Time to call time on the Quistclose trust

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***Conv. 109** It is a curious feature of the development of *Quistclose* trusts that, for so long, so much attention has been paid to the question of whether or not they can ever validly exist.[1] After all, the case from which they get their name— *Barclays Bank v Quistclose Investments Ltd*[2] —was a unanimous decision of the House of Lords. In addition, their operation survived a forensic review by Lord Millett in *Twinsectra v Yardley*.[3] What more proof of their viability might be needed? Yet just as strange as this near obsession with "the true nature of the *Quistclose* trust"[4] is the fact that, in the same period, so little attention has been given to the equally important issue of whether these arrangements should be part of our law at all.[5] Moreover, this should be a source of considerable regret. Reflecting on the *Quistclose* trust in its commercial context, there is at least one good reason why the courts should not be giving effect to them, and, especially in cases involving corporate borrowers, that reason might be thought to trump all other reasons for and against their validity.

What is a Quistclose trust and when will one arise?

As Lady Arden reminded us last year in *Prickly Bay Waterside Ltd v British American Insurance Co Ltd*,[6] the label *Quistclose* trust is in fact a catchall capable of covering settlements possessed of a number of different forms.[7] Nevertheless, there is still

some discernible commonality between all such arrangements. It is therefore possible to say with certainty that a *Quistclose* trust will arise when A transfers a right to money (or some other property) to B for a (mutually agreed) specific purpose. [8] B will have a power (and in some cases a duty) to apply that right in pursuance of that purpose, but unless and until they do so they will hold that right on trust for A. [9] Typically, such a set-up will be underscored by a contract between A and B, under which A loans B the money (or other property) which they have transferred to them. Indeed, in that case, as B applies the right which they hold in accordance with the terms of their stewardship, a proportionately sized ***Conv. 110*** debt will arise in A's favour. [10] Having said that, *Quistclose* trusts can also exist when A makes a gift to B (again, for a specific purpose). [11]

Quistclose trusts are creatures of consent. They exist because they are intended to. This means that they are appropriately classified as "express trusts". [12] In some cases, the relevant intention is directly manifested: the transferor of the right which will form the subject matter of the trust makes clear in as many words that they intend to create a trust in their own favour. [13] In others, and much more commonly, that intention is inferred from other established facts. [14] In *Quistclose Investments* itself, for example, Lord Wilberforce implied an intention to create a trust on the part of the transferor from its stipulation—agreed to by the transferee—that the money the transferor was lending it would be used for one purpose and one purpose only. [15] From that, his Lordship held that "the mutual intention of the [parties], and the essence of [their] bargain, was that the sum advanced should not become part of the assets of [the transferee]". [16] This mattered, he said, because, when one person (legal or natural) holds a right in such a way that they are not beneficially entitled to it, they are necessarily occupying a position of trusteeship. [17]

It is true that in some cases *Quistclose* trusts are referred to as "resulting trusts". [18] But in most of them, that term has only formal connotations. The transferor has become a beneficiary of the same right which, before they caused it to vest in the transferee, they were absolutely entitled to, and to result means (amongst other things) to recoil, rebound, or spring back. [19] In other decisions, including that in *Air Jamaica Ltd v Charlton* , [20] it is possible to find statements that resulting trusts, including *Quistclose* trusts, form their own distinct category of arrangement, arising not in response to a positive intention to create a trust, but rather "the absence of any intention on [a transferor's] part to pass a beneficial interest [in their right] to the recipient". [21] However, for reasons that do not now need repeating, this analysis has been effectively debunked. [22]

Justifying the Quistclose trust

The standard justification for the validity of *Quistclose* arrangements comes in two parts. The first emphasises that there is nothing new or legally challenging about such settlements. Rather, it is said that their nature is "entirely orthodox" [23] and consistent with "well-settled principles" [24] of equity. As Lord Wilberforce was at pains to point out in *Quistclose Investments* itself: ***Conv. 111***

"That arrangements of [such a] character … give rise to a relationship of … trust … has been recognised in a series of cases over some 150 years." [25]

The second part of the argument involves something of an appeal to intuition. The underlying idea is that, if two parties wish to create a *Quistclose* trust, then, all other things being equal, there is no reason for the law to stop them. [26] To put it another way, the very fact of the parties' common intention is cause enough for the law to recognise that their intended arrangement exists. On this view, the purpose of the law of express trusts is to facilitate peoples' coherent and appropriately manifested intentions, and to do so come what may. [27] Here, again, is Lord Wilberforce in *Quistclose Investments* :

"I must say that I find [the] argument [that as a matter of law two parties could never intend both a loan of money and a trust of the same sum] unattractive. It means that the law does not permit [such] an arrangement to be made … I should be surprised if an argument of this kind—so conceptualist in character—had ever been accepted." [28]

The problem with Quistclose trusts

The best way to understand why the courts should cease to recognise the validity of *Quistclose* settlements is to appreciate why parties create them. They are not generated for fun. Instead, it is because they are commercially useful. As Lady Arden noted in *Prickly Bay* , in giving effect to *Quistclose* trusts equity considers itself to be "[responding] to the need for different sorts of transactions". [29] More specifically, *Quistclose* trusts are an easy way of generating a so-called quasi-security interest, capable—at least in advance of the right being held on trust being applied in accordance with its specified purpose—of giving its transferor priority over that right in its transferee's insolvency. [30] Thus, as Lord Millett observed in *Twinsectra* , on this view *Quistclose* arrangements are "akin … to a retention of title clause (though with a different object)". [31]

Yet this is precisely why our legal system should have nothing to do with them. It is not that interests under *Quistclose* trusts constitute unbargained-for security. [32] As indicated above, they do not. Rather, it is that, notwithstanding that fact, such arrangements have the same effect—hence the term quasi-security—as if the transferee had granted the transferor a real (non-possessory) security interest over the right which forms its subject matter. This is a problem because, at least when it comes to corporate borrowing, such protection usually comes at a cost. The Companies Act 2006 s.859A imposes a requirement that "where a company creates a charge" it is officially registered within 21 days of the day after its creation. In addition, s.859H tells us that, in the absence of such registration, a charge to which ***Conv. 112*** s.859A applies will be void (so far as any security on the company's property is conferred by it) against both a liquidator of the company, and any of its (other) secured creditors. In contrast to all this, though, there is no requirement for *Quistclose* trusts to be registered.

The reason why the registration of charges is insisted upon is well known. The information provided by the register allows other potential secured creditors to make informed decisions about whether to lend money to companies (and, if so, on what terms), by taking into account the fact that other parties may already have priority over some or all of that company's assets. Thus, like the pari passu rule governing distribution between unsecured creditors, the justification for this state of affairs is the desire to achieve fairness between parties who have taken equal risks. Indeed, put like this, the efficacy of the systematically unregistered trusts in those cases which make up the corpus of *Quistclose* trust authorities, can be seen to affect considerable and unprincipled unfairness.

And it is not as if the judges are not aware of this problem. In *Re Bond Worth Ltd* , [33] a credit seller sought, in effect, to secure a buyer's obligation to pay the price for certain goods being transferred between them by parting with possession of those goods on the following terms: "Equitable and beneficial ownership [of the goods] shall remain with us until full payment has been received". [34] Looking at the substance of the parties' transaction as a whole, Slade J tore into "[the] misleading and inadequate form of [the parties'] drafting, which purported to disguise what was in essence a … charge as a bare trust". [35] Furthermore, treating the interest granted to the seller under the impugned contract as a charge, his Lordship held—inevitably—that it was void for non-registration. Of course, there are differences between credit sales and *Quistclose* -style loans. However, by engaging in a little joined up thinking, it should not be beyond the wit of the courts to start taking the same approach to all commercial debts quasi-secured in essentially the same way.

Conclusion

The history of commercial law is littered with attempts by parties to undermine the general principles of post-insolvency distribution by negotiating for themselves what might be effective get-out clauses. Sometimes they succeed, [36] although the loopholes they expose in doing so are eventually isolated and closed. [37] On other occasions, as in *Bond Worth* , they fail ab initio. Much ink has been devoted to analysing the mysterious nature of *Quistclose* trusts. But that has largely been at the expense of any consideration of the equally important question of whether or not they should be allowed to exist in the first place. So enthralled have lawyers become by the technical wonder which emerged from Lord Wilberforce's speech in *Quistclose Investments* that they have forgotten a fundamental and, in this case, ***Conv. 113*** critical truth. Just as an "is" does not imply and "ought", nor does a "can" necessarily entail a "should".

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Footnotes

1 For one particularly vehement argument against that notion, see *W. Swadling, "Orthodoxy" in W. Swadling (ed), The Quisclose Trust: Critical Essays (Oxford: Hart Publishing, 2004)*.
2 *Barclays Bank Ltd v Quistclose Investments Ltd [1970] A.C. 567; [1968] 3 W.L.R. 1097 HL*.
3 *Twinsectra Ltd v Yardley [2002] UKHL 12; [2002] 2 A.C. 164*.
4 *Twinsectra Ltd v Yardley [2002] UKHL 12; [2002] 2 A.C. 164* at [77].
5 For one exception, see W. Goodhart and G. Jones, "The Infiltration of Equitable Doctrine in English Commercial Law" (1980) 42 M.L.R. 489.
6 *Prickly Bay Waterside Ltd v British American Insurance Co Ltd [2022] UKPC 8; [2022] 1 W.L.R. 2087*.
7 *Prickly Bay Waterside Ltd v British American Insurance Co Ltd [2022] UKPC 8* at [32].
8 *Prickly Bay Waterside Ltd v British American Insurance Co Ltd [2022] UKPC 8* at [1].
9 *Twinsectra Ltd v Yardley [2002] UKHL 12; [2002] 2 A.C. 164* at [100].
10 *Barclays Bank Ltd v Quistclose Investments Ltd [1970] A.C. 567* at 581.
11 *Prickly Bay Waterside Ltd v British American Insurance Co Ltd [2022] UKPC 8* at [1].
12 P. Millett, "The Quistclose Trust: Who Can Enforce It?" (1985) 101 L.Q.R. 269, 284.
13 See, e.g. *R. v Common Professional Examination Board Ex p. Mealing-McCleod [2000] 4 WLUK 554*.
14 See, e.g. *Re EVTR Ltd (1987) 3 B.C.C. 389; [1987] B.C.L.C. 646 CA (Civ Div)*.
15 *Barclays Bank Ltd v Quistclose Investments Ltd [1970] A.C. 567* at 579–580.
16 *Barclays Bank Ltd v Quistclose Investments Ltd [1970] A.C. 567* at 580.
17 *Barclays Bank Ltd v Quistclose Investments Ltd [1970] A.C. 567* at 580.
18 See, e.g. *Re EVTR Ltd (1987) 3 B.C.C. 389*; *R. v Common Professional Examination Board Ex p. Mealing-McCleod [2000] 4 WLUK 554*.
19 *"Result, v. 2c" in Oxford English Dictionary, 2nd edn (Oxford: OUP, 1989)*.
20 *Air Jamaica Ltd v Charlton [1999] 1 W.L.R. 1399; [1999] O.P.L.R. 11 Privy Council (Jamaica)*. See, alternatively, *Twinsectra Ltd v Yardley [2002] 2 A.C. 164*.
21 *Air Jamaica Ltd v Charlton [1999] 1 W.L.R. 1399* at 1412.
22 See *J. Penner, "Lord Millett's Analysis" in W. Swadling (ed), The Quistclose Trust: Critical Essays (Oxford: Hart Publishing, 2004)*; W. Swadling, "Explaining Resulting Trusts" (2008) 124 L.Q.R. 72.
23 *Twinsectra Ltd v Yardley [2002] 2 A.C. 164* at [100].
24 P. Millett, "The Quistclose Trust: Who Can Enforce It?" (1985) 101 L.Q.R. 269, 290.
25 *Barclays Bank Ltd v Quistclose Investments Ltd [1970] A.C. 567* at 580.
26 See, for example, J. Glister, "The Nature of Quistclose Trusts: Classification and Reconciliation" (2004) 63 C.L.J. 632, 645.
27 For a stark example of this understanding in action, see *Smith v Lucas (1881) 18 Ch. D. 531* esp. at 542.
28 *Barclays Bank Ltd v Quistclose Investments Ltd [1970] A.C. 567* at 581.
29 *Prickly Bay Waterside Ltd v British American Insurance Co Ltd [2022] UKPC 8* at [32].
30 See *Re EVTR Ltd (1987) 3 B.C.C. 389* for an example of when some form of priority may also be obtained *after* the right has been properly applied.
31 *Twinsectra Ltd v Yardley [2002] 2 A.C. 164* at [81].
32 Which would bring with it its own set of problems.
33 *Re Bond Worth Ltd [1980] Ch. 228; [1979] 3 W.L.R. 629 Ch D*.
34 *Re Bond Worth Ltd [1980] Ch. 228* at 235.
35 *Re Bond Worth Ltd [1980] Ch. 228* at 268.
36 See, e.g. *Re Kayford Ltd (In Liquidation) [1975] 1 W.L.R. 279; [1975] 1 All E.R. 604 Ch D*.
37 See, e.g. *Re Farepak Foods and Gifts Ltd [2006] EWHC 3272 (Ch) at [52]; [2008] B.C.C. 22*.

