PROJECT SELECTION CRITERIA FORM

PROJECT SUBJECT: Trust Indenture Provisions in Corporate Statutes

For Consideration: ULCC August 2009

Project Summary

This is a proposal from the Securities Law Subcommittee, Business Law Section, Ontario Bar Association ("**OBA**") to the Uniform Law Conference of Canada ("**ULCC**") to consider a 2-part law reform project on the **Trust Indenture Provisions of Canadian Corporate Statutes.**

The proposed project includes 2 phases:

Phase 1 would involve compiling a set of recommendations on an appropriate uniform legislative model that could be adopted federally and in all provinces and territories either as stand-alone legislation or as a discrete component of each jurisdiction's general corporate legislation.

Phase 2 would involve developing a Uniform Act (or Uniform set of provisions) implementing the recommendations from Phase 1.

Background

A trust indenture sets out the financial terms of debt securities. Those terms will typically include the interest rate, repayment terms and financial covenants (promises). The trust indenture provisions serve to 1) ensure that holders of debt obligations are served by a disinterested trustee who will operate with the high requisite duty of care outlined in the various corporate statutes in each jurisdiction, 2) to ensure that full and fair disclosure be made to holders of debt obligations at the issue of such debt obligations but also throughout the life of such securities. In theory, then, the individual security holders no longer have to fend for themselves in the event of default by the issuer.[1]

Investors in debt obligations issued under corporate trust indentures (like investors in other types of corporate securities) can legitimately expect a high degree of uniformity in investor protection mechanisms across Canada and, indeed, south of our border. These investor protection regimes should apply uniformly irrespective of the jurisdiction of the issuer or the jurisdiction of the investor.

Similarly, trustees performing services as indenture trustees are entitled to

[1] Christopher Nicholls, *Corporate Law* [Edmond Montgomery] p. 352).

expect that substantially similar laws apply to their duties and to the duties of corporate issuers of debt obligations.

While U.S. law is uniform, Canadian law is highly fragmented. Canadian law is not internally consistent nor generally consistent with U.S. law. Arguably, therefore, Canada's current patchwork of corporate laws governing trust indentures is not fully serving any of their legitimate constituencies: issuers; trustees; and, most importantly, retail and institutional investors.

As intimated above, Canada has different statutory models that govern trust indentures. There are trust indenture provisions at the federal, provincial and territorial levels – reflecting the historical classification of these statutes as part of corporate law in Canada.

The attached table highlights the similarities and differences between the *Canada Business Corporations Act* ("**CBCA**") and the provisions contained in the corporate statutes of the provinces and territories.

Note that Québec, Nova Scotia and P.E.I. do not have statutory counterparts to the CBCA or OBCA; and the applicable corporate statute in New Brunswick does not contain provisions addressing those set out in the chart. Thus, six provinces and all three territories have trust indenture legislation while four provinces do not.

For those jurisdictions that have trust indenture legislation, the table compares trust indenture legislation federally, provincially, territorially and in the United States across several criteria - especially, the basis and scope of application of the regulatory regime and available exemptions. As the table highlights, in addition to the great disparity in legislation across Canada, there are some important underlying issues. These include:

1. Many jurisdictions (including the CBCA) regulate only where a trust indenture is part of a "distribution to the public" but omit any definition of the term. While the securities laws of some provinces contain a definition, the definition under provincial and territorial law may not be, or remain, uniform. In contrast, Part V of the OBCA only applies to a trust indenture where a prospectus or securities exchange issuer bid circular or take-over bid circular has been filed under the Ontario *Securities Act* or predecessor Ontario securities legislation. The B.C. legislation is to similar effect.

2. There are fundamental conceptual differences between (a) the CBCA model and its progeny, and (b) the U.S. *Trust Indenture Act of 1939* (the "**US Act**"), Part V of the Business Corporations Act (Ontario)(the "**OBCA**") and the *Business Corporations Act* (British Columbia)(the "**BCBCA**"). The CBCA model only seeks to regulate trust indentures issued by federal corporations. Thus, of necessity, Part VIII of the CBCA (and federal/provincial/territorial laws modelled on the CBCA) treats the matter as regulation of "corporate issuers of debt obligations" rather than one of "investor protection". The equivalent provisions of Part V of the OBCA, the BCBCA and the US Act have a different focus. Part V of the OBCA applies to more than just OBCA corporations. It applies to any "body corporate", which is defined under the OBCA as a "any body corporate with or without share capital and whether or not it is a corporation to which [the OBCA]

applies." – a definition that includes more than just corporations incorporated or continued under the OBCA but includes as well CBCA corporations, not-for-profit corporations and bodies corporate formed under provincial, territorial or foreign law. The scope of the BCBCA tracts that of Part V of the OBCA.

The US Act goes even further - disregarding whether the issuer is incorporated or unincorporated.

3. Some jurisdictions provide for exemptions; others do not. The Ontario Securities Commission (the "**OSC**") has the discretion to exempt trust indentures from the application of Part V of the OBCA. The statutory test applied in granting an exemption under the OBCA is whether the exemption "would not be prejudicial to the public interest". For this purpose, the "public interest" means the interests of Ontario investors. By contrast, Part VIII of the CBCA applies to all trust indentures in which the underlying debt obligations are part of a "distribution to the public". It, therefore, includes debt obligations that are never sold, or offered for sale, to Canadian investors. Nor does Part VII of the CBCA provide for any "public interest" exemption. There is great diversity of approach to exemptions in this country.

The provisions of the CBCA relating to trust indentures have been replicated in the following federal statutes, with minimal changes to conform to the applicable statute:

1. *Bank Act*, S.C. 1991, c. 46

2. *Canada Cooperatives Act*, S.C. 1998, c. 1

3. *Canada Not-for-profit Corporations Act*, S.C. 2009, c. 23 (not yet in force)

4. *Cooperative Credit Associations Act*, S.C. 1991, c. 48

5. *Insurance Companies Act*, S.C. 1991, c. 47

6. *Trust and Loan Companies Act*, S. C. 1991, c. 45

Appropriate Nature of the Proposed Project

The remainder of this document discusses the proposed project in relation to the Project Selection Criteria which have been provided by the ULCC.

1. Uniform Legislation is Desirable

1.1 Fairly widespread agreement that uniform legislation in this subject area is desirable, by industry as well as government

Investment in securities (including the debt obligations of corporations issued under trust indentures) transcends provincial, territorial and national boundaries. The goals of promoting investor protection and maximizing the efficiency of capital markets demand that underlying laws be as uniform as possible so that investors enjoy substantially the same rights and expectations regardless of the corporate statute under which the issuer happens to be incorporated at the time of the issuance of its securities. Likewise, issuers and intermediaries performing

services as trustees should be subject to substantially the same legal requirements.

Report No. 36, Alberta Law Reform Institute, Proposals for a New Alberta Business Corporations Act, says at p. 97:

> We think also that this is an area in which uniformity is very important, as trustees dealing with corporate finance should not be subject to varying duties across the country.

With the subsequent growth of cross-border trading in securities trading, it is of course now more important than ever to consider the advantages to investors, issuers and intermediaries of closely harmonizing with US legal requirements.

1.2 Jurisprudence can be better developed by the courts of a number of provinces

Not a meaningful factor as the trust indenture provisions have not been the subject matter of litigation.

1.3 The subject matter and legal and policy issues are the same in every jurisdiction

This is the case. The subject matter should be treated as a matter of investor protection under securities regulation, not corporate law.

2. Uniform legislation elsewhere

2.1 High degree of compatibility with American legislation would be desirable

As federal law, the US Act provides for uniform treatment of trust indentures in the U.S. regardless of whether the issuer is incorporated or unincorporated or under what law it is formed. The US Act treats the subject matter as an aspect of securities regulation.

The US Act served as the model for the Dickerson Committee, becoming Part VIII (comprising ss. 82 through 93) of the CBCA when it came into force in 1975. However, as discussed above, the CBCA departed from the US Act in some fundamental ways. The CBCA model has in turn been replicated in other federal corporate legislation and also in some provincial and territorial statutes. Significant exceptions, however, exist in three of the four largest Canadian capital markets: Ontario; B.C.; and Québec (which has no comparable legislation). The law in Ontario and B.C. is closer to the US Act than is the law in other Canadian jurisdictions.

2.2 There is a model law or international work that can be adopted

The US Act, which has been updated, serves as a useful model. It has, however, spawned at least two competing variants in Canada: the CBCA model; and the OBCA Part V model, which was adopted by the BCBCA when it came into force in 2003.

3. Industry operates beyond provincial boundaries

3.1 Business transcends provincial boundaries and the legal system should provide similar laws and procedures across the country to accommodate it, to reduce the administrative burden for business

See the discussion above on the integration of Canadian and US capital markets.

3.2 Companies use the same technology on both sides of the border

Having identical laws can be expected to increase the efficiency, and marginally lower the cost of providing the services, of indenture trustees.

4. No one else is undertaking this work

4.1 Undertaking a project would not duplicate the work of another body that is attempting to achieve uniformity in this area

This is the case.

5. ULCC has been requested to undertake the project

As discussed above, this project comes at the suggestion of the OBA Securities Law Subcommittee.

5.1 Referral from Ministers or Deputy Ministers

Not applicable.

6. Current issue

6.1 Provinces are undertaking work in the area

No. The Province of Québec is in the process of modernizing or replacing its *Companies Act*.

6.2 The need for reform is apparent to government and other interested groups, e.g., stakeholders, lawyers

Yes. See 2.2 and 5 above.

6.3 Demand for reform

Same as 6.2.

6.4 Widespread desire for a modern Act

Same as 6.2.

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6.5 Great amount of reform activity

Not the case.

6.6 Growing interest in reform in this area

Stakeholders have raised this issue. See 4.2 above. Also, there is a significant push taking place for a national securities regulator. The Federal Government has adopted pursuit of a national securities regulator as part of its agenda. Regulation of trust indentures is currently not treated under provincial and territorial securities laws. If a national securities regulatory regime comes to fruition, the work of the ULCC on trust indentures could inform any federal initiative in this area.

7. Likelihood of adoption

7.1 The state of the law is very non-uniform, although those jurisdictions that have enacted reformed legislation have addressed many issues in a similar way

There is a compelling case for uniform treatment of trust indentures across Canada and for substantial uniformity with US law. As discussed above, US law is uniform but Canadian law is highly fragmented. Reform of trust indenture legislation would make a non-political and uncontentious positive contribution to the laws governing Canadian capital markets.

7.2 Adoption of a uniform Act could encourage activity in those jurisdictions that have taken no steps to reform the law in this area

It seems likely that the ULCC could make a useful contribution to achieving uniformity in this neglected area of capital markets law.

8. Past consideration by ULCC

Nil.

8.1 There is an existing Uniform Act that needs to be updated

No.

9. Defined questions of policy to be considered by the ULCC

9.1 The policy issues for the ULCC are capable of definition

Yes. The Phase I work would include a description of the policy approaches and issues and the choice of an appropriate uniform model law.

9.2 The ULCC has the ability to address the issue

Yes, but will need assistance from private sector securities law practitioners.