The Quistclose *Trust in a World of Secured Transactions*†

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A. *Introduction*

A advances a sum of money to B for a specified purpose. Before that purpose can be accomplished, B becomes insolvent or divests himself of the money in favour of a transferee taking with notice of the circumstances in which it was obtained by B. If the purpose had been duly accomplished, B would have been indebted to A in the amount of the loan. May A in these circumstances recover the money and upon what basis? The House of Lords in *Barclays Bank Ltd* v *Quistclose Investments Ltd*[1] ruled in favour of A, on a more elaborate version of the above facts, on the ground that the money had come into B's hands impressed with a trust for the specified purpose. The failure of this purpose had the consequence that B held the money on a secondary, or resulting, trust in favour of A.

This article, in dealing with the *Quistclose* trust, seeks to treat it as a form of secured lending and to place it in the world of secured transactions alongside other forms of secured lending. The first half of the article will therefore explore the theme of security, making incidental references to the *Quistclose* trust, while the second half will be given over to a detailed treatment from the security point of view of the development of the trust. The equitable provenance of the trust is no impediment to the argument that it has a rightful place alongside other examples of security. Judicial statements have been made from time to time that equity has merely an unsettling effect when transplanted into the field of commercial law,[2] but equitable intervention is far from being an unwelcome irruption in the field of security. Indeed, a compelling claim may be made that the modern subject of security is the invention of equity, which created the possibility of future assets secured financing and so permitted the encumbering of shifting and productive assets.[3] The common law offered only the fixed mortgage over present assets and the possessory pledge.

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[1] [1970] A C 567 (HL).

[2] See, eg, *Re Wait* [1927] 1 Ch 606 (CA) (Atkin LJ); *Henry* v *Hammond* [1913] 2 KB 515 (Channell J).

[3] *Tailby* v *Official Receiver* (1888) 13 App Cas 523 (HL). These assets were described as the 'new collateral' by Gilmore: (1951) 16 *Law & Contemp Probs* 27, 29.

It would be a mistake to take developments such as the *Quistclose* trust and analyse them without also asking a series of fundamental questions. What do we mean by 'security'? Why do creditors take security? Why does the law allow the taking of security? To what extent do we truly have a rule of *pari passu* distribution on insolvency? Why do we allow certain creditors to take preventative steps so that they do not have to join the insolvency queue? What purpose is served by registration of security interests? Why do we allow certain creditors to take a security without having to register their interest? How ought we to arrange priorities among secured creditors and, in particular, should we accord a special priority to purchase-money financiers?[4]

These are questions that have to be asked at the outset, before the *Quistclose* trust is closely examined, though they cannot be answered fully within the compass of this paper. It seems fair to say that the literature on security and insolvency in this country has been slow to respond to the above line of inquiry.[5] Decided cases, moreover, offer less than an adequate explanation since bilateral litigation is an unsuitable vehicle for settling what are in effect major issues of distribution. An argument can be made that the traditional treatment of security as something contractual, to be defined as between debtor and creditor, flows from judicial discomfort at handling a subject that can only adequately be framed in a legislative context,[6] and also from legislative inaction in response to certain security practices.

What Do We Mean by 'Security'?

Security in its strict legal sense is classified under the possessory heads of pledge and lien and the non-possessory heads of mortgage and charge. Apart from lien, created by operation of law (except where a special lien is swollen by contract to a general lien),[7] these all arise where the debtor makes a grant in favour of the creditor. None is created by unilateral taking or retention on the part of the creditor. Hire purchase agreements, chattel leases and title retention clauses therefore fall outside the recognized heads of security despite the business sense of regarding an unpaid seller's reservation of the general property in goods as in substance the taking of security. Nor would legal resistance to the treatment of title retention as security crumble in the face of the realization that it is better than conventional security: it functions as a purchase-money form of security, ranking ahead of prior charges and mortgages, and it does not have to be

[4] This expression, common in North America but not yet in vogue in this country, signifies a form of special project, as opposed to general, financing by which the borrower acquires new assets purchased with the amount advanced for that purpose. A superpriority is given by which the purchase-money interest ranks for priority purposes ahead of earlier general security interests. The concept will be discussed further below.

[5] Perhaps because of legislative reticence and the tradition of section-by-section statutory commentary in the area of insolvency law. For a recent attempt to address the fundamentals of the subject, see R. M. Goode, *Principles of Corporate Insolvency Law* (1991).

[6] In connection with which, see the various Parliamentary papers dealing with the bills of sale legislation, eg, 'Evidence to the Select Committee on the Bills of Sale Act (1878) Amendment Bill, 1881' (341) VIII.

[7] See for example *George Barker (Transport) Ltd* v *Eynon* [1974] 1 All ER 900 (CA).

registered. The payer of the money under a *Quistclose* trust may therefore be regarded as having an advanced priority comparable to that of a purchase money financier.

We owe it to the American realists for the insight, translated into legislative form by Article 9 of the Uniform Commercial Code,[8] that title retention should be dealt with according to what it accomplishes rather than what it purports to be. This conclusion, firmly adopted also by the Crowther Committee[9] and by Professor Diamond in his report to the Department of Trade and Industry,[10] has already been accepted in part by legislation. Administrators of a company, appointed under Part II of the Insolvency Act 1986, have certain powers of interference with the rights of secured creditors that are explicitly extended to hire purchase, chattel leases and title retention agreements,[11] though not to money received by a company under a *Quistclose* trust.

There are also stirrings in the recent case law indicative of a growing judicial impatience with a law of security that elevates form over function. In *Re Curtain Dream Plc*,[12] a sale and resale agreement concerning stock-in-trade between a trading company and a financier was treated as an artificial transaction by a court that was prepared to look at the substance of the matter and recognize the lineaments of a mortgage wrapped up in the terminology of sale. What use, after all, could a financier have for large quantities of curtain fabric unless it had to look to it for security if the trading company defaulted on its 'repurchase' obligations? If this approach is typical of future decision-making, it poses a severe threat to unregistered sale and leaseback arrangements. An understandable judicial reluctance to disturb settled practice may nevertheless point to future restraint in handling what after all are infinitely variable issues of construction. One can predict that the enquiry: Does this transaction give rise to an equity of redemption? will play a significant question-begging role in the disposition of future cases.

An even more explicit assault on artificial transactions was repulsed by the Court of Appeal in *Welsh Development Agency* v *Export Finance Co.*[13] At first instance, Sir Nicholas Browne-Wilkinson V-C had shown his impatience with the existing law of security when referring to the 'anomalies and injustices' that would be removed by 'a new and more rational framework' of the sort advocated by the Crowther Committee. The transaction in question involved the sale of computer software to a financier prior to its resale, by the manufacturer on behalf of its undisclosed principal, the financier, to overseas buyers. Despite the structuring of the transaction to avoid any contact between the financier and the various overseas buyers,[14] and despite its avowed character as a pure financing

[8] The work of the American Law Institute and of the National Conference of Commissioners on Uniform State Laws, adopted as state law by the individual states.
[9] *Report of the Committee on Consumer Credit* 1971, Cmnd 4596 (Part V).
[10] *A Review of Security Interests in Property* 1989, Part I, ch 9.
[11] Sections 10(4), 15(9) and 251 ('chattel leasing agreement').
[12] [1990] BCLC 925. Note the important influence of *Re George Inglefield Ltd* [1933] Ch 1 (CA).
[13] [1992] BCC 270, reversing [1990] BCC 393.
[14] See Bridge, 'Form, Substance and Innovation in Personal Property Security Law' [1992] *JBL* 1.

arrangement, the Court of Appeal saw no reason to impugn it as an unregistered company charge merely because of its artificial character. Brown-Wilkinson V-C had reached the opposite conclusion since he was not prepared to extend to other transactions the 'extreme leniency' demonstrated by the courts in the past towards block discounting and factoring agreements.[15]

Even if a transaction is characterized as creating a security, it may not be regulated by law in the way that other security agreements are. In this country, a security agreement need only be registered for perfection purposes if it falls within the list explicitly stated in bills of sale legislation[16] and in the Companies Act 1985.[17] Recent reforms of the latter, though more precisely defining the concept of 'charge'[18] and excising the troublesome cross-reference to bills of sale legislation,[19] do nothing to alter the established position that a finite list governs the question of registration.

Why do Creditors take Security?

In the last dozen or so years, a major debate has been conducted in the United States about the reasons underlying the giving and taking of security. What appears to have prompted the debate is the facility with which security can be taken under Article 9 and the reaction this has prompted that nothing is left for distribution to the unsecured creditors. In this respect, the English counterpart to the Article 9 security interest is the all-embracing floating charge, together with its confederates, the fixed charge on present and future book debts and the legal charge on a company's land and premises. A lay commentator has recently remarked that '[t]he final liquidation ceremony often resembles an inversion of the miracle of the loaves and the fishes'.[20] The phenomenon is hardly new. Lord Macnaghten drew attention to it in famous language a hundred years ago.[21] In 1982, the Cork Committee recommended that 10 *per cent* of the net proceeds of the assets subject to a floating charge should be set aside for the debtor's unsecured creditors,[22] but this recommendation was not enacted in ensuing insolvency legislation. Unsecured creditors cannot in modern conditions look for satisfaction to uncalled share capital and it is not a common practice for companies to set aside a reserve liability for distribution only upon insolvency.[23]

[15] See eg *Olds Discount Co* v *John Playfair Ltd* [1938] 3 All ER 275; *Chow Yoong Hong* v *Choong Fah Rubber Manufactory* [1962] AC 209. See also the agreement set out in *Re Charge Card Services Ltd* [1987] Ch 150.

[16] Bills of Sale Acts 1878–91.

[17] The amendments in Part IV of the 1989 Companies Act have not yet been implemented.

[18] Section 395(2) (as amended) (not yet in force).

[19] See now instead section 396(1)(b) (as amended) (not yet in force), substituting 'a charge on goods or any interest in goods' for the former head of charge.

[20] M. Lewis, 'The Revenge of the Wimps', *Spectator* 20 April 1991 at 9, 10.

[21] In *Saloman* v *A Saloman & Co* [1897] AC 22, 53: 'Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is . . .'. But the same judge affirmed, ibid, 52: 'Every creditor is entitled to get and to hold the best security the law allows him to take.' For similar expressions of concern, see Templeman LJ in *Borden* v *Scottish Forest Timber Products Ltd* [1981] Ch 25.

[22] *Report on Insolvency Law and Practice* 1982, Cmnd 8558, paras 1538 *et seq.*

[23] Companies Act 1985, s 120.

Given the present spate of business failures, it seems an odd time to be asking why creditors take security.

Empirical observation would suggest that companies will only give security if they have to, preferring to exhaust first of all the possibilities of unsecured credit.[24] Blue chip companies will be more successful than others in warding off or delaying the giving of security. It has nevertheless been argued that a willingness to give security has a 'signalling' function: it demonstrates the company's conviction that credit can safely be extended to it. As Schwartz explains it: 'Security interests restrict future borrowing opportunities, give secured creditors greater leverage over firm behaviour, and make it more difficult for a firm to reschedule debts in the event of hard times. A firm willing to encumber its assets is, thus, "signalling" that, in its view, its prospects justify those potential costs.'[25] Kripke has convincingly argued, however, that the notorious unwillingness of companies to borrow on a secured basis when unsecured sources remain available sends 'an involuntary signal of the opposite kind, namely that the debtor cannot borrow unsecured because creditors think the risk is too great'.[26] Banks, especially in recent decades, have shown an avid appetite for security even though prudent bankers would not lend at all if they felt there was a significant risk that the security would have to be called in, an attitude expressed in the adage that the best security is no security. In medium- and long-term financing, there is a very strong likelihood that the creditor will take security. It should be understood for present purposes that even short-term or current assets, such a book debts and stock-in-trade, can be secured on a revolving, long-term basis. This overwhelming preference for secured credit, coupled with the general reluctance of borrowers to give it, would therefore leave no room for the operation of a signalling device in the way described by Schwartz.[27]

The American literature shows a clear tendency to ask why a debtor should wish to give security. In view especially of the chronic shortage of finance for small firms, it might be more appropriate to ask why a creditor should wish to take it. Looking through the debtor's lens, nevertheless, permits the issue to be framed in terms that are an adaptation of the Modigliani-Miller theory of stratification.[28] According to this theory, in perfect capital markets a firm's value

[24] Security in this context means security of a general kind, with its concomitant controls exercised by the creditor, rather than the specific forms of security (or quasi-security) employed to finance the acquisition of particular assets.

[25] 'Security Interests and Bankruptcy Priorities: A Review of Current Theories' (1981) 10 *J of Legal Studies* 1, 15 (hereafter Schwartz (1981)). See F. Oditah, *Legal Aspects of Receivables Financing* (1991), 15.

[26] 'Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact' (1985) 133 *U of Penn L Rev* 929, 969–70.

[27] The author seems now to have drawn back from signalling theory, largely, it seems, because of the ability and willingness of bad debtors to mimic the signals of good debtors: Schwartz, 'A Theory of Loan Priorities' (1989) 18 *J of Legal Studies* 209, 245 (hereafter Schwartz (1989)).

[28] 'The Cost of Capital, Corporation Finance and the Theory of Investment' (1958) 48 *American Econ Rev* 261 (cited in Kripke, above n26) (also known as the Irrelevance Theorem).

will not be affected by the mix of debt and equity in its capital structure.[29] As extended to the field of credit, the theory holds that the mix of secured and unsecured credit will not affect the overall cost of credit to the firm. Any savings flowing from the reduction in the cost of credit from a creditor taking security is balanced, as though on a seesaw basis, by the higher interest demanded by unsecured creditors whose lending has become more risky as a result of their being subordinated to secured creditors. There may even be transaction costs if the firm decides to grant secured credit, though in many instances, simple title retention being perhaps the best example, transaction costs will be negligible.

Naturally, there is no such thing as a perfect and properly informed credit market. In any event, some creditors are more risk averse than others,[30] so that not all creditors would charge the same for unsecured credit in the same conditions. Consequently, there is no 'precise mathematical relationship between yield and risk'[31] across the field of credit. Certain unsecured creditors lending to an unencumbered debtor might not anticipate the probability or inevitability of secured credit later being granted, while others might assume this and load their interest charges accordingly. Alternatively, they might incorporate negative pledge clauses of variable effectiveness demanding an equal and rateable security if the debtor later grants a security to another creditor.[32] Furthermore, the interposition of preferential creditors between secured and unsecured creditors[33] upsets any simple seesaw comparison between the latter two groups. What a secured creditor fails to take may go to a preferential creditor instead. The risk of insolvency cannot therefore be dissipated within a simple interest rate spread. In the absence of a perfect credit market, a creditor will thus want to take security to avoid the insolvency risk that comes with lining up alongside unsecured creditors.

Additional benefits to the secured creditor will include the ability to exercise self-help without having to wait for judicial process,[34] particularly potent in the case of a demand loan, and the *in terrorem* incentive, in consumer cases

[29] It is sometimes observed that debt finance is more attractive to a small company than equity finance. Apart from tax considerations, there is the possibility that debt will permit equity owners the chance to fix creditors with the losses accruing from hazardous ventures while they shield behind limited liability, whereas profits accruing from such ventures will go to the equity owners: Scott, 'A Relational Theory of Secured Financing' (1986) 86 *Col L Rev* 901, 919 ('asset substitutions') and Schwartz (1989), above n27, 233. Debt also involves lower placement costs (Scott, above, 916) and is easier for the market to value than equity and so likely to be pitched at a better price (Schwartz (1989), above, 227).

[30] White, 'Efficiency Justifications for Personal Property Security' (1984) 37 *Vanderbilt L J* 473, 494 *et seq.*

[31] Kripke, above n27, 952, paraphrasing B. Graham, D. Dodd and S. Cottle, *Security Analysis* (4th ed 1962).

[32] See *Palmer's Company Law* (ed G. K. Morse and others), ch 13. 107. Note that negative pledge clauses do not as such bind third parties and for that reason alone will be less effective than security. This is a significant factor in the theory of Schwartz (1989), above n27. See however the tort possibilities in Stone, 'Negative Pledges and the Tort of Interference with Contractual Relations' (1991) *J of Int'l Banking Law* 310.

[33] Insolvency Act 1986, ss 40, 59 and 175.

[34] Recognized by Schwartz (1989), above n27, who is prepared to permit the taking of security in the context of a general theory of priorities that orders insolvency distribution according to the date of creation of debts, whether secured or unsecured.

especially, arising out of the debtor's fear of losing needed possessions.[35] The security that includes the power to appoint a receiver may also be useful in keeping a debtor's unsecured creditors in line.[36] Further, there is the control or 'leverage' that security sometimes allows over the business of the debtor,[37] though the attractions of this might pale somewhat today for those secured creditors fearful of being branded as shadow directors privy to acts of wrongful trading.[38] Taking security may also, in a number of instances, be a cheaper alternative to an expensive credit enquiry.[39] It may have monitoring consequences too.

Monitoring[40] may be defined as the post-lending appraisal of the debtor's conduct to avoid misbehaviour prejudicial to the creditor's investment. It ranges from the particular investigation of a loan, dedicated to an agreed narrow purpose, being in fact so applied, to the more general and long-term scrutiny associated with broadly-based loans. In the latter case, the debtor's conduct is vetted for the due observance of proper business standards as reinforced by the terms of the loan agreement. The fondness of creditors for security hardly seems consistent with the insight that security is the mark of an inefficient monitor. A creditor with a narrow security may be content to leave to unsecured and other creditors the task of general monitoring: one with a floating security has the incentive and the opportunity to conduct general monitoring and may in the process reassure other creditors that the debtor's behaviour is being properly monitored.[41] In some cases, trade creditors, who tend to be unsecured, will be better general monitors since they are often better placed to detect signs of a debtor's incipient decline. Monitoring will be more or less effective according to the particular form in which the security is cast. An example of effective monitoring would occur with a fixed, as opposed to a floating, charge over book debts (and that includes factoring for present purposes) with its concomitant accounting controls over the proceeds of such debts.[42] The general monitoring of a debtor's business hardly fits the case of a *Quistclose* advance, given the latter's emergency and short-term nature, though a *Quistclose* payer may well take steps to ensure that money advanced for a defined purpose is actually applied to that end.

[35] Saskatchewan Law Reform Commission, *Tentative Proposals for a Consumer Credit Act* (1981), 3–11: 'The Commission . . . rejects as socially unacceptable the use of security solely as a collection tool rather than as an alternative source of payment'.

[36] Goode, 'Is the Law Too Favourable to Secured Creditors?' (1983) 8 *Canadian Business L J* 53, 56.

[37] See Scott, above n29, for whom this is a major plank in his relational theory of secured lending. It corrects the phenomenon of underinvestment (or underachievement) by the debtor, not as such tackled by the warranties typically to be found in an unsecured lending agreement, which are geared to the avoidance of debtor misbehaviour.

[38] Insolvency Act 1986, ss 214 and 251 ('shadow director'). For similar perils in the United States, see Scott, above n29, 934–6.

[39] Security functions here as a screening device: Scott, above n29, 906–7.

[40] See Kronman and Jackson, 'Secured Financing and Priorities Among Creditors' (1979) 88 *Yale L J* 1143. Cf White, above n30, 476. See also Oditah, above n25, 15–18.

[41] Scott, above n29, 931.

[42] This is illustrated by the various decisions dealing with attempts to create fixed charges over book debts, eg *Re Brightlife Ltd* [1987] Ch 200; *Re a Company (No 005009 of 1987)* [1989] BCLC 13.

Why Does the Law Allow Security?

The law of security sets against each other two fundamental principles of credit and insolvency law. First, a creditor has freedom of contract to bargain for a security that will advance his priority position at the expense of other creditors of the debtor.[43] Secondly, once insolvency supervenes, the assets of the insolvent debtor must be distributed among his creditors on a rateable (or *pari passu*) basis and, perhaps more importantly, the law will not allow any contracting out of the insolvency distribution scheme.[44] It is no satisfactory answer in the face of the conflicting thrust of these two principles to deny any logical contradiction between the two, on the ground that the former principle operates before insolvency to define what goes into the insolvency process, while the latter only comes into play once insolvency supervenes.[45] Freedom of contract is permitted to empty the content of an insolvent's estate. This sharp conflict between the two principles is blurred, admittedly, by provisions in the Insolvency Act 1986 striking down transactions at an undervalue, unlawful preferences and certain late floating charges where the debtor is unable to pay his debts at the relevant time and insolvency later occurs,[46] but it seems that relatively few secured transactions have ever been, or are ever likely to be, struck down on the above grounds.[47] It is certainly very difficult to imagine any circumstances in which a *Quistclose* trust bringing in late value would be vulnerable to such an attack. The discordancy of the two principles seems particularly marked in the case of after-acquired assets falling into the maw of the security during the course of liquidation itself.[48] When secured creditors are able to eviscerate an insolvent's estate prior to its vesting in the liquidator, one has to ask just how fundamental is the *pari passu* principle, so important that in corporate insolvencies one looks for it in the Insolvency Rules[49] and not in the body of the Act itself. It seems powerful enough, however, to prevent any contracting out of the insolvency set off rules, given the law's interest in the orderly distribution of insolvents' estates.[50] Moreover, the House of Lords invoked it in the mid-70s to strike down a clearing house arrangement,[51] a result inconvenient enough for financial markets that in their case it was reversed by recent companies legislation.[52]

The stark contrast between the freedom of contract and *pari passu* principles has persuaded some North American writers to describe the grant of security as the issue of insolvency rights,[53] though one ought not to lose sight of the other,

[43] *Saloman* v *A Saloman & Co*, *per* Lord Macnaghten, above n21.
[44] Discussed below.
[45] See Scott, above n29, 901. He also argues, ibid 909, that, in a world of informational asymmetry, security permits secured creditors to capture wealth at the expense of uninformed unsecured creditors.
[46] Insolvency Act 1986, ss 238–41, 245.
[47] See, eg, *Re M C Bacon Ltd* [1990] BCLC 324; *Re Beacon Leisure Ltd* [1991] BCC 213.
[48] See *Re Lind* [1915] 2 Ch 345.
[49] Rule 4.181.
[50] *National Westminster Bank Ltd* v *Halesowen Presswork and Assemblies Ltd* [1972] AC 785 (HL).
[51] *British Eagle International Air Lines Ltd* v *Compagnie Nationale Air France* [1975] 2 All ER 390 (HL).
[52] Companies Act 1989, Part VII.
[53] Schwartz (1981), above n25; Buckley, 'The Bankruptcy Priority Puzzle' (1986) 72 *Virginia L Rev* 1393.

non-insolvency advantages of security, discussed above. One author has been so struck with the metaphor as to remonstrate with unsecured creditors for demanding insolvency distribution rights for which they have not paid,[54] though he is on firmer ground in asking how unsecured creditors can claim to have been misled when it is notorious that nothing is left for distribution to them once secured and preferential creditors (and receivers for their expenses and remuneration) have been paid off.[55] Even here, however, one can sympathize with unsecured trade creditors for whom security is not a realistic possibility and who do not have genuine freedom or opportunity to police and screen rigorously all of their trading partners. Trade credit certainly has its price even if sometimes this price is dressed up as the loss of a discount for early payment. Not all trade credit, however, will consistently carry interest charges of one kind or another and, as we saw above, there is no stable relationship between the risk of a loan and its yield and thus no common currency between the two.

It has forcefully been argued by one writer, with a very lengthy history of involvement in the practical and academic aspects of credit, that the system of secured credit has been responsible for the phenomenal growth of the distribution economy. In the case of purchase money financing, 'the effect of security is enormous in keeping the sale primarily a commercial transaction and not a banking event'.[56] On the supplier's side, the 'discovery' of revolving assets, such as stock-in-trade and book debts, as collateral for a loan has extended the availability of business credit. Valuable as this may be as a *post hoc* insight, it is unlikely to have actuated courts that have desisted from placing obstacles in the way of secured credit though it might have persuaded legislatures not to interfere in a widespread business practice.

Professor Diamond did not canvass the possibility of legislative abolition of the floating charge, though he confesses that one of his correspondents took him to task for this.[57] The reform of company charges following in the wake of his report will if anything lead to their strengthening. At present there is no constructive notice of restrictive clauses in a floating charge.[58] This will change if the Secretary of State avails himself of the power to require by regulation the registration of restrictive clauses. There is a provision in the 1989 amendments to the Companies Act 1985 explicitly stating that later chargees are deemed to have notice of matters requiring registration.[59] In the present climate of opinion, there is little prospect of any attempt to overthrow the system of secured credit, despite the opinion of certain insolvency practitioners that security sometimes impedes corporate rescues. Consequently, the debate among American writers over the efficiency or otherwise of secured credit seems somewhat academic, though one's view of this might change if the empirical work called for by one of

[54] Buckley, above 1406.
[55] Ibid, 1410.
[56] Kripke, above n 26, 947.
[57] Report, above n10, ch 8.1.3.
[58] *English & Scottish Investment Co* v *Brunton* [1892] 2 QB 700 (CA).
[59] 1985 Act (as amended), ss 410(1), 416.

these writers to demonstrate various working hypotheses is ever accomplished.[60] Should this come to pass, it would raise an interesting evidentiary problem. Is the *pari passu* principle so strong that the burden of proving efficiency rests upon those who support secured credit, or is freedom of contract paramount so that the burden falls upon those who oppose security? One American writer has plausibly argued that the abolition of security would lead to bilateral subordination arrangements between unsecured creditors tending to replicate the abolished secured credit system, as well as to the rediscovery of evasive devices such as title retention and discounting that in substance amount to security.[61] The history of forms of lending in this country is quite supportive of this speculative line.[62]

Priority Rules

Those familiar with the rule of *nemo dat* in personal property law will have seen prevail, subject to certain exceptions, the rights of an owner against those of a later *bona fide* transferee. The law is debated in terms of the irreconcilable conflict between the need to protect property rights and the importance of promoting the integrity of commercial transactions,[63] as owner and third party try to impose on each other the cost of a rogue's fraudulent behaviour. The same priority approach is adopted in ordering the rights of competing secured creditors: one starts from the position that the first in time prevails.[64]

Kronman and Jackson[65] justify this approach on the ground that debtors would otherwise have a financial incentive in progressively granting paramount security outranking earlier security. Consequently, the first secured creditor could not confidently anticipate anything other than the gradual degradation of his security, with the result that security as such would no longer exist and the first creditor would charge the debtor as though the loan were unsecured in the

[60] Schwartz (1981), above n25, 37.

[61] White, above n30, 507.

[62] See, eg, the development of hire purchase to avoid the need to register under bills of sale legislation.

[63] The following statement of Denning LJ in *Bishopsgate Motor Finance Corpn* v *Transport Brakes Ltd* [1949] 1 KB 322, 336–7 sums it up:

'In the development of our law, two principles have striven for mastery. The first is for the protection of property: no one can give a better title than he himself possesses. The second is for the protection of commercial transactions: the person who takes in good faith and for value without notice should get a good title.'

[64] Schwartz (1989), above n27, argues at length that the law's commitment to the creditor who is first in time does not go far enough. In his view, the paradigm bargain arrived at in equilibrium between a debtor and his initial financier would seek to accord priority to that financier whether the loan was secured or unsecured. Later creditors, able to assess the debtor's position from its financial records more cheaply than any filing system would cost, would in the face of their subordination exact appropriately higher interest charges. It would moreover be easier for the first financier to agree to subordinate himself to a later creditor than it would under the present system for an initial unsecured financier to exact a priority from a later secured creditor, who is not bound as such by negative pledge clauses in the initial loan agreement. This would support a change to the existing priority system enacting this extended first in time approach as the default priority system. Schwartz would make an exception in this priority order for a narrowly stated purchase-money security interest. It seems fair to say that the author does not ask why an initial financier under the present system, with the opportunity to do so, yet chooses to rely on covenants, including a negative pledge clause, rather than take security. Moreover, the cost of enacting a major innovation cannot lightly be dismissed.

[65] Above n40, 1161–4.

first place. However that may be, the English law of secured transactions, dominated by contract and property notions, falls in naturally with a first in time approach. There is nothing like the meticulously ordered collocation of privileges and securities to be found in civilian systems historically resistant to non-possessory security, like the Civil Code of Lower Canada.[66] Nevertheless, the legislature in this country has occasionally interfered with the rights of creditors with a duly perfected security. Thus preferential creditors have long ranked ahead of floating chargees, a position strengthened by recent insolvency legislation.[67] Furthermore, the rights of a floating chargee during a company's administration stand to be diminished from day to day as the special priority given to those trading with a company in administration mounts up and as the expenses and fees of the administrator similarly increase.[68] Another departure from the first in time approach, this time a judicial one, is the rule in *Dearle* v *Hall*,[69] which arranges priority according to the date of notification to the account debtor rather than the date of creation of the assignment. It may be that this is a pragmatic departure based upon the tidiness of a rule of priority that accords with an assignee's ability to give a good discharge for payment to the account debtor. One writer has speculated that the durability of the rule owes something to its success in encouraging assignees of book debts to monitor the assignor's business,[70] though this smacks of *post hoc* reasoning.

A prominent feature of the Article 9 system is that the first-in-time rule gives way to the special priority status of the purchase-money financier. One explanation given for this is that it breaks the hold on a debtor that would otherwise be given to a first secured creditor with a situational monopoly.[71] The English law on floating charges, by which a company is impliedly or ostensibly (notwithstanding restrictive clauses) authorized to enter into ordinary course transactions giving a later creditor a higher-ranking security,[72] is congruent with this approach. Another explanation for the Article 9 special priority is that a purchase-money financier, whose advance must be traceable into tangible new assets,[73] adds new value to the debtor and therefore expands the asset base available for security.[74] A persuasive argument could be advanced that the very

[66] Macdonald, 'Modernization of Personal Property Security Law: A Quebec Perspective' (1985) 10 *Canadian Business L J* 182.

[67] Insolvency Act 1986, ss 40 and 175.

[68] Ibid, ss 15 and 19(4), (5).

[69] (1828) 3 Russ 1.

[70] Buckley, above n52, 1447.

[71] Criticized by Kronman and Jackson, above n40, 1145. Cf the future advances case of *Coin-O-Matic Service Co* v *Rhode Island Hospital Trust Co* (1966) 3 UCC Rep 1112 (Rhode Island SC).

[72] *Palmer's Company Law* (ed by G. K. Morse and others), ch 13. 126–7. Note that, under the 1989 reforms when enacted, the confluence of the new s 416(1) (notice of matters that have to be registered) and of the new s 415(2) (material required for registration may include restrictive clauses) would (depending on the scope of the restrictive clause) advance the bank with the floating charge at the expense of a later purchase-money financier with a true security as opposed to a title reservation: above n59 and accompanying text.

[73] See, eg *Re Manuel* (1975) 507 F 2d 990 (5th Cir).

[74] Kripke, above n26, 936. In his firm support for a first in time priority rule, Schwartz (1989), above n27, 242–3, makes an exception for a purchase-money special priority where 'a form of strict foreclosure' operates so that the debtor's payments correspond to the depreciation of the new asset and the later lender is made whole on the debtor's default by repossession. He also notes that a specialist purchase-money financier may be better able than a general financier to maximize resale proceeds.

refusal of English law to recognize title retention as security is consistent with this same policy, in that it is the next best thing to an overt recognition of the purchase-money security interest as part of a rational system compelling registration of all security interests. Furthermore, it is quite likely that a close analysis of the circumstances in which the *bona fide* purchaser of the legal estate ranks ahead of an earlier equitable interest holder would support the law's preference for purchase-money financiers. Another rationalized but perhaps rather more explicit acceptance of the purchase-money special priority is the decision in *Re Connolly Brothers Ltd (No 2)*.[75] In this case a creditor, granting new value to finance the acquisition by a company of freehold property, was allowed to rank ahead of earlier creditors with a first and floating charge. The somewhat artificial ground for the decision was that the sale of the property by a third party to the company, and the grant of the charge to the later creditor, were really one compound transaction whose effect was to vest in the company freehold property that had already been encumbered.[76] The same advanced priority is visible in the case of the *Quistclose* trust.[77] The payer, clearly adding to the asset base of the payee and rewarded with a commensurate priority status, ranks ahead of all prior secured creditors and is subsequently vulnerable to the *bona fide* purchaser of the legal estate for value and without notice of the trust. The very refusal of the law to treat the *Quistclose* transaction as a security agreement in fact serves to accord it the advanced priority that goes with similarly exempted transactions, such as hire purchase agreements and effective *Romalpa* reservations of title.

Finally, there is the matter of registration. This does not as such improve the creditor's priority position. Rather, it protects from defeasance the priority position otherwise allowed the creditor by the general law.[78] Thus, of two secured creditors, the first in time will rank ahead of the second even if the latter is the first to register, provided that the first secured creditor complies with the twenty-one day grace period in the Companies Act 1985. This should be contrasted with Article 9, where in the legislative scheme grace periods (of shorter duration) are the exception rather than the norm. It ought to be reiterated that any exemption from the need to register represents a policy judgment. First of all, pragmatic business reasons may militate against registration. Thus the exemption accorded to the shipowner's lien on sub-freights by the Companies Act 1989[79] supports the established practice in the shipping industry that excludes lawyers from the negotiation of certain routine, however large, transactions. Other examples concerning the export trade may be found in the text of bills of sale legislation. Secondly, buttressed by the provisions of the general law, it reflects the law's preference for a particular priority resolution

[75] [1912] 2 Ch 25.

[76] The decision has been affirmed by *Abbey National Building Soc* v *Cann* [1991] AC 56 (HL).

[77] See the unreported New Zealand case of *Sopp* v *Goldcorp Refiners Ltd*, noted in Rickett, 'Different Views on the Scope of the *Quistclose* Analysis: English and Antipodean Insights' (1991) 107 *LQR* 608, 640–1.

[78] Companies Act 1985, s 395(1) (s 399(1) when Part IV of the 1989 Act comes into force).

[79] Section 396(2)(g) (as amended).

that ought not to be upset by the relevant party's failure to register. That party's priority position is in fact boosted by the exemption from registration. If a *Quistclose* trust is seen as giving rise to a security interest, the absence of any need to register is striking but also justifiable in view of the emergency aspect of the matter, as well as (sometimes) the non-professional character of the arrangements. If Professor Diamond's reform proposals are ever enacted, the emphasis will be shifted away from arguments that certain securities ought to be added to the *numerus clausus* in the Companies Act 1985. Instead, the position will have to be established that a particular security should not have to be registered despite the wide functional definition of security. Where the system of registration is expeditious and cheap, that will not be the easiest of positions to adopt.

B. *The* Quistclose *Trust*

The ability of the *Quistclose* payer to recover the amount advanced in the face of the payee's insolvency compels a comparison to be made with secured creditors, who also are released (if their security is adequate for the purpose) from any need to line up with unsecured creditors for the usual minuscule insolvency dividend. The proposition put forward in this article is that from a functional point of view the *Quistclose* payer is a secured creditor and that a great deal of light can be thrown on the transaction if this observation is borne in mind. It may be that this proposition points the need to analyse the *Quistclose* transaction other than in trust terms.

The antiquated structure of the English law of personal property security makes it hard to view the *Quistclose* transaction as a form of secured credit. A lawyer schooled in the functional thinking that produced Article 9 of the Uniform Commercial Code would, however, have no such difficulty. For such a lawyer, the question would be, not what is the transaction called, but rather what in practical terms does it seek to accomplish.[80] Unless a transaction were to come within the list of explicit exceptions to the definition of a security interest—and there is nothing in the present list that corresponds to a *Quistclose* trust[81]—it is difficult to see how it could fall outside the broad sweep of a security interest as defined in the Uniform Commercial Code.[82] If the parties were to use explicit trust language to designate the separate character of money paid, this would show a clear, express intention that the payer is to be protected from the claims of other creditors of the payee, and would thus clearly evince an intention to seek and provide security. In the absence of explicit trust language, the courts would not be astute to make inroads into the general scope of Article 9, given that compliance with the registration scheme is not unduly onerous and expensive, and given the systemic losses that would flow from any invitation to statutory avoidance.

[80] See UCC Arts 1–201 and 9–102.
[81] Art 9–104.
[82] Art 1–201.

In contrast with an American lawyer handling functional legislation like Article 9, an English lawyer would begin by asking whether the *Quistclose* trust is a species of title retention or whether it operates by way of mortgage or charge. Apart from recent statutory innovations,[83] English law resolutely refuses to treat title retention as a form of security properly so called, whatever functional sense such an approach might make. Furthermore, if the beneficial property in money paid over is retained by the payer, there is no property in the payee that may be encumbered by way of property or charge. So, if the *Quistclose* transaction is analysed as a trust, it is difficult to see that the beneficial property ever leaves the payer, at least in those cases where the payer is also the beneficiary. Consequently, the payee receives nothing from the payer that can support a security given back to the payer. This difficulty would not arise if the trust were declared after payment by the payee rather than imposed at or before the time of payment by the payer.

If the *Quistclose* transaction were not viewed as a trust, it might instead be regarded as a two-step arrangement by which money is advanced outright to a payee, simultaneously coupled with a grant back by way of mortgage or charge to the payer.[84] In this instance, one might say that the money or its proceeds is subjected to a security in the strict sense of the term, though in all probability not one that is on the list of registrable bills of sale or corporate charges. The difference between these two approaches, as clear as it might be to a commercial lawyer, is unlikely to be a vivid one as far as the great bulk of *Quistclose* payers are concerned. Furthermore, in matters of trust or charge, even when these are created consensually, one ought never to underestimate the extent to which the transaction acquires its characteristic stamp by means of a judicial assessment of the facts as opposed to a consciously precise act of creation by the parties themselves.[85]

In sum, the *Quistclose* transaction could be treated as a security agreement if one view of the facts is taken, but if title retention expresses the payer's intention, then it could only be recognized as a security in a reformed law of personal property security inspired by functional insights drawn from the experience of Article 9. If the transaction is seen as giving rise to a security according to the present legal definition, this prompts the question, how ought the payer to be ranked, for priority purposes, with other secured creditors of the payee? A further question, posited upon the conclusion that the payer is a secured creditor of the payee, is whether the payer is or ought to be required to register his interest to perfect it against a trustee-in-bankruptcy or company liquidator. The *Quistclose* trust is not, as far as trusts lawyers are concerned, devoid of other matters of interest, notably, whether the trust is properly constituted, who has

[83] Insolvency Act 1986, Part II.

[84] Cf *Re Bond Worth Ltd* [1980] Ch 228.

[85] See *Swiss Bank Corpn* v *Lloyds Bank Ltd* [1980] 2 All ER 419, *per* Buckley LJ at 426: '[I]f . . . the parties have entered into a transaction the legal effect of which is to give rise to an equitable charge in favour of one of them over the property of the other, the fact that they may not have realized this consequence will not mean that there is no charge. They must be presumed to intend the consequence of their acts.'

the power to enforce it, is it revocable and who is its beneficiary. These issues have been lucidly dealt with on an extrajudicial occasion by Sir Peter Millett.[86] His conclusions will be drawn upon so far as they are material to the lending and security questions posed earlier. An Australian lawyer has urged that the spotlight now be directed at the commercial principles underlying the judicial desire to intervene with the *Quistclose* instrument. This paper responds to that suggested change of direction.[87] In the process it does not enter upon some of the finer points of trust analysis. Rather, its central concern is the earmarking of money for a particular purpose in such a way that, with equitable assistance, it escapes the insolvency distribution net.[88]

Early Cases

The roots of the *Quistclose* trust lie in a number of nineteenth century authorities. These cases are, for the most part, centred on three fact patterns, though the authorities relied upon in the *Quistclose* decision itself are confined to the first of these categories. First, A puts in funds B, a debtor, for the purpose of paying C, one of B's creditors. The practical issue here is whether the funds may be retained or recovered by B's trustee-in-bankruptcy. Secondly, A consigns goods to C in response to an order placed by B and A draws on B for payment of the price. The question here is whether the cargo has been appropriated to secure the due payment of the bill of exchange. This transaction can also occur in a two-party form, where A consigns goods to B and then, after so advising B, discounts a bill drawn upon B. Thirdly, A transfers to B, a bank, bills of exchange payable to A in payment for other bills drawn earlier by A upon B. B becomes insolvent before paying the bills drawn upon it. Is B merely indebted to A in respect of the bills transferred to it? Another bank insolvency problem occasionally presents itself where one bank is put in funds to be remitted to another bank and becomes insolvent before the remittance is made.

The first of these fact patterns presents the issue of equitable retention in two forms. In the hard form, the question is whether the trustee-in-bankruptcy may distribute funds in the debtor's hands among the unsecured creditors. In the soft form, the question is whether the trustee-in-bankruptcy may recover as unlawful preferences sums already disbursed by the debtor in accordance with the payer's directions.[89] In this latter case, equitable retention is only indirectly relevant, for its presence, whilst decisively rebutting an unlawful preference, is not essential for this purpose.

86 'The Quistclose Trust: Who Can Enforce It?' (1985) 101 *LQR* 269. See also Rickett, above n77; G. Moffat and M. Chesterman, *Trusts Law [:] Text and Materials* (1988), ch 15 ('Commerce, credit and the trust').

87 Austin (1986) 6 *OJLS* 444. He opens up the discussion, 455, with the suggested criterion of corporate rescue. See also Austin, 'The Melting Down of the Remedial Trust' (1988) 11 *Univ of NSWLJ* 66, 74 (referring to 'a very specific intention regarding the ownership and control of . . . money, the judicial recognition of which will facilitate salvaging operations for businesses of doubtful solvency'); Maxton, 'The *Quistclose* Trust in New Zealand' (1989) 13 *NZULRev* 303.

88 A more detailed trusts analysis is to be found in Rickett, above n77.

89 See now Insolvency Act 1986, ss 239 and 340.

A characteristic of these cases is the immediacy of the debtor's need for outside sources of funding. The debtor may already be faced with a bankruptcy petition by one of his creditors,[90] who may be a judgment creditor,[91] or he may be poised to abscond to evade his creditors,[92] or already be lying in a debtors' prison.[93] In one case, the money is paid over to the debtor to obtain the release of the payer's property from a sheriff executing on behalf of a judgment creditor of the debtor.[94] It does no harm to the payer's case if the money advanced is still capable of being returned *in specie*. This was so in one case where it was a *surety* who was seeking the return of the money to the payer, who unlike the surety was unaware that the money was being advanced conditionally to save a bank from bankruptcy.[95] In all of these cases, the party paying the money does so on an emergency, rescue basis and the debtor is merely a conduit through whom money is channelled to the outside creditor. In the circumstances, the debtor's possession of the money is far removed from misleading anyone entering into further dealings with him and any benefit accruing to the unsecured general creditors would be of a windfall nature. Nor is the payer, it seems, receiving anything in the nature of a premium or reward for the very high degree of risk attendant upon the transaction being a mere loan. It is therefore difficult to see that the payer receives an unfair advantage over the payee's other creditors, in the period leading up to the bankruptcy, making it unfair to allow him to retain or recover the money as the case may be.

The language spoken by the courts in the above cases is that of trust or its close equivalent. Nothing is said or reported that is expressly indicative on the part of either payer or payee of a trust obligation. In one case, money advanced for a special purpose was 'clothed with a specific trust' so that 'no property in it passed to the assignee of the bankrupt'.[96] In another case, the payer's stated entitlement to obtain an injunction, so as to prevent the money from being used other than for its designated purpose, meant that it did not form part of the payee's estate and so did not vest in his trustee-in-bankruptcy.[97] The presence of an intention shared by payer and payee that the money is not to be divided among the latter's unsecured creditors has also been regarded as relevant.[98]

The second group of cases, dealing with export transactions, raises issues akin to those in the *Quistclose* trust. The cases do not refer explicitly to money received on trust terms but rather to the 'appropriation' of bills of lading or the proceeds of sale of the cargo represented by the bills of lading. This language vaguely straddles the gap separating the retention of the general property in the goods supplied and the taking of a charge over them or their proceeds. The basic

[90] *Re Hooley* (1915) 84 LJKB 1415; *Re Drucker (No 1)* [1902] 2 KB 237.
[91] *Re Rogers* (1891) 8 Morr 243.
[92] *Re Vautin* [1900] 2 QB 325.
[93] *Toovey* v *Milne* (1819) 2 B & Ald 683.
[94] *Re Watson* (1912) 107 LT 783.
[95] *Edwards* v *Glyn* (1859) 28 LJ QB 350.
[96] *Toovey* v *Milne*, above n93. See also *Re Vautin*, above n92 and *Re Hooley* and *Re Drucker (No 1)*, above n90.
[97] *Re Rogers*, supra n92. See also *Re Watson*, supra n95, per Cozens Hardy MR.
[98] *Re Watson*, above n94, *per* Hamilton LJ.

question is whether the drawer of a bill of exchange retains an interest in the underlying goods sold pending the acceptance and payment of a bill of exchange for their price. There is one example in the Sale of Goods Act,[99] codifying earlier House of Lords authority,[100] where the general property in goods does not pass to the buyer who receives at the same time the bill of lading and a draft for the price. The passing of property by virtue of the bill of lading is conditional upon the buyer's acceptance of the draft.

It was common nineteenth century practice to dispatch the bill of lading to the consignee, whether buyer or factor, and only later to send an advice of draft, informing the consignee that the bill had been drawn against the particular cargo, the draft meanwhile being discounted before its acceptance by the consignee. In a number of cases, this was held to be insufficient to charge the underlying cargo.[101] As Fry LJ put it in one of these decisions: '[I]f the argument . . . were to succeed, it would appear to me to follow that every bill of exchange which represented a real transaction, would be a bill having a lien upon the goods which formed the subject of the transaction'.[102]

In one case, however, the charge argument succeeded on the following facts. An English seller sold a quantity of soap to an Australian buyer, the latter being represented by agents in England. These agents financed the seller by first drawing on him and then remitting to him the fruits of his own discounted acceptances. The understanding between the seller and the agents was that the price received from the Australian buyer should first be applied to the discharge of the seller's acceptances. To this end, the seller instructed the buyer to make payment to the agents. This arrangement was held to constitute an equitable appropriation of the price for the designated purpose. It also bound a bank, to whom the agents were indebted, which received the moneys with notice of the above arrangement.[103] In so far as the court in this case recognized that money paid over had been clearly earmarked for a particular purpose, the case stands comparison with the modern *Quistclose* trust. The other cases referred to above involved a refusal to accept that property had been earmarked for a purpose with the requisite degree of clarity.

The third fact pattern involves bills sent to a bank to pay for the bank's prior acceptances of the payer's drafts. In the early banking case of *Hollingworth* v *Tooke*,[104] light gold was remitted to a bank to pay for certain acceptances given by the bank. The bank acted also as a factor on behalf of the remitting party and thus had a possessory lien over its principal's property for amounts owing to it.

[99] Section 19(3).

[100] *Shepherd* v *Harrison* (1871) LR 5 HL 116.

[101] *Phelps Stokes & Co* v *Comber* (1885) 29 Ch D 813; *Konig* v *Brandt* (1901) 84 LT 748; *Robey & Co* v *Ollier* (1872) LR 7 Ch App 695; *Brown, Shipley & Co* v *Kough* (1885) 29 Ch D 848; *Ex p Dever* (1884) 13 QBD 766. To contrary effect, see the heavily distinguished case of *Frith* v *Forbes* (1863) 32 LJ Ch 10.

[102] *Phelps, Stokes & Co*, above, 825.

[103] *Steele* v *Stuart* (1866) LR Eq 84.

[104] (1795) 126 ER 670.

When the bank failed, the court recognized that the remitting party had retained the general property in the light gold designated for the acceptances that the bank would no longer meet. The bank merely had a factor's special property in the light gold in its possession.

The above result depended upon the assets sent to the bank retaining their original identity. In other cases of bank failure, the remitting party was held not to be entitled to follow the proceeds of bills sent in payment for acceptances that the payee bank would not now meet.[105] The practice of the payee bank in debiting itself with interest charges for the period between the discounting of the bills and the meeting of its earlier acceptances connoted a relationship of debtor and creditor between the remitting party and the bank. It showed that the bank was free to deal with the moneys generated by the discounts as its own property.[106] Where the bills, however, remained *in specie* at the date of the liquidation, and represented a surplus in favour of the remitting party in its dealings with the bank, the authority of the bank to discount the bills terminated with its liquidation[107] and the remitting party retained an equitable property in them.[108] In sum, these cases established that an equitable property may be retained in bills earmarked for a particular purpose, but this equitable property is superseded by a debt claim when the bills are discounted, even before the particular purpose, the meeting of the acceptances, has been accomplished.

In the similar situation where a customer pays money into a bank to be forwarded to another bank, and the first bank fails before the money is duly sent, the authorities are divided on what is a matter of construction. In *Farley* v *Turner*,[109] the court saw a transaction of this kind as specifically appropriating the money to the stated purpose, even if the initial payment could not be regarded as the deposit of valuables to be returned *in specie*. The notice left with the bank clerk clearly identified the acceptance, payable at the second bank, which the payment in at the first bank was designed to meet. In a similar case, however, the customer had to be content with proving as a general creditor of the bank.[110] A review of the various authorities dealing with specific appropriation supports the view that cogent evidence of such appropriation would be needed to satisfy any court, an approach consistent with modern *Quistclose* authorities. The balance appears to be tilted rather in favour of the general rule that the customer-bank relationship is one of debtor and creditor and against the assertion that the failing bank is merely a convenient and transient conduit through which a payment is made between distant parties.

[105] *Re Broad* (1884) 13 QBD 740.
[106] *Re Broad*, above; *Re Gothenburg Commercial Co* (1881) 29 WR 358.
[107] *Re Gothenburg Commercial Co*, above.
[108] *Ex p Gomez* (1875) LR 10 Ch App 639. And see *Re Boldero* (1812) 19 Ves Jun 25 (bills not yet discounted remained the property of the remitting bank).
[109] (1857) 26 LJ Ch 710.
[110] *Re Barned's Banking Co* (1870) 39 LJ Ch 635.

Modern Case Law

The modern *Quistclose* authorities may conveniently start with *Re Nanwa Gold Mines Ltd.*[111] In that case, subscriptions were invited for a new share issue on terms providing that the issue was conditional upon certain resolutions being passed and upon the subsequent sanction of the court to a reduction of its capital by the company. Should the conditions not be met, the subscriptions were to be returned and meanwhile were to be kept in a separate account. This account was maintained in the joint names of the company and its registrars. When the financing scheme was abandoned, the company's debenture holders sought to know whether the subscription moneys were the property of the company or of the subscribers. In deciding that the subscribers had a lien or equitable interest in respect of moneys in the account,[112] rather than a debt claim against the company, Harman J stressed the pivotal importance of the company's undertaking to hold the moneys in a separate account and played down the uncommunicated fact that the account was kept in joint names. Furthermore, the mere separation of the moneys without more would not have been sufficient. When it launched the plan, the company was at the end of its financial resources. If it had been allowed to keep the money, the debenture holders would have enjoyed a windfall. But this in itself would not have justified preferring the subscribers to all the other creditors of the company. The subscribers needed the company's special undertaking to achieve this. It is worth underlining that the subscribers were in competition, not just with the debenture holders, but with the company's unsecured creditors as well. Their merits, when measured against their two competitors individually, may not be assessed in precisely the same way. The decision of the court could, one imagines, have been equally expressed on the facts by ruling that the moneys in the special account, representing a debt owed by the bank to the company, had been charged by the company in favour of the subscribers.[113] That would not have been a registrable charge under the Companies Act 1985.[114]

In *Barclays Bank Ltd* v *Quistclose Investment Ltd*,[115] a company was promised loan finance if it first obtained finance from another source to pay a share dividend that had already been declared. The respondents made a loan for the precise amount and payment of this dividend, the cheque being paid into a special account created for this purpose with the appellants. When the company went into voluntary liquidation before this dividend was paid, the question was whether the respondents had retained an equitable interest in the money paid over, the appellant bank at all time having notice of the payment terms. It was the respondents' contention that: 'It is a fundamental principle of equity that if A

[111] [1955] 1 WLR 1080. Distinguished in *Re Associated Securities Ltd* [1981] 1 NZLR 742.
[112] The debenture holders mentioned, in order to dismiss it, the idea of bailment.
[113] Maxton notes that the *Quistclose* trust gives the creditor some of the advantages of a charge but avoids publicity to this effect: [1988] NZLJ 31.
[114] *Re Brightlife Ltd* [1987] Ch 200; cf *Re Permanent Houses (Holdings) Ltd* [1988] BCLC 563.
[115] [1970] AC 567.

pays money to B upon terms (accepted by B) that the money is to be applied for a specific purpose B is subject to an equitable obligation to apply the monies only for that purpose and cannot himself assert a beneficial title thereto and the money is subject to a trust of which B is trustee.' On the facts of the case, A's purpose was revealed in the resolution of its board that the money be obtained 'for the purpose of [the] company paying the final dividend', and B's consent to this on the terms on which it remitted the cheque to the appellant bank, 'this amount... only [to] be used to meet the dividend due'.

Ruling in favour of A, the House of Lords noted that the money was never intended to form part of the company's assets but was specifically directed at those entitled to the final dividend. It was consequently burdened with a primary trust and, since this trust was no longer possible to carry out, it reverted to the respondents according to a secondary, or resulting, trust to that effect. It was no impediment to the existence of this trust arrangement that the relationship between the party advancing the money and the company was also that of creditor and debtor. Trust and debt could coexist in the same relationship.[116] Venturing beyond the bounds of conventional trusts law in the way that it did, the House of Lords opened up the road to a substantial 'infiltration'[117] by equity of commercial law.

So stated, the decision presents a number of critical issues. First, it is not clear that the primary trust had failed so as to spring the secondary trust.[118] Secondly, the primary trust enured in favour of those entitled to the dividend even though it was the lender who had 'an equitable right to see that [the money] is applied for the primary designated purpose'. Who was the beneficiary? The analysis of Sir Peter Millett, that on facts like these the trust arises in favour of the lender, and is to be enforced according to his directions, appears to be irreproachable.[119] Thirdly, it is not clear why the existence of the secondary trust should depend upon an express or implied agreement between lender and company. In those cases where the beneficiary of the trust is the lender himself, the distinction between primary and secondary trust collapses, given that the company trustee would normally be responsive to the lender's directions from time to time.

As in *Re Nanwa*, the argument could be maintained that, on these facts, the company had charged the bank's indebtedness to it in favour of the lender, though this would depend upon the payment into the bank account being excluded from the bank's right to combine the company's various accounts.[120]

[116] Cf *Lister* v *Stubbs* (1980) 45 Ch D 1 (CA).

[117] The word comes from Goodhart and Jones, 'The Infiltration of Equitable Doctrine into English Commercial Law' (1980) 43 *MLR* 489.

[118] Millett, above n86. In the Court of Appeal, Harman LJ at [1968] 1 All ER 613, 616, put the matter in terms of the illegality of paying the dividend when the company was in liquidation, as noted by Tompkins J in *General Communications Ltd* v *Development Finance Corpn of New Zealand* [1990] 3 NZLR 406, 415. In *Stanlake Holdings Ltd* v *Tropical Capital Investment Ltd* (1991) (CA-unreported), Taylor LJ was of the view that the *Quistclose* purpose had failed.

[119] Above n86. This 'illusory trust' analysis was adopted by the New Zealand Court of Appeal in *General Communications Ltd* v *Developmental Finance Corpn of New Zealand*, above.

[120] *Garnett* v *M'Kewan* (1872) LR 8 Ex 10; *National Westminster Bank Ltd* v *Halesowen Presswork and Assemblies Ltd*, above n50. Presumably the bank may surrender by contract its right to combine just as it might surrender its

The tendency to dwell upon the money or cheque handed over, instead of upon the indebtedness into which it is soon permissibly transformed, deflects analysis away from the possibility of a charge and results in the *Quistclose* lender not being seen as one of a group of secured creditors. This may represent an instinctive response to the cumbrousness and intellectual incoherence of the English law of security. If a *Quistclose* security interest could quickly and cheaply be registered and attract the ranking of a purchase money interest, its comradeship with other security interests should more readily be recognized.

Be that as it may, the law is likely to continue analysing the *Quistclose* transaction in its existing terms, as long as the Diamond recommendations for an Article 9 system[121] remain unpalatable to those with a vested interest in the present system. In the meantime, the most difficult practical matter to resolve will be whether a purpose has been defined in a sufficiently rigorous way to attract the cachet of a *Quistclose* trust and to justify a departure from the normal insolvency distribution scheme. Although the inference of a *Quistclose* trust is a matter of construction of the particular circumstances, there is a danger that a too-ready willingness to infer the trust in non-insolvency cases will have a disruptive consequential impact on later insolvency cases. Viewing the process of construction, one will inevitably wonder if there exists an inarticulated agenda to add to the parsing of language used by lender and company. In the *Quistclose* case itself, it is noteworthy that the 'moving spirit' behind the company also owned or controlled the lender. Moreover, as in *Re Nanwa*, the transaction was in the nature of a last ditch rescue attempt.

Another corporate rescue case is *Re EVTR*,[122] where the company in question was facing considerable financial difficulties and needed new equipment to generate the additional turnover necessary if its business were to continue. The appellant, who was not in the business of lending money, had won a large sum in the premium bonds draw. On the advice of his accountant, who counselled against the making of a simple unsecured loan, he advanced to solicitors acting for EVTR, a company run by a friend of his, the sum of £60,000 'for the sole purpose of buying new equipment'. This money was paid over by EVTR to two other companies. The first was the manufacturer of a sound system which agreed to sell one of its systems to the second, which in turn agreed to provide it to EVTR on hire purchase terms. The terms involved a deposit of £60,000 and thirty-six monthly instalments. Meanwhile, until the sound system was ready, EVTR was to have the use of temporary equipment.

The bank financing EVTR sent in receivers before the new equipment arrived and the two supplier companies returned the balance of the £60,000 after deducting agreed sums representing expenses and interest charges. The Court of Appeal had no doubt that the initial payment had been made on *Quistclose* terms.

right to have an overdraft repaid on demand: *Williams and Glyn's Bank* v *Barnes* (1980) (Gibson J, unreported), discussed in *Encyclopedia of Banking Law* (ed by P. Cresswell and others), para C(183).

[121] Discussed in Bridge, 'Form, Substance and Innovation in Personal Property Security Law' [1992] *JBL* 1.

[122] [1987] BCLC 646. See also *General Communications Ltd* v *Development Finance Corpn of New Zealand*, above n118.

More difficult was the further question, whether the agreed purpose for the making of the loan had been accomplished. If it had, the appellant would be just another unsecured creditor, whereas if it had not, the balance of the moneys would be returned on a resulting trust to the appellant. The irony of course was that the appellant was claiming to be disappointed in his aim to make himself eventually an unsecured creditor of EVTR. Seeing no reason 'why the final whistle should be blown at half-time',[123] the Court of Appeal concluded that the appellant's purpose had not been achieved and so the balance had to be returned to him on a resulting trust.

As the financing scheme had initially unfolded, the appellant himself was going to purchase the equipment prior to letting it to EVTR. It was only because the equipment proved unexpectedly expensive that a different scheme involving the two outside companies was concocted. This scheme left the appellant with no readily defined access to title retention or a conventionally secured loan, so the *Quistclose* trust might in this light be seen as the law's sympathetic response to the provision of loan finance in an unconventional way from an unconventional source. Certainly, the language used in conveying the *Quistclose* intention to EVTR's solicitors was looser than one would have expected from competent and experienced legal counsel. The appellant was not a trade creditor thoroughly apprised of credit risk and the bank obtained its debenture from EVTR some considerable time after the appellant's financing scheme had been launched. The bank would have been a windfall creditor if the *Quistclose* trust, and its failure of achievement, had not been recognized.

Undertakings Given by the Payee

The *Quistclose* authorities also canvass the issue of the creation of the trust when money is paid over without explicit, or near-explicit, trust language on the part of the payer. It may be that a more or less specific undertaking is given by the payee or that there is merely an agreed purpose for the loan (a commonplace aspect of any lending agreement) between payer and payee. Or it may be that the money has already been paid over before any attempt is made to dedicate it to a particular purpose. A number of general points present themselves at the outset. The vaguer the language used, the larger will loom the shadow of the insolvency distribution scheme. Furthermore, possibly because of the influence of the law on preferences, it might be that the law looks more critically at payee undertakings than at payer impositions. Insolvency law is perhaps beginning to make its influence felt in other ways too. The Cork Committee was of the view that its proposals relating to wrongful trading would increase the number of instances of companies declaring themselves trustees of moneys received.[124] There appears to be little obvious evidence of such a widespread phenomenon but there are

[123] Ibid, per Dillon LJ at 651.
[124] *Report on Insolvency Law and Practice* (1982), Cmnd 8558, ch 22, para 1036.

certainly some instances where an apprehension of fraudulent trading[125] and perhaps also wrongful trading[126] has had an impact on the inference of a *Quistclose* trust.

In *Re Kayford*,[127] a company in financial difficulties acted on the advice of insolvency practitioners in reviving a dormant deposit account and christening it a 'Customers' Trust Deposit Account'. Into this account they paid new moneys received from customers as advance payment for mail order goods not yet delivered. The liquidator contended that these moneys were available for general distribution but the court held that the company had validly constituted itself a trustee of these moneys for the customers concerned. In the words of Megarry J: 'The whole purpose of what was done was to ensure that the moneys remained in the beneficial ownership of those who sent them, and a trust is the obvious means of achieving this.' There was no question of any preference being given to the relevant creditors, for their moneys were impressed with a trust on receipt by the company, so that they were always beneficiaries and never unsecured creditors of the company.[128] Emphasis was laid on the fact that these were not trade creditors, though why that should affect the determination of the question whether the company had constituted itself a trustee of the moneys is very hard to see. The spectre of fraudulent trading is evident in the judge's statement that the company's 'doubts as to [its] ability to fulfil its obligations' made its conduct 'proper and honourable'.

There is, however, one troubling feature of the decision unexplored by the court. It lies in the reference to the moneys 'remaining' in the beneficial ownership of the customers. If the customers had no idea that their payments were going into a trust account—and naturally the company would not be keen to advertise the fact—how could they retain the beneficial ownership? Surely the company had transferred to the customers the beneficial ownership. This prompts the question whether the transaction amounted to the creation of a charge and whether such charge was on the list of registrable charges in the Companies Act.[129] It is certainly hard to distinguish it from a charge, though it would not be on the registrable list even if so treated.[130] It need hardly be said that compliance with the formalities of registration would be quite impracticable in circumstances like those prevailing in *Re Kayford*. The result may therefore express a priority judgment, though a somewhat unsystematic one, as regards the various creditors of the company. Another point to note is that there was never any suggestion in the case that the transaction amounted to a contracting out of the *pari passu* insolvency distribution scheme for one class of creditor.[131] Again, it

[125] Insolvency Act 1986, s 213.
[126] Ibid, s 214.
[127] [1975] 1 W L R 279.
[128] Cf the *scintilla temporis* doctrine and its rejection by the House of Lords in *Abbey National Building Soc* v *Cann* [1991] AC 56.
[129] 1985 Act (as amended), s 396.
[130] Above, n113.
[131] Insolvency Act 1986, s 324; Insolvency Rules, rule 4.181.

might be said that this expresses the law's mute preference for one class of creditor.

A case that seems to take *Re Kayford* to the limits is *Re Chelsea Cloisters Ltd.*[132] A company took an equitable underlease of a block of flats in order to manage it and in that capacity received from time to time breakage deposits from tenants entering into short-term leases. These sums were to be returned to the tenants at the expiry of their leases, subject to necessary deductions. Shortly before the winding up of the company, an accountant brought in to supervise its affairs directed that all future deposits should be segregated from the general assets of the company. He later opened a separate 'tenants' deposit account' for this purpose. At no time was explicit trust language used by the company. Subsequently, the company surrendered possession of the block of flats to the landlords when the underlease expired and then went into voluntary liquidation. Reversing the trial judge, the Court of Appeal held that the deposits in the tenants' deposit account should not be distributed among the unsecured creditors of the company but should go to the landlords in trust for the tenants.

The precise features of the trust repay close attention. The legal title of the company to the deposits arose only by virtue of the equitable underlease. It retained 'this sum as agents for and to the order of the landlords'.[133] Such language is suggestive of the deposit retaining its original identity, as though it were money in a bag, but that is far from the case. It was commuted into a chose in action, namely the indebtedness of the bank to the account holder. This is not merely a technical matter since the language of deposit or bailment serves a rhetorical function in driving home the point that the deposit is the property of the tenant held for safekeeping by the company. To divert the deposit in such circumstances reeks of peculation. Whether we see the trust property as the original deposits or the consequent choses in action, one curious feature of this trust that went unremarked in the case is that it was created by a company acting as the unauthorized agent of its principal, the landlords. What makes the trust binding upon the principal to whom the agent must account anyway for the deposits? The landlords at no time gave a *Quistclose* undertaking. Apparent authority does not come into it since at no material time were the beneficiaries, namely the tenants, apprised of what it was that the company was doing in relation to the deposits.

It is hard to resist the conclusion that the decision was an exercise in discretionary justice. The accountant advising the company seems to have had an eye on the dangers of fraudulent trading. Viewed in this light, the decision indirectly reinforces the law on that subject. In the judgment of Bridge LJ, much was made of the accountant's subsequent affidavit and a statement in it coming close 'to a positive declaration of his intention to create a trust at the material time'. The statement in question read: 'I regarded the tenants' deposit account as available only for repaying the deposit . . .' None of this seems to amount to

[132] (1981) 41 P&CR 98.
[133] Ibid, *per* Bridge LJ at 104.

much for building a case that the deposits were impressed with a trust when paid into the account. A sceptic would be tempted to observe something that did not feature overtly in the court's decision: the total amount of tenants' deposits, the company's only asset, came to just over £20,000 but the company had debts in the region of £50,000,000. A lot more joy would be created by giving the deposits back to the tenants than by spreading them invisibly across the range of unsatisfied general creditors.

A case to be contrasted with *Re Chelsea Cloisters Ltd* is *Re Multi-Guarantee Ltd.*[134] In the latter case, a payee company had given no firm undertakings at the time of receiving moneys in respect of their destination, but an attempt was made by a third party to tease out such undertakings at a later date. The case concerned extended warranties given by the company to purchasers dealing with a major supplier of electrical goods. The supplier collected premiums from its customers and remitted them on an agency basis to the company on the latter's assurance that its guarantee scheme was covered by Lloyd's underwriters. When this was discovered to be untrue, the supplier moved quickly to safeguard its customers' premiums. Although the supplier had it in mind to have the balance in the relevant company account transferred to a trust account, its communications with the company fell a little short of the standard that would have satisfied a trusts lawyer. It asked for the balance to be transferred to a joint account for 'securing the premium monies'. To avert proceedings for an injunction or for the interim preservation of property, the company duly complied with the supplier's request. The supplier later arranged its own insurance coverage for the extended warranty protection but, before an agreement to transfer the balance in the joint account to the supplier could be executed, the company went into a creditors' voluntary winding up. The supplier then contended that the company had constituted itself a trustee of the moneys placed in the joint account, thus 'effectively divest[ing] itself of all beneficial interest therein'.

The Court of Appeal concluded that not enough had been done to create the necessary trust obligation. Whatever might have been in the mind of the supplier, it was clear that the company's response was the minimum needed to avert unpleasant action. The joint account was only a convenient place to hold moneys pending a variety of possible outcomes. The moneys might for example have been paid over to Lloyd's or to other underwriters or to the supplier itself. The very difficulty of establishing a clear-cut destination and, moreover, identifying a beneficiary (Was it the supplier or the customers?) militated against the inference of a trust. Yet it is difficult to avoid the feeling that the supplier failed in its endeavour on technical linguistic grounds. The court's failure to extend a sympathetic hand may have been due to an apprehension that the inference of a trust would have amounted to a preference in favour of the customers who, prior to the supplier's intervention, most certainly had the status only of unsecured creditors.

[134] [1987] BCLC 257.

Drawing Inferences from Conduct

The remaining cases in this article involve a scrutiny of various fact situations where the payer has not used rigorous language or explicit terms when making payment. They are cases where the payer is not consciously mounting a corporate rescue effort. It is in this area most of all that a too-easy judicial inference of a trust could have disturbing implications for insolvency distribution.[135] It should certainly be no easier to infer from a set of facts a *Quistclose* trust than it would be to infer a charge. A failure to use technical trust language was not fatal to the *Quistclose* trust in *Carreras Rothmans Ltd* v *Freeman Mathews Treasure Ltd*.[136] In this case, a tobacco company placed advertisements through an advertising agency. Benefiting from various discounts with third parties, the agency contracted with them as principal and remitted their invoices to the tobacco company. The latter paid the agency the invoice in time for the agency to settle with the third parties. When it became apparent that the agency was in financial difficulties, the tobacco company insisted that its payments be placed into a 'special account' to be opened by the agency in their joint names.[137] Cheques for the third parties were to be drawn on this account, which was to be used for no other purpose. When the agency took its solicitors' advice on fraudulent trading and went into a creditors' voluntary winding up, the liquidator froze the special account.

The arrangements made by the tobacco company were designed to allow the agency to carry on trading and to permit it to benefit from its discounts and options, whilst saving the tobacco company from the harmful consequences of having its advertising campaigns cancelled. In the opinion of the court, the agency's special account was merely a 'conduit' through which money was channelled by the tobacco company to the third parties. The agency had no discretion at all in the use of the moneys it received. Consequently, 'the moneys once paid never became the property of the [agency]' because equity had fastened upon its conscience. It was not necessary for explicit trust language to be used. While the tobacco company was not as such mounting a corporate rescue, it would have been a pure windfall for the agency's creditors if money on its way to the third parties had been trapped in transit. It seemed that the tobacco company would not have pressed the matter if the agency had baulked at the new payment arrangements, but this matter did not trouble the court in its conclusion.[138] In

[135] See the concerns of Pincus J in *Re Miles* (1989) 85 ALR 216, 221. Australian authorities seem particularly alert to this danger. Note the cases that lay stress on keeping the money separate from the payee's general assets: *Australasian Conference Association* v *Mainline Constructions Pty* (1978) 141 CLR 335; *Ausintell Investments Australia Pty* v *Lam* (1990) 19 NSWLR 637. See too the cases requiring a clear definition of the purpose: *Daly* v *Sydney Stock Exchange* (1986) 160 CLR 371. Merely paying money for a later share allotment is not enough: *Re Associated Securities Ltd*, above n111, following *Moseley* v *Cressey's Co* (1865) L R 1 Eq 405 and *Stewart* v *Austin* (1866) LR 3 Eq 299.

[136] [1985] Ch 207.

[137] FMT/Rothmans Client Account Only.

[138] The court relied on Megarry V-C in *Re Northern Developments (Holdings) Ltd* (Unreported, 6 Oct 1978) (discussed at length in Rickett, above n77) to hold that the tobacco company had parted with the beneficial interest in the moneys, which interest was in suspense until the third parties were paid. It is submitted, however, that Sir Peter Millett's analysis is greatly to be preferred.

contrast with *Rė Multi-Guarantee Ltd*, the agency had at no time the beneficial interest in the disputed moneys, so the question of unlawful preference never presented itself. As we have seen, a considerable number of the authorities fuelling the *Quistclose* principle involve an intimate and inseparable relationship between the questions of trust and of unlawful preference.

Before the issue of registrable charges, raised in *Carreras Rothmans Ltd*, is discussed, the general body of the decision should be contrasted with an earlier case, *Neste Oy* v *Lloyd's Bank Plc.*[139] A shipowner employed an English company as its agent to handle port services, and from time to time put the company in funds to meet its various commitments, such as pilotage, harbour services and advances to ships' masters. Although the moneys paid in this wäy matched the company's commitments, there was no settled pattern in the timing of payment. Whilst the payments were called 'advances', they were sometimes paid in advance and sometimes in arrears. No attempt was made to prevent the company from applying them to other purposes. No special accounts were to be opened and no trust language was employed. The company was a member of a corporate group which collapsed under a welter of debts and cross-guarantees. In relation to moneys not used to pay the commitments undertaken on the shipowner's behalf by the company, the court held that the shipowner had to prove as an unsecured creditor. There was no general principle that moneys received by an agent from his principal had to be held in a fiduciary capacity and applied exclusively to the purpose of paying the other contracting party. This is entirely consistent with those cases dealing with the purely personal nature of an estate agent's liability on receipt of a contractual or pre-contractual deposit.[140]

Although it was not cited in the later case, *Neste Oy* is clearly distinguishable from *Carreras Rothmans Ltd.* While, in one sense, the company in the former case was a conduit, the shipowner was not at any time aware of the insolvency risk and thus took no step to earmark its payments in a sufficiently circumscribed way. The more aware a payer is of an impending insolvency, the more likely it is that he can take the necessary steps to put himself beyond the reach of the *pari passu* principle, which highlights the contrast between security (broadly defined) and the insolvency distribution rules.

In *Neste Oy* itself, a different result was reached with regard to the last payment in the series. This payment was received when the corporate group had

[139] [1983] 2 Lloyd's Rep 658. A case to be contrasted with this is the recent unreported decision in *Stanlake Holdings Ltd* v *Tropical Capital Investment Ltd*, above n118. In that case, a lender had been induced to advance a sum of money by fraudulent representations as to the identity of the borrower. The stated purpose for the loan was to finance a deal for tyres in the Ivory Coast. Not all of the actual money reached the borrower; the bulk of it was discovered, in transit, by a solicitor in his safe. He interpleaded and there followed a priority contest between the lender and a judgment creditor of the borrower with a garnishee order. The Court of Appeal ruled in favour of the lender, the majority for the reason, *inter alia*, that the money had been earmarked on *Quistclose* terms for a purpose that had failed. With respect, it is hard to see that the court was aware of the insolvency implications of its ruling, in this non-insolvency case, since it recognized the trust on the basis of a very loose dedication of the money to its stated purpose. It could easily have invoked *Miller* v *Race* (1758) 1 Burr 452, to hold that the money, still present in its original form, was recoverable since it had not passed in currency (*viz*, to a *bone fide* purchaser for value etc). The court was able to dismiss the claim of the garnishee creditor on the public policy or discretionary ground that its process should not be operated to permit the recovery of money fraudulently obtained.

[140] *Barrington* v *Lee* [1972] 1 QB 326; *Potters* v *Loppert* [1973] Ch 399.

resolved that it and all its companies should cease trading immediately. There was 'no chance' that the company 'could pay for the services in question'. As Bingham J put it:

> Given the situation of [the company] when the last payment was received, any resonable (*sic*) and honest directors of that company . . . would have arranged for the repayment of that sum to the [shipowner] without hesitation or delay. It would have seemed little short of sharp practice . . . to take any benefit from the payment, and it would have seemed contrary to any ordinary notion of fairness that the general body of creditors should profit from the accident of payment made at a time when there was bound to be a total failure of consideration.[141]

In consequence, notwithstanding the failure of the shipowner to show that the earlier payments had been received on express trust terms, it was successful in establishing that the circumstances of the last payment made the company a constructive trustee in this regard. This passage establishes a very close link indeed between an imposed trust liability and fraudulent and wrongful trading. The following propositions would seem to be justified. When a company's circumstances plainly show that to accept payment would give rise to at least wrongful trading liability, a constructive trust will extend to the payment received. If the circumstances do not speak quite so plainly, but the company is concerned enough about its potential liability in this area to use effective trust language, its actions will not be seen as an unlawful preference. If the payer is apprehensive enough about insolvency to take steps to ensure that payments received will be isolated from the payee's other assets, no court will exact too high a linguistic standard when inferring an express trust. It should never be forgotten that the dividing line between an express and an imposed trust liability can be so faint as to be almost invisible.[142]

Registration of Charges

Finally, there remains the question of registrable company charges raised in the *Carreras Rothman* case. Any attempt to designate the ultimate recipient of the moneys, namely the sub-payee, as the beneficiary of the *Quistclose* trust has a tendency to deflect the charges argument from its true course. Indeed, it is arguable that the confusion surrounding the identity of the *Quistclose* beneficiary owes something to the general failure to see that the trust operates as a form of secured lending. Peter Gibson J rejected the claim of the liquidator that the agency in *Carreras Rothmans Ltd* had created a charge over its book debts in favour of the third party creditors, who had provided the advertising space. The book debts in question were the moneys due or to become due from the tobacco company as a result of the agency's services on its behalf. The rights of the third

[141] Approved in *Elders Pastoral Ltd* v *Bank of New Zealand* [1989] 2 NZLR 180 (CA).
[142] Above n85 and accompanying text.

parties only arose once the payments in question had reached the special account and, as soon as that had occurred, the indebtedness of the tobacco company to the agency ceased. Hence there was nothing that could be charged in favour of the agency. If the beneficiary of the trust had been seen to be the tobacco company, an altogether more plausible possibility on these facts, the registration argument ought to have been directed at the bank balance resulting from the moneys paid into the special account. The court might well have concluded that this balance was not a book debt owed to the agency for the purposes of charge registration,[143] but the enquiry would have been conducted on more rational lines.

Without justifying this lack of judicial focus, it has to be said that the *Quistclose* trust would in most, if not all, instances become unworkable if it had to be registered as a company charge granted by the payee. The present law, in a covert way, may be seen as furthering the prior status of purchase money financiers by this and other means. Moneys paid over on *Quistclose* terms add value to the payee company and do not upset the risk calculations of the company's other creditors. The moneys represent short-term assets as far as the company is concerned and do not mislead outside creditors. Whether *Quistclose* moneys ought to remain out of the reach of the company administrator when even title retention devices are included is another matter. Just as these devices amount in substance to security rights, so does the *Quistclose* trust, even though certain aspects of the security debate, such as general monitoring considerations, hardly seem applicable to it. The Diamond proposals would, if enacted, underline the functional nature of security and would provide an easy and expeditious filing scheme that would not be unduly onerous to satisfy in practice. As we also saw earlier in this article, a growing judicial insight into the nature and function of security may be in the process of emerging without the helping hand of the legislature.

[143] Above n114.