Abstract
This essay draws together material published separately in *The Law of Finance 1e*, *Equity & Trusts 6e*, *The Law of Trusts 2e* (with Geraint Thomas), and *The Law of Finance (Practitioner Edition, 1e)*. Its aim is to explain *Quistclose* trusts, and particularly Lord Wilberforce's speech in the root decision from a banking law perspective. It is suggested that his lordship's speech makes perfect sense only if we step away from an obsession with trying to decide "which form of trust it is" and instead think about how common law and equity combine to protect a lender in a loan transaction.

QUISTCLOSE TRUSTS CONSIDERED FROM A BANKING LAW PERSPECTIVE

The competing analyses of the Quistclose trust in trusts law

There is a particular form of security which is used in relation to loans known as a *Quistclose* trust.[1] A *Quistclose* trust is created by operation of law whenever the parties to a loan include a term in the loan to the effect that the loan moneys can only be used for a specified purpose. A *Quistclose* trust is generally analysed by trusts lawyers[2] on the basis that if the borrower were to go into insolvency, then a trust would be implied over the loan moneys so that those loan moneys are held on trust for the lender and are not therefore to be distributed among the insolvent person's estate. So, in *Barclay's Bank v. Quistclose Investments Ltd*[3] Rolls Razor Ltd borrowed money from Quistclose. A condition was placed on the loan to the effect that the money was only to be used to pay a dividend to Rolls Razor's preferred creditors. The loan moneys were paid into an account held with Barclays Bank. Rolls Razor went into insolvency before the dividend was paid. Barclays Bank sought to offset the money in the bank account against Rolls Razor's overdraft on its general account with Barclays Bank. The House of Lords upheld a resulting trust over the loan moneys such that Quistclose was held to have an equitable interest under a trust in those loan moneys, such that the loan moneys could not be distributed among any of the unsecured creditors (such as Barclays Bank) in Rolls Razor's insolvency.

The other way of conceiving of a *Quistclose* trust, from a banker's perspective, is that the inclusion of a term which imposes a condition on the borrower's use of the loan moneys will grant the lender of that money an equitable interest in those moneys, unless and until the money is used for the specified purpose at which point the equitable interest must cease to exist.[4] Thus, a form of security can be taken in relation to lent moneys by the inclusion of such a term in the loan contract.

A further analysis of the *Quistclose* trust would consider it to be a form of retention of an equitable interest by the lender. The minority speech of Lord Millett in the House of Lords in *Twinsectra v Yardley* suggested that the *Quistclose* trust should be considered to be akin to a retention of title by the lender such that the lender effectively retains an equitable interest in the property throughout the transaction, such that the property is held on resulting trust for the lender.[5] His Lordship held that:

[1] Derived from the decision in *Barclay's Bank v. Quistclose Investments Ltd* [1970] AC 567.
[2] Alastair Hudson, *Equity & Trusts* (6th ed, 2009), Chapter 22; Geraint Thomas and Alastair Hudson, *The Law of Trusts* (2nd ed., 2010).
[3] [1970] A.C. 567.
[4] If the loan contract's condition once satisfied did not cause the equitable interest to terminate, then the loan itself would be impossible to perform because the borrower would not effectively be able to spend the loan moneys. Instead, once the loan moneys are used for the specified purpose in accordance with the loan contract, then the lender's proprietary rights in those moneys must disappear, and instead the lender is left with rights in the law of contract.
[5] Lord Millett was clear that the trust was still a resulting trust.

> '… the *Quistclose* trust is a simple, commercial arrangement akin … to a retention of title clause (though with a different object) which enables the borrower to have recourse to the lender's money for a particular purpose without entrenching on the lender's property rights more than necessary to enable the purpose to be achieved. The money remains the property of the lender unless and until it is applied in accordance with his directions, and in so far as it is not so applied it must be returned to him. I am disposed, perhaps predisposed, to think that this is the only analysis which is consistent both with orthodox trust law and with commercial reality.'[6]

The lender could therefore be taken to retain the equitable interest in loan moneys throughout the life of the contract.[7]

The second sentence is very problematic: "The money remains the property of the lender unless and until it is applied in accordance with his directions, and insofar as it is not so applied it must be returned to him." There is a clear contradiction in terms here: if the money *remains* the property of the lender then how can it possibly be *returned* to him? If I retain property then I cannot possibly ask you to return it to me later because I have kept it. Imagine that you ask to borrow my umbrella because it is raining and I refuse to lend it to you, if I were then to come to you the next day and demand that you return my umbrella you would say "well, you kept your umbrella so how can you possibly have it returned to you?" It is the same problem with Lord Millett's formulation here: if the lender retains the money, it cannot logically be returned to him. What we might take Lord Millett to mean is that *ownership* of the money in equity remains with the lender even if *possession* of the money is passed to the borrower, such that the borrower has to return *possession* of the money to the lender. Similarly, Lord Millett's reference to "the property" is unclear because we cannot know if it means retention of absolute title (which would negate the possibility of there being a trust) or whether it is supposed to mean only retention of an equitable interest under a trust.

The following paragraph from Lord Millett's speech also presents problems; it is paragraph 100 in that judgment:

> 'As Sherlock Holmes reminded Dr Watson, when you have eliminated the impossible, whatever remains, however improbable, must be the truth. I would reject all the alternative analyses, which I find unconvincing for the reasons I have endeavoured to explain, and hold the Quistclose trust to be an entirely orthodox example of the kind of default trust known as a resulting trust. The lender pays the money to the borrower by way of loan, but he does not part with the entire beneficial interest in the money, and in so far as he does not it is held on a resulting trust for the lender from the outset. Contrary to the opinion of the Court of Appeal, it is the borrower who has a very limited use of the money, being obliged to apply it for the stated purpose or return it. He has no beneficial interest in the money, which remains throughout in the lender subject only to the borrower's power or duty to apply the money in accordance with the lender's instructions. When the purpose fails, the money is returnable to the lender, not under some new trust in his favour which only comes into being on the failure of the purpose, but because the resulting trust in his favour is no longer subject to any power on the part of the borrower to make use of the money. Whether the borrower is obliged to apply the money for the stated purpose or merely at liberty to do so, and whether the lender can countermand the borrower's mandate while it is still capable of being carried out, must depend on the circumstances of the particular case.'

[6] [2002] 2 All ER 377, 398-399.
[7] *Ibid*, 398, para 80. This approach was followed in *Re Margaretta Ltd, Freeman v Customs and Excise* [2005] All ER (D) 262, *per* Crystal QC (sitting as a Deputy Judge in the High Court), para [15] *et seq*.

Again, as with the paragraph quoted immediately above, there is a problem in that we are told that the money "remains throughout in the lender" and yet that "the money is returnable to the lender". Furthermore, the *Quistclose* trust is held explicitly to be a resulting trust, even though ownership of the money is said to *remain* with the lender. Therefore, this is not a resulting trust as Prof Birks has explained it because a resulting trust ordinarily requires that equitable ownership of the property has passed away and that it then "jumps back" (as Birks suggests property does in a resulting trust) to the lender. That cannot happen if the lender *retains* equitable ownership of the loan money throughout the loan contract. Alternatively, we must reject Prof Birks's analysis of a resulting trust and instead accept that Lord Millett has established that resulting trusts are merely a "default trust" in which a court of equity simply recognises that when there is a question as to the ownership of property then we should recognise that the last owner of that property is still its owner. This is the analysis of resulting trusts in general which I have advanced elsewhere,[8] to whit: an automatic resulting trust operates in circumstances in which it is unclear who is the owner of property to declare that the property is held on trust for the last person who was undoubtedly the owner of that property.

We are told that the borrower has merely a power to use the money for the described purpose (just like a power).[9] The money is said "to be returnable to the lender" (oddly even though the lender has nevertheless retained equitable ownership of it) because the power disappears (apparently) once it is not performed. In the final sentence, Lord Millett acknowledges that the precise nature of the parties' obligations will depend upon the precise terms of the contract between them. Therefore, we have a very stylised form of resulting trust in the speech of Lord Millett. This model is necessary for Lord Millett's analysis and yet Lord Millett delivered a dissenting speech in the House of Lords, and as such it is difficult to know what the force of this model is in English trusts law. What is important to note is that subsequent cases have supported it, and thus have lent it some gravitas. It is nevertheless suggested that the better analysis would be to infer the existence of an express trust (just as in *Re Kayford*[10]) from the circumstance.

A banking law analysis of the Quistclose trust

Much of the commentary – judicial and otherwise – which has been devoted to the nature of *Quistclose* trusts has been generated in the context of trusts law. However, it is important to consider exactly what Lord Wilberforce held and how a banking lawyer would understand those dicta. If Lord Wilberforce's speech is considered through the lens of traditional banking law, then it is considerably easier to understand. In essence, Lord Wilberforce was arguing for a type of *Quistclose* trust which operates as a *sui generis* "equitable right"[11] by which equity balanced out the ordinary banking law understanding at common law of the transmission of property rights during an ordinary loan. In *Barclays Bank v Quistclose*, the main argument advanced by Barclays Bank was that there was only a loan contract at common law between Quistclose and Rolls Razor, and under banking law there is a clear principle that loan contracts and contracts for bank accounts in themselves do not create a trust relationship.[12] That much is well-established banking law. The question, therefore, was whether or not there was any reason for the recognition of an equitable proprietary interest on the part of Quistclose in the loan moneys. More particularly, it was a question as to whether or not the common law of contract (governing the loan) and equitable principles

[8] Alastair Hudson, *Equity & Trusts* (6th edn, Routledge Cavendish, 2009), Chapter 11.
[9] See Alastair Hudson, *Equity & Trusts*, Chapter 3.
[10] [1975] 1 WLR 279.
[11] [1970] AC 567, 581-582.
[12] *Foley v Hill* (1848) 2 HL Cas 28, 9 ER 1002, 1005, *per* Lord Cottenham LC.

entitling the lender to a proprietary right could be understood as overlapping with one another. Lord Wilberforce found an equitable proprietary right to the loan moneys on the precise facts of that case, in line with earlier cases like *Re Rogers*, because the loan contract contained a statement of a limited purpose for which the loan money could be used.[13] His lordship also found that common law and equity worked together to provide that right in appropriate circumstances. It is important to dwell a little on the precise words which Lord Wilberforce used. His lordship held[14] that

> "It is not difficult to establish precisely upon what terms the money was advanced … to Rolls Razor Ltd. There is no doubt that the loan was made specifically in order to enable Rolls Razor Ltd. to pay the dividend … and for no other purpose".

The parties' contractual purpose was clear, therefore: the money was to be used only for a limited purpose. Lord Wilberforce continued, demonstrating how common law and equity intertwined:[15]

> There is surely no difficulty in recognising the co-existence in one transaction of legal and equitable rights and remedies: when the money is advanced, the lender acquires an equitable right to see that it is applied for the primary designated purpose:[16] when the purpose has been carried out (i.e., the debt paid) the lender has his remedy against the borrower in debt: if the primary purpose cannot be carried out, the question arises if a secondary purpose (i.e., repayment to the lender) has been agreed, expressly or by implication: if it has, the remedies of equity may be invoked to give effect to it, if it has not (and the money is intended to fall within the general fund of the debtor's assets) then there is the appropriate remedy for recovery of a loan.

This passage means that there is no conceptual problem with having obligations at common law (that is, to repay the loan) and obligations in equity (that is, to hold the money on trust until it is used for the specified purpose) existing simultaneously. Thus, if the purpose is performed then the lender has rights against the borrower at common law under the terms of the contract (i.e. "has his remedy in debt"). The "secondary obligation" arises in equity either on the express terms of the contract or impliedly from the circumstances. The "remedies of equity" in this context are the "secondary trust" which requires that the loan money is held on trust if it is not used for the specified purpose. Interestingly, though, Lord Wilberforce expressed this in terms of being a general "equitable right" rather than explicitly as being a resulting trust.[17] Interestingly, therefore, whereas much of the modern commentary focuses on the sort of trust which a *Quistclose* trust should be understood to be, Lord Wilberforce actually explained it as being an equitable right in general terms.

A similar formulation has been used by Lord Millett in *Twinsectra v Yardley,*[18] and approved by Evans-Lombe J in *Cooper v PRG Power Ltd,*[19] to the effect that "when the money is advanced, the lender acquires a right, enforceable in equity, to see that it is applied for the stated purpose, or more accurately to prevent its application for any other purpose": again, the right here is being explained as being an equitable ability to prevent misuse of the

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13 [1970] AC 567, 581.
14 [1970] AC 567, 581.
15 [1970] AC 567, 581-582.
16 *In re Rogers*, 8 Morr. 243, *per* both Lindley LJ and Kay LJ.
17 Because the House of Lords was asked specifically in this appeal whether or not a resulting trust came into existence, we must assume that they are therefore upholding the existence of a resulting trust on this appeal even though the expression "resulting trust" is not used by Lord Wilberforce.
18 [2002] 2 AC 164, para [69].
19 [2008] BCC 588, para [13]. It is an interesting feature of that case that a *Quistclose* trust was considered possible even though there was no loan contract in existence.

money. As Lord Wilberforce continued:

> "I can appreciate no reason why the flexible interplay of law and equity cannot let in these practical arrangements, and other variations if desired: it would be to the discredit of both systems if they could not. In the present case the intention to create a secondary trust for the benefit of the lender, to arise if the primary trust, to pay the dividend, could not be carried out, is clear and I can find no reason why the law should not give effect to it."

Therefore, the *Quistclose* trust arises from the interplay of the ordinary principles of the contract of loan at common law and the equitable principles which prevent ownership of the loan money being passed to a third party if it is misused. The manner in which the *Quistclose* trust arises then is by means of a "secondary trust" coming into existence for the benefit of the lender if the "primary trust … cannot be carried out".

Three points emerge. First, this trust was based on that inter-action of primary and secondary trusts being the intention of the parties, an idea which has been approved in subsequent cases.[20] For example, in *Abou-Rahmah v Abacha*[21] it was held that there could not be a *Quistclose* trust if the parties' intentions were that money was paid "unconditionally" from one to the other. Secondly, this does not require that the borrower must have misused the money; instead, it only requires that the purpose "cannot be carried out" for whatever reason, whether because of the borrower's insolvency or some other event. Thirdly, this form of trust must be a resulting trust because the equitable interest arises for the first time once the primary purpose cannot be carried out. It is this last conceptualisation of the *Quistclose* trust as a resulting trust which we should pursue into the model advanced by Lord Millett in *Twinsectra v Yardley*.[22]

It should be noted that the decided cases have focused on the *Quistclose* arrangement arising by operation of law, and not by an express trust. This raises two issues. First, there are commentators[23] and courts in Australia[24] which have expressed the view that this arrangement as being analysed better as an express trust (formed by inference from the loan contract[25]) with a power for the borrower to use the money for the purpose specified in the loan, as opposed to being a resulting trust. Secondly, it is suggested that the parties would be ill-advised to create a loan with the principal means of taking security in that arrangement being by means of a trust doctrine which is created by implication by the court – and which differently constituted courts seem to be interpreting differently from one another – as opposed to being specified in detail by the parties. Instead, it is suggested, that the parties would be better advised to use an express trust which they create by means of detailed provision in their loan agreement. Indeed, the lender would be better advised – if it is so concerned about the credit worth of the borrower – to hold the loan money in a separate account so that title in the money is retained absolutely by the lender until such time as it is to be applied for the contractually specified purpose, at which point *the lender* should make the payment directly to the intended recipient instead of paying it to a borrower whom it does not trust.[26]

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[20] *Re Niagara Mechanical Services International Ltd (in admin.)* [2001] B.C.C. 393; *Shalson v Russo* [2003] EWHC 1637 (Ch); [2005] Ch. 281 ; *Cooper v PRG Power* [2008] BCC 588.
[21] [2005] EWHC 2662 (QB), [2006] 1 Lloyd's Rep 484.
[22] [2002] 2 AC 164.
[23] See, for example, Alastair Hudson, *Equity & Trusts* (Routledge-Cavendish, 2009), section 22.4.3.
[24] *Re Australian Elizabethan Theatre Trust* (1991) 102 ALR 681, 691, *per* Gummow J.
[25] As in *Re Kayford* [1975] 1 WLR 279, where an express trust was formed by inference from the parties' actions.
[26] See Alastair Hudson, *Equity & Trusts* (Routledge-Cavendish, 2009), section 22.4.7.

The utility of a Quistclose trust when the loan moneys have been paid away

The real significance of the *Quistclose* trust in practice is often something different, however. What is little discussed in the decided case law is the following practical problem. Suppose that a lender lends money to a borrower subject to a contractual provision that the money be used for only a specified purpose. Then suppose that the borrower spends the money on some other purpose. Once that money has been spent, it is perfectly possible that the money will be impossible to locate – it may have been paid overseas, or it may have been paid rapidly through a series of bank accounts and mixed with other money. Suppose then that the original loan money has become inextricably mixed with other moneys in a bank account.[27] In this context the lender's only remedy would be by virtue of an equitable tracing action into the mixed fund in which the traceable proceeds of the original loan moneys rest.[28] Such a tracing claim into a mixture can only be brought in equity.[29] Such an equitable tracing claim can only be brought if the claimant had some equitable proprietary interest in the loan moneys from the outset.[30] An ordinary loan contract will not create an equitable interest. So, it is only the *Quistclose* trust which creates an equitable interest for the lender and therefore the *Quistclose* trust will enable the lender to commence that equitable tracing action. No other claim would grant any property right in such a mixed fund.

[27] In this context, "fund" is the word which property lawyers tend to use to encompass any holding or mixture of property which may include a bank account, or a trust fund, or even a heap of tangible property.
[28] The doctrine of loss of the right to trace will clearly be at issue here.
[29] See Alastair Hudson, *The Law of Finance*, para 24-06.
[30] *Westdeutsche Landesbank v Islington* [1996] AC 669; *Boscawen v Bajwa* [1996] 1 WLR 328, [1995] 4 All ER 769.