

Canadian Coalition for
GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

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Sent via e-mail

Dear Sir/Madame,

On behalf of the 46 members of the Canadian Coalition for Good Governance managing over \$1 trillion of assets on behalf of Canadians, we thank you for the opportunity to provide our comments on the proposed amendments to National Policy 41-201 Income Trusts and Other Indirect Offerings (NP 41-201).

The need for a rule

The distributions of an income trust can have an effect on the price of the underlying unit. When distributions are increased, the per unit price of the trust has a tendency to increase and vice versa. We recently saw this occur the day after the Government of Canada's decision to tax income trusts when prices for trusts fell dramatically, erasing billions of dollars of unitholder value.

Given the important role distributions play in the valuation of a trust, it is therefore imperative that unitholders are able to evaluate a trust's distributable cash consistently from trust to trust.

Currently, NP 41-201 is offered as guidance to income trusts. However, we believe it is necessary that the work of the CSA concerning income trusts be made into a rule. A rule is required in this instance to ensure consistency and clarity in the reporting of distributable cash among all income trusts.

Furthermore, a rule is necessary given the other aspects contemplated in NP 41-201. The disclosure of material debt, stability ratings, executive compensation, sales and marketing materials and corporate governance are important issues that an investor should consider before investing in an income trust. Their disclosure should be mandated to afford investors the opportunity to effectively perform their due diligence (including a comparison of trusts) prior and subsequent to making their investment.

In addition, the consistency and clarity of reporting provided in a rule is an advantage to income trusts as it allows them to attract their desired types of investors.

Following are our specific comments on the various parts of NP 41-201.

Part 2 – Distributable Cash

2.1 What is Distributable Cash?

We believe income trusts should avoid using the term distributable income interchangeably with distributable cash as income and cash are not identical. The CSA should develop a formal definition of distributable cash applicable to all income trusts.

The Canadian Performance Reporting Board (CPRB) of the Canadian Institute of Chartered Accountants has done some work defining distributable cash. The efforts of the CPRB in this area are significant and should be incorporated into the work done by the CSA. It is imperative that investors are able to rely on a consistent definition of distributable cash so as to effectively make comparisons among income trusts.

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

An income trust should fully disclose its distribution policy, including any amount of distributable cash retained in a reserve fund for future distributions should operating cash flows be insufficient to fund distributions.

In addition, there should be a commentary on how this reserve fund is maintained, how it is funded (from operations, financing activities, asset sales, etc.) and whether there has been any past usage of the fund.

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

We agree that distributable cash should be reconciled back to cash flow from operations. We also believe that the CSA should prescribe the form used to present this reconciliation to ensure consistency among the trusts and to facilitate analysis by investors.

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

We agree that income trusts should provide full disclosure in this area. Of particular importance is the discussion on subordinate provisions (where an original vendor's entitlement to distributions is subordinated for a set number of years) as this could negatively affect the amount of distributions paid in the future once the subordination agreement expires.

Part 3 – Other disclosure issues

A. Material Debt

We agree that material debt obligations are important and should be disclosed to current and potential unitholders. The policy suggests that this disclosure should be in the prospectus and AIF. We would also find it beneficial to include this information in the annual proxy circular in situations where debt covenants are in danger of being breached.

B. Stability Ratings

In cases where a stability rating was requested by the income trust, we agree that it should be disclosed. We believe that the disclosure should also appear in the annual proxy circular when a poor stability rating has been received.

C. Executive Compensation

We agree that the executive compensation of the operating entity should be disclosed in the annual proxy circular in the same manner that is required under Form 51-102F6. As well, any management contract of the operating entity should be disclosed on SEDAR and either referenced or disclosed in the annual proxy circular.

Part 5 – Sales and marketing materials

Due to the association of the term “yield” with fixed income investments, we believe income trusts should refrain from using this term in their communications as the returns to unitholders are not necessarily constant, as they are with a fixed income investment. More appropriate terms to use would be “return on capital” and “return of capital” (as measured by GAAP). In addition, disclosures should clearly delineate between distributions that are “returns on capital” and those that are “returns of capital”.

Part 6 – Continuous disclosure-specific issues

6.5.2 Discussion of distributable cash

We agree that issuers should provide a detailed explanation of the funding of distributions to allow unitholders to assess the sustainability of the distributions. To promote consistency and clarity, the disclosure should be in the form of a table similar to that provided in the policy. Within the disclosure there should be a clear demarcation between distributions classified as “return on capital” and distributions classified as “return of capital”.

In regards to sections D and E of the table provided in the policy, income trusts should present excesses and shortfalls in both dollars and percentages.

We agree with the disclosure requirements when there is a shortfall of cash (i.e. when distributions are greater than cash flow from operations).

Part 7 – Corporate governance

We agree there should be a discussion comparing the rights and obligations generally available to shareholders of corporations and those available to the unitholders of a trust.

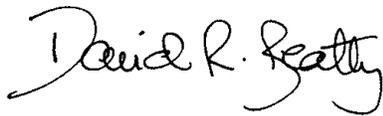
We believe this is important information to disclose as unitholders may be unaware of the difference between a corporation and an income trust with respect to their rights and the obligations of the trust.

The disclosure of this comparison should be included within the annual proxy circular as this is the main communication document between the trust and its unitholders. Unitholders do not receive the AIF as a matter of course nor would they necessarily know this document exists.

Finally, we believe that operating entities, in addition to issuers, should disclose how they will discharge their governance responsibilities, including how they will comply with certain instruments. This information is equally as important to investors as are the methods used by issuers to discharge governance responsibilities.

Should you have any questions on the above, please contact the Coalition. We appreciate the opportunity to be part of this process and look forward to reviewing the final version of NP 41-201.

Yours truly,

A handwritten signature in black ink that reads "David R. Beatty". The signature is written in a cursive, flowing style.

David R. Beatty, O.B.E.
Managing Director