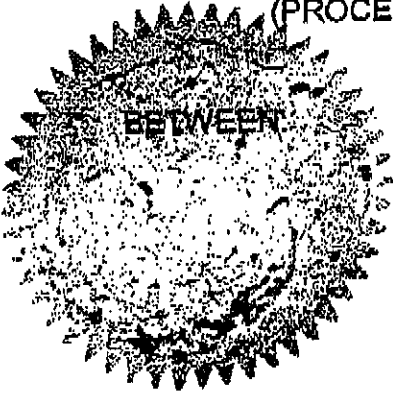


Court File No.: 07-CV-341493CP

**ONTARIO
SUPERIOR COURT OF JUSTICE
(PROCEEDING UNDER THE CLASS PROCEEDINGS ACT, 1992)**



SHARUKH PALSETIA

Plaintiff

and

MUSA SULEMAN and 1376563 ONTARIO INC.

Defendants

AND BETWEEN:

MUSA SULEMAN and 1376563 ONTARIO INC.

Plaintiffs by Counterclaim

SHARUKH PALSETIA and NADIA PALSETIA

Defendants by Counterclaim

STATEMENT OF DEFENCE AND COUNTERCLAIM

TO THE DEFENDANT(S) TO THE COUNTERCLAIM

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

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

If you are not already a party to the main action and you are served in another province or territory of Canada or in the United States of America, the period for serving

and filing your defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

If you are not already a party to the main action, instead of serving and filing a defence to counterclaim, you may serve and file a notice of intent to defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your defence to counterclaim.

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

IF YOU PAY THE AMOUNT OF THE COUNTERCLAIM AGAINST YOU, and \$750.00 for costs, within the time for serving and filing your defence to counterclaim, you may move to have the counterclaim against you dismissed by the court. If you believe the amount claimed for costs is excessive, you may pay the amount of the counterclaim and \$400.00 for costs and have the costs assessed by the court.

Date: May 21, 2008

Issued by


Local registrar

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AND TO: **NADIA PALSETIA**
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Scarborough, Ontario
M1B 5A6

STATEMENT OF DEFENCE AND COUNTERCLAIM

1. The defendants deny all the allegations contained in the Amended Statement of Claim except as specifically admitted herein.
2. The defendants admit the allegations contained in paragraph 2 of the Amended Statement of Claim.
3. The defendants have no knowledge in respect of the allegations contained in paragraphs 5, 8, 9, 11, 12 of the Amended Statement of Claim.

The Defendants

4. The defendant, Musa Suleman ("Musa") is 63 years of age and resides in the City of Mississauga. He is a well known, long standing and respected member of the Ismaili community.
5. Musa is in the business of providing bookkeeping and tax preparation services to members of the Ismaili community.
6. The defendant 1378563 Ontario Inc. ("137") is a company having its office in Etobicoke, Ontario. Musa is the President of 137, and at all material times, Musa acted solely in his capacity as an officer or director of 137.

The Plaintiff and Nadia

7. The plaintiff is also a member of the Ismaili community. He is the spouse of one Nadia Palsetia ("Nadia").
8. The plaintiff did not pay any investment monies over to 137 or Musa. It was Nadia who made the investment described below.

9. In April 2001, Nadia and the plaintiff fully released and agreed to save 137 and Musa harmless in connection with the matters set out in the Amended Statement of Claim.

Musa's Introduction to Damji's Company

10. In or about June 2000, Musa was approached by Farid Ibrahim, a.k.a. Freddy Ibrahim, ("Freddy") to discuss an investment proposal relating to a company owned by Salim Damji ("Damji"), STS Inc. ("STS"). Musa was not interested.
11. In or about July 2000, Freddy again contacted Musa. A meeting was arranged and took place between Musa, Freddy and Damji's brother, Amin Damji ("Amin"). Freddy and Amin requested that Musa provide a \$1,000,000 loan to STS for the purpose of taking STS public. They advised that Damji would personally guarantee the loan.
12. Freddy and Amin provided Musa with a sample of the product being marketed by STS (the "STS Product") and brought several documents, including audited sales reports, brochures, product information certificates, and test result reports, authenticating the product and venture.
13. Musa questioned Freddy and Amin about the documents that they had provided, some of which were later determined to be fraudulent. Freddy and Amin responded to Musa's questions and assured him that the investment was genuine and sound.

14. Freddy and Amin told Musa that Colgate-Palmolive ("Colgate") had a license to distribute the STS Product in the United States. This appeared to be corroborated by the documents provided by Freddy and Amin.
15. Musa conducted some investigation of the STS Product based on the documents, product, and information provided by Freddy and Amin.
16. Research indicated that the product was being sold on the internet by S.M.D. Distributors (which coincides with Damji's name -- Salim Mohamed Damji). The product was advertised for sale at \$16.95, a price that would warrant the investment.

Investment In Damji's Company

17. Subsequent to his meeting with Freddy and Amin, Musa met with Damji and agreed to raise \$1,000,000 if Damji provided his personal written guarantee. Damji agreed.
18. Musa's and his partner, Shiraz Karmali ("Karmali"), subsequently raised a \$1,000,000 loan for Damji of which they contributed \$320,000.
19. The investment in Damji's company was made partially in reliance on the documents and information provided by Freddy and Amin.
20. 137 was used to facilitate the loan to Damji and to allow for Damji to issue a guarantee to one rather than the several investors who had contributed to the loan.

21. In respect of the loan, 137 received two promissory notes (each for \$500,000) from Freddy which were supplemented with written guarantees from Damji.
22. Freddy confirmed in writing that the initial public offering of STS would occur before December 31, 2000.
23. This initial loan was subsequently agreed to be converted into shares of STS. The promissory notes given by Freddy were cancelled but Damji's personal guarantees remained in place.

Musa/137 Begin Receiving Funds from Investors

24. In or about August 2000, Musa was approached by Damji to assist in receiving funds from investors. Musa, on behalf of 137, agreed on the condition that Damji provide personal guarantees to secure the funds.
25. In addition, there were several individuals in the Ismaili community, including Freddy, who began receiving investor funds and transferring them to Damji or his company.
26. By and large, Musa's role *vis-a-vis* investors was, through 137, to receive funds and remit them to STS (through Damji) on the understanding that the investors would subsequently receive or be entitled to receive shares in STS.

Investment by the Community at Large

27. By September 2000, many members of the Ismaili community in the Greater Toronto Area and beyond became aware of the opportunity to invest in STS.

28. It was difficult to avoid knowledge of the STS investment. At most gatherings, either in mosque or outside at social events, it was talked about. News spread very quickly.
29. By May 2001, word spread even further as Damji made a \$5 million donation to the Institute of Ismaili Studies. Damji also made a pledge (\$1.5 million) to the Aga Khan Foundation. Large STS and "Instant White" banners were displayed prominently on the main stage during the 2001 Aga Khan Foundation Partnership Walk (a national event). Damji gave a speech at the start of the walk.
30. Everyone knew to whom they could go to get in on the deal. Prospective investors frequently approached Musa seeking to invest in STS. There was such a huge demand that people felt left out if they did not invest.
31. People called Musa or simply dropped off or mailed cheques payable to 137 for the purpose of investing in STS Inc. People called begging to make an investment.
32. There were rumours that investors were selling their rights to STS shares to other investors and making a profit.
33. People were investing because their friends or family were investing. No one wanted to miss out on what appeared to be the deal of a lifetime.
34. In all, in excess of \$78 million (\$100 million by the plaintiff's estimate) was invested in STS by thousands of people, of which \$7.7 million (net of refunds totalling approximately \$3.2 million) was received by 137 and remitted to STS through Damji.

Musa Did Not Make Representations

35. As such, Musa did not make the Representations or Trust Representation (as defined in the Amended Statement of Claim) and did not need to. Contrary to the allegations in the Amended Statement of Claim, Musa did not represent that he had performed Due Diligence (as defined in the Amended Statement of Claim).
36. In most cases, Musa had no opportunity to make any representation at all to potential investors.
37. There was a large number of investors from whom 137 received money and whom Musa had never met or to whom he had never spoken.

Investor Decisions Not Based on "Representations" or "Trust Representation"

38. Given the widespread knowledge within the Ismaili community regarding the opportunity to invest in STS, it is unreasonable to expect that anyone would rely on either the Representations or the Trust Representation to decide whether to invest in STS or to retain their investment in STS.
39. The incentive to invest came largely from emails and comments from Damji and the fact that a large number of people in the community were investing.
40. Among other factors influencing investor decisions were the following:
- a. Family and friends were investing;
 - b. Damji was part of the community;
 - c. Damji's own friends and family were investing.

- d. Damji made representations regarding the product and the future of STS;
and
 - e. To lend credibility to his claims, Damji made personal pledges, emphasizing his ties to the community including a \$5,000,000 donation to the Institute of Ismaili Studies and a \$1,500,000 donation to Aga Khan Foundation (to be paid over five years).
41. Others invested simply because they learned that Musa had personally invested.
42. The defendants deny that the Representations or Trust Representation were made and that Nadia or the plaintiff relied on them in making a decision to invest in STS.
43. Further, Musa denies that he knowingly made any false statements to the plaintiff or anyone regarding STS, the STS product, or the investment in STS.

Nadia Made Investments in STS Outside of Those Made Through 137

44. Nadia, or alternatively the plaintiff, made additional investments in STS separate and apart from the investment through 137. These additional investments were made by cheques payable directly to Damji. Neither Nadia nor the plaintiff received any shares of STS in return for these additional investments. These additional investments in STS were not made in reliance on any representation made by Musa or 137.

No Instructions Given to Musa or 137

45. The investors, including Nadia and the plaintiff, never instructed Musa or 137 not to forward the investment funds to Damji. Those who invested through 137 had the same expectation as those who paid money directly to Damji. They provided money on the understanding that they would be entitled, sometime in the future, to receive shares of STS.
46. Although the timing and manner of disbursement of funds to Damji was not specifically agreed upon, it was understood that receipt of shares was not prerequisite to disbursement of funds to Damji.
47. It was understood that the funds received by 137 would, or could be, immediately turned over to Damji, or would be turned over to Damji upon his request. Accordingly, the forwarding of money to Damji was done with the authority, express or implied, of investors.
48. The fact that the funds had been turned over to Damji was confirmed by a September 26, 2001 email from Damji (detailed below) by which Damji himself offered to "return investment funds for those investors who wish to have their initial investment refunded."
49. Investors were aware, at least by the time of Damji's email offering refunds, that their money had been forwarded to Damji or STS. As such, if 137's conduct in forwarding money to Damji or STS was done without the prior authorization of investors, which is denied, the subsequent actions or inaction of investors amounted to ratification of the defendants' conduct.

No Trust

50. There was never any agreement that funds would be held in trust by Musa or 137. Neither Musa nor 137 ever agreed to be trustee in respect of the investment funds received.
51. No cheques or drafts were made payable to "137 in Trust."
52. It was understood that the monies received by 137 would be turned over to Damji upon his request, secured by a personal guarantee. Accordingly, no trust or fiduciary relationship existed between Musa and/or 137 and the plaintiff or Nadia, or any other STS investor. Nor was there any breach of fiduciary duty.
53. If any trust existed at all, it was based on Damji acting as trustee in respect of funds received by Damji. Musa and 137 were strangers to any such trust.
54. As detailed below, Musa and 137 had no knowledge, actual or otherwise, of any breach of trust by Damji. Musa and 137 deny assisting Damji in any breach of trust or receiving any money or other benefit as a result of a breach of trust by Damji.

The Acknowledgement Authorization and Release

55. By late Fall 2000, Damji had spread the word that Colgate had shown an interest in purchasing STS, and, in fact, a deal was in the works.
56. In March 2001, Damji requested an up-to-date list of investors. Damji explained to Musa that each investor would be required to sign a document, agreeing to

sell their shares in STS to Colgate. Damji advised that the document had to be signed by each investor within 10 days.

57. Musa explained to Damji that it would be a huge task to get such a large number of people to sign the document.

58. Instead, Musa suggested that all the investors from whom 137 had received funds sign a document allowing 137 to act on their behalf in connection with the proposed sale to Colgate.

59. Damji agreed with Musa's suggestion and arrangements were made to have investors sign a document headed "Acknowledgement, Authorization and Release" (the "Authorization").

60. In April 2001, Damji held a meeting in connection with the Colgate deal, which was attended by all individuals receiving funds for investment in STS. Damji advised that funds would be released to the investors in six weeks and presented an unsigned offer letter from Colgate to be signed by all present. When Damji was questioned as to why the letter was not signed on behalf of Colgate, he said that it was a copy of a schedule to a much larger document his lawyers had prepared.

61. The Letter from Colgate confirmed that 137 owned ten million shares of STS.

62. Over the course of a number of days, the Authorization was signed by the majority (though not all) of investors who had invested through 137.

63. The Authorization was signed by both Nadia and the plaintiff.

64. If an agency relationship existed at all, it was created, pursuant to the Authorization, between 137 and the investors who signed it, the terms of which were specified in the Authorization. Pursuant to the Authorization, 137 was given discretion as to how the subject transaction would be effected.
65. The Authorization permitted 137 to act on behalf of the investors in connection with the "acquisition" or "sale" or other "disposition" of the shares.
66. The Authorization was not concerned with who had physical possession of shares. It was inconsequential who held the shares.
67. The investors knew or should have known that the Authorization was signed after 137 had already transferred the funds received from investors to Damji.
68. The Authorization was not false and was not intended to deceive anyone or to induce anyone not to request a refund.

Musa and 137 Released from Liability

69. In exchange for agreeing to act on behalf of the investors, Musa and 137 were fully released and saved harmless by those investors who signed the Authorization.

OSC Investigation Casts No Doubt on Authenticity of STS Investment

70. By letter dated June 13, 2001, 137 was contacted, through Musa, by the Ontario Securities Commission asking for information in regards to its involvement with STS.
71. At the time of this letter, 137 had already stopped accepting funds from investors.

72. Musa presented the OSC with an investor listing and answered all of the questions posed by the OSC. The OSC continued with its investigation but never again contacted 137 or Musa regarding the status of its investigation.
73. As there was no further action taken by the OSC, the STS investment was actually given greater credibility.

No Cause of Action for Breach of Statutory Duty

74. In any event, the alleged breaches of the *Securities Act* do not entitle the plaintiff to any of the relief claimed or any relief at all. The claims at paragraphs 65 and 67 fail to disclose a cause of action, and should, accordingly, be struck and not permitted to proceed. Similarly, the claim for breach of statutory duty fails to disclose a cause of action, and should, accordingly, be struck.

137 Complied with All Requests for Refunds

75. On September 26, 2001, Damji issued an email to numerous investors advising that the investment in STS would not be guaranteed and offering a refund to investors.
76. The email was widely circulated. Musa forwarded it to a number of investors and advised other investors of the contents of the message.
77. As a result of the email, approximately 150 investors requested refunds. Neither Nadia, nor the plaintiff requested a refund. Similarly, a large number of investors, even those to whom Musa had spoken directly regarding the refund, refused to have their money refunded.

78. Musa denies that he ever guaranteed repayment upon request. Nor was there any agreement in that regard. Nonetheless, prior to Damji's arrest, every investor who requested a refund, whether in response to Damji's September 26, 2001 email or otherwise, was given a refund. A total of approximately \$3.28 million was refunded to investors through 137.
79. Following Damji's arrest, there were no funds available from which a refund could be made. As was understood, all funds had, by that time, been turned over to Damji.

No Guarantee

80. Musa further denies giving any guarantee at all to the plaintiff or Nadia or anyone else in connection with the purchase of STS shares, and denies that an enforceable guarantee could be created in the circumstances alleged in the Statement of Claim.
81. In any event, there was no consideration for the alleged guarantee. It is, therefore, unenforceable. Further, the Authorization constituted a material change in the agreement between 137 and those who signed it such that if Musa gave a guarantee, which is denied, he is no longer liable under any such guarantee.

Damji's Arrest and Revelation of the Fraud

82. In or about March 2002, Damji called Kassam Juma ("Kassu"), who was then in charge of receiving funds. Damji explained to Kassu that the deal was done. His instructions to Kassu were very detailed as to how cheques would be issued to

investors; how many cheques would be issued per day; and where this would all take place.

83. Damji gave 137, through Musa, and all individuals who were receiving investor funds specific dates and times that cheques would be handed out to the investors.
84. Musa called all those people from whom 137 had received money to advise them of the cheque distribution. On April 26, 2002, the day before the distribution was to take place, Musa waited for the wire transfer of funds from Damji. No funds were transferred from Damji. Instead, Musa learned on the evening news that Damji had been arrested.
85. Contrary to the allegations in the Statement of Claim, Musa did not know that the investor funds being forwarded to Damji, or as directed by Damji, were being misused or misappropriated by Damji.
86. Musa was not aware of the fraud being perpetrated by Damji. Musa and Karmali lost in excess of \$700,000 (including the losses sustained by family members and related companies).

No Cause of Action for Misappropriation

87. The claim for misappropriation at paragraph 1(b) fails to disclose a cause of action and should, therefore, be struck and not permitted to proceed.

Limitation Period

88. This action is barred as it was not commenced on time. The defendants plead and rely on the provisions of the *Limitations Act*, R.S.O. 1990, c. L.15 and the *Limitations Act, 2002*, S.O. 2002, c. 24, Schedule B.
89. Damji's arrest was widely publicized and became well known, particularly within the Ismaili community.
90. Failure of the STS deal was also well known by at least April 27, 2002, the cheque distribution date. Accordingly, the majority of the investors, including the plaintiff and Nadia, knew, at least by April 27, 2002, of Damji's fraud. The plaintiff, Nadia, as well as others, may have had special knowledge even prior to this date and did not act upon it.

Contributory Negligence

91. If 137 and/or Musa is found liable to the plaintiff, which is denied, Nadia or, in the alternative, the plaintiff, caused or contributed to the loss by failing to take adequate care and failing to perform any due diligence.
92. If it is found that Musa or 137 ought to have discovered Damji's fraud, Nadia or, in the alternative, the plaintiff, was equally able to do so.
93. Nadia or, in the alternative, the plaintiff, decided to take an investment risk and elected not to request a refund of the STS investment when there was an opportunity to do so.

94. The defendants plead and rely upon the provisions of the *Negligence Act, R.S.O. 1990, C.N. 1*, as amended.

Mitigation

95. Nadia or, in the alternative, the plaintiff, is required to mitigate his or her damages, if any. They have failed to do so. Any losses suffered were subject to a tax deduction, thereby reducing tax otherwise payable. Should the defendants be found liable, Nadia or, in the alternative, the plaintiff, is required to account for the tax saving.
96. In May 2002, an action was commenced by Nyaz Jethwani against Damji, STS, and others pursuant to the *Class Proceedings Act* (the "Damji Class Action"). The receiver appointed pursuant to an order dated May 7, 2002 has collected money for the benefit of the plaintiff class. The defendants plead that Nadia and the plaintiff are members of the plaintiff class in the Damji Class Action and are entitled to a portion of the distribution.

Dismissal of Action

97. The defendants deny that the plaintiff is entitled to the interlocutory, declaratory or any of the relief claimed.
98. Musa further denies that he is personally liable to the plaintiff, Nadia or any member of the proposed class of plaintiffs. At all material times, Musa acted solely in his capacity as an officer or director of 137.

99. The defendants ask that the action be dismissed as against them with costs on a substantial indemnity basis given the unsubstantiated allegations of fraud, illegality, and other wrongdoing pleaded against them.

COUNTERCLAIM

100. The defendants, plaintiffs by counterclaim, claim:

- a. Indemnity for any amount for which the defendants are found liable to the plaintiff in the main action;
- b. prejudgment interest in accordance with section 128 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;
- c. postjudgment interest in accordance with section 129 of the *Courts of Justice Act*;
- d. the costs of this proceeding, plus goods and services tax; and
- e. such further and other relief as to this Honourable Court may seem just.

101. The defendants repeat and rely on the allegations in the Statement of Defence in support of the counterclaim.

102. Pursuant to the Authorization, the plaintiff and Nadia agreed to fully release and save harmless 137 and Musa.

103. If the defendants are found liable to the plaintiff in relation to the acquisition or sale of STS shares, which is denied, the defendants claim indemnity from Nadia and the plaintiff to the extent of the defendants' liability.

104. The defendants propose that the main action and the counterclaim be tried at the City of Toronto.

May 21, 2008

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SHARUKH PALSETIA

v.

MUSA SULEMAN ET AL.

Court File No. 07-CV-341493CP

ONTARIO
SUPERIOR COURT OF JUSTICE

PROCEEDING COMMENCED AT TORONTO

STATEMENT OF DEFENCE AND
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