CITATION: Polla v. Croatian (Toronto) Credit Union, 2018 ONSC 1641
COURT FILE NO.: CV-10-403252
DATE: 20190313

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:	)	
FERDINANDO POLLA	)	Larry J. Levine, Q.C. and Benjamin Salsberg, for the Plaintiff
Plaintiff	)	
– and –	)	
CROATIAN (TORONTO) CREDIT UNION LIMITED, ZVONIMIR JOSIPOVIC, STEPHEN P. KOVACEVIC, STANKO BINGULA, ANTON JURINCIC, MATO MENALO, ANTE MIMICA, IGNAC RADENCIC JOE SERTIC, JOSIP VINSKI, DEPOSIT INSURANCE CORPORATION OF ONTARIO, RETFORD LANE BATES LLP, and FINANCIAL SERVICES COMMISSION OF ONTARIO	)	Frank E.P. Bowman, Douglas B.B. Stewart and Deepshikha Dutt , for the Defendants Zvonimir Josipovic, Stephen P. Kovacevic, Stanko Bingula, Anton Jurincic, Mato Menalo, Ante Mimica, Ignac Radencic, and Joe Sertic Sandra E. Dawe and Jonathan Miller, for the Defendant Retford Lane Bates LLP
Defendants	)	
	)	**HEARD:** October 10-12, 13, 16-20, 23-27, 30, 31, 2017; November 1-3, 6-10, 14-17, 27-30, 2017; December 1, 2017; January 15-18, 2018, September 4, 2018

REASONS FOR JUDGMENT

J. E. FERGUSON, J.

Schedules to Reasons for Judgment

[1] Schedule "A" provides a list of the parties. Schedule "B" provides a list of other witnesses who testified. Schedule "C" sets out other relevant individuals and entities. All have been allocated acronyms as indicated. The Schedules are found at the end of these reasons. The acronyms are also provided in the "body" of the reasons for ease of reference.

Introduction and Background

[2] The time needed for this trial was underestimated by counsel and there were scheduling difficulties. As a result, the trial was broken up over five months. In an attempt to shorten the trial it was agreed that the evidence of the board members who testified bound all the members. The experts all testified at the end of the trial. After the evidence was completed all trial transcripts were obtained. Subsequently, I was provided with comprehensive written closing and reply submissions from which I have drawn extensively in writing these reasons. I have checked all of the provided references to the evidence and accept that they are accurate. Accordingly I have not provided those references in these reasons. I appreciate that the written submissions required significant effort on the part of counsel. After I received all submissions, I asked questions of counsel and received some written answers. Oral submissions were then heard on September 4, 2018.

Overview

[3] This case is about an investment that Ferdinando Polla ("Polla") made, and subsequently lost, in a financially troubled credit union, the Croation Credit Union (the "CCU"). Polla commenced a claim against each of the members of the board of directors (the "board") of the CCU and its external auditors, Retford Lane Bates LLP ("Retford"). It is a statutory claim brought under the *Credit Unions and Caisses Populaires Act, 1994*, S.O. 1994, c. 11 (the "Act"). The claim against the board is brought under s. 82(3)(c) and against Retford under s. 82(3)(d).

[4] Initially, Polla also pursued the CCU's regulators, the Deposit Insurance Corporation of Ontario ("DICO") and the Financial Services Commission of Ontario ("FSCO"), as well as Josip Vinski ("Vinski"), the CCU's former CEO. Polla's action was discontinued or dismissed against DICO and FSCO. He obtained default judgment against Vinski, who is bankrupt.

[5] On May 23, 2008, the CCU released an offering statement (the "OS") in accordance with the provisions of the Act in order to raise monies from its membership. This process was undertaken under the supervision of the regulators. Many other parties were involved in the process.

[6] Polla invested $5 million in preferred shares issued pursuant to the OS (the "investment"). As a result of various transactions that followed his investment, as well as the discovery of a fraud (the "OMF") committed by Vinski (and unknown others), the CCU was put into administration in July of 2009 and subsequently into liquidation.

[7] Polla seeks to recover his investment from the board members personally and from Retford. The board and Retford deny liability. The issue before the court is whether the OS contained a material misrepresentation of the nature contemplated in s. 82 of the Act.

[8] Over the course of the trial and in his written closing submissions, Polla essentially abandoned his original allegations of misrepresentation and negligence against the board and

Retford as pleaded in his amended statement of claim in favour of a new, different alleged misrepresentation. Polla seeks a further amendment of his amended statement of claim to add this new allegation. The defendants oppose the amendment. In a nutshell, Polla's new allegation is that the OS's description of the CCU's lending services as based on a property's "appraised value" is a material untrue statement, because the CCU often based residential mortgage approvals on the value provided in the property's purchase and sale agreement, instead of obtaining an independent appraisal opinion. This trial essentially boils down to those two words – "appraised value" – and whether those words were a misrepresentation of the nature contemplated by the Act. Section 82(6) of the Act defines a misrepresentation as an untrue statement of material fact, or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. If such a misrepresentation is established, s. 82(5) of the Act states there will be no liability if it can be demonstrated that the defendants did not believe nor had any reasonable grounds to believe that there had been a misrepresentation.

[9] I have set out a lot of background information in this introduction which at the end of the day is not particularly controversial. It was likely more contentious when Polla was proceeding with his original allegations. I believe, however, that this background information is important as it provides a "backdrop" to the various disputed issues.

The Issues – and the short answer to each (expanded on below)

1. Is the amendment to the amended statement of claim allowed?
   No.

   Is the amendment statute barred?
   Yes.

   Will it cause prejudice which cannot be compensated for by costs?
   Yes.

2. Did Polla invest as a trustee for Investex or personally?
   Polla invested as trustee for Investex.

3. Does Polla have a common law negligence action against the board and its directors?
   No.

4. Was there a material misrepresentation in the OS pursuant to section 82(1) of the Act?
   No.

   Do the defendants have a statutory defence?
   Yes.

5. Is the presumption of deemed reliance rebutted in this case?
   Yes.

6. Is there a causal link between Polla's loss and the alleged misrepresentation?
   No.

7. Is Polla partially liable for contributory negligence?
   If Polla has a valid cause of action (which he does not), he is 50% liable for contributory negligence.

8. If Polla is successful, what are his damages?
   If Polla was successful, his damages would be $5 million (the amount of his investment).

Relevant Sections of the Act

Standard of disclosure

77(3) The OS must provide full, true and plain disclosure of all material facts relating to the securities that the credit union proposes to issue.

Effect of misrepresentation

82(1) If an OS…contains a misrepresentation, a purchaser of a security shall be deemed to have relied upon the misrepresentation if it was a misrepresentation when the purchase was made.

82(2) Exception

Subsection (1) does not apply if the purchaser knew about the misrepresentation when purchasing the security.

82(3) Right of action

The purchaser has a right of action for damages against,

…

(c) every director of the credit union at the time the OS… was filed with the superintendent; and

(d) every person whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statement that have been made by them. (this section deals with Retford whose consent was filed to include the financial statements in the OS).

82(5) Defence

A person who signed the disclosure certificate required under subsection 77 (4) or a director is not liable under this section if the person proves one of the following:

> ...
>
> 3. The person had no reasonable grounds to believe, and did not believe, that there had been a misrepresentation.

82(6) Interpretation

"misrepresentation" means,

> (a) an untrue statement of material fact, or
>
> (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

Credit Union Governance

[10] Credit unions are governed provincially by their own legislation and associated regulations. In accordance with that legislation, the CCU was governed by a board of directors, who received reports from a three-person credit committee and audit committee (as well as from management). Board and committee members were elected by the membership, from the membership. The only eligibility requirements were that each candidate had to be at least 18 years old and a Canadian citizen. The audit committee and credit committee were both elected separately from the board, and remained separate and distinct from the board.

[11] FSCO and DICO were the statutory regulators for credit unions. An organization called Credit Union Central of Ontario ("CUCO") was effectively the central bank for credit unions in Ontario, including the CCU.

[12] FSCO issued the CCU's lending licence and regulated credit union functions assumed from the Act. DICO provided deposit insurance for the CCU's members and acted as the stabilization authority pursuant to supervision or administration orders ("SO" and "AO") issued by FSCO. Both FSCO and DICO maintained regulatory oversight over the CCU's committees, lending policies and practices. FSCO had a higher-level oversight role, and most of the detailed field work was done by DICO. FSCO relied on DICO to provide it with information. FSCO also looked at and provided input on items such as OS's.

[13] DICO had investigative powers under the Act to engage experts (typically accountants) to go into a credit union and assess how it was being operated on a variety of factors, including

capital; credit; and liquidity risks. This process was known as On Site Verification ("OSV") and was used to ensure the smooth operation and governance of credit unions.

[14] The OSV process involved DICO's experts conducting an inspection of the subject credit union over two to four days every one to three years. These expert external accountants examined the credit union's books; records; practices; procedures; portfolios; and policies. The experts generated a report from that inspection that identified any areas of concern, and made recommendations for improvement. The credit union had an opportunity to respond, outlining how these issues would be addressed. The responses would then be reassessed at the next OSV.

[15] The CCU underwent OSV's in 2004 and 2007 (the "2004 OSV" and the "2007 OSV"). The 2004 OSV report identified some issues, which were resolved, and the 2007 OSV report was mostly positive.

[16] A credit union could be placed on a "watch list" as a result of an OSV inspection. This informal list contained credit unions with issues to be resolved and was compiled to ensure that issues were brought forward and dealt with. It was not unusual for a small credit union (like the CCU) to be placed on a watch list.

[17] DICO looked to FSCO to issue any necessary orders to enable DICO's stabilization authority in the event of financial problems. For example, a SO from FSCO gave DICO broad powers under the Act, including attendance at all board meetings (at which it held veto power in respect of any board decisions), and access to any information that it wanted from the credit union.

[18] Credit unions were also required to have an external auditor. An internal auditor was discretionary and not a requirement. The CCU had a part time internal auditor, Rick Belsby ("Belsby"), at the material time. Retford was the external auditor.

The Structure of the CCU

[19] The CCU was created in 1958. As a credit union, it was governed by the provisions of the Act. It was a relatively small credit union which primarily serviced the Croatian community. At all material times, it had assets of no more than approximately $50 million. Its board of directors, committees and management were composed of members who were willing to serve in those roles. Since there were no substantive qualification requirements, the nomination process was not strenuous and people from many different backgrounds, including tradespeople, got involved. The board of the CCU was generally comprised of laypeople who were not experts in governance or financial services. The CCU had three small branches located in Toronto, Mississauga and Hamilton.

[20] The CCU's structure included the board; management; a controller; assistant managers; and both internal and external auditors. At the time of Polla's investment, those positions were occupied as follows:

(a) The board - The CCU's board was made up of volunteers from the Croatian community. Zvonimir Josipovic ("Josipovic") and Stephen P. Kovacevic ("Kovacevic"), respectively, were the chair and the vice chair of the board at the material time. The board conducted its business at monthly board meetings and was not involved in the day to day operations of the CCU;

(b) Management - The CCU was operated by Vinski, who first held the position of general manager and then became the CEO. Vinski had an MBA and had taken numerous courses with CUCO to learn about the different aspects of managing a credit union. He had joined the CCU in 1979, and from 1986 to 2008 he fulfilled the role of the senior management person. Vinski's duties as CEO included: (i) promoting the business of the CCU, which included attracting new members and business; (ii) managing the day-to-day operations, which included hiring employees; overseeing the lending processes; and preparing strategy and proposals for growth; (iii) helping prepare and present monthly financial reports and other information to the board; and (iv) coordinating the work between the different branches. Vinski was hands-on and did whatever was required of him. The Director's Handbook set out the delegation of day-to-day operations of the CCU to management. Aside from the day-to-day tasks involved in running a credit union, this also included the development, communication and implementation of policies; as well as the measuring, reporting and managing of the operations;

(c) The controller – Yves Chin Kow ("Kow") joined the CCU around 2000. He was primarily responsible for preparing the monthly financial reports, including the credit report that outlined the status of the loan portfolio. He had access to all financial records and attended monthly board meetings, where he was responsible for presenting the financial information and reports. He also reported to the board in respect of internal controls that were in place. He worked in support of the audit and credit committees and collected information for the preparation of financial and credit reports. He worked with DICO and FSCO during the OSV process and provided required information to the external and internal auditors;

(d) Assistant managers - Three assistant managers – Steve Gurgich ("Gurgich"), Ana Gasper ("Gasper") and Mary-Ann Miskic ("Miskic") – were responsible for managing the day-to-day operations of the Mississauga, Hamilton and Toronto branches. The assistant managers worked under Vinski's supervision. Their responsibilities included opening and closing the branches; receiving loan intake forms and performing other loan related tasks; cheque clearing in their branches; and managing their employees;

(e) Internal and external auditors - Belsby was retained to assist with the internal financial reporting and compliance of the CCU and Retford was retained to, among other things, perform yearly audits and prepare audited financial statements.

Committees and Lending Policies and Practices at the CCU

(a) The Credit Committee

[21] The credit committee was established as a separate, independent and distinct entity from the board, so as to avoid conflicts. Subject to certain exceptions, its role was to approve loans that went before the board for final approval. It oversaw the lending functions of the CCU.

[22] Given the CCU's small size, the loan and mortgage process was fairly straightforward. The steps in the loan process were:

(i) the person seeking a loan or mortgage was initially received by a loan officer, one of the branch employees or the branch manager;

(ii) an application was submitted, which in the case of a mortgage contained a mortgage loan offer, a purchase and sale agreement, and a confirmation of earnings. The individual responsible for gathering the loan information took the documents, interviewed the applicant, filled in the application form and created a folder with all documentation, which would then be given to Vinski for review;

(iii) Vinski checked the file for completeness and then performed a credit check within the CCU. As the CCU's members were from a tight community comprised of many immigrants, the internal credit check was more effective than an external credit bureau check;

(iv) Vinski then determined if the loan sought was permitted by the lending policy. He calculated the loan to value ratio ("LTV"); the debt service ratio ("DSR"); checked the collateral provided and the credit history. If all the factors were in accordance with the lending policy, the loan documentation was provided to the credit committee for review with a recommendation;

(v) the file presented to the credit committee contained the loan application, the documents collected; the purchase and sale agreements; the various calculations of the LTV ratios and other loan criteria; and a sheet containing the summary of the loan and Vinski's recommendation. Vinski only provided a file to the credit committee if the applicant was qualified for the loan; and

(vi) the credit committee met mostly on a monthly basis and discussed each loan file that was put before them by Vinski. Sometimes one of the loan officers was present. The credit committee had a checklist that it reviewed, checking the various aspects and documentation. The credit committee asked questions of Vinski (or other representative) and then either rejected or approved the loan. The credit committee relied on management to provide them with the loan policies.

[23] Management prepared two reports in respect of the loans that came up for review and approval by the credit committee: (i) the credit report, and (ii) the credit committee report, both discussed below. Management essentially completed the underwriting of the loans and mortgages. The board received the credit report and the credit committee report but did not review the actual loan/mortgage files. Members of the credit committee did not typically attend board meetings. The lending policies provided that the manager or the controller were responsible for presenting the reports to the board at their regular scheduled monthly meetings. The criteria for these reports as listed in the lending policies were in compliance with the Act.

(b) The Audit Committee

[24] The audit committee was also a separate, independent and distinct entity from the board. It was accountable to the membership and had two general roles: to provide independent assurance as to whether the procedures being followed met policy requirements; and to provide assurance that the financial statements were fairly presented. The audit committee reported to the board through its minutes. It had a prescribed list of duties under the Act. Belsby attended audit committee meetings and explained roles, responsibilities and obligations in accordance with the Act to newly elected audit committee members.

[25] The audit committee met at least once every three months and more often if required. Vinski and Belsby typically attended those meetings. At year-end, or as required from time-to-time, Retford also attended audit committee meetings. The audit committee also reviewed the various CCU policies, which were prepared by Belsby. The audit committee went through a checklist created by Belsby to ensure that it fulfilled all of its obligations under the Act and regulations.

[26] The audit committee prepared minutes of its meetings which were provided to the board along with any reports that went before the audit committee. Audit committee members did not attend board meetings and Vinski presented the audit committee minutes and any attached reports to the board.

(c) The Internal Auditor

[27] Belsby assisted the board in its oversight role for almost 10 years. He was a former DICO employee who had extensive experience working with credit unions. Belsby conducted periodic audits of different aspects of the CCU's business such as: corporate policy; controls; personal loan files; mortgages; and documentation analysis. Belsby's various reports provided the audit committee with reasonable assurance with respect to the CCU's operations. These reports were made to the audit committee and then went before the board as attachments to the audit committee's minutes.

[28] Belsby attended most of the audit committee meetings and had access to all of the loan files; the accounts; and financial reports. Belsby analyzed the CCU's policies as required by DICO and FSCO. If DICO identified any issues with the policies, Belsby and Kow revised the policies

to comply with the Act and regulations, and worked to ensure that any recommended changes were properly implemented. Revised policies were presented to the audit committee for review and approval. After the audit committee approved these policies, management would present them to the board.

[29] Belsby had unrestricted access to information, and if he identified issues, including issues with the CCU's management, he reported them to the audit committee and made recommendations to address them, if appropriate.

(d) The External Auditor

[30] Retford has been the external auditor for the CCU since the 90's. They audited the annual financial statements of the CCU and were also retained to perform other tasks from time-to-time. For example, Retford assisted with responding to the OSVs; checked the implementation of the OSVs; and reviewed the OS.

[31] Retford's primary focus in auditing the CCU's financial statements was to assure that its assets were not overstated. They specifically looked at the valuation of the credit portfolio.

[32] Retford also had a direct relationship with the audit committee and was therefore able to identify any issues that arose during the audit process directly to the audit committee.

[33] In 2005-2006, Retford was also retained to check on implementation of recommendations from the regulators, and the reliance that the board could place on those reports. Retford reviewed each recommendation contained in the OSV and found that the CCU was 92% compliant. The finding of 92% compliance indicated to the board that management had taken action to deal with the identified issues.

(e) The Board of Directors

[34] The board typically met once a month (often in the evenings) and conducted its business by working through an agenda of items presented by the chair.

[35] Meetings typically ran several hours and attendance levels were good. All members were engaged and asked questions of Vinski and Kow. Management followed up on the board's questions at subsequent meetings.

[36] Management provided the board with a package of reports for its review. A typical monthly board package included:

(i) A financial report, which included a detailed analysis of the financial situation of the CCU. It provided an historical comparison of asset, loan and cash balances along with monthly capital levels, monthly income and expenses, the leverage ratios, status of assets and liabilities, and whether the CCU ratios and finances were in statutory compliance. A financial report noted, "the credit union was as at the above date in compliance with the minimum statutory liability requirements". These financial reports were prepared and presented by Kow. The board asked questions and discussed these reports;

(ii) The credit report, which was prepared by Kow and presented either by him or Vinski. It showed the analysis of the loan portfolio, new loans, delinquent loans, impaired loans, and the risk structure of the loan portfolio. Each chart provided pertinent information. For example: the summary of delinquent loans in a report informed the board of the total loans that were due; whether they were personal, mortgage or commercial loans; and the time period of recovery. It confirmed that the credit portfolio was in compliance with board policy and regulatory requirements. The charts included account numbers and not names to ensure member privacy. The content of the credit report met the requirements of the regulations;

(iii) The credit committee report, which was prepared by management based on information that came before the credit committee at its meetings. It identified new loans that were approved by the credit committee each month. It provided detail to the board including the amount of loan approved; the loan installments; the rate of interest; the LVR to ensure that the approved loans met the lending policies; the amortization rate and; the DSR. The board did not see the information underlying this report which the credit committee had reviewed. The board relied on the credit committee in that regard;

(iv) The minutes of the audit committee and attached reports which provided information relating to audits of the CCU's operations, and in particular, Belsby's reports that went before the audit committee, which helped the Board to oversee management and ensure that corrective measures were being implemented for various issues that arose.

[37] The standard board package was prepared by staff, followed by a review and any necessary revision by Vinski if required. The board package included additional items for review and discussion as needed. For example, the board received all reports from the regulators informing them about the workings of the CCU.

[38] Vinski had a good working relationship with the board, who relied on him to manage the CCU's day-to-day activities and the development and implementation of various policies.

[39] DICO's 2005 Sound Business Practices and Financial Manual referenced the regulator's expectations of credit union boards as follows:

> The most significant responsibilities of the board are ensuring that the credit union meets the needs of its members by staying in business, planning the broad directions of the organization, and forming policy. The board appoints management to carry out policy and achieve results. Once board policy is decided, the board must give management the latitude to manage the day-to-day operations of the credit union. Management must be

able to choose staff, allocate budgets and plan course of action, provided these actions follow board policy. If the results are unsatisfactory, the board should resist the urge to take over management of the credit union, and instead encourage improvement or take steps to replace management.

[40] DICO by-law #5 directed that the board was to "gain reasonable assurance that the institution is adhering to its risk management policies". Accordingly, the board set the policies and then gained reasonable assurance from the reports it received that those policies were being followed. As detailed, the sources of those reports included management (Vinski and Kow); the internal auditor (Belsby); the external auditor (Retford); and the regulators (FSCO and DICO).

[41] Management was primarily responsible for developing and implementing risk management techniques and procedures. According to the Director's Handbook, these techniques and procedures had to be cost effective and proportionate to the size and complexity of the credit union's activities.

[42] The court heard evidence from DICO representatives; the external auditor; and legal counsel who assisted the board. All commented that the board was engaged, concerned about the well-being and stability of the CCU, and eager to do what needed to be done to fix its problems.

(f) The Lending Policies

[43] One of the key lending policies was the credit risk management policy approved by the board in December of 2005 (the "2005 credit policy"). There was a predecessor lending policy approved by the board in 2002 (the "2002 credit policy"). Although much of the content stayed the same, there were some changes from the 2002 credit policy to the 2005 version. I note that although Polla's submissions cite the 2002 credit policy in reference to the OS, that is not accurate. The OS was released in May of 2008, when the 2005 credit policy was in effect. I am using the 2005 credit policy in the analysis of the issues.

[44] Belsby assisted with the preparation of these policies. All policies were based on templates from the CUCO manual, which credit unions modified to meet their specific needs. Belsby worked with the audit committee and management to modify the policies before recommending them to the board.

[45] The board reviewed the policies with Vinski and Kow and approved them if appropriate. The policies were then sent to the regulators for approval. All of the CCU's policies were approved by Belsby; Vinski; the audit committee; the board; and the regulators.

[46] A chart comparing the 2002 and 2005 credit policies was entered as evidence (Exhibit 81). Although the 2002 credit policy had appendices detailing the kind of appraisals to be used, the 2005 credit policy had no such appendices. There was also a new management exception provision in the 2005 credit policy, in accordance with recommendations made by the regulators after the 2004 OSV.

[47] Both policies laid down the same requirements and conditions under which the CCU could lend. Both policies provided that, in approving mortgages, the CCU needed to follow certain procedures. The key provisions of the mortgage procedures in both policies were as follows:

(i) Residential mortgages that were not insured by the Canada Mortgage and Housing Corporation ("CMHC") could only be provided up to a maximum of 75% of the value of the home;

(ii) Different types of documentation were required before a mortgage could be approved, based on the amount of the mortgage being sought:

(a) if the mortgage loan being provided was less than 50% of the value of the residential property, then a drive-by appraisal would be considered sufficient to verify the value of the property (e(ii));

(b) if the residential property had: (i) a home on it; (ii) was a recently completed arms' length ML purchase; and (iii) the mortgage loan being provided was less than 75% of the value of the property, then a signed copy of the purchase and sale agreement could substitute for an appraisal (e(iii)) (Note: In the 2005 credit policy, the language was changed to "up to 75%" from "less than 75%". Nothing turns on this wording change);

(c) if an appraisal was required, the necessary qualifications of the appraiser depended on whether the property was within the metropolitan Toronto and Hamilton areas or outside of these metropolitan areas (e(i)).

[48] In their testimony, members of the board who had formerly served on the credit committee confirmed their familiarity with the CCU's lending policies, including that they permitted the use of purchase and sale agreements in certain circumstances instead of formal appraisals.

[49] Joseph Bates, an auditor with Retford who worked on the CCU, confirmed that the CCU's practice at all times, in accordance with its lending policies, was to rely on purchase and sale agreements when all three criteria mentioned in the policies at paragraph e(iii) were met.

[50] Bates stated that he had worked with various credit unions and that it was a common practice in the industry to use purchase and sale agreements to value a property. Bates indicated:

> The reality is, is the credit unions have traditionally dealt with small communities that they're in all the time, they know the individuals, they know the people. So historically loan losses have been low, particularly relative to other financial institutions [..].

> But suffice to say it is not uncommon or at that time, things have evolved. At that time it was not uncommon at all to see purchase and sale agreements used as substantiation of security value.

[51] The 2005 credit policy provided an important exception in respect of approving loans. During the 2004 OSV, the regulators had reviewed the CCU policies. They did not identify any issues with the appraisal process, or with the use of purchase and sale agreements to value properties. However, DICO required that the CCU add an exception to the 2002 credit policy, stating: "[t]he CEO may make exceptions to approval criteria requirements. Such exceptions will be recommended for approval to the credit committee and will include mitigating factors." This exception was added to the 2005 credit policy.

[52] The regulator reviewed policies as part of their pre-field work for the OSV in order to assess whether they were adequate and consistent with regulatory requirements. The regulator also selected mortgage and loan files to review on site. If the regulator found issues with the process for valuing properties, it was articulated as part of the OSV report. The regulators not only reviewed the language in the lending policies but also reviewed actual loan files. As a result, the board took assurance that, from the regulator's perspective, the lending policies and procedures met regulatory requirements.

2004-2007 Regulatory Oversight of the CCU

(a) The 2004 OSV

[53] DICO conducted an OSV and produced a report dated April 19, 2004 which identified several issues with the CCU's policies and procedures and placed the CCU on DICO's watch list. As a general rule, whenever an OSV was performed the credit union had two options: (i) it could disagree with the findings and provide an explanation; or (ii) it could accept the findings and provide a course of action identifying how the issues were to be corrected. OSVs were intended to be proactive and the findings in the 2004 OSV were not unusual.

[54] By November of 2004, DICO had received satisfactory responses to all items raised in the OSV and at a follow up meeting with the board in May of 2005, DICO representative John Hutton ("Hutton"), gave positive feedback and confirmed that the board had asked to be removed from the watch list. The minutes from that board meeting note that, "Hutton acknowledged the positive results of the credit union operation in the past year and promised that he would recommend such a decision upon receiving a response of the CCU to FSCO dated May 19, 2005".

[55] The board engaged Retford in October of 2005, and directed it and Belsby to ensure that DICO's recommendations were implemented. When Retford completed its investigation in 2006, it found that the CCU had implemented a significant majority (92%) of the recommended changes from the 2004 OSV.

(b) The 2007 OSV

[56] The next OSV performed by DICO was approximately 3 years later, from January 9-12, 2007. DICO issued a report on January 25, 2007 detailing the OSV results.

[57] Hutton's evidence was that the results were much better than the 2004 OSV and as a result, a meeting with the board was not necessary. In most areas the CCU rated "effective", and even in areas where they were not rated "effective", there was nothing out of the ordinary or concerning. The CCU's operational risk management, including its internal control system, obtained an "effective" rating.

[58] There was general consensus in the evidence that the 2007 OSV was very positive, indicating that the CCU had made remarkable progress and that there were no specific issues of concern. DICO did not follow up with any concerns with respect to the CCU's response to the 2007 OSV.

The OS and Polla's Share Subscription

(a) The Perfex Fraud and Resulting Liquidity Issue

[59] On June 5, 2007, the CCU became aware of an approximately $4.3 million deficiency in the account of one of its members, Perfex Int. Ltd. ("Perfex"), due to fraud. Polla initially asserted that CCU management and employees were parties to this fraud, which was not true and was not pursued at trial.

[60] The fraud was a cheque kiting scheme. Cheques from American banks were deposited into the Perfex account. Before the cheques cleared at the CCU, the funds were withdrawn from the Perfex account by issuance of new cheques that were negotiated at the Bank of Nova Scotia ("BNS"), and then wired from the BNS accounts to Dubai. Both the CCU and the BNS suffered losses as a result of this fraud. Nick Lela ("Lela") was the CCU employee whose mistake was responsible for enabling the fraud. He was immediately suspended and then terminated from the CCU. Lela was not involved with the fraud, or charged with any criminal offence. At trial, he admitted to making an error by not placing the correct hold on the deposited American funds and agreed that he did not follow protocol. Lela was a very credible witness and I accept and believe his evidence. Hutton confirmed that this was a third party fraud, not perpetrated by any CCU employee.

[61] As a result of the Perfex fraud, the CCU fell below its liquidity and capital requirements. In addition to that loss, member withdrawals significantly surpassed deposits in the weeks following the Perfex fraud. This put the CCU offside in its borrowings with CUCO and resulted in an approximately $18 million overdraft with CUCO.

[62] Vinski notified DICO and FSCO about the Perfex fraud and the resulting liquidity and capital issues. In order to operate, the CCU had to borrow money from CUCO. The regulators

worked directly with the CCU thereafter to develop a recovery plan outlining how it intended to recover the lost monies and pay back CUCO. The CCU retained a lawyer, Jeff Rosekat ("Rosekat"), in order to assist with the recovery of monies from Perfex. It also retained Tinkham and Associates ("Tinkham"), an independent consulting firm, to assist in the preparation of a recovery plan in August of 2007. Tinkham also helped to prepare independent financial projections to determine the amount of money that would be required for the CCU to get out of the crisis created by the Perfex fraud.

[63] As directed by CUCO, the recovery plan had three essential aspects: (i) raising risk capital from "knowledgeable investors" through the issuance of preferred shares; (ii) selling portions of the mortgage portfolio to raise immediate capital and make up for the deficiency; and (iii) raising the price of the existing member shares. The CCU also stopped lending money during this crisis.

(b) The 2007-2008 regulatory supervision of the CCU

[64] Given that the CCU was below its liquidity and capital requirements, both FSCO and DICO were involved immediately after the discovery of the Perfex fraud.

[65] On September 6, 2007, the CCU was put under supervision pursuant to a FSCO SO that identified the Perfex fraud as the reason for the CCU's failure to meet its liquidity and capital requirements. The SO appointed a stabilization authority - DICO. Hutton was the individual responsible for ensuring that the terms of the SO were enforced. Those terms provided that:

(i) DICO would receive monthly board packages and all the same financial and credit information that was being provided to the board;

(ii) Hutton would attend all board and committee meetings and had a right to veto any decision of the board or management;

(iii) No minutes of board meetings or resolutions passed by the board would become official until approved by Hutton;

(iv) DICO would have to approve the annual audited financial statements, the earnings and distribution proposal and the financial budgets of the CCU;

(v) DICO would have to approve any changes, additions or revisions to the CCU's policies, loan or investment write-offs, any changes to personnel, any contracts, any new commitments or activities undertaken by management or senior staff;

(vi) DICO had free and open access to all of the CCU's books, records and accounts.

[66] No action could be or was to be taken by the board without DICO's, and specifically Hutton's, input and approval.

[67] Hutton attended all meetings during the period of supervision. He did not raise any concerns to the board concerning the board's procedures.

(c) The 2007-2008 OS – Preparation and Content

(i) The Purpose of the OS

[68] After the CCU was put under supervision, the board and regulators decided that the best mechanism to bring it back into compliance was to raise significant monies from knowledgeable investors by issuing preferred shares.

[69] Accordingly, the CCU was to prepare and distribute an OS to interested investors with respect to this share issuance and to provide disclosure. The primary purpose of the OS was to raise money for the CCU so that it could overcome the deficiencies created by the Perfex fraud and re-establish lending activity. The OS included: (i) the narrative; (ii) the audited financial statements of the CCU for three prior years (2005, 2006 and 2007) prepared by Retford; and (iii) interim unaudited financial statements of the CCU up to March 31, 2008, also prepared by Retford.

[70] In preparing the OS, particular focus was placed on: (i) complete disclosure about the CCU's current financial situation as a result of Perfex fraud; and (ii) the plan on a go-forward basis to provide the investor with information about the CCU and how it planned to recover from the Perfex fraud. The OS explained to the potential investor that the CCU required at least a minimum offering of $3.45 million to address the CCU's current deficiency in its leverage ratio by reducing the CCU's overdraft. The details of the offering, for example, the kind of shares being issued; terms of the dividend payment; how it was going to be distributed etc.; were also detailed in the OS.

(ii) How the OS was Drafted

[71] Kathleen Skerrett ("Skerrett"), a securities lawyer who specialized in financing and disclosure compliance, was retained to spearhead the process. She had worked on more than 50 OS's and prospectuses. She had also sat on boards of public companies and neighbourhood associations and, as a result, was aware of the disclosure obligations; levels of involvement; and the process that a board needed to follow when issuing an OS. Skerrett began drafting the OS in November of 2007.

[72] Vinski and Kow provided the necessary information to Skerrett relating to the day-to-day workings of the CCU. Retford provided historical and current financial information about the CCU. Further, because the auditors had to provide their consent to the inclusion of the audited financial statements in the OS, they were obligated to review the OS to ensure that the numbers and information within the narrative were consistent with their knowledge and that there was no information in the narrative or body of the OS that contradicted the attached financial statements.

[73] Skerrett communicated directly with Bates, who provided her with comments on the narrative; the financial tables; and the audited financial statements. Bates reviewed various versions of the OS and provided substantive comments. Bates reviewed every draft of the OS.

[74] Tinkham's projections were incorporated in the OS, and were also reviewed by Bates.

[75] A member of the board (Kovacevic) was designated as the board contact during the preparation process, but he was not involved in the creation of the OS. The board received, reviewed and approved multiple versions of the OS at board meetings, which Hutton attended, before the final version was approved. Pursuant to the SO, Hutton was involved in the OS process and had to sign off on anything that was approved by the board, including all versions of the OS. Hutton was present at all board meetings and provided comments and input into the various drafts. The board also received a presentation on the OS from its lawyers and attended a meeting with FSCO at its lawyer's office.

[76] Skerrett's evidence was that the board, management and the external auditor all understood that full, plain and true disclosure was to be provided in the OS and that all were working to that end.

[77] FSCO provided significant input into various drafts of the OS, particularly before the OS was finalized in May of 2008. FSCO's role (as outlined by FSCO representative Anita Sastri ("Sastri")) was to make sure that the OS had good and fair disclosure of the CCU's financial position and to ensure that any investor was well-informed. FSCO reviewed every version of the OS and also conducted independent investigations to ensure that the information in the OS was accurate. The lawyers were at all times being directed by FSCO and working to ensure compliance with all of FSCO's comments and requirements. FSCO had the final say on the OS.

[78] The OS went through more than 20 drafts which were prepared by the lawyers and reviewed by the board with the benefit of and reliance upon review and input of management; Retford; Hutton; and FSCO.

[79] Prior to the final OS being issued and signed off by management and the chair of the board, specific approval was received by:

(i) Retford, who signed an auditor consent dated May 9, 2008;

(ii) FSCO, who approved and provided a receipt of the OS dated May 20, 2008; and

(iii) the board, who signed a resolution approving the OS, which included Hutton's approval.

[80] FSCO gave the final approval to its issuance and had final approval over investors. The OS was approved by the regulators effective May 23, 2008.

(iii) The Content of the OS

[81] The narrative of the final and issued OS was 29 pages long. It emphasized that an investment in the CCU would be a risky investment, stating that "the prospective purchaser… should carefully review the offering statement and any other documents it refers to, examine in particular the section on risk factors beginning on page 24 and may wish to consult his/her financial and tax advisors about this investment."

[82] The narrative stated that the CCU was under a FSCO SO and had implemented a recovery plan which included the within offering. It warned investors that "these securities are considered to be highly speculative due to the Corporation's current financial condition and other risk factors that are inherent in such an investment. An investment in the Series A Shares (the "Shares") of the Corporation should only be made by persons who can afford a significant or total loss of their investment." It outlined the Perfex fraud, and the resulting lending freeze, capital and liquidity shortages, and the $18 million overdraft with CUCO. It stated that "No market exists for the Shares and none is expected to develop as a result of this offering." It directed subscribers to obtain advice from their own investment and securities advisors with respect to trading restrictions on the resale of the offered securities.

[83] Under the heading "Risk Factors", the CCU's current financial condition and capital issues were described in more detail. The OS stated that the CCU had filed a recovery plan and was currently moving to rectify the situation, but "the possibility of regulatory intervention, including ceasing operations, exists." It stated that the proceeds from the offering would be used to bring the CCU in compliance with its capital requirements "however, there can be no assurances that the corporation can resume profitable operations enabling it to pay dividends or redeem the Series A Shares." Under the heading "Credit Risk", the OS warned of the risk of loss from uncollectible loans; and that the lending policies of the CCU, the care and attention of staff and management in applying such policies to loan applications and loans granted; and the security taken in connection with such applications, will affect the future profitability of the CCU and impact on its ability to pay dividends and redeem the shares.

[84] The OS further warned under the heading "Operating Risk" that the CCU "is exposed to risk of loss resulting from inadequate internal controls; policies that do not provide sufficient direction; practices that expose the Corporation to the risk of loss; human error; and management failure. Real or perceived changes in the Corporation's credibility could damage its reputation, image and customer confidence and its ability to grow its operations." The OS stated that there can be no assurance of a positive or specified return on the subscriber's investment, or even any return. It reiterated that the investment involves a high degree of risk and should be considered only by persons who can afford a loss of their entire investment.

(d) June-July 2008: Polla Subscribed for Shares in the CCU

(i) Reasons for Polla's Investment and Initial Meetings

[85] Vinski was primarily responsible for finding investors and bringing them to the attention of the board. There were various potential investors who were interested in investing in the CCU.

[86] Vinski was introduced to Polla through Arnold Milan ("Milan"), a long-term member of the CCU. Polla and his family had previously invested $22 million in a business operated by Milan. Vinski and Rosekat understood that Polla and Milan were business partners and that they knew each other very well.

[87] Polla was looking to get back into the mortgage business, which is why the investment in the CCU was a "dream come true" for him. He had always dreamed about having a trust company, but could never arrange the financing. Polla wanted to make an investment in the CCU so that he could then use the CCU to obtain mortgages for his clients and get referral fees.

[88] According to Vinski and Rosekat, Polla became aware of the CCU's potential need for an investment earlier than June of 2008 (which is the date when Polla initially believed he became aware of the potential investment). Rosekat's docket confirmed that there was an initial meeting with Polla in October of 2007. Rosekat and Vinski both gave evidence that they met Polla for the first time at Milan's office in Vaughan in 2007. Polla has no recollection of this 2007 meeting. Present at the meeting were Vinski; Kovacevic; Polla, Milan; and Rosekat. Rosekat described this as a "pitch meeting". Rosekat was invited to the meeting to answer any legal questions Polla had in regards to the investment. At the time of the meeting, it was not clear whether it was Milan or Polla (or both) who wanted to invest in the CCU.

[89] At that meeting, the Perfex fraud was explained, as well as the CCU's financial situation. Both Polla and Milan appeared interested in investing in the CCU.

[90] After the release of the OS at the end of May of 2008, Polla met again with Vinski to discuss his investment. That meeting took place at Milan's office with Milan present. Both Polla and Vinski indicated that they discussed the Perfex fraud; the CCU's loan with CUCO; details about the recovery of the monies from the Perfex fraud; and the plan going forward.

[91] There is no evidence from Polla that he asked Vinski about the lending policies of the CCU or, for that matter, any policies of the CCU, or that this was important to him.

[92] Polla and Vinski had at least two other meetings before Polla invested in the CCU. These meetings took place at Milan's office with Milan present. Generally, the topics of discussion were the current financial situation of the CCU; DICO's supervision of the CCU; and the plan for the future once the CCU was stabilized.

[93] Polla and Vinski both considered this investment to be a mutually beneficial opportunity. Polla wanted to get back into the mortgage business, using the CCU as a vehicle to obtain mortgage funding and Vinski wanted to find a suitable and knowledgeable investor for the CCU.

[94] There is no disagreement between Polla and Vinski that prior to Polla's investment into the CCU and prior to his meeting with members of the board, he had the following documents: (i) the OS and the attached financial statements; (ii) the Subscription Agreement; and (iii) the Recovery Plan. Other documents, including policies, were available to Polla upon request. In this regard, the OS offered to investors:

> The prospective purchaser of these securities should carefully review the offering statement and any other documents it refers to, examine in particular the section on risk factors beginning on page 24 and may wish to consult his/her financial and tax advisors about this investment.

(ii) Polla's June 2008 Meeting with the Directors

[95] Polla and Milan met with the board members on June 17, 2008. Vinski also briefly attended. Polla's recollection in regards to this meeting and when it took place was vague. Polla initially maintained that he did not meet with the board until July after he signed the OS and the Subscription Agreement. When asked about the other witnesses' evidence about the timing of the meeting, he fairly stated: "I just don't remember". Aside from the board's minutes of the June meeting, the evidence of Sertic, Kovacevic and Vinski, all of whom attended the meeting, was consistent that the meeting took place on June 17, 2008.

[96] Vinski was present for the beginning of the meeting and then left so that the board members could interact with Polla and Milan and get to know them and so that Polla and Milan could obtain any further information that they required. FSCO had confirmed that the board needed to ensure that potential investors understood the CCU's financial situation and that there were no side agreements or promises made to them in regards to their investment in the CCU.

[97] Polla made it clear at the meeting that he was interested in investing in the CCU so that he could get back into the mortgage business, and that he saw this investment as a mutually beneficial opportunity. The evidence of the board members present at the meeting as to what was discussed was as follows:

(i) Polla and Milan had read the OS, had no concerns and understood the CCU's financial situation. Polla and Milan both confirmed that their questions had been answered and that they understood the risks of the investment, were satisfied and did not require any further details.

(ii) There were no side agreements or promises made by management or the board members in return for the investment. Polla and Milan had previous dealings with the Croatian community and wanted to assist the community.

(iii) Polla indicated that the monies were in a term deposit which he was ready to invest.

[98] At no time during this meeting did Polla ask the board members about the CCU's policies or lending practices; the workings of the board or the committees; or any other details about the CCU.

[99] The board members always understood that Polla was going to be a personal investor in the CCU. At no time did Polla mention that he would be investing through a corporate entity or that he was part of a family investment business. As will be discussed in greater detail, at trial Polla and his accountant Kaiman revealed that the invested funds came from a family investment corporation called Investex Investments Limited ("Investex").

[100] Sertic performed a law society background check on Polla which confirmed that he was a member in good standing.

(iii) Polla Completed the Paperwork for his Investment

[101] After receiving the OS, the recovery plan and attending meetings with Vinski and the board, Polla decided to invest $5 million (pending approval from the regulators) and transferred money into trust with Gardiner Roberts. Relevant to the issue about Investex and as part of the investment process, Polla was required to sign and review various documents with various representations, including:

(i) An Account Membership Form dated June 18, 2008 making him a member of the CCU. In that form, Polla represented that he was not using the account "on behalf of a party that is not an account holder".

(ii) A Subscription Agreement dated June 18, 2008, which was a contract between the CCU and Polla in regards to the share subscription. That agreement was signed by Polla personally in his capacity as "self" and provided that his share subscription would only be accepted following an assessment of his suitability as required by FSCO. To facilitate the assessment, Polla agreed to complete the personal information form appended to the agreement, Schedule "B". The agreement stated that "If the Purchaser is a corporation, each director, officer and shareholder of the Purchaser must complete Schedule "B". The agreement at section 2(c) further stated that "The Purchaser understands and acknowledges the following… the subscription hereunder is being made by the Purchaser as principal for the Purchaser's own account and not for the benefit of, any person…" It also at section 6(a) required Polla to acknowledge and agree that he had not received any disclosure documents other than the OS and that his decision to purchase the securities was not based on any verbal or written representations made on behalf of the CCU. Finally, at section 8 it required Polla to make a host of warranties, including that:

(b) Membership — the Purchaser is a member of the Corporation. if the Purchaser is a corporation, each shareholder of the Purchaser is a member 'of the Corporation; [...]

(j) Authority — (i) the Purchaser is not contracting hereunder as agent for one or more other purchasers; [...]

(m) Investment Experience — the Purchaser, has knowledge and experience with respect to investments of this type enabling it to evaluate the merits and risks thereof and the capacity to obtain competent independent business, legal and tax advice regarding this investment;

(n) Highly Speculative — the Purchaser understands that the acquisition of the Purchased Securities is highly speculative and that the Purchaser may lose the entire amount of its investment;

(o) Offering Statement — the Purchaser has received, read and fully understands the OS and has had the opportunity, to ask and have answered any and all questions which the Purchaser wished with respect to the business and affairs of the Corporation and the Shares; and

(p) Due Diligence — the Purchaser is solely responsible for conducting its own due diligence in the affairs of the Corporation and it is not relying on any information about the proposed operations of the Corporation provided by any third party to make its decision to acquire the Purchased Securities.

As required by the Subscription Agreement, Polla filled Schedule "B", and the Personal Information Form attached to the subscription, with his personal information with no mention of any corporation or Investex.

(iii) A Statutory Declaration attached to the Subscription Agreement dated June 18, 2008, confirming that his answers in the Personal Information Form were true and correct; that he understood he was providing the form to the CCU and FSCO in order to determine his suitability to purchase shares of the CCU; and that he knew that the Statutory Declaration was of the same legal force and effect as if made under oath and under the *Canada Evidence Act*.

(iv) Approval of Polla by DICO and FSCO

[102] The investment was subject to approval by DICO and FSCO.

[103] Polla's subscription was presented to the board for its approval at its July 2, 2008 meeting. Hutton had reviewed the minutes of the board's June meeting with Polla. According to the minutes

from that meeting, the board and Hutton approved Polla as an investor and they understood that Polla was investing money personally.

[104] FSCO had the final say on the approval of the investor. Part of FSCO's role was to ensure that any CCU investor was suitable.

[105] FSCO's concerns included: (i) ensuring that any large investors were fully vetted and that the board had done its due diligence; and (ii) ensuring that there were no side agreements with the investor. Sastri confirmed that this second concern was important because a large investor could have significant influence over the CCU. Further, as the CCU was in financial distress, it was important to understand why a large investor would want to invest into the CCU.

[106] If a large investor was going to invest, FSCO would conduct additional background checks to ensure that they were not involved in terrorism, money laundering and that the money being invested was "clean money".

[107] FSCO asked the board to sign a representation which required the board to ensure that the investor was not laundering money and that there were no side deals with the investor. The representation was drafted by Skerrett, approved by FSCO, and signed by the board on May 7, 2008.

[108] FSCO also wanted to maintain ongoing checks and controls over the investor after the investment had been made, to ensure that the money did not leave the CCU immediately after the investment, especially given the CCU's sensitive financial position and the fact that it was under supervision. Given that FSCO was dealing with a risky investment and a less sophisticated board than that of a Schedule A bank, FSCO had significant ongoing involvement.

[109] Obtaining FSCO's approval was an involved process. Based on information provided by the board and management, Skerrett prepared a submission to FSCO which included the following documents: (i) a letter explaining Polla's background, including that he was a lawyer in good standing who understood the financial situation of the CCU, had been introduced to the proposed OS several months before, had been given the opportunity to ask questions about the OS, and that the board had done its due diligence in regards to Polla; (ii) a list of subscribers of the preferred shares; (iii) minutes of the board's meeting with Polla on June 17, 2008; (iv) the Personal Information Form signed by Polla in his personal capacity; (v) the Subscription Agreement signed by Polla; (vi) the Statutory Declaration signed by Polla; (vii) Polla's driver licence; (viii) a sheet which showed that Polla held a term deposit in the name of Investex; (ix) Polla's law society check; and (x) the resolution of the board and Hutton approving Polla as an investor in his personal capacity.

[110] At all times, Skerrett's understanding was that Polla was investing the monies personally.

[111] After filing this submission, FSCO wanted further confirmation from Polla that he was investing on his own behalf, as it wanted to continue to ensure: (i) that the investor had personally

read and understood the documents; and (ii) that the investor was not a front allowing invested monies to then leave the CCU.

[112] Despite Polla having made these various documentary representations that he was investing on his own behalf and not as an agent or in trust for anyone else, FSCO requested this separate acknowledgement from Polla.

[113] Vinski arranged for Polla to sign this acknowledgment dated July 9, 2008. Vinski and Skerrett's evidence regarding the acknowledgement is consistent that: (i) the document was typed at the CCU and not by Skerrett; and (ii) the language for the acknowledgement was taken from Skerrett's previous email and previous letters to FSCO.

[114] The acknowledgement, signed by Polla and on his letterhead, states:

> I, the undersigned Ferdinando Polla, confirm the following:
>
> 2. I understand and acknowledge Paragraph 2(c) of the Subscription Agreement that I signed, stating, "the subscription hereunder is being made by Purchaser as Principal for the Purchaser's own account and not for the benefit for any person".
>
> 3. I am investing in the $5,000,000.00 Croatian (Toronto) Credit Union Limited Series A Preferred Shares for myself and NOT in trust for anyone else.

[115] Both Josopovic and Polla agreed that the signatures on the acknowledgement were their signatures. Although Polla initially advanced unsupported speculation about fraud, there was no forensic evidence presented to suggest that the document was anything but authentic. At trial, Polla ultimately fairly stated, "I bear responsibility because this is my signature."

[116] Only after receiving the signed acknowledgement did FSCO approve Polla as the investor.

[117] Sastri indicated that, had FSCO learned that Polla was not investing his own money or was investing in trust for another, FSCO would not have closed the transaction until each person involved with Investex had been vetted and approved, because they would not want to run the risk of any "bad money" coming into the CCU.

[118] The representations in all documents and the evidence of all witnesses, except Polla, are absolutely consistent. The lawyers; the regulators; the board; and Vinski all understood that Polla was investing his own personal money and was not investing in trust for anyone. The share certificate was issued in the name of Ferdinando Polla.

[119] After approval by FSCO, the subscription to the OS closed and on July 15, 2008 the CCU received all monies from various subscribers, including Polla.

[120] On July 23, 2008, the audit committee passed a resolution confirming that the CCU could now start its lending activities again as it had met its liquidity and capital ratios.

(e) Administration

[121] On or about July 3, 2008, before the audit committee's resolution, Polla approached Vinski requesting a $100,000 loan from the CCU. Vinski, without the knowledge or approval of the board or DICO, approved this loan. In return, Polla signed an acknowledgment pledging the dividends on his preferred shares of the CCU as security for the loan. Polla and his wife also signed a personal loan application form in support of the loan, but dated the forms for four months after the loan was actually given, as the CCU was still under its lending freeze at the time.

[122] Almost immediately after the CCU started lending again, in late July, Polla contacted Vinski to seek another loan in order to finance townhouses owned by his company on Tansley Drive. On August 1, 2008, Polla received a loan of $2.7 million from the CCU and, in return, provided a second mortgage to the CCU over the Tansley townhomes.

[123] The board discovered these loans as well as lines of credit totaling $2.6 million that had been granted to Milan and his wife (collectively, the "August Loans"), at its meeting on November 5, 2008. Hutton and the board were shocked to see these loans and lines of credit. They investigated further, holding an in camera meeting on December 4, 2008. Vinski was suspended in early January of 2009, and terminated in April of 2009, because of the August Loans. John Wood ("Wood") was appointed a consultant for the CCU in March of 2009 and by April of 2009 became the CEO.

[124] In part because of these loans, the CCU's assets fell below its liquidity requirements. DICO ordered a preparatory examination to confirm that the CCU could not recover from its deficit and that it should be put into administration. The preparatory examination was conducted by English & Jones LLP ("E and J") over a period of three days and produced a report on February 20, 2009 (the "E and J report"). According to Hutton, the E and J report was one more step in seeking an administration order.

[125] The E and J report identified the August Loans as a cause of the severe impairment of the CCU's assets. The E and J report did not discover the OMF.

[126] On July 7, 2009, the CCU was placed into administration. At this stage, the board was dissolved and DICO took over the running of the CCU.

(f) Uncovering of the OMF

[127] Months later, a fraudulent scheme known as the Oklahoma Mortgage Fraud (the "OMF") was uncovered. The OMF was a complex fraud that involved a number of parties. Vinski, along with various other outside parties, was one of the perpetrators.

[128] The fraudulent loans underpinning the OMF started to default in the spring and summer of 2009, but these loans were not identified as fraudulent until after the CCU was put into administration.

[129] According to Wood, the full details were still being uncovered by the time he swore his affidavit for unrelated court proceedings in November of 2009, several months after the CCU was put into administration. Hutton's evidence was also that the OMF was not discovered until after the CCU was put into administration.

[130] According to Hutton, the OMF was not a factor in putting the CCU into administration. According to Wood, the CCU was put into administration as a result of large loans given after recapitalization, including the August loans.

[131] The OMF worked as follows:

(i) Person A, usually a numbered corporation (the "first fraudster"), purchased vacant land from an arm's length purchaser for a price of $7,500 to $15,000. The agreement of purchase and sale was drawn up by a real estate agent (the "second fraudster");

(ii) The first fraudster then sold the vacant land to Person B (the "third fraudster") for an arbitrarily inflated price of approximately $400,000 and a false purchase and sale agreement was prepared by the second fraudster;

(iii) To fund the inflated price, the third fraudster sought a loan from the CCU, which was kept under the limit so as to not require board approval or catch the attention of the regulators (less than $300,000);

(iv) Vinski (the "fourth fraudster") then approved the loan in return for a mortgage on the lands;

(v) In order to complete the mortgage registration, the same lawyer (the "fifth fraudster") was involved in the first and second sales of the lands; and

(vi) Lastly, the CCU loan cheques were made payable to the fifth fraudster (i.e. the lawyer) in trust rather than to an unknown entity.

[132] If anyone reviewed an OMF file, it contained: (i) a legitimate purchase and sale agreement; (ii) a lawyers title certification; (iii) an MLS listed property with a legitimate real estate broker; (iv) a legitimate mortgage registered on title; (v) loan cheques made to lawyers; and (vi) documents showing the mortgage amount corresponding to the loan amount. It looked like a legitimate transaction to anyone reviewing the file.

[133] Two files that were used in the OMF, (the only ones that were found,) were put into evidence and both had all the relevant documents that would be found in a legitimate loan file.

[134] Over the years DICO, as part of the OSV process, and Retford, as part of their annual audits, had both looked at OMF files and had not discovered fraud or any irregularity with the files.

[135] The OMF was sophisticated and very complex. It could not have been discovered until Vinski was removed from the CCU because: (i) it involved at least four other fraudulent parties, including real estate agents and lawyers; (ii) the lands could not be search electronically as they were located in rural Ontario; (iii) the loans were kept under the board's and the regulators' radar; and (iv) Vinski kept the fraudulent loans fully paid and therefore they never defaulted or appeared in any delinquency report provided to the board (until he was terminated when the loans started defaulting).

[136] Vinski was convicted of fraud and sentenced to prison as a result of the OMF. Nobody else at the CCU was suspected, investigated or charged.

The Alleged Negligent Misrepresentation

[137] The alleged three negligent misrepresentations against the board contained in the amended statement of claim are as follows [paraphrased]:

(a) they permitted an OS to go public when they knew or ought to have known it was misleading. In particular, they knew or ought to have known that the CCU's financial difficulties were not only the consequence of member account deficiencies, but also the result of frauds perpetrated upon the CCU by its own officers in conspiracy with third parties;

(b) they permitted Vinski to remain in a position of authority when they knew or ought to have known that he was unfit; was the perpetrator of the OMF and the Perfex fraud; and likely to mislead the public; and

(c) they permitted the mass redemption of term deposits in excess of $100,000.00 in favour of their friends and acquaintances. [Polla conceded that he was not pursuing this allegation at trial.]

[138] The claims against Retford are as follows [paraphrased]:

(a) it failed to abide by the terms of its engagement letter with the CCU by failing to recognize the OMF;

(b) it failed to recognize that loans in excess of the permissible limit of $300,000.00 were being made;

(c) it negligently failed to recognize the absence of appraisals in the OMF loan files;

(d) it prepared and delivered financial statements which it knew or ought to have known did not fairly represent, in all material respects, the financial position of the CCU.

[139] It became clear during the trial that none of these allegations were going to succeed. It was further made clear in Polla's closing written and subsequent oral submissions that he had abandoned these allegations. Polla developed a new theory of the case during the course of the trial, which led to a motion to further amend the statement of claim. Polla's lawyer Larry J. Levine ("Levine") provided an affidavit sworn on January 5, 2018 in support of Polla's motion requesting the further amendment, and he was cross-examined on his affidavit on March 15, 2018. The amendment is opposed by all defendants. It is unfortunate that it took a lengthy trial to narrow the issues as this pleadings motion could likely have been heard and decided without a trial. In a nutshell, the new proposed amendment is with respect to the directors' and Retford's knowledge that the CCU had approved and was continuing to approve residential mortgages based on the price in a purchase and sale agreement, rather than a professional appraisal. The motion is denied and is dealt with below.

1. Is the amendment to the amended statement of claim allowed? Is the proposed amendment statute barred? Will it cause prejudice which cannot be compensated for by costs?

[140] Polla proposes to amend his amended statement of claim to allege a new misrepresentation – essentially, that the OS represented that the CCU always based its mortgages on the opinion of a professional appraiser, even though the defendants knew that the CCU frequently approved mortgages based on an agreement of purchase and sale. This misrepresentation makes up the majority of Polla's submissions and in his reply he calls it "the sole issue in the case at bar." The defendants oppose the amendment on the basis that this is a new and separate misrepresentation claim which is statute-barred. They maintain that this claim has been discoverable since 2012 when Polla received the 2002 credit policy, and the statute of limitations for this claim has therefore passed. The defendants also oppose the amendment on the basis that it would cause prejudice to them which could not be compensated for by costs.

[141] The requested amendment reads as follows:

> 11 A The aforementioned OS provided, inter alia, at page 17, as follows:
>
> Lending Services
>
> CCU [Croatian (Toronto) Credit Union Limited] is licensed by the FSCO as a Class 2 Credit Union under the Act. As part of its license, CCU is subject to certain limits on its lending. The board has approved, and management follows, lending policies in all areas to minimize the risk of loan losses. These lending policies are in compliance with the Act and are applied by the Corporation's credit committee. For Residential Mortgages, the Corporation will lend up to 95% of the appraised value of the property where an insurance company insures the mortgage. Otherwise, the loan will be

limited to a maximum of 75% of the appraised value. The Corporation also has a recommended debt service level of 40% of the borrower's available income.

12. The plaintiff pleads that the Defendants, Zvonimir Josipovic, Stephen P. Kovacevic, Stanko Bingula, Anton Jurincic, Mato Menalo, Ante Mimica, Ignac Radencic and Joe Sertic negligently induced the plaintiff to purchase shares in CTCU in the following manner:

(a) They permitted an OS to go out to the public when they knew or ought to have known that it was misleading; in particular, they knew that the Credit Union had made, and was continuing to make, mortgage loans without appraisals and further knew or ought to have known that the true financial difficulty of the Credit Union was not simply a consequence of a "member's account deficiency", but rather the result of a fraud or frauds perpetrated upon the Credit Union by its own officers in conspiracy with third parties;

15 (e) Retford & Bates consented to the attachment of the Audited Financial Statement of the Croatian (Toronto) Credit Union Limited for the years 2015, 2016 and 2017 when they knew that the contents of the OS at page 17 thereof respecting "appraised values" were untrue and that the said financial statements were prepared on the basis that appraisals were not always required and taken by the credit union in respect of mortgage loans made and advanced by it. The plaintiff pleads that such conduct is contrary to the provisions of s. 82 of the Caisses Populaires Act and the standard of care applicable to professional accountants in like circumstances.

Law

[142] Rule 16.01 of the *Rules of Civil Procedure,* R.R.O. 1990, Reg. 194 provides that a "court shall grant leave to amend a pleading on such terms as are just, unless prejudice would result that could not be compensated for by costs or an adjournment." The defendants submit that they would be prejudiced by Polla's proposed amendment because it constitutes a new cause of action for which the limitation period has expired. They submit that the amendment would allow Polla to pursue a new, statute-barred cause of action. This prejudice, they submit, cannot be compensated for by costs or an adjournment. Polla submits that the amendment does not raise a new cause of action, only a claim that is part and parcel of the cause of action already pleaded.

[143] The case law dictates that what constitutes a particular "cause of action" is to be determined by a broad factually-oriented approach (the "broad approach"). In determining the scope of the cause of action as pleaded, the court must read the original statement of claim generously and with due allowance for drafting deficiencies.[1] The broad approach dictates that, as long as the defendants have notice of the factual matrix underlying the claim being advanced, then

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[1] *Rausch v. Pickering (City),* 2013 ONCA 740, 369 D.L.R. (4th) 691 at para. 94 ["*Rausch*"].

amendments that arise out of, or do not depart from, that factual matrix do not constitute "new causes of action", and should be permitted. It is sufficient if the facts pleaded implicitly advance such a claim because it is already part of the pleaded cause of action.[2]

[144] To constitute a new cause of action, the factual cause of the plaintiff's loss must be discrete, separate and arising from a different and unrelated factual context.[3] Accordingly, the critical question is: does the proposed amendment "arise out of the same facts or the factual matrix already pleaded?"[4] In other words, is the proposed amendment "part and parcel of the dealings" already described in the existing pleading?[5]

[145] The general principles applicable to amendments were also enumerated by the court in *Thompson v. Zeldin*[6] in which the court refused to grant an amendment after expiry of the limitation period and followed the law laid down by the Court of Appeal in *Frohlick v. Pinkerton Canada Ltd.*,[7] wherein the Court of Appeal stated,

> Rule 26.01 does not contemplate the addition of unrelated statute-barred claims by way of amendment to an existing statement of claim. Conceptually, this should be treated no differently than the issuance of a new and separate statement of claim that advances a statute-barred claim.

[146] Polla submits that a broad interpretation of the cause of action as pleaded is consistent with the Supreme Court of Canada's statement that, when interpreting statutory provisions which create limitation periods, the court cannot ignore the legitimate interests of potential plaintiffs.[8] Polla also submits that the requirement that a pleading should be read generously and the concomitant requirement to allow amendments unless they will inflict non-compensable prejudice leads to the presumption that any amendment that can reasonably be seen as falling within the four corners of the existing claim ought to be permitted.[9] He cites the following comment expressed in *Brand Name Marketing Inc. v. Rogers Communications Inc.*:[10]

> if a defendant knows that the 'finger of litigation' is being pointed in its direction, and an action is commenced on a timely basis on specific actions, [the] court ought to take appropriate steps to ensure that the true *lis* between the parties is addressed,

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[2] *Rabb Construction Ltd. v. MacEwen Petroleum Inc.*, 2018 ONCA 170.
[3] *Farmers Oil & Gas Inc. v. Ontario (Ministry of Natural Resources)*, 2016 ONSC 6359 (Div. Ct.), 134 O.R. (3d) 390 at para. 19 ["*Farmers Oil*"].
[4] *Sax v. Aurora*, 2017 ONSC 5563, 77 B.L.R. (5th) 102 at para. 21.
[5] *Farmers Oil* at para. 24.
[6] *Thompson v. Zeldin*, 2008 CanLII 46703 (Ont. S.C.J.).
[7] *Frohlick v. Pinkerton Canada Ltd.*, 2008 ONCA 3, 88 O.R. (3d) 401 at para. 24 ["*Frohlick*"].
[8] *Novak v. Bond*, [1999] 1 S.C.R. 808 at para. 66.
[9] *Farmers Oil* at paras. 13-17.
[10] *Brand Name Marketing Inc. v. Rogers Communications Inc.*, 2010 ONSC 2892 at para. 84.

rather than permitting one party to perhaps escape its possible liability by relying upon a technical *Limitations Act* defence.

[147] The defendants submit that the scope of a cause of action is less broad for cases of alleged negligent misrepresentation. They submit that, in order to establish a claim for misrepresentation, a plaintiff must specifically plead all material facts relevant to that misrepresentation. Each allegation of misrepresentation is a new cause of action. They submit that the law is clear that each misrepresentation is independent of the other such that each misrepresentation must meet the five part test set out in *Queen v. Cognos*[11]:

1. There must be a duty of care based on a "special relationship" between the representor and the representee;

2. The representation in question must be untrue, inaccurate, or misleading;

3. The representor must have acted negligently in making said misrepresentation;

4. The representee must have relied, in a reasonable manner, on said negligent misrepresentation; and

5. The reliance must have been detrimental to the representee in the sense that damages resulted.

[148] The defendants submit that the separate nature of Polla's claims is shown by the fact that, in order to be successful in his claim, Polla only needs to establish that any one misrepresentation meets the test. The defendants therefore need a separate defence to each misrepresentation.

[149] The defendants cite *Fuda v. Jim McIntosh Petroleum Engineering Ltd*[12] for the principle that each negligent misrepresentation alleged is a separate cause of action. The plaintiff in that case had also lost an investment in a corporation. The plaintiff attempted to amend its claim to plead additional misrepresentations. The defendant argued that these misrepresentations were new causes of action that were statute-barred under the *Limitations Act.* The court adopted the definition of cause of action described in *Ivany v. Financiere Telco Inc.*: a cause of action is the particular act on the part of the defendant which gives the claimant his cause of action, i.e. the factual matrix that describes the cause of the plaintiff's complaint.[13] On the facts in *Fuda,* the court found that each of the alleged misrepresentations arose from different acts on the part of the defendants. The amendment was refused and the court stated:

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[11] *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 at para. 33.
[12] *Fuda v. Jim McIntosh Petroleum Engineering Ltd.* 2013 ONSC 2122 at paras. 76 and 309 ["*Fuda* (S.C.)"], aff'd *Fuda v. Jim McIntosh Petroleum Engineering Ltd.*, 2014 ONCA 378.
[13] *Ivany v Financiere Telco Inc.*, 2011 ONSC 2785.

> Each of the alleged misrepresentations grounds a cause of action for negligent misrepresentation asserted by the plaintiff. Although there are common facts to one or more of such causes of action, each cause of action is separate from, and independent of, the others. None of these potential causes of actions requires the court's acceptance of any of the others to support the plaintiff's claim for damages.[14]

[150] The defendants also cite *Deep v. M.D. Management*,[15] another case in which the court dismissed the plaintiff's refused leave to amend a claim to add a new misrepresentation. The court stated:

> the particulars that must be pleaded in respect of any allegation of misrepresentation include: the alleged misrepresentation; when, where, how, by whom and to whom it was made; its falsity; the inducement; the intention that the plaintiff should rely upon it; the alteration by the plaintiff of his or her position relying on the misrepresentation and the resulting loss or damage to the plaintiff.[16]

[151] Finally, the defendants point to *National Industries Inc. v. Kirkwood*, in which the statement of claim pleaded that, "the defendants were negligent and breached their fiduciary duty to the plaintiffs when they failed to provide the plaintiffs with adequate insurance protection against foreseeable harm."[17] The plaintiffs brought a motion to amend, seeking to "expand the negligence allegation to allege the defendants were negligent in 2008 when they failed to increase the plaintiffs' D&O coverage from $10,000,000.00 to $25,000,000.00 and again in 2009 when they failed to recommend and obtain an increase of the plaintiffs' D&O coverage to $25,000,000.00."[18] The court in *National* cited the "broad approach" principle, and the requirement that pleadings be read generously. However, the court found that the "proposed new allegations [did] not arise from the same factual matrix"[19] and, the "existing claim [contained] no reference to the action or inaction of the defendants in 2008 or 2009."[20] The court concluded that the "factual basis on which the plaintiffs seek relief in these proposed amendments is not the same or substantially the same as set out in the factual matrix in the existing claim."[21]

[152] Polla responds that the principles articulated in *Fuda v. Jim McIntosh Petroleum Engineering* are not applicable to preclude his proposed amendment. He submits that the new misrepresentations in that case and the others cited were disallowed because they were unconnected to the factual matrix as pleaded, which is not the case here. He submits that the case law cited by the defendants does not establish any special requirement for amendments to add

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[14] *Fuda* (S.C.) at para. 76.
[15] *Deep v. M.D. Management* (2007), 35 B.L.R. (4th) 86 (Ont. S.C.J.) ["*Deep* (S.C.)"].
[16] *Deep* (S.C.) at para. 4.
[17] *National Industries Inc. v. Kirkwood*, 2017 ONSC 4196 at para. 7.
[18] *National* at para. 9.
[19] *National* at para. 17.
[20] *National* at para. 20.
[21] *National* at para. 20.

misrepresentations. The Ontario Court of Appeal's decision in *Fuda* makes this clear, stating that "The misrepresentation claims that were asserted after the expiry of the limitation period advanced new causes of action that were unconnected to the factual matrix pleaded in the original statement of claim."

[153] Citing the Divisional Court in *Farmers Oil and Gas Inc. v. Ontario (Natural Resources)*[22], Polla also emphasizes that the broader, factually-oriented approach remains the correct approach. The extent of the defendants' basic entitlement is to have notice of the factual matrix out of which the claim for relief arises and within which the defendants' possible liability is to be located. The broad approach was tacitly approved by the Ontario Court of Appeal in *Rausch v. Pickering (City)*, where the court stated that even if the plaintiff does not explicitly set out the technical cause of action on which it relies, if the facts as pleaded implicitly advance such a claim, the court ought to allow it to go forward.[23]

Submissions

[154] Polla's submissions on why the amendment should be allowed include the following:

(i) Paragraph 12(a) of the amended statement of claim already alleges that the OS was misleading. It cites, as a particular, that the CCU's financial difficulties were not simply the result of a "member's account deficiency", but rather a consequence of a fraud or series of frauds perpetrated by the CCU's own officers having conspired with third parties. This is a reference to the OMF. The new misrepresentation could not be more intertwined with this pleaded allegation. All of the alleged misrepresentations are part and parcel of the factual matrix within which Polla alleged that the defendants were liable. The proposed amendment specifically addresses the means by which the OMF was perpetrated. Had the referenced appraisals existed, the OMF could never have occurred. Given that the existence of the OMF is one of the misrepresentations already pleaded, no new cause of action is being asserted by adding an allegation about the means by which it was perpetrated.

(ii) There is no prejudice to the defendants if the requested amendment is made, as the directors and external auditors gave evidence at trial that they knew that the CCU did not always obtain professional appraisals before granting mortgages.

(iii) Polla's proposed amendment is not a new cause of action. It may represent a specific particular of Polla's case, but it arises out of the factual matrix already pleaded. Specifically, there has only ever been one OS; one distribution of that OS; one

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[22] *Farmers Oil.*
[23] *Rausch.*

investment by Polla in reliance upon that OS; and one loss of Polla's investment as a consequence of the misrepresentation.

(iv) This proposed amendment is directly connected to and based upon the allegations of fact already pleaded. Specifically, the pleading already alleges that the OS contained false representations about the CCU's finances. The proposed amendment does not change this or add anything new. The phrase "appraised value" is contained in the OS, and the financial statements appended to the OS are based on the appraised value of the CCU's mortgages. Accordingly, there is nothing new in the proposed amendment other than the specific allegation that the defendants knew that the CCU was not obtaining appraisals. That fact was never disclosed anywhere prior to trial. Even if the directors had disclosed this during the course of discoveries, by disclosing the 2002 and 2005 credit policies, which noted the policy of basing valuations on agreements of purchase and sale, those policies pre-dated the OS. Accordingly, it was reasonable for Polla to assume that, as at the date of the OS, those credit policies were not being followed. In any event, it cannot be said that the proposed amendment is unconnected to misrepresentations about the CCU's financial circumstances at the date of the OS.

(v) For all of the above reasons, the proposed amendment arises from the factual matrix as already pleaded. The only valid authority cited by defendants in opposition to the proposed amendment is *National Industries Inc. v. Kirkwood.* However, in that case, the proposed amendment concerned alleged tortious conduct during an entirely separate and distinct time period than that pleaded. In this case, the event at issue took place at the same time and in the same circumstances already pleaded. Paragraph 12(a) of the amended statement of claim already alleges that the OS was misleading. The misrepresentation alleged in the proposed amendment arose from the delivery of the same OS, concerned misrepresentations contained in the same OS and losses which arose from the same investment. It cannot be said that the newly proposed misrepresentation is unconnected to the claim already asserted. In fact, it could not be more intertwined.

[155] The defendants' submissions as to why the amendment should not be allowed include the following:

(i) For eight years through the discovery and undertaking process, the defendants have defended this action based on the original three alleged misrepresentations. Those misrepresentations were abandoned during the course of the trial, as Polla came to realize that none of them were factually sustainable. Although Polla from time-to-time appeared to communicate that there were other alleged misrepresentations, he did not seek any further amendments until mid-trial. After Polla realized that his misrepresentations as pleaded were not factually sustainable, a new misrepresentation was "discovered" weeks into the trial. Polla now seeks this further amendment in order to save his floundering case.

(ii) The separate and distinct nature of the new misrepresentation is self-evident in Polla's closing submissions. In order to plead and argue his claim in regards to the new misrepresentation, Polla does not rely upon any facts or any prior pleaded misrepresentations. The new misrepresentation is a self-contained complete claim allegedly discovered during the trial. Given that Polla has taken the position that the material facts were not known to him until trial, this establishes that the new misrepresentation is "separate from and independent of the others."

(iii) The evidence put forth by Polla in support of his amendment motion was his lawyer Levine's affidavit sworn January 5, 2018 and Levine's resulting cross-examination. In his affidavit, Levine attested that he and Polla only became aware of the appraisal issue when Sertic and Kovacevic testified.

(iv) Levine confirmed the following during his cross-examination:

(a) Polla was provided the 2002 credit policy, which addressed the CCU's lending policies, by letter of September 19, 2012 as part of answers to undertakings from the examination for discovery of Josipovic. Levine's letter to counsel of December 21, 2012 referenced the 2002 credit policy.

(b) With those letters before him on the cross-examination, Levine acknowledged that:

(i) He had received and reviewed the 2002 credit policy in 2012 which addressed lending policies at the CCU; and

(ii) Page 3 of the 2002 credit policy expressly indicated that an agreement of purchase and sale could be substituted for an appraisal if the advance was less than 75% of the purchase value and the property was sold on a recent MLS listing. Levine confirmed that he would have read that policy in 2012.

(c) Levine acknowledged that he had an opportunity to review the letter dated June 4, 2015 from Dawe to Levine enclosing the working paper files of Retford, which included an excerpt from the 2007 working paper files entitled "Croatian Credit Union personal mortgage and commercial loans." These files indicated that some mortgages were being approved using agreements of purchase and sale. Levine agreed that he had an opportunity to see this document in June of 2015, but nonetheless maintained that it "didn't jump out at him" until trial;

(d) In response to questions from Levine at his examination for discovery on December 15, 2011, Bates confirmed that the CCU's lending policies allowed reliance on purchase and sale agreements in some circumstances. Bates also confirmed that a number of credit unions with whom he worked used agreements of purchase and sale as support for property value;

(e) At Polla's examination for discovery on December 12, 2011, Levine explained the claim against the defendants: "...those Oklahoma mortgages were made in circumstances where there had to be appraisals and the directors knew or ought to have known that, and there weren't. I think perhaps, too, the accountants knew or ought to have known that." Levine informed counsel at that time that the "directors knew or ought to have known there had to be appraisals and there were not in some files." Levine agreed on his cross-examination that he had "stated a position that he understood that there is an issue as to whether appraisals are required or not";

(f) In a letter responding to undertakings dated March 30, 2012 from Levine to counsel, Levine acknowledged Polla's position that the directors knew that the CCU was not following prudent lending policies.

(v) Polla's justification for an amendment of the claim during trial – that he was unaware of the CCU's policy of granting mortgages based on agreements of purchase and sale until he heard testimony at trial – has been shown on cross-examination to be incorrect. Polla, his counsel and his auditor expert were all aware of the practice of the CCU to approve residential mortgages without appraisals, when permitted by the lending policies. This was known to them since at least the examinations for discovery, which makes the new proposed amendment statute-barred. If Polla actually believed that there was a misrepresentation in the OS by use of the term "appraised value", he ought to have discovered this by reasonable due diligence and pleaded it long before trial and before the expiry of the limitation period.

(vi) The amended statement of claim describes some misstatements in the lengthy OS, but does not make any mention of the page 17 extract that is the substance of the proposed amendment. An undertaking was given on Polla's examination for discovery to set out the "misleading and/or misleading by admission statements in the OS", and those are listed in the undertaking answers provided by Levine on March 30, 2012. None of them mention, expressly or by implication, the page 17 extract or even a misstatement or omission that relates to appraisals.

(vii) Polla submits law that is not applicable to a misrepresentation pleading. However, even under Polla's flawed legal theory, the board will suffer irreparable prejudice if the amendment is allowed. Because these allegations were raised so late, they could not be raised with Polla during his trial evidence. In fact, Polla's evidence was that there was no other misrepresentation upon which he relied (in the OS) other than the ones he identified in his examination-in-chief - which did not include the sole issue he raises now. These new allegations could also not be raised in the questioning of several other material witnesses, including Vinski and the regulators.

(viii) Like in *Fuda,* the plaintiff seeks to add the new proposed misrepresentation over five years after he first received the 2002 credit policy and had other sources of the information from the discoveries. His claim is therefore statute-barred.

(ix) The cases upon which Polla relies are all distinguishable because none of them dealt with an amendment to add an alleged misrepresentation. By Polla's own admission, the material facts were never pleaded in his claim, amended statement of claim nor was an amendment sought within the limitation period. These facts therefore cannot form part of the factual matrix.

Analysis

[156] The amendment sought by Polla mid-way through trial is not allowed for the following reasons:

(i) It is clearly a new and separate misrepresentation claim;

(ii) The claim was discoverable since 2012, when Polla received the 2002 credit policy. The fact that the 2005 credit policy actually surfaced during Bates' evidence is not relevant to Polla's motion because it is essentially the same as the 2002 credit policy; and

(iii) The proposed amendment, if allowed, would cause prejudice to the defendants that could not be compensated for by costs.

[157] Although the factual matrix as pleaded sets out the broad context that the new misrepresentation occurred within, the act complained of on the part of the defendants is fundamentally different. In this way, the proposed amendment departs from the factual matrix and is a new cause of action.

[158] The closest thing in Polla's existing pleadings to the proposed amendment is the allegation that the CCU "permitted an Offering Statement to go out to the public when it knew or ought to have known that it was misleading; in particular, it knew that the true financial difficulty of the Credit Union was not simply a consequence of a 'member's account deficiency' but rather the result of a fraud or frauds perpetrated upon the Credit Union by its own officers in conspiracy with third parties." This allegation is related to the proposed amendment as both involve misrepresentations in the OS. However, it alleges that the defendants are at fault for their failure specifically to disclose "a fraud or frauds" from which the CCU was suffering. The proposed

amendment is based on a different act of the defendants, a separate alleged failure to disclose, and therefore constitutes a different cause of action.

[159] As in *Fuda*, although there are common facts to one or more of the causes of action, each cause of action is separate from and independent of the others.[24] Polla attempts to show a factual connection between the lack of professional appraisals and the OMF – i.e., between the proposed amendment and the facts and allegations already pleaded. This factual connection is tenuous. Furthermore, it does not change the fact that the proposed amendment alleges an entirely separate misrepresentation or failure to disclose on the part of the defendants. The proposed amendment is not "part and parcel of the dealings" already described in the existing amended statement of claim.

[160] The alleged misrepresentation in the proposed amendment was discoverable since 2012 when Polla received the 2002 credit policy, which clearly noted that agreements of purchase and sale were being used to determine property values. This fact was not a "bombshell" dropped during the trial. It came up at the examination for discovery of Bates. The board had also confirmed its knowledge that value was being assessed by means other than third party appraisals. After that point, a reasonable person would have assumed that the 2002 credit policy was in place at the time that the CCU distributed its OS. If this had struck Polla as giving rise to material misrepresentation in the OS, he could have amended his statement of claim to add that allegation at that time. Under the *Limitations Act,* the limitation period has expired for this claim. As set out in *Frohlick v. Pinkerton Canada Ltd.*, Rule 26 does not contemplate the addition of unrelated statute barred claims.[25] I treat this proposed "new" amendment no differently than the issuance of a new and separate statute-barred claim. Obviously, the defendants would be irreparably prejudiced if Polla were to be allowed to pursue a statute-barred claim against them.

[161] Because the proposed amendment is not part and parcel of the existing pleading and the limitation period has expired, the amendment is refused. This conclusion is reached with a reading of the amended statement of claim that is generous and allows for drafting deficiencies.

[162] For eight years and right into the trial, the defendants have defended this action based upon the original three alleged misrepresentations. I agree that the defendants will suffer irreparable prejudice if the amendment is allowed. The defendants did not have notice of this new alleged misrepresentation. This new misrepresentation was not raised by Polla during his examination-in-chief. The new allegation was not and could not be raised by the defendants during the examination or cross-examination of Polla and several other material witnesses including Vinski, and the DICO and FSCO representatives.

[163] Polla's attempt to amend his pleadings to add this new misrepresentation is evidence that this trial was "a wild goose chase". Polla's claim started with routine allegations including the CCU's negligence in running the CCU and Retford's negligence in the preparation of the financial

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[24] *Fuda.*
[25] *Frohlick.*

statements. He cannot evolve his claim mid-way during trial to address different acts by the defendants based on an entirely new theory of the case.

2. Did Polla invest as a trustee for Investex or personally?

[164] At all times, Polla represented to the CCU and the regulatory bodies that he was investing the $5 million personally. The claim was commenced in his name. However, during the course of the litigation Polla confirmed that the funds came from Investex, a family corporation of which Polla's brothers were the officers and directors (Mario and Frank – Frank has passed away). Polla had no official status with Investex.

[165] Polla and his accountant Kaiman confirmed during their trial evidence of Polla that the funds were provided by Investex. The CCU was provided with a copy of a GIC certificate in the name of Investex, which represented the funds which were used for the investment.

[166] Polla subsequently took the position that he was a trustee for Investex and had invested the money in trust for Investex, which was confirmed by Mario. The trust is not pleaded in Polla's statement of claim.

[167] The defendants submit that Investex, as a result, was the true investor and, absent a valid trust agreement showing that Polla was the trustee for Investex, he has no standing to bring a claim. The defendants correctly point out that there is no written trust agreement or formal documentation of the trust relationship. They also challenge the validity of the trust on the basis that the certainties necessary to create a trust were not met. The defendants submit that Investex was the proper plaintiff and that it is too late for Polla to substitute Investex for himself as the plaintiff.

[168] Kaiman confirmed that in mid-June of 2008 he received a call from Polla, who told him he was going to make an investment in the CCU by purchasing $6 million in shares. Polla told him that Investex was going to loan him the money. Kaiman testified that he would have told Polla that Investex owed capital gains from the previous year when it sold property. He told Polla that he would be treated as a shareholder of Investex because he was a related party and that this would have tax consequences to Polla. Polla said that he would try and get the deal done under Investex's name and that he would get back to him. Polla and his brother came to the office on June 25, 2008. The investment had decreased to $5 million and the shares were still to be taken in Polla's name personally. Polla told Kaiman that Investex could not be the investor.

[169] Kaiman was concerned about the various tax implications of Investex loaning the funds to Polla. Specifically, Kaiman was concerned that this would create a tax liability for Polla.

[170] I accept Kaiman's evidence that he had a meeting with Polla and Mario on June 25, 2008, during which they discussed the investment. Because the shares were being taken in the name of Polla personally, a letter was prepared on Investex letterhead dated June 25, 2008 confirming that the 50,000 preference shares of the CCU were registered in the name of Ferdinando Polla only as trustee for the beneficial owner – Investex. Kaiman could not find this letter in his file but recalls

the meeting and the gist of the conversation. Accordingly there is a second letter dated June 29, 2010, also on Investex letterhead, confirming that Polla was acquiring the shares for the beneficial owner – Investex.

[171] Kaiman also confirmed that Investex declared a loss of $5 million from the investment and that the funds for the investment came from the sale of Investex's real estate.

[172] It is very unfortunate and does not speak well of Polla's credibility that:

(i) on an Account Membership Form on June 18, 2008 he represented that he was not using the account "on behalf of the party that is not an account holder";

(ii) he signed the Subscription Agreement (the contract between the CCU and Polla) personally in his capacity as self and did not complete the appropriate Schedule B dealing with corporate purchase; and

(iii) he signed a Statutory Declaration attached to the subscription on June 18, 2008 stating:

> (a) I have read and understood the questions, cautions, acknowledgments and consent in this PIF and the answers I have given to the questions in this PIF and in any attachments to it are true and correct, except stated to be to the best of my knowledge, in which case I believe the answers to be true; [..]
>
> (c) I understand that where I am providing this form to the Corporation and the Superintendent of the Financial Services Commission of Ontario in order to determine my suitability to purchase shares of the Corporation.
>
> (f) I make this solemn declaration conscientiously believing it to be true and knowing it is of the same legal force and effect as if made under oath and under the *Canada Evidence Act.*

[173] Polla also signed a separate document as required by FSCO again confirming that he was acquiring the shares personally.

[174] Despite the credibility issue and the "not so great paper" establishing a trust, I accept Kaiman's evidence as proof that a trust was created and find that Polla invested as trustee for Investex. This is consistent with the evidence of Polla and his brother.

[175] Although Polla's misrepresentations do not speak well of his credibility, I would not go so far as to say that his actions were the type of serious immorality or illegality that would prevent him from seeking a remedy under the "unclean hands" doctrine to which the defendants refer. Polla's evidence is that he was "foolish", but that he informed Vinski of the issue, who told him that there was no time to change the paperwork. I also do not find that, by allowing Polla's claim

to continue, the court is allowing Polla to "profit from his wrong."[26] The defendants acknowledge that it is possible that, if Polla had disclosed he was investing as trustee for Investex, the investment would have gone ahead. Both of Polla's brothers have no history of criminal or regulatory issues. In that scenario, the same claim for damages could have been made. This shows that Polla's misrepresentation as to his ownership of the shares is not directly linked to his claim against the defendants, so that allowing him standing does not equate to allowing him to "profit from his wrong."

3. Does Polla have a common law negligence claim against the board and its directors?

[176] Polla's statement of claim alleges negligence against the board's individual members for the misrepresentations in the OS; allowing Vinski to remain in a position of authority; and permitting the mass redemption of term deposits in favour of their friends.

[177] Polla's written closing submissions do not address the common law negligence claim, focusing rather on the statutory claim for a misrepresentation in the OS. The issue was not emphasized in oral submissions, which also focussed on the statutory cause of action. I have, however, received submissions from counsel for the board on this topic and will briefly deal with it.

[178] In order to plead and pursue a claim for common law negligence against the individual directors of the board, Polla needs to establish that the directors in their individual capacity owed him a duty of care. Polla has not put forward any evidence or law supporting this duty of care.

[179] I agree with counsel for the board that Polla, in essence, has conceded that there is no claim of negligence at common law available to him as against the board members.

[180] Counsel for the board has provided relevant law on this point. They submit that the law is clear on this issue. The Supreme Court of Canada in *BCE Inc* stated that directors owe a duty of care to the corporation and not to individual shareholders/investors.[27]

[181] In *Alvi v. Misir*[28], the court dismissed claims of common law negligence and breach of fiduciary duty brought by a shareholder against individual directors. Citing *Anger v. Berkshire Investment Group Inc.*[29], the court stated:

> 50. [...] In order to determine whether a person owes a duty of care to another person, the Court must apply the two part *Anns/Kamloops* test (*Anns v. Merton London Borough Council*, [1978] A.C. 728; *Kamloops (City of) v. Nielsen*, [1984] 2 S.C.R. 2): (1) whether the parties are in a relationship of sufficient proximity that a

[26] *Hall v. Herbert*, [1993] 2 S.C.R. 159 at para. 10.
[27] *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, [2008] 3 S.C.R. 560 at para. 37.
[28] *Alvi. v. Misir* (2004), 73 O.R. (3d) 566 (S.C.) at paras. 50, 52, 55-57, 63.
[29] *Anger v. Berkshire Investment Group Inc.* (2001), 141 O.A.C. 301 (C.A.).

prima facie duty of care is owed; (2) if so, whether the duty is limited or negated by policy considerations. The analysis of the duty of care issue is new legal territory in the context of personal liability of directors and officers of corporations. Certainly, the policy issues raised by the respondent will be very important as part of the application of the two part *Anns/Kamloops* test in the context of this analysis.

[...]

52. Cases where a director's or officer's fiduciary duty or duty of care is owed to someone other than the corporation are limited to:

... Fraud, dishonesty, want of authority or other conduct specifically pleaded which justifies piercing the corporate veil, where the corporate veil is a sham or whether the conduct exhibits a separate identity of interest from the *bona fide* interests of the corporation: *See Montreal Trust Co. of Canada v. ScotiaMcLeod Inc.* (1995), 26 O.R. (3d) 481 (C.A.), at 491.

[...]

55. Further, the plaintiffs argue that these directors were in sufficient proximity to the plaintiffs as shareholders that they ought to have contemplated that their carelessness or breach of duty as directors might have caused damage to the plaintiffs. Any policy considerations limiting such a claim should await the development of a full record rather than be determined on a motions record.

56. I disagree.

57. In view of the fact that the statutory duties of good faith, loyalty and care are owed to the corporation, the directors cannot have separate duties of the same nature owing to the shareholders. Such parallel duties would create untenable and unrealistic conflicts. They would render impossible the position of a director or officer of a corporation, particularly where the corporation is faced with adverse economic circumstances: *Brant Investments Ltd. v. KeepRite Inc.* (1990), 3 O.R. (3d) 289 (C.A.), at 301.

[...]

63. In summary the shareholders have no status to bring these claims against former officers and directors because:

[...] They plead causes of action based on breach by the directors of both statutory and common law fiduciary duties and duties of care. The directors cannot owe any such duties to shareholders if they are already owed to the corporation without placing the directors in an intolerable conflict of interest [...]

They do not plead facts which might justify piercing the corporate veil.

[182] The above principles were also recently applied and confirmed by the court in *Poole v. Phillips*[30], also a claim brought by an investor against the individual directors for, *inter alia*, common law duty of negligence.

[183] The threshold required to commence a claim for negligence against the directors in their personal capacity is extremely high. In *Piedra v. Copper Mesa Mining Corp.*,[31] the Court of Appeal dismissed the plaintiffs' case against the directors of the board and stated that the allegedly tortious acts of the directors must be separate and distinct from the interests of the corporation in order for the directors to be personally liable for them. The court stated at para. 75:

> Since the plaintiffs' claims against the Directors rest solely on the assertion that the Directors' acts were themselves tortious, the plaintiffs' pleadings against the Directors must withstand a high degree of scrutiny. See for example, *Abdi Jama (Litigation Guardian of) v. McDonald's Restaurants of Canada Ltd.*, [2001] O.T.C. 203 (S.C.), at para. 10. This accords with the responsibility of the courts to be "scrupulous in weeding out claims that are improperly pleaded or where the evidence does not justify an allegation of a personal tort": [*Adga Systems International Ltd. v. Valcom Ltd.* (1999), 43 O.R. (3d) 101] at p. 114. As this court has indicated, were it otherwise, there is a risk that corporate officers and directors could be "driven away from involvement in any respect in corporate business by the potential exposure to ill-founded litigation": *Adga*, at pp. 104-105.

[184] I agree with counsel for the board that the allegations against the board members in this action are not for fraud, dishonesty or want of authority. Unless it can be shown that the board members' conduct was tortious in itself or exhibited a separate identity or interest from that of the CCU to make the act or conduct complained of their own as opposed to that of the CCU, there can be no cause of action against the directors in common law negligence.[32] There is no such evidence in this case.

[185] The board also provided evidence establishing that it acted diligently. The board introduced evidence from credit union expert Fay Booker ("Booker"). Booker testified that the board was not involved in the day-to-day operations of the CCU. She confirmed that the board obtained reasonable assurances from various sources and experts. Bates confirmed that the board received and reviewed numerous reports from numerous entities and audits, and that the board took

[30] *Poole v. Phillips*, 2016 ONSC 8181, 136 O.R. (3d) 319.
[31] *Piedra v. Copper Mesa Mining Corp.*, 2011 ONCA 191, 332 D.L.R. (4th) 118.
[32] *Montreal Trust Co. of Canada v. ScotiaMcLeod* (1995), 26 O.R. (3d) 481 (C.A.) at paras. 25-32.

remedial action to address any concerns raised by the reports. Bates testified and I accept that this board was very active, relative to other boards in similar circumstances.

[186] Polla's claim in common law negligence against the board is dismissed.

4. Was there a material misrepresentation in the OS pursuant to s. 82(1) of the Act?

Law

[187] The SCC in *Sharbern* summarized the important aspects of materiality.[33] Materiality is a question of mixed fact and law to be determined objectively, from the perspective of a reasonable investor. An omitted fact is material if there is a substantial likelihood that it would have been considered important by a reasonable investor in making his or her decision – if there is a substantial likelihood that the reasonable investor would view the fact as having significantly altered the total mix of information made available.

[188] The standard is a substantial likelihood the fact would have assumed actual significance in a reasonable investor's deliberations. This standard is more than a mere possibility, but less than a certainty.

[189] Materiality is a fact-specific inquiry, to be determined on a case-by-case basis in light of all of the relevant considerations and from the surrounding circumstances forming the total mix of information made available to investors.

[190] The materiality of a fact, statement or omission must be proven through evidence by the party alleging materiality, except in those cases where common sense inferences are sufficient. A court must first look at the disclosed information and the omitted information. A court may also consider contextual evidence which helps to explain, interpret, or place the omitted information in a broader factual setting, provided it is viewed in the context of the disclosed information. As well, evidence of concurrent or subsequent conduct or events that would shed light on potential or actual behaviour of persons in the same or similar situations is relevant to the materiality assessment. However, the predominant focus must be on a contextual consideration of what information was disclosed, and what facts or information were omitted from the disclosure documents provided by the issuer.

[191] The defendants stress the jurisprudence on materiality which warns against the use of hindsight. In *Cornish,* the court stated:[34]

> Assessments of materiality are not to be made against a standard of perfection or with the benefit of hindsight. In *Re AIT Advanced Information Technologies Corp.,*

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[33] *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23, [2011] 2 S.C.R. 175 at para. 61.
[34] *Cornish v. Ontario,* 2013 ONSC 1310 at para. 49.

[31 O.S.C.B. 712 at para. 228] the OSC found that it was unfair to judge the respondents' disclosure decisions on the basis of what subsequently happened: "Instead, we must objectively assess the facts that were available to the AIT board during the [r]elevant [p]eriod, to determine in all the circumstances whether the three events constituted a material change in the business, operations or capital of AIT that triggered its disclosure obligation under section 75. It is important therefore, to recognize the dangers of hindsight in coming to this conclusion and to be careful not to look at the situation based on what subsequently happened."

[192] In *Skye,* the court stated that:

> The assessment of materiality is contextual. Assessments of materiality are not to be judged against a standard of perfection or with the benefit of hindsight.[35]

[193] Polla originally alleged that the CCU's financial difficulties were the result of a member account deficiency caused by the Perfex fraud. As the evidence progressed it became clear that the description of this fraud was true and accurate. He also originally alleged that there had been a mass redemption of term deposits. Again, there was no evidence of this and he did not pursue this allegation. Finally, Polla originally alleged that the board permitted Vinski to remain in a position of authority when it ought to have known that he was likely to mislead the public, i.e. that the board should have known that Vinski was committing the OMF. Again, as the evidence progressed it became clear that the board had no reasonable grounds to suspect that the OMF was occurring. The external auditor, the regulators, the external accountants, CUCO and a forensic examiner failed to discover the fraud or raise red flags about Vinski.

[194] At the end of the day, Polla confirmed that the sole remaining issue was whether the OS contained a material misrepresentation through language in its lending services statement implying that all of the CCU's mortgages were based on third party appraisals when in fact mortgages were frequently approved based on agreements of purchase and sale.

Submissions

[195] Polla's submissions on this remaining allegation of material misrepresentation include the following:

(i) At the time the OS was issued, the defendants knew that the CCU had been, "for the most part", making mortgage loans without appraisals. The OS stated that the CCU would only grant mortgages for up to 75% of the "appraised value" of a property. Mortgage loans cannot be described as being limited to 75% of "appraised value" if no appraisals were obtained. There was no disclosure indicating that "appraised value" was being determined by means other than

[35] *Skye Properties Ltd. v. Wu.* (2008), 56 B.L.R.(4th) 68 at para. 134.

professional appraisals. The meaning of the phrase "appraised value" is clear and unequivocal on its face – it means a value taken from a professional appraisal. Because most of the CCU's mortgages were not based on a professional appraisal, this statement was misleading.

(ii) The Act requires full, true and plain disclosure. Ambiguity in the OS is the antithesis of this statutory requirement. According to s. 64 of the *Legislation Act, 2006,* S.O. 2006, c. 21, Sched. F, a remedial requirement like this one must be generously and liberally interpreted in favour of Polla as the investor.

(iii) The defendants submit that the CCU's lending practices complied with its credit policies, which Polla could have requested to review. However, the OS did not disclose the existence of the 2002 or 2005 credit policies. Polla was not aware of these policies and therefore could not take them into consideration before investing.

(iv) It is evident that the defendants knew that the lending services statement was misleading when one considered the meaning ascribed to appraisals in Appendix "D" of the 2002 credit policy. The defendants knew that "appraised value[s]" meant values determined by an appraisal, not by an agreement of purchase and sale. The contents of the 2002 credit policy did not change the meaning of "appraised value" and only purported to permit agreements of purchase and sale to be substituted for professional appraisals in certain specific circumstances. In other words, the defendants' understanding of the term "appraised value" was the same as that of Polla – both understood that appraised value meant value obtained from a professional appraisal. The credit policy, in certain circumstances, accepted that an agreement of purchase and sale could be substituted for an appraisal. This shows that the defendants have always understood that the only commercially reasonable interpretation of "appraised value" is an independent, professionally prepared appraisal.

(v) The OMF could not have occurred had the CCU obtained professional appraisals. An appraisal of a property involved with the OMF would have revealed that the value of the subject property was grossly and fraudulently inflated, providing no security whatsoever.

(vi) This misrepresentation went to the very core of the investment proposed by the OS, namely the purchase of an interest in a financial institution whose primary business was to make loans secured by real estate. The terms of the CCU's lending license made it unlawful for the CCU to advance mortgage loans without actual and real security. The defendants knew that appraisals were not being obtained and this facilitated and enabled the perpetration of the OMF, through which the CCU made loans without proper security.

(vii) Polla introduced evidence from an expert on investing, Professor Eric Kirzner ("Kirzner"). Kirzner's testimony included the following:

(a) From an industry standard perspective, the purpose of an OS is to provide the pertinent information to potential investors that would allow them to make an informed decision as to whether or not to invest. Potential investors make decisions in various ways but ultimately rely on the information provided by the institution.

(b) The assets of the CCU consisted primarily of mortgages. In order for an investor to properly assess whether to invest, the value of the mortgages must be recorded accurately. Utilizing the recent purchase price to indicate the value was not a suitable method because it lacked independence and analysis. This was the case even where the agreements of purchase and sale arose from arms-length transactions or MLS listings.

(c) The value of the CCU's mortgages should have been determined by an analytic process, which would include engaging a professional appraiser to provide a third party opinion. Alternatively, the CCU could have engaged in a comparable type analysis, or used the replacement value method.

(viii) The board submits that the phrase "appraised value" could mean a value based on a professional appraisal or based on some other source. The very fact that the directors suggest that the phrase "appraised value" can have more than one meaning is an acknowledgment of the ambiguity in the OS. Such an ambiguity is, in and of itself, misleading and offends the requirement imposed by the Act which stipulates that disclosure must be full, true and plain.

(ix) It is irrelevant that the OS contained a myriad of warnings to prospective investors. The key question is whether the OS complied with the requirement to make full, true and plain disclosure. The lending services statement set out that the CCU gave loans up to 75% of "appraised values". There was no qualifier or restriction on that phrase. The fact that the document made reference to credit policies that were not disclosed makes the defendants liable. It would go against the purpose of the Act (which is remedial legislation) to interpret the situation differently or to place any onus upon Polla to inquire about unspecified credit policies or further to somehow have Polla bear any responsibility in respect of the misrepresentation because of warnings contained in the OS.

[196] The board's submissions on this remaining material misrepresentation include the following:

(i) The board's position on this issue is threefold: (a) the statement that the loan would be limited to a maximum of 75% of the appraised value was a correct statement of fact since the word "appraised value" did not only have one meaning; (b) this representation did not meet the qualification of materiality and (c) the board had no reasonable grounds to believe that there was a misrepresentation.

Use of the term "appraised value" and its meaning

(ii) The phrase "appraised value" is not defined in the OS and therefore does not have any one defined meaning. It is to be determined on a balance of probabilities what the term would mean to a reasonable person in Polla's circumstances.

(iii) Bates' evidence regarding appraised value was as follows:

Q. But in fairness, just on Her Honour's point, appraised value implies that there is an appraisal, right?

A. I don't know what it implies.

Q. You don't know what the word appraised means?

A. Well, yeah. Appraised doesn't mean appraisal, right? Appraise, appraise means somebody appraises something. I appraise the value of my used car that the lease is coming up. It doesn't mean I have a used car dealer look at it and come with the value. So that's all I'm saying. Cause appraised is a, is a loose term.

Bates also confirmed that many people believe that the actual market transaction is a more realistic indicator of value.

(iv) Jim Muccilli ("Muccilli"), the defendants' auditing expert, testified that appraised value could mean different things. To him, appraised value meant "the actual value of the property". In Muccilli's opinion, the CCU's lending policy had to be read in its entirety, not focusing only on one term in one sentence, especially when clearly section e(iii) of the credit policy provided circumstances in which purchase and sale agreements could be used to obtain the appraised value.

(v) Polla submits that there is only one way to determine appraised value. When met with disagreement from the board, Bates, Muccilli and Booker, Polla responded that the term "appraised value" was ambiguous. Polla is not correct. The term "appraised value" is a reference to assessing value of the property. There is no ambiguity in that meaning and the board had no reasonable grounds to think that there was any ambiguity.

(vi) There are many tools available to determine value – there is no dispute on this point given the concessions by Polla and Kirzner as to the variety of available methods. A formal appraisal report was only one of the means of obtaining an appraised value. Other means could be a simple drive-by appraisal, a letter from a real estate agent or a comprehensive report. The use of many tools to assess value does not create ambiguity or any reasonable grounds to think that the term was ambiguous.

(vii) No single way of determining value can be imputed into the meaning of the term "appraised value", much like there cannot be any one meaning imputed to any other undefined term in the OS. For example, the OS states that "the corporation also has a recommended debt service level of 40% of the borrower's available income". Available income, much like appraised value, can be calculated in different ways. It can include commercial income, residential income, cash earned or other sources of income, and it could mean net income or gross income. The fact that there are various ways to calculate available income does not mean that the term is ambiguous. The purpose of the section titled "lending services" is to convey the general lending principles of the CCU. Polla cites s. 64 of the *Legislation Act, 2006,* to argue that any ambiguity should be read in Polla's favour. This doctrine is not applicable in this case. Section 64 is relied upon by parties when there is inherent confusion in a statute or confusion between two or more competing statutes. There is no confusion in the application of the provisions of the *Credit Unions Act.*

(viii) In *Spoletini v. Calgary (City),*[36] the Alberta Land Compensation Board, while trying to determine the amount of damages resulting from land expropriation, considered the definition of the term "appraised value", as the term was not defined under the applicable legislation. Its reasons supported the use of purchase and sale agreements as a tool to appraise value. The court stated:

> The term "the appraised value" as used in cls. (a) and (b) of s-s. (4) means that market value. Again, as stated by Clement J.A., at p. 104:
>
> An appraisal of value for the purposes of the section is not, in my opinion, intelligible unless it is founded on market value ascertained by acceptable criteria. Market value is routinely determined by one or a

[36] (1984) L.C.R. 346 (Alta. L.C.B.).

combination of several approaches depending on the circumstances, but all of them have in view the probable sale value of the property.

(ix) The distinction that Polla tries to draw with this case is incorrect. Whether to expropriate land or to enforce a mortgage, the purpose of appraising value is to find a value at which the land can be bought and sold and to estimate the price a buyer would be expected to pay. This case is a helpful illustration of the board's reasonable understanding and assurance as to the use of the term "appraised value."

(x) The directors testified that a recent purchase and sale agreement for a MLS listed property could give a fair "appraised value" of the property. Booker also confirmed that it was typical for credit unions to substitute purchase and sale agreements for appraisals to determine property values. She opined that the board's interpretation of appraised value as including purchase and sale agreements was consistent with the industry practice of credit unions. Specifically, she stated:

> ...the sentence is relatively generic. The loan will be limited to a maximum of 75 percent of the appraised value. So then the question is what's the process by which you've determined the appraised value. It does not say a value as determined by a accredited appraiser, so it's generic in nature ... there will be different methods by which you will gather information to determine the appraised value.

(xi) Even according to Polla's evidence, he was investing in the CCU because he was having trouble obtaining financing to fund mortgages. He wanted the CCU to fund mortgages that he brought to them in order to get back into the mortgage business. He would essentially act as the middleman and lawyer, charging a 3% fee, and legals. Therefore, it was better for Polla's business model to have more mortgages approved by the CCU.

(xii) Both Polla and Kirzner's testimony confirmed that value can be appraised in a number of ways.

(xiii) Based on all of the evidence, the conclusion that can be drawn is that the term "appraised value" could include purchase and sale agreements, especially in the context of a credit union where such agreements are used as common practice. Reasonable enquiries by Polla would have confirmed this if there was any doubt on his part.

(xiv) Polla relies on various parts of the 2002 credit policy that he submits show that the board used the term "appraised value" to mean a value obtained by a professional appraisal. In any event, Polla cannot rely on the 2002 credit policy because the OS was drafted in 2008 when the 2005 credit policy was in place.

(xv) Polla's argument that the use of the term "appraised value" is a misrepresentation fails as the term is neither incorrect nor untrue.

The alleged new misrepresentation was not material

(xvi) Polla not only has the burden to establish that the term "appraised value" was untrue but also has to establish that this term was material to Polla when he made his investment, instead of a hindsight argument developed nearly 10 years later in the middle of the trial.

(xvii) Polla alleges that the new misrepresentation was material to him because it indicated the strength of the CCU's underwriting of loans and the value of the CCU's security, given that residential mortgages were the CCU's main assets.

(xviii) There are a number of flaws in Polla's theory. Notable is Polla's own evidence as to what was important or material to him at the time of his investment. During his examination-in-chief, Polla was asked if he had any general concerns about the OS. When he read the OS, he said that "nothing jumped up at me". In fact, the only term that puzzled him was "member's account deficiency". There was no mention in his evidence of "appraised value" or how important the issue of loan security was for him.

(xix) Polla also failed to cross-examine Skerrett or the regulators on whether they considered the meaning of "appraised value" to be material. In fact, there is no evidence that the lawyers or the regulators considered "appraised value" to be an important term in the totality of the disclosure in the OS. This is contextually relevant in assessing materiality. If Polla thought that "appraised value" was a material term and a misrepresentation, the regulator witnesses should have been questioned about the use of that phrase.

(xx) Materiality has to be determined from the context of each situation. The legal principles and remedies sought in *Sharbern* are analogous to these claims. *Sharbern* was an action involving misrepresentation in a prospectus. The trial judge found that the management's failure to disclose a conflict of interest was a material misrepresentation and accordingly held that the investor should be entitled to the statutory remedy. The SCC reversed the trial decision and said:

> The legal errors [made by the trial judge] were: treating the conflict of interest as inherently material; reversing the burden of proof of materiality from the plaintiff to the defendant; and failing to consider all of the evidence relevant to the determination of materiality. She

further erred in not considering the statutory defence which would avail to the benefit of VAC.[37]

(xxi) Polla is asking the court to assume that two words "appraised value" and their role in describing the CCU's lending services were inherently material and that the CCU was obligated to explain the nuances of its lending policy. The SCC warned against this very argument and said that:[38]

> Treating a conflict of interest as inherently material led the trial judge to other manifestations of the same error of law. One is that she misinterpreted the statutory disclosure requirement. She said that the conflict of interest must be disclosed so that investors can weigh its costs and benefits against those of other factors. However, the statutory requirement does not impose on issuers an obligation to disclose all facts that would permit an investor to sort out what was material and what was not. This approach would not only result in excessive disclosure, regardless of materiality, it would overwhelm investors with information and impair, rather than enhance, their ability to make decisions.

(xxii) Skerrett testified that the policies, details of the policies or day-to-day operational documents are never attached to an OS. This evidence was consistent with the testimony of Booker and Kirzner.

(xxiii) The OS clearly stated that, "the board has approved, and management follows, lending policies in all areas to minimize the risk to loan assets". Therefore, there was reference to lending policies, which Polla could have requested to review. Page 1 of the OS, clearly tells the prospective purchaser, in bold type face, to: "...carefully review the offering statement and any other documents it refers to, examine in particular the risk factors beginning at page 24".

(xxiv) It is incredible to suggest that Polla, a lawyer with 30 plus years' experience and a sophisticated investor, could or would not have availed himself of this opportunity to review the lending policies if those policies were actually material to him. It would have been a simple request and a relatively small and simple document to have reviewed.

(xxv) Further, one of the risk factors identified in the OS was:

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[37] *Sharbern* at para. 5

[38] *Sharbern* at para. 65.

> The Corporation is exposed to risk of loss resulting from inadequate internal controls, policies that do not provide sufficient direction, practices that expose the Corporation to the risk of loss and human error and management failure. Real or perceived changes in the Corporation's credibility could damage its reputation, image and customer confidence and its ability to grow its operations.

(xxvi) Polla's evidence was that he: (i) did not ask for any documents from Vinski; (ii) did not review any mortgage files; (iii) did not ask to meet the board (instead the board wished to meet him); (iv) did not ask any questions about the loan approval process; (v) did not seek advice of a lawyer; (vi) did not do any due diligence on the mortgage portfolio of the CCU; and (vi) was fully aware that the CCU had lending policies but did not ask for them. This leads to the conclusion that they were not material to him at the time he made his investment. Certainly there can be no inherent finding of materiality attached to the term "appraised value".

(xxvii) Other than the self-serving evidence of Kirzner, there is no factual or credit union industry evidence that supports Polla's position that the CCU's lending policies and specifically, the fact that those policies indicate that the CCU was not solely relying upon appraisals, would be material to a reasonable investor in the contextual circumstances of this case.

(xxviii) With the benefit of hindsight regarding the OMF, Polla is trying to create an air of inherent materiality around the term "appraised value" and reverse the onus to the board to prove that this term was not a material fact.

(xxix) The overwhelming bulk of evidence is that appraisals or lack thereof were not material at the time of making loans; nor were they material to carrying out the OMFs.

(xxx) The evidence of Bates and Muccilli was that an appraisal only became material when a loan went bad. It was at that stage, when the loan needed to be tested, that the appraisal became significant. However, at the time the loan was valued and tested for viability it was the ability to pay and cash flow that were the most important indicators of a good loan. Bates indicated that according to the recent Office of the Superintendent of Financial Institutions' guidelines, not much reliance should be placed on security values. The loans were made on ability to repay and that was the primary basis for the value in loans.

(xxxi) In *Sharbern*, the SCC confirmed that the burden of proof to establish that a certain fact is material rests on the plaintiff. Where the facts show that a common sense inference is not sufficient, the plaintiff has to discharge his burden. To do so, he must put forth other indicative evidence against the backdrop of the provided disclosure to show that the information omitted would have substantially altered the total mix of disclosed information.[39]

(xxxii) In this case the backdrop of disclosed information which must be considered when assessing materiality of "appraised value" was:

(a) the CCU was in a critical financial situation and had been the victim of the Perfex fraud;

(b) the CCU was not lending money and was under DICO supervision;

(c) as at March 31, 2008, the CCU was indebted to CUCO in the amount of $1,378,992 ($5,816,933 at December 31, 2007). The CCU had not yet complied with a demand for payment in full of the indebtedness to CUCO made on August 22, 2007;

(d) the CCU financial statements of December 31, 2007 included a going concern note;

(e) there was no market through which these securities could be sold;

(f) the securities were considered to be highly speculative;

(g) an investment in the CCU should only be made by persons who could afford a significant or total loss of their investment; and

(h) the CCU was exposed to risk in connection with its loans, investments and other business endeavors. The major activity of the CCU was the lending of money to members and, as a result, there existed the risk of loss from uncollectible loans.

(xxxiii) Polla presented no evidence to support his position that the information that the CCU advanced loans relying on purchase and sale agreements instead of appraisals (which according to Polla, created further risk as to the collectability of the loans) would have added anything to the total mix of the overall disclosure. The appraisal issue was not material.

(xxxiv) In addition to not considering the above disclosure in the OS, Polla ignores other relevant evidence and circumstances in this case. He ignores the evidence of Skerrett and Muccilli who clearly indicated that the going concern note about the impact of the Perfex fraud was the most material fact in the OS, as it

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[39] *Sharbern* at paras. 70 and 86.

immediately conveyed to the reader that the business was on its "last legs" and that it was a very direct warning to the investor. Polla also ignores the special characteristics of credit unions, which typically use purchase and sale agreements and ignores the evidence of the regulators, lawyers and the board that the most important factor to be set out in the OS was the Perfex fraud.

(xxxv) Polla is relying on Kirzner, who had not attempted to opine on the issue of materiality or how reliance on appraisals was a material fact until January of 2018, in a late report prepared after most of the trial evidence had been heard. Kirzner's evidence is unreliable. Prior to writing his report and giving testimony, Kirzner had surprisingly not even read Booker's reports, the documentary exhibits or the evidence of any of the other witnesses who were involved at the time of the drafting of the OS. Lastly, Kirzner admitted that he has no experience with small, closely bonded ethnic credit unions and no familiarity with the credit union system or with the Act.

(xxxvi) Polla has not demonstrated that the new misrepresentation was material. He has not demonstrated that there was a substantial likelihood that disclosure of the CCU's use of purchase and sale agreements as one of the means to value security would have assumed actual significance in a reasonable investor's investment decision, given the amount of disclosure made in the OS.

No reasonable grounds to believe that there was a misrepresentation

(xxxvii) In the event that the court allows (i) Polla's motion to amend the statement of claim to pleaded the new misrepresentation; and (ii) finds that the new misrepresentation was a material untrue fact or there was a material omission, the onus then shifts to the board to establish a defence under s. 82(5) of the Act – that the board did not believe and had no reasonable grounds to believe that there were any misrepresentations in the OS. This is amply demonstrated through the evidence.

(xxxviii) The CCU and its board did not unilaterally control the disclosure in the OS. Input came from lawyers, Retford, DICO and FSCO. In fact, given that the CCU was under supervision, the board could not approve any document or change to the OS without Hutton's input and approval. The OS also needed FSCO's final approval.

(xxxix) In *Sharbern*, the defendants had the same defence available to their directors. The court outlined the analysis required for such a test as follows:[40]

[40] *Sharbern* at para. 92.

> Even if VAC were found to have made a "material false statement", s. 75(2)(b)(viii) of the Real Estate Act provides VAC with a defence if it can prove that it "had reasonable grounds to believe and did, up to the time of the sale ... believe that the statement was true". To rely on the defence, VAC had to show: (1) that it subjectively believed the representations it made were true; and (2) that it objectively had "reasonable grounds" for such a belief. In considering the defence, the question is not whether VAC's conclusion itself was reasonable. Rather it is whether VAC subjectively believed its representations, and whether that belief had an objective basis in the sense that there were reasonable grounds for the belief.

(xl) As pointed out by the SCC, the last legal error in the trial judge's decision was the failure to properly consider the statutory defence available to the defendants. This is a further legal error in Polla's submission, as he is asking the court to ignore the avalanche of evidence that so clearly establishes the reasonable grounds defence.

(xli) The board, the external auditor and Hutton all knew about the CCU's lending policies and its reliance on purchase and sale agreements. Nobody considered the two words in the OS ("appraised value") to be anything other than true, full and plain disclosure.

(xlii) Therefore, the board's evidence that they had no reasonable basis to believe that any special meaning was assigned to the two words "appraised value", was a reasonable and objective explanation, supported by the view of subject matter experts upon whom the board was entitled to rely at the time it reviewed and approved the OS.

(xliii) As in *Sharbern,* the board produced evidence of common industry practice. Retford and Booker testified that the use of purchase and sale agreements to value security in the credit union industry was a typical and standard practice. Booker also gave evidence that the board's interpretation of "appraised value" was consistent with credit union industry practice. Booker's views should be given considerable weight given her broad experience with lending and working with credit unions and their boards.

(xliv) In light of all of the work that went into preparation of the OS over the course of eight months with input from multiple parties; all of the risks and issues highlighted in the OS specifically in regards to the lending policy; and the disclosed potential that the CCU's loans could be uncollectible, the Board clearly had no reasonable grounds to believe that there were any misrepresentations in the OS. It certainly would not have had any basis to think that the term "appraised value" was a misrepresentation given the general consistency of evidence as to what that term means.

(xlv) Polla presented no evidence that the board at any time attempted to hide anything in the OS. In fact, to the contrary, the evidence from all involved (the lawyers, Retford and the regulators) was that the board tried to meet the situation head on, fulfil their obligations and move forward with the situation.

(xlvi) The test is not that of perfection or hindsight. The board had to gain reasonable assurance from all the surrounding circumstances that the OS disclosed all material facts to prospective investors. They did that through the rigorous process of preparing the OS with the assistance of subject matter experts.

(xlvii) The OS went through more than 20 drafts and took eight months to draft. Not only did numerous parties read the entire OS many times, FSCO also provided substantive comments on the disclosure provided by the OS and had the final say on whether it was complete. Sastri confirmed that the fact that the CCU was under supervision meant that FSCO increased its scrutiny of the OS.

(xlviii) Given the number of parties involved; the number of OS drafts; the level of scrutiny from the regulators because the CCU was under supervision; the objective and subjective evidence of the various witnesses and the board in regards to the meaning assigned to "appraised value" in the OS; and the fact that the OS sought only "knowledgeable investors" who would understand the financial situation at the CCU, the court should conclude that the board had reasonable grounds to believe that they made full, true and plain disclosure of all material facts in the OS and that there was no misrepresentation in the OS.

[197] Retford's additional submissions (to those of the board) on this remaining material misrepresentation include the following:

(i) As in *Sharbern*, Polla could have, but did not, elicit evidence that the alleged misstatement was material, including that:

(a) other proposed investors knew about the approved valuation methods in the credit risk management policy and exhibited concern or doubt about the investment because of the lack of third party appraisals;

(b) other proposed investors declined to invest in the CCU because they found insufficient disclosure about the use of appraisals; or

(c) once other investors became aware of the approved valuation methods of the CCU, they expressed concern about them and challenged the CCU committee's ability to value a property for the purpose of granting a mortgage.

(iii) It is also significant that it was not until mid-way through trial that the language with respect to "appraised value" was alleged to be the material misrepresentation. In fact, in his direct examination, Polla did not take issue with the term "appraised value"; rather, he complained only about the non-functioning of the CCU's credit committee. He did not ever comment on the concept of appraised value in his direct evidence. When taken to the clause by his counsel most importantly he did not tell the court that he relied on the term, in fact, he completely ignored the term.

(iv) In any event, the reference to "appraised value" cannot reasonably be viewed as a misstatement. The credit policy did not state that the CCU only used third party appraisals: it rather applied its lending policies to determine the "appraised value" of the property, consistent with page 17 of the OS.

(v) Polla's own direct evidence recognized that he did not expect that formal appraisals would be required for him to get mortgages approved by the CCU.

(vi) Remarkably, Polla now submits that Bates' and Muccilli's views of the term "appraised value" are irrelevant. This is an odd assertion, since it was Polla's counsel who questioned Bates and Muccilli on that topic:

(a) Polla's counsel cross-examined Bates extensively on his understanding of the impugned paragraph at page 17 of the OS and the meaning of "appraised value"; and

(b) Polla's counsel also cross-examined Muccilli, who opined that an auditor reviewing the OS would not take exception to the language in the impugned paragraph. When Polla's counsel asked whether the auditor's knowledge that the credit policies were not disclosed in the OS made the OS inconsistent with the audited financial statements, Muccilli stated flatly, "I disagree" - and Polla's counsel did not question him further on the issue.

(vii) Both Bates' and Muccilli's evidence are objective views of the meaning of "appraised value", contrasted with Polla's subjective view. In assessing materiality, *Sharbern* calls for an assessment from the perspective of the "reasonable investor"; in other words, from the objective view.

(viii) The term "appraised value" is neither a misstatement nor material. Polla presents only his subjective view that "appraised value" meant a third party formal appraisal, which was blatantly self-serving, and so late in the trial that it is devoid of credibility.

Analysis

[198] I do not find that the OS contained a material misrepresentation pursuant to s. 82(1) of the Act. The OS did not misrepresent the CCU's affairs by implying that mortgages were based on third party appraisals when in fact they were frequently approved based on agreements of purchase and sale. Even if it had, or if its wording had been ambiguous, there is not a substantial likelihood that this omitted fact would have changed a reasonable investor's assessment of the total mix of information available. Polla has arrived at his remaining allegation of misrepresentation part way through the trial, with the benefit of hindsight. Whether a fact is material is not to be judged against a standard of perfection – it would be impossible and undesirable for the OS to disclose every single fact about the CCU's day-to-day operations and policies.

[199] Polla has not met his onus to prove that the phrase "appraised value" was an untrue statement of fact. Appraised value is not defined in the OS and therefore does not have one defined meaning. I must determine on a balance of probabilities what the term would mean to a reasonable person in the contextual circumstances. I prefer the evidence of the directors, Bates, Booker and Muccilli, who testified that appraised value meant the value of a property as determined by an appraisal method. There are many different methods of appraising value – including through the value found in agreements or purchase and sale, a drive-by appraisal or a real estate agent's report. Even Polla, when questioned about what he would submit to the CCU to get mortgages approved had an open-ended idea of how the CCU could appraise value – through an appraisal, a letter of opinion or "whatever it was". Kirzner also confirmed that value could be appraised in a "number of ways" and confirmed that there were "three or four different ways" of finding appraised value.

[200] I accept and apply the law as set forth by the court in *Spoletini*, which confirms that market value is routinely determined by one or a combination of several approaches depending on the circumstances, all having the probable sale value in common.

[201] Polla's submission that the term "appraised value" is a misrepresentation fails as the term is neither incorrect nor untrue.

[202] Polla's submission also fails on the issue of materiality. Polla has not proven that the CCU's method of appraising value was a material fact when he was making the investment. He has only shown that it was so with the benefit of hindsight, in the middle of trial, after the OMF became known to all and toppled the CCU, and after he "jumped upon" the acknowledgement by the officers that they knew agreements of purchase and sale were being used as the basis of mortgages.

[203] When asked what was important or material to him at the time of his investment, Polla did not mention appraised value or how important the issue of loan security was to him. There is no evidence from the lawyers or regulators involved in drafting the OS that they considered "appraised value" to be an important term in the totality of the disclosure in the OS. At the time

the OS was drafted and issued, the Perfex Fraud and the CCU's uncertain future and unstable finances were the most material issues to be disclosed.

[204] As stated in *Sharbern*, the statutory requirement does not impose on issuers an obligation to disclose all facts which would permit an investor to sort out what was material and what was not. That approach would result in excessive disclosure, regardless of materiality, and would overwhelm investors with information and impair their ability to make decisions.

[205] There was sufficient reference to the lending policies in the OS. These policies plainly stated the CCU's practices. The OS stated that an investor could examine any policies referenced in the OS, and warned that such policies may contain risk factors.

[206] The disclosure provided in the OS confirmed the CCU's critical financial position; the fact that it was under supervision and not lending money; that it owed significant funds to CUCO; that it was subject to a going concern note; that the securities were highly speculative and had no market; and that there was a risk from uncollectable loans. The "appraised value" issue was not material in view of the total mix of disclosure provided in the OS.

[207] Finally, if I had found that there was a material misrepresentation in the OS, I would have found that the board and auditors have established an entitlement to the statutory defence under s. 82(5) of the Act. There were no reasonable grounds for the board or Retford to believe that there was a misrepresentation. The OS was drafted with the close oversight of lawyers, the external auditor, DICO and FSCO. All of these parties, along with the board and Retford, were primarily committed to making full, true and plain disclosure and complying with the Act. The board and Retford could take assurance that the external auditor, lawyers, DICO and FSCO would not have approved a draft of the OS if it contained a material misrepresentation.

[208] The board, external auditor and Hutton, DICO's representative, knew about the CCU's lending policies and its reliance on purchase and sale agreements as a method of appraising value for mortgages. This was considered a proper and standard practice in the credit union industry. None of these parties considered the phrase "appraised value" to be anything other than true, full and plan disclosure. Based on their experience with credit unions and the fact that the phrase "appraised value" does not imply any one method for appraisal, these parties had reasonable grounds for that belief.

5. Is the presumption of deemed reliance rebutted in this case?

[209] I have not found that there was a misrepresentation in the OS. However, if I am incorrect, then Polla is deemed to have relied upon any misrepresentation in the OS by virtue of s. 82(1) of the Act. In this section, I will consider whether the presumption of reliance is rebutted in the circumstances of this case.

Submissions

[210] Polla's submissions on this issue include the following:

(i) Section 82(2) of the Act expressly provides the circumstances under which the presumption of reliance may be rebutted – if the investor had knowledge of the misrepresentation at the time of the investment. Polla had no knowledge of the misrepresentation, and is therefore deemed to have relied on it.

(ii) No reasonable investor (including Polla) would have purchased the shares on the terms offered under the OS, or at all, had they known all the circumstances.

(iii) Polla would never have invested but for the misrepresentation contained in the OS. His money was lost the moment he invested, as the CCU was already insolvent due to the OMF (although this was not discovered until later). Accordingly, any subsequent events are immaterial and irrelevant. Polla's losses were a direct result of his purchase of the shares, in reliance upon the contents of the OS.

(iv) Polla's experience as a residential real estate lawyer does not entail that he was aware that a mortgage lender often did not require an independent appraisal to lend money. Moreover, other mortgage lenders' practices are not relevant. The CCU expressly represented, or at the very least clearly implied, within the OS, that it required such appraisals. Even if Polla knew that other commercial lenders might not have required appraisals, the OS indicated that the CCU did. He is entitled to rely on this representation and cannot be presumed to have known that it could be false or misleading.

(v) The Act expressly provides that an agreement is not invalidated by virtue of non-compliance with the Act (i.e. that Polla failed to disclose the beneficial ownership of the purchased shares). It is clear that the legislature's intention was to preserve the validity of all contracts, wherever possible. As such there is simply no basis for the assertion that Polla was in no position to avail himself of the protection of the Act. It should be noted that the defendants have cited no authority for this assertion.

[211] The defendants' submissions on this issue include the following:

(i) In *Sharbern*, the Supreme Court of Canada expressly rejected the argument that a presumption of deemed reliance is not rebuttable. Although this decision was in the context of the *Real Estate Act,* R.S.B.C. 1996, c. 397, the court discussed the common elements between different acts governing the offering of securities to the general public. The statutory purpose behind disclosure obligations in these contexts involves balancing the interest of investors in receiving information against the burden imposed on issuers by disclosure requirements. A non-rebuttable presumption would interfere with this balance. It would be an absurd and unjust result for an issuer to be held liable for a misrepresentation if the investor was fully aware of the misrepresentation and of the true facts.[41]

(ii) Polla cannot credibly contend that he understood the term "appraised value" to mean that mortgages were only granted based on property value as determined by an independent third party appraisal. Polla is an experienced residential real estate lawyer. He would have been aware that a mortgage lender often did not require an independent third party appraisal.

(iii) Polla has been explicit throughout the trial and in his submissions that his claim is based on the Act and that it is through the Act that he is deemed to have relied upon the OS. It is critical to Polla that he avail himself on that deemed reliance because his own evidence shows little or no regard for the OS in his decision to invest in the CCU. Polla's own description of his purchase of the shares is as follows:

(a) he had two brief meetings with a stranger (Vinski, who was introduced to him by his business associate Milan);

(b) he was told that the CCU had serious financial problems and was under supervision by DICO;

(c) he was provided with the OS, which was replete with warnings;

(d) he did not meet or speak to any of the directors before the dinner meeting, which did not cover substance but rather was a friendly conversation about what they would do together going forward, including building retirement homes for Italians and Croatians;

(e) he decided to invest $5 million so that he could get back into the mortgage business;

(f) before investing, but after having read the OS, he went back to Vinski, whom according to Polla he barely knew, and said that the OS was full of warnings but was quickly reassured about his investment by Vinski (and only by Vinski); and

(g) he did not avail himself of any professional advisors or conduct any due diligence although he was aware that he could do so, and that in fact, the OS warned him that he should do so.

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[41] *Sharbern* at paras. 117-119.

(iv) Polla cannot establish subjective reliance on the OS nor can he establish deemed reliance, as interpreted in *Sharbern.*

(v) Polla's position that his loss arises from his reliance (both in fact and by virtue of the deemed reliance of s. 82(1) of the Act) upon the misrepresentation as to "appraised values" is patently wrong.

(vi) Polla said nothing about relying on "appraised value" when asked about it during his direct examination. How could those two words have been material to Polla or relied upon by him, either deemed or actually, when he did not make any allegation about appraised value until hearing the evidence of the directors at trial?

Analysis

[212] Polla, by virtue of s. 82(1) of the Act, is deemed to have relied upon the contents of the OS if the OS contained a misrepresentation. I have already found that there was no misrepresentation. As set out above, in the event that I am incorrect about this finding, I find that the exception stated in s. 82(2) of the Act applies and any deemed reliance has been rebutted. Polla is an experienced residential real estate lawyer. I agree that he would have been aware that mortgage lenders did not routinely require independent third party appraisals to grant a mortgage, especially a small community credit union. Therefore, to the extent that the OS misrepresented the CCU's practices, Polla would have been aware of the misrepresentation and of the true facts of the situation. Polla would have known about the misrepresentation at the time he invested. He cannot gain the benefit of the deemed reliance.

[213] Examining whether Polla in fact relied on the OS, I find that he did not. He read the OS and its warnings, but rather than rely on it he chose to consult and rely on the advice he received from Vinski - a virtual stranger, according to Polla. He did not follow-up on the OS's warnings by meeting with or questioning the board members, or seeking professional advice. His position that he took "appraised value" to mean only independent third party appraisals and that he relied on this statement in making his investment has no credibility and is made up after the fact in order to continue with a trial that fell apart and unraveled as it progressed.

6. Is there a causal link between Polla's loss and the alleged misrepresentation?

Law

[214] As explained by the Supreme Court of Canada in *Snell v. Farrell*:

> Causation is an expression of the relationship that must be found to exist between the tortious act of the wrongdoer and the injury to the victim in order to justify compensation of the latter out of the pocket of the former.[42]

[215] In order to justify the receipt of compensation from the alleged wrongdoer, the injured party must satisfy two distinct causal inquiries: cause in fact and cause in law. In order for the action(s) of the alleged wrongdoer to have caused the plaintiff's damage in law, the action must not be too remote from the harm to warrant recovery. [43]

[216] The causal nexus between the wrongdoer's actions and the harm must be a substantial one. The specified negligence must be an effective, or proximate, cause of the plaintiff's loss. The possibility of a causal connection is not enough.[44]

Submissions

[217] Polla's position is that there is a causal link between his loss and the alleged misrepresentation in the OS about appraisals. Polla's submissions include the following:

(i) At the time the OS was issued, the defendants knew that the CCU had been making mortgage loans without obtaining formal appraisals. The OS stated that mortgage loans were limited to 75% of "appraised value", but this cannot be true if no appraisals have been obtained. There was no disclosure indicating that "appraised value" was being determined by means other than professional appraisals. The lending services policy and, accordingly, the OS were false or misleading because there were no appraisals in respect of most of the mortgaged properties. The defendants knew that appraisals were not being obtained.

(ii) Further, the extent of the CCU's financial issues were not represented by the OS, as the OMF had not yet been discovered. Hutton testified that the CCU had to raise at least $3.5 million from the sale of the preferred shares to meet its minimum regulatory requirements. This figure did not, however reflect the then unrecognized losses from the OMF, which stood at about $6.6 million. Taking into account the OMF losses, the CCU's true capital deficiency was $1.1 billion. As less than $6 million was raised from the share offering, the CCU was actually in a deficit position of about $4 million following Polla's investment. It was therefore insolvent and could not lawfully operate and was never in a position to redeem the shares. As such, Polla's investment was lost in its entirety the moment it was made.

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[42] *Snell v. Farrell*, [1990] 2 S.C.R. 311 at para. 27
[43] *Mustapha v. Culligan of Canada Ltd.*, 2008 SCC 27, [2008] 2 S.C.R. 114.
[44] *Reid v. Galatai*, [2003] O.J. No. 2628 (S.C.) at paras. 25-28, citing *Roncato v. Caverly* (1991), 5 O.R. (3d) 714 (C.A.) [*Roncato*].

(iii) Polla's investment was lost because he relied upon the misrepresentation with respect to appraisals in deciding to purchase the shares. Any subsequent real or perceived reason for the demise of the CCU did not cause the loss because the CCU was already insolvent at the time that Polla purchased the shares. From that point on, Polla's investment could never be recouped. It was too late; he had already invested and lost his money.

(iv) The defendants always knew that appraisals were not being obtained. Accordingly, they cannot prove that they had no reasonable grounds to believe and did not believe that there was a material misrepresentation contained in the OS.

(v) The requisite causal link is not between the lack of the appraisals and the OMF (although common sense tells us that such a casual correction existed) – it is between the misrepresentation and the making of Polla's investment. Polla was induced by a misleading OS to invest in an insolvent credit union (even if its insolvency was not yet recognized). Subsequent events which contributed to the CCU's failure do not matter.

[218] The board's position is that Polla has not established a causal link between the alleged misrepresentation and his loss. The board's submissions include the following:

(i) Polla's argument is twofold: (i) the OMF was caused by the lack of appraisals and, (ii) as a result of the OMF, the OS overstated the CCU's assets, such that Polla's investment was lost when he invested it.

(ii) The evidence does not support Polla's submissions. The OMF was not caused by the CCU's reliance on purchase and sale agreements or the lack of appraisals, nor was Polla's loss caused by the underlying OMF.

(iii) The statutory remedy available to Polla under section 82(3) only provides the plaintiff a "right of action" against the directors, which relieves Polla of the burden of having to establish a duty of care or reliance on the OS. It allows Polla a right to commence an action against the board. However, the statutory remedy does not provide Polla a right of damages. Polla has failed to establish causation in fact or law.

a. No causal link between lack of appraisals and the OMF

(iv) The OMF was a complex fraud which involved multiple players. The Oklahoma mortgage loans, all at or below the CCU's permitted maximum of 75% of the property value and $300,000 total loan threshold, were in compliance with the CCU's lending policy, which allowed for use of purchase and sale agreements in those circumstances.

(v) The evidence does not establish a causal link between the lack of appraisals and how the OMF occurred. The fraud was complex and multilayered, and needed the involvement of many parties for it to work.

(vi) Polla has latched upon the lack of appraisals as the reason why the fraud took place. He makes this argument with no evidence (including expert evidence) and ignores the evidence to the contrary.

(vii) The OMF files that were reviewed in court met all three criteria for the use of purchase and sale agreement as indicated in e(iii) of the credit policy: (i) both files had an OREA purchase and sale agreement, which auditors Bates and Diluzo confirmed indicated that the property had been listed on MLS; (ii) both files had a mortgage application that reflected a house on the property; and (iii) both files indicated that the loan was 75% or less of the purchase price. For example, the loan provided to Oroz Radencko (Exhibit 72) was for $228,500, which was less than 75% of the purchase price of the property ($305,000). The loan provided to Oroz Dusica (Exhibit 73) was for $223,500, which was less than 75% of the purchase price of that property ($298,000).

(viii) Polla maintains that appraisals would have been an independent check on the loan files and therefore, would have prevented the OMF. There is no evidence, particularly from an expert, to support this and, in fact, there is expert evidence that establishes the contrary.

(ix) Muccilli was questioned about both of the OMF files. He confirmed that purchase and sale agreements and mortgage loan applications were both independent sources of information that could be properly relied upon when approving a loan. He reiterated that once parties outside the CCU got involved in a fraud, it was complex and hard to detect. A fraudster appraiser and a false appraisal report could easily have been made part of the fraud, and then an appraisal would equally have had no value. Given the number of professionals involved in the fraud, including lawyers and real estate agents, he opined that it would not be a far stretch to also involve an appraiser who was willing to prepare fraudulent appraisals. If an appraisal was part of the compliance requirement, then another fraudster could be added to the scheme and the OMF would continue.

(x) Bates also indicated that appraisals are not always accurate. In fact, DICO would not have looked favourably upon the CCU if it had blindly followed appraisals.

(xi) It is important to remember that the onus is on Polla to establish that there is a causal connection between the alleged new misrepresentation (lack of appraisals) and the OMF if he intends to argue that this fraud caused his loss.

(xii) In *Roncato v. Caverly*,[45] the Court of Appeal reversed the trial court's decision on the grounds that the plaintiff had failed to establish causation in a negligent misrepresentation case. The court, adopting the principles in Snell, said as follows:

> On my reading of the authorities, particularly what was said by Sopinka J. in *Snell v. Farrell*, the onus was upon the respondents, as plaintiffs, to prove on a balance of probabilities that there was a substantial connection between the economic loss that they suffered and the misrepresentations negligently made to them by the appellant. The trial judge was satisfied on the evidence that the respondents would not have hired Mrs. Cox as bookkeeper, or retained her as such, but for the misrepresentations of the appellant. On the other hand, he also was of the opinion that a coherent case on causation had not been made out and that the damages had not been systematically established (see quotation, supra). On a reading of all of the evidence, there is at most a tenuous nexus, certainly not a substantial nexus, between Mrs. Cox's incompetence and the losses which befell the company and, as a fallout of that, the shareholder respondents. Further to that, the economic loss can scarcely be brought home to the appellant to a degree that satisfies the onus in *Caparo*.[46]

(xiii) Similarly, in this case, there is no substantial nexus between the lack of appraisals and the OMF. Polla has failed to establish a causal link between the lack of appraisals and the OMF.

(xiv) Polla`s case fails on the first part of the causation test, as he has failed to link the lack of appraisals to the cause of the OMF.

b. No causal link between the OMF and the administration by DICO of the CCU resulting in Polla's losses

(xv) Polla's loss of investment was not caused by the CCU's lending practices or the OMF. Polla lost his investment because the CCU went into administration and was then put into liquidation for reasons wholly unconnected to either its lending policies or the OMF.

(xvi) Polla presented no evidence that the OMF was a proximate cause of the CCU going into administration. In fact, the evidence is to the contrary.

(xvii) Other than Polla's own inferences and theories, there is no evidence that there was any nexus between the OMF and the loss of Polla's investment. As in *Roncato*, there

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[45] *Roncato.*

[46] *Roncato* at para. 35.

is no evidence from Polla or any other witness that establishes the substantial causal nexus between the OMF and the CCU being put into administration.[47] Even a tenuous (or any) nexus is difficult to sustain given the clear evidence from multiple witnesses as to the actual cause of the administration of the CCU and loss of Polla's investment.

(xviii) Wood, Hutton and the board members testified that the OMF was not even fully discovered until after the AO and was not the cause of the downfall of the CCU. The August Loans were the problem.

(xix) As pointed out by Muccilli, the CCU continued to operate perfectly well for years after the OMF was committed, between 2002 and 2006. There were approximately 350 mortgages given by the CCU and only 24 were part of the OMF (approximately 7% of the CCU's total mortgage portfolio). The CCU also continued to operate after the Perfex fraud.

(xx) After Polla invested in the CCU, no further Oklahoma mortgages were given. In fact, the CCU had not even been lending money since June of 2007. From the date of Polla's investment (July 23, 2008) to the date of the AO (July of 2009), there was no intervening OMF activity that impacted the financial situation of the CCU.

(xxi) One of the key factors that kept the OMF from being detected was that Vinski kept those mortgage loan accounts up to date. Vinski would use money coming into the CCU to pay down the Oklahoma mortgage loans. Given this, there was no way of knowing if the OMF would have ever resulted in the administration of the CCU.

(xxii) The OMF did not result in the AO. The AO was caused by the intervening August Loans made to Polla and the Milans ($2.7 million and $100,000 to Polla and $2.6 million to the Milans). These loans put the CCU offside its liquidity requirements and led to its administration and the loss of Polla's investment.

(xxiii) The above facts and law expose the fallacy of Polla's argument that the alleged misrepresentation about "appraised value" caused the OMF and the consequent demise of the CCU and the loss of Polla's investment from the moment he invested in the CCU. Neither of those causal links are factually correct.

(xxiv) Not only is there no "substantial nexus" between the OMF and the CCU's demise (resulting in Polla's loss,) but there is ample evidence that the CCU would not have gone into administration but for the August Loans. (This submission is dealt with in more detail in the section addressing the negligence of Polla himself.)

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[47] *Roncato* at para. 34-36.

(xxv) Polla has not put forward any evidence or law establishing a causal link between the alleged misrepresentation and the loss of his investment. His claims cannot survive his failure to establish causation.

[219] Retford also submits that Polla has not established a causal link between the alleged misrepresentation and his loss. Retford's submissions include the following:

(i) Muccilli stated that it is difficult to identify any one factor that caused the demise of the CCU. There were a number of cash flow depletions subsequent to Polla's investment, including other loans. As well, the CCU continued to operate for a period of time after the discovery of the OMF.

(ii) Consistent with Muccilli's opinion on this issue, Polla's auditing expert Alan Mak ("Mak") acknowledged that when loans totaling $5.4 million were advanced by the CCU (to Polla and the Milans) only two weeks after the injection of $5.5 million through the OS process, the CCU was right back in the same cash position that it had been in before the OS. Mak had not been aware of these loans, and, once apprised of them under cross-examination, he withdrew the following assumption from his 2015 report: "as a result of the fraudulent Oklahoma mortgages CTCU suffered catastrophic losses and ultimately ceased operation."

(iii) Contrary to Polla's reply, Polla's investment was not lost, "the moment he invested". The CCU continued to operate after Polla invested in June of 2008 until it ceased operations in 2010.

(iv) Similarly without evidence, Polla's reply states, "The OMF was caused as a result of the board's failure to ensure that real estate appraisals were obtained... such that the plaintiff's investment was lost at the moment that it was made." Polla adduced no evidence that real estate appraisals would have prevented the OMF. To the contrary, Muccilli's evidence was that a fraud of this complexity would have involved real estate appraisers if that was required.

Analysis

[220] Polla has not established a causal link between the alleged misrepresentation and his loss. Polla attempts to draw a causal connection between the alleged misrepresentation and the OMF. However, the OMF was not caused by the CCU's reliance on purchase and sale agreements. It was caused by the work of a number of fraudsters, including the CCU's own CEO. This was a sophisticated fraud that took place over a number of years, and went undetected by the various auditors and regulators who worked with the CCU. The OMF was a well thought-out, successful fraud, and would likely have been so even if the CCU had required professional appraisals for every mortgage. Furthermore, Polla's loss was not caused by the OMF. Polla lost his investment because the CCU went into administration and then liquidation for reasons unconnected to its lending policies and only partially connected to the OMF. Polla's investment was not "lost at the

moment he made it." According to the expert evidence, the CCU would likely have survived the OMF, as it had survived the Perfex fraud, if it weren't for the August Loans. The August Loans were the trigger for the CCU being put into administration, and the subsequent loss of Polla's investment. The words "appraised value" in the CCU's OS played no part in this major aspect of the CCU's downfall.

7. Is Polla partially liable for contributory negligence?

Law

[221] Section 3 of the *Negligence Act* provides that:

> In any action for damages that is founded upon the fault or negligence of the defendant if fault or negligence is found on the part of the plaintiff that contributed to the damages, the court shall apportion the damages in proportion to the degree of fault or negligence found against the parties respectively.[48]

[222] Contributory negligence is a principle of tort law that is available in a claim for negligent misrepresentation.[49]

[223] In *Transpacific Sales Ltd. v. Sprott Securities Ltd.*[50] the plaintiff was a wealthy and sophisticated investor who actively traded securities in ten brokerage accounts. Through his broker at Sprott Securities Ltd., he purchased special warrants in two private companies. The subscription agreements contained many warnings as to the riskiness of the investments.[51] Although he signed the subscription agreements, he claimed he only read them superficially.[52] The trial judge found that "his conduct involved at least some failure on his part to take reasonable care of his own interests" and held him responsible for 50% of the damages suffered.[53] This decision was upheld by the Ontario Court of Appeal.[54]

Submissions

[224] Polla's submissions include the following:

(i) Contrary to the directors' submissions, Polla did not cause the loss of his own investment. Rather, the investment was lost as a result of his decision to invest, a

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[48] *Negligence Act*, R.S.O. 1990, c. N.1, s.3

[49] *Avco Financial Services Realty Ltd. v. Norman* (2003), 64 O.R. (3d) 239 (C.A.) at paras. 24-35; see also *Oberoi v. Newtek Automotive Distribution Inc.*, 2012 ONCA 179, 93 C.C.L.T. (3d) 205.

[50] (2001), 13 B.L.R. (3d) 78 (Ont. S.C.J.) [*Sprott Securities*].

[51] Ibid, at paras. 52-55, 61-62.

[52] Ibid, at paras. 54, 61.

[53] Ibid, at paras. 109, 114.

[54] *Transpacific Sales Ltd. v. Sprott Securities Ltd.* (2003), 67 O.R. (3d) 368 (C.A.).

decision he made relying on the misleading OS. Polla's investment was lost the moment he made it because, at the point that he advanced the funds, the CCU was already insolvent beyond the point of anything his investment funds could have remedied.

(ii) Polla was entitled to rely upon the OS. Indeed, he is deemed to have relied upon it. He was not required to exercise any further inquiries or due diligence as to whether the presentations contained in the OS were truthful. Polla was entitled to assume that the representations were in fact truthful and that they constituted full, true and plain disclosure.

(iii) It does not matter if the credit union industry defined the phrase "appraised value" as including the use of purchase and sale agreements as a means of appraisal. If this was the intended meaning, that should have been made clear in the OS. The failure to do so made the OS misleading. It created an OS which did not contain full, true and plain disclosure.

(iv) Polla did not have any concerns as to the contents of the lending services statement. On its face, the lending services statement indicated that residential mortgage loans were made based upon "appraised values", which indicated that there were appraisals. It certainly did not communicate that values were being determined through reference to agreements of purchase and sale, thereby eliminating the independent scrutiny associated with appraisals. Polla was entitled to take this term at face value in light of the obligation on the CCU to make full, true and plain disclosure.

(v) The board submits that Polla had a duty to inquire as to the nature of the lending policies, even though the lending services statement makes no reference to the use of purchase and sale agreements to value properties. This argument makes a mockery of the obligation on the directors to make full, true and plain disclosure. The directors' argument has in effect reversed the onus and placed the duty upon Polla to make inquiries rather than upon the directors to provide full, true and plain disclosure. While it might have been prudent for Polla to make some further inquiries, he was not obliged to do so. Kirzner's evidence does not support the proposition that Polla was under any obligation to make further inquiries.

(vi) *Transpacific Sales Ltd. v. Sprott Securities Ltd.* is not applicable to these facts and is distinguishable. Polla testified that he read the OS and that he understood the lending services statement to constitute the applicable lending policy in terms of valuing residential properties. Given that this interpretation was a reasonable one, it was certainly open to him to adopt such an interpretation when considering the document. As such, he had no obligation to make further inquiries. The board cannot point a finger at Polla and say that he is contributorily negligent for failing to have asked questions about something which they themselves chose not to disclose within the document, contrary to their obligation under the Act to do so.

(vii) Polla received a $100,000 loan secured by the shares he purchased in the CCU. Polla's company (861401 Ontario Limited) received a $2.7 million mortgage loan secured by a mortgage on a townhouse complex that his company owned. Polla had no way to know that these loans placed the CCU in any financial difficulty. He is not a member of the CCU's management or credit committee and there was no reason for him to inquire into the propriety of these loans.

(viii) There is no basis to apportion any contributory negligence to Polla. The loss arises solely from his investment, which he was induced to make by the OS. Although Polla was prepared to accept the risks enumerated in the OS, he was not prepared to invest based upon a misrepresentation about the appraisals that the CCU obtained before giving mortgages. Polla lost his investment the moment he made it, not when the CCU became insolvent. Furthermore, the CCU's insolvency was directly attributable to the OMF, which could not have existed but for the absence of independent, third party appraisals – the very appraisals that Polla believed existed.

[225] The board's submissions include the following:

(i) Polla was the author of his own misfortune. His entire claim is based in hindsight. After the OMF was revealed, Polla worked backwards to identify at trial the two words in a twenty-nine page OS, "appraised value", that he says are the "lynchpin" of his entire case. Polla says that it was because of the assurance provided by these two words that he invested in the CCU and from the moment he invested, he suffered his loss.

(ii) These arguments are a fallacy. In addition to the fact that Polla has failed to establish that there were any misrepresentations in the OS, he has caused his own loss of investment by his negligence.

(a) Polla's negligence and lack of due diligence at the time of the investment

(iii) Just as the board had the responsibility to gain assurance that the OS provided full, true and plain disclosure of material facts to the best of their abilities, it was the responsibility of a "knowledgeable investor" to ensure that he conducted his due diligence in regards to the OS. Even Kirzner confirmed that before investing millions of dollars, Polla should have undertaken an investigation of the loan approval process and lending policies.

(iv) Applying either an objective or subjective standard, from the board's perspective, there was no special meaning ascribed to the two undefined words "appraised value". The evidence of the board, Retford, and their experts was that the term "appraised value", given industry standards in the credit union system, included purchase and sale agreements as a means of valuation.

(v) Even if this avalanche of evidence were put aside, if Polla had any concerns or confusions about this allegedly important issue the OS specifically provided that:

> The prospective purchaser of these securities should carefully review the offering statement and any other documents it refers to, examine in particular the section on risk factors beginning on page 24 and may wish to consult his/her financial and tax advisors about this investment;

(vi) The OS made numerous references to the CCU's lending policies. If the issue was so important to Polla (which, according to his evidence, was not the case at the time of the investment), all he needed to do was ask for the lending policies to ensure that his subjective understanding of "appraised value" accorded with the objective standards of the credit union industry.

(vii) The OS informed Polla that: (i) he could lose his entire investment; (ii) the CCU was under the supervision of DICO; (iii) the CCU had suffered a third party fraud; (iv) there was no market for the sale of the securities; (v) the CCU had inadequate internal controls and its policies did not provide sufficient direction, which exposed the CCU to human error and management failure; (vi) the CCU had sold off a significant mortgage portfolio; and (vii) that there was a going concern note and that the CCU might in fact never recover from its current liquidity issues. Notwithstanding these warnings, Polla, a lawyer and sophisticated investor, did no due diligence.

(viii) Polla's argument is that Vinski was presented to him as the representative of the CCU and that he relied on him in regards to the information provided. However, according to Polla, he first met Vinski in June of 2008, only a few weeks before he invested $5 million in the CCU. No reasonable investor, let alone a sophisticated investor, would or should have relied solely upon the representations of one person when deciding to invest millions in an organization that had a going concern note and a future that hung in limbo. For a lawyer with more than 30 years' experience, Polla's evidence that he took Vinski's word over all the OS's warnings is baffling.

(ix) Polla admitted that he had an option to consult a lawyer, an accountant, and investment advisor or a member of the board at any time before investing but chose not to do so.

(x) Given that Polla's dream was to use the CCU to return to the mortgage business, it should have been even more imperative that he understood the lending policies, as they would be relevant to his mortgage business. However, he did not take any steps to enquire about the CCU's lending policies.

(xi) Even Kirzner stated that he would want to know a credit union's loan approval process and policies if he would be getting involved in mortgage business with that credit union. He would want to know whether there was an internal audit process, the identity of the external auditor, and the relationship between the board and these auditors. He further stated that getting to know the directors and how they made decisions would have been helpful at that point.

(xii) Even if the court were to believe his subjective understanding of the term "appraised value", it was Polla's own lack of due diligence and negligence that resulted in him not obtaining clarity on the issue. It was Polla's choice to not raise any questions at his meeting with the board, to not ask for the lending policies and to not get legal or investment advice. It was his choice to invest $5 million without any due diligence, which led to his alleged misunderstanding. Polla is therefore fully responsible for his own misunderstanding, if any, of the use of the term "appraised value".

(b) Polla's and Milan's improper August Loans caused the downfall of the CCU and the consequent loss of Polla's investment

(xiii) The OS provided that:

> The net proceeds of the Offering, after deducting the expenses of the Offering estimated to be $50,000 are estimated to be $3,450,000 if the Minimum Offering is completed and $5,950,000 if the Maximum Offering is completed. The net proceeds from the Minimum Offering will be used to address the Corporation's current deficiency in its Leverage Ratio by reducing the Corporation's overdraft with CUCO;

(xiv) Polla knew at the date he received the OS that the CCU needed at least $3.45 million ("minimum offering") to remain in compliance with the lending ratios and the Act. At the close of the OS in July of 2008, the CCU raised a total sum of $5,457,300, i.e. $2,007,300 more than the minimum offering that the CCU needed to meet its liquidity requirements.

(xv) In spite of that knowledge, the following events occurred:

(a) On August 1, 2008, Polla's company (864401 Ontario Limited) received a loan of $2.7 million using the Tansley property as security. Polla then gave the $2.7 million to Milan's company, in which Polla and his family were investors, in return for a promissory note. Polla personally was also a guarantor on the Tansley mortgage loan.

(b) As soon as $2.7 million left the CCU, just two weeks after Polla's investment, the CCU was again offside its lending limits.

(c) Also on August 1, 2008, Milan and his wife obtained credit lines of $1.3 million each from the CCU.

(d) In total, between July 15, 2008 and August 1, 2008:

(i) $5.45 million came into the CCU (the bulk from Polla); and

(ii) $5.3 million was transferred out of the CCU to Polla and the Milans.

(xxi) The CCU then had no means of surviving. Even though nobody knew of the OMF at this time, everybody, including Polla, knew that the CCU needed $3.5 million to survive and maintain liquidity. Therefore, if the CCU's liquidity was a concern for Polla (as mentioned in his submissions,) he should have refused the $2.7 million loan, which according to him was "volunteered" by Vinski.

(xxii) Polla's evidence was that he was suspicious of Vinski. We know, however, that he never brought any of his suspicions or even the Tansley transaction to the attention of the board. In fact, Polla's next steps established a substantial causal nexus between the August Loans and the downfall of the CCU:

(a) Hutton and the board discovered the August Loans in November of 2008. Hutton informed the board at a meeting in December of 2008 that he was suspicious of Vinski because of the August Loans and that it was clear at that point that the CCU was facing administration because the August Loans had put it offside its lending limits.

(b) Vinski was suspended, and DICO ordered a forensic investigation of the CCU and several questionable loans, including the August Loans, from Miclaur (which resulted in the "Miclaur report").

(c) DICO ordered a preparatory examination from English and Jones ("E and J") to confirm that the CCU could not recover from the deficit caused by the August Loans and that it should be put into administration. The E and J report identified the August Loans as a cause of the severe impairment of the CCU's assets.

(xxiii) The evidence of the board and Hutton was clear. The August Loans to Polla and Milan put the CCU back in its pre-OS position and led to the CCU being offside in its liquidity ratios and to its eventual administration.

(xxiv) Wood's evidence was also that CCU was put into administration as a result of the large loans given after recapitalization, including the August Loans. The CCU was facing liquidity issues as the August Loans could not be recovered and remained in arrears.

(xxv) Based on all of these facts, and contrary to Polla's argument that his investment was lost as soon as he put his monies into the CCU, it is clear that his monies were lost because he improperly took loans that caused the CCU to be put into administration. Wood, who discovered the OMF, confirmed that the OMF was not fully discovered until after the CCU was put into administration.

(xxvi) Therefore, on a balance of probabilities, there can be no dispute that the August Loans caused the demise of the CCU and Polla's consequent loss. Polla is thereby the author of his own misfortune and is 100% responsible for his damages, if any.

(xxvii) Polla's reply is fraught with misstatements, incorrect evidence and plainly wrong positions of evidence and law. Some of the notable issues are listed below:

(a) Polla states that he had no way of knowing that the $2.7 million loan would have put the CCU offside its lending limits or affect it adversely. However, the OS, which Polla states numerous times he is deemed to have relied upon, clearly states that the CCU needed a minimum subscription of $3.5 million to be able to survive and continue its business. Even if the court were to believe that Polla had no knowledge of the Milan loans (which is a completely incredible position), Polla's $2.7 million loan alone put the CCU offside its lending limits;

(b) Polla states that he did not know that the CCU could not make a loan of $100,000 to him in July 2008, as Vinski told him otherwise. Once again, the OS, which Polla is deemed to rely upon, clearly states that the CCU ceased all loan and lending activities in June of 2007 and could not make any loans until it received its minimum subscription of $3.5 million.

(c) Polla attempts to relegate the $2.7 million loan as irrelevant because it was repaid as part of a settlement of litigation. This is a preposterous position, especially taking into account the fact that the loan was repaid to DICO in 2011, nearly two years after the CCU was put into administration and liquidated due to large loans, including this $2.7 million loan.

[226] Retford's submissions include the following:

(i) Polla is contributorily negligent and caused or contributed significantly to the CCUs demise.

(ii) Factors which attribute blame to Polla are significant, and are as follows:

(a) He is a very sophisticated and an experienced real estate lawyer;

(b) He did no due diligence before purchasing the shares and barely read the OS and the subscription agreement;

(c) He did not engage any professionals to advise him on the investment, although he well knew that he could do that;

(d) To the extent that he had any concerns, he raised them only with Vinski; and

(e) He [and his company] received a total of $2.8 million from the CCU immediately after funds raised through the OS were injected, which caused or contributed to the demise of the CCU.

(iii) Within a few weeks of investing, Polla/his company obtained two separate loans of $100,000 and $2.7 million. Polla knew of the CCU's dire financial position. Polla also knew that the CCU was under a lending freeze.

(iv) Polla's attitude was cavalier at best, and he caused his own loss. As an example, when he was asked whether he questioned the CCU's ability to lend $2.8 million dollars without putting it back into a financially precarious position, Polla responded, "Was there a need for me to ask that question?".

(v) Polla was no prudent investor. He shirked at the opportunity to obtain legal, accounting or investment advice. He stated that he relied on Vinski's representations, a man he claims he met only a couple of weeks prior to investing. Despite the OS being replete with warnings, he simply, "believed whatever [he] was reading". Immediately after investing $5 million, he/his company stripped the CCU of $2.8 million. No prudent potential investor would ever behave in this manner.

(vi) Once Mak was made aware of the loans to Polla (and to the Milans) during his cross-examination, he tellingly withdrew the following assumption from his 2015 report: "As a result of the fraudulent Oklahoma mortgages, CTCU suffered catastrophic losses and ultimately seized operation".

(vii) Mak has admitted to making errors in his report. In his report, he opined that the 2007 financial statement overstated assets by $5 to $9 million. In his direct examination, he revised this to approximately $1 million. In cross he went further and acknowledged that his revised overstatement was $982,858. He further acknowledged that, once funds from member deposits, investments, cash reduction and increase in member shares was included, there was more than enough cash flow to cover the entire reduction of the CUCO overdraft. Mak also revised his opinion that Retford should have examined some of the OMF files, and the OMF would have been revealed if it had done so. When it was put to him that the evidence (including Muccilli's evidence) established that OMF files were reviewed and did not disclose fraud, he confirmed that he had not been informed that Retford had reviewed the

OMF files in 2005 and that an OMF file was part of the 2007 OSV. Mak further acknowledged that the lack of appraisals and substitution of agreement of purchase and sale as permitted by the credit management policy was not a red flag to an auditor. In sum, in the course of cross-examination Mak essentially abandoned the criticisms in his reports.

(viii) Polla was culpable for his own loss, or was at the very least willfully blind. He, a retired real estate lawyer, ignored the warnings and/or willingly accepted what he was told without scrutiny. In this respect, Polla admits that:

(a) He invested in the CCU without consulting professional advisors such as a lawyer, accountant or investment professional;

(b) As a lawyer, he would recommend that his clients have a lawyer for such a transaction;

(c) He only knew Vinski for approximately 2 weeks prior to his investment (in direct conflict with Rosekat's evidence that he met with Polla and Vinski much earlier - sometime in late 2007. Rosekat has a docket of the meeting);

(d) He was aware of all of the risks prominently displayed in the OS but nonetheless he simply, "believed whatever [he] was reading"; and

(e) He was aware of and understood the going concern note in the audited financial statements.

(ix) The OS dedicated an entire section to risk (in addition to the bolded warnings at the outset.) The section on credit risk consumed an entire page and, in particular, warned that there was a risk to investors that the policies of the CUU might not be followed:

> ...The lending policies of CCU, the care and attention of staff and management in applying such policies to loan applications and loans granted, and the security taken in connection with such applications, will affect the future profitability of CCU and impact on its ability to pay dividends and redeem Series A Shares.

(x) Further, it is submitted that Polla's contention that he was entitled to rely on what he alleges to be a misrepresentation, without making any efforts to properly inform himself about the risks, cannot be a fair interpretation of the Act or an attainment of its objects.

(xi) Contrary to the Polla's reply, Polla's investment was not lost, "the moment he invested". The CCU continued to operate after Polla invested, from June of 2008 until it ceased operations in 2010.

(xii) Similarly without evidence, Polla's reply states, "the OMF was caused as a result of the board's failure to ensure that real estate appraisals were obtained... such that Polla's investment was lost at the moment that it was made." Polla adduced no evidence that real estate appraisals would have prevented the OMF. To the contrary, Muccilli's evidence was that a fraud of this complexity would have included real estate appraisers if that was required.

Analysis

[227] If the defendants were liable to Polla for the loss of his investment (which I have not found) then I find that Polla was 50% responsible for the loss as a result of contributory negligence on his part.

[228] Like the investor in *Transpacific Sales Ltd.*, Polla did not take reasonable care to avoid or mitigate a foreseeable risk or harm. Having reviewed the OS and discussed it with Vinski and the board, Polla should have been able to foresee that taking a $2.7 million loan and a separate $100,000 loan from the CCU would destabilize the credit union. Polla knew that the CCU was making its offering because it was facing liquidity issues. He knew that it needed a minimum subscription of $3.5 million. He was a real estate lawyer and businessman who had experience with financing issues. By taking the $2.8 million in loans, Polla failed to take reasonable care to avoid the foreseeable consequence that the CCU would encounter liquidity and regulatory issues, and be put into administration. The loans undermined the CCU's recovery, and were the opposite of reasonable steps to protect Polla's investment.

[229] As for apportionment of liability, s. 4 of the *Negligence Act* provides that:

> If it is not practicable to determine the respective degree of fault or negligence as between any parties to an actions, such parties shall be deemed to be equally at fault or negligent.

In this case, it is not practicable to determine the respective degree of fault or negligence as between the parties. The parties are deemed to be equally at fault, with the result that Polla is 50% liable for the loss as a result of his contributory negligence.

Conclusion

[230] In conclusion, Polla's case cannot succeed because the amendment he seeks to add his sole remaining claim, the new alleged misrepresentation, is statute-barred. This claim is based on an act of the defendants that is not included in the factual matrix as pleaded and constitutes a new cause of action for which the limitation period has expired.

[231] Considering the other issues for completeness of analysis, I find that Polla had standing to pursue this action, as he made the investment as trustee for Investex and can therefore carry on this action on its behalf.

[232] Polla's claim in common law negligence against the individual board members is dismissed, as there is no evidence that the members have committed a tortious act that is separate and distinct from the interests of the corporation. Absent such a tortious act, the directors in their individual capacity did not owe Polla a duty of care.

[233] On the main issue, the new alleged misrepresentation, I find that the term "appraised value" was not incorrect or misleading. It referenced the value of the property as determined by an appraisal method. There was nothing improper or unexpected about the CCU's use of purchase and sale agreements as an appraisal method - indeed, this was disclosed in the credit policies which the OS referenced. Even if it had been misleading, the term "appraised value" was also not a material fact in the context of all of the serious financial and fraud-related issues which the OS described, and the multiple severe warnings it contained. Finally, the board and Retford have both established that they would be entitled to the statutory defence under s. 82(5) of the Act. Given the close scrutiny the OS came under from expert lawyers and regulators, the defendants had no reasonable grounds to believe that there was a misrepresentation in the OS.

[234] Furthermore, if there had been a misrepresentation, I would have found that the presumption of deemed reliance was rebutted. As an experienced real estate lawyer, Polla would have known that lenders did not always require a third party appraisal, particularly if the lender was a small community credit union. Polla did not rely on the OS – he relied on the advice he received from Vinski.

[235] Another barrier to Polla's success is his failure to establish a causal link between the alleged misrepresentation and his loss. The lack of professional appraisals did not cause the OMF, and the OMF did not cause the CCU to go into administration. Polla contends that his investment was "lost at the moment he made it", but the CCU likely would have survived the OMF, which had been ongoing for years, had it not been for the August Loans.

[236] Polla is at least partially to blame for the August Loans, which led to the CCU's administration and ultimate liquidation. For this reason, he would be 50% liable for his own contributory negligence to any loss he suffered.

[237] If Polla had been successful in his claim his damages would be $5 million (the amount of his investment).

[238] If the parties cannot agree on costs they can provide a timeframe on which to provide submissions.

J.E. Ferguson J.

Date: March 13, 2019

SCHEDULE "A"

LIST OF THE PARTIES

Stanko Bingula ("Bingula")	director of CCU
Croatian Credit Union Limited ("CCU")	
Deposit Insurance Corporation of Ontario ("DICO")	released from action
Financial Services Commission of Ontario ("FSCO")	released from action
Zvonimir Josipovic ("Josipovic")	director of CCU
Anton Jurincic ("Jurincic")	director of CCU
Stephen P. Kovacevic ("Kovacevic")	director of CCU
Mato Menalo ("Menalo")	director of CCU
Ante Mimica)"Mimica")	director of CCU
Ferdinando Polla ("Polla")	plaintiff
Ignac Radencic ("Radencic")	director of CCU
Retford Lane Bates LLP ("Retford")	external auditors
Joe Sertic ("Sertic")	director of CCU
Josip Vinski ("Vinski")	CEO/Manager of CCU - bankrupt

SCHEDULE "B"

OTHER INDIVIDUALS WHO TESTIFIED

Joseph Bates ("Bates")	auditor with Retford
Faye Booker ("Booker")	defendants' credit union expert
Larry Davies ("Davies")	president, Miclaur Enterprises Inc. ("Miclaur") – banker for over 30 years then risk evaluation consultant between 2003-2011primary client DICO
Emilo Diluzo ("Diluzo")	auditor with Retford
John Hutton ("Hutton")	DICO representative and supervisor of the CCU
Howard Kaiman ("Kaiman")	Polla's accountant
Eric Kirzner ("Kirzner")	plaintiff's credit union expert
Nick Lela ("Lela")	employee at CCU
Alan Mak ("Mak")	plaintiff's auditing expert
Mario Polla ("MPolla")	Polla's brother
Jim Muccilli (Muccilli)	defendants' auditing expert
Jeff Rosekat ("Rosekat")	lawyer at Gardiner Roberts
Anita Sastri ("Sastri")	FSCO representative
Kathleen Skerrett ("Skerrett")	lawyer at Gardiner Roberts
John Wood ("Wood")	CEO of CCU

SCHEDULE "C"

OTHER RELEVANT INDIVIDUALS, ENTITIES AND ACRONYMS

Arnold Milan ("Milan") – client of the CCU and business acquaintance of Polla

Yves Chin Kow ("Kow") – CCU controller since in or around 2000

Steve Gurgich ("Gurgich"), Ana Gasper ("Gasper") and Mary-Ann Miskic ("Miskic") – CCU supervisors and assistant managers of the branches

Rick Belsby ("Belsby") – CCU part-time internal auditor

Credit Union Central of Ontario ("CUCO")

On Site Verification ("OSV")

Oklahoma Mortgage Fraud ("OMF")

Perfex Int. Ltd. ("Perfex")

Tinkham and Associates ("Tinkham") – independent consulting firm retained to assist in preparation of the recovery plan

The Supervision Order (the "SO") and The Administration Order (the "AO")

English and Jones ("E and J")

CITATION: Polla v. Croatian (Toronto) Credit Union, 2018 ONSC 1641
COURT FILE NO.: CV-10-403252
DATE: 20190313

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

FERDINANDO POLLA

plaintiff

– and –

CROATIAN (TORONTO) CREDIT UNION LIMITED, ZVONIMIR JOSIPOVIC, STEPHEN P. KOVACEVIC, STANKO BINGULA, ANTON JURINCIC, MATO MENALO, ANTE MIMICA, IGNAC RADENCIC JOE SERTIC, JOSIP VINSKI, DEPOSIT INSURANCE CORPORATION OF ONTARIO, RETFORD LANE BATES LLP, and FINANCIAL SERVICES COMMISSION OF ONTARIO

Defendants

REASONS FOR JUDGMENT

J. E. Ferguson J.

Released: March 13, 2019