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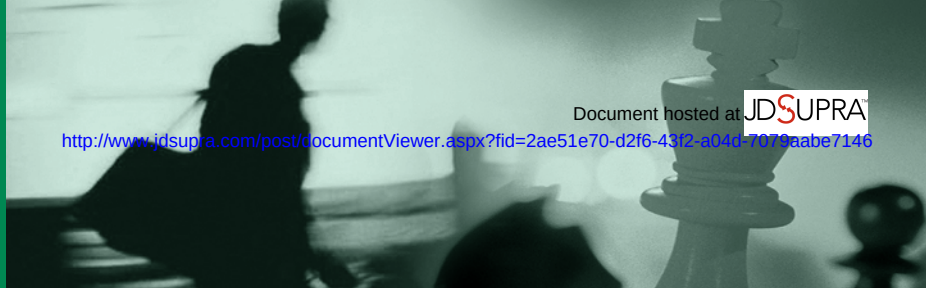

Securities/M&A Brief

Spring 2009

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In this issue, Mark Richardson discusses some considerations related to when and how an income fund might convert to a corporation; Andrew Tam outlines recent proposals by the CSA for a new insider reporting regime; and Amandeep Sandhu discusses the CSA proposal for a revised corporate governance practice and disclosure regime.

Income Fund Conversion Rules in Force: When and How to Convert to a Corporation

Mark Richardson

Following the federal Government's announcement on October 31, 2006 that the tax-favoured status of income funds would be eliminated by 2011, income funds have been anxiously awaiting the enactment of tax measures to facilitate conversion to a corporation. Those conversion rules came into force on March 12, 2009, enabling income funds to now chart their course of action.

What follows is a summary description of the considerations relevant to when and how to convert. Of course, an income fund should review its particular circumstances with its accounting and legal advisors before a decision is made as to the best way to proceed.

When to Convert

Tax-Favoured Status Ends January 1, 2011

- Conversions must be effected before January 1, 2013
- Does income fund have other sources of tax shelter to justify converting either before or after January 1, 2011?

Economic and Market Factors

- Declining income fund market, analysts' coverage and investor following
- Distributions reduced, suspended or in question
- Difficulty raising capital and renewing credit
- Impact of recession

Advantages of Corporate Structure

- Better access to capital
- Expected retention of cash for long-term growth and acquisition opportunities

- No foreign ownership limitations
- Statutory framework for liability of directors, amalgamations, etc.
- Simplified structure and reduced costs
- Easily understandable for analysts and investors
- Shares are recognized currency

Can Conversion be Combined with a Sale or Other Transaction?

- Is there an opportunity for consolidation?
- Are there potential buyers (or targets)?

Is The Business Viable as a Publicly Traded Entity?

- What are the market and other valuations?
- What is the unitholder base and what are their priorities?
- What is the extent of the cost savings and other advantages of going private?

Duties of Trustees

- Must act in the best interests of unitholders
  - Consider how and when to best provide a tax-efficient maximum return for unitholders
  - Be impartial as between unitholders
- Similar standard of care, skill and diligence to that of directors of corporations
- Entitled to the benefit of the business judgment rule, if:
  - sought all necessary legal and financial advice
  - actions are honestly believed to be in the best interest of unitholders
  - self interest avoided
- Process is important to minimize potential for claims against trustees
- Recommendation to unitholders should be supported by advice from financial and legal advisors

Conversions must be effected before January 1, 2013. Conversions can be through unit exchange, a redemption of units or a flexible plan of arrangement.

How to Convert

Two Methods of Conversion

- **Unit exchange**
  - Unitholders exchange their units for shares of a new corporation (Newco) on an automatic tax deferred basis
    - > Investor(s) can elect out of automatic rollover in order to realize a full or partial gain
  - Newco's shares are publicly listed
  - Entity below income fund (e.g. commercial trust) is wound up and its assets (e.g. units of the limited partnership, shares of the general partner, and promissory notes, as applicable) are distributed to the income fund
  - Income fund is wound up and the property it received is distributed to Newco

    Results

    > Former unitholders hold shares of Newco, a publicly traded corporation.

    > In the example given above, Newco is a limited partner of the limited partnership and it also owns all of the shares of the general partner and the promissory notes

    > The tax attributes of the income fund (and commercial trust, if applicable), such as losses etc., are transferred to Newco, whereas they are not transferred under the "redemption" method described below.

    > If FMV of Newco shares and units are not equal, a taxable shareholder benefit may be triggered

- **Redemption**
  - Newco is incorporated
  - Entity below income fund (e.g. commercial trust) transfers its assets (e.g. units of the limited partnership, its shares of the general partner and promissory notes) to Newco on a tax-deferred basis in exchange for common shares of Newco
  - In the example given above, commercial trust distributes its shares of Newco to the income fund on a tax-deferred basis

  - Income fund redeems units held by the public in exchange for shares of Newco
  - Newco's shares are publicly listed

    Results

    > Former unitholders hold shares of Newco, a publicly traded corporation
    > In the example given above, Newco is a limited partner of the limited partnership and it also owns all of the shares of the general partner and the promissory notes
    > The tax attributes of the income fund (and the commercial trust, if applicable) are **NOT** transferred to Newco

- Holders of exchangeable units of limited partnership, if applicable, can also transfer those units to Newco in exchange for shares of Newco on a tax-deferred basis
- Options and DSUs granted under income fund structure may be exchanged for options and DSUs of Newco on a tax-deferred basis
- Housekeeping rules allow income fund (and commercial trust, if applicable) to be wound up without negative tax consequences

A conversion requires the approval of 66⅔% of the unitholders. Unitholders generally vote as a single class and they have dissent rights.

Conversion Transactions Effected by Plan of Arrangement

- Provides flexibility to accomplish a number of steps contemporaneously under one instrument
- Provides a prospectus and registration exemption in Canada (and a registration exemption in the U.S.)
- Timeline is approximately three to four months
- Special meeting of unitholders to be called
- Information circular in prescribed form to be provided to unitholders in advance of meeting
- Fairness opinion from an independent financial adviser generally required
- Amendments typically need to be made to the income fund's declaration of trust

Approvals Required

- 66⅔% unitholder approval
  - Holders of income fund units and exchangeable limited partnership units (if applicable) vote as one class, unless limited partnership unitholders treated differently
  - If any trustee, director, officer or other related party of the income fund pre-conversion is entitled to any "collateral benefit" under the plan of arrangement, it would constitute a "business combination" for Ontario securities law purposes requiring majority of minority approval
  - Unitholders have dissent rights (i.e. to be paid fair value in cash instead of participating)
- Interim and final court approval (typically granted as a matter of course provided the plan of arrangement procedures have been followed and it is "fair and reasonable")
- TSX approval (typically granted as a matter of course)
- Listing of shares post-conversion treated as a "substitute listing" by TSX
- Third parties, as applicable
  - Lenders and other debt holders under credit facility, loan and security documents
  - Customers and suppliers under material contracts
  - Employee considerations

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Ed.: *This article appeared previously as a Lang Michener LLP* Mergers & Acquisitions Alert.

Five-Day Filing Deadline, Public Disclosure of Late Filings and Deemed Ownership Rule All Proposed in New Insider Reporting Regime


Andrew Tam

In late December 2008, the Canadian Securities Administrators ("CSA") unveiled their proposed new regime for insider reporting. The proposals are intended to harmonize and streamline insider reporting requirements across Canada and, when implemented, will replace the existing rules. The exception will be Ontario, where the main reporting requirements will remain in the *Securities Act* (Ontario). Despite this difference, however, the substance of insider reporting requirements will be the same across all CSA jurisdictions, including Ontario.

Among the more significant changes, the CSA proposes to:

- reduce the number of persons required to file insider reports;
- accelerate the deadline for filing insider reports from 10 calendar days to five calendar days;
- require issuers to disclose in their information circulars any late filings by insiders;
- introduce the concept of "post-conversion beneficial ownership" to deem securities that may be acquired within 60 days to be already held for the purposes of determining insider status; and
- facilitate reporting of stock-based compensation arrangements by allowing issuers to file "issuer grant reports" (similar to the current "issuer event report") rather than requiring insiders to file individual SEDI reports.

Who Will File: The "Reporting Insider" Concept

The CSA has proposed a new "principled" approach to determining who must file insider reports. This approach will focus on a narrower, "core" group of insiders, or "reporting insiders," who have regular access to material undisclosed information and power over the issuer. As under the current rules, directors of an issuer, its major subsidiaries, and its "significant shareholders" (i.e., shareholders who own, control or direct securities carrying more than 10% of the voting rights attached to all of the issuer's outstanding voting securities) will be required to file insider reports. The chief executive officer, chief operating officer and chief financial officer of an issuer, its major subsidiaries and significant shareholders will also continue to file insider reports, as will significant shareholders themselves. Under the proposed new rules, persons responsible for a principal business unit, division or function of a reporting issuer, as well as management companies providing significant services to an issuer, will also be "reporting insiders" and thus file insider reports. For remaining insiders of an issuer, only those who: (a) in the ordinary course have access to material undisclosed information concerning the issuer; and (b) directly or indirectly exercise, or have the ability to exercise, significant power or influence over the business, operations, capital or development of the issuer, will be "reporting insiders." This is expected to simplify reporting for large issuers, and enhance the value of insider reporting generally.

The CSA has proposed a new "principled" approach to determining who must file insider reports. This approach will focus on a narrower, "core" group of insiders, or "reporting insiders," who have regular access to material undisclosed information and power over the issuer.

Deemed Ownership

Of note to convertible securityholders of an issuer is the proposed concept of "significant shareholder based on post-conversion beneficial ownership," which will deem any securities that may be acquired within 60 days to be already held for the purposes of determining insider and reporting insider status. As a result, holders of convertible securities may become insiders of an issuer prior to gaining access to material information or power over the issuer.

"Primary" and "Supplemental" Reporting Obligations

The CSA has proposed dividing insider reporting obligations into two categories. The "primary" reporting obligation relates to the direct or indirect ownership of, or control or direction over, securities of an issuer, and includes any interest, right or obligation associated with a related financial instrument. The "supplemental" reporting obligation will apply to any agreement, arrangement or understanding which has the effect of altering a reporting insider's economic exposure to an issuer, involves a security or related financial instrument of the issuer, and does not otherwise fall under the primary reporting obligation.

Five-Day Filing Deadline

Under the proposed new rules, the deadline for filing insider reports will be accelerated from 10 calendar days to five calendar days. The current deadline of 10 calendar days for filing an initial report upon becoming an insider would remain the same.

Disclosure in Information Circular of Late Filing Fees

Also among the proposals is an amendment to Form 51-102F5 – *Information Circular*, which would require an issuer to disclose in its information circular whether any of its insiders have been subject to late filing fees.

Comment Period: Timeline

The details of the new regime are set forth in proposed National Instrument 55-104 – *Insider Reporting Requirements and Exemptions*. The CSA requested comments on the proposals and related consequential amendments no later than March 19, 2009.

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Proposed New Corporate Governance Rules

Amandeep Sandhu

The Canadian Securities Administrators ("CSA") has proposed a revised corporate governance practice and disclosure regime. This proposal would repeal and replace the following policy and instruments:

- National Policy 58-201 – *Corporate Governance Guidelines* (as proposed, the "Proposed CG Principles")
- National Instrument 58-101 – *Disclosure of Corporate Governance Practices* (as proposed, the "Proposed CG Disclosure Rule")
- National Instrument 52-110 – *Audit Committees* and Companion Policy 52-110CP – *Audit Committees* (as proposed, the "Proposed Audit Committee Rule")

The Proposed CG Principles are more principles-based and broader than the current corporate governance guidelines.

The Proposed CG Principles are more principles-based and broader than the current corporate governance guidelines. They contain nine broad corporate governance principles and commentary explaining the principles, as well as examples of corporate governance practices that can be used to achieve the objectives of the principles.

The CSA indicates that through the Proposed CG Disclosure Rule, the existing "comply or explain" model of applicable disclosure requirements would be replaced with more general disclosure requirements, that would apply to both venture and non-venture issuers.

Additionally, the current rules-based approach to determining director and audit committee independence would be replaced by a principles-based approach – the bright-line tests for independence would be replaced by a principles-based definition along with guidance on the types of relationships that could affect a director's independence.

This reformulation was undertaken by the CSA partly in response to the fact that the Canadian market has a large number of small issuers and controlled issuers. While the Alberta Securities Commission supports the objectives of the new proposals, it is concerned that the new rules will not substantially improve upon the current rules.

When it first published the final form of the current

corporate governance rules and policy, the CSA acknowledged that corporate governance was constantly evolving. Since that time, the CSA carried out a broad review of the corporate governance rules and policy, and it examined corporate governance regimes in other jurisdictions and considered the realities of the large number of small issuers and controlled issuers in the Canadian market. Through the Proposed CG Principles, the Proposed CG Disclosure Rule and the Proposed Audit Committee Rule, the CSA aims to provide guidance to issuers, greater transparency to the marketplace and a framework for strong, effective and independent audit committees.

The Proposed CG Principles, Proposed CG Disclosure Rules and Proposed Audit Committee Rules, as proposed, are open for comment until April 20, 2009, and the CSA intends to give issuers six months notice before the new rules take effect.

Proposed CG Principles

The nine principles under the Proposed CG Principles do not create obligatory practices or minimum requirements. The CSA recognizes that other corporate governance practices achieve similar objectives, corporate governance evolves as an issuer's circumstances change, and issuers should have flexibility to determine the practices appropriate for their circumstances. Following is an outline of the principles, together with some commentary provided by the CSA in the Proposed CG Principles:

Through the Proposed CG Principles, the Proposed CG Disclosure Rule and the Proposed Audit Committee Rule, the CSA aims to provide guidance to issuers, greater transparency to the marketplace and a framework for strong, effective and independent audit committees.

Principle 1: Create a Framework for Oversight and Accountability

An issuer should establish the respective roles and responsibilities of the board and executive officers.

The rationale for defining such responsibilities is to promote accountability to the issuer and its shareholders. The division of responsibilities will depend on the size, complexity and ownership structure of the issuer. In general, it is the board that is responsible for setting the issuer's overall vision and long-term direction, and the executive officers' role is to develop and implement an appropriate strategy that meets such vision and direction.

Principle 2: Structure the Board to Add Value

The board should be comprised of directors who will contribute to its effectiveness.

The CSA indicates that an effective board is structured such that it allows directors to fully and effectively carry out their fiduciary duties, and add value to the issuer with a view to its best interests.

Principle 3: Attract and Retain Effective Directors

A board should have processes to examine its membership to ensure that directors, individually and collectively, have the necessary competencies and other attributes.

While the responsibility for selecting and appointing directors rests with the board, a board nomination committee could facilitate the process. Smaller boards may not need a formal committee.

Principle 4: Continuously Strive to Improve the Board's Performance

A board should have processes to improve its performance and that of its committees, if any, and individual directors.

The board should provide comprehensive orientation and continuing education that covers the issuer and its business, financial condition, operations and risk-management practices, as well as its industry and competitive position.

Principle 5: Promote Integrity

An issuer should actively promote ethical and responsible behaviour and decision-making.

The board has a responsibility to set ethical standards applicable to the issuer's directors, executive officers and employees.

Principle 6: Recognize and Manage Conflicts of Interest

An issuer should establish a sound system of oversight and management of actual and potential conflicts of interest.

This can be accomplished through establishing an ad hoc or standing committee to identify, review, report and record actual or potential conflicts of interest. Additionally, obtaining independent advice on the situation related to the

actual or potential conflict of interest can be important. Further, where an ad hoc or standing committing for conflicts of interest has been established, such a committee should be composed of directors who are not interested in any matter being discussed or considered and have terms of reference and provide it with the authority to engage and compensate any internal or external advisor.

Principle 7: Recognize and Manage Risk

An issuer should establish a sound framework of risk oversight and management.

Risk oversight and management includes the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects. Risk oversight and management should focus on identifying the most significant areas of exposure that could have an adverse impact on the achievement of the issuer's goals and objectives.

Principle 8: Compensate Appropriately

An issuer should ensure that compensation policies align with the best interests of the issuer.

Compensation should be set and structured to attract and retain executive officers and directors and motivate them to act in the best interests of the issuer, and that this includes a balanced pursuit of short- and long-term objectives.

Under the proposed CG Disclosure Rule, issuers would be required to disclose the practices it uses to achieve the objectives of the nine principles set out in the Proposed CG Principles and disclose certain factual information.

Principle 9: Engage Effectively with Shareholders

The board should endeavour to stay informed of shareholders' views through the shareholder meeting process as well as through ongoing dialogue.

The board should promote a voting process that is understandable, transparent and robust and that facilitates the board obtaining meaningful information on shareholder views.

Proposed CG Disclosure Rule

The Proposed CG Disclosure Rule provides one disclosure regime for both venture and non-venture issuers. Under this rule, issuers would be required to disclose the practices it uses to achieve the objectives of the nine principles set out in the Proposed CG Principles and disclose certain factual information, such as the board's composition and information about any of its committees. This is a departure from the current corporate governance disclosure requirements, which require issuers to "disclose whether or not…" they complied with the current corporate governance guidelines and, if not, explain why they have not.

The Proposed CG Disclosure Rule requires issuers to describe many aspects of its governance structure. Issuers should refer to the full text of the Proposed CG Disclosure Rule for a full list of the matters to be described.

Proposed Audit Committee Rule

The current audit committee independence standard is based on the "no direct or indirect material relationship" standard, and there is a list of relationships that are deemed to constitute "material relationships." Under the Proposed Audit Committee Rule, a director is independent if he or she:

(a) is not an employee or executive officer of the issuer; and

(b) does not have, or has not had, any relationship with the issuer, or an executive officer of the issuer, which could, in the view of the issuer's board of directors having regard to all relevant circumstances, be reasonably perceived to interfere with the exercise of his or her independent judgment.

Under this definition, employees and executive officers of the issuer could never be considered independent. Also, while a control person or significant shareholder would not be disqualified from being independent, when assessing independence, boards would need to consider the control person's or significant shareholder's involvement with the management of the issuer and, depending on the nature and degree of involvement, this relationship may be reasonably perceived to interfere with the exercise of independent judgment.

The CSA believes the concept of perception is broader than that of expectation, and the proposed definition captures relationships that are reasonably perceived to interfere with the exercise of independent judgment, while the current definition captures relationships that are reasonably expected to interfere with the exercise of independent judgment.

The CSA has also included guidance in the proposed companion policy for assessing independence, and the determination of independence is left to the reasonable judgment of the board. The new definition would apply to all directors, not just audit committee members. The CSA also proposes two forms of transitional relief for the requirement that all audit committee members be independent. The first would apply when venture issuers become non-venture issuers, and the second would apply in the context of a reverse takeover when the acquirer is either a venture issuer or a non-reporting issuer.

The CSA proposes to remove exemptions for controlled issuers in light of the new approach to independence, and it also proposes to amend the temporary exemption from the requirement that all audit committee members be independent for limited and exceptional circumstances by removing the condition that the board determine, in its reasonable judgment, that the audit committee member relying on this exemption is able to exercise the impartial judgment necessary to fulfill his or her responsibilities. Instead, the exemption would not apply to an audit committee member unless the board determined that the reliance on the exemption will not significantly adversely affect, among other things, the ability of the audit committee to act independently.

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News

Lang Michener Listed in Bloomberg's Canadian M&A League Tables for Legal Advisers

Lang Michener is listed as one of the top 10 firms in Bloomberg's Canadian M&A League Tables for Legal Advisers. The firm is listed as completing 12 deals with a total value of US$11.9 billion, from Q1 to Q4 2008.

Lang Michener in mergermarket 2008 League Tables of Legal Advisers

Lang Michener has been listed in the mergermarket 2008 League Tables of Legal Advisers for both value of deals announced and volume of deals announced. The firm is listed as completing 15 deals with a total value of US$12.3 billion.

Securities/M&ABrief

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Publication Mail Agreement Number 40007871

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