of an income trust.
43.	Prospectus liability - support for clarification (Part 4)	One commenter welcomes clarification on the issue of prospectus liability. The commenter notes that it is critical to market integrity that issuers who access Canadian capital markets do so with transparency and	We acknowledge the support of the commenter.

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		full accountability. Vendors or promoters who indirectly access our capital markets through income trusts and other indirect offerings should be held accountable for their actions as they would be in a direct offering.	
44.	Prospectus liability - rule versus policy (Part 4)	One commenter notes that certain statements in the Policy (such as staff's view about application of the definition of "promoter") may be an improper modification of legislation.	The Policy is a CSA policy and reflects the views of the securities regulatory authorities across Canada. It is not a CSA staff notice. We are not amending or modifying the definition of "promoter" where it exists under Canadian securities legislation. We provide guidance on how the definition of promoter under securities legislation may apply in the context of income trust offerings. Securities legislation also provides the securities regulatory authority or regulator with the discretion to refuse a receipt for a prospectus where it is in the public interest to do so. An issue we often face with income trust prospectuses is whether it is in the public interest to issue a receipt when persons who would be selling security holders if the operating entity went public in a direct offering, avoid selling security holder provisions of securities legislation because of the income trust structure. A practice has developed to address this issue where selling security holders who are not promoters accept liability similar to that provided under the selling security holder provisions of securities legislation by entering into contractual arrangements with the issuer regarding the disclosure in the prospectus. We wish to make our concerns with this practice transparent through the Policy so that issuers are aware of our concerns and have a suggested approach when planning their offerings. We acknowledge that in the longer term, our concerns with the applicability of selling security holder provisions could be addressed through legislative amendment. In the interim, however, our concerns with vendors who are akin to selling security holders can be addressed through other means as discussed below.
45.	Prospectus liability - definition of promoter (Section 4.3.1)	One commenter states that it is not clear whether the receipt of proceeds in and of itself is contemplated as defining those who should be within the statutory definition of "promoter" in all jurisdictions. However, in most instances the commenter notes that it would expect the regulators to require vendors who receive substantial proceeds to execute a certificate as a promoter on the basis that they have had sufficient involvement in the founding, organizing or reorganizing of the trust.	We do not intend to create the impression that the receipt of proceeds in and of itself is contemplated as defining those who should be within the statutory definition of "promoter". We agree with the commenter that vendors who receive significant proceeds from an offering in consideration of services or property in connection with the founding, organizing or substantial reorganizing of an income trust may be promoters under securities legislation and required to execute a certificate in the prospectus. It is a question of fact whether a vendor is a promoter under

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			securities legislation. We have amended the guidance provided in the Policy regarding promoters.
46.	Prospectus liability and distinction between arm's length and non-arm's length transactions (Part 4)	A number of commenters note that there is no clear distinction between arm's length and non-arm's length transactions in this part of the Policy. In other words, one commenter notes that it would be helpful if the Policy made it clear that where there is a bona fide arm's length negotiation between the issuer and vendor and the vendor is not involved in the offering process and does not have the ability to materially affect control of the issuer, the principles set out in Part 4 do not apply. This concern was specifically highlighted by one commenter in the context of REITs.	We generally agree with the commenters. Our concerns lie primarily with vendors that 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). Where the transaction is a bona fide arm's length transaction, these concerns do not generally arise. We have amended the guidance provided in the Policy to address this issue.
47.	Prospectus liability - private equity investors (Part 4)	According to one commenter, in circumstances where the vendor is not acting as principal but, instead, is managing the investment on behalf of others (this is typically the case with private equity investors), the fund manager should only have liability for prospectus disclosure if it has acted in a manner analogous to a control person. For example, with private equity investors, it is typical for the asset management company to occupy one or more positions on the board and to have a fairly active involvement with senior management of the company. In these circumstances, it can fairly be concluded that the fund manager possesses a high degree of knowledge regarding the issuer and is in a position to accept liability for prospectus disclosure. The amount of this liability should be no greater than the proceeds realized by the fund manager as a result of the public offering.	As discussed above (Comment 45.), it is a question of fact whether a vendor has acted as promoter of an income trust. The presence of a private equity fund's asset manager on the operating entity's board of directors and fairly active involvement with senior management could indicate that a private equity fund has acted as a promoter. If, however, the particular factual circumstances indicate that a private equity fund or vendor did not take the initiative in founding the income trust or is not receiving proceeds in consideration of services or property under the offering in connection with the founding of the income trust, such a vendor may not be a promoter under securities legislation. Such a vendor may be more akin to a selling security holder under securities legislation. If the private equity fund or vendor is more akin to a selling security holder than a promoter, we expect that income trusts and vendors will address the potential loss, due to the income trust structure, of any rights and remedies with which securities legislation provides investors against vendors in a direct offering. We agree with the commenter that a vendor that has acted in a manner analogous to a control person is in a position to accept liability for prospectus disclosure. Public interest concerns regarding the potential loss of statutory rights and remedies could be addressed by a private equity fund or vendor accepting liability by entering into contractual arrangements that provide investors with similar rights and remedies against the vendors to those afforded by securities legislation in a direct offering. The vendor's liability could be subject to a due diligence defence. We expect that the amount of this liability would be commensurate with the proceeds realized by the vendor or the fund manager on behalf of the private equity fund under the public offering.
48.	Meaning of	One commenter notes that it should be possible to	We agree with the commenter and have amended

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	promoter - "significant portion" (Section 4.3.1)	ultimately receive some amount of the offering proceeds without being considered a promoter.	the guidance provided in the Policy to address this issue.
49.	Description of vendors' representations, warranties, and indemnities (Section 4.4.3)	One commenter disagrees with the requirement to provide a "detailed description of the vendors' representations, warranties and indemnities contained in the acquisition agreement". The commenter expresses skepticism over whether such summary disclosure is possible, without reproducing the entire list of representations.	We believe that an income trust should be able to provide an investor with meaningful disclosure without reproducing the entire list of representations. The purpose of the disclosure is two-fold. The first purpose is to alert investors that they may not have the same statutory remedies against the vendors as they would have in a direct offering. The second purpose is to inform investors what protections have been negotiated between the parties as a meaningful alternative to the remedies that may not be available to investors under securities legislation on account of the income trust structure.
50.	Sales and marketing materials (Part 5)	Several commenters believe that the expectation to file sales and marketing materials should apply to all issuers, not only to income trust issuers. Another commenter states that issuers should not be held responsible for documents like green sheets, which are the responsibility of underwriters and over which the issuer has limited control. Several commenters also note that the definition of yield in section 5.1 is confusing. For example, one commenter notes that the term "yield" is normally used to mean the total amount to be distributed by an issuer, divided by the market price of the particular share or unit, expressed as a percentage. The commenters question the exclusion of return of capital and suggest that it is more appropriate to refer to taxable and tax deferred distributions.	We continue to feel that it is appropriate to expect income trust issuers to file sales and marketing materials with their preliminary prospectuses based on the specific concerns that we have with respect to income trusts and other indirect offerings that are marketed primarily on the basis of yield. We may ask other issuers to file their sales and marketing material when similar concerns arise. We have revised the definition of yield in section 5.1 to address the concerns raised.

Appendix C
to Notice

Comparison between proposed and final versions of National Policy 41-201 Income Trusts and Other Indirect Offerings

~~6.1.2 Proposed~~ National Policy 41-201 Income Trusts and Other Indirect Offerings

~~PROPOSED~~ 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 offerings, in order to minimize inconsistent interpretations and to better ensure that the intent of the requirements is preserved. Our concerns relate to the quality and nature of prospectus disclosure and continuous disclosure records, 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 framework captures the issues relating to income trusts and other indirect offerings. Our goal is to provide guidance and recommendations about how income trusts and other indirect offering structures fit within the existing regulatory framework rather than create a new regulatory framework 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. 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 principles can apply more generally to issuers that offer securities which entitle holders of those securities to the 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 ~~final~~ prospectus where it would appear that the offering may be contrary to the public interest due to insufficient disclosure, structure of the offering, or a combination of the two~~. Many of the principles that we describe apply equally to direct offering structures~~.

Although the main focus of this policy is on the income trust structure in the context of public offerings, 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 ~~resulting prospectus-level disclosure~~information circular provided to relevant security holders, and that contains prospectus-level disclosure, will follow the principles set out in this policy. The principles that we describe also apply to income trusts in the fulfillment of their ongoing continuous disclosure obligations. 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.

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 entitle the holder to ~~substantially all of the~~ 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 proposed 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 which 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~~ (the operating entity). Substantially all of the net~~. Net cash flows that are generated by the operating entity's business are distributed to the income trust. The income trust then distributes that cash flow to its investors (referred to as unitholders or investors).

An income trust focuses on the ownership and management of assets of the operating entity.~~ The principal purpose of the income trust is to distribute cash generated by the operating entity to its unitholders.~~

Often the pre-offering owners (referred to as owners or vendors) of the operating entity (or its predecessors) sell less than their entire interest in the operating entity to the income trust. Through their retained ownership interest, the vendors ~~participate~~have a role in what the distributions of the operating entity's net income will be.

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 proceeds that the income trust raises are used 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 (IPO), 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. ~~Vendors~~Non-arm's length vendors that are involved in a ~~non-IPO~~follow-on offering~~ process~~ 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 - Prospectus disclosure

We describe below certain unique attributes of income trusts that we expect to be included in prospectus disclosure. We ~~would like~~recommend that these attributes, and the offering generally,~~ to~~ be described in a simple, clear and readable manner to ensure that investors understand the nature of their investment.

A. Distributable cash

2.1 What is distributable cash?

Distributable cash 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. 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, and the number of units outstanding.

2.2 Does an income trust's distributable cash provide an investor 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). The trust's ability to consistently make distributions to unitholders will fluctuate depending on the operations of the operating entity or the performance of the income trust's assets (such as income-producing real estate properties or oil- and gas-producing properties).

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 ~~non-taxable~~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 ~~non-taxable to a unitholder (but~~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 maintaining specified financial ratios or satisfying 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 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 include language ~~on the prospectus cover page~~ substantively similar to the following ~~would be helpful~~on the prospectus cover page:

~~The pricing of the units has been determined, in part, based on the estimate of distributable cash for the year ended~~A return on your investment in • ~~on page •.~~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 ~~unitholders~~you, these cash distributions ~~are not assured~~may be reduced or suspended. The actual amount distributed will depend on numerous factors including~~ the operating entity's financial performance, debt covenants and obligations, working capital requirements, future capital requirements and, if applicable, the deductibility for tax purposes of interest payments on the debt of the operating entity – [these details can be tailored according to the specific set of circumstances in each transaction]. The~~: [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 ~~deteriorate~~decline if the income trust is unable to meet its cash distribution targets in the future, and that ~~deterioration may be material~~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.] This 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 ~~will depend, in part, on the composition for tax purposes of distributions paid by the income trust (portions of which may be fully or partially taxable or may constitute non-taxable returns of capital). The composition for tax purposes of those distributions~~can be made up of both a return on and a return of capital. That composition may change over time, thus affecting ~~the~~your after-tax return~~ to unitholders. The estimated portion of your~~. [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 ~~is •~~ and the estimated portion that will be taxed as return of capital~~ is •~~.] Returns on capital are generally taxed as ordinary income or as dividends in the hands of a unitholder. Returns of capital are generally ~~non-taxable to a unitholder (but~~tax-deferred (and reduce the unitholder's cost base in the unit for tax purposes).

~~An investment in the units is subject to a number of risks that should be considered by an investor. See "Risk Factors".~~

B. Distributable cash – non-GAAP measures

2.5 What disclosure do we expect about the income trust's estimate of its distributable cash?

~~Distributable cash is often presented in a manner, and based on financial measures, that is not prescribed by generally accepted accounting principles (GAAP). Frequently, income trusts refer to "EBITDA" (earnings before interest, taxes, depreciation and amortization) and "adjusted EBITDA" as being relevant measures of their performance (on the basis that investors are concerned primarily with cash flow). Income trusts frequently derive their distributable cash estimates from these amounts. In presenting adjusted EBITDA, income trusts commonly make and incorporate assumptions about how the operating entity's business will be conducted post-offering. These include assumptions about capital expenditures, financing costs and administrative expenses, resulting in a distributable cash figure. Therefore, we expect any assumptions made to be clearly explained.~~

We remind issuers to refer to the guidelines contained in CSA Staff Notice 52-~~303~~306 – *Non-GAAP ~~Earnings~~Financial Measures*.

C. ~~Short-term~~Material debt

2.6 Why are we concerned about ~~the operating entity's short-term~~material debt?

We are concerned about debt obligations that are ~~renewable within 5 years or less that ~~incurred by the operating entity~~ has negotiated with persons other than the income trust (referred to as short-term debt). Those obligations typically rank before the operating entity's obligations to the income trust and, consequently, to~~ or other entity that rank before unitholders' entitlement to receive distributable cash. 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.

2.7 What disclosure do we expect about ~~short-term~~material debt?

We expect the principal terms of the ~~operating entity's short-term~~material debt to be included in the income trust's prospectus. This would include the following information about the debt:

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

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

(c) the term at which the debt is renewable, and the extent to which that term could have an impact on the ability to distribute cash,

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

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

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

2.8 Are agreements relating to the ~~operating entity's short-term~~material debt considered to be material contracts of the income trust?

We consider that in most cases, agreements relating to the ~~operating entity's short-term~~material debt that have been negotiated with a lender other than the income trust, will be material contracts if terms of 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, we expect it to be listed as a material contract in the prospectus. We also expect a copy of ~~that~~the material agreement to be filed on SEDAR upon its execution.

2.9 Do we expect the income trust to include a separate risk factor about ~~short-term~~the material debt?

Yes. We expect the income trust to include a separate risk factor about the ~~operating entity's short-term~~material debt in the income trust's prospectus. We recommend that the risk factor include a discussion of the following points:

(a) the need for the ~~operating entity~~borrower to refinance ~~its short-term~~the debt when the term of that debt expires,

(b) the potential negative impact on distributable cash if the debt is replaced by new debt that has less favourable terms,

(c) the impact on distributable cash if the ~~operating entity~~borrower cannot refinance the debt, and

(d) the fact that distributions from the operating entity to the income trust may be restricted if the ~~operating entity~~borrower fails to maintain certain covenants under the credit agreement (such as a failure to maintain certain customary financial ratios).

D. Stability ratings

2.10 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.

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

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

We believe that choosing to invest in income trust units is, in substance, a decision to purchase the cash flow generated by the operating entity. The presentation of distributable cash in an income trust prospectus is often the best measure available to an investor of the issuer's potential to generate and distribute cash. However, ~~as discussed in this policy,~~ we are concerned that the use of non-GAAP measures by income trust issuers makes it difficult or impossible for investors to compare income trusts. Therefore, it is difficult to compare the risk of investing in one income trust relative to the risk of investing in another. We believe that stability ratings can supplement the presentation of distributable cash in the prospectus 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.

2.12 ~~Do we expect an income trust to disclose whether it has or has not received a stability rating?~~

~~Yes. We expect the income trust to state on the prospectus cover page whether it has or has not received a stability rating. If an income trust chooses not to obtain a stability rating, we recommend that the income trust describe on the prospectus cover page its reasons for choosing not to obtain a rating.~~ ~~**2.13**~~ **What disclosure do we expect about an income trust's stability rating?**

~~As described above, if~~If an income trust has received a stability rating, we expect the rating to be described on the cover page of the prospectus. ~~To assist investors, we recommend that the income trust explain within the prospectus that a stability rating~~ We expect the income trust to 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 entitled Policy Statement No. Q-28 *General Prospectus Requirements* (or its successor), or section 8.7 of Form 44-101F3 *Short Form Prospectus* (or its successor). We recommend that this disclosure explain that a rating measures an income trust's ~~stability~~ stability relative to other rated Canadian income trusts ~~rather than relative to all income trusts. We expect the explanation to be substantively similar to the following:~~within a particular sector or industry. We also remind issuers of their statutory obligation to make timely disclosure of any material change in their affairs, which would include any change in a stability rating that constitutes a material change.

> ~~• has assigned a stability rating of • to the Units. The rating is based on a rating scale developed by •, which characterizes the stability of cash distribution streams. •'s stability analysis encompasses the variability and sustainability of a cash distribution stream in the medium to long-term with a single stability rating of • through •. Variability in the distribution stream refers to changes in the distribution from period to period over a business cycle, while sustainability of the distribution stream refers to the length of time that distributions can likely be made. Together, these two characteristics are referred to by • as the stability profile of the issuer. The stability rating scale is organized such that a rating of • signifies the lowest level of cash distribution variability and the highest level of cash distribution sustainability, while a rating of • signifies the highest level of variability and the highest amount of uncertainty in the sustainability of the cash distribution stream. A rating is not a recommendation to buy, sell or hold any security, and may be subject to revision or withdrawal at any time by •.~~

E. Determination of unit offering price

~~2.14~~2.13 What disclosure do we expect about the determination of the price of an income trust's units?

We do not currently ask 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 an initial public offering, we expect the income trust to describe the valuation in the prospectus and to file ~~the text of~~ the valuation on SEDAR. We expect the description to 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, we expect the prospectus to disclose that fact and to state that the value was determined solely through negotiation between the operating entity security holders and the underwriter(s).

F. Executive compensation

~~2.15~~2.14 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. We expect the income trust to provide that information in its prospectus as ~~though~~if the operating entity is a subsidiary of the income trust at the time that a ~~final~~ receipt for the prospectus is issued. We also remind issuers of their obligation under securities legislation to provide unitholders with executive compensation disclosure on ~~a continuous~~an ongoing basis.

~~2.16~~2.15 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 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. We expect disclosure about those contracts and plans to be included in the prospectus. If those contracts and plans have not been finalized, we expect the anticipated material terms to be described in the prospectus.

~~2.17~~2.16 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 ~~2.16~~2.15 to be filed on SEDAR. If those material contracts and plans have not been finalized before filing the ~~final~~ prospectus, we expect the income trust to provide an undertaking from the income trust and the operating entity to the securities regulatory authorities that those contracts and plans will be filed as soon as practicable after execution. We also remind issuers of their statutory obligation to make timely disclosure of any material change in their affairs, which would include any ~~material change to prospectus disclosure about executive compensation.~~change in executive compensation that constitutes a material change.

G. Risk factors

2.17 General

We remind issuers of their obligation to disclose all relevant risk factors relating to the offering in the prospectus. We recommend that the description include the principal factors related to this specific offering that could affect the predictability of cash flow distributions to unitholders. We also recommend that issuers assess the likelihood of a risk occurring as well as the potential consequences to a unitholder if a risk should occur. Relevant risk factors can 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.

Part 3 - Continuous disclosure

Reporting obligations relating to the operating entity

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

We believe that 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 management discussion and analysis for those 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.

~~In addition, if the operating entity is a party to a "related party transaction" as defined in Ontario Securities Commission Rule 61-501 *Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions* (Rule 61-501) and in the CVMQ's regulation entitled Policy Statement No. Q-27 *Protection of Minority Securityholders in the Course of Certain Transactions* (Q-27) (and any successor to Q-27), compliance with those rules will be expected.~~

To the extent the securities legislation in some CSA jurisdictions is 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, we expect the issuer to file an undertaking with the regulatory authorities prior to receiving a receipt for a~~ final~~ prospectus. We expect the undertaking to provide that while the issuer is a reporting issuer:

(i) 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 prohibit the consolidation of financial information of the operating entity and the income trust, we expect that, for as long as the operating entity (~~and~~including any of its significant business interests) represents a significant asset of the income trust, the income trust will provide unitholders with separate financial statements for the operating entity (~~and~~including information about any of its significant business interests), and

(ii~~) the income trust will obtain a commitment from the operating entity to comply with Rule 61-501 and Q-27, as applicable, as if the operating entity were a reporting issuer and the income trust's unitholders held directly those securities of the operating entity which are held directly or indirectly by the income trust, and(iii~~) 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 are 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. In those types of scenarios, we expect the income trust to ensure that it can follow the guidance described in this section 3.1 either through terms of the acquisition agreement or otherwise.

3.2 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.

~~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.~~

~~Recognizing that the legal structure of the entity has changed, and to ensure the continuity and the comparability of the periods presented for the statements of operations and cash flows, an income trust may want to present, using columns: (i) the results of the reporting period relating to the previous legal entity prior to the inception of the trust, (ii) the results of the reporting period from the creation of the income trust to the balance sheet date, and (iii) the results for the complete reporting period that would represent the aggregate of the results of (i) and (ii) on a pro forma basis. We expect the results for the complete reporting period to be shown in the financial statements. The information for the period prior to and after the creation of the income trust may be shown within, or in the notes to, the financial statements.~~

For those acquisitions accounted for by the purchase method, we expect income trusts to provide comparative financial information for the predecessor business in their interim and annual MD&A. Examples of relevant comparative information would include, but would not be limited to, the following:

- ~~Revenues/Sales~~revenues/sales,
- ~~Cost of Sales~~cost of sales,
- ~~Gross Margin~~gross margin,
- ~~General and Administrative Expenses, and~~general and administrative expenses, and
- ~~Net Income~~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 may believe that providing comparative information would not be appropriate, such as in certain situations where the income trust is formed as a result of multiple acquisitions, we encourage the issuer to engage in discussions with the relevant securities regulatory authority(ies) prior to filing the applicable continuous disclosure document(s).

3.3 Recognition of intangible assets

We remind income trust issuers that GAAP requires the appropriate recognition of all intangible assets on acquisitions to be accounted for under the purchase method. We encourage income trusts to provide a description of the method used to value the intangible assets in the offering document, so that investors may assess the objectivity of the valuation process.

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

Consistent with our belief that the performance and prospects of the 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 trust.

To the extent the securities legislation in certain CSA jurisdictions is 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 ~~final~~ prospectus. 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 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 trust), and (ii) comply with statutory prohibitions against insider trading. The income trust is expected to annually certify in the certificate described in section 3.1(iii) 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 request that additional undertakings be provided. The income trust will need to obtain the contractual commitments from the persons and entities in order to comply with these undertakings.

Recent amendments to securities legislation in Alberta deem insiders of operating entities and management companies to be insiders of the income trust. Until similar clarifications are adopted in other jurisdictions, we will continue to expect income trusts to provide the undertaking described above.

3.5 Management's discussion and analysis (MD&A)

3.5.1 Risks and uncertainties

We recommend that an income trust disclose, in its interim and annual MD&A, the specific risks and uncertainties relating to the operations of the underlying operating entity or the income trust's assets, as applicable, and the potential impact of those risks and uncertainties on future distributions of the income trust.

3.5.2 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 distributed cash that they receive, including whether the issuer borrowed amounts to finance the distribution, and whether distributions include amounts other than a return on capital. We therefore recommend that an issuer disclose in its interim and annual MD&A: (i) the source(s) of funding for distributions made in the current period to unitholders (such as cash generated by operations, borrowed funds, etc.), (ii) the breakdown between return on and return of capital for distributed cash, if available, and (iii) where applicable, a comparison between the expected distributable cash figure disclosed in the initial public offering document or circular, as applicable, and actual distributed cash.

Part 4 - Prospectus liability

4.1 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 liability. To provide discipline on prospectus disclosure, and to protect the integrity of the Canadian public markets, securities legislation imposes liability on certain persons involved in a public offering for any misrepresentation (as defined in applicable securities legislation) in a prospectus. Specifically, where a prospectus contains a misrepresentation, investors have the right to either rescind their purchases or to claim damages from the issuer or selling security holder that sold the securities, 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 experienced by investors as a result of the misrepresentation(s). We note that 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.

4.2 How does the regulatory framework about 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.

With respect to prospectus liability, what is different in the context of an indirect offering is that 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, which issue is addressed below) have statutory liability for a prospectus misrepresentation as they would if their operating entity security interests 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 issuer.

4.3 Promoter liability

4.3.1 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* (Quebec), and a broad approach is taken in Quebec 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.

4.3.2 What constitutes the "business" of the income trust issuer?

In the context of indirect offerings, there appears to be uncertainty about whether the "business of an issuer", as that phrase is often 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 qualify a person as 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 operating entity interest. 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, we would expect this determination to be made by the income trust and the underwriter(s) after reviewing the relevant facts.

4.3.3 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, we expect the prospectus to describe 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. It is also likely that the operating entity would have a limited ability to satisfy the 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 promoter will offer an additional benefit because the value in the operating entity held by vendors as their retained interest would be available to satisfy a damages claim without investors suffering a corresponding decline in the value of their securities of the income trust.

4.4 Contractual accountability

4.4.1 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 agreement (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).

4.4.2 What are our concerns about the application of the regulatory framework 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 ~~that representation~~those representations to be appropriate,~~ and~~

(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.

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

To address the concerns described in section 4.4.2, we expect prospectuses relating to indirect offerings, where part of the proceeds are being paid to vendors, to:

(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, ~~and~~

(iii) ~~(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.

We also expect the summary of the relevant acquisition agreement provisions to 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~~, such as deductibles or other thresholds that preclude indemnity claims against the vendors that are not, individually or in the aggregate, above a certain value or provide that any such claim will exclude or deduct that value or another prescribed amount from the total indemnity claim.~~.

We expect the summary of the acquisition agreement terms to 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 as a basis for the offering through the acquisition agreement, or as a result of signing the prospectus, or otherwise.

4.4.4 What are our concerns about the nature and extent of the representations 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 this responsibility in the context of indirect offerings have included situations where:

(i) certain vendors (active vendors), such as:

- vendors that affect materially the control of the operating entity prior to the offering, and 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 issuer's 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 representation is untrue~~,~~ is limited to an ~~unduly small percentage of~~amount less than the proceeds received by the vendor from the sale of the vendor's interest in the operating entity~~, and~~ 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; 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 an untrue prospectus representation being significantly below the period in which claims may be asserted against the issuer for a prospectus misrepresentation.

If an active vendor's liability for an untrue representation in the acquisition agreement is conditional on the active vendor having knowledge of the inaccuracy, we expect that the active vendor would generally have a corresponding obligation to take reasonable steps to support the representation. For example, we would expect a non-management active vendor to 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 those 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 ~~final~~ prospectus, and in the period following the receipt for the ~~final~~ prospectus until the primary distribution is completed. Along with the distribution of the preliminary prospectus (or ~~final~~ 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 those materials is typically a simplified version of the disclosure in the ~~preliminary (or final)~~ prospectus, and must 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 those 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 ~~(other than a return of capital)~~ that would be generated over a one-year period, as a percentage of the offering price of the units, if the amounts intended to be distributed by the income trust according to its distribution policy are so distributed.

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 distribution entitlement 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 prospectus disclosure (including, in particular, the pro forma presentation of distributable cash in the prospectus). Specifically, we expect expressions of yield in income trust offering marketing materials to 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.

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-~~free”~~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. We expect income trust issuers to 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 – Corporate governance

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

We expect issuers to provide prospectus disclosure about how they will comply with the following instruments or their successors (note that the instruments are not in force in all jurisdictions):

(a) Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*,
(b) Multilateral Instrument 52-110 *Audit Committees*,
(c) Proposed National Policy 58-201 *Corporate Governance Guidelines*, and
(d) Proposed National Instrument 58-101 *Disclosure of Corporate Governance Practices*.

We remind issuers to look 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 Proposed National Policy 58-201 *Corporate Governance Guidelines*.

6.2 Broader corporate law concerns

We are concerned that a unitholder in an income trust may not be afforded the same protections, rights and remedies as a shareholder in a corporation. We therefore recommend that issuers provide the following disclosure to unitholders:

A unitholder in the income trust has substantially all of the same protections, rights and remedies as 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 substantially all of the same protections, rights and remedies as 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 ***].

We further note that 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. We may review an income trust's refusal to provide a unitholders' list as a defensive tactic, as discussed in National Policy 62-202 -*Take-Over Bids - Defensive Tactics* or in Québec Notice 62-202 Relating to Take-Over Bids – Defensive Tactics if a potential offeror follows steps similar to those outlined in section 21 of the *Canada Business Corporations Act* in requesting a unitholders' list.