TAB 13

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. 349

2006 ABQB 236

62 Alta. L.R. (4th) 168

393 A.R. 340

21 C.B.R. (5th) 57

149 A.C.W.S. (3d) 192

2006 CarswellAlta 383

Docket: 24 112232; 24 112233

Alberta Court of Queen's Bench
Judicial District of Edmonton

Topolniski J.

Judgment: March 24, 2006.
Filed: March 27, 2006.

(86 paras.)

Insolvency law -- Trustees -- Remuneration -- The application to stop the trustee from using estate assets to pay its fees and expenses was denied, and the trustee was granted a retrospective charge over the assets for all of its reasonable fees and disbursements, etc. -- If it were granted, Kingsway ultimately might be prejudiced if it proved its claims to the extent asserted, but that prospect remained an "if" -- The sheer magnitude of the claim was no reason to hold the trustee and the bankruptcy system at bay pending determination of its validity -- Common sense dictated that trustees in bankruptcy should receive reasonable compensation, or they would be inclined to shy away from problems and the list of persons willing to take on the job would dwindle.

The application to stop the trustee from using estate assets to pay its fees and expenses was denied, and the trustee was granted a retrospective charge over the assets for all of its reasonable fees and disbursements, etc. -- The applicant insurance company, which claimed roughly $11,200,000 pursuant to

contractual, statutory and common law trusts from the bankrupt companies, applied for an order declaring that the trustee in bankruptcy was not entitled to use the realizations of any assets and property for the purpose of paying its fees and expenses pending the hearing of the appeal on the amount they claimed was owing -- It also sought the return of all fees already paid out, and the appointment of the trustee as interim receiver of the assets for preservation purposes until the appeal was resolved -- The trustee asked for a charge on the estate assets in order to pay its fees and disbursements, and was concerned about being able to respond to the appeal for lack of funding -- Held: The application to stop the trustee from using estate assets to pay its fees and expenses was denied, and the trustee was granted a retrospective charge over the assets for all of its reasonable fees and disbursements, etc. -- If it were granted, the applicant ultimately might be prejudiced if it proved its claims to the extent asserted, but that prospect remained an "if" -- The sheer magnitude of the claim was no reason to hold the trustee and the bankruptcy system at bay pending determination of its validity -- Common sense dictated that trustees in bankruptcy should receive reasonable compensation, or they would be inclined to shy away from problems and the list of persons willing to take on the job would dwindle -- As for the prospective charge, it would be granted after the trustee filed a report confirming that the inspectors had approved the actions it proposed to take, including its involvement in the appeal -- That charge would cover all preliminary applications, etc.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, s.39(1), s.47.2, s.81, s.136

Counsel:

Brian Rhodes Dolden Wallace Folick

John I. McLean, Davis and Company, for Kingsway General Insurance Company

Kent Rowan, Ogilvie LLP, for Deloitte & Touche Inc.

MEMORANDUM OF DECISION

TOPOLNISKI J.:--

I. Nature of the Application

1 This Decision concerns retrospective and prospective funding of a trustee in bankruptcy from assets under administration when all of the assets are subject to a disputed trust claim that is far from being resolved.

2 Residential Warranty Company of Canada Inc. (RWC) and Residential Warranty Insurance Services Ltd. (RWI) (collectively the Bankrupts) are Alberta companies that operated a home warranty business. They were in the process of winding up when, in late 2004, Deloitte & Touche LLP was appointed their interim receiver (IR) in the context of a minority shareholder's oppression action. On the companies' deemed bankruptcy in May 2005 (Bankruptcies), Deloitte & Touche LLP became their trustee in bankruptcy (Trustee).

3 The Applicant, Kingsway General Insurance Company (Kingsway), was an insurance underwriter of home warranty policies brokered or administered by the Bankrupts in Alberta and British Columbia. Kingsway filed proofs of claim in the estates pursuant to s. 81 of the *Bankruptcy and Insolvency Act* (*BIA*)[1] claiming approximately $11,200,000.00 pursuant to contractual, statutory and common law trusts. The Trustee gave notice under s. 81(2) that the trust claim was disputed. It maintains that all or substantially all of the insurance premiums collected by the Bankrupts for insurance policies on which Kingsway is liable have been paid to Kingsway and that the balance of the estate of the Bankrupts is income derived from the operation of their home warranty business. Kingsway has appealed the Trustee's decision (Appeal).

4 Kingsway's trust claim arises from a series of transactions that are detailed in a broadly drafted Amended Statement of Claim (BC Action) which it filed in the British Columbia Supreme Court in June 2004, prior to the Bankruptcies. The Amended Statement of Claim is comprised of 125 paragraphs over 42 pages and contains allegations of breach of contract, fraud, conversion, breach of trust, breach of fiduciary duty. The Bankrupts, along with certain of their directors, officers, and employees, are named as defendants in the lawsuit.

5 Kingsway now applies for an order:

1. declaring that the Trustee is not entitled to use the realizations of any assets and property of the Bankrupts for the purpose of paying its fees and expenses, both past and future, pending the hearing of the Appeal and the disposition of the BC Action;
2. directing that the Trustee return all fees paid after notice of its trust claim, subject to deduction for reasonable fees directly attributable to preservation of the alleged trust property;
3. appointing the Trustee as Interim Receiver of the Bankrupts' assets under s. 47.1 of the *BIA* (*BIA* IR) for preservation purposes pending determination of the Appeal and the BC Action; and
4. requiring the Trustee to post security for costs in respect of its defence of the Appeal and the BC Action;

6 The Trustee's position is that resolution of the Appeal to finally determine the validity of Kingsway's claim is central to administration of the Bankruptcies. The Trustee is concerned about prejudice to other creditors and competing trust claimants if it is unable to respond to the Appeal for lack of funding.

7 In response to Kingsway's application, the Trustee asks for a retrospective and prospective charge on all of the estate assets under its administration in order to pay its fees and disbursements, including legal fees and disbursements. The Canada Revenue Agency (CRA), an unsecured creditor, and a builder, Nucon Developments, support the Trustee's request.

8 The parties on this application focussed squarely on the issue of Trustee funding. Kingsway did not pursue its request for security for costs and, while mention was made of its request for the appointment of the Trustee as a *BIA* IR in Kingsway's written submissions, no evidence or argument was offered to support the relief requested. In supplemental written submissions, Kingsway argued that super-priority' funding for a *BIA* IR under s. 47.2 of the *BIA* is not applicable in a "straight bankruptcy" like this. I took this submission to mean that it had abandoned this arm of its application.

9 Kingsway has applied for an order transferring the Appeal to the British Columbia Supreme Court

(In Bankruptcy) and for an order granting it leave to continue the BC Action "to be heard at the same time as the Appeal, subject to the direction of the Judge of the British Columbia Supreme Court hearing the BC Action". The applications and the Appeal were adjourned at the parties' suggestion. The applications are now set to be heard in mid May. Kingsway wants to await the outcome of its applications before scheduling the Appeal.

10 As Kingsway's application to have the Court in British Columbia deal with the Appeal has not been decided, my Ruling on the present application presumes that the Appeal will proceed in the ordinary course of events in this Court.

II. Background

A. The Bankrupts, the Builders and Kingsway

11 The Bankrupts brokered and administered residential warranty policies sold in Alberta and British Columbia to builders which were underwritten by Kingsway as the insurer of record. The builders paid for membership in the programs. Each of them also paid money by way of cash deposit or letters of credit as security for repairs covered by the warranty policies. The Bankrupts held the cash deposits in a segregated account. Provided a builder did not owe any money on expiry of the warranty period, the deposit would be repaid to the builder. Letters of credit were treated in a similar fashion.

12 Relations between Kingsway and the Bankrupts soured to the point where Kingsway terminated its contracts with them in August 2003, alleging that the Bankrupts had sold unauthorized products and had failed to remit certain premiums. The Bankrupts denied the allegations and the fight was on.

13 In the spring of 2004, Kingsway complained to the British Columbia Financial Institutions Commission (FICOM), British Columbia's insurance regulatory authority, about the Bankrupts' conduct. FICOM investigated the companies and RWI responded by surrendering its broker's license for three weeks. The Insurance Council of British Columbia subsequently allowed reinstatement of its license on conditions, one of which was that RWI hold approximately $3,100,000.00 in trust with its lawyers for premiums allegedly owed to Kingsway.

14 Kingsway commenced the BC Action in June 2004, claiming a minimum of $2,108,576.35 plus additional unascertained damages. It started a similar lawsuit in Alberta, but did not prosecute it. About three weeks after the BC Action was commenced, RWC paid $3,092,612.50 to Kingsway, unconditionally.

15 By the date of the Bankruptcies in May 2005, the defendants to the BC Action had defended and counter-claimed (alleging outstanding commissions, expenses, third party costs, lost income, lost opportunity, and loss of reputation) and Kingsway had demanded document production. Kingsway's forensic accountant apparently calculated the amount that remained owing to Kingsway from the Bankrupts as at June 7, 2005 to be $3,786,606.00. In late June 2005, after receiving certain financial information from the Trustee, Kingsway's forensic accountant determined that $11,292,224.00 (over and above the monies already paid by RWC), plus additional amounts for unliquidated damages, was still owing from the Bankrupts.

16 Kingsway filed proofs of claim in the Bankruptcies on September 2, 2005 and put the Trustee on notice of its claim and of the position that it was taking with respect to the Trustee's fees and expenses on October 4, 2005.

17 In late 2005, the police charged the Bankrupts, one of their former directors, and a former employee with fraud, theft, uttering a forged document and drawing a document without authority. An Information was sworn and warrants were held until December 15, 2005. I was not provided with any additional information on this application as to the current status of the criminal proceedings.

B. The Interim Receiver, The Trustee and Stakeholders

18 The order appointing the IR granted the IR a super-priority' charge over the companies' assets, giving it priority over all security, charges and encumbrances affecting the assets.

19 The IR, which is also the Bankrupts' Trustee, complied with the Court's directions to investigate the Bankrupts' affairs, dispose of certain assets and report on numerous concerns, including the BC Action and the builders' deposits. It prepared three reports for the Court. Kingsway contends that the IR's mention of the BC Action in its first report, dated December 21, 2004, constitutes evidence of notice to Deloitte & Touche LLP of Kingsway's trust claim, and that funding for the Trustee from alleged trust assets, which comprise the entire estate of both Bankrupts, should not be allowed after that date. It asserts that funding should not extend beyond October 4, 2005 at the very latest, when its counsel particularized its trust claim and formally put the Trustee on notice of the position which it now advances.

20 The assets under the Trustee's administration include bank accounts and claims against various parties, but the vagaries of the Bankrupts' business and their relationships with others have somewhat complicated the Trustee's work. Apart from the typical issues arising in any bankruptcy (financial analysis, securing assets, reviewing proofs of claim, reporting to and meeting with creditors and inspectors, and acting as the point person coordinating court matters), the Trustee has instructed litigation and dealt with winding up business operations. It has also addressed enquiries from policyholders and builder claimants about warranties and the refund of deposits relating to 550 properties.

21 Kingsway has referred some policyholders to the Trustee on denying coverage under various policies and it has jointly instructed some litigation with the Trustee. The Trustee has provided it with financial analyses and other information, including information concerning the Trustee's findings on premium payments.

22 The Trustee predicts that its future work will entail continued realization of assets through litigation efforts, including intended litigation against Kingsway to recover $1,500,000.00 in allegedly overdue profit sharing, and resolution of creditor and proprietary claims. In due course, it will wind up the estates, return property rightfully belonging to others, and distribute residual property to the creditors.

23 There are 627 persons interested in the builders' deposit fund and letters of credit (Builder Claimants). The builders' deposit fund is worth approximately $1,000,000.00 while the letters of credit are valued at approximately $5,000,000.00. Both Kingsway and the Trustee concede that many of the Builder Claimants have trust claims against the cash builders' deposits. The method by which builders' claims are to be proved in the bankruptcy and a claims bar date were set by Order in December 2005. Kingsway has agreed to that process.

24 Kingsway has participated in case management meetings and applications relating to the claims of the Builder Claimants. It has requested that it be given notice of claims that the Trustee disallows. It also

wants to participate in the Trustee's application for directions as to whether the letters of credit are impressed with a trust and appeals of the disallowance by the Trustee of some builders' claims. Kingsway maintains that it is entitled to all of the value of the letters of credit, although it has not indicated how these can be considered traceable trust assets. It also claims approximately $300,000.00 of the builders' cash deposit fund as a result of alleged setoffs owed to it by builders for the cost of repairs. Kingsway takes the position that once the claims of the Builder Claimants who are seeking access to the cash fund have been resolved in these bankruptcy proceedings, the Builder Claimants must "duke it out" with Kingsway in the ordinary courts to determine who is entitled to the funds.

III. Analysis

A. Fairness, Practicality and Neutrality

25 A significant objective of the *BIA* is to ensure that all of the property owned by the bankrupt or in which the bankrupt has a beneficial interest at the date of bankruptcy will, with limited exceptions, vest in the trustee for realization and ratable distribution to creditors. To further this objective, the *BIA* provides for practical, efficient and relatively inexpensive mechanisms for asset recovery, determination of the validity of creditor claims, and distribution of the estate. A fundamental tenet of *BIA* proceedings is that fairness should govern.

26 The *BIA* expressly preserves the Bankruptcy Court's equitable and ancillary powers.[2] Accordingly, inherent jurisdiction is maintained and available as an important but sparingly used tool. There are two preconditions to the Court exercising its inherent jurisdiction: (1) the *BIA* must be silent on a point or not have dealt with a matter exhaustively; and (2) after balancing competing interests, the benefit of granting the relief must outweigh the relative prejudice to those affected by it. Inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfilment of the substantive objectives of the *BIA*, including the proper administration and protection of the bankrupt's estate.[3]

27 Solutions to *BIA* concerns require consideration of the realities of commerce and business efficacy. A strictly legalistic approach is unhelpful in that regard.[4] What is called for is a pragmatic problem-solving approach which is flexible enough to deal with unanticipated problems, often on a case-by-case basis. As astutely noted by Mr. Justice Farley in ***Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.***[5]:

> While the *BIA* is generally a very fleshed-out piece of legislation when one compares it to the *CCAA*, it should be observed that s. 47(2)(c): "The court may direct an interim receiver ... to ... (c) take such other action as the court considers advisable" is not in itself a detailed code. It would appear to me that Parliament did not take away any inherent jurisdiction from the court but in fact provided, with these general words, that the court could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands". It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organised and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability.

28 Neutrality is the necessary mantra of trustees in bankruptcy. They are neither an agent of the creditors nor of the debtor, but rather are administrative officials and officers of the court charged with the responsibility of looking after all parties' interests. Trustees are obliged to comply with the

procedures and rules of conduct set out in the *BIA*, the code of ethics in the *BIA General Rules*[6] and with professional codes of conduct, and cannot enter the fray between competing stakeholders.[7] They must present the facts in a dispassionate, non-adversarial manner in matters before the court.[8] Their job is to act as an independent voice of reason and to provide discipline in the oft-chaotic circumstances created on bankruptcy.

B. Trust Property

29 Unless otherwise provided by legislation, trustees in bankruptcy have no greater interest in the property they are responsible for administering than the bankrupt does.

30 The property held by a bankrupt in trust for another is not divisible among the creditors of the bankrupt.[9] However, this does not mean that the res of the trust is not subject to administration by the trustee in bankruptcy. On the contrary, property held by the bankrupt in trust for a third party becomes part of the bankrupt's estate in the possession of the trustee in bankruptcy, who is obliged to administer the property and to deal with it in accordance with the law.[10]

31 Section 81(2) of the *BIA* governs the actions of a trustee in bankruptcy when presented with a trust claim. Within 15 days of presentation, the trustee in bankruptcy is either to admit the claim or to give notice disputing it, together with the reasons for doing so. There is no intermediate position which may be taken.

32 Section 81(2) reads:

> 81(2) The trustee with whom a proof of claim is filed under subsection (1) shall within fifteen days thereafter or within fifteen days after the first meeting of creditors, whichever is the later, either admit the claim and deliver possession of the property to the claimant or give notice in writing to the claimant that the claim is disputed with his reasons therefor, and, unless the claimant appeals therefrom to the court within fifteen days after the mailing of the notice of dispute, he shall be deemed to have abandoned or relinquished all his right to or interest in the property to the trustee who thereupon may sell or dispose of the property free of any lien, right, title or interest of the claimant.

33 The Trustee in the present case has performed a quasi-judicial function in assessing and disallowing Kingsway's claim. There is no suggestion that it acted unfairly in doing so or that it has somehow entered into the fray between competing stakeholders. The Trustee has simply done its job.

34 The Trustee agrees that the Bankrupts had trust obligations to Kingsway for unremitted premiums, but disagrees with Kingsway's assessment that all of the money collected by the Bankrupts from their customers represented premiums. It also questions the merit of Kingsway's constructive trust claim arising from alleged "secret commissions" and breach of fiduciary duty. Tracing will be an issue concerning Kingsway's claim to entitlement to the letters of credit and possibly other aspects of its claim.

35 The Act is silent about the trustee's responsibilities on an appeal from its rejection of a claim. However, s. 41(4) of the *BIA* provides that an estate is deemed to have been fully administered only when "a trustee's accounts have been approved by the inspectors and taxed by the court and all objections, applications, oppositions, motions and appeals have been settled or disposed of and all dividends have been paid".

36 In my view, the Trustee is a necessary party to the Appeal, which it is to participate in as an officer of the court, presenting the relevant facts in a dispassionate, non-adversarial manner, leaving the court to decide the matter. The Trustee's responsibility is to ensure that only valid claims to the assets under administration are recognized.

37 Kingsway has asserted a significant trust claim that might prevail at the end of the day, but at present that claim is merely an assertion - a fact that weighs heavily on this application.

38 The onus of establishing a trust at the date of bankruptcy will rest with Kingsway and the ordinary law of trust applies in that regard.[11] Kingsway has not yet proved its claim of a valid trust. It has procured an accounting expert's opinion that it relies on, but that opinion is untested. The BC Action was in the early stages when stayed by the Bankruptcies. Other proceedings dealing with the same series of transactions are seemingly over or similarly not far advanced. FICOM's investigation resulted in a three-week licence suspension, but no further action was taken, and the criminal proceeding is in its early stages.

C. Trustee Funding

39 In a typical bankruptcy, the trustee is paid from estate assets. Like all insolvency professionals, trustees in bankruptcy are or should be alive to securing payment of their fees, particularly for work in the initial stages of a bankruptcy until the asset base from which they can be paid is assessed. Trustees often look to the petitioning creditor for an indemnity for their fees. Here, the Bankruptcies occurred when proposal deadlines were not met and there is no petitioning creditor. However, other interested parties include the CRA, an unsecured creditor and the Builder Claimants.

40 Section 39(1) of the *BIA* provides that: "The remuneration of the trustee shall be such as is voted to the trustee by ordinary resolution at any meeting of creditors." However, if remuneration has not been fixed under 39(1), the trustee is entitled under s. 39(2) to insert in his final statement and retain as remuneration, subject to increase or decrease on application to the court, a sum not exceeding seven and one-half per cent of the amount remaining out of the realization of the property of the debtor after the claims of the secured creditors have been paid or satisfied.

41 Ordinarily, a trustee in bankruptcy will not be funded from trust assets unless it shows that its work was necessary to preserve or otherwise benefit the trust assets,[12] or the work was required for resolution of the trust claim or to sort out beneficiaries.

42 The first exception developed as a result of the court's exercise of inherent jurisdiction in ordinary trust cases, a topic reviewed in some depth by Sigurdson J. in ***Re Gill*** and Tysoe J. in ***Re Eron Mortgage Corp***.[13] The court's inherent jurisdiction in this regard has been exercised sparingly and generally in circumstances where the beneficiary would have had to hire someone else to do the work performed by the trustee.[14] The second exception flows from the trustee in bankruptcy's duty under the *BIA* to approve or disallow of claims.[15]

43 There is also statutory authority in Alberta which allows for the funding of ordinary trustees. The *Trustee Act*[16] authorizes the court to order compensation for "the trustee's care, pains and trouble and the trustee's time expended in and about the trust estate". This compensation is available regardless of whether the trusteeship arises by construction, implication of law, or express trust.[17] Trustees in bankruptcy can avail themselves of this legislation to the extent that it is not in conflict with the *BIA*.[18]

44 The Alberta Court of Appeal in ***Re Sproule Estate***[19] considered the intent and scope of s. 44 funding (then s. 39). Mr. Justice Haddad commented that:[20]

> My concept of the term care and management is consistent with the expressions to which I have referred. It connotes to me not only the responsibility of reasonable supervision and vigilance over the preservation or disposition of assets but also the responsibility of judgment and decision making in the affairs of an estate to resolve problems from time to time arising over and above the usual and regular procedures attendant upon administration.

45 The Trustee in the present case was obliged to gather in trust property, which vested in the Trustee, but it cannot distribute the res of the trust to creditors. The Trustee therefore has two capacities, one as trustee in bankruptcy and the other as an ordinary trustee arising by implication of law. If Kingsway prevails at the end of the day, the Trustee is entitled to seek compensation for its work "in and about the trust". In my view, the broad scope of compensable work discussed by Mr. Justice Haddad in ***Sproule*** includes identifying which assets, if any, are subject to a trust and, if doubt exists, placing the necessary information before the court for determination of that issue.

46 There are several notable cases in which trustees in bankruptcy have been denied or given only limited funding from trust assets. ***Re Broome, Re Shirt Man Inc.*** and ***Re Genometrics Corp.*** involved assets impressed with undisputed statutory trusts for employee withholdings. In ***Broome***, as here, the trust claims were to the entirety of the funds gathering in by the trustee.

47 ***Broome*** concerned employee tax withholdings. Master Bowne described his ruling as:[21]

> ...A signal to trustees that where there are trust claims, before undertaking work with a view to realization of assets to benefit trust fund recipients, the trustee would be advised to make arrangements that remunerations would be paid by the administrator of the trust or otherwise.

48 Master Browne said in *obiter dicta* that even if the funds in the estate exceeded the amount of the trust claims, the expenses and fees which the trustee would be entitled to claim from the estate assets under s. 107 (now s. 136) of the *BIA* would not include indemnity for any work done which did not result in a benefit to the creditors. This aspect of the decision was qualified in ***Re Pugsley***,[22] an appeal of a registrar's taxing order which disallowed legal fees incurred by the trustee in obtaining an opinion on the validity of a trust claim asserted by Revenue Canada under s. 59 of the *Bankruptcy Act*, R.S.C. 1970, c. B-3 (now s. 81 of the *BIA*). Mr. Justice O'Driscoll in that case held that the comment of Master Browne in ***Broome*** should not be extended or expanded to include the assessed costs of legal counsel retained by the trustee to provide such legal services. He did not consider it logical that a trustee would be entitled to pay counsel for the opinion if in the end the proof of claim was adjudged invalid, but not if the claim was upheld, even though technically there was no benefit to the creditors in obtaining the opinion.

49 The debtor in ***Re CJ Wilkinson Ford Mercury Sales Ltd.***[23] sought a charge over statutory trust assets, again employee withholdings, to fund his legal counsel. The court denied the application, commenting that it would not allow money owned by one person to be paid over to another person so that he could pay it to yet another person.

50 ***Grant v. Ste. Marie Estate***[24] involved a summary trial in the ordinary courts, a bankrupt rogue, a finding of a valid express trust and competing claimants. The plaintiff was granted leave to proceed with his lawsuit against the bankrupt. The issue was whether the plaintiff, a victim of the bankrupt

defendant's fraud, could trace funds that he had paid to the bankrupt into the hands of the trustee in bankruptcy.

51 Mr. Justice Slatter found that the bankrupt had used words of trust to reassure the plaintiff. He ruled that the trustee's investigative work was instrumental in precluding improper payouts to others and thereby benefited the plaintiff. Likening the trustee to a *bona fide* purchaser for value without notice, he allowed encroachment on the trust property to pay certain expenses to the extent they related to the trustee's dealings with the traced funds, but only to the date the trustee received notice of the trust claim.

52 Slatter J. noted that the trustee's fees and expenses relating to general administration of the estate were a legitimate expense of the estate. Where trust funds are used to discharge a debt owed to the recipient of the funds, there is a giving of value and no tracing to the recipient is permitted.[25] Therefore, he reasoned that the trustee's payment of legal expenses and even its own fees prior to receiving notice of the trust precluded the trust claimant from tracing those funds and defeated the beneficiary's interest to that extent. He commented[26] that:

> ... the Trustee is an officer of the Court, and a necessary part of the bankruptcy regime, and the discharge of the estate's obligation to pay the Trustee should also be considered as the giving of value. Before receiving notice of the Plaintiff's claim the Trustee was a bona fide purchaser for value without notice, and the Plaintiff cannot recover the portion of funds used to discharge the legitimate expenses of the estate.

53 ***Re Westar Mining Ltd.***[27] addressed the issue from the opposite perspective. A group of trust claimants sought funding from estate assets to pay legal fees for their application to exclude certain assets from distribution to the creditors. The court held that the legal work did not benefit the bankrupt's estate nor was it necessary for the management and preservation of estate assets. The court was unmoved by the claimants' plea that it would be unfair to them to have to retain counsel when counsel for the trustee, who was paid for by the estate, represented the other creditors.

54 The court in ***Re Ridout Real Estate Ltd.***[28] charged trust funds that ultimately were held to belong to realty vendors and purchasers, brokers and salespersons with payment of the fees of a trustee in bankruptcy. The only mention of the trustee's work in connection to the trust assets was that he received a deposit and brought an application for directions concerning distribution of the assets. Presumably, this was sufficient to warrant compensation. The case report refers only to trust funds in the trustee's hands. There is no mention made as to whether there were any residual assets in the bankrupt's estate.

55 In ***Re NRS Rosewood Real Estate Ltd.***,[29]the court awarded the trustee in bankruptcy $25,000.00 in compensation from trust monies as it was satisfied that issues between the stakeholders had to be resolved by the court and it was the trustee's initiative which had caused that to happen. Apparently, there were some residual assets in that case.

56 Mr. Justice Urquhart in ***Re Nakashidze (No. 2)***[30] allowed the trustee compensation from securities that were not property of the bankrupt, noting that the trustee had undertaken a vast amount of work in sorting out and assembling the securities and claims. However, he reached a contrary conclusion in ***Re Frederick McLeod***,[31] finding that the trustee in bankruptcy was not entitled to compensation from proprietary assets because the proprietary claimant rather than the trustee had "salvaged" the asset. Nevertheless, he did indicate that any work undertaken by the trustee could be taken into account when the estate was wound up in fixing his general compensation.

57 ***Re Walter Davidson Ltd.***[32] involved a dispute between a secured creditor claiming under a general assignment of book debts, mechanics' lien claimants and unsecured creditors. The court ultimately ruled in favour of the statutory lien claimants, but held that it was the trustee in bankruptcy's efforts which had

made the money available to the lien claimants and therefore charged the trust assets with payment of the trustee's fees.

58 Like Kingsway, the miners' lien claimants in ***Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.***[33] protested funding of the insolvency professional. Funding in that case was pursuant to a super priority' charge granted under s. 47.2 of the *BIA*. In refusing the claimants' application, Mr. Justice Farley described the interim receiver's work as "providing discipline to the proceedings" and noted that the interim receiver had to be capable of exercising its own independent judgment. He commented as follows on the status of the applicants' claims in ***Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.***:[34]

> ...Secondly, it would seem to me that one should not presume what one is hopeful of establishing (i.e. the MLA claimants have not yet proved the validity and priority of their liens). Thirdly, while it should be recognized that the IR may be funded, there is no assurance that it will "win"; it may "lose" in whole or in part. However, at least there will be the testing of the Royalty Claim for the benefit of all creditors who have a valid claim against ***Curragh***...
>
> ... Simply put, it comes down to a question of cutting through the Gordian Knot: one does not know at this stage whether these opposing MLA claimants have a valid and prior claim. It seems to me that the amount of funding is reasonable in the circumstances and would be modest investment in the process.

59 The trustee is an integral part of the bankruptcy system. The claims review process is designed to ensure that only proper claimants are entitled to share in the bankrupt's property. The Trustee, at least in this case, is a necessary party to the Appeal. Kingsway should succeed only if it has a legitimate claim and not simply by default. To rule otherwise would be to open the door for possible abuse of the system by rogue claimants filing spurious proprietary claims.

60 If a charge is granted, Kingsway ultimately may be prejudiced if it proves its claim to the extent asserted, but that prospect remains an "if". The sheer magnitude of its claim is no reason to hold the Trustee and the bankruptcy system at bay pending determination of its validity. Mr. Justice Farley's words in ***Curragh*** resonate ... "one should not presume what one is hopeful of establishing".[35]

D. Charge on the Assets

61 Kingsway contends that an asserted trust claim valued at more than potential realizations, regardless of its facial merit, forces the trustee in bankruptcy to seek funding for an appeal of its disallowance of the claim from sources other than the assets under administration. It contends that responsibility to fund the Trustee falls on the shoulders of other creditors or claimants, whether by means of direct funding or an assignment under s. 38 of the *BIA*. Given the nature of the claims in these Bankruptcies, I disagree. The validity and priority of the trust claims must be determined. The Trustee is assisting the Court and all of the claimants in coordinating these matters and in providing the necessary information to resolve these issues.

62 The Trustee is not asking for a retrospective charge over undisputed statutory employee withholdings, as were the (unsuccessful applicant) trustees in bankruptcy in ***Broome***, ***Shirt Man*** and ***Genometrics***. Nor is the Trustee seeking a prospective charge over undisputed statutory employee withholdings like the bankrupt in ***C.J. Wilkinson Ford Mercury Sales***.

63 Mr. Justice Slatter held in ***Grant*** that the trustee in that case could not use the trust funds after receiving notice of the proprietary plaintiff's claim. It is unclear what position the trustee in that case took concerning the trust claim (offering financial and documentary information to the court does not equate to disputing the claim), what work, if any, it undertook after notice of the trust claim, and whether there were residual assets from which it could be funded. This is not surprising given that the case was not about trustee compensation or the charging of trust assets.

64 The role of the Trustee here is more akin to that of the trustees described in ***Ridout Real Estate***, ***NRS Rosewood***, ***Nakashidze (No.2)***, ***Walter Davidson Ltd.***, and ***Frederick McLeod***, each of whom was successful in obtaining a retroactive charge over established trust assets for their work in gathering and preserving trust assets or in sorting out the trust claims.

65 In ***Pugsley***, Mr. Justice O'Driscoll commented that a trustee should be able to pay counsel for their opinion and services in regard to a proof of claim whether the claim eventually is adjudged invalid or not. He reasoned that if the trustee cannot hire and remunerate counsel to process the claims, counsel to a trustee might refuse to do so because of the potential for non-remuneration. In his view, that would put the trustee in a "no win" situation with regard to legal advice and legal services regarding proofs of claim.

66 ***Sproule*** is also responsive to the "no win" situation identified by Mr. Justice O'Driscoll in ***Pugsley***.

67 Common sense dictates that trustees in bankruptcy should receive reasonable compensation when they are called on to exercise their judgment and to be real problem solvers in a situation such as the present one. If it were otherwise, trustees would be inclined to shy away from problems and the list of persons willing to take on the role of trustee would dwindle, particularly in situations where there was no personal connection between the potential trustee and the beneficiary or the assets under administration.

1. Retrospective Charge

68 Kingsway's application is denied. The Trustee is entitled to a charge on the assets under administration for its fees and expenses in undertaking work on the estate to date. Presuming success for Kingsway in the end, a significant part of the Trustee's work will have benefited Kingsway, given that its claim is to all of the assets under administration. Furthermore, the Trustee is entitled to compensation for all of its work to date in sorting out Kingsway's claim. The Trustee has offered its assistance to Kingsway in related proceedings concerning proposals made by various directors and officers of the Bankrupts, it has formulated a plan that Kingsway has joined in for resolving claims by Builder Claimants, it has coordinated and attended case management meetings, and it has argued a preliminary arm of Kingsway's jurisdictional application.

69 I have taken Kingsway's choices regarding process into consideration in determining whether it is appropriate to grant the Trustee a retrospective charge on the contested assets for its fees and disbursements. Kingsway has chosen to make a preliminary application to move the Appeal to British Columbia. It wants to continue the BC Action. While it is entitled to bring these applications, it cannot ignore the logical consequences of doing so. These applications, and others which it has brought in parallel proceedings relating to the proposals made by various officers and directors of the Bankrupts, have and will continue to delay the ultimate decision about the validity of Kingsway's trust claim. Kingsway wants to take advantage of the bankruptcy proceedings to have this Court determine the validity of the claims of the Builder Claimants and whether the letters of credit are impressed by a trust,

but to force builders with trust claims against which it alleges a right of setoff to "duke it out" in the ordinary courts. Finally, I observe that Kingsway did not seek an expedited hearing for this or its other applications.

70 Kingsway's application to stop the Trustee from using assets under its administration to pay its fees and expenses is denied and the Trustee is granted a retrospective charge over the assets under its administration for all of its reasonable fees and disbursements, including legal expenses, concerning the gathering in and preserving of assets in the estate and the general administration of the Bankruptcies, such as investigating Kingsway's trust claim. The charge is granted no matter what the outcome is of the Appeal.

71 If an appeal court decides that the retrospective charge should be restricted to fees and expenses relating to work undertaken before the Trustee had notice of Kingsway's claim, as in ***Grant***, I offer my finding that reasonable notice did not occur until November 25, 2005. The reasons for my finding in this regard are:

1. The Trustee's work in its capacity as IR was at the Court's behest. Like the insolvency professional in ***Ontario (Registrar of Mortgage Brokers) v. Matrix Financial Corp.***,[36] it is entitled to payment from trust assets for all work done prior to the Bankruptcies.
2. The Trustee, as IR, indicated in its reports to the Court between December 2004 and May 2005 that:

(i) the BC Action existed;
(ii) it had a concern about Kingsway's calculation of premiums owing;
(iii) it was premature to opine on the merits of the BC Action, but once that could be done, a decision would be taken to settle, vigorously defend or purse damages by counter-claim.

3. The allegation of breach of trust in the BC Action is just one of many claims in a broadly cast pleading. The filing of pleadings in a civil action does not mean that the plaintiff will pursue its claim in a bankruptcy.
4. It was not until October 4, 2005 that Kingsway's counsel particularized its trust claim and formally put the Trustee on notice of the position which it now asserts.
5. Kingsway's Notice of Motion was filed November 25, 2005. That is the date on which the clock should run.

2. Prospective Charge

72 ***Gill*** is the only reported bankruptcy case that specifically addresses prospective charges over trust assets. As might be expected, the decision there turned on the unique facts of the case. There were allegations that the bankrupt had been involved in a scheme to hide his interest in certain properties by having them registered in the names of others. The trustee filed 350 caveats to preserve the interests of creditors and potential proprietary claimants. Information about the extent of the trust property and the claimants was uncertain at the date of the application. The trustee sought a retrospective and prospective charge over the yet unascertained trust assets.

73 Mr. Justice Sigurdson found that the application for a prospective charge was premature, but

granted leave to the trustee to reapply on evidence of creditor prejudice. He noted that the trustee's request would ripen when valid trust claims were established and sale proceeds were ready for distribution. He was concerned that affected parties should have notice of the application, an impossibility at the time of the application given that the trustee did not know who they were.

74 The facts in ***Gill*** are distinguishable from those in the present case. Unlike the situation in ***Gill***, the Trustee's application here is not wholly premature. It is clear that Kingsway and the Builder Claimants advance trust claims. The value of Kingsway's claim is established. Values of the assets under administration are known, subject to some further collection efforts and potential litigation recoveries from actions against Kingsway. The trust claims have not been substantiated at present. That alone is not sufficient reason to defer the Trustee's application.

75 ***Eron Mortgage*** was followed in ***Gill*** and therefore merits brief discussion, although the facts in that case also are distinguishable. ***Eron Mortgage***involved the judicial trusteeship of an insolvent company. A court sanctioned lenders' committee sought a charge over (what appear to be undisputed) trust assets to secure past and future payment of expenses and remuneration.

Mr. Justice Tysoe concluded that he could exercise inherent jurisdiction to order the charge, but declined to do so, although he gave leave to the committee to reapply. His rationale for declining the charge was that the evidence was unclear about certain committee functions. He considered that it was premature to say what future efforts, if any, would benefit the trust assets.

76 In my view, it is clear in the present case that resolution of Kingsway's claim will benefit the trust claimant if it succeeds. Similarly, the creditors are entitled to have Kingsway's claim tested, presuming the Inspectors agree to the Trustee's involvement in the Appeal.

77 The Trustee's request, however, is not just for a charge over potential trust assets in relation to the Appeal, but for a charge in relation to furthering the general administration of the Bankruptcies, including the Appeal. I understand that the Trustee intends to seek a charge over the assets at issue in the Builder Claimants' matter. However, even excluding that work, the proposed charge encompasses more than the case law presently authorizes for sorting out claims and preserving trust assets. It is a request for a general "super priority" funding order like that available to *BIA* interim receivers under s. 47.2, to judicial receivers, and to debtors in *Companies' Creditors Arrangement Act*[37] proceedings for financing a restructuring (DIP or priming liens).

78 Except in the context of commercial restructuring cases under the *BIA*,[38] caution must be exercised when considering developments concerning inherent jurisdiction emanating from the *CCAA*. The *BIA* and *CCAA* are very different in degree of specificity and the policy considerations involved. For example, courts in *CCAA* proceedings routinely rationalize financing for commercial restructuring that compromises creditors' traditional interests in the name of the greater good. There is an overarching policy concern favouring the possibility of a going concern solution and the potential of a long-term upside value for a broad constituency of stakeholders.[39] Arguably, in some cases, super-priority financing and priming charges must be available if restructuring is to be a possibility.

79 Here, the policy consideration is not to facilitate a potential business survival, but rather to maintain the integrity of the bankruptcy system and to be fair, while recognizing established trusts law.

80 According to the court in ***Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd***,[40] "super priority" funding for judicial receivers ordinarily is limited to circumstances where either:

1. The receiver's appointment is at the request of or with the consent or approval of the holders of security.

2. The receiver's appointment is to preserve and realize assets for the benefit of all interested parties, including secured creditors.
3. The receiver has expended money for the necessary preservation or improvement of the property.

81 In my view, a prospective charge can be fashioned which will respect these limitations. Since the assets under administration are bank accounts and chose in action, the Trustee's work for general estate administration can be restricted to matters of some urgency. If the Appeal is dealt with in a timely fashion, significant hardship to the creditors can be avoided and Kingsway can be offered some assurance deductions from the assets over which it is claiming a trust will be minimized. I appreciate, however, that some litigation may be time sensitive. Therefore, the Trustee is granted leave to revisit this restriction on evidence of prejudice to the creditors by delaying litigation.

82 A prospective charge will be granted on the Trustee filing a report with the Court confirming that the Inspectors in these Bankruptcies have approved the actions which the Trustee proposes to take, including its involvement in the Appeal and all of the preliminary applications filed by Kingsway that may be heard prior to the Appeal. On the filing of that report, the prospective charge will cover the preliminary applications, the Appeal *per se*, and all steps to readying the Appeal for hearing, whether it is a "paper Appeal" or a directed trial of an issue. Conservative measures for asset maintenance and preservation also are covered by this prospective charge. However, the Trustee may not pursue new asset realization without leave of the Court or Kingsway's consent.

83 The Appeal will proceed on an expedited basis after the hearing of Kingsway's preliminary jurisdictional applications. Any application to have the Appeal dealt with by way of a trial of an issue is to be filed within 14 days of these Reasons and made returnable on May 12, 2005. If there is no such application, a case management meeting will be held May 12, 2005 for the purpose of setting deadlines for the exchange of affidavits, cross-examinations on affidavit and the filing of written submissions.

84 If, as a result of the Appeal, Kingsway establishes a recoverable trust of the magnitude claimed, it will have suffered a loss by virtue of the charge. Nevertheless, that loss will have been incurred, broadly speaking, to benefit the trust in realizing assets and to determine entitlements. If it is held that all of the assets under administration are not impressed with the trust claimed by Kingsway, a hearing is to be held in order to determine out of which funds (i.e. any trust monies owing to Kingsway, any trust monies owing to the Builder Claimants or other parties with a proven trust claim, and the monies to be distributed to creditors), and in what proportion the Trustees' fees and expenses (once approved) are to be taken.

3. Builder Claimants

85 The retrospective and prospective charges which I have granted have the potential to affect the Builder Claimants if they are successful at the end of the day in establishing entitlement to some of the assets under administration. There is no evidence that the Builder Claimants have been given notice of this application. Accordingly, I direct that the Trustee serve the Builder Claimants with notice of my decision. The charges which I am granting will not take effect on any monies claimed by the Builder Claimants until 14 days after the Trustee has filed proof with the Court of service of these Reasons on all of the Builder Claimants. Prior to that time, the Builder Claimants may challenge the charges which I am granting the Trustee over that portion of the assets to which they claim an interest.

4. Costs

86 Costs of this application will be determined following the Appeal. If the Appeal does not proceed for some reason, the parties may return on notice to settle the issue of costs.

TOPOLNISKI J.

cp/e/qw/qlmmm/qljxl

1 R.S.C. 1985, c. B-3, as amended and renamed by S.C. 1992, c. 27

2 s. 183(1)

3 ***Re Tlustie*** [1923] O.J. No. 663, (1923), 3 C.B.R. 654, 23 O.W.N. 622 (S.C.); ***Re Cheerio Toys & Games Ltd.*** [1971] 3 O.R. 721, 15 C.B.R. (N.S.) 77 (H.C.J.); varied [1972] 2 O.R. 845 (C.A.)

4 ***A. Marquette & Fils Inc. v. Mercure*** , [1977] 1 S.C.R. 547 at 556 (S.C.C.)

5 (1994), 114 D.L.R. (4th) 176 at 185, 27 C.B.R. (3d) 148 (Ont. Ct. (Gen. Div.))

6 Rules 34-53

7 ***Re Rassell*** (1999), 177 D.L.R. (4th) 396, 237 A.R. 136, 12 C.B.R. (4th) 316 (C.A.); ***Re Nagy***, [1997] 10 W.W.R. 348, 199 A.R. 146, 45 C.B.R. (3d) 160 (Q.B.); reversed on other grounds [1999] 11 W.W.R. 48, 232 A.R. 399, 13 C.B.R. (4th) 1 (C.A); ***Engles v. Richard Killen & Associates Ltd.*** (2002), 60 O.R. (3d) 572 at para. 150, 35 C.B.R. (4th) 77(Sup. Ct. Just.)

8 ***Re Beetown Honey Products Inc.*** (2003), 67 O.R. (3d) 511, 46 C.B.R. (4th) 195 (Ont. Sup. Ct. Just.); affirmed (2004), 3 C.B.R. (5th) 204 (Ont. C.A.)

9 s. 67(1)(a)

10 ***Ramgotra (Trustee of) v. North American Life Assurance Co.***, [1996] 1 S.C.R. 325, 37 C.B.R. (3d) 141 at para. 61

11 s. 81(3); ***Re Kenny*** (1997), 149 D.L.R. (4th) 508, 37 C.B.R. (4th) 291, 1997 CarswellOnt 6031, 34 O.T.C. 321 (Ont. Ct. (Gen. Div.))

12 ***Re Gill***, (2002) 37 C.B.R. (4th) 257, 2002 BCSC 1401 at para. 23; ***Grant v. Ste. Marie Estate***, (2005) 39 Alta. L.R. (4th) 71, 8 C.B.R. (5th) 81 at paras. 30 and 31, 2005 ABQB 35; ***Re Westar Mining Ltd.*** (1999), 13 C.B.R. (4th) 289, 1999 CarswellBC 2149 (S.C.); ***Re Broome***, (1986) 61 C.B.R. (N.S.) 233 (Ont. S.C.); ***Re CJ Wilkinson Ford Mercury Sales Ltd.*** (1986), 60 C.B.R. (N.S.) 289 (Ont. H.C.J.); ***Re Shirt Man Inc.*** (1987), 65 C.B.R. (N.S.) 309, 19 C.C.E.L. 148 (Ont. S.C.); ***Re Genometrics Corp.***, [2005] S.J. No. 714, 2005 CarswellSask 790, 2005 SKQB 488; ***Re Frederick McLeod*** [1949] O.J. No. 357, 1949 CarswellOnt 88, 29 C.B.R. 163 (S.C.(H.C.J.))

13 (1998), 53 B.C.L.R. (3d) 24, 2 C.B.R. (4th) 184 (S.C.)

14 ***Re Eron Mortgage Corp.***, footnote 14; ***Harris v. Conway***, [1989] 1 Ch. D. 32, [1989] B.C.L.C. 28, [1988] 3 All E.R. 71 (Eng. H.C.); ***Ontario (Securities Commission) v. Consortium Construction Inc.*** (1992), 9 O.R. (3d) 385, 14 C.B.R. (3d) 6 (C.A.); ***Ontario (Registrar of Mortgage Brokers) v. Matrix Financial Corp.*** (1993), 106 D.L.R. (4th) 132 (Ont. C.A.)

15 ***Re Ridout Real Estate Ltd.*** (1957), 36 C.B.R. 111 (Ont. H.C.J.); ***Re NRS Rosewood Real Estate Ltd.***, (1992) 9 C.B.R. (3d) 163 (Ont. Ct. (Gen. Div.)); ***Re Nakashidze (No. 2)***, [1948] O.R. 254, 29 C.B.R. 35 (H.C.J.); ***Re Walter Davidson Ltd.*** (1957), 10 D.L.R. (2d) 77, 36 C.B.R. 65 (Ont. H.C.J.)

16 R.S.A. 2000, c. T-8, s. 44. The Act expressly permits charging of trust assets for the fees of judicial trustees, but otherwise is silent.

17 *Trustee Act*, footnote 16, s. 1(b)

18 *BIA*, footnote 1, s. 72(1); see also the discussion concerning operational conflict in ***Multiple Access Ltd. v. McCutcheon***, [1982] 2 S.C.R. 161 at 190: "[T]here is no true repugnancy in the case of merely duplicative provisions since it does not matter which statute is applied; the legislative purpose of Parliament will be fulfilled regardless of which statute is invoked by a remedy-seeker; application of the provincial law does not displace the legislative purpose of Parliament." In my view, the overarching principle to be derived from ***Multiple Access Ltd.***and later cases is that a provincial enactment must not frustrate the purpose of a federal enactment, whether by making it impossible to comply with the latter or by some other means. Impossibility of dual compliance is sufficient but not the only test for inconsistency.

19 (1979) 95 D.L.R. (3d) 458, 13 A.R. 420 (C.A.)

20 ***Re Sproule Estate***, footnote 20, para. 11

21 ***Re Broome***, footnote 12, pp. 236 tp 237

22 (1988), 63 O.R. (2d) 635, 67 C.B.R. (N.S.) 98 (S.C.)

23 footnote 12

24 footnote 12

25 D.M. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors" (1989), 68 Can. Bar Rev. 315 at 321

26 footnote 12 at para. 31

27 footnote 12

28 footnote 15

29 footnote 15

30 footnote 15

31 footnote 12

32 footnote 15

33 [1994] O.J. No. 1917 (Ont. Ct. (Gen. Div.)) (QL)

34 1994 CarswellOnt 3853 at paras. 8 and 9 (Ont. Ct. (Gen. Div.))

35 footnote 34 at para. 8

36 footnote 14

37 R.S.C. 1985, c. C-36

38 ***Fiber Connections Inc. v. SVCM Capital Ltd.*** (2005), 10 C.B.R. (5th) 192, 5 B.L.R. (4th) 271, 2005 CarswellOnt 1963 (Sup. Ct. Just.), leave to appeal to Ont. C.A. granted (2005) 10 C.B.R. (5th) 201.

39 ***Re Royal Oak Mines Inc.*** (1999), 6 C.B.R. (4th) 314 (Ont. Ct. (Gen. Div.)); David B. Light, "Involuntary Subordination of Security Interests to Charges for DIP Financing under the *Companies' Creditors Arrangement Act*," (2005) 30 C.B.R. (4th) 245.

40 (1975), 21 C.B.R. (N.S.) 201 at 205-206 (Ont. C.A.)