



Cross-Border Income Trusts: Restructuring Issues

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Presentation Overview

- Income Trust Structures:
 - Domestic structures
 - Market vulnerabilities
 - Cross-border structures and U.S. tax issues
- Restructuring Issues
- Recent cross-border cases:
 - Heating Oil Partners Income Fund
 - Calpine Power Income Fund

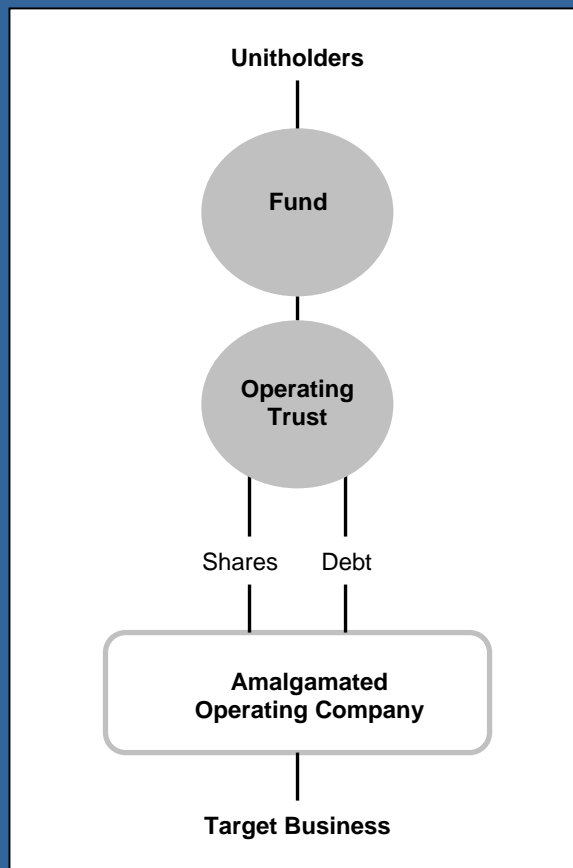


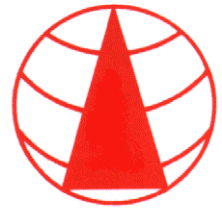
Domestic Income Trusts

- High return and tax efficient investment vehicles
- Tax efficiency a result of:
 - subordinated debt between entities within income trust structure or
 - use of flow-through entities like partnerships
- Leveraged structure allows income to flow through to unitholders on tax deferred basis by avoiding double taxation at operating level

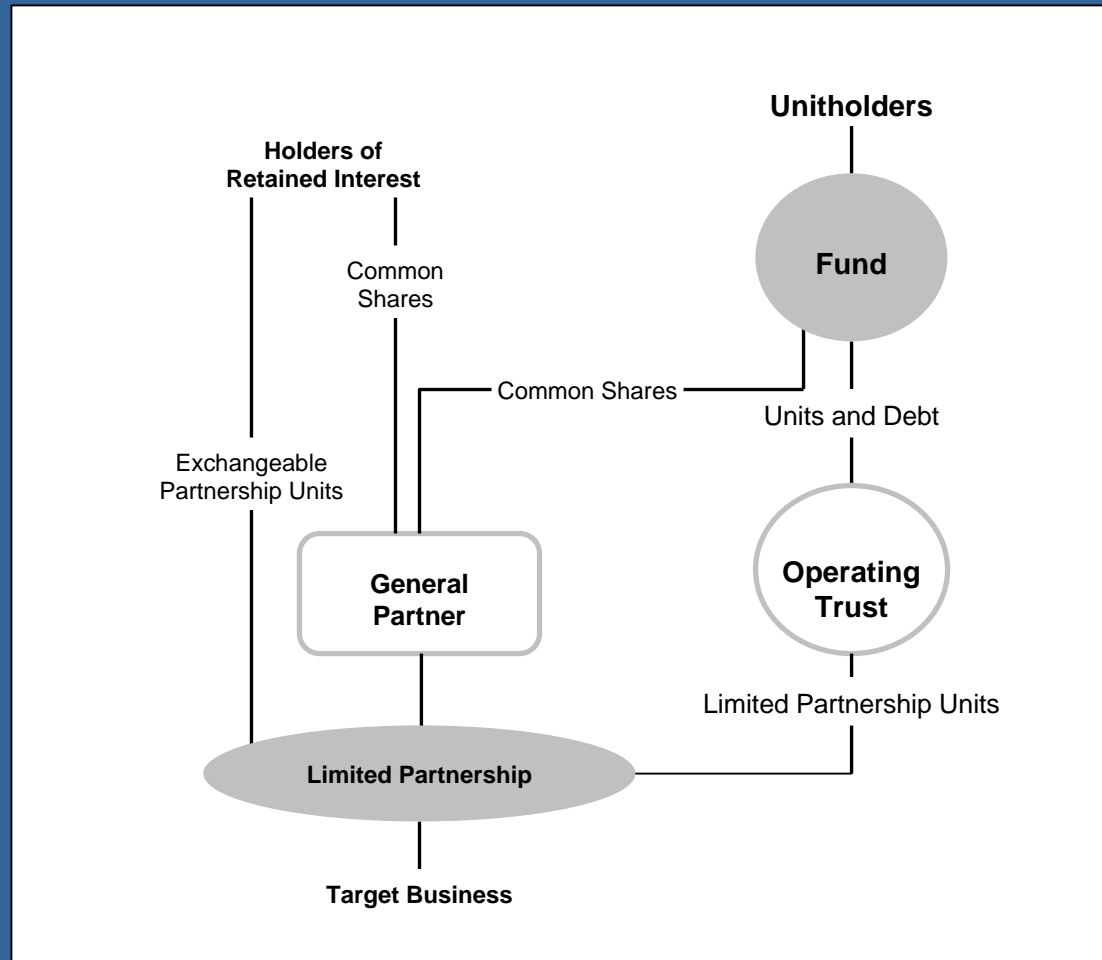


Corporate Income Trust Model





Partnership Income Trust Model





Income Trust Market

- Market capitalization of over \$256 billion
- Initially concentrated in
 - real property (eg. REITs)
 - oil and gas (eg. Royalty Trusts)
 - utilities (eg. Utility Trusts)
- Now - GBITs (general business income trusts)
 - diverse businesses have adopted income trust model



Income Trust Market - GBITs

- Account for market capitalization of \$9 billion
- Ideally suited to mature businesses with predictable cash flows
- Established businesses, Telus Corp. and BCE Inc., recently announced intention to convert assets to GBITs



Vulnerabilities

- Distributions:
 - Income trusts, especially GBITs, have significant obligations to distribute income to unitholders
- Units have inflated market value
- Cash-flow deficiencies may lead to suspension of distributions, leading to drop in unit value
- GBITs more vulnerable because investors' interest is distributions, rather than business growth

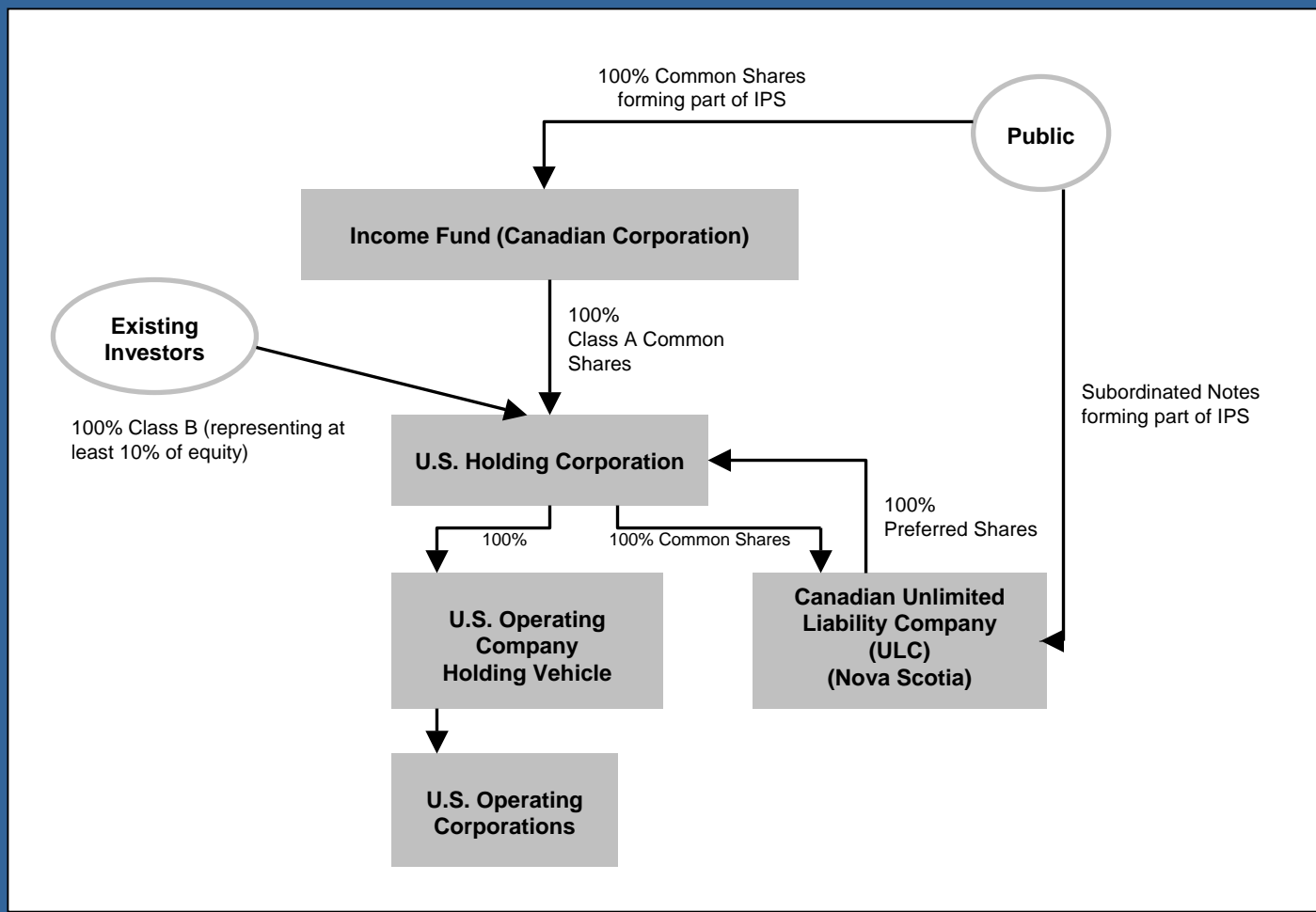


Cross-Border Income Trusts

- New opportunity to raise capital with tax deferral benefits
- Canadian trust holds interest (directly or indirectly) in U.S. operating business
- Historically there have been two forms of cross-border model:
 - U.S. Corp. “C”
 - Partnership model

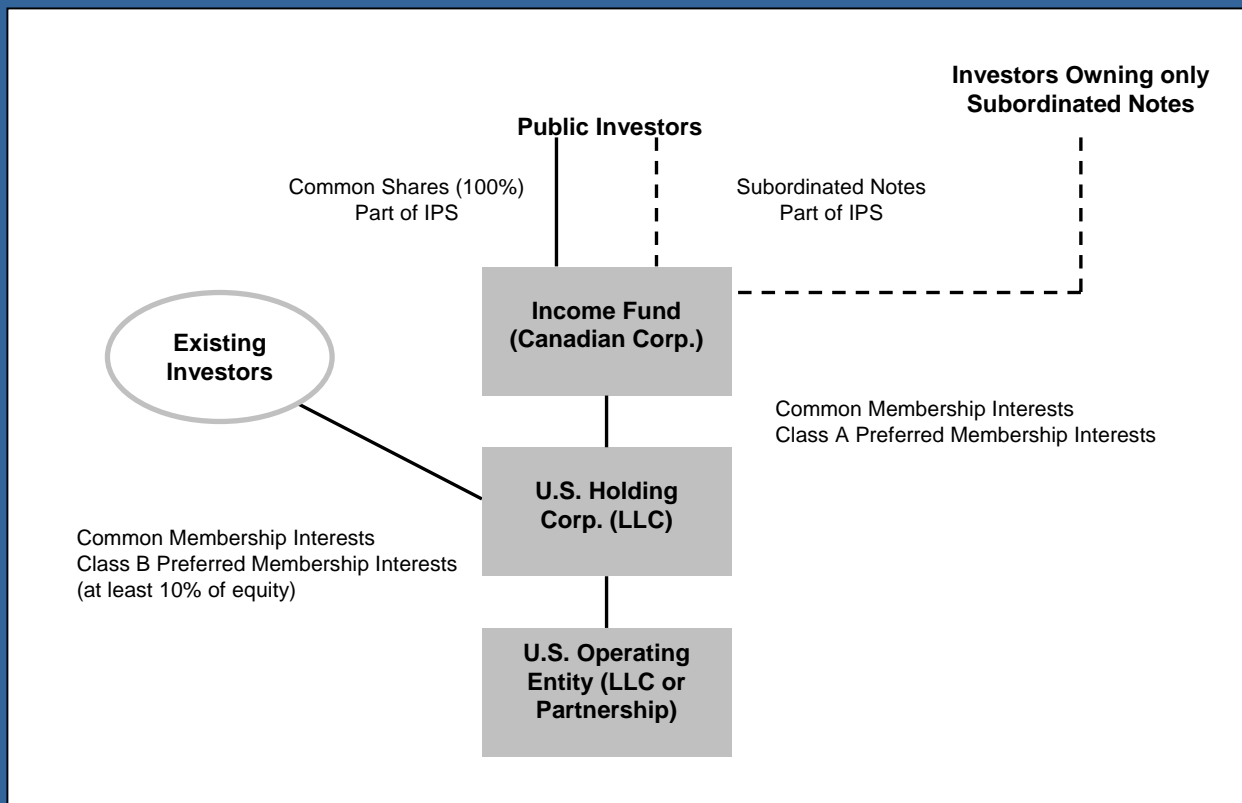


U.S. Corp. “C” Income Trust Model





U.S. Partnership Trust Model





U.S. Tax Issues

- New issues raised with respect to tax efficiency of cross-border model
- Lack of certainty over characterization of inter-company subordinated debt as either “debt” or “equity” by IRS
- IRS adopts substance over form analysis for debt/equity determinations



U.S. Income Tax Issues

- Concerns over debt/equity distinction culminated in 2003
- PricewaterhouseCoopers Inc. stepped down as auditor of Specialty Food Groups Income Fund citing tax concerns
- KPMG, Deloitte & Touche and BDO Dunwoody followed
- Result: public offerings of cross-border income trust units ceased

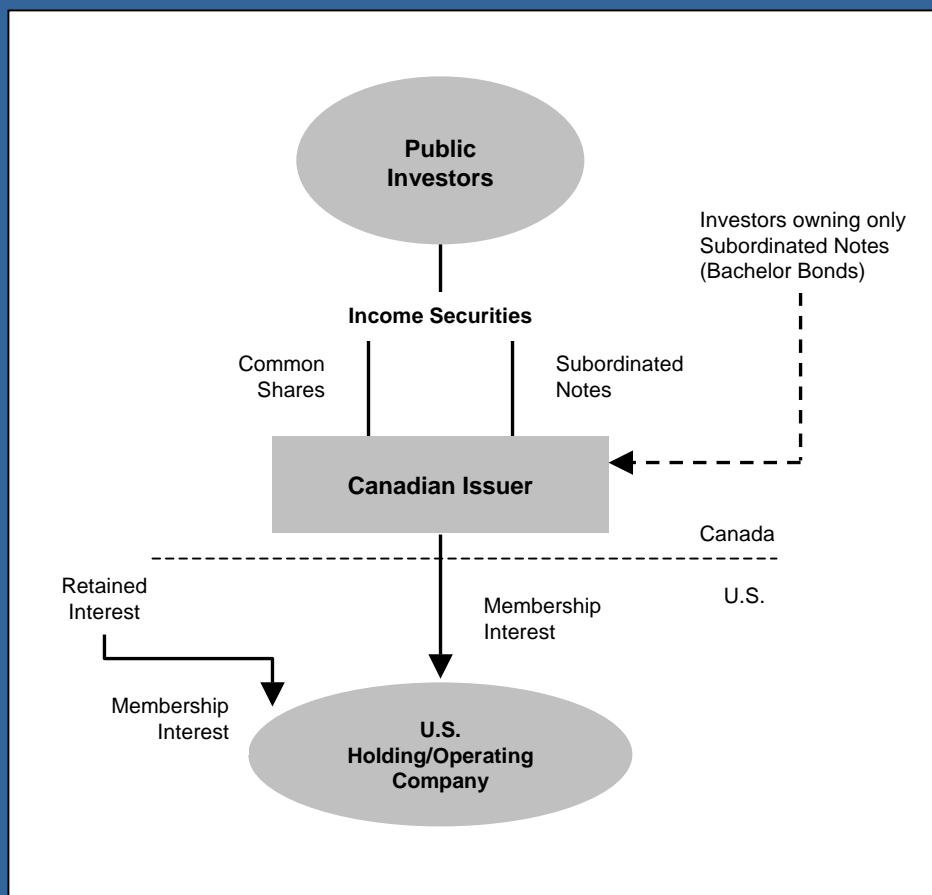


Income Deposit Securities (IDS)

- Alternative structure developed to provide same tax efficient distributions
- Delaware LLC issues unit of leveraged subordinated debt and equity to public on “clipped” basis
- Cross-border variation uses Canadian corporation to issue clipped securities



Income Deposit Securities (IDS)





Income Deposit Securities (IDS)

- Still relatively new to the market
- In 2004, Big Four audit firms released guidelines for IDS issues:
 - Clipped unit must be separable within 45-days of closing
 - At least 10% of face value of notes must be sold as separate units (eg. Bachelor Bonds)
 - Notes must rank *pari passu* with unsecured debt of the operating company
- Result: stronger U.S. tax opinions



Cross-Border Restructuring Issues

- Financing provided to operating company with guarantees provided by other entities in structure including income trust
- Guarantees provided by income trust are limited to the assets of the trust
- Relatively few liabilities at the trust level
- In most cases, insolvency occurs at operating company level



Cross-Border Restructuring Issues: Formal

- Chapter 11 of *United States Code* available to U.S. operating company or partnership
- If assets in Canada, proceedings under *Bankruptcy and Insolvency Act* (“BIA”) or *Companies’ Creditors Arrangement Act* (“CCAA”) may be brought in Canada
- Alternatively, U.S. recognition of Canadian insolvency proceedings may be sought pursuant to Chapter 15 of *United States Code*



Cross-Border Restructuring Issues: Formal

- Problems arise where trust must be included in formal proceedings
- In Canada, formal restructuring proceedings are conducted under two statutes: BIA and CCAA



Cross-Border Restructuring Issues: Formal

- Definition of “person” under BIA does not include a trust
- Definition of “company” under CCAA does not include a trust
- Result: income trusts arguably unable to file either:
 - proposal under BIA or
 - application for stay of proceedings under CCAA



Cross-Border Restructuring Issues: Formal

- Bill C-55
 - amendments to address gap in legislation by permitting publicly traded trust to file under BIA or CCAA
- Amendments not entirely complete
 - do not address the trust on trust structure where there is an operating trust between the public trust and the operating company/partnership
 - since, the operating trust does not have units which are publicly traded, its is arguably unable to file under BIA or CCAA



Cross-Border Restructuring Issues: Options

- Appointment of a receiver or receiver and manager over the income trust under *Courts of Justice Act* (Ontario) and *Law and Equity Act* (B.C.)
- Individual trustee of the income trust can file proposal under BIA
 - Significant personal risk to individual trustee
 - Failure of proposal results in automatic assignment in bankruptcy
 - Anomalous result: in a bankruptcy of the trustee, all property of the income trust will fall outside the bankrupt's estate



Cross-Border Restructuring Issues: Informal

- Informal workout involving U.S. and Canadian entities
- Or, informal workout of Canadian entities conducted in parallel with formal proceedings in U.S.
- Downside, inability of Canadian entities to benefit from stay of proceedings in Canada
- In addition, secured creditors may exercise remedies available under their security (including guarantees and pledges from the income trust)

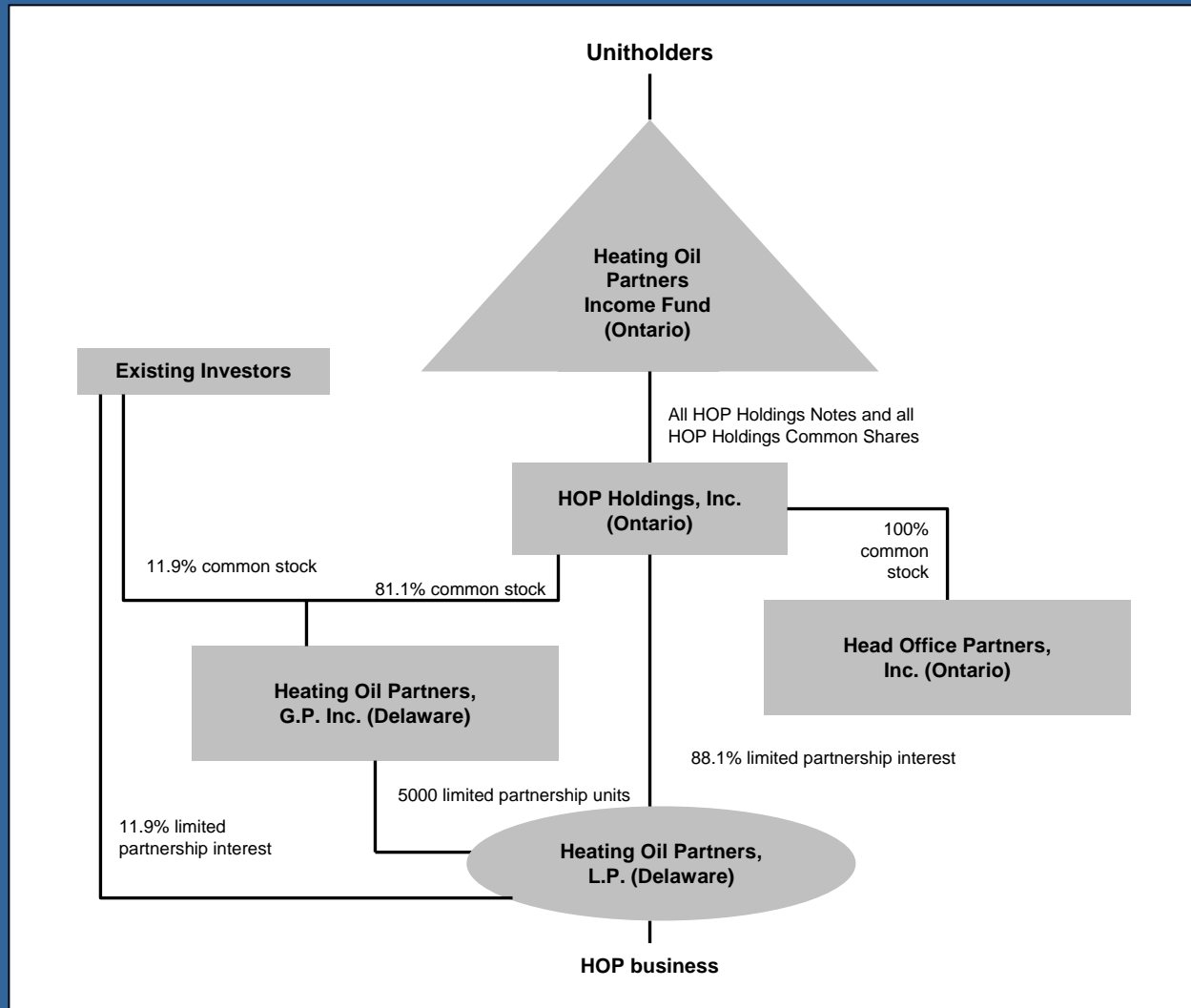


Recent Cross-Border Restructuring Cases

- Heating Oil Partners Income Fund
- Calpine Power Income Fund



Heating Oil Partners Income Fund





Heating Oil Partners Income Fund - Background

- In business of distributing fuel oil to residential and commercial customers
- Increasing cost of crude oil in 2004 and 2005 resulted in severe cash flow crisis
- Cash flow problems and HOP's distribution obligations put additional strain on HOP's working capital



Heating Oil Partners Income Fund – Formal Proceedings

- September 26, 2006 - certain HOP Entities filed for protection under Chapter 11
- Chapter 11 proceeding recognized in Canada pursuant to section 18.6 of CCAA
- Notably, the Fund was excluded from the Chapter 11 and CCAA proceedings
 - Not surprising - the Fund had no significant assets, creditors or employees in Canada or U.S.



Heating Oil Partners Income Fund – The Plan

- April 3, 2006 - debtors filed joint plan of reorganization with U.S. Bankruptcy Court
- Plan provided for:
 - compromise of secured claims in a debt for equity exchange
 - Rateable distribution to general unsecured creditors (15.56%)
 - Cancellation of all pre-petition equity interests; no distribution



Heating Oil Partners Income Fund – The Plan

- Equity interest held by HOP Holdings Inc. (Ontario) in Heating Oil Partners, L.P. (Delaware) was cancelled
- Result: cancellation of the claims of the Fund and its unitholders (as the only creditors of Holdings) in the reorganized HOP entities
- Plan approved in the U.S. and recognized by Justice Morawetz on June 26, 2006



Heating Oil Partners Income Fund - Conclusions

- Example of formal restructuring proceedings where income trust was excluded
- Likely that many cross-border restructurings will be patterned on HOP (to extent that the income trust has few assets and liabilities)
- Reinforces position of unitholders analogous to traditional equity holders in insolvent company



Calpine Power Income Fund

Background

- Several Calpine corporations (the “Calpine Applicants”) obtained CCAA protection
- Calpine Commercial Trust has a board of Trustees all independent of the Calpine group of corporations
- Calpine Power Income Fund is the only beneficiary of the Trust
- Calpine Canada Power Ltd (“CCPL”), a Calpine Applicant, administers the Fund and also manages the Trust under Administration and Management Agreements (the “Agreements”)

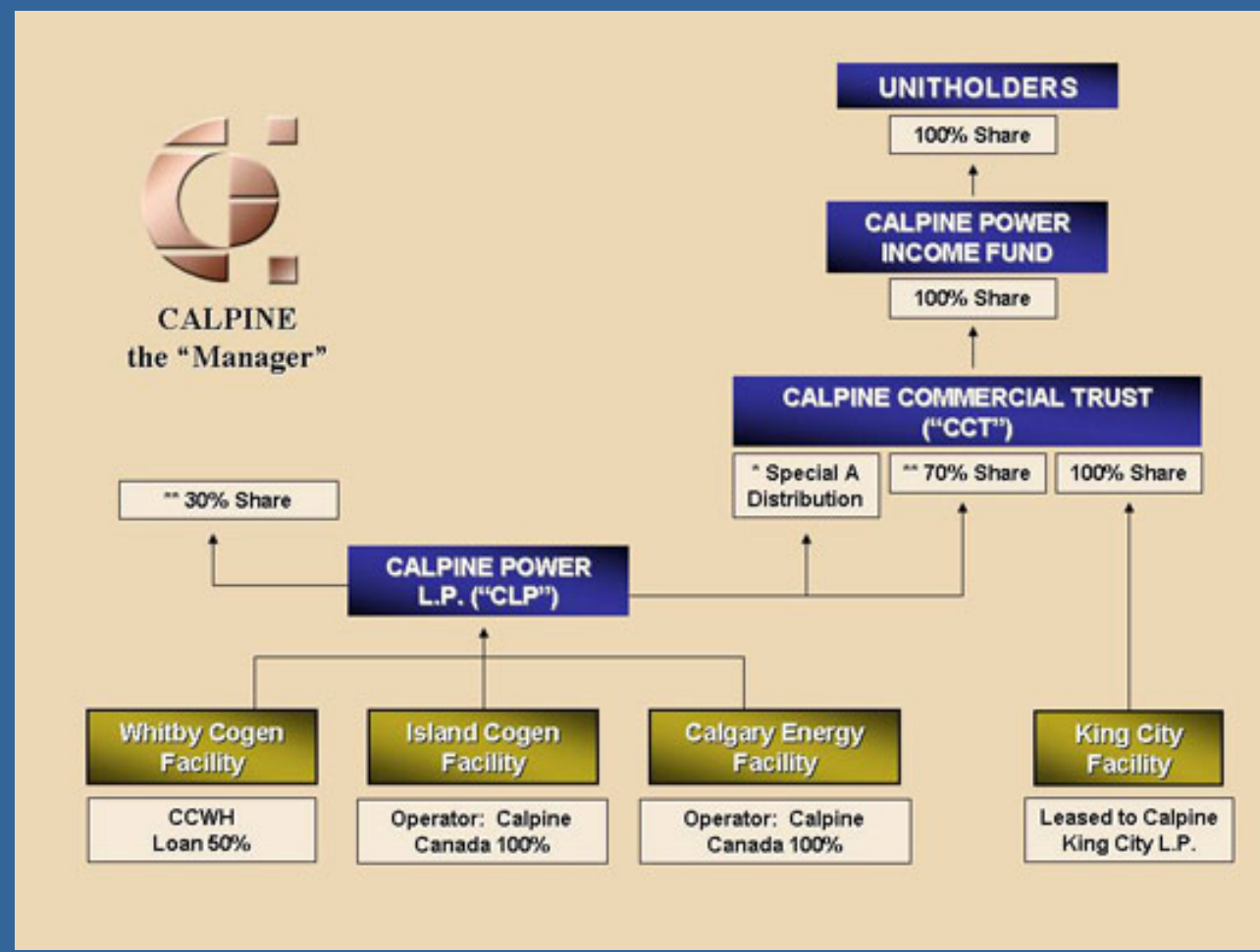


Background, cont'd

- Calpine Power L.P. (“CLP”) owns the Calgary Energy Centre (the “CEC”)
 - Limited partners – the Trust and CCPL
 - General partner – Calpine Power LP Ltd., a wholly-owned subsidiary of the Trust
- Tolling agreement between CESCO Partnership and CLP for the CEC
 - Tolling fee flows back to CLP → Unitholders, including the Trust → the Fund → Unitholders of the Fund



Organization – Flow of Funds





Application to Court

- CESCO Partnership repudiated tolling agreement → re-tolling process
- Trustees accused CCPL of conflict of interest → the Agreements allow them to determine how & by whom the re-tolling should be effected
- Calpine Applicants accused Trustees of asserting rights they do not have and of manoeuvring to give the Fund an advantage over other creditors



The Court's Findings

- The Agreements grant to CCPL “full and absolute right, power and authority” to manage the operations of the Fund, the Trust and CLP
 - Only if CCPL’s interests conflict with the Trust of CLP do the Trustees have authority to decide how to deal with the conflict
- CCPL does not have a conflict with respect to the re-tolling process – all interests are aligned
- Re-tolling of the CEC should be conducted in accordance with the Protocol
- Trustees’ applications dismissed



The Protocol

- Addresses how the temporary and long-term re-tolling of the CEC is to be conducted
- Addresses the disposition of agreements that are necessary for the re-tolling process
- Any sale of CCPL assets is subject to further order of the Court
- Addresses the resolution and disposition of any claims of CLP arising from the Tolling Agreement



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