Court File No. CV-22-00685736-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020,* S.O 2020, C.36, SCHED. 7, AS AMENDED

AND IN THE MATTER OF PACE SAVINGS & CREDIT UNION LIMITED

APPLICATION OF PACE SAVINGS & CREDIT UNION LIMITED UNDER SECTION 240 OF THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020,* S.O. 2020, C. 36, SCHED. 7, AS AMENDED

FIRST REPORT OF KPMG INC. in its capacity as LIQUIDATOR OF PACE SAVINGS & CREDIT UNION LIMITED

JANUARY 27, 2023

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I. INTRODUCTION

1. On August 24, 2022, PACE Savings & Credit Union Limited ("**PCU**" or the "**Credit Union**") was ordered to be wound up pursuant to section 240 of the *Credit Unions and Caisses Populaires Act, 2020* (the "**CUCPA**") by an Order (the **"Liquidation Order**") of the Ontario Superior Court of Justice (Commercial List) (the "**Court**"), and KPMG Inc. ("**KPMG**") was appointed as liquidator (in such capacity, the "**Liquidator**") of all the remaining assets, undertakings and properties of PCU. A copy of the Liquidation Order is attached hereto as **Appendix "A"**.

2. Prior to the Liquidator's appointment, on March 18, 2019, PCU commenced a claim in the Ontario Superior Court of Justice (Commercial List) bearing Court File No. CV-19-00616388-00CL against the former President and the former Chief Executive Officer ("**CEO**") of the Credit Union (Larry and Phillip Smith), their associated corporations and affiliates, certain of the Credit Union's former directors, and a number of other parties (the "**Claim Against Smiths et al**").

3. On February 28, 2022, PCU also commenced an action bearing Court File No. CV-22-00677550 against CUMIS General Insurance Company ("**CUMIS**") in relation to a claim detailed in a proof of loss filed by the Credit Union dated October 16, 2019 under a fidelity insurance coverage bond issued by CUMIS (the "**CUMIS Fidelity Bond**"), in respect of losses incurred by PCU in connection with various dishonest acts of the former President and CEO of the Credit Union (the "**CUMIS Fidelity Bond Claim**").

4. The above claims of the Credit Union and all related counterclaims, crossclaims and third-party claims are referred to herein collectively as the "**Recovery Litigation**".

II. PURPOSE OF REPORT

5. The purpose of this report, which is the Liquidator's first report to the Court (the "**First Report**") is to provide information to this Honourable Court in respect of:

   a. Certain background on PCU;

   b. The history of the Recovery Litigation and related mediation;

c. Details of settlements that have been entered into by the Liquidator in relation to the Recovery Litigation; and

d. The Liquidator's motion for orders substantially in the forms attached to the Liquidator's Notice of Motion seeking approval of the aforesaid settlements and ancillary relief.

III. TERMS OF REFERENCE

6. In preparing this First Report, the Liquidator has been provided with, and has relied upon, the books and records and other information of PCU, including unaudited financial information and information provided by former management, advisors, and the former administrator of the Credit Union (collectively, the "**Information**"). In accordance with industry practice, except as otherwise described in this First Report, the Liquidator has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Liquidator has not audited or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Generally Accepted Auditing Standards ("**GAAS**") pursuant to the Chartered Professional Accountants of Canada Handbook and, accordingly, the Liquidator expresses no opinion or other form of assurance contemplated under GAAS in respect of the Information.

7. Future oriented financial information reported or relied on in this First Report is based on assumptions regarding future events; actual results may vary from this forecast and such variations may be material.

8. Copies of the Liquidator's reports and all motion records and Orders in the liquidation proceedings are available on the Liquidator's website at http://www.kpmg.com/ca/pacecu.

9. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian dollars.

IV. BACKGROUND ON PCU

10. PCU was formerly an operating credit union headquartered in Vaughan, Ontario, which had approximately 34,000 members, 13 branches in the greater Toronto and surrounding area, and approximately $900 million in assets on its balance sheet. The Credit Union is incorporated under the CUCPA and is regulated by the Financial Services Regulatory Authority of Ontario ("**FSRA**").

11. Since September 28, 2018, and up until the Liquidator's appointment, PCU was under administration by FSRA, formerly the Deposit Insurance Corporation of Ontario ("**DICO**"). The administration was initiated by DICO in response to, among other things, certain misconduct and regulatory breaches committed by the Credit Union's former President and CEO. The affidavit of Mehrdad Rastan, Executive Vice-President, Credit Union & Insurance Prudential of FSRA, sworn on August 17, 2022 (the "**Rastan Affidavit**") in support of the motion brought by FSRA seeking the appointment of KPMG as Liquidator, sets out in further detail the background relating to the administration of the Credit Union. A copy of the Rastan Affidavit (without exhibits) is attached hereto as **Appendix "B"**.

12. As discussed in detail in the Rastan Affidavit, at the outset of the administration, it was DICO's intent, in its capacity as administrator of the Credit Union (in such capacity, the "**Administrator**[1]"), to resolve the governance issues which gave rise to the administration and return the Credit Union to a member-controlled governance in due course. For a number of reasons, including the onset of the COVID-19 pandemic, which are more particularly described in the Rastan Affidavit, the Administrator ultimately determined that the Credit Union's financial position had deteriorated to such extent that it would not be possible to do so. Accordingly, the Administrator made the decision to pursue a purchase and assumption transaction for the Credit Union and a sale of PCU's then wholly-owned subsidiary, Continental Currency Exchange ("**CCE**"), through separate but parallel competitive sale processes.

[1] FSRA succeeded DICO as administrator of PCU and accordingly, the defined term 'Administrator' also refers to FRSA in its capacity as administrator of the Credit Union.

13. On January 11, 2022, PCU, FSRA and DUCA Credit Union entered into a share purchase agreement in respect of the sale of all of the issued and outstanding share capital of CCE (the "**CCE Transaction**"). The CCE Transaction closed on March 31, 2022.

14. On April 20, 2022, PCU and FSRA entered into a purchase and assumption agreement (the "**Purchase and Assumption Agreement**") with Alterna Savings and Credit Union Limited ("**Alterna**"). Pursuant to the Purchase and Assumption Agreement, Alterna acquired substantially all of the business and assets and assumed substantially all of the liabilities, member deposits and employees of the Credit Union except for certain excluded assets and liabilities (the "**Purchase and Assumption Transaction**"). The Purchase and Assumption Transaction closed on June 30, 2022. Alterna has agreed to provide certain transition services to PCU for a limited period of time. The services include various finance and accounting services and information technology services for the purposes of facilitating the Credit Union's dealing with its remaining assets and liabilities.

15. Following the completion of the Purchase and Assumption Transaction, PCU no longer had any active business operations (other than a small prepaid card business which is being wound down) and accordingly, for the reasons set out in the Rastan Affidavit, the Administrator sought the appointment of KPMG as Liquidator for purposes of dealing with the Credit Union's remaining assets and liabilities and ultimately winding down the Credit Union.

16. The remaining assets and liabilities of the Credit Union include, among other things, proceeds from the CCE Transaction, the prepaid card business and related litigation, claims asserted in the Recovery Litigation, certain member deposits and accounts, certain loans, insurance claims or entitlements to proceeds of insurance, certain funds held in trust by the Credit Union for the benefit of former employees, and claims made in the winding-up proceedings of PACE Securities Corporation and its direct and indirect subsidiaries. Further details regarding PCU's remaining assets and liabilities are provided in the Rastan Affidavit. In addition to the above, the investment, profit, and membership shareholdings of PCU's approximately 34,000 members remain with the Credit Union.

V. RECOVERY LITIGATION

Background of the Recovery Litigation

Claim Against Smiths et al

17. Attached hereto as **Appendix "C"** is a copy of PCU's Further Amended Fresh-as-Amended Statement of Claim dated October 18, 2022[2], commenced against Larry and Phillip Smith (the "**Smiths**"), their associated corporations and affiliates, certain of the Credit Union's former directors (the "**Former Directors**") and a number of other parties who PCU alleges received improper benefits from the Credit Union. The Claim Against Smiths et al advances causes of action including breach of fiduciary duty, fraud, conspiracy, breach of contract and employment duties, breach of trust, knowing proceeds of breach of trust, conversion, unjust enrichment and negligence against the Smiths, the Former Directors, and the other parties.

18. Before issuing the claim, PCU sought and obtained an interim *Mareva* injunction against the Smiths. The Credit Union and the Smiths subsequently agreed to the terms of a permanent preservation order which was made on May 7, 2019, and remains in effect.

19. The defendants deny the allegations, and several have commenced counterclaims against PCU. The Smiths have commenced third-party claims against two of the Credit Union's former directors and Phillip Smith also brought a separate claim for wrongful dismissal against the Credit Union in September 2019. A copy of the Further Amended Statement of Defence, Counterclaim and Crossclaim of Larry Smith, 1428245 Ontario Ltd. and 809755 Ontario Limited (collectively, the "**Larry Parties**") dated October 26, 2022[3], is attached hereto as **Appendix "D"**. A copy of the Statement of Defence, Counterclaim and Crossclaim of Phillip Smith dated July 8, 2021, is attached hereto as **Appendix "E"**. A copy of Phillip Smith's Statement of Claim dated October 7, 2019, is attached hereto as **Appendix "F"**. A copy of the Statement of Defence, Counterclaim and Crossclaim of the Former Directors dated June 10, 2022, is attached hereto as **Appendix "G"**. A copy of the Statement of Defence and Counterclaim of Brian Hogan dated March 25, 2021, is attached

[2] PCU's Further Amended Fresh-as-Amended Statement of Claim dated October 18, 2022, has not yet been filed.
[3] The Further Amended Statement of Defence, Counterclaim and Crossclaim of the Larry Parties dated October 26, 2022, has not yet been filed.

hereto as **Appendix "H"**. A copy of the Amended Statement of Defence, Counterclaim and Crossclaim of Frank Klees and Klees & Associated Ltd. (collectively, the "**Klees Parties**") dated June 8, 2022, is attached hereto as **Appendix "I"**.

20. PCU has a directors and officers insurance policy (the "**D&O Policy**") which provides coverage to every director or officer of the Credit Union in connection with any loss arising from a claim made against them for which they are not indemnified by PCU, up to a limit of $15 million. It covers losses arising from "wrongful acts", a term which includes breach of duty, neglect, and error. The D&O Policy also restricts coverage for claims brought by PCU, except where the claim is, *inter alia*, a derivative claim. The D&O Policy has a diminishing limit given that the defence costs of the directors and officers are covered under the policy.

21. Certain of the Credit Union's former directors and officers (including the Smiths) sought coverage from CUMIS in respect of PCU's claims against them for breach of duty and negligence. CUMIS denied defence coverage on the basis that the claim was brought by PCU itself. The directors and officers brought an application for coverage and in an endorsement dated May 18, 2021, the Court found that PACE's claim was a derivative action, and that CUMIS is therefore obliged to defend the directors and officers. Although CUMIS has not formally conceded any obligation to indemnify under the D&O Policy, PCU has taken the position that CUMIS will be liable to the directors and officers for any damages award against them in favour of PCU in the Recovery Litigation, up to the remaining policy limit.

CUMIS Fidelity Bond Claim

22. The CUMIS Fidelity Bond provides fidelity insurance coverage with an effective date of January 1, 2018, and an expiry date of January 1, 2019. Pursuant to the terms of the CUMIS Fidelity Bond, CUMIS is liable to indemnify PCU for covered losses, which include losses resulting from dishonest or fraudulent acts of any director, employee, or contractor of the Credit Union to a maximum of $10.025 million.

23. PCU had claimed the maximum amount available under the CUMIS Fidelity Bond pursuant to the CUMIS Fidelity Bond Claim. Prior to the settlement discussed further in this report, CUMIS had made a partial payment to PCU in the amount of approximately $1

million. PCU commenced an action against CUMIS in relation to the unpaid portion of the CUMIS Fidelity Bond Claim. A copy of PCU's Amended Statement of Claim dated August 5, 2022, is attached hereto as **Appendix "J"**. A copy of CUMIS' Statement of Defence dated October 12, 2022, is attached hereto as **Appendix "K"**.

Status of the Recovery Litigation

24. The Recovery Litigation is currently pending before the Ontario Superior Court of Justice under three separate actions[4]. Pleadings have been exchanged between the parties, but documentary and oral discovery have not yet taken place.

25. The Smiths and the Former Directors brought motions to dismiss or permanently stay PCU's claims against them as an abuse of process on the basis of an alleged failure to immediately disclose settlement agreements that PACE entered into in 2020 and 2021 with other defendants in the Recovery Litigation (the "**Stay Motions**").

26. The Stay Motions were scheduled to be heard on December 19, 2022; however, as a result of scheduling issues, the Court vacated that date. The Stay Motions are now scheduled to be heard on March 20, 2023.

Efforts to Settle the Recovery Litigation and the Recent Mediation

27. The main parties to the Recovery Litigation agreed to participate in a mediation session before Larry Banack in an effort to try and settle all claims. The mediation took place on November 28 and 29 and December 1, 2022.

28. While a global settlement was not reached, the mediation did result in two settlements which are discussed further in this report. Larry Banack continues to have discussions with the non-settling parties regarding a potential global settlement.

VI. SETTLEMENTS IN THE RECOVERY LITIGATION

29. The mediation before Larry Banack resulted in a partial settlement of the Claim Against Smiths et al and a settlement of the CUMIS Fidelity Bond Claim as follows:

[4] The main action bears Court File No. CV-19-00616388-00CL, the action against CUMIS bears Court File No. CV-22-00677550 and Phillip Smith's wrongful dismissal action bears Court File No. CV-19-00628710.

a. A settlement agreement dated December 1, 2022, between PCU, by the Liquidator, and the Former Directors (the "**Former Directors Settlement Agreement**"). A copy of the Former Director Settlement Agreement (redacted to remove the settlement amount) is attached hereto as **Appendix "L"**; and

b. A settlement agreement dated December 1, 2022, between PCU, by the Liquidator, and CUMIS in respect of the CUMIS Fidelity Bond Claim (the "**CUMIS Settlement Agreement**", and together with the Former Directors Settlement Agreement, the "**Settlement Agreements**"). A copy of the CUMIS Settlement Agreement (redacted to remove the settlement amount) is attached hereto as **Appendix "M"**.

The Former Directors Settlement Agreement

30. The Former Directors Settlement Agreement contains the following key terms[5]:

a. The Former Directors shall cause CUMIS to pay the Settlement Funds within 30 days following the effective date of the Former Directors Settlement Agreement;

b. On the effective date, the parties will enter into a full and final mutual release of the claims against the Former Directors which shall be held in escrow until PCU's receipt of the Settlement Funds;

c. PCU will amend the Statement of Claim in the Recovery Litigation to remove the claims against the Former Directors and to clarify that any damages it is seeking from the Non-Settling Defendants do not include any amount apportionable to the fault or negligence of the Former Directors;

d. PCU will obtain orders dismissing the Recovery Litigation as against the Former Directors. The Former Directors will consent to dismissal of their counterclaim against PCU;

e. If requested by PCU, the Former Directors shall cooperate with counsel for PCU and/or the Liquidator in the prosecution of the Recovery Litigation against the Non-Settling Defendants, including by appearing and giving sworn evidence as witnesses at the trial of the Recovery Litigation as against the Non-Settling Defendants. PCU will pay the

[5] Capitalized terms not defined herein have the meaning defined in the Former Directors Settlement Agreement.

reasonable legal fees incurred by the Former Directors in connection with such cooperation;

f. CUMIS will not rely on the inclusion of an obligation to provide evidence in paragraph 5 of the Former Directors Settlement Agreement to allege that it constitutes a basis for denial of coverage. Should PCU exercise any rights to obtain such evidence, CUMIS may allege that it constitutes a basis for denial of coverage and PCU will be free to allege it does not constitute such a breach;

g. The Liquidator will seek an order from the Court approving the terms of the Former Directors Settlement Agreement on notice to all of the parties to the Recovery Litigation and CUMIS. The Former Directors and CUMIS will consent to the order; and

h. PCU will disclose the existence and terms of the Former Directors Settlement Agreement to the Non-Settling Defendants as required by law and as necessary to obtain the Approval Order. The parties shall otherwise keep the existence and terms of the Former Directors Settlement Agreement confidential and shall not reveal its existence and terms except to their respective legal and financial advisors and insurers, or as otherwise required by law.

The CUMIS Settlement Agreement

31. The CUMIS Settlement Agreement contains the following key terms[6]:

a. CUMIS shall pay the Settlement Funds from the CUMIS Fidelity Bond within 30 days following the effective date of the CUMIS Settlement Agreement;

b. On the effective date, the parties will enter into a full and final mutual release of the CUMIS Fidelity Bond Claim and any claims under the EPL Policy which shall be held in escrow until PCU's receipt of the Settlement Funds;

c. CUMIS agrees that it has waived or will waive any subrogation and/or recovery rights which arose or may otherwise arise under the terms of the CUMIS Fidelity Bond or the EPL Policy;

[6] Capitalized terms not defined herein have the meaning defined in the CUMIS Settlement Agreement.

d. PCU will obtain an order dismissing the action in relation to the Fidelity Bond Claim on a with-prejudice and without-costs basis; and

e. PCU will seek an order from the Court approving the terms of the CUMIS Settlement Agreement. CUMIS will consent to the order.

Status of the Settlements

32. PCU's counsel in the Recovery Litigation, Lax O'Sullivan Lisus Gottlieb LLP, provided written notice of the Settlement Agreements, including a redacted copy of the Former Directors Settlement Agreement, to all defendants in the Recovery Litigation on December 1, 2022.

33. The Settlement Funds under the Settlement Agreements were paid by CUMIS to the Liquidator on December 22, 2022.

34. All releases under the Settlement Agreements have been exchanged.

Court Approval of the Settlement Agreements

35. The Liquidator is seeking Court approval of the Settlement Agreements pursuant to their terms.

36. Attached hereto as **Confidential Appendix "A"** is a summary of relevant information pertaining to the Liquidator's decision to enter into the Settlement Agreements.

37. In the view of the Liquidator, the terms of the Settlement Agreements are fair and reasonable, they provide substantial benefits to the Credit Union's stakeholders, and they are consistent with the purpose and spirit of the winding up provisions of the CUCPA.

38. The quantum of the Settlement Funds and other information contained in Confidential Appendix "A" are not being publicly disclosed. The Liquidator respectfully requests an order sealing Confidential Appendix "A" until further order of the Court to maintain its confidentiality during the pendency of the Claim Against Smiths et al. It contains commercially sensitive information, public disclosure of which would be materially prejudicial to the interests of PCU and its stakeholders, which have an interest in maximizing recoveries from those defendants who have not settled. There is no alternative

measure available to protect this information, and no party is materially prejudiced by the sealing of this information.

VII. LIQUIDATOR'S CONCLUSIONS AND RECOMMENDATIONS

39. The Liquidator submits this First Report to the Court in support of the Liquidator's Motion for the relief as set out in the Notice of Motion and recommends that the Court grant such relief.

All of which is respectfully submitted at Toronto, Ontario this 27th day of January 2023.

KPMG Inc.,
in its capacity as Liquidator of
Pace Savings & Credit Union Limited
and not in its personal capacity

Per: _____

Anamika Gadia
Senior Vice President

TAB A

Court File No. CV-22-00685736-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

THE HONOURABLE	)	WEDNESDAY, THE 24TH
	)	
JUSTICE CONWAY	)	DAY OF AUGUST, 2022

IN THE MATTER OF THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020*, S.O. 2020, C. 36, SCHED. 7, AS AMENDED

AND IN THE MATTER OF PACE SAVINGS & CREDIT UNION LIMITED

APPLICATION OF PACE SAVINGS & CREDIT UNION LIMITED UNDER SECTION 240 OF THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020*, S.O. 2020, C. 36, SCHED. 7, AS AMENDED

ORDER
(WINDING UP & APPOINTING LIQUIDATOR)

THIS APPLICATION made by the Applicant, PACE Savings & Credit Union Limited (the "**Applicant**" or "**Credit Union**"), by its administrator, Financial Services Regulatory Authority of Ontario ("**FSRA**"), for an Order pursuant to section 240 of the *Credit Unions and Caisses Populaires Act, 2020,* S.O. 2020, c. 36, Sched. 7, as amended (the "**CUCPA**") winding up the Credit Union and appointing KPMG Inc. ("**KPMG**") as liquidator (in such capacity, the "**Liquidator**") without security, of all of the remaining assets, undertakings and properties of the Credit Union was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the affidavit of Mehrdad Rastan sworn August 17, 2022 (the "**Rastan Affidavit**") and the Exhibits thereto and on hearing the submissions of counsel for FSRA, KPMG, Larry Smith, 1428245 Ontario Ltd., 809755 Ontario Ltd. and Phillip Smith (collectively,

the "**Recovery Litigation Parties**"), Peter Budd, and Frank Klees and on reading the consent of KPMG to act as the Liquidator,

1. THIS COURT ORDERS that the capitalized terms which are not defined herein have the meaning given to them in the Rastan Affidavit.

SERVICE

2. THIS COURT ORDERS that the time for service of the Notice of Application and the Application is hereby abridged and validated so that this motion is properly returnable today and hereby dispenses with further service thereof.

WINDING UP

3. THIS COURT ORDERS that the Credit Union be wound up pursuant to section 240 of the CUCPA and in accordance with the terms of this Order.

APPOINTMENT

4. THIS COURT ORDERS that, pursuant to section 240 of the CUCPA, KPMG is hereby appointed Liquidator, without security, of all of the remaining assets, undertakings and properties of the Credit Union, including all proceeds thereof (the "**Property**").

LIQUIDATOR'S POWERS

5. THIS COURT ORDERS that the Liquidator is hereby empowered and authorized, but not obligated, to act at once in respect of the Property and, without in any way limiting the generality of the foregoing, the Liquidator is hereby expressly empowered and authorized to do any of the following where the Liquidator considers it necessary or desirable:

(a) to take possession of and exercise control over the Property and any and all proceeds, receipts and disbursements arising out of or from the Property;

(b) to receive, preserve, and protect the Property, or any part or parts thereof, including, but not limited to, the relocating of Property to safeguard it and the placement of such insurance coverage as may be necessary or desirable;

(c) to manage, operate, and carry on the business of the Credit Union so far as may be necessary for the beneficial winding up of the Credit Union, including the powers to enter into any agreements, incur any obligations in the ordinary course of business, cease to carry on all or any part of the business, or cease to perform any contracts of the Credit Union;

(d) without limiting the generality of (c), to manage, operate, and carry on the Prepaid Card Business so far as may be necessary for the beneficial winding up or transition of the Prepaid Card Business, including, without limitation, the authority to deal with the Prepaid Cardholder Amounts, which include any amounts held in one or more commercial accounts, at The Toronto-Dominion Bank or elsewhere, in the name of 1961783 Ontario Limited (the "**Prepaid Card Entity**");

(e) to engage consultants, appraisers, agents, experts, auditors, accountants, managers, counsel and such other persons from time to time and on whatever basis, including on a temporary basis, to assist with the exercise of the

Liquidator's powers and duties, including without limitation those conferred by this Order;

(f) to receive and collect all monies and accounts now owed or hereafter owing to the Credit Union and to exercise all remedies of the Credit Union in collecting such monies, including, without limitation, to enforce any security held by the Credit Union;

(g) to settle, extend or compromise any indebtedness owing to the Credit Union;

(h) to execute, assign, issue and endorse documents of whatever nature in respect of any of the Property, whether in the Liquidator's name or in the name and on behalf of the Credit Union, for any purpose pursuant to this Order;

(i) to initiate, prosecute and continue the prosecution of any and all proceedings and to defend all proceedings now pending or hereafter instituted with respect to the Credit Union, the Property or the Liquidator, including, without limitation, the Recovery Litigation and Other Ongoing Litigation, and to settle or compromise any such proceedings. The authority hereby conveyed shall extend to such appeals or applications for judicial review in respect of any order or judgment pronounced in any such proceeding;

(j) to market any or all of the Property, including advertising and soliciting offers in respect of the Property or any part or parts thereof and negotiating such terms and conditions of sale as the Liquidator in its discretion may deem appropriate;

(k) to sell, convey, transfer, lease or assign the Property or any part or parts thereof out of the ordinary course of business,

(i) without the approval of this Court in respect of any transaction not exceeding $250,000.00, provided that the aggregate consideration for all such transactions does not exceed $750,000.00; and

(ii) with the approval of this Court in respect of any transaction in which the purchase price or the aggregate purchase price exceeds the applicable amount set out in the preceding clause;

and in each such case notice under subsection 63(4) of the Ontario *Personal Property Security Act* shall not be required.

(l) to apply for any vesting order or other orders necessary to convey the Property or any part or parts thereof to a purchaser or purchasers thereof, free and clear of any liens or encumbrances affecting such Property;

(m) to carry out a claims process for the purpose of identifying and determining claims against the Credit Union and/or its current and former directors and officers, as this Court may direct by further order made on not less than two weeks' notice to the Recovery Litigation Parties and to such other Persons as the Liquidator deems appropriate or this Court may direct;

(n) to bring a motion for the power to borrow monies it may consider necessary or desirable for the purpose of carrying out its mandate under this Order, if

necessary, on such terms and upon such security over the Property as the Court may determine on such motion, which motion shall be brought on not less than two weeks' notice to the Recovery Litigation Parties and to such other Persons as the Liquidator deems appropriate or this Court may direct;

(o) to report to, meet with and discuss with such affected Persons (as defined below), including, without limitation, FSRA, as the Liquidator deems appropriate on all matters relating to the Property and the winding up, and to share information with such Persons, subject to such terms as to confidentiality as the Liquidator deems advisable;

(p) to apply for any permits, licences, approvals or permissions as may be required by any governmental authority and any renewals thereof for and on behalf of and, if thought desirable by the Liquidator, in the name of the Credit Union;

(q) to enter into agreements with any trustee in bankruptcy appointed in respect of the Credit Union, including, without limiting the generality of the foregoing, the ability to enter into occupation agreements for any property owned or leased by the Credit Union;

(r) to exercise any shareholder, partnership, joint venture or other rights which the Credit Union may have, including, without limitation, with respect to the Prepaid Card Entity, as the Liquidator deems necessary or desirable in connection with the Prepaid Card Business;

(s) to take any steps reasonably incidental to the exercise of these powers or the performance of any statutory obligations; and

(t) after the monetization or other disposition of the Property, to distribute the proceeds thereof only in accordance with this Order or any subsequent order of this court,

and in each case where the Liquidator takes any such actions or steps, it shall be exclusively authorized and empowered to do so, to the exclusion of all other Persons (as defined below), including the Credit Union, and without interference from any other Person.

LIQUIDATION NOMINATION AGREEMENT

6. THIS COURT ORDERS that the terms of the Liquidation Nomination Agreement between FSRA and KPMG dated August 17, 2022, appended as Exhibit "K" to the Rastan Affidavit, are hereby approved, and the Liquidator is hereby authorized and directed to perform the obligations thereunder.

DUTY TO PROVIDE ACCESS AND CO-OPERATION TO THE LIQUIDATOR

7. THIS COURT ORDERS that (i) the Credit Union, (ii) all of its current and former directors, officers, employees, agents, accountants, legal counsel and shareholders, and all other persons acting on its instructions or behalf, and (iii) all other individuals, firms, corporations, governmental bodies or agencies, or other entities having notice of this Order (all of the foregoing, collectively, being "**Persons**" and each being a "**Person**") shall forthwith advise the Liquidator of the existence of any Property in such Person's possession or control, shall grant

immediate and continued access to the Property to the Liquidator, and shall deliver all such Property to the Liquidator upon the Liquidator's request.

8. THIS COURT ORDERS that all Persons shall forthwith advise the Liquidator of the existence of any books, documents, securities, contracts, orders, corporate and accounting records, and any other papers, records and information of any kind related to the business or affairs of the Credit Union, and any computer programs, computer tapes, computer disks, or other data storage media containing any such information (the foregoing, collectively, the "**Records**") in that Person's possession or control, and shall provide to the Liquidator or permit the Liquidator to make, retain and take away copies thereof and grant to the Liquidator unfettered access to and use of accounting, computer, software and physical facilities relating thereto, provided however that nothing in this paragraph 8 or in paragraph 9 of this Order shall require the delivery of Records, or the granting of access to Records, which may not be disclosed or provided to the Liquidator due to the privilege attaching to solicitor-client communication or due to statutory provisions prohibiting such disclosure.

9. THIS COURT ORDERS that if any Records are stored or otherwise contained on a computer or other electronic system of information storage, whether by independent service provider or otherwise, all Persons in possession or control of such Records shall forthwith give unfettered access to the Liquidator for the purpose of allowing the Liquidator to recover and fully copy all of the information contained therein whether by way of printing the information onto paper or making copies of computer disks or such other manner of retrieving and copying the information as the Liquidator in its discretion deems expedient, and shall not alter, erase or destroy any Records without the prior written consent of the Liquidator. Further, for the

purposes of this paragraph, all Persons shall provide the Liquidator with all such assistance in gaining immediate access to the information in the Records as the Liquidator may in its discretion require including providing the Liquidator with instructions on the use of any computer or other system and providing the Liquidator with any and all access codes, account names and account numbers that may be required to gain access to the information.

NO PROCEEDINGS AGAINST THE LIQUIDATOR

10. THIS COURT ORDERS that no proceeding or enforcement process in any court or tribunal (each, a "**Proceeding**"), shall be commenced or continued against the Liquidator except with the written consent of the Liquidator or with leave of this Court.

NO PROCEEDINGS AGAINST THE CREDIT UNION OR THE PROPERTY

11. THIS COURT ORDERS, subject to paragraph 12 of this Order, that no Proceeding against or in respect of the Credit Union or the Property shall be commenced or continued (including but not limited to the actions commenced by Ying Jiang against All Trans Financial Services Credit Union Limited in the Court of Queen's Bench for Saskatchewan in Regina under Court File Q.B.G. 2024/14 and in the Supreme Court of British Columbia in Vancouver under Court File No. S-147229) except with the written consent of the Liquidator or with leave of this Court, and any and all Proceedings currently under way against or in respect of the Credit Union or the Property are hereby stayed and suspended pending further Order of this Court.

12. THIS COURT ORDERS that nothing in this Order shall:

(a) affect or in any way restrain the continuation of any of the proceedings or claims asserted, or the enforcement of any orders made, in the Recovery Litigation (including, but not limited to, the motions brought by the Recovery Litigation Parties relating to settlement enforcement, stay of the Recovery Litigation, and preservation of claims, which motions are pending in the Recovery Litigation), and any order made in the Recovery Litigation shall be binding on the Liquidator; or

(b) affect the Order of this Court dated December 22, 2020 in proceedings bearing court file number CV-20-00651509-00CL between the Applicant (as Applicant) and Arn Reisler, 1428245 Ontario Ltd, Larry Smith, Phillip Smith and Mary Benincasa (as Respondents).

NO EXERCISE OF RIGHTS OR REMEDIES

13. THIS COURT ORDERS that all rights and remedies against the Credit Union, the Liquidator, or affecting the Property, are hereby stayed and suspended except with the written consent of the Liquidator or leave of this Court, provided however that nothing in this paragraph shall (i) empower the Liquidator or the Credit Union to carry on any business which the Credit Union is not lawfully entitled to carry on, (ii) exempt the Liquidator or the Credit Union from compliance with statutory or regulatory provisions relating to health, safety or the environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

NO INTERFERENCE WITH THE LIQUIDATOR

14. THIS COURT ORDERS that no Person shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any right, renewal right, contract, agreement, licence or permit in favour of or held by the Credit Union, without written consent of the Liquidator or leave of this Court.

CONTINUATION OF SERVICES

15. THIS COURT ORDERS that all Persons having oral or written agreements with the Credit Union or statutory or regulatory mandates for the supply of goods and/or services, including without limitation, all computer software, communication and other data services, centralized banking services, payroll services, insurance, transportation services, utility or other services to the Credit Union are hereby restrained until further Order of this Court from discontinuing, altering, interfering with or terminating the supply of such goods or services as may be required by the Liquidator, and that the Liquidator shall be entitled to the continued use of the Credit Union's current telephone numbers, facsimile numbers, internet addresses and domain names, provided in each case that the normal prices or charges for all such goods or services received after the date of this Order are paid by the Liquidator in accordance with normal payment practices of the Credit Union or such other practices as may be agreed upon by the supplier or service provider and the Liquidator, or as may be ordered by this Court.

LIQUIDATOR TO HOLD FUNDS

16. THIS COURT ORDERS that all funds, monies, cheques, instruments, and other forms of payments received or collected by the Liquidator from and after the making of this Order from any source whatsoever, including without limitation the sale of all or any of the

Property and the collection of any accounts receivable in whole or in part, whether in existence on the date of this Order or hereafter coming into existence, may be deposited into existing accounts in the name of the Credit Union, or with respect to the Prepaid Card Business, in the existing accounts at The Toronto-Dominion Bank or elsewhere, or into one or more new accounts to be opened by the Liquidator, all of which shall be held by the Liquidator to be distributed in accordance with the terms of this Order or any further Order of this Court.

PIPEDA

17. THIS COURT ORDERS that, pursuant to clause 7(3)(c) of the Canada *Personal Information Protection and Electronic Documents Act*, the Liquidator shall disclose personal information of identifiable individuals to prospective purchasers or bidders for the Property and to their advisors, but only to the extent desirable or required to negotiate and attempt to complete one or more sales of the Property (each, a "**Sale**"). Each prospective purchaser or bidder to whom such personal information is disclosed shall maintain and protect the privacy of such information and limit the use of such information to its evaluation of the Sale, and if it does not complete a Sale, shall return all such information to the Liquidator, or in the alternative destroy all such information. The purchaser of any Property shall be entitled to continue to use the personal information provided to it, and related to the Property purchased, in a manner which is in all material respects identical to the prior use of such information by the Credit Union, and shall return all other personal information to the Liquidator, or ensure that all other personal information is destroyed.

LIMITATION ON THE LIQUIDATOR'S LIABILITY

18. THIS COURT ORDERS that the Liquidator shall incur no liability or obligation as a result of its appointment or the carrying out the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Liquidator by any applicable legislation.

LIQUIDATOR'S ACCOUNTS

19. THIS COURT ORDERS that the Liquidator and counsel to the Liquidator shall be paid their reasonable fees and disbursements incurred in relation to the winding up and liquidation of the Credit Union (including in connection with this application), in each case at their standard rates and charges unless otherwise ordered by the Court on the passing of accounts, and that the Liquidator and counsel to the Liquidator shall be entitled to and are hereby granted a charge (the "**Liquidator's Charge**") on the Property, as security for such fees and disbursements, both before and after the making of this Order in respect of these proceedings, and that the Liquidator's Charge shall form a charge on the Property in priority to all security interests, trusts, liens, charges and encumbrances, statutory or otherwise, in favour of any Person, but subordinate in priority to validly perfected security interests on the Property existing as of the date of this Order.

20. THIS COURT ORDERS that the Liquidator and its legal counsel shall pass its accounts from time to time, and for this purpose the accounts of the Liquidator and its legal counsel are hereby referred to a judge of the Commercial List of the Ontario Superior Court of Justice.

21. THIS COURT ORDERS that prior to the passing of its accounts, the Liquidator shall be at liberty from time to time to apply reasonable amounts, out of the monies in its hands, against its fees and disbursements, including legal fees and disbursements, incurred at the standard rates and charges of the Liquidator or its counsel, and such amounts shall constitute advances against its remuneration and disbursements when and as approved by this Court.

SERVICE AND NOTICE

22. THIS COURT ORDERS that the E-Service Protocol of the Commercial List (the "**Protocol**") is approved and adopted by reference herein and, in this proceeding, the service of documents made in accordance with the Protocol (which can be found on the Commercial List website at http://www.ontariocourts.ca/scj/practice/practice-directions/toronto/e-service-protocol/) shall be valid and effective service. Subject to Rule 17.05 this Order shall constitute an order for substituted service pursuant to Rule 16.04 of the Rules of Civil Procedure. Subject to Rule 3.01(d) of the Rules of Civil Procedure and paragraph 21 of the Protocol, service of documents in accordance with the Protocol will be effective on transmission. This Court further orders that a Case Website shall be established in accordance with the Protocol with the following URL: www.home.kpmg/ca/pacecu.

23. THIS COURT ORDERS that if the service or distribution of documents in accordance with the Protocol is not practicable, the Liquidator is at liberty to serve or distribute this Order, any other materials and orders in these proceedings, any notices or other correspondence, by forwarding true copies thereof by prepaid ordinary mail, courier, personal delivery or facsimile transmission to the Credit Union's creditors or other interested parties at

their respective addresses as last shown on the records of the Credit Union and that any such service or distribution by courier, personal delivery or facsimile transmission shall be deemed to be received on the next business day following the date of forwarding thereof, or if sent by ordinary mail, on the third business day after mailing.

GENERAL

24. THIS COURT ORDERS that the Liquidator may from time to time apply to this Court for advice and directions in the discharge of its powers and duties hereunder.

25. THIS COURT ORDERS that nothing in this Order shall prevent the Liquidator from acting as a trustee in bankruptcy of the Credit Union.

26. THIS COURT HEREBY REQUESTS the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States to give effect to this Order and to assist the Liquidator and its agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Liquidator, as an officer of this Court, as may be necessary or desirable to give effect to this Order or to assist the Liquidator and its agents in carrying out the terms of this Order.

27. THIS COURT ORDERS that the Liquidator, or FSRA on behalf of the Credit Union, be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order, and that the Liquidator is authorized and

empowered to act as a representative in respect of the within proceedings for the purpose of having these proceedings recognized in a jurisdiction outside Canada.

28. THIS COURT ORDERS that the Applicant shall have its costs of this motion, up to and including entry and service of this Order, on a substantial indemnity basis to be paid by the Liquidator from the Credit Union's estate with such priority and at such time as this Court may determine.

29. THIS COURT ORDERS that any interested party may apply to this Court to vary or amend this Order on not less than seven (7) days' notice to the Liquidator and to any other party likely to be affected by the order sought or upon such other notice, if any, as this Court may order.

IN THE MATTER OF THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020*, S.O. 2020, C. 36, SCHED. 7, AS AMENDED

AND IN THE MATTER OF PACE SAVINGS & CREDIT UNION LIMITED

APPLICATION OF PACE SAVINGS & CREDIT UNION LIMITED UNDER SECTION 240 OF THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020*, S.O. 2020, C. 36, SCHED. 7, AS AMENDED

Court File No. CV-22-00685736-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at
Toronto

ORDER
(WINDING UP & APPOINTING LIQUIDATOR)

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TAB B

Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020*, S.O. 2020, C. 36, SCHED. 7, AS AMENDED

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AFFIDAVIT OF MEHRDAD RASTAN
(SWORN AUGUST 17, 2022)

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AFFIDAVIT OF MEHRDAD RASTAN
(SWORN AUGUST 17, 2022)

I, Mehrdad Rastan, of the City of Toronto, in the Province of Ontario, MAKE OATH AND SAY:

1. I am the Executive Vice President, Credit Union & Insurance Prudential ("**CU&IP**") of the Financial Services Regulatory Authority of Ontario ("**FSRA**"), the administrator (in such capacity, the "**Administrator**") of the applicant, PACE Savings & Credit Union Limited (the "**Applicant**" or "**Credit Union**") appointed pursuant to the Administration Orders (defined below). Prior to assuming my current position with FSRA in January 2022, I was the Head, Relationship and Risk Management for CU&IP of FSRA since December 2019, and in that capacity, have been a key contact at FSRA for the Credit Union. Before joining FSRA, I worked for the Financial Institutions Commission, now the British Columbia Financial Services Authority, as the Executive Director, Regulation which included responsibilities for the regulatory oversight of credit unions in British Columbia.

2. As a result of serving in these capacities, as well as from my discussions with representatives of the Credit Union, including David Finnie, the former Chief Executive Officer, and Benjamin Choi, the former Chief Financial Officer, FSRA's management team, KPMG Inc. (which acted as financial advisor to FSRA in certain matters involving the Credit Union, as described below), and other advisors, and my review of relevant documents and information, I am generally familiar with the Credit Union's former business and operations as well as its financial affairs, books, and records. I therefore have personal knowledge of the matters contained in this affidavit, except where such matters are stated to be based upon information and belief, and where so stated, I have identified the source of the information and believe it to be true.

3. I swear this affidavit in support of the application made by the Credit Union, under the direction and authority of the Administrator, for an Order pursuant to section 240 of the *Credit Unions and Caisses Populaires Act, 2020*, S.O. 2020, c. 36, Sched. 7, as amended (the "**CUCPA**") winding up the Credit Union and appointing KPMG Inc. ("**KPMG**") as liquidator (in such capacity, the "**Liquidator**"), without security, of all of the remaining assets, undertakings, and properties of the Credit Union following completion of the Alterna Sale Transaction (defined below).

PART 1 - OVERVIEW

4. The Applicant is a credit union incorporated under the CUCPA and regulated by FSRA. The Credit Union has been under administration by FSRA, formerly DICO (defined below), since September 28, 2018, which DICO initiated in response to, among other things, certain misconduct and regulatory breaches committed by the Credit Union's former President and CEO.

5. The initial purpose and goal of the administration was to resolve the governance issues which gave rise to the administration and to return the Credit Union to member-controlled governance in due course. Between September 2018 and April 2020 (i.e., the onset of the COVID-19 pandemic), the Credit Union, under FSRA's administration, made significant initial progress on the path toward exiting administration and returning to member-controlled governance.

6. For the reasons set out below, the consequences of the COVID-19 pandemic on the Credit Union, combined with certain other factors, compromised the Credit Union's financial position to such an extent that the Administrator was forced to explore additional options for the

Credit Union rather than just the "recovery option" which had been the primary goal up until that point. These additional options included exploring a purchase and assumption transaction for the Credit Union and/or a liquidation and winding up of the Credit Union.

7. The Credit Union's financial position continued to deteriorate throughout 2020 and 2021. Because of these challenging circumstances, the Credit Union's newly-appointed board of directors and most of the Credit Union's senior management team resigned in late 2020. In this context, the Administrator determined that potential losses to the Credit Union's stakeholders could be mitigated more effectively, and the Administrator's regulatory objectives better served, by pursuing a purchase and assumption transaction for the Credit Union and a sale of the Credit Union's subsidiary, CCE (defined below), followed by a liquidation and wind-up strategy. This determination ultimately led to the Alterna Sale Transaction (defined below) and CCE Sale Transaction (defined below)—which closed in June 2022 and March 2022, respectively—and, ultimately, to this Application.

8. At present, as a result of the Alterna Sale Transaction, the Credit Union has no employees, no member deposits,[1] and no branches. Further, virtually all of the Credit Union's members have been granted membership in and are being served by another credit union, Alterna (defined below). As described further below, all that remains of the Credit Union is a collection of certain assets and liabilities which were excluded from the Alterna Sale Transaction.

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[1] With certain limited exceptions.

9. Under the provisions of the CUCPA, the Credit Union may apply to this Court for an order winding up the Credit Union where it cannot continue its business and it is advisable to wind the Credit Union up or it is just and equitable that the Credit Union should be wound up.

10. Because of the events described herein, the Credit Union is no longer operating as a credit union and can no longer perform the statutory object of a credit union under the CUCPA. In the circumstances of this case, including having regard to the nature and complexity of the remaining assets, operations, and liabilities of the Credit Union, the Administrator is of the view that a court-ordered winding up of the Credit Union by a court-appointed liquidator pursuant to the CUCPA is advisable and would be just and equitable.

11. As part of this Application, the Credit Union is seeking to have KPMG appointed as Liquidator. KPMG is well-known for its expertise in complex commercial matters and liquidation proceedings and is an appropriate choice to serve in this capacity. KPMG, through a previous advisory engagement, also has experience with the Credit Union and its assets, undertakings, properties, liabilities, and claims, all of which will benefit the Credit Union, its stakeholders, and the Court if KPMG were appointed as Liquidator.

12. The Applicant is also seeking, among other things, the following additional relief: (a) approval of the Liquidator Nomination Agreement (defined below) between FSRA and KPMG; (b) granting and approval of the Liquidator's Charge (defined below); (c) granting and approval of the Liquidator's power to borrow funds; and (d) granting and approval of the Liquidator's Borrowings Charge (defined below).

13. The Administrator believes that all of the relief requested on this Application is reasonable and appropriate in the circumstances of this case, and is reasonably necessary to ensure the successful and timely winding up of the Credit Union.

PART 2 - THE PARTIES

(A) FSRA

14. FSRA is a corporation established without share capital under the *Financial Services Regulatory Authority of Ontario Act, 2016*, S.O. 2016, c. 37, Sched. 8 (the "***FSRA Act***"). Since its launch in June 2019 and its amalgamation with DICO (defined below), FSRA has been the regulator of credit unions in Ontario under the CUCPA.

15. The objects of FSRA, as they pertain to credit unions in Ontario, and as set out in the *FSRA Act*, include, without limitation: providing insurance against the loss of deposits with credit unions; promoting and otherwise contributing to the stability of the credit union sector in Ontario; and pursuing the foregoing for the benefit of persons having deposits with credit unions and in such manner as will minimize the exposure of the DIRF (defined below) to loss (the "**Objects**").

16. Under the CUCPA, FSRA has three main responsibilities with respect to credit unions in Ontario:

(a) FSRA oversees insured deposit protection for credit unions in Ontario through its administration of the Deposit Insurance Reserve Fund (the "**DIRF**"), providing coverage of non-registered insurable deposits up to $250,000 and coverage of deposits in registered accounts (e.g., RRSPs or TFSAs) up to an unlimited amount;

(b) FSRA is the prudential and market conduct regulator of credit unions in Ontario; and

(c) FSRA can act as a "supervisor", "administrator", or "liquidator" of credit unions (as those terms are defined in the CUCPA), in appropriate circumstances.

17. Effective June 8, 2019, FSRA amalgamated with the Deposit Insurance Corporation of Ontario ("**DICO"**), the former entity that carried out the prudential regulation of credit unions in Ontario under the CUCPA and provided deposit insurance through the DIRF. For ease of reference, the regulator and Administrator of the Credit Union shall sometimes be referred to as FSRA or the Administrator regardless of whether the event described took place before or after June 8, 2019.

(B) The Credit Union

18. The Applicant is a credit union incorporated under the CUCPA and is therefore an entity regulated by FSRA. Before the Alterna Sale Transaction (defined below), the Credit Union had approximately 34,000 members and 13 branches throughout southwestern Ontario and had approximately $900 million in assets recorded in its financial statements.

PART 3 - RELEVANT BACKGROUND RELATING TO THE ADMINISTRATION OF THE CREDIT UNION

(A) DICO Orders the Credit Union into Administration

19. DICO had issued an administration order on September 28, 2018, pursuant to its authority under section 294(1) of the *Credit Unions and Caisses Populaires Act, 1994*, S.O. 1994,

c. 11 (which legislation was repealed effective March 1, 2022, and replaced with the CUCPA)[2] ordering that the Credit Union be subject to administration by the Administrator (the "**First Administration Order**", attached as **Exhibit "A"**).

20. The First Administration Order issued by DICO was supported by written reasons issued on the same day (the "**Reasons**", attached as **Exhibit "B"**). The Reasons are titled "***Preliminary*** Reasons for Issuance of Administration Order" [emphasis added] because they were intended to provide the Credit Union's then board of directors with an opportunity to file submissions in response to the First Administration Order. The board of directors did not respond to or oppose the First Administration Order, and therefore DICO did not issue any additional or "final" reasons.

21. Broadly speaking, the Reasons identified five prudential findings (i.e., misconduct related to the prudency of actions, conflicts of interest, and breaches of fiduciary duties) and five regulatory findings (i.e., breaches of the CUCPA and the regulations thereunder) which caused DICO to issue the First Administration Order. The prudential findings included:[3]

(a) borrowers of the Credit Union and others made payments to employees of the Credit Union, including to its former President (Larry Smith), and others in relation to various off-market loans and investments the Credit Union had made; these payments were incapable of being legally approved by the Credit Union's board of

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[2] For ease of reference, the 1994 and 2020 Acts are both hereinafter referred to as the CUCPA, regardless of whether the event being described took place before or after March 1, 2022.

[3] See the Reasons at paragraph 25. See also Schedule "A" to the Reasons, which contains the details of the transactions of which DICO was aware at the time and on which it relied in issuing the First Administration Order. I note that Schedule "A" is not exhaustive and other unlawful, improper, or imprudent transactions, payments, and conduct were discovered after Schedule "A" was drafted.

directors and were in breach of the relevant conflict of interest provisions under the CUCPA;

(b) the Credit Union's board of directors approved consulting arrangements which allowed the Credit Union's former President to be compensated by borrowers and partners of the Credit Union for transactions involving the Credit Union without proper disclosure;

(c) the Credit Union's former President offered or distributed various payments, contracts, positions, and other benefits to his family members and friends for their benefit and to the detriment of the Credit Union, including offering and distributing executive positions, consulting positions, and payments in the nature of secret commissions;

(d) the making of various off-market loans by the Credit Union, which were not in the best interests of the Credit Union and were imprudent and inconsistent with the Credit Union's minimum risk tolerance and were made without proper due diligence; generally speaking, these loans were made to companies in which the former President of the Credit Union or his associates or relatives held ownership interests and were made for the purpose of self-dealing; and

(e) other loans and investments which appeared on off-market terms and represented undue risk to the Credit Union.

22. The regulatory findings included: (a) failure to disclose the true beneficial ownership of the Credit Union's borrowers, investees, and subsidiaries; (b) properties being

improperly held by the Credit Union; (c) repeated establishment and operation of subsidiaries (including CCE and PSC, as defined and discussed below) without DICO's approval and with awareness of contraventions of the CUCPA; (d) breach of the investment limit in an existing subsidiary; and (e) inaccurate disclosure of total annual compensation on audited financial statements.[4]

23. DICO concluded it had reasonable grounds to believe that the Credit Union was conducting its affairs in a way that might be expected to harm the interests of members, depositors, or shareholders, or that would tend to increase the risk of claims by depositors against DICO, and that it was therefore appropriate to issue the First Administration Order to effect certain, necessary changes.[5]

24. Further administration orders were issued in respect of the Credit Union on February 19, 2020, April 28, 2020, and March 26, 2021 (the "**Second, Third,** and **Fourth Administration Orders**", respectively, attached as **Exhibits "C", "D",** and **"E"**). Together, the First, Second, Third, and Fourth Administration Orders, and any other administration orders which may be issued in respect of the Credit Union, are hereinafter referred to, collectively, as the "**Administration Orders**".

25. FSRA has published the Administration Orders and other documents related to its administration of the Credit Union on its website at https://www.fsrao.ca/enforcement-and-monitoring/pace-credit-union-administration.

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4 See the Reasons at paragraph 27.

5 See the Reasons at paragraph 29.

(B) Unanticipated Circumstances Ultimately Caused the Administrator to Implement a Resolution Strategy for the Credit Union

(i) Steps Taken In Furtherance of Initial Recovery Strategy

26. In the First Administration Order, issued September 28, 2018, the Administrator suspended the powers of the Credit Union's board of directors (with certain limited exceptions) and assumed the powers of the board of directors, thereby effectively taking control of the Credit Union. At this time, the purpose and goal of the administration was to resolve the governance issues which gave rise to the First Administration Order and to return the Credit Union to member-controlled governance in due course. To that end, an Interim CEO was hired by the Administrator, effective January 7, 2019, who was responsible for the day-to-day management of the Credit Union under the supervision of the Administrator. The Interim CEO was to remain in place for approximately one year and assist the Administrator with the recovery (i.e., recover financial strength) of the Credit Union.

27. With a view toward that goal, the Administrator had initially determined that the Credit Union could be removed from administration after a new board of directors had been elected and that board had hired a new management team. The Credit Union members elected a new board of directors at a special membership meeting held on January 27, 2020. The Administrator then issued the Second Administration Order on February 19, 2020, which appointed the new board members and granted them the authority to, among other things, take certain actions to orient themselves with the business and affairs of the Credit Union and recruit and appoint a new management team.

28. The new board of directors proceeded to hire a new Chief Executive Officer (CEO), Chief Financial Officer (CFO), and Chief Risk Officer (CRO) in early April 2020. The Administrator then issued the Third Administration Order on April 28, 2020, which granted the Credit Union's new board of directors and management team the authority to, among other things, carry on the management and conduct the operations of the Credit Union, subject to, among other things, the Administrator retaining the authority to: (a) order the Credit Union not to exercise powers granted to it under the Third Administration Order, (b) manage the Recovery Litigation (defined below) and certain other legal proceedings that had been commenced or would be commenced by the Administrator in relation to the events giving rise to the First Administration Order and (c) respond to claims, counterclaims, and cross-claims that had been or may yet still be filed in response to actions taken during the administration proceedings.

29. With a new board of directors and management team in place, the Credit Union continued to make significant initial progress on the path toward exiting administration and returning to member-controlled governance, as was initially intended by the Administrator.

(ii) The COVID-19 Pandemic and Other Circumstances Prevented the Credit Union from Exiting Administration

30. At the time of the Third Administration Order, Canada was more than one month into the COVID-19 pandemic. The economic impact of the pandemic and the related Investor Claims (defined below) represented unanticipated events which ultimately forced the Administrator to conclude that a recovery strategy was not possible and to consider other options, such as a purchase and assumption transaction and/or a wind-up and liquidation strategy. The

various impacts of the pandemic and the Investor Claims on the Credit Union and their significance are described below in this section.

The Failure of CCE

31. Continental Currency Exchange ("**CCE**") was a wholly-owned subsidiary of the Credit Union engaged in the business of a retail currency exchange that had been acquired by the Credit Union under its former management in contravention of the CUCPA and which was one of the bases for the First Administration Order. The pandemic had a drastic impact on the business of CCE, and it sustained significant operating losses in the 2020 financial year. After determining that a recovery of the Credit Union was not likely, the Administrator ultimately caused the Credit Union to sell CCE as part of the CCE Sale Transaction (defined and described in more detail below).

The Failure of PSC and the Related Investor Claims

32. PACE Securities Corporation ("**PSC**") was a wholly-owned subsidiary of the Credit Union engaged in the business of a securities dealer. Among other things, PSC distributed preferred shares of its subsidiary, Pace Financial Limited ("**PFL**") and preferred shares of First Hamilton Holdings ("**FHH**"), an unaffiliated entity under the control of persons managing PSC or related to such persons. On March 21, 2020, PSC notified the Administrator of certain developments caused by the pandemic, which, taken together, presented a significant solvency challenge for PSC and its direct and indirect subsidiaries. A copy of the Credit Union's organizational chart showing the Credit Union's relationship to the above entities is attached as **Exhibit "F"**.

33. Ultimately, the Credit Union, as sole shareholder of PSC, applied to the Ontario Superior Court of Justice to have PSC and its direct and indirect subsidiaries, including PFL, wound up, which order was granted on May 14, 2020. The same Court ordered that FHH be wound up on May 21, 2020.

34. The court-ordered wind up of PSC, PFL, and FHH crystallized substantial losses by investors in the preferred shares of PFL and FHH and gave rise to complaints from Credit Union members and the investors in the preferred shares of PFL and FHH. The Administrator identified misconduct by and potential claims against the Credit Union and its former officers and directors in relation to the business of PSC and the sale of the preferred shares of PFL and FHH that was not known in 2018 when the Credit Union was first placed under administration by DICO.

35. In early August 2020, the Ontario Superior Court of Justice appointed Paliare Roland Rosenberg Rothstein LLP as representative counsel ("**Representative Counsel**") in the wind-up proceedings for the investors in the preferred shares of PFL and FHH. Ultimately, after an expedited court-ordered mediation process, the claims of these investors (the "**Investor Claims**") were settled in June 2021 for $40 million, with a significant portion to be paid by the Credit Union (the "**Investor Settlement**"). The Investor Settlement received court approval on July 30, 2021. In connection with the Investor Settlement, FSRA, as administrator of the DIRF, provided an assurance that if the Credit Union was unable to fund its contribution towards the settlement for any reason, FSRA would ensure payment in full of the Credit Union's contribution. This assurance gave rise to an unsecured non-interest bearing promissory note in the amount of $25 million issued by the Credit Union in favour of the DIRF, dated October 27, 2021 (the "**FSRA Promissory Note**").

Resignation of the Directors and Senior Management of the Credit Union and the Fourth Administration Order

36. In late 2020, the Credit Union was still in the midst of the pandemic and dealing with the Recovery Litigation (defined below) and the various claims asserted therein as well as the continued operating losses at CCE and the failure of PSC and related Investor Claims. The Credit Union was also facing regulatory capital shortfalls which would require regulatory forbearance and an aggressive plan to restore capital adequacy. In this context, in late 2020, all of the directors of the Credit Union and its CEO and CRO resigned from their positions. This left the Credit Union without a functioning Board of Directors and with only one member of senior management, its CFO.

37. In response to these events, and following the appointment of a new CEO of the Credit Union on December 21, 2020, the Administrator issued the Fourth Administration Order on March 26, 2021, granting the Credit Union's newly-appointed CEO and other members of the Credit Union's senior management team, including the CFO, the authority to, among other things, carry on the ordinary management and conduct the operations of the Credit Union and its subsidiaries subject to, among other things, the Administrator's authority to (a) exercise the powers of the Credit Union for matters outside the ordinary course of business, and of the directors, officers, and committees, (b) manage the Recovery Litigation (defined below) and certain other legal proceedings that had been commenced or would be commenced by the Administrator in relation to the events giving rise to the First Administration Order, and (c) respond to claims, counterclaims, and cross-claims that had been or may yet still be filed in response to actions taken during the administration.

Administrator's Decision to Pursue a Purchase and Assumption Transaction and Wind-Up and Liquidation Strategy

38. Following the issuance of the Fourth Administration Order, the Credit Union's long-term viability remained uncertain in light of the ongoing pandemic, and the Credit Union's financial condition continued to deteriorate throughout 2021. Indeed, in or around early 2021, the Credit Union was required to seek a variance from the CEO of FSRA regarding its regulatory capital requirements. A copy of a letter from the CEO of FSRA to the Credit Union's members describing the capital variance decision is attached as **Exhibit "G"**.

39. In light of the foregoing circumstances, the Administrator ultimately determined that the long-term operation of the Credit Union's business was not reasonably likely to minimize the losses to the Credit Union's depositors and other creditors and ultimately to the DIRF. The Administrator further determined that these losses would be mitigated more effectively, and the Objects would be better served, by pursuing a purchase and assumption transaction for the Credit Union and a sale of CCE followed by a liquidation and wind-up strategy. This strategy was initiated by the Administrator in late May 2021 with the commencement of the CCE Sale Process (defined below), and the commencement of the Alterna Sale Process (defined below) in June 2021.

40. Following the completion of the CCE Sale Process and the Alterna Sale Process, the Administrator publicly announced that there would be a liquidation of the remaining assets and liabilities of the Credit Union by press release dated July 6, 2022, attached as **Exhibit "H"**.

(C) Alterna's Acquisition of Substantially all of the Credit Union's Assets and Operations

(i) The Alterna Sale Transaction

41. On April 20, 2022, following a careful assessment of the various options available to the Credit Union and the completion of a formal competitive sale process conducted in consultation with the proposed liquidator, KPMG[6] (the **"Alterna Sale Process**"), the Credit Union and FSRA entered into a purchase and assumption agreement (the "**Alterna Sale Agreement**") with Alterna Savings and Credit Union Limited ("**Alterna**"). Pursuant to the Alterna Sale Agreement, Alterna would acquire and assume substantially all of the assets and liabilities of the Credit Union except for certain excluded assets and liabilities and would continue the Credit Union's normal course business operations as part of Alterna (the "**Alterna Sale Transaction**"). On closing, Alterna acquired and assumed substantially all of the member deposits, both insured and uninsured, and substantially all retail and commercial loans. As part of the Alterna Sale Transaction, Alterna offered employment to substantially all of the Credit Union's employees, assumed all of the Credit Union's existing branches and agreed to keep them open for a period of time following the Alterna Closing Date, and provided substantially all of the Credit Union's existing members with membership in Alterna. The Alterna Sale Agreement contains a confidentiality provision; accordingly, I am not attaching the agreement as an exhibit.

42. FSRA, as Administrator of the Credit Union and according to the Objects, determined that the Alterna Sale Transaction was in the best interests of the members of the Credit Union whose accounts would be seamlessly transferred to Alterna and would continue to be served

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[6] At the time, KPGM was acting solely as a financial advisor and was not proposed to be the liquidator in these proceedings.

as members of Alterna, and the Credit Union's employees who would be hired by Alterna. The transaction was also consistent with the Objects, including to ensure that losses to the DIRF were minimized and the credit union sector continued to be stable. KPMG served as financial advisor to the Administrator in connection with the Alterna Sale Process and Alterna Sale Transaction. The Alterna Sale Transaction closed on June 30, 2022 (the "**Alterna Closing Date**").

43. A critical aspect of the Alterna Sale Transaction was continuity for members of the Credit Union: on the Alterna Closing Date, the Credit Union's existing members became Alterna members served by the Credit Union's former employees and branches, both of which were also assumed by Alterna. The membership of the Credit Union was not changed by the Alterna Sale Transaction; those individuals who were members of the Credit Union prior to the closing retained their membership in the Credit Union after closing and also (with very few exceptions) became members of Alterna.

44. Under the Alterna Sale Transaction, the Credit Union has certain potential post-closing liabilities, which may or may not result in certain payments to Alterna. This exposure is guaranteed by FSRA, subject to a monetary cap. The guarantee provides certain subrogation rights to FSRA.

45. In addition, Alterna has agreed to provide certain transition services to the Credit Union for a limited period of time. The services include various finance and accounting services and information technology services for the purpose of facilitating the Credit Union's dealing with its remaining assets and liabilities.

(ii) Assets and Liabilities Remaining in the Credit Union Subsequent to the Alterna Sale Transaction

46. Subsequent to the Alterna Sale Transaction, the Credit Union retained certain assets and liabilities which relate to, among other things, the CCE Sale Transaction (defined below), the Prepaid Card Business (defined below), claims asserted in the Recovery Litigation (defined below), the FSRA Promissory Note, certain member deposits and accounts, certain loans, certain insurance claims or entitlements to proceeds of insurance, certain funds held in trust by the Credit Union for the benefit of former employees, and certain severance obligations which may be owed by the Credit Union to former employees. The remaining assets and liabilities of the Credit Union are described in more detail below in Part 4 of this affidavit.

(D) The CCE Sale Transaction

47. As indicated above, CCE is a retail currency exchange business which, until March 31, 2022, was a wholly-owned subsidiary of the Credit Union. The acquisition of CCE by the Credit Union was one of several transactions that led to the Credit Union being placed under administration. According to the Reasons, the former President and CEO caused the Credit Union to acquire a controlling interest in CCE, without the necessary regulatory approvals, using a corporation controlled by them.

48. On January 11, 2022, following a careful assessment of the various options available to the Credit Union and including the completion of a formal competitive sale process conducted in consultation with KPMG which served as financial advisor to the Administrator in connection with the sale of all of the shares of CCE held by the Credit Union (the **"CCE Sale Process**"), which was run in parallel to the Alterna Sale Process, the Credit Union, FSRA, and the

successful bidder, DUCA Credit Union ("**DUCA**"), entered into a share purchase agreement (the "**CCE Sale Agreement**") in respect of the sale of all of the issued and outstanding shares in the capital of CCE (the "**CCE Sale Transaction**"). The CCE Sale Transaction closed on March 31, 2022 and resulted in a loss to the Credit Union which further eroded its already diminished financial capacity. The CCE Sale Agreement contains a confidentiality provision; accordingly, I am not attaching that agreement as an exhibit.

PART 4 - REMAINING ASSETS, OPERATIONS, AND LIABILITIES OF THE CREDIT UNION REQUIRING RESOLUTION BY THE LIQUIDATOR

49. In my current and former role at FSRA, I worked closely with KPMG, the financial advisor to the Administrator in connection with the Alterna Sale Transaction and the proposed Liquidator in these proceedings. Based on the analysis and information provided to me by KPMG, certain assets and liabilities remained with the Credit Union following the closing of the Alterna Sale Transaction, which assets and liabilities are described below in this Part of the affidavit.

(A) The Recovery Litigation

50. On April 17, 2019, the Credit Union commenced a claim in the Ontario Superior Court of Justice (Commercial List) against the former CEO and former President of the Credit Union (Phillip Smith and Larry Smith), their affiliates, certain of the Credit Union's former directors, and a number of other parties who received improper benefits from the Credit Union. The Credit Union through its Administrator is represented by the law firm of Lax O'Sullivan Lisus Gottlieb LLP in this claim.

51. The Credit Union's claim advances causes of actions including breach of fiduciary duty, fraud, conspiracy, breach of contract and employment duties, breach of trust, knowing receipt

of proceeds of breach of trust, conversion, unjust enrichment, and negligence against the Smiths. The grounds for these claims include the following alleged misconduct:

(a) the Smiths intentionally or recklessly underreported the income they received directly or indirectly from the Credit Union, contrary to their obligations under the CUCPA and its associated regulation; this under-reporting amounted to millions of dollars; the Smiths also took steps to conceal monies they had misappropriated from the Credit Union;

(b) the Smiths caused the Credit Union to purchase the entirety of CCE, contrary to regulatory limits which prohibit a credit union from acquiring more than 30% of any other corporation without FSRA's permission; they did so surreptitiously to avoid these regulatory limits, and received secret payments in connection with the transaction; the purchase of CCE caused significant risk of loss to the Credit Union, which came to pass when CCE suffered a downturn in its operations in 2020 and 2021 as a result of the COVID-19 pandemic;

(c) the Smiths, along with other former directors of the Credit Union, failed to properly supervise the business of PSC, which led to its failure and winding-up, and consequent claims against the Credit Union by a number of investors in PSC;

(d) the Smiths directed the Credit Union to make improvident loans, advance funds, and make other payments to parties connected to them, including corporations they controlled, friends, and relatives; these payments were not *bona fide* and/or were contrary to the Credit Union's best interests; and

(e) the Smiths overstated the value of loans on the Credit Union's books and records, thereby misrepresenting the Credit Union's financial position and performance.

52. The defendants to the Credit Union's claim deny the allegations and several have commenced counterclaims against the Credit Union. Phillip and Larry Smith have commenced third party claims against two of the Credit Union's former directors. Phillip Smith also brought a separate claim for wrongful dismissal against the Credit Union in September 2019. The Credit Union's claim, the Smiths' third party claims, Phillip Smith's claim, and all related counterclaims and crossclaims against the Credit Union are referred to herein collectively as the "**Recovery Litigation**".[7]

53. The Smiths' counterclaims, and Phillip Smith's separate claim, allege that the Credit Union breached their employment contracts by terminating them for cause following the issuance of the First Administration Order, that they have suffered damages as a result of the *Mareva* order (described below) and the freezing of their accounts at the Credit Union, that the Credit Union has defamed them, and that the Administrator has committed the torts of malfeasance in public office and regulatory negligence during the course of the administration. Two other defendants, Brian Hogan and Frank Klees, have also counterclaimed against the Credit Union for defamation and infliction of emotional distress (Hogan) and breach of contract (Klees).

[7] The Credit Union's claim bears the Court File No. CV-19-00616388-00CL. Phillip Smith's third party claim bears the Court File No. CV-19-00616388-CLA2, and his wrongful dismissal claim bears the Court File No. CV-19-00628710-0000.

54. The Recovery Litigation is currently pending before the Ontario Superior Court of Justice (Commercial List), where it is being case managed by Justice Gilmore. Pleadings have been exchanged, but documentary and oral discovery have not yet taken place.

55. Before issuing its claim, the Credit Union brought a motion for a *Mareva* injunction against Larry and Phillip Smith, which was heard on March 19, 2019. Following the hearing, Justice Hainey made an interim *Mareva* order against the Smiths. The Credit Union and the Smiths subsequently agreed to the terms of a permanent preservation order, which was made by Justice Conway on May 7, 2019. Justice Conway's preservation order remains in effect to this date.

56. Beginning in May 2019, the Credit Union collapsed certain accounts held by Larry Smith at the Credit Union (the "**Smith Accounts**") pursuant to its right of set off against him. In December 2019, Mr. Smith commenced an application, seeking an order that the amounts in the Smith Accounts be paid out to him or paid into court. The application was heard on August 5, 2020. On October 26, 2020, Justice Koehnen issued an endorsement finding that, while Mr. Smith had no right to demand the return of the funds held in the Smith Accounts, the Credit Union was not entitled to collapse the accounts. Justice Koehnen directed the Credit Union to reconstitute the Smith Accounts and to preserve the status quo with respect to them. The Credit Union continues to maintain the Smith Accounts on its financial statements as a liability, consistent with the endorsement of Justice Koehnen. The total value of the Smith Accounts is approximately $5 million. A copy of Justice Koehnen's endorsement is attached as **Exhibit "I"**.

57. On July 19, 2022, Larry and Phillip Smith brought a motion in the Recovery Litigation seeking another order requiring the Credit Union to pay funds in the Smith Accounts to

them or into trust, and to set aside a fund to satisfy a future judgment and/or costs award in favour of the Smiths, as well as security for costs. On July 25, 2022, Justice Gilmore ordered the Credit Union to maintain the status quo pending the return of the Smiths' motion. She also ordered that, in the event the Credit Union seeks to take additional steps, including "further dissipation of assets", it may do so on the consent of the parties or order of the Court. A copy of Justice Gilmore's endorsement is attached as **Exhibit "J"**.

58. Should this Application be granted, the Applicant expects that the Liquidator will continue to prosecute the claims, and defend the counterclaims, made in the Recovery Litigation, subject to the terms of the Liquidator Nomination Agreement (defined below). Accordingly, the Applicant is not seeking to stay the Recovery Litigation, and that proceeding will be expressly excluded from the stay provision in the Winding Up Order.

(B) Default Loans and Liabilities

59. The Credit Union has retained certain loans and accounts that are in default, having a face value of more than $8 million in Credit Union assets. A Credit Union member associated with most of these loans and accounts commenced a claim against the Credit Union in January 2022, which remains outstanding.

(C) Proceeds of CCE Sale Transaction

60. As indicated above, the Credit Union completed the sale of all of the issued and outstanding shares of CCE to DUCA on March 31, 2022. As of May 31, 2022, the Credit Union held net proceeds from the CCE Sale Transaction in the amount of approximately $16.3 million.

(D) The CUMIS Bond Claim

61. The Credit Union has a claim against CUMIS General Insurance Company ("**CUMIS**") in relation to a proof of loss filed on October 16, 2019 under the fidelity insurance coverage bearing Policy Number 01501254 and with an Effective Date of January 1, 2018, and an Expiry Date of January 1, 2019 (the "**CUMIS Bond**"), contained in the contract of insurance issued by CUMIS (the "**CUMIS Policy**"), in respect of losses incurred by the Credit Union in connection with the various dishonest acts of former employees and directors of the Credit Union, including its former President and CEO (the "**CUMIS Bond Claim**"). In the proof of loss, the Administrator calculated the Credit Union's losses to be approximately $23,579,078.00.

62. Pursuant to the terms of the CUMIS Bond, CUMIS is liable to indemnify the Credit Union for covered losses, which includes losses resulting from dishonest or fraudulent acts of any director, employee, or contractor, to a maximum of $10,000,000.00. The Credit Union, by its Administrator, FSRA, has claimed the maximum amount available under the CUMIS Bond. To date, CUMIS has only made partial payment to the Credit Union in the amount of approximately $1.0 million. The balance of the CUMIS Bond Claim remains outstanding.

63. The Credit Union has commenced an action bearing Court File No. CV-22-00677550-0000 against CUMIS in relation to the unpaid portion of the CUMIS Bond Claim. An amended statement of claim was served on CUMIS on August 9, 2022. The relief sought in the claim includes a demand for payment under the CUMIS Bond as well as damages against CUMIS for breach of the CUMIS Bond and the duty of good faith. The claim has not yet been defended and the period for delivering a statement of defence has not yet expired.

(E) The Berkshire Bond Claim

64. The Credit Union also has a claim against National Liability & Fire Insurance Company, carrying on business as Berkshire Hathaway Specialty Insurance ("**Berkshire**") in relation to a proof of loss filed on December 17, 2021 under Financial Institution Bond for Banking Institutions Bond Number 43-EPF-306798-03 (the "**Berkshire Bond**") issued in connection with insurance policies bearing Asset Manager Protection Policy Number 43-EPF-306800-03 and any relevant predecessor and successor policies (collectively, the "**Berkshire Policies**"), in respect of losses incurred by the Credit Union in connection with dishonest or fraudulent acts of the Credit Union's former Manager Retail Loans, acting alone or in collusion with other individuals or entities, and certain litigation arising therefrom (the "**Berkshire Bond Claim**"). In the proof of loss, the Administrator calculated the Credit Union's losses to be approximately $9,445,000.00.

65. Pursuant to the terms of the Berkshire Bond, Berkshire is liable to indemnify the Credit Union for covered losses, which includes losses resulting from dishonest or fraudulent acts of any director, employee, or contractor, to a maximum of $10,000,000.00. The Credit Union, by its Administrator has claimed the $9,445,000.00 under the Berkshire Bond, which amount has not been paid by Berkshire as of the date of the swearing of this affidavit.

(F) Prepaid Card Business

66. The Credit Union acts as the issuer of prepaid cards (the "**Prepaid Cards**") pursuant to various prepaid card programs transacting on the Mastercard and Visa networks and operated in conjunction with several program managers (the "**Prepaid Card Business**"). The Credit Union has the power to issue prepaid cards in all Canadian jurisdictions, and prepaid cards have been issued across Canada.

67. All amounts loaded by consumers ("**Prepaid Cardholders**") on the Prepaid Cards (the "**Prepaid Cardholder Amounts**") are held separate and apart for the benefit of cardholders in a commercial account at The Toronto-Dominion Bank in the name of a subsidiary of the Credit Union, 1961783 Ontario Limited (the "**Prepaid Card Entity**"). The sole function and activity of the Prepaid Card Entity is to receive and hold the Prepaid Cardholder Amounts for the benefit of the Prepaid Card Holders and ultimately to disburse the Prepaid Cardholder Amounts on behalf of the Prepaid Card Holders for the benefit of merchants.

68. Pursuant to the cardholder agreements entered into with consumers, the amounts loaded by consumers onto their Prepaid Cards are not considered deposits and the amounts are not insured by the Canada Deposit Insurance Corporation or the DIRF.

69. The Credit Union is in the process of transitioning or winding-down the Prepaid Card Business. This process of transition and wind-down is expected to take a period of months to complete and while that is occurring, the Prepaid Card Business will continue to operate in the normal course.

(G) Expected Distributions from the Wind Up of PACE Securities Corporation and Its Subsidiaries

70. In connection with the court-ordered wind-up of the Credit Union's wholly-owned subsidiary, PSC and its direct and indirect subsidiaries, including PFL and PACE Capital Partners LP ("**PCP**"), the Credit Union expects to receive certain interim distributions both as creditor and sole shareholder of PSC.

71. Ernst & Young Inc. ("**EY**") is the court-appointed liquidator of PSC, PFL, and Pace General Partner Limited, the general partner of PCP. On November 1, 2021, on the application of

the Credit Union, the Ontario Superior Court of Justice in Bankruptcy made a bankruptcy order in respect of PSC and appointed EY trustee in bankruptcy of PSC.[8]

72. On November 20, 2021, the Credit Union filed a proof of claim in the bankruptcy proceeding of PSC stating an unsecured claim against PSC in the total amount of approximately $4.7 million. I am advised by EY that the Credit Union can expect to receive interim distributions which would satisfy most, if not all, of the Credit Union's claims against PSC sometime in late 2022, but that the timing of any such distribution remains subject to the receipt of comfort letters from Canada Revenue Agency and approvals of the Court.

(H) BC Class Action

73. The Credit Union and others are named defendants in a certified class action in the British Columbia Supreme Court, BCSC Action No. S-147229, Vancouver Registry (the "**BC Class Action**"), in which the plaintiff, on behalf of the class, alleges, among other things, that the defendants (which includes the Credit Union) breached provisions of the *British Columbia Business Practices and Consumer Protection Act* by selling prepaid credit cards that allegedly have an expiry date and contain fees for the purchase and use of such cards. The BC Class Action remains in the documentary discovery phase. The Credit Union's potential exposure in the BC Class Action, if any, cannot be determined with reasonable precision at this time.

74. The Applicant is seeking a stay of the BC Class Action in order to see if a consensual resolution can be achieved.

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[8] Court File No. BK-21-208520-OT31; Estate No. 32-2780716

(I) Potential Claims by FSRA

75. The Credit Union remains subject to certain potential claims by FSRA in its capacities as both the administrator of the DIRF and the statutory Administrator of the Credit Union. These include a potential claim relating to FSRA's guarantee of certain post-closing obligations owed by the Credit Union in connection with the Alterna Sale Transaction, which may or may not ultimately result in payments to Alterna.

(J) Other Excluded Assets, Liabilities, and Obligations

76. The Credit Union's other excluded assets and liabilities include the following:

(a) a relatively small asset reflecting the Credit Union's remaining investments in certain completed joint venture projects;

(b) an accrued dividend and capital payments in connection with certain Class A profit and Class B investment shares it issued;

(c) a deferred tax asset in the form of an accrued credit for past losses; and

(d) other ordinary course litigation and claims, which exist or may in the future exist.

PART 5 - THE LIQUIDATOR NOMINATION AGREEMENT

77. Given all of the circumstance described herein—including, without limitation, that FSRA has certain claims against the Credit Union, both existing and contingent, all of which are in respect of the DIRF—KPMG and FSRA, in its capacity as the Administrator of the Credit Union, have entered into a liquidator nomination agreement (the "**Liquidator Nomination Agreement**"), attached as **Exhibit "K"**. Pursuant to the Liquidator Nomination Agreement, the

Administrator agreed to nominate or support the nomination of KPMG, and KPMG agreed to accept such nomination and consent to its appointment, as court-appointed liquidator of the Credit Union in these proceedings on the terms set out therein and in the form of the winding-up order sought on this application.

78. In connection with the appointment of the proposed Liquidator, the Applicant is seeking the Court's approval of the Liquidator Nomination Agreement. The appropriateness of KPMG as proposed Liquidator is addressed below in Part 6 of this affidavit.

PART 6 - APPLICATION TO WIND UP THE CREDIT UNION

(A) A Court-Ordered Wind Up of the Credit Union is Appropriate

79. The Administrator is of the view that: (a) having completed the Alterna Sale Transaction, the Credit Union no longer has member deposits, employees or branches and therefore can no longer fulfil its statutory object under section 23(1) of the CUCPA "to provide on a co-operative basis financial services primarily for its members"; (b) an orderly wind-up of the Credit Union is appropriate; and (c) in the circumstances, including having regard to the nature and complexity of the remaining assets, operations, and liabilities of the Credit Union, a court-ordered winding up of the Credit Union by a court-appointed liquidator pursuant to the CUCPA would be appropriate.

80. In particular, as a result of the sale of substantially all of its assets to Alterna and the departure of all of its employees, the substratum of the Credit Union's business no longer exists. The Credit Union is left with miscellaneous assets to administer and significant litigation to be prosecuted or defended. The Credit Union, by reason of the sale of its business and the liabilities being asserted against it, cannot continue its business and it is advisable to wind it up. In

addition, in view of all the circumstances herein, including the absence of any employees to deal with the Credit Union's remaining assets, operations, and liabilities, it is just and equitable that the Credit Union be wound up.

81. If appointed, the Liquidator will monetize or dispose of the remaining assets of the Credit Union, identify and determine claims against the Credit Union and/or its current and former directors and officers, defend or resolve the outstanding litigation described herein, and seek directions from the Court regarding any proposed distribution.

(B) Standing and Jurisdiction

82. The Chief Executive Officer of FSRA ordered that the Credit Union be subject to administration pursuant to the provisions of the CUCPA. Pursuant to the Administration Orders, the Administrator was granted and has retained the authority to, among other things, exercise the powers of the Credit Union for matters outside of the ordinary course of business, and of the directors, officers, and committees. Under the provisions of the CUCPA, the Credit Union may apply to the Ontario Superior Court of Justice (Commercial List) (the "**Court**") for an order winding up the Credit Union where it cannot continue its business and it is advisable to wind it up or it is just and equitable that it should be wound up. Those circumstances exist in this case. Accordingly, the Administrator may cause the Credit Union to bring an application to the Court seeking an order winding-up the Credit Union under the provisions of the CUCPA.

83. There is some urgency in commencing the winding up process as it will be beneficial for the Liquidator to have access to the transition services and information available from Alterna, as referred to in paragraph 45 above.

(C) Appointment of KPMG as Liquidator

84. Under the provisions of the CUCPA, the Court may appoint one or more persons as liquidator of the estate and effects of the Credit Union for the purpose of winding up its affairs and distributing its property.

85. The Administrator nominates KPMG to serve as the court-appointed liquidator of the Credit Union in these proceedings. KPMG is well-known for its expertise in complex commercial matters and liquidation proceedings and is an appropriate choice to serve in this capacity. FSRA believes that KPMG's engagement in respect of the Alterna Sale Process, Alterna Sale Transaction, CCE Sale Process, and CCE Sale Transaction and the background and experience gained in its financial advisory role regarding the Credit Union, its assets, undertakings, properties, liabilities, and claims will benefit the Credit Union, its stakeholders, and the Court if KPMG were appointed as Liquidator.

86. The proposed Liquidator has requested a charge on the remaining assets of the Credit Union to secure payment of its reasonable fees and expenses and those of its counsel, in each case at their standard rates and charges unless otherwise ordered by this Court on the passing of accounts (the "**Liquidator's Charge**"). The Administrator believes that the Liquidator's Charge is reasonable and appropriate in the circumstances of this case.

87. The proposed Liquidator may have to borrow monies for the purpose of funding the exercise of its powers and duties related to the winding-up of the Credit Union. For this reason, the Applicant is seeking an Order (a) empowering the Liquidator to borrow such monies, provided that the outstanding principal amount does not exceed $3,000,000.00 and (b) granting a fixed and

specific charge on the remaining assets of the Credit Union as security for the payments of the monies borrowed, together with interest and charges thereon (the "**Liquidator's Borrowings Charge**"). The Administrator believes that the Liquidator's Borrowings Charge is reasonable and appropriate in the circumstances of this case.

PART 7 - CONCLUSION

88. For the reasons stated herein, the Administrator believes that the relief requested by the Applicant on this Application is reasonable and appropriate in the circumstances of this case, and is reasonably necessary to ensure the successful and timely winding up of the Credit Union.

SWORN by Mehrdad Rastan of the City of Toronto, in the Province of Ontario, before me at the City of Toronto, in the Province of Ontario, on August 17, 2022 in accordance with O. Reg. 431/20, Administering Oath or Declaration Remotely.

DocuSigned by:
Mitch Stephenson
8A6E4EF09DF34D5...

Commissioner for Taking Affidavits
(or as may be)

MITCH STEPHENSON

DocuSigned by:
Mehrdad Rastan
33C59F46E89F4F3...

MEHRDAD RASTAN

TAB C

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

(Court Seal)

PACE Savings & Credit Union Limited, by its liquidator, KPMG Inc. ~~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

FURTHER AMENDED FRESH-AS-AMENDED STATEMENT OF CLAIM
(Notice of Action issued March 18, 2019)

TO THE DEFENDANT

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the Plaintiff. The Claim made against you is set out in the Statement of Claim served with this Notice of Action.

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 Plaintiff's lawyer or, where the Plaintiff does not have a lawyer, serve

it on the Plaintiff, and file it, with proof of service in this court office, WITHIN TWENTY DAYS after this Notice of Action 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 PLAINTIFF'S 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 plaintiff's 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 ~~March 4, 2022~~ October 18, 2022 Issued by _____

Local Registrar

Address of court office: Superior Court of Justice
330 University Avenue, 9th Floor
Toronto ON M5G 1R7

TO: Larry Smith
53 Treegrove Circle
Aurora, Ontario L4G 6M2

AND TO: Phillip Smith
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AND TO: 1428245 Ontario Ltd.
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AND TO: 809755 Ontario Ltd.
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AND TO: Malek Smith
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AND TO: 1916761 Ontario Ltd.
59 East Liberty Street, Suite 605
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AND TO: 1724725 Ontario Ltd.
8111 Jane Street, Suite 1, Vaughan, Ontario L4K 4L7; and
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53 Treegrove Circle, Aurora, Ontario L4G 6M2

AND TO: Frank Klees
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AND TO: Klees & Associates Ltd.
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AND TO: Ron Williamson
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AND TO: R. Williamson Consultants Limited
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AND TO: Ron Williamson Quarter Horses Inc.
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AND TO: Brian Hogan
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AND TO: Brent Bailey
90 Anglesey Boulevard
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AND TO: Deborah Baker
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AND TO: Wendy Mitchell
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AND TO: Jim Tindall
6390 Owen Road R.R. 1
Uxbridge, Ontario L9P 1R1

AND TO: Pauline Wainwright
3 Stornwood Court
Brampton, Ontario L6W 4H4

AND TO: Neil Williamson
790 Millbank Road
Pickering, Ontario L1V 3L5

AND TO: Joanna Whitfield

CLAIM

1. The Plaintiff claims against the defendants Larry Smith, Phillip Smith, 1428245 Ontario Ltd., and 809755 Ontario Ltd. the following amounts, to be reduced by the amounts set-off by the Credit Union (as defined below):

   (a) damages, compensation and disgorgement in an amount to be specified before trial for fraud, deceit, conspiracy, breach of contract, breach of employment duties, breach of fiduciary duty, breach of trust, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of proceeds of breach of fiduciary duty and breach of trust, conversion and unjust enrichment in connection with their participation in and involvement in the transactions as identified below, provided that the amounts sought do not include any amount apportionable to the actions or omissions of Alison Golanski, Stan Dimakos ~~and~~ Ken Topping, Kim Colacicco, Brian Mullan, Mitch Vininsky, Mary Benincasa, Benjamin Choi, David Finnie, Frederick Kreutlein, Heather Sarnecki and Lauren Thompson Cacovic;

   (b) an accounting of all amounts received, directly or indirectly, as a result of any of the conduct of the Defendants set out herein;

   (c) a tracing order and a constructive trust over the property directly or indirectly acquired with the proceeds from the improper conduct described herein; and

   (d) damages for the costs of enforcing and realizing on the Plaintiff's security in the CCE Receivership Proceedings (Court File No. CV-18-00610186-OOCL) on a full indemnity basis.

2. The Plaintiff claims against the defendant 1724725 Ontario Ltd.:

   (a) damages, compensation and disgorgement in an amount to be specified before trial for breach of contract, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of proceeds of breach of fiduciary duty and breach of trust, conspiracy, conversion and unjust enrichment in connection with its participation in and involvement in the transactions as identified below;

   (b) an accounting of all amounts received, directly or indirectly, as a result of any of the conduct of the Defendants set out herein; and

   (c) a tracing order and a constructive trust over the property directly or indirectly acquired with the proceeds from the improper conduct described herein.

3. The Plaintiff claims against the defendants Malek Smith and 1916761 Ontario Ltd.:

   (a) damages, compensation and disgorgement in an amount to be specified before trial for knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of proceeds of breach of fiduciary duty and breach of trust, conspiracy, conversion and unjust enrichment in connection with their participation in and involvement in the transactions as identified below;

   (b) an accounting of all amounts received, directly or indirectly, as a result of any of the conduct of the Defendants set out herein; and

   (c) a tracing order and a constructive trust over the property directly or indirectly acquired with the proceeds from the improper conduct described herein.

4. The Plaintiff claims against the defendants Frank Klees and Klees & Associates Ltd.:

   (d) damages, compensation and disgorgement in an amount to be specified before

trial for fraud, deceit, conspiracy, breach of contract, breach of employment duties, breach of fiduciary duty, breach of trust, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of proceeds of breach of fiduciary duty and breach of trust, conversion and unjust enrichment in connection with their participation in and involvement in the transactions as identified below;

(e) an accounting of all amounts received, directly or indirectly, as a result of any of the conduct of the Defendants set out herein; and

(f) a tracing order and a constructive trust over the property directly or indirectly acquired with the proceeds from the improper conduct described herein.

5. The Plaintiff claims against Ron Williamson, R. Williamson Consultants Limited, and Ron Williamson Quarter Horses Inc.:

(g) damages, compensation and disgorgement in an amount to be specified before trial for fraud, deceit, conspiracy, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of proceeds of breach of fiduciary duty and breach of trust, conversion and unjust enrichment in connection with their participation in and involvement in the transactions as identified below;

(h) an accounting of all amounts received, directly or indirectly, as a result of any of the conduct of the Defendants set out herein; and

(i) a tracing order and a constructive trust over the property directly or indirectly acquired with the proceeds from the improper conduct described herein.

6. The Plaintiff claims against Brian Hogan:

(j) damages, compensation and disgorgement in an amount to be specified before trial for breach of employment duties, breach of fiduciary duties, knowing assistance of breach of fiduciary duty and breach of trust, conversion, conspiracy, and unjust enrichment in connection with their participation in and involvement in the transactions as identified below.

7. The Plaintiff claims against Joanna Whitfield:

(a) damages, compensation and disgorgement in such amount to be specified before trial for deceit, breach of fiduciary duty, breach of trust, breach of contract, conspiracy, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of proceeds of breach of fiduciary duty and breach of trust in connection with her involvement in the CCE Transaction (described below); and

(b) damages for the costs of enforcing and realizing on the Plaintiff's security in the CCE Receivership Proceedings (Court File No. CV-18-00610186-OOCL) on a full indemnity basis.

8. The Plaintiff claims against the Directors (as defined below):

(a) damages and compensation in an amount to be specified before trial for negligence in connection with involvement in the matters as identified below, provided that the amounts sought do not include any amount apportionable to the fault or negligence actions of Golanski, Stan Dimakos, ~~and~~ Ken Topping, Kim Colacicco, Brian Mullan, Mitch Vininsky, Mary Benincasa, Benjamin Choi, David Finnie, Frederick Kreutlein, Heather Sarnecki and Lauren Thompson Cacovic; and

(b) contribution and indemnity for any damages arising from or in connection with the negligent failure to supervise or manage the Credit Union's relationship and interactions with Pace Securities Corp. and its direct and indirect subsidiaries, provided that the Plaintiff does not claim for any contribution and indemnity from Stan Dimakos and Ken Topping.

9. The Plaintiff claims against the defendants Larry Smith, Phillip Smith and the Directors (as defined below):

(a) for contribution and indemnity pursuant to the provisions of the *Negligence Act*, R.S.O. 1990, c. N.1, as amended, for the $25,000,000 paid to Investor Claimants (as defined below) in settlement of their claim for damages arising out of the design, development, offering, promotion, sale and the ultimate failure of the Preferred Shares (as defined below), to the extent any of those damages were caused or contributed to by any of them and provided that the Plaintiff does not claim for any contribution and indemnity from Stan Dimakos and Ken Topping.

10. The Plaintiff's claim against all of the Defendants:

(k) does not seek any damages or compensation that are found to be attributable to the fault or negligence of Golanski, Dimakos ~~or~~ Topping, Colacicco, Mullan, Vininsky, Benincasa, Choi, Finnie, Kreutlein, Sarnecki or Thompson Cacovic;

(l) for pre-judgment and post-judgment interest on all amounts claimed herein in accordance with the *Courts of Justice Act* R.S.O. 1990, c. C.42, as amended;

(m) for costs of this action; and

(n) for such further and other relief as the Plaintiff may request and this Honourable Court consider just.

B. The Parties

11. Financial Services Regulatory Authority ("**FSRA**" or the "**Administrator**") 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 Deposit Insurance Corporation of Ontario, 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.

12. PACE Savings & Credit Union Limited ("**PACE**" or the "**Credit Union**") is a credit union incorporated under the Act. It is therefore an entity that is regulated by FSRA. The Credit Union has 17 branches throughout southwestern Ontario and has over $1 billion in assets under management. PACE undertook substantial growth in the five to six years leading up to 2019, having acquired a number of other credit unions throughout southwestern Ontario.

13. Larry Smith ("**Larry**") is an individual who resides at 53 Treegrove Circle, Aurora, Ontario ("**Treegrove**"), with his common law partner Alison Golanski, who was

purportedly a consultant with the Credit Union ("**Golanski**"). Larry was both the President and CEO of the Credit Union in its various forms for approximately 20 years, until he appointed his son Phillip Smith ("**Phil**") as the CEO in 2016, after which Larry continued to act as the President of the Credit Union. Both Larry and Phil were placed on administrative leave with pay upon the issuance of the Administration Order (as defined below) dated September 28, 2018. Both were terminated by the Administrator for cause on December 5, 2018.

14. Phil is an individual who, with his wife and children, resides with Larry and Golanski at the Treegrove residence. The Treegrove residence is registered in Phil's name.

15. 1428245 Ontario Ltd. ("**142**") is a corporation incorporated under the laws of Ontario with a registered address of 53 Treegrove Circle, Aurora, Ontario.

16. 809755 Ontario Ltd. ("**809**") is a corporation incorporated under the laws of Ontario with a registered address of 53 Treegrove Circle, Aurora, Ontario. Elective Benefit Insurance Services ("**EBS**") appears to be an unincorporated division or alternative name of 809.

17. 1724725 Ontario Ltd. ("**172**") is a corporation incorporated under the laws of Ontario with a registered address of 8111 Jane Street, Suite 1, Vaughan, Ontario, the same address as the Credit Union. 172 is controlled by Larry and was used by him for his own benefit at all material times.

18. Malek Smith ("**Malek**") is another adult son of Larry. Malek lives in a condominium at 59 East Liberty Street, Suite 605, Toronto, Ontario.

19. 1916761 Ontario Ltd. ("**1916**") is corporation incorporated under the laws of Ontario with a registered address of 59 East Liberty Street, Suite 605, Toronto, Ontario. 1916 is a holding company owned and controlled by Malek and Larry. Malek is the sole director and officer of 1916.

20. Larry, Phil, 142, 809, Malek, 1916, and 172 are together referred to as the "**Smith Defendants**".

21. Frank Klees ("**Klees**") is a long-time friend of Larry and Vice President of the Credit Union. Klees is also a consultant of the Credit Union through his company, Klees & Associates Ltd. Klees was also purportedly appointed as a director of the Credit Union in or around April 2018.

22. Ron Williamson ("**Williamson**") is an individual residing at 86 Carrick Trail, Gravenhurst, Ontario, and Naples, Florida. Ron Williamson Quarter Horses Inc. ("**Quarter Horses**") is a corporation incorporated under the laws of Texas with a registered address of 604 South Elm Street, Denton, Texas. Williamson is the President of Quarter Horses. R. Williamson Consultants Ltd. ("**Williamson Consultants**" and together with Williamson and Quarter Horses, the "**Williamson Defendants**") is a corporation connected to Williamson. Its registered address is believed to be 86 Carrick Trail, Gravenhurst, Ontario.

23. Brian Hogan ("**Hogan**") is a former Vice President of the Credit Union and was Larry's "right-hand man".

24. Joanna Whitfield ("**Whitfield**") is an individual residing in Toronto, Ontario. Whitfield

is a real estate agent. Whitfield had a long-term intimate personal relationship with Larry.

25. Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, Peter Rebellati, Jim Tindall, Pauline Wainwright, Neil Williamson, George Pohle, and Klees (together, the "**Directors**") served as directors of the Credit Union during some or all of the material times. Each of Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Klees, Wendy Mitchell, Peter Rebellati, Jim Tindall, Pauline Wainwright, and Neil Williamson served as directors at the time of the Administration Order. George Pohle served as a director until in or around February 2018, when his term concluded and he was purportedly replaced by Klees.

C. FSRA's Issuance of the Administration Order

26. FSRA issued an Administration Order pursuant to section 294 of the Act on September 28, 2018. Pursuant to the Administration Order, FSRA, as Administrator, took control of the Credit Union and now exercises the powers of the board of directors and controls the management of the Credit Union.

D. The Claims

(i) **Failure to Disclose All Compensation in Contravention of the Act**

27. Pursuant to section 140(5) of the Act and section 28(1) and (2) of the General Regulation, O. Reg. 237/09 (one of the two regulations promulgated under the Act) (the "**Regulations**"), Larry and Phil, as President and CEO, were required to ensure that the compensation of the five highest paid officers of the Credit Union earning over $150,000 was reported in the Credit Union's audited financial statements.

28. Larry and Phil knowingly or recklessly underreported the income that they received both directly and indirectly from the Credit Union for years, including, but not limited to, each of the last six years of their employment. They underreported the income by millions of dollars.

29. Larry divided the income he received from the Credit Union between three separate agreements: (i) an employment agreement between the Credit Union and Larry; (ii) a consulting agreement between the Credit Union and 142; and (iii) a consulting agreement between the Credit Union and 809. Neither Larry nor Phil reported all of this income in the audited financial statements for the Credit Union as required under the Act and Regulations.

30. During the periods in which their income was underreported, Phil was an officer, director or shareholder of 142 and 809, and also received funds from 142 and/or 809.

31. In 2014, Larry's actual income was $624,878 more than his reported income. In 2015, Larry's actual income was $1,341,624 more than his reported income. In 2016, Larry's actual income was $1,398,972 more than his reported income. In 2017, Larry's actual income was $3,007,056 more than his reported income.

32. The failure of Larry and Phil to properly report the full amounts they were receiving as required by the Act and Regulations concealed and prevented the detection of the improper conduct described herein and misrepresented the true financial position of the Credit Union.

33. Larry and Phil, as the two most senior executives of the Credit Union, were ultimately

responsible for the financial reporting of the Credit Union, particularly as it relates to the amounts each of them were receiving.

34. Larry and Phil are liable to the Credit Union for all amounts received from the Credit Union in excess of their reported income. Their conduct amounts to a breach of the Act and its Regulations, fraud, deceit, breach of employment duties, breach of fiduciary duties, knowing assistance of breach of fiduciary duties, conversion and unjust enrichment.

(ii) CCE Transaction

35. The Act and the Regulations prescribe limits on any investment that a credit union may make in a company without receiving FSRA's approval. Section 200 of the Act requires a credit union to obtain FSRA's prior approval before forming a subsidiary. Section 198 of the Act and Section 64 of the Regulations provide that a credit union may not directly or indirectly acquire more than a 30% ownership interest without first obtaining FSRA's approval.

36. Larry and Phil were aware of the 30% limit, as they had previously applied for approvals and had been censured by FSRA in 2014 for failing to obtain such approvals.

37. In 2016, Larry and Phil developed a scheme to evade their statutory and regulatory requirements in connection with the Credit Union's acquisition of Continental Currency Exchange Canada Ltd. ("**CCE**"). This scheme involved: (i) causing PACE to acquire a 30% interest in CCE for $9.5 million; (ii) causing PACE to lend 2340938 Ontario Ltd. ("**2340**") another $15 million to acquire 45% of CCE; and (iii) agreeing with 2340 and

the vendor that, pursuant to a Unanimous Shareholders Agreement, as of March 31, 2019 the vendor could exercise a put option to force PACE to purchase the vendor's remaining 25% interest in CCE ("**CCE Transaction**").

38. 2340 was a sham entity controlled by Larry and Phil. It was a company that was ostensibly owned by Whitfield, who had a personal relationship with Larry, and was a failed, defunct company that was still indebted to the Credit Union for over $2 million following a previous failed and problematic loan that Larry had caused PACE to provide to it. Whitfield had no involvement in the negotiation of the CCE deal or management or control of 2340. Moreover, 2340 had no employees, and it was principally Larry's personal assistant at the Credit Union who administered the affairs of 2340 at Larry's direction.

39. Although the board of the Credit Union ostensibly approved the CCE Transaction, there was no actual or informed approval by the board of the transaction that Larry and Phil implemented. Larry and Phil did not disclose important and material information that was required to be disclosed to the board, including 2340's role in the transaction or Larry and Whitfield's personal relationship. Larry's connections to and interest in 2340, and with Whitfield in particular, were also never disclosed to the Board.

40. In connection with the CCE Transaction, Larry and Phil caused certain funds that should have been paid to the Credit Union from 2340 to instead be paid to themselves and certain others under the false pretence that the funds were being paid by CCE (the operating company) as fees for services provided to CCE when in fact the funds were paid by 2340 from funds that were to be paid to the Credit Union or held in trust for the Credit Union.

41. Larry and Phil also directed and/or acquiesced to the improper diversion of $591,000 of funds held by 2340, which were to be paid to or held in trust for the Credit Union, as follows:

(a) 2340 received quarterly dividends from CCE of $450,000 to service interest on the loan payments from PACE. These dividend payments were more than the amounts 2340 required to pay the interest on its loan from PACE. Whitfield received $141,000 in payments from 2340 since January 2017 but did no work for the company; and

(b) After the Administration Order was issued, Larry, Phil or Whitfield misdirected the $450,000 dividend payment from CCE that was payable on November 1, 2018, and caused it to be paid into an account at Royal Bank of Canada in contravention of the various contracts with PACE requiring that the dividends be deposited at PACE.

42. The $591,000 in diverted funds and the other payments directed by Larry and Phil to themselves and others total approximately $800,000.

43. In December 2018, the Administrator commenced receivership proceedings in respect of 2340 in order to protect the Credit Union's interests in the funds that had been misdirected (the "**2340 Receivership Proceedings**"). The Fuller Landau Group Inc. was appointed as the receiver, and the receiver was able to locate and recover the diverted $450,000 from another bank. The receivership proceedings are on-going. The Credit Union has suffered damages in the amount of the costs associated with the prosecution

of the 2340 Receivership Proceedings.

44. As part of the 2340 Receivership Proceedings, the shares of CCE held by 2340 have been transferred to the Credit Union.

45. The transactions through which Larry and Phil caused the Credit Union to acquire the interests in CCE also required the Credit Union to acquire the remainder of the shares from CCE's founder ("**Penfound**") anytime after March 2019 pursuant to a put option., Penfound exercised the option, and as a result, the Credit Union was left owning the entirety of CCE, contrary to the provisions of the Act and Regulations.

46. In addition to the foregoing, Larry and Phil failed to cause the Credit Union to obtain the necessary professional assistance and advice, or to take the necessary steps, to conduct appropriate or adequate due diligence into CCE, the proposed transaction, valuations of CCE, and the agreement giving effect to the transaction. As a result of such failures, the Credit Union will suffer a loss on its investment in CCE for which Larry and Phil are liable.

47. In total, the Credit Union has paid approximately $35 million for the acquisition of CCE, which acquisition only occurred because of Larry's and Phil's fraudulent scheme. CCE has lost most of its value since the CCE Transaction was entered into, resulting in significant loss to the Credit Union.

48. The Credit Union has recently been able to sell CCE for $16 million in mitigation of its losses. The sale of CCE to DUCA Financial Services Credit Union Ltd. is scheduled to close March 31, 2022.

49. Larry and Phil are liable to the Credit Union for fraud, deceit, breach of fiduciary duties,

knowing assistance of breach of fiduciary duties, knowing assistance of breach of trust, breach of employment duties, conversion, and unjust enrichment.

50. Whitfield is liable to the Credit Union for deceit, breach of fiduciary duty, breach of trust, breach of contract, conspiracy, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of proceeds of breach of fiduciary duty and breach of trust.

51. The issues raised in respect of the CCE Transaction are also the subject of the proceedings in Court File No. CV-18-00610186-00CL, which is currently stayed as a result of the Receivership Order that was granted by the Ontario Superior Court of Justice (Commercial List). The allegations and claims against Larry, Phil and Whitfield made in the Notice of Action, dated December 5, 2018, in Court File No. CV-18-00610186-00CL are incorporated herein. Whitfield has consented to be added as a defendant to this action so that all claims in relation to the CCE Transaction can be advanced in a single proceeding.

(iii) Geranium Joint Ventures

52. Geranium Corporation ("**Geranium**") is a company that develops residential real estate projects.

53. Larry and Phil caused the Credit Union to enter into a number of joint venture projects with, and to make loans to, certain of Geranium's projects.

54. Larry and Phil structured these agreements so PACE ostensibly owned only the statutory-limit of 30% of each joint-venture entity, but PACE in fact owned greater ownership rights by being contractually entitled to more than 30% of the profits and was obligated

to provide more than 30% of the capital for each of the projects. This structure was in breach of sections 198 and 200 of the Act and section 64 of the Regulations.

55. Further, Larry caused the Credit Union to pay $5.33 million to himself (directly and indirectly through 142, 809, 1916 and other defendants) from PACE and companies related to Geranium (who took such funds from monies paid by, or owing to, PACE). These amounts were not earned by Larry or the companies who received the payments, and were not approved by the Credit Union.

56. In addition to these payments, Larry caused PACE to pay Klees, who purportedly had a consulting agreement that also made him an officer of the Credit Union, $2.7 million in connection with the Geranium projects, despite the fact that the board was only advised that Klees would receive $1.6 million over the life of certain of these projects and despite the fact that those projects were in early stages of development and the funds were not due and owing. Klees kept these funds despite not being entitled to such funds.

57. Furthermore, Larry directed Geranium (or companies related or connected to it) to pay him, directly or indirectly through one of the other corporate defendants, additional sums on account of “consulting fees” or commissions. These amounts were taken from funds advanced by the Credit Union to Geranium or funds that were the Credit Union’s share of profits from the various joint ventures.

58. These secret commissions, many of them styled as “advance” payments, were not disclosed to the Credit Union or the Credit Union’s board as required by the Act or Regulations.

59. To the extent that Larry directed such improper payments through 172 or 1916, 172, 1916, and Malek were aware, were wilfully blind, or ought to have been aware of these improper transactions, and took no steps to inquire about the legitimacy or the source of the funds.

60. Larry, Phil, and Klees (acting as consultant and officer) failed to cause the Credit Union to obtain the necessary professional assistance and advice, or to take the necessary steps, to conduct appropriate or adequate due diligence into Geranium and the proposed transactions, valuations of the various transactions entered into with Geranium and the compensation being taken by Larry, Klees and others in connection with these transactions.

61. Klees misrepresented and concealed the true extent of his relationship with Larry and the Credit Union from the other directors and officers, including the fact he received monthly payments under an alleged consulting agreement and his purported appointment as a Vice President of the Credit Union. In particular, Klees did not disclose these facts to the other directors when he applied to be a director of the Credit Union, despite the fact that such disclosure was required by the Act and the director nomination forms he completed.

62. As a result of the foregoing conduct:

(a) Larry and Phil are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, breach of employment duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust;

(b) Klees is liable to the Credit Union for fraud, deceit, breach of fiduciary duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust; and

(c) To the extent that Larry directed payments through 142, 809, 172, or 1916, those companies, and Malek (to the extent that 1916 was involved), are liable to the Credit Union for conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust.

(iv) SusGlobal Energy Corp.

63. Larry and Phil caused the Credit Union to advance funds to SusGlobal Energy Corp. ("**SusGlobal**"), a borrower of the Credit Union, in a highly improvident and improper manner, and contrary to the Credit Union's risk tolerance.

64. Larry caused PACE to advance $1.6 million as part of the first tranche of a loan when at that time SusGlobal's only asset – a contract with two municipalities – had been terminated.

65. As part of the advancement of this tranche, Larry and/or Phil caused PACE to pay the defendant Williamson (or other of the Williamson Defendants or another company owned or controlled by Williamson) a "finder's fee" representing 25% of the funds advanced, from which Larry thereafter directly or indirectly received a secret commission of USD$150,000 back from one of the Williamson Defendants (or another company owned or controlled by Williamson) by directing the funds to 172, Golanski, 1916 and Malek.

66. Additionally, Larry and Williamson each received 810,000 shares in SusGlobal as part of their secret commission.

67. 172, 1916, and Malek were aware, were wilfully blind, or ought to have been aware of these improper transactions, and took no steps to inquire about the legitimacy or the source of the funds.

68. Subsequently, in September 2017, PACE advanced an additional $3.9 million to SusGlobal for a combined total exposure of $5.5 million, which also violated the Credit Union's risk tolerance.

69. The advancement of this $1.6 million tranche, and the total $5.5 million loan to SusGlobal, was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices.

70. To date, the SusGlobal loan has not been repaid and the anticipated loss to the Credit Union is anticipated to be $3.8 million.

71. As a result of the foregoing conduct:

(a) Larry and Phil are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust against the Credit Union; and

(b) the Williamson Defendants, 172, Malek and 1916 are liable to the Credit Union for fraud, deceit, conversion, unjust enrichment, knowing assistance of breach of

fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust.

(v) Inveraray Glen

72. Inveraray Glen is a real estate project in the Bracebridge, Ontario area. It is related to Evanco Corporation, which dealt with certain operational matters at the project (Inveraray Glen and Evanco Corporation are together referred to as "**Inveraray Glen**").

73. As of the date of the Administration Order, Inveraray Glen had $11.4 million in outstanding loans to the Credit Union, including accrued interest (the "**Inveraray Glen Loans**"). The loans have been in default since 2015.

74. Larry and Phil intentionally refused to record the bad loan charges required by sections 90 and 264(1)(g) of the Act or FSRA By-Law No. 6 (described in more detail below), which provide that charges for bad loans must be booked in the Credit Union's records on a monthly basis. The required charge with respect to the Inveraray Glen Loans would have eliminated the Credit Union's profits for the year in which the charge was booked.

75. Larry and Phil refused to book those charges despite the fact that they were in possession of two appraisals that showed that both the loan and the collateral were materially impaired. Larry and Phil instructed three members of the credit committee to hide or not disclose the appraisals, including from the Credit Union's CFO. As a result, they intentionally overstated the Credit Union's profits in the audited financial statements.

76. Larry advised certain employees at the Credit Union, in addition to certain directors, that he was allegedly in discussions with a developer in the Muskoka area who was interested

in creating a "fund" that would have acquired the Inveraray Glen properties for more than the outstanding loan. No such arrangement was possible or actually contemplated.

77. As a result of the foregoing conduct, Larry and Phil are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, breach of employment duties, conversion and unjust enrichment.

(vi) Lora Bay

78. Larry and Phil caused PACE to advance $6 million, in the form of a convertible debenture that was converted to equity, to the Lora Bay Corporation ("**Lora Bay**"), a real estate development project company. Lora Bay is a company that is majority owned by Larry Dunn ("**Dunn**") or a company related to him. Dunn already had millions of dollars in loans with the Credit Union at the time of the Credit Union's investment in Lora Bay.

79. The advancement of the initial loan to Lora Bay was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices.

80. In January 2017, Larry caused the Credit Union to directly or indirectly pay $180,000 to 1916 or Malek for "consulting and referral" fees in connection with Lora Bay, which fees were not payable, not earned, and were in fact a secret commission.

81. 1916 and Malek were aware, were wilfully blind, or ought to have been aware of these improper transactions, and took no steps to inquire about the legitimacy or the source of the funds.

82. As a result of the foregoing conduct:

(a) Larry and Phil are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, breach of employment duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust; and

(b) 1916 and Malek are liable to the Credit Union for fraud, deceit, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust.

(vii) Noble House Development Corporation

83. Noble House Development Corporation ("**Noble House**") owns a public storage facility in Huntsville, Ontario.

84. Larry and Hogan caused PACE to advance a $5.5 million secured line of credit to Noble House to replace the incumbent lender.

85. Larry and Hogan caused the loan to Noble House to be advanced despite the fact that the loan to value ratio of this loan is in violation of both section 184 of the Act and section 48 of the Regulations, and despite the fact they knew the borrower could not service the interest.

86. The advancement of this loan was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices. The Credit Union has incurred a $4.9 million loss on the loan.

87. The funds advanced by PACE were also used to pay a $452,000 "broker fee" to Williamson Consultants, who then paid 50% of the "broker fee" as a secret commission directly or indirectly to 1916 for Larry and Malek's benefit.

88. 1916 and Malek were aware, were wilfully blind, or ought to have been aware of these improper transactions, and took no steps to inquire about the legitimacy or the source of the funds.

89. As a result of the foregoing conduct:

(a) Larry and Phil are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, breach of employment duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust; and

(b) Williamson, Williamson Consultants, Malek and 1916 are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust

(viii) 1934811 Ontario Ltd. ("193")

90. Larry and Hogan caused PACE to provide 193 with a loan facility of up to $10 million. The current amount outstanding under the facilities is approximately $8.2 million.

91. The advancement of this loan was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices.

92. Larry received payments in the nature of a secret commission in connection with this transaction. Hogan facilitated the arrangement. As part of an agreement between the parties involved in the transaction, Larry was paid $275,000 plus HST for causing PACE to advance funds to 193, while Williamson (or his companies) received $300,000. Larry directed this secret commission, with Hogan's involvement, to 172.

93. 172 was aware, was wilfully blind, or ought to have been aware of these improper transactions, and took no steps to inquire about the legitimacy or the source of the funds.

94. Bill Player ("**Player**") is a friend or associate of Larry, and was previously sentenced to fourteen years in jail for fraud involving the notorious collapse of certain savings and loan companies in the 1980s. As part of the 193 transaction, Player was to receive certain rights to 193's future profits. These rights were then later given by Player to Ray Jarvis ("**Jarvis**") in exchange for Jarvis obtaining a loan from PACE, through Larry, and giving the proceeds of the loan to Player to pay his creditors in a formal consumer proposal under the *Bankruptcy and Insolvency Act* (the "**Jarvis Transaction**"). The Jarvis Transaction was an improvident loan, the exact nature of which Larry misrepresented to PACE, and was contrary to the Credit Union's risk tolerance and policies and any reasonable loan underwriting practices.

95. The Administrator interceded to prevent this loan from being advanced, but incurred significant professional fees in doing so.

96. As a result of the foregoing conduct:

(a) Larry and Hogan are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, breach of employment duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust; and

(b) the Williamson Defendants~~,~~ and 172 are liable to the Credit Union for fraud, deceit, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust.

(ix) Lagasco Transaction

97. In connection with loans made to Lagasco Inc. ("**Lagasco**"), Larry and Phil undertook efforts to evade the restrictions in the Act and Regulations that limit the amount that may be lent to any group of persons who are connected.

98. The principal of Lagasco is Jane Lowrie ("**Lowrie**"). Both Larry and Lowrie are connected to another business, Tribute Resources Inc. ("**Tribute**"), a publicly traded company. Larry is a director of Tribute, as is Lowrie.

99. Section 191 of the Act stipulates that a credit union "shall not make loans in excess of such lending limits as may be prescribed or as may be ordered under subsection (2) or (5)". The lending limits for credit unions are specified in the Regulations. Under section 58(2) of the Regulations, "a credit union may make a loan to a person if, as a result of

making the loan, the total amount of all outstanding loans made to the person and any connected persons *would not* exceed 25% of the credit union's regulatory capital". [emphasis added]

100. At the time, PACE's regulatory lending limit was approximately $16.8 million to a single borrower or a group of "connected" persons (as defined by the Regulations).

101. Larry, Phil and Hogan (until he retired) undertook efforts to advance a loan to Lagasco of almost $30 million in connection with Lagasco's attempt to purchase the assets of Dundee Oil & Gas through its CCAA proceedings that were then proceeding before the Ontario Superior Court of Justice (Commercial List).

102. Larry, Phil and Hogan actively worked with Lagasco and Lowrie to divide the loan between Lagasco and a brand new company, Forbes Resources Inc. ("**Forbes**"), that they alleged was separate and independent despite it purportedly being controlled by Lowrie's four adult children. In doing so, Larry and Phil ignored information and advice from the Credit Union's staff and the Credit Union's own counsel that the loans were improvident and contrary to the Act and Regulations. Moreover, they proceeded with the transaction despite the fact that they knew, or ought to have known, the transaction in substance was only one loan to Lagasco. In attempting to create the appearance of complying with the Act and Regulations, Larry, with the knowledge or awareness of Hogan or Phil, gave up normal, customary and prudent protection for the Credit Union, such as guarantees, which would customarily be required for transactions of this nature.

103. Although the Administrator was able to stop the bulk of this transaction after the

commencement of the Administration proceedings, the Credit Union incurred substantial costs and damages in stopping the loan and in attempting to limit the damage caused as a result of Larry's, Phil's and Hogan's breaches of fiduciary duties. Further, the Credit Union has not recovered the initial $3 million advanced in another connected loan as part of the same transaction.

104. The advancement of the Lagasco loans was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices.

105. As a result of the foregoing actions, Larry, Phil and Hogan are liable for fraud, deceit, breach of fiduciary duties, breach of employment duties, conversion and unjust enrichment.

(x) Diversion of Funds to Golanski, Larry's Common Law Partner

106. Larry engaged in a number of transactions in which he caused the amounts owing to the Credit Union to be diverted to either his common law partner Golanski or to 172, which is a company ostensibly controlled by Golanski but is *de facto* controlled by Larry, without the required disclosure to the board of directors.

107. One such situation that exhibits Larry's efforts to transfer PACE's funds to persons related to him pertains to PACE's arrangement with City View Bus Sales & Service Ltd. ("**City View**"), in which Larry directed that 172 be paid commission for work that Golanski did not do, or which could have been done by an existing employee at no additional cost to the Credit Union.

108. On or about October 2016, Larry agreed to provide City View, through PACE, with a $5 million asset-based financing facility which City View would draw upon based on purchase orders it received for the construction of buses. In addition, PACE would charge a fee or commission of 30% of the gross margin expected under the purchase orders. Larry required that this fee owing to PACE to be split between PACE and his common law spouse, Golanski, despite Golanski not providing any meaningful services to City View or PACE in relation to the business.

109. Furthermore, Larry caused PACE to enter into a consulting agreement with 172 under which 172 received monthly payments from PACE for purported consulting services provided by Golanski. However, this consulting agreement was merely another means of diverting funds to Golanski or Larry through the payment of retainers and expenses. Between January 1, 2015 and September 30, 2018, 172 received $149,160 in monthly retainers but only earned $9,788 in commissions, illustrative of the minimal work done by her. Larry exercised control over 172's accounts and affairs and used the company for his own benefit.

110. Larry prepared the consulting agreement for 172, and subsequent revisions to the consulting agreement, without Golanski's knowledge or involvement. Neither Golanski nor 172 performed any services or any meaningful services to warrant the payments made pursuant to the alleged consulting agreement.

111. As a result of the foregoing conduct, Larry and 172 are liable to the Credit Union for fraud, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and

breach of trust. The damages claimed by the Credit Union do not include any amount apportionable to the actions of Golanski.

(xi) Failure to Abide by By-Law No. 6

112. Larry and Phil, who were directly and ultimately responsible for the commercial loan portfolio, failed to abide by the Credit Union's Credit Policy as well as the Act and the Regulations.

113. According to FSRA By-Law No. 6, Larry and Phil were required to follow the processes in By-Law No. 6 to value and, if necessary, write-down the value of loans on the Credit Union's books and records whose values had declined as determined by By-Law No. 6

114. Larry and Phil misrepresented the value of a number of loans in the Credit Union's books and records. They misrepresented the value of loans by intentionally or negligently failing to properly review, or cause to be reviewed, the loans pursuant to FSRA By-Law No. 6, which has the force of a Regulation, as against the value of such loans on the books and records of the Credit Union, thereby misstating the Credit Union's financial position to FSRA and the Credit Union's members, and misrepresenting their performance.

115. The failure and refusal of Larry and Phil to properly review the value of the Credit Union's loans, and to cause such review to be done, and to adjust the books and records as required, concealed the true financial position of the Credit Union from the members and the regulators and allowed Larry and Phil to continue to advance loans that were contrary to the Credit Union's policy and risk tolerance. As a result, they prevented detection of the loan underwriting problems, which would have prompted corrective actions, and thus they

were able to ensure that they continued to receive their salary and bonuses based on an inaccurate view of the Credit Union's activities and financial position, and prevent earlier regulatory intervention. Accordingly, the Credit Union continued to make bad loans, and failed to collect on loans when appropriate, thereby incurring additional losses.

116. As a result of their failure to appropriately abide by By-Law No. 6, the Act and the Regulations in respect of the required ongoing valuation of commercial loans, Larry and Phil are liable to the Credit Union for breach of fiduciary duties, knowing assistance of breach of fiduciary duties, conversion, and unjust enrichment against the Credit Union.

(xii) False Invoices

117. Larry caused, with Phil's acquiescence, the Credit Union to pay invoices purportedly rendered by 142, 809 (a.k.a. EBS), 1916, and 172 for services that were not in fact rendered to the Credit Union. In the alternative, if the services were rendered, the quantum of the invoices was grossly disproportionate to the value of the services rendered.

118. The types of services allegedly rendered, as described on the invoices, include "trust fund administration" for the trust fund established for the Impugned Employment Contracts. There were ostensibly fees for managing the trust fund holding the termination or severance payments for certain employees at the Credit Union (discussed above). Arn Reisler, a lawyer and long-time friend of Larry's, was the trustee of the trust fund, while Kim Colacicco ("**Colacicco**") administered the trust fund at the Credit Union. Further, the trust fund required little-to-no administration. Despite this, Larry caused 142 and 809 (a.k.a. EBS) to invoice the Credit Union and to be paid by the Credit

Union at least $215,000 in improper trust fund administration fees between 2011 and 2018. Larry caused 142 and 809 to invoice these amounts to the Credit Union despite the fact that the contract for 142 provided that the amounts paid to it was on account of trust fund administration.

119. Additional false invoices were rendered by Larry through the various companies for pension administration, consulting fees, referral fees, retainers, commissions, for "contractual adjustments", and for other miscellaneous services.

120. The total amount of such false invoices is approximately $2,649,343.

121. As a result of the foregoing conduct, Larry, Phil, 142, 809 (a.k.a. EBS), 1916, and 172 are liable to the Credit Union for fraud, deceit, breach of fiduciary duties, conversion, unjust enrichment, knowing assistance of breach of fiduciary duty and breach of trust, and knowing receipt of proceeds from breach of fiduciary duty and breach of trust.

(xiii) Conspiracy

122. The Administrator states that the Smith Defendants, amongst themselves, and with Klees, Klees & Associates Ltd., the Williamson Defendants, Whitfield and Hogan, at precise dates and times known only to them, agreed amongst themselves to unlawfully engage in the above-mentioned conduct in order to unlawfully obtain money and other assets of value from and at the expense of the Credit Union. In particular, the Administrator states that the above-noted defendants agreed amongst themselves to carry out the various transactions as is described above, to violate the Act, to obtain or pay secret commissions, and to provide false invoices to the Credit Union, all as is detailed above. The

Administrator further states that the conduct described above:

(a) was undertaken with the predominant purpose of injuring the Credit Union and its economic interests; and/or

(b) was directed toward the Credit Union and the above-noted defendants ought to have known that, in the circumstances, injury and economic harm to the Credit Union would ensue.

(xiv) Concealment of Monies Taken by the Smith Defendants

123. Larry brought a folder with him to board meetings and audit committee meetings. This folder contained various invoices, agreements, and other documents, including documents that purported to justify the payment of amounts to Larry or other Smith Defendants. Documents were added to the folder by Colacicco or Larry's personal assistant on his instruction.

124. No other officers other than Larry, Phil, and Colacicco were aware of the contents of the folder prior to a meeting.

125. Larry brought the folder to various board and committee meetings. The documents inside the folder were already stamped with an "Approved by Audit Committee" stamp. This stamp was kept in the vicinity of Colacicco's desk, which she left unlocked.

126. During or after a board or committee meeting, Larry sat with two directors and caused or instructed them to sign or initial beside the stamp. Larry purposefully did not give

accurate or sufficient information to the two directors as to the contents of the documents or the relationship of Larry and the other Smith Defendants to the various individuals and companies named within those documents. Nor did Larry show the contents of the folder to the whole board or committee members. Larry discouraged any inquiries by other directors as to the contents of the folder.

127. Larry purposefully provided insufficient disclosure in order to conceal and obfuscate the existence of the amount of the monies being taken by him or otherwise being directed to the other Smith Defendants.

128. Moreover, the information contained in the folder was not sufficient to describe the nature and purpose of the payments or the basis on which the payments were justified. As a result, the documents within the folder were not properly approved by the board.

129. This "folder method" was purposefully employed by Larry, and acquiesced to by Phil, so that they could create a record that made it appear that the monies received by the Smith Defendants were ostensibly approved by the board, even though they knew or ought to have known that the board was in fact not made aware of the payments that were purporting to be "approved" by the board. By the use of the folder method, Larry and Phil were able to conceal the true amounts being taken directly by Larry, Phil, and the other Smith Defendants. The use of the folder method was part of Larry's and Phil's on- going concealment and obfuscation of the improper and dishonest receipt of monies taken directly or indirectly from the Credit Union, as described above.

(xv) Compensation Agreements

130. Larry and Phil caused the Credit Union to enter into certain compensation agreements

with themselves and certain other officers and employees that provided for salary, bonus, and severance payments that were materially unreasonable ("**Impugned Employment Contracts**") and contrary to the Credit Union's interests.

131. The Impugned Employment Contracts contain the following provisions that were not reasonable or in the interests of the Credit Union:

(c) a provision providing that the employees would receive a substantial termination payment whether or not termination was for cause or the employee resigned;

(d) some of these agreements provided these employees (including themselves) with termination payments far in excess of the amounts contemplated by law; and

(e) the termination payments were to be paid into a trust account without regard to the resulting tax requirements of establishing such an arrangement, including any requirement to pay withholding taxes, thereby exposing the Credit Union to potential penalties and other adverse financial consequences for failure to comply with requirements under the applicable tax laws.

132. Larry and Phil failed to cause the Credit Union to engage proper compensation and professional consultants or otherwise take the necessary steps to determine whether these extraordinary salary, bonus, and severance payments were reasonable or appropriate.

133. Moreover, they failed to engage the necessary experts to ensure that the termination trusts were organized in a manner that complied with the applicable tax laws. As a result, the termination trusts were organized in a manner that may be contrary to the applicable tax laws, thereby exposing the Credit Union to penalties and other damages as a result.

134. As a result of the foregoing, Larry and Phil are liable to the Credit Union for breach of fiduciary duties and negligence.

(xvi) De-risking Credit Union's Loan Portfolio

135. Larry and Phil caused and/or permitted the Credit Union to enter into numerous irregular and improper commercial loans. These loans were all sourced, directed or acquiesced in by Larry and Phil in breach of their duties to the Credit Union. In many instances, the loans were made to Larry's and/or Phil's associates and business partners on terms that were not commercially-reasonable and that were not in the Credit Union's interest.

136. In addition, Larry and Phil failed to fulfill their fiduciary and employment duties by properly overseeing the Credit Union's commercial and retail loan portfolio. They failed to ensure that appropriate loan approval and review processes were in place. As a result, the Credit Union made loans that were not prudent and were outside of any reasonable risk tolerance for a credit union. These loans and the loans referred to in paragraph 147 are the "**Imprudent Loans**".

137. The Credit Union recently discovered that Larry's and Phil's failure to implement proper controls and oversight of the Credit Union's retail loan business allowed a former employee to commit fraud in a number of loan accounts and account transfers.

138. To mitigate its losses on the Imprudent Loans, the Credit Union has had to de-risk and unwind these loans. Approximately $205 million of Imprudent Loans have been de-risked since 2019 and the process is ongoing.

139. The Imprudent Loans include loans that were made to Lowrie, Peter Budd and related

parties, Applefest, Silicorp and 124 Wellington.

140. The losses to date on these Imprudent Loans exceeds $8 million. Further losses are expected as the unwinding of the Imprudent Loans continues.

141. Larry and Phil are liable to the Credit Union for damages in relation to the Imprudent Loans. The damages suffered by the Credit Union include the lost opportunity to deploy the loan amounts towards other more prudent and commercially-reasonable loans and transactions.

(xvii) Directors' Breach of the Standard of Care

142. Each of Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, Peter Rebellati, Jim Tindall, Pauline Wainwright, and Neil Williamson were directors of the Credit Union at all material times and served in that capacity until the time of the Administration Order.

143. George Pohle served as a director until in or around February 2018, when his term concluded and he did not seek re-election.

144. Klees, Larry's long-time friend, Vice President of the Credit Union, and consultant of the Credit Union through his company, was elected as a director of the Credit Union in or about April 2018 to fill the vacancy left by George Pohle's departure.

145. Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, Peter Rebellati, Jim Tindall, Pauline Wainwright, Neil Williamson, George Pohle, and Klees (together, the "**Directors**") each owed a duty of care to the Credit Union pursuant to the Act and at common law, such that each of them had an obligation to act with the care, skill and

diligence reasonably required by the circumstances.

146. In each of the capacities occupied by these Directors there was a foreseeable risk that the Credit Union would be harmed if the actions of Larry, Phil, and the other employees of the Credit Union fell below the applicable standard of care.

147. The Directors, individually and collectively, had the ability to cause the Credit Union to take actions and enter into transactions that would affect the Credit Union's legal and practical rights and interests. The Credit Union and its members relied upon each of the Directors to exercise their powers and discretion in a manner that was consistent with sound business and lending practices, the Credit Union's regulatory requirements, the Act and the Credit Union's policies, and their duty of care.

148. Each of the Directors exercised their powers and discretion negligently and in breach of their duty of care to the Credit Union in relation to the transactions described above and their supervision of Larry, Phil, and the management of the Credit Union generally. In particular:

(a) The Directors had a duty to exercise their powers to ensure that the Credit Union's lending activities and the investments it was entering into were being undertaken in compliance with the Credit Union's policies and statutory obligations. The Directors failed to conduct sufficient or meaningful due diligence, or to ensure competent professionals were retained by the board or the Credit Union to conduct sufficient due diligence, and to ensure such compliance; and

(b) The Directors had a duty to exercise their powers so as to oversee and supervise the Credit Union's officers – in particular Larry and Phil, as President and CEO respectively. This duty required that they make meaningful enquiries as to payments being made to Larry, Phil, their family members and friends, and their related numbered companies received in excess of their contractual salary and in relation to transactions entered into by the Credit Union. The Directors failed to make such meaningful enquiries. In the alternative, if the Directors made such meaningful enquiries, they breached their duty of care in failing to prevent the improper payments.

149. Among the matters for which the Directors failed to exercise the necessary duty of care in considering the CCE Transaction, the Geranium Joint Ventures and matters relating to Pace Securities Corp. ("**PSC**") (described below), by failing to engage, or cause management to engage, the necessary independent experts to assist them in their decision-making process, and by failing to exercise the decision-making function sufficiently independently from management.

150. PSC is a wholly-owned subsidiary of the Credit Union.

151. PSC was an investment dealer regulated by the Investment Industry Regulatory Organization of Canada and an investment fund manager regulated by the Ontario Securities Commission.

152. One of PSC's subsidiaries was Pace Financial Limited ("**PFL**"). PFL carried on business as an investment vehicle for ~~accredited~~ investors to earn fixed dividends from an

investment in a basket of high-yield bonds (the **"Preferred Shares"**). PSC provided brokerage, investment and business management services to PFL in respect of the Preferred Shares.

153. On May 14, 2020, the Ontario Superior Court of Justice issued a Winding-Up Order in Court File No. CV-2000641059-00CL (the "**PSC Application**") directing that PSC and its subsidiaries, including PFL, be wound-up and appointing Ernst & Young Inc. as the liquidator of the estates and effects of PSC and its subsidiaries.

154. On August 6, 2020, the Ontario Superior Court of Justice appointed Representative Counsel to advance the interest of "Investor Claimants" within the PSC Application. Investor Claimants included 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.

155. The Investor Claimants asserted that they suffered significant actionable losses in connection with their investments in the Preferred Shares issued by PFL, and issued by another company, First Hamilton Holdings Inc. (**"FHH"**), to which PSC also provided certain management services. The Investor Claimants claimed that the Credit Union is liable for their losses, at least in part because the Investor Claimants (or some of them) allege they were referred to PSC by the Credit Union or were sold Preferred Shares directly by the Credit Union.

156. The Credit Union resolved the Investor Claimants' claims by paying $25,000,000.

157. The Directors, as well as Larry and Phil, owed both a duty of care and fiduciary duties to the Credit Union to properly supervise and manage the Credit Union, including its relationship with PSC and its subsidiaries, and to ensure that the distribution of the Preferred Shares was conducted in a regulatory compliant manner. The damages claimed by the Investor Claimants were caused or contributed to, in whole or in part, by the Directors', and Larry and Phil's, negligence and/or breach of fiduciary duty in that they failed to properly supervise and manage the Credit Union, including with respect to its relationship with PSC and its subsidiaries.

158. The Directors, and Larry and Phil, are liable to the Credit Union for contribution and indemnity for the $25,000,000 that was paid to the Investor Claimants to resolve their claims. The Credit Union pleads and relies upon sections 1 and 2 of the *Negligence Act*, R.S.O. c. N. 1, as amended.

159. The conduct described above was contrary to the interests of the Credit Union and a breach of the duty of care owed by the Directors. These breaches caused losses to the Credit Union, as set out in these pleadings. As a result, the Directors are liable to the Credit Union for negligence for the losses described above. The amounts sought against the Directors, and Larry and Phil, do not include any amount properly apportioned to the actions of Stan Dimakos and Ken Topping.

E. Defendants Are Jointly and Severally Liable to the Credit Union As A Result of Their Misconduct

160. Each of the Defendants has engaged in wrongful conduct against the Credit Union. Such wrongful conduct includes, but is not limited to, fraud, deceit, breach of fiduciary duties,

breach of employment duties, negligence, conversion, unjust enrichment, breach of trust, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of the proceeds from breach of fiduciary duty and breach of trust, and breach of contract, all as set out above. The Defendants are liable to compensate and pay damages to the Credit Union on a joint and several basis for the losses suffered by the Credit Union with respect to the wrongful conduct they were involved with, and to disgorge any amounts that they received on account of such wrongful conduct. The damages claimed by the Credit Union do not include damages apportionable to the actions of Golanski, Stan Dimakos, ~~and~~ Ken Topping, Kim Colacicco, Brian Mullan, Mitch Vininsky, Mary Benincasa, Benjamin Choi, David Finnie, Frederick Kreutlein, Heather Sarnecki and Lauren Thompson Cacovic.

161. This claim may be served outside Ontario, without leave, on the Defendant Quarter Horses, pursuant to Rules 17.02(a), (f), (g), (i), and (p). The action is in respect of property in Ontario, a contract or contracts made in Ontario, breaches of contract or contracts committed in Ontario, and/or torts committed in Ontario, and Quarter Horses is an ordinary resident in or caries on business in Ontario.

~~March 4, 2022~~
October 18, 2022

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PACE Savings & Credit Union Limited, by its liquidator, KPMG Inc. ~~by its Administrator, FINANCIAL SERVICES REGULATORY AUTHORITY~~
Plaintiff

-and-

LARRY SMITH et al.

Defendants

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

FURTHER AMENDED FRESH-AS-AMENDED
STATEMENT OF CLAIM
(Notice of Action issued March 18, 2019)

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TAB D

Schedule "A"

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 liquidator, KPMG INC. ~~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 ~~and, KIM COLACICCO and JANE LOWRIE~~ and JOANNA WHITFIELD

Defendants

A N D B E T W E E N:

LARRY SMITH, 1428245 ONTARIO LTD., and 809755 ONTARIO LTD. (A.K.A. ELECTIVE BENEFIT INSURANCE SERVICES)

Plaintiffs by Counterclaim

and

PACE SAVINGS & CREDIT UNION LIMITED, by its liquidator, KPMG INC. ~~BY ITS ADMINISTRATOR, FINANCIAL SERVICES REGULATORY AUTHORITY and ARN REISLER~~

Defendants by Counterclaim

and

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

Defendants by Crossclaim

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

TO THE DEFENDANTS TO THE COUNTERCLAIM

A LEGAL PROCEEDING has been commenced against you by way of a Counterclaim in an action in this Court. The Claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS COUNTERCLAIM, you or an Ontario lawyer acting for you must prepare a Defence to Counterclaim in Form 27C prescribed by the *Rules of Civil Procedure*, serve it on the Plaintiff by counterclaim's lawyer or, where the Plaintiff by Counterclaim does not have a lawyer, serve it on the Plaintiff by Counterclaim, and file it, with proof of service, in this Court, WITHIN TWENTY DAYS after this Statement of Defence and Counterclaim is served on you.

If you are not already a party to the main action and you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

If you are not already a party to the main action, instead of serving and filing a Defence to Counterclaim, 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 defence to Counterclaim.

IF YOU FAIL TO DEFEND THIS COUNTERCLAIM, 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.

Date October 19, 2020 Issued by "Maggie Sawka"
Local Registrar

Address of court office: Superior Court of Justice
330 University Avenue, 9th Floor
Toronto ON M5G 1R7

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

1. The defendants, Larry Smith ("**Larry**"), 1428245 Ontario Ltd. ("**142**"), and 809755 Ontario Ltd. ("**809**") (herein collectively called the "**Larry Parties**"), deny each of the allegations in the Amended Fresh as Amended Statement of Claim (the "**Claim**").

Overview

2. The Financial Services Regulatory Authority of Ontario ("**FSRA**"), as Administrator for PACE Savings & Credit Union Limited ("**PACE**" or the "**Credit Union**"), has made a series of meritless, and sometimes unprecedented, allegations against Larry, 142, and 809. FSRA's allegations fall into ~~two~~ three broad categories:

a) That Larry "caused" PACE to enter into a series of improvident loans and transactions, for which he ought to be personally liable; ~~and~~

b) That Larry, 142, and 809 received improper payments, either from third parties on projects relating to PACE's business, or from PACE itself, pursuant to 'impugned' contracts~~.~~; and

c) That Larry is liable to PACE for contribution and indemnity to the extent that PACE is liable for damages to any Investor Claimants (as defined in the Claim) associated with the Preferred Shares (as defined in the Claim).

3. FSRA's allegations are entirely without merit. A significant part of the claim against Larry imputes personal liability for alleged impairments to loans and investments made by PACE, all of which were made with corporate approvals and which have been subject to internal and external audit. To date, FSRA has not pled a legal or factual basis for its allegation that Larry is personally liable to PACE for loan impairments.

4. The remaining damages claimed relate to amounts received by Larry, 142, or 809 from PACE or others throughout his time as President or CEO of PACE. Notwithstanding the liberal use by FSRA of terms such as "secret commissions", "fraud", and "deceit", there has been no misappropriation of funds by Larry, nor is there any conduct at issue that can reasonably be categorized as fraudulent or even potentially fraudulent. Rather, in all cases, compensation was paid to Larry personally or to 142 or 809 pursuant to written and signed consulting agreements, signed board resolutions and acknowledgments, and a raft of individually stamped and initialed Audit Committee and board of directors approvals.

5. Underlying the claims by FSRA, and the administration order issued over PACE on September 28, 2018 (the "**Administration Order**"), is a fundamental disagreement about what business a credit union ought to be engaged in. Throughout his time at PACE, Larry helped PACE to grow its assets from around $50 million to over $2 billion in loans, investments, cash, deposits, and equity. A significant part of this growth was accomplished through the diversification of the business lines, including the formation of PACE Securities Corp. ("**PACE Securities**"), the introduction of property development as a line of business, and the purchase of Continental Currency Exchange Canada Ltd. ("**CCE**"). That diversification was intended to provide new revenue sources for PACE, as it tried to keep pace with the Schedule 1 banks, which had been similarly diversifying.

6. FSRA disagrees. As Brian Mullen (the "**Administrator**") stated to Scott Penfound of CCE, FSRA's goal in undertaking the administration of PACE is to 'take the credit union back to a traditional share/loan operation'. Since appointing itself as administrator, FSRA's actions have

systematically destroyed the value that would have accrued to the members of the Credit Union. For example:

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 prematurely, 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, ultimately, to its members; 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. 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.

7. All of these actions will have long-term detrimental effects on PACE itself, which will trickle down to its members.

8. In addition, FSRA has taken unprecedented and, frankly, alarming steps with respect to the assets that the Larry Parties had kept on deposit at PACE. On appointing itself administrator of PACE, FSRA unilaterally froze over $5,000,000 of their assets on deposit at PACE, taking the position that it was entitled to 'set off' the amounts on deposit against amounts claimed – but not proven – in its lawsuit. It has since collapsed those accounts outright and used the Larry Parties'

money to pay the fees of its own investigator and legal counsel, with PACE simply keeping the remainder for its own uses. It has done so without having proven any of its allegations against any of the Larry Parties and without having obtained any judgment.

The Parties

9. PACE is a credit union incorporated under the *Credit Union and Caisses Populaires Act, 1994*, S.O. 1994, c. 11 (the "**Act**"). PACE can trace its roots back to the Farm United Credit Union that began in 1940. Over the years, PACE has grown organically and through amalgamation with a number of smaller credit unions. When Larry joined PACE's predecessors, the Credit Union had approximately $50 million in assets, a number that grew to a total of approximately $2 billion in deposits, investments, loans, equity and property by the time of the Administration Order.

10. FSRA is an Ontario Provincial Agency that, in part, regulates and acts as the deposit insurer for credit unions in Ontario. Prior to June 8, 2019, credit unions were regulated by the Deposit Insurance Corporation of Ontario ("**DICO**").[1]

11. Larry is the former President of PACE. Larry was an employee of PACE and its predecessors from 1988 until his employment was terminated for alleged cause in December 2018.

12. The defendant 142 is a corporation that, until September 28, 2018, performed business development services for PACE starting in 2001. Larry is an officer and director of 142. The shares of 142 are held in trust for Larry by Phillip Smith ("**Phil**"), Larry's son and the former Chief Executive Officer of PACE.

[1] For the purposes of this document, FSRA and DICO will be referred to interchangeably.

13. The defendant 809 is a corporation formed under the laws of Ontario. Larry is the sole shareholder, officer, and director of 809. Starting in June 2006, 809 performed property development services for PACE.

14. The defendant by counterclaim, Arn Reisler ("**Reisler**") is a lawyer licenced to practice law by the Law Society of Ontario. Reisler is the trustee for the Severance Trust, as herein defined.

Compensation Received by Larry, 142, and 809

I. Contracts between PACE and Larry, 142, or 809 Are All Valid and Enforceable

15. Contrary to the allegations in the Claim, prior to FSRA's takeover of PACE, Larry's relationship with PACE and its predecessors was structured through employment agreements entered into personally by Larry, alongside consulting agreements between PACE and either 142 or 809. During the relevant time, PACE (or its predecessors) entered into the following contracts with Larry, 142, and 809, each of which was presented for approval to PACE's board of directors (the "**Board**"), was approved by resolution of directors, and was commercially reasonable:

a) An initial agreement (the "**IBM Agreement**") between IBM Employees (Toronto) Credit Union Ltd. ("**IBM Credit Union**"), a predecessor in interest to PACE, and MAS Consulting Services ("**MAS**"), (which later became 809);

b) A consulting agreement between Larry and IBM Credit Union, dating to 1991;

c) A consulting agreement (the "**Markham Stouffville Agreement**") between MAS and Markham-Stouffville Community Credit Union Limited ("**Markham-Stouffville Credit Union**"), a predecessor in interest to PACE, dated October 10, 1994 (the "**1994 Agreement**");

d) In or about July 1997, a consulting agreement between 809 and Greater Toronto Area (GTA) Savings and Credit Union ("**GTA Credit Union**"), upon Markham-Stouffville Credit Union's merger with Uxbridge Credit Union Limited;

e) An employment agreement, dated April 2000, between Larry and GTA Credit Union, pursuant to which he was employed as the CEO of GTA Credit Union;

f) 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;

g) In October 2002, 142 and PACE entered into a consulting agreement pursuant to which 142 agreed to perform management, data processing, and other services to PACE. This agreement was reapproved by the Board on December 13, 2006;

h) 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;

i) In May 2006, 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;

j) On June 26, 2006, 809 entered into a consulting agreement with PACE (although Larry had been using 809 or its predecessors as a vehicle for providing services to the Credit Union since 1988);

k) In July 2007, 142 and PACE entered into an updated consulting agreement (the "**142 Agreement**"). The 142 Agreement was amended in November 2012 and, most recently, on December 14, 2017;

l) On February 1, 2012, Larry entered into a subsequent employment agreement with PACE, in advance of PACE's amalgamation with Peoples Credit Union Limited (which was effective January 2013) (the "**2012 Agreement**");

m) On March 27, 2015, a further consulting agreement between 809 and PACE was concluded (the "**809 Agreement**"); and

n) On May 1, 2015, Larry and PACE entered into an agreement amending the terms of the 2012 Agreement (the "**2015 Agreement**"), pursuant to which Larry surrendered his role as CEO of PACE and continued as President and Managing Director.

16. All of the employment agreements and consulting contracts, as well as the payments made pursuant to them, were presented for approval to the Board and were, in fact, approved by the Board and the Audit Committee in the normal course.

17. Contrary to the allegations in the Claim, Larry could not "cause" PACE to enter into any of these agreements. There is no particular mystery to these documents, and it was known throughout that Larry was the beneficial owner of 142 and 809. These contracts were available to PACE's auditors and to FSRA throughout the relevant time and were, in fact, reviewed by those entities.

18. FSRA's view that any particular payment to Larry, 142, or 809 *should not* have been made is irrelevant, as all payments to Larry by PACE were made pursuant to valid contracts, and moneys received from third parties were properly accounted for and disclosed. FSRA's allegations that

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:

> <u>Valuation of allowance for impaired loans</u>
>
> 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

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

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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

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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.

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[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:

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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. The regulator conducted a diligent investigation which revealed that fraud had been committed by former senior executives 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

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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

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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 instalments;

(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

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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

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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

a n d

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.

11. PACE is a credit union incorporated under the Ontario *Credit Unions and Caisses Populaires Act*, 1994 (the "**Act**"). It operates seventeen (17) branches in the Greater Toronto Area and Southwestern Ontario and had over $1 billion in assets prior to FSRA taking over the administration of PACE. PACE is regulated by FSRA.

12. The Defendant, Brent Bailey ("**Brent**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE. Brent joined as a member of the Board of PACE in or around 2013. Brent was a secondary school teacher with the Toronto District School Board and served in the Etobicoke Teachers' Credit union, which eventually merged with PACE.

13. The Defendant, Deborah Baker ("**Deborah**"), is an individual residing in the Province of Ontario and a former member of the board of PACE. Deborah joined as a member of the Board of PACE in or around the mid-1990s, when Cangeco Credit Union merged with PACE . At the time of her membership with the Board, Deborah was a financial analyst and Chartered Accountant working with GE Canada.

14. The Defendant, Ian Goodfellow ("**Ian**"), is an individual residing in the Province of Ontario and a former member of the board of PACE. Ian joined as a member of the Board of PACE in or around 2013. At the time of his membership, Ian was the Director of Finance/Treasurer for the Town of Bradford West Gwillimbury (a position he holds to this date), and served on the Board of Directors of Peoples Credit Union. Ian joined PACE's Board of Directors following its merger with Peoples Credit Union and became the Chair of the Board of PACE in or around 2016.

15. The Defendant, Al Jones ("**Al**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE. Al joined as a member of the Board of PACE in or around

2013. Al is self-employed and in the business of providing insurance, investment and retirement income products.

16. The Defendant, Wendy Mitchell ("**Wendy**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE, which she served for approximately twenty (20) years. At the time of her membership with the Board, Wendy was an employee with IBM's Human Resources department and joined the Board of PACE following its amalgamation with IBM's employee credit union.

17. The Defendant, Peter Rebellati ("**Peter**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE. Peter joined as a member of the Board of PACE in or around 2001 to 2004, and then joined again in or around 2008. Peter is employed as the Financial Officer in the Development Financing Section in the Finance Department with the Region of Peel.

18. The Defendant, Jim Tindall ("**Jim**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE. Jim joined as a member of the Board of PACE in the 1990s as a result of its mergers with the Markham Stouffville Credit Union and the IBM Employees Credit Union. Jim is a food producer in the Durham Region and a Deacon at Goodwill Baptist Church. Jim also serves as a member of the Board of Directors of the Goodwood Cemetery.

19. The Defendant, Pauline Wainwright ("**Pauline**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE. Pauline joined as a member of the Board of PACE in or around 1988. She is presently employed as a Funeral and Cemetery Pre-Planning Advisor with the Mount Pleasant Group of Cemeteries.

20. The Defendant, Neil Williamson ("**Neil**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE. Neil joined as a member of the Board of PACE in or around 2003 at the time of its merger with North York Community Credit Union, where he served as a member of the Board. Neil is retired from full-time employment as a Math Department Head and Consultant and Administrator with the North York Board of Education.

21. The Defendant, George Pohle ("**George**"), is an individual residing in the Province of Ontario and a former member of the Board of PACE. George joined as a member of the Board of PACE when it merged with Peoples Credit Union. George is the General Manager of a gasoline station and convenience store. George retired from the Board of PACE prior to the Administrative Order (as defined below), in or around 2018.

22. Brent, Deborah, Ian, Al, Wendy, Peter, Jim, Pauline, Neil and George are hereinafter collectively referred to as the "**D&Os**". Most of the D&Os joined the PACE Board when it merged with other credit unions or entities which had been successful organizations. DICO in fact encouraged many of the D&Os to take positions as D&Os on the PACE board. Further, not all the D&Os were not on the PACE board at all the material times referenced to in the Claim.

23. The Defendant, Larry Smith ("**Larry**") was an employee of PACE and its predecessors from 1988 until his employment was terminated for alleged cause in December 2018. He was the CEO of PACE for 20 years until 2016.

24. Phillip Smith ("**Phil**") is Larry's son and was appointed the CEO of PACE in 2016.

25. Malek Smith ("**Malek**") is also Larry's son.

26. Larry, Phil, Malek, 1428245 Ontario Ltd. ("**142**"), 809755 Ontario Ltd. (a.k.a. Elective Benefit Insurance Services) ("**809**"), 1916761 Ontario Ltd. ("**191**"), 1724725 Ontario Ltd. ("**172**"), Frank Klees ("**Klees**"), Klees & Associates Ltd., Ron Williamson ("**Williamson**"), R. Williamson Consultants Limited, Ron Williamson Quarter Horses Inc., Brian Hogan ("**Hogan**"), and Jane Lowrie ("**Lowrie**") and Joanna Whitfield ("**Whitfield**") are hereinafter referred to as the "**Other Defendants**".

The Role of the D&Os

27. The D&Os of PACE were all voluntary board members whose role was to oversee the overall business and affairs of the Credit Union.

28. At all material times, the D&Os attended regular monthly meetings of the Board of Directors to discuss the overall affairs and management of PACE. The D&Os would receive board packages (comprising various reports from committees) prior to each board meeting. In addition, Larry and/or Phil would be present at the monthly meeting of the Directors and, among other things, presented a report of the management of PACE and answered questions of the D&Os in respect of various day-to-day activities being undertaken by PACE's management. PACE's management included, but was not limited to, the following individuals: Kim Colacicco (Corporate Secretary), Sandra Delabbio (Controller and Privacy Officer), Mary Benincasa (Chief Operating Officer), Dan Caldwell (Chief Marketing and Community Relations Officer), Gary Lockwood (Chief Risk Officer), Heather MacDonald (Senior Vice President Branch Sales), Joe Thompson (Vice President, Pace Securities), Brian Hogan (Vice President, Commercial Credit), Heather Lee (Vice President, Credit), Kumarie Annibale (Compliance Officer) and Kim Stoddart (Chief

Information Officer) (collectively, with Larry and Phil, hereinafter referred to as the "**Management**")

29. The D&Os plead that the duties of the board of PACE did not include the direct management or involvement in the day-to-day activities of PACE. Rather, the board oversees the Management's performance of those functions.

30. It is not the function of the board to duplicate the Management's functions. The D&Os correctly relied on PACE's Management to investigate and negotiate the transactions at issue, and such reliance was reasonable. The role of D&Os is to obtain reasonable assurance from the various reports and information provided to it.

31. As required by the *Act* and in accordance with the common law duties, the D&Os had various internal and external controls and checks and balances in place at the Credit Union in addition to their reliance on Management. These included, among other things, the following:

(a) Various committees established by the D&Os, including a Credit Committee and Audit Committee;

(b) Internal loan staff;

(c) PACE's internal auditor;

(d) PACE'S external auditor, Deloitte LLP, which would perform a yearly audit and provide a report to management in respect of its practices, including performing an audit of PACE's financial statements; and

(e) FSRA/DICO's periodic reviews of PACE's business, including On-Site Verifications

(collectively, the "**Safeguards**").

32. In addition to its own oversight of Management, the D&Os reasonably relied upon the Safeguards to ensure PACE was performing in accordance with the appropriate regulatory scheme. These Safeguards provided reasonable assurances to the D&Os with respect to the day-to-day operations of the Management.

33. Contrary to the allegations in paragraphs 154-160 of the Claim, the D&Os fulfilled their legislative and common law duties and plead and rely upon sections 97 (2), 109 and 121 of the Act.

The Whistleblower

34. In or around 2017, DICO, after conducting a routine examination of PACE, alleges that it found adverse findings in the areas of commercial lending, internal audit and board governance.

35. In or around October 2017, DICO learned about the CCE Transaction (as defined below at paragraph 55) through a letter from an anonymous whistleblower(s) (the "**Whistleblower Letter**").

36. On or about March 21, 2018, DICO delivered a Letter of Concern to PACE's management and Chair of the Board of Directors of PACE, setting out a number of concerns based on its findings and other information contained in the Whistleblower Letter.

37. At no time did DICO provide the D&Os with a copy of the Whistleblower Letter, nor did the whistleblower(s) approach the D&Os with any of the allegations regarding Larry, Phil or the general management of PACE that were the subject matter of the Whistleblower Letter.

38. On or about April 19, 2018, DICO met with individuals from PACE to discuss concerns, including meeting with the Board, Phil and Larry.

39. In or around May 2018, DICO appointed KSV Advisory Inc. ("**KSV**"), as special auditor and examiner to assist DICO in undertaking a special audit and examination of PACE pursuant to section 171(5) of the Act.

40. On or about May 10, 2018, DICO met with D&Os to discuss the nature of the allegations raised in the Whistleblower Letter and advised the D&Os that KSV was appointed by DICO to perform the special audit in accordance with the Act. The Whistleblower Letter was not produced at this meeting

41. It was around this time that the D&Os became aware and could have reasonably been aware of the allegations of the improprieties of Larry, Phil and others in the management of PACE. The whistleblower(s) did not report a complaint to the D&Os, and the D&Os received no advance indication of the specific irregularities until DICO began its investigation and the process for placing PACE under Administration.

42. When these matters were brought to the attention of the D&Os , the D&Os at all time co-operated with DICO and followed the orders of the DICO.

The Administrative Order

43. Within a few months of the Whistleblower Letters, on or about September 28, 2018, DICO issued an Administrative Order in respect of PACE, whereby, DICO suspended the powers of the the D&Os (with limited exceptions) and assumed the powers of same, thereby effectively taking control of PACE, among other things.

44. DICO subsequently terminated the employment of Phil and Larry.

Allegations Against the Other Defendants

Failure to Disclose Compensation

45. The D&Os do not have any knowledge of the allegations contained at paragraphs 30 to 37 of the within Claim, including among other things, allegations that Larry and/or Phil:

(a) Knowingly or recklessly underreported their income;

(b) Structured employment agreements with PACE, 142 and 809 to underreport their income (the "**Employment Agreements**");

(c) Failed to report all of their income in the audited financial statements for PACE as required under the Act; and

(d) Misrepresented the true financial position of PACE.

46. To the knowledge and belief of the D&Os, Larry accurately disclosed to the D&Os all income purportedly earned by Larry, 142 and 809. It was the D&Os understanding and belief that

all income purportedly received by Larry, 142 and 809 was reported on PACE's financial books and records in the normal course.

47. PACE's financial statements were subjected to multiple levels of yearly audits and regulatory checks. PACE received guidance and advice from its accountants and auditors and received a clean audit opinion. No issues were raised by PACE's internal and external auditors regarding the underreporting of income.

48. Larry provided information to PACE for the purposes of preparing financial statements. All information provided by Larry in respect of and in preparation for PACE's financial statements was reviewed by the Board for its exercise of appropriate diligence and discretion.

49. At all material times, the Employment Agreements were valid, commercial reasonable and approved by the Board through its exercise of reasonable diligence in reviewing and approving the Employment Agreements.

50. Further, these Employment Agreements were in place prior to the current D&Os assuming their role on the Board and were reviewed and approved or ought to have been reviewed and approved by DICO for all those years. At no time prior to the within Claim did DICO raise any issues with the Employment Agreements which go back decades.

51. Further, any unreported income by Larry, 142 or 809 is not a compensable loss to PACE that was caused by the D&Os. The Plaintiff has failed to prove a casual connection in respect of the breach and the damages being sought.

Improper Payments Received

52. The D&Os do not have knowledge of the allegations in the within Claim that Larry improperly obtained approvals for expenses and other payments received from third parties. The D&Os state that the Plaintiff has failed to particularize the payment(s) it objects to and puts the Plaintiff to the strictest proof thereof.

53. The D&Os approved expenses and/or payments to senior officers by exercising reasonable diligence in advance of their duties to PACE. All payments that were approved were appropriate, reasonable and considered by the D&Os in exercising their duties to PACE and applying business judgment.

54. If Larry is found to have improperly obtained approvals for expenses and other payments received from third parties, of which the D&Os have no knowledge, and if it is found that Larry underreported his income and created, among other things, a "contract scheme" with his related companies to facilitate the under reporting of his income, Larry knowingly or recklessly misrepresented the information to the D&Os.

55. Larry and Phil, as senior executives of PACE, were responsible for the financial reporting of PACE and the reporting of their own incomes. The D&Os were entitled to rely on the representations made by the Management and accept the representations as truthful, accurate and in the best interest of PACE. The D&Os applied their reasonable diligence in exercising their duties to PACE. It is not the role of the D&Os to identify alleged intentional misreporting, which is confirmed, reviewed by committees and audited by the internal and external auditors and DICO.

The Transactions

The CCE Transaction

56. In or around 2017, Larry and Phil approached the D&Os with the opportunity to purchase Continental Currency Exchange Canada Ltd. ("**CCE**") to raise capital and membership for PACE.

57. The Minutes of the Board of Directors dated November 29, 2017 provide the following in respect of the discussion of the Board of Directors and Larry in respect of CCE:

> CCE
>
> PACE investment/ownership is 30% only – CCE is a completely separate entity from PACE. Internal audit of all CCE locations has been completed. No plan at this time to introduce CCE services to PACE members and will move slowly to determine next steps. Smith [Larry] reiterated a detailed summary of the original rational for the investment and the rationale for the loan advance to 2340938 Ontario Limited and the Board **confirmed** support for the rational for the transaction, for the financing structure and its approval of same.

58. The Minutes of the Board of Directors dated December 14, 2017 provide the following:

> CCE
> In addition to the information previously provided to the board and recently requested by and provided to DICO, of which the board have been kept informed, the president again reviewed in detail the structure, ownership and reasoning for the investment and loan transaction. The board had no further questions of note.
>
> Scott Penfound, CEO of CCE provided a company history highlights of which include; family business, 30 successful years of which the past 5 years have been record breaking, largest independent foreign exchange company. 18 offices in prime retail locations, 98% client satisfaction rating, good value, consistency in results and services, untarnished record, no hidden skeletons, integrity, internal controls, compliance and a schedule 1 bank licence holder.

59. At the time Larry and/or Phil approached the D&Os in respect of CCE, the D&Os asked questions and after hearing from the CEO of CCE and other independent voices reasonably,

supported the strategic direction and growth of PACE's capital, membership and services. The D&Os were advised by Larry and Phil, among other things, that CCE would provide foreign exchange services to PACE members and provide access and growth to the memberships, including provide members access to automated teller machines at widespread locations.

60. Larry and Phil advised the D&Os of a structure that complied with the regulatory restrictions on the ownership of subsidiaries while PACE could raise the capital and await regulatory approval by DICO to own CCE in its entirety.

61. The structure proposed by Larry and Phil would allow PACE to own the maximum allowable percentage of CCE (30%) until such time as regulatory capital and approval could be obtained for it to acquire the rest and would grant an interest-bearing loan to 2340938 Ontario Limited ("**2340**"), for its purchase of a 45% share in CCE (the "**CCE Transaction**"). The D&Os approved the loan to 2340 at the meeting of the Board of Directors on or about February 28, 2018.

62. At the Board meetings, Larry regularly kept the D&Os apprised of various regulatory requirements in respect of the CCE Transaction. The Minutes of the monthly meeting of the Board of Directors held on April 25, 2018 set out the following in respect of regulatory updates in respect of the CCE Transaction:

> CCE
>
> Provide DICO with a Board-approved clear, consistent and conclusive account of the flow of funds in the CCE transaction and such other information as may be necessary for DICO to fully understand the transaction, including, but not limited to the actual purchase price paid by PACE. Provide DICO with a Board-approved clear, consistent and definitive explanation of the rationale for the transaction and PACE's future intentions for CCE and 234.

63. At all material times, the D&Os were aware that once PACE received regulatory approval, it would acquire 2340's share in CCE. Larry and Phil advised the D&Os that PACE had sought approval for a greater ownership stake in CCE from DICO and advised the D&Os that it was PACE's intention to acquire the additional 45% share of CCE from 2340 once PACE was granted approval by DICO. In the meantime, PACE would continue to retain profit by way of its receipt of interest on the loan to 2340 and its ownership of a 30% share of CCE.

64. At no time during the CCE Transaction did Larry, Phil or any one else advise the D&Os of the alleged relationship between 2340, advise on any related company to the CCE Transaction or advise on the financial health of 2340, and no such facts are within the knowledge of the D&Os.

65. At all material times, the D&Os, were aware of the regulatory requirements and obtained reasonable assurance that PACE was meeting applicable regulatory requirements. This transaction was, to the D&Os knowledge, also disclosed to FSRA, the internal and external auditors. No regulatory improprieties were brought to the D&Os by any other party.

66. Further, FSRA has failed to provide an accounting for the alleged losses it seeks from the CCE Transaction. Even if the regulatory requirements were not met as alleged by FSRA and of which the D&Os have no knowledge, the losses alleged were not caused by the approval of the CCE Transaction. In fact, the losses, if any, which are denied, were caused by mismanagement of CCE by FSRA since its Administration Order.

Geranium Joint Ventures

67. Contrary to the allegations in the Claim, the D&Os were informed by Larry and Phil that the joint ventures all 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 subject to rigorous internal and external audit. None of those audits raised concerns with the structure of any joint venture.

68. Further, the payments arrangement that was approved by the D&Os was reviewed by PACE's external auditors – Deloitte – who were tasked with reviewing such arrangements. Neither Deloitte nor FSRA, who over the years was also aware or ought to have been aware of these joint ventures, raised any concerns with the D&Os. All these arrangements were fully disclosed to all parties.

69. 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 alleged breaches did not cause any damages that are being alleged by PACE or FSRA.

SusGlobal Energy Corp.

70. The D&Os have no knowledge of the allegations as set out in the within Claim of Larry or Phil's activities in causing PACE to advance funds to SusGlobal Energy Corp. ("**SusGlobal**").

71. Moreover, the D&Os have no knowledge of the allegations related to Larry's or Phil's activities in causing PACE to pay the Defendants, Ron Williamson, R. Williamson Consultants Limited and Ron Williamson Quarter Horses Inc. (the "**Williamson Defendants**") a "finder's fee". This alleged finder's fee represented 25% of the funds advanced from which Larry thereafter received a secret commission of $150,000 USD from the Williamson Defendants through the Defendants, 172, 1916 and Malek.

72. The D&Os have no knowledge of the allegation that Larry and Williamson each received 810,000 shares in SusGlobal. If it is found that Larry and Phil improperly received a financial benefit, the D&Os plead that the D&Os had no knowledge of same and were deceived by Larry and Phil.

73. Further, as with all transactions, it remains unclear what caused the losses, if any, which are denied, as alleged in the Claim and when such losses were occurred. The D&Os rely upon the statements in paragraph 58 of Amended Statement of Defence and Counterclaim of the Defendants, Larry Smith, 1428245 Ontario ltd. and 809755 Ontario ltd. (the "**Larry Defence**") which states that in the more than two years after the date of the Administration Order, the loan continued to perform and the Credit Union had suffered no loss. No details to the contrary have been pleaded by FSRA and the losses, if any, which are denied, as alleged in the Claim were caused by mismanagement of FSRA after the Administration Order.

Inveraray Glen

74. Larry approached the D&Os with the opportunity of the Inveraray Glen investment. Larry advised the D&Os that this was a Muskoka Resort Corporation and possible joint venture opportunity with a book value of $10.5 million that could bring PACE a share value in joint venture of $13.5 million. It was always the understanding of the D&Os that they would continue discussions and that the Management would return with a plan for the D&Os for further consideration, review and due diligence in regards to this opportunity.

75. The D&Os have no knowledge of the allegations that Larry and Phil intentionally refused to record bad loan charges in respect of loans to Inveraray Glen, or that Larry and Phil refused to book those charges in accordance with the by laws of the Credit Union and the *Act*.

76. Further, as with all transactions, it remains unclear what caused the losses, if any, as alleged in the Claim and when such losses were incurred. The D&Os further plead if PACE has suffered losses, which are denied, such losses were caused by mismanagement of FSRA after the Administration Order.

Lora Bay and Noble House

77. The D&Os deny that any loan was advanced to the Lora Bay Corporation and Noble House that was contrary to reasonable loan underwriting practices or the Credit Union Policies.

78. The D&Os have no knowledge of the remaining allegations in paragraphs 81-85 of the Claim. Further, as with all transactions, it remains unclear what caused the losses, if any, as alleged in the Claim and when such losses were occurred. The D&Os further plead if PACE has suffered losses, which are denied, such losses were caused by the mismanagement of FSRA after the Administration Order and as FSRA caused PACE to breach its commitments for these loans after the Administration Order as stated in paragraph 66 of the Larry Defence.

Lagasco Transaction

79. The D&Os have no knowledge of the allegations in paragraphs 100-108 of the within Claim in respect of the improvident loan of $30 million to Lagasco Inc. advanced by Larry, Phil and Hogan in breach of the *Act.* No such transaction was approved by the D&Os.

80. Further, as with all transactions, it remains unclear what caused the losses, if any, as alleged in the Claim and when such losses were occurred. The D&Os further plead if PACE has suffered losses, which are denied, such losses were caused by the mismanagement of FSRA after the Administration Order.

Diversion of Funds to Golanski and False Invoices

81. The D&Os have no knowledge of the allegations contained in paragraphs 109-114 of the within Claim. At all material times, Larry, Phil and the Management assured the D&Os that all transactions in respect of 172 and invoices issued by Larry, 142 and 809 were legitimately rendered and paid in respect with valid contracts.

82. Amounts in respect of invoices and payments to 172 were approved by PACE's internal accounting staff and were subject to regular audit. The payments spanned a period of time before and after the current D&Os took on their role as the Board. The underlying contracts and payments were disclosed in the financial reports and no red flags were raised by the internal auditor, external auditor or FSRA over the years.

No breach of By-Law 6

83. At no time was any breach of By-Law 6 brought to the attention of the D&Os. Compliance with By-Law No. 6 is the responsibility of the Management of PACE.

84. The Credit Committee, Audit Committee and the internal auditor then conducted periodic reviews and prepared reports to ensure compliance with By-Law 6. No report was provide to the D&Os to indicate that PACE was lending money in breach of By-Law 6.

85. Further, the external auditors reviewed the loan portfolios and conducted specific checks to ensure that the true financial position of PACE was reflected in its audited financial statements every year. No reservations or limitations on financial statements were ever identified by the external auditors.

86. Further the entire loan portfolio was available to FSRA to audit during their Onsite Verifications or at anytime it so desired.

87. The D&Os deny that PACE was lending money in breach of By-Law 6 or in the alternative if it was, which is denied, then such breach was intentionally hidden from the D&Os by Larry and Phil.

D&Os have no knowledge of false invoices, conspiracy and concealment of monies by Larry and Phillip

88. The D&Os have no knowledge of the alleged transactions and activities of Larry and Phil Smith that PACE alleges precipitated the events leading to the Claim. Further, these alleged transactions and activities, as described in the Claim, were conducted through a web of shell corporations and related corporate entities. These were sophisticated, and any impropriety, if true, was never brought to the attention of the D&Os and were not reasonable discoverable by the D&Os. The role and standard of care applicable to the D&Os is that to obtain reasonable assurance from the information presented to them. The D&Os are not forensic auditors to be able to pierce through the various layers of corporations to discover the issues that have allegedly been discovered by FSRA after extensive forensic audits and information from the Whistleblowers.

89. Larry, Phil and Hogan were all officers of PACE and, accordingly, along with the Management, owed PACE and the D&Os a fiduciary duty and duty of care. It was incumbent on these Defendants that they provide:

(a) The D&Os information in a truthful and forthcoming manner keeping in mind the best interest of PACE;

(b) complete information that is accurate and not meant to conceal anything from the D&Os;

(c) accurate and sufficient reporting on contents of documents so as to present a fulsome picture of various transactions;

(d) accurate and fulsome information about or the relationship between Larry, Phil, Malek, and their related companies with various individuals and companies named within the Claim; and

(e) accurate reporting and information as received from the various committees and independent sources as retained by PACE for the purposes of the various transactions.

No Liability of D&Os regarding PSC

90. The D&Os deny all allegations in paragraphs 154-171 of the Claim. Specifically, the D&Os plead that the allegations in the Claim involving PSC are incorrect both in fact and law.

91. PACE, and its D&Os, do not owe any duty of care in law to the purchasers of the Preferred Shares. The D&Os had no duty to ensure that the Preferred Shares issued by PACE Financial ("**PFL**") and First Hamilton Holdings Inc. were distributed in a regulatory compliant manner.

92. FSRA, on behalf of PACE, has no right in law to commence a claim and seek to recover alleged damages on behalf of the Investor Claimants (as defined in the Claim) from the D&Os. D&Os are not liable to PACE or FSRA for contribution and indemnity relating to losses claimed

by Investor Claimants in connection with their investments in Preferred Shared issued by PFL. These allegations and claim for contribution and indemnity has no basis in law.

93. PSC provided brokerage, investment and business management services to PFL in respect of the Preferred Shares. Such liability for any damages to purchasers of Preferred Shares lies with PSC, which had its own directors and officers, compliance structure and was subject to the supervision of its regulator, the Investment Industry Regulatory Organization of Canada.

94. The D&Os deny that PSC required approvals by PACE for its issuance of the Preferred Shares. PSC had the expertise and responsibility for its own dealings.

95. Further, at the time the losses were allegedly suffered by the Investor Claimants, which are denied, PACE was controlled by FSRA and subject to the Administrative Order. To the extent the Investor Claimants suffered any losses, which is denied, FSRA/PACE bear responsibility.

96. The D&Os deny that they owed a duty of care and fiduciary duties to PACE and in respect to its relationship with PSC and its subsidiaries and in respect of the distribution of Preferred Shares.

97. Further, the D&Os deny that PACE sustained damages of $25,000,000.00 paid to resolve the claims of the Investor Claimants. FSRA chose to settle with the Investor Claimants without informing the D&Os and chose to keep the D&Os in the dark in regard to this alleged settlement, the details of which have not been disclosed even today. FSRA cannot in good faith seek to recover these alleged settlement monies from the D&Os. FSRA by choosing to not involve the D&Os in the settlement has caused irreparable prejudice to their ability to assess the merits of the claims, if any, by the Investor Claimants.

98. D&Os plead that FSRA is barred in equity and law from seeking any recoveries from the D&Os.

The D&Os met the standard of care

99. The D&Os exercised the care, diligence and skill that a reasonable person acting as a director and officer of a credit union would exercise in comparable circumstances. The D&Os attended monthly meetings of the Board of Directors; asked questions of the Management including Larry and Phil; undertook efforts to ensure that PACE was in compliance with its regulatory requirements; sought explanations from the Management including Larry and Phil during the meetings regarding the various opportunities advanced by the Management; and provided information and reporting to the regulator when it requested same.

100. The D&Os acted reasonably and fairly in the administration of their duties to PACE and in their exercise of business judgment. It was not reasonably foreseeable to the D&Os that the Other Defendants would engage in the improprieties, as alleged, which are outside the knowledge of the D&Os and which caused the alleged damages, if any, suffered by PACE.

101. In all of the above-cited transactions and activities of the Other Defendants, the D&Os acted reasonably and fairly in administrating their duties to PACE, including exercising their business judgment to reasonably rely on:

(a) Information provided by the Management, all of whom held a fiduciary duty to PACE;

(b) Reports provided by various sub committees including the Credit Committee and Audit committees at PACE;

(c) Reports and information provided by PACE's internal auditor and its independent external auditors, Deloitte LLP. Nothing in the reports of PACE's internal and external auditor gave the D&Os any reason to mistrust the assurances given to them by management or raise any red flags in regards to any agreements or transactions referenced in the Claim;

(d) Independent sources such as lawyers, the CEO of CCE and other parties who were involved in the various transaction, none of whom raised any concerns with the D&Os; and

(e) The oversight control processes established by FSRA, including its regular onsite verifications.

102. The D&Os exercised proper diligence, skill, care and control in the circumstances, and obtained reasonable assurances from all sources, and met the standard of care applicable to them in accordance with the *Act.*

103. The D&Os plead and rely upon, *inter alia*, sections 97-101, 105,109, 121 and 137 of the *Act.*

No recoverable damages

104. The D&Os deny that they are liable for any damages as alleged by the Plaintiff and puts FSRA/PACE to the strictest proof thereof. The D&Os further state that any alleged damages, as claimed, are exaggerated, excessive, remote and unrecoverable in law.

105. Any damages suffered by PACE which are not admitted but specifically denied, were caused or contributed to by the negligence of FSRA and/or the conduct of the Other Defendants, all of whom were directly in involved in the transactions referenced in the within Claim.

106. In particular, FSRA has taken steps to call loans that have been otherwise performing according to their terms, and which were not in default; caused loans to go into default that were otherwise performing; and has either sold or is in the process of selling PACE's interest in profitable investments, thereby harming PACE's long-term financial position. FSRA has not failed to mitigate the damages that were being suffered by PACE, which are not admitted but denied, and has in fact increased PACE's losses by mismanaging the assets of PACE in its role as the Administrator.

107. In particular, while under administration, PACE's operating income 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. FSRA and PACE 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*".

108. The D&Os plead and rely on the *Negligence Act*, R.S.O. 1990, c.N-1, as amended.

Action is Statute Barred

109. The D&Os plead that the Plaintiff discovered material facts relevant to its claim, or ought to have discovered the material facts relevant to its claim through the exercise of reasonable diligence, more than two years before the action was commenced and rely upon the provisions of the *Limitations Act, 2002, S.O.* 2002, c.24, s.B.

110. The D&Os plead that this action be dismissed as against them with on a substantial indemnity basis.

COUNTERCLAIM

111. The Plaintiffs by Counterclaim, 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"),** claim the following against PACE, by its administrator, FSRA:

(a) an order pursuant to PACE's By-Law No. 1 and, *inter alia*, section 123 of the Act directing PACE to indemnify the D&Os for all damages, costs, charges and expenses, including any amounts paid to settle any action or satisfy any judgment against them; and

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

112. The D&Os are entitled to complete indemnification for negligence claims under PACE's By-Laws. PACE will be liable for any award it can achieve in negligence against them, and therefore no damages will be at stake, rendering the within Claim moot and/or academic.

113. Pursuant to the By-Law, PACE is obligated to indemnify the D&Os for the within action. 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 of 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 judgment, reasonably incurred by him or her in respect of any civil, criminal or administrative action or proceeding 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 a body corporate, if:
>
> (a) he or she acted in good faith with a view to the best interest 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 being that his or her conduct was lawful.

The Credit Union shall also indemnify such person in such other circumstances as the Act permits of requires.

114. Further, and in the alternative, Section 123 of the Act states that:

Indemnification

(2) A credit union may indemnify an eligible person in respect of any proceeding to which the person is made a party by reason of serving or having served in a qualifying capacity.

Exception

(3) Despite subsection (2), the credit union may not indemnify the person in respect of a proceeding by or on behalf of the credit union to procure a judgment in its favour.

Advance to pay for costs, etc.

(4) 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.

Same, derivative action

(5) 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.

[…]

Restriction

(7) The credit union may indemnify an eligible person under this section only if,

(a) the person acted honestly and in good faith with a view to the best interests of the credit union; and

(b) in the case of a proceeding enforced by a monetary penalty, the person had reasonable grounds for believing that the impugned conduct was lawful.

Right to indemnity

(8) An eligible person is entitled to indemnity from the credit union in connection with the defence of a proceeding to which the person is made a party by reason of serving or having served in a qualifying capacity if the eligible person,

(a) was substantially successful on the merits in the defence of the proceeding; an

(b) fulfils the conditions set out in clauses (5) (a) and (b).

115. The D&Os are "eligible persons" under subsection 123(1) of the Act. At all material times, the D&Os acted honestly and in good faith with a view to the best interests of PACE. There are no allegations of bad faith made against the D&Os nor is there any basis in fact or law to make such allegations. Therefore, the D&Os, are entitled to complete indemnification from the within Claim.

116. The D&Os submit that this Counterclaim should be tried together with, or immediately following, the trial of the main action.

CROSSCLAIM

117. The D&Os claim against the Other Defendants in this action, 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 Joanna Whitfield, for the following:

(a) contribution and indemnity under sections 2 and 3 of the *Negligence Act*, R.S.O. 1990, c. N.1, as amended, for any amounts which the D&Os may be found to be responsible to the Plaintiff;

(b) contribution and indemnity under the common law and equity for any amounts which the D&Os may be found to be responsible to the Plaintiff;

(c) the costs of the main action and Crossclaim plus all applicable taxes;

(d) Pre-judgment and post-judgement interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

(e) such further and other Relief as to this Honourable Court may seem just.

118. The D&Os repeat and rely upon the allegations contained in the Statement of Defence in support of the Crossclaim.

119. For the purposes of this Crossclaim only, the D&Os incorporate by reference herein, the allegations contained in the Claim by the Plaintiff as against the Other Defendants.

120. The D&Os plead and rely on the *Negligence Act*, R.S.O. 1990, c.N-1, as amended.

121. The D&Os submit that this Crossclaim should be tried together with, or immediately following, the trial of the main action and the within Counterclaim.

Date: June 10, 2022

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

PACE SAVINGS & CREDIT UNION LIMITED, BY ITS ADMINISTRATOR, FINANCIAL SERVICES REGULATORY AUTHORITY
Plaintiff

- and -

LARRY SMITH et al.
Defendants

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST
PROCEEDING COMMENCED AT TORONTO

STATEMENT OF DEFENCE, COUNTERCLAIM AND CROSSCLAIM

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TAB H

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., 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 PHOLE, PETER REBELLATI, JIM TINDALL, PAULINE WAINWRIGHT, NEIL WILLIAMSON, KIM COLACICCO, and JANE LOWRIE

Defendants

STATEMENT OF DEFENCE AND COUNTERCLAIM OF THE DEFENDANT BRIAN HOGAN

1. The defendant, Brian Hogan (**"Brian"**), denies all allegations made in the Amended Fresh as Amended Statement of Claim (the "**Claim**").

BACKGROUND

2. The Financial Services Regulatory Authority of Ontario (the "**FSRA**"), has made a series of meritless allegations against the defendant, Brian, in this action as well as by leaking confidential information and meritless insinuations and allegations about him, and his

member ship of Pace Savings and Credit Union Limited ("**PACE**") to the public press and especially reporters of The Globe and Mail (the "**Globe**").

3. It appears that FSRA's allegations against Brian allege breach of employment, fiduciary duty and trust, knowing assistance, conversion and conspiracy and unjust enrichment related to the participation in an involvement in identified transactions in the Claim. These and all other allegations in the Claim are illegitimate and without foundation and are denied.
4. Prior to Brian's employment with PACE he was gainfully employed with banks and other financial institutions since 1974.
5. During 2003 Brian was recruited by PACE and commenced full-time employment with PACE on January 4th, 2004, as a Senior Manager, Commercial Lending.
6. Brian's duties at PACE included sourcing and reviewing lending opportunities and preparing potential loans with a "term sheet" for approval by the Credit Committee. At no time did Brian have any individual loan approval or lending authority.
7. A "term sheet" is a conditional offer letter to the borrower that outlines the proposed terms of the loan approval subject to stated conditions, and PACE's approval and governance processes with legal documents to follow.
8. All term sheets and loan applications required approval of the Credit Committee in accordance with PACE's approval and governance processes. Without failure, all loans were later reviewed by the Board. Brian was a member of the Credit Committee from 2015-2018 (his retirement date) but not part of the Executive Committee or the Board of Directors. He never formally attended any Board meetings.
9. In addition to the Credit Committee approval and Board approval, the loans were subject to review by the audit committee, internal audit, external audit (being Deloitte) and DICO (now

FSRA). Only in 2015 did Brian become one of a number of members of the Credit Committee.

10. Brian did not at any time divide loans so as to enable or by-pass qualification limits.
11. At no time did Brian report to Larry Smith (President) or Phillip Smith (CEO). He reported to Rene Laffree until his retirement and then to Mary Benincasa. The Plaintiffs allegations that Brian was Larry's "right hand man" are unfounded and defamatory given they attempt to tie Brian to the misfeasance alleged against Larry.
12. While Brian's title at the time of his retirement as VP Commercial Credit may suggest some executive or loan authority he was never a member of the Executive Committee that managed PACE. Brian was much lower on the "totem pole". Risk assessment, loan policy, and legal compliance were at levels above him, including the Board.
13. Brian was never asked for input, comments, or participation in the preparation of financial statements.
14. The governance structure of PACE obligated matters of Risk Assessment, Loan Policy, and overall compliance with the Act under the watch of the Executive committee which the Board validated by internal and external auditors including FSRA (formerly Deposit Insurance Corporation of Ontario).
15. Brian retired effective February 28, 2018 at age 62 and ceased doing any work for PACE. Consistent with his employment contract that had been approved by the Board, Brian was entitled to a retirement allowance. Rather than a lump sum he accepted PACE's offer for a staged payout which ended May 31, 2019. Other senior personnel were extended similar terms.

16. Brian acted in the best interest of PACE throughout his 14 years of employment. He is not responsible if there were failures or breaches of governance or misconduct at levels above him. Again, Brian recites that he had no individual authority to approve loans.

17. Brian denies any improper conduct, fraud, conspiracy, and all allegations against him and in respect of the following transactions listed in the Claim

THE CCE TRANSACTION

18. Brian formatted the commercial loan credit application for 2340938 ONTARIO LTD. for credit committee approval based on information, background contact and financial information provided by PACE executives Larry Smith, Phillip Smith, and Sandra Delabio (CFO). Brian was not responsible to vet same and had no involvement in PACE's investment. In the event there were breaches of compliance they ought to have been intercepted by the Compliance Officer, or the Executive, or the Board, or all of them.

THE GERANIUM JOINT VENTURES

19. Brian had no responsibility nor involvement in these alleged joint ventures or any "secret" commissions in the matter nor any other alleged violations.

SUS GLOBAL ENERGY CORP.

20. Brian was not the account manager on this file, Usual process would have been required that the loan was duly approved by the Credit Committee as it was required to approve all term sheets and commercial applications. Therefore it ought to have been reviewed at the Board level. Brian was not aware of any fees, commissions paid or shares issued nor any of the alleged improprieties.

INVERRARY GLEN

21. Brian had no involvement with these loans or appraisals which to the best of his knowledge preceded his employment with PACE.

LORA BAY

22. To Brian's knowledge the Lora Bay loans were adequately secured by real estate security and other general security. Brian was unaware of any alleged fees paid to Malek Smith or anyone else or 1916 which FSRA alleges was a "secret" commission. Any compliance issues as alleged would be captured by the PACE approval process and at levels above Brian's position.

NOBLE HOUSE CORPORATION

23. Brian was not the account manager on the Noble House file. To the best of his limited knowledge, in the ordinary course, the usual loan process would be expected to follow that account manager's formatting of the loan documents for approval of the Credit Committee and as well as the Board with the involvement of outside counsel. The allegations in paragraph 79 and 80 or elsewhere in the Claim that Larry *and Brian* caused the loan to be advanced are unfounded and denied as to Brian's conduct.

1934811 ONTARIO LIMITED ("193")

24. This loan involves a prime residential subdivision and development lands in Barrie, Ontario which 193 was purchasing. From the get go, in addition to proper valuations and favourable due diligence as to feasibility and development of the lands, 193 had already secured an agreement for the pre-sale of a significant phase of lots. Upon city approval, these lot sales to a well-recognized third party developer of substance would, upon closing, liquidate the entire PACE debt and leave the balance of the lands free and clear for further development

and profit. In addition to the mortgage land security, PACE included personal guarantees of 193's owner, and his haulage company who were credit worthy and a known PACE member. This was a well secured loan and performed well and to the best of Brian's knowledge was paid in full without any loss attributable to Brian or at all.

25. To Brian's knowledge the inflammatory allegations in the Claim as to the involvement by Bill Player were not part of the 193 loan.

26. The allegations as to a fee in the nature of a "secret commission" are denied by Brian. The written term sheet signed by the borrower and the guarantor clearly disclosed a commitment fee to PACE in the amount of $150,000.00 and a fee to R. Williamson Consultants Limited of $600,000. There was no "secret fee" or "secret commission" as the term sheet stating same was approved by the Credit Committee and was and signed by 193 and the guarantors. The commissions or fees for a loan referral to Williamson and PACE's commitment fee were not out of the ordinary for a mortgage loan in excess of ten million dollars. Upon the advance to 193 the full $600,000.00 fee was couriered to Williamson at his Florida address as he had requested.

27. The ultimate payout of the stated fees or the manner thereof as deducted from the loan advance are the administrative duties of others and not part of Brian's responsibility. Once fully approved, other PACE staff prepare instructions to the solicitor to document and secure the registered and other legal documents. Administration deducts the fees, advances the loan and then pays out the fees as agreed in the term sheet.

28. Brian denies any deceit or the involvement in these alleged secret commissions herein and elsewhere as alleged. The fees payable by 193 were fully disclosed, approved in accordance

with PACE's underwriting and approval policies, and the consent of the borrower and guarantors.

29. These commissions were not paid by PACE but the borrower in any event so PACE has no loss in that respect.

LAGASCO TRANSACTION

30. To Brian's knowledge only minimal Lagasco discussions had taken place by the time of his retirement. Any loan approvals or advances that took place would have post-dated his retirement from PACE in February 2018. Brian neither participated in, nor is aware of any violation of section 191 of the Act.

CONCEALMENT AND CONSPIRACY ALLEGATIONS

31. The allegations of Brian's involvement in a collective agreement and conspiracy among Larry, Phillip, Klees and his company, and the Williamson defendants, or any Defendant, are unfounded, defamatory and denied, and are designed to intimidate Brian

32. Brian was not involved in any meetings, agreements or conspiracy with said parties, or anyone, nor any fake invoices, "secret commissions" or other nefarious conduct as alleged.

33. Brian received regular salary payments and occasional bonus payments in the ordinary course as approved by management. Declared bonus payments were not uncommon at PACE or in the banking industry.

34. Brian's updated employment contract dated December 15, 2015 states that he "will participate in any annual bonus".

35. At all times Brian carried out his job as a dutiful and loyal servant of PACE. If there was such a conspiracy as alleged to harm PACE, which is not admitted, Brian was not a part of it nor did he benefit by it.

36. Any allegations of Brian's participation in any concealment from Credit Committee or the Board are denied; Brian was never a member of the Board, and took no part in preparation of the Board packages nor did he receive them.

37. Brian did not attend Board meetings except a Christmas dinner invite wherein Brian and other senior staff were invited to attend a social portion of the Christmas Board meetings. In 2015, 2016, and 2017 he attended the festive dinner portion. He had no involvement or input into the formal business part of said Board meetings.

RETIREMENT COMPENSATION AGREEMENTS

38. As earlier stated, the terms of the retirement allowance were part of his recruitment to work for PACE after an already decades long career with other banks and financial institutions. Beyond that, he had no reason, then or now, to believe the terms of his retirement allowance were unlawful and he does not believe it so. Brian believes his employment terms and payments were approved by Senior Management and the Board. Brian has no recollection of any formal performance reviews during his employment at Pace.

NO FRAUD, DECEIT OR CONVERSION

39. Brian again states he had no individual loan approval authority which to his knowledge without fail occurred at a formal and structured process when he was at PACE. There are no specific allegations pled in the Claim to support these allegations. They are unfounded and defamatory.

NO CONSPIRACY

40. Brian did his job as a dutiful employee. At no time did he conspire with anyone to engage in any conduct that was unlawful. He did not engage in any conduct designed to injure PACE or cause it damage. Such damages are denied.

NO BREACH OF CONTRACT OR FIDUCIARY OR OTHER DUTY

41. Brian conducted himself in a reasonable and dutiful manner and attempted to act in the best interest of his employer. There was no breach of fiduciary duty, duty of care, or breach of trust by him. He was not negligent in the performance of his employment.

ALLEGED ASSISTANCE IN BREACHES OR UNLAWFUL FUNDS

42. At no time, did Brian assist others in any breach of duty, receipt of illicit funds or breach of the law. In the event such matters occurred among the other defendants Brian is not responsible or liable for such conduct

UNJUST ENRICHMENT OR CONSTUCTIVE TRUST

43. Beyond his earned employment remuneration during his employment and then in his approved retirement package Brian did not receive any funds that would be the foundation upon which could be based a claim of unjust enrichment or constructive trust. There is no juristic reason for Brian to be liable to repay any monies he received for compensation as employee or in his retirement package.

JOINT AND SEVERAL LIABILITY

44. Brian denies any joint and several liability with the co-Defendants as alleged in the Claim.

DAMAGES

45. Brian denies that PACE suffered any damages attributable to his actions or conduct and puts the Plaintiff to the strict proof thereof. If PACE did sustain damages, which are not admitted, they were not attributable to Brian's breach of his employment contract. Losses do occur in the ordinary course of the lending business which is not a perfect science. Brian relied upon established governance processes during his employment and if there was any failure or illegality he is not responsible. The actions of DICO/FSRA as administrator of

PACE may well be responsible for alleged losses. In the event any damages are proved and attributable to Brian, the Plaintiff has failed to mitigate such losses.

THE CLAIM IS STATUTE BARRED

46. While Brian denies the allegations against him, he pleads that the facts upon which the statement claims against him were discoverable with the exercise of reasonable diligence more than two years before this Claim was issued to commence this action. Internal audits, external audits and investigations by PACE and the Plaintiff provided full access to facts well prior to commencement of this claim. Brian pleads and relies upon the *Limitations Act*, 2002, SO 2002, c.24.

47. The defendant, Brian Hogan, asks the claim be dismissed as against him with costs:

    a. on a solicitor and own client and full indemnity basis given the inaccurate allegations of fraud against him
    b. alternatively on a substantial indemnity basis
    c. if neither, on a party and party basis
    d. plus all applicable taxes in addition.

COUNTERCLAIM

48. Brian (as Plaintiff by counterclaim) claims:

    a. damages for defamation in the amount of $1,000,000;
    b. general damages for mental and physical distress, pain and suffering, and loss of enjoyment of life in the amount of $1,000,000.00;
    c. special damages in the amount of $1,000,000.00 for defamation, loss of income and related health issues and expenses;

d. punitive damages and exemplary damages, in the amount of $1,000,000, for the conduct described above and below;

e. An interim order pursuant to PACE's By-law No. 1 and section 157 of the *Credit Union's and Caisse Populaires Act*, 1994, S.O. 1994 Charter 11 (the Act) directing PACE to make advances for the legal expenses incurred by Brian 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 Brian for his legal expenses incurred in defending the claim;

g. Pre-judgement interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c C-43, as amended;

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

i. the costs of this proceeding, plus all applicable taxes on a substantial indemnity basis;

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

49. Brian repeats the facts pled in his Statement of Defence. Brian states that FSRA (formerly DICO), its officers, employees or agents became the administrator of PACE in September 2018. Prior to that, DICO had access to examinations of the PACE operations. Such access was privileged information and as it concerns Brian Hogan became the subject of unfounded allegations against him made by DICO/FSRA both prior to and after the administration order.

50. Notwithstanding the Statement of Claim was issued and placed under seal, the Plaintiff before, then and after maliciously released this information to members of Pace and the public press including the Globe. Such leaks to PACE members and to the press, and in particular the Globe, has caused unfounded allegations of fraudulent conduct by Larry Smith

and others tying in Brian Hogan without evidence. Said releases of information as to unlawful monies, a yacht, cottage and other valuable assets linked to Larry Smith alleged and implied that Brian was a co-conspirator in the alleged fraudulent transactions and malfeasances of other Defendants.

51. The often full pages of the Globe articles came to link Brian as "Larry's side-kick" in purported conduct leading to these alleged frauds, illicit gains and the scandal at PACE. In the result without any evidentiary foundation, Brian's 43 plus years of exemplary reputation as a career banker was destroyed. His personal, family, client, and business relationships became the subject of unfounded common gossip.

52. Despite such stressors and defamation, Brian attempted employment with another financial institution. He soon found his reputation so tarnished he could not present himself nor be received by clients as the reputable banker he had always been. He was unable to succeed in garnering trust and business for his new employer. Brian left this position after only six months. He has not felt able to return to his banking career in the face of such defamation. The open wound that he was *"Larry's right-hand man"* to a scheme and to fraudulently strip monies from PACE remains.

53. Brian has sustained ongoing stress, loss of sleep, and loss of credibility and reputation since these scandalous allegations were made. He has a loss of good health and social and employment activities that he enjoyed prior to these events.

54. Brian has been under his doctor's care for anxiety and depression related to these unfounded allegations. Brian has been prescribed anti-depression and panic disorder medication (Teva-Setraline). These health concerns cause a loss of enjoyment of life. The most recent stab was PACE's direction that Brian should take his PACE mortgage and accounts elsewhere

despite a perfect payment record. Brian's forty-three year career as a trusted banker, friend, and family member has been destroyed by the Plaintiff without cause. Brian claims general damages for his mental and physical distress, loss of enjoyment of life, and the consequences of PACE's damage to his reputation. He has lost income being unable to present himself as an experienced banker having been stripped of his credibility by the conduct of PACE and the Plaintiff.

55. The DICO/FSRA allegations of fraud by senior executives of PACE were broad enough to implicate Brian and its release of his private information to the press was malicious and with callous disregard for Brian such that it caused the Globe articles to implicate Brian as a co-conspirator and fraudster because PACE and the Plaintiff linked Brian to these fraudulent activities of others.

56. Certain derogatory reports by DICO/FSRA surmising the fraudulent or illegality might have been committed were carelessly publicized and calculated to intimidate the defendants including Brian and has defamed him. Brian adopts the pleadings of Phillip in his paragraph #150 that various oral and other statements were made to PACE members including at the PACE "Town Hall" of December 2019 that fraud had been committed. PACE members, many of which were his business contacts, his friends and family, were caused to believe he was a fraudster because PACE and the Plaintiff linked Brian to these fraudulent activities of others.

57. The conduct of the Plaintiff and its releases of confidential and private material have caused Brian to be defamed and suffer physical, emotional and other damages, embarrassment and humiliation that is ongoing.

PUNITIVE DAMAGES

58. The Plaintiff has engaged in an independent and actionable cause of conduct for which it is liable for punitive and exemplary damages.

59. The Plaintiff's conduct meets the test of harsh, vindictive, reprehensible and malicious conduct as it concerns Brian. Efforts to tie Brian's conduct to the allegations against other defendants are without foundation and without even asking Brian for information. The Plaintiff's conduct is deserving of an award of punitive and exemplary damages in favour of Brian. The Plaintiff was careless and in disregard of Brian's entitlement to a fair investigation as to the truth as a loyal employee. The defamatory words and evidence revealed to the Globe and published by their natural meaning claim that the plaintiff has proved fraud and that Brian was a participant and an enabler of such fraud and in breach of his employment duties.

BRIAN IS ENTITLED TO BE INDEMNIFIED

60. Brian is entitled to indemnification and an advance to his legal and other costs.

61. Pursuant to the bylaw and structure of PACE, Brian's title of VP Commercial Credit casts him as an officer of PACE.

62. Brian adopts paragraph 158 of Phil's Counterclaim as adapted that pursuant to Article 8.02 of PACE bylaw No. 1 (the By-law), PACE is obligated to indemnify Brian, as a former officer of PACE, and to advance his legal expenses to defend the Claim and 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, or a former director, or officer, or committee*

member, or a person who acts or acted at the Credit Unions 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.

63. The Credit Union shall also indemnify such person in such other circumstances as the Act permits or requires. 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 re-pay the money if either of the conditions described in sub-section (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

judgement in its favour to which the person is made a party by reason of serving or having served in a qualifying capacity.

64. Brian was an officer of the Credit Union identified under its By-Laws and policies at all relevant times and is an "eligible person" under section 157 (1) (b) of the Act. At all times, Brian acted in good faith, and in the best interest in PACE. He had reasonable grounds for believing his conduct was lawful at all times. He fulfills the requirements under the By-Law and under section 157 of the Act.

65. Brian also pleads and relies upon the terms of his employment contract dated December 15, 2015 when he became Vice-President, Commercial Lending. Said contract, drawn by PACE, states at paragraphs 10 and 11:

> 10. *The Credit Union acknowledges and agrees that the Employee is an "eligible person" as defined in subsection 157 (1) of the Act.*
> 11. *The Credit Union agrees to maintain officers and directors liability insurance as permitted by section 158 of the Act, for the benefit of the Employee, in an amount of not less than $2,000,000.00.*

66. Brian states that there were no exclusions of liability in the PACE agreement to provide liability insurance. In the event the policy PACE relies upon was that of CUMIS General Insurance Company who purports to exclude coverage based upon policy exclusions Brian states no such exclusions were stated in his employment contract drawn by PACE. Brian pleads and relies upon the doctrine of *contra proferentem.*

67. Brian states that as an officer of PACE and as provided in his employment contract that at Title H, paragraph 11, he is entitled to be indemnified for the claims alleged and to his complete defence costs.

68. Brian is entitled to indemnification of 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 Brian is entitled to indemnification for his fees pursuant to section 157 (4) of the Act and for the continuing advancement of legal fees pending disposition of the claim.

COSTS

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

70. The Plaintiff by Counterclaim requests that the trial of this action be heard with the main action or immediately following the main action.

DATE: March 25, 2021

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PACE SAVINGS & CREDIT UNION LTD. by its administrator FINANCIAL SERVICES REGULATORY AUTHORITY
Plaintiff

LARRY SMITH et al

Defendants

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding Commenced at
Toronto, Ontario

STATEMENT OF DEFENCE AND COUNTERCLAIM OF THE DEFENDANT, BRIAN HOGAN

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TAB I

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 JOANNA WHITFIELD

Defendants

AMENDED STATEMENT OF DEFENCE, ~~AND~~ COUNTERCLAIM AND CROSSCLAIM
OF THE DEFENDANTS, FRANK KLEES and KLEES & ASSOCIATES LTD.

1. The Defendants deny paragraphs 4, ~~20~~, 22, ~~24~~, 27 ~~and 26~~, 59, 63, 64, 65(b), 125, 156, 157, in particular and thereafter, the balance of the Fresh as Amended Statement of Claim.

2. These Defendants state that at no time was Frank Klees an officer of Pace Savings & Credit Union Limited (hereinafter referred to as “Pace”).

3. These Defendants state that Klees & Associates Ltd. was a party to valid

enforceable agreements with Pace relative to Geranium Corp. Developments ("Geranium") that entitled Klees & Associates Ltd. to receive certain payments from those developments whereupon they achieved certain designated milestones.

4. These Defendants state that Klees & Associates only received payments upon those conditions being met and were thereby earned and due.

5. These Defendants state that the invoicing of fees related to any and all payments related to the agreements with Pace relative to Geranium were issued in accordance with direction given to the Defendants by the President of Pace, Larry Smith.

6. These Defendants state that all of the terms, conditions and payments contained in the aforesaid agreements were fully disclosed, valid, enforceable and lawful.

7. These Defendants state that Klees & Associates was not only entitled to funds so paid and earned, but further state and plead that those agreements have been breached by the Plaintiff and that Klees & Associates continues to be entitled to receive further ongoing amounts, fees and entitlements as they become further due.

8. These Defendants state that at no time was Frank Klees an officer of Pace, but that he acted solely as an employee of a consultant with a limited role and mandate restricted to development issues. Neither of these Defendants had any obligation or duty to cause Pace to obtain any assistance or advice, or take any steps regarding the Geranium deals.

9. These Defendants further state that all Geranium deals substantially, adequately and validly benefitted Pace.

10. These Defendants deny that Frank Klees misrepresented or concealed any material fact from the Plaintiff or any relevant parties and, at all times, state that full and complete disclosure, if required, was made.

11. These Defendants repeat that at no time was Frank Klees a Vice President of Pace.

12. These Defendants deny any liability to the Plaintiff on any juridical ground, and in fact state that substantial funds are due Klees & Associates pursuant to the terms and conditions contained in the Development Agreements.

13. These Defendants therefore submit that the Plaintiff's claim be dismissed with full indemnity costs against them.

COUNTERCLAIM

14. By way of Counterclaim, the Defendant Klees & Associates Ltd, Plaintiff by Counterclaim, claims:

(a) damages in the amount of $5,000,000.00;

(b) pre-judgment interest pursuant to the Courts of Justice Act;

(c) post-judgment interest pursuant to the Courts of Justice Act;

(d) their costs of this action on a substantial indemnity basis; and

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

15. The Defendant, Plaintiff by Counterclaim, repeats and relies on the allegations contained in the Statement of Defence herein.

16. The Plaintiff by Counterclaim states that a number of Development Agreements remain lawfully in place, which by their terms and conditions entitle the Plaintiff by

Counterclaim to ongoing fees.

17. The Plaintiff by Counterclaim states that due to the breach of contract of each and every one of those Agreements by the Defendant by Counterclaim, that they have been excluded from progress information dissemination. As such, the Plaintiff by Counterclaim cannot at this time calculate the details and full amount that would be due under those Agreements.

18. The Plaintiff by Counterclaim undertakes to file a Bill of Particulars setting out the amounts and consequences of the damages suffered by the unlawful acts of the Defendant by Counterclaim prior to trial.

19. The Plaintiff by Counterclaim requests that the trial of this action be heard with the main action or immediately following the main action.

CROSSCLAIM

20. The Defendants/Plaintiff by Counterclaim (hereinafter referred to as the Defendants) claim as against the co-Defendant Larry Smith:

(a) Contribution and indemnity for any amounts for which they may be found liable;
(b) Pre-judgment and post-judgment interest in accordance with the Courts of Justice Act;
(c) Costs on a full indemnity basis together with applicable HST and;
(d) Such further and other Relief as this Honourable Court may deem just

21. The Defendants/Plaintiff by counterclaim repeat the allegations contained in their Defence and Counterclaim.

22. The Defendants state that any and all services provided to the Plaintiff were rendered in accordance with the Defendant's consulting agreement and as such any

damages suffered by the Plaintiff, which are not admitted but expressly denied, were as a result of the conduct of Larry Smith.

23. The Defendants state that at all material times Larry Smith represented to the Defendants that the consulting agreement was lawful and appropriate.

24. The Defendants state that they have no knowledge of any misrepresentations made by Smith to the board regarding the amounts collected by the Defendants and deny any liability for same.

25. The Defendants repeat that they only received payments upon certain conditions being met and were thereby earned and due and these Defendants further state that the invoicing of fees related to any and all payments related to the agreements with Pace were issued in accordance with direction given to the Defendants by the President of Pace, Larry Smith.

26. The Defendants state that such direction renders the co-defendant Smith primarily liable and responsible in the course of their relationships.

27. The Defendants seek full indemnity costs.

DATED: ~~November 19, 2019~~ June 8th, 2022

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

Plaintiff

-and-

LARRY SMITH et al

Defendants

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

ONTARIO
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TAB J

AMENDED THIS AUG 0 5 2022
MODIFIÉ CE PURSUANT TO CONFORMÉMENT
☑ RULE/LA RÈGLE 26.02 (A)
☐ THE ORDER OF
L'ORDONNANCE DU
DATED / FAIT LE
REGISTRAR GREFFIER
SUPERIOR COURT OF JUSTICE COUR SUPÉRIEURE DE JUSTICE

Court File No. CV-22-00677550-0000

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

(Court Seal)

PACE SAVINGS & CREDIT UNION LIMITED, by its Administrator,
FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO

Plaintiff

- and -

CUMIS GENERAL INSURANCE COMPANY

Defendant

AMENDED STATEMENT OF CLAIM

TO THE DEFENDANT

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiff. 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 plaintiff's lawyer or, where the plaintiff does not have a lawyer, serve it on the plaintiff, 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 PLAINTIFF'S CLAIM, and $2,500 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 plaintiff's claim and $400 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 28 Feb 2022

Issued by "Electronically Issued"
Local registrar

Superior Court of Justice
330 University Avenue
Toronto, ON
M5G 1R7

TO: CUMIS GENERAL INSURANCE COMPANY
P.O. Box 5065
151 North Service Road
Burlington, ON
L7R 4C2

CONTENTS

CLAIM

1. The Plaintiff, PACE Savings & Credit Union Limited ("**PACE**" or the "**Credit Union**"), by its administrator, Financial Services Regulatory Authority of Ontario ("**FSRA**", or the "**Administrator**"), claims against the Defendant, CUMIS General Insurance Company ("**CUMIS**"):

(a) $10,~~000~~025,000.00 in indemnity, payable to the Plaintiff under the fidelity insurance coverage bearing Policy Number 01501254 and with an Effective Date of January 1, 2018, and an Expiry Date of January 1, 2019, including any relevant successor bond (the "**Bond**"), contained in the ~~contract~~contracts of insurance issued by CUMIS (the "**Policy**"), in respect of losses incurred by PACE in connection with the various dishonest acts detailed in a Proof of Loss sworn October 16, 2019, and submitted to CUMIS on or about October 16, 2019, in accordance with the requirements of the Policy (the "**Claim**") and set out below;

(b) for a declaration that the Claim, in full or any portion thereof, is covered by the Policy and Bond;

(c) damages, in an amount to be quantified before trial, for breach of the Bond, including all costs and expenses associated with the recovery of insurance proceeds under the Policy and steps taken as a consequence of the breach of the Bond;

(d) damages for breach of the duty of good faith in the amount of $10,~~000~~025,000;

(e) punitive damages in an amount of $1,000,000;

(f) ~~pre-judgment~~pre-judgment interest (at a rate equal to PACE's or, alternatively, CUMIS' return on capital) and post-judgment interest on all amounts claimed herein pursuant to the *Courts of Justice Act*, R.S.O. 1990, c. C.42, as amended;

(g) costs of this action on a full indemnity basis; and

(h) such further and other relief as to this Honourable Court may seem just.

I. OVERVIEW

A. The Parties

2. The Credit Union is a credit union incorporated pursuant to the *Credit Union and Caisses Populaires Act, 1994*, S.O. 1994, c. 11 (the "**Act**").

3. The Credit Union's head office is located in Vaughan, Ontario. The Credit Union has multiple branches throughout southwestern Ontario and has over $1 billion in assets under management.

4. FSRA is the regulator of credit unions in Ontario pursuant to the Act. FSRA provides deposit insurance to members of Ontario's credit unions and, where necessary, acts as the supervisor, administrator and liquidator of credit unions (as those terms are defined by the Act). Effective June 8, 2019, FSRA amalgamated with the Deposit Insurance Corporation of Ontario, 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.

5. On September 28, 2018, FSRA issued an administration order placing the Credit Union into administration pursuant to section 240.1(7) of the Act (the "**Administration Order**").

6. CUMIS is an insurance company incorporated under the laws of Canada, with its head office in Burlington, Ontario. CUMIS carries on business as an insurance company specializing in providing insurance to credit unions and their members throughout Canada, which business includes issuing contracts of insurance, such as the Bond, and collecting and receiving premiums for contracts of insurance in Ontario, including those paid under the Bond. CUMIS offered a specific insurance program for credit unions, which it described as the Credit Union Bonding Program (the "**CUB Program**"), and represented itself as a "trusted partner of Canadian credit unions" which allowed credit unions to "experience timely claims processing with broad coverage interpretations" and provided coverage "designed exclusively to meet the needs of credit unions" (the "**Representations**").

B. Insurance – The Bond

7. CUMIS issued the Bond to the Credit Union. Pursuant to the terms of the Bond, CUMIS is liable to indemnify the Credit Union for covered losses to a maximum of $10,~~000~~025,000.00. CUMIS sold the Bond directly to the Credit Union; there was no broker representing the Credit Union when it purchased the Bond from CUMIS and the Credit Union, in determining whether the Bond and the Policy were appropriate for its needs, relied on the Representations made by CUMIS in respect of the CUB Program.

8. The Credit Union remitted premiums pursuant to the Bond in accordance with the Bond's provisions. The Bond was valid and in force at all relevant times.

9. The Bond is a binding and enforceable contract as between CUMIS and the Credit Union and subject to the doctrine of utmost good faith and the Representations made by CUMIS.

10. The Bond provides, *inter alia*, insurance against the risk that those charged with operating the Credit Union will act dishonestly and cause the Credit Union to incur a direct loss of property. In particular, the Bond covers, *inter alia*, losses resulting from the dishonest or fraudulent acts of the Credit Union's directors, employees (including contractors performing employee duties) and committee members.

11. The Bond's dishonesty coverage is set out in two paragraphs. The first paragraph (the "**First Paragraph**") provides coverage for losses caused by dishonest and/or fraudulent acts of any director, employee, contractors performing employee duties or committee members with the active and conscious purpose to cause the Credit Union to sustain a loss. As set out below, PACE satisfies each aspect of this insuring agreement.

12. The second paragraph of the Bond's dishonesty coverage (the "**Second Paragraph**") deals with losses related to extensions of credit. With respect to losses relating to extensions of credit, the Bond covers losses resulting from dishonest or fraudulent acts of any director, employee, contractors performing employee duties, or committee member, with the active and conscious purpose to cause the Credit Union to sustain such loss and there is a financial benefit with a value in excess of $5,000.00 for the employee, director, contractor performing employee duties or committee member, or his or her spouse, parent, child, brother or sister. As set out below, PACE satisfies each aspect of this insuring agreement.

In addition to the foregoing, the Bond insures, *inter alia*, losses that result from the transfer of property where that property was transferred as a result of reliance in good faith on a forged chattel instrument, evidence of debt or guarantee, security or mortgage instrument. Additionally, up to $1,000,000 of the Bond's $10,000,000.00 in coverage is available for losses that result from fraudulent instruction provided by e-mail, facsimile or telephone. As set out below, PACE satisfies each aspect of these insuring agreements.

C. The Participants

~~14.~~13. The Claim relates to the dishonest conduct of the following employees, contractors performing employment duties, and directors (the "**Primary Participants**"):

(a) Larry Smith ("**Larry**") was both the President and CEO of the Credit Union in its various forms for approximately 20 years until 2016, at which point he relinquished the CEO role but continued as President. Larry was placed on administrative leave with pay upon the issuance of the Administration Order and was terminated for cause on December 5, 2018. Larry performed certain of his duties personally and ostensibly through his numbered companies 1428245 Ontario Ltd. ("**142**") and 809755 Ontario Ltd. ("**809**").

(b) Phillip Smith ("**Phil**") served as CFO of the Credit Union until he took over the role of CEO from Larry in 2016. Phil was placed on administrative leave with pay upon the issuance of the Administration Order and was terminated for cause on December 5, 2018.

(c) Frank Klees ("**Klees**") is a long-time friend of Larry. Klees was also a consultant of the Credit Union and acted as a Vice President of the Credit Union through his company, Klees & Associates Ltd. Klees was also purportedly appointed as a director of the Credit Union in or around April 2018 and also had an office at the Credit Union.

~~15.~~14. The following employees, contractors performing employee duties and directors (the "**Secondary Participants**", and together with the Primary Participants, the "**Participants**") ~~knowingly or unknowingly~~ helped the Primary Participants execute the schemes that caused the losses detailed in the Claim:

(a) Alison Golanski ("**Golanski**") is Larry's common law wife and was a consultant of the Credit Union through her numbered company, 1724725 Ontario Ltd. ("**172**").

(b) Brian Hogan ("**Hogan**") is a former Vice President, Commercial of the Credit Union and was Larry's "right-hand man".

~~16.~~15. Each of the Participants are directors, employees (including contractors performing employee duties) and/or committee members within the meaning of the Bond.

D. The Losses

~~17.~~16. The Claim relates to losses sustained by the Credit Union as a result of the Participants unlawfully and without authorization causing the Credit Union to advance funds to or in respect of:

(a) the Credit Union's acquisition of Continental Currency Exchange Canada Ltd. ("**CCE**");

(b) the Credit Union's joint venture projects with Geranium Corporation ("**Geranium**");

(c) the Credit Union's extension of credit to SusGlobal Energy Corp. ("**SusGlobal**");

(d) the Credit Union's extension of credit to Lora Bay Corporation ("**Lora Bay**");

(e) the Credit Union's extension of credit to Noble House Development Corporation ("**Noble House**");

(f) the Credit Union's extension of credit to 1934811 Ontario Ltd. ("**193**");

(g) the Credit Union's loan to Lagasco Inc. ("**Lagasco**");

(h) 172 as commission payments for work neither 172 nor Golanski performed; and

(i) Larry, 142, 172 and/or 809 for false invoices for services that were not rendered.

~~18.~~17. As is set out in greater detail below, the Credit Union suffered a "direct loss of property" within the meaning of the Bond totalling more than $23,500,000 (the "**Losses**") as a result of the events giving rise to these nine (9) schemes, which includes $25,000 in expenses relating to audits, investigations, legal, records reconstruction, and other professional expenses part of its efforts to identify the wrongdoing and correct the records of the Credit Union for each of the nine (9) schemes.

~~19.~~18. In particular, each loss, as set out in the Claim, was:

(a) caused by the dishonest and/or fraudulent actions of one or more of the Participants, acting alone or in collusion with others;

(b) caused by one or more of the Participants acting alone or in collusion with others with the active and conscious purpose to cause the Credit Union to suffer a loss; and

~~(c) caused by one or more of the Participants acting alone or in collusion with others with the active and conscious purpose to confer a benefit on a person or entity; and~~

~~(d)~~(c) in the case of Losses resulting from an extension of credit, one or more of the Participants obtained a financial benefit for themselves (or their spouse, parent, child, brother or sister) with a value of at least $5,000.

~~20.~~19. A "loss" within the meaning of the Bond includes a financial loss incurred by the Credit Union resulting directly from an actual depletion or diminution of assets owned or held by the Credit Union. The Bond expressly contemplates coverage for *indirect* loss: "if some or all of the INURED's loss results directly or indirectly from a LOAN, then that portion of the loss is not covered unless..." All references to the term "direct" in the Bond and herein are to be read accordingly. PACE relies upon the principle of *contra proferentem*. Any ambiguities in the Bond are to be resolved in favour of PACE.

E. The Proof of Loss

~~21.~~20. The Claim (i.e., the Credit Union's Proof of Loss) was filed on October 16, 2019.

~~22.~~21. The Credit Union has worked in good faith to provide CUMIS with an extensive documentary record in support of the Claim, including five substantive affidavits and hundreds of supporting exhibits.

~~23.~~22. The circumstances giving rise to the Claims have also been reported to the police.

F. CUMIS Improperly Delayed Responding to the Claims

~~24.~~23. The Claim relates to losses that are covered under the Bond.

~~25.~~24. CUMIS improperly failed to investigate the Claim in a timely manner or at all. It delayed responding to the Credit Union for nearly two years, failed to provide information which it had obtained through its investigation into the Claim and only confirmed coverage for certain losses in the Claim on October 28, 2021~~ but has failed to make any payment under the Bond to the Credit Union.~~. At the same time, CUMIS advised that it was not satisfied there was coverage for certain other losses. CUMIS has still not responded to confirm its position regarding other losses set out in the Claim.

~~26.~~25. The Bond provides that, upon the payment by CUMIS in respect of losses, CUMIS shall be subrogated to the rights or causes of action of the Credit Union to recover against any person or entity to the extent of such payment (the "**Subrogation Provision**"). The Subrogation Provision provides for CUMIS to make a payment on losses to the Credit Union on an immediate basis, and for CUMIS to be subrogated to the rights or causes of action of the Credit Union rather than requiring the Credit Union to wait to recover losses in actions against the Participants (or other individuals or entities). ~~Nevertheless, CUMIS has still not made any payment to the Credit Union, even for those losses for which it has confirmed coverage.~~

~~27.~~26. As described below, the Losses are covered by the First Paragraph and, in the alternative, the Second Paragraph of the Bond's dishonesty coverage, and in the further alternative, the Bond's Forgery and Extended Forgery coverage. As a result, CUMIS is liable to the Credit Union in the amount of $10,~~000~~025,000, under the Bond, and in the alternative, for breach of contract.

II. THE CREDIT UNION

A. The Credit Union's Management Prior to the Administration Order

~~28.~~27. Since the year 2000, the Credit Union undertook an initiative to grow through acquiring or merging with other credit unions throughout southwestern Ontario.

~~29.~~28. Throughout much of this period of growth, Larry was both the President and CEO of the Credit Union (in its various forms) for approximately 20 years, years, until the appointment of his son Phil as the CEO in 2016. After Phil was appointed as CEO in 2016, Larry continued to act as President of the Credit Union.

~~30.~~29. After the Administration Order was issued on September 28, 2018, the Administrator immediately placed Larry and Phil on administrative leave, with pay, pending further investigation by the Administrator.

~~31.~~30. The Administrator terminated the employment of Larry and Phil for cause on December 5, 2018.

III. THE TRANSACTIONS UNDERLYING THE CLAIM

A. The CCE Transaction

(i) The Regulatory Context

~~32.~~31. The Act and the Regulations prescribe limits on the extent of any investment that a credit union may make in a company without first receiving FSRA's approval. In particular, (a) section 200 of the Act requires a credit union to obtain FSRA's prior approval before forming a subsidiary; and (b) section 198 of the Act and section 64 of the Regulations provides that a credit union may not directly or indirectly acquire more than a 30% ownership interest in a company or unincorporated entity without first obtaining FSRA's approval.

(ii) The Scheme to Acquire CCE

~~33.~~32. CCE was a foreign exchange company that operated branches in southwestern Ontario to sell foreign currency to travellers. While CCE was developing other products, the vast bulk of its business was selling foreign currency to individual travellers.

~~34.~~33. In 2016, Larry and Phil developed a scheme to evade the statutory and regulatory requirements applicable to the Credit Union's acquisition of CCE. This scheme involved: (i) causing PACE to acquire a 30% interest in CCE for $9.5 million; (ii) causing PACE to lend 2340938 Ontario Ltd. ("**2340**") $15 million to enable 2340 to acquire 45% of CCE; and (iii) agreeing with 2340 and the vendor that, pursuant to a Unanimous Shareholders Agreement, as of March 31, 2019 the vendor could exercise a put option to force PACE to purchase the vendor's remaining 25% interest in CCE.

~~35.~~34. 2340 was a sham entity controlled by Larry and Phil. It was a company that was ostensibly owned by Joanna Whitfield ("**Whitfield**"), who had a personal relationship with Larry, and was a

failed, defunct company that was still indebted to the Credit Union for over $2 million following a previous failed and problematic loan that Larry had caused PACE to provide to it. Whitfield had no involvement in the negotiation of the CCE deal or management or control of 2340. Moreover, 2340 had no employees, and it was principally Larry's personal assistant at the Credit Union who administered the affairs of 2340.

~~36.~~35. Although the board of the Credit Union ostensibly approved the CCE Transaction, there was no actual or informed approval by the board of the transaction that Larry and Phil implemented due to Larry and Phil's misrepresentation of the true nature of the transaction. Larry and Phil did not disclose important and material information that was required to be disclosed to the Credit Union's Board, including 2340's role in the transaction or Larry and Whitfield's personal relationship. Larry's connections to and interest in 2340, and with Whitfield in particular, were also never disclosed to the Credit Union's Board.

~~37.~~36. In connection with the CCE Transaction, Larry and Phil caused certain funds that should have been paid to the Credit Union from 2340 to instead be paid to themselves and others under the false pretence that the funds were being paid by CCE (the operating company) as fees for services provided to CCE when in fact the funds were paid by 2340 from funds that were to be paid to the Credit Union or held in trust for the Credit Union. These payments totalled $174,000.

~~38.~~37. Larry and Phil also directed and/or acquiesced to the improper diversion of $591,000 of funds held by 2340, which were to be paid to or held in trust for the Credit Union, as follows:

(a) 2340 received quarterly dividends from CCE of $450,000 to service interest on the loan payments from PACE. These dividend payments were in excess of the funds

2340 required to pay the interest on its loan from PACE. Whitfield herself received $141,000 in payments from 2340 since January 2017 but did no work for the company; and

(b) after the Administration Order was issued, Larry, Phil or Whitfield misdirected the $450,000 dividend payment from CCE that was payable on November 1, 2018, and caused it to be paid into an account at Royal Bank of Canada in violation of the various contracts with PACE requiring that the dividends be deposited at PACE. These funds were recovered by the receiver put in place over 2340 as a result of the 2340 Receivership Proceedings (defined below).

~~39.~~38. The $591,000 in diverted funds related to CCE alone and the other payments directed by Larry and Phil to themselves and others total approximately $800,000.

~~40.~~39. The Administrator also uncovered evidence that, in 2018, Larry was purchasing the shares of 2340 from Whitfield for his own benefit.

~~41.~~40. In December 2018, the Administrator commenced receivership proceedings in respect of 2340 in order to protect the Credit Union's interests in the funds that had been misdirected (the "**2340 Receivership Proceedings**"). The Fuller Landau Group Inc. was appointed as the receiver. The Credit Union has suffered loss and/or damages as a result of the dishonest conduct of Larry and Phil in the amount of the costs associated with the prosecution of the 2340 Receivership Proceedings, any losses on the loan to 2340, and any losses on the amounts paid for CCE in excess of the actual reasonable value of CCE (which amounts, if any, are to be determined based upon the sale of CCE which remains pending and will be completed on or before March 31, 2022). As part

of the 2340 Receivership Proceedings, the shares of CCE held by 2340 have been transferred to the Credit Union.

~~42.~~41. The transactions through which Larry and Phil caused the Credit Union to acquire the interests in CCE also required the Credit Union to acquire the remainder of the shares from CCE's founder ("**Penfound**") anytime after March 2019 pursuant to a put option. Penfound exercised the option, and as a result, the Credit Union was left owning the entirety of CCE, contrary to the provisions of the Act and Regulations.

~~43.~~42. In March 2020, the COVID-19 pandemic crisis began in North America, resulting in the cessation or severe curtailment of international travel and the mandatory closure of all or the majority of CCE locations that are located in malls. As a result, the Credit Union has suffered losses as a result of the loss of revenue and diminution of the value of the CCE, an entity that the Credit Union would not have acquired contrary to the Act and Regulations but for the dishonest and fraudulent conduct of Larry and Phil.

~~44.~~43. In total, the transactions involving CCE gives rise to a claim for losses to the Credit Union of at least the following amounts:

(a) A loss in the amount of $174,000 for improper payments by 2340 from funds advanced by PACE, to Larry, Phil, and other employees of the Credit Union based on misrepresentations by Larry to PACE's board of directors;

(b) A loss in the amount of $141,000 for improper payments by 2340 from funds advanced by PACE, to Whitfield based on misrepresentations by Larry to PACE's Board of Directors;

(c) loss of revenue ~~as a result of the COVID-19 pandemic~~;

(d) diminution in value of CCE, which will be quantified following the completion of the sale of CCE by the end of March 2022;

(e) A claim for costs, in an amount to be determined, incurred related to the 2340 Receivership Proceedings; and

(f) A claim for losses, in an amount to be determined, arising from the losses incurred from the loan that Larry caused PACE to advance to 2340 in exchange for payments, for his own personal benefit in acquiring shares of CCE and for the Credit Union's involvement in the ownership of CCE.

B. The Geranium Joint Venture

~~45.~~44. Geranium is a company that develops residential real estate projects.

~~46.~~45. Larry and Phil caused the Credit Union to enter into six (6) joint venture projects with, and to make loans to, certain of Geranium's projects.

~~47.~~46. Larry and Phil structured these agreements so PACE ostensibly owned only the statutory-limit of 30% of each joint-venture entity, but PACE in fact took more of the ownership rights by being entitled to more than 30% of the profits and was obligated to provide more than 30% of the capital for each of the projects. This structure was in breach of the limits in the Act and Regulations regarding the ownership of subsidiaries (as described above at paragraph 30), for which no permission from FSRA was sought or obtained. Larry and Phil deliberately structured the

agreements to conceal the true nature of PACE's ownership and to evade compliance with the Act and Regulations.

~~48.~~47. The following chart sets out the various rights and obligations of the partners in the joint ventures – as can be seen, while PACE's "ownership" stake remains at a constant 30%, the actual ownership rights and obligations (profits and capital contributions) greatly exceed the 30% limit:

JV Name	Date of JV	Property Location	PACE "Ownership"	PACE Profit	PACE Capital
Ballantrae	July 2010	Stouffville	30%	33.34%	56.67%
Ninth Line	July 2010	Stouffville	30%	50%	85%
Bloomington	February 2014	Stouffville	30%	50%	85%
Claremont	April 2015	Pickering	30%	50%	85%
Scugog	September 2015	Port Perry	30%	50%	100%
Highland Gate	December 2014	Aurora	30%	50%	100%

~~49.~~48. In every instance, Larry and Phil deliberately committed PACE to make capital contributions in excess of its notional or actual ownership interest.

~~50.~~49. In connection with two of the Geranium joint ventures, Larry caused the Credit Union to pay $5.33 million to him (directly, and indirectly through 142, 809 and 172) from PACE and two companies related to Geranium (who took such funds from monies belonging to PACE):

Company	2013	2014	2015	2016	2017	2018	Total
PACE	-	-	316,400	542,400	1,246,650	923,550	3,029,000
JLG Management Consulting Ltd.	-		565,000	154,434	678,000		1,397,434

Company	2013	2014	2015	2016	2017	2018	Total
Prime "R" Management Inc.	304,208	249,470	159,892	114,278	80,326	-	908,174
Totals:	**304,208**	**249,470**	**1,041,292**	**811,112**	**2,004,976**	**923,550**	**5,334,608**

~~51.~~50. Larry was already being paid ~~indirectly~~ by PACE through 142 and 809 for "property development services". These additional amounts were not earned and were not approved by the Credit Union, and were funds that belonged to the Credit Union.

~~52.~~51. In addition to these payments, Larry caused PACE to pay Klees, who purportedly had a consulting agreement that also made him an officer of the Credit Union, $2.7 million in connection with the Geranium projects, despite the fact that the Credit Union's Board was only advised that Klees would receive $1.5 million over the life of certain of these projects and despite the fact that those projects were in early stages of development and the funds were not due and owing. Klees kept these funds despite not being entitled to such funds. Furthermore, Klees concealed his relationship with Larry and the Credit Union from the other directors and officers, including the fact he received monthly payments under his consulting agreement with the Credit Union and his purported appointment as a Vice President of the Credit Union, when he applied to become a director and despite the fact he was required to disclose such information by the Act and the forms he filled out to become a director. This further concealed the improper payments taken by Klees from the Credit Union.

~~53.~~52. Furthermore, Larry directed Geranium, or companies related or connected to it, to pay him, directly ~~or indirectly~~ (through 142, 809 and 172, additional sums on account of "consulting fees" or commissions. These amounts were taken from funds advanced by the Credit Union to Geranium or

funds that were the Credit Union's share of profits from the various joint ventures. Larry misled Geranium into making the payments by falsely representing that the payments were authorized by the Credit Union when in fact they were not.

~~54.~~53. These secret commissions or amounts dishonestly taken, many of them styled as "advance" payments, were not disclosed to the Credit Union's Board as required by the Act or Regulations.

~~55.~~54. In total, the Geranium joint venture transactions give rise to a claim for losses of $6,588,531, the entirety of which relates to improper fees and secret commissions paid to Larry and Klees which came from PACE funds or amounts owing to PACE.

C. SusGlobal Transaction

~~56.~~55. Larry and Phil caused the Credit Union to advance funds to SusGlobal, a borrower of the Credit Union.

~~57.~~56. Larry and Phil caused PACE to advance $1.6 million as part of the first tranche of a loan when, at that time, SusGlobal's only asset – a contract with two municipalities – had been terminated. The advancement of this loan was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices.

~~58.~~57. As part of the advancement of this tranche, Larry caused PACE to pay Ron Williamson (or R. Williamson Consultants Limited, Ron Williamson Quarter Horses Inc. or another company owned or controlled by Williamson) ("**Williamson**") a "broker fee" of USD$300,000, from which Larry thereafter ~~directly or indirectly~~ received a secret commission of USD$150,000 back from Williamson or his companies by directing the funds to 1916761 Ontario Ltd. ("**1916**"), a company controlled by Larry and his son, Malek Smith ("**Malek**").

~~59.~~58. Additionally, in conjunction with advancing the loan to SusGlobal, Larry and Williamson each received 810,000 shares in SusGlobal as part of the secret commission.

~~60.~~59. Subsequently, in September 2017, PACE advanced an additional $3.9 million to SusGlobal for a combined total exposure of $5.5 million. The advance was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices. All of the advances to SusGlobal were done to facilitate the secret commissions received by Williamson and Larry and/or 1916.

~~61.~~60. In total, the SusGlobal transaction gives rise to a loss to the Credit Union of approximately $3,210,983, plus the value of 1,620,000 shares issued to Larry and Williamson, which consists of the following:

(a) A claim in the amount of USD$150,000 plus the value of 810,000 shares of SusGlobal, the entirety of which relates to a secret commission that was paid ~~indirectly~~ by PACE to Larry;

(b) A claim in the amount of USD$150,000 plus the value of 810,000 shares of SusGlobal, the entirety of which relates to a secret commission that was paid directly by PACE to Williamson; and

(c) A claim in the amount of $3,800,000 being the impaired amount of the improvident loan that Larry caused PACE to advance to SusGlobal in exchange for the secret commission.

D. Lora Bay

~~62.~~61. Larry and Phil caused PACE to advance $6 million, in the form of a convertible debenture that was converted to equity, to the Lora Bay, a real estate development project company. Lora Bay is a company that is majority owned by Larry Dunn ("**Dunn**") or a company related to him. Dunn already had millions of dollars in loans with the Credit Union at the time of the Credit Union's investment.

~~63.~~62. The advancement of this loan to Lora Bay was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices. The loan was made to facilitate the secret commission received by Larry, Malek and/or 1916.

~~64.~~63. In January 2017, Larry caused the Credit Union to directly or indirectly pay to Malek or 1916, a company controlled by Larry and Malek, $180,000 in "consulting and referral" fees in connection with Lora Bay, which fees were not payable, not earned, and were in fact a secret commission or a false invoice that constitute a loss to the Credit Union.

E. Noble House

~~65.~~64. Noble House owns a public storage facility in Huntsville, Ontario.

~~66.~~65. Larry caused PACE to advance a $5.5 million secured line of credit to Noble House to replace the incumbent lender.

~~67.~~66. The advancement of this loan was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices. The loan was made to facilitate the secret commission received by Williamson, Larry, Malek and/or 1916.

~~68.~~67. Larry received a secret commission with respect to a loan advanced to Noble House. The funds advanced by PACE were also used to pay a $452,000 "broker fee" to R. Williamson Consultants Limited, who then paid 1916, a company owned or controlled by Larry or Malek, 50% of the "broker fee".

~~69.~~68. The Noble House transaction gives rise to a claim for losses to the Credit Union of approximately $5,352,000, which consists of the following:

(a) A claim in the amount of $226,000, being the amount of a secret commission that Larry caused Noble House to ~~indirectly~~ pay to 1916 using funds advanced by PACE;

(b) A claim in the amount of $226,000, being the amount of a secret commission that Larry caused Noble House to directly pay to Williamson using funds advanced by PACE; and

(c) A claim in the amount of $4,900,000, being the impaired amount of the expected losses on the improvident credit facility that Larry caused PACE to advance to Noble House in exchange for the secret commission.

F. Loan to 193

~~70.~~69. PACE provided 193 a loan facility of up to $10 million. The current amount outstanding under the facilities is approximately $8.2 million.

~~71.~~70. The advancement of this loan was contrary to the Credit Union's risk tolerance and policies, and was contrary to any reasonable loan underwriting practices. The loan was made to facilitate the secret commission received by Williamson, Larry and/or 172.

~~72.~~71. Larry received payments in the nature of a secret commission in connection with the Credit Union's loan to 193. Hogan participated in or helped to facilitate Larry's secret commission.

~~73.~~72. As part of an agreement between the parties involved in the transaction, Larry was paid $275,000 for causing PACE to advance funds to 193, while Williamson received $300,000. Larry directed his secret commission, with Hogan's involvement, to 172.

~~74.~~73. The 193 loan transaction gives rise to a claim for losses to the Credit Union of approximately $610,750, which consists of the following:

(a) A claim in the amount of $275,000 plus HST (being $310,750), which relates to a secret commission paid by 193 to 172 from funds advanced by PACE;

(b) A claim in the amount of $300,000, which relates to a secret commission paid by 193 to Williamson from funds advanced by PACE.

G. Lagasco Transaction

~~75.~~74. Section 191 of the Act stipulates that a credit union "shall not make loans in excess of such lending limits as may be prescribed or as may be ordered under subsection (2) or (5)". The lending limits for credit unions are specified in the Regulations. Under section 58(2) of the Regulations, "a credit union may make a loan to a person if, as a result of making the loan, the total amount of all outstanding loans made to the person and any connected persons would not exceed 25% of the credit union's regulatory capital".

~~76.~~75. At the time and known to Larry and Phil, PACE's regulatory lending limit was approximately $16.8 million to a single borrower or a group of "connected" persons (as defined by the Regulations).

~~77.~~76. Larry and Phil undertook efforts to dishonestly evade the restrictions in the Act and Regulations that limit the amount that may be lent to any group of persons who are connected.

~~78.~~77. The principal of Lagasco is Jane Lowrie ("**Lowrie**"). Both Larry and Lowrie are connected to another business, Tribute Resources Inc. ("**Tribute**"), a publicly traded company. Larry is a director of Tribute, as is Lowrie.

~~79.~~78. Larry and Phil (and Hogan, until he retired) undertook efforts to structure the Lagasco transaction to make it appear that the total loans of almost $30 million were going to be advanced to Lagasco and a purported separate and independent entity purportedly controlled by Lowrie's four adult children. In doing so, they provided false information to the Credit Union and ignored information and advice from the Credit Union's staff and the Credit Union's own counsel.

~~80.~~79. Although the Administrator was able to stop the bulk of this transaction after the commencement of the Administration proceedings, the Credit Union incurred substantial costs and damages in attempting to limit the damage caused as a result of their breaches of fiduciary duties.

~~81.~~80. The Lagasco Transaction gives rise to a claim for losses to the Credit Union of approximately $7,342,862.26 plus costs of preventing further consequences arising from the dishonest conduct.

H. Diversion of Funds to Golanski/172

~~82.~~81. Larry engaged in secret transactions in which he caused the amounts owing to the Credit Union to be diverted to Golanski (his common law partner) or 172, which is a company ostensibly controlled by Golanski, but is *de facto* controlled by Larry and used by him for his own benefit. These secret transactions occurred without the required disclosure to the Credit Union's Board of Directors or their approval.

~~83.~~82. In addition to the transactions described above related to the Geranium joint ventures and PACE's loan to 193, Larry caused the diversion of funds to 172 through PACE's arrangement with City View Bus Sales & Service Ltd. ("**City View**"), in which Larry directed that 172, referred to as Golanski's company, be paid commission for work that she did not do.

~~84.~~83. On or about October 2016, Larry agreed to provide City View, through PACE, with a $5 million asset-based financing facility which City View would draw upon based on purchase orders it received for the construction of busses. In addition, PACE would charge a fee or commission of 30% of the gross margin expected under the purchase orders. Larry required that this fee owing to PACE would be split between PACE and 172, Golanski's company, despite 172 or Golanski not providing any services to City View or PACE in relation to the business.

~~85.~~84. Furthermore, Larry caused PACE to enter into a consulting agreement with 172 under which 172 received monthly payments from PACE for purported consulting services. However, this consulting agreement was merely another means of diverting funds to 172 through the payment of retainers and expenses so that the funds could be accessed and used by Larry. Between January 1, 2015 and September 30, 2018, 172 received $149,160 in monthly retainers but only earned $9,788 in alleged commissions.

~~86.~~85. Larry's diversion of funds from the Credit Union to 172 give rise to a claim for losses of $139,372.

I. False Invoices

~~87.~~86. Larry and Phil caused the Credit Union to pay invoices rendered by 142, 809, 1916, and 172 for services that were not actually provided. In the alternative, if the services were rendered, the quantum of the invoices was grossly disproportionate to the value of the services rendered, and was a dishonest scheme to enrich Larry at the expense of the Credit Union.

~~88.~~87. The types of services allegedly rendered, as described on the invoices, include "trust fund administration". These were ostensibly fees for managing the trust fund holding the termination or severance payments for certain employees at the Credit Union. Arn Reisler, a lawyer and long-time friend of Larry's, was the trustee of the trust fund, while the Credit Union's Corporate Secretary administered the trust fund at the Credit Union. Further, the trust fund required little-to-no administration. Despite this, the Credit Union paid to 142 and 809 at least $215,000 in improper trust fund administration fees between 2011 and 2018, which amounts are above and beyond those amounts paid to 142 pursuant to 142's consulting contract with the Credit Union for trust fund administration services.

~~89.~~88. Additional false invoices were rendered for pension administration, consulting fees, referral fees, retainers, commissions, for "contractual adjustments", and for other miscellaneous services.

~~90.~~89. The false invoices issued by Larry (and his related corporate entities), and the corresponding amounts paid by the Credit Union in respect of them, give rise to a claim for losses of approximately $2,676,165, being the cumulative amount of invoices paid by the Credit Union for improper fees

and commissions charged and taken by Larry and others associated with him, and for services not rendered.

J. Professional Expenses

~~91.~~90. The Credit Union has incurred audit expenses, records reconstruction, and other professional fees in excess of $25,000 for each activity as part of its efforts to identify the wrongdoing and correct the records of the Credit Union, which amounts are recoverable under the Bond. This amount is expressly above the aggregate limits available under the Bond.

IV. THE PARTICIPANTS' DISHONEST CONCEALMENT OF THEIR CONDUCT

~~92.~~91. At both Board and sub-committee meetings, Larry would bring a folder. This folder contained various invoices, agreements, and other documents, including documents that purported to justify the payment of amounts to Larry, his family and friends, and their personal corporations. Documents were added to the folder upon Larry's instruction.

~~93.~~92. Larry brought the folder to various Board and sub-committee meetings. The documents inside the folder were already stamped with an "Approved by Audit Committee" stamp.

~~94.~~93. During or after a Board or sub-committee meeting, Larry sat with two directors and caused them to sign or initial beside the stamp. Larry purposefully and deceitfully did not give accurate or sufficient information to the two directors as to the contents of the documents, the nature or purpose for any payments or the relationship of Larry and Phil to the various individuals and companies named within those documents. Nor did Larry show the contents of the folder to the whole Board or sub-committee members. Larry discouraged any inquiries by other directors as to the contents of

the folder. Moreover, the information contained in the folder was not sufficient to describe the nature and purpose of the payments or the basis on which the payments were justified.

~~95.~~94. Larry purposefully provided insufficient disclosure in order to obfuscate the existence or amount of the monies being received by Larry, and the individuals and companies related to him, in relation with the transactions, loans, secret commissions and false invoices that give rise to the losses that are the subject of the Claim.

~~96.~~95. This "folder method" was purposefully employed by Larry so that he could create a record that made it appear that the monies he received were ostensibly approved by the Board, even though he knew or ought to have known that the Board was in fact not made aware of such payments or the contents of the folder, and no approval had actually been given.

~~97.~~96. As a result of the above methods, the documents within the folder were not properly approved by the Board, but were rather part of Larry and Phil's fraudulent efforts to conceal their unlawful and unauthorized diversion of funds from the Credit Union.

V. BAD FAITH

~~98.~~97. CUMIS owes the Credit Union a duty of utmost good faith. That duty extends to the manner in which CUMIS investigates and assesses the Claim and the decision it makes as to whether or not to pay the Claim.

~~99.~~98. CUMIS has breached its duty of utmost good faith in the following respects:

(a) by delaying its investigation of the Claim;

(b) by failing to conduct a full and reasonable investigation of the Claim;

(c) by unduly delaying its evaluation of the Claim;

(d) by unduly delaying payment of the Claim;

(e) by failing to timely pay undisputed portions of the Claim while investigating other portions of the Claim;

(f) by paying less than the amount of the Claim covered by the Bond; and

(g) by failing to honor the Representations made to the Credit Union in respect of the CUB Program.

~~100.~~99. CUMIS unreasonably failed to perform a timely investigation of the Claim after the Proof of Claim was filed on October 16, 2019. It also unreasonably failed to make a timely assessment of the Claim despite being provided with significant documentation and evidence by the Credit Union in support of the Proof of Claim.

~~101.~~100. Since filing the Proof of Loss, the Credit Union has continued to supply CUMIS with new evidence that further supports the Claim.

~~102.~~101. CUMIS understood and repeatedly acknowledged that the Credit Union expected, and was entitled to a timely response on the matters clearly giving rise to coverage under the Bond.

~~103.~~102. However, CUMIS unreasonably failed to provide a timely response for any of the matters outlined in the Claim, including those that clearly gave rise to coverage under the Bond. CUMIS instead insisted on investigating all matters before it would confirm any coverage. It then delayed its investigation and/or failed to conduct it in a reasonable and timely manner. CUMIS did so in order to delay making a determination on coverage and making payment to the Credit Union for covered losses.

~~104.~~103. CUMIS' refusal to acknowledge any aspect of the Claim until it investigated and validated all aspects of the Claim is an inappropriate attempt to retain insurance proceeds that CUMIS should have already otherwise paid to the Credit Union.

~~105.~~104. On October 1, 2021, the Credit Union wrote to CUMIS to express its frustration with the delay, including the failure to investigate and adjust the Claim in a timely fashion. The letter also stated that CUMIS' refusal to state a definitive position regarding the Claim, or any potion of it, and its failure to make any payment for covered losses was causing harm to the Credit Union and was a breach of the insurer's obligations.

~~106.~~105. In response to the October 1, 2021 letter, on October 28, 2021, CUMIS finally confirmed coverage with respect to portions of the Claim as follows:

(a) SusGlobal Secret Commissions - $200,000;

(b) Lora Bay Secret Commissions - $180,000;

(c) Noble House Secret Commissions - $226,000;

(d) 193 Secret Commissions - $310,000; and

(e) 172 Secret Commissions - $140,000.

~~107.~~106. The total confirmed coverage amount of $1,056,000 ~~has still not been~~was only recently paid~~.~~ on March 2, 2022. There ~~is~~was no basis for CUMIS' failure to timely investigate, assess ~~and,~~ make a determination ~~with respect to~~and pay these covered claims.

~~108.~~107. CUMIS' failure to perform a timely independent investigation and to make a timely determination regarding the remaining aspects of the Claim is an ongoing breach of its obligations to the Credit Union.

~~109.~~108. CUMIS' breach of the duty of utmost good faith has caused and continues to cause damages to the Credit Union, including adversely impacting the Credit Union's credit levels and requiring it to seek a variance in order to continue to operate.

109. PACE is entitled to compensatory damages for CUMIS' breach of the duty of good faith.

110. CUMIS' bad faith conduct also warrants an award of punitive damages in favour of the Credit Union.

VI. CONCLUSION

111. The Losses incurred by the Credit Union in connection with the above-discussed transactions are Losses within the terms of the Bond which CUMIS has failed or refused to pay despite repeated demands~~.~~ (subject to the minor delayed payment noted herein). The Participants,

individually and in collusion with each other, carried out the various dishonest and fraudulent acts set out above with the active and conscious purpose to cause the Credit Union to sustain the Losses totalling approximately $23,579,008, in order to give benefits to themselves and others.

112. Accordingly, CUMIS is liable to the Credit Union for $10,~~000~~025,000 under the Bond, and in the alternative, for damages for breach of contract for failure to honour the terms of the Bond, plus punitive damages, pre- and post-Judgment interest and costs.

113. CUMIS is also liable to the Credit Union for damages arising from its bad faith conduct.

114. PACE relies upon the *Credit Union and Caisses Populaires Act, 1994*, S.O. 1994, c. 11, the *Courts of Justice Act*, R.S.O. 1990, c. C.42, as amended, and the *Insurance Act*, R.S.O. 1990, c.I.8, as amended.

February 25, 2022

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PACE SAVINGS & CREDIT UNION LIMITED, by its Administrator, FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO

Plaintiff

-and-

CUMIS GENERAL INSURANCE COMPANY

Defendant

Court File No. CV-22-00677550-0000

ONTARIO
SUPERIOR COURT OF JUSTICE

PROCEEDING COMMENCED AT TORONTO

AMENDED STATEMENT OF CLAIM

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Court File No.: CV-22-00677550-0000

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N :

PACE SAVINGS & CREDIT UNION LIMITED, by its Administrator,
FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO

Plaintiff

- and -

CUMIS GENERAL INSURANCE COMPANY

Defendant

STATEMENT OF DEFENCE

1. The defendant CUMIS General Insurance Company ("CUMIS") admits the allegations contained in paragraphs 2-9, 20, 28, 44, 74 and 97 of the amended statement of claim.

2. CUMIS denies the allegations contained in the paragraphs 10-12, 14-19, 23-26, 43, 54, 60, 68, 73, 80, 98, 99, 100 – 101 (subject to the comments set out herein), 102-103, 104-105 (subject to the comments set out herein), and 106-113 of the amended statement of claim.

3. CUMIS has no or has insufficient knowledge of the remaining allegations contained in the amended statement of claim and therefore does not admit them.

Overview

4. CUMIS provided certain coverage to the plaintiff PACE Savings & Credit Union Limited (hereafter, "PACE" or "the credit union") under Bond 01501254 in favour of the plaintiff, for the period January 1, 2018 to January 1, 2019 ("the Bond"). The aggregate limits under the Bond were $10,000,000, subject to a deductible of $10,000. The Bond also provided coverage for "Audit Expense" with aggregate limits of $25,000. The Bond provides for a wide range of different coverages including [Employee] Dishonesty coverage. While its coverages are extensive, the Bond is not intended to cover all losses arising out of fraudulent activity and each claim advanced under

the Bond must be analyzed on its own merits having regard to the specific and specialized language used in the Bond.

5. On or about October 16, 2019, the plaintiff delivered to CUMIS an interim proof of loss ("the POL") claiming that it had sustained a covered loss of some $23,579,008, plus various additional amounts to be determined, arising out of the alleged dishonest activities of its former President and CEO, Larry Smith ("Larry"), along with certain other former employees. The POL consists of some nine separate sub-claims, some of which also consist of multiple claims with the sub-claims. All of the sub-claims have as a common element the allegation that their losses were caused by, or as a result of the dishonest activities of Larry. Hereafter, the various separate sub-claims set out in the POL will be collectively referred to as "the Claim". The separate portions or components of the Claim will be referred to as "sub-claims".

6. In any bond claim, both the insured and insurer owe one another duties of utmost good faith. The insured is obliged to prove coverage in accordance with the wording in the bond, and to prove the quantum of the claim. The insurer is obliged to take all reasonable steps to investigate and adjust the claim in a timely manner. Where, in the insurer's opinion, acting in the utmost of good faith, additional documentation and information is required in order to allow the insurer to complete its investigation and coverage assessment, the insurer will make such inquiries and requests to the insured and it will be the insured's responsibility to fulfil such inquiries and requests in a timely and complete manner.

7. Upon CUMIS's receipt of the POL, it was anticipated by the parties that the finalizing of the POL by the plaintiff and the investigation and adjustment of the Claim by CUMIS – including the submission of any necessary inquires and requests by CUMIS to the plaintiff - would be complex and time-consuming. As a result, soon after the delivery of the POL, the parties entered into a tolling agreement so as to allow the parties sufficient time to carry out their respective obligations in this ongoing process.

8. Since receiving the POL, CUMIS and its external claims adjuster (collectively, "CUMIS") have reviewed it carefully and studied the supporting documentation in detail. Further, from at least January of 2020 to the present, CUMIS has engaged in frequent written and oral communications with the plaintiff. Within the written communications, CUMIS has provided

extensive coverage assessments (some of which have been tentative assessments) of the various sub-claims. Within these communications, CUMIS has clearly set out its concerns as to coverage and quantum in respect of the various sub-claims, and CUMIS has identified the additional information and documentation necessary for CUMIS to complete its investigation and coverage assessment. Unfortunately, the plaintiff has been slow to respond to several of these requests, and to date, the plaintiff has still not provided responses, or complete responses, to several important requests from CUMIS, thereby preventing CUMIS from completing its coverage assessment of the Claim.

9. CUMIS's major coverage concerns in respect of the Claim initially arose mainly out of following issues:

- First, in connection with claims for the "impaired" values of loans and investments, CUMIS was not convinced that the plaintiff had demonstrated that the alleged dishonest employee (i.e., Larry) had the "active and conscious purpose" to cause a loss to PACE in connection with the sub-claims at issue. It is CUMIS's position that under the relevant insuring agreement, for the plaintiff to establish coverage for losses sustained through loans and investments, the plaintiff must demonstrate that the particular dishonest employee (i) dishonestly caused the credit union to advance funds for the investment or loan, and (ii) had the subjective intention that the particular loan or investment should fail and thereby cause a loss to the credit union in the amount of that loan. It is not sufficient for coverage merely to show that a loan (or investment) was made in a manner which was, for example, inconsistent with the credit union's lending procedures, or even with commercial reasonableness.

- Second, with respect to the claims for secret commissions and other "unauthorized" or unjustified payments, CUMIS was not satisfied that all such allegedly secret or unauthorized payments making up this part of the Claim were in fact "secret"; meaning, not disclosed to the credit union, to the credit union's board, or to the Audit Committee, or were not otherwise authorized

pursuant to various consultancy contracts entered into by the plaintiff with various companies controlled by Larry Smith.

- Third, in connection with the Geranium and the False Invoices sub-claims, CUMIS has not been able to identify all of the allegedly fraudulent payments to Larry, or to persons or entities he controlled, and therefore could not satisfy itself as to (i) which payments were and were not authorized, and (ii) which payments pertained to the Geranium sub-claim and which pertained to the False Invoices sub-claim. To this end, CUMIS has requested that the plaintiff provide additional information and particulars of each particular payment so that CUMIS could assess both coverage and quantum.

- Fourth, CUMIS was not satisfied that the sub-claim (within the Geranium sub-claim) pertaining to payments to Frank Klees represented a covered loss, since it was not clear that Klees could satisfy the Bond's definition of "Employee".

- Finally, CUMIS takes the position that under the Recovery condition in the Bond, and so long as to covered losses do not exceed the Bond limits of $10 million, then to the extent that CUMIS makes any indemnity payments in respect of the Claim, CUMIS will be entitled to first right of recovery in respect of any recovery efforts, and in particular, in respect of the plaintiff's recovery action against Larry and others.

All of these coverage concerns and positions were clearly set out by CUMIS, through counsel, in its extensive written communications in 2021 and 2022 to the plaintiff's counsel. Within these communications, CUMIS also set out very clearly the additional information that it required from the plaintiff in order to complete its assessments of coverage and quantum, and/or to justify a reversal by CUMIS on coverage positions CUMIS had taken with respect to those sub-claims which pertained to loan and investment losses. For reasons known only to itself, the plaintiff has been very slow in providing meaningful responses to CUMIS's requests for such additional information, and in some cases, the plaintiff has still not provided the requested information.

10. In spite of the slow progress in obtaining meaningful responses from the plaintiff to its follow-up inquiries, CUMIS has been able to complete its coverage assessments in respect of a majority of the sub-claims. In the course of a mediation between the parties which took place in August and September of 2021, the plaintiff provided to CUMIS certain transcript and affidavit evidence; evidence which had previously been in its hands for several months prior to the mediation. As a result of this new information, and due to its own considerable efforts carried out before the mediation, CUMIS was able to conclude that coverage existed in respect of various sub-claims relating to the payments of secret commissions or other unauthorized or unjustified payments to Larry and his companies and to family members and close associates. These accepted sub-claims, in the total amount of $1,056,000, are as follows:

• SusGlobal Secret Commissions (item #1 on **Schedule A, attached**)	$200,000;
• Lora Bay Secret Commissions (item #3 on **Schedule A)**	$180,000;
• Noble House Secret Commissions (item #4 on **Schedule A**)	$226,000;
• 193 Ontario, Secret Commissions (item # 6 on **Schedule A**)	$310,000;
• 172 Ontario, Secret Commissions (item # 7 on **Schedule A**)	$140,000;
Total	$1,056,000

CUMIS advised the plaintiff by letter dated October 28, 2021 ("the October 28 letter") of its acceptance of coverage for these sub-claims. It held off paying this amount for a short time in anticipation that the plaintiff's counsel would provide substantive responses to the various outstanding inquiries and requests in the October 28 letter so that CUMIS could provide one final assessment of the Claim and make one indemnity payment. In early 2022, it became clear to CUMIS that the plaintiff was not going to respond to the October 28 letter at which time CUMIS decided to make the partial payment of $1,056,000.

11. CUMIS has declined coverage in respect of those sub-claims which pertain to the alleged loan and investment losses on the basis that the facts presented by the plaintiff for those sub-claims do not establish that a dishonest Employee had the "active and conscious purpose" to cause a loss

to the credit union. CUMIS has remained receptive to the possibility that the plaintiff might submit additional evidence to support an on-coverage position in respect of the loan and investment loss claims. For reasons known only to itself, the plaintiff has chosen not to do so.

12. Finally, CUMIS has thus far withheld acceptance of coverage in respect of the Geranium and False Invoices parts of the Claim. For these sub-claims, CUMIS has, for well over two years, requested of the plaintiff that it provide additional information to allow CUMIS to identify the specific payments to Larry (and related entities) which make up each sub-claim in order to allow CUMIS:

- to satisfy itself that the payments to Larry (and related entities) in respect of each sub-claim were not disclosed to PACE or otherwise authorised;
- to identify the specific payments which make up the Geranium and False Invoices sub-claims and thereby allow CUMIS to determine coverage in respect of each payment (should they not all share the same nature and characteristic); and
- to satisfy itself that there is no overlap between these two sub-claims (i.e., to confirm that there is no double-counting between the Geranium and the False Invoice sub-claims).

In respect of the "Frank Klees" portion of the Geranium sub-claim, the plaintiff has not yet provided sufficient evidence to demonstrate that Klees was an "Employee" as that term is defined under the Bond.

13. In spite of CUMIS's frequent written requests for additional information to satisfy its concerns about the Geranium and False Invoices sub-claims, the plaintiff has been unable or unwilling to provide the requested material, or to respond to CUMIS's concerns about this Klees part of the Geranium sub-claim. As a result, CUMIS (i) has concluded that plaintiff is not able to establish that Klees was an Employee of PACE such that the "Klees" part of the sub-claim is not a covered loss, and (ii) has been unable to complete its assessment of the balance of the Geranium sub-claim, and of False Invoices sub-claim. The defendant states that on numerous occasions, it has suggested to the plaintiff that representatives of the plaintiff and of CUMIS meet in person to

review the Geranium and False Invoices sub-claims, so that the parties might at least try to resolve their "accounting" differences and resolve some of CUMIS's concerns set out in paragraph 12 above. Unfortunately, the plaintiff has thus far not been willing to allow such a meeting to take place.

14. The plaintiff alleges in paragraph 26 of the amended statement of claim that, as an alternative, it seeks coverage under the Forgery and Extended Forgery coverage in the Bond. In fact, the plaintiff has not advanced in the POL any claim that there is coverage for any losses under this Insuring Agreement. Moreover, within the amended statement of claim, the plaintiff provides no particulars of any allegations in support of such claim.

15. For the reasons set out herein, CUMIS has at all times acted reasonably and in good faith and has made all reasonable efforts to complete its investigation and the adjustment of the Claim in a timely manner. CUMIS remains willing to work with the plaintiff to resolve outstanding issues and concerns and to finalize the adjustment of the Claim.

OVERVIEW OF COVERAGE ISSUES

16. The Claim as set out in the POL is made under the Bond's [Employee] Dishonesty coverage[1]. The majority of the sub-claims fall into three categories: (i) loan (and investment) losses, both actual and anticipated; (ii) secret commissions (including payments for services not provided); and (iii) fraudulent invoices rendered by Larry and related entities. CUMIS states that it is generally difficult to establish coverage under the Dishonesty coverage in the Bond in respect of loan losses. It is a less onerous task to establish coverage under this insuring agreement in respect of "secret commissions". A brief explanation of the relevant portions of the Bond coverage is set out below.

(i) Bond Wording and General Principles

17. The "Dishonesty" insuring agreement in the Bond, reads as follows:

1 Other than the claim for Audit/Claims Expense

DISHONESTY

ACTUAL LOSS resulting directly from dishonest or fraudulent acts committed by an EMPLOYEE, DIRECTOR or COMMITTEE MEMBER, acting alone or in collusion with others, with the active and conscious purpose to cause the INSURED to sustain such loss.

However, if some or all of the INSURED's loss results directly or indirectly from a LOAN, then that portion of the loss is not covered unless the EMPLOYEE, DIRECTOR or COMMITTEE MEMBER has received, in connection therewith, a FINANCIAL BENEFIT with a value of at least $5,000. ...

Under this Insuring Agreement, any conscious or deliberate

i. Failure to abide by statutes, bylaws, regulations, lending limits, lawful rules or instructions governing or directing the performance of duties; or

ii. engaging in improper, improvident, unauthorized, illegal or reckless lending; or

iii. concealment, alteration, manipulation or destruction of records, shall not alone, and without further proof of dishonest or fraudulent intent on the part of the EMPLOYEE, DIRECTOR or COMMITTEE MEMBER, be deemed to be "dishonest or fraudulent acts".

18. The Bond defines the term "Employee" as follows:

EMPLOYEE

Any or all of the following:

1. a natural person under the supervision of the INSURED that is:
   a. employed for wages or salary by the INSURED;
   b. provided by an employment agency to perform employee duties;
   c. employed under contract to perform employee duties; or
   d. who volunteers to perform employee duties, at the direction of the INSURED;

...

6. An Officer of the INSURED pursuant to the charter or bylaws of the INSURED or applicable legislation.

19. CUMIS states that it follows from the clear wording of the Bond that, to establish coverage under the [Employee] Dishonesty coverage, an insured must show that (i) it suffered a loss

resulting directly from "dishonest or fraudulent acts" committed by an Employee or Director (acting alone or in collusion with others), (ii) where the Employee was acting "with the active and conscious purpose to cause the Insured to sustain *such* loss" [emphasis added]. The insuring agreement expressly states, among other things, that "any conscious or deliberate … engaging in improper, improvident, unauthorized, illegal or reckless lending … shall not alone, and without further proof of dishonest, or fraudulent intent …" be deemed to be "dishonest or fraudulent acts".

20. CUMIS states that the "active and conscious purpose" language in the Dishonesty insuring agreement reflects that the "intention" requirement in the coverage is determined by what the Employee's subjective intention was at the relevant time. To satisfy the intention requirement in the Dishonesty coverage, therefore, an insured must demonstrate that the Employee subjectively intended (i.e., in his own mind) to cause a loss to his employer. This means that the Employee likely must have intended by his actions to steal or to embezzle funds from the employer, either for himself or others. It would not be sufficient (to establish coverage) to show, for example, that the Employee engaged in risky or unauthorized lending behaviour, even if he then dishonestly tried to cover it up.

21. Thus, in a Dishonesty claim under the Bond, the standard of proof is onerous, and it is two-pronged: first, the insured needs to show that a person who satisfies the definition of "Employee" engaged in a "dishonest or fraudulent act", where that term is defined narrowly, such that, among other things, reckless, improvident, improper, or dishonest lending practices are not, by themselves, sufficient to satisfy the definition; and second, if it can be shown that a "dishonest or fraudulent act" was committed by an Employee, and that the act in question directly caused a loss sustained by the insured, the insured must then also demonstrate that the Employee had the "active and conscious purpose" (i.e., the subjective intention) with that particular dishonest act to cause "such loss".

(ii) Coverage for Loan and Investment Losses

22. CUMIS states therefore that in order to establish coverage for a loan or investment loss, the plaintiff must demonstrate that the Employee in question (Larry Smith in most cases, here) effectively was trying to steal or to embezzle these loaned or invested funds from the credit union

for his benefit, or the benefit of others. This can be difficult to show in respect of loans and investments, even where these were made recklessly, or even illegally. In the case of a loan, the plaintiff insured must also demonstrate that the Employee obtained a financial benefit of at least $5,000 in respect of the particular loan.

23. Further, CUMIS states that for coverage purposes, the granting of a loan is one activity, while the receipt of a secret commission is another, separate activity. If a scenario were to arise in which a secret commission were paid out of the proceeds of a loan, it is possible that the secret commission might represent a covered loss under the Bond. However, the mere fact that some of the proceeds of the loan may have been used for an illegitimate purpose (paying the secret commission), does not mean that the loan itself represents a covered loss. Rather, for that to be the case, the plaintiff insured would need to demonstrate that the Employee who dishonestly caused the loan to be made did so with the active and conscious purpose to cause "such loss" to the insured; i.e., a loss in the amount of that loan, and that this Employee received a corresponding benefit of at least $5,000.

24. Investment losses are not specifically referenced in the Dishonesty insuring agreement. However, the coverage requirements discussed above are not limited to loan losses. Thus, to establish coverage, the plaintiff would need to demonstrate that the Employee actively and consciously intended to cause "such loss" to the credit union. In other words, by making the particular investment, the Employee must effectively have intended to steal or embezzle from the insured. This suggests that the Employee must have subjectively intended that investment would fail or would lose money for the credit union while creating a benefit of at least $5,000 for the Employee.

(iii) Coverage for Secret Commissions and/or Unauthorized Payments

25. CUMIS states that, in the instant case, to the extent that Larry or other "Employees" of the plaintiff credit union, directly or indirectly, received undisclosed payments from persons doing business with the credit union, these would likely be covered losses under the Dishonesty insuring agreement. CUMIS acknowledges that Ontario law provides that in such a case, the employer would have suffered a direct loss in the amount of the payment, and the payment would be deemed

to have been made and received with fraudulent intent, as a result of which it could be inferred that there was an active and conscious intention to cause a loss to the employer. The main issue for determining coverage in respect of payments described as "secret commissions" would likely be whether or not the payments at issue were truly "secret": if any of the subject payments were disclosed to the credit union, and/or if the credit union was aware of the payments, or if the payments were otherwise authorized, then coverage under the Bond for such payments would or might be difficult to establish.

26. In light of the foregoing, therefore, CUMIS states that in order for an insurer to satisfy itself that there is coverage for any claim relating to secret commissions and/or unauthorized payments, it is necessary that the insured identify for the insurer the precise payments which are alleged to have been secret or unauthorized so that the insurer can satisfy itself that each such payment is indeed a covered loss under the terms of the Bond.

(iv) Recovery Litigation Against Larry et al and Allocation of Recoveries

27. The plaintiff is presently involved in active litigation against Larry, and various other people and related corporations in order to recover losses sustained by the plaintiff as a result of Larry's (and others') alleged dishonest activities ("the Recovery Action"). The defendants within this Recovery Action have specifically denied allegations of fact which are relevant to the coverage determinations in the present matter.

28. CUMIS states that depending on the results of the Recovery Action, there may be issues arising out of how such recoveries are to be allocated. The Bond provides under its **Recovery** condition, for the following:

> **RECOVERY**
>
> Any recovery, whether effected by the Insurer or INSURED, shall be applied net of expenses in the following order of priority:
>
> 1. To the INSURED, in satisfaction of any direct loss in excess of the applicable limit stated in the Declarations for this Bond; then
>
> 2. Subject to the minimum Deductible, if the Deductible is a :

- percentage to the Insurer and INSURED, in proportion to the percentage absorbed in settlement of the loss; or
- flat amount, to the Insurer, as reimbursement of the amount paid in settlement of the loss; then

3. To the INSURED in satisfaction of any Deductible; then

4. To the INSURED in satisfaction of any consequential loss or damage, loss of use, loss of interest or earnings or any otherwise uninsured loss.

29. Under the Bond, the deductible is a flat amount. CUMIS states therefore that unless the covered losses exceed the Bond limits of $10,000,000, to the extent that CUMIS makes any indemnification payments under the Bond, then under this Recovery condition, CUMIS has first right of recovery over any net proceeds of recovery, to the extent of the indemnity payment(s).

(v) Indirect vs. Direct Losses

30. The Dishonesty insuring agreement provides coverage for "Actual Loss resulting *directly* from dishonest or fraudulent acts..." [emphasis added]. Some of the sub-claims advanced in the POL appear to be in respect of expenses incurred by the plaintiff in respect of receivership proceedings, or the unwinding of loans, and so on. Even if these can be categorized as "losses", they are "indirect" in nature because these expenses do not represent funds directly taken or paid out by any dishonest Employee. "Indirect or consequential loss or damages" are specifically excluded from coverage under the terms of the Bond.

THE CLAIMS INVESTIGATION

(i) CUMIS's Investigation Approach

31. As an insurer, CUMIS has an obligation to review all bond claims in the utmost of good faith. CUMIS takes its obligation in this regard very seriously and at all times, it has fulfilled its obligations in connection with the Claim.

32. CUMIS states that in any investigation, it is critical before any coverage determinations are made that it take the necessary time, acting diligently, to review all relevant documentation provided with any POL. To the extent that a POL may be incomplete or may give rise to follow-up questions, inquiries, or requests, it is the obligation of the insurer to pursue these inquiries, in

order to ensure that the full factual matrix is assembled, analysed and understood. In a perfect world, the insurer or the insurer's adjuster would interview all relevant and available witnesses once full documentary production had been made by the insured.

33. CUMIS states that it is best practice to wait for full documentary production and to complete review of the documents *before* conducting interviews in the course of an investigation. One strong reason for this is that the insurer has no means to compel cooperation of individuals no longer in the insured's employ such that the insurer's adjuster typically gets only one opportunity to interview a particular witness. This has been the long-standing practice of the defendant and its adjuster and it is a well-established industry practice.

(ii) Initial Document Requests by CUMIS

34. Attached to this statement of defence as **Schedule B** is a chronology prepared by the defendant's adjuster, Arthur Goguen, which sets out significant activities on the file from the date of delivery of the POL to February 2021. A copy of this chronology was provided to the plaintiff's counsel as an attachment to the letter dated February 11, 2021 from CUMIS's coverage counsel. A review of the history of the parties' dealings in this matter (set out in **Schedule B**) shows that there has been no delay on the part of CUMIS in its adjustment of the Claims. Rather, it has been the delays on the part of the plaintiff in providing the further information requested by the defendant which slowed CUMIS's investigation, and which prevented CUMIS from completing final coverage assessment.

35. The plaintiff provided the POL (with attachments) to CUMIS in October of 2019[2]. Mr. Goguen and others in his office, on behalf of CUMIS, reviewed with great urgency the many thousands of pages of documents, in order to absorb and understand the complex and inter-related facts pertaining to the various sub-claims. Within a couple of months, it was clear to Mr. Goguen that certain necessary information was missing such that follow-up inquiries and requests of the plaintiff were necessary.

2 At the plaintiff's request, CUMIS had earlier extended the deadline for delivery of the POL on four separate occasions.

36. As an aside, CUMIS notes that prior to the delivery of the POL, the plaintiff commenced the Recovery Action. As part of the POL materials, the plaintiff has provided some information relating to the legal and factual positions taken by Larry and others in the Recovery Action.

37. On December 19, 2019, Mr. Goguen advised the plaintiff's counsel that he would be submitting to the plaintiff's counsel in early January 2020 a detailed list of follow-up inquiries and requests. On January 7, 2020, he submitted to the plaintiff's counsel a detailed list of inquiries /requests. On January 20, 2020, Mr. Goguen provided brief supplemental requests (adding to the January 7 list of items).

38. On March 6, 2020, the plaintiff through counsel provided certain additional materials to Mr. Goguen but outstanding questions and requests remained. The plaintiff's counsel subsequently gave repeated assurances to Mr. Goguen to the effect that the further requested documentation would be forthcoming shortly. They were not. In respect of these outstanding document requests, Mr. Goguen followed up with the plaintiff's counsel in writing on numerous occasions: on May 6, May 27, June 19, June 23, September 28, and November 24, 2020, and January 11, 2021. Further, there were additional instances where Mr. Goguen spoke to the plaintiff's counsel by telephone while driving, or otherwise out of the office, such that no written record exists of these ongoing efforts.

39. Among other things, some of the materials requested by Mr. Goguen during these frequent communications in 2020 and 2021 were (i) general ledger materials for the Geranium joint ventures (related to the Geranium sub-claim); and (ii) a listing and reconciliation (*vis-à-vis* the dollar amounts claimed) of the specific invoices which constituted the Fraudulent Invoices sub-claim. On this latter point, in the POL, the plaintiff had provided a large number of invoices in support of that sub-claim, but the sum of the invoices did not match the amount claimed in the POL for this particular sub-claim so that it was impossible for CUMIS to determine which invoices formed part of the sub-claim and which did not. Moreover, as set out below, at various times, the amount claimed by the plaintiff in respect of this sub-claim has changed, with no reasonable explanation from the plaintiff as to why this was so.

40. The plaintiff's counsel finally delivered on the plaintiff's behalf a new tranche of documents on February 10, 2021, well over a year after the first requests were made and at or

about the same time that the insured was demanding a written assessment from CUMIS as to its tentative views on coverage. Notably, this new tranche of documents did not include the Geranium general ledger materials, nor any invoice reconciliation pertaining to the Fraudulent Invoices sub-claim.

41. Mr. Goguen made it very clear in his frequent discussions with plaintiff's counsel that he (Mr. Goguen) required the additional information before he could conduct any interviews of persons involved in any parts of the sub-claims, and more generally, in order to be able to complete his factual investigation of the Claim on CUMIS' behalf. He also made it clear to the plaintiff's counsel that because many of the prospective interviewees were involved in more than one of the sub-claims, these sub-claims were in fact interrelated, and it was not practical or advisable for the purposes of the investigation to treat the sub-claims as being separate and discrete.

42. As discussed further below, since the chronology in **Schedule B** was prepared, the plaintiff has produced some additional information. However, the plaintiff still has not produced some of the requested information which CUMIS needs to complete its investigation and coverage assessment. At no time has the plaintiff or its counsel ever provided an explanation to CUMIS as to why there was such an inordinate delay on the plaintiff's part in providing the requested information, nor as to why some information still has not been produced. More on this below.

(iii) Interim Coverage Letters and Responses

43. By way of letter dated February 11, 2021 ("the February 11 letter"), the defendant, through counsel, provided to the plaintiff an interim and comprehensive assessment of coverage in respect of the Claim. Among other things, the February 11 letter advised the plaintiff of the following:

- CUMIS was of the view that it was unlikely that there was coverage under the Bond for the loan and investment losses claimed in the POL;
- Some portions of the sub-claims which claimed for losses arising out of "secret commissions" might be covered under the Bond. However, CUMIS continued to have concerns as to whether all of the impugned payments were truly unauthorized or secret in nature;

- In this regard, CUMIS noted that Larry was the principal of two numbered companies which had, years before, entered into consultancy agreements with PACE and that there was evidence which suggested that at least some of the impugned payments to Larry and related entities (i.e., payments which the plaintiff alleged to have been secret commissions or otherwise unauthorized payments), might in fact have been authorized by the terms of the consultancy agreements, and/or disclosed by Larry to the PACE Board of Directors. If true, this suggested that some or many of the impugned payments did not satisfy the legal definition of "secret commission" or "bribe" and/or were authorized payments, and therefore might not be covered losses;

- CUMIS was not yet satisfied that the plaintiff could demonstrate that Frank Klees met the definition of "Employee" as set out in the Bond, and CUMIS requested that the plaintiff provide additional documentation and information in support of that assertion;

- Under the "Recovery" condition in the Bond, it appeared likely that, to the extent that the Bond were to respond to any parts of the Claim, then so long as this was not an "over-limits" claim, CUMIS would be entitled to first right of recovery to the extent of such indemnity payment(s);

- In order for CUMIS to complete its coverage analysis in respect of the Geranium and False Invoices portions of the Claim, it required that the plaintiff produce, among other things, the Geranium general ledger materials and a reconciliation of the relevant "Fraudulent Invoices" so that the defendant could ensure, among other things, that (i) the payments made to Larry (or to related entities) were not in fact authorized by, or disclosed to the plaintiff credit union, and that (ii) there was no double-counting in respect of these two sub-claims.

44. On February 22, 2021 ("the February 22 letter"), counsel for the plaintiff wrote to CUMIS's coverage counsel, ostensibly responding to the February 11 letter. Within this letter, and among other things, he complained that:

- the Claim had not yet been paid;
- the insurer was not looking at the evidence "holistically";
- CUMIS was acting in bad faith; and
- CUMIS had not told the plaintiff what CUMIS required from the plaintiff in order to complete its investigation.

In fact, none of these complaints was meritorious. Curiously, in the February 22 letter, counsel for the plaintiff chose not to respond to any of CUMIS's concerns about coverage, nor to any of the specific information requests set out in the February 11 letter.

45. By letter dated March 4, 2021 ("the March 4 letter"), counsel for CUMIS again wrote to plaintiff's counsel to address the various concerns outlined by plaintiff's counsel in the February 22 letter. In this March 4 letter, among other things, counsel for CUMIS again commented on CUMIS's coverage concerns, and again made requests for the various information referenced above.

46. In late July, 2021, the plaintiff through counsel finally provided to Mr. Goguen certain general ledger information for the Geranium joint ventures. While this material provided some assistance to CUMIS in adjusting the Geranium sub-claim, it did not resolve all of the defendant's questions in this regard. Meanwhile, in spite of CUMIS' frequent requests, by this time in late July 2021, the plaintiff had still not provided a reconciliation of the Fraudulent Invoices, nor any explanation as to why it had not done so.

47. In late August and early September of 2021, and prior to the commencement of the within action, the parties attended at a mediation in an effort to resolve the Claim's outstanding coverage and quantum issues. The mediation was a so-called "Big Tent" event in that it included two other proceedings which arose of the same allegations of fraud as against Larry: the plaintiff's Recovery Action (as against Larry and others), and the plaintiff's action against various former PACE directors. None of these proceedings was settled at the mediation. However, in the course of the Big Tent mediation, the plaintiff provided additional information to CUMIS most or all of which had been in the possession of the plaintiff for several months prior to the mediation ("the new

information"). This included transcripts of the cross-examinations of various former PACE directors and a sworn affidavit from Allison Golanski, Larry's former common law spouse.

48. During the mediation, the plaintiff advised the defendant for the first time that it was unable or unwilling to provide a reconciliation for the False Invoices sub-claim and that, in fact, this sub-claim was derived from a residual number; the difference between the total dollar figure of "authorized" payments made to Larry (and related entities), as set out in the credit union's audited annual financial statements, and the plaintiff's calculation of the total value of *all* payments made to Larry (and related entities). The plaintiff's counsel explained, therefore, that it was unable to determined exactly which invoices made up the False Invoices sub-claim.

49. The plaintiff has provided no reasonable explanation as to why:

- It did not provide the new information to the insurer as soon as it became available; and
- It did not disclose to CUMIS the nature of the Fraudulent Invoices sub-claim in early 2020, when CUMIS first requested the Invoice reconciliation.

50. During the "Big Tent" mediation, the plaintiff and CUMIS, through counsel, engaged in extensive and helpful discussions about the various aspects of the Claim including the Geranium and False Invoice portions of the Claim. These discussions assisted in (ultimately) resolving some previously unresolved issues, and narrowing the scope of others. In spite of this, at the conclusion of the "Big Tent" mediation in early September, CUMIS continued to request of the plaintiff that it provide additional information in respect of the Geranium and False Invoices sub-claims. It was CUMIS' understanding, based on discussions with the plaintiff's counsel during the mediation, that the plaintiff would be able to provide this information in fairly short order after the mediation such that CUMIS' final coverage assessment could then be completed.

51. To this end, by email dated September 15, 2021 ("the September 15 email"), counsel for CUMIS wrote to plaintiff's counsel setting out a list of questions pertaining to the Geranium and False Invoices sub-claims. CUMIS had posed these questions during the mediation, but the plaintiff did not provide responses at that time. Defence counsel wrote again to plaintiff's counsel

on September 27, 2021, to follow up on the September 15 email. CUMIS followed up again in this regard by letters dated October 8 and 28, 2021. In fact, the plaintiff has never provided any substantive response to the September 15 email.

52. On October 1, 2021, counsel for the plaintiff wrote to CUMIS ("the October 1 letter"). This letter contained little or no new information pertaining to the Claim and no responses to any of CUMIS' outstanding inquiries. Further, the letter repeated many points which had already raised by the plaintiff's counsel in previous letters, and which had already been discussed by CUMIS's counsel in the February 11 and March 4 letters. In spite of this, in the October 1 letter, the plaintiff through counsel demanded once again that CUMIS pay out the Bond's limits of $10 million and suggested yet again that CUMIS's failure to complete its coverage assessment amounted to bad faith on CUMIS's part.

53. Plaintiff's counsel helpfully attached as Schedule A to the October 1 letter a document setting out "a copy of the claim the [plaintiff] is asserting under the Bond and the amounts being claimed". An annotated copy of this document is attached herein as **Schedule A**: for ease of reference, the defendant has sequentially numbered the claimed losses set out on this **Schedule A** so that "SusGlobal Secret Commissions" is #1, "SusGlobal Loan Losses" is #2, and so on.

(iv) <u>October 28 Letter and Coverage Assessment For "Schedule A" Claims</u>

54. By letter dated October 28, 2021 ("the October 28 letter"), counsel for CUMIS responded to the October 1 letter. Among other things, in the October 28 letter, CUMIS, through counsel:

- Discussed again much of what the defendant had discussed in the February 11 and March 4 letters, responding again to coverage points raised by the plaintiff' counsel in the October 1 letter and in earlier communications;
- Requested yet again that the plaintiff satisfy CUMIS's outstanding inquiries and requests, including a request that the plaintiff respond to the September 15 email;
- explained yet again its coverage position on loan and investment losses;

- requested yet again further specific information to support the plaintiff's contention that Frank Klees met the definition of "Employee" as set out in the Bond; and

- provided coverage determinations for some portions of the Claim as set out below.

55. Within the October 28 letter, CUMIS acknowledged that, upon its review and consideration of the new material (obtained during the mediation), it accepted that the following claimed losses (as set out on **Schedule A**) were covered under the Bond:

• SusGlobal Secret Commissions (item #1 on **Schedule A**)	$200,000;
• Lora Bay Secret Commissions (item #3 on **Schedule A**	$180,000;
• Noble House Secret Commissions (item #4)	$226,000;
• 193 Ontario, Secret Commissions (item # 6)	$310,000;
• 172 Ontario, Secret Commissions (item # 7)	$140,000;
Total	$1,056,000

56. On or about March 2, 2022, CUMIS paid this sum of $1,056,000 to the plaintiff. While CUMIS advised the plaintiff in the October 28 letter of its acceptance of coverage for these sub-claims, it held off paying this amount for a short time in anticipation that the plaintiff's counsel would provide a substantive response to the various outstanding inquiries and requests in the October 28 letter so that CUMIS could provide one final assessment of the Claim and make one indemnity payment. In early 2022, it became clear to CUMIS that the plaintiff was not going to respond to the October 28 letter at which time CUMIS decided to make the partial payment of $1,056,000.

57. The plaintiff did not respond to the October 28 letter until February 23, 2022 ("the February 23 letter"), in a letter written by new counsel for the plaintiff. Once again, there was little that was substantively new in this February 23 letter other than certain information pertaining to the

Geranium sub-claim. Unfortunately, the questions posed in the September 15 email remained unanswered. Within the February 23 letter, the plaintiff once again demanded that CUMIS pay out the Bond's full limits. CUMIS responded by letter dated April 11, 2022 ("the April 11 letter") in which, among other things, CUMIS's ongoing, and unanswered, coverage concerns were laid out again.

58. Prior to the delivery of the April 11 letter, CUMIS's counsel approached plaintiff's counsel with a suggestion as to how the outstanding questions concerning the Geranium and False Invoices sub-claims might be resolved. CUMIS's suggestion was that the plaintiff's forensic accountant could meet in person with CUMIS's adjuster so that together, they could "go through the numbers and the transactions" in an effort to resolve CUMIS's outstanding concerns. While in March 2022, the plaintiff's counsel agreed in principle to the idea of this meeting, in fact, the plaintiff has been unable or unwilling to allow the meeting to take place and no such meeting has yet occurred.

Coverage Assessment for Remaining Sub-Claims

59. The February 11 and October 28 letters provided an assessment of the status of CUMIS' coverage assessments (as they were at the time the letters were written) pertaining to the sub-claims set out **Schedule A**. CUMIS sets out below a summary of all of the sub-claims asserted in the amended statement of claim. For the sake of clarity, and for the purposes of the discussion below, CUMIS will use the same numbering scheme as set out in the amended statement of claim for these sub-claims, and will use the following summary of the relevant persons and companies involved in the various sub-claims:

- Larry Smith ("Larry") owned and operated the following companies:
- 1428245 Ontario (**"142" or "142 Ontario"**);
- 809755 Ontario (**"809" or "809 Ontario"**)
- Phillip **Smith** ("Phil"; Larry's son) was CFO of PACE and later became CEO in 2016;

- Malek **Smith** ("Malek"; Larry's other son) owned 1916761 Ontario (**1916 or 1916 Ontario**) as a holding company. Larry apparently had an interest in **1916**.
- Allison **Golanski** ("Golanski") is Larry's common law wife. She owned and ostensibly controlled 1724725 Ontario (**1724 or 1724 Ontario**).
- Frank **Klees** ("Klees"): friend of Larry's and allegedly an officer of PACE (though the plaintiff has not proven this). Involved in the Geranium matter.
- Joanna **Whitfield** ("Whitfield"): friend of Larry's (possibly former girlfriend). Ostensible owner of 2340938 Ontario ("**2340" or "2340 Ontario"**), though it is possible that Larry controlled 2340. Involved in the CCE sub-claim.
- Ron **Williamson** ("Williamson"): a broker (through his company) and friend of Larry's.

A. CCE

60. In the POL, the sub-claims made in respect of the CCE investment by PACE are set out as follows:

- $174,000 for payments by 2340 to Larry, Phil and other employees of PACE;
- 141,000 for payments by 2340 to Whitfield;
- Claims for costs related the 2340 receivership proceedings; and
- Claims for losses arising out of "loan impairment" on PACE's loan to 2340.

61. The CCE sub-claim is not contained within **Schedule A**. In any event, in the February 11 letter, CUMIS provided its tentative coverage assessment for this sub-claim, stating that, based upon the facts as presented in the POL, CUMIS was not yet satisfied that coverage for any part of the sub-claim had been established yet:

- It was not clear to CUMIS that the payments by 2340 to Larry, Phil and others were undisclosed to, or unauthorized by PACE.
- The payments to Whitfield were not necessarily secret commissions, since Whitfield owned 2340, and at first instance, she was entitled to pay herself money out of that company.
- In respect of the relevant loan, and of PACE's investment in CCE, CUMIS was not satisfied that the plaintiff had shown that Larry intended to cause a loss to the insured. While Larry appears to have circumvented the relevant policies and procedures and concealed his true intentions, it appeared that his intention was to circumvent the ownership restrictions so PACE could invest in a going concern that was apparently a successful business. This in turn suggests that Larry's intention was to make money for PACE, rather than to cause it a loss.
- The costs of the 2340 receivership – whatever they might be – appear to be indirect or consequential in nature such that they are unlikely to be covered losses under the terms of the Bond.

62. The plaintiff has never provided any response to the Feb 11 letter as it pertains to the CCE sub-claim.

B. Geranium

63. In the POL, the Geranium sub-claim is set out as follows:

- $2.3 million for payments by third parties to Larry Smith;
- $1,100,000 for payments by PACE to Klees;
- $3 million for payments by PACE to Larry;
- $2,187,000 for "impaired value of real estate interests"

64. As noted above, CUMIS has requested that the plaintiff provide certain additional information relating to this sub-claim. As noted above, CUMIS has offered to the plaintiff to have

CUMIS's adjuster meet with the plaintiff's forensic accountant in an effort to resolve CUMIS's various outstanding concerns. Unfortunately, the plaintiff has not provided all the requested information, and the plaintiff has been unwilling to allow such a meeting between adjuster and accountant to take place. In the meantime, in the absence of this additional information, CUMIS is unable at this point to finalize its assessment as to coverage and quantum in respect of the various aspects of this sub-claim. CUMIS has identified in writing for the plaintiff the remaining outstanding coverage issues in respect of this sub-claim:

- CUMIS acknowledges that, to the extent that Larry received secret payments from entities which did business with PACE (JLG Management and Prime R), these might be secret commissions which could be covered losses. Thus far, it is unclear from the materials provided by the plaintiff as to what the quantum is in respect of any such secret payments.

- The payments made from PACE to Larry were made to numbered companies. These payments would not be secret commissions if they were authorized or otherwise disclosed to the Board. CUMIS has requested clarification from the plaintiff as to exactly which payments to Larry and related entities fall within this category.

- CUMIS is not satisfied that yet satisfied that Klees was an "Employee" as that term is defined under the terms of the Bond and the plaintiff has chosen not to respond to CUMIS's requests for additional information to support the plaintiff's allegations on this point. There has been no suggestion or evidence to support the notion that Klees was a director of PACE at any relevant time.

- The claim for $2,187,000 for the alleged impaired value of the investment would likely not be covered since the plaintiff has presented no evidence that anyone at PACE intended for these investments to fail and to cause a loss to the credit union, or to cause a loss in this amount.

- Some parts of the Geranium sub-claim relate to allegedly fraudulent invoices rendered by Larry to one or other entity (with subsequent unauthorized payments

to Larry). The Fraudulent Invoices sub-claim advances a similar claim such that it is possible that there may be overlap between this sub-claim and the False Invoices sub-claim. As noted above, CUMIS has sought but not yet received from the plaintiff additional information from the plaintiff which is necessary to resolve its concerns on this point.

C. SusGlobal

65. In the POL, the SusGlobal sub-claim is set out as follows:

- $3,800,000 for a loan loss; and
- $200,000 in respect of the payment of a secret commission.

66. CUMIS has accepted coverage for the claim for the secret commission part of this sub-claim (item #1 on **Schedule A**). CUMIS has rejected the loan loss claim, for the reasons set out in the February 11 letter. Among other things, in this earlier letter, CUMIS noted the following factual points:

- There was a formal underwriting process in place at PACE which reviewed the loan(s) at issue, and Ron Ghose was the loans officer at PACE in charge of the SusGlobal lending facility;
- The plaintiff had provided no compelling evidence to suggest that Larry "forced" this loan on PACE; and
- Williamson [a third party] and Larry discussed receiving partial payment in shares of the borrower, suggesting that Larry hoped that the business would prosper.

67. On the basis of these facts, as it understood them, CUMIS was not satisfied that (i) Larry caused the loans to be made; or that (ii) if he did, then he did so with the subjective intention of having the loans go into default and cause a loss in the amount of the loans to PACE. At no time has the plaintiff ever responded to the February 11 letter to advise that CUMIS's understanding of the relevant facts (set out above and in that letter) was incorrect, and/or to provide any evidence to

suggest that CUMIS' understanding of the relevant facts was not correct. As such, CUMIS was obliged to conclude that there was no coverage for this sub-claim.

D. Lora Bay

68. In the POL, the Lora Bay sub-claim is set out as follows:

- $180,000 representing an unauthorized and unjustified "fee" paid by PACE to 191 Ontario (Malek) for "services" which were allegedly never provided;
- $4,420.000 in respect of an improvident investment.

69. CUMIS has accepted coverage for the claim relating to the payment by PACE to 191 Ontario (item #3 on **Schedule A**). CUMIS has rejected the claim in respect of the allegedly improvident investment for the reasons set out in the February 11 letter (this part of the sub-claim is not included on **Schedule A**). Among other things, in this earlier letter, CUMIS noted the following factual points:

- The plaintiff has presented no evidence to support the conclusion that Larry or any other Employee had an active and conscious purpose to cause a loss to the credit union.
- There is evidence to suggest that the PACE Board of Directors approved the initial debenture and its conversion into equity.
- In any event, given that there was an ongoing relationship between PACE on the one hand and Lora Bay and its principal, Larry Dunn on the other, in the absence of any additional evidence, there is no reason to believe that an investment in Lora Bay would have been intended to cause a loss to the credit union.

70. On the basis of these facts, as it understood them, CUMIS was not satisfied that Larry, on his own, caused the investment at issue to be made; or that (ii) even if he did, that he did so with the subjective intention of having the investment fail and cause a loss to PACE. At no time has the

plaintiff ever responded to the February 11 letter to advise that CUMIS's understanding of the relevant facts (set out above and in that letter) was incorrect, and/or to provide any evidence to suggest that CUMIS' understanding of the relevant facts was not correct. As such, CUMIS was obliged to conclude that there was no coverage for this sub-claim.

E. Noble House

71. In the POL, the Noble House sub-claim is set out as follows:

- $226,000 in respect of a payment made by Noble House to 1916 (Malek's company);
- $226,000 in respect of a payment made by Noble House to Williamson;
- $4,900,000 being the impaired amount of the loan to Noble House.

72. CUMIS has accepted coverage for the claim in the amount of $226,000 in respect of a payment made by Noble House to 1916 (item #4 on **Schedule A**). For the reasons set out in the February 11 letter, CUMIS has rejected both the claim in respect of the payment to Williamson (which is not included on **Schedule A**), and the claim for the allegedly loan loss. Among other things, in this earlier letter, CUMIS noted the following factual points:

- Williamson was not an employee of PACE and the payment to him (or his company) was made by a third party;
- There was a formal underwriting process in place at PACE in 2017 for this loan, and PACE approved the loan based on what appears to be a legitimate appraisal which was obtained in June 2017;
- While the plaintiff obtained a less favourable appraisal in 2019, in the absence of any evidence that Larry provided, or caused to be provided a fraudulent 2017 appraisal, CUMIS questioned how the 2019 appraisal could be relevant to the issue of whether Larry had dishonest intent in 2017 when the loan was granted;

- CUMIS saw no compelling evidence to suggest that Larry "forced" this loan on PACE;

- The borrower had a plausible business plan and PACE's credit committee signed off on this loan.

73. On the basis of these facts, as the insurer understood them, CUMIS was not satisfied that (i) Larry caused the loan to be made; or that (ii) if he did, then he did so with the subjective intention of having the loan go into default. At no time has the plaintiff ever responded to the February 11 letter to advise that CUMIS's understanding of the relevant facts (set out above and in that letter) was incorrect, and/or to provide any evidence to suggest that CUMIS' understanding of the relevant facts was not correct. As such, the insurer was obliged to conclude that there was no coverage for the loan loss portion of this sub-claim.

74. CUMIS states that it is not satisfied that the amounts paid to Williamson represent a covered loss since Williamson was not PACE's employee, so that any such payments to him cannot meet the legal test for a bribe or secret commission *vis-à-vis* PACE.

F. 1934811 Ontario: Secret Commissions Sub-Claim

75. In the POL, the sub-claim relating to payments made by 193 Ontario is set out as follows:

- $310,750 relating to a payment from 193 Ontario to 172 Ontario (Golanski's company);
- $310,000 relating to a payment from 193 to Williamson.

76. CUMIS has accepted coverage for the payment from 193 Ontario to 172 Ontario (item #6 on **Schedule A**). For the reasons set out in the February 11 letter, CUMIS has rejected the claim in respect of the payment from 193 to Ron Williamson (which is not included on **Schedule A**) on the basis that at no time was Williamson an Employee of PACE and therefore a payment to him by a third party cannot be a secret commission *vis-à-vis* PACE.

G. Lagasco

77. In the POL, the sub-claims made in respect of the Lagasco investment by PACE are as follows:

- $3 million in respect of a loan loss;
- A claim for costs in an amount to be determined allegedly incurred to prevent the advancement of further planned, but improper loans.

78. The Lagasco sub-claim is not contained within **Schedule A**. For the reasons set out in the February 11 letter, CUMIS has rejected this sub-claim. Among other things, in this earlier letter, CUMIS noted the following factual points:

- Jane Lowrie, principal of Legasco, was a corporate CEO with a publicly traded company. She and Larry knew each other from their other respective business dealings;
- Legasco sought to borrow funds from PACE to assist with the purchase of assets of an insolvent entity, under a court proceeding, and PACE did advance funds at first instance to Legasco to pay a deposit on this purchase;
- The plaintiff Administrator chose not to complete Legasco's proposed financing, through PACE, of this purchase;
- Ultimately, Lowrie (through her company Lagasco) was able to complete the purchase through funds borrowed from another lender, but the funds so borrowed were not sufficient to pay-out PACE's interest;
- In any event, another financial institution evidently was of the view that the loan to Legasco was a risk worth taking, even if the Administrator was not prepared to lend further funds to Legasco;
- While there appears to be evidence that the loan was not in compliance with the lending requirement set out by the Act and Regulations, there is

no evidence that Larry intended the loan to go into default and cause a loss to the credit union.

- On the contrary, given the pedigree of the borrower's principal, Ms. Lowrie, it can be inferred that Larry believed that this was a good risk.
- The plaintiff has not provided evidence of any personal benefit received by Larry (or any other PACE employee) as a result of the transaction at issue.

79. On the basis of these facts, as the insurer understood them, CUMIS was not satisfied that (i) Larry caused the loan to be made; or that (ii) if he did, then he did so with the subjective intention of having the loan go into default. In any event, there is no evidence of any personal benefit being obtained by Larry here and in order to establish coverage, the plaintiff insured must demonstrate that Larry received a benefit of at least $5,000. At no time has the plaintiff ever responded to the February 11 letter to advise that CUMIS's understanding of the relevant facts (set out above and in that letter) was incorrect, and/or to provide any evidence to suggest that CUMIS' understanding of the relevant facts was not correct. As such, the insurer was obliged to conclude that there was no coverage for the loan loss portion of this sub-claim.

80. CUMIS also denies coverage for the portion of the sub-claim for expenses involved by the Administrator in setting aside the transaction. Since there is no coverage in respect of the $3 million loan loss, any incidental expenses involved in unwinding the Lagasco transaction are at best derivative expenses in respect of an uncovered loss, and therefore would be uncovered themselves. In any event, even if there were coverage for the loan loss, these expenses claimed by the plaintiff were indirect in nature and therefore, expressly excluded under the terms of the Bond.

H. Golanski Diversion

81. In the POL, the sub-claim made in respect of the diversion of funds to 172 Ontario was for $140,000. CUMIS has accepted coverage of this sub-claim (item #7 of **Schedule A**).

I. Fraudulent (False) Invoices

82. In the POL, the sub-claim made in respect of the Fraudulent Invoices sub-claim was $2,417,903. In **Schedule A** as attached to the October 1, 2021 letter from plaintiff's counsel, the Fraudulent Invoices sub-claim was revised downwards to $2,062,634. In the amended statement of claim, the amount claimed has been increased to $2,676,165. In spite of frequent requests made by the defendant CUMIS since early 2020, the plaintiff has been unable or unwilling to provide particulars to CUMIS as to which invoices make up this sub-claim. In the absence of such a listing or reconciliation of the invoices making up this sub-claim, CUMIS has been unable thus far to complete its assessment as to quantum and coverage. Further frustrating CUMIS' review is the fact that the quantum claimed by the plaintiff for this sub-claim is continuously changing. While CUMIS has suggested to the plaintiff that CUMIS's adjuster and the plaintiff's forensic accountant should meet in person in an effort to resolve the defendant's outstanding concerns in respect of this sub-claim, the plaintiff has not yet agreed to this.

J. Audit Expenses

83. CUMIS states that under the Audit Expense insuring agreement, the Bond provides that it will cover "necessary and reasonable expenses... incurred to prepare a Proof of Loss which constitutes a loss under the [Dishonesty] Insuring Agreement". The declaration page for the Bond provides for a $25,000 limit under Audit Expense coverage. In the circumstances, CUMIS states that no more than $25,000 in total can be payable under this coverage.

Allegations of Bad Faith

84. CUMIS acknowledges that both it and the plaintiff owe to each other a duty of utmost good faith in the presentation and the adjustment of the Claim. At all times, CUMIS has discharged its duty in the manner in which it has investigated and adjusted the Claim. For all the reasons set out herein, CUMIS denies vehemently that it has failed to investigate, adjust and the pay the Claim in a timely way, and denies that the insurer has at any time acted in bad faith *vis-à-vis* the plaintiff. In this regard, and for example, CUMIS has set out in the February 11, March 10, and October 28 letters the efforts to which CUMIS has gone to adjust and quantify the claim, and the efforts which CUMIS has made to get timely and meaningful responses from the plaintiff to its requests for

information and documentation. In this regard, CUMIS states that the written record shows very clearly the extent to which the plaintiff's slow and incomplete responses to CUMIS's reasonable inquiries have caused – and continue to cause – delay in the final adjustment of this Claim.

Conclusion

85. The defendant remains ready and willing to work with the plaintiff in its adjustment of the Claim. For the purposes of this statement of defence, however, the defendant takes the position that other than as set out herein, the sub-claims asserted by the plaintiff are thus far unsubstantiated and unproven (for all of the reasons set out herein, and for other reasons which may be determined, in due course), and therefore, not payable under the Bond.

86. The defendant pleads and relies on all of the terms of the Bond, and it reserves all of its rights and defences under the terms of the Bond. The defendant also pleads and relies upon the terms of the *Insurance Act*, R.S.O. 1990, as amended.

87. For all of the foregoing reasons, the defendant states that the within claim should be dismissed, with costs.

October 12 2022

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SCHEDULE "A"
CLAIM AMOUNTS

	Claim	Description	Claim Amount	Comments
1	SusGlobal	Secret Commission (in CDN$)	$200,000	• Claims is USD$150,00 converted to CDN$
2	SusGlobal	Loan Losses	$3,800,000	• Losses on loans for which Smith received secret commission
3	Lora Bay	Secret Commission	$180,000	
4	Noble House	Secret Commission	$226,000	
5	Noble House	Loan Loss	$4,900,000	• Loan losses on loan where Smith received secret commission
6	193	Secret Commission	$310,000	
7	172	Diversion to 172	$140,000	
8	Geranium	$ to Larry Smith	$5,334,608	• Payments to Smith
9	Geranium	$ to Klees	$1,253,923	• Being amounts paid to Frank Klees less $1.5 million allegedly disclosed to board
10	False Invoices	$ to Larry	$2,062,634	• Wrongful payments taken by Smith based on invoices he provided to the Credit Union and amounts paid to his accounts his entitlements versus the amount of compensation he was entitled to as detailed in the KSV report.
	Total		**$18,407,165**	
	Costs Claims	$25,000 per claim	**$225,000**	

Schedule B

PACE Credit Union

Date	Event Description
Oct-17	DICO receives the first whistleblower letter which contains allegations of self-dealing, secret commissions and excessive risk-taking
Oct-17 to Apr-18	DICO receives 5 additional letters from the whistleblower(s) and form the view that they are written by someone inside Pace CU
21-Mar-18	DICO issues letter of concern to Pace
3-Apr-18	DICO places Pace on their Watchlist
19-Apr-18	DICO meets with Pace Board & Larry Smith to discuss concerns, explanations received fail to alleviate DICO's concerns
Apr-18	DICO receives calls from two Pace Directors (Dimakos & Topping) expressing concerns about the "propriety" of various transactions and conduct similar to those expressed by the whistleblower(s)
10-May-18	DICO holds "in-camera" meeting with the Pace Board (excluding Larry Smith) and retains KSV Advisory Group to perform a "special audit"
May-Sept-18	KSV reports findings including: - "self-dealing payments" related to "off-market loans" received by employees of Pace and funneled through numbered companies (i.e. SusGlogal, CCE, Geranium, Dunn, 1934811 Ont. Ltd. - Undisclosed ownership interests in member companies that received loans from Pace (i.e. Trayco, Newmarket, Silver Lakes, 142 Ont, 80-9 Ont, Mass, Easyway - Various regulatory & financial statement issues (i.e. understating loan loss provisions, lack of DICO approval when establishing subsidiaries, inaccurate disclosure of annual compensation
28-Sep-18	DICO issued Order placing PACE under Administration
7-Oct-18	DICO places CUMIS on notice of potential D&O and Bond claim(s)
10-Oct-18	CUMIS Assigned BBCG to Investigate
27-Nov-18	BBCG provides DICO/PACE/Wadden blank Proof of Loss forms calling their attention to the time limitations in the Bond
28-Nov-18	BBCG Report #1
30-Nov-18	At DICO's request the time limitations for filing Proof of Loss are tolled to May 31, 2019 (agreed by CUMIS)
25-Feb-19	BBCG Report #2 with expanded Discovery details
23-Apr-19	BBCG Report #3 reporting details of the Asset Preservation Action commenced by PACE
24-Apr-19	At DICO's request the time limitations for filing Proof of Loss tolled to July 31, 2019 (agreed by CUMIS)
18-Jul-19	BBCG Report #4 update on Asset Preservation Action
19-Jul-19	At DICO's request the time limitations for filing Proof of Loss tolled to September 30, 2019 (agreed by CUMIS)
16-Oct-19	DICO/PACE files an Interim Bond Proof of Loss claiming $23.6M
25-Oct-19	BBCG acknowledges receipt of the POL under a reservation of rights
18-Dec-19	BBCG provides CUMIS Counsel with a detailed Memo regarding PACE POL submission

19-Dec-19	BBCG advises DICO/PACE/Wadden that a detailed question and requests would be submitted in early January 2020
7-Jan-20	BBCG Submits detailed questions/requests to DICO/PACE/Wadden
6-Mar-20	DICO/PACE/Wadden begin uploading documents requested by BBCG
April - May 2020	BBCG submits multiple detailed memos for each category of claim documented by DICO/PACE/Wadden
28-Sep-20	DICO/PACE/Wadden advise that they are working on providing the outstanding documents requested (i.e. False invoice reconciliation & Geranium JV & Loan files)
24-Nov-20	BBCG discusses status of outstanding documents with Wadden and are advised that they are working on it
25-Nov-20	BBCG updates CUMIS Counsel regarding the November 24, 2020 call between BBCG & Wadden
11-Jan-21	BBCG discusses status of outstanding documents with Wadden and are advised that they are working on it. Wadden advises that he has received instructions to start proceedings against CUMIS if CUMIS does not issue some form of positive indication regarding claim potential. BBCG advises that CUMIS has been clear from the outset that a coverage position will not be rendered until the investigation has been completed.
14-Jan-21	BBCG provides CUMIS outside counsel with an update on the January 11, 2021 call between BBCG & Wadden
26-Jan-21	BBCG receives a call from Wadden advising that he has instructions to file a claim against CUMIS including bad faith allegations.
26-Jan-21	BBCG updates CUMIS Counsel regarding the January 26. 2021 call between BBCG & Wadden
27-Jan-21	Wadden emails BBCG advising that they will proceed with suit against CUMIS is he does not receive some form of affirmative communication from CUMIS
10-Feb-21	BBCG receives letter from Wadden regarding the outstanding document requests with instructions for document download from a shared site

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

STATEMENT OF DEFENCE

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Lawyers for the Defendant

TAB L

SETTLEMENT AGREEMENT

THIS SETTLEMENT AGREEMENT is made as of December 1, 2022, between PACE Savings & Credit Union Limited, by its Liquidator, KPMG Inc. ("**PACE**") and Brent Bailey, Deborah Baker, Ian Goodfellow, Al Jones, Wendy Mitchell, George Pohle, Peter Rebellati, Jim Tindall, Pauline Wainwright, and Neil Williamson (the "**Former Directors**") (each individually, a "**Party**", and collectively, the "**Parties**").

WHEREAS PACE commenced an action bearing the Court File Number CV-19-00616388-00CL (the "**Action**") on March 18, 2019;

AND WHEREAS the Former Directors were added as Defendants to the Action by a Fresh as Amended Statement of Claim dated October 11, 2019;

AND WHEREAS CUMIS General Insurance Company ("**CUMIS**") has issued a Directors' & Officers' Liability insurance policy, bearing the policy number 01501254 (the "**Policy**"), to PACE;

AND WHEREAS PACE has brought claims against the Former Directors for negligence and breach of the duty of care they owed to PACE, including any duties owed in managing and supervising the relationship between PACE and Pace Securities Corp. (the "**D&O Claims**");

AND WHEREAS KPMG Inc. was appointed as Liquidator for PACE Savings & Credit Union Limited by Court order dated August 24, 2022;

AND WHEREAS the Parties have engaged in arm's-length, good faith negotiations to resolve PACE's claims as against the Former Directors;

AND WHEREAS PACE intends to pursue its claims against the Defendants in the Action, aside from the Former Directors (the "**Non-Settling Defendants**"), but only in respect of the Non-Settling Defendants' proportionate share of liability;[1]

AND WHEREAS the Former Directors have agreed to co-operate in PACE's pursuit of its claims against the Non-Settling Defendants in the Action, on the terms specified below;

AND WHEREAS PACE intends to seek an order from the Ontario Superior Court of Justice (Commercial List) (the "**Court**") approving this Settlement Agreement;

[1] For clarity, the Non-Settling Defendants are: 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, and Joanna Whitfield.

NOW THEREFORE in consideration of the covenants set out below and the representations made in the Recitals above and for other good and valuable consideration, the receipt and sufficiency of which are acknowledged, and subject to the provisions set out herein respecting Court approval of this Settlement Agreement and its material terms, the Parties agree as follows:

1. The Former Directors shall cause CUMIS to pay the sum of (the "**Settlement Funds**") by wire transfer of immediately available funds to PACE within 30 days following the effective date of this Settlement Agreement. Payment of the Settlement Funds will be the sole responsibility of CUMIS and the Former Directors will have no personal obligation to pay the Settlement Funds personally.

2. On the effective date of this Settlement Agreement, the Parties will enter into a full and final mutual release of the D&O Claims (the "**Release**"), in the form attached hereto as Schedule "A", or as counsel to the Parties, acting reasonably, shall otherwise agree. The Release shall be held in escrow until PACE's receipt of the Settlement Funds.

3. PACE will amend the Statement of Claim in the Action to remove the D&O Claims and to clarify that any damages it is seeking from the Non-Settling Defendants do not include any amount apportionable to the fault or negligence of the Former Directors.

4. PACE will obtain orders dismissing the Action as against the Former Directors. The Former Directors will consent to dismissal of their Counterclaim against PACE.

5. If requested by PACE, the Former Directors shall cooperate with counsel for PACE and/or the Liquidator in the prosecution of the Action against the Non-Settling Defendants, including by appearing and giving sworn evidence as witnesses at the trial of the Action as against the Non-Settling Defendants. PACE will pay the reasonable legal fees incurred by the Former Directors in connection with such cooperation.

6. CUMIS will not rely on the inclusion of an obligation to provide evidence in paragraph 5 to allege that it constitutes a basis for denial of coverage. Should PACE exercise any rights to obtain such evidence, CUMIS may allege that it constitutes a basis for denial of coverage and PACE will be free to allege it does not constitute such a breach.

7. The Liquidator will, at its expense, seek an order from the Court approving the terms of this Settlement Agreement (the "**Approval Order**") on notice to all of the parties to the Action and CUMIS. The Former Directors and CUMIS will consent to the Approval Order in a form that is acceptable to counsel, acting reasonably.

8. PACE will disclose the existence and terms of this Settlement Agreement to the Non-Settling Defendants as required by law and as necessary to obtain the Approval Order. The Parties shall otherwise keep the existence and terms of this Settlement Agreement

confidential, and shall not reveal its existence and terms except to their respective legal and financial advisors and insurers, or as otherwise required by law.

9. This Settlement Agreement and the documents referred to herein together constitute the entire agreement between the Parties with respect to the matter herein. The execution of this Settlement Agreement has not been induced by, nor do any of the Parties rely upon or regard as material, any representations, promises, agreements or statements whatsoever not incorporated herein and made a part hereof.

10. This Settlement Agreement shall be governed by, and will be construed and interpreted in accordance with, the laws of the Province of Ontario and the laws of Canada applicable in the Province of Ontario. The Parties hereby attorn to the jurisdiction of the Court in respect of any dispute arising from this Settlement Agreement.

11. No amendment, supplement, modification or waiver or termination of this Settlement Agreement and, unless otherwise specified, no consent or approval by any Party, is binding unless executed in writing by the party to be bound thereby.

12. Any failure by any Party to insist upon the strict performance by the other Party of any of the provisions of this Agreement shall not be deemed a waiver of any of the provisions hereof, and such Party, notwithstanding such failure, shall have the right thereafter to insist upon strict performance of any and all of the provisions of this Agreement to be performed by such other Party.

13. Except as specified herein, each of the Parties (and in the case of the Former Directors, CUMIS) shall pay their respective legal, accounting, and other professional advisory fees, costs and expenses incurred in connection with this Settlement Agreement and its implementation.

14. This Settlement Agreement may be executed in counterparts, each of which shall be deemed to be an original and which together shall constitute one and the same agreement. Delivery of an executed original counterpart of a signature page of this Settlement Agreement by facsimile or electronic transmission shall be as effective as delivery of a manually executed original counterpart of this Settlement Agreement.

15. The Settlement Agreement has been the subject of negotiations and discussions among the Parties. Each of the Parties has been represented and advised by competent counsel, so that any statute, case law, or rule of interpretation or construction that would or might cause any provision to be construed against the drafters of the Settlement Agreement shall have no force and effect.

IN WITNESS OF WHICH the Parties have executed this Settlement Agreement.

[signature pages follow]

PACE Savings & Credit Union Limited, by its liquidator, KPMG Inc.

DocuSigned by:
Anamika Gadia
EAA3121527848C...

ANAMIKA GADIA
Title: Vice President
I have the authority to bind the Corporation

CUMIS General Insurance Company

DocuSigned by:
438E07A50123483...

BOB HAGUE
Title: EVP/President of Credit Union Distribution, CUMIS Group Ltd.
I have the authority to bind the Corporation

DATED AT , this …... day of December, 2022

DocuSigned by:
Brent Bailey
9A363A512351446...

Witness

Brent Bailey

12/1/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
Deborah Baker
79B4936F8C374C5...

Witness **Deborah Baker**

12/1/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
Ian Goodfellow
AA5FA51DAB0D47A...

Witness **Ian Goodfellow**

12/2/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
D762FD03C77C483...

Witness **Al Jones**

12/1/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
Wendy Mitchell
705419AC9B4740A...

Witness **Wendy Mitchell**

12/1/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
F4517DA6DFB64B8...

Witness **George Pohle**

12/2/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
Peter Rebellati
319C2CD0CACE44E...

Witness

Peter Rebellati

DATED AT , this …... day of December, 2022

Witness

Jim Tindall

12/2/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
Pauline Wainwright
B7F1E217AB2410B...

Witness

Pauline Wainwright

12/1/2022

DATED AT , this …... day of December, 2022

DocuSigned by:
Neil Williamson
01912537E4AC44C...

Witness

Neil Williamson

Witness	Wendy Mitchell
Witness	Neil Williamson
Witness	Pauline Wainwright
Witness	Deborah Baker
Witness	Brent Bailey
Witness	Jim Tindall
Witness	Peter Rebellati
Witness	Al Jones
Witness	George Pohle

Schedule "A"

MUTUAL RELEASE

The undersigned, **PACE SAVINGS & CREDIT UNION LIMITED, by its liquidator, KPMG Inc. ("PACE"), CUMIS GENERAL INSURANCE COMPANY ("CUMIS"), IAN GOODFELLOW, WENDY MITCHELL, NEIL WILLIAMSON, PAULINE WAINWRIGHT, DEBORAH BAKER, BRENT BAILEY, JIM TINDALL, PETER REBELLATI, AL JONES, AND GEORGE POHLE** (which term includes their associated and related companies, and their respective officers, directors, employees, shareholders, partners, administrators, agents, assigns, executors, successors, subcontractors, insurers and heirs), for and in consideration of the execution of this Mutual Release and the promises made in the Settlement Agreement dated December 1, 2022 (the "**Settlement Agreement**"), the receipt and sufficiency of which is hereby acknowledged, do hereby remise, release and forever discharge each other from claims, actions, demands, manner of actions, causes of actions, suits, debts, duties, accounts, bonds, warranties, claims over, indemnities, contracts, losses, injuries, undertakings, covenants and liabilities of whatever nature and kind whether past, present and future, known or unknown, and whether in equity or at law, jointly or severally, one against the other, for or by reason or cause of any matter or thing, known or unknown, existing up to the present time, including, without limiting the generality of the foregoing, those arising out of, connected with or in any way related to the matters raised in the action (claim and counterclaim) bearing Court File No. CV-19-00616388-00CL (the "**Action**"), except as excluded herein.

AND IT IS HEREBY DECLARED, CONFIRMED AND ACKNOWLEDGED that the undersigned have not been induced to execute this Mutual Release by reason of any representation or warranty of any nature or kind whatsoever, and that there is no condition, express or implied or collateral agreement affecting the said Mutual Release, except as provided for herein and in the Settlement Agreement.

AND IT IS UNDERSTOOD that this Mutual Release excludes claims against CUMIS arising out of, connected with or in any way related to any claims by PACE against the Non-Settling Defendants, as that term is defined in the Settlement Agreement.

AND FOR THE SAID CONSIDERATION the undersigned covenant and agree not to make any claim or demand or commence, maintain or prosecute any action, cause or proceeding for damages, compensation, loss or any relief whatsoever against each other in respect of the claims subject to this Mutual Release. The undersigned further agree that this Mutual Release shall operate conclusively as an estoppel in the event of any such claim, action or proceeding and may be pleaded accordingly.

AND FOR THE SAID CONSIDERATION the undersigned covenant and agree not to continue, to make claim, to commence or to take proceedings against any other person, firm, partnership, business or corporation who or which might claim contribution from, or be indemnified by, the other parties, under the provisions of any statute or otherwise in respect of those matters to which this Mutual Release applies.

AND IT IS HEREBY DECLARED, CONFIRMED AND ACKNOWLEDGED that the undersigned have not assigned and will not assign to any other person or entity any of the

actions, causes of action, suits, demands, debts, accounts, contracts, damages, or other claims which are the subject of this Mutual Release.

AND IT IS UNDERSTOOD that upon providing this Mutual Release the undersigned, and each of them, do not admit any liability to the other or others and that such liability is specifically and expressly denied.

THIS MUTUAL RELEASE shall be deemed to have been made in and shall be construed in accordance with the laws of the Province of Ontario.

THIS MUTUAL RELEASE shall inure to the benefit of and be binding upon the undersigned and their respective heirs, executors, administrators, legal personal representatives, successors and assigns.

AND IT IS AGREED that this Mutual Release can be signed in counterparts and facsimile or scanned copies of the signatures sent by email are deemed to be and count as originals in all respects.

THE PARTIES have executed this Mutual Release, this 1st day of December, 2022.

PACE SAVINGS & CREDIT UNION LIMITED, by its liquidator, KPMG Inc.

DocuSigned by:
Per: Anamika Gadia
FAAA9124527848C...

Anamika Gadia
(I have authority to bind the corporation)

CUMIS General Insurance Company

DocuSigned by:
Per: [signature]
428E07A50123483...

(I have authority to bind the corporation)

DocuSigned by:
Ian Goodfellow
AA5FA51DAB6B47A...

Witness

Ian Goodfellow

	DocuSigned by: Wendy Mitchell 705419AC9B4740A...
Witness	Wendy Mitchell
	DocuSigned by: Neil Williamson 01912537E4AC44C...
Witness	Neil Williamson
	DocuSigned by: Pauline Wainwright B7F1F217AB2448B...
Witness	Pauline Wainwright
	DocuSigned by: Deborah Baker 79B4996F6C374C5...
Witness	Deborah Baker
	DocuSigned by: Brent Bailey 9A363A512351446...
Witness	Brent Bailey
Witness	Jim Tindall
	DocuSigned by: Peter Rebellati 319C2CD0CACE44F...
Witness	Peter Rebellati
	DocuSigned by: D762FD03C77C483...
Witness	Al Jones
	DocuSigned by: F4547DA6DFB84B8...
Witness	George Pohle

Witness	Wendy Mitchell
Witness	Neil Williamson
Witness	Pauline Wainwright
Witness	Deborah Baker
Witness	Brent Bailey
Witness	DocuSigned by: Jim Tindall 31D3BEACCF004AA... Jim Tindall
Witness	Peter Rebellati
Witness	Al Jones
Witness	George Pohle

TAB M

SETTLEMENT AGREEMENT

THIS SETTLEMENT AGREEMENT is made as of December 1, 2022, between PACE Savings & Credit Union Limited, by its Liquidator, KPMG Inc. ("**PACE**") and CUMIS General Insurance Company ("**CUMIS**") (each individually, a "**Party**", and collectively, the "**Parties**").

WHEREAS PACE commenced an action against CUMIS bearing the Court File Number CV-22-00677550-0000 (the "**Action**") on February 28, 2022;

AND WHEREAS CUMIS issued a Bond (the "**Bond**") and an Employment Practices Liability insurance policy (the "**EPL Policy**") under policy number 01501254 to PACE;

AND WHEREAS the Parties have engaged in arm's-length, good faith negotiations to resolve PACE's claims against CUMIS;

AND WHEREAS PACE intends to seek an order from the Ontario Superior Court of Justice (Commercial List) (the "**Court**") approving this Settlement Agreement;

NOW THEREFORE in consideration of the covenants set out below and the representations made in the Recitals above and for other good and valuable consideration, the receipt and sufficiency of which are acknowledged, and subject to the provisions set out herein respecting Court approval of this Settlement Agreement and its material terms, the Parties agree as follows:

1. CUMIS shall pay [redacted] (the "**Settlement Funds**") by wire transfer of immediately available funds to PACE within 30 days following the effective date of this Settlement Agreement.

2. On the effective date of this Settlement Agreement, the Parties will enter into a full and final release of PACE's claims against CUMIS in the Action and in connection with the Bond and the EPL Policy (the "**Release**"), in the form attached hereto as Schedule "A", or as counsel to the Parties, acting reasonably, shall otherwise agree. The Release shall be held in escrow until PACE's receipt of the Settlement Funds.

3. CUMIS agrees that it has waived or will waive any subrogation and/or recovery rights which arose or may otherwise arise under the terms of the Bond or the EPL Policy.

4. PACE will obtain an order dismissing the Action on a with-prejudice and without-costs basis.

5. PACE will, at its expense, seek an order from the Court approving the terms of this Settlement Agreement (the "**Approval Order**"). CUMIS will consent to the Approval

Order. The receipt of an Approval Order is a condition in favour of PACE that can be waived at the election of KPMG Inc., in its capacity as Liquidator of PACE.

6. This Settlement Agreement and the documents referred to herein together constitute the entire agreement between the Parties with respect to the matter herein. The execution of this Settlement Agreement has not been induced by, nor do any of the Parties rely upon or regard as material, any representations, promises, agreements or statements whatsoever not incorporated herein and made a part hereof.

7. This Settlement Agreement shall be governed by, and will be construed and interpreted in accordance with, the laws of the Province of Ontario and the laws of Canada applicable in the Province of Ontario. The Parties hereby attorn to the jurisdiction of the Court in respect of any dispute arising from this Settlement Agreement.

8. No amendment, supplement, modification or waiver or termination of this Settlement Agreement and, unless otherwise specified, no consent or approval by any Party, is binding unless executed in writing by the party to be bound thereby.

9. Any failure by any Party to insist upon the strict performance by the other Party of any of the provisions of this Agreement shall not be deemed a waiver of any of the provisions hereof, and such Party, notwithstanding such failure, shall have the right thereafter to insist upon strict performance of any and all of the provisions of this Agreement to be performed by such other Party.

10. Except as specified herein, each of the Parties shall pay their respective legal, accounting, and other professional advisory fees, costs and expenses incurred in connection with this Settlement Agreement and its implementation.

11. This Settlement Agreement may be executed in counterparts, each of which shall be deemed to be an original and which together shall constitute one and the same agreement. Delivery of an executed original counterpart of a signature page of this Settlement Agreement by facsimile or electronic transmission shall be as effective as delivery of a manually executed original counterpart of this Settlement Agreement.

12. The Settlement Agreement has been the subject of negotiations and discussions among the Parties. Each of the Parties has been represented and advised by competent counsel, so that any statute, case law, or rule of interpretation or construction that would or might cause any provision to be construed against the drafters of the Settlement Agreement shall have no force and effect.

IN WITNESS OF WHICH the Parties have executed this Settlement Agreement.

PACE Savings & Credit Union Limited, by its liquidator, KPMG Inc.

DocuSigned by:
Anamika Gadia
EAAA912452784BC...

ANAMIKA GADIA
Title: Vice President
I have the authority to bind the Corporation

CUMIS General Insurance Company

DocuSigned by:
438E07A50123483...

BOB HAGUE
Title: EVP/President of Credit Union Distribution, CUMIS Group Ltd.
I have the authority to bind the Corporation

Schedule "A"

MUTUAL RELEASE

The undersigned, **PACE SAVINGS & CREDIT UNION LIMITED, by its liquidator, KPMG INC. ("PACE") and CUMIS GENERAL INSURANCE COMPANY ("CUMIS")** (which term includes their associated and related companies, and their respective officers, directors, employees, shareholders, partners, administrators, agents, assigns, executors, successors, subcontractor and heirs), for and in consideration of the execution of this Mutual Release and the promises made in the Settlement Agreement dated December 1, 2022 (the "**Settlement Agreement**"), the receipt and sufficiency of which is hereby acknowledged, do hereby remise, release and forever discharge each other from claims, actions, demands, manner of actions, causes of actions, suits, debts, duties, accounts, bonds, warranties, claims over, indemnities, contracts, losses, injuries, undertakings, covenants and liabilities of whatever nature and kind whether past, present and future, known or unknown, and whether in equity or at law, jointly or severally, one against the other, for or by reason or cause of any matter or thing existing up to the present time, including, without limiting the generality of the foregoing, arising out of, connected with or in any way related to the allegations made in the Statement of Claim in the action bearing the Court File Number CV-22-00677550-0000, or to claims made under the Bond and Employment Practices Liability insurance policy issued by CUMIS under the policy number 01501254, except as excluded herein.

AND IT IS HEREBY DECLARED, CONFIRMED AND ACKNOWLEDGED that this Mutual Release does not apply to claims arising in relation to a directors' and officers' liability insurance policy issued by CUMIS to PACE under the policy number 01501254.

AND IT IS HEREBY DECLARED, CONFIRMED AND ACKNOWLEDGED that the undersigned have not been induced to execute this Mutual Release by reason of any representation or warranty of any nature or kind whatsoever, and that there is no condition, express or implied or collateral agreement affecting the said Mutual Release, except as provided for herein and in the Settlement Agreement.

AND FOR THE SAID CONSIDERATION the undersigned covenant and agree not to make any claim or demand or commence, maintain or prosecute any action, cause or proceeding for damages, compensation, loss or any relief whatsoever against each other in respect of the claims subject to this Mutual Release. The undersigned further agree that this Mutual Release shall operate conclusively as an estoppel in the event of any such claim, action or proceeding and may be pleaded accordingly.

AND FOR THE SAID CONSIDERATION the undersigned covenant and agree not to continue, to make claim, to commence or to take proceedings against any other person, firm, partnership, business or corporation who or which might claim contribution from, or be indemnified by, the other undersigned, under the provisions of any statute or otherwise in respect of those matters to which this Mutual Release applies.

AND IT IS HEREBY DECLARED, CONFIRMED AND ACKNOWLEDGED that the undersigned have not assigned and will not assign to any other person or entity any of the actions, causes of action, suits, demands, debts, accounts, contracts, damages, or other claims which are the subject of this Mutual Release.

AND IT IS UNDERSTOOD that upon providing this Mutual Release the undersigned, and each of them, do not admit any liability to the other or others and that such liability is specifically and expressly denied.

THIS MUTUAL RELEASE shall be deemed to have been made in and shall be construed in accordance with the laws of the Province of Ontario.

THIS MUTUAL RELEASE shall inure to the benefit of and be binding upon the undersigned and their respective heirs, executors, administrators, legal personal representatives, successors and assigns.

THIS MUTUAL RELEASE may be executed by facsimile or scan sent by email and, if so executed, shall be considered an original Release.