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Quistclose Trusts: Theory and Context

James Alexander Glister

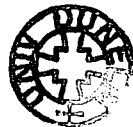
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ABSTRACT

Commonly employed in corporate rescue situations, the *Quistclose* trust (from *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567) is a device that enables an investor to advance funds to a troubled company to be used for a specific purpose. If the recipient company becomes insolvent before the money is spent then the funds will be held on trust for the original lender, thus ensuring that the property is not available for distribution amongst the company's unsecured creditors.

This thesis examines both the theory and context of *Quistclose* trusts. It is argued that, whilst the devices are most commonly found in insolvency situations, the *Quistclose* analysis should be available wherever property is transferred for a specific purpose. Thus the paper identifies and discusses such issues as the 'requirement' of segregation of the trust property, the specificity of purpose necessary, and the type of property that may be subject to a *Quistclose* trust. The context of the *Quistclose* trust is also examined by reference to other security devices: equitable charges and retention of title agreements. Similarities and differences are identified and analysed in the context of insolvency regimes: should *Quistclose* trusts be subject to legislative controls, given their apparent ability to circumvent legislative provisions?

Various commentators have attempted to categorise *Quistclose* trusts as express trusts, resulting trusts, *sui generis* trusts, or even full beneficial transfers coupled with equitable rights to restrain misuse. Following consideration of the strengths and weaknesses of each proposal it is argued that *Quistclose* trusts can indeed be reconciled with accepted principle. However, it is also suggested that there is no single correct classification: depending on the most accurate construction of the parties' actions and intentions the proper analysis may involve an express trust, a resulting trust, or indeed no trust at all.

NOTE

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INTRODUCTION

Quistclose trusts are a way of protecting an investment. An investor may be reluctant to advance funds to a troubled company because of the risk of that company becoming insolvent. Should that happen an investor would be in a potentially vulnerable position: not only will her investment have failed, there is a risk that she will not even get her initial funds back. The money may be enveloped by another creditor's security, or it may fall into the general funds for distribution amongst other unsecured lenders. The way to protect an investment is to take some form of security over the debtor's assets: this enables the creditor on insolvency to claim those assets for themselves and prevent them slipping into the hands of the trustee in bankruptcy. There are various forms of security that an investor may use, one of which is the *Quistclose* trust.

The first chapter discusses the mechanics of a *Quistclose* trust: the 'requirement' of segregation of the trust property, the specificity of purpose necessary, the property to which such a trust can attach, and the issue of third-party enforcement. The second and third chapters look at equitable security interests and retention of title agreements: other devices that are common bedfellows of the *Quistclose* trust. Having set the *Quistclose* trust in context, the fourth chapter analyses differing academic and judicial views on the theory of such devices, and attempts to reconcile their existence and operation with orthodox equitable principles.

This thesis has two goals: to show that *Quistclose* trusts do accord with accepted principle; and to distinguish between those trusts and other security mechanisms. Differences in creation, theory and – most importantly – operation will be explored. Equitable charges are subject to registration under the Companies Act 1985, and the Law Commission has recently advocated a new legislative scheme that would include both charges and retention of title agreements within its scope.¹ Despite the significance of establishing a *Quistclose* trust where a company becomes insolvent, it will be argued that *Quistclose* trusts should remain excluded from this new regime.

¹ Law Commission Consultation Paper No. 164, *Registration of Security Interests: Company Charges and Property other than Land* (July 2002).



CHAPTER ONE - QUISTCLOSE MECHANICS

Where money is lent to a debtor and it is mutually agreed that it is for the sole purpose of discharging the debtor's liabilities, the transferred funds do not become part of the debtor's general assets, but instead are 'clothed with a specific trust'.¹ Thus if the stated purpose becomes impossible to perform, commonly due to the subsequent insolvency of the debtor, the transferred funds do not form part of the debtor's general assets but are instead held on trust for the benefit of the lender. The leading case in the area is *Barclays Bank Ltd v Quistclose Investments Ltd*,² with these transactions commonly being referred to as '*Quistclose*' trusts.

The orthodox setting for a *Quistclose* trust involves a company in financial difficulties borrowing money to pay off its pressing debts: in *Quistclose* it was to enable Rolls Razor to pay a share dividend they had already declared. However, it will be argued that the underlying principle is that property transferred for a specific purpose, which is not carried out, will be held on trust. It will be necessary to consider factors concerning the intention of the parties, particularly with regard to the beneficial ownership of the property in question; together with questions regarding the nature of the purpose for which the property is transferred and the clarity with which this purpose is defined.

1.1 SEGREGATION OF FUNDS

It is a common maxim that equity looks to intention rather than form: there is no specific jargon needed to show the requisite certainty of intention to create a trust.³ Together with new specific purposes being accepted as giving rise to trust situations,⁴ this shows that there is considerable potential for *Quistclose* trusts to expand further. As Ulph suggests, 'there is at least some risk that promises made during negotiations

¹ *Toovey v Milne* (1819) 2 B & Ald 683 at 684 per Abbott CJ.

² [1970] AC 567.

³ *Tito v Waddell (No 2)* [1977] Ch 106.

⁴ In *Re EVTR* [1987] BCLC 646 a *Quistclose* trust was found where the purpose of the loan was to enable the debtor to purchase video equipment. The principle has also been applied where money has been lent for business ventures: see *Rowan v Dann* [1992] 64 P & CR 202; *Tropical Capital Investment Ltd v Stanlake Holdings Ltd* (1991) ET Law Reports, June 25.

for a loan could be found to suffice as evidence of an intention to create a trust'.⁵ This would have clear consequences for commerce in general, and insolvency situations in particular.

A check on this potential expansion may be a further requirement that the parties intend the debtor to segregate the loan monies from his general assets. As Channell J commented in *Henry v Hammond*:⁶

It is clear that if the terms upon which the person receives the money are that he is bound to keep it separate ... and to [treat it] as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If on the other hand he is not bound to keep the money separate, but is entitled to mix it with his own money and deal with it as he pleases ... he is not a trustee of the money, but merely a debtor.

Naturally recipient companies prefer to deal freely with funds, so segregation is indicative of an intention not to treat as their own. However, the important point is not whether the debtor did in fact segregate the funds, but whether there was a common intention that he should do so, thus evincing an intention not to treat the funds as part of his general assets. This intention can be express, for example a stipulation to segregate in the loan contract, or it can be implied. In cases with no express obligation to segregate the fact that a specific purpose is attached to the loan will go some way to showing that the lender did not intend the funds to become part of the recipient's general assets. The recipient may show his 'side' of the common intention by *in fact* treating the loan funds as a distinct fund.⁷ In *Re Kayford* the managing director of the recipient company was advised to open a separate account for the loan monies.⁸ Instead he chose to use an existing dormant deposit account that already contained a small credit balance. The intention to treat the funds as separate was found. Further, in *Quistclose* itself there was no requirement that Rolls Razor

⁵ Ulph J, 'Equitable Proprietary Rights in Insolvency: The Ebbing Tide?' [1996] JBL 482, p 495.

⁶ [1913] 2 KB 515 at 521.

⁷ It is suggested that when a specific purpose is combined with actual segregation then a trust construction will be available. However, in the absence of actual segregation by the recipient the fact that the parties agreed on a purpose for the transfer will not be sufficient: the provider would need to show that the recipient *should* have segregated the funds.

⁸ [1975] 1 WLR 279. The recipient company was not obliged to segregate under the contract.

had to pay the money from Quistclose into a separate account, though they in fact did, again showing the requisite intention to treat the loan monies as a separate fund.⁹

A common intention is not always found. *Guardian Ocean Cargoes Ltd v Banco de Brasil* concerned the refinancing of a shipbuilding contract. During negotiations with the defendant bank regarding the refinancing, GOC paid \$600,000 to the bank. Negotiations failed and five years later the bank seized the vessel. GOC protested and demanded the return of their \$600,000. The question was whether the plaintiffs could claim compound interest on the money. Counsel for the plaintiffs argued that the payments were made for the specific purpose of being taken into account in a refinancing deal: they were thus impressed with a trust for that purpose, and the accumulations would stay with the trust. However, this argument did not find favour with the Court of Appeal. Saville LJ (with whom Butler-Sloss and Mann LJ agreed) held:¹⁰

In my judgment it is quite impossible to spell out of the transactions between the parties any trust relationship at all ... there was nothing to indicate that what the parties intended was that the funds should not become the general property of the recipient, but should be kept and applied for a particular purpose. On the contrary, it seems clear that the plaintiffs simply transferred the money to the bank and remained wholly uninterested in how the particular fund was applied or used.

Similarly in *Re Goldcorp*, the Privy Council held that there was nothing to which a *Quistclose* trust could attach.¹¹ In considering suggestions that customers had paid money for the purpose of purchasing gold, and were thus beneficiaries under a trust, Lord Mustill commented that 'there was nothing in the express agreement to require, and nothing in their Lordships' view can be implied, which constrained in any way the company's freedom to spend the purchase money as it chose'.¹² The customers paid the money solely to perform their side of the bargain, under which they would be

⁹ As two Australian academics have commented, 'Although the loan paid in the *Quistclose* case was paid into a separate bank account this fact assumed no special significance in the House of Lords judgments'. Bryan M & Ellinghaus M, 'Fault Lines in the Law of Obligations: *Roxborough v Rothmans of Pall Mall Australia Ltd*' (2000) 22 SLR 636 at 664, n 101.

¹⁰ [1994] 2 Lloyd's Rep 152 at 159-160.

¹¹ [1995] 1 AC 74.

¹² *Ibid* at 101.

entitled, in due course, to obtain delivery. Goldcorp was free to use any funds it wanted to buy the gold and fulfill its contractual duty.

It must be noted that the requirement of a common intention to segregate appears to vary in strength through the line of cases. In *Re EVTR*, Dillon LJ commented that in a *Quistclose* situation a ‘trust normally arises by implication of law when circumstances happen to which the parties have not addressed their minds’.¹³ Thus there appeared to be no need for a common intention to treat the loan monies as separate. However, in this respect *Re EVTR* is at odds with the earlier cases,¹⁴ and the Privy Council in *Re Goldcorp* did not follow the reasoning of Dillon LJ. Lord Mustill held that what was required was ‘a mutual intention that the monies should not fall within the general fund of the [borrower’s] assets but should be applied for a special designated purpose’.¹⁵

Thus a mere declaration of purpose is not sufficient: there must also be a common intention that the borrower will not receive full beneficial ownership of the loan monies. This is often shown expressly, most commonly through a term of the loan contract obliging the borrower to segregate the funds from those he owns absolutely. However, a segregation clause (or lack of) is not determinative as the intention can also be shown by implication, as in *Quistclose* itself.¹⁶

1.1.2 *Westdeutsche*

Lord Browne-Wilkinson, in *Westdeutsche Landesbank Girozentrale v Islington LBC*, voiced judicial concerns regarding the ‘wholesale importation into commercial law of equitable principles inconsistent with ... the orderly conduct of business affairs’.¹⁷ In

¹³ *Supra* n 4 at 650.

¹⁴ See *Re Northern Developments (Holdings) Ltd*, unreported, 6 October 1978; *Carreras Rothmans Ltd v Freeman Matthews Treasure Ltd* [1985] 1 Ch 207. C.f. comments of Peter Gibson J at 222.

¹⁵ [1995] 1 AC 74 at 100.

¹⁶ See discussion above, text to n 9. Note also the comment of Rimer J in *Shalson v Russo*: ‘the fact that this money was not to be kept in a separate account ... points away from an intention to create a trust’ [2003] All ER (D) 209 (July) at para 129. It is the intention that is crucial and so the issue of segregation, whilst undoubtedly a helpful indicator, is not conclusive.

¹⁷ [1996] AC 669 at 704. See also *Manchester Trust v Furness* [1895] 2 QB 539 at 545 per Lindley LJ: ‘if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralyzing the trade of the country’; *Re Wait* [1927] 1 Ch 606 at 639-640 per

June 1987 the plaintiff bank had entered into an interest rate swap agreement with the defendant local authority. The bank transferred £2.5m to the local authority on the date of commencement, and by June 1989 the local authority had made reciprocal payments to the bank totalling £1.35m. Interest rate swap agreements were subsequently found to be outside the powers of local authorities and void ab initio.¹⁸ The bank subsequently brought an action against the authority, claiming inter alia repayment of £1.15m and compound interest as from June 1987.

Both Hobhouse J and the Court of Appeal found that property in the money had not passed to the local authority.¹⁹ Hobhouse J relied on *Sinclair v Brougham*, citing the words of Lord Parker: 'If [a statutory association] borrows money which it has no power to borrow, the money borrowed is in their hands the property of the lender'.²⁰ In the Court of Appeal, Dillon LJ (with whom Leggatt LJ agreed) held that *Sinclair v Brougham* was a direct parallel to the instant case, and the bank were therefore entitled to the return of the balance of the £2.5m, together with compound interest. The local authority appealed to the House of Lords against the award of compound interest.

If the local authority had received the £2.5m as a trustee it would then be accountable in equity for the benefits it received, including the benefit of not having to borrow £2.5m on the market at compound interest. Lord Browne-Wilkinson analysed the case in the context of his 'type A' and 'type B' resulting trusts:²¹

There was no transfer of money to the local authority on express trusts: therefore a resulting trust of type (B) could not arise. As to type (A), any presumption of resulting trust is rebutted since it is demonstrated that the bank paid, and the local authority received, the upfront payment with the intention that the monies so paid should become the absolute property of the local authority.

Atkin LJ: 'If...beneficial interests in property are created as suggested, the whole course of business transactions will be fundamentally affected'.

¹⁸ *Hazell v Hammersmith and Fulham LBC* [1992] 2 AC 1, HL.

¹⁹ [1994] 4 All ER 957, CA, affirming [1994] 4 All ER 890.

²⁰ [1914] AC 398 at 442. Here monies paid under an ultra vires banking operation were found to be held on trust for the depositors.

²¹ [1996] AC 669 at 708.

When the payment was made the intentions of the parties were such that the local authority would have complete freedom to deal with the money they received.²² Thus the presumption of resulting trust was rebutted.²³ The bank had a restitutionary claim at common law for money had and received, but this was a merely personal action and thus could only result in the awarding of simple interest.²⁴

Westdeutsche shows us that equitable proprietary rights are not an automatic consequence of the failure of a contract. Evidence of any intention of the parties inconsistent with a trust analysis will rebut presumptions of resulting trust. But what does this mean? It is undoubtedly true that *Westdeutsche* did not care what the local authority did with the money, but this alone could not rebut the presumption: indeed it is for precisely this reason that we have a presumption of resulting trust in these circumstances.²⁵ It seems that the intention inconsistent with a trust must therefore have come from the recipient local authority. If the council had instead placed the money into a separate account, left it unmixed and not spent any, would a resulting trust have arisen? It is suggested that this act of segregation would show intention consistent with a trust situation, and certainly not intention inconsistent with such an analysis.²⁶ But if this is correct, it must then follow that a presumption would either be rebutted or not depending on what a recipient chose to do with the transferred funds, rather than the intention of the donor. This would, of course, contradict accepted principles.

It is suggested that the real difference between *Westdeutsche* and the hypothetical case above is the issue of identification of the trust property. Given that the money went

²² See the comments of Dillon LJ in the Court of Appeal at 962: 'Since, contrary to the expectations of the parties [the agreement was void], the purpose for which the £2.5m was paid ... has wholly failed, and the £2.5m has, from the time the Council received it, been held on a resulting trust'. In *Westdeutsche* there were no restrictions on how the money was to be spent, i.e. there was no specific purpose, leaving no room for a *Quistclose* analysis.

²³ It is not necessary to adduce evidence of intention to make a gift, merely evidence of any intention inconsistent with a trust. See Swadling W, 'A New Role for Resulting Trusts?' (1996) 16 LS 110.

²⁴ It is suggested that there are difficulties with their Lordships' analysis: for example, when a valid contract is avoided, at that moment equitable proprietary rights re-vest in the lender. It should then follow that where a contract is void ab initio, proprietary rights should also return. See Ulph J, 'The Proprietary Consequences of Contract Failure - A Comment' in Rose (ed) *Failure of Contracts: Contractual, Restitutionary and Proprietary Consequences* (Hart, 1997).

²⁵ Otherwise *Westdeutsche* would need to show evidence that they *intended* a resulting trust. If this were required there would be no value in having a presumption to that effect.

²⁶ Evidence that a resulting trust was intended is not required (there is a presumption to that effect), but there must not be any evidence that indicates an intention inconsistent with a resulting trust.

straight into the local authority's general accounts, and was spent almost immediately, one might suspect 'that there was almost a spontaneous reaction to deny a trust in these circumstances'.²⁷ Had the bank in *Westdeutsche* been afforded equitable proprietary rights, they would presumably have been able to trace.²⁸ Indeed Lord Browne-Wilkinson, clearly mindful of the potential consequences of finding a trust relationship, commented that:²⁹

A businessman who has entered into transactions relating to or dependent upon property rights could find that assets which apparently belong to one person in fact belong to another; that there are 'off balance sheet' liabilities of which he cannot be aware; that these property rights and liabilities arise from circumstances unknown not only to himself but also to anyone else who has been involved in the transactions.

These arguments are similarly applicable in the specific realm of *Quistclose* trusts. We have seen that, whilst a specific purpose is required for a *Quistclose* trust to be found, there must also be a common intention that the recipient should not treat the loan monies as part of his general assets. This common intention is most clearly evidenced by a contractual obligation to segregate, though can be implied by, for example, an actual segregation.³⁰ Yet it is suggested that there are deeper issues in play. Like *Westdeutsche*, not only will the court consider the intention of the parties in respect of their relationship with each other, it will also look to the potential consequences for third parties who may unwittingly deal with the 'trust' monies. In short, its view will be driven by policy considerations regarding the consequences of importing equitable proprietary rights into commercial transactions.

²⁷ Ulph (1997), op cit n 24, p 92. For a slightly different emphasis see also Swadling, 1996 All England Annual Review: 'The crucial fact... was that the *Westdeutsche* money ceased to be identifiable in Islington's hands before Islington's conscience was affected by knowledge of its liability to repay. That is why *Westdeutsche* could claim no proprietary interest'.

²⁸ See the addendum to Worthington S, *Proprietary Interests in Commercial Transactions* (Clarendon Press, Oxford, 1996), though on the facts no attempt was made to locate the funds as the bank were only concerned with the question of compound interest.

²⁹ [1996] AC 669 at 704; [1996] 2 All ER 961 at 987.

³⁰ See Section 1.1 above.

1.2 THE AGREED PURPOSE

1.2.1 Types of Purpose

Quistclose situations most commonly involve loans made for the purpose of paying other creditors of the borrower. However, the underlying principle seems to be that property transferred for a specific purpose, which is not carried out, will be held on trust. The range of *Quistclose* situations has thus widened as more ‘specific purposes’ have been funded. For example, a *Quistclose* trust has been found to exist where funds were lent to enable the debtor to purchase video equipment,³¹ and the principle has been applied in cases concerning money lent for business ventures.³² In Canada the accepted purposes have included the meeting of a dishonoured cheque,³³ and levies made by municipalities for the purpose of making local improvements.³⁴

It is therefore not surprising that Chambers has argued that ‘the *Quistclose* trust is not limited to [the orthodox] situation, but is possible whenever money is paid to another on the condition that it be used for a specific purpose’,³⁵ also suggesting that ‘there does not appear to be any principle or policy which requires that the *Quistclose* trust be limited to any particular purposes’.³⁶

However, it has also been suggested that a *Quistclose* trust should only arise when money is lent for the purpose of paying off the recipient’s existing debts.³⁷ *Re Associated Securities* was one case concerning a share allotment scheme.³⁸ Prior to a company going into liquidation, some stockholders had paid money in the expectation

³¹ *Re EVTR*, supra n 4.

³² See *Rowan v Dann*, supra n 4; *Tropical Capital Investment Ltd v Stanlake Holdings Ltd*, supra n 4; though trusts were not found on the facts in these cases.

³³ *Gamble v Lee* (1878) 25 Gr 326.

³⁴ *Smith v Township of Raleigh* (1882) 3 OR 405 at 411; *Ferguson v City of Toronto* [1944] 3 DLR 317.

³⁵ Chambers R, *Resulting Trusts* (Clarendon Press, Oxford, 1997) p 85.

³⁶ Chambers R, ‘Conditional Gifts’ in Palmer & McKendrick (eds.) *Interests in Goods*, (LLP, 1998) p 445.

³⁷ Swadling proposes an even more restrictive interpretation. Discussing the line of cases prior to *Quistclose*, he comments: ‘they form an anomalous rule applicable only to the law of bankruptcy and, for that reason, cannot be applied outside that context’. Swadling (1996), op cit n 23, p 122.

³⁸ [1981] 1 NSWLR 742. See also *Moseley v Cressey’s Co* (1865) LR 1 Eq 405; *Stewart v Austin* (1866) LR 3 Eq 299; *Re Namwa Gold Mines* [1955] 1 WLR 1080.

of an issue of preference shares. Some of the monies were paid into the company's ordinary bank account before receivers were appointed; others were later deposited by the receivers into a separate nominated account. The shares were never issued and the receivers sought the direction of the court as to whether the monies were part of the general assets, or whether they were subject to a trust.

Needham J relied on the judgment of Lord Wilberforce in *Quistclose*. His lordship had said of the share allotment cases:³⁹

They are merely examples which show that, in the absence of some special arrangement creating a trust ... payments of this kind are made upon the basis that they are to be included in the company's assets. They do not negative the proposition that a trust may exist where the mutual intention is that they should not.

According to Needham J, there was nothing in *Re Associated Securities* which distinguished it from the other share allotment cases Lord Wilberforce had discussed: the requisite 'special arrangement' was absent. It would therefore appear that Needham J was simply stating that, on the facts, no intention had been established to the effect that the company was not to become the full beneficial owner of the monies.⁴⁰ Such a statement would have been wholly unproblematic, yet it is clear that this is not what Needham J meant: apparently he did not think it possible that the potential trust in the case could *ever* be a *Quistclose* trust. He stated that 'it is plain that the House of Lords took the view that the principle being applied in [*Quistclose*] did not apply (necessarily) to cases of promises to allot shares'.⁴¹

The word 'necessarily' indicates that the *Quistclose* analysis *cannot* apply, not that it might in certain circumstances. It is suggested with respect that this must be incorrect: Lord Wilberforce clearly entertained the possibility of a share allotment scheme giving rise to a *Quistclose* analysis.

³⁹ [1970] AC 567 at 581; quoted by Needham J, *supra* n 38 at 749-750.

⁴⁰ It being suggested that this is what Lord Wilberforce's 'special arrangement' is. See below, n 43.

⁴¹ *Supra* n 38 at 750.

Yet the reasoning of Needham J has also been used by the Federal Court of Australia. In *Re Miles*, when discussing the speech of Lord Wilberforce in *Quistclose*, Pincus J commented:⁴²

Lord Wilberforce distinguished [a] second line of authority, saying of the group of [share allotment] cases:

'They are merely examples which show that, in the absence of some special arrangement creating a trust ... payments of this kind are made upon the basis that they are to be included in the company's assets.'

The remark appears significant, as implying a view that not all purposes of payment are within the principle of the *Quistclose* case.

However, with respect it is suggested that Pincus J also misunderstood Lord Wilberforce. As argued above, his lordship was not referring to *purposes* outside the *Quistclose* principle, but to situations where there was not the requisite intention that the borrower should not receive full beneficial title to the property.⁴³ As Worthington suggests, 'many payments made for particular purposes do not thereby give the lender a proprietary right to recover the money should the purpose fail; that depends upon the intention of the parties'.⁴⁴ It is not suggested that a loan for any specific purpose will, ipso facto, create a *Quistclose* situation: rather that a loan for any specific purpose is capable of giving rise to a *Quistclose* trust.⁴⁵

1.2.2 *Specificity and Twinsectra*

Turning to how 'specific' the purpose should be, this question has rarely been directly addressed by the courts. Comment has often been made on the nature, or type, of purpose that can be the subject of a *Quistclose* trust, but the particular question of

⁴² (1989) 85 ALR 216 at 221. Interestingly, since the reasoning in both cases is the same, *Re Associated Securities* was apparently not cited to Pincus J.

⁴³ Indeed, in *Moseley v Cressey's Co* (one of the cases to which Lord Wilberforce was referring), Page Wood VC held that there was no trust because it was not contended 'that the plaintiffs said or did anything whatever when they paid in these moneys, or that the bank constituted themselves trustees.' (1865) LR 1 Eq 405 at 410. The borrower's repayment obligation need not be anything more than personal.

⁴⁴ Worthington (1996), op cit n 28, p 63.

⁴⁵ Assuming the parties' intentions are such that the recipient should not treat the funds as his own.

specificity, or clarity, appears to have been subsumed within this wider question. However, in *Twinsectra v Yardley*, Lords Hoffman and Millett considered the point.⁴⁶

Mr Yardley, a property developer, wanted to buy property in Bradford (Apperley) for £1m. Having encountered delays in securing a loan from his bank he was introduced to Twinsectra, who agreed to lend Yardley the money providing they were issued with an undertaking that the loan funds were solely to be ‘applied in the acquisition of property’. While negotiations with Twinsectra continued, Yardley was able to obtain funds from his original bank, and he duly used these to purchase the Apperley property. Despite this, Yardley still proceeded to borrow £1m from Twinsectra.

Twinsectra had agreed to the loan on the condition that Yardley’s solicitor, S1, gave a personal undertaking to repay. S1 already owed Yardley over £1m, pursuant to some previous transactions involving engineering contracts in Nigeria. Yardley appeared to think that he would receive the loan funds and that S1 would be solely, or primarily, liable to repay Twinsectra. Following receipt of the £1m, Yardley transferred it to another of his solicitors, S2. Around two-thirds of the money happened to be used in connection with other property deals, with the rest being spent on various other business transactions.

The difficulty in determining whether the arrangement created a *Quistclose* trust was that the parties paid little or no attention to the loan purpose. The following two terms appeared in the undertaking signed by Yardley’s solicitor, S1:

The loan moneys will be retained by us until such time as they are applied in the acquisition of property on behalf of our client.

The loan moneys will be utilized solely for the acquisition of property on behalf of our client and for no other purpose.

Twinsectra envisaged the loan funds being used to buy the Apperley land, as Yardley had originally contemplated. However, the stipulation attached to the loan referred only to the ‘acquisition of property’. Twinsectra contended that the loan funds, as far as they had not been used in the acquisition of other property, were nevertheless

⁴⁶ *Twinsectra Ltd v Yardley and others* [2002] 2 AC 164, HL.

subject to a *Quistclose* trust. It was argued for the appellants that the stated purpose was too uncertain to be enforced. The House of Lords was therefore concerned with how specific, or certain, a stated purpose must be to create a *Quistclose* trust. Lord Millett stated:⁴⁷

Provided the power is stated with sufficient clarity for the court to be able to determine whether it is still capable of being carried out or whether the money has been misapplied, it is sufficiently certain to be enforced. If it is uncertain, however, then the borrower has no authority to make any use of the money at all and must return it to the lender under the resulting trust.

Similarly, Lord Hoffman commented:⁴⁸

The charge of uncertainty is levelled against the terms of the power to apply the funds. "The acquisition of property" was said to be too vague. But a power is sufficiently certain to be valid if the court can say that a given application of the money does or does not fall within its terms: see *In re Baden's Deed Trusts* [1971] AC 424.

The House of Lords considered that a *Quistclose* trust was an example of an orthodox trust with the recipient holding a superadded mandate, or power, to apply the funds for the stated purpose. Thus the House concluded that the test for clarity of purpose was the same as the test for certainty of objects regarding powers: the 'given postulant' test.⁴⁹

Chambers argues that the clarity of the purpose in a *Quistclose* situation need not meet the requirements for a valid trust or power: he suggests that the *Quistclose* trust is characterised by the restriction of the recipient's right to use the property, not by the existence of an express or resulting trust.⁵⁰ Thus, the purpose needs only to be sufficiently specific as to 'create an enforceable restriction on the recipient's use of the money'.⁵¹ According to Chambers, the lender has a right to restrain misuse, rather than compel performance. It should then follow that it is not necessary to determine

⁴⁷ Ibid at 192. Other issues in the case, such as accessory liability, are beyond the scope of this discussion.

⁴⁸ Ibid at 169.

⁴⁹ See *Re Gulbenkian's Settlements* [1970] AC 508.

⁵⁰ That is, the recipient receives beneficial as well as legal title. Chambers (1997), op cit n 35, p 86.

⁵¹ Ibid.

what the purpose is; it is necessary only to be able to ascertain what it is not. This would clearly be an easier test to satisfy. Yet it is suggested that there are many cases where the recipient was clearly under a positive obligation to *apply* the funds, rather than a mere (negative) obligation to *not misapply* them. North J, in *Gibert v Gonard*, observed that ‘if [a recipient] chooses to accept the money tendered for a particular purpose, it is his duty, and there is a legal obligation on him, to apply it for that purpose’.⁵² Correspondingly, in *Hassall v Smithers*, a recipient died intestate without having satisfied debts for which the money had been loaned.⁵³ The lender, joining the deceased’s creditors, was able to compel payment by the intestate’s representative. There existed a positive duty to apply the funds for the stated purpose.⁵⁴

Proposing that the beneficial interest in the loan property is transferred to the recipient, Chambers argues that the lender retains only an equitable right, based on the contract, to restrain misapplication. In this situation it follows that the purpose need be only as specific as required to ‘create an enforceable restriction’: that is, only as specific as needed to determine what the purpose is not. However, it is suggested that there is considerable difficulty in applying this analysis to cases where the recipient is under a duty to apply the funds; in these situations it is otiose to talk of an ‘enforceable restriction’. Indeed it is also difficult to see the recipient as holding the full beneficial title to the property if he is under a duty to apply that property for some purpose. It is suggested that a better view in such cases is that of Lords Millett and Hoffman: beneficial title remains in the lender with the recipient receiving legal title and a bare power to apply the property for the stated purpose.⁵⁵ Thus, the ‘certainty’ of purpose needed is the same as the test for certainty of objects regarding powers: a court must be able to say whether a purported exercise of that power would or would not fall within its terms.

⁵² (1884) 54 LJ Ch 439 at 440.

⁵³ (1806) 12 Ves 119.

⁵⁴ These cases are discussed further below in Section 1.4 in relation to third-party enforcement of a *Quistclose* trust.

⁵⁵ This difficulty with Chambers’ analysis, and the distinction between a duty to apply funds and a duty not to misapply, are discussed further in Chapter Four, Section 4.2.2.

1.2.3 Purposes and Purpose Trusts – *Re Denley*

The question remains, though, as to how ‘abstract or impersonal’ a purpose may be.⁵⁶ That is, could the *Quistclose* analysis apply ‘where the stated purpose would not involve in its fulfilment any factual benefit to ascertainable “beneficiaries”’?⁵⁷

Much discussion in this area has centred on an apparent overlap between a *Quistclose*-type trust for a purpose and a *Re Denley* instance involving a trust for the direct or indirect benefit of ascertainable beneficiaries.⁵⁸ Rickett suggests that an ‘abstract or impersonal’ trust may be acceptable: ‘Some might suggest that [the *Quistclose* principle could not be applied], since the primary purpose in such a case would be unenforceable. This overlooks, however, the right of the lender, and of other ‘interested parties’, to enforce and control the trust.’⁵⁹ Rickett’s ‘interested parties’ are *Denley* beneficiaries.

It is suggested that this overlap must be clarified. The borrower of funds in a *Quistclose* situation owes a duty to the lender: thus the lender can enforce the trust.⁶⁰ The *Denley*-type trust depends for its existence on ascertainable beneficiaries to save it from invalidity through being a non-charitable purpose trust, i.e. these ascertainable beneficiaries can enforce and control the trust. As Chambers points out, ‘although these dispositions are alike, they are differently constituted: the *Quistclose* trust exists because of the equitable rights of the provider, whereas a conventional trust depends on the interest of the intended beneficiaries’.⁶¹ It may seem odd to discriminate on such apparently technical grounds, but it is suggested that this discrimination is consistent with established equitable principles: a court will not save an ineffective trust by construing it to be some other valid disposition.⁶²

⁵⁶ See Rickett CEF, ‘Different Views on the Scope of the *Quistclose* Analysis: English and Antipodean Insights’ (1991) 107 LQR 608, p 617.

⁵⁷ Ibid.

⁵⁸ *Re Denley’s Trust Deed* [1969] 1 Ch 373.

⁵⁹ Rickett (1991), op cit n 56 (footnotes omitted).

⁶⁰ That is, the duty is not owed to the ultimate ‘beneficiaries’, the recipient’s creditors. This is accepted whether one subscribes to Chambers’ view that the beneficial title is transferred (subject to the lender’s equitable right to restrain), or to the view that the lender retains the equitable ownership all along.

⁶¹ Chambers (1997), op cit n 35, p 88.

⁶² *I.R.C. v Broadway Cottages Trust* [1955] Ch 20 at 36; *Re Shaw* [1957] 1 WLR 729 at 746. Chambers notes that in the USA a non-charitable trust does not fail entirely, but is construed as a power

In *Re Astor's ST*, a settlement contained trusts of income to be applied for a number of non-charitable purposes which included, among other things, 'the maintenance...of good understanding...between nations; the preservation of the independence and integrity of newspapers; the control, publication, ... financing or management of any newspapers; and the protection of newspapers...from being absorbed or controlled by combines'.⁶³ Roxburgh J held that the dispositions were void for uncertainty of objects, it being conceded that the objects were non-charitable. *Re Astor* was not a *Quistclose*-type trust, but would it be possible to transfer money to be applied for the abstract and impersonal 'maintenance of good understanding between nations'? It is suggested that it would depend on whether the recipient was under a duty to apply the money for that purpose, or whether he was merely at liberty to.⁶⁴ Were it the former, the principle should not be accepted. However, the latter example does not seem problematic. It would indeed be a rare situation to find a lender transferring money for an abstract purpose, highly unlikely to fail, and not attempting to place the recipient under a duty to apply the monies for that purpose, but this should not obscure the point that a trust for an abstract purpose should be theoretically valid.⁶⁵

Finally it should be noted that an abstract or impersonal purpose could not be accepted if one took the view that the beneficial interest in a *Quistclose* transaction in fact vested in the third party, i.e. the 'ultimate' beneficiaries.⁶⁶ As Tettenborn points out, it may be possible to hold money and be restricted from spending it on anything other than an abstract purpose, but this is not the same as holding it *on trust* for that purpose.⁶⁷ This particular problem does not arise if one takes either Chamber's view that the beneficial interest transfers to the borrower, or that of Lords Millet and Hoffman that the interest remains with the lender throughout.

of appointment. Courts in this country have apparently not been willing to treat a similar disposition as better than no disposition at all.

⁶³ [1952] Ch 534.

⁶⁴ See above, Section 1.2.2. Also see Chapter Four, particularly Section 4.2.2.

⁶⁵ Such an instance is clearly very different to the 'classic' *Quistclose* corporate rescue situation, but it is argued that a *Quistclose* analysis should still be available. See Chambers: 'Although an abstract purpose would not create an enforceable restriction on the use of money if it was too uncertain or offended a rule of public policy, there is no logical reason why the abstract nature of the purpose should itself have any effect.' (1997), *op cit* n 35, p 88.

⁶⁶ An abstract or impersonal purpose would not satisfy the requirement of certainty of objects. For a discussion of the possibility of the beneficial interest vesting in the third party, assuming the presence of certainty of intention and objects, see Chapter Four, Section 4.1.

⁶⁷ Tettenborn, A '*Quistclose* trusts, fraud and third parties' [2000] LMCLQ 459.

1.3 TRUST PROPERTY

We have seen that there is some support for a *Quistclose* analysis applying only in limited situations.⁶⁸ Most notably in *Re Miles*, Pincus J expressly adopted a very narrow view, confining a *Quistclose* analysis to the context of recovery of money lent to a borrower for the purpose of discharging the borrower's debts, that purpose having failed. Pincus J would thus not only restrict the purpose for which property could be transferred, his analysis must also restrict the type of property that can be subject to a *Quistclose* trust.⁶⁹ As discussed above, Pincus J's decision was based partly on an interpretation of Lord Wilberforce's judgment in *Quistclose*, and partly on a consideration of commercial propriety.⁷⁰

Pincus J appeared to regard a *Quistclose* lender's claims to repayment as no more appealing than those of any other party engaged in a transaction interrupted by bankruptcy.⁷¹ However, as Worthington points out, in doing so the judge 'impliedly favoured different treatments of lenders and sellers'.⁷² It is suggested that this position is highly questionable: whilst the necessary intention to create a trust may be more easily inferred from a loan contract, this should not obscure the fact that sellers are similarly competent to establish them.⁷³ Indeed, in the case of *Re Wait*, Atkin LJ was clearly concerned about preferential treatment when he commented that:⁷⁴

[T]he buyer of goods in these circumstances is in no better position in bankruptcy than a seller. If a seller of goods delivers them to the buyer before payment, trusting to receive payment in due course, and the buyer becomes bankrupt, the seller is restricted to a proof, and can assert no beneficial interest in the goods. There seems no particular reason why a different principle should prevail where a buyer hands the price to the seller before delivery of the goods trusting to receive delivery in due course. In both cases credit is given to the debtor, and the buyer and the seller respectively take the well-known risk of the insolvency of their customer.

⁶⁸ See discussion above, Section 1.2, of *Re Miles*, supra n 42, and *Re Associated Securities*, supra n 38.

⁶⁹ Supra n 42 at 221.

⁷⁰ See above, Section 1.2.1.

⁷¹ Supra n 42 at 221.

⁷² Worthington (1996), op cit n 28, p 64.

⁷³ Indeed some retention of title sale agreements incorporate features such as stipulated purposes and provisions for segregation.

⁷⁴ [1927] 1 Ch 606 at 640.

If all parties to a transaction are thus endowed with the same powers to create equitable proprietary rights, it is suggested that there is no theoretical reason to confine a *Quistclose* analysis to loans of money. It is a fundamental principle that any property can be subject to a trust, and there appears no need to make *Quistclose* trusts a special case.⁷⁵

1.4 THIRD-PARTY ENFORCEMENT

We have seen that in *Twinsectra*⁷⁶ the House of Lords concluded that the test for ‘certainty of purpose’ was the same as the test for certainty of objects regarding powers: the ‘given postulant’ test.⁷⁷ Yet interestingly, it would seem that this power could be either imperative or discretionary, depending on the facts. Lord Millett held:⁷⁸

Whether the borrower is obliged to apply the money for the stated purpose or merely at liberty to do so, and whether the lender can countermand the borrower’s mandate while it is still capable of being carried out, must depend on the circumstances of the particular case.

Lord Millett asserts that the borrower, the trustee of the power, may be under either a positive or a negative obligation. That is, he may be obliged to actually apply the funds, or his duty may extend only so far as to prohibit misapplication. Thus a positive obligation would necessitate an imperative power. However, earlier in his speech his Lordship had commented:⁷⁹

When the money is advanced, the lender acquires a right, enforceable in equity, to see that it is applied for the stated purpose, *or more accurately to prevent its application for any other purpose.*

It is suggested with respect that these dicta cannot stand together. The earlier dictum – quoted second - clearly envisages the recipient being ‘at liberty’, rather than

⁷⁵ Worthington argues that if the commercial consequences of equal treatment of lenders and sellers are unacceptable, then the only solution would be legislative intervention: (1996), op cit n 28, p 64.

⁷⁶ See discussion in Section 1.2.2 above of *Twinsectra Ltd v Yardley and others*, supra n 46.

⁷⁷ See *Re Gulbenkian’s Settlements*, supra n 49.

⁷⁸ Supra n 46 at 193.

⁷⁹ Ibid at 184 (emphasis added).

'obliged', to exercise the power. The recipient would be under a negative obligation. This describes a situation much more compatible with established trust principles: B holds money on trust for A, but subject to a power to benefit people in the class C. In any situation A will hold an equitable right to restrain distribution outside the bounds of that power, but A will not have an equitable right to compel B's exercise of that power, nor will any members of the class C.

If we accepted that exercise of the power could be imperative, with the trustee of that power being under a positive duty to apply the funds, then we must ask who could compel the exercise of that power. The third parties, C, would have rights if they were beneficiaries under a discretionary trust, but not if they were merely within a class of people who may benefit from the exercise of a power. In *Mettoy Pension Trustees Ltd v Evans*, the court was prepared to 'step in' and exercise a fiduciary power when the original trustee (the company) had gone into liquidation.⁸⁰ However, this was because it was otherwise impossible for the power to be exercised, not because the original trustee of the power had refused to exercise it. Thus, in our example the only person who could compel performance would be A, and as we have seen this would represent a marked departure from established principles. Of course A, as an absolutely-entitled beneficiary, may be able to direct the trustee B to pay money to whomever he wants under the principle in *Saunders v Vautier*.⁸¹ However, this is not the same as a beneficiary (or indeed settlor) compelling the exercise of a power.

Yet there are many cases where the court clearly considered the recipient to be under an obligation to apply the funds, rather than a mere obligation to not misapply them. To return to North J in *Gibert v Gonard*:⁸²

⁸⁰ [1990] 1 WLR 1587.

⁸¹ (1841) 4 Beav 115. It is argued that a resulting trustee will owe fiduciary duties to his beneficiary, but it is not certain that these obligations will be owed to the same extent as an express trustee. See Professor Burrows' comment on the Court of Appeal judgment in *Westdeutsche*, 'Swaps and the friction between common law and equity' [1995] RLR 15, p 27; also Chambers (1997) op cit n 35, pp 196-200; and Millett PJ, 'Restitution and Constructive Trusts' (1998) 114 LQR 399, p 404. In the *Quistclose* context it is suggested that the relationship between the lender and debtor is such that the imposition of more strict duties is justifiable. However, it is accepted that this will change depending on the particular facts. Thus we cannot say for certain that the beneficiary under the resulting trust would be able to avail herself of *Saunders v Vautier*. These issues are also discussed in Chapter Four, Section 4.3.3.

⁸² *Supra* n 52 at 440.

It is very well known law that if one person makes a payment to another for a certain purpose, and that person takes the money knowing it is for that purpose, he must apply it to the purpose for which it was given. He may decline to take it if he likes; but if he chooses to accept the money tendered for a particular purpose, it is his duty, and there is a legal obligation on him, to apply it for that purpose.

Similarly in *Hassall v Smithers*,⁸³ the provider of the funds, joining the deceased's creditors, was able to compel payment by the intestate's representative. There existed a positive duty to apply the funds for the stated purpose.⁸⁴

North J could have been referring to simple contract law principles, but it is suggested that this is unlikely. *Hassall v Smithers* may appear similar to a *Mettoy Pensions* situation: in both cases the court stepped in to exercise a power that was otherwise incapable of being exercised. However, in *Hassall* this decision was clearly based on what the court saw as a positive duty to use the funds as specified. Grant MR stated that 'Clearly the intestate was bound so to apply that remittance...'.⁸⁵ Plainly the courts did not consider the borrower's duty to be a merely personal obligation. Again Lord Millett:⁸⁶

It is unconscionable for a man to obtain money on terms as to its application and then disregard the terms on which he received it. Such conduct goes beyond a mere breach of contract. ... The duty is not contractual but fiduciary. ... The duty is fiduciary in character because a person who makes money available on terms that it is to be used for a particular purpose only and not for any other purpose thereby places his trust and confidence in the recipient to ensure that it is properly applied.

It is clear that Lord Millett did not think the recipient's duty was merely contractual, and indeed would go further than the normal fiduciary duty to periodically consider

⁸³ *Supra* n 53.

⁸⁴ As Ho & Smart point out ('Re-interpreting the *Quistclose* Trust: A Critique of Chambers' Analysis' (2001) 21 OJLS 267), the uncertainty left open by this case is the nature of the right the creditors held to enforce the trust. The court avoided the question as the settlor joined the creditors in their petition.

⁸⁵ *Supra* n 53 at 121.

⁸⁶ *Twinsectra*, *supra* n 46 at 186. Taken on its own this formulation would suggest that any loan with a purpose attached would give rise to a *Quistclose* trust. It is suggested that this formulation must be taken together with a consideration of the parties' intentions as to the beneficial interest in the loan funds, often inferred or demonstrated by, for example, a term obliging segregation from the recipient's general assets.

the exercise of a power.⁸⁷ His Lordship asserted that a fiduciary relationship arose due to the parties' relationship being such that it would be unconscionable for the recipient to disregard the terms on which he received the money. Thus, this fiduciary relationship creates a positive duty on the recipient's part to 'properly apply' the funds.⁸⁸

Lord Millett contemplated an example of a recipient being under a positive obligation to apply the money for the stated purpose, with the lender being unable to revoke the mandate while the said purpose was still capable of fulfilment.⁸⁹ This would result in the recipient being under an irrevocable obligation to apply the funds for that purpose. If the lender cannot, as a matter of property law, countermand the mandate, then can we properly term him a beneficiary under an 'orthodox resulting trust'?⁹⁰ Further, in this example it is suggested that it would be erroneous to talk of the third parties as merely members of a class who may benefit from the exercise of a power. If the power is imperative and irrevocable, then the third parties begin to look very much like beneficiaries under a discretionary or fixed trust.⁹¹ Of course, if this were the case then they would presumably be able to call for the trust property and terminate the trust under the principle in *Saunders v Vautier*.⁹² It would be thus impossible to claim that the beneficial interest in the property remained with the lender throughout.

It is suggested that this situation arises because of an unnecessary fusion of contractual and proprietary obligations. If A loans money to B to enable B to pay off C, then it is suggested that B holds the funds on trust for A subject to an orthodox, i.e.

⁸⁷ See *Re Hay's ST* [1982] 1 WLR 202. See also the discussion and sources cited in n 82 above.

⁸⁸ See Chapter Four, Section 4.2.2, especially n 41. Where the terms on which B receives money are such that she may only apply the money for a purpose (that is, she is not compelled to), then it is argued that fiduciary relations do not arise. Further, it is also contended that no trust arises here because a lack of intention on A's part to compel the application of the funds would be incompatible with any presumption that she did not intend B to receive full beneficial title. Whether a presumption would be in play here is discussed in Chapter Four, Section 4.3.2.

⁸⁹ See above, text to n 78.

⁹⁰ *Twinspectra*, supra n 46 at 192. That is, in such a situation it is difficult to see how beneficial ownership would not have been transferred to the borrower, B. See Chapter Four, Section 4.2.2.

⁹¹ In 'The Quistclose Trust: Who Can Enforce It?' (1985) 101 LQR 269, P J Millett QC (as Lord Millett then was) considered the possibility of third parties being the beneficiaries of such a trust: 'If A's intention was to benefit C, or his object would be frustrated if he were to retain a power of revocation, the transaction will create an irrevocable trust in favour of C, enforceable by C but not by A. The beneficial interest in the trust property will be in C.' His Lordship did not adopt this formulation in *Twinspectra*, although it is argued in Chapter Four that a trust for a third party can exist in a *Quistclose*-type situation. See Section 4.1.

⁹² Supra n 81. Also see discussions above of *Hassall v Smithers*, nn 53 & 83.

discretionary, power to benefit C. If B does not exercise that power, then neither A nor C hold any equitable right to so compel him. This is the case even if the agreement clearly states that B is under a duty to apportion the money to C; for this is a contractual duty. Thus if B does not exercise the power then he will breach his contract with A, incur appropriate personal liability, and be susceptible to A demanding the return of the funds under the resulting trust. However, B will not be in breach of his fiduciary duties.⁹³

To observe from a different angle, A as the beneficiary can revoke B's power to benefit C. One result of this analysis which may appear difficult is shown by the following example: a contract of loan clearly provides that the lender shall not revoke the borrower's licence to apply the loan funds for the stated purpose. The lender reneges on this promise and, in breach of contract, revokes the mandate. The borrower subsequently spends the money according to the stated purpose, but the lender has already revoked his authority to do so. Has the borrower committed a breach of trust? It is suggested that, due to the lender's equitable right to revoke the power given to the borrower, the borrower has indeed acted in breach. Clearly the borrower will have a remedy in contract but as a matter of property law the lender can revoke at any time, notwithstanding his contractual obligations.⁹⁴

It is suggested that this analysis receives implicit support from the Court of Appeal in *Bristol and West Building Society v Mothew*. In discussing whether the defendant solicitor's authorisation to use the society's money to purchase property had been revoked, Millett LJ (as he then was) held:⁹⁵

The defendant held [the money] in trust for the society but with the society's authority (and instructions) to apply it in the completion of the transaction of purchase and mortgage of the property. Those instructions were revocable but, unless previously revoked, the defendant was entitled and bound to act in accordance with them.

⁹³ See discussion above, n 81.

⁹⁴ In Chapter Four it is argued that the better view when A promises not to revoke B's power / licence is that there is no trust, as the promise not to revoke would be inconsistent with a resulting trust analysis. See Section 4.3.3. However, here we are highlighting a particular difficulty with Lord Millett's opinion in *Twinssetra*, supra n 46.

⁹⁵ [1998] Ch 1 at 22.

The instructions in this case were 'revocable', both in the sense that a misrepresentation had made the contract voidable, and that the instructions were revocable under the contract anyway. The Court found that the society had not rescinded the transaction, and thus the solicitor's authorisation had not been revoked. However, it is clear that if the Court had found the instructions to have been revoked, the solicitor would not have been liable merely for breach of contract.⁹⁶

In my judgment the defendant's [unrevoked] authority to apply the mortgage money in the completion of the purchase was ... effective to prevent his payment being a breach of trust.

In *Mothew* the instructions were revocable under the contract, yet the Court clearly considered that a revocation of those instructions would make the recipient liable for a breach of trust if he continued to use the money. Thus, revocation of mandates revocable under the contract gives rise to liability for breach of trust as well as contract. This being so, it is suggested that revocation of mandates *irrevocable* under the contract must similarly give rise to liability for breach of trust. Otherwise, the attempt of a lender to revoke a contractually-irrevocable mandate would have no effect, and this cannot be so if we are to term the lender an 'orthodox beneficiary'.⁹⁷

It will be seen that the analysis above requires a clear distinction between property rights and contractual obligations. Indeed, it assumes that the proprietary rights of the lender / beneficiary will 'trump' the contractual rights of the borrower. It is suggested that this is consistent with established principles, though it must be noted that such a situation does not exist in all circumstances where contractual licences and proprietary rights conflict. Contractual licences relating to the occupation of land were once thought to be always de facto revocable: in *Wood v Leadbitter* the owner of Doncaster racecourse was able to eject a ticket-holder from the grounds with impunity, notwithstanding the plaintiff's contractual right to be there.⁹⁸ However, later cases have substantially modified this doctrine and it now appears that equity has a discretion to grant injunctive relief to restrain breaches of these contractual

⁹⁶ *Ibid* at 24.

⁹⁷ *Twinsectra*, HL, *supra* n 46 at 192. Note the comments at n 94 above, where it is argued that a contractually irrevocable mandate would in fact be inconsistent with a resulting trust analysis.

⁹⁸ (1845) 13 M & W 838; see dicta of Megarry J in *Hounslow LBC v Twickenham Garden Developments Ltd* [1971] Ch 233 at 249, referring to the 'old distinction' between a property-owner's power to revoke a licence effectively, and his right to do it lawfully.

licences.⁹⁹ The proprietor no longer has an ultimate power in such circumstances to eject a licensee and leave him to his remedy in damages.

Such a change should not be brought into the *Quistclose* trust arena. It is argued that the modern approach to contractual licences in land, outlined above, is 'merely one emanation of a more ancient doctrine relating to the irrevocability of certain kinds of licence'.¹⁰⁰ That is, the modern approach to these licences can be considered an extension of the old doctrine of a licence 'acted upon', or 'coupled with an equity'. In *National Provincial Bank Ltd v Hastings Car Mart*, Lord Denning MR explained that a licence 'coupled with an equity' arose in an estoppel situation:¹⁰¹

If the owner of land grants a licence to another to go upon land and occupy it for a specific period or a prescribed purpose, and on the faith of that authority the licensee enters into occupation and does work, or in some way alters his position to his detriment then the owner cannot revoke the licence at his will.

If it is recognised that the irrevocability of certain licences is due to a form of equitable or proprietary estoppel, then we see why the courts' shift in approach to contractual licences in land need not be followed in the *Quistclose* arena. If a borrower relies to his detriment on a lender's contractual promise not to revoke the borrower's licence, and the lender does so revoke, then a promissory estoppel may arise.¹⁰² This is not inconsistent with asserting that the lender, as beneficiary, can revoke the power as a matter of property law. The estoppel only affects the relationship between the lender and borrower, with any third parties who encounter funds transferred in breach of trust still taking subject to that trust. Of course, these third parties will most often be the equivalent of bona-fide purchasers for value without notice. The beneficiary would then normally proceed against the trustee personally, and it is at this stage that the estoppel would preclude an action.

⁹⁹ See *Winter Garden Theatre (London) Ltd v Millenium Productions Ltd* [1946] 1 All ER 678; *Errington v Errington and Woods* [1952] 1 KB 290; *Ashburn Anstalt v Arnold* [1989] Ch 1; *Chandler v Kerley* [1978] 1 WLR 693.

¹⁰⁰ See Gray & Gray, *Elements of Land Law*, (3rd ed, Butterworths, 2001) pp 184-5.

¹⁰¹ [1964] Ch 665 at 686.

¹⁰² See *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130; *Combe v Combe* [1951] 2 KB 215.

If it is accepted that *Quistclose* lenders are beneficiaries under resulting trusts,¹⁰³ then the above formulation is the most acceptable: it does not conflict with established principles of trust law, it allows for circumstances where the transfer is not pursuant to a contract,¹⁰⁴ and it allows for such variations in the duties and obligations of both lender and recipient as the parties agree to. These duties are contractual and are in addition to, but separate from, the fiduciary duties that the recipient may owe to the lender as trustee of his funds. What this construction does not allow for is third-party enforcement, at least in the realm of property law.¹⁰⁵ The one caveat is the situation where the purpose is still capable of fulfilment, but the power cannot be exercised: *Mettoy Pensions* suggests that the court could exercise the power in this instance. However, whilst the power is still capable of being exercised, the decision whether or not to do so must remain with the trustee of that power.

1.5 A NOTE ON THEORY

This chapter has dealt with the mechanics of a *Quistclose* trust. It has been argued that there is no ‘requirement’ of segregation: what is needed is evidence that the parties did not intend the recipient to have free use of the property. I have also considered questions regarding the types of purposes for which money can be advanced, the clarity with which those purposes must be defined, the property which may be subject to such a trust, and the identity of those who can enforce the trust. As far as possible I have attempted to do this in a ‘theory-neutral’ manner, although identifying occasions when the answer to a question may depend on one’s view as to the underlying theory of *Quistclose* trusts. The most obvious example of this is the third-party enforcement discussion, although one’s view of the required level of specificity of purpose may also depend on theoretical perspectives.¹⁰⁶

¹⁰³ As mentioned in nn 94 and 97 above, it is argued that not all *Quistclose* situations necessarily involve resulting trusts. However, for the moment I am dealing with the question of third-party enforcement of the *Quistclose* trust as envisaged by Lord Millett in *Twinsectra*, supra n 46. Whether his Lordship’s model applies in all circumstances – I argue that it does not – is a question that is dealt with later. See Chapter Four, Sections 4.3.3 & 4.4.

¹⁰⁴ In this instance the only duties on either side would be those arising from the trust relationship. Thus, the recipient would be at liberty to apply the funds for the purpose, i.e. exercise the power, but could not be compelled to by either the transferor or the third party.

¹⁰⁵ Though note the potential application of the Contracts (Rights of Third Parties) Act 1999.

¹⁰⁶ See, respectively, Sections 1.4 and 1.2.2.

In the third-party enforcement section I try to highlight the difficulties – and suggest some solutions – in analysing Lord Millett’s judgment in *Twinsectra*.¹⁰⁷ The arguments advanced are attempts to reconcile or clarify Lord Millett’s proposals as regards orthodox principles of property law. The suggestions are not my preferred model: for my own analysis and views on the theoretical bases of *Quistclose* trusts see Chapter Four.

¹⁰⁷ *Supra* n 46.

CHAPTER TWO - EQUITABLE CHARGES

It has been argued in Chapter One that the *Quistclose* trust analysis need not only be applied in commercial situations. However, this is where it is most commonly seen, and arguably where the analysis has the most significance from an insolvency perspective. Having considered the nature of a *Quistclose* lender's interest in the transferred property, we now examine the interests acquired by holders of equitable charges.

An equitable charge is a non-possessory security, similar to a *Quistclose* trust in providing the creditor with a proprietary interest in the secured goods. Should the debtor become bankrupt, or fall into liquidation, the charged assets will not be available for normal *pari passu* distribution amongst creditors but will instead be available for sale to satisfy the interest of the individual chargee.¹ Both *Quistclose* trusts and equitable charges² thus operate to shield a creditor from the potential losses of unsecured creditors in insolvency: unlike the common law lien they allow a proprietary interest to be retained without actual possession of the property. However, whilst the effects of these two devices may be similar, there are differences in creation, operation, and theory.

Equitable charges are created 'when property is expressly or constructively made liable, or specially appropriated, to the discharge of a debt or some other obligation, and confers on the chargee a right of realisation by judicial process'.³ However, it is also necessary to determine whether the particular charge created is a 'fixed' or 'floating' charge. Fixed charges, created over identified property, usually by contractual stipulation, prevent the debtor from dealing with that property without first either paying off his debt to the chargee or securing the chargee's permission.⁴ Fixed charges over property not yet acquired are valid, though the property must be sufficiently well-described to enable the charge to take effect. Since charges are an

¹ Though see discussion below, text to n 15.

² All charges of personal property are equitable, except those legal charges provided by statute. The common law also provides for certain general and specific liens.

³ *Swiss Bank Corporation v Lloyds Bank Ltd* [1982] AC 584 at 595 per Buckley LJ.

⁴ Should the debtor deal with the property anyway, the third party will take subject to the charge unless he is a bona fide purchaser for value without notice.

example of a proprietary right arising from a contract, it is also necessary for that underlying contract to be valid, that is, be supported by consideration or satisfy the formalities of a deed.⁵

A floating charge, on the other hand, does not attach to any specific property but instead ‘hovers’ over a fund of assets, including in its scope property acquired by the debtor after the charge was created. The debtor is free to deal with the charged fund in the normal course of his business, and does so at this point free from any encumbrance.⁶ The charge will ‘crystallise’ into a fixed charge on the occurring of an event either provided for in the contract or which necessarily ends the debtor’s licence to deal with the property; often the appointment of a receiver or the insolvency of the debtor company.⁷ The chargee can then apply to the court for sale or release of the assets or, depending on the contract, seize them immediately without recourse to the court.

2.1 CATEGORISATION: FIXED OR FLOATING?

2.1.1 Definition

An early point to note is the lack of a single definition of a floating charge. Although various statutes refer to such devices, they do not define them.⁸ A useful starting point is the well-known guidance given by Romer LJ in *Re Yorkshire Woolcombers Association Ltd*:⁹

I certainly do not intend to attempt to give an exact definition of the term ‘floating charge’, nor am I prepared to say that there will not be a floating charge ... which does not contain all the three characteristics I am about to mention, but I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge.

⁵ *Holroyd v Marshall* (1862) 10 HL Cas 191. If the charge includes future assets, the agreement must be for value.

⁶ See *Driver v Broad* [1893] 1 QB 744 at 749 per Kay LJ: ‘the company shall, notwithstanding the debentures, be at liberty to carry on its business, and in the ordinary course of such business to dispose of the property, as if the debentures did not exist’.

⁷ Only companies can give floating charges over their assets: for an individual borrower to do so would infringe the Bills of Sale Acts 1878 and 1882 (which do not apply to companies).

⁸ See Companies Act 1985, s 744; Insolvency Act 1986, s 251.

⁹ [1903] 2 Ch 284 at 295.

- (1) If it is a charge on a class of assets of a company present and future;
- (2) If that class is one which, in the ordinary course of the business of the company, would be changing from time to time, and;
- (3) If you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with.

Romer LJ did not attempt to define a floating charge, rather he sought to describe one. When the case reached the House of Lords, as *Illingworth v Houldsworth*, Lord Macnaughten tackled the issue himself:¹⁰

I should have thought there was not much difficulty in defining what a floating charge is in contrast to what is called a specific charge. A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is entitled to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge.

Once again there is no clear definition: Lord Macnaughten contrasts fixed and floating charges, but does not tell us when either one will arise. It is suggested that the third limb of Romer LJ's description (the freedom of the debtor to deal in the normal course of business) is the determining characteristic of a floating charge, as although the first two limbs are typical of a floating charge they are not necessarily inconsistent with a fixed one.¹¹ However, as Worthington points out, the many different levels of 'freedom' that a debtor may enjoy, depending on what he has agreed to, present the courts with difficult cases.¹² Thus a relatively minor restriction on the debtor's freedom to deal does not automatically mean that the charge is fixed,¹³ nor does a certain amount of leeway necessitate it be floating.¹⁴ The problems with

¹⁰ [1904] AC 355 at 358.

¹¹ Note that the parties' description of the device as either floating or fixed is not conclusive: the courts will look to the substance of the agreement, not its form. See *Re Armagh Shoes Ltd* [1984] BCLC 405, and the following discussion in Section 2.1.2.

¹² Worthington S, *Proprietary Interests in Commercial Transactions* (Clarendon Press, Oxford, 1996) p 78.

¹³ See *Re Brightlife Ltd* [1987] Ch 200 at 209 per Hoffman J; *Re Cosslett (Contractors) Ltd* [1998] Ch 495 at 510 per Millet LJ.

¹⁴ See *Siebe Gorman & Co Ltd v Barclays Bank* [1979] 2 Lloyds Rep 442, where restrictions on the company's ability to deal with its book debts were not exhaustive yet the charge was still held to be fixed.

distinguishing between the two forms of charge are considered in the following section.

2.1.2 Construction and Categorisation

Both the Privy Council and House of Lords¹⁵ have recently considered the issue of categorisation. In *Agnew v CIR*, Lord Millett, giving the judgment of the Privy Council, said: ¹⁶

The question is not merely one of construction. In deciding whether a charge is a fixed charge or a floating charge, the Court is engaged in a two-stage process. At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the Court can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument, is to grant the company rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it.

His Lordship continued:

So here: in construing a debenture to see whether it creates a fixed or a floating charge, the only intention which is relevant is the intention that the company should be free to deal with the charged assets and withdraw them from the security without the consent of the holder of the charge; or, to put the question another way, whether the charged assets were intended to be under the control of the company or of the charge holder.

This case is particularly illustrative of the difficulties of categorisation, in that the debenture in *Agnew* had almost certainly been drafted specifically to take advantage

¹⁵ *Smith v Bridgend County Borough Council* [2002] 3 WLR 1347.

¹⁶ *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 at 725-6.

of the decision of the Court of Appeal in the case of *Re New Bullas Trading Ltd.*¹⁷ In that case, Nourse LJ had considered that the parties were free to make whatever agreement they liked. That is, the question was simply one of construction: the intention of the parties, to be gathered from the terms of the debenture, must prevail. His Lordship held that it was clear from the descriptions attached to the charges that the parties had intended to create a fixed charge over the book debts while they were uncollected and a floating charge over the proceeds. Given that it was open to the parties to do this, the law would give their agreement suitable effect.

As we have seen, the Privy Council in *Agnew* considered that *Re New Bullas* was wrongly decided, instead preferring a two-stage test of construction and categorisation. In *Re New Bullas* the parties had clearly intended a fixed charge over the relevant debts, and according to Nourse LJ this was all the Court required. In *Agnew* however, the Privy Council found that the parties had clearly intended a specific relationship, but their lordships reserved to themselves the right to categorise that relationship. As Lord Millett points out, this is similar to the courts' way of identifying leases and licences in real property: the form of the agreement must not be inconsistent with the substance of the rights and obligations of the parties.¹⁸

2.2 BENEFICIAL OWNERSHIP – *QUISTCLOSE* TRUSTS

As mentioned above, both fixed and floating charges arise through agreement: the debtor agrees with his creditor that certain of his assets will be 'appropriated to the discharge' of the debt. Thus, when the debt has indeed been satisfied, the charge disappears. This is similar to a *Quistclose* situation, where the trust relationship ends when the recipient has exhausted the funds and has done so in the agreed way. However, until that point the *Quistclose* lender has an equitable interest in the property: he is the beneficiary under a resulting trust. Neither the fixed nor floating chargee is in such a simple position.

¹⁷ [1994] 1 BCLC 449. In both cases the question before the court was whether book debts, which were uncollected when receivers were appointed, were subject to a fixed charge or a floating charge.

¹⁸ *Agnew v CIR*, supra n 16 at 725, referring to *Street v Mountford* [1985] 1 AC 109.

It is clear that the holder of a fixed charge has a proprietary interest in the goods, albeit one that does not amount to equitable ownership (unlike the *Quistclose* lender).¹⁹ Of course, when a floating charge crystallises the holder of that charge will also have such an interest, even if for only so long as it takes to obtain a court order allowing seizure. However, it is unclear what the nature of a floating chargee's right is whilst that charge remains floating. The charge itself exists from the moment of creation, but what rights, if any, does it give its holder before crystallisation?

Once a charge is categorised as fixed or floating, the position in an insolvency situation differs: the security of a fixed charge is greater than that of a floating charge. For example, the interest of a floating charge holder is subordinate to those of preferential creditors in a receivership.²⁰ However, whilst the statutory regime may be clear, there still remains the question of the 'strength' of a floating chargee's interest against competing proprietary interests. This is important because it can result in differing priorities as regards these parties.²¹

2.3 OTHER PROPRIETARY INTERESTS

The extent of a floating chargee's proprietary interest is a question necessarily linked with that of the nature of a floating charge. Is a floating charge no more than an agreement to create a fixed charge at a later date, or is it a proprietary device in its own right? We may imagine four points on a scale: equitable ownership, the proprietary interest of a fixed equitable charge, a type of proprietary interest which is more qualified than that of a fixed charge, and a contractual interest (perhaps coupled with a mere equity).

¹⁹ *Agnew v CIR*, supra n 16 at 717.

²⁰ Insolvency Act 1986, ss 40, 175. Further, a floating charge created just before a company's liquidation may be avoided under s 245 of the Insolvency Act. This is clearly different to a *Quistclose* situation, where an advance can be made security, despite the risk of the borrower's insolvency.

²¹ For a more detailed exposition see Gough WJ, *Company Charges* (2nd ed, Butterworths, 1996), p 344.

2.3.1 The 'defeasible charge' theory

It is clear that the holder of an equitable charge (whether floating or fixed) does not have equitable ownership of the property subject to that charge.²² However, the holder of a fixed charge nevertheless has a 'strong' proprietary interest: charged property cannot be disposed of freely without the chargee's consent (unless to a bona fide purchaser), and in the event of insolvency the chargee has a proprietary claim. However, notwithstanding the different legislative provisions that apply to fixed and floating charges, it is argued that they are merely 'two sides of the same coin'.

It has been argued above that the 'freedom to deal' with the charged assets is the main distinguishing factor between fixed and floating charges: if the chargor has a significantly greater freedom to deal then his assets are subject to a floating charge, if he has significantly less ability to do so we classify the charge as fixed. Yet this freedom to deal is determined by the parties' agreement, which they are free to alter at any time. In this way a fixed charge can be converted into a floating charge, and vice versa. Further, there seems little reason why a floating charge could not crystallise into a fixed charge, and then 'decrystallise' should the parties agree. The decrystallisation could be seen as creating a *new* charge,²³ but it is suggested that since crystallisation does not bring a new security interest into existence, neither should decrystallisation.²⁴ Given this fluidity, it would seem strange to classify the nature of the interests under each charge as different. Perhaps Worthington puts it most succinctly: 'the difference is that with fixed charges no dealing is permitted unless and until otherwise provided, while with floating charges all dealing is permitted unless and until otherwise provided'.²⁵ The law may apply different rules to the different charges, but this should not obscure the fact that the proprietary interest they give is of the same nature.

²² See *Illingworth v Houldsworth* supra n 10; *National Provincial Bank v Ainsworth* [1965] AC 1175.

²³ See Grantham R, 'Refloating a floating charge' [1997] *Canadian Insurance Law Reporter* 53.

²⁴ Goode asserts that 'All that happens is that in [crystallisation] the debtor's power to deal with the property is determined and in [decrystallisation] the restriction on his dealing power is removed. The security interest is still a single and continuous interest.' Goode RM, 'Charges Over Book Debts: A Missed Opportunity' (1994) 110 LQR 592, p 604.

²⁵ Worthington S, 'Floating Charges – An Alternative Theory' [1994] CLJ 81, p 84.

2.3.2 *The 'licence' theory*

The theory set out above is known as the 'defeasible charge' theory: the floating chargee has the same quality of proprietary interest as the fixed chargee, but his interest is liable to be defeased when the chargor deals with the property in one of the permitted ways. Moving further along the line, we encounter the 'licence theory'. This posits that the chargee has an interest before crystallisation, but that this interest is linked to a licence held by the chargor to utilise the assets in the ordinary course of their business.

It is suggested that the problem with this theory is that it still leaves us unclear as to what precise form the proprietary interest takes. The chargee is the legal owner, with a contractual licence enabling him to utilise the assets in agreed ways. The chargor has an equitable interest. Put like this, there seems to be little difference between the licence theory and the defeasible charge theory: we may mention the existence of a licence in one, but it would be perfectly possible for the equitable interests of the chargee to be identical. That is, both fixed and floating charges give the same interest to the chargee, but the floating chargor acquires a licence to deal with the goods. The difficulty with this is that, as shown above, not all fixed chargees impose an absolute restriction on dealing, and neither do all floating chargors receive complete freedom to deal in the ordinary course of business. Do all chargors acquire a licence to deal, just to a greater or lesser extent? This could be the case, but advocates of the licence theory argue that the existence of the licence *diminishes* the interest of a floating chargee, so that it is something less than that of a fixed charge holder. However, it is not clear why this should be so. It is suggested that the existence of a contractual licence enabling the chargor to deal should not affect the nature or extent of the chargee's equitable proprietary interest in the goods.

To return to the assertion that *all* chargors may hold a licence to deal, to a greater or lesser extent,²⁶ it may appear that this would make talk of whether a licence existed or not somewhat redundant. However, as Pennington points out, 'the difference of

²⁶ Although, in the relatively rare case of a fixed chargor under a complete restriction, to no extent at all.

judicial opinion as to whether there is an implied licence given to the company is not merely a metaphysical one. It can result in different answers to problems concerning the rights of debenture holders'.²⁷ For example, if we assume that a chargor proposes to deal with the property outside his allowed remit,²⁸ whether or not the chargee may obtain an injunction to prevent this would depend on whether or not there existed an implied licence. In *Re Woodroffes*, Nourse J thought that such a licence did indeed exist:²⁹

It is a mistake to think that the chargee has no remedy while the charge is still floating. He can always intervene and obtain an injunction to prevent the company from dealing with its assets otherwise than in the ordinary course of business.

Of course, in seeking an injunction, a chargor is not attempting to vindicate any proprietary right (unlike a *Quistclose* lender trying to restrain misuse), but is instead relying on his contractual rights. If such a licence did not exist, the chargee may only seek an order when the floating charge crystallises. Pennington advocated this latter view,³⁰ though he did so twenty-six years before the dicta of Nourse J in *Re Woodroffes*. Pennington derived support from Buckley LJ in *Evans v Rival Granite Quarries Ltd*:³¹

A floating charge is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security.

It is suggested that, if *Re Woodroffes* is correct, then it must be accepted that an implied licence exists, allowing the chargor to deal with the property in the course of business (or to whatever extent the parties agree), and allowing the chargee to restrain him from dealing outside those restrictions. However, it is also argued that this does

²⁷ Pennington RR, 'The Genesis of the Floating Charge' (1960) 23 MLR 630, p 645.

²⁸ Note that 'ordinary course of business' does not necessarily equate to intra vires transactions allowed by the chargor's memorandum of association: in *Hubbuck v Helms* (1887) 56 LJ Ch 536, an assignment of a company's entire undertaking was authorised by the company's articles, but was still held to be outside the ordinary course of business.

²⁹ [1986] Ch 366 at 377-378.

³⁰ Pennington (1960), op cit n 27.

³¹ [1910] 2 KB 979 at 999.

not necessarily conflict with the 'defeasible charge' theory. The 'strength' or nature of the equitable proprietary interest that the chargee holds is the same, whether the charge in question is fixed or floating. In essence the defeasible charge theory sees a floating charge as a 'fixed charge plus a licence to deal'.³² This is not to say that the charge should therefore be classified as fixed, but rather to illustrate the similarities between the two charges: two species of the same genus. Worthington shows that the 'quality' of the proprietary interest is the same in both cases, 'except that the floating interest is defeasible while the fixed one is not'.³³ This is in conflict with the licence theory only in so much as the licence theory denies the equivalence of the quality of the equitable interest. In short it is submitted that there is an implied licence, but that this merely affects the contractual position of the parties, not the nature of the chargee's proprietary right.

2.3.3 *The 'mortgage of future assets' theory*

The third theory, furthest along our scale, sees floating charges as having no proprietary effect prior to crystallisation. Known as the 'mortgage of future assets' theory, it is in particular advocated by Gough:³⁴

Although under a floating charge there is a present and immediate charge prior to crystallisation, there is no present and immediate equitable proprietary interest conferred on the chargee prior to crystallisation by reason of ownership of specifically identified existing assets or acquisition of future assets in compliance with the contract description. Prior to crystallisation, the rights of the chargee remain contractual.

This theory asserts that the proprietary rights of chargees are conferred by assignment, and that a floating charge is simply an incomplete assignment, which becomes complete on crystallisation. Perhaps the clearest authority for this proposition comes from Kay LJ in *Biggerstaff v Rowatt's Wharf Ltd*:³⁵

³² Worthington (1996), op cit n 12, p 81.

³³ Ibid.

³⁴ Gough (1996), op cit 21, p 347.

³⁵ [1896] 2 Ch 93 at 106.

The debentures must be regarded as incomplete assignments which do not become complete until the time when the receiver is appointed.

Gough also cites, *inter alia*,³⁶ two more recent cases to support the ‘mortgage of future assets’ theory. First he considers the remarks of Blayney J in *Re Tullow Engineering (Holdings) Ltd.*³⁷

The effect of the crystallisation of the floating charge which occurred was that there was an immediate equitable assignment of the shares to the debenture holders so that, in equity, they became the owners of the shares. [The chargor] was divested of its ownership in favour of the debenture holders.

Next Gough quotes from the case of *Re ELS Ltd.*³⁸

[T]he crystallisation of the bank’s floating charge in this case completed the assignment of the goods of [the chargor] affected by the floating charge ... with the consequence that such goods were thereafter no longer the goods of [the chargor].

At first sight these cases may indeed appear to support the argument that the floating chargee has no equitable proprietary interest prior to crystallisation. However, it is suggested that in fact there is nothing in these dicta to conflict with the defeasible charge theory. It is not contended that any charge holders receive equitable ownership, whether they be fixed or floating chargees. Thus the assertions (in *Re Tullow* and *Re ELS*) that crystallisation resulted in the equitable ownership switching to the chargee are, it is suggested, mistaken: crystallisation merely turns a floating charge into a fixed one.³⁹

Further, and most importantly, even were the assertions to be correct they would not conflict with the defeasible charge theory. The defeasible charge theory does not suggest that floating chargees have beneficial ownership, because neither do holders of fixed charges. The defeasible charge theory merely suggests that, since fixed chargees clearly have some form of equitable interest prior to crystallisation, and

³⁶ See the cases cited in Gough (1996), *op cit* n 21, p 342.

³⁷ [1990] 1 IR 452 at 458.

³⁸ [1994] 2 All ER 833 at 845 per Ferris J.

³⁹ See above, text to n 25. The power to deal is determined, but if that power is still capable of reinstatement (‘decrystallisation’), then equitable ownership cannot have been transferred.

since both charges are species of the same genus, then floating chargees must similarly have some form of equitable interest, of the same nature and quality (if not the same extent) as fixed chargees. Thus the fact that 'full' or 'complete' assignment may not take place until crystallisation in no way precludes the existence of some form of equitable proprietary interest before this event.⁴⁰

2.3.4 Conclusions

The mortgage of future assets theory draws a sharp distinction between floating and fixed charges, which admittedly reflects the distinction drawn by statute. However, it is suggested that this theory does not take account of the similarities between the two charges. It is argued that the main indicia used to determine a fixed from floating charge refer to the level of dealing freedom that the chargor retains, and to suggest that equitable proprietary rights exist on one side of the line and not on the other seems unduly harsh.

It is submitted that the 'modified' defeasible charge theory, as explained above, is to be preferred. Nonetheless, it is accepted this still does not tell us precisely what the nature of the equitable interest is: it is merely asserted that, whatever the interest is, it is the same as that held by a fixed chargee. Notwithstanding the fact that the law does treat fixed and floating charges in different ways, it is suggested that this is still the most acceptable argument. There are myriad levels of 'dealing freedom', and the parties may choose any arrangement within this spectrum. At some point on the spectrum the law draws a line and distinguishes between the two charges. But this line is essentially a policy decision reflecting the needs of commercial certainty, freedom to contract, and the protection of secured and unsecured creditors.

For the differing statutory provisions to apply, we must categorise a particular charge as either fixed or floating, and thus at some point we must make this distinction. Whilst both the existence and location of this arbitrary distinction may be criticised,

⁴⁰ Though again it is argued that assignment must in fact take place sometime after crystallisation, as otherwise crystallisation would operate to transfer beneficial ownership, which in turn would mean that fixed chargees held beneficial title, which is not the case.

its role is nonetheless clear: Parliament chooses to treat the two in very different ways. However, in recognising the arbitrary nature of this exercise, it is suggested that we should also recognise that the actual *nature* and *quality* of proprietary interest that charge-holders gain is the same, whether that charge be of one kind or another.

2.4 REFORM

In 1996 Professor Goode wrote that ‘principles and rules extracted with effort from a huge body of case law are no substitute for a modern personal property security statute in which all transactions intended to serve a security function are brought together in a uniform system of regulation, with rules of attachment, perfection and priorities being determined by legislative policy rather than conceptual reasoning’.⁴¹ Sir Roy advocated abolishing the floating charge in this process of enacting a new unified system modelled on Article 9 of the United States’ Uniform Commercial Code.⁴²

A recent Law Commission Consultation Paper⁴³ has also addressed this issue, proposing a scheme that would include all security interests in a notice-filing system.⁴⁴ This would differ from the present Companies Act scheme in that only a ‘bare bones’ notice would need to be filed, stating that the lender has taken (or intends to take) security over the borrower’s property.⁴⁵ McCormack identifies three particular weaknesses with the present system that the Law Commission’s proposed scheme would address. Firstly, the current mechanism is ‘burdensome’ and ‘time-consuming’. Secondly, the system does not allow prospective notification or registration, nor does it allow a single filing to cover more than one particular

⁴¹ Goode RM, ‘The Exodus of the Floating Charge’ in Feldman & Meisel (eds) *Corporate and Commercial Law: Modern Developments* (Lloyd’s of London Press, 1996), p202.

⁴² See also Goode RM and Glower LCB, ‘Is Article 9 of the Uniform Commercial Code Exportable? An English Reaction’ in Ziegel & Foster (eds) *Aspects of Comparative Commercial Law* (McGill University Press, Oceana, 1969), p 346.

⁴³ LCCP No. 164, *Registration of Security Interests: Company Charges and Property other than Land*, (July 2002).

⁴⁴ Including retention of title clauses, not subject to current registration requirements. See Chapter 3, Section 3.5.1.

⁴⁵ The current scheme is governed by the Companies Act 1985, Part XII. Once a charge has been created the details of that security must be delivered to Companies House within 21 days, together with the instrument of charge. If this is not done then the charge is invalid in the event of the debtor falling into liquidation.

instrument of charge. Thirdly, and perhaps most importantly, the time of registration does not determine priorities in the event of there being successive charges over the same property.⁴⁶

It is suggested that the Law Commission's proposals regarding the determining of priorities are the most deserving of attention. Under the current regime subsequent fixed charges rank ahead of prior floating charges, meaning that priority can depend on the date of crystallisation of a floating charge; an event which other creditors may not be able to predict.⁴⁷ Under the proposed scheme, priority between security interests would depend on the date of filing.

Given that this 'first-to-file' rule would apply to both fixed and floating charges, the Law Commission recognised that a floating chargor could no longer be able to create new fixed charges that ranked ahead of the floating charge.⁴⁸ In this respect the proposals would certainly strengthen the position of the floating chargee, and possibly too much so.⁴⁹ It could be argued that the proposals would allow the first charge holder to control the financing of the chargor, given that the chargor would be unable to create any charges ranking ahead of the first one without the original chargee agreeing to subordinate their interest. However, it must be remembered that it would be open to a subsequent creditor to take a Purchase Money Security Interest - which would have 'super-priority' status - as long as the advance is specifically tied to the acquisition of new assets.⁵⁰

⁴⁶ McCormack G, 'The Floating Charge and the Law Commission Consultation Paper on Registration of Security Interests' [2003] *Insolvency Lawyer* 1, p 3.

⁴⁷ Many floating charges crystallise on the appointment of a receiver, as this necessarily terminates the chargor's licence to deal with the property. However, the parties remain free to choose their own event (see above, text to n 7), and details of this agreement need not be registered or disclosed to other creditors. Note, though, that Goode has argued that third parties are not bound by the crystallisation if they are relying on the chargor's ostensible authority to dispose of the property. See Goode RM, *Legal Problems of Credit and Security* (2nd ed, London, 1988).

⁴⁸ LCCP No. 164, paras 4.136 – 4.142.

⁴⁹ The Law Commission argue that the chargor often has no authority to create subsequent ranking charges anyway, given the ubiquity of 'negative pledge' clauses. However, as Gullifer points out, 'in practice there is no effective way to give notice of a negative clause to subsequent chargees, and so the implied authority to create subsequent charges prevails'. Gullifer L, 'Will the Law Commission sink the floating charge?' [2003] LMCLQ 125, p 129.

⁵⁰ See Chapter 3, Section 3.5.1. It may also be pointed out that first chargee may well be willing to subordinate their interest as it would be in their interests to keep the chargor's business afloat. See Gullifer (2003), loc cit n 49; and McCormack (2003), op cit n 46, p 4.

Whilst these choices of the Law Commission may be criticised, they must nevertheless be seen as a welcome recognition of the role of policy in this area of personal property security law. If Parliament debates the proposals they may conclude that too much protection is given to the chargee, or of course they may decide to follow the Law Commission's recommendations. However, the important point is that these necessarily policy-laden decisions will be made in the proper forum (Parliament), and by the proper mechanism (legislation). In *Agnew v CIR* Lord Millett commented that:⁵¹

A curiosity of the case is that the distinction between fixed and floating charges, which is of great commercial importance in the United Kingdom, seems likely to disappear from the law of New Zealand when the Personal Property Security Act 1999 comes into force.

It is to be hoped that in this country too the importance of the distinction – if a distinction is to remain at all – will be a matter for the legislature.

Despite the Law Commission's recommendation of retaining the floating charge, albeit in a modified form, it is not clear whether it would indeed survive a full-scale reform of personal property security. McCormack, while giving a cautious welcome to the proposals, argues that they are 'unnecessarily complex because they involve retaining the floating charge'⁵² and also points out that Canada and New Zealand have both dispensed with the distinction.⁵³ Gullifer, on the other hand, considers that abolition of the floating charge would be extremely complex, would require another policy rethink, and may involve a 'clash between functionalism and formalism'.⁵⁴

It is argued that too much value is being placed on the historical role of floating charges as the bedrock of lenders' security. Banks would cope just as well under a single-charge scheme. Also, the practical need to distinguish between the two kinds of charge would greatly diminish under the Law Commission's proposals, so the argument for retaining them as separate devices may not seem strong. Gullifer suggests that the floating charge concept is important as a way of identifying charges

⁵¹ *Supra* n 16 at 716.

⁵² McCormack (2003), *op cit* n 46, p 4.

⁵³ See the Personal Property Securities Act 1999 (NZ) and the various legislative schemes in the common law provinces of Canada.

⁵⁴ Gullifer (2003), *op cit* n 49, p 144.

that merit particular treatment.⁵⁵ To put this in one particular context, it may be argued that this is only because the insolvency legislation currently requires a distinction to be made in order to determine priorities. If such a distinction no longer mattered, then an ability to make that distinction should not be seen as an advantage. If Parliament decided that it wanted to keep treating fixed and floating charges in different ways, then the developed floating charge jurisprudence would naturally be invaluable. However, if it was considered that the benefits of a single-charge system – efficiency, certainty – outweighed the arguments for retaining the distinction, then there would be no charges that merited particular treatment. Thus the ability to identify these charges would be redundant.

The Law Commission's proposals should be welcomed for suggesting a generally consistent, unifying scheme. However, it is argued that they do not go far enough. Equity is generally more flexible than the common law and whilst in many areas this is an undoubted advantage, it is arguable that such flexibility is achieved at the expense of certainty. This is a particular concern in relation to commercial matters,⁵⁶ and in this respect the difficulties in distinguishing between fixed and floating charges do not reflect well on English jurisprudence. It was suggested above that if Parliament decided to retain a distinction, then the developed case law would be most useful. This should not obscure the fact that the case law is highly problematic: considerable judicial time has been spent on the distinction between fixed and floating charges, yet the outcome is not necessarily settled nor satisfactory. Perhaps the jurisprudence should be considered invaluable in another respect: as a warning of the difficulties inherent in attempting to maintain a distinction. We should learn from Canada and New Zealand, not to mention the United States, and abolish the floating charge.

⁵⁵ Ibid.

⁵⁶ See the comments of Lindley LJ in *Manchester Trust v Furness* [1895] 2 QB 539 at 545, 'if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralyzing the trade of the country'; Atkin LJ in *Re Wait* [1927] 1 Ch 606 at 639-640, 'If...beneficial interests in property are created as suggested, the whole course of business transactions will be fundamentally affected'; and Lord Browne-Wilkinson in *Westdeutsche v Islington LBC* [1996] AC 669 at 704, 'My Lords, wise judges have often warned against the wholesale importation into commercial law of equitable principles inconsistent with the certainty and speed which are essential requirements for the orderly conduct of business affairs'.

CHAPTER THREE - RETENTION OF TITLE CLAUSES

We have seen that in *Quistclose* situations the lender retains full beneficial ownership of the loan monies, and that with equitable charges the chargee obtains a form of equitable proprietary interest in the charged goods. The commercial reasons for employing such devices are the same: to protect an investment and thus secure the investor's position in the event of the recipient or chargor becoming insolvent. Clearly this security is obtained at the expense of unsecured creditors, for whom there will be less money available (if any at all) for normal *pari passu* distribution.¹ Retention of title, or *Romalpa*,² clauses are devices by which a normal trade creditor may retain some form of security in relation to goods supplied.³

In a typical 'retention of title' situation the buyer is likely to be a company engaged in manufacturing or construction, buying raw materials or components from the seller for the purposes of its business. In these situations the full purchase price will often not be paid until the buyer has manufactured and sold his end product. However, as an unsecured creditor the seller is in a potentially hazardous position: as soon as he delivers the goods to the buyer there is a risk that those goods will feed a floating charge already hovering over the buyer's assets. Should the buyer then become insolvent, the seller who did not retain title would most likely lose both the goods and any chance of payment.

A simple clause, which retains legal title to the goods supplied until payment is made, provides the seller with a measure of security. However, the Sale of Goods Act 1979 does not place limits on the conditions that a seller can insist upon. Clearly the requirement that the clause be incorporated as a term in the contract, and that the goods claimed by the seller must be those to which the contract relates, may present

¹ See the comment of Templeman LJ in *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25 at 42: 'unsecured creditors ... receive a raw deal'.

² From the leading case, *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd* [1976] 1 WLR 676.

³ Retention of title clauses do not need to be registered, due to them falling outside the provisions of the Companies Act 1985 Part XII. Property does not pass to the buyer, so there can be no granting back of a security interest. Such agreements do not therefore provide a legal security interest but nevertheless give functional security. It should be noted early that this security is not absolute, for example there is always the danger of the goods being resold by the buyer who, as a buyer in possession, is able to pass good title: s25(1) Sale of Goods Act 1979.

practical difficulties, but there appears to be no legal barrier to extension. Thus the courts have upheld 'all-monies' retention of title clauses, where the clause secures the seller payment of all monies owed to him by the buyer, not just those due under the present transaction.⁴ Indeed, these clauses can also include money owed by the buyer's associated companies to companies associated with the seller. Further, attempts have been made to assert title to the products and proceeds of the original goods, though such attempts have met with little success.⁵

3.1 THE PASSING OF PROPERTY

Compared to *Quistclose* trusts and equitable security interests the theoretical basis for retention of title clauses is relatively straightforward. In a contract for the sale of goods, property will usually pass at the latest by delivery.⁶ However, section 19 of the Sale of Goods Act 1979 provides for a 'reservation of right of disposal': the seller is permitted to impose conditions on the passing of legal title.

s19(1): Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled; and in such a case, notwithstanding the delivery of the goods to the buyer ... the property in the goods does not pass to the buyer until the conditions imposed by the seller are met.

It must be pointed out that retention of title clauses are not just a matter of form, though this may appear to be the case from a plain reading of the Sale of Goods Act. Such clauses will not be upheld if they are inconsistent with the substance of the parties' agreement.⁷ However, it is suggested that a buyer would need very wide-ranging powers, if not total dominion, before the substance of the agreement would outweigh the 'form' of the retention of title clause.⁸ In *Clough Mill Ltd v Martin* a

⁴ *Armour v Thyssen Edelstahlwerke AG* [1991] 2 AC 339. These variations are also known as 'all-liabilities' and 'current account' clauses, and had been thought to look suspiciously like charges: see for example Goodhart W, '*Clough Mill Ltd v Martin* – A Comeback for Romalpa?' (1986) 49 MLR 96; McCormack G, 'Reservation of Title – Past, Present and Future' [1994] Conv 129.

⁵ See below, Section 3.4.

⁶ Sale of Goods Act 1979, ss 16, 18 Rule 5 (unascertained goods); s18, Rules 1-3 (specific goods).

⁷ *McEntire v Crossley Bros Ltd* [1895] AC 457 at 462-3 per Lord Herschell LC.

⁸ Indeed in *McEntire* Watson LJ considered that a court should not ignore the normal meaning of a term unless the substance of the agreement necessarily deprived that term of its 'primary significance': *ibid* at 467. See further Bridge M, '*The Quistclose Trust in a World of Secured Transactions*' (1992)

company sold yarn to a fabric manufacturer.⁹ By way of a simple retention of title clause Clough Mill had sought to retain title to the yarn until Martin had either paid for it, or sold it on at full market value. Martin did neither and Clough Mill sought to repossess the goods. In this case the retention of title clause was upheld, despite Martin's authority to either use the yarn to make fabric or to sell it on at market value. It is clear that a buyer may enjoy wide-ranging powers as regards management and alienation of the goods in question, yet still not benefit from full legal ownership. This should not be too surprising: it has been argued that a floating chargee obtains an equitable security interest despite the chargor still being capable of dealing with the property in much the same way as he might if no charge existed.¹⁰ Further, agency agreements, bailments, leases and hire purchase agreements all grant certain rights of dominion over assets without stripping the owner of his legal title.

3.2 THE EQUITABLE INTEREST

Unlike *Quistclose* trusts and equitable charges, retention of title clauses operate to retain legal title to the goods supplied. However, it is also necessary to determine the location of the equitable ownership. It will be remembered that the *Quistclose* lender retains beneficial title, with the recipient exercising a power to apply the funds for the stated purpose: the lender's legal title is lost once the money is transferred and mixed in the recipient's bank account. A chargee receives only an equitable security interest, with the chargor retaining legal ownership. Does the buyer under a retention of title agreement receive beneficial title when he takes delivery of the goods, i.e. before the contingency upon which his legal ownership depends has been satisfied; or do such devices enable the seller to retain both facets of ownership? There is some

12 OJLS 333, p 346, comparing the United States Uniform Commercial Code with the 'antiquated structure of the English law of personal property security'.

⁹ [1985] 1 WLR 111. In *Clough Mill* the simple clause included a sub-clause by which the seller claimed an interest in the products of the original goods. This sub-clause was held to create a registrable charge, void for non-registration. Such 'products' clauses are discussed below at Section 3.4.1, but note that the invalidity of such a sub-clause, as long as it is severable, does not affect the validity of the simple retention of title clause.

¹⁰ See Chapter 2, Section 2.3.4. Even if it is not accepted that the floating chargee receives an equitable interest prior to crystallisation (i.e. if one subscribes to the 'mortgage of future assets' theory) it is still the case that the chargor's dominion over the assets has been slightly diminished: he may now only deal with them in the ordinary course of his business.

authority for the former proposition: In *Borden (UK) Ltd v Scottish Timber Products Ltd*, Bridge LJ commented: ¹¹

I am much attracted by the view ... that the beneficial interest in the [goods] passed to the defendants ... and that all that was retained by the plaintiffs was the bare legal title to the [goods], held as security for the unpaid price.

Bridge LJ regarded the seller as retaining only the legal title, and thus in effect becoming a bare trustee. Although his Lordship referred to the seller's security interest, with respect it is difficult to see how much security the position of bare trustee would afford. Further, as Worthington points out, if the buyer does gain the beneficial title then it must be through the operation of law, as the parties themselves will not intend the equitable interest to be transferred. Indeed, to do so would actually defeat their intention.¹² An operation of law explanation seems unlikely as Atkin LJ, in *Re Wait*, rejected the suggestion that either party to a sale of goods agreement could acquire an equitable interest by this method.¹³

It is suggested with respect that the seller must in fact retain both legal and equitable ownership. Should the beneficial title be transferred the seller would become in effect a bare trustee, a position that would afford little security.¹⁴ Yet it has already been noted above that, while retention of title agreements do not provide a legal security interest, they are an effective functional security.¹⁵

3.3 A CHARGE?

We have seen above that a clause purporting to retain the seller's title may fail if the rights given to the buyer necessarily indicate ownership.¹⁶ Another argument, often

¹¹ *Supra* n 1 at 35.

¹² Worthington S, *Proprietary Interests in Commercial Transactions* (Clarendon Press, Oxford, 1996) p 15.

¹³ [1927] 1 Ch 606 at 635. Of course, parties remain free to expressly agree to create equitable interests. This decision is also important as it denies the argument that a purchaser under an 'all-monies' retention of title clause, who has paid for identifiable goods but not satisfied all debts to the seller, may obtain a beneficial interest in those goods.

¹⁴ Worthington argues further that the law relating to option agreements is consistent with this analysis: the holder of an option (the intended purchaser) does not seem to receive equitable ownership by operation of law. Worthington (1996), *loc cit*, n 12.

¹⁵ See above, n 3.

¹⁶ See discussion of *McEntire v Crossley Bros Ltd*, *supra* nn 7 & 8.

employed in order to defeat a retention of title clause, is that on true construction the limited rights of the seller point to the existence of a charge created in his favour rather than a retention of ownership. If this were to be the case any security would be denied, as such a device would fail as an unregistered charge.¹⁷ The following discussion deals only with 'simple' and 'all-monies' retention of title clauses.¹⁸

It appears that this situation arises because of the difficulty in defining precisely what charges are. If defined in wide enough terms, they can appear to include retention of title clauses. Consider the comments of Slade J in *Re Bond Worth Ltd*:¹⁹

In my judgment any contract which, by way of security for the payment of a debt, confers an interest in property defeasible or destructible upon payment of such debt, or appropriates such property for the discharge of the debt, must necessarily be regarded as creating a mortgage or charge, as the case may be. The existence of the equity of redemption is quite inconsistent with the existence of a bare trustee-beneficiary relationship.

3.3.1 'Confers an interest'

Does a retention of title clause confer on the seller an interest in the property defeasible on payment? In *Clough Mill Ltd v Martin*, Robert Goff LJ considered the matter:²⁰

So far as the retention of title in unused materials is concerned, I see no difficulty in distinguishing the present case from that envisaged by Slade J. Under the first sentence of the condition, the buyer does not, by way of security *confer* on the [seller] an interest in property defeasible upon the payment of the debt so secured. On the contrary, the [seller] *retains* the legal property in the material.

As Goodhart points out, this passage 'can be regarded as saying no more than that in such a case the seller has an option whether to secure himself by retaining full

¹⁷ Registrable under the Companies Act 1985, Part XII. The great advantage of retention of title clauses is that they do not need to be registered. Thus, they invariably are not.

¹⁸ For discussion of the status of 'advanced' retention of title clauses see Section 3.4.

¹⁹ [1980] 1 Ch 228 at 248. For further commentary in this context see Goodhart W and Jones G, 'The Infiltration of Equitable Doctrine into English Commercial Law' (1980) 43 MLR 489.

²⁰ *Supra* n 9 at 117 (original emphasis).

ownership of the goods or by taking a charge over the goods, and that the clause in question effectively exercises the ownership option'.²¹ However, also in *Clough Mill*, Oliver LJ went further:²²

The operative word here is 'confers' and the whole of Slade J's judgment in that case was based upon the fact, as he found, that the legal title to the goods had passed to the buyer. ... Of course, where the legal title has passed, security can be provided by a charge created by the new legal owner. But it is not a necessary incident of the seller's securing his position that he should pass the legal title. The whole question is, how has his position been secured? If in fact he has retained the legal title to the goods, then *by definition the buyer cannot have charged them in his favour*.

It is thus suggested that this argument that retention of title clauses are in fact charges is misleading. That is, the argument relies for its validity upon an acceptance of the previous contention: that the extensive rights given to the buyer on true construction necessarily indicate full ownership.²³ Of course, if this were to be the case then a purported retention of title clause would already be deprived of its import. As we have seen, to be competent to create a charge one must be dealing with one's own property. The very essence of retention of title clauses is that they do not permit this. If a clause fails in this task, perhaps due to the buyer's rights necessarily indicating ownership, then the buyer is the owner and he is then competent to create a charge over his goods. Naturally, if this charge is not registered then it will not be upheld, but the point is that there cannot be any charge or mortgage created while the seller remains the owner of the goods.²⁴

3.3.2 '*Appropriates such property*'

We have seen that, as long as the retention of title clause successfully retains legal title to the seller, the buyer is not competent to 'confer' an interest in the goods. However, in *Re Bond Worth*, Slade J also spoke of an alternative to a contract which

²¹ Goodhart (1986), op cit n 4, p 100.

²² Supra n 9 at 124 (emphasis added).

²³ As Slade J found in *Re Bond Worth*, supra n 19.

²⁴ For a further examination of the issues discussed above, see Chapter 1 of Odith F, *Legal Aspects of Receivables Financing* (Sweet & Maxwell, 1991).

confers an interest in property, namely 'any contract which ... appropriates such property for the discharge of the debt'.²⁵ Slade J held that these too must be regarded as creating a mortgage or charge. In a retention of title situation property is, of course, appropriated to the discharge of a debt: indeed this is the very essence of the device. Thus, if we were to accept Slade J's definition, retention of title clauses would in fact be mortgages with the buyer holding an 'equity of redemption'.²⁶

It is suggested that these words are simply too wide. Property is appropriated to the discharge of a debt in hire-purchase agreements, yet these contracts do not create registrable charges. Property may also be appropriated to the discharge of a debt by contract in a classic *Quistclose* situation, yet nor do these agreements create charges. Further, the 'equity of redemption' is problematic as it still depends on the idea of the buyer *conferring* the equitable security interest: the buyer confers the interest and, when he pays his debts, may redeem it. Yet these are not the mechanics of a retention of title agreement: here the buyer obtains nothing, and the seller retains both legal and beneficial ownership. When the price is paid, the buyer will become the owner. The buyer *obtains* an interest that she never had; she does not *redeem* one previously conferred.

3.4 'ADVANCED' RETENTION OF TITLE CLAUSES

Simple and 'all-monies' retention of title clauses operate to retain title to identifiable goods. As long as these goods remain identifiable, and the buyer's debt remains unsatisfied, it is possible for the seller to retake the original goods.²⁷ However, often the original goods supplied by the seller are raw materials that are soon combined with other goods and transformed into a finished product. This procedure may be performed either with or without the seller's authorisation.

²⁵ *Supra* n 19.

²⁶ *Ibid.*

²⁷ See, for example, *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd* [1984] 1 WLR 485 where engines to which the seller had retained title were built into generators. Although separation of the engines would require considerable effort, Staughton J allowed the seller to repossess, as the engines were unaltered in substance.

Should the buyer mix the goods wrongfully, then the seller would retain proportionate ownership of the new product. In *Glencore v MTI* the defendants mixed oil from several claimants with their own oil. The mixing included both 'blending' oils of differing grades, and 'commingling' oils of the same value. Moore-Bick J held:²⁸

[W]hen one person wrongfully blends his own oil with oil of a different grade or specification belonging to another person with the result that a new product is produced, that new product is owned by them in common. In my view justice also requires in a case of this kind that the proportions in which the contributors own the new blend should reflect both the quantity and the value of the oil which each has contributed.

Also in a case of 'commingling':²⁹

All those who had contributed to the bulk, including MTI, would become owners in common of the bulk in proportion to their contributions.

However the original contract, whilst retaining the seller's ownership of the goods, may authorise the buyer to utilise those goods prior to payment.³⁰ When the original goods cease to be identifiable, the seller ceases to have a security interest. In an attempt to circumvent this problem, creative sellers have sought to obtain an interest in the 'proceeds' or 'products' of the original goods.³¹

3.4.1 *Products Clauses*

Worthington identifies four possible avenues that a seller may explore in order to acquire an interest in the 'products' of the original goods.³² An interest may be

²⁸ *Glencore International AG & Ors v Metro Trading International Inc* [2001] 1 Lloyd's Rep 284 at 330.

²⁹ *Ibid* at 331.

³⁰ Again sellers must be wary that granting too much freedom to the buyer may be interpreted as in fact necessarily indicating a transfer of ownership. See above, Section 3.1.

³¹ 'Products' clauses are also known as 'aggregation' clauses.

³² Worthington (1996), *op cit* n 12, pp 27-28. It is not that the seller's ownership of the original goods is somehow extinguished. Rather, the question regards the nature of his interest in the finished product: is it an 'extension' of his interest in the original goods, or some new interest created in the seller's favour by the buyer? If it is the latter then we return to the issue of registration. See discussion below, text to n 36.

protected by: (i) an ability to identify and separate the original goods;³³ (ii) a rule of law enabling the seller to assert legal ownership or co-ownership of the products without needing any express provision in the contract of sale; (iii) a rule of equity enabling the seller to trace ownership of the original goods into their products and assert an equitable proprietary interest without needing any express provision to that effect in the contract; or (iv) an express contractual provision that purports to give the seller a legal or equitable proprietary interest in the proceeds.

It will be seen that only option (iv) deals with a 'true' attempt at a products retention of title clause. Option (i) merely deals with the extent to which a simple retention of title clause will operate, whilst the questions of application of options (ii) and (iii) are answered by determining whether the seller has actually retained title to the original goods. One must ask whether the authority that the buyer has to utilise the goods goes so far as to transfer ownership to him.³⁴ If so then, as the buyer is both legal and beneficial owner, the seller will be unable to trace either in equity or at common law. If, on the other hand, the extent of the buyer's authority is not sufficient to effect a transfer of ownership then it would be possible for the seller to argue along the lines of options (ii) and (iii).

The reason why the ownership of the original goods is so vital to this analysis is simple: the answer determines whether the purported security needs to be registered or not and, since retention of title clauses are rarely registered, the question of original ownership will determine the validity of the security. If title passes to the buyer, and the seller claims a security, it follows that the buyer must have created this security, *over his own goods*. Thus this interest must be a charge, or an assignment by way of mortgage from buyer to seller, and registrable accordingly.³⁵ Returning to option (iv), we can see that most 'true' products retention of title clauses necessarily fail for this reason: if the contract expressly gives the seller an interest in the products then it must follow that the buyer has created a charge or made an assignment.³⁶

³³ As in *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd*, supra n 27.

³⁴ If the buyer had no such authority then clearly the seller would have no difficulty following the products and tracing the proceeds of his goods. See *Jones, FC (A Firm) v Jones* [1996] 3 WLR 703.

³⁵ Companies Act 1985, Part XII.

³⁶ As a corollary, it is suggested that such a clause would also indicate that title is intended to pass when the buyer utilises the goods in a manufacturing process. Thus, where a seller attempted to retain title to the original goods *and* the products thereof: should the 'products part' of the clause be found

As for a seller protecting an interest in the products of the original goods, we can conclude that this may be possible if the process is in fact viewed as tracing or following; effectively vindicating proprietary rights that the seller held in the original goods and never lost.³⁷ That is, the rights that the seller has to the products are merely an extension of the rights always held in the original goods. However, should the seller attempt to acquire an interest in the products through an express contractual provision, it is likely that this would be ineffective. Simply put, such a clause would indicate that title passed to the buyer on utilisation, with a right to the products of such utilisation being given to the original seller. This would involve the creation of a new right, not the extension of an old one, the security interest created therein would be registrable, and would invariably be void for want of the same.³⁸

3.4.2 *Proceeds Clauses*

Together with claiming interests in the products of the materials that they supply, sellers also seek to assert rights over any proceeds that the buyer may accrue from resale. This is not so much an issue of the buyer selling the goods at a higher price than that which he paid: it is more a question of security.³⁹ Should a buyer sell the goods on, and then become bankrupt, the security of the original seller will have been extinguished. However, as in the case of 'products' retention of title clauses, 'proceeds' clauses have not been upheld by the courts.⁴⁰

ineffective, it is argued that the 'simple retention part' should be effective only until the buyer utilised the original goods. That is, the existence of a 'products part' of a retention of title clause indicates that title to the original goods is intended to pass when those products are produced: it cannot be supposed that the parties intended to be a mere bailee throughout the whole manufacturing process. See the comments of Vinelott J in *Re Peachdart Ltd* [1984] 1 Ch 131 at 142.

³⁷ The cause of action could be conversion. Whether the procedure was one of following or tracing would depend on the nature of the products of the original goods: are they merely 'extensions' of those goods, or are the products more properly considered exchanges?

³⁸ For a discussion of the feasibility of the seller actually registering the device see Hicks A, 'Retention of Title – Latest Developments' [1992] JBL 398, p 413.

³⁹ Although the possibility that the seller might be able to claim all the proceeds of the subsale – and thus gain a windfall – has clearly figured in judicial minds when refusing to uphold such clauses: see *Compaq Computer Ltd v Abercorn Group Ltd* [1991] BCC 484 at 495 per Mummery J; *Carroll Group Distributors Ltd v G & JF Bourke Ltd* [1990] ILRM 285 at 289 per Murphy J. See discussion below at Section 3.5.

⁴⁰ See *Tatung (UK) Ltd v Galex Telesure Ltd* (1989) 5 BCC 325 at 332 per Phillips J: 'In no reported case since *Romalpa* has a court held that a retention of title clause had the effect of conferring an

3.4.2 (i) *By implication*

There are two arguments that a seller may employ in an attempt to persuade the court of the validity of his claim. Firstly it may be argued that, notwithstanding the sale contract's silence as to the ownership of proceeds, by necessary implication the parties must intend ownership of the proceeds of sub-sales to vest in the original seller. Secondly one may try to rely on an express proceeds clause in the original contract.⁴¹ The success of the first argument depends on whether the court is prepared to imply such a term to a silent contract: essentially, is there sufficient commercial justification for a rule of law that would prevent title to the original goods passing to the buyer despite the fact that the buyer's rights of dominion extend so far as to permit resale? It seems that this question must be answered in the negative. It may seem harsh that a seller's security would fail, and he would have no claim to the proceeds of the sub-sale, but it is the seller who stipulates the extent of the rights of dominion enjoyed by the buyer. Similarly the law does not consider it unconscionable for the original buyer to take the proceeds of an authorised sub-sale for himself: if the contract is silent then this is essentially what the parties bargained for, and such a situation is exactly what occurs in unsecured contracts of sale.

3.4.2 (ii) *By express clause*

Thus it is suggested that a seller would not be successful in trying to persuade the court to imply a 'proceeds' term into a contract that is silent on the point. We now turn to instances where the seller expressly attempts to retain title to the proceeds of sub-sales: there is clearly no doubt here that the intention of the parties was to have the ownership of the proceeds vested in the original seller. However, such clauses

interest on the vendor by reason of the application of the principle in *Re Hallett's Estate* (1879) 13 ChD 696.'

⁴¹ It will be seen that the arguments that one may employ here closely mirror those that a seller would make in relation to 'products' retention of title clauses. See above, n 32 and text.

encounter the same obstacles as 'products' retention of title clauses: on inspection they may be found to in fact create a charge over the proceeds of the sub-sale.⁴²

It is suggested that the main problem with categorising such devices as 'advanced' retention of title clauses, and not charges, is the fact that the interest claimed by the original seller is determinable when the original buyer satisfies his debts. In *Modelboard Ltd v Outer Box Ltd*, a case concerning a proceeds clause, Michael Hart QC found that the arrangement between the parties had created a defeasible interest in the goods which constituted an interest by way of a charge, and as this interest had not been registered it was void. The judge said:⁴³

[This option] is the only one which, in my judgment, meets the requirements of commercial reality and does not involve the implication of an elaborate system of implied contractual obligations. The beneficial interest in the proceeds of sale given to the plaintiff by the contract is therefore capable of being defeated by the defendant by payment of the purchase price. If that is so, then the appropriate description of the nature of the plaintiff's interest therein is an interest by way of charge.

This argument is easy to see: if one follows the definition of a charge given by Slade J in *Re Bond Worth* then one can certainly agree that a retention of title clause creates an interest which is defeasible on payment of a sum of money.⁴⁴ However there are two points to be made: firstly, as alluded to above, it may not be accepted that Slade J's definition applies to all circumstances.⁴⁵ Secondly, and necessarily linked to the first point, is the issue of who owns the goods. A charge over X's goods is given *by X, to Y*. As pointed out above, if a retention of title clause should fail for some reason then the buyer becomes the owner and of course is then free to create a charge over his property in favour of whoever he chooses. However, if a retention of title clause is upheld, then it is otiose to talk of an interest being created by the buyer in favour of the seller. In essence, rights in the proceeds of goods are not given to the original seller by the buyer; they are an extension of the original rights of ownership that never

⁴² A charge that, once again, would invariably fail for want of registration: Companies Act 1985, Part XII.

⁴³ [1992] BCC 945 at 950. See further *Compaq Computer Ltd v Abercorn Group Ltd*, supra n 39 at 495 per Mummery J; *Carroll Group Distributors Ltd v G & JF Bourke Ltd*, supra n 39 at 289 per Murphy J.

⁴⁴ Supra, n 19.

⁴⁵ See discussion above, Section 3.3.

left the seller.⁴⁶ As Worthington argues, 'to conclude that the seller's interest in the proceeds is a charge conferred by the buyer simply because it is defeasible is to neglect the very question which is central to this whole area of the law: whether defeasible or not, is the seller's interest in the proceeds one granted by the buyer, or is it an original interest?'.⁴⁷

3.4.2.(iii) *In trust*

In *The Associated Alloys Case*, a proceeds sub-clause included the following provision:⁴⁸

In the event that the [buyer] uses the goods/product in some manufacturing or construction process of its own or some third party, then the [buyer] shall hold such part of the proceeds of such manufacturing or construction process as relates to the goods/product in trust for the [seller]. Such part shall be deemed to equal in dollar terms the amount owing by the [buyer] to the [seller] at the time of the receipt of such proceeds.

The High Court of Australia found that such a device would satisfy the three certainties requirement, and could thus give rise to a trust 'defeasible upon payment of the debt'.⁴⁹ We return once more to the definition of a charge given by Slade J in *Re Bond Worth*:⁵⁰

... any contract which, by way of security for the payment of a debt, confers an interest in property defeasible ... upon payment of such debt, or appropriates such property for the discharge of the debt, must necessarily be regarded as creating a mortgage or charge, as the case may be.

It is clear that express trusts are not equitable security interests: they confer beneficial ownership, not just mere security, and they do not need to be registered. Could a

⁴⁶ See discussion above at n 32 in relation to the nature of the seller's rights in the products.

⁴⁷ Worthington (1996), op cit n 12, p 39.

⁴⁸ *Associated Alloys Pty Limited v ACN 001 452 106 Pty Limited* (2000) 202 CLR 588. See further discussion of this case below at Section 3.5.

⁴⁹ *Ibid* at 608. Unfortunately for the seller in this case there was not the necessary evidence to link the buyer's funds to the goods supplied by the seller under particular invoices. Thus a trust was not found on the facts.

⁵⁰ *Supra* n 19.

valid 'proceeds' retention of title clause operate along these lines? It is suggested that once again we must consider closely the mechanics involved.

A sells material to B on credit, expressly reserving title until A is paid in full. B is allowed to resell the material, but any proceeds he accrues must be placed in a separate account and held in trust for A. Is this a valid retention of title clause?⁵¹ It is argued that it is not: such a clause would operate to create an express trust over the proceeds in favour of A. Despite the fact that its genesis is contained within an agreement between the two parties, this is a trust created by B, in favour of A. Thus, while it may be a simple example of the 'flexible interplay of law and equity',⁵² such a clause would not be an example of a device that can properly be termed a retention of title clause. Contracts to create trusts may well provide the security that a seller desires, but it is argued that they should be considered as discrete devices when discussing retention of title clauses.⁵³

3.4.2 (iv) *Fiduciary Relationships*

It will be noted that so far no reference has been made to the existence or otherwise of a fiduciary relationship between the buyer and seller in a retention of title situation. Yet such discussion is necessary because, for an original seller to successfully claim the intended interest in the proceeds of a resale, it will be necessary for him to show that the original buyer was holding those proceeds as the seller's fiduciary.⁵⁴ In short, the relationship between the buyer and seller must be one of a fiduciary nature.

⁵¹ I have ignored for the moment the important issue of whether all of the resale money is held in trust, or merely that which would have satisfied the original debt. See below, Section 3.5, for discussion on this point. Also note that the issue of whether or not the resale money is actually placed in a separate account is not determinative: it is the parties' intentions, not their actions, that equity will first appraise. See below, n 66 and text.

⁵² The phrase is from *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 at 582 per Lord Wilberforce.

⁵³ For a further discussion of what Worthington refers to as an 'effective proceeds clause' see Worthington (1996), op cit n 12, p 40.

⁵⁴ Of course, the seller may have an interest by way of charge over the proceeds of the resale. However, this would be void for want of registration, and would not be the interest that the parties either intended or contemplated.

If A sells goods to B on credit, retaining title until B has paid the full amount due, then B, until he satisfies the debt, will be either a bailee or fiduciary agent.⁵⁵ That is, a buyer under a 'simple' retention of title situation may or may not owe fiduciary duties to the seller, depending on the parties' agreement. A fiduciary relationship was found to exist in *Romalpa*⁵⁶ where the purchaser was held to be a bailee of the kind having fiduciary duties to the seller. Conversely, in both *Hendy Lennox*⁵⁷ and *Re Andrabell*,⁵⁸ the courts found that the obligations imposed on the purchaser by the contract of sale were inconsistent with a fiduciary relationship: the relationship was merely one of bailment.

It may then be thought necessary to find an 'original' fiduciary relationship which can then be extended to cover the proceeds of sub-sale. However, it is suggested that the character of the 'original' relationship does not determine the nature of the post sub-sale relationship. What is required is for the relationship between the buyer and the seller to be of a fiduciary character: however, their relationship need only be fiduciary as regards the proceeds of sub-sale.⁵⁹ That is, pending sale or consumption, the relationship may still be one of bailment. In essence, a non-fiduciary bailment relationship may become a fiduciary agent relationship when the seller re-sells the goods.

It is suggested that, despite judicial findings to the contrary,⁶⁰ there is no reason why such a relationship should not be found, assuming of course that the parties intend one to exist. If the proceeds of a resale were intended to be placed in a separate account for the original seller, this would be indicative of a trust situation.⁶¹ If however the agreement did not provide for this segregation, then it is indicative of the parties not

⁵⁵ B may be a mere bailee despite the fact that he will normally have authority to resell or mix the goods. See comments of Robert Goff LJ in *Clough Mill Ltd v Martin*, supra n 9 at 116: 'I do not see why the relationship between A and B, pending sale or consumption, should not be the relationship of bailor and bailee, even though A has no right to trace the property in his goods into the proceeds of sale. If that is what the parties have agreed should happen, I can see no reason why the law should not give effect to that intention'.

⁵⁶ Supra n 2.

⁵⁷ Supra n 27.

⁵⁸ [1984] 3 All ER 407.

⁵⁹ Although the nature of the relationship pre-subsale will of course be relevant to questions of, eg, tracing.

⁶⁰ See in particular *Re Andrabell Ltd*, supra n 58 at 415 per Peter Gibson J.

⁶¹ Discussed above, Section 3.4.2 (iii), where it was argued that such trusts should be considered as discrete devices, operating 'on top' of retention of title clauses.

intending the seller to 'retain' beneficial title to the proceeds.⁶² Thus the question of a fiduciary relationship does not arise.

One may conclude, then, that attempts to retain title to the proceeds of resale should properly be seen as attempts to create trusts over the proceeds in favour of the original seller: if such an attempt fails then beneficial title to the proceeds was never truly intended to vest in the seller.⁶³ On the other hand, these are mere indications and perhaps should not be taken as determinative. A situation may be conceivable whereby ownership of the proceeds is clearly intended to vest in the seller, yet the buyer has the right to pay such proceeds into his own account.⁶⁴ In such a situation it is argued that there would be no reason not to find a fiduciary relationship.⁶⁵

3.5 POLICY AND CONCLUSIONS

A leading commentator has noted that "simple" retention of title clauses and current account clauses have been given the judicial imprimatur but the more complex variants, namely "proceeds" and "products" clauses have met with judicial

⁶² Notwithstanding the express words of the contract. See *Henry v Hammond* [1913] 2 KB 515.

⁶³ Worthington also favours this analysis, commenting that 'the fiduciary step seems unnecessary': (1996) *op cit* n 12, p 38.

⁶⁴ This mixing would undoubtedly create difficulties regarding the identification of trust property, and it is recognised that such a situation would more commonly indicate an absence of intention to create a trust. However, this is not the same as the trust being void for uncertainty of subject-matter. The subject-matter is whatever proceeds are received, whether or not those proceeds are immediately mixed and are thus impossible to identify. See the comment of Gaudron, McHugh, Gummow and Hayne JJ in *The Associated Alloys Case*, *supra* n 48 at 604: 'it is no objection to the effective creation of a trust that the property to be subjected to it is identified to be a proportion of the proceeds received by the Buyer; a proportion referable to moneys from time to time due and owing but unpaid by the Buyer to the Seller'.

That said, one must also take account of *Paragon Finance Plc v DB Thakerar & Co* [1999] 1 All ER 400 at 408-409, where Millett LJ made it clear that, although an agent could still be described as a fiduciary where he was authorised to mix his principal's money with his own, no proprietary remedy would be available in those circumstances because he would not be a trustee in relation to the money itself. See also Lord Millett's judgment in *Dubai Aluminium v Salaam* [2003] 1 All ER 97 at 130. An analysis involving the existence of a fiduciary relationship, yet with the principal having no proprietary remedy, would seem to be of little utility in a security situation; although of course it is always open to the creditor to stipulate that the money be segregated.

⁶⁵ As Millett points out in 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 'when the question is concerned with the imposition of fiduciary duties, the distinction is not between commercial and non-commercial *transactions* ... but between commercial and non-commercial *relationships*' (original emphasis). See also the discussion in n 64 above of the judgments in *Paragon Finance v Thakerar* and *Dubai Aluminium v Salaam*.

disfavour'.⁶⁶ Despite this chapter's criticisms of the courts' approach, Professor McCormack's comment is undoubtedly accurate. 'Simple' and 'all-monies' clauses retain ownership to the seller: the buyer thus obtains no proprietary interest that would enable him to grant an interest 'back' to the seller in the form of a charge.⁶⁷ 'Advanced' clauses, on the other hand, have been held to create charges.⁶⁸

It has been suggested above that the various justifications used by the courts to deny effect to these advanced clauses are not necessarily convincing.⁶⁹ It is further argued that this area of law is heavily policy-laden, with the courts concerned with balancing protection for trade creditors against the general legal desire to register security interests. There is also the problem of sellers obtaining windfalls. In *Clough Mill* the sellers sought to rely on an advanced retention of title clause that read:

If any of the material is incorporated in or used as material for other goods before such payment the property in the whole of such goods shall be and remain with the Seller until such payment has been made, or the other goods have been sold as aforesaid, and all the Seller's rights hereunder in the material shall extend to those other goods.

This is effectively a products *and* a proceeds clause. It was not upheld. Robert Goff LJ commented:⁷⁰

Now, no injustice need arise from the exercise of the seller's power to resell such goods provided that, having applied the price received from the resale in satisfaction of the outstanding balance of the price owed to him by the buyer, he is bound to account for the remainder to the buyer. But the difficulty of construing the [clause] as simply giving rise to a retention by the seller of title to the new goods is that it would lead to the result that, on the determination of the contract under which the original material was sold to the buyer, the ownership of the seller in the new goods would be retained by the seller uninhibited by any terms of the contract, which had then ceased to apply; and I find it impossible to believe that it was the intention of the parties that the seller would thereby gain the windfall of the full value of the new product, deriving as it may well do not merely from the labour of the buyer but also

⁶⁶ McCormack G, 'Personal Property Security Law Reform in England and Canada' [2002] JBL 113, p 134.

⁶⁷ See *Clough Mill Ltd v Martin*, supra n 9.

⁶⁸ E.g., *Clough Mill Ltd v Martin*, supra n 9; *Re Peachdart*, supra n 36; *Compaq Computer Ltd v Abercorn Group Ltd*, supra n 39; *Carroll Group Distributors Ltd v G & JF Bourke Ltd*, supra n 39.

⁶⁹ See the above criticisms of the wide definition of charges, the possible existence of a proceeds clause by way of trust etc: Sections 3.4.1 and 3.4.2.

⁷⁰ Supra n 9 at 120.

from materials that were his, without any duty to account to him for any surplus of the proceeds of sale above the outstanding balance of the price due by him to the seller. It follows that the [clause] must be read as creating either a trust or a charge.

...

Accordingly, consistent with the approach of Vinelott J to a similar provision in *Re Peachdart Ltd* [1983] 3 All ER 204, [1984] Ch 131, I have come to the conclusion that, although it does indeed do violence to the language of the [clause], that sentence must be read as giving rise to a charge on the new goods in favour of the seller.

Robert Goff LJ framed it in terms of the parties' intentions, but it is argued that policy considerations were clearly at work here: indeed his Lordship recognised that his conclusion 'did violence to the language of the clause'. We see the windfall consideration most clearly at the start of the extract, where his Lordship comments that 'no injustice need arise', provided that the seller takes only his fair share of the proceeds. That is, it is the risk of the seller gaining an interest in *all* of the proceeds that is the concern.⁷¹

In this respect *Clough Mill* can be contrasted with the judgment of the High Court of Australia in *The Associated Alloys Case*. In that case, a proceeds subclause read:

In the event that the [buyer] uses the goods/product in some manufacturing or construction process of its own or some third party, then the [buyer] shall hold such part of the proceeds of such manufacturing or construction process as relates to the goods/product in trust for the [seller]. Such part shall be deemed to equal in dollar terms the amount owing by the [buyer] to the [seller] at the time of the receipt of such proceeds.

In this case the seller did not purport to retain title to any or all of the proceeds: rather, the parties intended to create a trust over a proportionate part of the proceeds. It may be argued that the cases should be distinguished on this basis. However, the same policy considerations were clearly at work. Gaudron, McHugh, Gummow and Hayne JJ said:⁷²

If the Proceeds Subclause had been drafted so as to constitute a trust over the entire proceeds, a question would have arisen as to whether the parties intended that the seller obtain the

⁷¹ In *Modelboard Ltd v Outer Box Ltd*, supra n 43 at 949, Judge Michael Hart QC thought that a clause which would give the original seller all the proceeds 'would be an astonishing provision'.

⁷² Supra n 48 at 607.

beneficial interest in the profits of the buyer. It may be, as Robert Goff LJ emphasised in *Clough Mill Ltd v Martin*, a manifestly peculiar outcome to find that the parties to such an agreement intended that the seller obtain the windfall of the full value of the newly manufactured products.

In essence, the subclause in *Associated Alloys* avoided the potential injustice of its counterpart in *Clough Mill*: there was no risk of a windfall as the clause only gave the seller a proportionate amount of the proceeds.

3.5.1 Reform

This chapter has attempted to analyse the legal bases of retention of title clauses, and to criticise the courts' reasons for failing to uphold advanced clauses. It has been argued that the language of unregistered charges and parties' intentions masks a judicial dislike of such clauses. This dislike is due to reasons of policy: the risk of the seller obtaining an undeserved windfall; the potential undermining of the priority system in insolvency; and the general dislike of security interests existing without other businesses being able to identify the existence of such security. Retention of title clauses provide functional if not legal security, and thus come under this scrutiny.

A recent Law Commission Consultation Paper has suggested that retention of title clauses, as 'quasi-securities', should be subject to a new notice-filing system of registering security interests.⁷³ The Law Commission noted that even 'simple' clauses provided functional security, and pointed out that 'all-monies' clauses effectively provided security over goods for which the purchase price had already been paid.⁷⁴ The Commission thus proposed that all retention of title clauses should be subject to notice-filing, with a simple 'first-to-file' priority system.

⁷³ LCCP No 164, *Registration of Security Interests: Company Charges and Property other than Land*, (July 2002). The Commission echoed the view of the Company Law Review Steering Group that the present system of registering company charges should be replaced by a model similar to that contained in Art. 9 of the United States' Uniform Commercial Code. See CLRSG Report *Modern Company Law for a Competitive Economy* (July 2001).

⁷⁴ LCCP No 164, para 7.24.

These recommendations, if enacted, would weaken the position of a seller of goods:⁷⁵ for example they will have to register their interests, increasing the costs of dealing. Further, under the current law if a seller successfully retains title to goods then he enjoys super-priority status in the event of the buyer's insolvency. Under a notice-filing system the position would be less clear. The Law Commission proposed that 'simple' clauses could still enjoy such status, as Purchase Money Security Interests (PMSIs), but whether an 'all-monies' clause would also be considered to be a PMSI is, it seems, open to debate.⁷⁶

The problem would arise where an all-monies clause sought to retain title to goods conditional upon the satisfaction of a debt that was extraneous to that particular contract. Should the clause still be invested with PMSI status, given that the money it is securing is not the 'purchase money' of that particular contract? In the US, Canada and New Zealand the PMSI super-priority is limited to interests in property that secure the price of that particular property. To extend the scope of a PMSI to encompass an 'all-monies' retention of title clause would rather undermine the policy decision to ring-fence a proportion of charged assets for unsecured creditors. That is, if a policy choice were made so as to curb the power of the floating chargee to secure all the company's assets,⁷⁷ it would not then seem logical to give super-priority status to holders of 'all-monies' retention of title clauses – even if notice of the existence of such a security must be filed.

It should also be noted that the justification for allowing even 'simple' PMSIs to have super-priority is not beyond criticism. As McCormack explains, 'a security interest granted over the debtor's existing property may remove that property from the debtor's estate but a security interest over newly-acquired property to secure the price paid for that property is said to be neutral in its effect, with the new debt being offset by the addition of the property'.⁷⁸ To allow an earlier creditor to rely on a future-

⁷⁵ For an excellent further discussion of the potential changes, see McCormack G, "Quasi-securities" and the Law Commission Consultation Paper on security interests – a brave new world' [2003] LMCLQ 80.

⁷⁶ For a discussion of this issue of 'cross-collateralisation' see Honnold, Harris & Mooney, *Security Interests in Personal Property* (3rd ed, Foundation Press, 2001), pp 247-252.

⁷⁷ As has been done by s 252 of the Enterprise Act 2002 which introduces a new s 176A into the Insolvency Act 1986. See also Goode RM, 'Is the law too favourable to secured creditors?' (1982) 8 *Canadian Business Law Journal* 53, p 71.

⁷⁸ McCormack (2003), op cit n 75, p 84.

property clause to the detriment of the more recent investor would give the earlier creditor an undeserved windfall. Yet these arguments are not conclusive: it may be argued that the company only exists to take advantage of the recent investment because of the prior dealings with the earlier creditor. In this sense any windfall would not be undeserved. Further, as Gough points out, such a policy would seem to assume that an injection of funds tied to particular property is automatically worthy of more protection than an advance to enable the company to pay its workforce.⁷⁹

That said, academic comment on the Law Commission's proposals has been generally favourable. Gullifer considers the scheme to be 'coherent and attractive'⁸⁰ while McCormack is a little more cautious, opining that 'while the Consultation Paper should be accorded a warm welcome, there are various shortcomings which ... need to be addressed'.⁸¹ In my view the Law Commission is to be congratulated for grasping the nettle. It has been argued that the courts' tacit recognition of policy considerations has hindered legal analysis in this area: the Consultation Paper expressly recognises these policy considerations and proposes to enshrine them into a coherent legislative scheme. Retention of title agreements provide security, and if Parliament chooses to enact new legislation dealing with security interests in insolvency then such clauses cannot be excluded from the scope of the new regime. In terms of the status accorded to retention of title clauses in a new system it seems that the needs of commerce would require that at least simple clauses be vested with PMSI status, although it is recognised that such an exemption may enable creditors to avoid the proposed ring-fencing provisions. Partly to counterbalance this risk, it is suggested that 'all-monies' clauses should be given lower priority. In addition, the certainty provided by both the need to file notice and the tying of security to particular assets would enable the unsecured creditor to make an adequately-informed choice. Once again it is suggested that whether one agrees with these priority choices or not, it must be accepted that they are policy decisions that must be taken by Parliament, through legislation. For this potential aid to clarity at least, the Law Commission's proposals are to be welcomed.

⁷⁹ Gough WJ, *Company Charges* (2nd ed, Butterworths, 1996), p 436.

⁸⁰ Gullifer L, 'Will the Law Commission sink the floating charge?' [2003] LMCLQ 125.

⁸¹ McCormack (2003), op cit n 75, p 94.

CHAPTER FOUR – QUISTCLOSE THEORY

Having examined the mechanics of such devices, and having looked at the context within which they most commonly operate, we now turn to the theory of *Quistclose* trusts. Is a *Quistclose* trust really a trust at all? That is, are these devices a true example of property being legally owned by one party whilst beneficial title is vested in another? If so, we must identify the beneficiary: it might be the transferor of the funds or the ultimate recipient of the money. The type of trust – express, resulting or constructive – must also be determined. At least one commentator has argued that, at least while the purpose is still capable of fulfilment, *Quistclose* trusts are in fact not trusts at all but rather instances where both legal and beneficial title are held by the borrower, with the transferor holding only an equitable right to restrain the borrower's misuse of the funds.¹

The various possibilities will be discussed and criticised below, particularly in terms of their adherence to equitable principles. Finally, it will be argued that these theories as to the nature of the *Quistclose* trust are not necessarily mutually exclusive and that there is no single 'right answer'. Depending on the parties' agreement it may in any given situation be more appropriate to categorise the relationship as that of express trust, resulting trust, or of no trust at all. In essence, it will be argued that the existence and operation of *Quistclose* trusts can indeed be reconciled with orthodoxy.

4.1 BENEFICIAL OWNERSHIP IN C – TRUST FOR THE THIRD PARTY

If A transfers money to B subject to the condition that it only be used to pay C, it could be that a trust for C is created whereby B is the trustee. That is, A's direction that B should use the money for C goes beyond a vague intention to benefit and becomes an intention that C has the right to use and enjoy the benefit of that money.² There is some support for this view that the beneficial interest vests in the third party. In *Quistclose* itself Lord Wilberforce said that:³

¹ Chambers R, *Resulting Trusts* (Clarendon Press, Oxford, 1997), Chapter 3.

² See *Paul v Constance* [1977] 1 WLR 527.

³ *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 at 580.

[A]rrangements of this character for the payment of a person's creditors by a third person, give rise to a relationship of a fiduciary character or trust, in favour, as a primary trust, of the creditors, and secondarily, if the primary trust fails, of the third person.

Extra-judicially, Lord Millett has expressed similar views. In 1985 he wrote: ⁴

If A's intention was to benefit C, or his object would be frustrated if he were to retain a power of revocation, the transaction will create an irrevocable trust in favour of C, enforceable by C but not by A. The beneficial interest in the trust property will be in C.

The case of *Hassall v Smithers* is also worth noting, although it may ask as many questions as it answers.⁵ Funds were provided to enable the recipient to discharge certain debts he had incurred. However, the recipient soon died, intestate, without having satisfied these debts. The 'provider' of the funds brought a joint action with the deceased's creditors and they were able to compel the deceased's representative to pay off the debts. This could be seen as the creditors ('C') having a right to compel performance, which would suggest that they were the beneficial owners. However, it could also be argued that it was the action of the provider ('A') that was successful, as he had retained the beneficial interest throughout.⁶

Of course there is nothing abhorrent about the idea of A transferring property to B, directing that it be held on trust for C. In most cases this transfer will create a simple express trust with B holding as trustee for C and the settlor, A, dropping out of the picture as a stranger to the trust.⁷ However, there are two important considerations that must be addressed. Firstly, in the model above I have assumed that A is the settlor, but it could also be B. On this construction B would borrow money from A to enable B to create a trust in favour of C. Thus B is the settlor. If A intended that the money would end up in C's hands then the situation is not as clear: the beneficial interest may pass straight from A to C. However, I would suggest that the level of A's knowledge or intention must be carefully scrutinised to see whether it is sufficient

⁴ Millett PJ, 'The Quistclose Trust: Who Can Enforce It?' (1985) 101 LQR 269, p 290.

⁵ (1806) 12 Ves 119.

⁶ The Court did not answer this question. See Ho L & StJ Smart P, 'Re-interpreting the *Quistclose* Trust: A Critique of Chambers' Analysis' (2001) 21 OJLS 267, p 279.

⁷ As Chambers points out, the transfer could also take effect as a secret (constructive) trust if the transfer was part of a testamentary disposition that did not satisfy the requirements of the Wills Act 1837: Chambers R, 'Restrictions on the Use of Money' in Swadling (ed) *Quistclose Trusts* (Hart, forthcoming 2004).

to effect the creation of a trust. If it is, then A is the settlor and B only ever receives legal title. However, it is more likely that A will recognise and contemplate that C will gain the ultimate benefit of the funds, but that this recognition will not be enough to show the requisite certainty of intention to create a trust.

The identity of the settlor may be relevant for taxation purposes, and also when dealing with preferences if B settles a trust for C shortly before insolvency.⁸ The capacity of B to create trusts may also be an issue. Much more importantly for our purposes, though, the identity of the settlor tells us who receives the money in the event of the trust failing for uncertainty of objects. Should C be ill-defined, extinct or otherwise unidentifiable then the beneficial interest will revert to the settlor with B either holding on trust for A, or obtaining full beneficial and legal title for himself.⁹

A situation is therefore conceivable where A transfers money to B, contemplating that B will use it to benefit C. However, A's contemplation, or indeed intention, is not sufficient to make her the settlor of the trust: instead the money is transferred to B who declares herself trustee of it in favour of C. It then turns out that C does not exist and the beneficial interest reverts to B as the settlor on resulting trust. A will no doubt have a contractual claim against B, as it is very likely that B has borrowed the money from A, but this will provide little security in an insolvency situation. It may be possible to imply an intention that the beneficial interest should revert to A in the event of C being unidentifiable. However, this would be the equivalent of B declaring

⁸ There seem to be two possible lines of reasoning as to why such a device would *not* be a preference. In *Re Kayford* [1975] 1 WLR 279 at 281, it was thought that the question was not one of preferring particular creditors, but rather of preventing donors of money from becoming creditors (by making them beneficiaries instead). The case has been criticised on this point, and the weakness is amply demonstrated by Waters in 'The Trust in the Setting of Business, Commerce and Bankruptcy' (1983) 21 *Alberta Law Review* 395, p 417.

Alternatively, following the distinction drawn by Millett J in *Re MC Bacon Ltd* [1990] BCLC 324, one could argue that whilst the debtor company may have *intended* to prefer the creditor company, it did not necessarily *desire* to. That is, a declaration of trust would only be vulnerable if there was a positive desire to improve the creditor's position, rather than simply an appreciation of the necessity of such an act. This is a stronger ground on which to deny a preference but it must be recognised, as Robert Wright QC noted in *Re Beacon Leisure Ltd* [1991] BCC 213, that the distinction may be very small. In short, a declaration of trust in the run up to insolvency may still be vulnerable to claims that the device created a preference. See further McCormack G, *Proprietary Claims and Insolvency* (Sweet and Maxwell, 1997) pp 58-64.

⁹ It is important to note that we are concerned here with a trust failing initially for uncertainty of objects, not subsequently because of B's supervening insolvency. In that circumstance the funds will not be available for distribution amongst B's other creditors as the beneficial ownership of those funds would already be in C.

herself trustee in favour of A and would have the attendant problems regarding certainty of intention, preferences, capacity to create trusts etc.

We must also consider the mechanics of the trust whilst the purpose is still capable of fulfilment. Here the identity of the settlor is irrelevant: as long as the beneficial interest is vested in C it does not matter whether A created the trust or B declared himself trustee of money received from A. C is the beneficial owner while B holds legal title. B will owe fiduciary duties to C as trustee and may also owe contractual duties to A, both in terms of repayment of the loan and of fulfilling the purpose for which the loan was made.¹⁰ In *Twinsectra* Lords Millett and Hoffman spoke of the recipient (B) holding a power to apply the funds for the specified purpose,¹¹ although at the time their Lordships were clearly contemplating the beneficial interest in the money to be in A.¹² It seems rather redundant to speak of B having a power to benefit C when C is the beneficial owner. As regards A, B may have a contractual duty to pay C. As regards C, B will be under a duty to do what they ask.¹³

4.1.1 Problems and Classification: is this a Quistclose trust?

It is not doubted that the beneficial interest could vest in C in a transaction that appeared very similar to a *Quistclose* situation. However, it is argued that such a transaction should not properly be termed a *Quistclose* trust. The very essence of such a device is that it protects A's interests in the event of B's insolvency.¹⁴ It could be argued that if A directs B to apply the funds to C, then A's interest is protected through the benefit gained by C: after all, this is what A desired in the first place. A could also de facto protect the investment by taking security over B's other assets. However, whether B would be capable of giving such security and whether it would

¹⁰ It is recognised that A obligating B by contract to benefit C could easily be construed as A intending the beneficial interest to pass straight to C. However, this does not conflict with the notion of B owing contractual duties to A, and those duties replicating proprietary obligations that B owes to C.

¹¹ *Twinsectra Ltd v Yardley and others* [2002] 2 AC 164 at 192 (Lord Millett) and 169 (Lord Hoffman).

¹² Their Lordships may have disagreed over whether this was through the mechanism of an express trust or a resulting trust.

¹³ C is an absolutely entitled beneficiary and so may direct B to pay money to whomever C desires. C may also terminate the trust under the principle in *Saunders v Vautier* (1841) 4 Beav 115.

¹⁴ In *Twinsectra v Yardley*, supra n 11 at 187, Lord Millett said that the 'whole purpose of the arrangements ... is to prevent the money from passing to the borrower's trustee-in-bankruptcy in the event of his insolvency'.

be a commercially realistic option for A may be doubtful. Other than these frankly unsatisfactory suggestions, A's options would be severely limited.

Under this construction the only right A could have to compel performance would be contractual,¹⁵ and indeed this is also problematic: what if B contracts with A to give the money to C in regular instalments, but C as beneficiary then directs B to give him all the money at once, terminating the trust? C could even terminate the trust and direct B to pay the money to someone else. B has to comply with the wishes of his beneficiary, but in doing so necessarily breaches his contract with A.¹⁶ The House of Lords in *Quistclose* held that the lender actually has 'an equitable right to see that [the funds] are applied for the primary designated purpose'.¹⁷ But how strong is this equitable right when facing the directions of an absolutely-entitled beneficiary? If C's interest is subject to A's equitable right then it is difficult to see how C could truly be the beneficial owner. If, on the other hand, C's beneficial interest outweighs any equitable right of A then A's security is again limited.

Most importantly, though, if B becomes insolvent having applied half the funds for the agreed purpose, it is difficult to see how the other half could revert to A. This would be necessary for A to have any security. C has been the beneficial owner of all the money since the start of the arrangement,¹⁸ and at the time of B's insolvency C has been paid – and thus acquired legal title to – half of the money. The purpose has been fulfilled as far as this half is concerned, whilst the other half is still owned by B on trust for C. How does A get it back? This is the 'secondary' trust that Lord Wilberforce spoke about in *Quistclose*.¹⁹

¹⁵ This may conflict with the decision in *Hassall v Smithers*, supra n 5, depending on one's view of that case.

¹⁶ This would still be a problem even if C had agreed not to direct B in this way. C's proprietary rights 'trump' his contractual obligations. See Glister J, '*Twinssectra v Yardley*: Trusts, Powers and Contractual Obligations' (2002) 16 TLI 223, p 228.

¹⁷ 'Equitable' may refer to a personal right enforceable by injunction, or to a proprietary right. The 'equitable' right of the lender in Chambers' thesis is clearly of the former kind: see discussion below, Section 4.2.1. For the purposes of the current discussion the distinction is irrelevant: the question is the strength of this right against the directions of an absolutely-entitled beneficiary.

¹⁸ Whether the settlor was A or B.

¹⁹ Supra n 3. See discussion below, Section 4.3, of the trust being for A, whereupon the distinction between primary and secondary trusts collapses.

A cannot unilaterally remove C's beneficial interest in the money, and neither can B. The only way would be to either impute an unlikely intention to C that he transfers his equitable interest in the remaining funds back to A, or to consider that C keeping the interest in the remaining money would be unconscionable: also, it is suggested, unlikely. In short, it is argued that a true *Quistclose* trust is characterised by the lender, A, retaining some form of security. Such an arrangement is not possible if the beneficial interest in the transferred funds is taken to be in the creditor C.

Returning to Lord Millett's extra-judicial writing, he says that if '[A's] object would be frustrated if he were to retain a power of revocation, the transaction will create an irrevocable trust in favour of C'.²⁰ With respect, it is difficult to imagine a situation where A's object would be so frustrated. No doubt C would prefer it if A did not have a power of revocation, but A's foremost consideration will be the protection of his own investment. Should this not be his foremost consideration, A is always free to simply give the money to C or loan it to B without attempting any form of security. To summarise; it is suggested that a trust for third parties of the kind that Lord Millett envisages, whilst of course conceivable, is not a true *Quistclose*-type trust. The trust for third parties encounters problems when applied to insolvency situations and, whilst it is recognised that *Quistclose* does not only apply here, it is suggested that the use of a 'trust for C' construction would rather undermine the point of employing a *Quistclose* device in those situations. Perhaps the point is better made from another angle: that is, the lack of security for A's advance would undermine any attempt to argue that A had intended the beneficial ownership to vest in C.

4.2 BENEFICIAL OWNERSHIP IN B – NO TRUST

It is clear that if B borrows money from A the beneficial interest in that money will normally be in B, with B owing A the money at common law under a contract of loan.²¹ This will be the case whether or not B intends to pay C with the money. It

²⁰ Millett (1985) op cit n 4, p 290.

²¹ Strictly speaking, a person solely entitled to both legal and beneficial estates in property does not have an equitable interest: the legal title carries with it all the rights. See *Vandervell v IRC* [1967] 2 AC 291 at 311 & 317; *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 at 702. However, for ease of expression in this discussion the beneficial and legal title will be kept separate even when they vest in the same person.

will also be the case if A knows that B intends to pay C. We are concerned with the point at which A's knowledge and intentions regarding B's use of the money alter the location of the beneficial interest in those funds. When discussing the possibility of the beneficial interest being in C it was argued that either A or B would need to show the requisite certainty of intention to create a trust in favour of C.²² If the requisite certainty of intention is not present, we must determine where the beneficial interest lies: A or B.

If A merely contemplates that B will use the funds for a specific purpose then B will receive unrestricted beneficial ownership.²³ A good illustration is the Australian case of *Roxborough v Rothmans of Pall Mall Australia Ltd* where the appellants were tobacco retailers who bought cigarettes from Rothmans, a wholesaler.²⁴ Tobacco wholesalers and retailers in New South Wales were required to pay a licence fee to the State, but any products in respect of which a fee had already been paid by the wholesaler were disregarded in the calculation of the retailer's fee. Roxborough bought tobacco from Rothmans and was duly invoiced, with the amount due being expressly apportioned between the actual price of the cigarettes and the proportionate amount of the licence fee. In effect, Rothmans passed on the fee to its retailers. The licence fee was subsequently held to be constitutionally invalid by the High Court, but the retailers had already paid certain sums to Rothmans in anticipation of licence fees payable in the future. Since the invoices had specifically mentioned amounts payable as regards the licence fee, could the appellants claim that those sums of money now held by Rothmans were held on trust for them?²⁵

In the High Court, Gleeson CJ, Gaudron and Hayne JJ found that 'the tax component of the net total wholesale cost was treated as a distinct and separate element by the

²² Depending on who is considered the settlor.

²³ In *Re Osoba* [1979] 2 All ER 393 a man left money to his wife on trust for his daughter's 'training up to university grade'. It was held that the daughter took unrestricted ownership. See also *Re Bowes* [1896] 1 Ch 507 where a trust was expressed as being for the planting of trees. It was held that the owners of the relevant estate took free of any trust, the tree planting being considered as merely expressing a motive.

²⁴ (2001) 185 ALR 335.

²⁵ Interestingly, in the Full Federal Court the retailers had conceded that Rothmans had not received money on terms of a *Quistclose* trust. This was because there was no obligation to keep the 'tax money' segregated. Bryan and Ellinghaus doubt the correctness of this concession ('Fault Lines in the Law of Obligations: *Roxborough v Rothmans of Pall Mall Australia Ltd*' (2000) 22 SLR 636 at 664, n 101); and it has also been argued in Chapter One, Section 1.1, that a requirement of segregation is not necessarily determinative in these cases.

parties'.²⁶ It could thus be argued that, given A's clear contemplation that the money be applied for a specific purpose, B did not receive unrestricted beneficial ownership. However, although the parties considered the tax money to be severable from the rest of the contract, it did not necessarily follow that they also intended the 'further step' of intending the beneficial interest in the tax money to remain in the donor (or at least restricting the beneficial ownership of the wholesaler). As Gummow J held:²⁷

That is not to maintain that Rothmans failed to acquire ownership in specie of the funds it was paid; nor does it mean that Rothmans was obliged to earmark and keep those funds separate or otherwise treat them as if they were impressed with trusts in favour of the appellants.

In this case the intention was not 'strong' enough to prevent B from receiving full ownership of the funds. What is required is a binding condition that the relevant money will only be used for a specific purpose. Simply put, if it had been contended that a *Quistclose* trust existed in *Roxborough*, the High Court could have said: 'we accept that the retailers paid a specific and severable amount of money to Rothmans so that they could pay the licence fee; but we do not accept that the parties intended that *that specific property itself* should necessarily be the money applied'.

4.2.1 The Lender's Right – Personal or Proprietary?

Chambers argues that the existence of a binding condition need not necessarily mean that the beneficial interest remains in A, but rather that B can receive the beneficial ownership, albeit restricted by that condition.²⁸ The existence of the condition as a restriction on B's ownership would carry with it a right, exercisable by A, to restrain B's misuse.²⁹ The nature of this right is important: if it is a merely personal right then A's security is denied as the right will not be enforceable against third parties.³⁰

²⁶ Supra n 24 at 342.

²⁷ Ibid at 350.

²⁸ Chambers (1997) op cit n 1, pp 73-78. For further discussion of the clarity and specificity required to establish a binding condition see Chapter One, Section 1.2.

²⁹ Note that even if the right is purely personal A could still seek specific performance of B's obligations by injunction: *Conservative and Unionist Central Office v Burrell* [1982] 2 All ER 1.

³⁰ It is true that as soon as B misapplied any money the rest could revert to A on resulting trust, because the misapplication would mean that the original purpose became incapable of fulfilment, and in that instance it was never intended that B should have full ownership. (*Westdeutsche*, supra n 21, can be distinguished on the grounds that we are not simply dealing with a void contract: unlike *Westdeutsche*,

Yet if the right is a proprietary right then it is difficult to identify. In acknowledging that it does not fit into the accepted categories of proprietary rights to money,³¹ Chambers argues that we are dealing with a form of personal right that developed in parallel with restrictive covenants in land and the *De Mattos v Gibson* principle.³² In short, the *Quistclose* right is a personal right to money that should have, but never did, make the transition into a proprietary right.

As mentioned above, the problem with A's right being merely personal is that the level of security that that would afford is less than if the right was of the proprietary kind.³³ Under this construction once the purpose has failed A would become the beneficiary of a resulting trust. However, A's position before the trust fails may also be important, and it is unclear whether Chambers' analysis adequately accounts for this situation. Not only is there the problem of A's right to restrain being a merely contractual right; it may also be legitimately questioned whether *Quistclose* cases are indeed characterised by the lender's right to restrain misuse rather than, at least in some cases, a right to compel performance. In *Gibert v Gonard*, North J appeared to be mindful of a right to compel when he observed that 'if [a recipient] chooses to accept the money tendered for a particular purpose, it is his duty, and there is a legal obligation on him, to apply it for that purpose.'³⁴ Similarly, in *Hassall v Smithers*, Grant MR held that the 'intestate was bound so to apply that remittance'.³⁵ Ho and Smart also point out that 'if counsel had asked the directors of the plaintiff in *Quistclose* whether it was intended that Rolls Razor might sit on the money (for an indeterminate time) or, alternatively, that Rolls Razor had (within a reasonable time) to use the money to pay off the dividend, one suspects an obvious reply would have been forthcoming'.³⁶

A does care what B does with the money). However, this does not account for the money that has already gone.

Chambers points out that this money would normally have disappeared anyway, either into the hands of a bona fide purchaser or received by an innocent volunteer who has since changed their position. This may often be true, but not all the time and it is suggested that it would still be clearly more beneficial to A to be able to exercise a proprietary right.

³¹ Ownership, possession, a right of rescission, and security interests. See Chambers (2004), op cit n 7.

³² Chambers (2004), op cit n 7, discussing *Tulk v Moxhay* (1848) 41 ER 1143; *De Mattos v Gibson* (1859) 45 ER 108.

³³ Neither would afford as much security as beneficial ownership, discussed below.

³⁴ (1884) 54 LJ Ch 439 at 440.

³⁵ *Supra* n 5 at 121.

³⁶ Ho & Smart (2001), op cit n 6, p 278.

At least in some cases, it seems that B's application of the funds for the specific purpose is obligatory, not permissive. That is, B is under a positive obligation to apply the funds, not merely a negative obligation to not misapply them. Ho and Smart contend that Chambers' view is 'unavailable' in these cases involving positive obligations: the existence of a positive obligation would necessarily mean that 'the "entire beneficial ownership" of the money could scarcely be in the lender'.³⁷ This seems irreproachable, and received support from Lord Millett in *Twinsectra*.³⁸ His Lordship did not accept Chambers' opinions regarding the nature of the lender's right to restrain misuse:³⁹

The duty is not contractual but fiduciary. It may exist despite the absence of any contract at all between the parties, as in *Rose v Rose* (1986) 7 NSWLR 679; and it binds third parties as in the *Quistclose* case itself. The duty is fiduciary in character because a person who makes money available on terms that it is to be used for a particular purpose only and not for any other purpose thereby places his trust and confidence in the recipient to ensure that it is properly applied. This is a classic situation in which a fiduciary relationship arises, and since it arises in respect of a specific fund it gives rise to a trust.

4.2.2 *Reconciliation*

It is suggested that it is necessary once more to separate positive and negative obligations. Lord Millett's words seem to suggest a positive duty, i.e. the fiduciary duty arises when A trusts that B will properly apply the money; when A makes money available on terms that it is *to be used* for a particular purpose only. To disregard these terms would be unconscionable. Chambers on the other hand is concerned with cases involving negative duties: where B may not spend the money on anything else, but is not compelled to apply the money. It may seem a very narrow distinction, but could it not be argued that it is the intention of the parties that B be *compelled* to apply the funds that is crucial? That is, if the parties agree that B will not use the money for anything other than X then no fiduciary relationship arises: if B misapplies

³⁷ Ibid (footnote omitted).

³⁸ Supra n 11 at 190-191.

³⁹ Ibid at 186.

the money then A is left to his remedy in contract.⁴⁰ However, if they agree that B must spend the money on X then B becomes A's fiduciary. There is clearly a distinction between being compelled to do something and merely being at liberty to: in this circumstance it is suggested that the distinction determines where the beneficial ownership in property lies.⁴¹

Chambers' model has also been criticised for being unable to apply in instances where the transfer is not pursuant to a contract.⁴² In this situation, so the argument goes, there would be no basis for a contractual right to prevent misuse, and so the duty must be fiduciary. It is suggested that this is somewhat misleading: the contract exists as evidence of the parties' intentions as to the beneficial ownership of the funds. I have argued that if the contract creates a positive duty on the part of the recipient, B, then that is indicative of an intention that B should not be the equitable owner. B has undertaken to apply the funds for a purpose, A has reposed trust and confidence in B to this effect, and B is therefore A's fiduciary. If the agreement does not create a positive duty to apply the money, then there is no fiduciary relationship. It so happens that, in a case where this transfer was pursuant to a contract, A may have a contractual right to prevent misuse. Yet Chambers' model does not suggest that it automatically follows that voluntary transfers cannot involve fiduciary relationships: it merely asserts that there is no contract that can be used as evidence to determine whether the parties intended a relationship that the law may classify as fiduciary. Evidence must be sought from other means: a non-contract transfer may or may not involve fiduciary duties on the part of the recipient. The only difference is that where a non-contract transfer does not involve fiduciary duties there will also not be any contractual duties on which the transferor could rely.⁴³

⁴⁰ A is left to this remedy for the money that has already been misapplied. Any remaining funds will be held by A beneficially under a resulting trust, as the initial misapplication would mean that the purpose of the trust had failed.

⁴¹ Lord Millett, *supra* n 11 at 186, stated that it would be 'unconscionable for a man to obtain money on terms as to its application and then disregard the terms on which he received it'. It is suggested that this supports the suggested distinction: if B receives money under a negative obligation, then as long as she does not misapply it she is not disregarding the terms on which she received those funds.

⁴² See the comments of Lord Millett in *Twinsectra*, *supra* n 11 at 190-191, and those of Ho & Smart (2001), *op cit* n 6, p 279.

⁴³ Again, as soon as some of the property is misapplied the purpose will have failed and the rest of the funds will be held by the transferor on resulting trust.

4.3 BENEFICIAL OWNERSHIP IN A – TRUST FOR THE LENDER

In 1985, Lord Millett proposed that under a *Quistclose* trust the beneficial ownership of the transferred property might remain in the lender.⁴⁴ This suggestion ‘cleared away a lot of the fog’⁴⁵ in the *Quistclose* area and was received with considerable academic and judicial favour.⁴⁶ The construction has also been recently adopted by the House of Lords in *Twinsectra v Yardley*.⁴⁷ When A transfers funds to B, B does not take them beneficially but instead holds the money on trust for A, under either an express trust or resulting trust.

4.3.1 Express Trust for A

The lender, A, may retain the beneficial ownership of the transferred property as a beneficiary under either an express or resulting trust. Under the former construction A transfers both legal and beneficial title to B who, immediately and pursuant to the contract, declares himself trustee of those funds in favour of A. B will hold a power to apply the funds for the agreed purpose. This model has attracted academic support,⁴⁸ and seems to have been the basis upon which the majority of the Lords found a trust in *Twinsectra*.⁴⁹ Lord Hoffman made no mention of *Quistclose* trusts, but held that the money Sims had received from *Twinsectra* was indeed held in trust. His Lordship said:⁵⁰

⁴⁴ Millett (1985), op cit n 4.

⁴⁵ The phrase is Chambers’: (1997), op cit n 1, p 74.

⁴⁶ See in particular Bridge M, ‘The Quistclose Trust in a World of Secured Transactions’ (1992) 12 OJLS 333, p 352; and Priestley J, ‘The Romalpa Clause and the Quistclose Trust’ in Finn (ed) *Equity and Commercial Relationships* (The Law Book Co, 1987) Chapter 8, p 237. The construction was also adopted by the New Zealand Court of Appeal in *General Communications Ltd v Development Finance Corp of New Zealand Ltd* [1990] 3 NZLR 406, and was favourably considered by Gummow J in the Australian Federal Court in *Re Australian Elizabethan Theatre Trust* (1991) 102 ALR 681.

⁴⁷ Supra n 11.

⁴⁸ Speirs A, ‘Escape from the Tangled Web’ [2002] 3 WebJCLI; Rickett CEF, ‘Quistclose Trusts and Dishonest Assistance’ [2002] RLR 112.

⁴⁹ This cannot be stated with certainty. On the trust point Lord Millett held that a resulting trust had been created, and Lord Hoffman appeared to think it was an express trust. Lord Slynn agreed with Lord Hoffman. Lord Steyn agreed with Lord Hoffman and Lord Hutton, who agreed with both Lord Hoffman and Lord Millett.

⁵⁰ Supra n 11 at 168.

The terms of the trust upon which Sims held the money must be found in the undertaking which they gave to *Twinsectra* as a condition of payment.

That is, the trust was an express trust. The agreement between the parties contained the requisite certainty of intention to the effect that Sims would hold that money in trust for *Twinsectra*.

There should be no objection to this. As long as the necessary intention to create a trust can be inferred from the parties' agreement, there is no reason to deny them the relationship that they objectively intended. One issue to consider, though, is the identity of the settlor. In the model I described the settlor is B as she declares herself trustee of the property (notwithstanding that she is contractually obliged to do so). It could also be argued that A is the settlor and, as a result, never relinquished the beneficial interest.⁵¹ There may be an advantage to the latter: B declaring herself trustee may be seen as creating a preference.⁵² However, apart from this point the distinction would little matter: the genesis of the trust is contained within the same agreement as that which transfers the money to B in the first place, so the declaration of trust would be instantaneous.

4.3.2 Resulting Trust for A

A lender may also retain or acquire the beneficial interest in the transferred funds through the mechanism of a resulting trust. Here the legal title may pass from A to B, with the beneficial title remaining in A. Alternatively full ownership may pass but, since the funds have not yet been applied to the purpose (and A did not intend B to receive full beneficial ownership), the equitable interest immediately jumps back to A on resulting trust.⁵³ In either case B will have a power to apply the funds for the specified purpose. Lord Millett preferred a resulting trust model in *Twinsectra*:⁵⁴

⁵¹ This may be the better view of the facts in *Twinsectra*: see Rickett (2002), op cit n 48 p 113.

⁵² See discussion above, n 8.

⁵³ Like the slightly different constructions of the express trust idea referred to above, this very narrow distinction need not worry us unduly: the transfer of funds takes place at the same instant as the resulting trust arises. The former construction (i.e. beneficial title never leaving A) is probably to be preferred, as this is generally the situation where a resulting trust arises due to a voluntary transfer (rather than on an election to avoid a voidable contract). See Meagher RP & Gummow WMC, *Jacob's*

As Sherlock Holmes reminded Dr Watson, when you have eliminated the impossible, whatever remains, however improbable, must be the truth. I would reject all the alternative analyses ... and hold the *Quistclose* trust to be an entirely orthodox example of the kind of default trust known as a resulting trust. The lender pays the money to the borrower by way of loan, but he does not part with the entire beneficial interest in the money, and insofar as he does not it is held on a resulting trust for the lender from the outset.

Resulting trusts arise either because an express trust fails to exhaust the beneficial interest or because the transferor did not intend the recipient to take full beneficial title.⁵⁵ Here we are concerned with the latter type, the presumed intention resulting trust. However, despite the nomenclature, it is argued that presumptions of either resulting trust or advancement are of little use here. If the transfer from A to B was an apparent gift then the location of the beneficial interest may depend on the relationship of the parties.⁵⁶ More commonly, though, B will have provided consideration for the transfer through a contract of loan. In these instances it is assumed that A intended B to take beneficial title, unless the restriction on B's use of the funds points away from this analysis. We must then examine the restriction to determine whether or not such an analysis is indeed compatible with the facts.⁵⁷ In any case, as Chambers argues, 'the presumptions of resulting trust and advancement do not apply if the question whether the provider intended to benefit the recipient can be answered from the evidence'.⁵⁸ *Quistclose* trusts do not only apply in corporate insolvency, but that is where they are most commonly found. In such an arena the negotiations and finalised contracts should contain enough information to allow the court to decide upon the intentions of the parties, and thus the location of the beneficial title. As Lamm J said, 'Presumptions may be looked on as the bats of the law, flitting in the twilight but disappearing in the sunshine of actual facts'.⁵⁹

Law of Trusts in Australia (5th ed, Butterworths, 1986), p 263: 'the property comes back to [the beneficiary] after it has been given away, although in truth the beneficial interest may never have left'.

⁵⁴ *Supra* n 11 at 192-193.

⁵⁵ See Lord Browne-Wilkinson in *Westdeutsche v Islington LBC*, *supra* n 21.

⁵⁶ The presumption of advancement would apply to transfers from husband to wife and father to child: *Pettitt v Pettitt* [1970] AC 777; *Dyer v Dyer* (1788) 2 Cox Eq 92.

⁵⁷ It is argued in Section 4.2.2 above that the important distinction - which determines the location of the equitable ownership - is whether the restriction enables A to compel B to apply the funds, or alternatively whether it merely enables A to restrain misuse.

⁵⁸ Chambers (1997), *op cit* n 1, pp 32-33, referring to *Pettitt v Pettitt*, *supra* n 56 at 823; *Muschinski v Dodds* (1985) ALJR 52 at 64.

⁵⁹ *Mackowik v Kansas City* (1906) 94 SW 256 at 262. Quoted by Chambers, *ibid*.

4.3.3 *Express Trust or Resulting Trust?*

At first sight it may appear that it does not matter much whether the device is taken to be an express or resulting trust: what is important is that the beneficial ownership of the property is in the lender. However, there is reason to distinguish between the two: whilst in either case A is an absolutely-entitled beneficiary, it is not necessarily so clear that B's duties to A would be the same. As a beneficiary under an express trust A would doubtless be able to terminate the trust, or direct B to pay money to whoever he wanted, under the principle in *Saunders v Vautier*.⁶⁰ The law is not so clear on the position of beneficiaries under resulting trusts.⁶¹

The separation of legal and equitable ownership, while creating a trust, does not necessarily create fiduciary relations:⁶² thus a resulting trust is not, ipso facto, a fiduciary arrangement. However, as Millett points out, 'the circumstances which give rise to it may ... be sufficiently known to the trustee to subject him to such obligations'.⁶³ It is suggested that a *Quistclose* situation is one of those instances where the trustee would be sufficiently aware of the transferor's intention and motivation as to make him the subject of fiduciary duties. However, these duties need not be the same as those owed by an express trustee. In the United States a resulting trust gives rise to some fiduciary obligations, at least in relation to the trust property,⁶⁴ but does not expose the trustee to the same liabilities as an express trustee in English law. Millett argues that the same is true in this country: that is, while all fiduciaries are subject to fiduciary obligations, they are not all subject to the same fiduciary obligations.⁶⁵ It is thus argued that the fiduciary duties owed by B to A could vary, depending on whether A is the beneficiary under an express or resulting trust.

⁶⁰ *Supra* n 13.

⁶¹ See Chambers (1997), *op cit* n 1, pp 196-200; Burrows A, 'Swaps and the friction between common law and equity' [1995] RLR 15, p 27; Millett PJ, 'Restitution and Constructive Trusts' (1998) 114 LQR 399, pp 403-405. This issue is also discussed in Chapter One, Section 1.4, n 81.

⁶² Millett (1998), *op cit* n 61, discussing the comments of Lord Browne-Wilkinson in *Westdeutsche v Islington LBC*, *supra* n 21 at 703.

⁶³ Millett (1998), *op cit* n 61, p 405.

⁶⁴ *Tricentrol Oil Trading Inc v Annesley* (1991) 809 SW 2d 218.

⁶⁵ Millett (1998), *op cit* n 61, p 403. See also the comments of Lord Browne-Wilkinson in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 at 206.

If A transfers money to B and the parties agree that B is under a positive duty to apply the funds for that purpose, then I have argued that B will not receive beneficial ownership. Rather, A will be beneficially entitled whether under a resulting or express trust. What if A promises not to revoke B's power to use those funds for that purpose, but then breaks that promise and attempts to terminate the arrangement while the purpose is still capable of fulfilment? This situation involves a conflict between proprietary rights and contractual obligations. If entitled under an express trust, there is little doubt that A could successfully revoke B's mandate and leave B to his remedy in contract. In short, the lender's proprietary rights will 'trump' the contractual rights of the recipient.⁶⁶ However, if A is entitled under a resulting trust he may not be able to exercise the same control.⁶⁷ Further, in a case where there is no certainty of intention to create an express trust in favour of A, and where A promises not to revoke B's ability to use the funds, it is arguable that there was never a resulting trust in the first place. As Chambers explains:⁶⁸

That contract is the indirect source of the resulting trust. The reason why B holds the money on resulting trust for A is because the contract between A and B prevented B from obtaining beneficial ownership of the money. If the contract gave B an enforceable right to use the money to pay C, then B would have a beneficial interest in the money and would not hold it wholly on resulting trust for A from the outset.

If the terms of the agreement were clear enough to be able to infer an intention to create an express trust for A, then a promise by A not to revoke B's power would not, it is submitted, undermine that intention. However, it would undermine an inference (or indeed rebut a presumption) that A had not intended B to have beneficial ownership. It is thus tentatively suggested that the difference between the express and resulting trust constructions is that a person entitled under a resulting trust is unable to terminate the arrangement whilst the purpose is still capable of fulfilment. However, it is important to note here that an inability to terminate the arrangement is not the same as an inability to compel the recipient to carry out what the parties agreed.

⁶⁶ Glister (2002), loc cit n 16.

⁶⁷ See the sources cited above, n 61, and the associated text.

⁶⁸ Chambers (2004), op cit n 7.

4.3.4 *Or Both?*

Clearly an express trust model can by definition only be employed in cases where there is sufficient certainty of intention to create a trust in favour A. It is not contended that such intention could never be found in the case of a non-contract transfer, but it is certainly true that evidence of that intention would normally be found in the terms of the parties' express agreement. Thus an express trust construction could only be used in certain situations, and in many of the older cases the requisite intention to create a trust would seem to be lacking.⁶⁹

It is therefore argued that both constructions must be potentially valid, depending on the facts of the case. An express trust requires intention to create a trust, while a resulting trust analysis requires only that A did not intend B to receive full beneficial title. As Yeo and Tjio point out, this clearly involves 'a lower threshold for proving a trust'.⁷⁰ However, as suggested above, the two constructions do differ in their effects and it would still be more advantageous to a lender to be in the position of a beneficiary entitled under an express trust.

4.4 CONCLUSIONS

Several constructions are possible, depending on the facts of a particular case:

- Express trust for C, with B as trustee.
- Express trust for A, with B as trustee.
- Resulting trust for A, with B as trustee.
- Full ownership to B, with A holding a personal right to restrain misuse.
- Full ownership to B, unrestricted by A.

We must determine three issues. Firstly we must decide whether or not each model concurs with established equitable principles. Secondly it must also be considered whether the differing models can co-exist, or must some necessarily contradict each

⁶⁹ See, for example, *Toovey v Milne* (1819) 2 B & Ald 683; *Hassall v Smithers*, supra n 5; *Gibert v Gonard*, supra n 34; *Re Vautin* [1900] 2 QB 325.

⁷⁰ Yeo TM and Tjio H, 'The *Quistclose* Trust' (2003) 119 LQR 8, p 12.

other. Finally we must identify the constructions that are true examples of a *Quistclose* trust.

4.4.1 *Non-Quistclose arrangements – Express trust for C*

There are two constructions that, it is suggested, can be dealt with quickly. The first of these is the ‘trust for C’ construction, whereby the beneficial interest in the advanced funds is held on trust by the recipient, B, for the third party, C. Such a model would be apposite where the agreement between A and B contained the requisite certainty of intention to create the trust for C. Under this construction A could transfer his equitable interest directly to C, or he could transfer full ownership to B who would subsequently declare himself trustee of that property for C. The third party would be an absolutely-entitled beneficiary under an express trust, able to restrain misuse, compel performance and terminate the trust.⁷¹ The identity of the settlor would be relevant in the event that C could not be the ‘object’ of a trust,⁷² but otherwise this model is straightforward and does not pose any problems as regards concordance with equitable principles. However, the problem with characterising this arrangement as a *Quistclose* trust is the lack of security that A would retain. As has already been mentioned, ‘the whole purpose of the arrangements ... is to prevent the money from passing to the borrower’s trustee in bankruptcy in the event of his insolvency’.⁷³ It is thus concluded that while such a device would be consistent with orthodoxy, and can happily exist without undermining the other models, it should not properly be termed a *Quistclose* trust.

4.4.2 *Non-Quistclose arrangements – Unrestricted ownership to B*

The second model that is also unproblematic arises where A transfers money to B to enable B to apply those funds for a particular purpose, but does not attempt to restrict B’s use of that money. In this instance the full ownership of that property is

⁷¹ All through exercising rights under *Saunders v Vautier*, supra n 13.

⁷² See above, Section 4.1.

⁷³ Per Lord Millett in *Twinsectra*, supra n 11 at 187.

transferred to B, most commonly with B owing A an appropriate amount under the terms of a loan agreement. A does not attempt to retain beneficial ownership, nor restrict B's use of the money (although a purpose may be intended or contemplated), and thus A does not have any security over the funds.⁷⁴ Again, while such an arrangement is clearly conceivable – and may appear similar in some cases to a *Quistclose* device – it is argued that A's lack of security once again precludes it from being characterised as a *Quistclose* trust.

4.4.3 True *Quistclose* arrangements – Express trust for A

Three constructions remain: an express trust for A, a resulting trust for A, and a situation whereby B owns the property but A holds a personal right to restrain misuse. The first of these is relatively straightforward, but requires a high degree of scrutiny of the parties' expressed intentions. Under this model A becomes the beneficiary of an express trust, the requisite certainty of intention being contained within the parties' transfer agreement (most commonly a loan contract). However, there must be a clear intention that B is to hold the funds on trust for A: a mere intention that B is not to receive full beneficial title himself is not sufficient. It is in this respect that the intentions must be carefully scrutinized: as Ulph suggests, 'there is at least some risk that promises made during negotiations for a loan could be found to suffice as evidence of an intention to create a trust'.⁷⁵ That said, should the required intention be present, there would be no reason to deny the existence of an express trust in favour of A: such an interpretation is clearly consistent with established principles. The effect of such an arrangement would be that A would have security over the funds: as B would not be the beneficial owner the property would not be available to his trustee in bankruptcy. In addition to this security in the event of his debtor's insolvency, A would also be able to exercise certain rights in his position as beneficiary: he would be able to both restrain misuse and compel performance, and could also bring the arrangement to a end by terminating the trust.⁷⁶

⁷⁴ It may be possible for A to have de facto security through other means, but again this would not pertain to a restriction on B's use of that particular property.

⁷⁵ Ulph J, 'Equitable Proprietary Rights in Insolvency: The Ebbing Tide?' [1996] JBL 482, p 495.

⁷⁶ The beneficiary could exercise all these rights through the principle in *Saunders v Vautier*, supra n 12. In this respect A's position as beneficiary would be identical to C's. However, depending on the

4.4.4 *True Quistclose arrangements – Resulting trust for A*

An express trust for A is both conceivable and, due to A's security, a true example of a *Quistclose* trust. However, it is also argued that such a construction is not the only one available to the courts: a resulting trust analysis may be more appropriate. This is similar to the express trust model in that B holds on trust for A, but it arises in different circumstances. Whereas an express trust construction would require certainty of intention to create a trust for A, a resulting trust model requires only that B was not intended to receive full beneficial ownership of the property. The beneficial title would then revert to A. It has been argued that, should B be required to apply the funds for the purpose (rather than being merely at liberty to do so), then this is indicative of an intention that B should not receive full beneficial title.⁷⁷ A reposes trust and confidence in B to the effect that B will apply the funds, B is fully aware of the situation, and is thus a fiduciary. It should also be noted that, unlike in an express trust situation where the certainty of intention will nearly always need to be adduced from a contract, a resulting trust analysis is more readily available in the case of non-contract transfers.

Under a resulting trust, the beneficiary A would be able to restrain misuse and compel application of the funds.⁷⁸ However, it has been argued that the fiduciary duties owed by B to A will differ if the trust is resulting, and more specifically A may not be able to terminate the arrangement whilst the purpose is still capable of fulfilment.⁷⁹ Simply put, B's fiduciary obligations should not extend this far. This is the distinction between a situation where A is entitled under an express trust and a case where the device is a resulting trust.

A resulting trust construction satisfies our criteria: both models are potentially valid in that a finding of the requisite intention to create an express trust in one case would not preclude a resulting trust analysis in another; analysis in this area would proceed

agreement, A could also have concurrent personal rights. Should such personal rights exist, it may well be easier for A to compel performance or restrain misapplication through the common law, especially given that B would still be solvent. The equitable rights would then act as a 'long-stop'.

⁷⁷ See above, Sections 4.2.2 and 4.3.3.

⁷⁸ By exercising both personal rights under the contract and equitable rights held by virtue of his position as beneficiary. See n 76 above.

⁷⁹ See above, Section 4.3.3, in particular nn 61-65 and text.

in the same way as any other resulting trust case; and the lender does indeed hold security over the transferred assets.

4.4.5 True Quistclose arrangements – Restricted ownership to B

The final construction is that of B obtaining full ownership of the transferred funds, but with A holding a personal right to restrain misuse of those funds. This is the theory advanced by Chambers, although he appeared to think that such an analysis was inconsistent with a resulting trust analysis. That is, Chambers argued that *Quistclose* trusts were characterised not by an ability to compel performance, but by the restriction of the recipient's right to use the property.⁸⁰ This assertion has been rightly criticised,⁸¹ but it is argued that Chambers' theory is still valid in the cases where there was indeed no right to compel performance. In such a situation the lack of A's right to compel performance would undermine any argument that B had not been intended to gain full beneficial ownership. Thus a resulting trust would not arise. Instead B would receive full ownership, subject to A's personal right to restrain misuse of the money.

Such an arrangement seems unproblematic, but it also seems to deny A any security. Unlike beneficiaries under express or resulting trusts, here the lender cannot compel the application of the funds to the purpose: all she can do is seek an injunction to prevent misapplication. However, it is important not to confuse a lack of control during the life of the trust with security on a debtor's insolvency. Under this construction the distinction between primary and secondary trusts, irrelevant when dealing with trusts for the lender, becomes important again. During the 'primary' stage – while the purpose is still capable of fulfilment by the borrower – the beneficial title to the property is vested in the borrower. At this stage A does intend B to have beneficial ownership. However, there is a potential 'secondary' stage: should B become insolvent, and thus unable to carry out the purpose, the beneficial interest will at that point revert to A. In short, the resulting trust will arise when the purpose is

⁸⁰ Chambers (1997), *op cit* n 1, p 86.

⁸¹ See the comments of Ho & Smart (2001), *op cit* n 6, p 278; and Lord Millett in *Twinsectra*, *supra* n 11 at 186-187 and 190-191.

incapable of fulfilment by the borrower, because although A intended B to have full ownership in the 'primary' stage, she did not intend that to be the case in the event that B became insolvent. The lender has very little control over the borrower in the first stage, but that does not mean that she has no security in the potential second stage. Thus, although under this construction there exists only a 'secondary' trust, this may be accurately described as a *Quistclose* trust.

Express trusts for third parties and unrestricted transfers are not *Quistclose* trusts: not because they are invalid, but simply because they do not provide security for the original lender. Although evidential issues may mean they are relatively rare, express trusts for lenders are *Quistclose* trusts: they are entirely consistent with established principles and provide security for the original transferor. Resulting trusts for lenders and instances where restricted ownership is vested in the recipient are perhaps more worthy of discussion due to the various attempts to categorise all *Quistclose* trusts as one or the other. Yet such attempts are unnecessary: both are consistent with orthodoxy, provide adequate security and can co-exist with each other. If A attempts to restrict B's use of money, but does not compel her to use that money, then the former construction will apply. A's ability to control B during the primary stage will be much less than if A were a beneficiary, but in the secondary stage the beneficial title reverts to her under resulting trust. If on the other hand A does have a right to compel B to spend the money, then that is indicative of A retaining a beneficial interest. It is argued that both models are potentially valid, with the critical distinction being A's right to either compel the application of funds, or merely to restrain misuse.

TABLE OF COMPETENCE

| | Terminate trust while purpose capable of fulfilment | Compel application of funds during life of trust | Restrain misuse of funds during life of trust |
|--|---|--|---|
| Express Trust for A B as trustee | ✓ | ✓ | ✓ |
| Resulting Trust for A B as trustee | | ✓ | ✓ |
| B owns, A has right to restrain misuse | | | ✓ |
| B has full ownership unrestricted by A | | | |
| Express Trust for C B as trustee | ✓ (C) | ✓ (C) | ✓ (C) |

CHAPTER FIVE - CONCLUSIONS

The introduction to this thesis identified three questions, the answers to which are important in terms of our appreciation of what *Quistclose* trusts are, what they do, and whether or not they should be brought under legislative control. The second and third questions are necessarily linked and will be dealt with together.

1. Are *Quistclose* trusts consistent with orthodox equitable principles?
2. Do other security devices perform the same functions?
3. Given that *Quistclose* trusts are most commonly seen in insolvency situations, should they be subject to the same requirements (registration or notice-filing) as other security devices?

5.1 CONSISTENCY

The discussion of the theoretical bases of *Quistclose* trusts in Chapter Four concludes that the devices are indeed consistent with principle. There is no one model to which all *Quistclose* trusts conform: depending on the intentions of the parties they may properly be seen as express trusts, resulting trusts or transfers of beneficial title subject to a right to restrain misuse. All these constructions are potentially valid and are consistent with equitable theory. They also all involve A retaining some security in the transferred funds, although the 'strength' of this interest - and the other rights it gives to the transferor - will vary depending on the analysis applied.¹

Not all transfers of property with purposes qualify: the essence of a *Quistclose* trust is the transferor's retention of security. Although it would be possible to infer the necessary intention to create a trust in favour of C, these express trusts for third parties are not true *Quistclose* trusts: A would become a stranger to the trust and would thus lack security. Similarly, transfers where A contemplates that B will use the funds for a particular purpose, but where A does not actually attempt to restrict the use of the money, are not *Quistclose* trusts. Again, the transferor retains no security.

¹ Such as the right to terminate the arrangement whilst the purpose is still capable of fulfilment in the case of an express trust for the transferor. See Chapter Four Section 4.3.3.

5.2 COMPARISON AND CONTRAST

The theoretical differences are straightforward: chargees hold an equitable security interest short of full beneficial title while legal title remains with the chargor; retention of title agreements retain both legal and equitable title to the seller; *Quistclose* transferors retain² equitable title as beneficiaries under trusts.³ But how similar in *function* are equitable charges, retention of title clauses and *Quistclose* trusts? Given the Law Commission's proposal to include retention of title clauses within the scope of a new legislative scheme on security interests, and the fact that charges are already subject to registration requirements, we must consider whether *Quistclose* trusts should also be subject to a new regime.

5.2.1 Equitable Charges

Floating charges and *Quistclose* trusts can be distinguished easily. Unlike the trust, a floating charge does not attach to any specific property but instead 'hovers' over a fund of assets, including in its scope property acquired by the debtor after the charge was created. The floating chargor is free to deal with the charged fund in the normal course of his business, free from any encumbrance, whereas the *Quistclose* borrower is only free to apply the property for a specific purpose.⁴ Further, the floating chargee's equitable interest – if any – is not the beneficial ownership held by the *Quistclose* lender.⁵ In addition to these clear differences in operation and theory the

² The word 'retain' is used for ease of expression. See the discussions in Chapter Four, Sections 4.3.1 and 4.3.2.

³ This is always true of those entitled under an express or resulting trust from the outset. It is also true, once the purpose has failed, of a lender not immediately entitled under a trust. That is, once the 'secondary' trust has sprung into existence.

⁴ See *Driver v Broad* [1893] 1 QB 744 at 749 per Kay LJ: 'the company shall, notwithstanding the debentures, be at liberty to carry on its business, and in the ordinary course of such business to dispose of the property, as if the debentures did not exist'. Although it is accepted that a charge may still be categorised as floating despite certain restrictions on the chargor's dealing freedom, it is argued that the *Quistclose* specific purpose will always be much narrower than the width of dealing freedom that is enjoyed by the floating chargor.

⁵ See the discussions of the 'defeasible charge', 'licence' and 'mortgage of future assets' theories in Chapter Two, Section 2.3.

two devices also differ in their potential consequences for third parties, with floating charges requiring registration under the Companies Act 1985.⁶

Quistclose trusts and fixed charges appear more alike: the latter, created over identified property, usually by contractual stipulation, prevent the debtor from dealing with that property without first either paying off his debt to the chargee or securing the chargee's permission.⁷ This is much more akin to a *Quistclose* transaction: the small amount of freedom that that may be granted to the chargor can be compared to the specific purpose for which the *Quistclose* borrower may apply the funds, and both the charge and the trust concern specific property.

Nevertheless, there are distinctions. Fixed charges over property not yet acquired are valid, although the property must be sufficiently well described to enable the charge to take effect. Also, since charges are an example of a proprietary right arising from a contract, it is also necessary for that underlying contract to be valid, e.g. be supported by consideration or satisfy the formalities of a deed.⁸ Neither of these applies in the *Quistclose* scenario: although most *Quistclose* trusts will involve a contract, the contract is not vital to the analysis if the relevant intentions can be evidenced by other means. In relation to future property there is nothing to prevent parties from agreeing to enter a *Quistclose* transaction in the future, but until property is transferred there is no trust relationship. Indeed perhaps this indicates the most important difference between the two: fixed charges secure property of the debtor that he might acquire from anyone, *Quistclose* trusts secure only property which belonged to the creditor.⁹

It is suggested that this distinction is what justifies different treatment of fixed charges and *Quistclose* trusts. If A lends B £100,000 he may take as security a fixed charge over some property of B. The value of the charged property may far outweigh the

⁶ The Law Commission recently proposed that floating charges be subject to notice-filing requirements: LCCP No 164, *Registration of Security Interests: Company Charges and Property other than Land*, (July 2002). See discussion in Chapter Two, Section 2.4.

⁷ Should the debtor deal with the property anyway, the third party will take subject to the charge unless he is a bona fide purchaser for value without notice. The same applies to a third party who unwittingly deals with misapplied *Quistclose* property.

⁸ *Holroyd v Marshall* (1862) 10 HL Cas 191.

⁹ It may also be pointed out that the nature of the beneficial interest enjoyed by fixed chargees and *Quistclose* beneficiaries is different, although it is accepted that if this was the only distinction it would be a rather semantic one.

funds that A originally advanced. That is, as collateral for a £100,000 loan, A may take security over a £200,000 house. However, if A lends B £100,000 in a *Quistclose* transaction it is only the £100,000 that is secured. Imagine the following transaction:

In January Anne Ltd lends Bob Ltd £100,000 for the purpose of debt consolidation. It is agreed that Bob will repay £150,000 to Anne in one year's time. In February Bob expends the money on the agreed purpose and consolidates all his other debts. However, by next January Bob has run up more debts and falls into insolvency. Anne is still owed her £150,000.

If a *Quistclose* analysis is employed, Anne will be merely an unsecured creditor. The security she held pertained only to the £100,000: when this was applied to the agreed purpose the trust relationship came to an end and Anne was owed the £150,000 under a simple contract of loan. If Anne had taken a fixed charge over Bob's £200,000 house the £150,000 debt would have been secured. It is suggested, whilst recognising the other distinctions, that this disparity in the strength of security awarded justifies differing treatment of fixed charges and *Quistclose* trusts, both under the current insolvency regime and the new Law Commission proposals.

5.2.2 Retention of Title Clauses

Quistclose trusts do not secure debt that was previously owed by B to A. Neither do they allow title to be retained to the products and proceeds of the trust money.¹⁰ In this respect 'all monies' and 'advanced' retention of title clauses can be easily distinguished from *Quistclose* trusts. However, *Quistclose* trusts can appear very similar to 'simple' retention of title agreements.

In contrasting *Quistclose* trusts with 'simple' retention of title clauses it is argued that the main difference is in what the recipient is required to do with the money. In a *Quistclose* situation A transfers funds to B so that B can carry out X. That is, the parties agree a purpose for the transfer, and this purpose is a vital part of the analysis. Without a specified purpose the transaction may be one of simple loan due to the lack

¹⁰ It is true that if the fund accrued interest in a bank account then this would stay with the trust. However, if the money was applied to the agreed purpose, the 'proceeds' or 'products' of this application would not be held on trust for the lender.

of a restriction on B's beneficial ownership.¹¹ In a retention of title case A transfers assets to B, without relinquishing ownership. When B pays the price she obtains full ownership, yet crucially B does not have to do anything in particular with those assets in the meantime (as long as she keeps up repayments). Depending upon the wording of the contract, the buyer may enjoy wide-ranging powers as regards management of the goods in question, yet still not benefit from full legal ownership.¹² If a seller transferred assets to a buyer and did not attempt to retain title, she could not later claim that the assets were clothed with a trust in her favour: there would be no specified purpose that could be used to determine whether or not the recipient had acted properly. Further, the lack of a specified purpose would undermine the seller's argument that full beneficial ownership had not been intended to pass.

It is suggested that the above distinction is conclusive as regards 'simple' retention of title clauses and the express and resulting *Quistclose* trusts. However, it is much harder to distinguish between these retention of title agreements and the 'third' *Quistclose* trust: that is, where beneficial ownership is transferred to B with A holding a personal right to restrain misuse.¹³ The 'specificity' of purpose required is of a lower level in these cases,¹⁴ and it may be that this standard would be satisfied by the (often relatively minor) restrictions that an ROT seller must place on the buyer.¹⁵ Further, like the ROT buyer, this type of *Quistclose* borrower is also free to do nothing with the property. However, it must be noted that an ROT seller would only attempt to make the difficult claim that a *Quistclose* trust existed if the attempted retention of title had failed. Such a claim could only be made if the seller could point to some agreed purpose for the property, even if this purpose was defined widely. Yet the place for such an agreed purpose to be found would be the retention of title clause: if the rights given to the seller necessarily indicated that ownership passed, then the same evidence would also undermine an attempt to frame those rights as an agreed purpose. That said, the two devices do appear very similar indeed: not least because,

¹¹ In that case full legal and beneficial ownership will pass to the recipient.

¹² See *Clough Mill Ltd v Martin* [1985] 1 WLR 111.

¹³ In Chapter Four, Section 4.2.2, I argued that this construction should be applied when the recipient is at liberty – rather than compelled – to use the funds for the stated purpose.

¹⁴ Chapter One, Section 1.2.2.

¹⁵ There must be some restrictions otherwise the seller will be unable to argue that full ownership was not intended to pass: *Clough Mill v Martin*, supra n 12. See also n 18 below.

unlike floating charges and other retention of title clauses, they are both relatively narrow in scope.

5.2.3 *Legislation?*

Quistclose trusts do not deserve the same treatment as equitable charges or ‘all monies’ and ‘advanced’ retention of title clauses. The potential consequences for other creditors (present or future) are much less dramatic, and the security held by the lender is also less.¹⁶ Further, the transaction can be considered as a discrete arrangement, most commonly with a separate bank account opened for the funds to be segregated from the general assets. However, at least some *Quistclose* trusts are analogous to ‘simple’ retention of title clauses. The Law Commission has recently suggested that these ROT agreements should be covered by a new legislative regime, but that they should enjoy super-priority status as Purchase Money Security Interests.¹⁷ There is a strong argument that *Quistclose* trusts should also be covered by any new legislation. To assert that one device should be encompassed by an overarching legislative insolvency scheme, even if endowed with a special status within that scheme, whilst the other is left to the jurisprudence of equity, seems too sharp a distinction. I have argued that *Quistclose* trusts can be reconciled with orthodoxy. That is not to say that they should not be beyond the scope of legislation.

On the other hand, it is only the ‘third’ type of *Quistclose* trust that bears close resemblance to a retention of title clause.¹⁸ The express and resulting trust constructions involve the recipient being obliged to apply assets to a particular purpose, and indeed may often look more like agency agreements than a security interest. One might conclude that a distinction should be drawn between these trust

¹⁶ If the recipient applies all the money to the purpose, then the trust relationship comes to an end. If a contractual debt is still owed by B to A then this debt is unsecured. This is different to, for example, an ‘all-monies’ retention of title clause where title to property is retained until all debts owed are satisfied. See the example above, Section 5.2.1.

¹⁷ LCCP No 164, *supra* n 6.

¹⁸ Despite their clear similarity, it is suggested that it is possible to draw policy distinctions between the two, even if they are not wholly convincing in theory: in the vast majority of cases the agreed *Quistclose* purpose will be much more specific than the width of the dominion granted to an ROT buyer. Also, even if the *Quistclose* lender does not compel the borrower to use the funds for the purpose, the fact that they will normally have intended the transferred assets to be segregated from the recipient’s general stock can also be used to distinguish the two devices.

constructions and the ‘third’ model, whereby the latter should be treated as a PMSI under a new regime and the former left outside the scope of any legislation. Such a distinction can be justified on a theoretical level, but would be extremely problematic in practice. In fact it would be a rather meaningless exercise, as to require notice to be filed of ‘third’ type *Quistclose* trusts, while not requiring the same of the express and resulting trusts, would quickly lead to the death of the ‘third’ construction.¹⁹ All lenders would simply compel their borrowers to apply the funds, while granting them extremely long periods of time in which to carry out their duty.

It should also be noted that the Law Commission’s proposals for ‘simple’ retention of title clauses were somewhat tentative.²⁰ However, the Law Commission seemed undecided between, on the one hand, granting ‘simple’ clauses PMSI status, and on the other including them in the same first-to-file scheme as other security interests. It is suggested that the better question may be whether ‘simple’ clauses should be subject to the new scheme at all, not whether to grant these clauses special PMSI status within that new regime. The characteristics shared by ‘simple’ clauses and some *Quistclose* trusts can be used here to argue that those clauses should not be subject to notice-filing: if *Quistclose* trusts are not considered sufficient quasi-security to arouse legislative interest, then why are ‘simple’ retention of title agreements? Perhaps the line should not be drawn between *Quistclose* trusts and retention of title agreements, but rather between ‘simple’ retention of title clauses and ‘all-monies’ agreements.

The conclusions of this thesis are both conventional and unusual. It is argued that *Quistclose* trusts can indeed be reconciled with principle: indeed it is suggested that there is in fact ‘nothing special’ about them. The correct analysis may involve express trusts, resulting trusts or conditional transfers, depending on the appropriate construction of the parties’ intentions. To attempt to categorise all *Quistclose* trusts as one or another unnecessarily exposes the device to theoretical criticism. Given the

¹⁹ The possible demise of the ‘third’ construction may not be lamented. It could be argued that there is no room for another model between an outright transfer and a resulting trust analysis: it may be further thought that the distinction between compulsion and liberty is rather semantic. These arguments are not without merit, although they do not reflect my own views.

²⁰ See Chapter Three, Section 3.5.1, and McCormack G, “‘Quasi-securities’ and the Law Commission Consultation Paper on security interests – a brave new world’ [2003] LMCLQ 80, p 83.

academic debate that has taken place regarding the ‘correct’ classification, this conclusion might be seen to be both orthodox and atypical.²¹

It may also appear surprising to conclude that *Quistclose* trusts should not be subject to any new legislative insolvency scheme, unlike equitable charges and (most) retention of title clauses. The view is not taken lightly. It is recognised that *Quistclose* trusts most commonly arise in insolvency situations: precisely where policy demands that parties’ agreements are subject to legislative scrutiny. However, it is argued that there are sufficient variations in creation, theory and – most importantly – operation to justify this differing treatment.

²¹ The various theories are considered in Chapter Four, but it is suggested that the most important contributions are from Chambers and Millett. See Chambers R, *Resulting Trusts* (Clarendon Press, Oxford, 1997), Chapter 3; Chambers R, ‘Restrictions on the Use of Money’ in Swadling (ed) *Quistclose Trusts* (Hart, forthcoming 2004); Millett PJ, ‘The Quistclose Trust: Who Can Enforce It?’ (1985) 101 LQR 269; and Lord Millett’s judgment in *Twinsectra Ltd v Yardley and others* [2002] 2 AC 164 at 184-194.

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