
A Comparison of Business Income Trust Governance and Corporate Governance: Is There a Need for Legislation or Further Regulation?

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This paper compares corporate governance to the governance of business income trusts, highlighting corporate governance features that may be lacking in business income trust governance. One observation drawn from this comparison is that declarations of trust for income trusts largely replicate provisions of corporate statutes such as the *Canada Business Corporations Act* ("CBCA"). There are, however, features of the CBCA that are not replicated. These include shareholder proposals, the appraisal remedy, the derivative action, and the oppression remedy. The avoidance of these rights and remedies may be to the disadvantage of investors. This disadvantage could be addressed either by statute or through securities regulatory or stock exchange requirements. If legislation simply replicates corporate governance in an income trust structure, however, the only remaining difference would be tax treatment. A difference in tax treatment for two otherwise essentially identical forms of organization would be hard to justify in terms of tax policy, particularly in light of the underlying tax principle of neutrality.

Cet article établit une comparaison entre la gouvernance d'entreprise et la gouvernance des fiducies de revenus d'affaire en mettant en valeur certaines caractéristiques propres à la gouvernance d'entreprise qui ne font pas partie de la gouvernance des fiducies de revenus d'affaire. A partir de cette comparaison, l'auteur observe que les déclarations de fiducie dans les fiducies de revenu reprennent en grande partie les dispositions de la *Loi canadienne sur les sociétés par actions*, à l'exception cependant de certaines caractéristiques de cette loi comprenant les propositions d'actionnaires, la demande d'évaluation judiciaire, l'action indirecte et le recours en cas d'abus de droit. L'absence de ces droits ainsi que de ces recours peut constituer un désavantage pour les investisseurs. Il serait toutefois possible de remédier à ce désavantage par l'adoption d'une loi, par la réglementation du marché des valeurs mobilières ou encore par la mise en place de formalités visant à réglementer les transactions sur le marché boursier. Si une loi reproduisant simplement la gouvernance d'entreprise était introduite dans une structure de fiducie de revenu, l'unique différence qui demeureraient entre les deux modèles se trouverait au niveau du traitement fiscal. Une différence au niveau du traitement fiscal pour deux structures organisationnelles qui sont pour le reste en tous points identiques s'avèrerait difficile à justifier, surtout en ayant à l'esprit le principe de neutralité sous-jacent en matière de fiscalité.

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Introduction

Income trust structures were used in the past for real estate investment trusts and oil and gas royalty trusts.¹ More recently, a variation of these trusts has been used to raise capital for a wide variety of businesses including restaurants, consumer products, transportation, and industrials.² These “business income trusts” are used to distribute operating entity income to a trust in the form of interest or royalty payments. The income is then distributed to trust unitholders. The deduction of interest or royalty payments to the trust reduces tax at the operating entity level. Distributing these amounts to investors through the trust allows the operating revenues (net of expenses other than the interest or royalties paid to the trust) to flow through to the investors to be taxed in their hands.

Business income trusts had become so popular by 2002 that eighty-six per cent of initial public offerings (“IPOs”) were income trusts.³ By February 2003 there were over one hundred income trusts listed on the Toronto Stock Exchange, with a market capitalization of over \$45 billion.⁴ In September 2003, it was reported that there were \$60 billion worth of income trusts and the amount was expected to grow to \$150 billion within two years.⁵ The growing importance of business income trusts caught the attention of the media, leading to numerous newspaper and magazine articles on various aspects of business income trusts.⁶ It might have been a temporary

¹ See Michael Torkin, “Real Estate Investment in the 1990s: An Analysis of REITs” (1997-98) 13 B.F.L.R. 199 at 206-11, which discusses the development of real estate investment trusts in Canada in the 1990s. Although oil and gas royalty trusts gained renewed popularity in the 1980s, Waters says the development of these trusts can be traced to the 1920s and early 1930s (Donovan W.M. Waters, Mark R. Gillen & Lionel D. Smith, *Waters’ Law of Trusts in Canada*, 3d ed. (Toronto: Carswell, 2005) at 457, n. 60).

² See prospectuses available through SEDAR Search for Public Company documents, online: SEDAR <http://www.sedar.com/search/search_form_pc_en.htm> [SEDAR Search]. For the restaurant business see e.g. A&W Revenue Royalties Income Fund, The Keg, and Boston Pizza. For consumer products see e.g. FP Newspapers, Heating Oil Partners, and Consumers’ Waterheater. For transportation see e.g. IAT Air Cargo and Westshore Terminals. For industrials see e.g. Advanced Fibre, BFI, and Superior Propane.

³ See Michele Robitaille & Mike Hoehn, “Business Income Trusts Evolving into a Core Asset Class”, National Bank Financial: Equity Research (6 March 2003) at 1. See also “IPO Activity Falls Off in First Half” *Ottawa Business Journal* (7 July 2003), online: Ottawa Business Journal archives <<http://archive.ottawa.businessjournal.com>> [“IPO Activity”]. While the dominance of income trusts in the IPO market was less significant in the first half of 2003, they still accounted for 45% of IPOs and for 80% of their gross value.

⁴ Robitaille & Hoehn, *ibid.* at 1. See also Andrew Willis, “Business Trusts No Laughing Matter” *Globe and Mail* (24 June 2003) B5, where the author put the number of income trusts at 111 [Willis, “No Laughing Matter”].

⁵ See Andrew Willis, “Ontario Election Call Puts Trust-Liability Issue on Hold” *Globe and Mail* (9 September 2003) B18.

⁶ See e.g. “IPO Activity”, *supra* note 3, noting the increasing importance of income trusts in the IPO market; Fabrice Taylor, “Will Feds Spoil Trust Tax Rush?” *Globe and Mail* (23 June 2003) B5;

phenomenon. Income trust IPOs dipped somewhat in 2003, but increased again in 2004 and 2005. Income trust offerings in the first half of 2005 accounted for \$1.8 billion (or nearly seventy per cent) of the \$2.6 billion worth of IPOs in that period.⁷ One investor service listed 116 business income trusts as of July 2005.⁸

Lawyers, dealers, and institutional investors expressed concern over the potential exposure of unitholders to liability, which led to legislation in Ontario, Alberta, British Columbia, and Manitoba aimed at putting the unitholders on par with shareholders in terms of their exposure to liability.⁹ When the Ontario government announced in its budget speech in February 2003 that it would introduce legislation dealing with the issue of unitholder liability, it also noted that it would look into income trust governance issues.¹⁰

The introduction of a trust that distributes trust units to investors, instead of a direct distribution of shares of the operating corporation, creates an opportunity to avoid many of the mandatory corporate law governance provisions intended to protect investors who buy shares in a corporation.¹¹ An important question is the extent to which income trusts provide governance provisions that correspond to corporate governance provisions. Another important question is the extent to which existing legal mechanisms require them to provide corresponding provisions. The purpose of this paper is to compare corporate governance to business income trust governance and highlight what corporate governance features may be lacking in business income trusts.

Willis, "No Laughing Matter", *supra* note 4; Elizabeth Church *et al.*, "A Matter of Trust" *Globe and Mail* (23 June 2003) B1; Rob Carrick, "Putting Trust in Trusts" *Globe and Mail* (1 June 2002), online: GlobeInvestor.com <<http://www.globeinvestor.com/servlet/ArticleNews/trusts/GAM/20020601/carrieK>>; Andrew Willis, "Trust Kings Fear Fad Will Ruin Reign" *Globe and Mail* (1 July 2003) B1; Amanda Long, "Nothing in Life is Free—Trusts Included" *Globe and Mail* (23 June 2003) B6.

⁷ See Sinclair Stewart, "Hot Trust Sector Yields IPO Bonanza" *Globe and Mail* (6 July 2005) B1. Although income trusts are said to be interest rate sensitive, it has been suggested that an increase in interest rates won't spell the end for income trusts. See Wayne Cheveldayoff, "Interest Rates Won't Scuttle Income Trusts" *Daily Gleaner* (8 July 2005).

⁸ For up-to-date information see Investcom, "Income Trusts", online: Investcom.com <www.investcom.com/incometrust/incometrust.htm>.

⁹ The Government of Ontario proposed a *Trust Beneficiaries' Liability Act*, introduced as Schedule L to Bill 41, *An Act to Implement Budget Measures*, 4th Sess., 37th Leg., Ontario, 2003 (first reading 22 May 2003). The legislature was dissolved prior to the election, before the legislation was enacted. The legislation was later enacted in a subsequent session: see the *Trust Beneficiaries' Liability Act, 2004*, S.O. 2004, c. 29, Schedule A [*Trust Beneficiaries' Liability Act*]. See also *Income Trusts Liability Act*, S.A. 2004, c. I-1.5 [*Alberta Income Trust Act*]; *Income Trust Liability Act*, S.B.C. 2006 c. 14 [*B.C. Income Trust Act*]; *Investment Trust Unitholders' Protection Act*, S.M. 2005, c. 36 [*Manitoba Unitholders' Protection Act*]. See also Bill 40, *An Act respecting Income Trusts*, 2d Sess., 25th Leg., Saskatchewan, 2006 (Third Reading 1 May 2006).

¹⁰ See 2003 Ontario Budget—*The Right Choices: Securing Our Future* at 13, online: Ontario Minister of Finance <http://www.fin.gov.on.ca/english/budget/bud03/pdf/papers_all.pdf>.

¹¹ See Part II, below, *infra* note 18-28 and the accompanying text noting the flexible nature of trust law and the consequent potential for avoiding mandatory corporate law provisions.

One observation drawn from this comparison is that declarations of trust for business income trusts largely replicate provisions of corporate statutes, such as the *Canada Business Corporations Act*.¹² There are, however, features of the *CBCA* that are not replicated. These include shareholder proposals, the appraisal remedy, and, at least at the trust fund level, the derivative action and the oppression remedy. The avoidance of these investor rights and remedies may be to the disadvantage of investors. This disadvantage could be addressed by legislation that mandates these rights for unitholders in business income trusts or by additional securities regulatory or stock exchange requirements. If such legislation or regulation only recreates existing corporate statutes in a trust context, what purpose would it serve? If the only remaining difference were in tax treatment, what could be the tax policy reason for the difference in treatment, particularly in light of the accepted principle of neutrality? If, however, avoiding corporate statute rights and remedies actually increases firm value, perhaps it is time to review the efficacy of these corporate rights and remedies. If such a review leads to corporate law modifications, so corporate law comes into line with income trust governance, the same concern arises: why have different tax treatment for two essentially identical forms of organization?

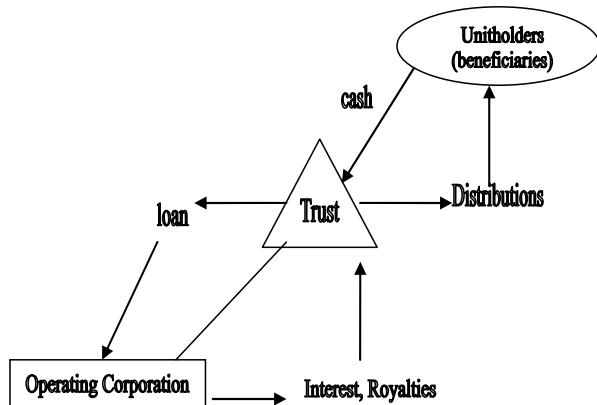
Part I of the paper sets out the basic structure of business income trusts, which is essential to assessing the extent to which the rights given to unitholders correspond to the rights they would have as shareholders in a corporation. Part II outlines the legal environment for the regulation of corporate governance and compares it to the legal environment for the regulation of business income trusts. Part III notes the indirect nature of unitholder control at the level of the entity carrying on the underlying business operations (the “operating entity”) and the need to assess unitholder governance at the level of both the trust and of the operating entity. Part IV provides specific comparisons of corporate governance and business income trust governance. Part V summarizes and discusses key differences between business income trust governance and governance under corporate statutes. Part VI notes other governance concerns that may arise in the context of business income trusts. Part VII discusses the need for a business income trust statute, and Part VIII recommends a reconsideration of tax policy or a reconsideration of those corporate law provisions that business income trusts avoid.

I. Basic Structure

A wide variety of business income trust structures have been used and generalizations are difficult.¹³ For the purposes of the discussion that follows, it is useful to keep in mind a simple structure and a few modified versions of it.

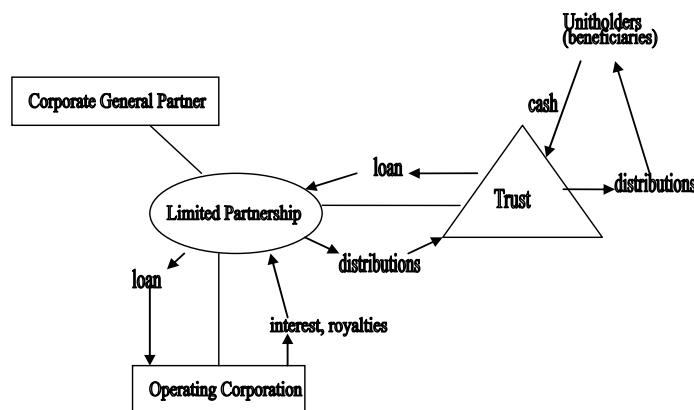
¹² R.S.C. 1985, c. C-44 [*CBCA*].

¹³ See Robitaille & Hoehn, *supra* note 3 at 44, 61-66, where the authors provide a breakdown of six general structures.

Diagram A

A very simple business income trust structure (see Diagram A) is one in which a trust fund has sold units to the public. The funds raised are invested in an entity that carries on the business operations. Unitholders are the beneficiaries of the trust. Trustees hold the equity interests in the operating entity, with the majority of funds advanced to the operating entity as a loan. The terms of the loan allow for most of the before-interest expense income of the operating entity to be distributed to the trustees as interest, thereby reducing the taxable income of the operating entity. The trustees can then distribute the amounts they receive from the operating entity to unitholders, so the pre-interest income of the operating entity flows through to unitholders to be taxed in their hands. The devices for extracting income from the operating entity may include the acquisition of rights to its trade names or marks which are then licensed back to the operating entity in exchange for royalty fees. The operating entity is normally a corporation, which provides limited liability for the trustees as shareholders. In some cases, however, the operating entity is a limited partnership or another trust.¹⁴

¹⁴ For examples where the operating entity is a limited partnership, see e.g. Consumers' Waterheater Income Fund, prospectus, 5 December 2002, available through SEDAR Search, *supra* note 2; Bell Nordiq Income Fund, prospectus, 9 April 2002, available through SEDAR Search, *supra* note 2; Noranda Income Fund, prospectus, 18 April 2002 at 16, available through SEDAR Search, *supra* note 2. In some cases, the operating entity is an operating trust, the units of which are held by the trustees of the trust that issues units to the investing public (this trust is usually referred to as the "Income Fund"). See e.g. Great Lakes Hydro Income Fund, prospectus, 28 June 2000 at 2, available through SEDAR Search, *supra* note 2; Clean Power Income Fund, prospectus, 30 October 2002 at 4, available through SEDAR Search, *supra* note 2.

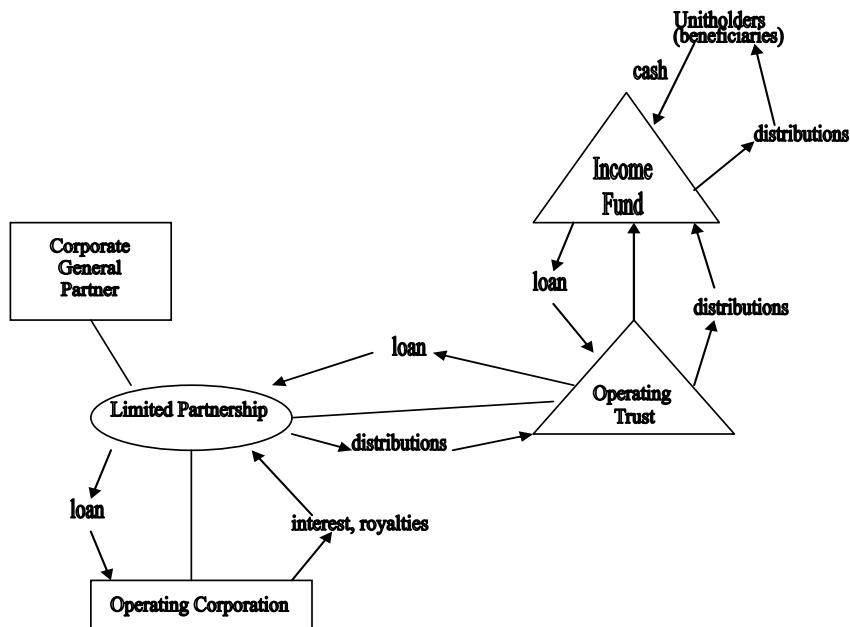
Diagram B

A modification to this simple structure is the insertion of one or more limited liability entities between the trust fund and the operating entity. A limited partnership is frequently used (see Diagram B). The trustees own limited partnership interests and the limited partnership owns equity interests in the underlying operating entity. The general partner in the limited partnership is normally a corporation.¹⁵ In some business income trusts, there is an additional trust (see Diagram C).¹⁶ The trust fund that distributes units to the investing public is often referred to as the “income fund” and the trustees of the income fund are beneficiaries of another trust, often referred to as the “operating trust.”¹⁷ The trustees of the operating trust own the limited partnership interests and receive, at least initially, the distributions of interest or royalties from the operating entity.

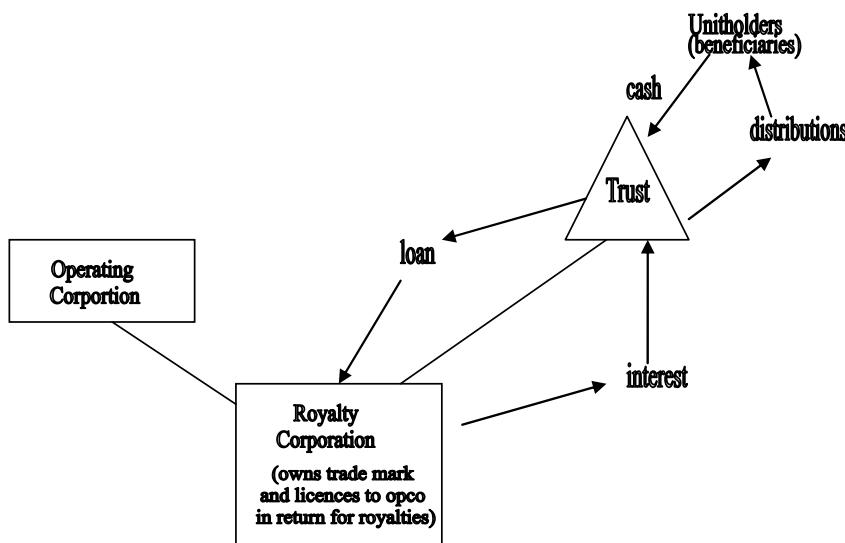
¹⁵ Structures with limited partnerships are briefly described in Robitaille & Hoehn, *supra* note 3 at 63-64. See e.g. Menu Foods Income Fund prospectus, 10 May 2002 at 14, 17, 40, available through SEDAR Search, *supra* note 2. The general partner in the limited partnership is Menu Foods General Par Limited, a corporation incorporated under the laws of Ontario. The operating trust owns all the shares of the general partner.

¹⁶ In some cases, the trustees of operating trusts directly own the operating assets. See e.g. Great Lakes Hydro Income Fund, *supra* note 14; Clean Power Income Fund, *supra* note 14. In other cases, the trustees of the operating trust own interests in the operating entity. See e.g. Bell Nordiq Income Fund, *supra* note 14; Noranda Income Fund, *supra* note 14. In still other cases, the trustees own interests in an entity that owns interests in the operating entity. See e.g. Menu Foods Income Fund, *ibid.*

¹⁷ See e.g. Menu Foods Income Fund, *ibid.*; Bell Nordiq Income Fund, *ibid.*; Noranda Income Fund, *ibid.* A structure with both an operating trust and fund trust is also briefly described in Robitaille & Hoehn, *supra* note 3 at 62.

Diagram C

In some structures, trustees may have very limited control over management of the operating entity. For instance, the operating entity may enter into a management contract with another corporation that manages significant aspects of its business. Another structure that limits control occurs where the loan from the trustees is made to a royalty corporation that owns the trade name and marks under which the business is operated. The royalty corporation then licenses the trade name and marks to the entity that carries on the business, but the trustees do not own the equity interests in the operating entity (see Diagram D).

Diagram D

Key documents include a trust instrument, usually entitled “declaration of trust”, which sets out the terms of the trust, and a note indenture setting out the terms of the loan between the trustees and the operating entity. The declaration of trust is the primary source of governance provisions for the trust.

II. Regulatory Environment

In common law jurisdictions, a corporation is normally subject to the statute under which it was incorporated and the case law in the jurisdiction where it was incorporated.¹⁸ A corporation will be subject to securities law requirements in jurisdictions in which it distributes securities to the public.¹⁹ If the corporation lists its securities on an exchange, it will be subject to requirements of the exchange.²⁰

¹⁸ See *National Trust Co. v. Ebro Irrigation & Power Co.*, [1954] O.R. 463 at 478, [1954] 3 D.L.R. 326 (H.C.); *Brown, Gow, Wilson v. Beleggings-Sociteit N.V.*, [1961] O.R. 815 at 829, 29 D.L.R. (2d) 673 (H.C.J.). See also Jean-Gabriel Castel & Janet Walker, *Canadian Conflict of Laws*, 6th ed., looseleaf (Markham, Ont.: Butterworths, 2005) at para. 30.1.

¹⁹ For instance, subject to an exemption, a person or company that distributes securities is required to provide a prospectus. See e.g. *Securities Act*, R.S.O. 1990, c. S-5, s. 53 [OSA]; *Securities Act*, R.S.B.C. c. 418, s. 61 [BCSA]. Once securities have been distributed under a prospectus, the issuer

Normally, a trust will be subject to the trust law of the jurisdiction designated in the trust instrument,²¹ or failing that, the jurisdiction with which the trust is most closely connected.²² It will be subject to the securities law requirements of jurisdictions in which it distributes units subject to a prospectus requirement.²³ If units of the trust are listed on an exchange, it also will be subject to the requirements of the exchange.²⁴

The key difference between the two is that the trust is governed by trust law, while the corporation is governed by corporate law. Corporate statutes in Canada generally have several mandatory provisions that provide certain rights to shareholders.²⁵ Trust law is primarily case-based and is very flexible.²⁶ While trust

becomes a “reporting issuer” (*OSA, ibid.*, s. 1(1); *BCSA, ibid.*, s. 1(1)), and is subject to continuous disclosure requirements such as financial disclosure (*OSA, ibid.*, ss. 77-79; *Securities Rules*, B.C. Reg. 194/97, s. 112 [B.C. Reg 194/97]), proxy solicitation (*OSA, ibid.*, ss. 84-88; *BCSA, ibid.*, ss. 116-19), reporting of insider trades (*OSA, ibid.*, ss. 107-109; *BCSA, ibid.*, s. 87), and reporting of material changes (*OSA, ibid.*, s. 75; *BCSA, ibid.*, s. 85).

²⁰ The Toronto Stock Exchange requires each listed company to sign a “Listing Agreement” that makes the company subject to the rules and policies of the exchange. The company agrees to “comply with all Exchange requirements applicable to listed companies, including Exchange rules, policies, rulings and procedural requirements, and any additions or amendments which may be made thereto from time to time ...” (“Listing Agreement” in *Toronto Stock Exchange Company Manual* (N.p.: CCH Canadian, 2006) at s. 351 and Appendix A at 1038, para. 1 [“Listing Agreement”], online: Toronto Stock Exchange <<http://www.tsx.com/en/pdf/CompanyManual.pdf>> [*TSX Company Manual*]).

²¹ See *Frymer v. Brettschnieder* (1992), 10 O.R. (3d) 157, 9 C.P.C. (3d) 294 (Gen. Div.), aff’d (1994), 19 O.R. (3d) 60, 115 D.L.R. (4th) 744 (C.A.). See also Jean-Gabriel Castel & Janet Walker, *supra* note 18 at 28.2(b). Where there is no designation by the settlor, the residence of the trustee will be a significant factor in determining the applicable law for administration of the trust. See *Branco v. Veira* (1995), 8 E.T.R. (2d) 49 (Ont. Gen. Div.). See also *Convention on the Law Applicable to Trusts and on their Recognition* at art. 6, online: Hague Conference on Private International Law <http://www.hcch.net/index_en.php?act=conventions.text&cid=59> [*Law Applicable to Trusts*]. The convention has not been ratified in the United States and has not been extended to or implemented in the provinces of Ontario, Quebec, or Nova Scotia. It has been implemented by other provinces in Canada. See the conventions of the Hague Conference on Private International Law, online: Hague Conference on Private International Law, <http://www.hcch.net/index_en.php?act=conventions.listing> and in particular *Law Applicable to Trusts*, *ibid.*

²² Castel & Walker, *ibid.* at 28.2(b).

²³ See e.g. *OSA, supra* note 19, s. 53; *BCSA, supra* note 19, s. 61. Trust units are likely to be considered securities under provincial securities legislation. A business income trust unit could be covered under any of several elements of the definition of “security” common in provincial legislation. See e.g. *OSA, ibid.*, s. 1(1). Business income trust units could fall within paragraph 1(1) “security” (e) as a “unit”; under paragraph 1(1) “security” (h) as a “certificate of share or interest in a trust ...”; and failing these, either paragraph 1(1) “security” (n) as an “investment contract”; or paragraph 1(1) “security” (i) as a “profit-sharing agreement or certificate”. Given the similarity of a unit in a business income trust to a share in a corporation, and given the jurisprudence on the expression “investment contract”, it would be highly unlikely that a unit in a business income trust would not be considered a security under provincial securities legislation.

²⁴ In *TSX Company Manual, supra* note 20, Part I, a “company” is defined to include a trust. A trust that lists units on the Toronto Stock Exchange would have to enter into a listing agreement.

²⁵ See e.g. *CBCA, supra* note 12, ss. 173, 183, 211, 176, 241, 190.

law developed with a view, in part, to protecting the interests of beneficiaries, they were usually beneficiaries of estate-planning trusts.²⁷ They were not usually investors.²⁸ Trust law thus does not have the kinds of provisions found in corporate law to provide rights to shareholders. Since trust law is flexible, however, a trust instrument could be drafted in a way that replicates for unitholders most of the rights that shareholders in a corporation would have in Canada. Although replication of shareholder rights in a trust instrument is possible, no feature of trust law makes it mandatory.

Units of business income trusts in Canada are typically publicly traded and listed on the Toronto Stock Exchange (“TSX”), so business income trusts are subject to securities regulatory control and to control by the TSX. Either securities regulators or the TSX could require that business income trusts replicate standard corporate governance features. Securities regulators could use their public interest discretion by refusing to issue a receipt for a prospectus where unitholders were not given rights

²⁶ With respect to the duty of care, see e.g. *Re Poche* (1984), 6 D.L.R. (4th) 40, 16 E.T.R. 68 (Alta. Q.B.) where it was held that a trust instrument may not waive the liability of a trustee for gross negligence. It was implicit that the trust instrument can otherwise waive the duty of care. The court cited several cases in which waiver provisions were considered. More recently in *Armitage v. Nurse* (1997), [1998] Ch. 241, [1997] 2 All E.R. 705 (C.A.) [Armitage cited to Ch.], Millet L.J. on behalf of the court noted that there was an “irreducible core” of obligation owed by trustees, but went on to note that “[t]he duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient” (*Armitage, ibid.* at 253-54). With respect to conflicts of interest, see e.g. *Kelly v. Cooper* (1992), [1993] A.C. 205, [1992] 3 W.L.R. 936 (P.C.). In an agency context, there were said to be implied terms varying the duty of the agent not to put itself in a position where its interests conflicted with those of the principal. The case varied the duty of the agent to keep the principal informed about matters of concern to the principal). See also *Space Investments Ltd. v. Canadian Imperial Bank of Commerce Trust Co. (Bahamas) Ltd.*, [1986] 1 W.L.R. 1072, [1986] All E.R. 75 (P.C.). The court noted that, “[a]lthough as a general rule, a trustee is not allowed to derive a benefit from trust property, that general rule may be altered by the express terms of the trust instrument” (*ibid.* at 1075).

²⁷ Many of the cases that laid the foundations of trust law are from the nineteenth century and early part of the twentieth century. See Gregory S. Alexander, “The Transformation of Trusts as a Legal Category, 1800-1914” (1987) 5 L.H.R. 303 at 322-49. While the business trust (i.e., the use of a trust as a means of organizing for the carrying on of business) appears to have begun in England near the beginning of the eighteenth century, this use of the trust “is one which historically has found only occasional popular appeal” (Robert D. Flannigan, “The Nature and Duration of the Business Trust” (1984) 6 E.&T.Q. 181 at 181). See generally Robert D. Flannigan, “Business Trusts—Past and Present” (1982-84) 6 E.&T.Q. 375 [Flannigan, “Past and Present”].

²⁸ There was limited use of business trusts in England in the nineteenth century and mutual funds did not appear in England until the 1930s. See Flannigan, “Past and Present”, *ibid.* at 375-78. See also John H. Langbein, “The Secret Life of the Trust: The Trust as an Instrument of Commerce” (1997) 107 Yale L.J. 165 at 165-66, 189. Langbein says that the main forms of commercial trust are twentieth-century inventions.

comparable to those provided in corporate statutes.²⁹ The TSX could also refuse to approve a listing for a business income trust that did not provide such rights.³⁰

Where business income trust units are publicly traded in Ontario and listed on the TSX, regulation by the Ontario Securities Commission sets the same governance requirements required of corporations. For instance, Ontario Securities Commission Rule 61-501 concerning related-party transactions would apply, as would National Instrument 58-101.³¹

III. Unitholder Control in Business Income Trusts Is Indirect

Although the trust instrument may be able to effectively recreate a corporate structure, with unitholder rights mimicking those provided by a corporate statute, the business income trust complicates the structure. The structure has at least two tiers³² and unitholders are thus one step further removed from the managers of the underlying operating entity. Unitholder control over management of the operating entity is exercised through the trustees who hold the shares (or other interests) and can exercise the rights associated with them. Unitholder control of the management of the underlying entity is indirect. They either direct the trustees concerning, for instance, voting on corporate fundamental changes, or they replace the trustees³³ where they feel the trustees have not effectively monitored the management of the underlying operating entity.

Declarations of trust for income trusts typically set out a regime for unitholders similar to that for shareholders. Unitholders elect the trustees and can vote to remove

²⁹ See e.g. OSA, *supra* note 19, which provides that “the Director shall issue a receipt for a prospectus filed under this Part unless it appears to the Director that it is not in the public interest to do so” (*ibid.*, s. 61). See also BCSA, *supra* note 19, s. 64.

³⁰ As noted above at note 20, the TSX requires a person listing on the Exchange to enter into a listing agreement. The opening words of the standard form listing agreement provide that “[i]n consideration of the listing on Toronto Stock Exchange ... the Applicant agrees with the Exchange as follows: ...” (“Listing Agreement”, *supra* note 20). The Listing Agreement is contractual in nature. The TSX could refuse to enter into a listing agreement with the business income trust if its declaration of trust did not provide certain terms specified by the exchange.

³¹ *Disclosure of Corporate Governance Practices*, O.S.C. NI 58-101 (17 June 2005) [National Instrument 58-101].

³² See Part I, above.

³³ Typically, a declaration of trust grants voting rights regarding the election and removal of trustees comparable to those provided for in the CBCA, *supra* note 12, ss. 106(3), 109. See e.g. A&W Revenue Royalties Income Fund, Declaration of Trust, 18 December 2001, ss. 8.2, 8.6, available through SEDAR Search, *supra* note 2 [A&W Declaration]; BFI Canada Income Fund, Amended and Restated Declaration of Trust, 15 April 2002, ss. 8.2, 8.6, available through SEDAR Search, *supra* note 2 [BFI Declaration]; Chemtrade Logistics Income Fund, Amended and Restated Declaration of Trust, 11 July 2001, ss. 8.2, 8.6, available through SEDAR Search, *supra* note 2 [Chemtrade Declaration].

trustees.³⁴ They can requisition a meeting of unitholders.³⁵ They vote on other important matters, such as the amendment of the declaration of trust, the sale of all or substantially all of the trust assets, or the dissolution of the trust.³⁶ The meeting process is similar to the meeting process for shareholders of a *CBCA* corporation.³⁷ There are important differences, however. Unitholders normally do not directly elect the management board of the underlying operating entity.³⁸ Although trustees are typically required to obtain unitholder consent to certain operating entity fundamental changes,³⁹ they do not directly control fundamental changes in the underlying entity. In comparing the governance of business income trusts to that of corporations in Part IV below, the analysis looks at the rights of unitholders at the trust level and also at the level of the operating entity.

The discussion below assumes that trustees of the trust that has issued units to the public have either direct or indirect control over the equity interests of the operating entity. It should be noted, however, that while this situation is normal, there are exceptional situations in which trustees have neither direct nor indirect control of the operating entity's equity interests.⁴⁰ There are also some situations in which the operating entity has entered into a management contract that significantly impinges on the degree of control over management of the operating entity, even if trustees have direct or indirect control over the equity interests.

IV. Specific Comparisons of Corporate Governance and Business Income Trust Governance

This Part compares the governance of business income trusts to that of corporations. Section A looks at investor rights, noting the particular voting rights, the

³⁴ See e.g. A&W Declaration, *ibid.*, ss. 8.2, 8.6; BFI Declaration, *ibid.*, ss. 8.2, 8.6; Chemtrade Declaration, *ibid.*, ss. 8.2, 8.6.

³⁵ Typically, a declaration of trust contains a section comparable to *CBCA*, *supra* note 12, s. 143. See e.g. A&W Declaration, *ibid.*, s. 12.2; BFI Declaration *ibid.*, s. 12.1; Chemtrade Declaration, *ibid.*, s. 12.5.

³⁶ See *CBCA*, *ibid.*, ss. 211, 189. Compare A&W Declaration, *ibid.*, ss. 11.1, 14.2, 9.4(a)(iii), 9.4(b); BFI Declaration, *ibid.*, ss. 11.1, 12.6, 14.2, 9.4(a)(iii), 9.4(b); Chemtrade Declaration, *ibid.*, ss. 11.1, 14.2, 9.4(a)(iii), 9.4(b).

³⁷ See Part IV.A.3, below.

³⁸ There are some exceptions. First, it is not uncommon for the trustees to also serve as the directors of the operating entity. The elections of trustees thus may be tantamount to an election of directors of the operating entity. Second, some declarations of trust call for trustees to vote only for directors approved by unitholders. See e.g. BFI Declaration, *ibid.*

³⁹ See e.g. A&W Declaration, *supra* note 33, s. 9.4(a); BFI Declaration, *ibid.*, s. 9.4(a); Chemtrade Declaration, *supra* note 33, s. 9.4(a).

⁴⁰ For instance, according to the A&W prospectus, the trustees own equity interests in a corporation that licenses the trademark to the operating entity. The licensing corporation does not own the operating entity. The licensing corporation is partly owned by the operating entity. See A&W Revenue Royalties Income Fund prospectus, 8 February 2002 at 12, available through SEDAR Search, *supra* note 2 [A&W Prospectus].

disclosure that supports those rights, and the process through which those rights are exercised. Section B looks at the management structure, noting the structure of the board of trustees and the board of the underlying operating entity as well as the powers and duties of the trustees. Section C examines the remedies available to investors.

A. Investor Rights

1. Voting Rights

a. Common Corporate Law Requirements

Shareholders in a corporation have a right to vote on certain matters. They vote to elect directors.⁴¹ They can also vote to remove one or more directors.⁴² They normally vote to appoint auditors⁴³ and on certain fundamental changes including the amendment of the articles,⁴⁴ an amalgamation,⁴⁵ a sale, a lease, or an exchange of all or substantially all of the corporation's assets,⁴⁶ or a voluntary dissolution of the corporation.⁴⁷ Voting on fundamental changes requires a supermajority vote,⁴⁸ which under the *CBCA* is two-thirds of the votes cast.⁴⁹ In addition, where a corporation has more than one class of shares, certain fundamental changes may require separate special resolutions from affected classes of shares.⁵⁰

b. Trust Level

Declarations of trust for business income trusts typically give unitholders the right to elect and to remove the trustees of the fund by majority vote.⁵¹ Unitholders also typically must approve appointment of an auditor.⁵²

⁴¹ *CBCA*, *supra* note 12, s. 106(1); *Ontario Business Corporations Act*, R.S.O. 1990, c. B-16, s. 119(4) [*OBCA*].

⁴² *CBCA*, *ibid.*, s. 109; *OBCA*, *ibid.*, s. 122.

⁴³ *CBCA*, *ibid.*, s. 162; *OBCA*, *ibid.*, s. 149. Note that corporate statutes usually provide that shareholders can vote to waive the appointment of an auditor if the corporation has not made a distribution to the public. *CBCA*, *ibid.*, s. 163; *OBCA*, *ibid.*, s. 148.

⁴⁴ *CBCA*, *ibid.*, s. 173; *OBCA*, *ibid.*, s. 168.

⁴⁵ *CBCA*, *ibid.*, s. 183; *OBCA*, *ibid.*, s. 176.

⁴⁶ *CBCA*, *ibid.*, s. 189; *OBCA*, *ibid.*, s. 184.

⁴⁷ *CBCA*, *ibid.*, s. 211(3); *OBCA*, *ibid.*, s. 193.

⁴⁸ *CBCA*, *ibid.*, ss. 173, 183, 189(3), 211; *OBCA*, *ibid.*, ss. 168, 176, 184(3), 193 requiring approval by “special resolution”.

⁴⁹ *CBCA*, *ibid.*, s. 2(1) “special resolution”; *OBCA*, *ibid.*, s. 1(1) “special resolution”.

⁵⁰ See e.g. *CBCA*, *ibid.*, ss. 176(1), 183, 211, 189.

⁵¹ See e.g. A&W Declaration, *supra* note 33, ss. 8.2, 8.6; BFI Declaration, *supra* note 33, ss. 8.2, 8.6; Chemtrade Declaration, *supra* note 33, ss. 8.2, 8.6.

Unitholders must vote to approve the amendment of the declaration of trust,⁵³ which is the constitutional document of the trust. It is similar to the articles of incorporation. They must also typically approve other fundamental changes that are particularly relevant at the trust level. Two such changes (similar to fundamental changes to a corporation) are the termination of the trust (equivalent to the dissolution of a corporation)⁵⁴ and the sale, lease, or exchange of all or substantially all of the trust assets.⁵⁵ Two other fundamental changes that typically must be approved by unitholders are an amendment to the “note indenture” and a sale of the notes issued by the underlying operating entity⁵⁶ or the interests in, or connected to, the underlying operating entity.⁵⁷ The note indenture is normally the document appointing an indenture trustee and setting out the terms on which a loan has been made to the underlying operating entity.⁵⁸ Since interest on the loan is normally the main source of distributions to the trust, it is of vital importance to unitholders. Notes issued by the operating entity and the interests in or connected to it are, in a sense, the *raison d'être* of the unitholder's investment. The sale of these interests is of fundamental importance. Voting on these fundamental changes typically mimics the *CBCA* requirement of a two-thirds majority of the votes cast.⁵⁹

c. Operating Entity Level

What rights do unitholders have concerning the voting of shares of the operating corporation? In the simplest business income trust structures, trustees are the registered holders of the shares of the operating corporation. The trustees thus exercise voting rights on the shares. Declarations of trust typically provide that the unitholders must approve certain fundamental changes at the level of the operating entity, including its voluntary dissolution, an amalgamation of the operating corporation (or other form of combination or merger of a noncorporate operating

⁵² See e.g. A&W Declaration, *ibid.*, s. 17.2; BFI Declaration, *ibid.*, s. 17.2; Chemtrade Declaration, *ibid.*, s. 17.2.

⁵³ See e.g. A&W Declaration, *ibid.*, s. 11.1; BFI Declaration *ibid.*, ss. 11.1, 12.6; Chemtrade Declaration, *ibid.*, s. 11.1.

⁵⁴ See *CBCA*, *supra* note 12, s. 211. Compare A&W Declaration, *ibid.*, s. 14.2; BFI Declaration *ibid.*, ss. 14.2, 12.6; Chemtrade Declaration, *ibid.*, s. 14.2.

⁵⁵ See *CBCA*, *ibid.*, ss. 189. Compare A&W Declaration, *ibid.*, s. 9.4(b); BFI Declaration, *ibid.*, s. 9.4(b); Chemtrade Declaration, *ibid.*, s. 9.4(b).

⁵⁶ See e.g. A&W Declaration, *ibid.*, ss. 9.4(a)(iii), 9.4(b); BFI Declaration *ibid.*, ss. 9.4(a)(iii), 9.4(b); Chemtrade Declaration, *ibid.*, ss. 9.4(a)(iii), 9.4(b).

⁵⁷ Usually these are shares in an operating corporation. See e.g. A&W Declaration, *ibid.*, s. 9.4(b); BFI Declaration, *ibid.*, s. 9.4(b); Chemtrade Declaration, *ibid.*, s. 9.4(b).

⁵⁸ See e.g. A&W Revenue Royalties Income Fund, “Note Indenture Between A&W Trade Marks Inc. and Computershare Trust Company of Canada”, 1 February 2002, available through SEDAR Search, *supra* note 2; BFI Canada Income Fund, “Note Indenture between BFI Canada Holdings Inc. and Computershare Trust Company of Canada”, 25 April 2002, available through SEDAR Search, *supra* note 2.

⁵⁹ See A&W Declaration, *supra* note 33, s. 9.4(b); BFI Declaration, *supra* note 33, s. 9.4(b); Chemtrade Declaration, *supra* note 33, s. 9.4(b).

entity), or an amendment to its articles (or other constituting document). The trustees are not to vote the operating entity equity interests in favour of such fundamental changes without the approval of unitholders.⁶⁰

d. Summary

Unitholders' rights at the trust level appear to generally replicate the corporate law regime. Unitholders have rights, roughly corresponding to those of shareholders, to choose the trustees and to control changes in the trust that are of fundamental importance to unitholders. They also have rights at the level of the operating corporation that roughly replicate rights they would have as shareholders of that corporation, except that those rights must be exercised indirectly through the trustees.

2. Disclosure

a. Prospectus Disclosure

Members of the investing public acquiring shares in a corporation are provided with initial disclosure in the form of a prospectus. Securities laws require this disclosure,⁶¹ and also require prospectus disclosure where units of a trust that would constitute a "security" are sold to the public.⁶²

Business income trust units are securities under provincial securities laws⁶³ and thus the distribution of business income trust units to the public requires a prospectus. Part 2 of National Policy 41-201⁶⁴ sets out a number of expectations the Canadian Securities Administrators ("CSA") have for income trust prospectus disclosure. These expectations concern unique features of income trusts that should be disclosed for the prospectus to contain "full, true and plain disclosure of all material facts."⁶⁵ For instance, paragraphs 2.1 to 2.5 deal with disclosure concerning "distributable cash" that forms the base from which distributions to the trust and then to unitholders can be made. Paragraphs 2.6 to 2.9 deal with disclosure concerning "material debt," that is, debt that ranks before rights of unitholders to distributable cash. Interest charges

⁶⁰ See e.g. A&W Declaration, *ibid.*, s. 9.4(a); BFI Declaration, *ibid.*, s. 9.4(a); Chemtrade Declaration, *ibid.*, s. 9.4(a). Since the declaration of trust requires the trustees to refer such changes to unitholders, a vote on such changes without unitholder approval would be a breach of trust.

⁶¹ See e.g. *OSA, supra* note 19, s. 53; *BCSA, supra* note 19, s. 61.

⁶² *OSA, ibid.*, provides that "[n]o person or company shall trade in a security ... where such trade would be a distribution of such security, unless a preliminary prospectus and a prospectus have been filed and received therefor obtained from the Director" (*ibid.*, s. 53). A "person" is defined to include a trust. See the definition of "person" in *OSA, ibid.*, s. 1(1); *BCSA, ibid.*, ss. 1(1), 61.

⁶³ See *supra* note 23 and accompanying text.

⁶⁴ *Income Trusts and Other Indirect Offerings*, O.S.C. NP 41-201 (3 December 2004) [National Policy 41-201].

⁶⁵ Legislation requires that the issuer provide a certificate with this wording. See e.g. *OSA, supra* note 19, s. 58; *BCSA, supra* note 19, s. 68.

on such debt, particularly where it is floating rate debt, and breaches of financial covenants on such debt could have a significant effect on distributions to unitholders. National Policy 41-201 also deals with stability ratings that rate the stability of the cash flows from the income trust. While paragraph 2.11 says that a stability rating is not required, paragraph 2.12 provides that where one is obtained the CSA expect it to be displayed on the cover page of the prospectus. Paragraphs 2.14 to 2.16 of the policy also indicate the CSA's expectation that income trust prospectuses will contain disclosure concerning the executives of the operating entity (as if the operating entity were a subsidiary of the income trust), including management compensation, management incentive plans, and external management contracts.

b. Continuous Disclosure

Once shares have been issued, corporate statutes in Canada require that certain information be provided, or made available, to shareholders. This information may assist shareholders in monitoring the performance of the corporation's management and help them make informed decisions when exercising their voting rights. These requirements include access to specified corporate records,⁶⁶ the provision of financial statements,⁶⁷ and a proxy circular.⁶⁸ There are similar securities law requirements for financial statement disclosure,⁶⁹ proxy solicitation, and proxy circular disclosure⁷⁰ where the corporation has distributed securities to the public by way of a prospectus.⁷¹ If the shares of the corporation are also listed on the TSX, there will be a TSX requirement to provide financial disclosure as well.⁷² The *CBCA* and similar corporate statutes in Canada also provide shareholders with access to records such as the articles and bylaws, minutes of shareholder meetings, copies of notices of directors and of the registered office, and access to the securities register.⁷³ In addition, they can request that the corporation provide a list of shareholders.⁷⁴

⁶⁶ *CBCA*, *supra* note 12, ss. 20, 21; *OBCA*, *supra* note 41, ss. 141, 142.

⁶⁷ *CBCA*, *ibid.*, s. 155; *OBCA*, *ibid.*, s. 154.

⁶⁸ *CBCA*, *ibid.*, ss. 149, 150; *OBCA*, *ibid.*, ss. 111, 112.

⁶⁹ See e.g. *OSA*, *supra* note 19, ss. 77, 78; *B.C. Reg.* 194/97, *supra* note 19, ss. 144, 145. See also *Continuous Disclosure Obligations*, O.S.C. NI 51-102 (2 April 2004), Part IV [National Instrument 51-102] on financial disclosure requirements.

⁷⁰ See e.g. *OSA*, *ibid.*, ss. 85, 86; *BCSA*, *ibid.*, s. 117. See also National Instrument 51-102, *ibid.*, Part IX on proxy solicitation and information circulars.

⁷¹ It is "reporting issuers" that are subject to the financial disclosure, proxy solicitation, and information circular requirements. See e.g. *OSA*, *ibid.*, ss. 77, 78, 85, 86; *BCSA*, *ibid.*, s. 117; *B.C. Reg* 194/97, *supra* note 19, ss. 144, 145. A "reporting issuer" is defined under *OSA* as "an issuer ... that has filed a prospectus and obtained a receipt therefor under [the] Act" (*ibid.*, s. 1(1)). See also *BCSA*, *ibid.*, s. 1(1) "reporting issuer" (a), (b).

⁷² See *TSX Company Manual*, *supra* note 20 at ss. 436-54.

⁷³ *CBCA*, *supra* note 12, ss. 20, 21(1), (1.1), (2).

⁷⁴ See *CBCA*, *ibid.*, s. 21.

Securities laws also require reporting issuers to provide annual information forms and management discussion and analysis.⁷⁵

At the trust level, the declaration of trust normally gives unitholders corresponding rights. There is usually a provision calling for the delivery of financial statements to unitholders.⁷⁶ The delivery of an information circular (corresponding to a proxy circular) is also required.⁷⁷ Even if these rights were not specifically given in the declaration of trust, unitholders would have rights to financial disclosure and proxy solicitation under securities laws.⁷⁸

Declarations of trust for business income trusts usually also provide for access to records, although the access is usually limited to the declaration of trust and the list of unitholders.⁷⁹ There is, however, a broader general trust law right of beneficiaries to request that trustees, on reasonable notice, produce documents relating to the trust for their inspection. It is not clear what documents are included. An application to court may be necessary where the trustees dispute the obligation to disclose the particular documents requested.⁸⁰ This right of access might extend to minutes of unitholder meetings and to bylaws passed concerning the affairs of the trust, thereby making the right of access to documents roughly equivalent to rights of access under corporate statutes such as the *CBCA*. Declarations of trust also usually provide for a list of unitholders to be provided to a unitholder on request in a manner similar to the *CBCA*.⁸¹

While disclosure at the trust level is important, disclosure of what is happening at the operating corporation level is at least as important, if not more so. Distributions to unitholders ultimately depend on the performance of the operating corporation. Financial disclosure at the trust level should address this fact, since securities law requires that the issuer provide audited financial statements.⁸² Generally accepted

⁷⁵ See National Instrument 51-102, *supra* note 69 at Parts V and VI.

⁷⁶ See e.g. A&W Declaration, *supra* note 33, s. 16.7; BFI Declaration, *supra* note 33, s. 16.9; Chemtrade Declaration, *supra* note 33, s. 16.7.

⁷⁷ See e.g. A&W Declaration, *ibid.*, s. 16.8; BFI Declaration, *ibid.*, s. 16.10; Chemtrade Declaration, *ibid.*, s. 16.8.

⁷⁸ See e.g. OSA, *supra* note 19, ss. 77, 78; B.C. Reg. 194/97, *supra* note 19, ss. 144, 145; National Instrument 51-102, *supra* note 69.

⁷⁹ See e.g. A&W Declaration, *supra* note 33, s. 16.5; BFI Declaration, *supra* note 33, s. 16.5; Chemtrade Declaration, *supra* note 33, s. 16.5.

⁸⁰ On the rights of beneficiaries to disclosure see e.g. *Re Ballard Estate* (1994), 20 O.R. (3d) 350, 119 D.L.R. (4th) 750 (Gen. Div.); *Re Murphy's Settlement*, [1998] 3 All E.R. 1 (Ch. D.); *Re Londonderry's Settlement* (1964), [1965] Ch. 918, [1964] 3 All E.R. 855 (C.A.); *Jones v. Shipping Federation of British Columbia* (1963), 37 D.L.R. (2d) 273, 41 W.W.R. 636 (B.C.S.C.). *Schmidt v. Rosewood Trust Ltd. (Isle of Man)*, [2003] 3 All E.R. 76, [2003] UKPC 26 provides a recent and extensive discussion of the issue of beneficiary access to trust documents.

⁸¹ See e.g. A&W Declaration, *supra* note 33, s. 16.5; BFI Declaration, *supra* note 33, s. 16.5; Chemtrade Declaration, *supra* note 33, s. 16.5.

⁸² OSA, *supra* note 19, ss. 77, 78; B.C. Reg. 194/97, *supra* note 19, ss. 144, 145; National Instrument 51-102, *supra* note 69. These statements are to be prepared according to generally

accounting principles require consolidated information concerning entities controlled by the trust.⁸³ Since the trust normally controls the shares of the operating corporation (either directly or indirectly through a limited partnership or another trust), financial statements should include disclosure concerning the underlying operating corporation. Financial statements of income trusts are generally consolidated and provide operating corporation financial information.⁸⁴ National Policy 41-201 confirms the expectation that financial statements will include disclosure of financial information concerning the operating entity.⁸⁵ It adds that where securities laws of certain jurisdictions are ambiguous in this respect, the issuer of income trust units will be required to provide an undertaking that the operating entity will be treated as a subsidiary of the income trust.⁸⁶

The extent to which proxy circular disclosure extends to the level of the underlying operating corporation is an interesting question. For corporations that have made distributions to the public, regulations under the *CBCA* contain specific requirements for proxy circular disclosure.⁸⁷ There is also a common law principle that shareholders be given sufficient information to make a reasoned decision on any matter to be voted on at a shareholders' meeting.⁸⁸ Provincial securities regulations contain detailed information circular requirements. There is also a requirement that if action other than approval of financial statements is to be taken at a meeting of security holders, "the substance of the matter ... should be described ... in sufficient detail to permit security holders to form a reasoned judgment concerning the matter."⁸⁹ Where unitholders vote to approve an amalgamation of the operating corporation, an amendment of its articles, a voluntary dissolution of the operating

accepted accounting principles, as set out in the *CICA Handbook—Accounting*, looseleaf (Toronto: Canadian Institute of Chartered Accountants, 1999) [*CICA Handbook*]. See *OSA*, R.R.O. 1990, Reg. 1015, s. 2; *BCSA* Rules ss. 1, 2. See also *Notice of Rule Under the Securities Act*, O.S.C. NI 14-101 (31 December 2002) [as amended].

⁸³ See *CICA Handbook*, *ibid.* s. 1590, which deals with when financial statements should be consolidated.

⁸⁴ See e.g. Chemtrade Logistics Income Fund, 2002 Annual Report at 21, n. 2, available through SEDAR Search, *supra* note 2, concerning the basis of consolidation. Whether financial statements include a consolidation of the operating entity itself may depend on the structure of the income trust. For instance, the A&W Revenue Royalties Income Fund Annual Report for 2002, available through SEDAR Search, *supra* note 2, consolidates the accounts of the trust and of A&W Trade Marks Inc. at 19, n. 2. A&W Trade Marks Inc. does not operate the business. Instead it owns trademarks that are licensed to A&W Food Services of Canada Inc., which operates the business. The annual report and the management discussion and analysis therein focus on the underlying business of the operating entity at 10-14. On the organization of the income trust, see the A&W Prospectus, *supra* note 40.

⁸⁵ *Supra* note 64 at para. 3.1.

⁸⁶ *Ibid.*

⁸⁷ S.O.R./2001-512, s. 57.

⁸⁸ See e.g. *Pacific Coast Coal Mines Ltd. v. Arbuthnot*, [1917] A.C. 607, 36 D.L.R. 564 at 571-72 (P.C.); *Re N. Slater Ltd.*, [1947] 2 D.L.R. 311 at 313-14, O.W.N. 226 (H.C.J.); *Re Nat'l Grocers Ltd.*, [1938] O.R. 142 at 154 (H.C.J.); *Garvie v. Axmith* (1961), [1962] O.R. 65, 31 D.L.R. (2d) 65 at 84-87 (H.C.J.).

⁸⁹ *Information Circular*, B.C.S.C. BCF 54-901F (1 June 2001), Item 11.

corporation, or a sale, lease, or exchange of all or substantially all of its assets, unitholders would have to be given information sufficient to make an informed decision on the matter, much as if they were shareholders of the operating corporation.

In addition to proxy disclosure, an income trust that has made a distribution of units to the public pursuant to a prospectus will be required to provide an annual information form and management discussion and analysis.⁹⁰ National Policy 41-201 indicates the CSA expectation that these forms of disclosure for an income trust cover information about the operating entity.⁹¹

What information should unitholders be given about the managers of the underlying operating corporation? Arguably unitholders should be given detailed information, particularly about the directors (or other equivalent managers in a noncorporate operating entity). Since one of the main functions of trustees, at least in a simple business income trust structure,⁹² is appointing the directors of the operating corporation, unitholders should be given information about the directors to assess the performance of the trustees. To the extent there is uncertainty, it might be helpful for securities regulators to add an item to the form for a proxy circular, requiring business income trusts to provide information about the managers of the operating entity. This information should correspond to the information that shareholders would get in a proxy circular concerning the managers of a corporation. National Policy 41-201 indicates that the annual information form of the income trust should provide complete business disclosure about the operating entity. Where securities laws are ambiguous in this regard, an undertaking to provide such disclosure will be required before a receipt for a prospectus is provided to permit the issuance of income trust securities.

c. Timely Disclosure

Securities laws and stock exchanges require timely disclosure to shareholders. Most provincial securities laws require that if shares have been distributed by way of

⁹⁰ See National Instrument 51-102, *supra* note 69, Parts IV and V.

⁹¹ *Supra* note 64 at para. 3.1.

⁹² Things may be more complex in the context of more complicated income trust structures. For instance, the trustees of the fund may own units in an operating trust. The trustees in the operating trust may own units in a limited partnership, which owns shares in the corporation. It may be more difficult to argue that unitholders in the fund need information about the directors and officers of the operating corporation if it lies three layers below the fund. The trustees of the fund have control over the appointment of trustees of the operating trust, but the trustees of the operating trust might not have control over the appointment of directors of the operating corporation. Their rights as limited partners might be so limited for fear of losing their limited partnership status (by taking part in control of the limited partnership). Nonetheless, information about who runs the operating entity from which their returns come is important information for unitholders.

a prospectus, the corporation must disclose “material changes.”⁹³ A material change is typically defined as “a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer ...”⁹⁴ When a material change occurs, the corporation must issue a press release and file a report with the securities commission as soon as possible.⁹⁵ If the shares are listed on the TSX, the timely disclosure requirement extends to “material facts”.⁹⁶ A material fact is any fact that would reasonably be expected to have a significant effect on the market price or value of the issuer’s securities.⁹⁷ The units of a business income trust are securities⁹⁸ and if (as is the normal case) they have been distributed to the public by way of a prospectus offering, the trust will be subject to the timely disclosure requirements under provincial securities laws.⁹⁹ If units are listed on the TSX, as is also normally the case, the timely disclosure requirement extends to material facts as well.¹⁰⁰

The question is just how far this disclosure extends. The shares of the operating corporation (or the equity interests of a noncorporate operating entity) in a business income trust are not publicly distributed. Typically they will not have been part of a prospectus offering. They will also typically not be listed on a stock exchange. The operating entity thus will not be subject to the timely disclosure requirement either under securities laws or TSX rules. Does the trust’s timely disclosure obligation extend to disclosure of material facts concerning the operating entity itself? Any fact or change material for the operating entity would also be material for the trust, since the value of the units of the trust is directly tied to the fortunes of the operating entity. National Policy 41-201 indicates the CSA expects that material changes at the operating entity level be reported.¹⁰¹

3. Meeting Process

a. Common Corporate Law Requirements

Corporate statutes in Canada require that notice of meetings be given to shareholders of record.¹⁰² The statutes allow directors to set a record date to determine

⁹³ *OSA*, *supra* note 19, s. 75; *BCSA*, *supra* note 19, s. 85.

⁹⁴ *OSA*, *ibid.*, s. 1(1). See also *BCSA*, *ibid.*, s. 1(1).

⁹⁵ See e.g. *OSA*, *ibid.*, s. 75; *BCSA*, *ibid.*, s. 85.

⁹⁶ *TSX Company Manual*, *supra* note 20 at ss. 407, 410.

⁹⁷ *OSA*, *supra* note 19, s. 1(1). See also *BCSA*, *supra* note 19, s. 1(1).

⁹⁸ See *supra* note 23.

⁹⁹ “Reporting issuers” are subject to the timely disclosure requirements. See e.g. *OSA*, *supra* note 19, s. 75. See also *supra* note 71.

¹⁰⁰ See *TSX Company Manual*, *supra* note 20 at ss. 407, 410. “Company” is defined to include a trust *TSX Company Manual*, *ibid.*, Part I.

¹⁰¹ *Supra* note 64 at para. 3.1.

¹⁰² *CBCA*, *supra* note 12, s. 135; *OBCA*, *supra* note 41, s. 96.

the shareholders who will be entitled to get notice.¹⁰³ Corporate statutes generally give shareholders a right to vote by proxy¹⁰⁴ and require management of the corporation to solicit a proxy from shareholders.¹⁰⁵ They also typically specify that the business of annual meetings include the presentation and approval of the financial statements, election of directors, and appointment of auditors.¹⁰⁶ They set out a default quorum for the meeting¹⁰⁷ and allow for voting by a show of hands, with a right to demand a poll.¹⁰⁸ Provision is also made for resolutions in writing signed by all shareholders entitled to vote on the matter, in lieu of a meeting.¹⁰⁹ Corporate statutes also allow shareholders to requisition meetings.¹¹⁰ The *CBCA* allows shareholders holding five per cent or more of the rights to requisition a meeting to vote on matters for which the meeting is requisitioned.¹¹¹ Many corporate statutes also permit a shareholder to make a proposal to amend corporate bylaws¹¹² or to otherwise put matters before the shareholders using the management proxy solicitation materials.¹¹³

Not all resolutions passed by shareholders will be binding. Corporate law divides powers between directors and shareholders. Shareholders can pass resolutions on those matters that are within their powers. They can also pass resolutions relating to matters falling within the powers of directors, but such resolutions are not binding on the directors.¹¹⁴ Shareholder resolutions that purport to dictate to directors how they are to exercise their powers are sometimes referred to as “precatory resolutions” because they are not legally binding. They amount to no more than expressions of the wishes of the majority of shareholders.

b. Trust Level

For the most part, corporate meeting requirements are replicated at the trust level. Declarations of trust contain provisions for notice of meetings,¹¹⁵ the setting of a

¹⁰³ *CBCA*, *ibid.*, s. 134; *OBCA*, *ibid.*, s. 95(2).

¹⁰⁴ *CBCA*, *ibid.*, s. 148; *OBCA*, *ibid.*, s. 110.

¹⁰⁵ *CBCA*, *ibid.*, s. 149; *OBCA*, *ibid.*, s. 111.

¹⁰⁶ *CBCA*, *ibid.*, s. 135(5); *OBCA*, *ibid.*, s. 96(5).

¹⁰⁷ *CBCA*, *ibid.*, s. 139; *OBCA*, *ibid.*, s. 101.

¹⁰⁸ *CBCA*, *ibid.*, s. 141; *OBCA*, *ibid.*, s. 103.

¹⁰⁹ *CBCA*, *ibid.*, s. 142; *OBCA*, *ibid.*, s. 104.

¹¹⁰ *CBCA*, *ibid.*, s. 143; *OBCA*, *ibid.*, s. 103(5).

¹¹¹ *CBCA*, *ibid.*, s. 143. *OBCA*, *ibid.*, s. 103(5) also allows a requisition of a meeting by shareholders with five per cent or more of the rights to vote on matters for which the meeting is requisitioned.

¹¹² *CBCA*, *ibid.*, s. 103; *OBCA*, *ibid.*, s. 116(5).

¹¹³ *CBCA*, *ibid.*, s. 137; *OBCA*, *ibid.*, s. 99.

¹¹⁴ See *e.g.* *Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cunningham*, [1906] 2 Ch. 34 (C.A.); *Kelly v. Electrical Construction Co.* (1907), 16 O.L.R. 232 (H.C.J.); *Scott v. Scott*, [1943] 1 All E.R. 582 (Ch.).

¹¹⁵ See *e.g.* A&W Declaration, *supra* note 33, s. 12.3; BFI Declaration, *supra* note 33, s. 12.2; Chemtrade Declaration, *supra* note 33, s. 12.2.

record date to determine unitholders entitled to receive notice,¹¹⁶ a right to vote by proxy,¹¹⁷ and provision for trustees to solicit proxies.¹¹⁸

Declarations of trust also provide that annual meetings include presentation and approval of the financial statements, election of trustees, and appointment of auditors.¹¹⁹ They set out a default quorum and allow for voting by a show of hands with a right to demand a poll.¹²⁰ They also provide for resolutions in writing, although they differ from the *CBCA* by typically allowing resolutions signed by two-thirds of unitholders entitled to vote on the matter, rather than the unanimous signing required by the *CBCA*.¹²¹ Declarations of trust typically also allow unitholders to requisition meetings, but only by unitholders holding ten per cent of the units. This requirement contrasts to the five per cent threshold in the *CBCA*.¹²² The other significant difference between trust regimes and corporate statutes is the lack of any right for unitholders to make proposals to amend the trust declaration or bylaws or to put any other matter before the unitholders using the trustee (management) notice of meeting and proxy circular. Unitholders wanting to make proposals would have to requisition a meeting (typically requiring unitholders holding collectively at least ten per cent of the trust units).

Declarations of trust also contain provisions restricting the types of unitholder resolutions that will be binding on trustees. These provisions appear to be intended to replicate the corporate law position that only resolutions within shareholder powers are binding. Resolutions that are binding on trustees typically include the appointment or removal of trustees, the appointment or removal of auditors, the appointment of an inspector, amendments to the declaration of trust, termination of the trust, and frequently also the sale of all or substantially all of the trust assets.¹²³

¹¹⁶ See e.g. A&W Declaration, *ibid.*, s. 12.9; BFI Declaration, *ibid.*, s. 12.8; Chemtrade Declaration, *ibid.*, s. 12.8.

¹¹⁷ See e.g. A&W Declaration, *ibid.*, s. 12.5; BFI Declaration, *ibid.*, s. 12.4; Chemtrade Declaration, *ibid.*, s. 12.4.

¹¹⁸ See e.g. A&W Declaration, *ibid.*, s. 16.8; BFI Declaration, *ibid.*, s. 16.10; Chemtrade Declaration, *ibid.*, s. 16.8. In any case, trustees would be required to solicit proxies by securities laws: see e.g. *OSA*, *supra* note 19, s. 85; *BCSA*, *supra* note 19, s. 117.

¹¹⁹ See e.g. A&W Declaration, *ibid.*, s. 12.2; BFI Declaration, *ibid.*, s. 12.1; Chemtrade Declaration, *ibid.*, s. 12.1.

¹²⁰ See e.g. A&W Declaration, *ibid.*, ss. 12.4, 12.5; BFI Declaration, *ibid.*, ss. 12.3, 12.4; Chemtrade Declaration, *ibid.*, ss. 12.3, 12.4.

¹²¹ *CBCA*, *supra* note 12 at 142. Compare A&W Declaration, *ibid.*, s. 12.11; BFI Declaration, *ibid.*, s. 12.10; Chemtrade Declaration, *ibid.*, s. 12.10.

¹²² *CBCA*, *ibid.* at 143. Compare A&W Declaration, *ibid.*, s. 12.2; BFI Declaration, *ibid.*, s. 12.1; Chemtrade Declaration, *ibid.*, s. 12.5.

¹²³ See e.g. A&W Declaration, *ibid.*, ss. 8.2, 8.6, 17.2, 11.1, 14.2, 9.4(b); BFI Declaration, *ibid.*, ss. 8.2, 8.6, 17.2, 11.1, 12.6, 14.2, 9.4(b); Chemtrade Declaration, *ibid.*, ss. 8.2, 8.6, 17.2, 11.1, 14.2, 9.4(b).

B. Management Structure and Powers

1. Trustee Board Structure and Management Board Structure

a. Common Corporate Law Requirements

The *CBCA* deals with board structure through provisions on the number of directors,¹²⁴ their qualifications,¹²⁵ the circumstances in which they cease to hold office,¹²⁶ the filling of vacancies,¹²⁷ and the need for nonemployee directors in distributing corporations.¹²⁸ The *CBCA* also sets out a default quorum requirement for directors' meetings¹²⁹ and allows meetings to be held by telephone or other forms of electronic communication.¹³⁰ It deals with the validity of acts of the board in situations where there has been an irregularity in appointments to the board.¹³¹ *CBCA* distributing corporations must also have an audit committee with a majority of independent directors.¹³² The *CBCA* also allows for the formation of other committees of directors and the delegation of powers to such committees.¹³³ Governance committees or compensation committees may be formed pursuant to this provision.

Corporations that are reporting issuers are required to provide corporate governance disclosure that includes an indication of whether the majority of directors are independent directors.¹³⁴ An independent director is a director who has no direct or indirect relationship that could reasonably interfere with the exercise of independent judgment by the director.¹³⁵

b. Trust Level

Declarations of trust for business income trusts include the same basic elements as the *CBCA* for the structure of the board and meetings of the board. They contain similar provisions on the number of trustees, their qualifications, the circumstances in

¹²⁴ *CBCA*, *supra* note 12, ss. 6, 102, Form 1; *OBCA*, *supra* note 41, ss. 5, 115, Form 1.

¹²⁵ *CBCA*, *ibid.*, s. 105; *OBCA*, *ibid.*, s. 118.

¹²⁶ *CBCA*, *ibid.*, s. 108; *OBCA*, *ibid.*, s. 121.

¹²⁷ *CBCA*, *ibid.*, s. 111; *OBCA*, *ibid.*, s. 124.

¹²⁸ *CBCA*, *ibid.*, s. 102(2); *OBCA*, *ibid.*, s. 115(3).

¹²⁹ *CBCA*, *ibid.*, s. 114(2). See also *OBCA*, *ibid.*, s. 126(3).

¹³⁰ *CBCA*, *ibid.*, s. 114(9). See also *OBCA*, *ibid.*, s. 126(13).

¹³¹ *CBCA*, *ibid.*, s. 116. See also *OBCA*, *ibid.*, s. 128.

¹³² *CBCA*, *ibid.*, s. 171. See also *OBCA*, *ibid.*, s. 158.

¹³³ *CBCA*, *ibid.*, s. 115. See also *OBCA*, *ibid.*, s. 127.

¹³⁴ National Instrument 58-101, *supra* note 31, para. 2.1, Form 58-101F2.

¹³⁵ See *ibid.*, para. 1.2(1); *Audit Committees*, O.S.C. MI 52-110, (2004) 27 O.S.C. Bull. 837 (16 January 2004), para. 1.4.

which they cease to hold office, and the filling of vacancies.¹³⁶ They provide for meetings by telephone or other means of electronic communication.¹³⁷ Declarations of trust also provide for the validity of acts of the trustees.¹³⁸

Income trusts typically have a majority of independent trustees. Trustees, however, typically include persons who are directors of the operating corporation. Declarations of trust for many income trusts do not set out a specific requirement for an audit committee at the trust level.¹³⁹

It should be noted that the mimicking of corporate statute provisions for trustees is optional in trust law. In the absence of specific legislation, the requirement that corporate statute provisions on board structure and operation be mimicked depends on requirements by either securities regulators or the TSX.

c. *Operating Corporation Level*

At the operating corporation level, corporate statute provisions, such as those described above for the *CBCA*, will apply. Although operating corporations normally are not distributing corporations and do not have shares listed on the TSX, they generally have a majority of independent directors. Not being distributing corporations, they are not required to have an audit committee under corporate statutes such as the *CBCA*, although they normally do have an audit committee.¹⁴⁰

d. *Trustees as Directors of the Operating Corporation*

Is there a concern if the board of trustees consists largely or wholly of persons who are directors of the operating corporation? The two main functions of the board of trustees are: first, to oversee the administration of the trust; and second, to monitor the performance of the operating corporation. The main trust assets in the simplest income trust structure will be the shares and notes of the operating corporation. Trustees have a duty of care that would presumably include a requirement to monitor the performance of the corporation on which the value of those shares and notes

¹³⁶ See *CBCA*, *supra* note 12, ss. 6(1)(e), 105, 108, 111. Compare A&W Declaration, *supra* note 33, ss. 7.1, 8.1, 8.5, 8.7; BFI Declaration, *supra* note 33, ss. 7.1, 8.1, 8.5, 8.7; Chemtrade Declaration, *supra* note 33, ss. 7.1, 8.1, 8.5, 8.7.

¹³⁷ See *CBCA*, *ibid.*, s. 114(9). Compare A&W Declaration, *ibid.*, s. 7.4; BFI Declaration, *ibid.*, s. 7.4; Chemtrade Declaration, *ibid.*, s. 7.4.

¹³⁸ See *CBCA*, *ibid.*, s. 116. Compare A&W Declaration, *ibid.*, s. 8.8; BFI Declaration, *ibid.*, s. 8.8; Chemtrade Declaration, *ibid.*, s. 8.8.

¹³⁹ There are exceptions. See *e.g.* Consumers' Waterheater Income Fund, Amended and Restated Declaration of Trust, 4 December 2002. The operating entity will not necessarily be a corporation and even if it is it will not be a reporting issuer. The operating entity itself will not be specifically required to have an audit committee. There will, of course, still be audited financial statements, as required under securities laws where the income trust units have been distributed to the public.

¹⁴⁰ See *e.g.* *CBCA*, *supra* note 12, s. 171, requiring a distributing corporation to have an audit committee.

depend. The duty may also require them to exercise their power as shareholders to replace the directors of the operating corporation if it performs poorly. If many or all of the trustees are also directors of the operating corporation, they may be ineffective at monitoring themselves. It is unlikely that, in their capacity as trustees, they will remove themselves as directors of the operating corporation. The only way the directors of the operating corporation are likely to be replaced is if the trustees are replaced.

Unitholders have the power to replace the trustees. They may also have a claim against trustees for breach of their duty of care if they imprudently supervise the management of the operating corporation.¹⁴¹ If the unitholders consist of a disperse group of retail investors, however, it is unlikely that they will engage in the monitoring necessary to determine when the trustees should be replaced. They are also unlikely to communicate and coordinate their voting to remove the trustees. It is possible that an investor, such as an institutional investor, might monitor the operating corporation and the trust units and, where the operating corporation is performing poorly, buy up enough trust units to replace the trustees. The investor could then have the new trustees replace the directors and officers of the operating corporation. If there are provisions that discourage takeovers, such an action may not happen readily. While unitholders' disinclination to replace trustees may be a concern, it is arguably not more of a concern than it is for shareholders of a corporation. If a corporation with significant takeover deterrence devices makes an IPO, the market (if it is reasonably efficient) should price the shares accordingly. But what if institutional or other substantial investors are reluctant to invest in trust units, perhaps out of a concern for unitholder liability? Without institutional or substantial investor involvement, it is unlikely that anyone would purchase enough units to provide sufficient voting rights to replace trustees, even where takeovers are not deterred. Without institutional or substantial investor involvement, would IPOs for business income trusts with substantial antitakeover devices be properly priced? It seems unlikely. The issues can be complex and it may be important to have institutional investors who are sophisticated enough to properly price trust units, taking into account provisions affecting the probability of a takeover.

2. Trustee Board Powers and Management Board Powers

Corporate law statutes generally set out several powers for the board of directors. It has broad powers to manage or supervise the management of the corporation.¹⁴² It also typically has the power to appoint officers and delegate powers to officers.¹⁴³ It usually has the power to appoint committees of the board and delegate powers to

¹⁴¹ See e.g. *Bartlett v. Barclays Bank Trust Co. Ltd.*, [1980] Ch. 515 at 532, [1980] 1 All E.R. 139; *Walker v. Stones* (2000), [2001] Q.B. 902 at 916-17, [2000] 4 All E.R. 412 (C.A.) [*Walker* cited to Q.B.].

¹⁴² *CBCA*, *supra* note 12, s. 102(1); *OBCA*, *supra* note 41, s. 115(1).

¹⁴³ *CBCA*, *ibid.*, s. 121; *OBCA*, *ibid.*, s. 133.

those committees.¹⁴⁴ It has the power to determine the remuneration of the directors and officers.¹⁴⁵ It typically has power to borrow,¹⁴⁶ to issue shares of the corporation,¹⁴⁷ to call shareholder meetings,¹⁴⁸ and to make changes to the bylaws of the corporation with immediate effect (but subject to confirmation by shareholders for their continued effectiveness).¹⁴⁹

Business income trust declarations of trust mimic these corporate law provisions concerning the powers of the board of directors. They give trustees powers to manage or supervise the management of the trust, appoint officers for the trust, delegate duties to the officers, and create committees of trustees and delegate duties to them.¹⁵⁰ They also give trustees the power to issue units of the trust, borrow for the trust, call unitholder meetings, and enact bylaws for the trust.¹⁵¹

3. Duties of Directors and Officers

a. Common Corporate Law Rules

Directors and officers of corporations are subject to a range of duties. They have a duty of care, codified in the *CBCA* and other corporate statutes in Canada, requiring that they act with the “care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.”¹⁵² Directors and officers of corporations must also not take corporate opportunities for themselves.¹⁵³ They must exercise their powers for the purpose for which they were intended¹⁵⁴ and in the best

¹⁴⁴ *CBCA*, *ibid.*, s. 115; *OBCA*, *ibid.*, s. 127.

¹⁴⁵ *CBCA*, *ibid.*, s. 125; *OBCA*, *ibid.*, s. 137.

¹⁴⁶ *CBCA*, *ibid.*, s. 189(1); *OBCA*, *ibid.*, s. 184(1).

¹⁴⁷ *CBCA*, *ibid.*, s. 25(1); *OBCA*, *ibid.*, s. 23.

¹⁴⁸ *CBCA*, *ibid.*, s. 133; *OBCA*, *ibid.*, s. 94.

¹⁴⁹ *CBCA*, *ibid.*, s. 103; *OBCA*, *ibid.*, s. 116.

¹⁵⁰ See *CBCA*, *ibid.*, ss. 102, 121, 115. Compare A&W Declaration, *supra* note 33, ss. 9.2(a), 9.2(x), 9.2(y), 7.10, 10.1; BFI Declaration, *supra* note 33, ss. 9.2(a), 9.2(h), 9.2(i), 9.2(j), 7.10, 10.1; Chemtrade Declaration, *supra* note 33, ss. 9.2(a), 9.2(h), 9.2(i), 7.10, 10.1.

¹⁵¹ See *CBCA*, *ibid.*, ss. 25(1), 189(1), 133, 103. Compare A&W Declaration, *ibid.*, ss. 9.4(cc), 9.4, 12.2, 9.4(gg); BFI Declaration *ibid.*, ss. 9.2(m), 9.2(s), 12.1, 9.2(r); Chemtrade Declaration, *ibid.*, ss. 9.2(m), 9.2(s), 12.1, 9.2(r).

¹⁵² *CBCA*, *ibid.*, s. 122(1)(b).

¹⁵³ See e.g. *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All E.R. 378 (H.L.); *Peso Silver Mines Ltd. (NPL) v. Cropper*, [1966] S.C.R. 673, 58 D.L.R. (2d) 1; *Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592, 40 D.L.R. (3d) 371 [*O'Malley* cited to S.C.R.].

¹⁵⁴ See e.g. *Bonisteel v. Collis Leather Co.* (1919), 45 O.L.R. 195 (H.C.) [Bonisteel]; *Hogg v. Cramphorn Ltd.*, [1967] Ch. 254, [1966] 3 W.L.R. 995 [Hogg]; *Howard Smith Ltd. v. Ampol Petroleum Ltd.*, [1974] A.C. 821 (H.L.). In *Teck Corporation Ltd. v. Millar* (1972), 33 D.L.R. (3d) 288, [1973] 2 W.W.R. 385 (B.C.S.C.) [Teck cited to D.L.R.], Berger J. suggested that the test is simply whether the directors acted in good faith in the best interests of the corporation, rather than whether they acted for a proper purpose. The approach of first assessing whether the directors acted within the

interests of the corporation.¹⁵⁵ The duty to act in the best interests of the corporation is codified in the *CBCA* and other corporate statutes.¹⁵⁶ These statutes provide that the duty of care and the duty to act in the best interests of the corporation cannot be waived.¹⁵⁷

The common law rule concerning conflicts of interest was, without exception, that directors and officers were not to put themselves in a position where their personal interests conflicted with the interests of the corporation.¹⁵⁸ This duty could be modified. It was frequently modified in a way that allowed some conflicts to occur, as long as certain procedural safeguards were followed.¹⁵⁹ In particular, it was typically required that notice of the conflict be given and that the directors approve the conflict transaction. The director who had the conflict was not to vote.¹⁶⁰

Corporate statutes have provisions allowing conflicts of interest as long as procedural safeguards are met.¹⁶¹ These safeguards generally include that notice of the conflict be given,¹⁶² that the transaction be approved by directors (with the interested director not voting), and that the transaction be reasonable and fair.¹⁶³ As an alternative, the transaction may be approved by a special resolution of shareholders upon sufficient disclosure, if the transaction is reasonable and fair.¹⁶⁴ The statutory provision on conflicts of interest is not a default provision. One cannot substitute an alternative scheme.

In Ontario, statutory provisions on conflicts of interest are now supplemented by Ontario Securities Commission Rule 61-501,¹⁶⁵ which sets out requirements for related-party transactions that raise conflict of interest concerns. The rule also deals with issuer bids, insider bids, and business combinations, which can also raise

scope of their authority and then assessing whether they did so in the best interests of the corporation is more consistent with the agency law approach.

¹⁵⁵ See e.g. *CBCA*, *supra* note 12, s. 122(1)(a); *OSA*, *supra* note 19, s. 134(1)(a). See also *Teck, ibid.; Olsen v. Phoenix Industrial Supply Ltd.* (1984), 9 D.L.R. (4th) 451, [1984] 4 W.W.R. 498 (Man. C.A.).

¹⁵⁶ See e.g. *CBCA*, *ibid.*, s. 122(1)(a).

¹⁵⁷ *Ibid.*, s. 122(3).

¹⁵⁸ See *Aberdeen Railway Co. v. Blaikie Brothers* (1854), 1 Macq. 461, [1843-60] All E.R. Rep. 249 (H.L.).

¹⁵⁹ See e.g. *Transvaal Lands Co. v. New Belgium (Transvaal) Land and Development Co.*, [1914] 2 Ch. 488 (C.A.) [*Transvaal Lands*]; *The Liquidators of the Imperial Mercantile Credit Association v. Coleman*, [1873] L.R. 6 H.L. 189 [*Liquidators*]; *Gray v. New Augarita Porcupine Mines Ltd.*, [1952] 3 D.L.R. 1 (P.C.) [*Gray*].

¹⁶⁰ See *Transvaal Lands*, *ibid.* at 488, referring to art. 98 of the company's articles; *Liquidators*, *ibid.* at 192, referring to art. 83 of the company's articles; *Gray*, *ibid.* at 13, referring to company bylaws 54 and 55.

¹⁶¹ See e.g. *CBCA*, *supra* note 12, s. 120; *OBCA*, *supra* note 43, s. 132.

¹⁶² *CBCA*, *ibid.*, s. 120; *OBCA*, *ibid.*, s. 132.

¹⁶³ *CBCA*, *ibid.*, s. 120(7); *OBCA*, *ibid.*, s. 132(7).

¹⁶⁴ See e.g. *CBCA*, *ibid.*, s. 120(7.1); *OBCA*, *ibid.*, s. 132(8).

¹⁶⁵ *Insider Bids, Issuer Bids, Business Combinations and Related Party Transactions*, O.S.C. Rule 61-501 (7 May 2004) [Ontario Rule 61-501].

conflicts of interest between insiders (or control block shareholders), and minority shareholders. The requirements of the rule would apply where shares of the corporation are traded in Ontario.

b. Trust Level

Trust is the origin of much of the law on fiduciary duties. Trustees have fiduciary duties corresponding to those of directors and officers of corporations.¹⁶⁶ In some respects, trustees' duties may be stricter than the duties of directors of corporations.¹⁶⁷ These duties include a general duty of care¹⁶⁸ and a duty that trustees not take advantage of opportunities for themselves that arise in the context of carrying out their duties as trustees.¹⁶⁹ Trustees are also not to put themselves in a position where their personal interests conflict with the interests of beneficiaries.¹⁷⁰ These duties can, for the most part, be varied in the trust instrument.¹⁷¹ A key difference between trust law fiduciary duties and the fiduciary duties codified in corporate statutes is that trust law fiduciary duties can generally be modified, while corporate statutory fiduciary duties cannot.

Declarations of trust for business income trusts generally attempt to include corporate fiduciary duties by reference to corporate statutory requirements.¹⁷² This substitution replaces strict trustee fiduciary duties with the arguably more lenient duties of directors and officers.¹⁷³ The job of corporate managers involves

¹⁶⁶ See e.g. Waters, *supra* note 1 at 857-955 where trustees' duties are discussed.

¹⁶⁷ See e.g. *Keech v. Sandford* (1726), Sel. Cas. Ch. 61 [*Keech*] (which applied a strict test concerning trustees taking advantage of opportunities they became aware of while acting in their capacity as trustees); *Boardman v. Phipps* (1966), [1967] 2 A.C. 46, [1966] 3 All E.R. 721 (H.L.) (a case involving persons acting opportunistically on knowledge gained while acting on behalf of a trust). Compare *O'Malley*, *supra* note 153, concerning the taking of corporate opportunities by directors and which applied a more lenient fairness test. See also *Fales v. Canada Permanent Trust Co.*, [1977] 2 S.C.R. 302, 70 D.L.R. (3d) 257 [*Fales* cited to S.C.R.] with the corporate duty of care cases such as *Re Cardiff Savings Bank*, [1892] 2 Ch. 100; *Re Brazilian Rubber Plantations and Estates Ltd.*, [1911] 1 Ch. 425; *Re City Equitable Fire Insurance Co.*, [1925] Ch. 407 (C.A.); *Soper v. Canada* [1998] 1 F.C. 124, 149 D.L.R. (4th) 297 (C.A.); *Peoples Department Stores Inc. v. Wise*, [2004] 3 S.C.R. 461 at paras. 54-57, 244 D.L.R. (4th) 564, 2004 SCC 68 [*Peoples* cited to S.C.R.]; *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002), 214 D.L.R. (4th) 496, 27 B.L.R. (3d) 53 (Ont. Sup. Ct. J.), aff'd (2004), 250 D.L.R. (4th) 526, 183 O.A.C. 310, 42 B.L.R. (3d) 34 (C.A.), which arguably take a more lenient approach to the duty of care.

¹⁶⁸ See e.g. *Fales*, *ibid.*

¹⁶⁹ See e.g. *Ex Parte James* (1803), 8 Ves. Jr. 337, 32 E.R. 385 (Ch.) [*James*]; *Keech*, *supra* note 167; *Crocker v. Tornroos*, [1957] S.C.R. 151, 7 D.L.R. (2d) 104.

¹⁷⁰ See e.g. *Ex Parte Lacey* (1802), 6 Ves. Jr. 625, 31 E.R. 1228 (Ch.); *James*, *ibid.*; *Williams v. Barton*, [1927] 2 Ch. 9.

¹⁷¹ See *supra* note 26 and accompanying text.

¹⁷² See e.g. A&W Declaration, *supra* note 33, ss. 9.6, 9.11; BFI Declaration, *supra* note 33, ss. 9.6, 9.11; Chemtrade Declaration, *supra* note 33, ss. 9.6, 9.11.

¹⁷³ See *supra* note 152 and accompanying text.

entrepreneurial risk taking whereas trustees, in their traditional capacity managing estate funds, are normally expected to avoid risks and preserve the capital of the fund. Since the business income trust approximates a corporate form of organization and is intended to oversee the operation of a business entity, the corporate approach to fiduciary duties may be more appropriate. A contrary argument could be made that the duties of trustees, in their capacities as trustees, do not involve the management of a corporation. Their task may more closely approximate the task of estate trustees, requiring prudent and capital-preserving investment of funds received as interest or royalties pending distribution to unitholders.

The conflict of interest provisions in declarations of trust generally mirror the corporate statute provisions by requiring disclosure of the conflict and that the interested trustee not vote on the matter. These provisions do not specifically contain the additional *CBCA* requirement that “the contract or transaction was reasonable and fair to the corporation when it was approved.”¹⁷⁴

Since units of business income trusts are typically listed on the TSX, they are traded in the province of Ontario. The conduct of the affairs of the trust would thus be subject to Ontario Rule 61-501.¹⁷⁵ Accordingly, the requirement for issuer bids, insider bids, business combinations, and related-party transactions would apply to business income trusts. The operating entity itself, however, would not be a reporting issuer and would not be subject to Ontario Rule 61-501. Business combinations would not apply since the operating entity is private. Similarly the issuer bid and insider bid provisions of the policy are not likely to apply to the operating entity, since it will normally not be a reporting issuer in Ontario. It might be argued that Ontario Rule 61-501 does not apply to related-party transactions in the income trust structure that do not involve the trust that has issued units to the public. They might nonetheless be a concern to the extent they affect the value of the trust units. Ontario Rule 61-501, however, now provides that “a transaction of an underlying operating entity of an income trust is deemed to be a transaction of the income trust, and a related party of the underlying operating entity is deemed to be a related party of the income trust.”¹⁷⁶ Related-party transactions not involving the trust that has issued units to the public would be subject to the common law rules on conflict transactions or statutory standards (such as those in the *CBCA*) if the transaction involved a corporation in the income trust structure.

¹⁷⁴ *CBCA*, *supra* note 12, s. 120(7)(c). It might be argued that the requirement that the transaction be reasonable and fair is implicit in the duty of the trustees to act in good faith in the interests of the trust. While a failure to fulfill the duty might not make the transaction void or voidable, it would leave open an argument that the trustees approving the transaction are nonetheless liable for losses incurred as a result of the transaction. For an American case in which such an argument was accepted by the court although procedural requirements were met (disclosure and interested director not voting) see *Remillard Brick Co. v. Remillard-Dandini Co.* (1952), 241 P.2d 66 (Cal. C.A.).

¹⁷⁵ *Supra* note 165.

¹⁷⁶ *Ibid.*

C. Investor Remedies

1. Personal Action

Shares constitute bundles of rights granted to shareholders by the corporation. The corporate statute may grant shareholders other rights against the corporation. A breach of such rights would allow an action by the shareholder against the corporation. In some cases in the past, shareholders were allowed to bring a personal action to remedy acts of directors or officers where a derivative action would probably not have been possible.¹⁷⁷ Today, many personal action claims would be pursued as an oppression application.

In a business income trust, unitholders would have personal actions against the trustees for breach of trust if the trustees failed to honour the rights of beneficiaries set out in the declaration of trust. As noted above, beneficiaries have a personal right of action for a breach of a fiduciary duty by trustees.

It is unlikely that unitholders would have personal actions against the underlying operating corporation, as they are not shareholders of the corporation. They would not have rights as shareholders either pursuant to the share rights granted by the corporation or the rights of shareholders under the corporate statute. Shareholder rights would be exercised by the trustees or an intermediate entity holding the shares.

2. Derivative Action

a. *Derivative Action in Corporate Law*

The corporation is a separate legal entity. The directors (as a group) act on behalf of the corporation and the officers (individually) act as agents of the corporation. Directors and officers owe fiduciary duties to the corporation.¹⁷⁸ The action for a breach of a fiduciary duty by directors or officers thus is the corporation's action. The corporation's decision to bring an action, however, is a management decision within the discretion of the board of directors. The board may be reluctant to cause the corporation to bring such an action against themselves. They may also be reluctant to cause the corporation to bring an action against officers if officers of the corporation constitute a substantial portion of the board. Shareholders could bring an action on behalf of the corporation: a so-called derivative action. This type of action was once

¹⁷⁷ See e.g. *Hogg*, *supra* note 154; *Bonisteel*, *supra* note 154; *Teck*, *supra* note 154.

¹⁷⁸ *Percival v. Wright*, [1902] 2 Ch. 421; *Peoples*, *supra* note 167 at paras. 42-47. See also *Clarkson v. Davies*, [1923] A.C. 100 (P.C.); *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289, 1 B.L.R. (2d) 225 at 244 (C.A.); *Western Finance Co. Ltd. v. Tasker Enterprises Ltd.* (1979), 106 D.L.R. (3d) 81, [1980] 1 W.W.R. 323 (Man. C.A.).

subject to stringent conditions,¹⁷⁹ but modern corporate statutes now set more lenient ones.¹⁸⁰ Prior to the expansion of the oppression remedy to include complaints that are derivative in nature,¹⁸¹ the statutory provisions for leave to bring a derivative action would have been the logical remedy for a breach of a fiduciary duty. The expansion of the procedurally simpler oppression remedy to include complainants of a derivative nature has limited the use of the derivative action.¹⁸²

b. Similar Actions in the Trust Context

Breaches of fiduciary duty by trustees in a business income trust would be addressed by a direct action by beneficiaries, rather than a derivative action. The trust is not a separate entity. Trustees therefore cannot owe fiduciary duties to the trust.¹⁸³ Instead trustees owe fiduciary duties directly to the beneficiaries.

¹⁷⁹ *Foss v. Harbottle* (1843), 2 Hare. 461, 67 E.R. 189 (Ch.) significantly constrained actions by shareholders on behalf of the company against directors who had breached their fiduciary duty. It required that a majority of shareholders approve the action. Actions by shareholders were further constrained in *North-west Transportation Co. Ltd. v. Beatty* (1887), 12 A.C. 589 (P.C.), which allowed interested majority shareholders (who might indeed have also been the directors alleged to have breached their fiduciary duty to the company) to vote their shares at a shareholders' meeting on a resolution ratifying the breach. A number of very limited exceptions developed over the years. In jurisdictions where the power to manage is exclusively assigned to directors, it is doubtful that even a majority of shareholders could cause a suit to be brought by the company. See Stanley M. Beck, "An Analysis of *Foss v. Harbottle*" in Jacob S. Ziegel, ed., *Studies in Canadian Company Law* (Toronto: Butterworths, 1967) 545 at 560-96. On development of the common law derivative action in the U.K., see e.g. *Prudential Assurance Co. Ltd. v. Newman Industries Ltd.* (No. 2), [1982] Ch. 204 (C.A.); *Gerber Garment Technology Inc. v. Lectra Systems Ltd.*, [1997] R.P.C. 443 at 468-78 (C.A.); *Johnson v. Gore Wood & Co.*, [2002] 2 A.C. 1, [2001] 1 All E.R. 481, [2001] 2 W.L.R. 72 (H.L.); *Walker*, *supra* note 141 at 927-34. This subsequent development of the common law derivative action is of limited relevance to the development of derivative actions, because statutory derivative actions have superseded the common law action in Canada.

¹⁸⁰ See e.g. *CBCA*, *supra* note 12, ss. 238-40.

¹⁸¹ Several cases have addressed the relationship between the derivative action provision and the oppression remedy. See Dennis H. Peterson, *Shareholder Remedies in Canada*, looseleaf (Markham, Ont.: Butterworths, 1989). Peterson says that the "preponderance of authority ... supports the idea that the oppression remedy should be available to a complainant even though other remedies are available" (*ibid.* at para. 18.237). It is still necessary to show that a breach of duty by directors or officers was oppressive or unfairly prejudicial to or unfairly disregarded the interests of the complainant (see *ibid.*). See also Jeffrey G. MacIntosh, "The Oppression Remedy: Personal or Derivative?" (1991) 70 Can. Bar Rev. 29. It is not necessary to establish a breach of a duty to succeed in an oppression claim, but a breach of a fiduciary duty that is oppressive or unfairly prejudicial to, or unfairly disregards the interests of the complainant may support an oppression claim.

¹⁸² It appears that the derivative action continues to have a role where the corporation has rights against third parties, as opposed to cases involving breaches of fiduciary duties. See Peterson, *ibid.*

¹⁸³ See e.g. *Kingsdale Securities Co. Ltd. v. Minister of National Revenue*, [1974] 2 F.C. 760, 74 D.T.C. 6674 at 6681 (C.A.). See also David J. Hayton, *Underhill and Hayton: Law Relating to Trusts and Trustees*, 16th ed. (London: Butterworths, 2003) at 6.

A derivative action might arise in the corporate context where the corporation has a right of action that arises, not as a result of a breach of a fiduciary duty owed by the directors or officers, but out of some independent right. It could be a right on a contract or because the corporation was the victim of a tort. A shareholder might be allowed to pursue such an action on behalf of the corporation. In the trust law context, if the trustees have a right of action arising out of the conduct of the affairs of the trust but fail to pursue it, one or more of the beneficiaries might seek a court order to pursue the action in the name of the trustees on behalf of the trust.¹⁸⁴ In some cases, the beneficiary may have a direct right of action where third parties have received trust property in circumstances where they knew or should have known of the trust.

c. Income Trust Unitholders and Derivative Actions Concerning the Operating Corporation

While unitholders would have rights of action at the trust level that may correspond to the right to bring a derivative action in corporate law, their right to bring a derivative action at the level of the operating corporation is more tenuous. As noted above, most corporate law statutes in Canada have derivative action provisions that replace the common law approach. The most common form of derivative action provision in Canada allows a complainant to bring an action on behalf of the corporation, subject to satisfying certain procedural safeguards.¹⁸⁵ Complainant is defined to include a registered or beneficial holder of a security or any person a court thinks is a proper person to bring an application for leave to bring a derivative action.¹⁸⁶ Unitholders might be able to seek leave on the basis that they are beneficial owners of the shares of the operating corporation. Failing this, they may be able to apply for leave if they can convince a court that they are proper persons to bring an action.

If the trustees own the shares of the operating corporation, unitholders might be able to argue that they are beneficial holders of the shares. The situation, however, is different than most beneficial holders of shares where, for instance, a depository institution is the registered holder of the shares. The depository institution is usually a bare trustee of the shares. Trustees in business income trusts do not hold the shares as bare trustees. Unitholders' interests are in the income of the trust and not in the shares of the operating corporation *per se*. This fact might suggest that they should not be considered beneficial holders of securities for the purpose of the definition of "complainant" in corporate law statutes such as the *CBCA*. For the reasons discussed below, these differences should not mean that unitholders are not entitled to leave to bring a derivative action.

¹⁸⁴ See Waters, *supra* note 1 at 1204-205; L.A. Sheridan, *The Law of Trusts*, 12th ed. (Chichester: Barry Rose, 1993) at 451-52.

¹⁸⁵ See e.g. *CBCA*, *supra* note 12, s. 239.

¹⁸⁶ See e.g. *CBCA*, *ibid.*, s. 238 regarding "complainant".

Since the conduct of the affairs of the underlying corporation is critical to the value of the units, it seems likely that the court would consider unitholders proper persons to make an application for leave to bring a derivative action. A court might also consider the wording in a provision for application for leave to bring a derivative action, such as *CBCA* section 239 that allows a complainant to “apply to a court for leave to bring an action in the name and on behalf of a corporation or any of its subsidiaries ...”¹⁸⁷ While an underlying operating corporation does not quite fit the definition of “subsidiary”,¹⁸⁸ the position of unitholders relative to the underlying operating corporation is clearly analogous to the position of shareholders in a parent corporation. This fact would reinforce the argument in favour of finding business income trust unitholders to be proper persons to apply for leave to bring an action in the name of and on behalf of the underlying operating corporation. It seems possible that unitholders in a business income trust would be given leave to bring a derivative action. Even if unitholders were not considered complainants, they might instead, as beneficiaries of the trust, ask to be subrogated to the rights of the trustees to seek leave to bring a derivative action.

Where there is a complaint against the directors of the operating corporation and those directors are the same persons as the trustees, unitholders might be able to make their claim directly against the trustees. The argument might be that in carrying out their duties as directors of the operating corporation, they had a duty to do so in a way consistent with the best interests of the beneficiaries. Although in their capacity as directors, they would owe duties to the corporation, their duty would be to act in its best interests. This duty would, in many situations, arguably be synonymous with their duty as trustees. In other words, a failure to act in the best interests of the corporation might be a breach of their duty as trustees, as well as a breach of their duty as directors.

The rights of unitholders to seek leave to bring a derivative action pursuant to corporate legislation would not apply if the operating entity is not a corporation. It might be possible in these cases for unitholders to address breaches of fiduciary duties by management of the operating entity by seeking a court order allowing them to sue in the names of the trustees on behalf of the trust.¹⁸⁹ For instance, where the trust owns units in a limited partnership operating entity, unitholders might be able to sue the general partner in the name of the trustees. Subrogation might be much more complicated where the income trust structure is more complex. For example, if the trustees of the trust with publicly issued units are beneficiaries of an operating trust

¹⁸⁷ *Ibid.*, s. 239(1) [emphasis added].

¹⁸⁸ *CBCA*, *ibid.* defines “subsidiary” as “a body corporate is a subsidiary of another body corporate if ...” (*ibid.*, s. 2(5) [emphasis added]). For a corporate operating entity to be a “subsidiary” under the *CBCA* it would have to be a subsidiary of “another body corporate”. A “body corporate” is defined as “a company or other body corporate wherever or however incorporated” (*ibid.*, s. 2(1)). The trust is not an incorporated entity and thus would not be a body corporate. The operating corporation would not be a subsidiary of the trust under the *CBCA*.

¹⁸⁹ See Waters, *supra* note 1 at 1204-205; Sheridan, *supra* note 184 at 451-52.

that owns units in a limited partnership, which in turn owns interests (e.g., shares or a partnership interest) in the underlying operating entity, it becomes more difficult to construct a right to sue in the name of the trustees on behalf of the trust that would get at breaches of fiduciary duties by managers of the operating entity.¹⁹⁰

3. Oppression Remedy

a. *Operating Corporation Level*

Shareholders in corporations can apply to court for a remedy on the basis that some conduct of the affairs of the corporation or any of its affiliates, or the exercise of powers by directors of the corporation or any of its affiliates has been oppressive or unfairly prejudicial to the applicants or unfairly disregarded their interests as shareholders.¹⁹¹ The application can be brought by a complainant. “Complainant” is defined for this purpose in the same way as for the derivative action discussed above. The definition includes any registered or beneficial security holder. While unitholders of a business income trust would not be registered shareholders of the underlying operating corporation, they might be considered beneficial shareholders of the underlying operating corporation. Also, for the reasons noted above, they might be considered proper persons to bring an application.¹⁹²

Being recognized as a complainant for the purposes of making an oppression application is only the first step. One must show that the conduct of the affairs of the corporation or the exercise of the powers of the directors is oppressive, unfairly prejudicial to, or unfairly disregards the interests of, “any security holder, creditor, director or officer.”¹⁹³ Unitholders would not be creditors,¹⁹⁴ directors, or officers of

¹⁹⁰ Unitholders might seek an order to pursue rights of the trustees of the fund trust, as beneficiaries of the operating trust, to seek an order to sue on behalf of the operating trust. They might then pursue the rights of the trustees of the operating trust, as limited partners, to apply to be considered a proper person to bring an action on behalf of the general partner corporation. From there, they could pursue the right to bring an action on behalf of the operating corporation.

¹⁹¹ See e.g. *CBCA*, *supra* note 12, ss. 241(1), 241(2).

¹⁹² See e.g. *CBCA*, *ibid.*, s. 238(d) regarding “complainant”. The argument would be similar to that made above for unitholders to be proper persons to seek leave to bring a derivative action. Since the conduct of the affairs of the underlying corporation is critical to the value of the units, it seems likely that a court would consider unitholders proper persons to make an application. A court might also look at the use of the word “affiliate” in an oppression provision such as *CBCA*, *ibid.*, s. 241. Unitholders would not be shareholders in an affiliate because it is defined as a “body corporate” (*ibid.*, s. 2(2)), and the trust fund is not a body corporate (since a body corporate is defined as an incorporated entity: *ibid.*, s. 2(1)). The position of the unitholders of the trust is clearly analogous to the position of shareholders in an affiliate. Consequently a court might take the position that finding unitholders to be proper persons to make an oppression application is consistent with the oppression application provision, since unitholders occupy essentially the same position as shareholders in an affiliated controlling corporation.

¹⁹³ *CBCA*, *ibid.*, s. 241(2).

the corporation, so the only category in the list of capacities under which they might claim to have suffered oppression is as a security holder. The expression “security holder” is not defined in the part of the *CBCA* in which the oppression remedy appears, nor is it defined in subsection 1(1) for the purposes of the Act as a whole. However, “security” is defined as “a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation.”¹⁹⁵ Unitholders of the trust would not be registered holders of shares or debt obligations of the underlying operating corporation. It might be argued, however, that since the trustees hold the shares (and notes) on behalf of unitholders, unitholders are beneficial shareholders, thereby qualifying them as “security holders” for the purposes of arguing that they have, in that capacity, been oppressed or unfairly prejudiced or disregarded.¹⁹⁶

Even if an oppression application were available against an underlying operating corporation, one should bear in mind that the oppression remedy is provided in corporate statutes. It might be avoided altogether if the operating entity were not a corporation. For instance, the operating entity might be a limited partnership. Limited partnership statutes do not have oppression remedy provisions.

b. Trust Level

The trust in which unitholders are beneficiaries is, as noted above, largely set up to reflect many features of the corporate form of organization. It replicates many rights provided to shareholders by corporate statutes. Since the trust recreates the rough equivalent of a corporate form of organization, it carries the potential for the kinds of problems that led to the adoption of the oppression remedy in corporate statutes. If unitholders in a business income trust are to be put on a par with shareholders in corporations, they should be given a right to relief from oppression at the trust level, in addition to relief from oppression at the level of the operating entity. Declarations of trust for business income trusts do not provide for relief from oppression. While beneficiaries can apply to court for orders concerning the interpretation or administration of trusts,¹⁹⁷ there is the question of whether orders can be made on the same basis as on an oppression application. It is also uncertain

¹⁹⁴ If unitholders can sue on behalf of the trust to pursue the rights of trustees as creditors, they might make an oppression claim on the basis that the trustees were prejudiced in their capacity as creditors of the operating corporation. This sort of claim could only be made where the operating entity was a corporation and where the trustees were the persons who loaned to the operating corporation the funds received from unitholders.

¹⁹⁵ *CBCA*, *supra* note 12, s. 2(1).

¹⁹⁶ It might also be argued that unitholders have been oppressed in their capacity as security holders where the trustees have a debenture representing a debt owed by the operating corporation. The debenture would also fall within the definition of “security” as including “a certificate evidencing ... a debt obligation” (*ibid.*). Since the trustees would hold the debenture for the benefit of unitholders, the unitholders might be said to be beneficial owners of that security.

¹⁹⁷ See e.g. *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, Rule 14.05(3).

whether the court has the same range of possible orders as on an oppression application.

In trust law, trustees have a duty to be impartial as between beneficiaries.¹⁹⁸ This duty developed largely to ensure fairness between beneficiaries with life interests and beneficiaries with remainder interests.¹⁹⁹ It might be a stretch to extend this concept to unitholders in a business income trust. Even stretching the duty of impartiality may not fully serve the purposes for which the oppression remedy was designed.²⁰⁰ If the duty were extended to business trusts such that it worked as a rough equivalent to statutory oppression provisions, it would not empower a court to use the wide range of remedies provided by statutory oppression remedy provisions. Even if it were roughly equivalent to statutory oppression provisions, the duty of impartiality could be waived or modified in the declaration of trust.²⁰¹

Applications might also be made where trustees act beyond the scope of their powers, act for improper purposes, or fail to act. These bases for claims against trustees are more consistent with breaches of fiduciary duty in the corporate context. The unique feature of the oppression application, which may not be easy to replicate in a declaration of trust, is that it can also be the basis for claims where there is neither a breach of duty nor an act contrary to the statute, articles, or bylaws, but where the acts nonetheless operate oppressively, unfairly prejudicial, or unfairly disregard the interests of a complainant in their capacity as a security holder, creditor, director, or officer.

4. Appraisal

In certain situations the *CBCA*, or the statutes modeled after it, allows shareholders of a corporation to apply to have the corporation acquire their shares at a “fair value.”²⁰² The situations include certain amendments of the articles, fundamental changes such as an amalgamation, a continuance, a sale, a lease, or an exchange of all or substantially all of the corporation’s property, or a going-private transaction or

¹⁹⁸ Waters, *supra* note 1, at 966-70.

¹⁹⁹ *Ibid.* at 970-1063.

²⁰⁰ See *Primewest Energy Trust v. Orion Energy Trust (Trustee of)* (1999), 238 A.R. 193, 1 B.L.R. (3d) 294 (Q.B.). The court considered whether the duty of trustees to maintain an even hand applied in the adoption of a poison rights plan that denied exercise of the rights to the unitholder. The unitholder acquired sufficient units to trigger the rights plan while allowing other unitholders to exercise their rights. The court accepted that the trustees’ adoption of the plan did not violate their duty to maintain an even hand, since every holder of a unit had the same rights and was subject to the same consequence of acquiring sufficient units to trigger the rights. The situation may be somewhat different where a unitholder has acquired a triggering number of units before the adoption of the plan (see *Rio Tinto Canadian Investments v. Labrador Iron Ore Royalty Income Fund*, [2001] O.J. No. 2440 (S.C.J.) (QL), aff’d, (2001), 41 E.T.R. (2d) 283 (Ont. C.A.) (although in that case the decision was based on an interpretation of the declaration of trust and not on a duty of evenhandedness)).

²⁰¹ See Waters, *supra* note 1 at 969, 1055.

²⁰² See e.g. *CBCA*, *supra* note 12, s. 190.

squeeze-out transaction.²⁰³ The statutes provide procedures to determine a fair value.²⁰⁴

The appraisal right is available only to shareholders.²⁰⁵ Trustees in a business income trust could exercise an appraisal right if they are shareholders in the operating corporation²⁰⁶ but unitholders, not being shareholders of the operating corporation, could not exercise an appraisal right against it. The trust, not being incorporated under a statute providing an appraisal remedy, would not be subject to a mandatory statutory appraisal remedy. A declaration of trust could provide unitholders with such a right, but they generally do not do so.²⁰⁷

5. Compliance

Many corporate statutes in Canada have a compliance provision. The compliance provision in section 247 of the *CBCA* allows a complainant or a creditor of the corporation to apply to court for an order directing a director, officer, employee, or agent of the corporation to comply with the Act, the regulations, the articles, or bylaws of the corporation or restraining such persons from breaching the provisions of the Act, the articles, or the bylaws of the corporation. Complainant has the same broad meaning described above with respect to leave to bring a derivative action or oppression application.

At the trust level, there would be a roughly corresponding right for a unitholder to seek an order of the court requiring the trustees to comply with the terms of the declaration of trust, or perhaps also to restrain trustees from breaching a provision of the declaration of trust. The right of unitholders to seek compliance at the level of the operating entity using a corporate compliance provision, such as *CBCA* section 247, would depend on the operating entity being incorporated under a statute having a

²⁰³ See e.g. *CBCA*, *ibid.*, s. 190(1). Amendments of articles that could lead to an appraisal remedy are an amendment to add, change, or remove any provisions restricting or constraining the issue, transfer, or ownership of shares of a class (*ibid.*, s. 190(1)(a)); an amendment to add, change, or remove any restriction on the business or businesses that the corporation may carry on (*ibid.*, s. 190(1)(b)); or any amendment that would create a class voting right (*ibid.*, s. 190(2)).

²⁰⁴ See e.g. *CBCA*, *ibid.*, s. 190.

²⁰⁵ See e.g. *CBCA*, *ibid.*, ss. 190(1), 190(2). For example, “a holder of shares of any class of a corporation may dissent ...” (*ibid.*, s. 190(1)).

²⁰⁶ It seems unlikely that they would ever do so, however.

²⁰⁷ I have reviewed more than a dozen declarations of trust and I have yet to find anything corresponding to an appraisal remedy provided to unitholders. This absence may be due not only to the cost that such a remedy might impose on the trust, but also to the fact that units of income trusts are generally publicly traded. Unitholders have a ready form of appraisal remedy: they may simply sell the units. This remedy may not precisely correspond to the appraisal remedy, particularly if the market price of the units already reflects a change that has a negative impact on their value.

corporate compliance provision. The unitholders would also have to be recognized as complainants.²⁰⁸

6. Investigation

Corporate statutes in Canada typically provide for court-ordered investigations upon the application of a security holder.²⁰⁹ Declarations of trust for business income trusts also provide for investigations upon the request of unitholders.²¹⁰ Rather than being made at the request of a single unitholder, the request must typically be made at the request of unitholders holding twenty-five per cent or more of the units. Under the corporate law provisions, a court can control against abusive uses of investigations. A court has a discretion to order an investigation where,

- (a) the business of the corporation or any of its affiliates is or has been carried on with intent to defraud any person,
- (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted, or the powers of the directors are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of a security holder,
- (c) the corporation or any of its affiliates was formed for a fraudulent or unlawful purpose or is to be dissolved for a fraudulent or unlawful purpose, or
- (d) persons concerned with the formation, business or affairs of the corporation or any of its affiliates have in connection therewith acted fraudulently or dishonestly.²¹¹

The requirement for twenty-five per cent or more of unitholders to request an investigation of the affairs of an income trust presumably is intended to control against abusive uses of investigations. The cost of an investigation, which would likely be borne out of trust funds, could be quite high and might reduce the value of trust units. Some restriction is justified. At the same time, the twenty-five per cent threshold probably puts it beyond the reach of most unitholders. While they could request the list of unitholders and encourage others to join in a request for an investigation, the cost is likely to make an investigation impractical.

V. Summary of Differences in Governance Provisions

The comparisons in Part IV noted various differences between governance provisions in corporate statutes and business income trust governance provisions. This Part reviews and discusses significant differences highlighted in Part IV.

²⁰⁸ Whether unitholders could be considered complainants is discussed in Part IV.C.2.c, above.

²⁰⁹ See e.g. *CBCA*, *supra* note 12, ss. 229-35.

²¹⁰ See e.g. A&W Declaration, *supra* note 33, s. 12.10; BFI Declaration, *supra* note 33, s. 12.9; Chemtrade Declaration, *supra* note 33, s. 12.9.

²¹¹ *CBCA*, *supra* note 12, s. 229(2).

A. Disclosure

1. Declarations of Trust on the SEDAR Database

An issue related to the access to records is unitholder access to important documents on SEDAR.²¹² When an issuer of securities files a prospectus, it must also file material contracts and other material documents. In many cases, they are filed in electronic form and made available on the SEDAR database. One can often find a business income trust's declaration of trust on SEDAR, along with other material documents. The track record for electronic filing appears to be inconsistent. In some cases, declarations of trust appear to be unavailable on SEDAR. In other situations, they are difficult to identify amongst a list of "other documents" (of which there are often many in complex business income trust restructurings). The declaration of trust is the crucial document for income trust investors to determine the rights the trust units provide. It would help if it were consistently available on SEDAR and clearly identified.

2. Continuous Disclosure

The trust that issues units to the investing public is the reporting issuer in a business income trust. A narrow view of reporting obligations might focus on just developments concerning the trust. While ongoing information about the trust itself is important, the most important information to unitholders is information about the operating entity. Some clarification is needed to make it clear that proper continuous disclosure for a business income trust includes timely disclosure of material information concerning the operating entity, as well as the trust.²¹³ It should also be clear that proper continuous disclosure includes financial information concerning the operating entity, and management discussion and analysis focusing on its business. Information circular disclosure requirements should cover the operating entity as well as the trust, so that unitholders have information about such matters as the backgrounds of the directors of the operating entity and their executive compensation. National Policy 41-201 provides some clarification in this respect.²¹⁴

²¹² *Supra* note 2.

²¹³ In 2003, I canvassed material change reports of several business income trusts filed on SEDAR (*ibid.*). In some cases, there are numerous reports and the nature of the reports suggests that the reporting issuer (the trust) is taking the broader view that anything that would be material information for the operating entity is also material for the trust. In other cases, there are relatively few reports. These reports mostly relate to distributions of units or regular distributions of trust income to unitholders. It may be that there was little or nothing to report on the activities of the underlying operating entity (perhaps because the business was a relatively stable business, as is often the case with businesses restructured as income trusts). It might also be that disclosure for these trusts has focused on material changes involving only the trust and has not considered changes at the operating entity level.

²¹⁴ *Supra* note 64 at para. 3.1. See also the discussion in Part IV.A.2, above.

B. Requirements to Requisition a Security Holder Meeting

The CBCA requires five per cent of shareholders entitled to vote on the matters to be considered at the meeting to support a shareholder-requisitioned meeting. Although there are corresponding provisions in income trust declarations of trust, they typically require a ten per cent threshold. The difference raises several questions, many of them empirical. Is there a reason for this difference? Do shareholders of CBCA corporations overuse the shareholder meeting requisition process? Will a ten per cent threshold so restrict unitholder-requisitioned meetings that they are unlikely to occur? If so, what is the point in providing for unitholder-requisitioned meetings? Are issuers of income trust units simply giving the appearance of a right, but doing so in such a way that in all likelihood it will never be exercised?

C. Unitholder Proposals

Corporate statutes typically provide shareholders with a right to make shareholder proposals. Presumably shareholders could always have made proposals to management, asking that management include the proposal on the shareholder meeting agenda. Management might not have agreed and might have exercised its power to call a meeting without putting the shareholder's proposal on the agenda. A shareholder might requisition a meeting. This procedure, however, could be difficult and costly. It would discourage many shareholder proposals. The unique feature of the corporate statute shareholder proposal provisions is that they require management, subject to certain exceptions, to put the proposal on the meeting agenda and allow the shareholder to put a statement in the management proxy solicitation materials concerning the proposal.

Declarations of trust for income trusts generally do not provide a corresponding unitholder proposal right. Shareholder proposals are no doubt annoying to management. They no doubt often complicate shareholder meetings and perhaps do so unnecessarily, given that they rarely garner enough votes to carry a resolution in favour. Should we allow the use of a business income trust structure to bypass a shareholder proposal requirement of corporate statutes, which is presumably intended to increase shareholder democracy by allowing them an easier means to bring matters of concern before their fellow shareholders?

D. Remedies

Key remedies in corporate statutes not replicated in business income trusts are the derivative action, the oppression remedy, and the appraisal remedy. While it seems possible to draft a version of an appraisal remedy in a trust instrument, it may not be possible to recreate either a derivative action or oppression remedy. These remedies involve conferring powers on a court that it might not otherwise have and that could not be conferred by an agreement or trust instrument.

1. Derivative Action

As noted above in Part IV.C.1, it is possible that a unitholder in a business income trust could be a complainant as either a beneficial owner of securities or as a proper person to apply for leave to bring a derivative action. It is not entirely clear that unitholders would have such a right. As noted in Part IV, the right of unitholders to address breaches of fiduciary duties by managers of the operating entity become more complex where the operating entity is not a corporation and where the income trust structure becomes more complex.

The situation might be clarified by legislation that allowed unitholders a means of addressing breaches of fiduciary duties at the operating entity level if the trustees choose not to address them. Clarifying this right would put unitholders in a position corresponding more closely to the rights of shareholders in a corporation or, indeed, the rights of shareholders in a parent corporation, (which is arguably a more analogous situation). It seems inconsistent that shareholders of a parent corporation would have a right to apply for leave to bring a derivative action while unitholders would not. If the income trust structure is a conduit for distributing operating corporation profits to investors in a tax-efficient way, unitholders should be in a position consistent with that of shareholders. They should have a right to apply for leave to bring a derivative action.

In the corporate law context, the derivative action has become relatively insignificant. Claims that might be described as “derivative in nature” can normally be addressed in the procedurally simpler and cheaper oppression application.²¹⁵ If business income trust unitholders are to be treated on a par with corporate shareholders, a simple approach might be to provide a statutory form of oppression application provision that clearly extends to breaches of fiduciary duties throughout the income trust structure. It should also extend to corporate actions by any corporation in the structure.

2. Oppression Remedy

As noted above in Part IV.C.3, unitholders may have difficulty pursuing an oppression remedy if they have to establish that the conduct of the affairs of the corporation or the exercise of the powers of the directors was oppressive, or unfairly prejudicial to, or unfairly disregarded their interests as a “security holder, creditor, director or officer.”²¹⁶ The operating entity may not be a corporation. An attempt to extend the oppression remedy to oppression in capacities other than as a “security holder, creditor, director or officer” may not be sufficient. It may be necessary to have a statutory provision that deals directly with business income trusts. The “oppressive”

²¹⁵ See *supra* note 181 and accompanying text.

²¹⁶ CBCA, *supra* note 12, s. 241(2).

acts might arise at the level of the income trust itself,²¹⁷ or at other levels of the income trust structure. Consideration should be given to a mandatory statutory provision for business income trusts that allows unitholders to apply to court for relief from oppression in the conduct of the affairs of the trust or at any level of the income trust structure.

As discussed with respect to the derivative action above, to the extent that the income trust structure is a conduit for distributing operating corporation profits to investors, unitholders, as investors, are in essentially the same position as shareholders. There is no reason to treat them differently. Consideration should be given to providing unitholders with rights equivalent to an oppression remedy.

3. Appraisal

As noted in Part IV.C.4, unitholders in a business income trust generally do not have an appraisal right relating to fundamental changes at either the trust level or the level of the underlying operating entity. Since business income trusts are structured to replicate a corporate form of organization, and replicate many of the rights provided under corporate statutes, the same concerns that led to the adoption of an appraisal right in corporate statutes also apply in the context of business income trusts. Consideration might be given to a statutory provision that provides appraisal rights to unitholders in business income trusts.²¹⁸ Since fundamental changes at the operating entity level are arguably as important to unitholders in business income trusts as they are to shareholders in corporations, the appraisal right, if provided, should extend to cover fundamental changes, not only at the trust level, but also at the operating entity level (and perhaps also for fundamental changes occurring anywhere in the overall income trust structure).

VI. Other Governance Concerns

Other governance problems may arise in the context of business income trusts. In particular, there may be concerns over the use of external management contracts, methods of executive compensation, the obtaining of and disclosure of stability

²¹⁷ While “oppressive”, “unfairly prejudicial”, or “unfair disregard” of a unitholder’s interests might be addressed through a modified approach to the trust law duty of impartiality, it could be waived by the trust instrument. A statutory form of oppression provisions would be necessary to make it mandatory.

²¹⁸ This is not to say that an appraisal remedy should necessarily be adopted. It might be time to review the appraisal remedy in the *CBCA* (*supra* note 12) and similar corporate law statutes. It involves a complex procedure that can be expensive to comply with if a substantial number of minority shareholders opt to use it. It also can create considerable uncertainty for the corporation doing a transaction that creates such a right, since it may be difficult for the corporation to anticipate the number of shares on which the dissent right will be exercised. The cost of payments for shares will be unknown until after the shareholder meeting.

ratings, the calculation of distributable cash, and difficulties the income trust structure might encounter in an economic downturn.

A. External Management Contracts

In some income trusts, the operating corporation has entered into a management contract with another corporation to manage the affairs of the operating corporation. If the management contract gives the management corporation substantially all the powers relating to the management of the operating corporation, the ability of unitholders to address concerns about the management of the operating corporation will be effectively neutralized. Unitholders may be able to replace the trustees of the trust and, through the new trustees, replace the directors of the operating corporation. This action will be to no avail, however, if the new directors have no management powers because they have been given away in a contract.

While extensive management contracts are used in some income trusts,²¹⁹ their use is not limited to income trusts. Any corporation might enter into a management contract and might attempt to transfer essentially all of its management powers to others. The problem of extensive management contracts is not unique to income trusts or to business income trusts. There will be situations where it makes sense for the corporation to contract out certain parts of its management. The law should not preclude these sorts of contracts, but it should constrain the use of management contracts that confer essentially all management powers to others. Such contracts can completely neutralize the control shareholders would have over management. There are American cases that have held contracts that purport to convey all, or substantially all, of the management powers of a corporation to others to be void on the basis that they are contrary to public policy.²²⁰ A limitation on contracting out management powers is at least implicit in our corporate statutes. The statutes give the power to manage or supervise management to directors²²¹ and limit the extent to which

²¹⁹ It has been noted that external management contracts were common in earlier income trusts but, while still used occasionally, are less common in more recently created income trusts. See Michael J. Johnson, "Survival of the Fittest: The Corporate Governance of Income Trusts" in Poonam Puri & Jeffrey Larsen, eds., *Corporate Governance and Securities Regulation in the 21st Century* (Toronto: Butterworths, 2004) 293 at 302-303.

²²⁰ See e.g. *Sherman & Ellis v. Indiana Mutual Casualty*, 41 F.2d 588 (7th Cir. 1930); *Kennerson v. Burbank Amusement Co.*, 260 P.2d 823 (Cal. C.A. 1953). The key factors appear to be the extent of management powers conveyed and the length of time for which they are conveyed. The greater the extent of management powers conveyed and the longer the time for which they are conveyed, the more likely it is that the contract would be void. If the contract is valid, it can be breached and management powers reassumed by the directors of the corporation. If the contract is valid, however, payment of damages will be required. The longer the contract is for, the greater the damages are likely to be. The greater the damages, the more costly it will be for investors to reassert control over the management of the corporation.

²²¹ See e.g. *CBCA*, *supra* note 12, s. 102.

directors can delegate those powers.²²² There may be some doubt as to the validity of management contracts in which a business income trust corporate operating entity severely constrains the management powers of directors.

There are also ways other than a management contract to effectively freeze unitholders from control over the operations of the entity that generates the returns. For instance, one technique is to first create a corporation, and then to transfer to it the title to the name under which the operating entity carries on business. That corporation then licenses the use of the name back to the operating entity in return for royalties. This royalty corporation is the source of the funds for unitholders. While unitholders can, through the trustees, replace the directors of the royalty corporation, the royalty corporation does not carry on the underlying business that generates the revenues. The only control the royalty corporation has over the actual operating corporation is through the royalty contract. That control may be quite limited.

As it may make sense for some aspects of corporate management to be contracted out, it would be difficult to create a statutory or regulatory provision that draws the proper line between valid management contracts and those that transfer too many management powers. It is probably a matter that should be left to courts. The existing contract law notion of contracts contrary to public policy may be sufficient to provide courts with the discretion to control against overly extensive management contracts.

Where the operating entity of the business income trust is not a corporation, the validity of an extensive management contract may not be as dubious. The market for income trust units should address loss of control over management by pricing the units accordingly. Price adjustments are more likely to occur if institutional investors become a more significant part of the market for income trust units. Otherwise, it may be something stock exchange and securities regulators should monitor. Regulators could also set guidelines on the extent of management powers conveyed in external management contracts and the time periods for which such contracts can operate.

Investors must be made aware of significant management contracts. These contracts would normally be disclosed in a public offering of securities.²²³ Securities regulators should be careful in their reviews of business income trust offerings to ensure that significant management contracts are disclosed and discussed in the prospectus. Securities regulation of income trusts should provide that any external management contract entered into after the public offering be disclosed as part of timely disclosure, even though it might not strictly be considered a change in the business, operations, or capital of the trust itself. If the market is aware of the details of management contracts, it should price income trust units accordingly. One might

²²² See e.g. *ibid.*, s. 115(3).

²²³ Indeed, the CSA expresses this expectation in National Policy 41-201, *supra* note 64, at paras. 2.14-16. It is expected that disclosure of executive compensation and executive contracts, including external management contracts, will be made at the level of the operating entity in the prospectus and on an ongoing basis. It is expected that material contracts in this regard will be filed on SEDAR, *supra* note 2.

expect (or hope) that the market would apply a discount where a management contract effectively precluded unitholders from dealing with poor management performance. Increasing institutional investor investment in business income trusts may increase the effectiveness of the market in assessing the effects of management contracts, as long as the management contracts have been properly disclosed.

B. Executive Compensation

Executive compensation schemes should provide competitive levels of compensation that attract good managers and should be designed to align the interests of management with the interests of investors. Compensation schemes may need to vary with the particular circumstances of the issuer of securities. They will rarely, if ever, provide a perfect alignment of management and investor interests. There will be advantages and disadvantages to each possible scheme. The promoters of an issuer will generally determine the initial compensation scheme, and the board of directors will usually determine changes to it. If governance mechanisms provide weak controls over management compensation schemes, it may result in a scheme that is excessive and poorly aligns the interests of management and investors. These problems affect compensation schemes no matter in what form of organization the business is carried on. The question in the income trust context is whether the income trust creates unique problems.

It has been suggested that certain traditional management incentive schemes may not work well in the income trust context. For instance, an incentive stock option scheme might not work well where the underlying business has stable earnings and is intended to provide investors with regular and steady distributions. The value of units should be relatively stable, since it depends on the expected future stream of cash flows, which are unlikely to change significantly. Managers may be left with options on units with exercise prices near market value and little prospect of benefiting from the option, since the market value of the units is not likely to increase. Management might have the incentive under such a scheme to withhold distributions and engage in growth-oriented acquisitions. Such a strategy would be contrary to the interests of an existing investor clientele primarily interested in steady distributions.²²⁴

This problem, however, is not really unique to income trusts. A business with steady earnings and investors primarily interested in steady distributions might be organized as a corporation, were it not for the additional taxation of corporate income. The same concern about using a stock option incentive scheme might arise. The reason this problem may appear to be unique to income trusts is that the income

²²⁴ To deal with the incentives for an income trust intended to create steady distributions of cash flows, Johnson suggests the use of unit incentive plans in which the exercise price would be reduced by given percentages for distributions in excess of a target amount, the use of significant management ownership of units as an alternative to unit options, or some combination of significant management ownership of units and unit option plans with the exercise price reduction modification (*supra* note 219 at 313-15).

trust structure has become common for businesses with steady earnings, as a means of reducing the effects of the double taxation of corporate income.

C. Stability Ratings and Disclosure of Stability Ratings

Prior to offerings of income trust units, rating companies may be engaged to provide a rating of the stability of the cash flows that the income trust is expected to generate. Occasionally when the rating was unfavourable, those involved in issuing the income trust units have chosen not to disclose the results. For sophisticated investors, failure to disclose might not be much of a problem; they may be able to assess the likely stability of cash flows to be generated by the underlying business. Where the investors are retail investors, the failure to disclose a stability rating may be a greater issue. The issuer has information that could be helpful to retail investors and which might otherwise be obtained only at significant cost. If a stability rating has been done, disclosure of it could reduce the costs to investors, both retail and institutional, of assessing the variability of future returns.

National Policy 41-201 says that if the issuer has received a stability rating the CSA expects the rating to be disclosed.²²⁵ This requirement seems consistent with existing securities regulatory requirements. The disclosure required in a prospectus is “full, true and plain disclosure of all *material facts*.²²⁶ Material facts are those that would reasonably be expected to have a significant effect on the market price or value of the securities. If stability of cash flows is important, as it often is for investors who invest in income trusts, an unfavourable stability rating would have a significant effect on the market price or value of the income trust units.

D. Calculations of Distributable Cash

In recent years, there have been high-profile instances of manipulations of accounting practices by corporations to improve reported net income.²²⁷ In the income trust context, there may be incentives to manipulate accounting treatments, which may manifest themselves in the calculation of distributable cash. The incentives may be strong where investors focus on stable distributions. There may be attempts to influence the calculation of distributable cash to make it appear more stable than might otherwise be the case. The difficulty with calculations of “distributable cash” is that these amounts are not standardized calculations under generally accepted accounting principles. This fact may make the calculation more susceptible to manipulation. One might standardize the definition of distributable cash to be used in income trusts, but such an action would limit flexibility, which may be needed to

²²⁵ *Supra* note 64 at para. 2.12.

²²⁶ See e.g. OSA, *supra* note 19, s. 58; BCSA, *supra* note 19, s. 68.

²²⁷ There was, for instance, the Worldcom case in the United States and the Atlas Cold Storage situation in Canada. On Atlas Cold Storage, see Ontario Securities Commission, News Release (3 June 2004).

respond to different income trust contexts. If the numbers that go into the calculation, however defined, are properly audited on a regular basis against the definition in the declaration of trust, it should limit the potential for manipulations. Consideration should be given to requiring auditors for income trusts to include an assessment of calculations of distributable cash in their audit report.

E. Refinancing in an Economic Downturn

It has been suggested that the structure of income trusts could create challenges should interest rates go up or should there be an economic downturn. Since the income trust distributes eighty to ninety-five per cent of its earnings, funds may not be available to replace aging assets or reinvent the trust as a growth investment.²²⁸ The difficulty with this claim is that income trusts have a way to raise funds for replacement of assets, to invest in new businesses, or expand existing businesses. They can sell more units to the public. If the proposed use of the funds makes sense, the market should take up the new offering. The requirement to return to the market may be an advantage to the income trust, in addition to its significant tax advantages. The tax treatment of dividends has been said to discourage corporations from paying significant dividends. This policy increases retained earnings and provides an internal source of funds for investment. While this policy provides a low-cost source of funds, it reduces the frequency with which management must return to the market for funds. A high-payout policy, forcing frequent return to the market, has been said to be an important corporate governance discipline on management.²²⁹ The advantage of the income trust is that the different tax treatment of distributions encourages a high-payout policy. Through this policy, management can signal to investors an obligation to return to the capital market, thus giving an incentive to manage the business in a way that maximizes securities values.²³⁰

²²⁸ Johnson, *supra* note 219 at 326-27.

²²⁹ See e.g. Frank H. Easterbrook, "Two Agency-Cost Explanations of Dividends" (1984) 74 Amer. Econ. Rev. 650; Richard A. Posner, *Economic Analysis of Law*, 5th ed. (New York: Aspen Publishers, 1998) 453. See also Vijay Jog & Liping Wang, "The Growth of Income Trusts in Canada and the Economic Consequences" (2004) 52 Can. Tax J. 853 at 858.

²³⁰ This potential advantage of an income trust is briefly discussed in Paul D. Hayward, "Income Trusts: A 'Tax Efficient' Product or the Product of Tax Inefficiency?" (2002) 50 Can. Tax J. 1529. See also Jog & Wang, *ibid.* at 858.

VII. Is There a Need for Legislation?

A. Introduction

Legislation concerning income trusts has been enacted to respond to potential unitholder liability in income trusts,²³¹ but is there a need for legislation concerning governance of income trusts? It has been suggested that the income trust phenomenon in Canada is just a bubble, or market anomaly.²³² If it is a bubble, it will presumably phase itself out, so any legislation created for income trust governance will become largely irrelevant. The income trust phenomenon has lasted for several years, however. With many new income trust IPOs in the first half of 2005,²³³ it does not appear to be fading any time soon. Legislation might address potential abuses of income trust structures. Even if there were no abuses, legislation might be enacted to reduce costs associated with creating business income trust structures, the regulation of business income trusts, and investment analysis of business income trusts.

B. Legislation to Control Against Potential Abuse

1. Potential for Management Abuse

While tax motivations may have been significant in the creation of business income trusts, there is potential for management to use business income trust structures to restrict investor control. As noted in Part II, the trust law that governs business income trusts does not contain the kind of mandatory shareholder protection provisions found in corporate statutes. This leaves scope for management to use business income trust structures in an abusive way. The move to income trust structures could be viewed, in the language of the corporate chartering debate, as a “race to the bottom.”²³⁴ Legislation might set out business income trust governance provisions to provide protections similar to those in corporate statutes.²³⁵

²³¹ *Trust Beneficiaries Liability Act*, *supra* note 9; *Alberta Income Trust Act*, *supra* note 9; *B.C. Income Trust Act*, *supra* note 9; *Manitoba Unitholders' Protection Act*, *supra* note 9.

²³² Dirk Zetzsche, “The Need for Regulating Income Trusts: A Bubble Theory” (2005) 63 U. T. Fac. L. Rev. 45 at 73-99.

²³³ See Introduction, above.

²³⁴ There has been an extensive debate on the corporate charter competition. Some of the early writing in the corporate charter competition debate saw the competition as a “race to the bottom.” See William L. Cary, “Federalism and Corporate Law: Reflections Upon Delaware” (1974) 83 Yale L.J. 663. The counter-argument was that it was in fact a “race to the top.” See Ralph K. Winter Jr., “State Law, Shareholder Protection and the Theory of the Corporation” (1977) 6 J. Legal Stud. 251. The debate and empirical evidence is reviewed in Roberta Romano, *The Genius of American Corporate Law* (Washington: AEI Press, 1993). In the Canadian context, see Ronald J. Daniels, “Should Provinces Compete? The Case for a Competitive Corporate Law Market” (1991) 36 McGill L.J. 130; Jeffrey G. MacIntosh, “The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law: A Second Look” (University of Toronto Law and Economics Working Paper 18, 1993); Douglas

2. Control of Abuses by the Market, Securities Regulators, or the Stock Exchange

Potential management abuses might be controlled without legislation. First, the market might reduce prices for units of business income trusts that have questionable or restrictive governance features. This kind of control may improve with increased institutional investor involvement in the market for units of business income trusts. Second, securities regulators and the stock exchange could impose requirements on business income trusts to protect investors from potential abuses.

3. Are Existing Differences Abusive?

As the analysis in Part IV suggests, whether as a result of market forces, or requests from securities regulators or the stock exchange, business income trusts generally replicate most of the provisions in corporate statutes, such as the *CBCA*. There are, however, some differences (such as those summarized in Part V, above). Are these differences an abusive management use of the business income trust structure, or do they actually make investors better off?

There are generally significant increases in value when corporations shift to an income trust structure.²³⁶ These increases may be largely due to tax savings.²³⁷ We

J. Cumming & Jeffrey G. MacIntosh, “The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law” (2000) 20 *Int’l Rev. L. & Econ.* 141; Douglas J. Cumming & Jeffrey G. MacIntosh, “The Rationales Underlying Reincorporation and the Implications for Canadian Corporations” (2002) 22 *Int’l Rev. L. & Econ.* 277.

²³⁵ The extent to which legislation should provide mandatory provisions for business organizations has been extensively debated in corporate law literature. See e.g. Frank H. Easterbrook & Daniel R. Fischel, “The Corporate Contract” (1989) 89 *Colum. L. Rev.* 1416; Robert C. Clark, “Contracts, Elites, and Traditions in the Making of Corporate Law” (1989) 89 *Colum. L. Rev.* 1703; Henry N. Butler & Larry E. Ribstein, “Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians” (1990) 65 *Wash. L. Rev.* 1 at 7-18; Larry E. Ribstein, “The Mandatory Nature of the ALI Code” (1993) 61 *Geo. Wash. L. Rev.* 984 at 987-98; Melvin A. Eisenberg, “The Structure of Corporate Law” (1989) 89 *Colum. L. Rev.* 1461; Lewis A. Kornhauser, “The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel” (1989) 89 *Colum. L. Rev.* 1449; Jeffrey N. Gordon, “The Mandatory Structure of Corporate Law” (1989) 89 *Colum. L. Rev.* 1549; Roberta Romano, “Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws” (1989) 89 *Colum. L. Rev.* 1599; Lucian A. Bebchuk, “The Debate on Contractual Freedom in Corporate Law” (1989) 89 *Colum. L. Rev.* 1395; Bernard S. Black, “Is Corporate Law Trivial? A Political and Economic Analysis” (1990) 84 *Nw. U. L. Rev.* 542. The issue has not been clearly resolved. One argument in favour of mandatory provisions is that they can protect investors from opportunistic downstream changes that reduce the value of their investment. See Bebchuk, *ibid.* A downstream change is one made after investors have made their investments. Subsequent major transactions (such as an amalgamation) or changes in the constituting documents of the investment vehicle (e.g., a corporation or a trust) may have a significant, and potentially detrimental, effect on the value of an investment. Such transactions or changes may be necessary, but investors may need some means of protecting themselves against transactions or changes that prejudicially affect their interests.

²³⁶ See Hayward, *supra* note 230; Lalit Aggarwal & Jack Mintz, “Income Trusts and Shareholder Taxation: Getting it Right” (2004) 52 *Can. Tax J.* 792.

may never know whether these tax savings are swamping otherwise negative effects of the shift to these income trust structures. One problem is that institutional investors have, at least until recently, avoided investment in business income trusts supposedly due to a concern over potentially unlimited liability.²³⁸ The market for income trust units has thus been dominated by retail investors who may not appreciate the governance structure differences and therefore may not have efficiently priced the units. They may not have properly priced the tax savings either, further complicating the assessment of the effect of governance structure changes. It is especially difficult to assess whether these governance structure differences are value-increasing or value-decreasing. The recent increase in institutional investor involvement may provide some assistance. Assuming that institutional investors are sufficiently sophisticated to demand protection, particularly against value-reducing downstream changes, persistent avoidance of certain corporate statute provisions suggests the corporate statute provisions are actually value-reducing.

Investors may be better off if they avoid certain corporate statute provisions. While well intended, these provisions may, in fact, reduce the value of the investments for the very investors they were intended to protect. The avoidance of certain corporate statute provisions in business income trusts may highlight provisions that should be reconsidered. How often are they used, particularly in the context of publicly held corporations? Can the benefits and costs be quantified?

While such an assessment is beyond the scope of this paper, some preliminary observations are made here. First, the lack of an appraisal remedy may not be a major shortcoming in a business income trust with publicly traded units. The unitholders would have ready access to a rough appraisal remedy equivalent—they could simply sell their units. This alternative might be simpler and less costly to both the investor and the trust than a cumbersome procedural appraisal mechanism such as that provided in corporate statutes. There may be situations, however, where an approved fundamental change reduces the market value of the interests of some unitholders. It

²³⁷ See Hayward, *ibid.* at 1535-37. See also Aggarwal & Mintz, *ibid.*, who estimate annual tax benefits from income trusts in the order of \$600 million. See also Tim Edgar, “The Trouble with Income Trusts” (2004) 52 Can. Tax J. 819, where it is argued that “Income trusts are largely tax-driven structures that offer very little in the way of desirable efficiency or equity effects” (Edgar, *ibid.* at 820 [footnote omitted]).

²³⁸ The limited liability concern and the legislative response is addressed in Mark R. Gillen, “Income Trusts Unitholder Liability: Risks and Legislative Response” (2005) 42 Can. Bus. L.J. 325. The paper argues, as have several legal opinions, that the potential for unlimited liability is remote (probably as remote as the risk of unlimited liability as a shareholder in a public corporation). Institutional investors may become more inclined to invest in business income trusts now that they are protected by legislation in Ontario, Alberta, British Columbia, and Manitoba (see *supra* note 9). The paper argues that these statutes do nothing to alter the main basis (the agency basis) on which unitholders in a business income trust might be liable beyond the amount of their investment.

may be worthwhile to have a method that allows them to sell their units at a price that does not include a reduction for the fundamental change.²³⁹

Second, the lack of a derivative action provision or an oppression provision may, in part, be due to the difficulties that would be encountered in creating precise equivalents in a trust instrument, given the need to confer certain powers on a court. The conferral of powers may require legislation. In the case of the derivative action, its current limited use suggests that it might be either abandoned (leaving only an oppression remedy), or given a more limited role.²⁴⁰

Third, the oppression application provides its greatest benefit where there is no public market for the investment interests. Investment interests may be locked in, even in the face of changes that significantly reduce their value. Publicly traded income trust units can be sold in the market, which responds to proposed negative downstream changes. There may nonetheless be situations where value-reducing downstream changes have not been anticipated by provisions dealing with fundamental changes. These changes may reduce the market value of the units before they can be sold. The value of the units may be greater with the protection that an oppression provision provides against unanticipated downstream changes.

4. Minimum Standards That Might Be Adopted

If the differences make investors worse off, a statute might set minimum standards.²⁴¹ For instance, the statute might mandate certain unitholder rights and remedies. These remedies might include an oppression remedy provision that clarifies the availability of the oppression remedy to unitholders at the trust level and perhaps

²³⁹ Possible benefits and costs of the appraisal remedy were reviewed in Jeffrey G. MacIntosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1987) 24 Osgoode Hall L.J. 201. Market forces may discourage opportunism where the issuer has to return to the market on a regular basis for further infusions of capital. Businesses that are converted to income trust structures are often relatively stable businesses that may not return to the capital market often. The market for income trust units has also been, at least until recently, primarily a retail market in which the holdings of trust units are likely to be widely dispersed. This fact may cause collective action problems, limiting the degree to which the market may control opportunism, suggesting that the benefits of an appraisal remedy may be sufficient to yield benefits net of costs.

Statutory appraisal remedy provisions may provide for a calculation of fair value that does not include the effect of the fundamental change. Provisions normally require that fair value be calculated as of the day before the approval of the fundamental change. See e.g. *CBCA*, *supra* note 12, s. 190(3). They may also provide that the fair value not include gains or losses in the value of shares that were the result of the anticipation of a proposed change. See e.g. *Corporations Act*, R.S.M. 1987, c. C-225, s. 184(3). See also Peterson, *supra* note 181.

²⁴⁰ For instance, claims against directors or officers for breaches of fiduciary duties might be brought through an oppression claim, leaving the derivative action as a means through which shareholders or other proper persons might be allowed to pursue actions, on behalf of the corporation, that the corporation has against persons other than directors and officers.

²⁴¹ Zetsche, *supra* note 232 at 104-105 suggests the adoption of corporate statute provisions as minimum standards for income trusts.

also at the level of the underlying operating entity. A provision that clarifies rights for unitholders to act in the name of and on behalf of the trustees in certain circumstances might also be included. Consideration could be given to mandatory unitholder voting rights on fundamental changes, such as amendment of the declaration of trust, amalgamation of the trust, sale of all or substantially all of the trust assets, or termination of the trust. It might also require trustees to seek unitholder approval to exercise voting rights at the operating entity level on transactions such as an amalgamation of the operating entity, the sale, lease, or exchange of all or substantially all of its assets, the winding up or dissolution of the operating entity, or amendments to its constating documents. Consideration could also be given to mandatory class voting rights where an income trust has different types of units, similar to classes of shares in a corporation. It might also be useful to have a provision for trustees to waive any right of indemnification from the beneficiaries. A provision that ensures the trust will not be treated as a bare trust might be useful in order to reduce the risk of unitholders being subject to liability beyond the extent of their investment.

5. Regulatory Competition

If a particular province developed such a statute, what would stop income trust promoters from creating the income trust under the laws of another province without a corresponding statute? A province that developed an income trust statute might prohibit sales of income trust units not established under the statute or corresponding statutes of other provinces. In practice, such a prohibition might be difficult to enforce. While one might be able to control sales activities in the province, it would be difficult to prevent resident investors from buying income trust units outside the province.

A well-devised statute hopefully would lead over time to a reputation for better investor protection. This protection might be supplemented with investor education, indicating that the provincial income trust statute has investor protection provisions not found in other income trust statutes. Ontario sits in a unique position, since the promoters of an income trust will likely want to have the units listed and posted for trading on the TSX. Trading in the trust units would thereby be subject to regulation by the TSX and the Ontario Securities Commission.

C. Legislation as a Means of Reducing Transaction Costs

Another advantage of a statute is that it can provide a default structure. The default structure may reduce the cost of setting up a business income trust and the associated regulatory costs. It may also reduce costs for investors analyzing business income trust investments.

Many provisions in declarations of trust are identically, or virtually identically, worded. Declarations of trust might be simplified if many of the terms were contained in a statute. Although existing declarations of trust are readily available to use as a

basis for drafting a new declaration of trust, a statute that simplifies these declarations by setting out default terms may reduce the cost of setting up income trusts. Declarations of trust might simply set out the ways in which the rules governing the trust differ from those set out in the statute. Many of the provisions in these declarations of trust mirror provisions in the *CBCA* or similar corporate statutes. These corporate statutes might be a useful model for drafting an income trust statute.

Legislation might also reduce regulatory costs associated with the creation of a business income trust. Securities regulators need to review business income trust offerings to ensure that it is not contrary to public interest before issuing a receipt for a preliminary prospectus. The stock exchange, with a view to protecting its reputation, might likewise review a potential listing of a business income trust to see that the provisions provide adequate protections for investors. These reviews might be simplified if regulators could simply confirm that the business income trust was created under the legislation and examine the declaration of trust for permitted deviations. They need not search the declaration of trust for mandated investor protection provisions once they have confirmed that the business income trust is established under the legislation.

Legislation setting up a default structure for business income trusts might also reduce costs for investors analyzing business income trust investments. Instead of searching through long declarations of trust for particular governance provisions or investor protection provisions, investors could simply confirm that the trust was created under the legislation. They could then look through shorter declarations of trust for the permitted deviations from the statutory structure.

VIII. Tax Neutrality and Legislation That Replicates Corporate Law Statutes

If a statute for business income trusts replicates corporate law statutes such that the only remaining difference is the tax advantage of the business income trust, the issue reduces to a question of tax policy. If the difference is simply the tax advantage, it would favour one form of business organization over another, essentially identical, form of business organization. Taxes should be neutral—that is, they should affect economic decision making as little as possible. Given the underlying principle of neutrality, it is hard to imagine what the tax policy justification could be for favouring the business income trust structure. The income trust structure may be a convenient, non-tax-law institutional innovation that addresses the double taxation concern.

The tax advantage may also create a governance benefit. It allows management to distribute free cash flow to investors without the double taxation that arises in a corporate dividend distribution. Reducing free cash flows can operate as a credible signal by management to investors that they will act in the interests of investors. It

does so by forcing management to return to the market for further infusions of capital, rather than relying on internally generated funds. It gives management an incentive to perform well in order to maintain and improve the market value of the firm's securities.²⁴² This "signalling" device²⁴³ comes at a cost. Financing with internally generated funds is cheaper than seeking funds in the capital market. The double taxation of distributed corporate profits imposes a further cost that may deter management from using this signalling device in a corporation. Avoiding double taxation of distributed profits in business income trusts reduces the cost of this signalling device. While this advantage for income trusts, if it exists, is a governance advantage, it is one created by the different tax treatment between business income trusts and corporations. It is not one that arises purely from the structural difference. An income tax that significantly favours one form of organization over another is not neutral. The approach to business income trusts should not be to encourage them or accept them as a way of addressing corporate double taxation, but rather to address the double taxation of corporate income head on.

Conclusion

Declarations of trust for business income trusts replicate many of the governance provisions of corporate statutes. There are, however, some notable exceptions. In particular, they omit the appraisal remedy and unitholder proposal provisions provided in corporate statutes. They also do not provide equivalents to the derivative action or the oppression remedy. While there may be some scope for unitholder derivative or oppression actions at the level of an underlying operating entity, such a right may not exist if the operating entity is not a corporation or if the shares are held by an intermediate entity rather than directly by trustees.

If avoidance of certain corporate shareholder rights and remedies is seen as a sort of "race to the bottom" in which unitholders may be exposed to detrimental downstream changes, a statute should be adopted to protect investors. This statute should mandate rights and remedies corresponding to those in corporate statutes. A statute might also set out various default provisions for business income trusts, thereby reducing the costs of creating, regulating, or performing investment analysis of such trusts. If the statute were to completely replicate corporate statutory provisions, however, there would be two forms of organization (corporations and business income trusts) that are virtually identical in terms of governance.²⁴⁴ Tax treatment would be the only remaining significant difference. If that is the case, the

²⁴² See e.g. Easterbrook, *supra* note 229; Posner, *supra* note 229.

²⁴³ Distribution of free cash flows by management operates as a "signal" to investors that management will return to the market for needed funds. By committing to return to the market, management gives itself an incentive to perform well so that funds can be raised.

²⁴⁴ The multi-tiered structure of income trusts might remain with a statute that mandated rights to unitholders identical to those in corporate statutes, since the essential legal governance features would be the same.

issue reduces to a tax issue. The response should be a tax policy that better integrates corporate and personal income taxes by enhancing the dividend tax credit, or otherwise directly addresses the double taxation concern.

If the avoidance of certain corporate shareholder rights and remedies is seen as more of a “race to the top” in which these corporate provisions are avoided because they actually reduce the value of the equity interests, we would not want to mandate these rights and remedies in a statute (thereby making investors worse off). If these rights and remedies reduce equity values, it is time to review their efficacy. In other words, if certain shareholder rights and remedies are being avoided because they are value-reducing, the focus should be on amending corporate statutes rather than creating a special statute for business income trusts.
