



## **Quistclose trusts in English law**

Paraphrased from:

*v Challinor* [2015] EWCA Civ 59 at 56–57, per [Briggs LJ](#)

"*Quistclose*-type trusts are a species of **resulting trust** which arise where property (usually real property as opposed to personal property) is **transferred** on terms which do not leave it at the free disposal of the transferee.

That restriction upon its use is usually created by an arrangement that the property should be used **exclusively** for a stated purpose or purposes.

There must be an intention to create a trust on the part of the transferor. This is an objective question. It means that the transferor must have intended to enter into arrangements which, viewed objectively, have the effect in law of creating a trust."

A **Quistclose trust** is a trust created where a creditor has lent money to a debtor for a particular purpose. If the debtor uses the money for any other purpose, then it is held **on trust** for the creditor. Any inappropriately spent money can then be **traced**, and returned to the creditors.

- **Tracing is a procedure in English law used to identify property (such as land) which has been taken from the claimant involuntarily (via bankruptcy or insolvency) or which the claimant wishes to recover.** It is not in itself a way to recover the property, but rather to identify it so that the courts can decide what **remedy** to apply. The procedure is used in several situations, broadly demarcated by whether the property has been transferred because of **theft, breach of trust, or mistake**.
- Tracing is divided into two forms, **common law tracing** and **equitable (equity) tracing**. Common law tracing relies on the claimant having legal ownership of the property, and will fail if the property has been mixed with other property, the legal title has been transferred to the defendant, or the legal title has been transferred by the defendant to any further recipient of the property. Equitable tracing, on the other hand, relies on the claimant having an **equitable interest** in the property, and can succeed where the property has been mixed with other property.
- Defenses to tracing are possible, particularly if returning the property would harm an innocent defendant, where the claimant has made false representations that the defendant relied on to his detriment, or where the property has been transferred to an innocent third party without anything given to the defendant in return that the claimant could recover in lieu.

The name and trust comes from the House of Lords decision in *Barclays Bank Ltd v Quistclose Investments Ltd* (1970), although the underlying principles can be traced back further.

There has been much academic debate over the classification of *Quistclose* trusts in existing trusts law: whether they are **resulting trusts, express trusts, constructive trusts** or, as Lord Millett said



in *Twinsectra Ltd v Yardley*, **illusory trusts**. At least one textbook has been written dedicated solely to exploring issues around the true nature and classification of *Quistclose* trusts.

Lord Millett, **writing extra-judicially**, has called the *Quistclose* trust:

**"probably ... the single most important application of equitable principles in commercial life", and further noting that despite 200 years of existence "it has resisted attempts by academic lawyers to analyse it in terms of conventional equitable doctrine" .**

## Definition

A *Quistclose* trust is a method by which a creditor can hold a **security interest** in loans, through inserting a clause into the contract which limits the purposes for which the borrower can use the money. **If the funds are used for a different purpose, a trust is created around the money for the benefit of the moneylender.** This allows the moneylender to **trace** any inappropriately spent funds, and, in the case of the borrower's insolvency, prevents the money from being taken by creditors.

The name and trust comes from the House of Lords decision in *Barclays Bank Ltd v Quistclose Investments Ltd*, in which Lord Wilberforce maintained that in *Quistclose* situations, the intention must be to create a secondary trust for the benefit of the moneylender, arising if the "primary trust" (the appropriate use of the money) is not fulfilled.

The idea of a primary and secondary trust comes from *Toovey v Milne*, where money was lent by A to B, to pay off his debts. When B went bankrupt and returned the money to A, the courts held that the creditors could not recover this money, as it was held in a form comparable to a trust. Most situations in which a trust will arise require that a specific use of the money is identified by the contract.

## Categorization

The primary problem with *Quistclose* trusts is their categorization within the accepted types of trust. The two-part trust structure (primary and secondary trusts) explained by Lord Wilberforce in *Quistclose* does not appear elsewhere in English trusts law, and the type of trust used affects the rights available to the parties.

*Quistclose* trusts have variously been considered **resulting, express or constructive** in nature. An alternate explanation is given by Lord Millett in *Twinsectra Ltd v Yardley*; this is that **the *Quistclose* trust is an "illusory trust", where the apparent beneficiary, i.e., the moneylender, for example takes no active role.**

This trust is created by the intention of either party, and is revocable at any time. The problems with this idea are that the facts in *Quistclose* are not those of a normal illusory trust, and Millett failed to consider the mutual intention of the parties and any underlying contracts.



## Resulting trust

Lord Wilberforce, in *Quistclose*, stated that the contract gives the moneylender an **equitable interest** in the loan. Under Wilberforce's two-stage trust, the interest in the money first goes from the lender to the borrower (the primary trust) and then, when the trust's purpose fails, reverses (the secondary trust).

In *Twinsectra* Lord Millett also explained that a *Quistclose* trust is a resulting trust, but held that the lender retains the interest throughout the transaction, with no need for this interest to reverse if the purpose of the loan fails. The problem with Wilberforce's analysis, as explained by Alastair Hudson, Professor of Equity and Finance Law at the University of Exeter, is that because the resulting trust only comes into existence after the misuse of the loan, **(PAY TO THE ORDER OF for ex... WITHOUT RECOURSE)** for example, it may come too late; if the money is not available when the claim is brought, **there is no remedy. The borrower may already have spent the money, or already be insolvent and the subject of claims by creditors.**

Another flaw with both Wilberforce's and Millett's explanations is that if the interest is retained by the lender from the outset of the contract, it is not a resulting trust at all; **the complete transfer of money (at closing for example) should end the lender's equitable interest.**

**It could be argued that the creation of a *Quistclose* trust is not based on the recovery of the original interest, but the creation of a new one.**

Doubts have also been raised about the *Twinsectra* case in general, in that the facts of the case did not create a stereotypical *Quistclose* trust; this causes problems with applying Millett's analysis.

## Express trust

The second possibility is that *Quistclose* trusts are express trusts. If the contract included a provision that the money was to only be used for certain purposes, it could be interpreted that this money is held on trust until it is used for those purposes.

**The borrower would be a trustee; using the money for any other purpose would be in violation of the trustee's duties, and so void. (PAY TO THE ORDER OF for ex... WITHOUT RECOURSE).**

This trust would be created as soon as the contract is agreed, with the normal requirement for it to be **validly created**. Two problems with this are that it has not been upheld by the English courts, and that the courts would require those explicit terms to be part of the contract; Hudson considers it the most advantageous however, because it would offer the simplest protection of the money by not requiring the contract to be breached for the trust to come into existence.

In *Swiss Bank Corporation v Lloyds Bank Ltd*, the courts considered a situation similar to *Quistclose*, in that a loan agreement was made where the borrowers explicitly agreed to follow guidelines on the use of the money, something they failed to do. The Court of Appeal and the House of Lords refused to constitute any kind of trust or return the money however, applying Lord Wrenbury's judgment in *Palmer v Carey*, when he said that "such a stipulation will not amount to an equitable assignment".



## Constructive trust

The third main theory is that *Quistclose* trusts could be constructive trusts, which are created when the future trustee uses the money in an "unconscionable" manner.

In *Quistclose* situations, the requirement of "unconscionableness" could be met by the borrower using the money for a purpose other than the one for which it was lent, allowing the lender to claim an equitable interest in it.

In *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd*, the *Quistclose* trust principle was said by Peter Gibson J. to be that:

"equity fastens on the conscience of the person who receives from another property transferred for a specific purpose only and not therefore for the recipient's own purposes, so that such person will not be permitted to treat the property as his own or to use it for other than the stated purpose"; this reference to "conscience" could make *Quistclose* trusts constructive in nature. **However, no constructive trust could be created until the money is misused, which may be too late for an effective remedy.** Defalcation is the criminal charge to be made. Defalcation is misused of trust property during administration; insolvency or bankruptcy.