22.3 THE FUNDAMENTALS OF *QUISTCLOSE* TRUSTS

22.3.1 *Quistclose* trusts in outline

A general definition of the Quistclose trust

Commercially-speaking, a *Quistclose* trust is a means by which a lender of money can retain a "security interest" in loan moneys by inserting a clause into the loan contract which provides that the borrower may use those loan moneys only for specified purposes. If the borrower uses the money for some other purpose, then a trust is imposed on the moneys in the lender's favour. This form of trust is particularly significant as a means of protecting the lender against the borrower's insolvency because the loan moneys are treated as being held on trust for the lender and therefore are not distributed in the insolvency proceedings as part of the insolvent borrower's estate. Even if the borrower remains solvent after lending the money then the lender has a right under the *Quistclose* trust to recover the loan moneys or to trace those loan moneys into the hands of any third party who has received them in breach of the loan contract.

While this will serve as an adequate description of the commercial usefulness of a *Quistclose* trust a number of complex legal questions arise.[1] First, it will be important to identify precisely what sort of "security interest" the lender acquires. Secondly, it will be important to know whether the lender "retains" a right in the original loan moneys throughout the life of the loan contract, or whether that right only comes into existence for the first time when the borrower disobeys the terms of the loan contract, or whether the right comes into existence in some other way. Thirdly, it will be important to know what form of trust – express trust, resulting trust, constructive trust, or some other construct – best explains the *Quistclose* trust. Fourthly, while all of the preceding issues have generated a complex legal literature in the abstract, it may be important to consider how the precise terms of any loan contract alter the appropriate analysis on the facts of any given case. Before turning to these questions, however, we should consider chronologically the cases which have given rise to the modern *Quistclose* trust concept.

[1] See, for example, Thomas & Hudson, 2004, 292 *et seq*; Priestley, 1987, 217; Ricketts, 1991; Bridge, 1992; Payne, 2000; Chambers, 1997, Ch 3; Worthington, 1996, Ch 3; Thomas, 1998, 260; and more generally Swadling (ed), 2004.

The source of Quistclose trusts

The *Quistclose* trust takes its name from the decision of the House of Lords in *Barclays Bank v Quistclose*.[2] The principle in *Barclays Bank v Quistclose* in turn derives from a number of earlier decisions including *Hassall v Smither*.[3] In short, where a transferor transfers property subject to a contractual provision that the transferee is entitled only to use that property only for limited purposes, then the transferee will hold the property on trust for the transferor in the event that the property is used for some purpose other than that set out in the contract. Significantly, in the event that the transferee purports to transfer rights to some third party in breach of that contractual provision, the transferor is deemed to have retained its rights under a trust which will preclude the transferee from acquiring rights in that property. At present the *Quistclose* arrangement has been applied only to loan moneys but, as Worthington suggests, there is no reason in principle why it should apply only to money and not to other forms of property.[4] This issue is discussed below.[5] The following discussion will examine the *Quistclose* decision and the various explanations for the nature of the trust created.

22.3.2 The decision in *Barclays Bank v Quistclose*

The decision in Barclays Bank v Quistclose itself

In *Barclays Bank v Quistclose*[6] a loan contract was formed by which Quistclose lent money to Rolls Razor Ltd on the condition that the loan moneys were to be used solely for the payment of dividends to its preferred shareholders. That money was held in a share dividend bank account separate from all other moneys. Memorably, Harman LJ described Rolls Razor as being 'in Queer Street' at the time – referring to the fact that the company had already exceeded its overdraft limit with the bank on its general bank account and was clearly in financial difficulties. The specific purpose for the loan, after negotiation between Quistclose and the company, was to enable the company to pay a dividend to an identified category of shareholders but it was a condition of this arrangement that the loan money was not to be used for any other purpose. In the event Rolls Razor went into insolvency before the dividend was paid. Therefore, the loan money rested in a bank account held with Barclays Bank without being paid in fulfilment of the term of the loan contract. Rolls Razor's bank accounts with Barclays Bank were in overdraft: an overdraft is, in effect, a loan made by a bank to the person who is entitled to draw on the overdraft. Therefore if a bank uses money to pay down an overdraft then it is using that money to pay off a loan owed to it. Once Rolls Razor had become insolvent, Barclays Bank was concerned to pay off the overdraft which it had provided to Rolls Razor. Consequently, Barclays Bank argued that it should be entitled to set-off the money held in the share dividend account against the overdraft which Rolls Razor had with the bank. Quistclose contended that the money in the share dividend account was held on trust for Quistclose and therefore that the bank was not entitled to set that money off against the outstanding overdraft on Rolls Razor's other account.

The House of Lords decided that the loan money held separately in the share dividend bank account should be treated as having been held on trust for Quistclose. The trust was said to have come into existence on the basis that the specified purpose of the loan had not been performed and that the loan moneys were purportedly being used for a non-authorised purpose. Furthermore, the House of Lords held unanimously that the money in the share dividend account was held on resulting trust for Quistclose.

Lord Wilberforce upheld the resulting trust in favour of Quistclose on the basis that it was an implied term of the loan contract that the money be returned to the Quistclose in the event that it was not used for the purpose for which it was specifically lent. Lord Wilberforce found that there were two trusts: a "primary trust" (which empowered Rolls Razor to use the money to pay the dividend) and a "secondary trust" (which required Rolls Razor to hold the money on resulting trust for the bank if it was not used to pay the dividend). As his Lordship held:

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[2] [1970] AC 567.

[3] (1806) 12 Ves 119; *Toovey v Milne* (1819) 2 B & Ald 683, (1819) 106 ER 514.

[4] Worthington, 1996, 63. See now also *Farepak Food & Gift Ltd* [2006] All ER (Dec) 265 (D).

[5] Section 22.4.9.

[6] *Barclays Bank v Quistclose Investments Ltd* [1970] AC 567.

> 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.

From this proposition we can derive the general principle that *Quistclose* trusts take effect as resulting trusts by means of this two-level, primary/secondary trust structure.

Examples of Quistclose trusts

The case of *Twinsectra v Yardley*[7] gives us another factual example of circumstances in which a *Quistclose* trust might arise. In that case moneys were lent by Twinsectra to Yardley. Twinsectra wanted the security of knowing that the loan moneys would only be used for specified purposes which were specified in the loan contract. Yardley's solicitor was also required to give a formal undertaking to Twinsectra as to the proper use of the money. The first solicitor was replaced by a second solicitor, Leach, who followed Yardley's instructions to use the money in accordance with Yardley's instructions: those instructions were in breach both of the terms of the loan contract and also of the terms of the undertaking which the first solicitor had given and which by Leach had agreed to be bound. The loan money was spent and Yardley was unable to repay the loan, so Twinsectra sought to recover their loss. This case is discussed in detail in section 20.2.5 in relation to Leach's potential liability for the misuse of the loan money. Lord Millett, in a minority speech, held that this arrangement had also created a *Quistclose* trust because their was a contractual limitation on the use of the loan moneys. None of the other law lords expressed a view on the detail of the *Quistclose* trust question in their speeches. The precise nature of the *Twinsectra* trust suggested by Lord Millett is considered below; for the present we are simply trying to understand the sort of factual bases on which a *Quistclose* trust will come into existence.

Another example of a *Quistclose* trust arose in *Templeton Insurance Ltd v Penningtons Solicitors LLP*[8] a case in which money was lent by Templeton to clients of Penningtons, a firm of solicitors, to purchase a "brown-field" development site. These moneys were lent on the condition that the loan moneys would be held by Penningtons subject to a solicitor's undertaking that the money was to be used to complete the purchase of that land or, in the event that the sale could not be completed, on the condition that the loan money would be held in Pennington's client bank account on trust for the lender. It was held that this constituted a *Quistclose* trust in favour of Templeton.

There are numerous other examples on the cases. Most of the cases require that the loan contract identify a single, specific use of the loan moneys. In *Re Northern Developments Holdings Ltd*,[9] the loan money was paid for 'the express purpose of providing money for the subsidiary's unsecured creditors over the ensuing weeks and for no other purpose' and consequently a *Quistclose* trust was upheld. In *Re EVTR*[10] the loan money was advanced 'for the sole purpose of buying new equipment', with the same result. Similarly, in *General Communications Ltd and Development Finance Corporation of New Zealand Ltd*[11] the loan money was paid 'for the express purpose' of purchasing new equipment, with the result that a *Quistclose* trust was found.

Outright transfers of the loan moneys mean there is no Quistclose trust.

A *Quistclose* trust requires that the loan moneys are transferred subject to a specific obligation to use the moneys only for a specified purpose. There will not be a *Quistclose* trust if the loan moneys are transferred outright to the borrower, as would be the case in an ordinary loan contract, without any obligation to use the loan moneys only for a specified purpose being imposed on the borrower.[12] Otherwise, there is a tendency for claimants who have had their property misused to seek to claim that the defendant *ought*

[7] [2002] 2 AC 164.
[8] [2006] EWHC 685.
[9] Unreported, 6 October 1978, *per* Megarry V-C.
[10] [1987] BCLC 646.
[11] [1990] 3 NZLR 406, 432.
[12] *Abou-Rahmah and Others v Abacha and Others* [2005] EWHC 2662 (QB), [2006] 1 Lloyd's Rep 484.

to have used that property for such-and-such a purpose, and so that a *Quistclose* trust should be taken to have arisen over the property, even though there was no contractual provision which required such a use of that property.[13]

The structure of the rest of this chapter.

So much for the precise facts of the decisions which have illustrated the decision in *Barclays Bank v Quistclose*: the issue now is to identify what type of a trust a *Quistclose* trust is. To do this we will need to examine a range of different analyses which have been proposed in cases after the decision of the House of Lords in *Quistclose*. As we identify each different analysis we will pause to consider whether or not each argument is watertight before moving on to the next analysis. Therefore, we shall consider arguments for resulting trust, express trust and constructive trust in that order. As will emerge below, the speech of Lord Millett in *Twinsectra v Yardley*[14] has received a great deal of support although,[15] it is suggested, there are some gaps in its logic: this approach is considered last.

22.4 CATEGORISING THE *QUISTCLOSE* TRUST

22.4.1 The issue

Categorising the *Quistclose* trust within the pantheon of established forms of trust is problematic. The real problem is explaining the nature of the rights of the lender, the rights of the borrower and the time at which those rights come into existence. This two-layered trust structure used by Lord Wilberforce in *Barclays Bank v Quistclose* (combining a primary and a secondary trust) is unique to the case law in this area – although it would be possible to create a complex express trust which mimicked it. What is significant is that the *Quistclose* trust will be imposed in circumstances in which the parties to a loan contract have been silent as to the precise construction which is to be placed on their contract. The courts have not yet considered a contract which expressly imposed a categorisation on its trust: the suggestion which is made below is that such an express categorisation would be decisive of the question. For present purpose we shall have to consider this question in the abstract. It should be recalled that the House of Lords in *Barclays Bank v Quistclose* has used the expression 'resulting trust' to describe this arrangement.[16] It is with this analysis that we shall begin.

22.4.2 Resulting trust

The argument for resulting trust: are there two different types of resulting trust here?

The first explanation of the nature of a *Quistclose* trust, which was accepted by Lord Wilberforce in *Barclays Bank v Quistclose*, is that the *Quistclose* trust transfers the equitable interest in the loan moneys back to the lender on resulting trust. This analysis suggests that title in the loan moneys passes away from the lender to the borrower, under Lord Wilbeforce's "primary trust", before then bouncing back to the lender on resulting trust when the "secondary trust" comes into existence at the moment when the borrower has breached the terms of the loan contract. It should not be forgotten that the lender also retained rights to sue at common law for breach of contract, if the defendant were solvent. Lord Wilberforce held that it was clearly the "mutual intention" of the parties on these facts that the loan moneys should not become part of the assets of Rolls Razor Ltd but rather that those moneys were to be used to pay the dividend.[17] Indeed, his Lordship held that this was "the essence of the bargain".[18]

[13] *Re Foodpak Food & Gift Ltd* [2006] All ER (D) 265.
[14] [2002] 2 AC 164.
[15] See for example, Underhill and Hayton, 2002 and *Templeton Insurance Ltd v Penningtons Solicitors LLP* [2006] EWHC 685.
[16] *Ibid*, and *Westdeutsche Landesbank v Islington* [1996] AC 669, *per* Lord Browne-Wilkinson.
[17] *Barclays Bank v Quistclose* [1970] AC 567, 580.
[18] *Ibid*.

By contrast, as is considered in greater detail below, Lord Millett in the House of Lords in *Twinsectra v Yardley*[19] recognised that this sort of trust is a resulting trust[20] but Lord Millett's explanation of the resulting trust form of *Quistclose* trust was that the lender retained ownership of the equitable interest in the loan moneys throughout the life of the transaction.[21] Therefore, this resulting trust would not really involve any property "jumping back" to the lender (as a resulting trust, taken literally, is supposed to do[22]): instead the resulting trust would be recognising that the lender had had some equitable ownership of the loan moneys until the borrower used them for their proper purpose. If the loan moneys were not used for their proper purpose, then the resulting trust would recognise the continued equitable ownership on the part of the lender. (There are, however, difficulties with the way in which Lord Millett expresses this idea, as considered below at para 22.4.5.)

The *Quistclose* approach can be distinguished from the transaction at issue in *Westdeutsche Landesbank v Islington*[23] (which denied the existence of any proprietary rights on resulting trust to effect restitution of unjust enrichment in general terms) on the basis that the moneys paid in that case were transferred outright without any condition being placed on their use – although it should be remembered that Lord Browne-Wilkinson did expressly accept that a *Quistclose* trust is a form of resulting trust. The *Quistclose* trust, by distinction, operates only in circumstances in which there is a condition attached to the purpose for which the loan moneys are to be used. The principle reason for supporting a resulting trust in favour of the lender appears to be that, if the court held otherwise, it would permit the borrower to affirm the transaction in part (by taking the loan moneys and passing that money to creditors on insolvency) but to refuse to be bound by the condition that the property could only be used for a specified purpose.[24]

Therefore, on this analysis, the *Quistclose* trust would appear to operate such that the borrower has title to the money at common law and is entitled to dispose of it in the way provided for in the contract subject to the fact that equity prevents the borrower from using that money for any purpose other than the purpose set out in the loan agreement. Consequently, the lender retains an interest in the money on resulting trust principles throughout the life of the transaction which entitles the lender to recover that property if the purpose is not carried out. The fact that this interest appears to be continuous throughout the transaction is the element which gives rise to the argument that this trust is resulting trust, rather than a new constructive trust imposed by the court when the borrower seeks to act unconscionably.

On this analysis the *Quistclose* right appears to be similar to the *Romalpa* clause under which a person who transfers property to another for the purposes of a contract expressly retains title in that property during the life of the contract. As such, it should properly be said that the right comes into existence at the time that the contract is created. Therefore, the lender should be treated as holding that right in the property from the moment of the creation of that contract.

Against a resulting trust: the equitable interest comes into existence too late

The principal problem with Lord Wilberforce's model of the *Quistclose* trust is explained by reference to the diagram set out immediately below. That problem concerns the fact that a resulting trust will only come into existence once the loan moneys have been misused and therefore the lender's security interest is created only after there has been a breach of contract. Therefore, it is suggested, that this security interest will come into existence too late to be of use in many circumstances. The time sequence in a *Quistclose* transaction should be understood as operating in the following way:

Day 1: Loan contract entered into	**Day 2**: Loan moneys transferred	**Day 3**: Borrower breaches the term in	**Day 4**: Lender seeks to recover the loan

[19] [2002] 2 AC 164.
[20] [2002] 2 AC 164, para [100].
[21] See Thomas and Hudson, 2004, 293.
[22] See 11.1, where the expression resulting trust is said to derive from the Latin "resalire" meaning to "jump back".
[23] [1996] AC 669.
[24] *Re Rogers* (1891) 8 Morr 243, 248, *per* Lindley LJ.

between lender and borrower, including a provision that the borrower use the money only for a specific purpose.	at common law to borrower.	the loan contract by using the money for an unspecified purpose.	moneys as a result of the breach of the term in the loan contract.

It is not necessary in practice that these events take place on different "days"; and so you may prefer to think of them as "stages"; although I do think that breaking them out into different "days" makes the explanation easier. So, to consider the table. The loan moneys are transferred outright to the borrower on Day 2. The borrower is the absolute owner of the loan moneys on Day 1. The loan moneys are then paid away by the borrower on Day 3. Lord Wilberforce's resulting trust analysis says that the secondary trust only comes into existence once the moneys have been misused. Therefore, the resulting trust will only be able to bite if the loan moneys are still separately identifiable on Day 3, or on the day when the claim is brought.

The question as to the categorisation of *Quistclose* trusts is therefore as follows: does the lender retain some equitable interest in the loan moneys from Day 1, or are all rights given up on Day 2 with the transfer of the loan moneys, or does the lender only re-acquire rights in the money on Day 3? For there to have been a trust it cannot be that the lender acquires rights in the loan moneys only on Day 4 because that would be to make the trust remedial, something which is not possible at English law.[25] The principal problem with having the resulting trust come into existence on Day 3 is that there is only a security interest for the lender *after* the breach of contract has been committed. By the time that the lender's interest comes into existence the money will have disappeared and the borrower may already be insolvent. The most satisfying approach would be one which imposes a property right in favour of the lender from Day 1, as suggested below in relation to the use of express trusts. It is true that even such a structure runs the risk that the borrower will still misuse the money in practice, but at least the property right will have pre-dated any insolvency of the borrower.

It might be possible to analyse Lord Wilberforce's model differently. It could be argued that the purpose of the primary trust is to impose a trust over the loan moneys throughout the life of the loan contract. However, this would be an express trust – as is considered below – and it would seem illogical to have a resulting trust come into existence on Day 3 which superseded the primary, express trust.

Lord Millett's verson of the resulting trust could be understood as meaning that there is a retention of an equitable interest in favour of the lender throughout the loan contract too – although, again, it is difficult to see how this differs from an express trust, as considered below.[26] The better analysis might be think of this form of *Quistclose* trust as being an express trust, which Lord Millett does not do, which is imposed from the outset in the loan contract on Day 1 and which grants the borrower a power to use the money for the contractually specified purpose. Significantly, if the trust comes into existence on Day 1, then the lender has her security interest before the breach of contract. If the purpose is contravened then the express trust provides that the money is held on trust by the borrower for the lender absolutely from that time onwards.

Against a resulting trust: retention, not transfer

In advancing the argument that a *Quistclose* trust is a resulting trust, it is commonly said that the trust imposed on the borrower when seeking to use the property for an unauthorised purpose does have the hallmarks of a resulting trust properly so-called because it returns equitable title in property to its original owner once that original owner had transferred title away. Alternatively, in rebutting the contention that a *Quistclose* trust is a resulting trust, it could again be argued that the retention of rights by the original owner constitutes a *creation* of an equitable interest and not a *recovery* of an equitable interest after some transfer away on a typical resulting trust model. After all, the secondary trust could be said to have created the equitable interest for the first time, as opposed to returning it to the lender.

[25] *Westdeutsche Landesbank v Islington* [1996] AC 669.
[26]

The principal weakness of a resulting trust analysis, from a security interest perspective, is the time at which the lender acquires its proprietary rights. The resulting trust is said by Lord Wilberforce in *Barclays Bank v Quistclose* to come into existence in the form of a secondary trust only at the time at which the borrower misuses the loan moneys. If the loan moneys were received on Monday before the borrower went into insolvency on the Tuesday before the loan moneys were misused contrary to the terms of the contract on the Wednesday, then the resulting trust would only come into existence *after* the borrower had gone into insolvency. Therefore, the lender would not have a proprietary right, on this analysis, before the insolvency and would therefore not be a secured creditor. The risk for the lender is that there is no resulting trust over the loan moneys between the time of transfer to the borrower and the misuse of the money.

In the manner this form of resulting trust is explained by Lord Millett in *Twinsectra v Yardley*, there is a retention of title by the lender. A *Quistclose* trust, significantly, does not arise on the basis of a transfer of property away from the lender which is then returned to the lender. As such it could not be a resulting trust, as a resulting trust is ordinarily described.[27] If there were an outright transfer of the loan moneys from the lender to the borrower, as ordinarily happens in loan contracts, the lender would cease to have any title in the property which could be held on resulting trust.[28] So, Worthington juxtaposes the *Quistclose* trust with a transfer in the sale of goods context in which the seller gives up title to the buyer as part of the sale contract and therefore does not retain rights in the property.[29] Rather, an alternative conceptualisation of this structure would be that the lender transfers the loan moneys to the borrower on the basis that the borrower is entitled to use those moneys for the contractually specified purpose. If that purpose is carried out the lender is bound by the contract to release any proprietary rights in the loan moneys; if the purpose is not carried out the lender does not release those proprietary rights. The equitable interest in the loan money does not leave the lender – it would be, in fact, an express trust contained in the contract. The express trust analysis and the reasons for preferring it are considered next.

22.4.3 Express trust

The express trust analysis

The analysis of the *Quistclose* trust as a form of express trust would proceed as follows. The lender enters into a contract of loan with the borrower. That contract does not conform to the ordinary presumption of a loan contract that the lender intends to transfer outright all of the interest in the loan moneys but rather contains an express contractual provision which precludes the borrower from using the money for any purpose other than that provided for in the contract. The contract could be understood as containing an express trust for the benefit of the lender on the following terms: the loan moneys will be advanced to the borrower as trustee with a power to pay away that money for the purposes specified in the loan contract and for no other purpose; otherwise the loan moneys are held on trust for the lender by the borrower until the loan moneys are used for the contractual purpose. Those terms would continue: if the borrower purports to use the loan moneys for any other purpose then the borrower will be acting in excess of her power, such that the exercise of the power will be void, and those loan moneys would continue to be held on trust for the benefit of the lender. The lender would be able to trace the loan moneys into the hands of any third party and so recover them, as considered in chapter 19. The borrower would be liable to account to the lender for any breach of trust, as considered in chapter 18.

The lender's rights under the express trust would come into existence from the moment that the loan contract was created. The lender's security interest would therefore be in existence from the date of the creation of the contract. What would be required would be sufficient certainty of intention to create an express trust from that moment as opposed to transferring absolute title in the loan money to the borrower, as is more usual in relation to loan contracts.

27 Hackney, 1987, 154; Payne, 2000.

28 *Westdeutsche Landesbank v Islington* [1996] AC 669.

29 Worthington, 1996, 44.

What is perhaps difficult about this analysis is that, first, it has not been upheld in an English case yet, although it has been upheld in Australia;[30] and secondly, it is perhaps sufficiently complex to require drafting explicitly in a loan contract. It is clearly the most advantageous analysis of a *Quistclose* arrangement, it is suggested, because it offers the neatest protection for the lender of the money throughout the life of the loan contract by not relying on the commission of a breach of contract before the trust comes into existence for the first time.

More frequently the cases have turned on contracts in which it is not clear what the parties intended. Such contracts may nevertheless disclose an express trust (such intention being capable of imputation by the court as an unconscious express trust).[31] As contended in the diagram in para 22.4.2, the lender does not part with equitable title in a *Quistclose* situation: rather, the lender retains equitable title in the loan moneys. That retention of title in which the borrower acquires legal title (and thus the ability to pay the loan moneys into its own bank account) coupled with the retention of the equitable title by the lender and the contractual limitation on the use of the property, constitutes this *Quistclose* trust as a form of express trust.[32] It is suggested that it would have been preferable if Lord Millett had referred to his trust in *Twinsectra v Yardley* as being an express trust rather than a resulting trust, as considered below. What his Lordship did not do was to explain the nature of the borrower's power to use the loan moneys.

An example of the express trust analysis

The Australian case of *Re Australian Elizabethan Theatre Trust* has held that there is no need for a separate analysis of the *Quistclose* trust and that, instead, ordinary principles of express trust law are sufficient to explain the appropriate property law principles.[33] Thus, it is said,[34] there is an express with two limbs: one granting a power to the borrower to use the loan moneys for the contractually-specified purpose and the second which provides that any misuse of the loan moneys causes the entire equitable interest to be held for the lender.[35] In *Templeton Insurance Ltd v Penningtons Solicitors LLP*[36] there was a suitable factual matrix to permit this analysis. Templeton wanted to lend money to J for the purposes of buying an identified plot of land for development. The loan contract was structured so that Templeton did not pay the money to J but rather paid it to Penningtons, J's solicitors, subject to a solicitor's undertaking on Penningtons' part that Penningtons would keep the money in its client account only to be used to acquire the absolute title in the development land, or else to be held in an identified account so as to collect interest for Templeton. Whereas Lewison J analysed this transaction on the basis of *Twinsectra v Yardley* – a resulting trust analysis – it would have been possible to say that Pennington held the money as trustee under an express trust which could be inferred from the circumstances of paying the money into a client account[37] and that Pennington had a limited power as trustee to advance the loan moneys complete the purchase of the development land. If Penningtons had breached the terms of the trust then it would have acted in excess of that power and in breach of its obligations as trustee.

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[30] *Re Elizabethan Theatre Trust* (1991) 102 ALR 681, 691, *per* Gummow J.

[31] As in *Paul v Constance* [1977] 1 WLR 527.

[32] Thomas, 2000.

[33] *Re Elizabethan Theatre Trust* (1991) 102 ALR 681, 691, *per* Gummow J.

[34] *Ibid*. See Thomas and Hudson, 2004, para 9.84.

[35] *General Communications Ltd and Development Finance Corporation of New Zealand Ltd* [1990] 3 NZLR 406, 432.

[36] [2006] EWHC 685.

[37] As was the case in *Target Holdings v Referns* [1996] AC 421 and in *Boscawen v Bajwa* [1996] 1 WLR 328.

Against the express trust

The principal argument against the express trust model, it is suggested, is not a theoretical objection but rather a practical one: in *Barclays Bank v Quistclose* and in *Twinsectra v Yardley* two, differently-constituted Houses of Lords have not found that there was an intention to create an express trust. Perhaps after Lord Wilberforce's dicta in *Barclays Bank v Quistclose* the courts have become locked into a resulting trust analysis which has prevented them from seeing the trust in any other way. Lord Wilberforce's "primary trust" does suggest the existence of some form of trust from the time of the creation of the loan contract and, it is suggested, this could be understood as being an express trust in relation to which the borrower has a power to advance the money for the purposes identified in the loan contract. Equally, Lord Millett's retention of title could be understood as being a retention of title on the basis of an express trust, which would have been a more comfortable analysis than a resulting trust where that resulting trust would ordinarily be understood as coming into existence at some time after the loan contract had been created. That is, if the lender is taken to have retained some interest in the loan money from the creation of the contract, then it could have been said that that interest takes the form of an equitable interest under an express trust. Nevertheless, the express trust analysis does not have the support of English authority at present.

To return to the diagram at para 22.4.2 above, the finding of an express trust would require that that trust be created on Day 1 at the same time as the loan contract is created. Thus, when the loan moneys are transferred to the borrower, they are transferred to the borrower as trustee. This would need to be made clear on the terms of the loan contract. In this sense the lender would be retaining an equitable interest in the money. This goes against the ordinary mechanism of a loan contract whereby the lender transfers absolute title to the borrower, as opposed merely to the legal rights of a trustee.

22.4.4 Constructive trust

The argument in favour of a constructive trust

The third explanation of the nature of these trusts would be that the *Quistclose* trust could be considered to be a constructive trust on the general basis that it would be unconscionable for the lender to assert title to that money if it was not used for the purpose for which it was lent. The *Quistclose* trust principle was stated in *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd*[38] to be that:

> ... equity fastens of the conscience of the person who receives from another property transferred for a specific purpose only and not therefore for the recipient's own purposes, so that such person will not be permitted to treat the property as his own or to use it for other than the stated purpose.

This statement could be taken to be authority for one of three competing understandings of the *Quistclose* arrangement. At first blush, the reference to the 'conscience' of the recipient equates most obviously to a constructive trust, although these *dicta* are capable of multiple analyses. This judgment was given immediately at the end of the trial, whereas it is more usual for a judge to retire to reflect on his judgment at the end of a complex trial, and therefore some commentators[39] have suggested that this expression should not be relied upon too closely as requiring any particular analysis of the *Quistclose* trust. In line with the general theory of trusts advanced in *Westdeutsche Landesbank v Islington*, to define the *Quistclose* trust as operating solely on the conscience of the recipient of the money is merely to place the situation within the general understanding of the trust as part of equity, rather than to categorise it necessarily as any particular type of trust.

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38 [1985] Ch 207, 222.

39 Thomas and Hudson, 2004, …

Against a constructive trust

The principal argument against the imposition of a constructive trust is that the equitable interest of the lender appears to exist *before* the borrower seeks to perform any unconscionable act in relation to the property. As the speech of Lord Browne-Wilkinson in *Westdeutsche Landesbank v Islington*[40] reminds us, a constructive trust only comes into existence when the trustee has knowledge of some factor which affects her conscience. In the context of a *Quistclose* arrangement the rights of the lender arise under the contract and therefore pre-date the transfer of the loan moneys. A constructive trust would seem to require that the borrower misapply the loan moneys before her conscience could be affected so as to create a constructive trust. It is not the court imposing a constructive trust to grant rights, nor to restore pre-existing rights, to the lender. Rather, the lender appears to have retained its proprietary rights throughout the transaction. So, if the contract is created on Day 1 and the loan moneys are transferred to the borrower on Day 2, it is not until Day 3, when the borrower misuses the money contrary to the terms of the contract, that any constructive trust could come into existence because it is only on Day 3 that there is any unconscionable action in the form of the misuse of the loan moneys. If the borrower had gone into insolvency on Day 2 then there would be no effective proprietary rights in favour of the lender over the loan money because the insolvency would have occurred before those constructive trust rights came into existence.

One further shortcoming with the analysis of this form of trust as a kind of constructive trust is that it really avoids the question of what form of trust is a *Quistclose* trust: bracketing it off as being something imposed by operation of law is to ignore the structure used by the parties and the two-tier trust accepted by the courts in *Quistclose*. Its strength is that is recognises that, where the parties have failed to create a conscious express trust (as set out in para 21.3.2), it is necessarily equity which intervenes to allocate title between the parties. That intervention is to police the conscience of the borrower as trustee in the manner in which she deals with the loan moneys.

22.4.5 The *Quistclose* trust as a retention of title: the *Twinsectra* model

The nature of the Twinsectra model

An alternative analysis of the *Quistclose* trust, as considered in outline above, was advanced by Lord Millett in his minority speech in the House of Lords in *Twinsectra Ltd v Yardley*.[41] The approach advanced there was that the *Quistclose* trust should be considered to be akin to a retention of title by the lender whereby the lender effectively retains an equitable interest in the property throughout the transaction. In that case which a solicitor permitted loan moneys to be used by his client in breach of the express terms of a loan contract. On this analysis, a *Quistclose* trust enables a party to a commercial contract to retain their equitable interest in property provided as part of a commercial agreement. There is a similarity between *Quistclose* trusts in equity and *Romalpa* clauses at common law (as considered in section 22.2 above) to the extent that the original titleholder is able to retain rights in property: in *Romalpa* clauses it is the absolute title which is retained whereas in *Quistclose* trusts it is the equitable interest which is retained. Lord Millett took the view that the solicitor's undertaking to use the money only for a limited purpose gave rise to a *Quistclose* trust. His Lordship took the opportunity to ventilate the following understanding of a *Quistclose* 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

[40] [1996] AC 669.

[41] [2002] 2 All ER 377. See also Lord Millett in *Re Crown Forestry Rental Trust; Latimer v Commissioner of Inland Revenue* [2004] 4 All ER 558, [2004] STC 923 and Millett, 1985. For an analysis of this approach see Penner, 2004.

> 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.'[42]

The lender could therefore be taken to retain the equitable interest in the loan moneys throughout the life of the contract.[43] However, a closer reading of Lord Millett's words, quoted above, and in particular the expression "the money remains the property of the lender", could be read so as to suggest that the property remains absolutely the property of the lender: that is, the entire title, both legal and equitable, could be said to remain with the lender. It is suggested, however, that this analysis would mean that there was no trust of any sort at all because no title would have passed to the borrower so as to constitute a trust of any sort. Instead, the lender would have remained the outright, absolute owner of the money. This is not how loan contracts operate: ordinarily the borrower becomes absolute owner of the money. Perhaps the use of the vague term "property" by Lord Millett here is unfortunate. Maybe, the lender would remain the owner of all of the property rights in the borrowed money and the borrower would be merely the bailee of the borrowed money until such time as it was applied for the contractually-specified purpose:[44] again this seems unlikely on most loan contracts. It is suggested that Lord Millett's expression "the money remains the property of the lender" should be interpreted to mean that it is merely all of the *equitable* interest in the money which remains vested in the lender, except that the borrower is vested either with the legal title in that money so as to be entitled to use it for the purpose identified in the loan contract as a trustee, or else with a power to advance that money for the contractually-specified purpose. Consequently, the lender's equitable interest must be defeasible by the borrower's proper use of the money, with the result either that the borrower has the power as trustee of the money to defeat the lender's rights in that money or alternatively that the borrower itself has an equitable interest in the money which is contingent on the borrower's proper use of the loan moneys. This last analysis would suggest that the lender does not hold all of the equitable interest, but rather all of the equitable interest except for that part represented by the borrower's contingent rights; or alternatively that the borrower has a mere power to use the money subject to the lender's outright title.

[42] [2002] 2 All 377, 398-399.

[43] *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*.

[44] As Lord Browne-Wilkinson reminded us in *Westdeutsche Landesbank v Islington* [1996] AC 669: if there is no separation of the equitable title from the legal title such that a trustee or trustees hold the equitable title for identified beneficiaries, then there is no trust: rather, absolute title remains with the outright "owner" of the property – the person whom civilian lawyers would consider to have dominium in the property.

It is suggested, then, that the least satisfactory analysis of a *Quistclose* trust would be that the lender retains absolute title in the money because that would deny the existence of a trust. It would be the case that the lender retained absolute title in the loan moneys if the loan contract provided that the borrower had merely a facility with the lender such that the borrower could instruct the lender to make payment of the loan moneys to a third party identified in the loan agreement (in a manner similar, perhaps, to a letter of credit facility).[45] In such a situation, however, there would be no trust but rather merely a contractual right to instruct the lender to transfer the money at the borrower's instruction in the manner provided for in the loan agreement. In accordance with commercial reality, this mimics a retention of title clause with title in the money only passing once the money is used for its specified purpose. Similarly, the borrower does not acquire full title in the property because that would defeat the purpose of the arrangement if the borrower were found to have an entirely free use of the money.[46] However, for there to be a trust at all there must be a declaration of a trust such that there is a division between the ownership of the legal and of the equitable interests in the loan moneys between two or more people. As considered earlier in this chapter, the commercial purpose of a *Quistclose* trust – that the borrower be prevented from using borrowed moneys for some purpose other than that agreed between borrower and lender – can be achieved by a number of devices by which the lender retains some proprietary rights in the loan moneys and thus makes those moneys available to the borrower but without vesting absolute title in the loan moneys in the borrower. It is suggested that deciding which of those models has been used will depend upon a proper analysis of the terms of the individual loan contract.

There is one other problem with Lord Millett's formulation, which falls into two parts. First, the *Twinsectra* trust is said by Lord Millett to be a resulting trust. Secondly, despite it being a resulting trust the lender is said to retain her interest in the loan property. A resulting trust operates by the property "jumping back" to the beneficiary of that resulting trust. In the example of a *Quistclose* arrangement, as under the diagram set out in para 22.4.2 above, this would necessitate that the resulting trust could only come into existence on Day 3 when the trust money is misused and, in any event, only once the interest in the property has been transferred away to the borrower. This does not sit well, however, with the notion that the lender has retained an interest in the loan money. The lender has either relinquished her rights in the money so that a resulting trust can come into existence later, or else the lender has retained an equitable interest in the loan money as from Day 1 in which case that equitable interest cannot be said to jump *back* to the lender because she has retained it throughout. Alternatively, we would have to re-write our understanding of a resulting trust as a doctrine which returns ownership to its beneficiary. It is suggested that there is no need for that, however, because this is simply a confusion between an inappropriate resulting trust and a more useful express trust which is to be inferred from the circumstances.

Thus Lord Millett has only served to raise as many questions as he has answered. The commercial difficulties with Lord Millett's model of the *Quistclose* trust are considered at para 22.4.6 below.[47]

22.4.6 The nature of the *Quistclose* trust is dependent on the terms of the loan contract

The effect of the terms of the loan contract

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[45] See Millett, 1985.
[46] [2002] 2 All 377, 399, para 81.
[47] See also GW Thomas and AS Hudson, *The Law of Trusts*, 2004, para 49-14 *et seq* for a more detailed discussion of *Quistclose* trusts in general.

While the preceding analysis of the *Twinsectra*–model[48] of the *Quistclose* device might appear to present a step towards a settled understanding of the *Quistclose* trust, it is suggested nevertheless that the precise nature of any given *Quistclose* arrangement will depend upon the structure of the loan agreement which the parties have effected. It might of course be that the loan moneys are not to be advanced to the borrower until the contractually-specified object has been performed or under terms whereby the bank insists on a payment facility which can only be used for the completion of that specified purpose, such as by way of a banker's draft in favour of the third party who is specified in the loan contract. The use of the loan moneys might be made available to the borrower subject to a trust arrangement made explicit in the loan contract that the funds were to be held by some custodian subject only to a power to use them for the contractually specified purpose. In consequence, the commercial objective of a *Quistclose* trust would be achieved without the use of either a traditional *Quistclose* model (with its primary and secondary trust) or the *Twinsectra* model (with the retention of rights in the property by the lender).

Alternatively then, as discussed above, a *Quistclose* trust could be conceived of on the basis that the loan moneys are subject to an express trust under which the borrower acts as trustee with a power to use the trust property for the purpose specified in the contract, but for no other. The benefit of such a structure would be that the borrower, as trustee, would bear personal liability for the breach of any trust as well as an obligation to reconstitute the trust fund in the event that the moneys were transferred away for some purpose other than that specified in the contract. For such an express trust analysis to be viable in any given circumstance, it would be necessary for there to be sufficient intention on the part of the contracting parties for the borrower to hold the loan moneys on trust from the outset of the transaction, and not simply that the trust is enforced by the court subsequently to prevent the borrower unconscionably from seeking to apply those moneys otherwise than for the contractually agreed purpose. In other words, the loan contract would need to make this express trust explicit on its face. This analysis of a loan contract does not conform to the ordinary presumption of a loan contract that the lender intends to transfer outright all of the interest in the loan moneys but rather contains an express contractual provision which precludes the borrower from using the money for any purpose other than that provided for in the contract. A well-drafted contract may well provide that the borrower shall hold the loan moneys on trust for the lender until such time as the contractually stipulated purpose is performed. At that time the borrower would be obliged to transfer the money outright. Such a contract would clearly contain an express trust. More frequently the decided cases have considered loan contracts in which it is not clear what the parties intended. Such contracts may nevertheless suggest the existence of an express trust (such intention being capable of imputation by the court in an unconscious express trust).[49] The question is to identify the most secure method of structuring a *Quistclose* trust arrangement to protect against these uncertainties.

22.4.7 The safest commercial approach to controlling borrowed moneys

[48] [2002] 2 All 377, 398-399.
[49] *Paul v. Constance* [1977] 1 WLR 527.

If a lender is seeking to protect itself against either the misbehaviour of the borrower or the insolvency of the borrower, then it is suggested that, instead of using a *Quistclose* trust, the following structure would be the safest approach: the lender should remain the absolute owner of the loan moneys and never transfer them to the "borrower" but rather should merely grant a facility to the borrower to instruct the lender when to make payment such that it is the lender itself who transfers the loan moneys for the contractually specified purpose at the borrower's order. The lender, then, should not transfer legal title nor indeed any title to the borrower. Rather, the lender should pay the loan moneys into a separate bank account which is held in the lender's sole name without any declaration of trust in favour of the borrower. The borrower should then have a mere power, granted by contract, to direct the bank when the appropriate time has arisen to make the payment to the person or for the purpose identified in the loan contract. Thus, the borrower cannot acquire title in the loan moneys should it become insolvent, nor can the borrower use the money for any purpose other than that specified in the contract.

The workings of the *Quistclose* trust, in the wake of Lord Millett's speech in *Twinsectra v Yardley*, are explained by Thomas and Hudson as operating in the following way:[50]

> … akin to a retention of title clause (though with a different object) [the *Quistclose trust*] 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, notwithstanding the borrower's insolvency. It is therefore a form of asset protection.

It is suggested that this is the clearest description of the best means of using a *Quistclose* trust. It avoids the ambiguity in Lord Millett's formulation[51] in which Lord Millett refers to the trust as arising as a "resulting trust", suggesting that title had passed to the borrower only to jump back on resulting trust when the borrower breaches the term of the contract. It is possible that Lord Millett intended the trust to come into existence at the same time as the loan contract but the reference to a resulting trust makes this unclear. Therefore, the contested forms of *Quistclose* trust should not be used. After all, no commercial client would be content to take a troubled form of equitable interest over money instead of the retention of *absolute* title which I am advocating here.

In my suggested structure, the assets remain the property of the lender throughout the life of the transaction but the borrower has a power to direct the use of that money. This structure would achieve three things. First, the lender would retain proprietary rights in the loan moneys. Secondly, the lender itself would be able to vet the purposes for which the moneys are intended to be used rather than rely on the good faith of the borrower under an ordinary outright transfer of loan moneys. Thirdly, the moneys retained in the account would constitute an identifiable fund which could be subjected to a trust without confusion as to its identity.

I have suggested in the passage before this quotation a further refinement to the effect that the lender should limit the borrower's power to spend the money without the

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[50] Thomas and Hudson, *The Law of Trusts*, Oxford University Press, 2004, 292.
[51] *Twinsectra v Yardley* [2002] 2 AC 164, 187-193.

lender's prior consent. This change would require that there is no trust created at all: instead the lender should retain absolute title in the money and instead simply agree contractually to transfer it directly to the third party identified in the loan contract at a time when the borrower may direct. By controlling the borrower's use of the money by preventing the borrower from having any property right in it, the lender is protected against the borrower's insolvency and should be able to protect itself against misapplication of the money by its own clerks ensuring that the moneys are being advanced for the contractually specified purpose before paying them away themselves on behalf of the lender.

22.4.8 The *Quistclose* trust as a form of purpose trust

The argument has been raised that a *Quistclose* trust is a form of abstract purpose trust whereby the trust comes into existence for the purpose of retaining title in money. However, it is suggested that it is not a purpose trust, which ought properly to be void due to its lack of a beneficiary, but rather there will always be a beneficiary of the trust arrangement, whether the lender or the borrower, who can take an immediate interest in the loan money. Which of them takes that interest from time-to-time is dependent on whether or not it has been used in accordance with the terms of the loan contract. Therefore, this form of trust will be valid because there is some person who has an equitable interest in the property, such that the beneficiary principle is satisfied. In truth there are many "purpose trusts" of some sort which are given effect in English law, provided that there is also some beneficiary of the trust. So, there is no objection to a trust for the benefit of identified persons also containing a statement of a purpose for which the trust property is to be used. The trust is valid because there are beneficiaries and what is more the trustees have a clear statement of their goals as trustees in the form of their obligations and powers.

22.4.9 Two different commercial contexts in which *Quistclose* trusts are significant

The Quistclose trust in the abstract

There are two different practical contexts in which a *Quistclose* trust may be important. The first is that in which the borrower of the money goes into insolvency. The purpose of the *Quistclose* trust will be to keep the loan moneys separate from the borrower's estate which will be divided up among the borrower's unsecured creditors. The second context is that in which the borrower has transferred the loan money to some third party so that the lender will have difficulty in recovering it. The discussion of *Quistclose* trusts in the cases and amongst the commentators has tended to focus on their advantages in protecting against insolvency and has therefore simply assumed that the loan money would be separately identifiable in a bank account so that it could form the subject matter of a trust without undue complication. However, what if the loan money has been paid away and it is not separately identifiable in a way which satisfies the requirement of certainty of subject matter in trusts law?

In addressing these different contexts we should begin by reminding ourselves of the example used in para 11.3 to describe a *Quistclose* trust. It went as follows:

> Suppose Laura agrees to lend money to Bill. Bill is facing personal bankruptcy. His business is the manufacture and sale of modern, metal furniture. Bill has been unable to sell enough of his furniture but he thinks that if he were able to adapt his machinery to manufacture a particular type of fashionable furniture then he would be able to move back into profit. Laura therefore agrees to lend Bill £10,000 on the condition that the money is only to be used to adapt that machine. The money is transferred to Bill. The next week, Bill is declared insolvent and his trustee in bankruptcy seeks to divide up the £10,000 among Bill's creditors.

In dealing with the first context in which *Quistclose* trusts are used – to guard against the borrower's insolvency – this hypothetical example was explained as being analysed legally in the following manner:

> The *Quistclose* trust means that the £10,000 is held on trust for Laura and therefore does not form part of Bill's estate for insolvency purposes. Consequently, Laura will be able to recover the loan money (and using the rule in *Saunders v Vautier*, as the sole beneficiary under the *Quistclose* trust, she will be able to compel the trustee to transfer the money to her absolutely).

However, instead of Bill going into insolvency and leaving the £10,000 easily identifiable, suppose that Bill had used the money in the following way:

> In breach of the contractual condition, Bill decides to use the money to pay one of his suppliers of leather, Caroline. Caroline has paid the money into her general bank account and mixed it up with her other money.

In this changed set of facts it is not possible simply to impose a trust over "the loan money" because the loan money has ceased to exist separately from the other money in Caroline's bank account. It could be said that the *Quistclose* trust could not be imposed because of lack of certainty of subject matter.[52] However, in this context, the utility of the *Quistclose* trust – as is discussed in detail in chapter 19 *Tracing* – is in giving Laura the equitable foundation to trace her loan money into Caroline's general bank account and to impose an equitable remedy (such as a charge or a lien) over that general bank account so as to recover her money. To trace her money into a mixed account like this, Laura would be required to demonstrate that she had had an equitable interest, such as an interest under a trust, in the loan money before it was misapplied.[53] The *Quistclose* trust grants Laura such an interest and so permits her to trace her money into this mixed account. This second use of *Quistclose* trusts is the main focus of this section after we have outlined the applicable principles of insolvency law which are important in this context.

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[52] *MacJordan v Brookmount* [1992] BCLC 350.
[53] *Westdeutsche Landesbank v Islington* [1996] AC 669.

Insolvency

If a person – whether a human being or a company – goes into bankruptcy or insolvency, liquidation or administration, then that person is not at liberty to dispose of its property as it may otherwise wish. Frequently, trusts are used as shelters against insolvency of all of the types just mentioned by providing that the person whom it is feared might go into insolvency is merely the trustee of property which would otherwise be considered to be her own property and which would consequently fall to be divided up among her creditors on her insolvency. *Quistclose* trusts are one means of shielding money against a borrower's insolvency in loan transactions. However, sham trusts are often used so as to give the mere appearance of separating property from the insolvent person's assets whereas the insolvent person continues to use the property as though it remains entirely her own.[54] The Insolvency Act 1986 gives the court the power to unpick transactions – such as the settling of property on trust – which are done in an attempt to elude the effects of personal bankruptcy or corporate insolvency. In relation to a personal bankruptcy, if the bankrupt had entered into any transaction with anyone at an undervalue then the trustee in bankruptcy may apply to the court, inter alia, to have the transaction set aside and any property transferred or settled on trust restored to the position it was previously.[55] Similarly, if a bankrupt has given a "preference" to anyone then that transaction may be treated in the same manner.[56] If a transaction is undertaken at an undervalue so as to defraud the insolvent person's then creditors or future creditors, then the court may order the return of the position to the *status quo ante* as though the transaction had not taken place.[57] This statutory power is considered in detail at para 11.4.7. By providing that the lender retains or re-acquires (depending on whether it is an express or a resulting trust) title in the loan moneys, a *Quistclose* trust provides that the lender has a beneficial interest in those loan moneys which she will retain even if the borrower goes into insolvency.

Quistclose trust as an equitable device enabling tracing where the loan moneys have been put beyond reach

Much of the debate surrounding *Quistclose* trusts proceeds on the basis of an abstract intellectual analysis of the structure itself. Primarily, the question has been put as to whether a *Quistclose* trust is truly a resulting trust, or an express trust or simply a different form of trust altogether.[58] For the purposes of this section, however, the more

[54] See section 3.3 "Sham trusts".
[55] Insolvency Act 1986, s 339.
[56] Insolvency Act 1986, s 340.
[57] Insolvency Act 1986, s 423.
[58] Yet another explanation would be that the *Quistclose* trust is properly to be considered as a constructive trust on the basis that it would be unconscionable for the lender to assert title to that money if it was not used for the purpose for which it was lent, on which see the dicta from *Carreras Rothmans Ltd v. Freeman Mathews Treasure Ltd* [1985] 1 Ch 207 reproduced above. The principal shortcoming with the analysis of this form of trust as a kind of constructive trust is that the equitable interest of the lender appears to exist *before* the borrower seeks to perform any unconscionable act in relation to the property. In the context of a

important question is as to the manner in which a contractual provision sets out to achieve the general aim of a *Quistclose* trust: that is, to provide security for the lender in relation to loan moneys which were to have been used only for a specified purpose. The assumption made by many of the judges when dealing with *Quistclose* trusts is that the borrower is obliged to keep the money separate from all other moneys, so as to use that money for the contractually-specified purpose, and that consequently there will be some identifiable fund over which the *Quistclose* trust can take effect in a way that will avoid it being declared to be invalid under the principle that there be sufficient certainty of subject matter.[59] The principal difficulty, it is suggested, with the operation of *Quistclose* trusts is that the borrower who breaches the stipulation in the loan contract that the loan moneys be used only for a specified purpose will necessarily have paid those moneys away such that there may not be a fund over which such a trust can take effect. To put it crudely: the money will have gone, so what use is the *Quistclose* trust? That problem is considered in this section.

It is suggested that the central issue in the design of a *Quistclose* structure is that it ought properly to be ineffective in the event that the loan moneys or their traceable equivalent are not identifiable in the hands of the borrower. Suppose, for example, that a loan is made to a borrower subject to an express contractual provision that the loan moneys are to be used solely to discharge sums owed to identified trade creditors. If those loan moneys were in fact dissipated by the borrower on general expenses otherwise than for those identified trade creditors, such that the moneys had passed into a general current account which had subsequently gone overdrawn, then it would be impossible to identify property which could be the subject matter of a trust in that general current account. In theory, the *Quistclose* trust would exist because of its inclusion in the loan contract. However, where there is no identifiable subject matter of a trust, that trust will fail.[60]

As considered briefly above, that is not the principal strength of the *Quistclose* trust in these circumstances, however. What the lender will need to do in such circumstances is to trace after the loan moneys to seek to take title over whatever substitute property has been acquired with the loan moneys or to take title over whichever bank account which comes to be the moneys last resting place. Only equitable tracing can trace loan moneys through mixtures: such as bank accounts in which the loan moneys have been mixed with other money (see section 19.4). Equitable tracing can only be begun if the claimant had an equitable interest, such as an interest under a trust, in those loan moneys: simply having absolute title in the loan moneys would not be enough to commence an equitable tracing claim.[61] What the *Quistclose* trust analysis would provide is exactly such an equitable interest on the basis of which the lender could seek to trace

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Quistclose arrangement the rights of the lender arise under the contract and therefore pre-date the transfer of the loan moneys. A constructive trust would seem to require that the borrower misapply the loan moneys before her conscience could be affected so as to create a constructive trust: *Westdeutsche Landesbank v Islington LBC* [1996] AC 669. It is not the court imposing a constructive trust to grant rights, or restore pre-existing rights, to the lender. Rather, the lender would ordinarily appear to have retained its proprietary rights throughout the transaction.

[59] See para 3-01.

[60] See para 3-01 *et seq*.

[61] *Westdeutsche Landesbank v Islington* [1996] AC 669.

those funds in equity through other bank accounts.[62] This is a very important strength of the *Quistclose* trust.

Can a Quistclose trust arise in situations not connected to loan contracts?

Quistclose trusts have arisen only in relation to loan contracts thus far on the decided cases. It has been suggested by Sarah Worthington that this need not necessarily be the case because there seems to be nothing about the *Quistclose* technique *per se* which means that the trust could only take effect over money and only when that money is being loaned.[63] In the High Court in *Re Farepak Food and Gifts Ltd*,[64] Mann J considered the availability of a *Quistclose* trust over moneys which had been pre-paid in the expectation of being exchangeable for goods in the future. There was no contract of loan. The point that *Quistclose* trusts had only previously arisen in relation to loan contracts was not taken by Mann J. No such trust was found on the facts because it was not found to have been within the contemplation of the parties. However, had the facts been different, there was nothing in the judgment to suggest that that trust might not have arisen.

The reason why Mann J found that there was no *Quistclose* trust was because it would have made no business sense on the facts for Farepak to have been intended to put all of the moneys received to one side subject to a *Quistclose* trust. It is not clear from the judgment on what basis a *Quistclose* trust was being argued for by counsel: there was no contract of loan and therefore this would have been a novel type of *Quistclose* trust; and it is not clear what the purported use of the money should have been to lead to the inference of a *Quistclose* trust in these circumstances. Therefore, it is difficult to know against what Mann J was arguing. His lordship held as follows:[65]

> 'I have already held that the money is taken by the Agents as agent for Farepak. That of itself does not militate against the existence of a *Quistclose* trust. However, there is no suggestion that the Agent was expected to keep the money separate from other money (or indeed his or her own), and it is indeed known that it was mixed with the money of others and paid over to Farepak with the money of others. Again, that of itself it not inconsistent with a *Quistclose* trust, but it does not help.'

However, normal service appears to have been resumed as his lordship carried on in the following manner:[66]

> 'But crucially, there is no suggestion that the money ought to have been put on one side by Farepak pending the transmutation from credited money to goods or vouchers. If there were a *Quistclose* trust then that obligation would have been inherent in it, but the business model would have made no sense. It would have

[62] See para 33-97 above.
[63] Worthington, 1995.
[64] [2006] All ER (Dec) 265 (D).
[65] [2006] All ER (D) 265, [34].
[66] [2006] All ER (D) 265, [34].

required Farepak to have kept all the customer moneys in a separate account from January until November, untouched until the time when the goods or vouchers were acquired and then sent out. That is completely implausible. It would turn Farepak into a very odd savings organisation. Even banks do not have to do that.'

There is, however, nothing to prevent the finding of a *Quistclose* trust that the trustees were permitted to use the property subject to the *Quistclose* trust in the approved manner – that is, subject to a power to use the property otherwise held on trust – but such that any breach of the conditions on which the property was to be used would cause the imposition of the *Quistclose* trust to prevent the misuse and/or to permit the beneficiaries to begin a tracing claim to recover their property. Therefore, it is suggested, Mann J could have held that the moneys were subject to an express trust such that Farepak could use the money for appropriate purposes in the running of the Christmas fund but so that a *Quistclose* trust would be imposed in the event that they purported to misuse any of the property.

22.4.10 The rights of third parties to the loan moneys

It has been suggested in one decided case[67] that, if the loan contract required that the borrower pay the loan moneys to X then X would acquire an equitable interest in the loan moneys before they were even paid to him. It is suggested that such an analysis could only be possible if the third party's acquisition of such rights were demonstrably within the contemplation of the parties.

22.4.11 Conclusion

As the playwright and diarist Alan Bennett once said, when writing one wonders if one has merely succeeded in adding to the number of words in the world, rather than adding anything of significance. Given the sheer volume of discussion of the *Quistclose* trust this is perhaps just another opinion tossed into the ether. However, it does appear to me that a *Quistclose* trust is properly to be considered to be a form of commercial express trust contained in a contract which retains an equitable interest for the lender of money until such time as that interest is discharged by the application of the loan moneys for their contractually-stipulated purpose.

[67] *Re Northern Developments (Holdings) Ltd*, 6 October 1978 (unreported).