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How far do you have to go?

Examining the impact of “best efforts,” “commercially reasonable,” “reasonable,” and “good faith”

by Simina Ionescu-Mocanu

Introduction

Language such as “good faith,” “acting reasonably,” “best efforts,” and using “commercially reasonable efforts” is often encountered in banking loan and security documentation. The obvious question becomes: what is the significance of these terms and how are they interpreted?

The answer appears to be, that in Canada, the four concepts show varying degrees of responsibility. Indeed, according to some authorities, the terms may be placed on a continuum, with “best efforts” having the most significant impact and the duty of “good faith” being the least onerous.

In Alberta, “good faith” is likely implied and may not need to be specifically stated in the contract’s terms. In commercial transactions such as lending agreements, however, parties may prefer to agree to a standard of “commercial reasonableness” in accordance with the practices of the particular industry.

“Best Efforts”

The term “best efforts” originates from English jurisprudence and is probably the most stringent phrase in the collection.

In Canada, the leading case on the subject suggests that “best efforts” imposes a higher obligation than mere “reasonable efforts.” “Best efforts” means “taking, in good faith, all reasonable steps to achieve the objective, carrying the process to its logical conclusion,” and “leaving no stone unturned.” The term includes doing “everything known to be usual, necessary and proper to ensure the success of the endeavour...”¹

The above implies that “best efforts” necessitates a significant standard of conduct. Certainly, the notion of “leaving no stone unturned” is quite onerous, particularly from a financial perspective, and should give a party contracting on a “best efforts” basis a moment of second thought. Another, and perhaps a more appealing, choice of language in some circumstances may be “commercially reasonable.”²

“Reasonable” and “Commercially Reasonable”

Less onerous alternatives to “best efforts” are “acting reasonably” or using “commercially reasonable” efforts. The concept of “commercial reasonableness” is derived from American jurisprudence and is sparsely defined in Canadian law.

In Canada, “commercially reasonable” implies an objective and pragmatic standard of conduct that is established by existing business practices.³ In personal property securities contexts, “commercial reasonableness” refers to the type of behaviour exhibited by “the reasonably prudent business person in similar circumstances.”⁴ “Commercially reasonable” has also been described as “keeping with the prevailing trade practices among reputable and responsible business and commercial enterprises engaged in the same or a similar business.”⁵

On its own, the term “reasonable” (often seen as “acting reasonably”) stems from many contexts, the most popular of which is tort law. In the law of contracts, “reasonable judgment” implies “sound judgment, a sensible view, a view that is not absurd.”⁶

Similar to “commercially reasonable,” the term “reasonable” has also been found to impose an objective standard of conduct. However, the concept of pure reasonability is less stringent than “commercially reasonable,” since it lacks the goal of profit or financial gain⁷ and does not necessitate a connection to an established commercial practice.

“Good Faith”

Cases generally define “good faith” as the lack of bad faith, unfairness, fraud, or wilful misconduct, or the absence of reckless and improvident behaviour (although the term has evolved in the last few decades from the absence of bad faith to a more positive duty of fairness, openness, and honesty).

For several reasons, “good faith” likely imports the lowest degree of responsibility of the four standards. First, in most Canadian provinces, it is generally accepted that parties who have entered into binding contracts must perform their respective obligations in “good faith.”⁸ Second, unlike “commercial reasonableness,” which is judged objectively, “good faith” is closely connected with parties’ intentions and is therefore judged from a subjective point of view. This stems from the fact that the standard may be met through an honest yet unreasonable belief, which makes it possible for a party to act unreasonably and in “good faith” at the same time.

Conclusion

When creating lending contracts, drafters and lawyers should first determine the degree of effort necessitated in the contract’s performance or obligation.

In Alberta, “good faith” is likely implied and may not need to be specifically stated in the contract’s terms. In commercial transactions such as lending agreements, however, parties may prefer to agree to a standard of “commercial reasonableness” in accordance with the practices of the particular industry. This choice ensures that parties’ efforts are guided, or, more importantly, constrained by common business practices. If the desire is to ensure that parties take all steps necessary (and perhaps without financial limitation) to secure the success of a particular endeavour, the more desired phrase may be “best efforts.”

No matter which standard is used, it is important to keep in mind that each of the above terms is sufficiently broad to allow a range of interpretations. Add to that the possible variation in a court’s interpretation of any contract language, and parties should recognize that the selection of specific language may not always be a guarantee as to the outcome.

Footnotes

¹ *Atmospheric Diving Systems Inc. v. International Hard Suits Inc.* (1994), 89 B.C.L.R. (2d) 356 (S.C.), at para. 75.

² The Canadian Bar Association, “What Should Your Client Agree to? ‘Best Efforts’ v ‘Commercially Reasonable Efforts’”, *Bar Talk* (April 2002).

³ McLaren, Richard H., *The 2008 Annotated Alberta Personal Property Security Act* (Toronto: Thompson Canada Limited, 2008) at p. 384.

⁴ *Ibid.*

⁵ See also E. Mirth, Q.C., “Good Faith Duties of Secured Parties and Receivers Under the Personal Property Security Act” (1992), 30 Alta. L. Rev. 1216-1232, at 1226.

⁶ 364511 *Ontario Ltd. v. Darena Holdings Ltd.* (1999), 120 O.A.C. 280 (C.A.)

⁷ *Ibid.*

⁸ One province which may deny this duty is Manitoba (See *Imasco Retail Inc. v. Blanaru* (1995), 104 Man. R. (2d) 286 (Q.B.), aff’d at (1996), 113 Man. R. (2d) 269 (C.A.)).

Legal Opinions: they are not insurance

by Christie Martin

Introduction

More often than not, banking transactions incorporate legal opinions issued to the lender by the borrower's counsel, the lender's counsel, or both. These opinions, rightly or wrongly, have come to serve many purposes:

- they provide a road-map and document trail for a transaction, which is particularly helpful at a later time when amendments may become necessary,
- they help focus counsel's review and highlight potential issues to the parties that may not be apparent until considered in the context of an opinion; and
- they provide the lender with some comfort that counsel has vetted the loan documents and provided some measure of approval.

Reasons Opinions Are Not Insurance

Opinions, however, should not be considered to be insurance or in any sense a guarantee. There

are many ways that an opinion can be incorrect without any negligence on the part of the opinion provider. Why is this the case?

- Opinions provide legal conclusions that require some level of reliance on facts given to the opinion provider. For example, opinion providers usually rely on an officer's certificate of the borrower which sets out certain facts about the borrower. If these are incorrect then the legal opinion that relies on the factual statements may also be incorrect. For example, consider a statement that "The Borrower does not own assets in, nor conduct any business in any jurisdiction other than Alberta." If in fact it does, then the portions of the legal opinion which address the due registration of security or its enforceability may be incorrect in certain aspects.
- Where an enforceability opinion is provided (that is, "the loan documents constitute a

legal, valid and enforceable obligation of the Borrower and are enforceable in accordance with their terms") there is often a set of 'qualifications' that follows. The qualifications state limited sets of circumstances or conditions under which the enforceability opinion may be inapplicable or not available. Qualifications may highlight legitimate points of law that are either contrary or unsettled but which may be applicable to the transaction at hand. Qualifications are often one of the more negotiated portions of opinions, particularly where counsel is outside of Alberta, as qualifications tend to vary amongst jurisdictions.

Summary

In summary, while legal opinions serve many useful purposes, lenders should be aware that the legal opinion should not be viewed as "blessing" a transaction or as any form of "good housekeeping seal of approval."

Resolutions in Lieu of Best Practices for Boards with “Conflicted”

by Simina Ionescu-Mocanu

Introduction

As a general rule, directors may only pass resolutions at a duly constituted meeting of the board. Nevertheless, corporate statutes throughout Canada provide that a resolution in writing signed by all of the directors entitled to vote on that resolution is as valid as if the resolution had been passed at a meeting.¹ Since it may not always be possible to hold directors' meetings, corporations have eagerly adopted the practice of passing motions through the “round-robin” resolution.

Conflict of Interest: Directors' Right to Vote Following *Western Canadian Coal Corp. v. Fawcett*

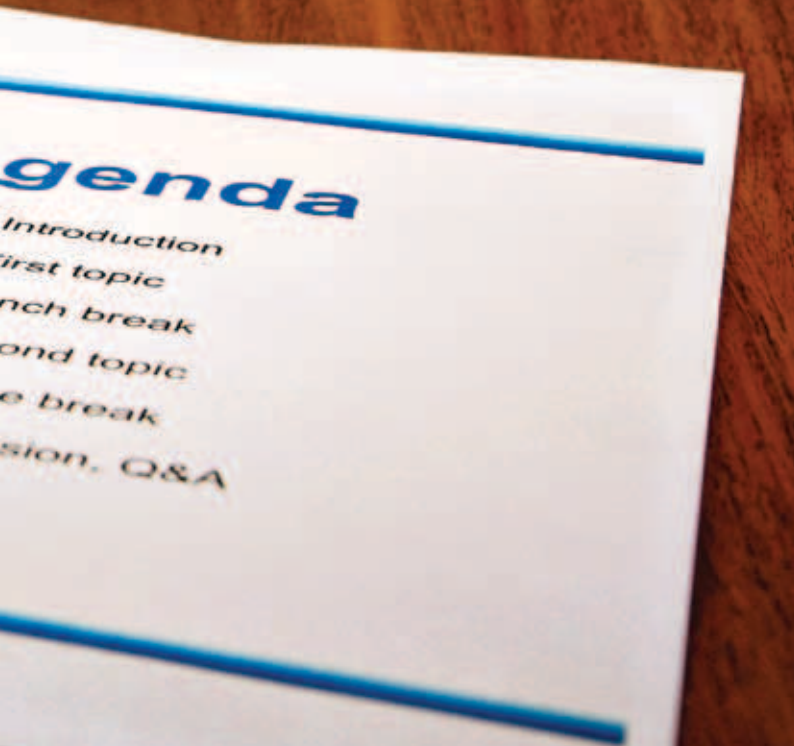
A director who has a personal or a professional conflict of interest must fully disclose such interest.² In addition to disclosure, the “interested” director must also abstain from voting on a motion approving the transaction in question. This rule is easy to implement if the resolution is passed at a meeting of the directors; it is less so in the case of a resolution in lieu of a meeting.

Prior to the British Columbia Supreme Court case of *Western Canadian Coal Corp. v. Fawcett* (“*Fawcett*”),³ the general corporate practice was to allow a “conflicted” director to execute a written resolution, so long as the resolution stated that the sole purpose of the director's signature was to comply with the execution requirements laid out in the corporate statutes.

In *Fawcett*, two directors who had a conflict of interest followed this procedure. The recitals of the resolution approving the transaction not only outlined the two directors' interests, but also explained that the directors' signatures were provided only to ensure compliance with the requirements of section 125 of the *British Columbia Company Act* (the “*Company Act*”).⁴ The resolution explicitly stated that the directors abstained from voting on the contemplated transaction. Section 125 was worded as follows:

- (1) A resolution of the directors or of any committee of them may not be passed without a meeting, except as permitted by subsection (3).

Meeting: Directors



- (3) Unless the articles provide otherwise, a resolution of the directors... may be passed without a meeting if all the directors... consent to the resolution in writing and the consent is filed with the minutes of proceedings of the directors or the committee [emphasis added].

Based on this language, the Court held that the company's directors had two options: they could hold a meeting to approve the transaction or they could pass a consent resolution in writing, *if* all of the directors consented to the resolution. Since the two directors who had an interest in the proposed transaction abstained from voting, they did not (and could not) consent to the resolution. In the view of the Court, it was impossible to consent to a resolution and to abstain from voting on it at the same time.

In a more recent case of *Witzel Capital Corp. v. LED Medical Diagnostics Inc.* ("Witzel")⁵, the British Columbia Supreme Court recognized the

limiting impacts of *Fawcett* on the decision-making abilities of directors. However, in light of the stringent wording of the British Columbia statute, the Court was forced to concur with the *Fawcett* decision.⁶

Courts in other provinces have not judicially considered *Fawcett* on this issue. Nevertheless, academics and legal writers have consistently distinguished the case by drawing attention to the different wording contained in other corporate statutes throughout the country.⁷ For instance, the corresponding provision in the *Canada Business Corporations Act* ("CBCA") provides as follows:

A resolution in writing, signed by all the directors entitled to vote on that resolution at a meeting of directors... is as valid as if it had been passed at a meeting of directors...⁸ [emphasis added].

The difference between the two statutory provisions is noteworthy. The use of the words "entitled to vote" may very well distinguish the finding in *Fawcett* in the case of a corporation incorporated under the CBCA or Alberta *Business Corporations Act* ("ABCA").⁹

In 2004, the Government of British Columbia repealed the *Company Act* and subsequently enacted the *Business Corporations Act* (the "BCBCA"),¹⁰ thereby further diminishing the effect of *Fawcett* in the province of British Columbia. Subsection 140(3) of the BCBCA currently mandates the following:

A resolution of the directors or of any committee of the directors

(a) may be passed without a meeting in any of the following circumstances:

- (i) in the case of a resolution to approve a contract or transaction in respect of which a director has disclosed that he or she has or may have a disclosable interest, within the meaning of Division 3, if each of the other directors who have not made such a disclosure in respect of the contract or transaction and who are entitled to vote on the resolution consents in writing to the resolution ... [emphasis added]

The new language in 140(3) provides even more context to the words "entitled to vote" by specifying that execution in a written resolution is needed only from the directors who do not have a "disclosable interest."

Best Practices

As mentioned above, directors who have an interest in a proposed contract or transaction are precluded from voting on a resolution approving such transaction.

(a) Corporations with Two or More Directors

The optimal practice for corporations with two or more "conflicted" directors is to forego the written resolution in favour of a duly constituted meeting of the board. Of course, the conflicted directors will have to absent themselves from discussing the transaction and refrain from voting during the meeting.¹¹

No matter which practice is chosen, in all cases, the existence of a conflict by a director in respect of matters coming before the Board, ought to be recorded in the corporation's minute book. In the case of board meetings, directors may wish to outline the reason for the abstention in the meeting minutes.

Nevertheless, if a formal meeting is impossible or impractical, as explained above, boards still have the option of circulating a "round-robin" resolution, particularly given the predominant use of the words "entitled to vote" found in most corporate statutes in Canada.¹² This resolution should be executed by the non-conflicted directors only.

(b) Single Director Corporations

Decision-making in single director corporations may bring about different queries.

Neither the *CBCA* nor the *ABCA* specify what must be done when a corporation has only one director. In these cases, disclosure to the board is meaningless because the director is effectively disclosing an interest to himself/herself.¹³ In fact, it is difficult to envision how a contract or transaction can be approved if the director is forced to refrain from acting due to his/her interest in the contract.

It is important to note that the voting restrictions imposed on directors who have an interest in a transaction do not apply to shareholders who also act as directors. Subject to very limited exceptions, courts will not invalidate a shareholder's vote simply because the shareholder has a personal interest in a contract; a shareholder has a right to vote regardless of conflict.¹⁴

As such, in cases where a sole director corporation has other shareholder interests, the better practice is for the director to disclose the interest to the shareholders and to seek their approval or confirmation of the transaction in question.¹⁵ This can be done through a special resolution at a meeting of the shareholders.¹⁶ Directors may follow the same practice if the single director is also the sole shareholder of the corporation.

Some legal writers have gone so far as to suggest that disclosure by the "interested" or "conflicted" director may not be required if there are no minority shareholder interests and if the corporation remains solvent at the time when the contract or transaction is approved.¹⁷ Although this option makes sense from a practical perspective, considering the consequences of an invalid resolution, directors should proceed with caution.

Conclusion

No matter which practice is chosen, in all cases, the existence of a conflict by a director in respect of matters coming before the Board, ought to be recorded in the corporation's minute book. In the case of board meetings,

directors may wish to outline the reason for the abstention in the meeting minutes. Alternatively, if the directors opt for a round-robin resolution to be executed by the non-conflicted directors only, it may be wise to disclose the abstention and the nature of the conflict in the preamble of the written resolution.

Footnotes

¹ See Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9 ["**ABCA**"], s. 117(1), the Ontario *Business Corporations Act*, R.S.O. 1990, c. B-16, ["**OBCA**"], s. 129(1), and the Canada *Business Corporations Act*, R.S.C. 1985, c. C-44 ["**CBCA**"], s. 117. It should be noted that the corporate legislation in effect in Prince Edward Island does not allow written resolutions in lieu of a meeting.

² *CBCA*, *ibid.*

³ 2006 BCSC 463.

⁴ R.S.B.C. 1996, c. 62.

⁵ 2009 BCSC 1000.

⁶ *Ibid.*, at para. 97. The Court admitted that the finding in *Fawcett* may have been based on an "unintended consequence" of the Company Act.

⁷ Nathan, Hartley R. and Mihkel E. Voore, *Corporate Meetings Law and Practice* (looseleaf) (Scarborough: Carswell, 2008) at 11-13.

⁸ *CBCA*, *supra* note 1, s. 117(1). See also *ABCA*, *supra* note 1, s. 117(1); *OBCA*, *supra* note 1, s. 129(1).

⁹ *The Directors Manual* (loose-leaf) (New York, Ontario: CCH Canadian Limited Business Library, 2008) at para. 10-350.

¹⁰ S.B.C. 2002, c. 57.

¹¹ *Supra* note 7; see also *supra* note 9.

¹² Carol Hansell, *Directors and Officers in Canada: Law and Practice* (loose-leaf) (Toronto: Thompson-Carswell, 2008) at 6-66; see also *supra* note 9 and *supra* note 7.

¹³ McGuinness, Kevin, *Canadian Business Corporations Law*, 2nd ed. (Markham: LexisNexis Canada Inc., 2007) at 852.

¹⁴ Nathan, Hartley R., *Nathan's Company Meetings Including Rules of Order*, 7th ed. (Toronto: CCH Canadian Limited, 2007) at p. 19.

¹⁵ *Ibid.*

¹⁶ *CBCA*, *supra* note 1, s. 120(7.1), which provides that a transaction for which disclosure may be required will not be invalid by reason only of the interest of the director in the contract or transaction, IF (a) the contract or transaction is approved or confirmed by special resolution at a meeting of the shareholders; (b) disclosure of the interest is made to the shareholders in a manner sufficient to indicate its nature before the contract or transaction was approved or confirmed; and (c) the contract or transaction was reasonable and fair to the corporation when it was approved or confirmed [emphasis added]. See also *ABCA*, *supra* note 1, s. 120(8) (slightly different wording; allowing approval by the corporation's shareholders and directors).

¹⁷ *Supra* note 13.



What We've Been Up To

BD&P recently offered a 4 part luncheon seminar series for junior bankers entitled Fundamentals of Banking Law which included the topics of Demand & Term Loan Agreements, Guarantees & Indemnities, Security Documentation & Priorities and Legal Opinions.

BD&P recently offered a 4 part luncheon series to mid and senior level bankers entitled Banking in Today's World which included the topics of Developments in the Syndicated Credit Market, Current Trends and Preparation for Insolvency, Coordinating Your ISDA with Your Credit Agreement and IFRS – Selected Impacts on Borrowers & Lenders.

The Banking & Finance Team would be pleased to customize any of our presentations or seminars to meet the needs of any of our clients who have sufficient interest to make a private seminar useful to them.

What Constitutes

by Byron Chan

Introduction

In the context of a loan agreement, the term “material” is often used as a qualifier to certain definitions and representations and warranties. It is not unusual to find references to terms such as a *material* adverse effect, *material* contracts or *material* subsidiaries. While a common sense interpretation leads the reader to infer that a term immediately preceded by the word “material” implies something more substantial or significant, the agreement often does not provide a clear definition as to what exactly constitutes materiality. Faced with such uncertainty, the reader is often left wondering what determines the threshold as to whether something can or should be classified as “material.”

While there does not appear to be much literature that specifically addresses the concept of materiality in the context of a loan agreement, consulting legal sources that examine and discuss materiality in other contexts can provide a helpful starting point.

A Variety of Definitions and Contexts

In *Black’s Law Dictionary* (7th ed.),¹ “material” is defined as:

3. Of such a nature that knowledge of the item would affect a person’s decision-making process; significant; essential <material alteration of the document>.

Other dictionaries define “material” using words such as “pertinent,” “essential,” “relevant,” “serious,” “important,” “of consequence,” “significant” and “influential.”

The U.S. Financial Accounting Standards Board came up with the concept of a “material item” to apply some constraints—defining it as: “an omission or misstatement of accounting information that in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item.”² The U.S. Securities and Exchange Commission’s definition of “material” is an item “about which an average prudent investor ought reasonably to be informed.”³

In the context of civil practice and procedure, “material” has been defined as “that which goes to the foundation of the decision or which goes to the crux of a central issue before the court. ‘Material’ obviously means something different from and, in this context, more than ‘relevant’ ...”⁴

In the context of a purchase and sale agreement, the Ontario Court of Appeal held that: “(a) representation is material ... if it is so pertinent, germane or essential that it could affect the decision to purchase ...”⁵

In relation to material adverse change clauses, the British Columbia Supreme Court paraphrased the test for materiality as set out in an insurance case and stated the following:

“the term ‘material’ ... is the word in this phrase which eliminates from consideration trivial changes and changes arising from the unexceptional day-to-day business of an operating entity... the words

Materiality?

clearly ask whether the changes, if known, would have reasonably affected the mind of a prudent experienced purchaser of shares in deciding whether he would make the purchase ...⁶⁷

Question of Fact

The British Columbia Court of Appeal has described the general parameters for materiality as, “(w)hat is material in a contractual context will depend on the nature of the contract, who the parties are, and the state of their knowledge about the subject-matter of the contract.”⁷ In other words, materiality depends entirely on the facts and context of the particular situation or transaction.

Despite this broad statement, the British Columbia Court of Appeal later concluded that materiality is tested objectively, with a view to the reasonable purchaser:

“Whether material fact information must be disclosed is always tested by its effect on the reasonable purchaser’s deliberations. Material fact information that could reasonably be expected to have a material adverse effect ... need not be disclosed unless the failure to disclose it would raise a ‘substantial likelihood’ that it would assume actual significance in the purchaser’s deliberations or would be viewed by it as altering the total mix of information available.”⁸

Conclusion

Whether something can be classified as material or not will depend on how significant or essential it is in the context of the particular transaction. It appears safe to conclude that if the judgment of a reasonable party relying on the information, in the context of a significant decision relating to a transaction, would have been changed or influenced by the inclusion or correction of the item in question, then it is material. Although the test for materiality is sometimes objective, it cannot be applied without facts. The other important message is that “materiality” is a term that imparts “essentiality” or “fundamentality” and is not to be assumed to be something which necessarily arises because of an absolute dollar amount that may be associated with a decision or fact.

Footnotes

¹ Bryan A. Garner, Editor, *Black’s Law Dictionary*, 7th ed. (West Group, 1999)

² http://www.bnet.com/2410-13502_23-66519.html

³ http://www.bnet.com/2410-13502_23-66519.html

⁴ *International Corona Resources Ltd. v. LAC Minerals Ltd.* (1988), 54 D.L.R. (4th) 647 (Ont. H.C.) at para. 47.

⁵ *Apotex Inc. v. Hoffmann-La Roche Ltd.* (2000), 195 D.L.R. (4th) 244 at para. 17

⁶ *McMillan v. Ludlow*, [1995] 6 W.W.R. 746 (B.C. S.C.) at para. 32.

⁷ *Inmet Mining Corp. v. Homestake Canada Inc.*, [2003] B.C.J. No. 2588 at para. 29.

⁸ *Ibid.*, at para. 30.



Put the Boots to Hunger

PUT THE BOOTS TO HUNGER is a campaign partnership between BD&P and the Calgary Inter-Faith Food Bank to raise funds and to encourage the donation of food with the hope that all Calgarians who need to rely on the Calgary Food Bank can do so. In 2009, the Food Bank experienced its largest need for emergency food hampers in nearly 10 years, with the majority of people relying on the Food Bank for emergency food hampers continuing to be the working poor.

BD&P feels that corporate responsibility during these times is to not only maintain our support for our community but, where possible, to increase our commitment. For that reason, BD&P is advising clients and friends that we are increasing our support from \$150,000 in 2009 to \$200,000 in 2010 for this Stampede-themed fund and food raising campaign.

We thank all of our community partners, clients and friends who made the 2009 campaign a success, collectively raising \$350,000 in food and cash donations for the Calgary Food Bank. Our 2010 goal is \$500,000.

BD&P is very excited by this continued opportunity the PUT THE BOOTS TO HUNGER campaign affords us to recognize the true "Stampede Spirit" of community support. The proposed elements of the PUT THE BOOTS TO HUNGER initiative offers the Calgary Food Bank a unique and valuable opportunity to raise awareness in our community and to inspire individuals, community groups and corporations to support BD&P in achieving this goal — "to provide quality, emergency food to those in need".

Please join us in making a donation to the Calgary Inter-Faith Food Bank during the PUT THE BOOTS TO HUNGER campaign and help raise awareness and funds for a critical organization upon which far too many Calgarians have to rely. Donations can be made by cheque to the Calgary Inter-Faith Food Bank, noting our Put the Boots to Hunger campaign, and sent either directly to the Food Bank or to BD&P or can be made online by visiting www.putthebootstohunger.com where you will find more information about the campaign.

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