

CORPORATE BULLETIN

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ULCC APPROVES REPORT ON THE PROPOSED UNIFORM INCOME TRUSTS ACT

At its 2006 annual meeting, the Uniform Law Conference of Canada (ULCC) approved the recommendations set out in a comprehensive report entitled the “*Proposed Uniform Income Trust Act: Closing the Gap Between Traditional Trust Law and Current Governance Expectations*” (Report) (available online at: <http://www.ulcc.ca/en/poam2/>). The firm’s Wayne Gray acted as chair of, and reporter to, the ULCC working group.

Within the last few years, the income trust sector of the securities marketplace has experienced explosive growth. However, in contrast to the extensive regulation governing various types of corporations in the marketplace, there is almost no statutory underpinning for income trusts. Accordingly, in 2005, income trust legislation was placed at the top of the list of possible ULCC projects in the area of business associations.

The Report sets out 40 recommendations for the *Uniform Income Trusts Act* (UITA or Act). What follows is a brief overview of the Report’s recommendations.

Note that the Report was written before the Federal Minister of Finance announcement on October 31, 2006 that the *Income Tax Act* (Canada) would be amended to tax distributions of an income trust in the same manner that corporate dividends are taxed. Nevertheless, even under the announced tax changes, the UITA will still be useful:

- (a) for real estate investment trusts (REITs), which are exempted from the new tax regime;
- (b) existing non-REIT trusts before January 1, 2011, the date on which existing non-REIT trusts will become subject to the new tax regime (unless they chose to convert into corporate form);
- (c) existing non-REIT trusts after December 31, 2010 to the extent that they elect to remain as trusts;
- (d) with respect to unitholder liability, ordinary mutual fund trusts; and
- (e) trusts that elect to convert before January 1, 2011 into corporations and require a statutory conversion mechanism.

1. SCOPE OF THE ACT

With limited exceptions, the UITA would only apply to trusts that are reporting issuers in Canada and any trust the majority of whose units are, directly or indirectly, owned by or for the benefit of the income trust.

2. LEGAL STATUS

It is critical that the UITA not jeopardize the tax status of income trusts in Canada, putting them at risk of becoming taxed domestically as corporations. Taxing income trusts as corporations would defeat the purpose of allowing flow-through investment *via* income trusts as an efficient and attractive alternative to the use of corporations. For that reason, the Report states that, at this time, corporate rules should not be blindly super-imposed onto income trusts. Instead, the Report seeks to strike a balance between super-imposing corporate law rules onto income trusts in the interests of investor protection while, at the same time, preserving for as long as possible the flow-through tax status of the trust for the ultimate benefit of those same investors. Accordingly, the UITA would provide that an income trust is not a legal person and that nothing in the Act makes an income trust a body corporate.

3. UNITHOLDER LIABILITY PROTECTION

The Report recommends that investors in publicly-traded issuers enjoy comparable immunity against personal liability regardless of the legal form of the underlying issuer: corporation; income trust; ordinary mutual fund; or limited partnership. Thus, the UITA would subsume any stand-alone provincial statute providing a liability shield in favour of unitholders and would adopt the immunity formulation found in the *Trust Beneficiaries Liability Act* (Ontario), making it apply on a uniform basis in all provinces. Like the *Income Trusts Liability Act* (British Columbia), the unitholder immunity rule in the UITA would apply retroactively.

4. UNITHOLDER RIGHTS AND REMEDIES

The UITA would enshrine the principle that all units of the same class or series of an income trust are equal in all respects subject only to the qualification that a controlled subsidiary entity not be permitted to vote any units that it holds in the parent income trust.

The Act would also enshrine flexibility in the election or appointment of trustees by permitting designated unitholders such as sponsors to continue to elect or appoint one or more trustees in accordance with the terms of the trust declaration. Between annual meetings, trustees would have the right to appoint replacement trustees to fill any vacancies and, if the trust declaration so provides, appoint up to 1/3rd the number of trustees elected at the last annual meeting. Unitholders entitled to elect any particular subset of trustees would have the exclusive right to fill any vacancies within that subset. Furthermore, to place unitholders in substantially the same position as shareholders of a corporation, no more than a simple majority of votes cast by unitholders entitled to vote on the election of trustees, or a subset of trustees, would be needed to remove those trustees.

The UITA would contain a provision entitling registered or beneficial voting unitholders to submit a written proposal for circulation in advance of an annual meeting. The provision would be modelled on the shareholder proposal regime set out in the *Canada Business Corporations Act* (CBCA).

Like the CBCA, the UITA would provide that, notwithstanding any contrary provision in a trust declaration, registered or beneficial unitholders holding not less than 5% of the voting units may requisition a meeting of unitholders.

There are a number of specific statutory remedies available to shareholders that the Report recommends be extended to unitholders either on a mandatory or opt-in basis. A statutory investigation regime would be mandatory. Opt-in provisions would consist of the oppression remedy and the derivative action. An opt-in provision would allow underwriters and, ultimately, purchasers of units to decide for themselves the relative advantages and disadvantages of each provision with respect to their particular income trust. The Report recommends a similar approach with respect to the dissent and appraisal right, which would be modelled on the CBCA. However, the right would apply only to the extent, and upon the triggering events, specified in the applicable trust declaration or, where the trust declaration so provides, to specific transactions designated by the trustees.

5. POWERS AND DUTIES OF TRUSTEES

As a general principle, the UITA would seek parity for trustees with the functions, duties, liabilities and immunities of corporate directors. If parity were achieved, income trusts would be in the same position in recruiting and retaining trustees as corporations are with respect to recruiting and retaining directors.

Accordingly, the UITA would set out mandatory rules whereby trustees of an income trust would have the power to manage, or supervise the management of, the property and affairs of the income trust.

The UITA would codify the power of trustees of an income trust to delegate any part of their authority to internal (including a committee of trustees) or external management.

The Act would state that trustees of an income trust owe their duties of loyalty and care exclusively to unitholders as a general body. Further, the standard of care would be to exercise the care, diligence and skill of a reasonably prudent person with comparable skills and experience. To ensure that the standards for trustees set out in the UITA are minimum standards that cannot be further lessened in a trust declaration, the UITA would state that no provision in a trust declaration, contract or resolution can relieve a trustee from the duty to act in accordance with the Act or relieve a trustee from liability for breach of the Act.

The UITA would contain a minimum conflict of interest code modelled on s. 120 of the CBCA.

The Act would codify the historical practice of allowing income trusts to have either corporate or individual trustees.

6. TRUSTEE LIABILITY AND INDEMNIFICATION

To place trustees in approximately the same position as directors, the general liability of trustees would be limited to the trust *corpus*, and trustees would have a right of indemnification out of those assets, subject to very limited qualifications. For example, unless the debt instrument or other contract expressly states otherwise, the liability of trustees under any debt instrument or other contract expressly entered into in their capacity as trustees would be limited to the *corpus* of the income trust. Trustees would also be placed in a similar position to directors insofar as it relates to their liabilities in tort.

Trustees of an income trust would have rights of indemnification out of trust assets similar to those available to directors of a CBCA corporation. The right to indemnification would not be lost solely because the trustee failed to comply with the trust declaration. Trustees would also be entitled to the advance of defence costs but would have to repay the advance if subsequently found to have not satisfied the conditions for indemnification.

7. RESIGNATION OF TRUSTEES

Corporate directors are free to resign at any time. However, trustees are not generally able to resign until a replacement trustee is appointed, which is generally concurrently. The inability to resign could pose a significant problem should a trust be on the verge of insolvency. Accordingly, the UITA would provide that trustees are free to resign at any time provided that at least one trustee remains in office. The last trustee of an income trust would be permitted to resign if approved by the court or on or after the appointment of a trustee in bankruptcy, receiver, receiver-manager or interim receiver to administer the whole, or substantially the whole, of the assets of the trust.

8. UNSECURED CREDITORS AND CLAIMANTS

Currently, the status at common law of the claims of unsecured trade creditors and other unsecured creditors and claimants having unliquidated claims against the trust is unclear. The unsecured creditor or claimant may have no claim against the trust assets *per se* because the trust is not a separate legal person. To resolve these issues in a manner consistent with the legitimate expectations of creditors and other claimants that have business dealings directly with an income trust, the UITA would declare that unsecured creditors, including unsecured trade creditors and persons with unliquidated claims, would have a direct unsecured claim against the *corpus* of the trust subject to the terms of their respective claims.

9. STATUTORY MERGERS

The UITA would include a statutory arrangement provision modelled on s. 192 of the CBCA, which would empower the court to approve arrangements that effect fundamental changes in the affairs of an income trust (such as a conversion into a corporation), provided that the arrangement satisfies the statutory conditions and the fair and reasonable test. Likewise, the UITA would include a statutory reorganization provision modelled on s. 191 of the CBCA empowering the court to amend trust declarations where the court has made an order in respect of the income trust under the *Bankruptcy and Insolvency Act* (Canada) or the *Companies' Creditors Arrangement Act* (Canada), legislation that would be extended to income trusts by Bill C-55.

To ensure that all trusts have workable compulsory acquisition provisions (particularly in hostile bid situations) and to reduce the length of trust declarations, a compulsory acquisition regime patterned after s. 206 of the CBCA would be included in the UITA. The provision would facilitate take-over bids for all units of an income trust. A dissenting offeree would be entitled to challenge the fair value of the offeror's buy-out price. Likewise, to protect minority unitholders in a change of control transaction, the UITA would contain a compelled acquisition provision patterned after s. 206.1 of the CBCA.

These provisions, especially, the appraisal right, reorganization and compulsory acquisition provisions will take on heightened significance in light of the announced tax changes and the limited time for existing trusts to benefit from the phase-out of the prevailing tax regime.

10. CONFLICTS OF LAWS

It is critical that the UITA provide simple, clear and certain conflict of laws rules so that investors know what law applies to their particular trust. If, as in almost all cases, the trust declaration sets out a law governing the trust instrument, that law will be the governing law of the trust. Each province would give reciprocal recognition to a trust declaration choosing the law of a sister province or territory. The UITA would also specify that, in addition to any other or higher requirement provided for in the trust declaration, holders of not less than 2/3rds of the units voted may change the governing law of an income trust.

11. ISSUES NOT CONSIDERED APPROPRIATE FOR THE UITA AT THIS TIME

The Report also seeks to explain why certain matters do not, for various reasons, warrant specific legislative treatment in the UITA at this time. For example, the Report recommends that there not be any registration or additional filing under the Act to create or recognize an income trust. The UITA would apply exclusively on the basis of the status of the trust as a reporting issuer under provincial securities law.

Similarly, to avoid unnecessary duplication and confusion, the UITA would not deal with matters that are adequately covered under securities laws or substantially all trust declarations. Thus, for example, the UITA would not cover insider trading, continuance disclosure, unitholder meetings, notices of unitholder meetings, proxy solicitations, appointment of auditors, audits, dissemination of audited financial statements, the composition and functions of audit committees, mergers or take-over bids (except to the extent that the UITA includes provisions on statutory arrangements, insolvency reorganizations, compulsory acquisitions and compelled acquisitions). Likewise, the UITA would not cover voting rights (except to enshrine the equity principle as discussed above), termination of the trust, amendments to trust declarations, distributions of capital or income, qualifications of trustees, meetings of trustees and written resolutions of trustees.

12. CONCLUSION

In short, the Report does not recommend simply mirroring the entire body of corporate law in the UITA for the sake of substantive uniformity. Rather, it takes into account the very different tax and commercial law character of trusts. Nor does the Report recommend the wholesale application of corporate law rights and remedies to the very different world of income trusts. While a strong case exists for ensuring that investors enjoy similar protections regardless of whether their investment is in a corporation or a trust, the authors of the Report have strived not to lose sight of the crucial differences between these fundamentally different investment vehicles and blindly assimilate trust and corporate law.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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