



Income Funds

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Recent Developments in Income Funds

by Jeff Lloyd and Dallas Droppo

In recent months, public offerings by income funds have become increasingly popular. According to a recent survey, there were over 60 income fund offerings in 2001 (which raised over \$4.5 billion) and over 20 income fund offerings in the first quarter of 2002 (which raised over \$2.0 billion). These offerings have included financings by previously established funds that have accessed the public markets to obtain additional capital, as well as initial public offerings by new income funds.

The number of initial public offerings by income funds has been particularly notable. Another recent survey found that eight of the ten largest initial public offerings in Canada in 2001, excluding offerings of structured products, were income fund IPOs. It is also noteworthy that many of the recent income fund IPOs have involved businesses which operate in industries where income fund structures have not traditionally been used. These recent offerings suggest that the income fund has matured into a versatile vehicle for taking public a wide variety of businesses whose principal common characteristics are stable, sustainable cash flows and minimal ongoing capital expenditure requirements.

Broadly speaking, an income fund is a mutual fund trust which holds securities of a corporation or operating trust, which in turn owns a business or other income-producing assets. An income fund will often be structured so that income earned by the operating business or assets is not subject to tax within the fund or its subsidiaries, at least for the first few years after the offering, provided the income is regularly distributed to securityholders. As a result, the securities issued by income funds are essentially "yield" securities which are designed to offer securityholders a stable, long-term source of distributions, rather than prospects for significant capital gains.

In the establishment of a typical income fund, the income fund issues trust units to the public and uses the proceeds of the offering to indirectly acquire the business or income-producing assets to be held by its wholly-owned subsidiary or operating trust. As a practical matter, the party that wishes to sell its business or assets to the income fund acts as the promoter of the fund and, together with the underwriters of the offering, is responsible for the creation of the fund and the completion of the public offering of units of the fund. Unlike a typical initial public offering outside the income

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The Attractiveness of Income Funds

by *Peter Lee*

The significant number and size of new income fund offerings (particularly outside the traditional energy, resource and real estate sectors) attests to the attractiveness of these vehicles both to the vendor of assets and to the investing public. The reasons for the popularity of income funds are not hard to explain. From the vendor's perspective, packaging assets into an income fund frequently provides the most favourable valuation for the assets. From the investor's perspective, income funds are commonly seen as a high-yield, tax-effective and moderate-risk alternative to fixed-income securities such as government or corporate bonds. In addition, as the securities of most publicly-held income funds are traded on a stock exchange, they also provide investors with a high degree of liquidity.

A typical income fund business is one which features a comparatively reliable cash flow (but no major potential for future growth) and which requires relatively little ongoing capital expenditures. Such a business is often (but not always) a mature business in a mature industry which, for a variety of reasons, particularly the lack of significant capital gains "upside", may not even be considered as an ordinary corporate equity offering. However, the stable cash flows and minimal ongoing capital expenditure requirements make such businesses particularly suited for income funds, which as indicated above are usually marketed as income-producing or yield investments. In the current low-interest rate environment, income fund investors have commonly been prepared to pay vendors more for their assets than the vendors might otherwise receive (for instance in a private sale). Nevertheless, recent income fund offerings have featured forecast cash flow or yield in the very acceptable range of 8% to 12% per year.

A further consideration which may play a part in some income fund offerings is the potential to improve the pre-tax cash flows of a business through lower financing costs. Businesses that go public by way of income funds sometimes use the offering as an opportunity to reduce their financial leverage, which may allow the funds to negotiate a lower cost of borrowing.

A significant factor explaining the popularity of income funds is their tax-effectiveness to the investors. From the perspective of taxable investors, income fund distributions are often

treated for tax purposes as a combination of income, dividends, capital gains and return of capital. As a result, the overall tax rate applicable to distributions is often significantly lower than the tax rate applicable to other steady-yield investments, such as GICs.

Of particular interest to taxable investors is the characterization of a portion of a fund's distributions as a return of capital for tax purposes, since such distributions are not subject to tax in the hands of the investor. This treatment may arise where, for instance, the fund has available to it some form of tax shelter, such as depreciable basis in its assets, which effectively allows the fund to avoid fund-level income tax without having to flow out the taxable character of its income to investors. In such cases, the tax-free distribution will normally be considered to reduce the cost base (for tax purposes) to the investor of their fund units.

A further advantage of income fund offerings over more traditional equity offerings is that a typical public company will, to the extent it is profitable, be subject to potentially significant income and capital taxes. For individual investors in a public company, this entity-level tax is to some degree mitigated (though not eliminated) through a dividend gross-up and tax credit mechanism which effectively reduces the tax rate applicable to most dividends below the rate for other income (such as interest). However, the gross-up and tax credit mechanism is of no use to tax-exempt investors, such as RRSPs, to whom entity-level tax constitutes an unrecoverable cost. In contrast to public companies, income funds can often be structured so that no entity-level tax applies (at least for several years after the offering). This gives income funds a significant additional advantage over ordinary corporate equity offerings, particularly for RRSPs and registered pension plans, which comprise a very significant proportion of a typical income fund's investors.

Both the lower tax rate that is often applicable to fund distributions, and the absence or reduced level of entity-level tax in most income funds, probably contribute to the higher asset valuations that are often available through income funds, as a portion of the tax savings is passed back to the vendor in the form of a higher selling price.



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Tax Deferred Acquisitions by Income Funds

by Doug Richardson and Ron Mar

As income funds take on an increasingly important role in the market, it is critical that these funds be able to make acquisitions in order to sustain an appropriate level of distributions to unitholders. In this respect, while a corporate purchaser can make share or asset acquisitions on a taxable or tax deferred basis, the *Income Tax Act* (Canada) (the "Tax Act") generally does not permit a tax deferred rollover to a mutual fund trust. The only tax deferred rollover provided by the Tax Act applies in the limited circumstances where one mutual fund trust transfers all or substantially all of its assets to another (the "transferee") solely in exchange for trust units of the transferee. This provision is restrictive in a number of respects, including the fact that it only applies to transfers between mutual fund trusts and is not applicable where the transferor receives consideration other than trust units of the transferee. As a result of these limitations, other methods for achieving a tax deferred rollover have been developed. These mechanisms apply regardless of the identity of the purchaser (i.e., mutual fund trust or otherwise) and generally permit target shareholders to receive a limited amount of cash consideration in the exchange.

To the extent the target corporation shareholders have accrued losses on their target corporation shares, most, if not all, shareholders will want to recognize such loss by structuring the exchange as a taxable transaction. This objective is achieved by having the target shareholders simply transfer their target corporation shares directly to the fund in exchange for trust units. However, where a target corporation shareholder has an accrued gain on their target corporation shares, the shareholder would recognize a taxable gain if their target corporation shares were transferred directly to the fund.

In order to obtain a tax deferred rollover, but still provide the target corporation shareholders with the economic equivalent of receiving trust units, a modified exchangeable share structure is typically used. As is the case in the original exchangeable share structure, where the goal is to obtain tax-deferred treatment for Canadian

shareholders involved in cross-border acquisitions, the modified exchangeable share structure allows an income fund to offer tax deferred treatment to a target corporation's shareholders.

Although the terms of the exchangeable shares are detailed, their purpose is fairly straightforward. Exchangeable shares are intended to provide the target corporation shareholders with the ability to claim a tax deferred rollover on the transfer to a wholly-owned subsidiary of the fund ("Subco"), yet still provide such shareholders with treatment similar to that which they would enjoy had they acquired the trust units of the fund directly. This is accomplished by three primary mechanisms. First, the exchangeable shares are exchangeable at the option of the holder into trust units of the fund based on a predetermined exchange ratio. Second, in order to ensure that the holders of exchangeable shares receive the benefit of any distributions made on the trust units, the exchangeable shares effectively accrue distributions in the form of an upward adjustment in the exchange ratio. Finally, to avoid the onerous income tax consequences which would arise if dividends were paid on the exchangeable shares, the exchangeable shareholders enter into agreements, the purpose of which is to ensure that the fund, and not Subco, will ultimately acquire the shares. Although the value of these arrangements to a shareholder will be treated as non-share consideration, current taxation can be avoided if the tax basis of the target corporation shares is at least equal to the value of the non-share consideration.

A variation of the exchangeable share concept which has recently appeared is the exchangeable limited partnership unit. Conceptually, exchangeable partnership units work the same way as an exchangeable share by using a security that can be issued on a tax deferred basis to acquire a particular asset. To implement this structure, the acquiring mutual fund trust forms a limited partnership which is authorized to issue the exchangeable units. The relevant vendors transfer the targeted assets or shares to the limited partnership in exchange for the

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Structuring Income Funds

by *Leslie Morgan*

Income funds are structured as mutual fund trusts in order to accomplish a number of tax objectives. As trusts, income funds can generally be structured to avoid entity-level income taxation. As mutual fund trusts, their units are qualified investments for certain tax deferred plans (principally RRSPs and RRIFs) and will generally not be foreign property for such plans and pension plans. Finally, as trusts, income funds are not subject to Canadian federal and provincial capital tax.

Qualification as a Mutual Fund Trust

In order to qualify as a mutual fund trust, the trust must generally be a unit trust whose sole undertaking is the passive investing of its funds, and must meet certain requirements with regard to the public distribution and wide dispersal of its units. In the context of an income fund, the assets in question generally form part of a business and as such cannot be held directly by the mutual fund trust if its sole undertaking is to passively invest its funds. Accordingly, the business and its assets are generally held in a separate operating entity which may be organized as either a corporation or a trust. The income fund then holds units or shares and debt of the applicable operating entity.

Qualification as a Unit Trust

In order to be a unit trust, the income fund must either be a “closed end” or an “open end” fund. A closed end fund is not required to make its units redeemable on demand by the unit-holders, but is subject to restrictions as to the nature of its investments and the sources of its income. It is generally difficult for an income fund to qualify as a closed end fund and accordingly most income funds are open end, which means that 95% or more of their units (based on value) must be redeemable on demand. The redemption feature is, however, highly structured due to the generally illiquid nature of the assets underlying such funds. In particular, usually the redemption price for the units is no greater than the trading value of the listed units

less a discount, and the aggregate amount of monthly cash redemptions is generally restricted to a specified dollar amount. The fund will be permitted to satisfy redemptions in excess of the monthly cash limit by distributing assets in kind having a fair value equal to the applicable redemption amounts. Although income fund units are usually listed on a stock exchange, care is given to ensuring that the redemption mechanics are potentially useful to unit-holders and may, in certain circumstances, be preferable to selling units on the stock exchange.

Foreign Property

The business assets are generally held in a corporation or trust of which the mutual fund trust holds shares and debt or units and debt. If a corporation owns the assets, the structure creates the possibility of entity-level income taxation and the corporation will also be subject to capital tax. It becomes imperative to structure the corporation’s affairs so that it can, to the greatest extent possible, reduce its taxable income by claiming business deductions including capital cost allowance and interest on debt. The imposition of capital tax generally cannot be avoided and is a cost of utilizing a corporation.

The use of a Canadian corporation can, however, achieve significant benefits with regard to foreign property. The units of the mutual fund trust will not themselves be foreign property unless the assets of the mutual fund trust which are foreign property exceed 30% of the total of all of its assets (based on cost). Shares of a Canadian corporation and debt of a Canadian corporation will generally not be foreign property unless the shares of the corporation derive their value primarily (more than 50%) from foreign property. Even if this 50% limit is exceeded (and many income funds are heavily invested in the US), the debt and shares of the corporation will not be foreign property if the Canadian corporation has “a substantial Canadian presence”. For tax purposes, the corporation will be considered to have a substantial Canadian presence if it expends more than \$250,000 per

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The Going Public Process for an Income Fund

by *Ken Pearce*

The going public process for a new income fund can be fairly complex. Numerous issues will need to be addressed as part of the process, such as determining the structure of the fund (e.g. whether to hold the business through an operating subsidiary or trust); settling corporate governance matters (including composition of the board of trustees, identifying the manager and defining trust company involvement); drafting all required agreements (such as declaration of trust, partnership agreement, shareholders' agreement, management agreement and/or operations agreement); considering anti-takeover precautions; and resolving tax and accounting issues. However, pursuant to applicable securities laws, one of the principal requirements will be the preparation of a prospectus which will be the principal selling tool for the fund and which will contain representations by the fund as to the nature and condition of the business for which the fund (among others) may be held accountable by investors.

The company selects a lead underwriter to conduct the offering. Considerations in making such selection are: industry experience; availability of experienced analysts; reputation; distribution strength for both institutional and retail sales; relationship with company management (appropriate chemistry between the individual investment bankers representing the underwriter and company management); pricing; and ability to provide after market price support.

Once a lead underwriter has been selected, an organizational meeting will be scheduled to acquaint team members with each other, set out a timetable for the proposed offering and allocate responsibilities. Key timing considerations include sufficient time to allow for the due diligence process; preparation of a prospectus; regulatory review by applicable securities regulatory authorities, including securities commissions and any stock exchange(s) where the securities offered will be listed as part of the offering; and road show presentations relating to marketing of the offering.

The lead underwriter will select a syndicate of underwriters to market the offering in consultation with the company, the issuer and the vendor from whom the fund assets are acquired.

A determination will be made as to whether the offering will be made on a "best efforts" agency basis or a firm underwritten basis. In the case of a best efforts agency, the underwriters will only undertake to use their best efforts to sell the offering (with no guarantee of success). In the case of a firm underwriting, once the pricing has been settled and the underwriting agreement is signed, the underwriters are committed to purchasing the issuer's securities at the agreed price except upon the occurrence of certain specified circumstances, commonly referred to as "market out", "regulatory out" and "material adverse change out" circumstances, among others. The company and the underwriters will determine the amount of money to be raised and the approximate number of securities to be issued. This will necessitate a valuation of the business or assets to be acquired by the issuer from the company. The company will also have to determine whether it will retain an interest in the business.

The matters which must be covered in the prospectus are largely prescribed under securities law, and include in particular a description of the business, details concerning any acquisitions to be made, risk factors associated with the business and the offering, selected financial data, management's discussion and analysis of financial conditions and operations, a description of the underwriting arrangements (referred to as the plan of distribution) and financial statements. The prospectus is required to include full, true and plain disclosure concerning these matters, failing which investors will have a right of action against the issuer, the underwriter and possibly the vendor from whom the fund assets are acquired (as well as their respective trustees, directors and officers) for any resulting damages they sustain, subject to a defence of due diligence. For this defence to be available, significant due diligence must be conducted during the preparation of the prospectus. The company should establish a data room to facilitate review of materials by counsel. A data room checklist may include materials such as the following: permits and licenses; material contracts; title to real property and title insurance; intellectual property documents,

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including those relating to patents, copyrights and trade-marks; labour agreements and employment and consulting agreements; employee benefit plans; pending or threatened litigation; and business plans, budgets and other financial information, among others.

Not only is the prospectus used to comply with the disclosure requirements under applicable securities laws, but it is also the principal marketing document in connection with the offering. The first draft of the prospectus is usually prepared by the issuer's counsel. The document is then revised during a series of drafting sessions attended by all working group members. The draft prospectus document is submitted to the issuer's financial printers and once the final draft is approved and receipts for the preliminary prospectus are received from applicable securities regulatory authorities, sufficient copies of the prospectus are printed for use by the underwriting syndicate in marketing the offering. Typically, immediately prior to filing both the preliminary prospectus and the final prospectus, the underwriters will hold a due diligence session, involving interviewing the company's and the issuer's senior management and attending at the issuer's facilities and, if considered necessary, interviewing the issuer's employees, suppliers and customers. The underwriter's counsel will request that the issuer's counsel prepare and arrange for the directors and officers of the company and the issuer to complete a directors' and officers' questionnaire assisting the company in satisfying its disclosure obligations under applicable securities laws and to assist the underwriters in performing their due diligence investigation.

The preliminary prospectus is filed with applicable securities regulatory authorities for review. In Canada, there are three levels of review, referred to as detailed, selective and no review. Typically, for an initial public offering, there would be a detailed review, since the issuer has not previously filed a prospectus and the business may not represent a portion of the business of a public company for which detailed disclosure has already been provided.

The period commencing on the date of filing the preliminary prospectus and the date when receipts for the final prospectus has been obtained, and during which the applicable securities regulatory authorities will review the prospectus filing, is commonly referred to as the "waiting period". During the waiting period, the offering may only be marketed to prospective investors through oral statements and the preliminary

prospectus. Management must be very careful to ensure that no other written material, including press releases, public presentations or other actions are taken which could be construed as advertising or in furtherance of marketing the offering. One element of the marketing process is commonly referred to as the "road show". This often consists of a one to three week period during which the financial community becomes acquainted with the offering. The underwriters plan a series of meetings with potential investors at which the issuer and the offering are discussed. Often a team comprised of members of the lead underwriter and members of the issuer's senior management will attend meetings with large institutional investors, securities analysts and brokers in various cities across Canada and, if applicable, the US. If the offering is being marketed in the US, the prospectus will also have to be cleared with the United States Securities and Exchange Commission, as well as applicable state securities regulatory authorities in those states where the offering will be marketed.

Comments are received by way of comment letters from the securities regulatory authorities, and these typically result in amendments to the prospectus. Once all comments have been satisfied, the issuer will be invited to file a final prospectus. Immediately prior to such filing, the underwriter will meet with the company and the issuer to determine pricing and the size of the issue and enter into an underwriting agreement with the issuer. Once a receipt for the final prospectus has been received by the issuer, the final prospectus will be printed and the underwriters will deliver copies of the final prospectus to those investors who have agreed to purchase securities of the issuer. Closing of the offering typically takes place not less than several days and not more than two weeks after receipts for the final prospectus have been obtained.

There are a number of expenses which will be incurred in the going public process. Underwriters typically charge commissions in the range of 5% to 8% of the proceeds in an initial public offering. Legal fees of the issuer's counsel and the underwriters' counsel are typically paid for by the issuer. The issuer will incur accounting fees relating to the accounting and audit work conducted by its auditors on the financial statements to be included in the prospectus. In addition, certain printing costs and filing fees will be incurred in connection with printing and filing the prospectus. A detailed summary of the estimated costs of the offering should be prepared at an early stage in the process.



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Governance and Incentive Compensation Issues in Income Funds

by Pat Finnerty and Brock Gibson

In the last decade, income funds have been viewed as attractive investment vehicles in Canada and we have seen an evolution in their governance, management and compensation structures.

Many early income funds were royalty trusts in the oil and gas business where the trust holds a royalty on oil and gas properties owned by a subsidiary operating company, while a separate management company, typically owned by the promoters or organizers of the vehicle, manages the properties. The manager is responsible for both managing the properties (which often were operated by other oil and gas companies) and pursuing additional property acquisitions to reduce the depletion inherent in an oil and gas asset base.

The governance structure of the typical fund was simple. The trust either had independent individual trustees or a corporate trustee, while the board of the operating company was comprised of both independent individuals and representatives of the manager. The depth of management of the operating company was not crucial, as it owned interests in oil and gas properties that often were operated by others and typically did not undertake the strategic exploration activities of a traditional oil and gas company.

Fees paid to the manager could be one or both of incentive fees, payable on the increase in the distributions to unitholders, or acquisition fees payable on the acquisition of assets. The incentive fees with respect to increased distributions in the energy sector were substantially dependent on fluctuating oil and gas prices, as distributions could easily rise or fall with commodity prices. Acquisition fees were appropriate, as a major part of the manager's function was to acquire oil and gas properties to replace the original asset base. If acquisitions were not successfully completed, the asset base would deplete, production decline and distributions plummet.

In the mid-1990s when the income fund model was expanded beyond the oil and gas

industry to power, pipeline and other industrial sectors, the concept of separate board of trustees for the fund and board of directors for the operating company was retained, with a separate management company, again typically owned by the promoters or organizers, providing management services under a contract that would provide cost reimbursement, base fees, incentive fees and acquisition fees. However, as the income fund sector evolved certain issues with this governance and management structure became apparent:

- where there was both individual trustees at the trust level and a board of directors at the operating company level, confusion arose as to the role that these two decision making bodies should take. Should the trustees merely approve distributions previously approved by the operating company board, or did the trustees have an obligation to more closely supervise the operating company? Typically the trustees were independent and had less knowledge of the business than the operating company board, which often had a considerable number of management representatives. Questions also arose where the trust had a corporate trustee rather than individual trustees. A troublesome situation was where an unsolicited bid was made for a trust with a corporate trustee. Not surprisingly, the corporate trustee did not want to be involved in a hostile bid (but concluded it was compelled to fulfil an oversight role under trust law), while the management dominated operating company board was keenly interested and sought to control the defense of the bid;
- incentive fees based on increasing distributions had less glitter in a fund that held utility-like assets where growing distributions was a function of improving efficiency, rather than fluctuating commodity prices;
- acquisition fees could be perceived as distorting incentives, rewarding acquisition activity as opposed to accretion in unitholder distributions; and

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Recent Developments

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fund sector, where the proceeds of the offering are used by the public company to finance its growth and operations, the offering proceeds in an income fund IPO are paid to the third party that is selling the business or assets to the fund. This reflects the fact that businesses acquired by income funds generally are mature operations with significant and stable cash flows and do not require additional capital to finance their operations.

In the current low interest rate environment, investors have displayed a strong appetite for investments providing relatively stable cash flow in excess of that which is provided by conventional government or corporate bonds. This demand has enabled owners of businesses with stable long term cash flows to realize very attractive valuations for their businesses by selling them to the public through an income fund. Many of these businesses are in industries outside of the real estate, energy and resource sectors which have traditionally dominated the income fund field, as evidenced by recent IPOs of the following income funds:

- A&W Revenue Royalties Income Fund, which acquired the trademarks related to the A&W chain of restaurants in Canada;
- Advanced Fiber Technologies Income Fund, which acquired the fiber screening business of CAE Inc.;
- ChemTrade Logistics Income Fund, which acquired Marsulex Inc.'s chemical by-product removal business;
- Connors Bros. Income Fund, which acquired the Connors Bros. canned fish and seafood

products subsidiary of George Weston Limited;

- Davis + Henderson Income Fund, which acquired the Davis + Henderson cheque printing business from MDC Corporation;
- Livingston International Income Fund, which acquired the Livingston customs brokerage business from its shareholders; and
- Sun Gro Horticulture Income Fund, which acquired the Sun Gro Horticulture peat moss business from Hines Horticulture, Inc.

Many of the income funds that have been established in the real estate, energy and resource sectors are managed and operated by the former owner of the assets pursuant to management and operating agreements with the fund. This reflects the rationale for the creation of many of these income funds, which was to permit the operator of a business to improve its balance sheet by selling fixed assets into a fund while continuing to earn income from managing the fund's assets.

In many of the more recent income fund IPOs, the fund has acquired an entire operating business, including significant numbers of employees and a complete management team. After the IPO, the business continues to be carried on largely in the same manner as it had previously been conducted, often with no ongoing involvement by the former owner of the business. This new model reflects the evolution of the income fund into a vehicle through which a stand-alone business can be sold to the public as an alternative to a private sale to a strategic or financial buyer.

Tax Deferred Acquisitions

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exchangeable units. Provided that all of the partners in the limited partnership are Canadian residents, this transaction can be accomplished on a tax deferred rollover basis. Each exchangeable partnership unit can be exchanged for a trust unit at the option of a holder. One key difference between exchangeable partnership units and exchangeable shares is that it is possible to make distributions of cash to the holders of exchangeable units on a tax efficient

basis. As mentioned above, a cash distribution on an exchangeable share gives rise to onerous tax consequences for the issuing corporation.

While neither of these exchangeable structures is commonplace, they have begun to appear with some regularity. The recent renewal of interest in income funds and the attraction of the tax deferral offered by these hybrid structures should only increase the popularity of these vehicles.

Structuring Income Funds

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year on qualifying services provided by individuals in Canada, or if it has more than five employees in Canada employed full time, in a business other than an investment business of the corporation. Generally speaking, it is possible to structure the Canadian corporation to satisfy one or more of these requirements for a substantial Canadian presence, so that the shares and debt of the Canadian corporation are not foreign property even if a significant proportion of the Canadian corporation's assets are shares and/or debt of foreign entities.

More recently, income funds have been structured so that the business assets are held by a business trust which is a unit trust wholly-owned by the fund. The units of such a trust will generally be foreign property, however, its debt will not be foreign property. The Canada Customs and Revenue Agency (the "CCRA") has issued a number of technical interpretations confirming that the debt of a Canadian resident trust will not be foreign property and the Canadian general anti-avoidance rule will not be applied to recharacterize the debt provided that a

certain percentage of value of the assets of the trust are not foreign property. The advantage of utilizing a trust in these circumstances is that the income can flow directly through to the mutual fund trust unitholder without an intermediate level of income taxation. At the same time, the bulk of the fund's investment in the business trust will be structured as debt rather than units of the trust, and the fund will still be able to meet the requirements necessary to ensure that its units are not foreign property. Also, because trusts do not pay Canadian capital tax, this disadvantage of a corporation will be avoided.

Through proper structuring, it is possible to establish an income fund which will not experience tax on its income or capital at an intermediate level and which will be able to invest in significant foreign assets, including shares of corporations that carry on business outside of Canada, without the units of the fund itself being foreign property. Such a fund can be an ideal investment for tax-deferred plans and individual taxpayers.

James S. Hausman

1937–2002

It is with regret that we inform you of the death of our partner, James S. Hausman, following his battle with cancer. Jim was a partner at Blakes from December 1, 1969 until his death in March of this year.

His practice extended to all aspects of taxation but with a special emphasis on international tax planning. Not only was Jim an exceptional lawyer who was consistently ranked in the top levels of his profession in national and international surveys, but he was also a dedicated teacher, lecturer and author.

Jim was a significant contributor to his profession, both at the international level as a member of the Permanent Scientific Committee of the International Fiscal Association and a member of Council of the Canadian branch, and at the national level as a former chairman of the National Taxation Section of the Canadian Bar Association, a former governor and member of the Executive Committee of the Canadian Tax Foundation and the co-founder and co-chair of the Annual Senior Tax Practitioners' Institute. Jim spent his entire professional career at Blakes, as an articling student, associate and partner. All of us who worked with him over the course of that career benefited greatly from the breadth of his knowledge and experience and his innate integrity and kindness.

Jim is survived by his wife Sandra and his two sons, David, who is a lawyer, and Jonathan, who is a financial analyst.



Governance *(cont'd from page 7)*

- the termination provisions of management contracts also came under scrutiny as M&A activity for funds increased. Often management contracts were not terminable by the fund except for serious mismanagement or only on notice periods significantly longer than typical for terminating a senior business executive. Many of these management contracts had been given to managers who were also promoters of the fund, and who sought to retain effective control over the assets they placed in the fund.

The recent burst of income funds owning businesses in new industrial and service sectors appears to be bringing forth new governance and incentive structures for these funds. A key factor is that many of these funds are being established by selling shareholders who are not active in present management and wish to exit the business and, accordingly, have no ongoing interest that may influence the structure. In these recent funds, the trustee of the fund is either a corporate trustee or a board of individual trustees that is identical with or has significant overlap with the board of directors of the operating company. At the operating company board level, the board is comprised of strong, experienced outside directors that one would expect in a normal public company. In particular, the board is not dominated by management, as is sometimes the case in the older structures.

More importantly, whether or not there is a management company owned by the original promoter or professional manager, the management and governance structure is now often structured like a normal business organization, where management reports to the board. This shift rationalizes management's incentives and reporting while strengthening the role of the board as the governance body for the business entity.

In addition, the rationalization of the management incentive and ownership reward structures avoids the risks of actual or perceived conflict in decision making introduced by incentive and acquisition fees and allows the board to structure compensation for management based on alignment of the goals and objectives of the business and the economic value created, rather than being limited to primarily activity based formulas (as opposed to results) in older arrangements.

The governance and fee structure of income funds will no doubt continue to evolve to fit both the needs of the business in question as well as the interests of promoters and investors. We expect future governance structures will continue to evolve towards structures that reflect the traditional incentive and responsibility structure of the modern business entity, while accommodating the sometimes unique business opportunities created by income funds.

Blakes Montréal

In one of North America's oldest and most enduring business centres, Blakes has recently set up shop – assembling a growing roster of Montréal's best legal talent.

The Montréal gateway to Blakes offers opportunities not only for new and existing clients in Québec, but also for those elsewhere interested in the region's rising prosperity. While Blakes has been working with clients in Québec for many years, having an office there allows for the same seamless, top-quality legal services the firm has been providing from other offices. And, because Blakes hires the best local talent, it can also offer national and international clients the finest legal expertise available in Québec.

The scope of Blakes' practice in Montréal is predominantly corporate/commercial law with emphasis on banking, financial services, securities, mergers & acquisitions, restructuring, litigation, real estate and project finance.



Professional NOTES

A sampling of recent publications and presentations.

Pat Finnerty, speaker, “Negotiating and Structuring the Public Deal”, *Insight Conference on Cross Border Mergers & Acquisitions*, Houston, May 22-23, 2002.

Doug Richardson, speaker, “Canadian Tax Techniques to Add Value”, *Insight Conference on Cross-Border Mergers and Acquisitions*, Houston, May 22-23, 2002.

Brock Gibson, co-chair, *Insight Conference on Cross-Border Mergers & Acquisitions*, Houston, May 2002.

Janice McCart, named in the *International Tax Review’s Guide To World’s Leading Transfer Pricing Advisors*, 2002.

Ron Riehler, author, “Partnership – An Alternative Method of Merging Businesses”, *Third Annual Conference – Taxation of Corporate Reorganization*, Toronto, Federated Press, February 28, 2002.

Janice McCart, chair, *Toronto Centre Canada Customs and Revenue Agency & Professionals Consultation Group*, February 27, 2002.

Tim Unwin of our Corporate Group and **Ron Riehler**, presenters, “The Private Equity Market: What You Need to Know and Why - Legal Issues” *12th Annual Securities Superconference, The Canadian Institute*, Toronto, February 19, 2002.

Janice McCart, author, “Transfer Pricing: Canada Customs and Revenue Agency Takes Aim”, 2002 *LEXPERT/American Lawyer 500*, February 2002 and in Canadian Legal *LEXPERT* Directory 2002.

Ron Riehler, author, “The Private Equity Market: Recent Tax Developments”, *12th Annual Securities Superconference, The Canadian Institute*, Toronto, February 19, 2002.

Pat Finnerty, speaker, “Anatomy of an M&A Transaction—A Case Study”, *Insight National Conference on Mergers and Acquisitions*, Calgary, December 2001.

Brock Gibson, co-chair, *Insight National Conference on Mergers and Acquisitions*, Calgary, December 2001.

FAX BACK - Publications Request

To receive a copy of any of the following publications, please complete this form and fax it to Young Lee at BLAKE, CASSELS & GRAYDON LLP, 416.863.2653.

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Blakes Dispute Review

Blakes Report (commentary on current legal trends & developments affecting businesses)

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Environmental Law Bulletin

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- The \$220 million IPO of Sun Gro Horticulture Income Fund, which used the net proceeds of the offering to acquire the Sun Gro Horticulture peat moss business from Hines Horticulture, Inc.
- The \$188 million IPO of Clean Power Income Fund, which used the net proceeds of the offering to acquire or invest in hydro-electric, biomass and wind power facilities in Canada and the United States.
- A \$175 million public offering of Pembina Pipeline Income Fund, which used the proceeds to pay down debt from earlier acquisitions.
- A \$100 million public offering of units by Enerplus Resources Fund, which used the net proceeds of the offering to acquire additional securities of or royalty interests in EnerMark Inc. and Enerplus Resources Corporation.
- The offer by Algonquin Power Income Fund to purchase for \$84 million all of the units and convertible debentures of KMS Power Income Fund.
- A \$71 million public offering of units by Algonquin Power Income Fund, which used the net proceeds of the offering to acquire interests in additional generating facilities, repay debt and for working capital.

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