

Court file no.
(Estate No. 31-207468-T)

COURT OF APPEAL FOR ONTARIO

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

NOTICE OF APPEAL

Certain of the unsecured creditors (hereinafter, "THE APPELLANTS") of the estate of I. Waxman & Sons Limited ("IWS"), in bankruptcy, APPEAL to the Court of Appeal from the Order of the Honourable Justice Pepall dated March 6, 2008, made at Toronto.

THE APPELLANTS ASK that the Order be set aside and that an Order be made as follows:

- (a) declaring that the proof of claim dated September 20, 2007, and filed by or on behalf of Morris Waxman constitutes (save as is set out in para. (b), below) a claim for distribution of the capital, or equity, of IWS and that, as such, it shall not be paid by the Trustee until the proven claims of all ordinary, unsecured creditors of IWS have been paid in full;
- (b) declaring that that portion of the Morris Waxman proof of claim pertaining to damages for "wrongful dismissal" and postjudgment interest thereon constitutes a debt claim entitled to rank *pari passu* with all proven debt claims of the unsecured creditors of IWS;
- (c) directing the Trustee in bankruptcy of IWS to act accordingly in its administration of this estate;

- (d) directing the Trustee in bankruptcy of IWS to disallow that portion of the Morris Waxman proof of claim described as "punitive damages" and valued by him at \$350,000.00 on account of principal with "postjudgment interest" calculated to September 4, 2007, of \$72,692.20, for a total of \$422,692.20;
- (e) ordering that the costs of the appellants, both here and below, be paid out of the estate of IWS, on a solicitor-and-client basis, in the same manner and on the same priority as the costs of the Trustee in bankruptcy of IWS are paid; and
- (f) such further and other relief as counsel may advise and this Honourable Court may deem fit.

THE GROUNDS OF APPEAL are as follows:

Background

1. IWS is a limited company incorporated under the laws of the Province of Ontario;
2. Morris Waxman ("Morris") is now, and was at all material times, a shareholder of IWS, owning 50% of the shares ("the Morris shares"); and his brother Chester Waxman ("Chester") owns the remaining 50% of the shares of IWS;
3. By virtue of the Judgment of the Honourable Justice Sanderson dated June 27, 2002, in Superior Court of Justice Court file no. 33234/88, Chester held the Morris shares in trust for Morris from and after December 22, 1983;
4. By Order dated April 30, 2004, in Court of Appeal file no. C38616, the Court of Appeal for Ontario varied the Judgment of the Honourable Justice Sanderson in some respects but not with respect to the ownership of the Morris shares;
5. By para. 4 of its Order, the Court of Appeal for Ontario also ordered and adjudged that:

...Morris Waxman shall recover from Chester Waxman and IWS, severally but not jointly, 50 percent of: the **profits and distributions of equity** of

IWS between December 22, 1983 and June 27, 2002 (the "IWS Profits"), as determined on a reference before a Master (of which Morris Waxman shall have carriage) in accordance with the directions set out in paragraphs 1676-1682 of the Reasons for Decision of the trial judge in this action, following an election by Morris Waxman in accordance with paragraph 2592(a) of the said Reasons for Decision (the "Adjusted Amounts"). [Emphasis added.]

6. Following the ordered reference, Master Linton determined (in his Report dated January 4, 2007) that these "profits and distributions of equity" ordered to be paid to Morris by Chester and IWS, severally but not jointly, totalled \$37,900,475.00, inclusive of compounded prejudgment interest up to and including January 4, 2007;

7. Master Linton's Report on Reference dated January 4, 2007, was confirmed by Justice Sanderson via her decision released August 30, 2007;

8. In his proof of claim, Morris valued these "profits and distributions of equity" at \$39,711,278.00 (including prejudgment interest to August 30, 2007, the date of Justice Sanderson's confirmation of the Report on Reference), and also claimed "postjudgment interest" thereon calculated to September 4, 2007, of \$21,759.00, for a total (under this heading) of \$39,733,037.60;

9. By its Order dated April 30, 2004, and its Reasons for Decision underlying that Order, the Court of Appeal for Ontario (approving with variations the Judgment of Justice Sanderson) described the following sums ordered to be paid to Morris by Chester and IWS, severally, as "distributions of equity":

1981-82 bonuses	\$2,312,200.00
profit diversions	\$ 590,036.50
1979 bonus	\$ 125,000.00

10. In his proof of claim, Morris valued these amounts, with "postjudgment interest" thereon calculated to September 4, 2007, at \$2,792,136.15, \$712,567.20, and \$150,961.50, respectively;

11. In his proof of claim, Morris included a claim for "punitive damages" of \$350,000.00, together with "postjudgment interest" thereon calculated to September 4, 2007, at \$72,692.20, for a total claim of \$422,692.20;

12. However, neither Justice Sanderson nor the Court of Appeal for Ontario awarded Morris such "punitive damages" *against IWS*. They did so only against Chester;

13. The Trustee in bankruptcy of IWS has not indicated whether it will disallow this heading of Morris' proof of claim and Justice Pepall did not address it in her Order appealed from, although this anomaly was brought to Her Honour's attention;

14. Following the Judgment of Justice Sanderson and the Order of the Court of Appeal, IWS continued to carry on its business, including, *inter alia*, contracting with the companies, individuals, and entities which are now unsecured creditors of its estate for the supply of goods and services in the ordinary course of business;

15. Chester and IWS sought leave to appeal to the Supreme Court of Canada from the Order of the Court of Appeal for Ontario dated April 30, 2004. The Supreme Court of Canada denied leave to appeal;

16. Thereafter, Morris and those acting on his behalf petitioned to have IWS put into receivership, in efforts to recover some or all of the amounts ordered to be paid to Morris. By Order dated March 26, 2007 ("the Receivership Order"), the Honourable Justice Ground appointed Deloitte & Touche Inc. as receiver of the assets, property, and undertaking of IWS and authorized it, *inter alia*, to sell the assets of IWS;

17. Upon its appointment, the receiver took possession of proceeds of sale of \$16,518,948.00, arising from realty previously owned by IWS and known as the Centennial Property;

18. By virtue of the terms of the Receivership Order, IWS and the receiver were not permitted to pay, and the unsecured creditors (including the appellants) were not permitted to take steps to collect or recover, any of the amounts owing to the unsecured creditors by IWS as of March 26, 2007;

19. In its Second Report dated December 4, 2007, the receiver reported that its asset realizations for the period March 26 to November 30, 2007, totalled \$35,821,411.00;

20. By Order dated September 4, 2007, made on the petition of Morris and those acting on his behalf, Justice Pepall adjudged IWS bankrupt and appointed Deloitte & Touche Inc. Trustee in bankruptcy of the estate of IWS. Deloitte & Touche Inc. continued as receiver of IWS as well, pursuant to the Order of Justice Ground dated March 26, 2007;

21. The proof of claim submitted by Morris² claims from the estate of IWS an overall amount (\$46,627,215.21), calculated as of the date of bankruptcy (September 4, 2007), greater than the receiver's reported asset realization (\$35,821,411.00). Morris, however, is permitted by the terms of his Judgment to collect the amounts owed to him by Chester as well, not just from IWS;

22. In its preliminary report dated September 21, 2007, the Trustee reported that the total claims against the estate, as per the bankrupt's Statement of Affairs, amounted to \$57,738,314.50, all of them unsecured, but that one or more proofs of claim had been filed with it (for \$1,446,020.15) asserting status as secured creditors. The unsecured total amount included the Morris Judgment;

23. The number of unsecured creditors listed by the Trustee as of September 21, 2007, totalled some 160, including Morris. These unsecured creditors consisted of trade creditors, employees who lost their positions at IWS as a result of the Receivership Order, some Waxman family members, and others;

24. By letter dated November 7, 2007, Lerner's LLP wrote to counsel for the Trustee informing them, *inter alia*, that it represented 14 of the unsecured trade creditors of IWS, stating their position that the Morris claims should be recognized as a shareholder's claim for equity that can only be honoured following payment in full of *all* proven claims of unsecured creditors, advising that Lerner's LLP would seek to intervene in the bankruptcy of IWS, if necessary, to assert that position, and requesting the Trustee's

response and suggestion as to how this position might be brought to the attention of the Court in the most cost-effective manner;

25. Upon receiving this letter, the Trustee evidently instructed its counsel to conduct legal research concerning this position; and the counsel produced a lengthy opinion concluding that the Morris proof of claim should be "allowed" and that the Trustee should pay the amount claimed therein rateably with all other proven and allowed proofs of claims of unsecured creditors;

26. By reaching these conclusions in this opinion, the Trustee and its counsel recognized that there was a divergence of interests within the general body of unsecured creditors, between Morris Waxman on the one hand and all the remaining unsecured creditors, including trade creditors and former employees, on the other hand;

27. The Trustee thereupon brought a motion for the advice and directions of a Judge of the Superior Court of Justice in Bankruptcy as to whether the Morris proof of claim should be "allowed" and such further and other relief as that Court deemed just. In bringing this motion and in carrying it through to conclusion, the Trustee advised the Court of its opinion and, by doing so, did not represent the interests of some 160 unsecured creditors of IWS and did not purport to do so. Rather, it put forward views consistent with the interests of claimant shareholder Morris;

28. The motion was heard by Justice Pepall on December 14, 2007. Counsel appeared on behalf of the Trustee and Morris. Lerner's LLP appeared on behalf of 14 unsecured trade creditors. The Trustee's "service list" for its motion material consisted of those firms, Canada Revenue Agency, unsecured creditor Pointe-Claire Steel, law firm Simpson Wigle LLP, and Chester's son Robert Waxman. As none of these others given notice of the motion appeared, Lerner's LLP *de facto* was the only firm representing the point of view of the unsecured creditors generally and it so informed Justice Pepall at or near the outset of its submissions;

29. Justice Pepall took her decision under reserve and released her decision on March 6, 2007;

The Order and decision under appeal

30. The learned motions judge erred in law and misdirected herself on the evidence in failing to ascertain the "substance" of the Judgment claims submitted by shareholder Morris and determine whether his Judgment was one for equity, for debt, or for a mixture of equity and debt. Although she recognized that this was required, she did not do so;

31. The learned motions judge erred in law and misdirected herself on the evidence in ruling that the Morris claims "relate primarily" to "dividends and bonuses" and not "a return of invested capital", since Justice Sanderson and the Court of Appeal for Ontario had already determined, via final judgments, that the bulk of his claims relate to equity and it was not open to either the Trustee or Morris to contend otherwise before her;

32. The learned motions judge erred in law and misdirected herself on the evidence in deciding, contrary to Justice Sanderson and the Court of Appeal for Ontario, that she could re-characterize the Morris Judgment and in describing it as "fixed debt";

33. The learned motions judge erred in law and misdirected herself on the evidence in concluding that the Morris claims had been "transformed" into debt simply by virtue of having been quantified in a Judgment;

34. The learned motions judge erred in law and misdirected herself on the evidence in failing to uphold the established common-law principle that, in an insolvency, the claims of shareholders cannot be paid until the proven claims of all unsecured creditors have been paid in full;

35. The learned motions judge erred in law by failing to appreciate that it was open to her to apply the American doctrine of "equitable subordination", as it has evolved in United States jurisprudence, to support the established common-law doctrine that the claims of shareholders must, in an insolvency, be subordinated to the claims of unsecured creditors;

36. Such further and other grounds as counsel may advise and this Honourable Court may permit.

THE BASIS OF THE APPELLATE COURT'S JURISDICTION IS:

- (a) the *Bankruptcy and Insolvency Act*, R.S.C. 1995, ch. B-3 , ss. 183(2) and 193(c), as amended;
- (b) Rule 31(1) of the General Rules under the *Bankruptcy and Insolvency Act*, and
- (c) s. 6(1)(b) of the *Courts of Justice Act*, R.S.O. 1990, ch. 43, as amended.

March 17, 2008

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in the City of Hamilton, in the Province of Ontario

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Solicitors for certain unsecured trade
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APPELLANTS' CERTIFICATE

The appellants certify that the following evidence is required for the appeal, in the
appellants' opinion:

1. the Motion Record of the Trustee in bankruptcy of the estate of I. Waxman &
Sons Limited, dated December 4, 2007;
2. the Receivership Order in Superior Court of Justice – Commercial List Court file
no. 05-CL-5881, dated March 26, 2007; and
3. the Affidavit of Carolyn Grace sworn December 8, 2007, without Exhibit "A".

March 17, 2008

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