the employment and consulting contracts are "impugned" for lack of reasonableness is no more than a transparent attempt to avoid contracts that were validly entered into by parties that had the authority to enter into them. The Board, by entering into those contracts, was exercising its valid business judgment and FSRA has no lawful reason to challenge their enforceability. Any failure by the Board to exercise reasonable diligence in reviewing or approving the contracts, which is denied, is PACE's own failure and not one for which Larry, 142, or 809 are responsible, or for which damages are payable.

II. Additional Compensation Properly and Validly Received

19. Starting at paragraph 119 of the Claim, FSRA alleges that Larry, through the use of what is dubiously named the "folder method", improperly obtained approvals for expenses and other payments received from third parties. FSRA alleges that the Board approvals of payments received by Larry were not properly granted. FSRA has failed to particularize any particular payment to which it objects; rather, it impugns all payments by its inability to specify which payments were actually improper.

20. While FSRA characterizes this alleged conduct as improper conduct by Larry, it is in effect alleging that the officers and directors of PACE – throughout the nearly 30 year period during which Larry was employed by PACE or its predecessors – mechanically approved expenses of or payments to a senior officer without determining whether the expense was valid or the payment appropriate and, by doing so, failed to exercise reasonable diligence or breached their duties to the Credit Union.

21. In any event, FSRA's allegations are without merit. Each of the payments was appropriate, both at the time that each payment was made and in retrospect. Irrespective of whether FSRA now takes the view that the payments were inappropriate, each of the officers and directors who were tasked with approving Larry's expenses fulfilled their duties to PACE and exercised the diligence required in doing so. Those tasked with reviewing the expenses and payments disclosed by Larry, 142, and 809 – such as the Chair of the Board and Chair of the Audit Committee – were themselves accountants. They were aware of, and fulfilled, their duties to PACE.

22. Throughout, Larry provided all the information necessary for the approvals to be granted. FSRA has not identified a single piece of information that it alleges ought to have been provided but was not – its very serious allegations are notably bald and unparticularized. To the contrary, Larry provided significant insight into his personal finances so that PACE's officers and directors could make an informed decision and, when requested, provided additional information. The allegation that Larry "purposely" did not give sufficient information is entirely without merit. Larry provided more information than required by the applicable governance standards. In particular, Larry disclosed to the Board and Audit Committee his entire income – not only from PACE but from all outside sources – including every single transaction in his accounts with a value of $10,000 or greater.

23. The receipt by Larry, 142, or 809 of payments related to specific projects – such as the Geranium Corporation ("**Geranium**") joint ventures – was commonly known, and was not a matter of controversy. Those payments were specifically acknowledged and approved of by the Board. In particular, the receipt of such payments was acknowledged in the 809 Agreement as part of the compensation to which 809 was entitled. Payments by PACE to 142 and 809 were

recorded on PACE's books, and were subject to yearly audit by Deloitte LLP ("**Deloitte**") and regular audit by FSRA.

24. Historically, disclosure and approval of the compensation received by Larry, 142, and 809 was done through the Board and the Audit Committee. For new and material items, Larry would present a President's Report to the Board detailing any proposed expenses, material contracts, or amendments, which would be approved by resolution or a vote. Any items requiring approval would be noted in the Board minutes and detailed in the President's Report for discussion and approval. Larry disclosed all such amounts and received approval from the Board and Audit Committee for the same.

25. For payment of expenses and fees on an ongoing basis that had already been approved by the Board/Audit Committee, Larry would disclose the amounts received to Ian Goodfellow, the Chair of the Board, and Deborah Baker, the Chair of the Audit Committee. Mr. Goodfellow and Ms. Baker would typically confirm their review and approval of the payments by signing and/or stamping the documents that were provided to them demonstrating the payments. Larry disclosed all such amounts and received approval from the Board and Audit Committee for the same.

III. No Breach of s. 140 of the Act – Larry's Income Was Properly Reported

26. FSRA's allegation that Larry underreported income contrary to section 140 of the Act and section 28 of the General Regulation is without merit. The obligations under section 140 of the Act and section 28 of the General Regulation fall upon PACE as an organization, not Larry personally. FSRA has no cause of action against Larry for breach of those sections.

27. In any event, the obligations imposed upon PACE were complied with at all times. Section 28 of the General Regulation prescribes that the following information be contained within the Credit Union's financial statements:

a) The name of the officer or employee;
b) The title of the officer or position of the employee;
c) The total amount of salary received;
d) The total amount of bonuses received; and
e) The monetary value of benefits received.

28. That prescribed information was always properly disclosed. The General Regulation does not require that amounts received by any officer or director from third parties be disclosed. To the contrary, the purpose of PACE's financial reporting – and the purpose of the prescribed information in the General Regulation – is to advise members of PACE's financial activities, not those of its clients or business associates. PACE had no obligation to report amounts received by 142 or 809 pursuant to those regulations. In any event, the income earned by those companies, as well as Larry's connection to them, was known to both the entirety of PACE's Board, as well as to its accountants (who prepared the financial statements). All of the income received by 142 and 809 was received pursuant to valid contracts and was recorded on PACE's books in the normal course.

29. The Credit Union's financial position and, in particular, its financial statements were the subject of multiple levels of audit each year, as described below. In preparing its financial statements, PACE received guidance and advice from its accountants and auditors. Each year, PACE was not advised to record any additional amounts, and each year PACE received a clean

audit opinion. Even if PACE's reporting was deficient, which is denied, liability for that deficiency falls not upon Larry – who had no role in the preparation of PACE's financial statements and who did not sign off on them – but on those accountants and auditors, who were tasked with ensuring that PACE complied with all applicable regulatory requirements, and with PACE's Board, who had final responsibility for the approval of the financial statements. In the alternative, if the alleged failure to report constituted a breach of fiduciary duty by others, then none of Larry, 142, or 809 assisted with that breach of duty.

30. Finally, there is no causal connection between the breach alleged by FSRA – a failure to report income – and the damages sought, being the return of that income. The receipt of any unreported income by Larry, 142, or 809 is not compensable to PACE in the circumstances.

Larry Could Not "Cause" or "Fail to Cause" PACE to Take the Actions Alleged in the Claim

31. FSRA has taken the unprecedented legal position that Larry – just one of the senior executives at PACE – ought to be *personally* liable to PACE for losses incurred in PACE's loan portfolio and for the performance of other investments made by PACE, all of which were approved in accordance with PACE's usual governance structures.

32. FSRA's claim is fundamentally misguided, and is based on erroneous and legally specious allegations that Larry alone (or with Phil) "caused" the Credit Union to take certain actions or "failed to cause" PACE to take necessary actions. In particular:

a) Paragraph 38 – That Larry "caused" PACE to make a $2 million loan to 2340938 Ontario Inc. ("**2340**") (a loan that, incidentally, dates back to 2012);

b) Paragraph 48 – That Larry (and Phil) "caused" PACE to enter into the Geranium joint ventures, and that "failed to cause" PACE to conduct adequate due diligence into Geranium;

c) Paragraph 50 – That Larry "caused" PACE (or companies related to Geranium) to pay $5.33 million to himself or related corporations;

d) Paragraph 51 – That Larry "caused" PACE to make payments to Frank Klees of $2.7 million;

e) Paragraph 58 – That Larry "caused" PACE to advance funds to SusGlobal Energy Corp. ("**SusGlobal**"), and "caused" PACE to pay Ron Williamson a finder's fee;

f) Paragraph 73 – That Larry "caused" PACE to advance $6 million to the Lora Bay Corporation, and "caused" the Credit Union to pay $180,000 to 1916761 Ontario Ltd. ("**1916**");

g) Paragraph 79 – That Larry "caused" PACE to advance $5.5 million to Noble House in violation of the Act;

h) Paragraph 85 – That Larry "caused" PACE to advance $10 million to 1934811 Ontario Ltd. ("**193**");

i) Paragraph 96 – That Larry "undertook efforts" to advance loans to Lagasco Inc. ("**Lagasco**");

j) Paragraph 104 – That Larry "caused" PACE to enter into a consulting agreement with 1724725 Ontario Ltd. ("**172**") and "caused" PACE to divert funds to Alison Golanski ("**Golanski**") or 172;

k) Paragraph 106 – That Larry caused the value of the Credit Union's commercial loan portfolio to be misrepresented, and failed or refused to review PACE's commercial loans;

l) Paragraph 111 – That Larry "caused" PACE to pay invoices rendered to 142, 809, 1916, and 172 for services not rendered;

m) Paragraph 122 – That Larry "caused" the Chair of PACE's Board of Directors and the Chair of PACE's Audit Committee to approve payments; and

n) Paragraph 133 – That Larry and Phil "caused" PACE to enter into contracts with themselves or others, and that Larry "failed to cause" PACE to engage consultants with respect to these contracts.

33. FSRA does not specify how Larry was able to wield this extraordinary and apparently unsupervised influence. In fact, Larry had no ability to simply "cause" those things to happen. FSRA's allegations ignore the basic governance structures operating at PACE, and improperly seek to attribute actions taken by the Credit Union to Larry personally. In reality, PACE operated by robust governance structures:

a) It had a Board that was elected by the Credit Union's members. The members of the Board owed fiduciary duties to PACE, were aware of those duties, and acted in accordance with those duties. They were able to, and did, make further inquiries when they were uncertain about a course of action. FSRA's action seeks to improperly second-guess decades of decision-making by the Board (whose members changed regularly) and seeks to overturn their legitimate business judgment;

b) Commercial lending at PACE was subject to a rigorous approval process, involving due diligence by qualified credit officers, and credit committee and board approval. Contrary to FSRA's allegations, Larry did not participate in that approval process and could not "cause" a loan to be made without those approvals being granted. PACE's commercial

lending process was subject to rigorous audit – PACE commissioned independent internal audits, was audited by Deloitte, and was regularly audited by FSRA itself; and

c) Larry could not simply "cause" money to be paid to himself or others. Any payments made by PACE were processed through the normal channels, were included in PACE's financial reporting, and were subjected to rigorous review and audit. Notably, FSRA has not alleged that Larry took any action to disguise the fact of the payments. Rather, it has made an opaque allegation that Larry somehow "caused" payments to be made.

34. As outlined above, FSRA has alleged that Larry "caused" PACE to enter into various loan transactions. However, contrary to the allegations in the Claim, Larry had no authority to "cause" PACE to make a loan and, in fact, did not ever personally "cause" PACE to make a loan. Prospective loans were reviewed and vetted through numerous individuals in PACE's credit department and, where necessary, the Audit Committee and/or Board.

35. Typically, Larry did not participate in that approval process. Rather, PACE's commercial loan portfolio tended to originate from a referral – often through a broker or a business connection, often from past loans. From the time that he stepped down as CEO until the termination of his employment, Larry's primary responsibility at PACE was in the origination of such loans and sourcing other business opportunities for PACE. While his role included the discussion of loan terms with PACE's internal loan staff, Larry had no authority to cause PACE to enter into a loan agreement with any party, and never did so.

36. Contrary to FSRA's allegations, when such a loan opportunity presented itself, the basic terms would be presented to one of PACE's internal loan officers, or loan adjudicators, who would be responsible for the following:

a) Preparation of paperwork relating to the loan, including a term sheet, summary of the loan and credit file;

b) An assessment of the security available for the loan, including the preparation of valuations relating to the loans; and

c) A recommendation as to whether the loan ought to be advanced.

37. Once the paperwork and recommendation for the proposed loan was ready, it was brought to PACE's Credit Committee for approval. The Credit Committee would then assess all of the terms of the loan. Once its due diligence was complete, the Credit Committee would determine – as a body with the required quorum – whether to advance the requested funds. The Credit Committee took special care to ensure that the loans complied with applicable regulations and internal standards. One of the members of the Credit Committee was a compliance officer, who was responsible for ensuring that the loans were compliant with all applicable regulations. Although Larry was formally a member of the Credit Committee, he did not attend meetings or take a role in the loan review and approval process. As set out above, he was primarily responsible for sourcing opportunities and was rarely, if ever, involved in the approval of a loan by the Credit Committee.

38. Loan transactions that were within the usual commercial or retail lending limits and did not involve related or restricted parties would usually be reported in the minutes of the Credit Committee. The Credit Committee minutes would be provided to the Board in advance of scheduled meetings, and would then be approved at the Board meetings.

39. For related or restricted party transactions, the Board would be polled in advance for approval. Typically, Larry would present a President's Report to the Board detailing any expenses,

material contracts or amendments, which would all be approved by resolution or a vote on the President's Report and signed off on by the Chairs of the Board and the Audit Committee. Any items requiring approval would be noted in the Board minutes and detailed in the President's Report for discussion and approval.

40. All of the transactions referred to the in the Claim were reviewed and approved pursuant to this process. There is no basis for Larry to be held personally responsible for these loans.

41. Further, each of the transactions has either been profitable for PACE, or would have been profitable but for the intervention of FSRA, who has sold assets for less than their market value and has called loans that were otherwise performing and were being repaid on their terms. If PACE suffers any losses, which is denied, it is FSRA's actions – and not the loans themselves – that will have been the cause.

Transactions Raised by FSRA in this Action

42. Underpinning each of the transaction-specific allegations is the false conclusion that Larry and/or Phil "caused" PACE to either enter into the transaction or to advance the loan at issue. In each case, however, the transactions were presented to the Board and/or Credit Committee along with all of the information required for that body to make an informed decision about the transaction. In each case, the transactions were approved on behalf of PACE by the Board and/or Credit Committee, and PACE itself took the steps required to execute the steps necessary to give effect to the transaction. Larry is not liable to the Credit Union for any losses suffered by PACE in conjunction with any of the transactions referenced in the Claim.

43. Further, in every case, Larry, 142, and 809 properly disclosed any and all compensation received in conjunction with any of the transactions, and that compensation was reviewed and approved by the Board and/or Audit Committee in keeping with the relevant governance standards.

I. CCE

44. FSRA has mischaracterized the nature of the transaction involving CCE. FSRA's primary allegation is that the CCE deal was structured to circumvent regulatory requirements. In fact, PACE structured this transaction specifically to *comply* with the regulatory requirements while taking advantage of a valuable opportunity for the Credit Union.

45. When PACE's management was presented with the opportunity to purchase CCE, it was aware of the regulatory restrictions on the ownership of subsidiaries. Therefore, it structured the transaction to comply with those regulatory requirements while it raised the capital and while it awaited the necessary regulatory approval that would allow PACE to own CCE in its entirety. In particular:

a) 30% was purchased by PACE directly;

b) 45% was purchased by 2340, using an interest-bearing loan from PACE, secured by the shares of CCE. The intention was for PACE to acquire this additional 45% once capital levels were achieved and regulatory approval was obtained; and

c) The remaining 25% was retained by the vendor – Scott Penfound – who was the president and founder of CCE, who had significant management experience with CCE and who would remain with CCE until such time as PACE was in a position to fully purchase his interest.

46. It was intended that PACE would only own the maximum allowable percentage of CCE (30%) until such time as regulatory capital and regulatory approval could be obtained for it to acquire the rest. *It would only purchase the remainder of the company if FSRA ultimately granted that approval*. If approval was granted, PACE's loan would be repaid in full and it would earn any additional equity accumulated. In the meantime, and if no approval was forthcoming, then PACE would continue to own (or could sell) its 30% interest, and would continue to profit from the interest on its loan to 2340.

47. At all times, the Board was aware of the ultimate intention for PACE to acquire 2340's interest in CCE after the receipt of regulatory approval.

48. Despite FSRA's mismanagement since the Administration Order, CCE continued to be a highly profitable transaction for PACE, and CCE has significant resale value. In particular, in the days leading up to FSRA's issuance of the Administration Order, the shareholders of CCE were in the process of negotiating a sale of CCE to Currency Exchange International ("**CXI**") for a total purchase price of $41 million which, if concluded, would have resulted in a profit of $3 million on PACE's 30% interest alone. The Audit Committee gave preliminary approval for the proposal on September 26, 2018, two days before FSRA took over administration of PACE. FSRA took steps to prevent any deal with CXI from closing after it took control of PACE.

II. Geranium

49. FSRA's allegations relating to the various Geranium joint ventures are threefold:

a) In effect, FSRA characterizes the joint ventures as being a 'bad deal' for which Larry "failed to cause" the Credit Union to conduct sufficient due diligence;

b) It alleges that the receipt of fees by Larry, 142, or 809 from Geranium was improper; and

c) It alleges that the joint ventures are contrary to sections 198 and 200 of the Act.

50. The undertone of FSRA's allegations is that the Geranium joint ventures are somehow harmful to PACE. The opposite is true. As with each of the transactions at issue, the Geranium joint ventures are, or will be, profitable to PACE, subject to any meddling by FSRA itself.

a) Larry Could Not "Cause" the Joint Ventures

51. FSRA further alleges that Larry "caused" PACE to enter into the joint ventures and that he "failed to cause" the Credit Union to conduct sufficient due diligence. As above, this is wrong. While Larry assisted in sourcing the business opportunity and negotiating the particulars of the arrangement, each of the joint ventures – which date between 2010 and 2015 – was presented for approval to the Board and was approved by the Board. Each of the joint ventures was signed by other members of the Board on behalf of PACE. Larry did not have the authority to commit PACE to the joint ventures, and did not purport to do so.

b) The Joint Ventures Complied with the Act

52. The joint ventures all complied with sections 198 and 200 of the Act. Details of each joint venture was publicly disclosed in the Credit Union's financial statements, which were approved by the Board and ratified by PACE's membership. Each of the joint ventures, including the particular ownership structures, was subject to rigorous internal and external audit. None of those audits raised concerns with the structure of any joint venture.

53. In any event, the obligation to comply with sections 198 and 200 of the Act falls to PACE, and not to Larry. Larry cannot personally be liable for any breach of section 198 or 200 of the Act

by PACE. In the alternative, if any of the joint ventures is contrary to those sections of the Act, then PACE has suffered no damages as a result of those breaches, and the allegations of breach are irrelevant to any claim for damages by PACE or FSRA.

c) No Secret Commissions

54. None of the payments received by Larry or related corporations from any of the Geranium joint ventures constituted "secret commissions". Rather, the payments were made by Geranium, and received on account of project-specific services provided to Geranium, not PACE, by Larry, 142, or 809. At all times, the Board was familiar with, and approved, any management fees that were received by Larry, 142, or 809 in connection with the Geranium ventures. In particular, PACE's Board authorized a "Acknowledgment and Resolution", wherein PACE acknowledged and resolved that:

> Whereas the Credit Union and Larry Smith and the personal services corporations owned by Smith, being 809755 Ontario Limited and 1428245 Ontario Limited – the shares of which are held in trust for Larry Smith by Phillip Smith ("Smith") are parties to compensation agreements for various consulting and management services dated March 27th, 2015 for 809755 and November 7th, 2015 for 1428245 (the "Consulting Agreements") and
>
> **Whereas 809755 and 1428245 may receive payments from time to time from the partners of Pace [sic], namely Geranium, Prime R Investments and JLG management consulting [sic] which payments are disclosed, acknowledged and approved by the Executive and Audit Committees of Pace and** [emphasis added]
>
> …
>
> Whereas the Credit Union and Smith wish to clarify that the services of 809755 and 1428245 to Pace more specifically relate to various development projects and joint venture projects the costs of which are more appropriately charged and/or capitalized and/or allocated to the specific projects with costs being recovered at a later date from future revenues
>
> Be it therefore RESOLVED

> **THAT effective January 1st, 2015, the Credit Union confirms that the services agreements of 809755 and 1428245 are specifically project related and such costs be allocated on a project by project basis or expensed to operations by Pace in and at its sole discretion.** [emphasis added]

55. The Acknowledgment and Resolution is an explicit recognition of that decision – amounts paid by PACE to 809 or 142 in the future would be allocated as expenses to the specific projects and not as payment by PACE of salary or other compensation. The decision to treat these payments as expenses was one that was taken by the Credit Union as an entity – with knowledge of the CFO and the approval of its Audit Committee. As noted above, this arrangement was reviewed by PACE's external auditors – Deloitte – who were tasked with reviewing such arrangements and who also approved of the accounting arrangement.

56. The Acknowledgment and Resolution is an explicit confirmation by the Board and Audit Committee of its knowledge that Larry, 142 and 809 had already received fees directly from Prime R and JLG Management and would continue to receive those fees in the future. It is also an explicit acknowledgment that the Board and Audit Committee approved of the receipt of these fees. All payments received by Larry, 142, or 809 prior to 2015 were disclosed to the Board Chair and/or Audit Committee Chair and approved. The disclosures are stamped (and initialed) by PACE's Audit Committee. Future payments were also disclosed and approved. Larry had no input into the Credit Union's accounting arrangements with respect to these payments.

III. SusGlobal

57. FSRA alleges that, in relation to SusGlobal:

a) Larry "caused" PACE to advance the loan, which was contrary to the Credit Union's policies; and

b) That he received a “secret” commission.

58. Larry did not cause PACE to make any loan to SusGlobal. To the contrary, the normal loan procedures – as described above – were followed. The SusGlobal loans were approved by the Credit Committee, and that approval was reviewed by the Board. The loans to SusGlobal were consistent with PACE’s loan policies and the loan was performing on its terms prior to FSRA’s unwarranted intervention. As of the date of this Amended Statement of Defence – more than two years after the date of the Administration Order – the loan continues to perform and the Credit Union has suffered no loss. Any loss to the Credit Union, which is denied, will be the result of FSRA’s improper and improvident actions in its handling of the loan.

59. Further, Larry did not “cause” PACE to pay a finder’s fee to Mr. Williamson. Rather, that finder’s fee was included in the initial term sheet for the loan, which was reviewed and approved by PACE in accordance with its normal process. Larry did not receive any “secret” commission relating to the SusGlobal loan. 172 did receive a payment of $150,000 relating to the loan. However, that payment was disclosed and approved. FSRA’s allegation that, by the receipt of 810,000 shares of SusGlobal, Larry breached a duty to PACE is specious. Those shares, which were initially issued by SusGlobal in the name of 142, were assigned to PACE. They are, in fact, the property of PACE.

IV. Inveraray Glen

60. FSRA alleges that Larry and Phil “intentionally refused” to record bad loan charges relating to the Inveraray Glen project, which was a real estate project pursuant to which PACE advanced

loans. Those loans, which date back over 10 years, were reviewed and approved in the normal course by a credit adjudicator and the Credit Committee prior to being advanced.

61. Contrary to the allegations in the Claim, no bad loan charge was required to be recorded relating to the Inveraray Glen loans, as PACE had adequate security to recover its loans, and was in the process of such recovery. Further, contrary to the allegations, the obligation to report bad loans did not fall to Larry; rather, that responsibility was left to the credit officer tasked with managing the loan and the Credit Committee. From 2015 onwards, the Credit Committee at PACE was aware of the default and of the security available for recovery, and the Board was regularly presented with a "watch list", which included entries relating to Inveraray Glen. Throughout the relevant time, none of the individuals or groups tasked with the classification of loans on PACE's books, exercising their discretion, considered it necessary to record a loan charge despite the fact that PACE could have received tax advantages from doing so. Larry had no distinct personal obligation to ensure that PACE recorded a charge for which he can be liable to PACE.

62. Finally, FSRA has failed to identify any damages suffered by PACE that were caused by the failure to record a bad loan charge, and there were no such damages.

V. Lora Bay and Noble House

a) Lora Bay Loan

63. Larry did not "cause" the loan to be made to Lora Bay. Rather, the Lora Bay investment, which was a convertible debenture, was discussed and approved by the Board and was approved pursuant to the November 30, 2016 Board minutes, which include a note indicating: "TO proceed with the Lora Bay debenture and development investment of 6.5m in accordance with the

debenture/share issue/shareholder". At all times, the investment was consistent with the Credit Union's policies.

64. The Lora Bay debenture has performed on its terms since its inception. PACE has suffered no losses relating to the transaction.

b) Noble House Loan

65. The Noble House loan was a construction loan and, in accordance with the normal process for construction-related financing transactions, interest was capitalized until construction was complete and revenue could be earned. The loan was consistent with PACE's loan policies and requirements under the Act. At the time the loan was granted, there was more than enough security to justify the loan amount. As recorded in the Credit Committee minutes dated August 30, 2017:

> NOBLE HOUSE DEVELOPMENT CORPORATION
>
> COMMERCIAL CONSTRUCTION LINE OF CREDIT $5,500,000 Line of credit to be used for the construction of a second floor on a 24,000 square foot 7 mini-heated storage units. Secured by a first mortgage over 3 Crescent Road, Huntsville. General Security Agreement from the Borrower, personal Guarantee and Postponement of Claim from Ray Jarvis in the amount of $5,500,000, and personal Guarantee and Postponement of Claim from John Jarvis in the amount of $5,500,000. LTV ratio 68.8%. DSCR 1.20:1. Total credit exposure $5,500,000.

66. FSRA's *ex post facto* reassessment of the value of the loan or its security is not what the adjudicator and Credit Committee considered at the time. As with all of the loans at issue in this action, the Noble House loan was reviewed by one of PACE's credit adjudicators, and then approved by the Credit Committee without Larry's input.

67. Subsequent to the Administration Order, FRSA caused PACE to renege on its contractual financing commitment which, in turn, forced Noble House into receivership and caused an

otherwise performing loan to be impaired. This action by FSRA resulted in a loss to the Credit Union and its members.

c) No "Secret Commissions"

68. FSRA has falsely alleged that 1916, Larry's son Malek Smith's company, received undisclosed payments relating to the Lora Bay and Noble House projects, which it (also falsely) characterizes as being "secret commissions". Both of the impugned payments were disclosed to PACE's Board and Audit Committee and were approved. Larry made this disclosure as part of his own compensation, and advised the Board and Audit Committee that the amounts should be paid to 1916. Mr. Goodfellow signed off on and approved these payments on behalf of the Board, while Ms. Baker signed off on and approved these payments on behalf of the Audit Committee.

VI. 1934811 Ontario Ltd.

69. Any loans to 193 were not "caused" by Larry, but were advanced in accordance with the usual practice of the Credit Union, as described above. The loan was consistent with PACE's risk tolerance policies and all loan underwriting practices. Throughout its life, the loan performed on its terms. PACE earned significant interest from the loan.

70. FSRA alleges that Larry received a "secret commission" relating to the loan to 193, which he directed to 172. To the contrary, as with all payments at issue, the commission directed to 172 was disclosed and approved by the Board and Audit Committee.

VII. Lagasco Inc.

71. FSRA makes allegations about a series of contemplated loans to Lagasco that *would have been* undertaken contrary to the Act and regulations, and alleges that the loan itself was improvident. Contrary to the Claim, the transactions were not "connected" within the applicable rules, and the loan was within the applicable Credit Union risk tolerances and policies.

72. The transaction involving Lagasco, which was cancelled by FSRA following the issuance of the Administration Order, is another transaction where a suspect motive is imputed to a transaction where no such motive is warranted. Similar to CCE, the structure of the Lagasco transaction was created in order to ensure that the loans could be made in compliance with the Act and regulations, not to avoid them. While FSRA might not, having appointed itself administrator, have decided to complete the transaction for PACE, there was no impropriety or attempt to evade regulatory restrictions. The $3 million advance referred to in FSRA's Claim was advanced to a company that was not connected to Lagasco and, in any event, the loan was performing on its terms as of the Administration Order.~~, and~~ PACE has suffered no losses relating to that transaction.

73. Contrary to FSRA's allegations, the Lagasco transaction was not "caused" by Larry. Rather, the transaction was proceeding in the normal course as described above. The transaction had received preliminary approval from PACE's Credit Committee and was also disclosed to, and approved by, the Audit Committee. Larry is not liable for any of the costs associated with FSRA's (ill-advised) business decision to cancel the loan, which resulted in legal action against PACE and a loss to its members.

No Breach of By-Law 6

74. FSRA's allegation that Larry (along with Phil) is personally responsible for an alleged misvaluation of the commercial loan portfolio is without merit. In particular:

a) Larry was not "directly and ultimately responsible for the commercial loan portfolio" as alleged by FSRA. While Larry undertook the sourcing of commercial loans for PACE, the approval of those loans was done pursuant to the process described above. Ultimately, the Credit Committee at PACE, as well as the Board, were responsible for PACE's commercial loan portfolio. Larry was not responsible for the valuation or audit of that portfolio;

b) Valuation of the commercial loan portfolio was completed by PACE's credit department and its financial team, not Larry. Larry did not determine when allowances would be taken on particular loans. That decision was made by PACE's credit department; and

c) The commercial loan portfolio was subject to rigorous audit, as described below.

75. More generally, the valuation of any individual loan, including the strength of its security, involves the exercise of business judgment, as was explicitly recognized by Deloitte in the process of conducting the audit of PACE's finances. In particular:

> Valuation of allowance for impaired loans
>
> The calculation, fairness and adequacy of the specific and collective allowance for impaired loans requires management to make estimates and assumptions regarding the credit risk of members and their ability to discharge their obligations pursuant to lending agreements.

76. That judgment was always exercised reasonably by PACE and its employees. Any discrepancy in the value of a loan as determined by PACE and a value as determined by FSRA is wholly explainable by the overly conservative judgment applied in hindsight by FSRA, and not by

any improper conduct by PACE or its employees, including Larry. At all times, PACE's loan portfolio, and all the individual loans within it, complied with relevant rules and regulations.

77. Notably, with one exception[2], all of the loans about which FSRA complains (many of which had been in place for years at the time of the Administration Order) were performing on their terms at the time of the Administration Order. Any default on those loans, which is denied, was the result of FSRA's own mismanagement of PACE, and its unwarranted decision to call loans prior to maturity without providing a reasonable opportunity for borrowers to obtain alternate financing. Despite FSRA's mismanagement, many borrowers were able to obtain alternate credit, often on terms that were superior to the credit terms offered by PACE. By calling loans that were otherwise performing, FSRA itself caused damage to PACE by lowering its revenue and weakening its balance sheet. It now transparently seeks to have Larry and the other defendants pay for these mistakes to protect its own reputation.

I. Loan Valuation and Audit Process

78. Throughout the relevant time, PACE's commercial loan and personal/residential loan books were subject to regular valuation, revaluation, and audit. In particular:

a) Details relating to all material loans approved by the Credit Committee, as set out in the minutes, were presented to the full Board for further review;

b) The loans were subjected to annual review by PACE's internal loan staff to ensure that the loans are performing as expected;

c) PACE's internal auditor reviewed the loan portfolio yearly;

[2] A loan that was in default since 2014 and for which PACE had realized on its security, which was adequate.

d) The internal auditor's findings (which were reviewed by the Board) were then presented to Deloitte, PACE's external auditors, who conducted further review and provided a formal audit opinion; and

e) FSRA reviewed PACE's loan portfolio during their On-Site Verification reviews.

79. To elaborate on the above, PACE conducted regular internal reviews of commercial loans to ensure that those loans continued to perform as expected. In particular, the credit adjudicator assigned to the file was responsible for the annual review of all loans, the results of which were presented to the Credit Committee for review.

80. Larry was not involved in the loan review or valuation process. Typically, valuation of PACE's loan book would begin with the credit adjudicators (or loan officers) who had the most knowledge of an individual loan and who would determine on a preliminary basis – with the assistance of PACE's credit and financial staff – whether an impairment to the value of a loan was required. If there was no impairment, the loan would be valued at the level of the outstanding credit, and recorded as an asset (loan payable) on PACE's books and records. The aggregate values would be provided to PACE's Chief Financial Officer for review and inclusion in PACE's financial statements, after multiple levels of audit, including:

a) *Internal Audits*: PACE was subject to yearly internal audits by Rick Belsby of Rick Belsby & Associates Inc. Mr. Belsby specializes in conducting internal audits for credit unions, including the Energy Credit Union Limited, PenFinancial Credit Union, and the Police Credit Union. Mr. Belsby's reports were reviewed by the Audit Committee and were presented to the Board;

b) *External Audit*: PACE's financial statements were also subjected to yearly audit by Deloitte, which provided a report to management in respect of its practices. This audit always included a review of PACE's commercial loan book. Each of Deloitte's audit opinions for the years 2015, 2016, and 2017, as expressed in the financial statements, is that "…the consolidated financial statements present fairly, in all material respects, the financial position of PACE Savings & Credit Union Limited as at December 31, [year] and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards"; and

c) *Reviews by FSRA*: In addition to the internal and external audits, FSRA would also conduct periodic reviews of PACE's business, informally called On-Site Verifications ("**OSVs**"). None of the OSVs identified any of the deficiencies complained of in the Claim, despite the fact that FSRA reviewed several of the loans at issue.

81. If deficiencies in PACE's loan approval and valuation processes existed, those deficiencies would have been caught by the audits described above. In this case, in each year, Deloitte determined that:

> Valuation of the loans and deposits portfolio
>
> The valuation of loans and deposits requires management to assess the fair value of the financial instruments in the financial statement disclosures as at December 31, 2015. Management determines the fair value by discounting the expected future cash flows of these loans and deposits at current market rates for products with similar terms and credit risks. **We concur with management's valuation**. [emphasis added]

Funds Paid to Alison Golanski or 172

82. FSRA's allegations relating to transactions involving 172 and Golanski are without merit. As with all transactions at issue, the transactions at issue in the Claim were presented to the Board for approval, and were validly approved. Golanski completed all necessary work pursuant to those contracts. Larry did not approve those contracts. Golanski did not report to Larry with respect to her engagement with the Credit Union. Rather, she performed her responsibilities and reported to the Chief Operating Officer and other PACE personnel.

83. The allegations relating to City View have been included in the Claim wholly for effect. The City View program – which was intended to involve the purchase and refurbishment of buses for sale to municipalities – never got off the ground, and only two or three transactions were undertaken. PACE profited from these transactions, and has suffered no damages.

False Invoices

84. FSRA alleges that Larry, 142, and 809 issued invoices, and were paid by the Credit Union, for services not rendered or which, in the alternative, were grossly disproportionate to the services rendered. To the contrary, all invoices rendered by Larry, 142, and 809 were validly issued and paid for services rendered. In each case, the payments were made pursuant to valid contracts between PACE and Larry, 142, or 809, respectively.

85. In each case, the amount was inspected and approved by PACE's internal accounting staff, and by the Board and Audit Committee. The invoices – including the payments made pursuant to the invoices – were subject to regular audit, as described above. Larry had no input into the manner in which such payments were accounted for at PACE.

No Fraud, Deceit, or Conversion

86. As set out above, none of Larry, 142, or 809 engaged in fraud, deceit, or conversion in their dealings with PACE, and such allegations by FSRA are vigorously denied. All amounts received by the Larry Parties from PACE were received pursuant to valid contracts and/or invoices. All amounts received from third parties were specifically disclosed for approval. The Credit Union's auditors were aware of all amounts paid to Larry, 142, or 809 and the compensation received was appropriately disclosed on the Credit Union's financial statements.

87. Rather, underlying FSRA's complaint appears to be the idea that Larry, 142, and/or 809 were being paid 'too much'. However, disagreement with the terms of a contract does not provide a basis for avoiding it, and FSRA's unparticularized allegations that the manner of Larry's disclosure was insufficient – when no such contemporaneous complaint was raised – ought to be viewed with significant suspicion.

No Conspiracy

88. Larry, 142, and 809 deny FSRA's allegations that they participated in either a conspiracy to injure PACE or in an unlawful means conspiracy. Contrary to FSRA's allegations, Larry, 142, and 809 acted in the Credit Union's interests – they sourced profitable deals for PACE and presented those deals to the Board for approval. None of Larry, 142, or 809 violated the Act or caused PACE to do so, did not receive secret commissions or render false invoices, as set out above.

No Breach of Contract

89. At all material times, Larry acted in accordance with the terms of his governing employment contract, and 142 and 809 acted in accordance with the terms of their governing consulting contracts. At no time, and as particularized in this Statement of Defence and Counterclaim, did Larry, 142, or 809 breach any fiduciary duty to PACE or breach any duty of care owed to the Credit Union. Rather, Larry has at all times acted in the best interest of PACE and in accordance with his duties.

No Breach of Fiduciary Duty or Breach of Trust

90. Neither 142 nor 809 owed a fiduciary duty to PACE and, as a result, cannot have breached any fiduciary duty or trust obligation to PACE. While Larry admits that he owed a fiduciary duty to PACE arising out of his long-standing position with the Credit Union, Larry never breached that duty. To the contrary, Larry acted at all times in the best interest of PACE and in accordance with his duties, as described above. In the alternative, if 142 or 809, as corporations, owed a fiduciary duty to PACE (either through Larry or otherwise), then those entities acted in accordance with those duties at all material times.

No Knowing Assistance

91. FSRA has alleged that Larry knowingly assisted others with breaching their fiduciary duties with respect to:

a) The CCE transaction;

b) The Geranium joint ventures;

c) The SusGlobal loan;

d) The Lora Bay loan;

e) The Noble House loan;

f) The 193 loan;

g) The alleged diversion of funds to Golanski;

h) The alleged failure to comply with By-Law No. 6; and

i) The alleged false invoices rendered by 142, 809, 1916, and 172.

92. As pleaded above, none of those transactions constituted breaches of fiduciary duty by Larry, 142, 809, or others. In the alternative, if any other person breached a fiduciary duty owed to the Credit Union by their participation in those transactions, then none of Larry, 142, or 809 assisted in that breach of duty.

No Knowing Receipt

93. FSRA has alleged that the funds held by 2340 in connection with the management of CCE were "held in trust for the Credit Union". As set out above, the shares of CCE were validly acquired by 2340, and were not held in trust for PACE. None of the funds received by 2340 by CCE were held in trust for PACE. Rather, 2340 made payments on its loan from PACE as required, and retained any additional profits validly. Payments from 2340 to the Larry Parties were made validly, for the provision of management services performed on behalf of 2340. Those fees were specifically approved by PACE's board of directors. PACE has no claim to any of those funds, or any of the assets of 2340.

94. FSRA has not particularized any other funds allegedly held in trust for PACE that were received by the Larry Parties, and has not pleaded any facts to support a finding that any other

funds received by the Larry Parties ought to be impressed with a trust in favour of PACE. No other funds received by the Larry Parties were impressed with a trust. In particular:

a) Payments made to Larry personally were in the nature of salary or bonus, which were allocated and paid in the normal course, like any other employee of the Credit Union;

b) Payments made by PACE to 809 or 142 were made pursuant to contract, from PACE's general expense ledger; and

c) Payments received by 809 or 142 from third parties were made pursuant to valid contracts. Those monies were never intended to be paid to PACE, and PACE has no claim to those funds. All such payments were disclosed to, and approved by, the Credit Union.

No Unjust Enrichment

95. Contrary to the allegations in the Claim, none of Larry, 142, or 809 were unjustly enriched. PACE did not suffer a deprivation resulting from any of the payments received by these defendants, each of which were received pursuant to a valid juridical reason. Each payment complained of was made and received pursuant to contract and, where received from a third party, was disclosed to PACE. Where a payment was received from a third party by Larry, 142, or 809, PACE had no legal or equitable right to those funds, and can have no expectation that they would have received those amounts but for their payment to the Larry Parties.

96. In particular, FSRA's allegation that the failure to report income contrary to the Act – which is denied – constituted an unjust enrichment of Larry makes no logical sense. PACE's failure to report Larry's income on its financial statements (which is denied) is fundamentally different from Larry's right to receive such income, and any such failure does not give rise to a right of recovery for unjust enrichment.

No Constructive Trust

97. PACE is not entitled to a constructive trust over any of the assets of the Larry Parties. There is no basis for the imposition of a constructive trust over any particular asset, as an order for damages would sufficiently compensate the plaintiffs for the harms alleged (which are denied).

98. Further, as set out above, none of the Larry Parties received any funds impressed with a trust in favour of PACE. In the alternative, PACE cannot trace any trust funds into any assets owned by Larry, 142, or 809 and, as a result, no trust can be imposed over those assets.

No Liability for Contribution and Indemnity to PACE Regarding the Preferred Shares

98.1 Larry is not liable to PACE for contribution and indemnity related to the Preferred Shares. Liability for any damages to purchasers of the Preferred Shares lies with PACE Securities itself. PACE Securities had its own compliance structure in place, which, was subject to the supervision of PACE Securities' primary regulator, the Investment Industry Regulatory Organization of Canada ("**IIROC**"). PACE, and by extension, its officers and directors did not owe a duty of care to the purchasers of the Preferred Shares.

98.2 Contrary to the allegations at paragraphs 8(b) and 145g of the Claim, Larry did not owe a duty of care or fiduciary duty to the Credit Union to oversee PACE's relationship with PACE Securities and its subsidiaries. The CEO of PACE Securities reported directly to the Board of Directors of PACE. Larry was not a director of the Credit Union and, therefore, did not and could not approve any of PACE Securities' or PACE Financial Limited's ("**PACE Financial**") actions on behalf of the Credit Union, including any actions related to the Preferred Shares. To the extent that PACE Securities required any approvals by PACE for its issuance of the Preferred Shares,

and it is not clear that they did, PACE would have relied on PACE Securities to advise the PACE Board about the investment characteristics and risk profile of the Preferred Shares and with respect to any issues of regulatory compliance related to their issuance. These were matters squarely within the expertise and legal responsibility of PACE Securities.

98.3 It follows that Larry had no duty to ensure that the Preferred Shares issued by PACE Financial, and First Hamilton Holdings Inc. ("**FHH**") were distributed in a "regulatory compliant manner", nor was he qualified to do so. Neither the clients of PACE Securities, nor the Credit Union itself, relied on Larry to supervise PACE Securities' compliance with securities laws.

98.4 Larry was never an officer or director of PACE Securities, PACE Financial, and/or FHH. He was not involved in the development or approval of the preferred shares by PACE Securities. In addition to this not being his role as President of PACE, he had no expertise in the development of securities products or in assessing their investment quality or risks. Nor did Larry have any knowledge of or involvement in the sale of the Preferred Shares by any employees of PACE. Accordingly, there is no basis in fact or law for Larry to be liable for any investor losses associated with the sale of the Preferred Shares and PACE's claim for contribution and indemnity has no merit.

98.5 In any event, as outlined below, PACE itself, through the Administrator, concluded that the Preferred Shares were suitable to be sold to clients of PACE Securities as medium risk securities. In reality, the losses suffered by investors in respect of the Preferred Shares were not caused by any defect in the Preferred Shares or by any "unsuitable" sales to investors, they were the result of a combination of adverse market conditions, regulatory interference, and the improvident actions of Laurentian Bank Securities, the carrying broker for PACE Securities.

98.6 The events leading to the alleged investor losses began after Larry had left the Credit Union. In 2019, after assuming control of PACE pursuant to the Administration Order, FSRA adopted a work plan to address certain concerns expressed by IIROC about PACE Securities and engaged an independent consultant to analyze and assess the Credit Union's business and operations, including those relating to PACE Financial and FHH. The consultant's report concluded, among other things, that the Preferred Shares were rated "medium-risk" and were properly sold to investors.

98.7 At approximately the same time, with the agreement of IIROC and FSRA, a special committee of the independent directors of PACE appointed by FSRA engaged an independent professional valuator to provide a valuation of PACE Financial's preferred shares and FHH's preferred shares. That valuation concluded that the net asset value of the portfolios underlying the Preferred Shares and the FHH securities exceeded the amount required to redeem those shares. In summary, the securities were profitable.

98.8 However, in early 2020, Laurentian Bank Securities, the carrying broker for PACE Securities, called the margin loan with which the securities underlying the Preferred Shares had been purchased. This was done without any reasonable justification. As a result, PACE Securities was forced to sell those securities during a global pandemic at a fraction of their value. These actions, rather than the characteristics of the securities themselves and/or Larry's alleged negligence, were the cause of the alleged investor losses.

98.9 In the alternative, FSRA/PACE bear responsibility for any losses suffered by investors in respect of the Preferred Shares. At the time that those losses were suffered, the Credit Union was

controlled by FSRA through the Administration Order, and it was FSRA's management of the Credit Union and PACE Securities that caused any such losses.

Losses Caused or Contributed to by PACE

99. As set out in detail above, any losses suffered by PACE, which are denied, are the result of PACE's own actions. In particular, all of the transactions referred to in the Claim were completed in the normal course of business:

a) All loan transactions were reviewed by a credit officer and approved by the Credit Committee and, in some cases by the Board itself. Any losses on loans approved by the Credit Committee and/or the Board, which are denied, are the responsibility of PACE itself. Larry did not approve any of the loans and did not "cause" PACE to make any advances;

b) The Board approved all other transactions including, but not limited to, the Geranium joint ventures and CCE. Larry did not "cause" the Credit Union to enter into any of those transactions. Any losses resulting from those transactions are the responsibility of PACE itself, and not Larry; and

c) All of the 'impugned' payments were either made to Larry, 142, and/or 809 by PACE itself, and pursuant to contracts that it had validly entered into, or were approved by the Board and Audit Committee. PACE could have stopped any payment if it considered the same to be 'improper' in some way, but never did.

Losses Caused or Contributed to by FSRA

100. FSRA, in the course of its administration of PACE, is causing significant loss to PACE and its members. In particular, at the time that FSRA appointed itself administrator without notice, the

impugned loans were performing on their terms, the Geranium joint ventures were performing as expected and CCE was making a profit for PACE. Since then:

a) FSRA has been taking steps to call loans that have been performing according to their terms, and which were not in default. FSRA continues to harass Credit Union members by calling loans, by recommending increases in loan rates to as high as 16% and imposing unreasonable and usurious additional fees or "pay downs", with the effect of reducing PACE's commercial loan portfolio by some $200 million in performing, well secured transactions. In many cases, the borrowers have been able to secure more favourable loan terms from other financial institutions, resulting in direct losses to PACE and its members. In other cases, FSRA, by its unreasonable actions, has caused the loan to go into default where it was otherwise performing; and

b) FSRA is threatening to sell PACE's interest in profitable investments such as CCE and various real estate joint ventures for liquidation prices, rather than allow those investments to perform as planned or selling them for their true market value. By doing so, FSRA has destroyed the significant value that those loans and investments would have created for PACE and has harmed the Credit Union's long-term financial position.

101. By calling loans or changing the terms upon which they were originally granted, FSRA has not only failed to mitigate any damages (which are denied), but has actually exacerbated PACE's risk of loss. In particular, even if FSRA's allegations that loans were granted without proper security are true (which is denied), then PACE was only *at risk* of suffering losses where, as here, the loans were performing on their terms. By calling loans prior to maturity, demanding additional security, or increasing interest rates, FSRA *caused* the loans to go into default, thereby directly causing loss to PACE. It is FSRA, not Larry, that bears responsibility for those losses.

102. In particular, while under administration, PACE's operating income for 2019 dropped to $3.7 million in 2019 from $8.5 million in 2018, and the value of its commercial lending portfolio fell over $100 million, to $760 million. PACE and FSRA have admitted publicly that those declines are largely the result of the Administration Order. In particular, the "direct" costs of the Administration Order were estimated in January 2020 to be between $4 million and $5 million. In addition, FSRA's CEO, Mark E. White, stated that Administration Order has another "hidden" cost:

> Regulators are not meant to operate businesses…The book is being de-risked, which is of course what a regulator would like to do. But there is also the possibility that business is not being done to its fullest.

103. As set out above, the 'de-risking' exercise being undertaken by FSRA was and is unnecessary, as PACE's loan portfolio had an acceptable amount of risk prior to the Administration Order. Prior to the Administration Order, the rate of defaults in PACE's loan portfolio was in line with other credit unions and with industry standards, and the loans within the portfolio would have continued to perform on their terms.

Action is Statute Barred

104. The Larry Parties plead and rely upon the provisions of the *Limitations Act*, *2002*, S.O. 2002, c. 24, s.B. The plaintiff discovered the material facts relevant to its claim more than two years before the action was commenced. In the alternative, the material facts upon which the claim is based were discoverable with the exercise of reasonable diligence more than two years before the action was commenced.

COUNTERCLAIM

104.1 The plaintiffs by counterclaim, Larry Smith, 1428245 Ontario Limited and 809755 Ontario Limited (together, the "**Larry Parties**"):

a) An order requiring PACE to pay the Larry Parties the monies formerly held in their Accounts at PACE, as defined below, plus the interest ordered payable pursuant to the decision of Justice Koehnen dated October 26, 2020;

b) An order requiring PACE to pay the Larry Parties the $50,000 outstanding costs award ordered by Justice Koehnen (the "**Outstanding Costs Award**") in connection with the Account Application, as defined below;

c) An order requiring PACE to compensate the Larry Parties for the fair value of their investment shares in PACE as at the date of the Administration Order;

d) Prejudgment interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

e) Post-judgment interest in accordance with section 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

f) The costs of this proceeding, plus all applicable taxes; and

g) Such further and other relief as to this Honourable Court may seem just.

105. The plaintiff by counterclaim, Larry Smith, claims for the following:

a) A declaration that Larry terminated the 2015 Agreement (as herein defined) in accordance with section 5(iii) of the 2015 Agreement and that PACE's purported termination of Larry's employment is of no force or effect;

b) An order requiring PACE to pay Larry the sum of $1,933,064 in accordance with section 6 of the 2015 Agreement;

c) In the alternative, damages for breach of the 2015 Agreement in the amount of $1,933,064;

d) In the further alternative, common law damages for wrongful dismissal in the amount of $1,288,709 representing 24 months of payment in lieu of notice;

e) Damages, in an amount to be determined, for losses suffered from the Mareva Order (as herein defined);

f) An interim order pursuant to PACE's By-Law No. 1 and section 157 of the Act directing PACE to make advances for the legal expenses incurred by him, 142 and 809 in defence of the Action, pending its disposition, including those costs already expended in defence of the Action;

g) An order pursuant to PACE's By-Law No. 1 and section 157 of the Act directing PACE to indemnify the Larry Parties for the legal expenses incurred in defending the Action;

h) General damages for defamation in the amount of $1,000,000**;**

i) Special damages for defamation in the amount of $100,000**;**

j) Punitive and exemplary damages in the amount of $1,000,000;

k) Prejudgment interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

l) Post-judgment interest in accordance with section 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

m) The costs of this proceeding, plus all applicable taxes; and

n) Such further and other relief as to this Honourable Court may seem just.

106. The plaintiff by counterclaim, 1428245 Ontario Ltd., claims the following against PACE, FSRA, and Reisler:

a) A declaration that 142 is entitled to receive payment from the Severance Trust according to the terms of the 142 Agreement and the Irrevocable Directions (as herein defined);

b) An order requiring Reisler, as the trustee of the Severance Trust, to make payment to 142 from the Severance Trust in accordance with the 142 Agreement and the Irrevocable Directions in an amount of no less than $1,500,000;

c) Damages for breach of contract in an amount to be determined, but no less than $1,840,000;

d) Prejudgment interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

e) Post-judgment interest in accordance with section 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

f) The costs of this proceeding, plus all applicable taxes; and

g) Such further and other relief as to this Honourable Court may seem just.

107. The plaintiff by counterclaim, 809755 Ontario Ltd., claims the following against PACE and FSRA:

a) Damages for breach of contract in an amount to be determined, but no less than $120,000;

b) Prejudgment interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

c) Post-judgment interest in accordance with section 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

d) The costs of this proceeding, plus all applicable taxes; and

e) Such further and other relief as to this Honourable Court may seem just.

108. The plaintiffs by counterclaim repeat and rely on the allegations in their Statement of Defence.

Procedural History

I. FSRA Issues the Administration Order Without Notice

109. At 9:01 a.m. on Friday September 28, 2018, following an investigation by KSV Advisory, Larry was first advised that FSRA had taken over administration of PACE without notice under section 294(1) of the Act. Concurrently, Larry was placed on administrative leave with immediate effect. FSRA's letter stated, *inter alia*, that "evidence had come to light regarding [Larry's] apparent involvement in improper and unlawful activities against the Credit Union" and alleged that he had engaged in unlawful activities amounting to civil fraud. FSRA's letter also stated that all accounts that he held at PACE, or "which [he] control[led]", had been "blocked until further notice."

110. FSRA stated that it would provide Larry with details of the allegedly improper and unlawful activity that Larry "appeared to be involved in" and would "provide [Larry] with an opportunity to fully respond to the information before the Administrator makes any final decisions regarding [his] employment and involvement with the Credit Union." That opportunity was never provided.

111. On the same date, FSRA sent a letter to 142 and 809 stating that FSRA had become "aware of evidence that suggests that [142 and 809] knowingly induced and knowingly assisted in various breaches of fiduciary duty and engaged in other transactions that amount to civil fraud or corrupt

practices against the Credit Union." As set out above, FSRA stated in this letter that it was "of the view" that the 142 Agreement and the 809 Agreement were "*void ab initio*" such that:

> [A]ny property (including, but not limited to, monies, funds, securities and tangible properties) that [Larry] received from the Credit Union or from others on account of any of the Credit Union's businesses and affairs, and the proceeds or assets purchased directly or indirectly with such property, subject to a constructive trust to the benefit of the Credit Union until directed by the Credit Union on how to return such property.

112. Prior to sending out the letters referred to above, FSRA and/or PACE froze all of the accounts held at the Credit Union by Larry, 142, or 809, totalling $5,299,520.53 at the time (together, the "**Accounts**") in purported reliance on a statutory set off. At the same time, FSRA directed PACE Securities, a related company to PACE, to freeze the securities accounts held by Larry, 142, and 809 at PACE Securities. As of December 31, 2018, the value of those accounts totalled $4,264,825.

The CCE Receivership and Termination of Larry's Employment

113. On December 5, 2018, PACE purported to terminate Larry's employment "for cause". The "cause" asserted by PACE mirrors the allegations in this action, in particular:

> During the course of the Administration, the Administrator has discovered evidence that has confirmed your involvement in various improper and unlawful activities against the Credit Union, including activities that amount to a breach of your fiduciary duties to the Credit Union. Specifically, DICO became aware of evidence that suggests that you engaged in, assisted in, or failed to stop various breaches of fiduciary duty and other actions that amount to civil fraud or corrupt practices against the Credit Union (the "Impugned Actions"). These Impugned Actions include, but are not limited to:
>
> (a) intentionally evading the requirements of the Act in connection with the Credit Union's acquisition of shares of Continental Currency Exchange Canada Ltd. ("CCE"), including through the use of 2340938 Ontario Ltd. in connection with that transaction;

> (b) working to manipulate the structure of transactions so as to evade the regulatory lending limits in the Act and the regulations promulgated thereunder, including in connection with the contemplated Lagasco transaction;
>
> (c) receiving payments in the nature of special commissions;
>
> (d) repeatedly causing the Credit Union to advance funds in a number of transactions on unreasonable terms in transactions for which you were personally benefitting, contrary to your fiduciary duties; and
>
> (e) misappropriation of the Credit Union's property.
>
> In addition to the information set out in Schedule "A" to DICO's Preliminary Reasons, a copy of which has been previously provided to you through your counsel, some of the evidence that the Administrator is aware of in connection with the CCE transaction is found in the Affidavit of Brian Mullan affirmed December 5, 2018, which is contained in the Motion Record provided to you today.

114. On the same day, PACE issued a Notice of Action claiming damages with respect to a transaction involving CCE and PACE (the "**CCE Proceeding**"). The amounts claimed in the CCE Proceeding relate to allegations about: (i) a payment received by Larry in the amount of $75,000 (that had been approved by PACE's Board of Directors); and (ii) receipt by Larry and five other individuals of a total of $300,000 in annual management fees (also reviewed and approved by PACE's Board of Directors). 142 and 809 are not parties to the CCE Proceeding, and no damages are sought from them in that action.

The Mareva Injunction and Subsequent Malfeasance by FSRA

115. On March 19, 2019, FSRA obtained an interim Mareva injunction (on 45 minutes-notice) against the worldwide assets of Larry, 142, 809, and others and, at the same time, commenced the within action. The Mareva injunction was obtained on the basis of inaccurate and incomplete evidence, including a wildly inflated claim for damages. Larry sought to challenge the continuation of the Mareva injunction and filed comprehensive evidence exposing the inaccuracies

in FSRA's evidence and submissions. The Mareva injunction was settled on the eve of the return motion.

The Accounts

115.1 The Accounts are governed by contracts between the Larry Parties, on the one hand, and PACE, on the other, pursuant to which PACE is obligated to return the funds held in the Accounts on demand.

116. Subsequent to the settlement of the Mareva injunction, in or around May 2019, FSRA collapsed the ~~a~~Accounts held by Larry, 142, and 809 at PACE and used the proceeds to pay the costs of its own Administration Order and its actions against Larry, 142, and 809. PACE's 2018 audited financial statements dated June 25, 2019 (the "**Financial Statements**") indicate that the funds previously held in the ~~a~~Accounts had~~ve~~ been used by FSRA/PACE to pay for the costs of the Administration Order, including FSRA's counsel's fees. PACE had~~s~~ simply kept the rest of the funds. In particular, the Financial Statements state:

> DICO filed an affidavit on behalf of the Credit Union in December 2018. The litigation was against certain former senior management employees. **The court froze the bank accounts owned by the individuals at the Credit Union. Subsequently, the funds were released to the Credit Union in accordance with the Credit Union Act. The recovery amount was $3.8 million after netting the administration fees, taxes, and legal cost**. The recovered amount was recorded as the Credit Union's incomes or expenses in 2019. It would have increased the capital ratio from 8.32% to 8.87% and leverage ratio from 5.07% to 5.41% as at December 31, 2018. [emphasis added]

116.1 The Larry Parties brought an application in August 2019 seeking an order directing FSRA/PACE to pay the amounts formerly held in the Accounts to them or, in the alternative, for

an order directing FSRA/PACE to pay those amounts into court pending a resolution of the within action (the "**Account Application**").

116.2 The Account Application was heard by Justice Koehnen on August 5, 2020. In his decision dated October 26, 2020, Justice Koehnen granted the Account Application in part and ordered FSRA/PACE to restore the Larry Parties' Accounts to the state they were in prior to being "collapsed" and to compensate the Larry Parties for any loss of interest. He held that the "preferable way of proceeding in situations like this is simply to preserve the status quo."

116.3 In an endorsement dated December 28, 2020, Justice Koehnen ordered PACE to pay the $50,000 Outstanding Costs Award in favour of the Larry Parties. That award remains due and owing despite the Larry Parties' demands.

116.4 Contrary to Justice Koehnen's order, no interest payments have been made to the Larry Parties to date and no interest was accrued in the Accounts. All such payments remain due and owing. On the sale of the assets of PACE to Alterna Savings and Credit Union Limited in June 2022, PACE no longer operated as a credit union or a deposit taking institution, contrary to Justice Koehnen's order.

Larry's History with PACE and its Predecessors

a) Larry's Employment Agreements

117. Larry joined IBM Credit Union in or around 1988. At that time, Larry was engaged as IBM Credit Union's General Manager pursuant to the IBM Agreement through MAS (the predecessor to 809). In or around October 1994, Larry entered into the Markham-Stouffville Agreement, which confirmed his continued engagement as General Manager. The Markham-

Stouffville Agreement contained an Irrevocable Direction on behalf of Markham-Stouffville Credit Union with respect to the Severance Trust (explained in greater detail below).

118. In or about July 1997, Uxbridge Credit Union Limited and Markham-Stouffville Community Credit Union amalgamated and continued as GTA Credit Union. Following that merger, 809 entered into a further consulting agreement with GTA Credit Union in order to confirm the continuation of Larry's appointment as President and CEO of GTA Credit Union.

119. In or around April 2000, Larry entered into an employment agreement with GTA Credit Union pursuant to which he was employed as the CEO of GTA Credit Union. On January 1, 2001, 142 entered into a consulting agreement with GTA Credit Union pursuant to which 142 agreed to provide management services and advice to GTA Credit Union.

120. In or around November 2002, GTA Credit Union and PACE took steps to amalgamate and continue as PACE. As a result of that amalgamation, Larry entered into an employment agreement with PACE dated November 7, 2002 pursuant to which he was engaged as the Chief Executive Officer of PACE. The 2002 Agreement (as herein defined) included a termination provision at section 5(iii) which provided that it was terminable at Larry's election one minute before the effective date of an administration order made under section 294 of the Act. As with Larry's earlier agreements with PACE's predecessor credit unions described above, PACE agreed to hold certain funds in the Trust Fund administered by Reisler for Larry's benefit in the event of termination.

121. In May 2006, upon the retirement of PACE's then-current President, Larry entered into an additional agreement with PACE confirming his appointment as President of PACE effective May 1, 2006 and continuing until his 65th birthday. That agreement did not replace his 2002 Agreement.

122. On February 1, 2012, Larry entered the 2012 Agreement, pursuant to which:

a) Larry was appointed as CEO and Managing Director until October 3, 2020;

b) Larry was entitled to an annual salary of $200,000 from February 1, 2020 to October 3, 2015 and an annual salary of $144,000 from October 4, 2015 to October 3, 2020;

c) Larry was entitled to participation in PACE's annual bonus pool;

d) Larry was entitled to participate in PACE's employee benefits program;

e) Commissions equivalent to ¼% to 1% of the total assets acquired on the amalgamation of PACE with any other credit union;

f) PACE agreed to make a contribution equal to 12% of Larry's annual salary, fees and bonuses to Larry's RRSP, or an equivalent contribution made to an employee pension plan;

g) PACE agreed to pay "membership dues and fees, business related membership costs, and out of pocket business or business related expenses, including Clublink and Beacon Hall memberships, (being a condition of employment) shall be paid for by the Credit Union"; and

h) An advance of $4,500/month against expenses, if necessary.

123. The 2012 Agreement explicitly limited the Credit Union's ability to terminate. In particular, the 2012 Agreement could be terminated only in the following ways, "in which case the Credit Union agrees to pay to the Employee the Termination Payment described in paragraph 6 below":

a) At any time by written notice by Larry, or at any time, by written notice of the Credit Union's intent to terminate this Agreement provided that such notice shall not be given prior to October 3rd, 2020;

b) Upon Larry's death; or

c) At Larry's option, one minute before the effective date and time of an administration order made pursuant to subsection 294(1) of the Act or the appointment pursuant to the Act of a Liquidator of the Credit Union's assets.

124. On an event of termination, PACE agreed to pay an aggregate payment comprised of all compensation amounts due to Larry set out in sections 4(i) 4(ii), 4(iii), and 4(iv) of the 2012 Agreement until October 3, 2020, being:

a) Larry's salary and benefits;

b) A bonus allocation; and

c) Any commissions due on amalgamations with other credit unions.

125. The termination payment was due and payable immediately on the occurrence of a termination event.

126. Pursuant to section 4 of the 2012 Agreement:

> The foregoing appointment and the entering into of this Agreement by the Credit Union has been duly authorized by the Board of Directors/Executive Committee of PACE Credit Union by way of Resolution. The directors of PACE who are signatories to this agreement are duly authorized by the board of Directors to enter into and approve this agreement. A copy of such Resolution will be provided to the employee by the Credit Union, if requested.

127. The 2012 Agreement was signed by Gerry Robin (Chair of the Board) and Pauline Wainwright (Board Secretary) and was ratified by a resolution of the Board.

128. The 2012 Agreement provides that it "shall enure to the benefit of and be binding upon the parties hereto and their respective heirs, executors, administrators, successors and assigns".

129. In December 2015, Phil transitioned into the role of CEO of PACE and Larry continued as President. The Board considered and approved the transition. The minutes also indicate that Larry's "[s]pecific duties, responsibilities and authorities [would] be clarified with and agreed to by [him] and the Board Chair by authority of the Board." The Board subsequently approved the Executive Committee's recommendations in this respect on December 17, 2015.

130. On May 1, 2015, Larry and PACE entered into the 2015 Agreement, pursuant to which Larry surrendered his role as CEO of PACE and continued as President and Managing Director. Pursuant to section 1 of the 2015 Agreement, Larry was appointed as President and Managing Director from the period of May 1, 2015 to October 3, 2021. The 2015 Agreement set out the following compensation:

a) Larry was entitled to an annual salary of $300,000 from February 1, 2015 to October 3, 2021;
b) Larry was entitled to participation in PACE's annual bonus pool;
c) Larry was entitled to participate in PACE's employee benefits program;
d) Commissions equivalent to ¼% to 1% of the total assets acquired on the amalgamation of PACE with any other credit union;
e) PACE agreed to make a contribution equal to 12% of Larry's annual salary, fees and bonuses to Larry's RRSP, or an equivalent contribution made to an employee pension plan;
f) PACE agreed to pay "membership dues and fees, business related membership costs, and out of pocket business or business related expenses, including Clublink and Beacon Hall

memberships, (being a condition of employment) shall be paid for by the Credit Union"; and

g) An advance of $5,000/month against expenses, if necessary.

131. The 2015 Agreement explicitly limited the Credit Union's ability to terminate. In particular, the 2015 Agreement could be terminated only in the following ways, "in which case the Credit Union agrees to pay to the Employee the Termination Payment described in paragraph 6 below":

a) At any time by written notice by Larry, or at any time, by written notice of the Credit Union's intent to terminate this Agreement provided that such notice shall not be given prior to October 3rd, 2021;
b) Upon Larry's death; or
c) At Larry's option, one minute before the effective date and time of an administration order made pursuant to subsection 294(1) of the Act or the appointment pursuant to the Act of a Liquidator of the Credit Union's assets.

132. On an event of termination, PACE agreed to pay an aggregate payment comprised of all compensation amounts due to Larry set out in sections 4(i) 4(ii), 4(iii), and 4(iv) of the 2015 Agreement until October 3, 2021, being:

a) Larry's salary and benefits;
b) A bonus allocation; and
c) Any commissions due on amalgamations with other credit unions.

b) 809's Agreements

133. 809's consulting agreement with PACE was originally approved by PACE's Executive Committee on June 26, 2006 (although Larry had been using 809 or its predecessors as a vehicle for providing services to the Credit Union since 1988). The 809 Agreement, 809's most recent consulting arrangement with PACE, was executed on March 27, 2015.

134. Under the 809 Agreement, 809 agreed to report to the Board and perform duties as assigned to it by the Board. The primary responsibilities of 809 were stated as follows:

> [T]he day to day operation and management of the Credit Union's property development division. This will include but not be limited to land acquisition, approval of development budgets, interaction with development partners and the approval of financing … as required in order to complete such projects in a timely and risk effective and profitable manner.

135. Section 4 of the 809 Agreement confirms that it was "duly authorized by the directors of the Credit Union pursuant to the authority conferred upon the executive committee and such agreement was originally approved by the executive committee on June 26th, 2006."

c) 142's Agreements

136. The 142 Agreement was originally approved by PACE's Executive Committee on October 28, 2002, pursuant to which 142 agreed to perform management, data processing, and other services to PACE. This agreement was subsequently reapproved by the Audit Committee on December 13, 2006. The 142 Agreement was memorialized in writing in July 2007, and then amended in November 2012 and, most recently, on December 14, 2017.

137. Under the 142 Agreement, 142 agreed to perform certain duties as assigned to it by the Board, including public relations, marketing, management and/or data processing services,

investigation and analysis of merger and acquisition opportunities, other duties as mutually agreed by 142 and the Board, mergers and acquisitions, amalgamations, and trust fund administration.

Wrongful Dismissal

138. Larry exercised his option to terminate the 2015 Agreement pursuant to section 5(iii), being one minute before the effective date of the Administration Order. Accordingly:

a) PACE's purported termination of December 5, 2018 is of no force and effect; and

b) Larry is entitled to the amounts set out in section 6 from the date of the Administration Order to October 3, 2021, currently calculated based on Larry's average compensation between 2015 and 2017 at $1,933,064.

139. In the alternative, by terminating Larry, purportedly for cause where no just cause exists, PACE breached the terms of the 2015 Agreement. Pursuant to the terms of the 2015 Agreement, Larry is entitled damages for breach of contract in accordance with the payment set out at section 6 of the 2015 Agreement, being $1,933,064. In the further alternative, Larry is entitled to common law reasonable notice of termination. Considering his age at termination of 68, his senior position as President and Managing Director (as well as his former position as CEO), his thirty years of service to the Credit Union and the relative lack of availability of similar employment, reasonable notice in this case is 24 months, or $1,288,709.

140. As discussed in further detail below, following the Administration Order both FSRA and PACE defamed Larry and, in so doing, caused significant and continuing damage to Larry's personal and professional reputation. As a consequence of this defamation and resulting reputational damage, Larry has no prospect of successfully mitigating his damages.

Breach of Contract – 142

I. The Severance Trust

141. Beginning in 1994, with the agreement entered into between Larry and PACE (or its predecessor), the Credit Union has established and maintained a severance trust (the "**Severance Trust**"), pursuant to which Larry or his associated companies would be entitled to the receipt of a portion of the proceeds of the Severance Trust on termination of his employment.

142. The genesis of the Severance Trust is a consulting agreement between Larry, 809 (then carrying on business as MAS) and the IBM Credit Union (a predecessor to PACE). Pursuant to that consulting agreement, PACE issued an irrevocable direction to Reisler, the trustee for the Severance Trust, that he "…place in trust a sum equal to eighteen (18) months' salary due to [Larry] in the first year of the term to secure the severance which may be due to [Larry]…" and to pay the amounts to MAS upon receipt of a Notice of Termination. The Severance Trust was payable to 809 even if the Credit Union terminated Larry's contract without notice.

143. On October 10, 1994, Larry and the Markham-Stouffville Credit Union (a predecessor to PACE), entered into a further contract, wherein the parties acknowledged:

> AND WHEREAS pursuant to paragraph 9 of the Consulting Agreement the Credit Union has agreed to place in trust a sum equal to eighteen (18) months' compensation due to Smith in the first year of the term to secure the severance which will be due to Smith pursuant to the terms of the Consulting Agreement;
>
> AND WHEREAS pursuant to the Consulting Agreement the Credit Union has agreed to appoint Arn C.J. Reisler Trustee of the monies to be retained in accordance with its terms and deliver this irrevocable direction to the Trustee;

144. In that agreement, the parties agreed to increase the amount in the Severance Trust from $184,500 to $243,000. At the same time, PACE signed an irrevocable direction to Reisler

requiring him to "retain the sum of $243,000 in the name of the Credit Union and to pay out the funds on receipt of a Notice of Termination".

145. In November 2002, when Larry and PACE updated his employment agreement upon the amalgamation that formed PACE (the "**2002 Agreement**"), the Credit Union agreed that:

> In order to secure the Severance due to Smith in accordance with the terms of this Agreement the Credit Union has agreed to place in trust a sum equal to three year's base wages due Smith to be administered by the Trustee…

146. In addition, the 2002 Agreement contained detailed provisions relating to the management of the Severance Trust, including:

a) "The [Severance Trust] shall be maintained in the name of [Reisler], in trust for PACE, at Nesbitt Burns or such other financial institution as chosen by [Reisler], together with the [Severance Trust], now in existence, for the benefit of other senior employees of the Credit Union to be jointly administered by [Reisler] and the senior employees who are beneficiaries of the trust…;"

b) PACE would increase the Severance Trust to ensure that the principal would secure the agreed upon severance; and

c) Interest or other monies earned by the Severance Trust would accrue and be the property of Larry and would be payable at least on an annual basis. Until the Administration Order, Larry and the other beneficiaries received these payments.

147. Pursuant to section 11 of the 2002 Agreement, PACE made an irrevocable direction to Reisler to pay the funds in the Severance Trust to Larry upon the occurrence of any of the events referred to in the "termination" sections of the contract.

148. On July 1, 2007, PACE and 142 entered into the 142 Agreement, pursuant to which the Severance Trust became payable to 142, as opposed to Larry personally. In addition, the amount held in trust for 142 was increased from 36 months of Larry's salary to 56 months of 142's consulting fees. All other terms of the Severance Trust remained materially the same, except that the Credit Union undertook the obligation to 'top up' the Severance Trust if its principal fell below the amount required to make the severance payment. Section 12 of the 142 Agreement states:

> Upon receipt of a copy of the [Notice of Termination]…the Credit Union and the Consultant hereby irrevocably authorize and direct the Trustee to forthwith pay to the Consultant the Termination Payment, and for so doing this shall be the Trustee's good and sufficient authority for so doing. (the "**Irrevocable Direction**")

149. On November 7, 2012, the 142 Agreement was amended and updated to increase the amount held in the Severance Trust from 56 months to 75 months of 142's consulting fees, which at the time were $20,000/month, or $1,500,000. On December 14, 2017, the 142 Agreement was amended to extend the date of the agreement to July 31, 2025. No changes to the Severance Trust were made.

150. Contrary to the allegations made by FSRA, the 142 Agreement is not "*void ab initio*". Even if 142 engaged in the conduct asserted in FSRA's letter of September 28, 2018, such conduct could not legally support a finding that the 142 Agreement is void. Rather, PACE's obligations pursuant to those agreements are clear and unequivocally enforceable.

151. FSRA's reasoning for issuing the Administration Order without notice was, in part, to avoid triggering the payment of the funds from the Severance Trust to Larry, as required by the 142 Agreement. In particular, in unsigned reasons delivered October 11, 2018, FSRA stated that the Administration Order was issued under section 240.1 because:

> Any delay to effect notice pursuant to section 240.1 would likely result in the triggering of the immediate loss of $1.5 million or more to the Credit Union in termination payments to Larry.

152. However, one minute before the Administration Order was issued by FSRA, the direction to pay the Severance Trust to Larry was triggered and, pursuant to the Irrevocable Direction, the amount from the Severance Trust – $1,500,000 plus applicable interest – is due and owing. In the alternative, PACE was required to pay the balance of the Severance Trust to Larry or 142 as a condition of terminating the contract and, upon its decision to terminate the contract (by declaring it "*void ab initio*"), PACE owed the balance of the Severance Trust to Larry or 142. In the further alternative, 142 terminated the 142 Agreement one minute before the effective date and time of the Administration Order, and the Severance Trust became payable at that time.

153. FSRA and Reiser have refused make payment to 142 from the Severance Trust in accordance with the 142 Agreement and the Irrevocable Direction. Larry and 142 are entitled to no less than $1,500,000 in accordance with the 142 Agreement from the Severance Trust.

II. Breach of the 142 Agreement

154. Pursuant to section 6(i) of the 142 Agreement, PACE can only terminate the 142 Agreement:

a) Upon payment of the compensation referred to in the contract to the termination date; and

b) Upon further payment of the proceeds of the amounts due from the Severance Trust net of advances, borrowing or drawdowns by 142 (which were, in fact, $0).

155. Upon making the Administration Order, PACE/FSRA ceased making payments to 142 pursuant to the 142 Agreement. FSRA has never terminated the 142 Agreement on its terms. To

the contrary, its assertion that the 142 Agreement was "*void ab initio*" and refusal to continue the contractual payments constituted a breach of the 142 Agreement. FSRA's refusal to pay the amounts owing pursuant to section 6(i) of the 142 Agreement – including the amounts due from the Severance Trust – is a further breach of that contract.

156. As a result of those breaches of contract, 142 is owed the monthly amount of $20,000, plus any applicable bonuses, from September 28, 2018 to the date of judgment, as well as a $120,000 termination fee pursuant to section 6 of the 142 Agreement. In the alternative, if FSRA's letter of September 28, 2018 is deemed to be "notice" pursuant to section 6(i) of the 142 Agreement, then 142 is owed the compensation due under the contract, being six months of consulting fees, annual bonus payment, and amounts payable from the Severance Trust, as set out above.

Breach of Contract – 809

157. Pursuant to the 809 Agreement – last amended on March 27, 2015, 809 was entitled to:

a) Consulting fees of $240,000 per annum;
b) Annual bonus payment as determined from time to time and approved by the Board and/or the Executive Committee; and
c) Occasional and additional profit-sharing disbursements from development partners.

158. Pursuant to section 6 of the 809 Agreement, it can only be terminated on 6 months notice by PACE or 809, or on Larry's death. Where the Credit Union seeks to terminate the 809 Agreement, that termination is only effective "upon payment of the compensation referred to in the contract to the termination date".

159. To date, FSRA has not terminated the 809 Agreement on its terms. It has not paid "the compensation referred to in the contract to the termination date" and, instead, has taken the false position that the contract is "*void ab initio*". Contrary to FSRA's assertions, the 809 Agreement is not "*void ab initio*". Even if 809 engaged in the conduct asserted in FSRA's letter of September 28, 2018, such conduct could not legally support a finding that the 809 Agreement is void.

160. FSRA's assertion that the 809 Agreement was "*void ab initio*", and/or its subsequent refusal to pay any further fees due pursuant to the contract, was a breach of the 809 Agreement. Its refusal to pay the amounts required under section 6(i) is a further breach of the 809 Agreement.

161. Accordingly, 809 is owed the annual amount of $240,000, plus any applicable bonuses, plus amounts that would have been received pursuant to section 5(iv) of the 809 Agreement from September 28, 2018 to the date of judgment, as well as $120,000 termination fee pursuant to section 6 of the contract. In the alternative, if FSRA's letter of September 28, 2018 is deemed to be "notice" pursuant to section 6(i) of the 809 Agreement, then 809 is owed the compensation due under the contract, being six months of consulting fees, annual bonus payment, and compensation pursuant to section 5(iv).

FSRA and PACE Defamed Larry

162. Following the Administration Order, both FSRA and PACE uttered libelous words and published slanderous words (collectively, the "**Defamatory Words**"), as set out below, about Larry. The Defamatory Words were published by FSRA both in its capacity as Administrator of PACE and in its own capacity.

163. In particular, on November 22, 2019, PACE published a memo to all of its members. The memo stated, *inter alia*:

> DICO's supervision of PACE discovered failed governance and fraud – e.g. former senior executives acting in their own personal interest, and not in the best interest of the credit union, but at the expense of the credit union's members.

164. The note was referring to Larry, a fact that PACE intended to convey and the Credit Union's members, in fact, understood. Further down in the memo, specific reference is made to PACE having commenced litigation against Larry and Phil.

165. By their natural and ordinary meaning, the Defamatory Words meant, were intended to convey, and were understood to mean that Larry had committed fraud, had breached his duties to PACE, and was responsible for governance failures at the Credit Union. The note was false, as Larry was never involved in fraudulent activity, was not responsible for any governance failures at PACE (which are denied), and did not breach any duty to PACE at all.

166. In addition to the above, employees of FSRA and/or PACE have made various oral statements to members of PACE – including at the PACE 'town hall' held in December 2019 – conveying the idea that Larry had committed fraud, had breached his duties to PACE, and was responsible for governance failures at the Credit Union. Those statements are also false.

167. The Defamatory Words were false and maliciously published by FSRA and/or PACE knowing that they were false or with careless disregard as to whether they were true or not. As a result of the publication of the Defamatory Words, Larry has been subject to contempt and has suffered damages to his reputation personally and professionally.

168. Larry spent nearly 30 years building a professional reputation around his commitment to PACE and its members. As a result of the Defamatory Words, and all repetitions, republications, and broadcasts of them, Larry's professional character and reputation in his profession have been irrevocably damaged. Larry has also suffered personal embarrassment, humiliation, and damage to his personal character.

169. As a result of the Defamatory Words, Larry has suffered and will continue to suffer damages for which FSRA and PACE are liable.

Damages – Freezing of Assets

170. Upon the issuance of the Administration Order, FSRA/PACE 'froze' all of the bank ~~a~~Accounts and other assets belonging to the Larry Parties held at the Credit Union, and at PACE Securities. PACE had no right to do so. In particular, the account agreements for 142 and 809 contained no right to freeze the ~~a~~Accounts, and the account agreement for Larry's personal accounts only allowed PACE to freeze assets if:

a) PACE becomes aware of "suspicious or possible fraudulent or unauthorized Account activity that may cause a loss to [Larry], [PACE], Central 1, or an identifiable Third Party;
b) An issue arises as to who the proper signing authorities are on the Account"; or
c) A claim is made by a Third Party to the funds in the account which, in PACE's sole discretion, is potentially legitimate.

171. None of the conditions were met, either in September 2018, or at any time. In particular, PACE has not made any allegations against the Larry Parties relating to "suspicious or possible fraudulent or unauthorized Account activity". Rather, PACE – acting in bad faith and solely in its

own interests – froze the ~~a~~Accounts in order to protect its own litigation interests, and not for any valid or lawful reason.

172. In March 2019, concurrently with obtaining the Mareva injunction, FSRA and/or PACE gave an "undertaking as to damages" that it would pay damages to Larry, 142, or 809 for losses suffered as a result of the imposition of the Mareva injunction. As set out above, FSRA's claim is without merit, and the Mareva injunction obtained in connection with that claim was equally unfounded. Larry, 142, and 809 have suffered damages as a result of the injunction and as a result of FSRA's illegal freeze of the ~~bank~~ Accounts held at PACE and the securities accounts held at PACE Securities. In particular, Larry, 142, and 809 have suffered a loss of opportunity to profit from the inability to deploy their capital in the manner of their choosing.

173. As a result of the freezing of the Larry Parties' ~~a~~Accounts and as a result of the Mareva injunction, the Larry Parties have suffered damages, to be particularized at trial.

Malfeasance in Public Office or Regulatory Negligence by FSRA

174. FSRA committed the torts of malfeasance in public office or, in the alternative, regulatory negligence by its actions in obtaining the Administration Order and/or the Mareva injunction, including:

a) Issuing the Administration Order without notice for the specific purpose of denying 142 its rightful payment from the Severance Trust;

b) By declaring the 142 Agreement and 809 Agreement "*void ab initio*" while knowing that there was no valid legal authority to do so, and for the purpose of avoiding the payments owed by PACE to 142 and 809;

c) By freezing the bank accounts held by Larry, 142, and 809 at PACE, and by freezing the accounts held by Larry, 142, and 809 at PACE Securities without any lawful authority; and

d) By obtaining and maintaining the Mareva injunction where no cause to do so existed and for the purpose of gaining an undeserved tactical advantage.

175. By taking the above steps, FSRA acted with malice, and for the purpose of injuring Larry, 142, and/or 809. In the alternative, FSRA acted recklessly and with a mindful indifference to the probability that its actions would cause unjustified injury to Larry, 142, and/or 809. In the further alternative, in exercising its statutory power to put PACE into administration, FSRA acted negligently, and below the standard expected of a prudential regulator.

Indemnity for Legal Fees

176. Pursuant to Article 8.02 of PACE By-Law No.1 (the "**By-Law**"), PACE is obliged to indemnify Larry, as a former officer of the Credit Union, and to advance his legal expenses to defend this action and any related civil and administrative proceedings. The By-Law states:

> **8.02** subject to the limitations contained in the Act, the Credit Union *shall indemnify* a director, officer, or committee member, *a former director or officer or committee member,* or a person who acts or acted at the Credit Union's request as a director or officer of a body corporate of which the Credit Union is or was a member, shareholder or creditor, and his or her heirs and legal representatives, *against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgement, reasonably incurred by him or her in respect of any civil, criminal or administrative action or proceeding to which he or she is made a party by reason of being or having been a director or officer of the Credit Union or such body corporate*, if:
>
> (a) he or she acted in good faith with a view to the best interests of the Credit Union; and
>
> (b) in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, he or she had reasonable grounds for believing that his or her conduct was lawful.

> The Credit Union shall also indemnify such person in such other circumstances as the Act permits or requires. [emphasis added]

177. Section 157 of the Act states that:

> (3.1) A credit union may advance money to an eligible person to pay for the costs, charges and expenses of any proceeding to which the person is made a party by reason of serving or having served in a qualifying capacity, but the person is required to repay the money if either of the conditions described in subsection (5) is not satisfied.
>
> (4) With the approval of a court, a credit union may indemnify an eligible person in respect of a proceeding by or on behalf of the credit union or entity to procure a judgment in its favour to which the person is made a party by reason of serving or having served in a qualifying capacity.

178. Larry was an officer of the Credit Union pursuant to the By-Law at all relevant times and is an "eligible person" under section 157(1)(b) of the Act. At all times, Larry acted in good faith and in the best interest of the Credit Union. He fulfils the requirements under the By-Law and under section 157 of the Act.

179. Larry is entitled to indemnification for the legal fees that he has already incurred in defending the action on his behalf and on behalf of the other Larry Parties, and is entitled to continuing advancement of legal fees pending disposition of the action. In the alternative, this action was commenced by FSRA, acting as Administrator for PACE. In the event that this is a derivative action pursuant to the Act, then Larry is entitled to indemnification for his fees pursuant to section 157(4) of the Act and for continuing advancement of legal fees pending disposition of the action.

Punitive Damages

180. Larry, 142, and 809 state that FSRA engaged in independent actionable wrongs, as described above, for which they are entitled to punitive and exemplary damages. FSRA's conduct

was harsh, vindictive, reprehensible, and malicious and this Honourable Court should find that the conduct of FSRA and PACE is deserving of an award of punitive and exemplary damages.

CROSSCLAIM

181. The Defendants Larry, 142, and 809 make the following Crossclaims against the Defendants Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, Peter Rebellati, Jim Tindall, Pauline Wainwright, Neil Williamson, and George Pohle, all of whom are former directors of PACE (the "**Directors**"):

a) Contribution and indemnity under section 2 of the Ontario *Negligence Act*, R.S.O. 1990, c. N.1, as amended, for any amounts for which Larry, 142 and/or 809 may be held liable to the Plaintiff in this action;

b) Contribution and indemnity under the common law and equity for any amounts which, Larry, 142, and/or 809 may be held liable to the Plaintiff in this action;

c) The costs of this action on a substantial indemnity basis, plus all applicable taxes; and

d) Such further and other relief as to this Honourable Court may seem just.

182. Larry, 142, and 809 repeat and rely on their Amended Statement of Defence for the purposes of this Crossclaim. In particular, Larry, 142, and 809 deny any and all liability in respect of: (a) the impugned loans transactions and other transactions; (b) the impugned payments; (c) PACE's financial reporting; and/or (d) the Preferred Shares. Larry, 142, and 809 further deny that PACE has suffered any losses as a result of the Defendants' alleged misconduct.

183. However, if Larry, 142, and 809 are liable to the Plaintiff, which is not admitted, but specifically denied, Larry, 142, and 809 plead that the Plaintiff's losses were caused or contributed to by the Directors' failure to fulfil their duties to PACE.

184. The Directors were fiduciaries of and owed a duty to PACE to act with the care, skill, and diligence reasonably expected of a prudent director. Larry was at all times honest and transparent with the Board and Credit Committee and provided the Directors with all of the information and documentation that they required to fulfil their duties to PACE. The Directors nonetheless breached their duties to PACE and caused PACE to incur losses by:

a) If any of the payments referred to in paragraphs 111-115 or 117-125 of the Claim were improperly received by the Larry Parties, failing to conduct reasonable due diligence, make reasonable inquiries, and follow PACE's governance standards when reviewing the expenses that Larry submitted to the Board and when approving the payments made by PACE to Larry. Larry disclosed every dollar that he received, and each of those payments was stamped and approved;

b) If any of the loans granted by the Credit Union were offside lending practices, failing to conduct reasonable due diligence, make reasonable inquiries, and follow PACE's governance standards, statutory obligations, and commercial lending practices when reviewing and approving the impugned loans and other transactions. In particular, the Directors voted to approve and/or were aware of the following transactions referred to in the Claim by PACE, *inter alia*:

   i. The 2012 Agreement between PACE and Larry and the 2015 amendment to that agreement;

   ii. The 809 Agreement;

iii. The amendments to the 142 Agreement in 2012 and 2017;

iv. The CCE transaction;

v. The "Acknowledgement and Resolution" relating to payments to Larry, 142, and 809;

vi. The default by Inveraray Glen and the subsequent accounting treatment by PACE;

vii. The City View loan;

viii. The SusGlobal loan;

ix. The 1934811 Ontario Ltd. loan;

x. The proposed Lagasco transaction; and

xi. The Lora Bay and Noble House loans;

c) If PACE's financial reports were inaccurate, failing to ensure that PACE met its financial reporting obligations under section 140 of the Act and section 28 of the General Regulations. The Directors voted to approve the Credit Union's financial statements each year; and

d) If damages are owed to the investor claimants, failing to oversee and ensure the regulatory compliance of PACE's subsidiaries including in relation to the Preferred Shares. In particular, the Directors approved the sale of the Preferred Shares and the FHH investments to investors (including Credit Union members) by PACE Securities.

185. It was reasonably foreseeable that PACE would suffer harm if the Directors failed to meet their requisite standards of care to PACE.

186. The Defendants Larry, 142, and 809 rely on the provisions of the Ontario *Negligence Act*, R.S.O. 1990, c. N.1 in support of this Crossclaim.

~~October 16, 2020~~ ~~June 21, 2021~~
October 26, 2022

CRAWLEY MACKEWN BRUSH LLP
Barristers & Solicitors
Suite 800, 179 John Street
Toronto ON M5T 1X4

Alistair Crawley (LSO#: 38726D)
acrawley@cmblaw.ca
Tel: 416.217.0806
Clarke Tedesco (LSO#: 55391C)
ctedesco@cmblaw.ca
Tel: 416.217.0884
Dana Carson (LSO#: 65439D)
dcarson@cmblaw.ca
Tel: 416.217.0855

Tel: 416.217.0110

Lawyers for the defendants (plaintiffs by counterclaim), Larry Smith, 1428245 Ontario Ltd., and 809755 Ontario Ltd.

PACE SAVINGS & CREDIT UNION LIMITED et al. -and- LARRY SMITH et al.
Plaintiff Defendants
LARRY SMITH et al. -and- PACE SAVINGS & CREDIT UNION LIMITED et al.
Plaintiffs by Counterclaim Defendants by Counterclaim

Court File No. CV-19-00616388-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT
TORONTO

FURTHER AMENDED STATEMENT OF DEFENCE ~~AND~~, COUNTERCLAIM AND CROSSCLAIM OF THE DEFENDANTS, LARRY SMITH, 1428245 ONTARIO LTD. AND 809755 ONTARIO LTD.

CRAWLEY MACKEWN BRUSH LLP
Barristers & Solicitors
Suite 800, 179 John Street
Toronto, ON M5T 1X4

Alistair Crawley (LSO#: 38726D)
acrawley@cmblaw.ca
Tel: 416.217.0806
Clarke Tedesco (LSO#: 55391C)
ctedesco@cmblaw.ca
Tel: 416.217.0884
Dana Carson (LSO#: 65439D)
dcarson@cmblaw.ca
Tel: 416.217.0855

Tel: 416.217.0110

Lawyers for the defendants (plaintiffs by counterclaim), Larry Smith, 1428245 Ontario Ltd., and 809755 Ontario Ltd.

#433466

Email for parties served:
Crawford Smith: csmith@lolg.ca
Andrew Winton: awinton@lolg.ca
Shaun Laubman: slaubman@lolg.ca
Philip Underwood: punderwood@lolg.ca
David Ionis: dionis@lolg.ca
Steven Weisz: sweisz@cozen.com
Pat Corney: pcorney@reconllp.com
Janice Wright: janice@wrighttemelini.com
Jonah Arnold: jonah@healthlawfirm.ca
Michael Cohen: michaelcohen@michaelcohenbarrister.ca
Edwin Upenieks: eupenieks@lawrences.com
Jonah Waxman: jwaxman@lawrences.com
Victor Vandergust: vic@vandergustlaw.com
Frank E.P. Bowman: frank.bowman@dentons.com
Douglas B.B. Stewart: douglas.stewart@dentons.com
Deepshikha Dutt: deepshikha.dutt@dentons.com
Rita Benjamen: rita.benjamen@dentons.com
Ted Frankel: tfrankel@cassels.com
Sophie Moher: smoher@cassels.com

TAB E

Court File No.: CV-19-00616388-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

PACE SAVINGS & CREDIT UNION LIMITED, by its administrator, FINANCIAL SERVICES REGULATORY AUTHORITY

Plaintiff

- and -

LARRY SMITH, PHILLIP SMITH, 1428245 ONTARIO LTD., 809755 ONTARIO LTD. (a.k.a. ELECTIVE BENEFIT INSURANCE SERVICES), MALEK SMITH, 1916761 ONTARIO LTD., ALISON GOLANSKI, 1724725 ONTARIO LTD., FRANK KLEES, KLEES & ASSOCIATES LTD., RON WILLIAMSON, R. WILLIAMSON CONSULTANTS LIMITED, RON WILLIAMSON QUARTER HORSES INC., BRIAN HOGAN, BRENT BAILEY, DEBORAH BAKER, IAN GOODFELLOW, AL JONES, WENDY MITCHELL, GEORGE POHLE, PETER REBELLATI, JIM TINDALL, PAULINE WAINWRIGHT, NEIL WILLIAMSON, KIM COLACICCO and JANE LOWRIE

Defendants

A N D B E T W E E N:

PHILLIP SMITH

Plaintiff by Crossclaim

-and-

BRENT BAILY, DEBORAH BAKER, IAN GOODFELLOW, AL JONES WENDY MITCHELL, PETER REBELLATI, JIM TINDALL, PAULINE WAINWRIGHT, NEIL WILLIAMSON, and GEORGE POHLE

Defendants by Crossclaim

STATEMENT OF DEFENCE, COUNTERCLAIM AND CROSSCLAIM OF THE DEFENDANT PHILLIP SMITH

July 8, 2021

WEISZ FELL KOUR LLP
Royal Bank Plaza, South Tower
200 Bay Street
Suite 2305, P.O. Box 120
Toronto, ON M5J 2J3

Steven Weisz
LSO No. 32102C
sweisz@wfklaw.ca
Tel: 416.613.8281

Sharon Kour
LSO No. 58328D
skour@wfklaw.ca
Tel: 416.613.8283

Pat Corney
LSO No. 65462N
pcorney@wfklaw.ca
Tel: 416.613.8287

Fax: 416.613.8290

Lawyers for the Defendant,
Phillip Smith (Plaintiff by Counterclaim)

TO: **GOODMANS LLP**
Barristers and Solicitors
Bay Adelaide Centre
333 Bay Street
Suite 3400
Toronto, ON M5H 2S7

Jason Wadden (LSO#: 467575M)
jwadden@goodmans.ca
Tel: 416.597.5165

Meghan King (LSO#: 80030P)
mking@goodmans.ca
Tel: 416.597.4164

Michael Wilson (LSO#: 646740)
mwilson@goodmans.ca
Tel: 416.597.4130

Tel: 416.979.2211

Lawyers for the Plaintiff

AND TO: **CRAWLEY MACKEWN BRUSH LLP**
Barristers & Solicitors
Suite 800, 179 John Street
Toronto, ON M5T 1X4

Alistair Crawley (LSO#: 38726D)
acrawley@cmblaw.ca
Tel: 416.217.0806

Clarke Tedesco (LSO#: 55391C)
ctedesco@cmblaw.ca
Tel: 416.217.0884

Jonathan Preece (LSO#: 68873T)
jpreece@cmblaw.ca
Tel: 416.217.0897

Tel: 416.217.0110

Lawyers for the defendants
Larry Smith, 1428245 Ontario Ltd. and 809755 Ontario Ltd.

AND TO: **WRIGHT TEMELINI LLP**
411 Richmond Street East, Suite 303
Toronto, ON M5A 3S5

Janice Wright
janice@wrighttemelini.com
Tel: 416.479.9685

Lawyers for the defendants
Malek Smith and 1916761 Ontario Ltd.

AND TO: **WEINMAN, ARNOLD LLP**
390 Bay Street, Suite 1202
Toronto, ON M5H 272

Jonah Arnold
jonah@healthlawfirm.ca
Tel: 416.640.0508

Lawyers for the defendants
Alison Golanski and 1724725 Ontario Ltd.

AND TO: **MICHAEL COHEN**
Barrister and Solicitor
151 Turbine Drive
Toronto, ON M9L 2S7

michaelcohen@michaelcohenbarrister.ca
Tel: 416.920.5252

Lawyers for the defendants
Frank Klees and Klees & Associates Ltd.

AND TO: **LAWRENCE, LAWRENCE, STEVENSON LLP**
Barristers and Solicitors
43 Queen Street West
Brampton, ON L6Y 1L9

Edwin Upenieks
eupenieks@lawrences.com
Tel: 905.452.6873

Jonah Waxman
jwaxman@lawrences.com
Tel: 905.451.6876

Tel: 905.451.3040

Lawyers for the defendants Ron Williamson, R. Williamson Consultants
Limited and Ron Williamson Quarter Horses Inc.

AND TO: **VANDERGUST LAW**
11 Hurontario Street
PO Box 39, Stn. Main
Collingwood, ON L9W 2L7

Victor Vandergust
vic@vandergustlaw.com
Tel: 705.445.4544

Lawyers for the defendant
Brian Hogan

AND TO: **DENTONS CANADA LLP**
Barristers and Solicitors
77 King Street West, Suite 400
Toronto, ON M5K 0A1

Frank E.P. Bowman
frank.bowman@dentons.com
Tel: 416.367.6820

Douglas B.B. Stewart
douglas.stewart@dentons.com
Tel: 416.863.4388

Deepshikha Dutt
deepshikha.dutt@dentons.com
Tel: 416.863.4550

Lawyers for the defendants Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, George Pohle, Peter Rebellati, Jim Tindall, Pauline Wainwright and Neil Williamson

AND TO: **DUNTRUNE LLP**
439 University Avenue
5th Floor
Toronto, ON M5G 1Y8

Matthew Dewar
mdewar@duntrune.law
Tel: 437.836.3170

Lawyers for the defendant
Kim Colacicco

STATEMENT OF DEFENCE

1. The Defendant, Phillip Smith ("**Phil**"), denies all allegations made in the Amended Fresh as Amended Statement of Claim (the "**Claim**").

Overview

2. The Financial Services Regulatory Authority of Ontario (the "**FSRA**"), is the Administrator of PACE Savings and Credit Union Ltd. ("**PACE**") pursuant to an Administration Order issued on September 28, 2018. The Administration Order followed a high-handed investigation of PACE, during which FSRA had clearly pre-judged Phil (and the other Defendants) and denied him basic procedural fairness. In the Claim, FSRA has asserted 11 causes of action against Phil – yet the particulars target other Defendants. None of the causes of action are established on the facts.

3. In summary, the FRSA's allegations against Phil fall into three categories:

(a) Phil failed to disclose his compensation as required by the *Credit Unions and Caisses Populaires Act*, 1994, SO 1994 Chapter 11 (the "**Act**");

(b) Phil failed to stop PACE from entering various transactions and loans, for which he ought to be personally liable; and

(c) Phil received, and failed to stop others from receiving, improper payments, either from third parties on projects related to PACE's business, or from PACE itself, pursuant to "impugned" contracts.

4. These allegations are meritless. Phil always acted in the best interests of PACE. Moreover:

(a) Phil always complied with the Act;

(b) Phil was not involved structuring the transactions and loans deemed improper by FSRA, and such transactions and loans were made according to PACE's approval and governance processes; and

(c) Phil received no improper payments and had no knowledge of any improper payments made to others.

A. THE PARTIES

5. Phil is the former Chief Executive Officer ("**CEO**") of PACE. He was employed by PACE (and its predecessor organization) since he was hired as a teller and administrative assistant in 1989.

6. PACE is a credit union governed by Act. PACE operates 17 branches in Ontario and provides personal, business, and organizational products and services. As at May 28, 2018, PACE had over $1 billion in assets under administration and approximately 35,000 members.

7. PACE operates various business lines, including but not limited to personal and commercial banking, personal and commercial lending, investments, and the acquisition of and partnership with other credit unions.

8. FSRA – who is not a party to this claim in its own capacity – is an Ontario Provincial Agency established under the Act. FSRA administers a deposit insurance program for all Ontario credit unions pursuant to the Act. FSRA first adopted this role in 2019, following an amalgamation with the previous regulator, the Deposit Insurance Corporation of Ontario ("**DICO**"). Hereinafter, both regulators are referred to only as "FSRA" unless specified otherwise.

B. BACKGROUND

Phil is hired by PACE's predecessor organization

9. Phil was hired by PACE's predecessor, GTA Savings and Credit Union, in 1989, on a part-time basis. He worked as a teller and administrative assistant. In 1996, he obtained a full-time position as a teller.

10. In and around 1997, Phil was relocated to a different branch and took on the roles of teller and administrator of the IBM Employees' Charitable Fund.

Phil is promoted to Head Office

11. In and around 1998, Phil was transferred to the Head Office in an information technology role and reported to the VP of Business Development. For several years following, Phil was responsible for IT tasks such as automatic payroll, troubleshooting, processing and clearing files, and implementing IT upgrades.

Mergers and the expansion of PACE

12. In and around 2003, GTA Savings and Credit Union merged with PACE Credit Union and formed PACE. As a result of the merger, Phil became Manager of IT of PACE and was responsible for, among other things, merging the IT systems of the two credit unions.

13. In and around 2007, PACE merged with North York Credit Union and Phil was promoted to Chief Financial Officer ("**CFO**") reporting to the corporate secretary and former CFO, Kim Colacicco, and Chief Operating Officer, Mary Benincasa.

Phil is promoted to the role of CEO

14. Larry Smith ("**Larry**") – Phil's father – was the the President of PACE from December 2015 until September 2018 and prior to that, was the CEO and President of PACE at all relevant times.

15. In and around 2014, Larry fell ill. The Board of Directors unanimously appointed Phil as interim CEO.

16. In 2015, Larry recovered from his illness and was appointed the President of PACE. Around the same time, Phil was appointed CEO.

Activities as CEO

17. Phil was an operational CEO. As CEO, Phil oversaw the management team and was responsible for the day-to-day operations of PACE. He reported directly to the Board. Phil did not take on any role in respect of sourcing business opportunities, including commercial lending, or the growth of PACE's commercial lending and investment portfolio, nor did he aspire to do so.

18. Larry had a gift for business development and was therefore responsible for sourcing commercial loans and potential transactions during his tenure as CEO and/or President of PACE, including while Phil was CEO.

19. Due to their familial relationship, Phil did not supervise or approve the compensation of PACE's President, Larry. Larry reported directly to the Board and his compensation, expenses, and bonuses were all approved by the Board, not Phil.

20. The Board followed a reporting structure that had been in place for years before Phil's appointment as CEO and that continued once Phil became CEO.

21. Phil’s performance as CEO was evaluated by the Board on an annual basis and the results were consistently favorable.

C. LENDING ACTIVITIES AND OVERSIGHT

22. A key focus of PACE's business strategy is its lending portfolio. At the material time between 2015 and 2017, PACE's commercial loan portfolio grew from approximately $49 million to $396 million. Total members’ equity over that same period grew from approximately $53.6 million to $63.1 million. PACE paid an average of approximately $460,000 in dividends to members each year between 2015 and 2017.

23. During the material time, once a loan was sourced and referred to PACE, it went through various layers of review before approval, and then was subject to further review and audit by PACEs internal auditor, the external auditor, and DICO, as described below.

24. PACE is required to ensure that its lending practices comply with the Act, the credit union’s policies, and FSRA guidelines; they are also approved by the Audit Committee of the Board of Directors (the “**Audit Committee**”). Furthermore, PACE monitors its impaired loan allowance on a month by month basis and conducts a detailed review annually.

25. Jim Tindall, Peter Rebellati, George Pohle, Brent Bailey, and Deborah Baker were all members of the Audit Committee at some point since 2015 (the composition of the Audit Committee would change on an annual basis). At all material times, the Audit Committee was chaired by Ms. Baker, a chartered accountant.

26. Rick Belsby of Rick Belsby & Associates (the “**Internal Auditor**”) conducted internal audits of PACE on a regular basis, which covers all matters within the scope of PACE. The Internal Auditor’s

reports were reviewed by the Audit Committee and presented to the Board. The internal audit process did not reveal or result in any significant issues for PACE.

27. PACE is also subject to an annual third-party audit by Deloitte LLP ("**Deloitte**"). As part of their audit, Deloitte reviews all facets of the credit union's activity including policies, compliance, financial results, impairment, misstatements, and recommendations. Between 2015 and 2017, Deloitte identified no significant misstatements, including statements relating to compensation.

28. Pursuant to its regulatory powers, FSRA conducts on-site visits ("**OSVs**") to inspect and review the affairs of the credit union. As part of the OSVs, FSRA reviews Board packages, which provides FSRA with information about PACE's investment activities. Additionally, FSRA routinely submits a "pull-list" of commercial lending matters for close review.

29. As a part of its regulatory oversight, FSRA could require that a FSRA representative attend PACE Board meetings. From 2017 on, a FSRA representative, Roman Sochaniwsky, frequently attended PACE Board meetings. As such FSRA knew, or should have known, what was being discussed at PACE Board meetings from 2017 onward and did not object to any activities as they occurred.

Role of the Credit Committee

30. As a matter of practice, commercial lending opportunities are presented to the PACE Credit Committee (the "**Credit Committee**") for approval.

31. Before a lending opportunity reaches the Credit Committee, it has been reviewed in detail by a commercial lending representative. After an opportunity is initially reviewed, the lending representative assembles a package of information for the Credit Committee. That package typically

includes: the lending term sheet, asset base security valuations, credit information, a summary of the loan, and the commercial lending representative's recommendations for or against approval.

32. During the presentation of the loan to the Credit Committee, a commercial lending representative typically discusses the merits of the loan based on PACE's lending criteria, commercial lending policies, the Act, and FSRA bylaws.

33. The actions of the Credit Committee are recorded in the Minutes of the Credit Committee meetings, which are approved monthly by the Board and recorded in the minutes of the Board meetings. The Credit Committee minutes include the details of the loan approvals.

34. A quorum of the Credit Committee is necessary to approve a commercial loan (except for restricted party loans, which require Board approval). Once a loan is approved, an annual review is performed to ensure that the loan continues to comply with the terms of the loan agreement, that security continues to be adequate, and that the loan remains compliant with PACE policies and the Act.

Summary

35. At all material times, all of PACE's loans and transactions were overseen by multiple individuals, including PACE's Credit Committee, the Audit Committee, the Board of Directors, various PACE employees, Deloitte, and FSRA. Phil had no power of authority to approve loans or transactions on his own, nor cause loans or transactions to be rejected. Further, Phil did not to attempt manipulate or falsify Board (or Board committee) approval of loans, transactions, and/or fees involving PACE, nor conceal the payment of any monies to Larry or others; nor did Phil acquiesce to such conduct. Kim Colaccio, PACE's former CFO, Corporate Secretary and Compliance Officer, was a member of the Credit Committee at all material times and never raised any concerns regarding

PACE's compliance with the Act, Regulations, or FSRA by-laws; nor did Ms. Colacicco ever raise any other compliance issues.

D. CONTROVERSY AND REFORM IN DICO AND FSRA

36. On March 31, 2016, a report on the Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario was released (the "**Ritchie Report**").

37. Among other things, the Ritchie Report was critical of DICO, noting that its mandates were unclear and outdated, and it was in an inherent conflict of interest as both a prudential regulator and an insurer.

38. The Ritchie Report recommended the creation of a new, independent, and integrated regulator called the Financial Services Regulatory Authority and concluded that DICO's independence and efficiency could be enhanced by transferring its prudential oversight and regulatory functions to FSRA.

39. DICO had acknowledged at various times prior to the investigations at issue in this action and the Administration Order, that its preference was for PACE to merge or be acquired by a larger credit union.

E. THE FSRA INVESTIGATIONS AT ISSUE

DICO discovers no issues during routine investigation in 2017

40. In or around May 29 to June 2, 2017, DICO conducted an OSV. As part of this review, DICO was provided with minutes and packages from Board meetings up to and including March 2017. The Board minutes and packages disclosed the details of a particular transaction with the Continental

Currency Exchange (the "**CCE Transaction**"). The CCE transaction was also included on the pull list from this OSV.

41. Despite having pulled and reviewed the CCE Transaction and a related loan, DICO did not raise any concerns specific to these transactions in its report.

An anonymous letter of complaint is sent to DICO

42. In and around October 2017, DICO received an anonymous letter regarding the CCE Transaction, which prompted DICO to investigate further.

DICO initiates a further investigation in 2018

43. In and around March 21, 2018, DICO delivered a letter to PACE's management team and to Ian Goodfellow, the chair of the Board, setting out certain concerns based on the information that DICO had received as a result of the anonymous letter. DICO's concerns included (among other things) the CCE Transaction and described steps that PACE could take to remedy what it saw as the issues with the CCE Transaction (which issues are denied).

44. DICO requested a meeting with PACE's management and Board to discuss the concerns set out in its letter. Amongst the individuals that DICO met with were Phil, Larry, Mr. Goodfellow, and Ms. Baker.

45. Phil understood the meetings to be forums for open discussion with DICO about the concerns set out in DICO's letter. DICO did not advise Phil that any statements made in the meetings would be relied upon as his formal response to the allegations set out in the letter, nor did DICO advise him to seek legal advice or retain counsel to represent him at these meetings.

46. Without notice to Phil, in May 2018, DICO engaged KSV Advisory Inc. ("**KSV**") to conduct an examination and audit (the "**Special Audit**") of PACE.

47. On May 10, 2018, DICO met with the Board and informed them that the Special Audit was commencing. DICO asked the Board to keep the reasons for the investigation confidential.

48. At DICO's request, Phil was interviewed by KSV on May 18, 2018. He was not permitted to have counsel in attendance.

49. Phil cooperated with DICO and KSV during this examination. He provided DICO and KSV with access to his laptop and phone. As Phil's laptop and phone included both personal and professional information, DICO and KSV executed an acknowledgment promising to seal the information from the laptop and phone until such time as a court order was obtained that would govern the document review protocol.

50. Despite this, no document review protocol was ever proposed by DICO and KSV.

51. Phil is not aware of the full scope of information reviewed by DICO during the Special Audit.

52. Throughout the course of the investigation, DICO failed to particularize its allegations against Phil and did not allow Phil to respond to these allegations.

FSRA issues an Administration Order

53. On or around September 28, 2018, without any prior notice to Phil, DICO made an application for an Administration Order under section 295 of the Act granting DICO the authority to assume the powers of the Board and take control of PACE. This was the first time that DICO advised Phil of

allegations of his involvement in "improper and unlawful activities against the Credit Union", despite a series of correspondence with his counsel beginning in June 2018.

54. Prior to this point, no significant issues were ever raised by PACE, the Board, Deloitte or DICO in respect of Phil's conduct as CEO.

55. PACE immediately suspended Phil's employment without providing him an opportunity to respond to the allegations. DICO represented that Phil would have an opportunity to respond before any final decision was made in respect of his employment or ongoing involvement with PACE.

Improper seizure and set-off of Phil's funds

56. As early as November 2018, Phil had difficulty accessing his PACE accounts and noticed that funds had been removed from his accounts. It was not until on or around March 19, 2019 that PACE obtained, without notice to Phil, an order that froze Phil's accounts and appointed a monitor over Phil's assets.

57. When Phil complained about funds being removed from his accounts, DICO, as administrator of PACE, claimed it was exercising a right of set-off.

58. There is no juristic reason entitling the administrator to seize funds from Phil's accounts for set-off purposes; moreover, set-off is a defence.

Improper handling of Defendant's documents

59. On or around November 6, 2018, PACE compiled a document review database that contained a complete copy of the materials from Phil's laptop and phone, in direct breach of its obligations under a Document Preservation Acknowledgement between KSV, DICO, and Phil.

60. The documents in the database include approximately 340,000 documents, including Phil's personal and solicitor-client privileged information and communications.

Termination of Phil's Employment

61. On December 5, 2018, DICO, as administrator of PACE, issued a letter terminating Phil's employment for cause. At no time had he been given an opportunity to respond to PACE's allegations.

62. Phil denies that there was cause for his termination and has brought a claim for damages for wrongful dismissal, amongst other things (Court File No. CV-19-00628710-0000) (the "**Phil Smith Employment Claim**"), which is ongoing.

Results of FRSA's Administration

63. As a result of the investigations, the subsequent Administration Order, and the termination of Phil, the normal course operations of PACE, including the advancing of commercial and personal loans, has declined. PACE is not renewing loans as they mature, and it is no longer seeking out business opportunities or commercial loans. Accordingly, its loan portfolio has diminished with corresponding impact on the credit union's valuation, making it an attractive target for a merger or acquisition.

F. COMPENSATION DISCLOSURE

64. Phil's compensation as CEO included an annual salary, an annual bonus allocation, and benefits. Phil's annual bonus entitlement was set by Larry in conjunction with the Chair of the Board and the Chair of the Audit Committee and was approved by the Board. For the years ending December 31, 2016 and December 31, 2017, part of Phil's bonus was paid to Phil personally and part was paid to 809755 Ontario Ltd. ("**809**"), for tax reasons. FRSA has not particularized any amount by which it

claims Phil's income was underreported. Phil denies that he underreported income pursuant to the requirements of the Act and Regulations (as defined in the Claim), or at all, and puts FSRA to the proof thereof.

65. In 2016, Phil was awarded a bonus of $400,000, of which $150,000 was payable to Phil directly and $225,000 was payable to 809. In 2017, Phil was awarded a bonus of $320,000, of which $150,000 was payable to Phil directly and $170,000 was payable to 809. These amounts were fully disclosed in PACE's financial statements. However, for these years, there was an unintentional error in Note 24 of PACE's financial statements. Note 24 is a supplementary compensation disclosure item. For 2016 and 2017, Note 24 only included the bonus and car allowance paid to Phil personally and not the portion of Phil's bonus paid to 809. Phil did not prepare Note 24 and does not know who prepared it. Phil does not recall focusing on Note 24 during his review of the financial statements.

66. Lastly, the income reporting obligations of section 140 of the Act and section 28 of the Regulations fall upon PACE as an organization, not Phil personally. FSRA has no cause of action against Phil for breach of those sections and, in any event, the obligations imposed upon PACE were always complied with.

G. IMPUGNED TRANSACTIONS AND CONDUCT

67. The Claim does not make allegations against Phil in respect of all PACE transactions and loans impugned in the Claim. FSRA alleges that Phil was involved in the following transactions and loans (each as defined in the Claim, if not defined above): (i) the CCE Transaction; (ii) the Geranium Joint Ventures; (iii) the SusGlobal Energy Corp. Loan; (iv) the Lora Bay Loans; (v) the Inveraray Loan; and, (vi) the Legasco Transaction (collectively, the "**Impugned Transactions**"). Phil denies any wrongdoing with respect to the Impugned Transactions.

68. The Claim also makes allegations against Phil in respect of (i) a failure to abide by FSRA By-Law No. 6; and (ii) alleged "false invoices" rendered by Larry. Phil denies any wrongdoing with respect to FSRA By-Law No. 6 and regarding the alleged "false invoices".

69. Further, the Claim seeks damages from Phil in respect of a line of credit advanced to the public storage facility Noble House but makes no allegations as to actions or omissions by Phil regarding the Noble House line of credit. If this claim for damages is not a drafting error, Phil denies any liability regarding the Noble House line of credit. A credit adjudicator and the Credit Committee approved the Noble House line of credit in the ordinary course. Phil was not present at the Credit Committee meeting that considered the Noble House line of credit because he was on vacation.

70. The following general context is important in assessing the Impugned Transactions.

71. First, Phil did not source any of the Impugned Transactions, nor did he negotiate their terms.

72. Second, Phil did not receive a referral fee or any other "finders fee" compensation regarding any of the Impugned Transactions, nor was he aware of most of the fees that are alleged to have been paid regarding the Impugned Transactions. Phil did not approve any of the fees that are alleged to have been paid.

73. As discussed in more detail below, Phil only received one payment relating to an Impugned Transaction: a $50,000 consulting fee related to the CCE Transaction, which was disclosed to and approved by the Board. The funds for this fee did not come from PACE.

74. Third, other than the CCE Transaction, Phil's role in the Impugned Transaction was limited to his role on the Credit Committee and his operational responsibilities as CEO. Phil did not have any

ability to "cause" PACE to enter, or not enter, any of the Impugned Transactions or stop the alleged improper payments.

75. Fourth, at all material times, Phil believed the Impugned Transactions were in the best interests of PACE.

(1) The CCE Transaction

76. In 2016, PACE acquired a 30% interest in Continental Currency Exchange ("**CCE**"), with the intention of later obtaining regulatory approval to acquire CCE in its entirety. The CCE Transaction was structured so that PACE would own the maximum allowable percentage at the time (30%), until such time as FSRA granted approval for PACE to acquire the rest:

(a) 30% would be purchased by PACE directly;

(b) 45% was purchased by 2340938 Ontario Ltd. ("**2340**"), using an interest-bearing loan from PACE, secured by the shares of CCE. The intention was for PACE to acquire this additional 45% once capital levels were achieved and regulatory approval was obtained; and

(c) The remaining 25% was retained by the vendor – Scott Penfound – who was the President and founder of CCE, who had significant management experience with CCE and who would remain at CCE until such time as PACE was in a position to fully purchase his interest.

77. The Claim makes no allegations specific to Phil regarding the CCE Transaction. Rather, it alleges that "Larry and Phil" structured the transaction to evade the regulatory requirement that limited PACE's ownership interest in CCE to 30%.

78. Phil did not participate in any "scheme" or "sham" regarding the CCE Transaction; he does not control any corporate entities involved in the CCE Transaction, including 2340; and he did not act to deceive or mislead the Board. Phil's actions regarding the CCE Transaction were approved by the Board, which had a full and complete understanding of the structure of the CCE Transaction and, in particular, that PACE hoped to eventually acquire a 100% interest in CCE (following the requisite regulatory approvals). Further, Scott Penfound, prior to closing of the CCE Transaction, had a lengthy discussion with the Board where Mr. Penfound addressed all of the Board's questions regarding the transaction.

79. In April or May 2017, Phil received a $50,000 payment from 2340, which was made not from loan proceeds paid to 2340 from PACE but from the first dividend payment to 2340 from CCE. This payment was a consulting fee for services rendered to 2340 during the CCE Transaction.

80. The 2340 consulting arrangement and fees were disclosed to the Board in a disclosure notice dated April 23, 2017 (the "**Disclosure Notice**"). The Disclosure Notice listed those individuals who were to be appointed as directors, officers, or advisors to 2340 and stated that these individuals and/or their related corporations or designates could receive remuneration in the form of directors, management and/or consulting fees not to exceed an aggregate of $300,000 per annum as approved by the Board.

81. Phil did not prepare the Disclosure Notice or arrange for its approval. The Disclosure Notice was approved by the Board on April 26, 2017 as acknowledged by the Chair of the Board, Ian Goodfellow, and the Chair of the Audit Committee, Debra Baker.

82. The CCE Transaction has been highly profitable for PACE.

(2) The Geranium Join Ventures

83. FSRA has effectively made three non-specific allegations against Phil relating to the various Geranium Joint Ventures:

(a) The joint ventures were, in effect a "bad deal" for which "Larry and Phil" "failed to cause" PACE to conduct sufficient due diligence;

(b) The joint ventures are contrary to sections 198 and 200 of the Act; and

(c) Phil failed to prevent the payment of "secret commissions" to Larry and Frank Klees related to the joint ventures.

Phil Was Not Involved in Sourcing or Structuring the Joint Ventures, and They Were Not a "Bad Deal"

84. PACE's involvement in the Geranium Joint Ventures began in 2010. These opportunities were sourced and negotiated directly by Larry. Phil was not at all involved in sourcing or negotiating these ventures; he did not negotiate or otherwise influence the capital contributions or profit allocations. All Geranium Joint Venture agreements were approved by the Board on behalf of PACE. Phil did not have the authority to commit PACE to the joint ventures and did not purport to do so.

85. The Geranium Joint Ventures were ultimately very profitable for PACE and PACE continued to enter joint ventures in respect of new projects between 2010-2018.

86. The Geranium Joint Ventures and the structure of the underlying agreements were audited on an annual basis since 2010 and subject to review by FSRA on several occasions. Yet, FSRA took no steps to challenge the Geranium Join Ventures until the commencement of this action.

The Joint Ventures Complied with the Act

87. The Geranium Joint Ventures complied with sections 198 and 200 of the Act. Details of each joint venture were publicly disclosed in the Credit Union's financial statements, which were approved by the Board and ratified by PACE's membership. Each of the joint ventures, including the ownership structures, was subject to rigorous internal and external audit. None of these audits raised concerns with the structure of any joint venture.

88. In any event, the obligation to comply with Sections 198 and 200 of the Act falls to PACE and not to Phil. Phil cannot be personally liable for any breach of section 198 or 200 of the Act by PACE. Alternatively, if any of the joint ventures is contrary to those sections of the Act, then PACE has suffered no damage as a result of those breaches, and the allegations of breach are irrelevant to any claim for damages by PACE or FSRA.

Phil Did Not Approve Any Payments Related to the Joint Ventures

89. Phil did not negotiate or approve the payments related to the Geranium Joint Ventures described in the Claim. Nor did he receive any payments in connection with the Geranium Joint Ventures.

90. In any event, there were no "secret commissions" paid in respect of the Geranium Joint Ventures.

91. Alternatively, Phil could not have prevented such payments and the Board approved all management fees that were received by Larry, 142 or 809 in connection with the Geranium Joint Ventures. All payments received by Larry and Klees were audited by Deloitte.

(3) The SusGlobal Energy Corp. Loan

92. The Claim makes one non-specific and one arguably specific allegation against Phil regarding the SusGlobal Loan:

(a) "Larry and Phil" "caused" PACE to advance an improvident and improper loan to SusGlobal; and

(b) "Larry and/or Phil" "caused" PACE to pay an improper "finders fee" to a third party in relation to the loan.

93. The SusGlobal Loan was approved at a meeting of the Credit Committee held on February 1, 2017. That approval was reviewed by the Board. The Committee approved the loan based on the recommendation of the credit adjudicator, Brian Hogan, and in reliance on a $1.6 Million personal guarantee given by Mark Hazout.

94. The loans to SusGlobal were consistent with PACE's loan policies and the loan was performing on its terms prior to FSRA's unwarranted intervention. Any loss to the Credit Union, which is denied, will be the result of FSRA's improper and improvident actions in its handling of the loan. As of the date of this Statement of Defence, more than two years after the date of the Administration Order, the SusGlobal Loan continues to perform and the Credit Union has suffered no loss.

95. Further, Phil did not "cause" PACE to pay a finder's fee to Mr. Williamson. That finder's fee was included in the initial term sheet for the loan, which was reviewed and approved by PACE in accordance with its normal process.

96. Phil was not aware of the US $150,000 payment referred to at paragraph 60 of the Claim.

(4) The Inveraray Glen Loans

97. The Claim does not make any allegations specific to Phil regarding the Inveraray Glen Loans.

98. FSRA alleges that "Larry and Phil" "intentionally refused" to record bad loan charges relating to the Inveraray Glen project, which was a real estate project pursuant to which PACE advanced loans. Those loans, which date back over 10 years, were reviewed and approved in the normal course by a credit adjudicator and the Credit Committee prior to being advanced.

99. Contrary to the allegations in the Claim, no bad loan charge was required to be recorded regarding the Inveraray Glen Loans, as PACE had adequate security to recover its loans, and was in the process of such recovery. Further, the obligation to report bad loans did not fall to Phil. That responsibility was with the credit officer tasked with managing the loan, and with the Credit Committee. Moreover, the Internal Auditor regularly reviewed the security, including property appraisals, to ensure that the provisions were adequate.

100. From 2015 onwards, the Credit Committee was aware of the default and of the security available for recovery, and the Board was regularly provided with a "watch list", which included entries relating to Inveraray Glen.

101. Throughout the relevant time, none of the individuals or groups tasked with the classification of the loans on PACE's books, while exercising their discretion, considered it necessary to record a loan charge, despite the fact that PACE could have received tax advantages from doing so. Phil had no distinct personal obligation to ensure that PACE recorded a charge for which he can be liable to PACE.

102. At all material times, Phil was not aware of the appraisals referred to at paragraph 70 of the Claim (the "**Impugned Appraisals**"). Phil did not hide or refuse to disclose these appraisals. The Credit Committee reviewed the Inveraray Glen loan at a meeting in August 2017. The Impugned Appraisals were discussed at this meeting, but Phil was absent from this meeting because he was vacationing. While Phil later reviewed the Credit Committee minutes from that meeting, they did not state that any allowance should have been made as a result of the Impugned Appraisals.

103. FSRA reviewed the Inveraray Glen loans in 2017 and identified no issues with respect to the loans.

104. Finally, FSRA has failed to identify any damages suffered by PACE that were caused by the failure to record a bad loan charge, and there are no such damages.

(5) The Lora Bay Debenture

105. The Claim does not make any allegations specific to Phil regarding the Lora Bay debenture.

106. FSRA alleges that "Larry and Phil caused PACE to advance" a $6 million convertible debenture to Lora Bay, a real estate development company, and that this credit "was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices".

107. The Lora Bay debenture was reviewed and approved by the Board and was consistent with PACE's policies.

108. The Lora Bay debenture has performed on its terms since its inception. PACE has suffered no losses relating to the transaction.

109. Phil did not approve the payment of consulting and/or referral fees in relation to the Lora Bay debenture.

(6) The Lagasco Transaction

110. FSRA does not make any allegations specific to Phil regarding a proposed series of loans to Lagaso.

111. The Claim impugns loans *contemplated but not made* to Lagaso, for the purchase of the assets and business of Dundee Oil and Gas Limited out of its *Companies' Creditors Arrangement Act* proceeding. FRSA also alleges that a $3 million loan that was previously advanced to Clear Beach, was improvident. To be clear, no funds were ever advanced by PACE to Lagaso.

112. Phil was not involved in sourcing or negotiating the proposed loans. Phil was not aware of any efforts to evade the restrictions under the Act and/or Regulations made pursuant to the Act.

113. Phil was generally aware that the Lagasco transaction was being pursued, though was not aware of any details of the proposed transaction until it came before the Credit Committee for review on or around September 2018.

114. However, before the Lagaso transaction could be formally approved, the Administration Order was issued and FSRA cancelled the transaction. This was a bad business decision and Phil is not responsible for any associated costs.

115. Prior to the Administration Order, the existing $3 million loan was preforming on its terms and PACE has suffered no losses relating to that loan.

(7) No Breach of By-Law No. 6

116. FRSA does not make any allegations specific to Phil regarding the alleged breach of FSRA By-Law No. 6.

117. FSRA claims that Phil (along with Larry) is personally responsible for an alleged misvaluation of the commercial loan portfolio. This allegation is meritless as:

(a) The Credit Committee and the Board were "ultimately responsible for the commercial loan portfolio", not Phil personally;

(b) The valuation of PACE's commercial loan portfolio (including write-downs) involves the exercise of business judgment and was done by PACE's credit department and its financial team, not Phil personally;

(c) PACE and its employees always exercised reasonable business judgement when valuing its commercial loan portfolio;

(d) At all times, PACE's commercial loan portfolio, and all the individual loans within it, complied with relevant rules and regulations; and

(e) PACE's commercial loan portfolio was subject to a rigorous valuation and audit process.

118. Moreover, all but one of the loans about which FSRA complains were performing on their terms at the time of the Administration Order and PACE recovered on its security (which was adequate) for the one loan that was in default. Any other default on those loans, which is denied, was the result of FSRA's own mismanagement of PACE, and its unreasonable decision to call loans prior to maturity without providing a reasonable opportunity for borrowers to obtain alternative financing.

By calling loans that were otherwise performing, FSRA itself caused damage to PACE by lowering its revenue and weakening its balance sheet.

(8) Phil Has No Knowledge of Any False Invoices

119. FSRA alleges that Phil "acquiesced" to PACE's payment of "grossly" inflated invoices, or "acquiesced" to PACE's payment of invoices for services that were not in fact rendered.

120. Phil has no knowledge of the invoices referred to at paragraphs 111 through 115 of the Claim because they are not identified; but, in any event, Phil does not have any knowledge of inflated or false invoices paid by PACE.

121. Moreover, invoices paid by PACE are inspected and approved by PACE's internal accounting staff, the Audit Committee, and/or the Board. During the relevant time, invoices paid by PACE were subject to regular audits. Phil had no input into the manner in which invoice payments were accounted for at PACE.

(9) Response to PACE Securities Amendments

122. On February 10, 2021, the Plaintiff served its Amended Fresh-as-Amended Statement of Claim. The amendments seek, among other things, contribution and indemnity from Phil,

> to the extent that the Credit Union is found liable for damages to any Investor Claimants[1] …arising out of the design, development, offering, promotion, sale and the ultimate failure of the Preferred Shares[2]…, and any of those damages that were caused or contributed to by any of them.

---

[1] Defined by the Plaintiff as: "all individuals asserting or who may be entitled to assert a claim or cause of action as against PSC or any related organizations (including the Credit Union) in respect of certain investments made by the Investor Claimants."
[2] Defined by the Plaintiff as: "an investment vehicle for accredited investors to earn fixed dividends from an investment in a basket of high-yield bonds". The Preferred Shares were preferred shares in PFL, the proceeds of which PFL used those proceeds to purchase high-yield bonds on "margin" through its accounts at PSC. The interest and any trading

123. As a preliminary matter, there is no basis in fact or law to seek contribution and indemnity from Phil. There is no underlying claim that Phil could chose to defend or otherwise participate in. The Plaintiff's potential liability to the Investor Claimants arises out of the winding-up and liquidation of PSC (as defined in the Statement of Claim, the "**PSC Application**"). In the PSC Application, the Investor Claimants are pursuing claims related to the Preferred Shares through a mediation and claims adjudication process. PACE is a defendant in this process, Phil is not. The Investor Claimants have explicitly chosen not to advance a claim against Phil. As such, the Plaintiff's claim for contribution and indemnity is untenable.

124. Negligence and breach of fiduciary duty are the only causes of action pleaded to give rise to Phil's liability for contribution and indemnity. The Claim has not pleaded facts sufficient to establish a cause of action against Phil in negligence (let alone negligence for pure economic loss) or breach of fiduciary duty. No such facts exist.

125. The Plaintiff alleges that Phil is liable for contribution and indemnity because Phil (and Larry and others) "failed to properly supervise and manage the Credit Union, including with respect to its relationship with PSC and its subsidiaries…and to ensure that the distribution of Preferred Shares was conducted in a regulatory compliant manner" (the "**PSC Claim**"). The Plaintiff does not offer any particulars of Phil's alleged failures of supervision and management.

126. Phil denies that he failed to properly supervise the Credit Union, regarding the Preferred Shares or otherwise:

---

profits earned on the bonds were used to pay management fees to PSC and dividends to the holders of the Preferred Shares.

(a) The Preferred Shares were sold by Pace Financial Limited ("**PFL**"), a subsidiary of Pace Securities Corp. ("**PSC**"). PSC was, in turn, a subsidiary of PACE. PSC had an independent board of directors (the "**PSC Board**"), and independent, experienced management. Phil has never been an officer or director of PSC or PFL (or First Hamilton Holdings Inc. ("**FHH**") – which also issued Preferred Shares).

(b) In his role as CEO of PACE, or otherwise, Phil was never involved in and had no obligation to be involved in the management of PSC, PFL, or FHH. The CEO of PSC reported directly to the Board of Directors of PACE.

(c) Phil was not a director of PACE and, therefore, did not and could not approve any of PSC's or PFL's actions on behalf of PACE, including any actions related to the Preferred Shares.

(d) Phil was never involved in, and had no obligation to be involved in, the design, distribution, development, offering, promotion, or sale of the Preferred Shares, nor their regulation. Further, Phil denies that any Preferred Shares were sold directly by PACE and, if Preferred Shares were sold by PACE (which is denied), Phil had no knowledge of same.

127. Phil had no duty to ensure that the Preferred Shares issued by PFL and FHH were distributed in a "regulatory compliant manner", nor was he qualified to do so. Neither the clients of PSC, nor PACE, relied on Phil to supervise PSC's compliance with securities laws. To the extent that PSC required any approvals by PACE for its issuance of the Preferred Shares, and it is not clear that they did, PACE would have relied on PSC to advise the PACE Board about the investment characteristics

and risk profile of the Preferred Shares and with respect to any issues of regulatory compliance related to their issuance. These were matters squarely within the expertise and legal responsibility of PSC.

128. The sale of Preferred Shares was explicitly considered and approved by FSRA, despite concerns from the Investment Industry Regulatory Organization of Canada ("**IIROC**").

129. In late June 2019, IIROC gave FSRA notice of potential issues with the sale of the Preferred Shares.

130. In response, FSRA hired an independent third-party consultant, Louise Tymocko (the "**Independent Consultant**"), to conduct a general review of PSC, based upon a workplan determined in consultation with IIROC (the "**Independent Review**"). Among other things, the Independent Review considered regulatory compliance issues at PSC and the pricing of and policies regarding the Preferred Shares. As part of the Independent Review, Mitch Vininsky (the a KSV managing director who had lead responsibility for the Special Audit), and Paul Dempsey (FSRA senior legal counsel), were placed on the PSC Board. FSRA also engaged an independent third-party valuator (RSM) to conduct an independent comprehensive valuation (the "**Independent Valuation**") of the Preferred Shares (RSM – and the terms of its engagement – was also vetted and approved by IIROC).

131. The Independent Review was rigorous. The Independent Consultant spent at least 120 hours on the review, including 13 days of meetings with PSC employees.

132. Following her review, on October 30, 2019, the Independent Consultant concluded, among other things:

(a) "overall, PSC engages in sound business practices";

(b) "…attention is paid to regulatory requirement and industry standards";

(c) "qualified staff are in place for various functions, including compliance";

(d) "staff is appropriately supervised";

(e) "I found no evidence of ethical breaches, misconduct or inappropriate business conduct";

(f) "I did not find any major suitability or eligibility issues and I found nothing which suggested any pervasive or systemic issue [regarding the Preferred Shares]";

(g) "No issues [regarding the Preferred Shares] were noted that required notifying the Special Committee of the PSC board of directors immediately"; and

(h) the level of risk associated with the Preferred Shares was "medium".

133. On November 20, 2019, FSRA wrote to IIROC, summarizing the results of the Independent Review and Independent Valuation:

> …the independent consultant has determined, after an extensive review, that here **are no areas of concern regarding PSC's operations that cannot be easily addressed or which potentially give rise to public harm** (e.g. determined that the issued securities [the Preferred Shares] had a 'medium risk rating'). Similarly, the valuator's report does not identify any issues which would give rise to any concerns of public harm. **Consequently it is our assessment, and we have been advised by our outside counsel at Goodmans LLP, that there are no grounds for the Administrator to continue to direct PSC to refrain from resuming its normal operations** and entering into an agreement (subject to IIROC's consent to a change in control) to well PSC to its management.
>
> (…)
>
> Therefore, and absent receiving clear and specific information from IIROC regarding why PSC cannot, from a regulatory perspective, resume normal operations, **we have**

> **been advised by Goodmans that the Administrator is obliged to let PSC resume normal business activities**.
>
> (…)
>
> Finally, and in light of the fact that the oversight of the work plan required by IIROC for PSC has now been completed, the two directors which the Administrator had placed on PSC's board resigned effective November 13th.
>
> [Emphasis added.]

134. FSRA cannot seek contribution from Phil in circumstances where, over one year after suspending Phil as CEO, FSRA advised IIROC that there were "no grounds" to restrain PSCs operations and that FSRA was in fact "obliged" allow PSC to resume normal operations.

135. On November 28, 2019, IIROC responded by letter to FSRA. IIROC wrote, among other things, "we confirm that we continue to be of the view that [the Preferred Shares] are high-risk securities and must not be sold unless disclosed as such." IIROC further recommended that the holders of Preferred Shares undergo a suitability assessment, through which "PACE should address all suitability concerns identified for any client that exceeds their stated risk tolerance…and explain how they will be remedied." The Plaintiff did not undertake this suitability assessment or, if it did so, it was inadequate. Phil pleads that, having regard to IIROC's November 28, 2019 letter, a reasonable suitability assessment would have included (among other things) a written advisement to every holder of Preferred Shares that they should only continue holding such shares if the investor could "afford a total loss of their investment."

136. Phil pleads that had the Plaintiff immediately performed a reasonable suitability assessment, and notified the Investor Claimants of the assessment's conclusions, the Investor Claimants could have made a fully informed decision as to whether to continue holding Preferred Shares.

137. Further, or in the alternative, a reasonable suitability assessment should have caused the Plaintiff to repurchase the Preferred Shares from the Investor Claimants, or unwind the Preferred Shares in some other manner, prior to the market crash in spring 2020. Had the Investor Claimants sold their Preferred Shares prior to spring 2020, or had the Preferred Shares been repurchased or otherwise unwound before that time, the Investor Claimants would have suffered no or *de minimus* losses.

138. The Investor Claimants' losses are entirely the responsibility of Laurentian Bank Securities, the carrying broker for PSC; and/or the Plaintiff. At the time that those losses were suffered, PACE was controlled by FSRA through the Administration Order, and it was FSRA's management of PACE and PSC that caused any such losses.

139. In early 2020, Laurentian Bank Securities, called the margin loan with which the securities underlying the Preferred Shares had been purchased. This was done without any reasonable justification. As a result, PSC was forced to sell those securities during a global pandemic at a fraction of their value.

140. Moreover, in or about May 2020, FSRA and/or PACE decided to wind up PSC and PFL, which decision ensured that the holders of Preferred Shares would lose most or all of their investment.

H. THE PLAINTIFF IS NOT ENTITLED TO THE RELIEF SOUGHT

(1) No Fraud, Deceit, or Conversion

141. Phil did not commit fraud, deceit, or conversion in his dealings with PACE, and puts the Plaintiff to the proof thereof. Moreover, FSRA has not pleaded allegations sufficient to establish these causes of action against Phil.

142. Phil pleads and relies on the fact that all lending activities, as well as all significant accounting matters – which include compensation arrangements, service invoices rendered, and all impairments – were approved by PACE at all material times.

(2) No Conspiracy

143. Phil did not engage in a conspiracy to injure PACE or engage in an unlawful means conspiracy and puts the Plaintiff to the proof thereof. To the contrary, Phil always acted in the best interests of PACE. Moreover, FSRA has not pleaded allegations sufficient to establish that Phil participated in a conspiracy.

144. During the material time of Phil's tenure at PACE, PACE's commercial loan portfolio grew from approximately $49 million to $396 million. Total members' equity over that same period grew from approximately $53.6 million to $63.1 million. PACE paid an average of approximately $460,000 in dividends to members each year between 2015 and 2017.

(3) No Breach of Contract

145. At all material times, Phil acted in accordance with the terms of his governing employment contract. At no time did Phil breach any fiduciary duty or duty of care owed to PACE. Phil always acted in the best interests of PACE.

(4) No Breach of Fiduciary Duty or Breach of Trust

146. Phil did not breach his fiduciary duty to PACE. Phil always acted in accordance with his fiduciary duty and in the best interests of PACE.

(5) No Knowing Assistance

147. Phil did not knowingly assist in others breaching their fiduciary duties, which breaches are also denied. None of the Impugned Transactions, the alleged failure to comply with FSRA By-Law No. 6, and the alleged false invoices constituted a breach of fiduciary duty by anyone. Alternatively, if any other person breached a fiduciary duty owed to PACE by their participation in the events described in the Claim, then Phil did not assist in that breach of duty.

(6) No Knowing Receipt

148. No funds described in the Claim were held in trust and, with the exception of funds held by 2340 in connection with the CCE Transaction, FSRA has not particularized any funds allegedly held in trust for PACE.

(7) No Unjust Enrichment

149. Phil was not unjustly enriched. PACE has not suffered a deprivation arising from any payments received by Phil, all of which were received pursuant to a juridical reason.

(8) No Constructive Trust

150. PACE is not entitled to a constructive trust over any of Phil's assets. There is no basis for a constructive trust over any asset because damages would sufficiently compensate PACE for the harms alleged (which are denied).

151. Phil did not receive any funds impressed with a trust in favour of PACE and, even if Phil received trust funds (which is denied), PACE cannot trace any trust funds into assets owned by Phil.

(9) No Negligence

152. The Statement of Claim does not particularize to whom Phil is alleged to owe a duty of care. In any event, Phil always exercised the care, diligence, and skill of a reasonable person in carrying out his roles at PACE. To the extent Plaintiff alleges that PACE and/or Phil owed a duty of care to Investor Claimants, such duty would be a novel duty and is denied.

153. In any event, Phil's actions or omissions were not the cause (proximate or at all) of any loss suffered by the Investor Claimants, PACE and/or FSRA related to the Preferred Shares (or otherwise).

154. Even if the Plaintiff is liable to PSC and/or the Investor Claimants, no facts are pleaded or exist that could flow this liability to Phil; there is no basis to pierce the corporate veil. At all relevant times, Phil never exhibited a separate identity or interest from that of PACE to make the conduct complained of his own. Phil never acted fraudulently, deceitfully, dishonestly or without authority in respect to the Preferred Shares. Moreover, neither the clients of PSC, nor PACE itself, relied on Phil to supervise PSC's compliance with securities laws (nor did such a duty to supervise exist).

(10) No Damages

155. Phil denies that PACE has suffered any damages and puts PACE to proof thereof.

156. Any losses suffered by PACE, which are denied, are the result of: (a) PACE's own actions that were completed in the ordinary course of business; and/or (b) the actions of FSRA; and/or the actions of PSC's management and directors of which Phil had no knowledge or control.

157. FSRA assumed control of PACE and ran it into the ground. PACE's current financial difficulties are unrelated to Phil's tenure as CEO. Following Phil and Larry's terminations in late 2018, PACE's net income plunged because of FSRA's mismanagement:

(a) In 2017, PACE generated a net income of $5,302,091;

(b) In 2018, PACE generated a net income of $4,057,000;

(c) In 2019, PACE generated a net income of $364,000;

(d) In 2020, PACE suffered a net **loss** of $22,722,000.

2017 was the full last year of Phil and Larry's tenure. Since FSRA assumed control of all relevant aspects of PACE's business, its net income has declined a staggering **660%**. As a result, in April 2021, PACE breached its statutory minimum capital thresholds and FSRA was required to reduce these minimum capital requirements and extend $500 million in credit to PACE.

158. This sad situation was not caused by the Impugned Transactions, nor any actions or omissions of Phil.

(a) CCE Transaction: in 2020 FSRA decided to cause PACE to acquire 100% ownership of CCE, which current CEO David Finnie described to PACE members at the April 2021 Annual General Meeting as "fully allowed under the legislation". Any losses related to CCE are exclusively the result of legitimate CCE transaction costs and the COVID-19 pandemic.

(b) Geranium Joint Ventures: PACE has suffered no losses related to the Geranium Joint Ventures.

(c) SusGlobal, Lora Bay, Inverary Glen, and Lagaso loans: these loans have always performed in accordance with their terms. Any losses related to these loans (which are denied), resulted from PACE's "de-risking" agenda – a business decision of

FSRA/PACE to offload approximately $101 million in loan balances for which Phil bears no liability. As stated by PACE's current CFO Benjamin Choi at the April 2021 Annual General Meeting, the "de-risking" was "…not all about bad loans, we have changed our risk appetite…".

Moreover, from the date of the Administration Order (September 28, 2018) to December 31, 2020, PACE has burned **$7,267,000** on legal, financial advisory, and other expenses related to FSRA's administration of PACE. As of the date of this pleading, these administration expenses continue to accrue.

(11) The Claim is Statute Barred

159. Phil pleads and relies upon the *Limitations Act, 2002*, SO 2002, c 24, s B. FRSA discovered the material facts relevant to the Claim more than two years before the action was commenced. Alternatively, the material facts upon which the claim is based were discoverable with the exercise of reasonable diligence more than two years before the Claim was commenced.

COUNTERCLAIM

160. Phil, as plaintiff by Counterclaim, claims:

(a) Damages, in an amount to be determined, for losses suffered from the freezing of Phil's assets at PACE and the Mareva Order (defined below);

(b) General damages for defamation in the amount of $1,000,000;

(c) Special damages for defamation in the amount of $100,000;

(d) Punitive damages and exemplary damages, in the amount of $1,000,000, for the conduct described above and below, including but not limited to malfeasance in public office and/or regulatory negligence;

(e) An interim order pursuant to PACE's By-Law No. 1 and section 157 of the Act directing PACE to make advances for the legal expenses incurred by Phil in defence of the Claim, pending its disposition, including those costs already expended in defence of the Claim;

(f) An order pursuant to PACE's By-Law No. 1 and section 157 of the Act directing PACE to indemnify Phil for his legal expenses incurred in defending the Claim;

(g) Prejudment interest in accordance with section 128 of the *Courts of Justice Act*, RSO 1990, c C-43, as amended;

(h) Postjudgment interest in accordance with section 129 of the *Courts of Justice Act*, RSO 1990, c C-43, as amended;

(i) the costs of this proceeding, plus all applicable taxes; and

(j) such further and other relief as this Honourable Court may deem just.

161. Phil repeats and relies upon the allegations contained in his Statement of Defence and the Phil Smith Employment Claim.

A. FSRA'S MALICIOUS CONDUCT

(1) The Administration Order

162. At 9:01 a.m. on Friday September 28, 2018, following an investigation by KSV Advisory, Phil was advised that FSRA had taken over administration of PACE without notice. Concurrently, Phil was placed on administrative leave with immediate effect. FSRA's letter stated, among other things, that "evidence had come to light regarding [Phil's] apparent involvement in improper and unlawful activities against the Credit Union" and alleged that he had engaged in unlawful activities amounting to civil fraud. FRSA's letter also stated that all accounts that Phil held at PACE, or "which [he] control[led]", had been "blocked until further notice." FRSA's letter was so high-handed that it did not even allow Phil *prima facie* access to funds for "living necessities".

163. FSRA stated that it would provide Phil with details of the allegedly improper and unlawful activity that Phil "appeared to be involved in" and would "provide [Phil] with an opportunity to fully respond to the importation before the Administrator makes any final decisions regarding [his] employment and involvement with the Credit Union." As mentioned above and in the Phil Smith Employment Claim, that opportunity was never provided.

164. Phil pleads that FSRA issued the Administration Order without notice to, among other things, avoid triggering payment of monies owing immediately owing to Phil upon his termination. Under

Phil's employment agreement dated December 17, 2015, as amended December 14, 2017 (the "**Employment Agreement**"), one minute before the effective date and time of an administration order, Phil may elect to receive his severance pay (an amount equivalent to three years' base salary, including all incentive and bonus income, all benefits, car allowance, and vacation entitlement). Under the Employment Agreement, severance funds equal to three years' base salary were to be placed in a trust account (the "**Severance Trust**") for Phil's benefit. The Employment Agreement is commercially reasonable, was approved by the Board, and is binding upon PACE and FRSA in its capacity as Administrator of PACE.

165. Indeed, in unsigned reasons delivered October 11, 2018, FSRA stated that the Administration Order was issued under section 240.1(7) – which allows an administration order to be made without notice in certain circumstances – because notice would likely trigger the Termination Trust.

166. FSRA has refused to make payment from the Severance Trust.

(2) Account Freeze and Mareva Order

167. Upon the issuance of the Administration Order, FSRA/PACE froze all the bank accounts and other assets belonging to Phil, held by PACE. PACE had no right to do so. The account agreement for Phil's accounts only permits PACE to freeze assets if:

(a) PACE becomes aware of "suspicious of possible fraudulent or unauthorized Account activity that may cause a loss to [Phil], [PACE], Central 1, or an identifiable Third Party;

(b) An issue arises as to who the proper signing authorities are on the Account"; or

(c) A claim is made by a Third Party to the funds in the account which, in PACE's sole discretion, is potentially legitimate.

168. None of these conditions were met, either in September 2018, or at any time. PACE has not made any allegations against Phil relating to "suspicious or possible fraudulent or unauthorized Account activity." Rather, PACE – acting in bad faith and solely in its own interests – froze the accounts in order to protect its litigation interests, and not for any valid or lawful reason.

169. On March 19, 2019, FSRA obtained an order for an interim Mareva injunction (the "**Mareva Order**"), on 45 minutes notice, against the worldwide assets of Phil (and others), and at the same time commenced the Claim. The Mareva Order was obtained on the basis of inaccurate and incomplete evidence, including a wildly inflated claim for damages. The injunction was settled on the eve of the return motion.

170. Phil has suffered damages, to be particularized at trial, as a result of FRSA's illegal freeze and depletion of his bank accounts held at PACE, and the worldwide injunction against his assets. Phil has suffered a loss of opportunity to profit for the inability to deploy his capital in the manner of his choosing.

(3) Defamation by FSRA and PACE

171. FSRA, both in its capacity as Administrator of PACE and in its own capacity, caused PACE to publish the following words (the "**Defamatory Words**"):

(a) on November 22, 2019, PACE published a memo to all of its members. The memo stated, among other things:

> …DICO's supervision or PACE discovered failed governance and fraud – e.g. former senior executives acting in their own personal interest, and not in the best interest of the credit union, but at the expense of the credit union's members…; and

(b) a Notice to Members regarding an Annual General Meeting of Members on April 28, 2020, stated, among other things:

> Why was PACE put under administration?
>
> In 2017, DICO conducted a routine examination of PACE Credit Union during which it encountered adverse findings with respect to various areas of operations. <u>The regulator conducted a diligent investigation which revealed that fraud had been committed by former senior executives</u> at the expense of the credit union's depositors, members, and shareholders. To protect members and other stakeholders, DICO/FSRA placed PACE under administration in September 2018. [emphasis added]

172. These statements were referring to Phil (and Larry), a fact that PACE intended to convey and its members, in fact, understood. The November 2019 memo refers to PACE having commenced litigation against Phil (and Larry).

173. The Defamatory Words claim that the FRSA investigation had proven fraud, which is untrue. By their natural and ordinary meaning, the Defamatory Words meant, were intended to convey, and were understood to mean that Phil had committed fraud, had breached his duties to PACE, and was responsible for governance failures at PACE.

174. In addition to the above, employees of FSRA and/or PACE have made various oral statements to members of PACE - including at the PACE "town hall" held in December 2019 - conveying the idea that Phil had committed fraud, had breached his duties to PACE, and was responsible for governance failures at the Credit Union. Those statements are also Defamatory Words and false.

175. The Defamatory Words were false and maliciously published by FSRA and/or PACE knowing that they were false or with careless disregard as to whether they were true or not.

176. As a result of the publication of the Defamatory Words, Phil has been subject to contempt and has suffered damage to his reputation personally and professionally. All repetitions, republications, and broadcasts of the Defamatory Words have irrevocably damaged Phil's professional character and reputation in his profession; as a further consequence, Phil has suffered embarrassment, humiliation, and damage to his personal character and reputation.

177. As a result of the Defamatory Words, Phil has suffered and will continue to suffer damages for which FSRA and PACE are liable.

(4) Malfeasance in Public Office and Regulatory Negligence by FSRA

178. FSRA committed the tort of malfeasance in public office by obtaining the Administration Order (in itself and by the fact that it was obtained without notice for an improper purpose) and the Mareva Order, as well as (among other things):

(a) By freezing Phil's accounts without any lawful authority; and

(b) By maintaining the Mareva injunction where no cause to do so existed and for the purpose of gaining an undeserved tactical advantage.

179. By taking the above steps, FSRA acted with malice, for the purpose of injuring Phil; or acted recklessly and with a mindful indifference to the probability that its actions would cause unjustified injury to Phil. FRSA's actions and omissions (described in this Defence and Counterclaim and the Phil Smith Employment Claim) directly caused Phil to suffer damages.

180. In the further alternative, by taking the above steps, FSRA acted negligently, and below the standard expected of a prudential regulator.

(5) Punitive Damages

181. FSRA engaged in independent actionable wrongs, as described above, for which Phil is entitled to punitive and exemplary damages. FSRA's conduct was harsh, vindictive, reprehensible, and malicious and this Honorable Court should find that the conduct of FSRA and PACE is deserving of an award of punitive and exemplary damages.

B. PHIL IS ENTITLED TO BE INDEMNIFIED

182. Pursuant to Article 8.02 of PACE By-Law No. 1 (the "**By-Law**"), PACE is obligated to indemnify Phil, as a former officer of PACE, and to advance his legal expenses to defend the Claim and any related civil and administrative proceedings. The By-Law states:

> 8.02 subject to the limitations contained in the Act, the Credit Union *shall indemnify* a director, officer, or committee member, *a former director or officer or committee member*, or a person who acts or acted at the Credit Union's request as a director or officer of a body corporate of which the Credit Union is or was a member, shareholder or creditor, and his or her heirs and legal representatives, *against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgement, reasonably incurred by him or her in respect of any civil, criminal or administrative action or proceeding to which he or she is made a party by reason of being or having been a director or officer of the Credit Union or such body corporate*, if:
>
> > (a) he or she acted in good faith with a view to the best interests of the Credit Union; and
> >
> > (b) in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, he or she had reasonable grounds for believing that his or her conduct was lawful.
>
> The Credit Union shall also indemnify such person in such other circumstances as the Act permits or requires. [emphasis added]

183. Section 157 of the Act states that:

> (3.1) A credit union may advance money to an eligible person to pay for the costs, charges and expenses of any proceeding to which the person is made a party by reason of serving or having served in a qualifying capacity, but the person is required to repay the money if either of the conditions described in subsection (5) is not satisfied.
>
> (4) With the approval of a court, a credit union may indemnify an eligible person in respect of a proceeding by or on behalf of the credit union or entity to procure a judgment in its favour to which the person is made a party by reason of serving or having served in a qualifying capacity.

184. Phil was an officer of the Credit Union pursuant to the By-Law at all relevant times and is an "eligible person" under section 157(1)(b) of the Act. At all times, Phil acted in good faith and in the best interests of PACE. He fulfils the requirements under the By-Law and under section 157 of the Act.

185. Phil is entitled to indemnification for the legal fees that he has already incurred in defending the Claim and is entitled to continuing advancement of legal fees pending disposition of the action. In the alternative, this action was commenced by FSRA, acting as Administrator for PACE. In the event that this is a derivative action pursuant to the Act, then Phil is entitled to indemnification for his fees pursuant to section 157(4) of the Act and for continuing advancement of legal fees pending disposition of the Claim.

C. COSTS AND CONSOLIDATION

186. The Plaintiff by Counterclaim seeks his costs of this action on a substantial indemnity basis.

187. The Plaintiff by Counterclaim proposes that this counterclaim be tried together with the main action and the Phil Smith Employment Claim.

CROSSCLAIM

188. The Defendant, Phil makes the following Crossclaims against the Defendants Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, Peter Rebellati, Jim Tindall, Pauline Wainwright, Neil Williamson, and George Pohle, all of whom are former directors of PACE (the "**Directors**"):

a) Contribution and indemnity under section 2 of the Ontario *Negligence Act*, R.S.O. 1990, c. N.1, as amended, for any amounts for which Phil may be held liable to the Plaintiff in this action;

b) Contribution and indemnity under the common law and equity for any amounts for which Phil may be held liable to the Plaintiff in this action;

c) The costs of this action on a substantial indemnity basis, plus all applicable taxes; and

d) Such further and other relief as to this Honourable Court may deem just.

189. Phil repeats and relies on his Statement of Defence for the purposes of this Crossclaim. In particular, Phil denies any liability in respect of: (a) the impugned loans transactions and other transactions; (b) the impugned payments; (c) PACE's financial reporting; and/or (d) the Preferred Shares. Phil further denies that PACE has suffered any losses as a result of the Defendants' alleged misconduct.

190. However, if Phil is liable to the Plaintiff, which is not admitted, Phil pleads that the Plaintiff's losses were caused or contributed to by the Directors' failure to fulfil their duties to PACE.

191. The Directors were fiduciaries of and owed a duty to PACE to act with the care, skill, and diligence reasonably expected of a prudent director. Phil was at all times honest and transparent with the Board and Credit Committee and provided the Directors with all of the information and

documentation that they required to fulfil their duties to PACE. The Directors nonetheless breached their duties to PACE and caused PACE to incur losses by:

a) If any of the payments referred to in paragraphs 111-115 or 117-125 of the Claim were improperly received, failing to conduct reasonable due diligence, make reasonable inquiries, and follow PACE's governance standards when reviewing the expenses submitted to the Board and when approving the payments made by PACE. Larry and Phil disclosed every dollar that they received, and each of those payments was stamped and approved;

b) If any of the loans granted by the Credit Union were offside lending practices, failing to conduct reasonable due diligence, make reasonable inquiries, and follow PACE's governance standards, statutory obligations, and commercial lending practices when reviewing and approving the impugned loans and other transactions. In particular, the Directors voted to approve and/or were aware of the Impugned Transactions;

c) If PACE's financial reports were inaccurate, failing to ensure that PACE met its financial reporting obligations under section 140 of the Act and section 28 of the General Regulations. The Directors voted to approve the Credit Union's financial statements each year; and

d) If damages are owed to the investor claimants, failing to oversee and ensure the regulatory compliance of PACE's subsidiaries including in relation to the Preferred Shares. (Among other things, the Directors approved the sale of the Preferred Shares and the FHH investments to investors (including Credit Union members) by PACE Securities.)

192. It was reasonably foreseeable that PACE would suffer harm if the Directors failed to meet their requisite standard of care to PACE. Phil, PACE, and its members relied on the Directors to exercise their discretion in a manner that was consistent with their fiduciary duty and standard of care.

193. If the court in the main action finds that Phil is liable for damages relating to any matter approved by the board or relating to any matter of which the board had knowledge, then the Directors breached their duty and standard of care and fiduciary duties to PACE. The Directors breached those duties by failing to conduct sufficient due diligence and by failing to make sufficient inquiries with respect to the Impugned Transactions during their tenure as directors of PACE and/or members of the audit committee. To the extent that PACE has suffered damages in relation to any of the Impugned Transactions during the period of the Directors' tenure as directors of PACE, those damages were caused by the negligence of and breaches of fiduciary duty by the Directors.

194. Phil relies on the provisions of the Ontario *Negligence Act*, R.S.O. 1990, c. N.1 in support of this Crossclaim.

July 8, 2021

WEISZ FELL KOUR LLP
Royal Bank Plaza, South Tower
200 Bay Street, Suite 2305
Toronto, ON M5J 2J3

Steven Weisz - LSO No. 32102C
sweisz@wfklaw.ca
Tel: 416.613.8281

Sharon Kour - LSO No. 58328D
skour@wfklaw.ca
Tel: 416.613.8283

Pat Corney - LSO No. 65462N
pcorney@wfklaw.ca
Tel: 416.613.8287
Fax: 416.613.8290

Lawyers for the Defendant,
Phillip Smith (Plaintiff by Counterclaim)

Court File No. CV-19-00616388-00CL 632

PACE SAVINGS & CREDIT UNION LIMITED and **LARRY SMITH, et al.**

Plaintiff Defendants

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

STATEMENT OF DEFENCE, COUNTERCLAIM AND CROSSCLAIM

WEISZ FELL KOUR LLP
Royal Bank Plaza, South Tower
200 Bay Street, Suite 2305
Toronto, ON M5J 2J3

Steven Weisz - LSO No. 32102C
sweisz@wfklaw.ca
Tel: 416.613.8281

Sharon Kour - LSO No. 58328D
skour@wfklaw.ca
Tel: 416.613.8283

Pat Corney - LSO No. 65462N
pcorney@wfklaw.ca
Tel: 416.613.8287
Fax: 416.613.8290

Lawyers for the Defendant,
Phillip Smith (Plaintiff by Counterclaim)

TAB F

Court File No.: CV-19-00628710-0000

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

PHILLIP DEEN SMITH

Plaintiffs

- and -

PACE SAVINGS AND CREDIT UNION LTD. by its administrator Financial Services Regulatory Authority of Ontario, formerly Deposit Insurance Corporation of Ontario, STAN DIMAKOS, and KEN TOPPING

Defendants

STATEMENT OF CLAIM

TO THE DEFENDANTS:

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiffs. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the *Rules of Civil Procedure*, serve it on the plaintiffs' lawyer or, where the plaintiffs do not have a lawyer, serve it on the plaintiffs, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

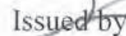
Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the *Rules of Civil Procedure*. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

IF YOU PAY THE PLAINTIFFS' CLAIM, and $5,000.00 for costs, within the time for serving and filing your statement of defence, you may move to have this proceeding dismissed by the court. If you believe the amount claimed for costs is excessive, you may pay the plaintiffs' claim and $400.00 for costs and have the costs assessed by the court.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date: October 7, 2019



Issued by ______________________
Local registrar

Address of court office
393 University Avenue
10th Floor
Toronto, Ontario M5G 1E6

TO: PACE SAVINGS AND CREDIT UNION LTD. by its administrator Financial Services Regulatory Authority of Ontario, formerly Deposit Insurance Corporation of Ontario
8111 Jane Street, Unit 1, Concord, ON L4K 4L7

AND TO: DEPOSIT INSURANCE CORPORATION OF ONTARIO
4711 Yonge Street, North York, ON M2N 6K8

AND TO: FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO
5160 Yonge St, 16th Floor
Toronto, Ontario M2N 6L9

AND TO: STAN DIMAKOS
c/o PACE SAVINGS AND CREDIT UNION LTD. by its administrator Financial Services Regulatory Authority of Ontario, formerly Deposit Insurance Corporation of Ontario
8111 Jane Street, Unit 1, Concord, ON L4K 4L7

AND TO: KEN TOPPING
c/o PACE SAVINGS AND CREDIT UNION LTD. by its administrator Financial Services Regulatory Authority of Ontario, formerly Deposit Insurance Corporation of Ontario
8111 Jane Street, Unit 1, Concord, ON L4K 4L7

CLAIM

1. The plaintiff, Phillip Deen Smith ("**Mr. Smith**"), claims as against the defendant, PACE Savings and Credit Union Ltd. by its administrator Financial Services Regulatory Authority of Ontario, formerly Deposit Insurance Corporation of Ontario ("**PACE**"):

(a) damages for breach of contract and/or wrongful dismissal and common law damages in the amount of $2,000,000.00;

(b) damages in the amount of $2,000,000.00 for negligent investigation;

(c) moral damages in the amount of $1,000,000.00 for bad faith conduct in the termination of the plaintiff;

(d) aggravated damages in the amount of $2,000,000.00 or such other amount as may be proven at trial, arising out of the matters pleaded herein, including but not limited: to the manner of and motivation for the wrongful termination of the plaintiff's employment without notice and for cause; the improper initiation of certain regulatory investigations and subsequent proceedings; or in the alternative, damages for abuse of process;

(e) punitive and/or exemplary damages in the amount of $1,000,000.00 or such other amount as may be proven at trial, arising out of the matters pleaded herein;

(f) payment of any and all outstanding expenses incurred by the plaintiff on PACE's behalf prior to the termination of his employment;

(g) payment of any and all bonuses pursuant to the Plaintiff's employment agreement;

(h) payment of all earned and outstanding vacation pay to the date of the termination of the plaintiff's employment, and in the notice period;

(i) damages in the sum of $200,000.00, or such other amount as may be proven at trial, on account of all benefits which the plaintiff would have enjoyed

over the course of the notice period but for the wrongful termination of his employment for cause;

(j) damages in the sum of $100,000.00, or such other amount as may be proven at trial, for reimbursement of expenses which the plaintiff incurs in the course of mitigating his damages;

(k) a declaration that the plaintiff has been wrongfully dismissed; and

(l) a declaration that the defendant, PACE breached its statutory, contractual and common law duties owed to the plaintiff.

2. The plaintiff claims as against Stan Dimakos, and Ken Topping,

(a) damages in the sum of $2,000,000.00 for conspiracy, inducing breach of contract, and unlawful interference with economic interests;

(b) punitive and/or exemplary damages in the amount of $1,000,000.00 or such other amount as may be proven at trial, arising out of the matters pleaded herein, including but not limited to the improper and improperly motivated initiation of regulatory investigations and subsequent proceedings;

(c) aggravated and compensatory damages in the amount of $1,000,000.00 or such other amount as may be proven at trial, arising out of the matters pleaded herein, including but not limited to embarrassment and humiliation of the plaintiff.

3. The plaintiff claims as against all defendants,

(a) pre-judgment and post-judgment interest in accordance with the *Courts of Justice Act*, or in the alternative, interest at the plaintiff's rate of return over the relevant period;

(b) costs of this action on a full indemnity, substantial indemnity, or alternatively, partial indemnity basis, together with Harmonized Sales Tax thereon, and;

(c) such further and other relief as counsel may advise and this Honourable Court deems just.

OVERVIEW

A. THE PARTIES

4. The plaintiff, Phillip Smith, is the former Chief Executive Officer ("**CEO**") of PACE Savings and Credit Union Ltd. He was continuously employed by PACE since he was hired as a teller and administrative assistant in 1989.

5. PACE is a credit union governed by the *Credit Unions and Caisses Populaires Act, 1994*, S.O. 1994 Chapter 11 (the "**Act**"). PACE operates 17 branches in Ontario. As at May 28, 2018, PACE had over $1 billion in assets under administration.

6. DICO, not a party to this claim in its own capacity, is an Ontario Provincial Agency established under the Act. DICO administers a deposit insurance program for all Ontario credit unions pursuant to the Act. DICO has now amalgamated to become the Financial Services Regulatory Authority of Ontario (hereinafter "**DICO**').

7. Stan Dimakis and Ken Topping (hereinafter the "**individual defendants**") are members of the Board of Directors of PACE.

8. In and around 2014, the plaintiff was appointed by the Board of Directors of PACE as interim CEO following the illness of the previous CEO, Larry Smith.

9. The plaintiff was subsequently appointed by the Board of Directors as CEO of PACE in 2015 and worked in that role until his termination on December 5, 2018.

B. THE PLAINTIFF'S EMPLOYMENT HISTORY

10. The plaintiff graduated with honours from McMaster University in May 1995, with a degree in economics.

11. The plaintiff commenced his employment with PACE's predecessor, GTA Savings and Credit Union, on a part-time basis in 1989. He worked during the summers as a teller and administrative assistant. In 1996, he obtained a full-time position as a teller at a branch.

12. In and around 1997, the plaintiff was relocated to a different branch and took on the roles of teller and administrator of the Employees Charitable Fund.

13. In and around 1998, the plaintiff was transferred to the Head Office in an information technology role reporting to Terry Chapman, the VP of Business Development. In this role, the plaintiff was tasked with, among other things, administering the conversion of the banking platform to ensure Y2K compliance. For a number of years following, the plaintiff was responsible for general IT functions such as processing of clearing files, automatic payroll, troubleshooting IT issues, and upgrade implementation.

14. In and around 2003, GTA Savings and Credit Union merged with PACE Credit Union and formed PACE. As a result of the merger, the plaintiff became Manager of IT of PACE and was responsible for, among other things, merging the IT systems of the two credit unions.

15. In and around 2007, PACE merged with North York Credit Union and the plaintiff was promoted to Chief Financial Officer (**"CFO"**) reporting to the corporate secretary and former CFO, Kim Colacicco, and Chief Operating Officer, Mary Benincasa.

16. In and around 2014, PACE's Board appointed the plaintiff as interim CEO to replace Larry Smith, who was experiencing health issues. In 2015, the plaintiff was appointed as CEO by unanimous resolution of the Board of Directors. Larry Smith was appointed President of PACE.

17. As CEO, the plaintiff was responsible for the day to day operations of the credit union. He was not engaged in the sourcing of business opportunities.

18. Throughout his term as CEO the plaintiff reported directly to the Board. Due to their familial relationship, the plaintiff did not supervise PACE's President, Larry Smith, directly. Instead, Larry Smith also reported directly to the Board.

C. THE EMPLOYMENT AGREEMENT

19. The plaintiff and PACE executed an employment agreement dated December 17, 2015 and amending agreement dated December 14, 2017 (together, the "**Employment Agreement**"), in consideration of the plaintiff's appointment as CEO of PACE.

20. The Employment Agreement provided that the plaintiff's appointment as CEO was effective as of February 1, 2016.

21. Pursuant to the Employment Agreement the plaintiff was entitled to:

(a) an annual salary of $400,000 payable in bi-weekly installments;

(b) annual review of the plaintiff's salary and benefits;

(c) annual bonus up to 80% of the plaintiff's annual salary or such other amount in addition as authorized from time to time by the Executive Committee of the Board of Directors, based on the performance of the plaintiff, and the plaintiff was entitled to direct payment of the bonus to the account or corporation of his choosing;

(d) participation in PACE's benefit package offered to senior employees;

(e) a contribution equal to 10% of the current year's salary to be paid into an RRSP or pension plan;

(f) use of a vehicle up to $60,000 in value and replaced every three years;

(g) membership dues and fees, business related membership costs, and out of pocket business or business-related expenses, including association and golf memberships;

(h) a monthly advance of $1,500 net of tax against un-vouched expenses if necessary and as approved by the Board;

(i) 6 weeks' vacation per annum;

(j) the option to accept director or advisor appointments to boards and/or operating entities associated directly or indirectly with PACE, provided that such appointments and compensation are consistent with the business of PACE and the appointments and compensation are disclosed to the Board and/or Executive Committee of the Board of Directors on a regular basis.

22. Upon his appointment as CFO in 2007, the plaintiff became entitled to a severance payment equivalent to one year's salary. Pursuant to the Employment Agreement, his severance entitlement was increased to an amount equivalent to three years' salary. Such severance is deemed due, earned and the property of the plaintiff on the date notice is given or upon the occurrence of certain events.

23. Pursuant to the Employment Agreement, severance is payable at the option of the plaintiff, one minute before the effective date and time of an administration order made pursuant to subsection 294(1) of the Act or the appointment pursuant to the Act of a liquidator of PACE's assets.

24. This severance arrangement is consistent with the compensation arrangements of other PACE executives and reflected arrangements that had been in place since about 1993 when the IBM Employees (Toronto) Credit Union merged with Stouffville Credit Union to create the Markham Stouffville Credit Union, a predecessor of PACE.

25. Upon termination, any benefits program remains in force until the earlier of, the death of the plaintiff; the time the plaintiff reaches age 65; or 36 months from the date of notice of termination.

26. Under the Employment Agreement, severance funds equal to three years' base salary were to be placed in a trust account for the benefit of the plaintiff.

27. The Employment Agreement and Amended Employment Agreement are binding upon PACE and DICO in its capacity as administrator of PACE.

D. BUSINESS OPERATIONS OF PACE

28. PACE is a credit union providing personal, business and organizational products and services. As at May, 2018, PACE had approximately 35,000 members comprised of individuals, corporations and organizations.

29. PACE operates various business lines, including but not limited to personal and commercial banking, personal and commercial lending, investments, and the acquisition of and partnership with other credit unions.

30. A key focus of PACE's business strategy is its lending portfolio. It is required to ensure that its lending practices comply with the credit union's policy, DICO guidelines, and are approved by the Audit Committee of the Board of Directors. Further, PACE monitors its impaired loan allowance on a month by month basis and conducts a detailed review once per year.

31. Between 2015 and 2017, PACE's commercial loan portfolio grew from approximately $49 million to $396 million. Total members' equity over that same period grew from approximately $53.6 million to $63.1 million. PACE paid an average of approximately $460,000 in dividends to members each year between 2015 and 2017.

32. PACE's commercial lending business is subject to oversight by the Audit Committee of the Board of Directors as mandated by the Act and its by-laws.

33. Jim Tindall, Peter Rebellati, George Pohle, Brent Bailey, and Deborah Baker have been members of the Audit Committee since 2015. During that period the Audit Committee was chaired by Deborah Baker, a Chartered Accountant.

34. PACE is also subject to audit by an independent auditor, Deloitte LLP ("**Deloitte**"). As part of the annual audit, Deloitte reviews all facets of the credit union's activity including policies, compliance, financial results, impairment, misstatements, and recommendations. Between 2015 and 2017, Deloitte identified no significant misstatements, including statements relating to compensation.

35. All transactions conducted at the relevant time were overseen by multiple individuals, including the credit committee and/or Board, internal audit committees, various PACE employees, PACE's external auditor, Deloitte, and DICO.

36. Prior to the fall of 2018, no significant issues were ever raised by PACE, the Board, Deloitte or DICO in respect of the plaintiff's conduct as CEO or in relation to any transactions of PACE, or regarding the compensation arrangements described herein.

E. THE IMPUGNED TRANSACTIONS

i. CCE Transaction

37. The plaintiff first became involved in a potential investment in Continental Currency Exchange ("**CCE**") in and around June 2016.

38. The plaintiff was advised by Larry Smith that the principal of CCE, Scott Penfound, wished to sell the corporation to a group of interested purchasers and there was an opportunity for PACE to fund a commercial loan to one of the interested buyers, 2340938 Ontario Ltd. ("**2340**"). Larry Smith also advised there may be an opportunity for PACE to invest directly in CCE.

39. At the material time, CCE operated a retail currency exchange business with approximately 17 retail locations across southwestern Ontario and the Greater Toronto Area, including most major shopping centres in the region.

40. On or around September 10, 2016, Larry Smith presented to the Board a potential transaction involving PACE's acquisition of 30% of CCE. The Board was advised that:

(a) the investment in CCE is consistent with PACE's core business and operating principles;

(b) the expected ROI from CCE was approximately 15 to 20% per annum;

(c) the investment in CCE would allow PACE access to CCE's client base, which processed approximately 850,000 transactions per annum valued in the aggregate at $400 million;

(d) the investment would allow PACE to expand its foreign exchange business and remain competitive in the foreign exchange space;

(e) PACE would be able to leverage CCE's core banking system to upgrade its legacy technology and banking systems. This resulted in a cost savings to PACE of up to $7 million; and,

(f) CCE had applied for and received a Schedule I banking license.

41. Following that meeting, PACE's Board provided its approval to pursue the CCE Transaction through due diligence. The plaintiff considered detailed and extensive due diligence information provided by CCE as well as other information on comparable companies.

42. As a result of the plaintiff's due diligence review, he concluded that an investment in CCE would benefit PACE for the following reasons:

(a) CCE had an experienced management team and robust and profitable financial performance;

(b) post acquisition, CCE was expected to double the number of its retail branches;

(c) PACE would benefit from increased market scope and brand visibility;

(d) PACE would be able to diversify its client demographic;

(e) the acquisition would increase PACE's online presence;

(f) PACE would be able to offer PACE products and services at the new PACE/CCE locations; and,

(g) CCE boasted exceptional corporate governance, regulatory compliance, and risk management.

43. On November 6, 2016, Larry Smith provided the Board with an update on the due diligence review.

44. On December 15, 2016, Larry Smith presented to the Board regarding the CCE transaction. CCE's principal, Scott Penfound, also attended the meeting and presented to the Board.

45. The Board was provided with detailed information regarding the CCE transaction, including the loan to 2340. None of the members of the Board ever raised any concerns about the contemplated CCE transaction.

46. On December 28, 2016, PACE entered into a memorandum of understanding ("**MOU**") with CCE, 2340 and Scott Penfound's company, 2549560 ("**Penfound NewCo**") regarding the quarterly distribution of income from CCE.

47. Pursuant to the MOU, PACE would receive $250,000 and 2340 would receive $500,000, quarterly beginning on March 31, 2017. The MOU was signed by Ian Goodfellow and Deborah Baker on behalf of PACE.

48. On or around January 31, 2017, PACE executed a share purchase agreement (the "**SPA**") with CCE, 2340, and Penfound NewCo. Pursuant to the SPA, CCE transferred the "business" to Penfound Newco and in turn, PACE and 2340 together acquired 75% of the issued and outstanding shares of Penfound Newco.

49. The parties entered into a unanimous shareholders agreement defining the rights and obligations of each shareholder of Penfound NewCo.

50. The CCE transaction was described in the President's report dated June 28, 2017, which was presented to and approved by the Board. The CCE transaction was also discussed at a Board meeting held on November 29, 2017.

51. At no time did PACE breach any of its obligations under the Act or the Regulations. The aggregate of shares beneficially owned by PACE and by any entities controlled by it was 30% or less. In the alternative, the CCE transaction was a prescribed exception under the Act and the Regulations. At no time did the plaintiff cause PACE to breach any obligation it owed under the Act, or himself breach any duty owed to PACE in connection with the CCE transaction.

ii. Role of 2340 in the CCE Transaction

52. PACE was only entitled to acquire up to a 30% ownership in CCE without DICO approval. Accordingly, PACE acquired only 30% of CCE. PACE provided a commercial loan to 2340 for it to acquire a separate 45% interest in CCE.

53. It was the plaintiff's hope that in the future, PACE might be able to pursue an opportunity to acquire the remaining interest in CCE if applicable funding and regulatory approvals could be obtained.

54. At all material times, the plaintiff understood 2340 to be an arm's length corporation. The plaintiff was not aware of any trust declaration or other agreement that would provide PACE with control or ownership, beneficial or otherwise, over 2340 or its principal.

55. To confirm that the structure complied with PACE's regulatory obligations, the plaintiff and Larry Smith obtained a verbal legal opinion and later a written legal opinion approving the structure of the transaction.

56. As the plaintiff and Larry Smith were already engaged in due diligence review for PACE, they were retained by 2340 as consultants to also review the transaction for 2340

and to negotiate a share purchase agreement on 2340's behalf. These appointments were disclosed to and approved by PACE's Board, and no conflict arose from the dual appointment.

57. In consideration for his services to 2340, the plaintiff was entitled to payment from dividend proceeds payable to 2340 by CCE. In total, the plaintiff received $50,000.00 in payment from 2340. In addition to the plaintiff, other individuals at PACE also received payment from 2340 in relation to the CCE investment. The payment to the plaintiff was disclosed to and approved by the Board.

58. As part of the CCE transaction, PACE advanced a $15 million commercial loan to 2340, of which $500,000 was in a line of credit held by 2340. In addition, PACE received approximately $800,000 in a previous loan loss recovery. The loan was secured against the purchased assets, being the shares of CCE held by 2340.

59. As a matter of practice, commercial lending opportunities are presented to the PACE credit committee for approval. The package that is assembled by the commercial lending representative for the credit committee typically includes the lending term sheet, asset base security valuations, credit information, a summary of the loan, and the commercial lending representative's recommendations for or against approval.

60. During the presentation of the loan to the credit committee, the commercial lending representative typically discusses the merits of the loan based on PACE's lending criteria, commercial lending policies, the Act, and DICO bylaws.

61. A quorum of the credit committee is necessary to approve a commercial loan. Once a loan is approved, an annual review is performed to ensure the loan continues to comply with the terms of the loan agreement, security continues to be adequate, and to ensure the loan remains compliant with PACE policies, the Act, and regulations.

62. The 2340 Loan was presented to the Board at PACE's November 2016 Board meeting and approved by it along with the 2340 financing.

F. THE INVESTIGATIONS

i. Routine Investigation by DICO in 2017

63. Pursuant to its regulatory powers, DICO conducts on-site visits ("**OSVs**") on an annual basis to inspect and review the affairs of the credit union. As part of the OSVs, DICO reviews board packages for the preceding year, which provides DICO with information about PACE's investment activities for the year prior.

64. In or around May 29 to June 2, 2017, DICO conducted an OSV. As part of this review, DICO was provided with minutes and Board packages from Board meetings up to and including March 2017. The Board minutes and packages included disclosure about the CCE transaction.

65. In addition, DICO routinely compiled a "pull-list" of commercial lending matters for review. Their pull list for the June 2017 OSV included the commercial loan to 2340 and its equity investment in CCE, which was pledged as security for the loan.

66. Despite having pulled and reviewed the 2340 Loan, DICO did not raise any concerns in its report specific to the 2340 Loan or the CCE Transaction.

67. In and around October 2017, an anonymous individual or individuals sent DICO a letter regarding the CCE Transaction, prompting DICO to investigate the CCE transaction and the 2340 Loan. The identity of the sender of this letter was never disclosed to the plaintiff by DICO or PACE.

68. In and around March 21, 2018, DICO delivered a letter to PACE's management team and to Ian Goodfellow, the chair of the Board, setting out certain concerns based on the information that DICO had received as a result of the anonymous letter. DICO's concerns included the CCE transaction.

69. DICO requested a meeting with PACE's management and Board to discuss the concerns set out in its letter. Amongst the individuals that DICO met with were the plaintiff, Larry Smith, Ian Goodfellow, and Deborah Baker, chair of the audit committee.

70. The plaintiff understood the meetings to be forums for open discussion with DICO about the concerns set out in DICO's letter. DICO did not advise the plaintiff that any statements made in the meetings would be relied upon as his formal response to the allegations set out in the letter, nor did DICO advise him to seek legal advice or retain counsel to represent him at these meetings, or that he was in any way at risk.

71. Without notice to the plaintiff, in May 2018, DICO engaged KSV Advisory Inc. ("**KSV**") to conduct an examination and audit (the "**Special Audit**") of PACE.

72. On May 10, 2018, DICO met with the Board to advise that the Special Audit was being commenced. DICO asked the Board to keep the reasons for the investigation confidential.

73. At DICO's request, the plaintiff submitted to an interview with KSV on May 18, 2018. He was not permitted to have counsel in attendance.

74. The plaintiff cooperated with DICO and KSV during the course of this examination. He provided DICO and KSV with access to his laptop and phone. As the plaintiff's laptop and phone included both personal and professional information, KSV and DICO executed an acknowledgment promising to seal the information obtained from the laptop and phone until such time as a court order was obtained that would govern the document review protocol.

75. Despite this, no document review protocol was ever proposed by DICO and KSV.

76. The plaintiff is not aware of the full scope of information reviewed by DICO during the Special Audit, nor the information provided by anonymous persons to DICO.

77. Throughout the course of the investigation, DICO failed to particularize its allegations against the plaintiff, and refused the plaintiff an opportunity to respond to allegations made against him in the investigation.

78. As a result of the secretive nature of the investigation, the plaintiff and his family were subject to much rumour and negative speculation, to which the plaintiff was unable to effectively respond.

ii. Administration Order

79. On or around September 28, 2018, without any prior notice to the plaintiff, DICO made an application for an order under section 295 of the Act (the "**Administration Order**") granting DICO the power to assume the powers of the Board and take control of PACE.

80. The plaintiff first learned around this time that PACE, by its administrator DICO, was making allegations that the plaintiff was involved in "improper and unlawful activities against the Credit Union."

81. PACE immediately suspended the plaintiff's employment without providing him an opportunity to respond to the allegations. PACE represented to the plaintiff that he would have an opportunity to respond to the allegations before any final decision was made in respect of his employment or ongoing involvement with PACE.

82. From September 28, 2018 to the date of his termination, the plaintiff was shut out of the operations of PACE, including any meetings of management and or the Board.

iii. Inappropriate and High-Handed Conduct by PACE

83. Subsequent to the granting of the Administration Order, PACE conducted further investigations in breach of representations made to the plaintiff and without allowing the plaintiff a reasonable or any opportunity to respond. The plaintiff has no knowledge of the full extent of the investigations conducted and the information reviewed. Such knowledge and information is in the sole power, possession and control of PACE.

84. As early as November 2018, the plaintiff had difficulty accessing his accounts online and noticed that funds had been removed from his accounts. It was not until on or around March 19, 2018 that PACE obtained, without notice to the plaintiff, an order that among other things froze the plaintiff's accounts with PACE and appointed a monitor over the plaintiff's assets.

85. When the plaintiff complained in and around November 2018 about amounts being removed from his accounts, DICO, as administrator of PACE, claimed it was exercising a

right of set-off in respect of the plaintiff's accounts, including the plaintiff's registered accounts.

86. On or around November 6, 2018, PACE compiled a document review database that contained a complete copy of the materials copied from the plaintiff's laptop despite their promise to seal the materials until a court-approved document review protocol was in place.

87. The documents in the database included approximately 340,000 documents, including the plaintiff's personal and solicitor-client privileged information and communications.

iv. Termination of the Plaintiff's Employment

88. On December 5, 2018, DICO, as administrator of PACE, issued a letter (the "**Termination Letter**") terminating the plaintiff's employment for cause. The Termination Letter was accompanied by a motion record filed by PACE for the appointment of KSV Advisory Inc. as receiver over 2340.

89. The Termination Letter alleged that the plaintiff did the following:

(a) intentionally evaded the requirements of the Act in connection with the Credit Union's acquisition of shares of CCE, including through the use of 2340 in connection with that transaction;

(b) worked to manipulate the structure of transactions so as to evade the regulatory lending limits in the Act and the regulations promulgated thereunder, including in connection with the contemplated Lagasco transaction;

(c) received payments in the nature of special commissions; and,

(d) repeatedly caused the Credit Union to advance funds in a number of transactions on unreasonable terms in transactions for which the plaintiff was personally benefitting, contrary to his fiduciary duties.

90. The plaintiff denies that there was cause for his termination, or that he breached his fiduciary duty to PACE, and puts the defendant PACE to the strict proof thereof.

91. The plaintiff further states that the investigations by DICO and PACE were improperly commenced and primarily undertaken for an unlawful purpose. Further, the investigation itself was conducted in a biased and unfair manner, in part reflected in the failure to provide the plaintiff with any opportunity to respond. In addition, the investigation was conducted negligently and failed to meet the minimum criteria for a fair investigation.

92. The termination of the plaintiff's employment for cause was widely publicized. As a result of the failure to permit the plaintiff to respond and because of PACE's and the individual defendants' improper conduct and the secretive nature of the investigations conducted by PACE and DICO, the plaintiff has been unable to effectively respond to allegations of cause and misconduct against him.

93. PACE ought to have known that the manner in which the plaintiff's employment was terminated would also result in damaging and negative comment in the media and in the industry. PACE disregarded or, alternatively, intended the reputational damage and media comment and the ensuing impact on the plaintiff's reputation.

94. PACE was aware of the serious consequences to the plaintiff's reputation which would result from his suspension and termination for cause becoming public and was well aware of the importance of individual reputation within the financial services industry and the ease with which a reputation can be destroyed. Despite that, PACE took no steps to maintain confidentiality in connection with the decision to suspend and terminate the plaintiff and indeed publicly communicated the false allegations of cause.

v. PACE Approved the Plaintiff's Conduct

95. The plaintiff denies PACE has cause to terminate his employment. The plaintiff was never involved in soliciting financing or investment opportunities for PACE. At all times, the plaintiff was only involved in the management of PACE not in the promotion of business opportunities. All financing or investment opportunities, in any event, went

through a substantial vetting process, over which the plaintiff had no control. All such opportunities were reviewed and required recommendations by the Credit Committee and approval by the Board of PACE.

96. In all of the circumstances, PACE is estopped from relying on the plaintiff's involvement in the CCE transaction or 2340 Loan, or any other alleged misconduct as a basis for terminating the plaintiff's employment.

97. At all material times, the plaintiff's conduct was overseen by DICO, PACE, its credit and audit committees, and the Board. The Board and senior officers of PACE were intimately aware of the plaintiff's practices and activities throughout his tenure as CEO. The Board was continuously kept apprised of PACE's transactions and never raised any issues with the plaintiff's conduct.

98. PACE's decision to terminate the plaintiff for cause on the grounds alleged is deliberately or recklessly harmful to the plaintiff's reputation, based on a failure to properly consider the information, or make any reasonable enquiries, and without any attempt to understand the technical nature of the impugned transactions and investments.

99. The defendants acted in concert, systematically and intentionally isolating the plaintiff. The plaintiff was denied an opportunity to participate in a meaningful way in the investigation, and more importantly he was denied an opportunity to adequately and properly defend himself. The defendants' conduct was intended to and did result in the plaintiff's wrongful termination for cause.

100. The defendants' conduct has caused financial, emotional and reputational injury to the plaintiff and the plaintiff in fact suffered damage as a result.

101. At all material times, PACE, the Board, and the individual defendants, approved, implicitly or explicitly, the plaintiff's conduct, practices, and performance.

iv. Negligent Investigation

102. The plaintiff further asserts that the investigations conducted by PACE by its administrator, DICO, were commenced for the primary unlawful and improper purpose of

devaluing the credit union, reducing its ability to compete in the marketplace, and ultimately positioning the credit union for a potential takeover by a competitor.

103. Alternatively, the investigations were conducted to advance certain personal agendas by the individual defendants against the plaintiff.

104. In the further alternative, DICO *qua* administrator of PACE was in a position of conflict at the time the investigations were conducted which resulted in the plaintiff's termination.

105. On March 31, 2016, a report on the Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario was released (the "**Ritchie Report**").

106. Among other things, the Ritchie Report was critical of DICO, noting that its mandates were unclear and outdated, and it was in an inherent conflict of interest as both a prudential regulator and an insurer.

107. The Ritchie Report recommended the creation of a new, independent and integrated regulator called the Financial Services Regulatory Authority ("**FSRA**") and concluded that DICO's independence and efficiency could be enhanced by transferring its prudential oversight and regulatory functions to FSRA.

108. In response to the recommendations of the Ritchie Report, the Ontario government established FSRA and took steps to transfer DICO's regulatory and prudential oversight mandates to FSRA.

109. DICO's conflict of interest as regulator and insurer was never as acute as during the period leading up to the transition. Subsequent to the Ontario government's decision to transfer DICO's regulatory function to FSRA, DICO's interest going forward was solely to maximize premiums. At the material time, DICO had incentive to use its regulatory powers against credit unions in order to rationalize future increases in premium rates.

110. In addition, DICO had acknowledged at various times prior to the investigations and Administration Order, its preference that PACE merge or be acquired by a larger credit union. DICO had a bias against the management style of the plaintiff and his predecessor CEO, Larry Smith.

111. As a result of the investigations, the subsequent Administration Order, and the termination of the plaintiff, the normal course operations of PACE, including the advancing of commercial and personal loans, has declined. PACE is not renewing loans as they mature and it is no longer seeking out business opportunities or commercial loans. Accordingly, its loan portfolio has diminished with corresponding impact on the credit union's valuation, thereby creating an environment conducive to merger or acquisition.

112. The plaintiff states that PACE was negligent in its investigation of the allegations against him. Particulars of this negligence include but are not limited to the following:

(a) it failed to permit the plaintiff to respond to the allegations and failed in a number of instances to make any specific allegation against the plaintiff making it impossible for the plaintiff to respond;

(b) the investigation was not independent and fair because DICO was in a conflict of interest and/or improperly motivated;

(c) it failed to conduct any investigation and relied entirely on DICO's purported investigation; and,

(d) it failed entirely to consider that the Board received and approved the impugned transactions and approved any benefit received by the plaintiff.

vi. Inducing Breach of Contract and Unlawful Interference

113. The individual defendants communicated defamatory allegations to DICO, which allegations are untrue. These allegations are within the sole knowledge of DICO and the individual defendants. These allegations and the individual defendants' subsequent conduct was in breach of their fiduciary duty to PACE, was in their own personal interest, and was intended to cause PACE by its administrator to terminate the plaintiff for cause.

114. This conduct by the individual defendants was intended to and did cause PACE to breach its Employment Agreement with the plaintiff and terminate his employment, without justification, for cause. These defendants further by their conduct unlawfully interfered with the Plaintiff's economic interests and triggered the plaintiff's termination by PACE. As a result, the plaintiff has suffered damages, including but not limited to, loss of employment, loss of the opportunity to earn income in the future, and loss of reputation in the financial services industry.

115. The individual defendants stand to gain personally from the diminished value of the credit union and its increased vulnerability to merger or acquisition. Details of such interests are in the Defendants' sole knowledge, and further particulars will be provided at trial.

vii. Damages Suffered by the Plaintiff

116. PACE owed the plaintiff a duty of good faith throughout his employment, and in the manner of his termination. It ought to have safeguarded his reputation throughout the investigation process and subsequent regulatory proceeding through the proper conduct of the investigation and reasonable handling of his suspension and termination. PACE failed to do so, and in fact acted in bad faith.

117. As a result of the PACE acts and omissions, including the conduct of a bad faith and/or negligent investigation, the plaintiff has suffered significant reputational damage, loss of existing position and ability to obtain comparable employment at a level of compensation consistent with his earnings prior to termination, or at all.

118. No other individual was terminated as a result of the CCE Transaction. PACE singled out the plaintiff for termination for cause and scapegoating and in doing so acted unlawfully.

119. The plaintiff has lost competitive advantage in the marketplace. This will result in a permanent impairment of his earning capacity, which will follow him through the rest of his professional life. Accordingly, the plaintiff is entitled to aggravated damages to compensate for his loss.

viii. Compensation in Lieu of Notice

120. Throughout the term of his employment with PACE, the plaintiff at all times acted in the best interests of PACE and its stakeholders. He was a loyal and conscientious employee who performed his role to the best of his ability, consistent with his employer's expectations, objectives and direction.

121. The plaintiff, in accordance with the Employment Agreement, is entitled to 36 months pay in lieu of notice, including all incentive and bonus income, at a rate based on his compensation in the last full year of his employment, all benefits, car allowance, and vacation entitlement. In the alternative, the plaintiff is entitled to 30 months pay in lieu of reasonable notice at common law together with all bonus entitlements, and all benefits to which he is entitled throughout the reasonable notice period.

122. The plaintiff is entitled to punitive and exemplary damages as a result of the conduct pleaded as a sanction by this Honourable Court for the heinous and aggregated conduct by PACE in complete disregard of its obligations to the plaintiff.

October 7, 2019

BRAUTI THORNING LLP
161 Bay Street, Suite 2900
Toronto, ON, M5J 2S1

Steven Weisz (LSO# 32102C)
Email: sweisz@btlegal.ca
L. Leslie Dizgun: (LSO#27993E)
Email: ldizgun@btlegal.ca
Sharon Kour (LSO#58328D)
Email: skour@btlegal.ca
Tel: 416.362.4567
Fax: 416.362.8410

Lawyers for the Plaintiff,
Phillip Deen Smith

PHILLIP DEEN SMITH Plaintiff	and	PACE SAVINGS AND CREDIT UNION LTD. et al. Defendants	Court File No. CV-19-00628710-0000

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

STATEMENT OF CLAIM

BRAUTI THORNING LLP
161 Bay Street, Suite 2900
Toronto, ON, M5J 2S1

Steven Weisz (LSO# 32102C)
Email: sweisz@btlegal.ca
L. Leslie Dizgun: (LSO#27993E)
Email: ldizgun@btlegal.ca
Sharon Kour (LSO#58328D)
Email: skour@btlegal.ca

Tel: 416.362.4567
Fax: 416.362.8410

Lawyers for the Plaintiff,
Phillip Deen Smith

TAB G

Court File No. CV- 19-00616388-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

BETWEEN:

PACE SAVINGS & CREDIT UNION LIMITED, BY ITS ADMINISTRATOR, FINANCIAL SERVICES REGULATORY AUTHORITY

Plaintiff

and

LARRY SMITH, PHILLIP SMITH, 1428245 ONTARIO LTD., 809755 ONTARIO LTD. (a.k.a. ELECTIVE BENEFIT INSURANCE SERVICES), MALEK SMITH, 1916761 ONTARIO LTD., 1724725 ONTARIO LTD., FRANK KLEES, KLEES & ASSOCIATES LTD., RON WILLIAMSON, R. WILLIAMSON CONSULTANTS LIMITED, RON WILLIAMSON QUARTER HORSES INC., BRIAN HOGAN, BRENT BAILEY, DEBORAH BAKER, IAN GOODFELLOW, AL JONES, WENDY MITCHELL, GEORGE POHLE, PETER REBELLATI, JIM TINDALL, PAULINE WAINWRIGHT, NEIL WILLIAMSON and JOANNA WHITFIELD

Defendants

STATEMENT OF DEFENCE, COUNTERCLAIM AND CROSSCLAIM OF BRENT BAILEY, DEBORAH BAKER, IAN GOODFELLOW, AL JONES, WENDY MITCHELL, PETER REBELLATI, JIM TINDALL, PAULINE WAINWRIGHT, NEIL WILLIAMSON, AND GEORGE POHLE

1. The Defendants, Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, Peter Reballati, Jim Tindall, Pauline Wainwright, Neil Williamson, and George Pohle (collectively, "**the D&Os**"), deny, or have no knowledge, of the allegations contained in the Fresh as Amended Statement of Claim (the "**Claim**") unless expressly admitted herein.

Overview

2. The within Claim is brought by the Financial Services Regulatory Authority of Ontario ("**FSRA**" or the "**Administrator**"), as Administrator for PACE Savings & Credit Union Limited

("**PACE**" or the "**Credit Union**"). In this Claim, FSRA alleges, without any factual or legal basis, that the D&Os failed to detect and stop various transactions that were orchestrated by the Other Defendants (as defined below at paragraph 26), or any of them and seeks to recover damages suffered by the Credit Union, as a result of, among other things, FSRA's own decisions as a regulator and administrator.

3. The within Claim makes bald allegations, and does not allege any particulars against the D&Os. The D&Os deny the allegations as set forward in the within Claim and plead that there is no basis whatsoever for the relief claimed against them in paragraph 9 of the Claim.

4. Contrary to the allegation in the Claim, the D&Os, at all material times, exercised their powers and discharged the duties of their office honestly, in good faith and in the best interest of PACE. Further, the D&Os exercised the degree of care, diligence and skill that a reasonable person acting as a director and officer of a credit union would exercise in comparable circumstances.

5. Further, the D&Os were entitled to rely on Larry Smith, Phil Smith and the Management (as defined below) to carry on the day-to-day business of PACE, including with respect to the PACE's investment(s) and the D&Os were entitled to accept information and explanations provided by Larry Smith, Phil Smith and the Management with respect to PACE's investment(s).

6. Further, the alleged improprieties of the Other Defendants, for which FSRA is seeking damages from the D&Os, were undetected by FSRA as the regulator (formerly a function performed by Deposit Insurance Corporation of Ontario or "**DICO**"), by PACE's internal and external auditors and other experts retained by PACE for a number of these transactions over the years.

7. Contrary to the allegations in paragraph 10 of the Claim, the D&Os deny that they owed any direct or indirect duty of care or fiduciary duties to Pace Securities Corp. ("**PSC**") or to the Investor Claimants. They did not have any duty to supervise PSC's relationship with the Credit Union, its subsidiaries, or to supervise the design, development, offering, promotion, sale and distribution of the Preferred Shares (as defined in the Claim). PSC had its own board of directors who were responsible for the functions of PSC which was also a regulated entity.

8. Further, the D&Os deny that the alleged damages claimed by the Investor Claimants (as defined in paragraph 166 of the Amended Statement of Claim and referred to hereinafter as the "**Investor Claimants**"), were caused or contributed by the D&Os. FSRA's Claim lacks the factual and legal foundation to seek these alleged damages from the D&Os.

9. The D&Os deny that they are liable for the $25,000,000.00 alleged to have been paid to Investor Claimants in the purported settlement of their claim for damages as particularised in paragraph 10(a) of the Claim. The D&Os, did not participate in this purported settlement, the details of which remain undisclosed to the D&Os.

The Parties

10. FSRA is the regulator of credit unions in Ontario pursuant to *Credit Unions and Caisses Populaires Act*, 1994 (the "**Act**"). FSRA administers deposit insurance to members of Ontario's credit unions and is the regulatory supervisor and, where required, administrator and liquidator of credit unions (as those terms are defined by the Act). Effective June 8, 2019, FSRA amalgamated with DICO, the former entity that carried out the prudential regulation of credit unions in Ontario under the Act. For ease of reference, the regulator shall be referred to as FSRA regardless of whether the event described took place prior to or after June 8, 2019.