UNIFORM LAW CONFERENCE OF CANADA

CIVIL LAW SECTION

UNIFORM AND SIMPLIFIED TRUST INDENTURE LEGISLATION

A Report of the Working Group
to the Uniform Law Conference of Canada, Civil Law Section.

The ideas of conclusions set forth in this paper, including any proposed statutory language, any comments or recommendations, have not been adopted by the Uniform Law Conference of Canada, and do not necessarily reflect the views of the Conference or any of its delegates.

Halifax, Nova Scotia
August 2010

Table of Contents

1. Introduction

[1] At the August, 2009 Annual Meeting of the Uniform Law Conference of Canada ("ULCC"), the ULCC approved a project to study and report on the trust indenture provisions found in certain corporate statutes in Canada. A working group was formed to consider possible approaches to developing uniform trust indenture legislation (the "Uniform Provisions").

[2] As we explain in detail below, trust indentures are a facilitating mechanism, employed in commercial financing to simplify the issue and administration of debt instruments involving numerous investors. Trust indentures involve aspects of corporate law, securities law, trust law and contract law. For Canadian issuers, it is also often necessary to consider applicable US law and practice. An understanding of the regulatory issues associated with trust indenture financing also requires some consideration of elementary price theory as it applies in relation to corporate and commercial financing. Reflecting the interdisciplinary nature of the subject, the working group included practitioners, regulators, legal academics and in-house trust company officers and who practice or work in these areas.

[3] What follows, therefore, is the Report of the working group on the possible content of Uniform Provisions.

The members of the Working Group are:

George Bragg, Vice President, BNY Trust Company of Canada, Toronto

Wayne Gray, Partner, McMillan LLP (Secretary), Toronto

Coleen Kirby, Manager, Policy Section, Industry Canada, Ottawa

Geralyn Krowles, Account Manager, CIBC Mellon, Toronto

Kevin McGuinness, Barrister & Solicitor (Principal Reporter), Stoney Creek

Gordon G. Raman, Partner, Borden Ladner Gervais LLP, Toronto

Stéphane Rousseau, Associate Professor, University of Montreal, Montreal

Trevor Scott, Partner, Farris, Vaughan, Wills & Murphy LLP, Vancouver

Philippe Tardif, Partner, Borden Ladner Gervais LLP (Chair), Toronto

2. Executive Summary

[4] Legislation regulating trust indentures is unique to North America. There is no corresponding legislation in effect in the United Kingdom,[1] Australia or the European Union.[2] Canadian legislation is largely modelled on the American *Trust Indenture Act of 1939*, although is not as expansive in scope. This legislation must be seen as part of a broader package of legislative remedies designed to protect investors in debt instruments.

[5] The argument for regulating trust indentures is not strong. Nevertheless, there is sufficient evidence in the historic record to indicate that at least some minimal level of regulation may be beneficial. Also, so long as the American *Trust Indenture Act of 1939* remains in effect, there would seem to be some benefit in maintaining corresponding legislation in Canada.

[6] There is little evidence in the case law, or in reported instances of which we are aware, to suggest that the existing regulatory regime requires expansion.

We recommend a number of changes that would simplify and harmonize the administration of the current law. These include the following:

- The use of trust indentures in the securities market should continue to be regulated as long as trust indentures in the U.S. are regulated.

- Consistency in Canada's capital markets means that all Canadian jurisdictions should have a uniform (or substantially harmonized) model law.

- The provisions should apply to all trust indentures, irrespective of the domicile of the issuer or the nature of the issuer, if it is distributing its bonds into a particular province or territory (by way of public offering). The failure to regulate non-corporate issuers is anomalous. Bonds issued by non-corporate issuers present exactly the same types of risk to the investing public. If there is a need to regulate corporate bond trustees, then there is a need to regulate all bond trustees.

- The relevant trust indenture provisions should be moved from corporate statutes to the relevant securities statutes as trust indentures generally involve the distribution of securities.

- The specific requirements of the regulatory regime should be dealt with by way of a subordinate body of law comparable to the current National Instrument system of the Canadian Securities Administrators.[3] Such an approach would allow a considerable measure of flexibility, which may be highly advisable should

problems arise, and would lead to greater uniformity among participating jurisdictions.

- To the extent securities legislation relating to the distribution of securities is confirmed to be a matter of Federal Jurisdiction, trust indenture provisions should be added by way of amendment to that statute.

- A uniform and reciprocal scheme of exemptions should apply, such that issuers would only be subject to one statutory legislative scheme governing trust indentures.

- Blanket (or class) exemptions should be created for bond issues covered primarily by the legislation of other jurisdictions which have comparable laws in place.

- Canadian securities regulatory authorities should have the discretion to grant relief in respect of the application of trust indenture provisions on a case by case basis.

- Compliance with the regulatory requirements should be required once there has been a filing of a prospectus with respect to the bonds to which the indenture relates.

- The uniform law should include the principal sustentative provisions of the *Canada Business Corporations Act* and the *Business Corporations Act* (Ontario).

3. Background

3.1 What Are Trust Indentures?

[7] Business entities raise finance from the capital markets by issuing different classes of financial instruments: by issuing shares (or equity), debt obligations or hybrid instruments known as mezzanine financing, which mix features of debt and equity. A common method of raising debt finance is to issue bonds, notes or debentures. In corporate finance parlance, bonds, debentures and notes are often used interchangeably. For the purposes of this Report, no distinction need be made between bonds, notes or debentures to which a trust indenture relates. To simplify matters, we will refer to all such debt obligations as "bonds". The holders of such debt obligations will be referred to as "bondholders". Affiliates of the issuer may also provide guarantees, in which case the guarantors may grant collateral security against their own respective assets.

[8] Where there are more than a few investors expected to hold the bonds, it may be considered desirable to issue the bonds under a trust indenture.[4] A trust indenture is a deed, indenture or similar document under the terms of which the issuer or guarantor of certain debt obligations appoints a second person to act as the trustee for the holders of those debt obligations. In Canada, indenture trustees almost invariably are licensed trust companies. Such institutional trustees are used because a bond trustee must have adequate staff and systems to efficiently perform its duties and comply with all applicable regulatory bond, fiduciary and contractual requirements. Where the trust indenture approach is employed, the bond itself is

simply a promise by the borrower to pay a specified amount of principal on a specified date, together with interest at a specified time, in accordance with the terms of, and subject to the conditions in, the trust indenture. The use of indenture trustees has been explained as follows:[5]

> "Bondholders rarely can act as a cohesive group because the identity of individual bondholders constantly changes, public bonds being actively traded; and any individual bondholder's investment is likely to be relatively small, minimizing economic incentive to take action or cooperate. Custom and law have provided a partial solution to this problem: for each public bond issue, an indenture trustee—the term derives from an "indenture," the traditional name for the loan agreement governing a public bond issue—is appointed to act as a type of agent on behalf of the bondholders collectively."

[9] The issue of bonds under a trust indenture is important to our economy. Trust indentures permit corporate, government and other large-scale debt issuers to raise large amounts of capital by borrowing relatively small amounts on identical terms from large numbers of investors. Often these investors are geographically scattered. By employing trust indenture financing, the cost of funds to such bond issuers is reduced. Trust indenture financing also allows relatively small scale investors to invest in debt securities issued by top rated issuers. In effect, the trust indenture vehicle provides alternative debt financing for borrowers and alternative investment opportunities for investors to participate in.

[10] The general need for trust indenture arrangements may be easily explained by way of example. Suppose for instance, that ABC Limited wishes to raise $250 million of debt by way of a public issue of bonds. It proposes to secure that debt by way of a 25 year amortization, first mortgage against a number of factories, warehouses and retail facilities scattered across Canada. To permit the bonds to be traded in a secondary market (so as to enhance their liquidity, and thus their attractiveness as an investment), ABC also proposes to issue the debt as a series of bonds, each of which will rank on an equal footing (or "*pari passu*") with all other bonds of the series

with regard to payment entitlement and all other rights, including security. Each bond in the series will have an issue price of $250,000 meaning that 1000 such bonds will be issued in all. Even if all of the holders of the bonds were to agree to hold their bonds for the full 25 year period, as a practical matter, it would not be sensible to register all of the bondholders as mortgagees. Further, for an on-going business, it is often necessary to have an expeditious method available for dealing with the subject properties in the ordinary course of business. One factory may be closed; another may be opened in its place. The first factory site will be sold. The second factory site must be added to the list of secured properties. Since it is not practical to deal with 1000 bondholders in such situations, there is a need for a single point of contact between ABC and the bondholders, which will allow ABC to carry on its business in a timely and efficient manner. It is the trustee under the trust indenture who plays this role.[6]

[11] Given the range of duties that the trustee is required to perform, trust indentures are complex instruments and usually contain elaborate provisions governing a number of matters. Since the recovery of their money is always of concern to investors, the subject of default by the bond issuer or its guarantor is a matter of special concern. The trust indenture must not only define what constitutes a default, it must dictate the circumstances and processes surrounding a default. However, the document also deals with numerous matters of on-going administration. It must give clear direction for dealing with how unforeseen incidents will be dealt with. It must also set out how any subsequent conflict of interest is to be dealt with, and how new trustees may be appointed should such a need arise.[7]

[12] Without a trust indenture, widely-scattered bondholders find it difficult to coordinate oversight of compliance with the covenants in the trust indenture and to coordinate legal action

in the event of default. Except in unusual cases, bondholders do not negotiate directly the content of the trust indenture or the underlying bonds. Instead, the issuer and the lead underwriter negotiate the terms of the trust indenture and the bonds. The lead underwriter wants to ensure that terms of the trust indenture and the bonds make the bonds readily marketable to investors. It also wants to make sure that the trustee is up to the job.[8] Further, as we discuss below in the context of the special protection afforded to trustees, most indentures bar any right of action by bondholders, unless the trustee is given prior notice of their intention to bring an action in respect of the bond.

3.2 The Unique Status and Protection of Trust Indentures

[13] Indenture trustees occupy a fiduciary position relative to the bondholders, but the scope of their duties as trustees is one of limited scope. It is well accepted that the fiduciary concept is a flexible one that varies to meet the circumstances of each situation. The application of fiduciary principles in the context of indenture trustees illustrates this element of flexibility that trust law encompasses.[9] In *Peak Partners, LP v. Republic Bank,*[10] Barry, Cir. J. provided the following summary of the law with respect to the fiduciary duties of an indenture trustee.

> "It is hornbook law that a trustee owes a strict fiduciary duty of undivided loyalty to the beneficiaries of the trust. … An Indenture Trustee, such as U.S. Bank, however, is a different legal animal. 'Unlike the ordinary trustee, who has historic common-law duties imposed beyond those in the trust agreement, an indenture trustee is more like a stakeholder whose duties and obligations are exclusively defined by the terms of the indenture agreement.' … New York common law imposes two duties on an Indenture Trustee in addition to those specified in the Indenture: (1) a duty to avoid conflicts of interest with the beneficiaries, … and (2) a duty to 'perform basic non-discretionary ministerial tasks.'
>
> It is only after an 'event of default' occurs, as that term is defined in the Indenture, that an Indenture Trustee's duty to note-holders becomes more like that of a traditional trustee. In that case, the Indenture Trustee must 'use the same degree of care and skill in [its] exercise as a prudent man would exercise or use under the circumstances in the conduct of his own affairs'

> while exercising its rights and powers under the Indenture. … While not required to act outside of its rights and powers under the Indenture, the trustee still must, 'as prudence dictates, exercise those singularly conferred prerogatives in order to secure the basic purpose of any trust indenture, the repayment of the underlying obligation'."

[14] In Canada and the United States, it is common for trust indentures to include numerous provisions protecting trustees from liability. In both countries, the extent to which such protection can be granted is now regulated by statute. Trustees are also usually protected by a requirement for prior notice of action. The necessity for such protection has been explained in the following terms:[11]

> "The virtually universal inclusion in indentures of standard provisions protecting and exonerating the trustee reflects the economic realities of trustees' relationships to debt offerings. Trustees are usually named late in the preparation of a transaction (with accordingly limited ability to negotiate terms) and are paid relatively small fees to act as trustees in transactions involving large sums of money. A trustee's willingness to act is premised upon its documented understanding that the trustee can have no liability in the transaction except for its own negligence or wilful misconduct in carrying out its prescribed duties. Thus, trustees require indemnification and a lien against trust assets for their expenses in enforcing the indenture and defending themselves against claims."

3.3 Canadian Legislation Relating to Trust Indentures

[15] As we will explain in greater detail below, legislation governing trust indentures exists at both the Federal and Provincial level in Canada. The Federal legislation is set out in the *Canada Business Corporations Act* (the "CBCA") and other statutes relevant to other forms of regulated business organizations (e.g. banks, insurance companies). The relevant portions of the CBCA are reproduced in Appendix "A" and are discussed in detail below. There are some Provinces which have not incorporated such provisions into their corporate law statutes. Among those that have, there are differences in the terms that the legislation includes. The legislation of the Province of Ontario is set out in Appendix "A", side-by-side with the CBCA equivalent so as to permit easy comparison. As we will discuss there are some significant differences in the Provincial and

Federal legislation. In particular, the Ontario and British Columbia legislation is broader in scope, and captures all corporate debt obligations issued under a trust indenture and qualified for distribution under a prospectus filed in Ontario or British Columbia, respectively. In contrast, the CBCA and certain other provincial corporate legislation deals only with trust indentures issued by corporations incorporated under those Acts.

[16] American legislation is also relevant to many Canadian bond issuers (particularly the major issuers of such instruments) because their bonds are traded in the US capital market.[12]

4. American Trust Indenture Legislation

4.1 Introduction

[17] Before dealing in any detail with the relevant existing legislation in Canada, it is helpful to consider the background to its adoption. Canadian legislation owes its genesis to legislation passed earlier in the United States. For many decades, North American debt markets have been highly integrated. They are becoming more so with the increasing globalization of capital and securities markets. For this reason, in our view, any reforms enacted in Canada in relation to trust indentures, should take into account the requirements of American law. A failure to do so could complicate the issue of debt securities by Canadian debt issuers, rather than assist them.

4.2 United States Securities Legislation

[18] In the United States, the regulation of trust indentures is considered part of the overall securities law regime. In Canada, it is dealt with primarily as a part of corporate law. Prior to the Great Crash of September 1929, US securities laws existed only at the state level under what are referred to as "Blue Sky Laws". Kansas passed the first Blue Sky legislation in 1911, during the heyday of the Populist movement in that State.[13] The law was a response to unsophisticated investors being hoodwinked by conmen who sold worthless interests in fly-by-night mines along the back roads of that state. The popular name of the Act reflected the fact that no assets backed up those securities—nothing but the blue skies of Kansas.[14] Within two years, twenty-three states enacted similar legislation. By the end of 1923, forty-five of the forty-eight states had followed suit.[15]

[19] The US Federal Government moved into the regulation of the banking and securities industries during FDR's administration. One of the causes of the 1929 Great Crash was the over-valuation of stock, relative to the true earning power of the companies that had issued it. The *Securities Act of 1933* (the "*1933 Act*") was enacted in the first year of Roosevelt's first term. It provided for the full disclosure of all material facts—applying the "sunlight theory of regulation" which assumes that if investors are given all of the necessary information they will make wise investment decisions. In the words of the State of Wisconsin Department of Financial Institutions:[16]

> "Congress did not take away from the citizen his inalienable right to make a fool of himself. It simply attempted to prevent others from making a fool of him."

The *1933 Act* was only the first among several initiatives to impose greater control over securities and banking industries. The *Securities Exchange Act of 1934* (the "*1934 Act*") was enacted in the following year. Among other things, the *1934 Act* gave birth to the Securities and Exchange Commission (the "SEC"). The SEC was a necessary vehicle required to give effect to and police the disclosure regime which the *1933 Act* had created. Other regulatory changes were introduced over the next few years, following more detailed consideration of the markets concerned.

4.3 The Enactment of the Trust Indenture Act of 1939

[20] US Federal legislation in relation to trust indentures was one of those changes. In 1936, the Chairman of the SEC appointed a subcommittee charged with examining trust indenture investments (the "Protective Committee"). Section 211 of the *1934 Act* required the SEC to conduct various studies. In 1936, the Protective Committee published its report on indenture trustees (the "SEC Report").[17] This publication led to a series of Senate hearings,[18] which ultimately led to special legislation, the *Trust Indenture Act of 1939* (the "1939 Act"), dealing specifically with the subject of trust indentures.

[21] There is no question that the Great Depression caused a spike in the number of corporate bond defaults, as the following chart makes clear.[19] The spike in defaults, and consequent losses to the investment community would only make out a case for regulation, however, if there was reason to believe that one of two situations prevailed:

- the spike was the result of deficiencies in the manner in which such bonds were issued and administered, rather than being due to the catastrophic impact of the Great Depression;

- the losses suffered by bond holders were attributable to questionable practices on the part of indenture trustees.

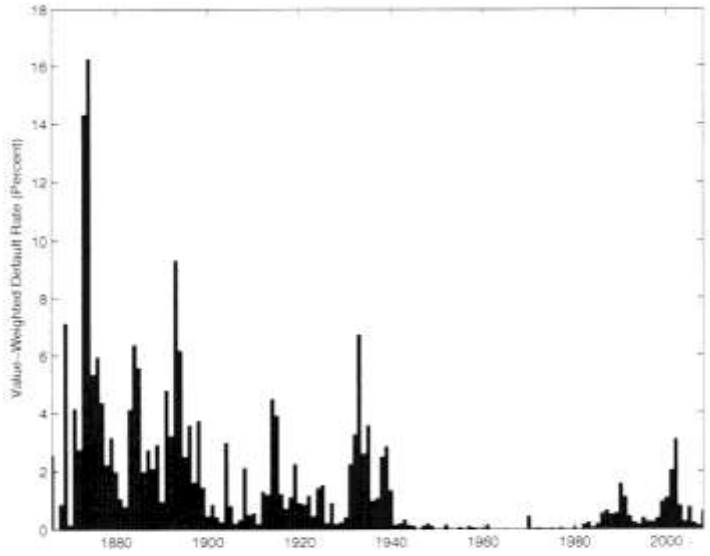

Figure 1. Historical Default Rates. This graph plots the annual value-weighted percentage default rates for bonds issued by domestic nonfinancial firms for the 1866–2008 period.

It will be noted that following the introduction of the Roosevelt era reforms, the level of bond default dropped off dramatically—for close to 40 years, it clung close to the zero level. Only when regulation was relaxed during the 1990s did the level increase sharply again.

[22] One of the most important issues in connection with practices of trustees was in relation to trustee negligence, for here there were reported instances in which bondholders had lost significantly, at least in part due to the failure of the trustee to exercise reasonable care. In *Re*

Baldwin Locomotive Works,[20] an investigation into the failure of a train engine manufacturer found that a trustee had for some years failed to carry out its contractual obligations to obtain a confirmation of the assets of the bond issuer. Instead, it had accepted the annual report of the issuer as sufficient confirmation as to its assets on hand. In fact, the corporation had consolidated the assets of another (profitable) corporation into its own financial statements, even though it held only a part interest in that corporation.[21]

[23] The recommendations set out in the SEC Report formed the basis of the 1939 Act.[22] Essentially, the 1939 Act is a supplement to the *1933 Act*, which specifically governs the distribution of debt securities. The rationale for the legislation was declared in section 3.02(a) of the Act. It provides (in part):

> "… it is hereby declared that the national public interest and the interest of investors in notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, which are offered to the public, are adversely affected—
>
> (1) when the obligor fails to provide a trustee to protect and enforce the rights and to represent the interests of such investors, notwithstanding the fact that
>
> (A) individual action by such investors for the purpose of protecting and enforcing their rights is rendered impracticable by reason of the disproportionate expense of taking such action, and
>
> (B) concerted action by such investors in their common interest through representatives of their own selection is impeded by reason of the wide dispersion of such investors through many States, and by reason of the fact that information as to the names and addresses of such investors generally is not available to such investors;
>
> (2) when the trustee does not have adequate rights and powers, or adequate duties and responsibilities, in connection with matters relating to the protection and enforcement of the rights of such investors; when, notwithstanding the obstacles to concerted action by such investors, and the general and reasonable assumption by such investors that the trustee is under an affirmative duty to take action for the protection and enforcement of their rights, trust indentures

(A) generally provide that the trustee shall be under no duty to take any such action, even in the event of default, unless it receives notice of default, demand for action, and indemnity, from the holders of substantial percentages of the securities outstanding there- under, and

(B) generally relieve the trustee from liability even for its own negligent action or failure to act;

(3) when the trustee does not have resources commensurate with its responsibilities, or has any relationship to or connection with the obligor or any underwriter of any securities of the obligor, or holds, beneficially or otherwise, any interest in the obligor, or any such underwriter, which relationship, connection, or interest involves a material conflict with the interests of such investors;

(4) when the obligor is not obligated to furnish to the trustee under the indenture and to such investors adequate current information as to its financial condition, and as to the performance of its obligations with respect to the securities outstanding under such indenture; or when the communication of such information to such investors is impeded by the fact that information as to the names and addresses of such investors generally is not available to the trustee and to such investors;

(5) when the indenture contains provisions which are misleading or deceptive, or when full and fair disclosure is not made to prospective investors of the effect of important indenture provisions; or

(6) when, by reason of the fact that trust indentures are commonly prepared by the obligor or underwriter in advance of the public offering of the securities to be issued thereunder, such investors are unable to participate in the preparation thereof, and, by reason of their lack of understanding of the situation, such investors would in any event be unable to procure the correction of the defects enumerated in this sub- section.

Section 3.02(b) of the 1939 Act read, in part, as follows:

> "Practices of the character above enumerated have existed to such an extent that, unless regulated, the public offering of notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, by the use of means … in interstate commerce … is injurious to the capital markets, to investors, and to the general public."

The substantive provisions of the Act largely follow from these factual declarations set out in section 3.02. The overall approach embodied in the 1939 Act may be summarized as follows:

- Provide machinery for collective action by bondholders;

- Prohibit exculpatory clauses in favour of trustees;

- Regulate conflicts of interest affecting trustees;

- Ensure that debtors provide current information on their financial condition;

- Ensure adequate disclosure of the terms of the trust indenture; and

- Offset the lack of direct investor involvement in the negotiation of the terms of trust indentures.

4.4 How the *1939 Act* Works

[24] With certain enumerated exceptions, the 1939 Act applies to trust indentures under or in respect of which debt securities are issued to the public. The trust indenture itself must be filed with the SEC and a receipt must be issued. A trustee appointed under a trust indenture must be one or more persons, at least one of which is a trust corporation formed under US Federal or State law.

[25] The 1939 Act requires the trustee to perform certain minimum duties. Before a default under the trust indenture, the trustee must comply with its contractual obligations under the trust indenture. However, the trustee is entitled to rely in good faith on the truth of certificates and opinions conforming to the requirements of the indenture. After a default, however, the trustee must "use the same degree of care and skill in their exercise, as a prudent man would exercise or

use under the circumstances in the conduct of his own affairs." Inconsistent exculpatory clauses are not effective. All of these concepts are generally carried over into the present Canadian legislation.

[26] The 1939 Act precludes the trustee from acting in certain conflict of interest situations but not in others. For example, subject to certain exceptions, a trustee cannot be a controlling shareholder of the issuer or an underwriter of the issuer. As well, the 1939 Act draw limits of the extent of interlocking directorships and management. Although the Canadian legislation contains conflict of interest provisions, the overall approach is not the same as in the 1939 Act.

[27] The American conflict of interest regime changed when the 1939 Act was revised in 1990. After the *1990 Reform Act*, a "conflicting interest" was recognised only when default under the indenture is pending and one of the specified conflicts also exists. The SEC proposed and Congress enacted this change because they believed that a trustee's pre-default role is only administrative or ministerial. This change made disqualifying trustee conflicts applicable to a trustee at substantially the same time as the prudent man standard becomes applicable to the trustee. It implicitly recognizes that, before any default occurs under an indenture, a trustee has no duties under the indenture other than the duties it has explicitly undertaken to perform. These changes have not been carried forward in Canada. The 1990 Reforms also allow a trustee an extended cure period. The trustee must eliminate the conflict of interest within 90 days or resign. If the trustee fails to comply, it must (within 10 days after the expiration of the 90-day period) transmit notice of such failure to the bondholders.

[28] The 1939 Act also set up a regime whereby issuers are required to provide annual compliance certificates to the trustee, and the trustee is required to notify bondholders of a default. If requested, trustees are also required to provide bondholders with contact particulars for all bondholders. Bondholders can communicate with each other to mobilize for common action. Again, comparable provisions are to be found in the Canadian legislation.

[29] The 1939 Act also contains a number of provisions which were not carried forward into Canadian law. For instance, there are limits on the cross-ownership of voting securities either by the issuer in the trustee or in the trustee in the issuer or an affiliate of the issuer. The 1939 Act permits the trustee to make loans and take security from the issuer while it is a trustee. However, in some circumstances, the trustee must share, on a *pari passu* basis, in any proceeds received in a short period of time before a payment default or received anytime after a payment default. The 1939 Act requires that bondholders unanimously agree to a reduction in the principal amount owed, a reduction in the interest rate or an extension of the maturity date of the bonds. The practical effect of this unanimity requirement is to make these amendments impracticable in the case of widely-held bond issuances outside of insolvency proceedings, such as those conducted under Chapter 11 of the *US Bankruptcy Code*.[23] In contrast, Canadian trust indenture bond issues usually contractually provide for majority voting in relation to the compromise of debt.

4.5 1990 Reform of the 1939 Act

[30] In 1990, the 1939 Act was updated by the *Trust Indenture Reform Act of 1990* (the "*Reform Act*"). The changes made include the following:

[31] First, the *Reform Act* broadened the SEC's exemption authority under the 1939 Act so that the SEC is empowered to grant a conditional or unconditional exemption for any person, indenture, security or transaction or class of persons, indentures, securities or transactions from one or more of the provisions of the 1939 Act. In each case, the SEC's exemption is predicated on a determination being made that it is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the 1939 Act.

[32] Second, as noted above, the *Reform Act* changed the basis for determining when a conflict of interest arises. Under the *Reform Act*, a trustee is entitled to serve under an indenture so long as there is no default under the indenture. However, once a default occurs, the trustee is allowed a period of 90 days after the default to eliminate any conflict of interest or to resign. With one rare exception, the trustee can also apply to the SEC for an order allowing the trustee to continue to act despite a conflicting interest. The change reflects the recognition by Congress that a trustee's independence only becomes necessary to protect the bondholders upon a default. Before default, the trustee's duties are primarily ministerial, and the trustee has no incentive to favour its own interests over those of the bondholders.

[33] Third, the *Reform Act* authorized the SEC to permit foreign persons to act as sole trustees under a qualified indenture. There are two related conditions. Specifically:

- there must be reciprocal legislation in a foreign jurisdiction allowing US trust companies to act as sole trustee in the host jurisdiction, and

- the foreign trustee must be subject to regulation comparable to laws regulating US trust companies.

As we will discuss in greater detail below, one of the advantages of the existing Canadian legislation is that it satisfies these requirements (insofar as the issuer complies with the CBCA, the *Business Corporations Act* (Ontario) (the "OBCA"), the *Bank Act* (Canada) or the *Company Act* (British Columbia)).[24] As a result, it is possible for Canadian bond issuers to escape from the application of the 1939 Act. This may significantly lower the cost of issuing bonds into the US capital market.

4.6 Proposed Repeal of US Legislation in 1995

[34] In 1995, the US House of Representatives considered Bill HR 2131, the *Capital Markets Deregulation and Liberalization Act of 1995*. HR 2131 contemplated sweeping changes to a number of US Federal securities statutes. Of particular moment, it proposed the repeal, without replacement, of the 1939 Act (and the *1990 Reform Act*). HR 2131 never became law. However, at the hearings on the Bill in November and December of 1995, expert opinion divided on this question. With press coverage running generally against repeal, the Subcommittee opted for the tried and true approach of suggesting that more study was necessary. Ultimately, no full SEC study of the proposed repeal of 1939 Act was ever completed. The movement for repeal of the 1939 Act seems to have died out.

5. Canadian Legislation

5.1 Lawrence Report

[35] Canadian jurisdictions took many years to follow the American lead in relation to trust indentures. Until the publication of the Lawrence Report by the Legislative Assembly of Ontario in 1967,[25] there is no indication that any legislature in Canada considered importing all or any part of the 1939 Act into Canada. In 1966, Ontario fundamentally changed its *Securities Act*, which substantially upgraded the degree and quality of disclosure in connection with the primary distribution of securities to the public. Some of the subject matter in the 1939 Act was, therefore, already embraced in the then new Securities Act.

[36] The reasoning of the Lawrence Committee with regard to the issue of trust indenture regulation is set out in the following extracts from its Report:

> "While the Committee is conscious of the fact that the practices and abuses concerning trustees under trust indentures as they existed in the United States thirty years ago are not, either in degree or kind, necessarily duplicated in Ontario today, nevertheless it is useful as a background to this topic to set out at some length an extract from the Report of the Securities and Exchange Commission of the United States reporting to Congress in 1936."

That statement is essentially the same as the declarations of fact set out in section 302(a) of the 1939 Act (see paragraph 23 above). Based upon this thirty year old collection of allegations in a foreign country, the Lawrence Report went on to recommend that broadly comparable legislation should be enacted in Ontario:[26]

> "… to ensure that the security holders will enjoy the services of a disinterested trustee and that such trustee will conform to high standards of conduct."

Was the Lawrence Report responding to a genuine need? There is little evidence to suggest that it was. During the 10 year period prior to the issue of the Lawrence Report, there were only seven reported Canadian decisions in which the trust indentures of any kind were even mentioned, and none of these cases involved any wrong-doing on the part of an indenture trustee.[27] In addition, while Douglas (in 1936) could point to at least some recent cases of serious negligence that had gone unaddressed, there was no such factual basis in Canada in the 10 years leading up to the Lawrence Report.

[37] What is clear is that the Lawrence Committee was particularly concerned to bring into Ontario those provisions of the 1939 Act that would ensure that bondholders gained the services of a disinterested trustee and that the trustee would conform to high standards of conduct. Accordingly, the Lawrence Committee recommended that the then proposed new *Business Corporations Act* (Ontario) ("1970 OBCA") contain provisions substantially to the following effects:

> (1) The trustee be required to exercise the degree of care, diligence and skill that a reasonably prudent trustee would exercise in comparable circumstances (without the standard varying depending on whether default occurred under the trust indenture);
>
> (2) The trustee be entitled to rely, in good faith, on certificates or opinions conforming to the requirements of the trust indenture;
>
> (3) The trustee be required to give holders of securities notice of all events of default within 60 days after their occurrence;
>
> (4) The trust indenture not contain any escalpatory provisions inconsistent with the degree of care, diligence and skill imposed on a trustee; and
>
> (5) A trustee not be appointed where there is any conflict of interest with its role as trustee and must resign from its role as a trustee should any conflict of interest subsequently arise.

Ultimately, the Lawrence Report recommendations were enshrined in the 1970 OBCA that came into force on January 1, 1971. However, we will defer consideration of that legislation for the moment, in order to consider the corresponding developments which would soon follow at the Federal level. This will permit the Ontario and Canada provisions to be compared and contrasted.

5.2 Dickerson Report

[38] The *Proposals for a New Business Corporations Act for Canada* (the "Dickerson Report") was released in 1971. Echoing the Lawrence Report, it also recommended that the proposed federal *Business Corporations Act* (the "Proposed CBCA") include a part addressing "Trust Indentures".

[39] The Dickerson Report stated that provisions requiring qualification of both the trust indenture and the trustee before a securities commission are unnecessary in light of Canadian experience. It concluded that if no distribution to the public is contemplated, then the creditor is sophisticated enough to protect itself. If there is a distribution to the public, the securities commission before whom the prospectus must be qualified will have adequate discretion to review both the qualifications of the trustee and the terms of the trust indenture. Nevertheless, the Dickerson Report proposed the new CBCA should implement the following objectives:

> (1) Ensure that bondholders will have the services of a disinterested indenture trustee and that such trustee will conform to the high standards of conduct observed by the more conscientious trust institutions;
>
> (2) Provide machinery whereby continuing full and fair disclosure may be made to bondholders and whereby they may get together for the protection of their own interest; and

(3) Provide full and fair disclosure not only at the time of the original issue of the bonds but throughout the life of such securities.

[40] The Dickerson Report proposed that, instead of declaring with great specificity what constitutes a conflict of interest as in the 1939 Act or setting out criteria that are subject to judicial interpretation as in the 1970 OBCA, the trustee should be empowered to apply to court either before or any time after accepting a trust to determine whether a conflict of interest exists. This preclearance approach is not set out in the present CBCA or OBCA, and in our view it should not be. There is too great a risk that a court hearing such an application would have little or no representation from the bondholders whom might be prejudiced by it. In addition, it is not advisable in general for courts to make rulings without a proper evidentiary basis for doing so.

5.3 Current Canadian Law

5.3.1 Federal Model: Canada Business Corporations Act

[41] Following the Dickerson Report, the CBCA was enacted. It came into force effective December 15, 1975. With limited changes, Part VIII of the CBCA implemented those recommendations of the Dickerson Report pertaining to trust indentures. No amendments have been made to Part VIII since it was originally enacted. The CBCA language was influenced heavily by the corresponding provisions set out in the 1970 OBCA.

[42] There are significant differences between the CBCA and the 1939 Act. Unlike the 1939 Act that, with limited exceptions, generally applies to all corporate and non-corporate issuers that file a prospectus or registration statement with the SEC or otherwise offer their debt securities to

the public, the CBCA only applies to a CBCA corporation. Moreover, the CBCA regime only applies to a CBCA corporation that issues debt obligations as part of a "distribution to the public", a defined term that was removed from the CBCA as part of the 2001 amendments. Thus, the application of the CBCA provisions now turns on an undefined test. The removal of the definition may have been inadvertent (other provincial corporate acts utilizing the CBCA model continue to define "distribution to the public"). Unfortunately, the intended scope of the Act is far from clear.

[43] Where a distribution to the public is made, a person must be appointed as a trustee for the holders of bonds issued under the trust indenture. The CBCA applies directly only to those issuers that are CBCA corporations. However, as a result of the CBCA's definition of "debt obligations", Part VIII applies indirectly to publicly issued bonds that are guaranteed by a CBCA corporation.

[44] The CBCA permits the CBCA Director to exempt a trust indenture from Part VIII "if the trust indenture, the debt obligations issued under it and the security interest effected thereby are subject to the law of" a province or country other than Canada whose laws are "substantially equivalent" to Part VIII. Thus, for example, if a CBCA corporation is issuing or guaranteeing debt obligations under a registration statement filed with the SEC, or a prospectus filed with Ontario Securities Commission (the "OSC") or the British Columbia Securities Commission (the "BCSC") as contemplated by the OBCA or the *Business Corporations Act* (British Columbia) (the "BCBCA"), then an exemption is available under subsection 82(3) of the CBCA. The exemption is not automatic. It must be applied for in each instance. As we will explain below, such a case by case approach is unnecessarily costly, and should be reconsidered.

[45] The CBCA prescribes who may serve as a trustee. First, at least one of the trustees, if more than one is appointed, must be a body corporate incorporated under the Federal, Provincial or Territorial law that is authorized to carry on business as a trust company.

[46] Second, the CBCA imposes obligations on trustees to observe fiduciary duties and the duty of care and to avoid conflicts of interest. Thus, section 91 of the CBCA requires a trustee to act honestly and in good faith with a view to the best interests of the holders of debt obligations issued under the trust indenture and to exercise the care, diligence and skill "of a reasonably prudent trustee". A trustee standard of care is an extremely high one. No term of a trust indenture or any agreement between the trustee and holders of trust indentures can relieve a trustee from the duties imposed by section 91. However, a trustee is entitled to rely in good faith on statements contained in a statutory declaration, certificate, opinion or report that complies with the CBCA or the trust indenture.

[47] Third, subsection 83(1) of the CBCA states that no person may be appointed as a trustee if there is a material conflict of interest between its role as a trustee and its role in any other capacity. Since conflicts of interest may arise after appointment, a trustee must, within 90 days after becoming aware that material conflict of interest exists, eliminate the conflict of interest or resign from office. If there is a failure to do so, any interested person (which would include a bondholder) may apply to have the trustee replaced. However, so far as we are aware, there is no case in which this has ever been done.

[48] Under Sections 86 to 88 of the CBCA, the issuer of the bonds must furnish the trustee with evidence of compliance with the conditions of the trust indenture relating to the issue,

certification and delivery of bonds thereunder, the release or release and substitution of properties subject to a security interest constituted by the trust indenture or the satisfaction and discharge of the trust indenture before the issuer does any act relating to such matters. The evidence of compliance must consist of a statutory declaration or certificate made by a director or officer of the issuer. Where the trust indenture requires a review by legal counsel or the auditor, the necessary legal opinion or auditor's review must also be provided. The declaration, certificate, opinion or report must include a statement by the person giving the evidence declaring that such person has read and understands the relevant conditions of the trust indenture, describing the nature and scope of the examination or investigation on which such person relies and declaring that such person has made the examinations or investigations that are believed to be necessary to enable such person to make the statements or give the opinions obtained or expressed therein.

[49] Under Section 88 of the CBCA, the trustee may, at any time, require the issuer of the bonds to furnish the trustee with evidence as to compliance with any condition thereof. Such evidence may be in such form as the trustee requires. At least once a year, the issuer must furnish the trustee with a certificate to the effect that the issuer has complied with all requirements of the trust indenture that, if not complied with, would constitute an event of default thereunder and, if there has been a failure to so comply, give particulars thereof. In addition, the issuer must furnish such certificate at any other time on demand of the trustee.

[50] Section 90 of the CBCA provides that the trustee is required to give bondholders notice of every event of default arising under the trust indenture that continues at the time the notice is given. The trustee must give the notice within 30 days after it becomes aware of the occurrence

of such an event of default. The trustee has the power, however, to withhold such notice where it reasonably believes that is in the best interests of the bondholders to do so.

[51] Finally, section 85 of the CBCA provides the machinery required for bondholders to band together for protection of their own interests. Thus, a bondholder has the right to require the trustee to provide a current list of outstanding bondholders. The list must contain the names and addresses of each of the registered bondholders, the principal amount of outstanding bonds owned by each holder and the aggregate principal amount outstanding. As with the CBCA rules governing use of lists of shareholders, the lists of bondholders can only be used in connection with an effort to influence the voting of bondholders, an offer to acquire bonds or any other matter relating to the bonds or the affairs of the issuer or guarantor. A person who, without reasonable cause, uses a list of the bondholders for any unauthorized purpose commits an offence under the CBCA.

5.3.2 Ontario Business Corporations Act

[52] At first glance, Part V of the OBCA bears a strong resemblance to Part VIII of the CBCA. However, there are important differences between these two sets of provisions.

[53] Unlike Part VIII of the CBCA, Part V of the OBCA applies to any body corporate wherever incorporated, including bodies corporate incorporated outside Canada, where it issues bonds in Ontario pursuant to a prospectus filed under the *Ontario Securities Act* (the "OSA"). It is notable that the OBCA does not apply to non-corporate issuers of trust indentures. Non-corporate issuers include limited partnerships and certain *inter vivos* trusts (including mutual

fund trusts, income trusts and real estate investment trusts), although like the CBCA, the OBCA applies to trust indentures involving bonds issued by a non-corporate issuer if such bonds are guaranteed by a body corporate.

[54] Under the OBCA, the basis for application is not a "distribution" of the bonds "to the public" (terms not defined in the CBCA) but rather the filing of a prospectus under the OSA or predecessor legislation. It is therefore clear as to when the provisions of the OBCA apply. Prospectus filing requirements are not dealt with in the OBCA itself. However, such obligation are imposed under the OSA, since the definition of "security" in the OSA encompasses bonds (subject to the normal range of exemptions).

[55] Another significant difference relates to the exemption power. In contrast to the CBCA, the exemption power under the OBCA resides with the OSC, rather than the OBCA Director. Second, the OSC's exemption power is much broader than that of the CBCA Director (albeit the OSC's power only applies if the applicant is "a body corporate incorporated otherwise than under the laws of Canada, a province or territory"). Under the CBCA, the exemption can only be made if the "law" of another Canadian or foreign jurisdiction are "substantially equivalent" to Part VIII of the CBCA. Under the OBCA, the OSC has the power to exempt a trust indenture from Part V where the OSC is satisfied that "to do so would not be prejudicial to the public interest". Third, the OSC may exempt a trust indenture subject to such terms and conditions as the OSC may impose. Part VIII of the CBCA does expressly permit the CBCA Director to make exemptions subject to terms. Fourth, under the OBCA, only a foreign body corporate (*i.e.*, a body corporate incorporated outside of Canada) can apply for an exemption order. In practice, exemptions from Part V of the OBCA almost always relate to the appointment of a foreign trust

company to act as trustee, *i.e.*, one that otherwise does not conform to the requirement that it carry on business in Ontario.

[56] In other respects, the provisions of Part V of the OBCA resemble Part VIII of the CBCA with few differences. In particular, the duties of care and loyalty imposed on an indenture trustee under the OBCA are the same as those imposed under the CBCA. The prohibitions against exculpatory clauses are the same, and the conflict of interest regimes are the same. The only other substantive difference between the CBCA and the OBCA regimes is that, under the OBCA, section 50 states that a trustee under a trust indenture and any related person to the trustee cannot be appointed as a receiver or receiver manager or liquidator of the assets or undertaking of the issuer or guarantor of the debt obligations under the trust indenture. The CBCA contains no equivalent provision.

5.3.3 The British Columbia Business Corporations Act

[57] Conceptually, the trust indenture provisions of the BCBCA more closely resemble those of the OBCA than those of the CBCA. Like the OBCA, the BCBCA trust indenture provisions apply if a prospectus has been filed under the *British Columbia Securities Act* (the "BCSA") or predecessor legislation.

[58] One difference between the OBCA and the BCBCA is that, currently, the executive director under the BCBCA may grant exemptions from the BCBCA trust indenture provisions if not contrary to the public interest. Currently, the executive director's decision may be appealed to the BCSC. However, amendments are pending to the BCBCA that would transfer the

executive director's exemption power to the BCSC. Another important difference with the OBCA is that, under the BCBCA, an exemption may apply not only to a specific trust indenture but to a class of trust indentures, viz., the executive director under the BCBCA may grant a blanket exemption whereas the OSC has no equivalent power under the OSC. In our view, a blanket exemption provision adds valuable flexibility to the regulatory regime.

[59] In other respects, the BCBCA trust indenture regime is a close analogue of Part V of the OBCA. In particular, the BCBCA captures all bonds issued or guaranteed under a trust indenture by a body corporate wherever it may be incorporated if it files a prospectus under the BCSA. However, like the OBCA, the BCBCA regime does not capture trust indentures issued or guaranteed by a non-corporate issuer.

5.3.4 Other Jurisdictions

[60] The CBCA model has been imported into the *Canada Cooperatives Act*, the *Canada Not-for-Profit Corporations Act* and federal financial institutions legislation including the *Bank Act*, the *Insurance Companies Act* and the *Trust and Loan Companies Act*. The CBCA has also served as a model for general business corporation statutes in Alberta, Saskatchewan, Manitoba, Newfoundland and Labrador and all three territories. However, in contrast to the CBCA, the legislation in Alberta, Manitoba, Saskatchewan and each of the territories omits any discretionary exemption by the corporations director or registrar. In our view, this omission is a serious oversight. The Newfoundland and Labrador legislation tracks the CBCA more closely by including a comparable discretionary exemption in favour of the registrar under the

Newfoundland and Labrador *Corporations Act*. The provinces of Québec, Nova Scotia, New Brunswick and Prince Edward Island have not enacted laws governing trust indentures.

6. The Need for Regulation and for Uniform Legislation

[61] Any discussion relating to the reform of a law should begin with at least some consideration of whether there is a need for the law at all. It is a fair question whether there is any need for legislation such as that now embodied in the OBCA, CBCA, BCBCA and other Canadian legislation in relation to trust indentures. As we have noted, the laws of the United Kingdom and Australia contain no special regulatory regime relating to trust indentures. In Canada, the provinces of Québec, Nova Scotia, New Brunswick and Prince Edward Island have enacted no provisions governing trust indentures. The fact that these jurisdictions have survived without any apparent ill effect despite the absence of trust indenture legislation further raises the question as to need.

[62] In this section of our Report, we set out the rationale given for regulation of trust indentures. We approach this part of our Report from a very pragmatic perspective. Confidence in the integrity of business transactions is essential. Lack thereof stagnates business. It is self-evident that bond trustees must be reliable and trustworthy. If they are not, the protection afforded by security interests and contractual rights to the bondholders is greatly compromised.[28] Their value as investments will be destroyed, and the liquidity that they provide to the investment community will be lost.

[63] In our view, the primary rationale for regulation grows out of the possible inadequacy of available information and higher transaction costs that would result if the general scheme of regulation set out in the OBCA, CBCA and other statutes was abandoned. Problems of this nature may result from "informational asymmetry," or a market-wide lack of information or access to information. Fundamentally, the argument that was put forward in section 302(a) of the 1939 Act (see paragraph 23) was that there are informational asymmetries of a significant magnitude to justify the measures in question.

[64] We are not convinced that this is the case. However, in our view, there is another strong argument for much of the existing regulatory regime which is in place. This is that there are informational defects that arise due to the cost of acquiring and processing relevant information. Take, for instance, the negligence cases which so influenced the SEC in its 1936 Report. The most likely argument is not that investors were unable to appreciate the significance of exclusion clauses, but rather than that they lacked the practical chance to identify those clauses in a long, complicated document.[29]

[65] Essentially, the scheme of regulation under Canadian legislation relating to trust indentures covers the following matters. For the most part, a standardized legislative regime governing the matter in question reduces the cost of negotiating the terms of a bond issue, and simplifies investor evaluation of the bond issue in question:

- The core duties of a trustee: Under general principles of equity, trustees are expected to exercise reasonable care in the discharge of their duties as trustees. The exact formulation of this duty varies in the case law, but there is no doubt that

the duty is high. In contrast, under the pre-1939 Act law, it was common for the equitable duty of care to be significantly qualified by contract. Bondholders had no direct involvement in the negotiation of that contract, and absent a requirement for comprehensive disclosure of information, might well be unable (at least as a practical matter) to identify whether conventional or more limited protection was afforded. Problems of identifying the scope of protection available are complicated where securities such as bonds are likely to be traded in a secondary market, since in such a market there can little immediate access to the information required.

- Conflict of interest: Earlier we indicated that there was little evidence in the record to suggest that there was a widespread problem with trustee conflict of interest in the years leading up to the enactment of the 1939 Act. However, whatever the state of the law might have been in 1939 (or 1966, for that matter), it is doubtful that a trustee for bondholders would be able to escape liability for breach of trust, should such a claim be made today, irrespective of whether the present conflict of interest rules were set out in legislation.[30]

- Evidence of compliance with the terms and conditions of the bond, and notice of default: Most bonds provide the bondholders with certain entitlements if performance, security and other covenants are not satisfied. However, such rights are meaningless unless supported by an effective mechanism for confirming whether the circumstances which would bring them into being have occurred. The trustee is the logical interface between the issuer of a bond and the investors who

have purchased it. The whole idea of having a trustee is to simplify the administration of the bond as a species of debt obligation. The obligation of the trustee to secure routine reports confirming that the bond is not in default, and to pass along notice where it is, serve that administration simplification goal.

- Where a list of debt bondholders must be furnished: It is in the nature of bond security that the bondholders act collectively. Since bondholders rights are restricted in this way, it is necessary that they be afforded some mechanism for exercising those rights on a collective basis. The obligation to provide information in relation to who owns bonds serves that goal.

[66] Transaction costs also constitute an obstacle to contract where the legal requirements that apply in one jurisdiction differ widely from those which apply in another. If Canadian jurisdictions were to move away from a similar system of law in relation to trust indentures to that which applies in the United States, the effect would be to create such transaction costs. Given the existence of the American legislation, there is a strong argument that the continued existence of corresponding Canadian legislation can reduce the cost of inter-jurisdictional bond financing for Canadian issuers. As noted, under the present terms of the 1939 Act, a Canadian issuer may obtain an exemption from the application of that Act, where it is subject to a corresponding regime under the laws of its home jurisdiction. Since most Canadian corporations issuing debt securities into the American market would likely be subject to the CBCA, OBCA, *ABCA*, or the BCBCA, this requirement would appear to be satisfied. It is widely recognized that regulatory legislation which reduces identifiable and material transaction costs is economically beneficial.[31]

7. Recommendations and Conclusions

[67] **Retain Trust Indenture Legislation**: On the basis of the foregoing, we have concluded that some Canadian trust indenture rules should be retained. Our views on this point are buttressed by the fact that many Canadian bond issuers would nonetheless be subject to the US legislation even if the Canadian rules were eliminated, if their bonds are issued into the US securities market. Our first recommendation, therefore, is as follows:

> R1: As long as the 1939 Act remains in force in the U.S., Canadian legislation governing trust indentures should not be abandoned in favour of deregulation.

[68] We will now move to a more detailed discussion concerning the terms of improved and uniform Canadian legislation. However, if the United States ever does eliminate or scale back its legislation regarding trust indentures, there would seem to be some wisdom in reconsidering whether Canada should do the same.

[69] **Uniform Legislation**: The next question is whether Canada would benefit from the adoption of uniform legislation. In our view, the case in favour of uniformity is overwhelming. A lack of uniformity adds to both the complexity and cost of issuing securities. It also undermines the effectiveness of the protection afforded by the law, if only by leading to confusion as to which rules of law apply. In many areas of law, and of social and economic policy, an argument can be made that social, cultural and commercial practices differ sufficiently from one Province to another to justify differing approaches towards aspects of economic regulation. This is far less true with respect to the issue of securities into the capital markets. Most such securities are held

by institutional investors, which operate on a national or international scale. Moreover, the prevailing interests are uniform across the country. Security issuers want access to capital. Investors want to know that their investments are valid, effectual and capable of ready enforcement. Uniformity is the path best suited to meeting these needs, which takes us to our second recommendation:

> R2: Consistency in Canada's capital markets means that all Canadian jurisdictions should have a uniform (or substantially harmonized) model law.

[70] In our view, a uniform legislation approach accomplishes the following objectives: (a) consistency of approach among all participating jurisdictions; (b) elimination of duplicate regulation; and (c) mutual recognition of the laws in effect across Canada.

[71] **Application to corporate and non-corporate issuers**: We note that market practice already dictates voluntary compliance with trust indenture provisions of the corporate statutes even in the case of non-corporate issuers. Generally speaking, when the market has moved to bring non-regulated securities into compliance with the regulated market, then it is wise to extend the scheme of regulation so as to cover the securities in question. Bonds issued by non-corporate issuers present exactly the same types of risk to the investing public. If there is a need to regulate corporate bond trustees, then there is a need to regulate all bond trustees. Therefore, our next recommendation is:

R3: The trust indenture provisions should apply to all issuers (including bodies corporate and non-corporate issuers such as trust, partnerships and limited liability companies).

[72] **A Securities Law Based Approach**: A question to resolve is whether trust indenture legislation should be part of corporate law or securities law. In the United States, it has always been clear that the regulation of trust indentures is a securities law matter. The 1939 Act is one of the statutes administered by the SEC; it only applies to trust indentures in which a prospectus or registration statement is filed or a public offering of bonds is otherwise made. The 1939 Act requires the qualification of both the prospectus and the trust indenture with the SEC. The SEC is the body that is charged with granting exemptions. In the United States, the Federal Government has only very limited power to legislate with respect to corporations as such. Its ability to regulate securities is derived from its jurisdiction over interstate commerce.

[73] In Canada, the characterization of trust indenture legislation is ambiguous. Under the CBCA and those statutes which have followed the language in that statute closely, the regulation of trust indentures is sited firmly in the corporate law sphere. While securities concerns are not irrelevant under the CBCA (it applies only where bonds are issued to the public), administration of this part of the statute is not carried out by securities regulators, but rather by the Director under the CBCA. In contrast, in Ontario the trust indenture provisions—although sited in Part V of the OBCA rather than the OSA—are tied closely to the securities law regime. The provisions come into play once a prospectus is filed under the OSA. Part V applies to all corporate issuers, whether incorporated under the OBCA or under federal, extra-provincial or foreign law. The

OSC has control over the exemption power, rather than the Director under the OBCA. The law in British Columbia is similar to that in Ontario.

[74] In our opinion, the securities law-based approach is the preferable one. The provisions should apply to all trust indentures, irrespective of the domicile of the issuer and the nature of the issuer, if it is distributing its bonds into a particular province or territory. Moreover, we believe that it is the Securities Commission, rather than the director under the relevant corporate legislation, which is best placed to exercise reasonable oversight over the trust indenture marketplace. Accordingly, our fourth recommendation is:

> R4: Trust indentures should be regulated under securities law rather than corporate law. The domicile of an issuer should be irrelevant to the regulatory scheme which applies. The critical issue is whether an issuer is distributing securities within a jurisdiction. Subject to the applicable exemptions as indicated in these recommendations (e.g reciprocal exemption), trust indentures applicable to all bonds distributed within a jurisdiction should be subject to the securities laws applying within that jurisdiction.

[75] **Use of a National Instrument Type Approach**: Although we would recommend that the relevant trust indenture provisions should be moved from corporate statutes to the relevant securities statutes, in our view, the legislative scheme should provide a basis for regulation, rather than set out the detail. The specific details of regulation would be set out in a subordinate body of law comparable to the current National Instrument system of the Canadian Securities Administrators (the "CSA").[32] The use of a national instrument has the following advantages:

first, it is a highly flexible approach, allowing members of the CSA to respond to changing market and regulatory requirements quickly. Second, it is now the recognized approach towards securities regulation in Canada. Third, instead of having several different statutes, each of which is drafted in slightly different language, to reflect the drafting preferences of local Legislatures or Parliament, national instruments are truly national and uniform in scope and application. We believe that such an approach would lead to greater uniformity among participating jurisdictions.[33] Hence, our next recommendation is:

R5: The CSA should develop a uniform national instrument (the "National Instrument") that would replace all of the federal, provincial and territorial corporate law provisions governing the minimum requirements of trust indentures. An issuer and a trust indenture would be deemed to in compliance with provincial/territorial law if they are compliant with the National Instrument.

[76] **Federal or Provincial Law**: We express no opinion as to whether jurisdiction over securities law should be sited at the Federal or Provincial level of government. However, in our view, responsibility in respect of trust indentures would logically flow to whichever level of government is active in securities regulation.

R6: To the extent that the qualification of distributions of securities by way of prospectuses becomes a matter of federal jurisdiction, the trust indenture provisions should be added by way of amendment to that statute.

[77] **Reciprocal Recognition**: Under the current CBCA model a CBCA issuer can obtain an exemption from the CBCA regime if it files a prospectus in Ontario or British Columbia or files a prospectus or registration statement in the US.[34] In our view, this is a good first step. However, since applications for such exemption are almost always granted for certain jurisdictions, we would propose that automatic, blanket exemptions be provided for in the case of a trust indenture complying with the laws of certain prescribed jurisdictions. This would be consistent with the blanket exemptions provided under the 1939 Act (see paragraph 33 above) Consistent with our recommendation below, that instead of actual statutory rules, trust indentures should comply with the National Instrument, the CBCA should expressly contemplate such a National Instrument.

In addition, Federal, provincial and territorial corporate statues that contain trust indenture provisions could be modified so that they would be deemed to have complied with or would be exempt from the statutes concerned, if the issuer complies with such National Instrument or with the trust indenture provisions of the OBCA or BCBCA. Such a deeming provision may be necessary to enable Canadian issuers or guarantors to continue to receive a partial exemption under the 1939 Act for trust indentures that are compliant with the CBCA, OBCA or BCBCA**.**

R7: The CBCA (and its regulations) and other federal corporate legislation should be amended to provide:

(a) an automatic exemption where the trust indenture is governed by a prescribed law; and

(b) an automatic exemption where no prospectus in respect of the debt obligation is required to be filed in Canada.

The prescribed laws could include the OBCA, the BCBCA and the 1939 Act. In addition, the regulations could be amended from time to time to include the legislation of other provinces/territories or the National Instrument.

[78] **Discretionary Exemptions**: Where a blanket exemption is not available, we would recommend that the relevant securities administrator should have the authority to grant a discretionary exemption, where to do so would not be contrary to the public interest. We are also of the view that, it should be possible to attach conditions to any such an exemption. These changes would result in an exemption regime that is comparable to the SEC's exemption power under the current iteration of the 1939 Act. Hence, our next recommendation is:

R8: The legislation include a specific discretionary exemption that would be available, on application, in all other cases where the Securities Commission (or in the case of the CBCA, the Director) is satisfied that the exemption is not contrary to the public interest. The Securities Commission (or, in the case of the CBCA, the Director) would have the power to attach conditions to any such exemption. For example, a foreign (other than the U.S.) issuer that wishes to access the Canadian capital market may be able to seek an exemption from the application of the Canadian legislation on the basis that its home country legislation satisfactorily protects Canadian investors.

[79] **When Regulation Should Triggered**: Consistent with our view that trust indenture legislation should be administered as part of securities law, the Working Group recommends that the application of the relevant regulatory regime should be similar to the approach followed in the 1939 Act. In other words, compliance with the regulatory requirements should be mandated once there has been a filing of a prospectus or registration statement with respect to the bonds to which the indenture relates. The applicability of the regime should be tied to some objectively verifiable event. The current trigger in the CBCA and other statutes relating to a distribution "to the public" may result in ambiguities and uneven application of the statutory requirements to distributions of bonds on a private placement basis which may or may not involve members of the "public".

R9: An issuer should be subject to the mandatory trust indenture provisions if, but only if, it is required under applicable Canadian law (federal, provincial or territorial) to file a prospectus in respect of the issue of the bonds. Thus, a Canadian issuer that is not required to file a prospectus anywhere in Canada because the bonds are not being offered for sale to Canadian investors should not be subject to a requirement to comply with Canadian trust indenture provisions. Likewise, this rule would continue to exclude privately placed bonds (including loan instruments) from the trust indenture regime.

[80] **Residency of Trustees**: The present Canadian and American legislation exhibits no uniformity of approach with respect to the residency and status of trustees. Under the CBCA, a Canadian federal or provincial trust company must be trustee of the trust indenture for a CBCA issuer licensed to carry on business. However, where an exemption is granted from the CBCA

regime in favour of the 1939 Act, the result is that, in practice, a US federal or state-incorporated trust company may be appointed. Part V of the OBCA does not specifically require an indenture trustee to be a trust company, although the trustee must be resident or authorized to do business in Ontario. If the trustee is a corporation, then it must effectively be a trust corporation under the *Loan and Trust Corporations Act* (Ontario) to act—but only where there is a distribution of bonds within Ontario (so as to bring Part V into application).

[81] If an OBCA corporation distributes bonds only outside Ontario, then Part V of the OBCA is not applicable. In that case, the question of whether the trustee under a trust indenture should be a trust company or an individual is left to the marketplace. In practice, regulating the legal form of the indenture trustee is unnecessary. Trust companies have a secure lock on the business.

[82] Under the 1939 Act, at least one trustee must be a trust company incorporated under US federal or state law. The SEC has power to grant exemptions and uses it to exempt trust indentures from requirement to have a U.S domestic trustee corporation as a trustee. As discussed at Part II.2(b)(iii) above, the 1939 Act requires reciprocity.

[83] The Working Group favours the use of the National Instrument approach, as the primary instrument for trust indenture regulation. Under this option, the CSA would develop and promulgate a uniform national rule (the "National Instrument") on trust indentures. In the case of trust indentures governed by Québec law, the National Instrument should have a limited carve-out for those provisions that are already covered by the *Civil Code of Québec*. We would expect that such a National Instrument would provide that the trustee must be a Canadian and federal or

provincial trust company. It may also provide that the National Instrument could be complied with by complying with the 1939 Act. This would effectively allow trust companies in the U.S. to serve as trustees. Therefore, our next recommendation is:

R10. The National Instrument should:

(a) specify that a trustee must a trust company incorporated under Canadian federal, provincial or territorial law or U.S. federal or state law;

(b) not include the specific OBCA rule prohibiting a trustee from acting as a receiver, receiver-manager or liquidator (on the basis that these provisions are unnecessary); and

(c) include a limited carve-out for those provisions already covered by the *Québec Civil Code*.

[84] **Conflict of Interest Rules**: Despite some controversy, the 1990 *Reform Act* amended the statutory duty of care applicable to trustees under the 1939 Act so that it only has meaningful application upon default, not before default. This has not become an issue in Canada, and trust companies that act as trustees under Canadian trust indentures have not sought a parallel change on this side of the border. Although the current legal position is unclear, there is a considerable body of American case law pre-dating the 1939 Act which indicates that before default, the consensus view is that the functions of indenture trustees are largely ministerial. Although this

case law may be sufficient to resolve the question, we can see no reason for abandoning the approach embodied in the CBCA and all other Canadian legislation. Thus, we recommend:

R11: The uniform law should continue the CBCA provisions:

(a) setting out the statutory duties of loyalty and care; and

(b) governing compliance certificates, notices of events of default and provision by the trustee of a list of bondholders.

[85] The approach of the CBCA, OBCA and BCBCA is to prohibit material conflicts of interests or require resolution of such conflict within 90 days. The CBCA, OBCA and BCBCA do not attempt to define a "material conflict of interest" further. The 1939 Act approach is to enumerate specific types of prohibited conflicts of interest. After the 1990 *Reform Act*, there are 10 categories of specific conflicts. However, with one limited exception, the *Reform Act* states that conflicts of interest are only tested (or become legally relevant) upon and after a default (whether notice has been given or time has elapsed so that the default becomes "an event of default" within the meaning of the trust indenture.

[86] Again, this has not become an issue in Canada, and trust companies active in the business have not sought a parallel relaxation of the rules under Canadian legislation. It may be that the inclusion of the "material" qualifier in "material conflict of interest" rules out conflicts of interest that arise before default (where the trustee has no incentive to act contrary to the interests of bondholders). It appears that, in the nearly 40 years since their first enactment as part

of the *1970* OBCA, the trust indenture provisions of the CBCA and cognate corporate legislation have never been judicially considered. Thus, while on the one hand some interpretative issues remain open, it cannot seriously be argued that the present "uncertain" state of the law appears to be leading to costly litigation or injustice. This leads to our next recommendation:

R12: The uniform law should include the CBCA prohibition against material conflicts of interest and the resolution thereof within 90 days.

[87] A possible issue is whether the requirement to avoid material conflicts of interest acts as a barrier to market entry by prospective trust companies who wish to offer such services in Canada. If it does, then the consideration might be given to codifying the *Reform Act* rule to the effect that a conflict of interest can only become disabling after default and, even then, the indenture trustee can seek an temporary or permanent exemption (rather than put the issuer and the bondholders to the incremental expense of hiring a replacement indenture trustee).

[88] **Ban on Receivership**: The OBCA rule that prohibits a trustee from acting as a receiver, receiver-manager or liquidator is expendable. In light of the earlier discussion on conflict of interest, we see little benefit in continuing this prohibition. At the time when the OBCA provisions were originally put into place, there was little opportunity for the courts to superintend the receivership process. In view of numerous legislative changes in the debtor-creditor field, and the ever-expanding concept of fiduciary duty at common law, this is no longer the case. In the unlikely event that problems were encountered with having a trustee serve also as a receiver, those problems are best dealt with on a case-by-case basis, rather than by way of an all-encompassing rule. Hence, we recommend:

R13. The uniform law should not include the OBCA rule prohibiting a trustee from acting as a receiver, receiver-manager or liquidator of the issuer.

8. Amendments Considered but Not Recommended

[89] **Exemptions**: There appears to be no call in Canada for the creation of further specific exemptions from the present trust indenture regimes. In contrast, in the United States, as a result of the 1990 *Reform Act*, small trust indentures (less than US$10 million) are automatically exempt from the regulatory regime. Some concern must be expressed with regard to adopting a floor level exemption of this kind. Very often, it is low value securities issues that offer the most tempting opportunities for the fraudulently inclined. Instead of creating small trust indenture exemption, giving authority to Securities Commissions to grant exemptions where not contrary to the public interest would seem to be the preferable approach. Hence, we recommend:

R14: The uniform law not follow the 1990 amendments to the 1939 Act by including an exemption for small issuers.

[90] In addition, the Working Group has considered, and has determined that there would be no benefit in adopting, any of the following aspects of the 1939 Act:

- The adoption of a unanimity rule for adverse changes to principal, interest and maturity provisions in trust indentures. Sophisticated investors should be allowed to negotiate or demand an appropriate amending formula in their trust indentures. Freedom of contract seems preferable to legislating uniformity. The disadvantage

of the American approach is that it often causes corporations to commence a needless and expensive Chapter 11 proceeding under the *US Bankruptcy Code*, simply to work around the requirement for unanimity under the 1939 Act. In Canada, either the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act* (more likely, the latter) would allow a similar work around. There is little point in adopting a regulatory rule when that rule can be circumvented under other legislation.

- A requirement that a trustee share certain payments it receives after default or within 90 days of default with bondholders on a *pari passu* basis. Such an approach negates the relative status as secured, unsecured or subordinated creditors, that the bondholders have voluntarily elected to assume,

Our final recommendation, therefore, is as follows:

R15: The uniform law should not be expanded to include more of the 1939 Act than is currently covered by the CBCA, including the requirements that:

(a) adverse changes to principal, interest and repayment provisions of the trust indenture require unanimous bondholder approval; or

(b) payments received by the trustee within 90 days of default be shared with bondholders on a *pari passu* basis.

[91] In summary, there appears to be little, if anything, to be gained by adopting more of the 1939 Act than the Lawrence Committee and Dickerson Committee recommended 40 years ago.

9. Summary of Recommendations

1. As long as the 1939 Act remains in force in the U.S., Canadian legislation governing trust indentures should not be abandoned in favour of deregulation.

2. Consistency in Canada's capital markets means that all Canadian jurisdictions should have a uniform (or substantially harmonized) model law.

3. The trust indenture provisions should apply to all issuers (including bodies corporate and non-corporate issuers such as trust, partnerships and limited liability companies).

4. Trust indentures should be regulated under securities law rather than corporate law. The domicile of an issuer should be irrelevant to the regulatory scheme which applies. The critical issue is whether an issuer is distributing securities within a jurisdiction. Subject to the applicable exemptions as indicated in these recommendations (e.g reciprocal exemption), trust indentures applicable to all bonds distributed within a jurisdiction should be subject to the securities laws applying within that jurisdiction.

5. The CSA should develop a National Instrument that would replace all of the federal, provincial and territorial corporate law provisions governing the minimum requirements of trust

indentures. An issuer and a trust indenture would be deemed to in compliance with provincial/territorial law if they are compliant with the National Instrument.

6. To the extent that the qualification of distributions of securities by way of prospectuses becomes a matter of federal jurisdiction, the trust indenture provisions should be added by way of amendment to that statute.

7. The CBCA (and its regulations) and other federal corporate legislation should be amended to provide:

(a) an automatic exemption where the trust indenture is governed by a prescribed law; and

(b) an automatic exemption where no prospectus in respect of the debt obligation is required to be filed in Canada.

The prescribed laws could include the OBCA, the BCBCA and the 1939 Act. In addition, the regulations could be amended from time to time to include the legislation of other provinces/territories or the National Instrument.

8. The legislation include a specific discretionary exemption that would be available, on application, in all other cases where the Securities Commission (or in the case of the CBCA, the Director) is satisfied that the exemption is not contrary to the public interest. The Securities Commission (or, in the case of the CBCA, the Director) would have the

power to attach conditions to any such exemption. For example, a foreign (other than the U.S.) issuer that wishes to access the Canadian capital market may be able to seek an exemption from the application of the Canadian legislation on the basis that its home country legislation satisfactorily protects Canadian investors.

9. An issuer should be subject to the mandatory trust indenture provisions if, but only if, it is required under applicable Canadian law (federal, provincial or territorial) to file a prospectus in respect of the issue of the bonds. Thus, a Canadian issuer that is not required to file a prospectus anywhere in Canada because the bonds are not being offered for sale to Canadian investors should not be subject to a requirement to comply with Canadian trust indenture provisions. Likewise, this rule would continue to exclude privately placed bonds (including loan instruments) from the trust indenture regime.

10. The National Instrument should:

(a) specify that a trustee must a trust company incorporated under Canadian federal, provincial or territorial law or U.S. federal or state law;

(b) not include the specific OBCA rule prohibiting a trustee from acting as a receiver, receiver-manager or liquidator (on the basis that these provisions are unnecessary); and

(c) include a limited carve-out for those provisions already covered by the *Québec Civil Code*.

11. The uniform law should continue the CBCA provisions:

(a) setting out the statutory duties of loyalty and care; and

(b) governing compliance certificates, notices of events of default and provision by the trustee of a list of bondholders.

12. The uniform law should include the CBCA prohibition against material conflicts of interest and the resolution thereof within 90 days.

13. The uniform law should not include the OBCA rule prohibiting a trustee from acting as a receiver, receiver-manager or liquidator of the issuer.

14. The uniform law not follow the 1990 amendments to the 1939 Act by including an exemption for small issuers.

15. The uniform law should not be expanded to include more of the 1939 Act than is currently covered by the CBCA, including the requirements that:

(a) adverse changes to principal, interest and repayment provisions of the trust indenture require unanimous bondholder approval; or

(b) payments received by the trustee within 90 days of default be shared with bondholders on a *pari passu* basis.

[1] As to the position of a trustee under general principles of equity, see the comments of Maugham, J. in Re Dorman, Long & Co. Ltd., [1934] 1 Ch. 636 at p. 671. As to common law liability in negligence, see: *Mutual Life Citizens Co. v. Evatt*, [1971] A.C. 793 (P.C.); *Unfair Contracts Terms Act 1977*; *Midland Bank Trustee (Jersey) Ltd. v Federated Pension Services Ltd*., [1997] 2 L.R.C. 81 (C.A. Jersey); *Bartlett v. Barclays Bank Trust Co Ltd.* [1980] 1 All E.R. 139 per Brightman J. at 152.

[2] In the European Union, the Markets in Financial Instruments Directive 2004 (204/39/EC) sets out detailed rules for the managing of conflicts of interest by investment firms and banks that carry on an investment business. The definition of investment services and activities mainly relates to dealings in securities, portfolio management, investment advice and underwriting. In the view of the leading authority on European financial law, this Directive does "not seem to include acting as a syndicate agent or a trustee of bondholders, so that the provisions ought not to apply to these activities." Philip Wood, *International Loans, Bonds, Guarantees, Legal Opinions*, (London: Thomson, Sweet & Maxwell, 2007, 2nd ed.) at ¶17-009

[3] Any amendment to the corporate law would need to reconcile with exemption available under the *United States Trust Indenture Act of 1938*

[4] *Report of the Select Committee on Company Law*, (Toronto: Queen's Printer, 1967) at ¶11.1.1

[5] S.L. Schwarcz and G. Sergi, "Bond Defaults and the Dilemma of the Indenture Trustee," (2008), 59 Ala. L. Rev. 1037

[6] *Elektrim SA v Vivendi Holdings 1 Corp.; Law Debenture Trust Corp. plc v. Vivendi Holdings 1 Corp.*, [2008] E.W.C.A. Civ. 1178 per Lawrence-Collins, L.J. at ¶2: "The use of a trustee is an effective way of centralizing the administration and enforcement of bonds. Bondholders act through the trustee, and share *pari passu* in the fortunes of the investment, and do not compete with each other. The trustee represents and protects the bondholders, who are treated as forming a class, and who give instructions to the trustee through a specified percentage of bondholders. Such a scheme promotes liquidity. Individual bondholders rely on the trustee as the exclusive channel of enforcement and can be confident that on enforcement principal and interest will be distributed *pari passu*."

[7] C.E. Dropkin, "Implied Civil Liability Under the *Trust Indenture Act*," (1978), 52 Tulane L. Rev. 299

[8] "… the saleability of the bonds depends in inconsiderable degree upon the character of the persons who are selected to manage the trust. If they are of well-known integrity and pecuniary ability, the bonds are more readily sold." *Merrill v. Farmers Loan & Trust Co*. 31 N.Y. Sup. Ct. 297 at p. 299 (1881)

[9] K. McGuinness, *Canadian Business Corporations Law*, (Toronto: LexisNexis, 2007, 2nd ed.) at pp. 1038-39

[10] (2006), 191 Fed. Appx. 118 (3rd. Cir.)

[11] American Bankers Association, Corporate Trust Committee, "The Trustee's Role in Asset-Backed Securities," March 12, 2003, on-line at www.aba.com/NR/rdonlyres/B1449D99.../TRUSTEES999997.doc

[12] See, for instance, *Semi-Tech Litigation, LLC v. Bankers Trust Co*. 353 F. Supp. 2d 460 (S.D.N.Y. 2004)

[13] Amanda J. Kiefer, "Kansas Blue Sky Law is not On the Market," (2003), 42 Washburn L.J. 281 at p. 295

[14] Will Payne, "How Kansas Drove Out A Set Of Thieves," (December 2, 1911), 184 *The Saturday Evening Post* (No. 23)

[15] Jonathon R. Macey, Geoffrey P. Miller, "Origins of the Blue Sky Laws," (1991) 70 Tex. L. Rev. 347

[16] See also *Moos v. Landowners' Oil Assoc*., 15 P.2d 1073 at p. 1076 (Kan. 1932): "The inordinate birth rate of the 'sucker' is proverbial, and there is no birth-control measure adequate to inhibit the spawning of unscrupulous individuals who prey upon those who are easily duped. Hence we have a *Blue Sky Law*."

[17] "SEC Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part VI, 1936"

[18] Reported at "To Provide for the Regulation of the Sale of Certain Securities in Interstate and Foreign Commerce and though the Mails, and the Regulation of the Trust Indentures Under Which the Same Are Issued and For Other Purposes," Hearings Before a Subcommittee of the Senate Comm. on Banking and Currency, 76th Cong. 34 (1939)

[19] Copied from Kay Giesecke, Stephen Schaefer, Francis A. Longstaff, Ilya Strebulaev, "Corporate Bond Default Risk: A 150 Year Perspective," available on-line at: http://www.stanford.edu/dept/MSandE/cgi-bin/people/faculty/giesecke/pdfs/glss.pdf

[20] April 11, 1935, Securities Exch. Act Release No 137

[21] See also *Hazzard v. Chase National Bank*, 159 Misc. 57, 83; aff'd. 257 App. Div. 950; aff'd. 282 N. Y. 652 (C.A.N.Y., 1940); *Continental Corp. v. First National Bank of Westfield*, 285 Mass. 419; 189 N.E. 184; 1934 Mass. LEXIS 943 (S.J.C. of Mass., 1934); See also *Richardson v. Union Mortg. Co*., 210 Iowa 346; 228 N.W. 103; (S.C. Iowa, 1930) per Kindig, J.

[22] 15 USC. 77

[23] Tile 11 of the *United States Code Annotated*

[24] See Section 260.4d-9 under title 17 of the United States Consolidated Federal Regulations. The reference to the *Company Act* (British Columbia) has not been updated to reflect the *Business Corporations Act* (British Columbia).

[25] *Report of the Select Committee on Company Law*, (Toronto: Queen's Printer, 1967), pp. 99-103

[26] At ¶11.1.3

[27] *Gunnar Mines Limited v. Minister of National Revenue* (1963), 63 D.T.C. 836 (T.A.B.)—classification of income for tax purposes; *Montreal Trust Co. v. Atlantic Acceptance Corp*., [1965] O.J. No. 507 (Ont. H.C.) procedure for the realization of assets by a trustee; *R. C Huffman Construction Company of Canada Limited v. Minister of National Revenue*. (1965), 65 D.T.C. 597 (T.A.B.)—classification of income for tax purposes; *Re Meyerhoff*, [1963] B.C.J. No. 152 (B.C.S.C.)—liability for estate tax; *Re McPhee Canada Permanent Trust Co. v. Stewart*, [1965] B.C.J. No. 145 (B.C.S.C.); *Brilund Mines Ltd. v. Canadian Imperial Bank of Commerce*, [1964] O.J. No. 299 (Ont. H.C.); *Aaron Kagna v. Minister of National Revenue*. (1963), 64 D.T.C. 20 (T.A.B.)—classification of income for tax purposes.

[28] *Richardson v. Union Mortg. Co*., 210 Iowa 346; 228 N.W. 103; (S.C. Iowa, 1930)

[29] See, for a greater discussion of economic theory, C.G. Veljanowski, "The Coase Theorems and The Economic Theory of Markets and Law" (1982), 35 *Kuklos* 61, Keith J. Crocker, Scott E. Masten, "Regulation and administered contracts revisited: Lessons from transaction-cost economics for public utility regulation," (1996), 9 Journal of Regulatory Economics 5; Oliver E. Williamson, "The Institutions of Governance," (1998), 88 American Economic Review (No. 2), Papers and Proceedings of the Hundred and Tenth Annual Meeting of the American Economic Association 75; P.L. Joskow, "The Role of Transaction Cost Economics in Antitrust and Public Utility Regulatory Policies, (1991), 7 J. Law Econ Organ. 53

[30] See, generally, *Tercon Conractors Ltd. v. British Columbia*, [2010] S.C.J. No. 4

[31] See, generally, Shelanski and Klein, "Empirical Research in Transaction Cost Economics: A Review and Assessment" (1995), II N2, *Journal of Law, Economics, and Organisation*, 335

[32] In our deliberations, the Working Group also considered the viability of a stand-alone statute comparable to the *1939 Act* for Canada. The working group is doubtful that there would be any appetite to create a stand-alone statute dealing with trust indentures. The approach of *1939 Act* has never been used in Canada. In contrast to Canada, the US Federal securities law regime is embodied in seven different federal statutes. Efforts to create a comprehensive *Federal Securities Code* were abandoned long ago. We see no benefit to be derived from splitting securities legislation into different stand-alone statutes that deal with discrete securities law matters.

[33] An analogue for this is the going-private transactions provision in section 193 of the *CBCA*. In effect, section 193 only operates as a default rule – in this case defaulting to Multilateral Instrument 61-101 (Protection of Minority Security Holders in Special Transactions). Another comparable analogue is the recent amendments to the proxy circular requirements set out in the *CBCA*, which, with limited exceptions, adopts Form 51-102F5 (Information Circular) of National Instrument 51-102 (Continuous Disclosure Obligations).

[34] See the CBCA Exemption Kit, available on-line at: http://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs02650.html

C:\DOCUME~1\ptardif\LOCALS~1\Temp\MetaSave\TOR01-4414854-v3-

Report_on_Trust_Indenture_(formatted).DOC