



SUPERIOR COURT OF JUSTICE
COUR SUPÉRIEURE DE JUSTICE

*361 University Avenue
Toronto, ON M5G 1T3*

Telephone: (416) 327-5284 Fax: (416) 327-5417

FAX COVER SHEET

Date: October 1, 2012

TO:

Matthew P. Gottlieb & J. Renihan
Lisa S. Come & Elisa G. Giacomelli

FAX NO.:

416-598-3730
416-865-1398

FROM:

The Honourable Mr. Justice Peter A. Cumming

TOTAL PAGES (INCLUDING COVER PAGE): 8

MESSAGE:

Endorsement: First Leaside Wealth Management v. Phillips

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CITATION: First Leaside Wealth Management Inc. v. Phillips, 2012 ONSC 5443
COURT FILE NO.: CV-12-9821-00CL
DATE: 20121001

**SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)**

**RE: FIRST LEASIDE WEALTH MANAGEMENT INC., FIRST LEASIDE
FINANCE INC., FIRST LEASIDE SECURITIES INC. AND F.L.
SECURITIES INC., Plaintiffs**

AND:

**DAVID PHILLIPS, MARGARET DAVIS AND 970877 ONTARIO INC.,
Defendants**

BEFORE: CUMMING J.

COUNSEL: Matthew P. Gottlieb and J. Renihan, for the Plaintiffs

Lisa S. Corne and Elisa G. Giacomelli, for the Defendants

HEARD: SEPTEMBER 27, 2012

ENDORSEMENT

The Motions

[1] The Plaintiffs bring a motion pursuant to s. 103 of the *Courts of Justice Act* for leave to issue a Certificate of Pending Litigation ("CPL") against the property known as 430 Regional Road #8, Uxbridge, Ontario (the "Uxbridge Property") or for alternative relief by way of any sale proceeds being paid into court as security or in the further alternative, interlocutory injunctive relief.

[2] In the course of the hearing in respect of the Plaintiffs' motion, the Plaintiffs indicated the sole form of relief they sought was a CPL order. Neither side was prepared to agree that in the event the Plaintiffs were successful that security in respect of the sale proceeds could be given in lieu of a CPL being issued.

[3] The Defendant, Margaret Davis ("Davis"), brings a cross-motion to strike certain paragraphs of the affidavit of Greg MacLeod, sworn September 14, 2012, filed in support of the Plaintiffs' motion.

[4] The motions were heard September 27 in a full day hearing. A decision was required by September 28. I communicated my decision the morning of September 28 that the cross-motion was dismissed and the Plaintiffs' motion for leave to issue a CPL was granted, with written reasons to follow. These are my reasons.

Background

[5] The four Plaintiffs (referred to as the "FL Plaintiffs") are a group of affiliated corporations, now insolvent and currently under *Companies' Creditors Arrangement Act* ("CCAA") proceedings, commenced on February 23, 2012. They are controlled by a court-appointed Chief Restructuring Officer ("CRO").

[6] The FL Plaintiffs are part of an enterprise of a much larger number of affiliated corporations involved in the operation and development of commercial properties and the provision of investment and wealth management services to over 1000 investors (the collective larger group or overall enterprise, inclusive of the FL Plaintiffs, is referred to as "First Leaside").

[7] The Defendant, David Phillips, has been the primary directing mind of the First Leaside enterprise. The Defendant Davis is Mr. Phillips' spouse. She was an officer and director of the Plaintiff, First Leaside Wealth Management Inc. ("FLWM"), a holding and operating company and the ultimate parent corporation in the First Leaside group. From its incorporation until November 2011, Mr. Phillips was the Chief Executive Officer of FLWM. Mr. Phillips and Ms. Davis each had signing authority in respect of payments made by First Leaside entities. The Defendant, 970877 Ontario Inc. ("970"), is a holding company wholly owned by Mr. Phillips. Mr. Phillips is the sole common shareholder of the overall First Leaside enterprise.

[8] Ms. Davis is the owner of the Uxbridge Property, in which she and Mr. Phillips reside. The record indicates the home was transferred from the Plaintiff, First Leaside Securities Inc. ("FL Securities"), a wholly owned subsidiary of FLWM, in 1999 for the transfer amount of \$400,000.

[9] A portion of the Uxbridge Property was used to operate First Leaside with its head office located there.

[10] The Uxbridge Property is the subject of a present Agreement of Purchase and Sale by Ms. Davis, with the sale by her scheduled to close October 1, 2012.

[11] The Ontario Securities Commission ("OSC") undertook an investigation into First Leaside about March 2010 following an audit commenced in the fall of 2009. In November 2011, an Independent Committee was appointed to oversee First Leaside's operations in place of Mr. Phillips. In December 2011, G. S. MacLeod & Associates was appointed CRO of the FL Plaintiffs. In the course of the CRO's examination of the financial records of the FL Plaintiffs,

the CRO formed the view that Mr. Phillips and Ms. Davis improperly diverted and converted assets of the FL Plaintiffs to their own use.

[12] On June 4, 2012, the OSC issued a Statement of Allegations against Mr. Phillips and John Russell Wilson, a senior sales person at the Plaintiff FL Securities. The OSC alleges that between August 22 and October 28, 2012 Mr. Phillips "a founder and the directing mind of the First Leaside Group...intentionally deceived investors by selling and overseeing the sales of almost \$19 million in securities while withholding important information".

[13] On June 20, 2012, Ms. Davis listed the Uxbridge Property for sale and the Agreement of Purchase and Sale was entered into August 7, 2012, with the closing date of October 1, 2012.

[14] The FL Plaintiffs filed a Statement of Claim on August 28, 2012, which alleges, *inter alia*, that Mr. Philips and Ms. Davis caused the FL Plaintiffs, in particular, FL Securities, to make improper payments for renovations, maintenance and improvements of the Uxbridge Property and caused FL Securities to make improper rent payments to Ms. Davis for the use of the Uxbridge Property under one or more purported office lease agreements. It is alleged the Defendants breached fiduciary duties owed to the Plaintiffs, made fraudulent misrepresentations and converted the Plaintiffs' assets.

[15] The Plaintiffs claim a tracing order and a constructive trust in respect of the alleged improper payments made in respect of the Uxbridge Property. The Plaintiffs by their motion at hand seek to preserve their claimed rights in the Uxbridge Property.

[16] The Defendants Phillips and Davis say that they are impecunious and require the sale of the Uxbridge Property for ongoing living expenses. The FL Plaintiffs say that, if the Uxbridge Property is sold and the proceeds paid out to Ms. Davis, effectively the FL Plaintiffs will be precluded from ever being able to recover some \$4,000,000 alleged to have been misappropriated for maintenance and improvements to the Uxbridge Property.

The Cross -Motion

[17] The Defendant, Ms. Davis, brings the cross-motion under Rules 25.1.1 and 39.01(4) to strike out portions of Mr. MacLeod's affidavit on the asserted basis they are "scandalous, irrelevant, inserted simply for the purpose of atmosphere, are not based upon personal knowledge and do not specify the source of the deponent's information".

[18] The paragraphs in issue are: the second, third and fourth sentences of paragraph 2, paragraph 28, exhibit H, paragraph 29, the third sentence of paragraph 35, the second last sentence of paragraph 40, the last sentence of paragraph 42, the last sentence of paragraph 51, paragraph 52, paragraphs 53, 56, 57 and 62.

[19] In my view, there is no merit to the cross-motion and it is properly dismissed. The complained of provisions are informational, contextual and relevant to the issues at hand, are based upon the forensic investigation of the accounting and financial records, and are necessary

and appropriate to the narrative of Mr. MacLeod as to what his investigation on behalf of the CRO revealed.

The Evidence on the Main Motion seeking Leave to issue a CPL

[20] A CPL operates to protect a claimed interest in land by effectively preventing disposition of the property in issue prior to judgment following a trial on the merits. To succeed in obtaining a CPL, it must be established there is a triable issue as to whether the plaintiff has an interest in the land and the issuance of a CPL must be just in light of all relevant factors. *G.P.I. Greenfield Pioneer Inc. v. Moore* (2002), 58 O.R. (3d) 87 (C.A.); *Roseglen Village for Seniors Inc. v. Doble* (2010), 100 C.P. C. (6th) 183 (Ont. S. C.).

[21] Where the interest claimed is a constructive trust, as in the instant situation, the question is simply whether there is a triable issue in respect of such interest claimed, not whether the plaintiff will likely succeed ultimately at trial. It is enough to establish that a constructive trust is a possible remedy at trial based upon the evidentiary record at this point. Moreover, the Court does not “assess the credibility of deponents or decide disputed issues of fact” at the juncture of an interlocutory motion for a CPL. *Golden Bull Estates Ltd. v. Generex Biotechnology Corp.*, 2012 ONSC 4975 at paras. 2,10 and 11.

[22] The evidence on the return of the FL Plaintiffs’ motion, through the 19 page affidavit of Mr. MacLeod setting forth his examination of the financial and accounting records, demonstrates that leasehold improvements and property maintenance expenses in respect of the Uxbridge Property have been funded by the FL Plaintiffs, in particular, FL Securities, in the amount of some \$4,000,000. This assertion is not disputed.

[23] These monies were used to maintain and improve the Uxbridge Property by way of such things as extensive landscaping, a home gym, windmill, sauna, multiple ponds, pool and waterfalls, garage, greenhouse and guest house. The FL Plaintiffs assert that these expenditures had no conceivable business purpose.

[24] The position of the Defendants is that the payments by FL Securities were commercially reasonable and were properly and lawfully approved by First Leaside and, in particular, by FL Securities and FLWM. The Defendants assert that the By-Laws of the FL Plaintiffs provide that any contract is binding on the corporations if signed by any one director and the authorization of the Board of Directors is not required. Moreover, Mr. Phillips says he believed that the Director of Finance and in-house legal counsel had obtained all requisite approvals for compensation paid to him. Hence, the Defendants ask that the motion be dismissed.

[25] Ms. Davis and FL Securities entered into a lease agreement on January 1, 2005, effective January 1, 2004, whereby FL Securities would pay 44% of certain maintenance expenses and in respect of capital improvements relating to the Uxbridge Property. It seems that three other lease agreements were later entered into.

[26] The financial records suggest that from, 2004 to 2011, FL Securities paid at least \$742,528.16 in respect of its 44% allocation for leasehold improvements. Moreover, the FL

Plaintiffs assert that some \$334,344.16 relating to the 56% allocation to Ms. Davis in respect of leasehold improvements was improperly allocated to Mr. Phillips' loan receivable account and never repaid.

[27] The records indicate as well that, from 2004 to 2009, the FL Plaintiffs paid some \$2,590,000 (some \$1,326,000 as the FL Securities' 44% allocation and \$1,264,486.94 as the 56% allocation to Ms. Davis) in property maintenance expenses related to the Uxbridge Property.

[28] The FL Plaintiffs claim the lease agreement is oppressive and entered into breach of the duties of directors owed to the FL Plaintiffs.

[29] The record indicates that the 56% allocation of leasehold improvements to Ms. Davis under the lease agreement were typically paid by FL Securities and recorded as a loan by FL Securities to Mr. Phillips, with FL Securities offsetting the outstanding loans payable at the end of the financial year by the issuance of bonuses and dividends within the corporate group to Mr. Phillips.

[30] The FL Plaintiffs allege that the directors of FLWM and FL Securities (other than Mr. Phillips and Ms. Davis) were never made aware of the lease agreements or allocation payable by FL Securities under the lease agreements. The FL Plaintiffs claim that the annual bonuses and dividend payments used as crediting offsets against the outstanding loans were unauthorized. The Defendants claim that all payments were properly and lawfully authorized by the boards of directors and that the lease agreements were approved.

[31] Ms. Joan L. Wilson, in her affidavit sworn September 17, 2012, states that she is a chartered accountant who was an employee of the Plaintiff FLWM between September 2004 and April 2008. She states that, although the company records suggest she was a director of FL Securities, she does not believe she ever knew she was a director and that, while Mr. Phillips advised her at one point that she was the "President" of FL Securities, she did not in any way act as President, nor was she treated as President, and that she signed an office lease agreement dated January 1, 2005 on behalf of FL Securities in respect of the Uxbridge Property simply because she was asked to do so by Mr. Phillips.

[32] Mr. Leo de Bever, a former independent director of FLWM, states in his affidavit that the directors of FLWM were never asked to vote on a resolution to approve the compensation paid to the Defendants Phillips and Davis, were never shown the details of compensation paid to them, never authorized dividends, and were not asked to approve financial statements for most fiscal years.

[33] Mr. John Wilson, an affiant for the Defendants, states that he has been a director of FLWM from 2003 to the present. He says that the compensation payable to Mr. Phillips was transparent to the board of directors as were "the leasing, occupancy and capital improvement costs paid by [FLWM] subsidiary companies in connection with the Uxbridge Property....".

[34] It is noted incidentally that the Agreement of Purchase and Sale provides for a \$25,000 deposit, a further \$875,000 on closing and a vendor take-back mortgage for the balance payable in 54 months with interest only payable in the interim. With an outstanding first mortgage of some \$687,000 in favour of the TD Bank, there would be a minimal cash balance on closing.

[35] However, it is also noted that the financial records indicate that in 2010 and 2011, FL Securities paid a total of \$320,744.76 on account of the 56% allocation for improvements and maintenance to Ms. Davis, which had been charged to Mr. Phillips' loan receivable account but (unlike previous charges) not purportedly offset for those years through bonuses and dividends, due to the CRO's assumption of management of First Leaside in 2011. Thus, the full \$320,744.76 arguably remains outstanding as a debt of Ms. Davis to FL Securities in all events, notwithstanding the bookkeeping paper entry recognition of her debt as a loan to Mr. Phillips.

[36] A claim based upon the doctrine of constructive trust and the right to trace funds in respect of property may give rise to an interest in the property such as to be the subject of a CPL.

[37] In my view, the FL Plaintiffs have established on the evidentiary record to date that there is a triable issue as asserted in the Statement of Claim that there has been a misappropriation of FL Plaintiffs' monies through unauthorized payments in respect of rent, maintenance and improvements relating to the Uxbridge Property owned by Ms. Davis such as to be an unjust enrichment and subject to a constructive trust.

[38] There are triable issues as to alleged unauthorized conversion of debts owed by Ms. Davis to FL Securities into purported loans receivable from Mr. Phillips. There are triable issues as to the arguably unlawful and unauthorized purported offsets to these asserted loans through arguably unauthorized compensation, bonuses and dividends to Mr. Phillips' credit. There are triable issues as to the alleged breach of directors' duties and as to the alleged oppressive conduct.

[39] The Defendants raise a host of defences to the asserted claims of the FL Plaintiffs and their counsel made forceful arguments in respect thereof. However, this hearing was not, of course, properly to equate to a trial of the issues; rather, the question is simply whether or not there are triable issues such that a CPL should properly issue pending the ultimate determination of the issues at trial.

[40] It is not disputed that some \$4,000,000 of the FL Plaintiffs' monies were expended in respect of the Uxbridge Property which is now the subject of the Agreement of Purchase and Sale for \$2,235,000. In my view, given the triable issues, as I have found, as to whether those monies are properly subject to a constructive trust, there is an 'interest' in the Uxbridge Property on the part of the FL Plaintiffs such as to support their request for a CPL.

[41] The record establishes a strong possibility that the FL Plaintiffs and their underlying investors would effectively be without any practical remedy if successful at trial and a CPL were not to be granted.

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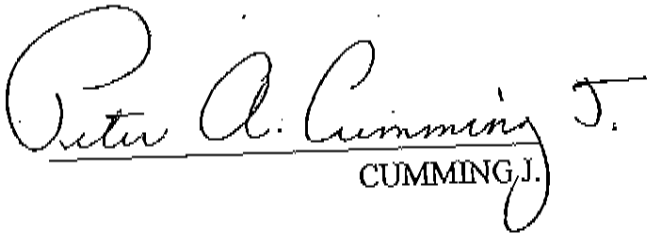
[42] The Defendants argue that if the CPL is granted then they will not only have lost access to funds for which there is an immediate need because of their claimed present impecuniosity but if they are ultimately successful at trial they may well face an unfavourable price as compared to that seen in the present Agreement of Purchase and Sale.

[43] In my view, and I so find on the basis of the evidentiary record, the balance of convenience favours the FL Plaintiffs.

Disposition

[44] For the reasons given, the FL Plaintiffs' motion for leave to issue a CPL in respect of the Uxbridge property is granted. The requisite Order was signed Friday, September 28, 2012, following upon my advising counsel as to my decision.

[45] If the parties cannot agree on the question of costs, the parties may make written submissions. In such event, the FL Plaintiffs shall make their submission by October 10, 2012, the Defendants shall make their submission by October 18, 2012 and the FL Plaintiffs may make any reply thereto by October 22, 2012.


CUMMING J.

Date: October 1, 2012