

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
(IN BANKRUPTCY AND INSOLVENCY)**

B E T W E E N:

IN THE MATTER OF THE BANKRUPTCY OF I. WAXMAN & SONS LIMITED  
a corporation incorporated under the laws of the Province of Ontario  
carrying on business in the City of Hamilton, in the Province of Ontario

**FACTUM OF MORRIS WAXMAN**  
(Motion returnable December 14, 2007)

**PART I—OVERVIEW**

1. Morris Waxman (“Morris”) files this factum in respect of the motion brought by Deloitte & Touche Inc. (the “Trustee”) in its capacity as trustee in bankruptcy of the estate of I. Waxman & Sons Limited (“IWS”) for advice and directions concerning Morris’s claim against the estate of IWS. IWS was adjudged bankrupt on September 4, 2007.

2. As described in the Trustee’s factum filed on this motion, in a decision delivered in June 2002, and subsequently affirmed on appeal (the “Judgment”), Madam Justice Sanderson awarded Morris a money judgment which, after further particularization in a Reference proceeding and net of amounts received to date, totalled \$46.6 million dollars. This Judgment is against, among others, IWS. The proper characterization of the amounts owing to Morris by IWS under this Judgment is the central issue on this motion.

3. The Judgment has not been satisfied in full, despite Morris’ best efforts to collect the amounts owing from the defendants. As a substantial judgment creditor of IWS, Morris has submitted a proof of claim with respect to his unsatisfied judgments. A number of unsecured

creditors (the “Objecting Creditors”), all of whom became creditors after Morris obtained his judgments and either knew of Morris’s Judgments or chose not to make enquiries, have objected to the allowance Morris’s claim on the basis that Morris’s claim is somehow an equity claim that should be subordinated to the claims of other unsecured creditors.

4. Morris submits that the arguments of the Objecting Creditors are without merit. There is simply no basis in law to subordinate Morris’s claims, nor is there any compelling reason to seek to do so.

5. Morris’s claim is not one for his share of the current equity of IWS; rather, it is related to dividends and bonuses declared many years ago – before any of the Objecting Creditors were creditors of IWS. It is a crystallized debt claim. Moreover, it is a crystallized debt claim that is back by a final judgment. The claims advanced by Morris are judgment debts and share *pari passu* with the other unsecured creditors of IWS.

6. Finally, the alternative suggestion of the Objecting Creditors that the doctrine of “equitable subordination” allows the Court to subordinate Morris’s claim is quite remarkable. Even assuming that the doctrine of equitable subordination is part of the law of Canada, the Supreme Court of Canada has expressly held that the doctrine requires some form of misconduct on the part of the creditor in question. The Objecting Creditors’ are reduced to arguing that the Supreme Court’s holding was made in *obiter*, or alternatively in suggesting that Morris – the person who, according to Justice Sanderson, was the innocent victim of serious misconduct perpetrated on him, and who has had to fight for almost 25 years to obtain redress from Chester and IWS – is somehow guilty of misconduct by simply by attempting to enforce his judgments. This position is without merit.

## PART II—FACTS

### (a) Background to Morris's Claims

7. From essentially the beginning of his working life, Morris worked together with his brother Chester in the business, IWS, founded by their father, Isaac. From 1964, Chester and Morris each held approximately 50 percent of the IWS common shares. Subsequently, Chester and Morris held exactly equal shareholdings; each with 50 percent of the IWS shares.

**Second Report of Deloitte & Touche Inc. in its Capacity as Trustee in Bankruptcy of The Estate of I.Waxman & Sons Ltd, Motion Record, Tab 2, p. 11**

8. In 1988, Morris commenced litigation to set aside certain documents dated December 22, 1983 by which Chester purported to acquire Morris' 50% shareholding in IWS. The litigation, which gave rise to five actions, went to trial before Madam Justice Sanderson between 1998-2000.

**Second Report of Deloitte & Touche Inc. in its Capacity as Trustee in Bankruptcy of The Estate of I.Waxman & Sons Ltd, Motion Record, Tab 2, p. 12**

9. On June 27, 2002, Justice Sanderson released her Reasons for Decision (the "Reasons") in the principal litigation. Justice Sanderson found that Chester had acted oppressively and breached his fiduciary duty (among other things) in relation to the December 1983 transaction by which Chester purported to acquire Morris' shares, as well as a related lease. Her Honour set aside the share sale transaction, re-instated Morris as a 50% shareholder of IWS, and declared that Chester had held 50 percent of the shares in trust for Morris since the December 1983 transfer. Morris had no involvement in IWS, nor was he able to exercise any rights as a shareholder of IWS, until after he was restored as a shareholder in 2002.

**Second Report of Deloitte & Touche Inc. in its Capacity as Trustee in Bankruptcy of The Estate of I.Waxman & Sons Ltd, Motion Record, Tab 2, p. 12**

*Waxman v. Waxman*, [2002] O.J. No. 2528 at paras. 1530-1535 [hereinafter the “Judgment”]

10. In her Reasons, Her Honour also found that Chester acted oppressively, and caused IWS to act oppressively, with respect to millions of dollars of bonuses declared in favour of Chester’s sons, Warren, Robert and Gary, and with respect to the related party transactions between IWS and companies controlled by Robert and/or Gary.

**Judgment, paras. 1330-1535**

11. With respect to approximately 50 percent of the profits of IWS that Chester had taken from December 1983 to the date of the judgment, the bonuses paid to Chester’s sons, and the related party transactions, Her Honour also granted Morris various constructive trust and elective proprietary and tracing remedies against Chester, IWS and Warren, Robert and Gary. These remedies allowed Morris to follow or trace the funds in question to determine if any assets (including monies) remained in the hands of persons other than bona fide purchasers for value without notice. Her Honour also directed a Reference before a Master to precisely quantify the amount of Morris’ post-sale profit award.

**Judgment, para. 1674**

**(b) IWS Liability for the Share Sale**

12. IWS was also found severally liable with Chester as a result of what the Court of Appeal called IWS’s “deep involvement” in Chester’s breach of fiduciary duty arising out of the share sale transaction. Morris was awarded (in addition to the reversal of the Share Sale) a personal damages remedy against IWS arising out of IWS’s participation in Chester’s wrongdoing. Master Linton, in a Report confirmed by Justice Sanderson, quantified Morris’s loss of profits arising from his exclusion from the business at \$37,711,278.

**(c) The Bonus Claims**

13. The bonus claims relate to payments that should have been made to Morris. However, they are not a claim in specie to the specific bonuses that were in fact paid. Morris's alternative proprietary remedies were granted to him in order to follow the actual property conveyed out of IWS into the hands of Chester and his sons. The damages awarded against IWS in this regard are intended to compensate Morris for the losses caused to him because of IWS's participation in the process.

14. Some confusion on this motion has been occasioned by a few paragraphs in Justice Sanderson's reasons in which she described the bonuses that were in fact paid out as "distributions of equity." This is because the Objecting Creditors are confusing two different concepts: the profits generated by a company from its operations (and paid out as declared dividends or bonuses) versus the actual share capital of the company. Justice Sanderson's references to "equity" are a reference to the fact that the monies taken out by Chester and his sons by way of bonuses were not true bonuses – *i.e.*, payment for the value of services they provided – but were rather the improper attempts to take the profits of IWS out of the company by way of bonuses rather than declaring dividends to its shareholders. This is clear, because the essence of the Reference she directed was to determine whether Chester and his sons were entitled to keep some of the bonuses as proper compensation for services performed. It is clear that Justice Sanderson's award of a money judgment to Morris against IWS was made to compensate Morris for IWS's participation in Chester's dishonest scheme to divert declared bonuses out of IWS to himself and his sons. The same is true as regards the portions of the Judgment relation to the 1981-82 bonus diversions.

**Decision, Paras. 309, 1288-1289 and 1694**

**(d) Characterization of the Judgment**

15. It is plain that the basis for the monetary remedy granted by Justice Sanderson had nothing to do with any return of invested capital. Rather, the damages remedy was founded upon IWS's wrongful and oppressive involvement in Chester's scheme to prevent Morris from receiving money that he was entitled to:

As IWS was involved in the implementation of the Share Sale, it is also liable for the same burdensome, harsh and wrongful acts. It was a party to the December 1983 lease and is liable to Morris and Morrison. All of Chester, Robert and IWS are liable for their harsh, wrongful and burdensome acts in relation to profit diversions from Greycliffe and other related companies and for the payment of expenses improperly by IWS.

**Judgment, para. 1425**

16. IWS's liability for damages to Morris was based upon what the Court of Appeal in its decision called IWS's "deep involvement" in the wrongful acts perpetrated by Chester:

[538] Having found such a transaction here and having concluded that it was oppressive to Morris, the trial judge found that part of the appropriate rectification of that oppression was a remedial order against IWS itself because of its deep involvement in the process. This order represents no error in the exercise of her broad remedial authority, given the very significant participation of IWS in the oppression, as the trial judge spelled out graphically at para. 1387 of her reasons:

The way in which the Share Sale was implemented deeply implicated IWS. Chester, acting as if he were already the 100% owner of IWS, put the resources of IWS at his own disposal to make his share purchase so that he would have 100% ownership of IWS. By causing the corporation to act, he engaged s. 248(2)(a). He arranged for IWS to declare a million-dollar dividend that he would use to pay for part of Morris' shares; for IWS to reallocate \$412,000 of Morris' 1982 bonus to himself to pay for Morris' shares; for IWS to borrow \$500,000 from Morris, interest-free; for Linton, the IWS comptroller, to issue an IWS cheque in the amount of \$500,000 payable to Morris, even though the Share Sale Agreement provided that payments were to be made by Chester personally. By his actions and IWS' actions, Chester secured control of IWS. Chester made IWS a party to the December 1983 lease.

**Court of Appeal Decision, para. 538**

17. At paragraphs 1673 and 1674 of the Judgment, Justice Sanderson made it clear that her award of damages in favour of Morris was intended to compensate him for historical lost profits and declared bonuses and dividends, and was completely distinct from the reversal of the share sale, which restored Morris's 50% capital interest in IWS:

I order and declare that Chester has held 50% of the shares of IWS on constructive trust for Morris since December 22, 1983. [Had Shirley been named as a plaintiff in this case, as a shareholder in IWS, I would have found her to be entitled to the same relief as Morris in connection with 56 1/4 IWS shares.] I make this order despite my finding that the Share Sale was a staged sale and despite the January 4, 1984 date on the Share Sale Agreement. Chester conducted himself as a 100% owner of IWS after December 22, 1983 and took all IWS profits for himself and his family. I order Chester to transfer Morris' shares [50% of the shares of IWS] from his name to Morris' as of today's date.

Mere transfer of Morris' shares will not adequately compensate him for his lost profits in the interim. While it is possible to restore 50% of the shares of IWS to Morris, to put Morris in the same position as he would have been in but for the Share Sale and to prevent Chester from benefiting from his breach of fiduciary duty, oppression, his undue influence and the unconscionable transaction, I have attempted to quantify Morris' lost profits and Chester's undeserved profits in the interim.

**Judgment, paras. 1673-4**

18. Justice Sanderson's reasons indicate that Her Honour was aware of the different remedies available to her under the oppression remedy to address Chester's wrongful conduct.

Her Honour commented on two of those possibilities at paras. 1632 and 1633:

1632 Section 248(3)(j) of the OBCA provides for an order compensating an aggrieved person. An award under s.248 may be made to compensate a shareholder for amounts, such as bonuses, that he would have received but for the oppression.

1633 A court on an oppression application may order a return of funds improperly removed from a corporation and can deem such amounts to be assets of the corporation for the purpose of valuing the complainant's shares.

**Judgment, paras 1632-1633**

19. It is apparent that Justice Sanderson in no way sought to “capitalize” the relief on account of dividends and bonuses denied to Morris by somehow adjusting Morris’s equity position. She rather elected a straightforward money damages remedy to compensate Morris for bonuses and dividends he should have received but did not because of IWS’s participation in Chester’s wrongful conduct.

20. In explaining the distinction between the *personal* basis for the remedies made against IWS as opposed to the *proprietary* basis for the remedies granted as against the recipients of the bonuses, Justice Sanderson’s reasons indicate clearly that she appreciated the consequences of issuing a judgment granting a personal damages remedy against IWS:

A personal remedy imposes an obligation on the defendant to pay the plaintiff a sum of money. The defendant becomes a judgment debtor, [*sic*] ranking behind secured creditors in the event of bankruptcy or insolvency proceedings.

**Judgment, para. 1668**

21. It is clear that Justice Sanderson was aware of the consequences of awarding a money judgment against IWS on account of Morris’s claim, *i.e.*, that Morris would rank as an unsecured creditor in any insolvency of IWS.

**(e) Morris’s Post-Trial Enforcement Efforts**

22. Despite having been restored as a 50 percent shareholder of IWS in 2002, Chester, as the President and sole director of IWS, continued to ignore Morris’ interests and to oppress Morris. For example, despite having given an undertaking to Morris and the Court to operate IWS in the ordinary course of business, Chester removed over \$6 million from IWS after the trial judgment. Morris was required to bring an application on the Commercial List, which was case-managed by Justice Farley. His Honour appointed Deloitte & Touche as a Monitor in

May 2004 and granted numerous interlocutory orders in that proceeding, before granting final judgment in September 2005.

**Affidavit of Michael Waxman, sworn February 28, 2007, paras 19-22, Motion Record of the Trustee, p. 138-140**

23. As a result of Chester's continuing oppressive conduct, including concerns that Chester was assisting to divert accounts from IWS to a company owned by Chester's grandson, Morris brought an application for an order directing the sale of IWS as a going concern, which was granted by Farley J. in September 2005. As a result of that order, Deloitte & Touche was appointed as Marketing Agent to attempt to sell IWS' business as a going concern.

**Affidavit of Michael Waxman, sworn February 28, 2007, paras 23-25, Motion Record of the Trustee, p. 140-142**

24. However, despite the best efforts of the Marketing Agent, it could not find a buyer for IWS as a going concern, in no small part because Chester's grandson continued to take IWS accounts.

**Affidavit of Michael Waxman, sworn February 28, 2007, paras 26-29, Motion Record of the Trustee, p. 142-144**

25. At the same time, IWS was losing customers and losing money. IWS had an operating loss of \$1.1 million in fiscal 2005. While IWS 2006 year-end statements had yet to be produced by February 2007, the monthly financial statements showed an operating loss of another \$560,000 for 2006. Accordingly, it appeared to Morris that IWS was being run into the ground and would never be turned around. As a result, the value of IWS' assets was decreasing every day, and every dollar that IWS lost was a dollar less for Morris and the other creditors. Accordingly, the Marketing Agent recommended that IWS be sold on a liquidation basis, and

Morris supported this recommendation, seeking to convert the Marketing Agent to a Receiver. The formal Receivership began on March 26, 2006.

**Affidavit of Michael Waxman, sworn February 28, 2007, paras 30-32, Motion Record of the Trustee, p. 144-145**

26. The Objecting Creditors raise in their factum (for the first time) some suggestion that Morris has not done all he could to collect on his judgments from Chester and others before turning to IWS. As a judgment creditor, Morris is of course entitled to enforce his judgments against any party liable. It is clearly in Morris' interest, however, to attempt to collect on his judgments from the other judgment debtors first, because if he could collect from those debtors, he would not be enforcing judgments against a company of which he is a 50 percent shareholder. Indeed, the only evidence before the Court on this point is that Morris has conducted judgment debtor examination on those debtors and that no material assets have been disclosed (other than the Chesterton funds held by the Trustee).

**Affidavit of Michael Waxman, paras 25-26, Motion Record of the Trustee, p. 115**

**(f) The Objecting Creditors Were Aware of Morris' Judgments**

27. In the Trustee's report, the Trustee has set out a chronological summary of the claims, which demonstrates that the claim of every single one of the trade creditors (including, but not limited to, the Objecting Creditors) post-dates not only Madam Justice Sanderson's 2002 trial decision but also the decision of the Court of Appeal in 2004 affirming that judgment. Indeed, almost all of the trade creditors' claims are between 0 and 60 days.<sup>1</sup>

**Chronological Summary of Claims, Schedule C to the Trustee's Report, Motion Record of the Trustee**

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<sup>1</sup> The exceptions are the contingent claims of Stackpole Limited (2005 and 2006), \$904 owed to Nevena Electric from 2006 and approximately \$11,000 owed to Canadian Nation Railway for 2006 and 2005. Excluding Stackpole's contingent claim, the Objecting Creditors have claims of \$658,751, of which \$624,893 is less than 30 days old, and the balance is 30-60 days old.

28. Accordingly, all of the creditors, including the Objecting Creditors advanced credit to IWS several years after Morris was granted his judgments against IWS. Notably, not a single creditor has filed an affidavit suggesting that they were unaware of Morris' judgments, which is not surprising given the notoriety of the litigation, particularly in the industry.<sup>2</sup> The clear inference can be drawn that all of the Objecting Creditors were aware of the litigation and Morris's Judgments,<sup>3</sup> but determined that they would take the risk of dealing with IWS because the benefits of doing so outweighed the risks of doing so. Further, even if some creditor was unaware of Morris's judgments, they clearly could have made the most basic enquiries and found out about the judgments.

### **PART III— THE LAW AND ARGUMENT**

#### **(a) The *Bankruptcy and Insolvency Act* – Debts are Provable Claims**

29. By s. 121(1) of the *Bankruptcy and Insolvency Act* ("BIA"), all debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt are claims provable in bankruptcy.

#### ***Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3, subsection 121(1)***

30. Morris is a judgment creditor of IWS. A money judgment adjudging a sum certain of money to be paid creates an independent obligation in the nature of a debt as between Morris and IWS. When a Court adjudges a sum of money to be paid, a binding obligation to pay is

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<sup>2</sup> Indeed, Alan Waxman, on of the principals of the Waxman Recycling Industries, an Objecting Creditor, testified at the trial of the main litigation.

<sup>3</sup> The one affidavit filed by on behalf of the Objecting Creditors only deposes that the creditor "was not a party to and had no interest in" the litigation, and had no "inside" information concerning the litigation. Ms. Grace clearly does not say that she was unaware of the litigation or the judgments.

thereby created, and an action of debt may be brought on such judgment. IWS thus owes Morris a debt.

*Aldrich v. Aldrich* (1893), 24 O.R. 124 at 127 (C.A.)

*Williams v. Jones*, (1845) 13 M. & W 628 at 633-34

31. In general, those who assert a proposition have the burden of establishing it. Morris thus submits that the onus is upon the Objecting Creditors to establish that his judgment debt is anything other than what it appears to be.

*Authorson (Litigation Administrator of) v. Canada (Attorney General)* (2007), 86 O.R. (3d) 321 at para. 137 (C.A.)

**(b) Objecting Creditors Cannot Look Behind the Judgments**

32. A money judgment (indeed, any judgment) is a distinct right from the underlying facts giving rise to it. The merits of any cause of action leading to the judgment merge into it and can no longer affect its character as a judgment. This principle is reflected in the recent case of *Hislop v. Canada (Attorney General)*, where the Supreme Court of Canada considered the standing of members of a class of plaintiffs to pursue remedies based on section 15 of the *Charter* as for discrimination as a result of being denied certain CPP survivor benefits for same-sex couples. Class members who died before being able to commence an application for survivor benefits were held not to have standing to commence proceedings based on section 15 because, the court held, section 15 claims are personal and expire when the claimant dies. The main class plaintiff, however, had obtained a judgment before he died. The court held that this fact fundamentally altered this plaintiff's position, because when a judgment is obtained, the cause of action upon which the judgment is based is merged in the judgment. Once the plaintiff's claim passed into judgment, its status as a purely personal claim was no longer relevant.

*Hislop v. Canada (Attorney General)* (2007), 278 D.L.R. (4th) 385 at para. 75 (S.C.C.)

33. Donald Lange in the second edition of his text summarizes this doctrine of merger as follows:

. . . the claim and the relief are inextricably bound together. The merger by judgment means that the cause of action has been extinguished. It is transformed into and replaced by a judgment which creates an obligation of a higher nature. The inferior remedy of the cause of action is merged in the higher remedy of the judgment. The judgment is all that is left to rely upon after the trial. Hence, the term used in some early cases is “*transit in rem judicatum*”.

**Donald Lange, *The Doctrine of Res Judicata in Canada*, 2d ed. (Toronto: Butterworths, 2004) at pp. 128-129**

34. Thus, once Morris obtained his money judgment against IWS, as a matter of law the status and merits of the underlying claim became irrelevant for the purpose of characterizing his judgment. Once Morris’s rights crystallized into a money judgment, they were merged into that judgment, creating a completely different right that now forms the basis of Morris’s claim.

**(c) Unsecured Claims, Once Established as Provable Claims, Rank Equally**

35. The fact that Morris’s rights have passed into a money judgment makes it impossible to characterize Morris’s claim as being a form of equity claim. An obligation, for characterization purposes, must be either debt or equity: it cannot be both. In order to disallow Morris’s claim, this Court would have to somehow find that a money judgment of the Court should be characterized as something other than a money judgment – a proposition that is without precedent.

*Re Central Capital Corporation* (1996), 27 O.R. (3d) 494 at 540 (C.A.)

36. The test in subsection 121(1) of the BIA is clear: either a claim is provable in bankruptcy or it is not. If a claim is properly characterized as equity, it is not a claim provable in bankruptcy. If the claim is a debt, it is a claim provable in bankruptcy.

37. The correct approach, therefore, in each case is to determine whether the claim is a debt or whether it is equity. In both *Central Capital* and *Canadian Commercial Bank*, the courts were required to examine the particular instruments before them to determine whether the instrument created an obligation in debt. There is nothing in either case to suggest that the relevant enquiry is whether the claim *arises out of* an equity interest.<sup>4</sup> Indeed, any such proposition is directly refuted by Justice Laskin's observation (that has never been questioned by any Canadian court) that a declared dividend – which of course can only arise out of an equity interest – is a debt provable in bankruptcy.

*Re Central Capital Corporation* (1996), 27 O.R. (3d) 494 and 545 (per Laskin J.A.)  
(and see at 516 (per Finlayson J.A. dissenting, but not on this point) (C.A.)

38. Section 141 of the BIA clearly provides that once a claim is characterized as a claim provable in bankruptcy, it ranks rateably with other claims, subject to any explicit provision in the BIA to prefer or subordinate it. The principle of equality among unsecured creditors, subject only to expressed exceptions, is one of the fundamental tenets of insolvency law.

*Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3, s. 141

*Re Cicoria* (2000), 21 C.B.R. (4<sup>th</sup>) 232 at para. 2 (Ont. C.A.)

*Re Orzy* (1923), 3 C.B.R. 737 at 738 (Ont. C.A.)

39. The Objecting Creditors make reference to section 139 of the BIA. However, this provision expresses Parliament's clear intention to postpone certain types of claims, but those are

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<sup>4</sup> Indeed, even in the *Blue Range* case, Justice Romaine's analysis is dependant upon her conclusion that the claim was in substance a claim by a shareholder for a return of the money that "it invested qua shareholder" or "a return of what [the shareholder] invested in equity".

not in issue here.<sup>5</sup> The fact, however, that Parliament has not<sup>6</sup> chosen to do so in relation to damage claims having a connection with shareholder status suggests that Parliament did not intend to allow the common-law prioritization of claims based on how much they resemble equity.

**(d) Re-characterizing the Judgment is a Collateral Attack on It**

40. In the leading cases cited by the Trustee concerning the difference between equity claims and debt claims, courts attempt to characterize the true nature of the transaction based upon the terms of the parties' agreements with one another, be they in the form of written contracts or share provisions contained in the articles of a corporation. This process involves examining the relevant documents and attempting to determine whether they reflect an intention that the relationship be one of equity or debt.

*Re Central Capital Corporation* (1996), 27 O.R. (3d) 494 at 537 (C.A.)

*Canada Deposit Insurance Corp. v. Canadian Commercial Bank* (1992), 97 D.L.R. (4th) 385 at 405 (S.C.C.)

41. This type of analysis has no application here. Morris did not bargain with IWS to obtain the status of a judgment creditor holding a money judgment. He sued IWS almost twenty years ago because of its participation in Chester's scheme to cheat him. The fact that Morris is claiming on the resulting money judgment quite clearly separates the present case from *National Bank of Canada v. Merit Energy Ltd.* and *Re Blue Range Resource Corp.*

*National Bank of Canada v. Merit Energy Ltd.* [2001] 10 W.W.R. 305 (Alta. Q.B.), affirmed [2002] 3 W.W.R. 215 (C.A.)

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<sup>5</sup> Indeed, Parliament has chosen to postpone certain other specific claims as well in ss. 137 (reviewable transactions), 138 (preferred claims for wages of relatives) and 140 (preferred claims for wages by officers and directors).

<sup>6</sup> Parliament has proposed in the form of Bill C-12, which was referred to committee November 15, 2007, to postpone certain defined "equity claims" to the claims of other unsecured creditors. Interestingly, there would be no need for such legislation if all claims "rooted in equity" are not claims provable in bankruptcy.

*Re Blue Range Resource Corp.* [2000] 4 W.W.R. 738 (Alta. Q.B.)

42. In each of those cases, the Court had to consider the status of an unadjudicated unliquidated civil claims brought by shareholders in insolvent corporations. In each case, the Courts applied the intention-based analysis in *Central Capital* and *Canadian Commercial Bank* to characterize the true nature of the claims being asserted against the respective corporations by their shareholders. Because those claims were had not passed into judgments, there was no impediment either in *Merit Energy* or *Blue Range* to the Court looking behind the asserted claims to determine the true nature of the claims. In *Merit Energy*, for example, LoVecchio J.'s ruling heavily relied on the objective of the investor plaintiffs in commencing their proceeding as justification for concluding that the claims were attempts to reclaim equity investments and were not bona fide debt claims.

*National Bank of Canada v. Merit Energy Ltd.* [2001] 10 W.W.R. 305 at 319 (Alta. Q.B.), affirmed [2002] 3 W.W.R. 215 (C.A.)

*Re Blue Range Resource Corp.* [2000] 4 W.W.R. 738 (Alta. Q.B.)

43. However, this intention-based analysis has no application to a judgment creditor's rights under a settled money judgment. A judgment is not an expression of the intention of either of the parties. It emanates not from the parties, but from the Court. It is a matter of record and cannot be collaterally attacked in subsequent proceedings.

*Bank of Montreal v. Coopers Lybrand Inc.* (1996), 137 D.L.R. (4th) 441 at 446-447 (Sask. C.A.)

*Wilson v. R.* (1983) 4 D.L.R. (4th) 577 at 597 (S.C.C.)

*Manis v. Manis* (2001) 55 O.R. (3d) 758 at para. 22 (C.A.)

44. There is no need, nor any basis in law, to look behind Morris's money judgment. Moreover, the doctrine of collateral attack prevents this Court from doing so.

45. Moreover, and significantly, Morris's money judgment claim against IWS was not an attempt to reclaim from IWS his investment in IWS. Sanderson J.'s reasons (as affirmed by the Court of Appeal) provide that Morris's claim was a personal claim for profits (that IWS had resolved to distribute) based upon IWS's liability as an accessory to Chester's wrongdoing. They are fundamentally claims for money damages. Morris submits that this fact ends the characterization analysis.

46. Morris did have a separate claim to be restored as a shareholder. That claim led to restoration as a 50% shareholder, however, his equity interest was lost in the bankruptcy.

**(e) Even if the Judgement Could be Re-opened, Morris's Claims are Still Provable**

47. Even if it were somehow possible to look behind Sanderson J.'s judgment, the claims in issue are in any event debt claims.

48. The principal claims against IWS relate to the improper diversion of profits from IWS and Morris's lost opportunity to participate in IWS's profits in the period between 1983 and 2002 as a result of the share sale. The profits alleged to have been diverted related to historical IWS profits that were dividended or bonused out to shareholders. The bonus and dividend claims at issue in this case not really a return *of* invested capital, but were rather compensation for the loss of a crystallized return *on* capital.

49. When a corporation resolves to distribute profits, each shareholder's right to receive those profits becomes an actionable, personal right of a shareholder against the corporation. As a result, the law is clear that claims for declared dividends are debts provable in bankruptcy, not equity claims. The Ontario Court of Appeal in *Central Capital* explicitly so held.

*Re Central Capital Corporation* (1996), 27 O.R. (3d) 494 at 516 (per Finlayson J.A. dissenting, but not on this point) and 545 (per Laskin J.A.) (C.A.)

*Re Montego Forest Products Ltd.* (1998), 1 C.B.R. (4<sup>th</sup>) 74 at para. 6 (Ont. Registrar)

50. The Objecting Creditors' attempts to undermine that proposition because Laskin J.A. did explicitly say that, in that situation, equity is 'converted' or 'transformed' into a debt" is simply tilting at windmills. The Court of Appeal clearly accepted that when a dividend is declared, that gives rise to a debt claim in the hands of the shareholder and thus a claim provable in bankruptcy.

51. The fact that many private corporations such as IWS distribute their profits by way of bonus as opposed to dividends does not change the character of the payment as a distribution of the profits of the business, and not a distribution of invested capital. Indeed, it is also established law that declared bonuses are debts. Hence, in *Stuart v. Hamilton Jockey Club*, the plaintiff, who was the victim of a fraudulent transfer of her shares by her late husband's father, sued the defendant company for bonuses declared on the shares but not paid to her and recovered judgment in debt against the defendant company on the basis that the bonuses were debts due to her as the rightful owner of the shares.

*Stuart v. Hamilton Jockey Club* (1911), 2 O.W.N. 673 at 674-5, affirmed as to the claim against the company (1911), 2 O.W.N. 1402 at 1403 (C.A.)

52. Bonuses, therefore, once declared, are debts in the same way dividends are. Therefore, even if were somehow possible to look behind Sanderson J.'s judgment, the result is still the same: Morris's claims are not equity claims. They are debt claims for shareholder profits and are fully provable in bankruptcy.

**(f) Even Assuming it Exists in Canada, Equitable Subordination is Inapplicable**

53. Morris agrees with the Trustee that there is no basis for the application of the uncertain doctrine of equitable subordination in this case, even assuming the doctrine exists in Canada. Section 141 of the BIA clearly provides that claims are to be paid rateably unless some provision of the BIA mandates otherwise. There is arguably no room to apply the doctrine under the BIA.

54. Even assuming the doctrine exists in Canada, the Supreme Court of Canada in the *Canadian Commercial Bank* case has held that a prerequisite for the application of the doctrine is some form of inequitable conduct on the part of the person whose claim is to be subordinated.

*Canada Deposit Insurance Corp. v. Canadian Commercial Bank* (1992), 97 D.L.R. (4th) 385 at 419 (S.C.C.)

55. Contrary to what is asserted at paragraph 94 of the factum filed on behalf of the Objecting Creditors, it is manifestly not the case that the Supreme Court of Canada's "comments" on the doctrine of equitable subordination were "entirely *obiter*". The Court expressly described a three-part test for equitable subordination and found that one of the requirements, namely inequitable conduct, had not been satisfied:

As I understand it, in the United States there are three requirements for a successful claim of equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute: see *Re Mobile Steel Co.*, 563 F. 2d 692 (5th Cir., 1977) at p. 700; *Re Multiponics Inc.*, 622 F. 2d 709 (5th Cir., 1980); A. DeNatale and P. B. Abram, "The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors" (1985), 40 Bus. Law. 417 at p. 423; and L. J. Crozier, "Equitable Subordination of Claims in Canadian Bankruptcy Law" (1992), 7 C.B.R. (3d) 40 at pp. 41-2. Even if this court were to accept that a comparable doctrine to equitable subordination should exist in Canadian law, I do not view the facts of this case as giving rise to the

"inequitable conduct" and ensuing "detriment" necessary to trigger its application.

*Canada Deposit Insurance Corp. v. Canadian Commercial Bank* (1992), 97 D.L.R. (4th) 385 at 420 (S.C.C.)

56. The finding of no inequitable conduct was necessary to dispose of the issue before the Supreme Court of Canada. Had the Court found inequitable conduct (and corresponding detriment), the issues before the Court would have required it to go on and determine whether or not the doctrine existed in Canadian law for the benefit of the appellants in that case.

57. Further, even if on some basis this Court were not bound by the Supreme Court's formulation of the test in the *Canadian Commercial Bank* case, this Court should not depart from that formulation. It would be inappropriate to assume that the Supreme Court somehow had an "outdated and incomplete" understanding of the doctrine of equitable subordination (as the Objecting Creditors claim) when the *Virtual Network Services* case was decided two years before the *Canadian Commercial Bank* case and was cited to the Supreme Court.

58. Moreover, lower courts in Ontario since the Supreme Court of Canada's decision in the *Canadian Commercial Bank* case have exercised extreme caution in relation to the proposed doctrine of equitable subordination. C. Campbell J. has recently held (in a case involving the BIA) that "[t]he application of the doctrine of equitable subordination is limited and questionable at best in Canadian law." Even in refusing to apply the doctrine, C. Campbell J. reiterated that inequitable conduct is a threshold.

*New Solutions Financial Corp. v. 952339 Ontario Ltd.* (2007) 29 C.B.R. (5th) 222 at para. 32 (S.C.J.)

59. There is no basis whatsoever in Morris's conduct to subordinate his claim to those of the other creditors of IWS. Morris has done nothing except sue IWS based on its unlawful

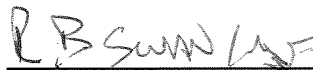
assistance in Chester's breach of fiduciary duty to him. There is nothing even remotely inequitable in Morris's conduct – nothing is really even seriously suggested.

60. Furthermore, applying concepts of equitable subordination to Morris's claims completely ignores the fact that Morris's claim is based on a judgment of the Court which issues from the Court and is not to be regarded as any act of Morris. There is nothing inequitable about enforcing a judgment of the Court in accordance with its terms.

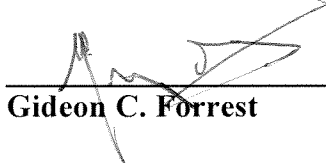
**PART IV – ORDER SOUGHT**

61. The applicant respectfully requests that this Court direct the Trustee to allow Morris's claim, with costs on the appropriate scale as against the Objecting Creditors.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED, THIS 11<sup>th</sup> DAY OF DECEMBER, 2007**



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**Richard B. Swan**



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**Gideon C. Forrest**

Of Counsel for Morris Waxman