

1987 WESTERN SECURITIES LAW PRACTITIONERS' SYMPOSIUM**NEW TRENDS IN FINANCING****OCTOBER 31, 1987****A. INTRODUCTION**

This paper highlights selected current trends in financing, with emphasis on examples of new products, new techniques and new players relevant to the Alberta capital market. In particular, the paper reviews currently popular tax-driven oil and gas financing techniques as well as other recent examples of popular or otherwise interesting financing innovations.

This paper is qualified in its entirety by the caveat that all financing techniques must be reassessed in light of the current market collapse. In other words, products and techniques which were attractive yesterday are probably no longer appropriate today.

Examples of numerous recent financings are attached to this paper.

B. OIL AND GAS RELATED OFFERINGS**1. Flow-Through Share Limited Partnership/Mutual Fund Offerings**

Flow-through share limited partnerships are not a new financing technique, but one that has continued to exhibit market appeal in 1987 due, in part, to the scarcity of other tax shelter investment opportunities.

(a) The Renunciation Mechanism

As of January 1, 1987, the structure of flow-through share financing was fundamentally altered by changes in the federal Income Tax Act (the "Tax Act"). Investors are no longer required to incur resources expenses directly, but rather the issuing corporation itself incurs the expenses which it then renounces in favour of investors, thereby eliminating the need for complex agency, indemnity and insurance arrangements.

Although the limited partnership purchases flow-through shares at a premium representing compensation to the issuer for the value of its tax pools to be renounced to the partnership, investors ultimately acquire the shares at an after tax discount from market. At least, this is the case in a stable market. Unfortunately, issuers in a number of current partnership offerings have committed to purchase flow-through shares at pre-October 19, 1987 prices. In my view, the subsequent decline in the market value of such shares is a material change in the business and affairs of such partnerships necessitating a prospectus amendment where such issuers are still in distribution.

From the point of view of a currently non-tax paying resource company, flow-through share financings represent a source of permanent equity to finance exploration programs with less inherent risk than would result from bank financings secured by charges on producing properties.

Issuers receive several benefits from participating in a partnership/mutual fund offering rather than in promoting their own offerings, including lower issue costs, since the issuance to the partnership is by way of private placement and the partnership incurs the expenses of the public

offering and the opportunity for the issuer to obtain exposure to national securities markets, which might not be available to the issuer in its own right.

(b) The Advantages of the Limited Partnership
/Mutual Fund Structure

A state of the art flow-through share offering now typically takes the form of an offering of units of a limited partnership investing by way of private placement in flow-through shares of listed public resource companies. Under the old tax rules, use of a limited partnership was dictated by liability considerations. Now other factors favour the use of the partnership structure.

The use of a limited partnership permits portfolio diversification in a manner which could not be achieved by the use of a corporate entity since the flow-through share tax rules do not permit resource expenditures to be flowed through two tiers of unrelated corporations. It also permits warehousing of expenditures in that the partnership can enter into flow-through share subscription agreements prior to or during the offering and expenses incurred and renounced subsequent to the date of such agreements can then be stored in the partnership for allocation to investors who are partners of the partnership at the end of its fiscal year.

Liquidity for investors is achieved by dissolving the partnership once substantially all of the resale restrictions on its portfolio of flow-through shares have expired and by the distribution to investors at that time of either shares of a mutual fund corporation into which the partnership has transferred its portfolio of flow-through shares on a tax deferred basis (for examples,

see the CMP and MTC offerings) or the distribution to investors of their pro rata undivided interest in the portfolio of flow-through shares (for examples, see Enerfund and Somicom). The distribution of undivided interests is mandated by applicable provisions of the Tax Act and, in practice, these undivided interests are subsequently exchanged by the resource issuers for divided interests in the underlying securities.

(c) Securities Law Aspects

Typically, the initial prospectus for partnership units also serves to qualify the mutual fund as a reporting issuer thereby permitting the exempt distribution of the mutual fund shares on the liquidation of the partnership.

Further, a number of securities law exemption orders or no-action letters are required abridging the otherwise applicable hold periods for the flow-through shares and granting relief from commission policies otherwise applicable to mutual funds, including temporary suspension of the 10 - 10 rules which prohibit a mutual fund from acquiring more than 10% of the shares of any one issuer or investing more than 10% of its assets in the securities of any one issuer.

(d) The Future of Flow-Through Share Offerings

Some of the more exotic varieties of flow-through share limited partnership offerings have fallen by the wayside as a result of recent income tax changes, including the amendments broadening the prescribed share rules applicable to flow-through shares.

For example, it appears no longer possible to offer flow-through shares convertible into securities of other issuers such as the CDC Flow-Through Limited Partnership unit offering consisted of interests in the CDC Partnership and flow-through shares of Canterra Energy Ltd., both of which were automatically exchanged for Canada Development Corporation common shares after the end of the first fiscal period of the partnership.

Similarly, the extension of the at risk rules to Canadian resource expenses incurred by limited partnerships appears to have put an end to or necessitated a restructuring of most levered partnership deals such as the recent Knight Exploration and Royal Trust Energy offerings.

The current \$300 million CMP and \$400 million NIM offerings evidence the continued viability of flow-through shares in the 1988 market, albeit with decreased attractiveness to investors as a result of lower marginal tax rates, increased capital gains tax, the reduction in the lifetime capital gains exemption, the restrictions on the availability of the capital gains exemption resulting from application of the net investment loss rules and the phase-out of mining exploration depletion allowance and the CEDIP program.

2. Mutual Fund Trusts/Royalty Interest Offerings

Early 1987 saw several examples of offerings of undivided interests in mutual fund trusts and master royalties (for example, the Royal Trust Energy Income Fund, Enerplus Resources Corporation's offering of Petroleum Royalty Units and Trust Units and the FT 1986 Oil & Gas Production Fund).

(a) Purpose of the Offerings

These offerings permit institutional investors and taxpayers with unutilized depletion base to invest in oil and gas royalty income streams and RRSP's and other similar tax-deferred plans to invest in resource royalty income streams through the purchase of trust units of a trust investing in royalty units. The use of the trust vehicle permits the flow-through of resource revenues without the imposition of a corporate layer of taxation.

(a) Basic Structure

The offerings are similar to flow-through share offerings in that strict compliance with a myriad of technical requirements of the Tax Act is required. The basic income tax requirement in structuring the mutual fund trust is that 90% of the income of the trust must be derived from royalty interests in petroleum and natural gas production.

In a typical deal, a holding company is established to purchase working interests in high quality producing oil and gas properties. Immediately after the purchase, the holding company grants a royalty interest equivalent to substantially all of the economic interest in the properties to the mutual fund trust. This royalty typically takes the form of a net profits interest ("NPI").

The offering of trust units is generally accompanied by an offering of royalty units qualified as investments for institutional investors. In summary this means the properties must have at least a three year production history and that the royalty interest must create or be derived from an interest in land.

Typically, the royalty interests are listed for trading and the mutual fund units are redeemable, with redemptions met through the issuance of further royalty units rather than by liquidation of the underlying working interest in the properties.

(c) The Future of Royalty Trusts

In spite of their popularity with investors, there have been few royalty trust offerings in the second half of 1987 due to the difficulties encountered by promoters in successfully bidding for suitable producing properties.

The unavailability of properties has been due, in part, to uncertainties as to long-run oil prices and to the fact that many resource companies, as a result of smaller exploration programs and the use of flow-through financings, have depleted resource expenditure pools and would incur tax on substantial property sales.

In this regard, the banks, to the extent that they have realized on producing oil and gas assets, may be a source of suitable properties. In cases where the banks have not already written down non-performing loans, proceeds of disposition received in a realization would not constitute income to the banks but rather a tax-free return of principal.

3. Class 29 Asset Deals

Anticipation of the elimination of the preferential Class 29 capital cost allowance applicable to manufacturing and processing equipment resulted in a number of tax driven gas plant financings prior to the June White Paper. In addition, I

am aware of at least one pre-budget public offering of units of a limited partnership formed to acquire and operate natural gas field gathering systems and compression and processing facilities (see the Enerplant offering).

(a) The Basic Structure

In the typical transaction, investors purchase undivided interests in processing facilities through a joint venture or limited partnership structure in order to take advantage of the Class 29 capital cost allowance rates, investment tax credits, interest expense deductions and the manufacturing and processing tax credit associated with the assets. In the usual arrangement, the joint venture contracts to produce the vendor's gas pursuant to a long term contract on a fee for service basis. Care must be taken to avoid the leasing property rules which would otherwise limit capital cost allowance deductibility.

(b) Equipment Trusts

In the current Union Carbide Canada Equipment Trust offering, a trust was established to acquire and own gas production and distribution equipment and other assets of Union Carbide Canada Limited. Assets acquired by the trust with the proceeds of the issue are leased to Union Carbide pursuant to two long-term net leases.

The trust distributes rental income to registered unitholders and each unitholder is allocated capital cost allowance to the extent available to the trust up to the amount of the income distributed to the unitholder. It is anticipated that capital cost allowance allocations will fully offset distributed income for at least the first five years. To provide liquidity, Union Carbide has undertaken

to subscribe for units from time to time as necessary in an amount equal to the amount required to fund redemptions.

(c) The Future

Although gas plant refinancing by way of private placement may become a popular year-end financing transaction, refinancing activity may not be as popular as originally anticipated since Revenue Canada's replacement of the straight line 25%-50%-25% capital cost formula with the new 25% declining balance formula is being phased in over the next three years, with a 40% write-off being available next year.

4. Land Funds

(a) The Basic Structure

Pension fund land deals are essentially joint ventures between groups of pension fund resource corporations, pension fund trusts and other non-taxable institutional investors and a taxable or near-taxable oil and gas exploration company. Institutional investors desiring to participate directly in oil and gas production finance the low rate write-off expenses incurred in acquiring exploration properties and a resource company in a better position to use the write-offs or desiring to replenish its resource expense pools contributes the higher write-off exploration and development expenses.

For liability protection purposes, the participation of the institutional investors is often through a limited partnership, with the resource industry participant acting as general partner, although this causes the investment to

be classified as 'foreign property' and subjects the institutional investor to a one percent per month penalty tax on all such property exceeding 10% of its aggregate investments.

(b) Example

In one recent private placement, a group of pension funds purchased exploration properties from the subsidiary of an operating oil company (the "Exploration Company") and then immediately farmed the properties out to the Exploration Company under an arrangement whereby the Exploration Company agreed to spend an amount equal to at least four times the contribution of the pension funds on exploring and developing the lands in return for a 100% working interest in the properties. The institutional investors retain a 12 1/2 percent net profit interest ("NPI") convertible into a carried working interest. Since they reimburse the Exploration Company for the NPI's proportionate share of non-deductible Crown royalties, the institutional investors are eligible for Alberta Royalty Tax Credit. The Exploration Company manages the exploration program and operates the properties pursuant to a management agreement.

The institutional investors receive some downside protection by a covenant of the Exploration Company to purchase any electing participant's NPI interest at the end of the exploration program at original cost less revenues generated to that point.

The concept of the NPI (a strictly contractual interest) provides limited liability for investors, but suffers from the drawbacks that it does not allow for registration of the investor's interest and it would probably be treated as an unsecured interest in a receivership or bankruptcy.

C. OTHER NEW PRODUCTS

1. Oil-Indexed Securities

(a) Oil-Indexed Debentures

In June 1986, The Standard Oil Company filed a U.S. prospectus offering units including an "oil indexed" note. The notes were non-interest bearing but could be redeemed for a price equal to the issue price plus a premium varying with the price of West Texas Intermediate ("WTI") crude oil. No premium is payable below a certain level and the premium increases with the increase in the price of WTI, to a certain maximum.

A recent Canadian oil-indexed debenture was structured not as an oil indexed note paying a premium based on oil prices, but rather as a debt instrument bearing a low fixed rate of interest plus an additional component linked to the price of oil.

In December 1986, Home Oil Company Limited issued a subordinated \$200 million unsecured oil-indexed debenture bearing interest at a rate equal to 5% plus an indexed rate varying from 0% to 16.8% depending on the market price of crude oil. Canadian Oil Debco Inc. acquired the debenture and issued 11% fixed-rate debentures secured by a pledge of the oil indexed debenture and by an assignment of Debco's rights under an interest rate conversion agreement with a bank under which Debco pays the bank the oil-indexed component of the interest on the debenture and in return receives from the bank a fixed amount of interest.

(b) Oil-Indexed Preferred Shares

A recent offering by Canadian Pioneer Oils Ltd. consisted of units each consisting of one oil price indexed cumulative redeemable convertible preference share and one gold purchase warrant. Holders of preference shares are entitled to fixed cumulative cash dividends and an additional annual cash dividend of 10% of the amount by which the average daily price of Arabian Light Crude for the year exceeds \$22 per barrel. Each gold purchase warrant entitles the holder to purchase 0.02 troy ounces of gold from the issuer at U.S. \$550 per troy ounce.

2. Cross-Border Offerings

(a) Basic Structures

Two methods of organizing complex multinational offerings have developed. One method, suitable in most Canada-U.S. cross-border offerings, is to draft a single common prospectus which complies with both the Canadian and U.S. disclosure requirements.

For example, in the recent offering by Varsity Corporation of U.S. \$1.30 Senior Convertible Redeemable Preferred Class I shares, Series A pursuant to a prospectus dated June 30, 1987, all but the front and back covers of the Canadian prospectus and the U.S. prospectus were identical. The differences in the cover pages reflected the different styles used by Canadian and U.S. investment dealers and the differing back pages reflected the Canadian requirements respecting purchasers' statutory rights and issuer's and underwriter's certificates.

The other alternative is to prepare different prospectuses complying with the applicable securities laws in each country. Prominent examples of this procedure include the British Telecom, British Gas and British Airways privatizations and the current British Petroleum offering.

(b) The British Privatizations

The British privatizations are illustrative of the types of issues that arise in international offerings:

(i) Differing disclosure Standards

British and Canadian statutory disclosure standards are different, yet it was important to have the British and Canadian prospectuses provide the same material information or risk that investors in one market will claim that they were misled because they lacked information provided in another market.

Specifically, the U.K. legislation has no concept of strict issuer liability and the general disclosure requirement in section 146 of the U.K. Financial Services Act is that a prospectus must contain such information as investors and their professional advisors would reasonably require for the purpose of making an informed assessment of "the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities and the rights attaching to those securities".

This may be compared to the Canadian standard of strict liability for "any untrue statement of a material fact or omission to state a material fact required to be stated or that is necessary to make a statement not misleading".

The result of these legal differences is that a U.K. prospectus is usually shorter, more optimistic and seeks to provide the investor with more information on the future prospects of the issuer.

The solution which was adopted in the British privatizations was to first draft a British prospectus, including comments from Canadian lawyers and investment dealers, and then to add to the Canadian prospectus those comments rejected for inclusion in the U.K. document but required in Canada. Future oriented statements in the U.K. prospectus were integrated into the Management Discussion and Analysis section of the Canadian prospectus.

(ii) Pre-Clearance

In the U.K., the practise is to issue only a final prospectus. There is no preliminary prospectus, but rather only what is called a "Pathfinder Prospectus" which is not distributed to members of the public but is available to financial institutions.

For U.K. marketing reasons, it is important that the final U.K. Prospectus not contain any material differences from the Pathfinder Prospectus.

As a result, it is important that the Canadian prospectus not change between preliminary and final as a result of comments from the staff of the provincial securities commissions. The solution has been to arrange pre-clearance in Canada of preliminary drafts of the preliminary prospectus.

(b) International Energy Offerings

In one recent U.S./Canada cross-border offering by a seasoned U.S. issuer listed on the New York exchange

(Triton Energy), Canadian securities regulators were persuaded to accept SEC-type disclosure in respect of financial statements and reserve reports. In particular, the Canadian prospectus included three rather than five - year financial statements and in-house rather than independent reserve reports.

The Bow Valley Industries Ltd. secondary offering of common shares in June, 1987 included an international tranche which was not governed by a global underwriting agreement. There was no contractual nexus between the issuer and the European dealers freeing the issuer from having to deal with an independent European market out clauses. Rather the European dealers acted as sub-agents of Canadian underwriters who, in a side-deal, indemnified the European dealers.

3. Preferred Shares

A distinctive characteristic of the Canadian capital market in recent years has been the heavy reliance on preferred shares as a fundamental source of corporate finance. Preferred shares represented 35% of total capital raised in Canada in 1984 and 27% in 1985.

Until recent tax changes, preferred shares constituted a cost effective after-tax financing technique for currently non-taxable issuers.

(a) The Impact of Tax Reform

The June 18, 1987 Ways and Means Motion imposes a new layer of tax ("Part VI.I Tax") on dividends paid on most types of newly issued preferred shares. Taxable preferred shares

include any shares issued after that date which entitle the holder to receive dividends or liquidation proceeds that are either fixed or subject to a minimum or maximum amount, as well as all other shares which are convertible into taxable preferred shares.

An issuer of taxable preferred shares is now subject to tax equal to 25% or, if the share conditions so require and the issuer so elects, 40% of the dividends payable on those shares. If the issuer elects to pay the 25% tax rather than the 40% tax, an additional tax of 10% is imposed on public corporations and specified financial institutions that receive dividends on the issuer's shares. Generally, to attract institutional investors, an issuer will agree to incur the 40% advance tax, thereby relieving institutional investors of the 10% tax.

Issuers of taxable preferred shares currently in a fully taxable position receive a full refund of any Part VI.I tax payable by way of a deduction under Part I for 5/2 of the tax paid.

Issuers that are not immediately taxable suffer an immediate tax cost but are entitled to carry forward a non-capital loss resulting from the deduction. The result is to eliminate the financing advantage of preferred shares for the most common issuers of this type of equity, that is corporations paying little tax.

(b) The Future of Preferred Shares

Generally speaking, as a result of the new Part VI.1 Tax, oil and gas companies, which are typically in a tax-deferred position, will in most cases be better off raising capital by way of the issue of common shares or debt securities.

There are, however, exceptions to this rule. For example, because of the dividend allowance, no Part VI.I Tax is payable on the first \$500,000 of annual dividends paid on taxable preferred shares by an associated group of corporations. Assuming an 8% dividend rate, this permits an issuer to offer up to \$6.25 million of preferred shares without attracting the new tax.

Second, in the case of a corporation which is fully taxable at rates of 40 percent or above, the Part VI.1 Tax can be fully offset against existing corporate tax payable.

In each of these cases, the issuing corporation will generally elect to pay tax at 40% with the result that the shareholder will not be required to pay the additional 10% tax. In each case, the shares may be supported and retractable after five years, provided that such support is not secured. Also, there is no limit on the percentage of the class which may be held by any corporation including, generally speaking, a specified financial institution. Further, the shares need not be listed.

Finally, in some circumstances it is possible for a non-taxable parent corporation issuing taxable preferred shares to shift liability for the Part VI.1 tax down to a controlled taxable subsidiary where it can then be deducted from Part I tax payable by the subsidiary.

Typically, where junior oil and gas companies have offered preferred shares, the offerings have been convertible preferred shares in order to attract interest in the market.

4. Convertible Debentures

The current stock market uncertainty has caused at least a short term revival in bond markets and a consequent increase in debt offerings as evidenced by the current offerings of American Express, Johnson & Johnson, General Electric Credit Corp. and Chrysler Financial Corp.

Taking into consideration the reduced value of interest deductibility resulting from the lower corporate tax rates applicable in 1988, the applicability of Part VI.I Tax on dividends paid on taxable preferred shares and the Part I deduction available in respect of payments of Part VI.I Tax, the after-tax cost of debt financing (even for a taxable issuer) will continue to be less in 1988 than the cost of preferred share financing.

Convertible debentures have been popular in the market in 1987. For example, Sceptre Resources Ltd. did an issue of convertible debentures in the spring of 1987 with a conversion price of \$4.50 (a 12.5% conversion premium), a 7% coupon and a two year non-call period. Sceptre can force redemption if the trading price of the shares reaches \$6.00.

Encor's issue of convertible debentures carried a ten dollar conversion price (a 29% conversion premium), a 6 3/4% coupon and a five year non-call period.

5. Adjustable Rate Convertible Subordinated Debentures

Adjustable rate convertible subordinated debentures are essentially a common share substitute with "tax deductible dividends" aimed at non-taxable investors such as pension funds and RRSP's. The recent offerings by Norcen Energy Resources Limited were modelled after the successful Labatt offerings.

The most recent John Labatt offering carried a relatively low conversion premium and a yield starting at 5% and increasing as the dividend on the common shares increases, but which is always at least 1% higher than on Labatt common shares. As a result, investors have an opportunity to fully participate in dividend growth and capital appreciation.

For the issuer, the after-tax cost of the financing is lower than the cost of dividends on common share because the interest is deductible. The company has the option at maturity to redeem the debentures using common shares instead of cash and if at any interest payment date it believes it would be insolvent after paying the interest, it may elect to pay the interest in common shares. These later two features ensure that the rating agencies will treat the debentures as equity in calculating balance sheet ratios.

6. Asset-Backed Securities

Creating an asset-backed security involves a corporation either using its assets as collateral securing bonds or other securities issued by the corporation or selling interests in the assets in the form of securities.

(a) The Basic Structure

The basic structure of an asset-backed securitization usually involves the sale of assets to another vehicle (often a partnership, trust or joint venture) which then uses the asset to secure funding of a public or private issue of securities. The vehicle is used to avoid consolidation treatment for either accounting or tax purposes. Variants in the basic structure result from legal, tax, accounting and regulatory considerations.

This corporation (typically designated by the suffix NT) then issues: (i) capital shares which entitle holders to participate in increases in the capital value of the underlying bank shares and (ii) participating redeemable retractable preferred shares which entitle holders to receive all dividends paid on the underlying bank shares.

Capital shares are issued directly to the public and the redeemable preferred shares are issued to a second newly created issuer which then issues preferred shares to the public which are retractable only after 6-7 years.

This two-issuer structure permits the first issuer to qualify as a mutual fund corporation for tax purposes while at the same time forestalling a premature winding-up of the offering. Retraction of the capital shares is discouraged by imposing a discount from market price on retractions. Market-making by the dealer and redemptions are used to keep the numbers of the two class of shares in balance.

It is also possible to avoid the mutual fund complication, and the two-tier structure which it involves, by issuing installment receipts instead of capital shares. The installment receipts entitle their holders to all capital appreciation of the underlying securities, but may not be eligible investments for all purchasers.

8. Alberta Stocks Savings Plans Offerings

For a number of reasons, the Alberta Stock Savings Plan ("ASSP") has been less successful than originally anticipated. In part, this has been due to the lack of liquidity in ASSP securities resulting from the provision in the legislation that any investor who withdraws eligible shares from a stock savings plan

(b) Mortgage Backed Securities

The most common example of asset-back securities are mortgage-backed securities such as the current MBS 87-2 offering by Merrill Lynch of securities representing undivided interests in a portfolio of first mortgages acquired from London Life.

Issuing mortgage-backed securities allows a trust company or other owner of mortgages to convert a pool of mortgages into cash before the stated maturity of the mortgages.

The recent Canadian issues of NHA mortgage-backed pass-through certificates are exempt offerings of undivided interests in a pool of residential fixed mortgages secured by the value of the underlying real estate and unconditionally guaranteed as to timely payment of principal and interest by CMHC.

There is a technical difficulty under the Securities Act (Alberta) which results in uncertainty as to whether pass-through mortgage-backed certificates carrying a guarantee of timely payment from a financial institution or government (such as the CMHC NHA Mortgage-backed Securities Program) are exempt securities.

Although there is a technical argument that investors acquiring pass-through certificates are acquiring an ownership interest in the underlying mortgages and that the Section 66(e) exemption is therefore applicable, there is Ontario case law which makes clear that the normal pass-through structure for mortgage-backed securities does not qualify for this exemption.

The alternative is to consider pass-through securities as constituting evidences of indebtedness guaranteed by the

government of Canada or a financial institution and to rely on the Section 66(a) exemptions. However, a certificate representing a pass-through security does not normally represent or constitute indebtedness of the issuer to the investor. Although, there is U.S. case law supporting the proposition that pass-through securities constitute evidences of indebtedness for U.S. securities law purposes, there are those who take a contrary view.

(c) Other Examples of Asset-Backed Securities

The issue of 11.25% Secured Bonds in January, 1986 by Nova Realty represents a Calgary-based example of the securitization of an office building along the lines of the December, 1985 issue of Olympia and York 240 Sparks Street Limited 10.8% Bonds (but without the strip bond credit enhancement feature).

The Nova transaction was structured through Nova Realty Associates, a limited partnership constituted with a Shearson Lehman subsidiary as general partner and U.S. individuals as limited partners. The partnership purchased Nova's Calgary head-office building in consideration of a \$157 million first mortgage bond and rented the building back to Nova pursuant to a net lease.

NovaCorp Realty Finance, incorporated for the sole purpose of refinancing the original mortgage bond, purchased the bond from Nova in return for a secured bond of NovaCorp Realty. NovaCorp then repurchased this bond with the proceeds from a public offering of bonds secured by the value of the underlying real estate and unconditionally guaranteed as to timely payment of principal and interest by CMHC.

(d) The Future of Asset-Backed Securities

In a bad market, asset-backed securities may prove to be one of the few viable financing techniques. In this regard, almost any asset capable of constituting acceptable security can be securitized.

Petroleum industry-related examples of assets which can and have been securitized include prepaid gas, pipeline throughput contracts, gas plants, royalty income streams and the tax benefits of drilling expenditures.

The following examples of Alberta-based securitizations of petroleum industry related assets may serve to illustrate the types of opportunities which may arise in the coming year.

(i) The Topgas Arrangements

TransCanada Pipelines Topgas arrangements are a prominent example of securitization, although they may not be readily recognized as such.

Prior to closing the Topgas transaction in 1982, TCPL carried on its balance sheet as a non-productive asset over \$1 billion of prepaid gas financed by \$733 million of term loans and \$280 million of retractable preferred shares. This gas had been purchased by TCPL pursuant to its contractual take-or-pay obligations requiring TCPL to purchase a minimum level of contracted gas even if it is unable to nominate such gas for delivery.

Topgas Holdings is owned by a charitable trust for the benefit of a to be determined Alberta beneficiary but controlled by a syndicate of Canadian and foreign banks. The banks advanced \$2.28 billion to Topgas, which was used

to replace TCPL's prior gas pre-payments and future pre-payment obligations to Alberta producers, thereby permitting TCPL to eliminate an equivalent amount of debt from its balance sheet.

TCPL is now obligated to nominate sufficient pre-paid gas annually to repay 10% of the principal of the bank loan. Interest and fees are paid as part of the Alberta Cost of Service. TCPL indemnifies Topgas for losses arising due to the inability or failure of Alberta producers to deliver prepaid gas or Topgas's failure to recover interest through the Alberta Cost of Service. The banks, which advanced the funds at 70% of prime plus 7/8 of 1%, do not have an actual security interest in either the gas reserves or TCPL's contracts, but rather take comfort from a series of amendments which added certainty to the terms and cash flows from TCPL's contracts.

(ii) Interprovincial Pipeline Debentures

Another example of the securitization of an oil and gas asset is the November 1984 issue by Interprovincial Pipeline (NW) Ltd. of a \$75 million issue of 12.70% Debentures secured by an assignment of Interprovincial's Norman Wells Pipeline Agreement with Imperial Oil Limited. Under the terms of the pipeline agreement, Imperial is required to pay to Interprovincial amounts sufficient to enable Interprovincial to service the debentures.

7. Split Preferred Offerings

In a typical split preferred share offering, such as RYII/RY NT, BMO II/BMO NT and CM Pref. Corp./CM NT Equity Corp., a legal-for-life corporation is set up by an investment dealer to purchase common shares of a Canadian chartered bank or other blue-chip issuer.

before two years following the end of the calendar year in which they were contributed is subject to recapture of the tax credit unless he acquires substitute ASSP qualified shares having at least the same tax credit value. In addition, the incentives are less generous than those in the similar Quebec program and the restrictions on eligibility for large issuers, employee stock plans, etc. are more constraining.

There has, however, been one recent notable ASSP offering. During the summer of 1987, Alberta Treasury issued an ASSP certificate of eligibility to Altafund Investment Corp., corporation investing primarily in securities of Alberta based issuers. The offering consisted of \$40 million of units made up of ASSP qualified common shares and warrants entitling the holder to purchase further ASSP qualified securities in 1988 and 1989.

Investors are entitled to a credit against Alberta provincial income tax of 30% of the subscription amount. In 1992, after the two year recapture period applicable to the third tranche under the ASSP has terminated, a special resolution will be presented to shareholders of Altafund to approve the conversion of Altafund into an open-ended mutual fund corporation, thereby assuring investors of ultimate liquidity. Alberta Treasury has made clear that it will not in the future issue ASSP certificates of eligibility in circumstances similar to those involved in the Altafund offering.

9. Junior Capital Pools

In 1987, the Alberta Securities Commission has continued at a rapid pace to receipt prospectuses for Junior Capital Pool Offerings ("JCP's"). JCP issuers must be conditionally listed for trading on the Alberta Stock Exchange prior to issuance of a prospectus receipt. Notable offerings include Jordan Petroleums, Jani International and Sun Ice.

A JCP offering is typically a relatively small (\$50,000 - \$150,000 offering) by a shelf issuer with no business and no significant assets other than management, cash invested by the promoter and the proceeds of the offering.

JCP's are subject to detailed regulation under Alberta Securities Commission Policy 4.11 and Alberta Stock Exchange draft circular No. 7 (the "JCP Policies").

The purpose of a JCP is to enter into a major transaction whereby it acquires an existing business or assets, usually by way a reverse takeover in which the JCP issues treasury shares and control of the JCP usually transfers to the acquired company.

At the time it engages in its major transaction, the JCP must file an information circular giving prospectus level disclosure on the proposed takeover and which is subject to vetting by the Alberta Securities Commission. The transaction must be approved by the majority of the minority of the JCP's shareholders.

Promoters shares are subject to escrow arrangements, with full escrow release taking place in stages in the three years after a major transaction has been identified.

Although such a pre-arranged plan would be in express contravention of the JCP Policies, I am aware of one instance where a junior resource issuer with unproven properties found it easier and cheaper to access the market by clearing a prospectus for a JCP and then rolling its existing assets into the JCP rather than clear the issue pursuant to the Junior National Resource Policy.

10. Normal Course Issuer Bids

One immediate consequence of 'black' Monday has been the resurgence of corporate stock repurchases. In Canada, the list of companies which have announced stock buy-backs include Olympia and York Developments Ltd.'s announcement of its intent to repurchase up to 15 million common shares of Gulf Canada Resources Ltd. and up to 6.9 common shares of Abitibi-Price and the corporate share repurchases announced by Derlan Industries Ltd., Fleet Aerospace Corp., International Pagurian Corp, LSI Logic Corp of Canada Inc., Elite Insurance Management Ltd., Central Capital Corp. and Cabre Exploration Ltd.

The Toronto and Montreal stock exchanges have both implemented temporary policies waiving the requirement that companies wishing to buy back their own stock file a notice of intention and wait 10 trading days before proceeding with a normal course issuer bid. Instead, listed companies are now required merely to notify the exchanges of their intention to purchase shares.

Subject to exchange approval, companies may begin buying back their securities 24 hours after dissemination of a press release announcing their intention. Companies must file weekly press releases disclosing the number and prices of any securities purchased.

There are now no restrictions on monthly purchases, but, as usual, companies may not purchase more than 5 percent of any class of their securities issued and outstanding or 10 percent of the public float of any class in a one year period. But there will be no restrictions on monthly purchases.

D. NEW TECHNIQUES

1. Special Warrants

Special warrant transactions have become increasingly popular in the last year as a method of permitting issuers not meeting the requirements to qualify for the Prompt Offering Prospectus ("POP") system to nevertheless offer securities within the attenuated time frame usually available only to POP system issuers.

In the typical special warrant deal, the issuer either directly or through agents, in reliance on a prospectus exemption, places special fully-paid warrants with institutional investors.

Each warrant entitles the holder to purchase common shares of the issuer at an exercise price equal to one special warrant per share. The terms of the purchase agreement underlying the transaction impose an obligation on the issuer to prepare, file and clear a prospectus to qualify the underlying securities within a specified time period, typically with financial penalties for breach.

Subsequent to issuance and settlement in respect of the warrants, the shares are qualified by way of a conventional long-form prospectus.

2. Bought Deals

As a result of 'black' Monday, bought deals may at least temporarily be a thing of the past, with the possible exception of debt financings where the underwriters can effectively apply hedging techniques to eliminate the market risk occasioned by fluctuating interest rates.

I am aware of at least one Calgary-based bought deal (with no market out clause) in which an underwriter was left holding equity securities of an intermediate resource issuer.

3. Restricted Voting Shares

Restricted common shares are a method of raising capital while at the same time allowing an existing controlling shareholder to retain control.

The recent offering by Wardair Inc. of Class "A" subordinate voting shares included an interesting special escrow arrangement designed to permit the Ward to retain voting control while at the same time protecting public shareholders from a sale of control at a premium.

The offering was structured after the Ontario Supreme Court had rendered its decision in Bowater Canadian v. R. L. Crain. That decision struck down a step-down provision reducing the votes attached to a class of voting securities upon a change of their ownership as offending the fundamental principle that share rights attach to the shares themselves and not to specific shareholders.

In the Wardair transaction, Wardair Inc., a legal-for-life company, acquired the shares of Wardair International Ltd. The Ward family received Class "B" Voting Shares of Wardair Inc., each carrying 12 votes per share until such time as the holders of 50% of the shares serve notice requiring that the voting rights be reduced to one vote per share. The remaining shareholders of Wardair International acquired single-vote Class "A" subordinate voting shares.

The Class "B" super-voting shares were subjected to an escrow arrangement which prohibited the transfer of the Class "B" shares outside of the Ward family unless the Class "B" shares were first converted into Class "A" subordinate voting shares, except in the circumstance where the shares are being transferred pursuant to an identical tender offer being given to all shareholders.

In other offerings (eg., Repap Enterprises and Onyx), a trust agreement prohibits transfer of the super-voting shares outside of a defined group without their conversion into restricted voting shares.

E. NEW PLAYERS

1. Regulated Financial Institutions

A number of federally-regulated banks, life insurance companies and trust companies which have recently formed securities subsidiaries under the new federal and Ontario provisions are seeking exemptive relief from the Alberta Securities Commission to permit them to sell securities in Alberta under more flexible conditions than have been permitted to date under the Section 185 order granted to The Toronto-Dominion Bank in May, 1987 in connection with its Green Line Investor Service.

(a) The Situation Prior to Toronto-Dominion Greenline

Trust Companies are permitted to trade securities of mutual funds through their offices so long as such funds are promoted, managed and administered by the trust company and provided that no sales or other acquisition changes are levied.

Similarly, the Alberta Commission has from time to time granted Section 116 exemption orders exempting individual banks from the dealer and sales person registration requirements of the Securities Act (Alberta) in respect of trades in mutual funds promoted by the bank. The orders allow the banks to trade in units of their mutual funds only through their branches in Alberta, prohibit sales charges and restrict the bank's advertising to advertising within bank premises and to the distribution of material outside the bank only to existing bank customers.

Insurance companies have been permitted to market mutual funds through dual licensed salesmen pursuant to Alberta Policy No.3.7.

(b) The Toronto-Dominion Greenline Decision

The Greenline Decision goes further than these prior policies by permitting the registration of The Toronto-Dominion Bank as a securities dealer in Alberta for the limited purpose of offering its Greenline Investor Service. The order was granted on a number of conditions including a requirement that Toronto-Dominion's senior vice-president, Alberta division be responsible for approving the opening of new accounts and the supervision of trades for Alberta clients and that Toronto-Dominion establish an office in Alberta for administration of Alberta client files and staff such office with registered non-commission salesmen.

The order limited Toronto-Dominion to dealing with customers who possess sufficient investment experience to make their own investment decisions or who have access and intend to rely on the advice of someone with sufficient investment experience. It prohibited Toronto-Dominion from

advising clients on the purchase and sale of securities and, in that context only, permitted Alberta customers to place their orders through Ontario or Alberta registrants located at Toronto-Dominion's trading desk in Ontario for execution through registered dealers with offices in Alberta.

(c) The Current Applications

The orders currently being requested by the new subsidiaries of the banks would generally go considerably further than the Toronto-Dominion Greenline order, permitting: (i) selling through an 800 number in Toronto, (ii) national advertising and (iii) unregistered bank employees to answer questions related to prospectuses.

Whether the Alberta Commission will respond to requests for such orders prior to the report of the Cashion committee remains to be seen. In view of the seeming sales abuses disclosed in the Principal affair, the Alberta Commission may not be as receptive as some believe to permitting financial institutions to offer an array of products to their customers without extensive regulation.

2. Related and Connected Issuers

One recent offering of a tax shelter security in Alberta involved participation by the in-house investment dealer of a major Canadian life insurance company as agent for the issue and the participation by a trust company subsidiary of the life insurance company as promoter of the offering.

Although there were technical arguments that the offering did not fall within the related issuer provisions of the new Ontario

Securities Act Regulation in that the issuer dealt at arms length from the underwriter, the Ontario Commission nevertheless took the view that the dual underwriter requirement was applicable to the offering.

In response to a Section 208 application for an exemption from the dual underwriter requirement, the Ontario Commission granted the requested order on condition that the dealer comply with the requirements of Sections 198 and 201 of the Ontario regulation which came into force September 30, 1987. These provisions require prospectus disclosure of the relationship between the related or connected parties, including a bold face cross-reference on the face of the prospectus and bold face disclosure in a letter accompanying the prospectus. The Alberta Commission imposed similar disclosure requirements.

3. Networking Arrangements

The same offering involved distribution through a limited networking arrangement whereby the agent sells to customers of dual licensed insurance salesmen of the parent life insurance company, paying a commission to the life company and its agents.

The Ontario and Quebec Commissions have permitted the distribution of the securities pursuant to this networking arrangement, but the Alberta and British Columbia Commissions have not yet come to a decision on the arrangement.

F. CONCLUSION

In today's uncertain market, no future trends in financing techniques can be predicted with certainty. My personal view is that the current market correction has not yet run its course. Continued volatility, with its negative impact on certainty in financing alternatives, may persist for some time to come.

For those who are not faint of heart, the best opportunities may be in acquisitions of undervalued issuers before the market returns to fundamentals.

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