Case Name:

Residential Warranty Co. of Canada Inc. (RE)

In the Matter of the Bankruptcy of Residential Warranty Company of Canada Inc.
Estate No. 24-112232
AND In the Matter of the Bankruptcy of Residential Warranty Insurance Services Ltd.
Estate No. 24-112233

[2006] A.J. No. 872

2006 ABQB 522

393 A.R. 286

25 C.B.R. (5th) 26

151 A.C.W.S. (3d) 16

2006 CarswellAlta 929

Docket: 24 112232, 24 112233

Alberta Court of Queen's Bench
(Bankruptcy and Insolvency)
Judicial District of Edmonton

Topolniski J.

Heard: July 6, 2006.
Judgment: July 11, 2006.
Filed: July 12, 2006.

(37 paras.)

Insolvency law -- Trustees -- Remuneration -- Application by trustee for charge in the deposits in respect of administration fees allowed -- It was appropriate for court to exercise inherent jurisdiction to charge deposits and letters of credit to secure costs associated with their administration in relation to 627 claimants -- Trustee's work benefitted ultimate beneficiaries of assets and it was only reasonable that costs of administration be charged against them.

Insolvency law -- Practice -- Proceedings in bankruptcy -- Application by trustee for charge in the deposits in respect of administration fees allowed -- Application by several builders for certification of committee and charge against deposits in bankrupt's possession allowed in part -- Application by trustee for charge in the deposits in respect of administration fees allowed -- Application by insurer for control *over bankrupt's deposits and letters of credit dismissed -- Certification allowed, as large number of builder claimants and small value of individual claims made separate representation of each builder impracticable -- Builders' application for charge over deposits and letters of credit was premature, as no evidence that efforts of builders' committee benefitted the trust -- Court exercised inherent jurisdiction to allow trustee to charge costs associated with administering 627 claims against deposits and letters of credits, as trustee's work benefitted entire trust -- Potential prejudice of granting control over deposits and letters of credit to insurer overshadowed any benefits, as agreement gave insurer right to claim against assets and insurer was able to draw these down to satisfy its claims in priority to claims of others, and there was live issue about whether insurer entitled to assets.*

Application by several builders for certification of committee and charge against deposits in bankrupt's possession -- Application by trustee for charge in the deposits in respect of administration fees -- Application by insurer for control over bankrupt's deposits and letters of credit -- Bankrupt operated home warranty program -- Builders provided letters of credit or deposits as performance security -- Trustee in bankruptcy in possession of deposits and letters of credit -- 627 builders brought claims for deposits and letters of credit and 67 builders sought to form committee to represent builders in litigation -- Two insurers claimed against deposits and letters of credit -- Trustee sought charge over deposits and letters of credit to pay its fees and expenses in regard to its administrative tasks in determining whether any deposits or letters of credit should be returned to builders -- HELD: Application of builder allowed in part -- Application by trustee allowed -- Application by insurer dismissed -- Certification allowed, as large number of builder claimants and small value of individual claims made separate representation of each builder impracticable -- Builders' committee facilitated communications between parties and streamlined court applications -- Builders' application for charge over deposits and letters of credit was premature -- No evidence that efforts of builders' committee benefitted the trust -- It was appropriate for court to exercise inherent jurisdiction to charge deposits and letters of credit to secure costs associated with their administration -- Trustee's work benefitted ultimate beneficiaries of assets and it was only reasonable that costs of administration be charged against them -- Potential prejudice of granting control over deposits and letters of credit to insurer overshadowed any benefits, as agreement gave insurer right to claim against assets and insurer was able to draw these down to satisfy its claims in priority to claims of others -- Creditors could have been prejudiced if insurer drew down deposits to satisfy own claims -- There was a live issue of whether breach of agreement between bankrupt and insurer occurred that would have given insurer right to claim against assets -- Insurer's unheeded pre-bankruptcy request to bankrupt for delivery of letters of credit did not entitle insurer to take property from trustee -- No agreement about what would have happened to deposits and letters of credit if insurer held possession but no claim was made on them under warranty program.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 67, s. 81(2)

Counsel:

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George Raymond

Memorandum of Decision

TOPOLNISKI J.:--

I. Nature of the Applications

1 Residential Warranty Company of Canada Inc. ("RWC") and Residential Warranty Insurance Services Ltd. ("RWI"), collectively the "Bankrupts," operated a home warranty business in Alberta and British Columbia. It was a condition of membership in the Bankrupts' home warranty program that builders provide a letter of credit or cash deposit as performance security.

2 The Bankrupts' trustee in bankruptcy ("Trustee") is in possession of builders' cash deposits worth $834,438.00 and letters of credit valued at $4,448,000.00. The individual cash deposits and letters of credit range between $5,000.00 and $20,000.00, with the vast majority having a value of $10,000.00. The Trustee also is in possession of $50,000.00 representing letters of credit cashed by the Trustee because they were not renewed by the five builders who posted them prior to expiry. The nature of this property, the competing claims to it, and the sheer number of claimants pose unique challenges for the administration of the Bankrupts' estates.

3 There are 627 builders interested in the builders' cash deposits and letters of credit (Builder Claimants). The Builder Claimants intend to assert security or trust claims, primarily the latter, over the cash deposits and letters of credit. Two insurance underwriters of the Bankrupts' warranty program, Kingsway General Insurance Company ("Kingsway") and American Bankers Insurance Company of Florida ("American Bankers"), are interested in the cash deposits and letters of credit, as is the Trustee whose interest arises only if the others do not succeed in establishing their claims.

4 The method for proving builders' claims in the bankruptcies and a claims barred date were set by Order some time ago. Argument concerning disputed builders' claims is scheduled for early this fall. Before then, significant work must be done to determine if any of the letters of credit should be returned to the builders who posted them because the period for which the security was posted has lapsed. The Trustee is not prepared to undertake this work without assurance of compensation, and seeks a retrospective and prospective charge over the builders' cash deposits and letters of credit to pay for its fees and expenses in regard to its administrative endeavours in sorting out that and other issues relating to the deposits and letters of credit.

5 There are 67 builders who have joined forces to seek certification of a Builders' Committee to represent the Builder Claimants and to instruct counsel on their behalf. They apply for a prospective charge over the builders' cash deposits and letters of credit to pay for the fees and expenses of the Builders' Committee.

6 Kingsway asserts a trust claim over all of the assets under administration by the Trustee. The Trustee's disallowance of its Proof of Claim is under appeal. Kingsway seeks physical control of the builders' deposits and letters of credit.

II. Certification of the Builders' Committee and Builders' Committee Charge

7 The number and relatively small value of the Builder Claimants' individual claims make separate representation by each impracticable. The certification of a Builders' Committee will facilitate communications amongst and between the Builder Claimants, the Court, the Trustee and others. In addition, it will assist in streamlining any Court applications which are necessary and will facilitate negotiations with other stakeholders.

8 The Trustee supports certification of the Builders' Committee, but opposes the Committee being granted a charge over the disputed property. The Trustee wants some assurance that the Committee will not be permitted to reargue matters already determined by the Court. Its concern in that regard arises as a result of the Builder Claimants' stated intention to seek to vary the process for determining the validity of builders' claims and the claims barred date. While I appreciate the Trustee's desire for finality, it is premature to foreclose this type of application.

9 In my view, administration of the Bankrupts' estates will benefit by the Builder Claimants as a group being represented by a Builders' Committee. Therefore, I grant the application to certify the Committee. The mandate and limitations on liability of the Builders' Committee are set out in the form of Order attached as a Schedule to this Memorandum for Decision. Should counsel wish to speak to further terms of such an Order, they may do so on appropriate notice to all interested parties.

10 In a previous decision in this case (***Residential Warranty Co. Canada Inc. (Re)***), [2006] A.J. No. 349, 2006 ABQB 236 at paras. 41 to 68), I discussed the jurisprudence concerning the charging of trust assets. Kingsway had applied to prohibit the Trustee from using assets under its administration to compensate itself, arguing that the value of its asserted but as yet unproven trust claim, exceeded the value of all of the assets under the Trustee's administration. In turn, the Trustee applied for a charge over the assets.

11 As I indicated in that decision, the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended and renamed by S.C. 1992, c. 27 (*BIA*) does not authorize the charging of trust assets. I concluded that, in order to do so, the Court must invoke its inherent jurisdiction. That jurisdiction is to be exercised sparingly and generally only if the work undertaken is for the benefit of the trust and the beneficiary would have had to have hired someone else to do the work performed by the party seeking the charge. Courts have varied in their interpretation of what constitutes work for the benefit of a trust.

12 In ***Re Westar Mining Ltd.*** (1999), 13 C.B.R. (4th) 289 (B.C.S.C.), a group of trust claimants asked for funding from estate assets to pay the legal fees for an application to exclude certain assets from distribution to the creditors. The court held that the legal work involved did not benefit the bankrupt's estate, nor was it necessary for the management and preservation of estate assets. Accordingly, it denied the application.

13 The court's inherent jurisdiction to grant a charge over trust assets was invoked in ***Eron Mortgage Corp. (Trustee of) v. Eron Mortgage Corp*** (1998), 2 C.B.R. (4th) 184 (B.C.S.C.), which involved an application similar to the present one. The court in that case appointed a judicial trustee and creditors' committee. The creditors' committee applied for a charge over trust assets to fund its fees and expenses.

The court acknowledged that its inherent jurisdiction permitted the granting of the charge, but it declined to do so because the application was premature and there was insufficient evidence to warrant it. Tysoe J. stated that he could not ascertain at that time what, if any, of the committee's efforts would benefit the trust assets, and suggested (at para. 38) that the issue likely would have to be dealt with on an instance-by-instance basis.

14 The individual Builder Claimants in the present case do not have a large stake in the outcome of these proceedings, and there is no evidence before me to show that they are in any different position than the creditors who were represented by a committee in ***Eron Mortgage***. As in ***Eron Mortgage***, there is nothing at this stage to show that the Committee's efforts will benefit the trust. If the assets sought to be charged eventually fall to the Bankrupts' estates because of the claims barred date or the inability of any given builder to establish a security or trust claim, the charge will have eroded the assets available for creditors of the estates. If Kingsway proves its claim, the same, of course, holds true.

15 In my view, the application by the Builders' Committee for a charge over the builders' cash deposits and letters of credit is premature. The application, therefore, is denied with leave to reapply on evidence when the Builders' Committee's efforts crystallize. Like the court in ***Eron Mortgage***, I observe that the issue of a charge may have to be addressed on an instance-by-instance basis.

III. Trustee's Charge

16 The Trustee has been administering the builders' deposits and letters of credit, although it may turn out that some or all of them are not included in the Bankrupts' estates and therefore are not available for distribution to the creditors. The Trustee has two choices, either abandon the property or seek a charge over it for payment of its fees and expenses in administering the builders' deposits and letters of credit . The Trustee considers it improper to simply abandon the property and therefore has chosen the latter course.

17 Having taken possession of the builders' deposits and letters of credit, the Trustee has answered inquiries from homeowners, homebuilders and Kingsway, acted as a liaison between them, and provided requested documents to Kingsway in relation to the property. In addition, it has brought applications concerning preservation of the builders' deposits and letters of credit, and for advice and directions respecting their administration. The Trustee in essence has quarterbacked efforts to sort out ownership of the property. Understandably, it wants the comfort of knowing that it will be compensated for its work in that regard.

18 The Trustee must analyze each claim carefully and only if it is determined that the claim is valid may it turn the property over to the claimant (*BIA*, s. 81(2); ***Ramgotra (Trustee of) v. North American Life Assurance Co.***, [1996] 1 S.C.R. 325, 37 C.B.R. (3d) 141. It is the claimant who has the onus of establishing a claim.

19 The Trustee considers it debatable whether the builders' deposits can be proved to be the subject of a trust. This view is based on recent decisions from the British Columbia Supreme Court dealing with the insolvencies of new home warranty businesses. For the most part, the trust claims of builders who provided cash deposits as performance security failed, and their cash deposits for that purpose became part of the general estate for distribution to the creditors [See ***Re New Home Warranty of British Columbia Inc.*** [***Value Developments Blackberry Road Inc.***] (2000), 29 C.B.R. (4th) 232, 2000 BCSC 1879, where a trust was established on the unique facts of the case; ***Re New Home Warranty of British Columbia Inc.*** [***Silversea Properties Ltd.***] (2001), 27 C.B.R. (4th) 301, 2001 BCSC 1112; ***430872 B.C. Ltd. v. New Home Warranty of British Columbia Inc. (Trustee of)*** (2002), 33 C.B.R. (4th) 257, 2002

BCSC 439, reversed on other grounds (2004), 50 C.B.R. (4th) 224, 2004 BCCA 186; and ***Re New Home Warranty of British Columbia Inc.*** [***Osoyoos Desert Developments Ltd.***] (2003), 42 C.B.R. (4th) 271, 2003 BCSC 731].

20 Based on the British Columbia Court of Appeal's decision in ***430872 B.C. Ltd.***, the Trustee is of the view that the letters of credit likely will not be considered trust property of the Builder Claimants, but also believes that they will not be available for distribution to the Bankrupts' general creditors. However, the Trustee cannot relinquish the letters of credit until it is determined which of the competing parties is entitled to them.

21 As a preliminary step in dealing with the builders' deposits and letters of credit, the Trustee must determine which insurance underwriter is interested in a particular asset. For example, some are exclusive to Kingsway and others to American Bankers. In terms of the letters of credit, the Trustee has retained a former employee of the Bankrupts and has ascertained construction completion dates. Tasks yet to be undertaken include the determination of when the letters of credit lapse and any necessary applications concerning entitlement.

22 The Trustee has not yet undertaken a detailed analysis of the actual or estimated future costs of administering the builders' deposits and letters of credit, but estimates that a charge equal to five percent of the value of those assets would be realistic. While I appreciate the Trustee's desire to have an amount fixed now for its sake and that of the Builder Claimants, so that they will know in advance what they will be paying and can make their decisions based on that knowledge, I am concerned that the Trustee's estimate may prove to be unrealistic. In my view, it is better to wait to see what the Trustee's actual charges are. In the end, this will be fairer to all concerned.

23 Given the peculiar circumstances of this case, it is appropriate that the Court exercise its inherent jurisdiction to charge the builders' deposits and letters of credit to secure the costs associated with their administration. The Trustee's work in that regard, broadly speaking, will benefit the ultimate beneficiaries or owners of the assets and it is only reasonable and practical that the costs of administration of those assets be charged against them. The present charge is for the Trustee's reasonable past and future actual fees and expenses, not to exceed five percent of the value of the builders' deposits and letters of credit. The reasonableness of the Trustee's fees and expenses will be determined at taxation on notice to the Builders' Committee, Kingsway, American Bankers, and any other party claiming an interest in the builders' deposits and letters of credit.

IV. Kingsway's Application for Control of the Builders' Deposits and Letters of Credit

24 Kingsway wrote insurance policies for some 50,000 homes before its relationship with the Bankrupts soured and it demanded payment and terminated its contract with RWI in 2003. Litigation ensued, following which Kingsway asked the Bankrupts to deliver up all of the letters of credit posted by builders as performance security. The Bankrupts declined to do so. Kingsway now asks the Court for an order requiring that they do. It is willing to bear the costs and responsibility associated with administering the builders' deposits and letters of credit if the Court agrees with its proposition.

25 American Bankers is the successor insurer to Kingsway. It required the Bankrupts to post funds to stand as a form of guarantee for any warranty which it might be required to pay out. American Bankers, together with the Trustee and Builder Claimants, opposes Kingsway's request for an order requiring that the builders' deposits and letters of credit be delivered up to it.

26 The following is representative of the wording used in the membership agreements signed by builders concerning the performance security to be posted with the Bankrupt, RWC:

> If a Letter of Credit, cash deposit, or other security is required of the Builder as a condition precedent to acceptance of the Builder as a member of the Program, the Builder agrees that RWC or the Program Insurer may draw upon the full amount of the Letter of Credit or the cash deposit, or enforce the security in the event that the Builder becomes indebted to RWC or the Program Insurer under the terms of this Agreement or any other agreement between RWC and the Builder. RWC may demand and collect the full amount of the Letter of Credit if a replacement Letter of Credit satisfactory to RWC is not delivered to RWC by the Builder at least 30 days prior to the expiration of any existing Letter of Credit held by RWC.

27 Kingsway has administered warranty claims since mid-2004. If a builder has been unwilling to effect repairs, Kingsway has hired a contractor to do the work and has demanded reimbursement from the member builder under the membership agreement. No evidence has been proffered as to whether Kingsway has sought access to builders' deposits and letters of credit since the bankruptcies. Similarly, there is no evidence as to whether it has commenced action against a builder rather than seek recourse to the builders' deposits or letters of credit, or elected not to litigate because of the modest value of a warranty claim.

28 Potential cost efficiencies might be realized by removing the Trustee as a "middle person." However, the potential prejudice to others overshadows any such benefit.

29 First, both Kingsway and American Bankers likely are to be considered "Program Insurers" within the meaning of the membership agreement with the attendant right to claim against the builders' deposits and letters of credit. The extent of potential overlap between policies underwritten by Kingsway and American Bankers is not yet known and the membership agreement does not allocate the builders' deposits or letters of credit to any particular "Program Insurer." If Kingsway controls the builders' deposits, it might draw these down to satisfy its claims in priority to the claims of American Bankers. Although American Bankers may hold other security, its right to recourse against the builders' deposits and letters of credit is not necessarily foreclosed.

30 Second, as previously stated, the builders' deposits have not yet been determined to be trust property. Each Builder Claimants' case will turn on its own unique facts. If there is no trust, the builders' deposits may fall to the Bankrupts' estates and be available for distribution to their general creditors. Those creditors may be prejudiced if Kingsway controls the builders' deposits and draws them down to satisfy its own claims. I am mindful that Kingsway has asserted, but not yet proven, a trust claim for premiums collected by the Bankrupts, which exceeds the value of all assets under the Trustee's administration. While Kingsway ultimately may succeed in proving its trust claim over the builder's deposits and letters of credit, that is not a certainty at this date.

31 Third, although Kingsway's contract with the Bankrupts provides that, in the event of an uncured default, all "records" will vest in Kingsway if it terminates the contract, it is not clear that the term "record" in the contract encompasses the letters of credit. In any event, whether there has been default under the agreement is a live issue and is the subject of Kingsway's appeal of the Trustee's disallowance of its claim. Furthermore, without making any determination as to the validity of Kingsway's claim in that regard, I observe that builders posted the letters of credit as performance security under the terms of the membership agreements to which Kingsway was not a party.

32 Fourth, Kingsway's contention that its unheeded pre-bankruptcy request for delivery up of the letters of credit entitles it to possession of the builders' deposits and letters of credit is unsustainable. An unheeded demand on a debtor does not equate to a right to take property from a trustee in bankruptcy. To find otherwise would defeat the objects and scheme of the *BIA*. It is only when a creditor establishes that the property in question is not property of the bankrupt within the meaning of s. 67 of the Act, or when the Trustee decides to renounce its interest in the property, that the Trustee must turn over possession. Neither scenario applies at this time.

33 Fifth, the issue is live as to what would happen to the builders' deposits and letters of credit if Kingsway is in possession of them but no claim is made on them under the warranty program.

34 Sixth, Kingsway's submission that, like an agent in a securities firm insolvency, it should have control of the builders' deposits and letters of credit on behalf of the Builder Claimants, draws on an analogy which is unhelpful. Specific provisions in Part XII of the *BIA* govern the administration of securities on the bankruptcy of a securities firm. There is no parallel provision in the *BIA* concerning the scenario at bar. In any event, Kingsway has not established an agency relationship with the Builder Claimants.

35 In my view, it would be inappropriate in all of these circumstances to allow Kingsway to assume physical control of the builders' deposits and letters of credit. Therefore, Kingsway's application fails. I am mindful that a Guideline circulated by the Insurance Council of British Columbia in 2006 says that insurers for home warranty insurance will be responsible for collecting builder security unless the insurer delegates that responsibility to an agent. The Guideline is not retroactive. More importantly, the wishes of the Insurance Council of British Columbia do not override this Court's jurisdiction and its determinations.

36 As I observed in my previous Memorandum of Decision in this case (2006 ABQB 236 at para. 28), trustees in bankruptcy are not an agent of the creditors nor of the debtors, but rather are administrative officials and officers of the court charged with the responsibility of looking after all parties' interests. Their job is to act as an independent voice of reason and to provide discipline in the oft-chaotic circumstances created on bankruptcy. The Trustee here is well suited to administering the builders' deposits and letters of credit and to assisting the Court and the parties in sorting out claims to these. The builders' deposits and letters of credit will remain in the Trustee's possession.

37 If necessary, costs may be spoken to within 30 days of the date of this Memorandum.

TOPOLNISKI J.

"Schedule A"

Bankruptcy #24 - 112232 Bankruptcy #24 - 112233

IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL DISTRICT OF EDMONTON
IN BANKRUPTCY

IN THE MATTER OF THE BANKRUPTCY OF
RESIDENTIAL WARRANTY COMPANY OF CANADA INC.
Estate No. 24- 112232

IN THE MATTER OF THE BANKRUPTCY OF
RESIDENTIAL WARRANTY INSURANCE SERVICES LTD.
Estate No. 24- 112233

BEFORE THE HONOURABLE	)	At the Law Courts, in the City
MADAM JUSTICE TOPOLNSKI	)	At the Law Courts, in the
IN CHAMBERS)	)	City of Edmonton in the Province of Alberta, on Thursday the ___ day of June, 2006.

ORDER

UPON THE APPLICATION of counsel for those Applicants listed on Schedule "A";

AND UPON HEARING counsel for the Trustee;

AND UPON READING the Affidavit of Tom Goode;

IT IS HEREBY ORDERED THAT:

1. A Builders' Committee is hereby certified and recognized to represent builders having deposits with one of the bankrupts in these proceedings at the time of the bankruptcy. The Builders' Committee is directed and authorized:

   a) to represent builders whose cash deposits or Letters of Credit (the "Deposits") are being withheld and to permit the Builders' Committee's representation and right of appearance in all matters and Court proceed ings in these actions, and for that purpose to instruct legal counsel as deemed appropriate;
   b) to bring applications in Court on matters concerning the interests of the builders and to conduct or participate in the appeals of any rulings made on such applications;
   c) to make representations to the Trustee and before the Court with respect to matters relating to the Deposits;
   d) to make representations to the Trustee or the Court regarding the commencement or prosecution by the Trustee of any related legal proceedings;
   e) to provide its own internal structure and rules for making decisions and for instructing counsel on the proceedings and representations to be brought before the Court;
   f) to enter and conduct negotiations with the Trustee and other parties on procedural and substantive matters, and to compromise and settle particular claims and matters in relation to the Deposits;
   g) to apply to the Court, on two (2) days' clear notice having been given to the Trustee and other interested parties, for a further order or advice and directions in relation to the powers and duties of the Builders' Committee.

2. The Builders' Committee shall initially consist of the members listed on Schedule "A" to this Order.
3. Walsh Wilkins Creighton LLP is hereby appointed as legal counsel to the Builders' Committee.
4. The Builders' Committee and any and all of its Members shall not incur any liability whatsoever (other than in respect of any form of gross negligence and willful misconduct)

as a result of its appointment or the appointment of its Members, or as a result of the performance of its duties, whether by the Builders' Committee or by its Members in their personal capacities or in their capacities as Members of the Builders' Committee.

Per: ______________________
J.C.Q.B.A.

Entered this ____ day of _____, 2006.

Clerk of the Court

SCHEDULE "A" to the Order

"To be completed"

BUILDER'S NAME	LOCATION

cp/e/qw/qlmmm/qljxl