Trusts
Fall Term 2017

Lecture Notes – No. 10

'PURCHASE MONEY' RESULTING TRUSTS

As we considered in respect of gratuitous transfers, equity doesn't concern itself as much with legal title as with beneficial interests and thereafter uses the resulting trust to force the title-holder to hold on trust for the transferor unless there is a good reason not to interfere with the beneficial interest following the legal interest – e.g. through proof of donative intention.

It is not unusual in commercial and even domestic arrangements for the purchaser of property to use another's money to complete the transaction; the title may be put in the purchaser's name, the name of the person who supplied the money, a third party with an interest in the money, a third party stranger, or some or all of them in joint tenancy or tenancy in common. Obviously the parties can structure arrangements to suit their interests and preferences.

Thus, A advances money to B to purchase property in B's name. A would normally be considered the beneficiary of a resulting trust for the gratuitous transfer of the money to B which could be followed into the property (even if the property is land**; Neazor v Hoyle (1962), 32 DLR 92 (2d) 131 (Alta SC App Div).**

What if the situation was not truly a gratuitous transfer, but it was A and B's common intention that A should be treated as having a beneficial interest in the property notwithstanding not having any part of the title to the property? A purchase money resulting trust can arise - **a 'purchase money' resulting trust means that A can claim an interest through a resulting trust where he or she supplied the purchase money 'in the character as a purchaser' meaning that there was a common intention between the A and B such that A would retain the beneficial interest in the purchase money and can claim a proprietary interest in the property.** How can the A's claim be defeated? Simply by showing that he or she intended to benefit B or another and was content to have a debt owed to him or her by B (or not at all).

Thus, in **Dewar v Dewar [1975] 1 WLR 1532 (Ch)**, two sons argued as to the nature of rights in a house that was purchased through money obtained through a mortgage, contributions by their late mother, and contributions by one of the sons. Goff J held that the intention of the parties was the key to characterizing the expectations of the parties:

> ... where a person intends to make a gift and the donee receives the thing given, knows that he has got it and takes it, the fact that he says: "Well, I will only accept it as a loan, and you can have it back when you want it "does not prevent it from being an effective gift. Of course, it does not turn it into a loan unless the donor says:

> "Very well, let it be a loan." He could not force the donor to take it back, but the donor, having transferred it to him effectively and completely, intending to make a gift, and he - so far from repudiating it - having kept it, it seems to me that that is an effective gift and accordingly I hold that the defendant has established that the mother's contribution was a gift.'

Thus, (i) the plaintiff son was the beneficiary of a 'purchase money' resulting trust reflecting his own contributions to the purchase of the house (his £500 contribution to purchasing the house for £4250, which meant he could claim proprietary relief in the increased value of the house in proportion to his contribution to the purchase price); (ii) given that the mother had contributed without an expectation of retaining rights to the beneficial interest in the money but truly gifting it to the other son (the defendant), her Estate had no claim over that money or the house purchased with it.

Nishi v. Rascal Trucking Ltd.
2013 SCC 33

The *dramtis personae* for this particular comedy of errors are:

Hans Heringa: a civil engineer and owner of **Rascal Trucking Ltd**.
Cidalia Plavetic: a realtor and owner of **Kismet Enterprises Ltd.**
Edward Nishi: common law partner of Plavetic.
The City of Nanaimo: A place in British Columbia which is evidently the 'Bathtub Racing Capital of the World' in addition to being responsible for the ubiquitous 'Nanaimo bar'.
CIBC: The people who own the ATM machines distributed around campus.

Heringa and Plavetic were business partners who at one time had a romantic relationship. Kismet owned two acres of land in Nanaimo where Nishi and Plavetic lived. Heringa proposed a topsoil processing venture on the land; Plavetic agreed. Rascall leased the land from Kismet and commenced operations. The residents nearby complained that the business constituted a nuisance. The City of Nanaimo passed a by-law disallowing such businesses at the location and ordered that the topsoil on site be removed; nothing was done. The City removed the topsoil and added tax arrears to Kismet's account for $110,679.74. Rascal admitted liability for the charge to Kismet based on an indemnity clause in their contract. Rascal didn't pay the tax owing but sued the City instead for damages including its liability to pay the tax. Kismet defaulted on the mortgage on the property and CIBC foreclosed. The bank paid the tax arrears and offered the property for sale. Nishi bought the land for $237,500 (which was the fair market value plus the costs of the taxes). Heringa agreed to put $85,000 of Racal's money towards the purchase and assume $25,000 of the mortgage (that is, paying the equivalent of the taxes). Nishi and Plavetic then made improvements with a view to selling the property as a development. Rascal claimed an interest in the land.

At trial, it was found as a fact that there was no agreement between Nishi and Heringa or Rascal to grant Rascal an interest in the land (although that was what Rascal wanted). Indeeed the trial judge found that '[Nishi and Plavetic] would not have spent that money if Mr. Heringa was to have had an interest in the land;' 2010 BCSC 649,

para. 20. The trial judge held that the money was advanced by Rascal as it was liable to pay the taxes and Heringa promised that he would do so – Dley J. held, 'The contribution toward the purchase price by Rascal was simply to put Ms. Plavetic, Kismet, and Mr. Nishi in the same position as if the nuisance and its accompanying charges had not been caused by the plaintiff;' 2010 BCSC 649, para. 55.

In the BCCA, the Court held that the trial judge wrongfully considered Nishi's intention rather than Rascal's intention. That is, Rascal provided money gratuitously and thus a resulting trust arose. The presumption was not rebutted by Nishi given that the trial judge did not make clear findings of fact that a gift was intended.

The appeal was allowed in the Supreme Court of Canada. Per Rothstein J.:

> [21] The purchase money resulting trust is a species of gratuitous transfer resulting trust, where a person advances a contribution to the purchase price of property without taking legal title. Gratuitous transfer resulting trusts presumptively arise any time a person voluntarily transfers property to another unrelated person or purchases property in another person's name: D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., Waters' Law of Trusts in Canada (4th ed. 2012), at p. 397.
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> [22] As Cromwell J. noted in Kerr v. Baranow, 2011 SCC 10 (CanLII), 2011 SCC 10, [2011] 1 S.C.R. 269, at para. 12, it has been "settled law since at least 1788 in England (and likely long before) that the trust of a legal estate, whether in the names of the purchaser or others, 'results' to the person who advances the purchase money". Despite this recent endorsement of the purchase money resulting trust, Mr. Nishi argues that it should be abandoned in favour of the doctrine of unjust enrichment. The purchase money resulting trust provides certainty and predictability. Mr. Nishi has not advanced arguments that would support overruling the Court's jurisprudence in this area.
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> [23] This Court has recently considered under what circumstances it should overrule a prior decision of the Court: R. v. Henry, 2005 SCC 76 (CanLII), 2005 SCC 76, [2005] 3 S.C.R. 609; Ontario (Attorney General) v. Fraser, 2011 SCC 20 (CanLII), 2011 SCC 20, [2011] 2 S.C.R. 3; Canada v. Craig, 2012 SCC 43 (CanLII), 2012 SCC 43, [2012] 2 S.C.R. 489. It is best not to depart from precedent unless there are compelling reasons to do so: Henry, at para. 44. The Court will exercise caution in overturning decisions of firm majorities, particularly when those decisions are recent: Fraser, at para. 57.
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> [24] **In this case, Mr. Nishi is asking this Court to depart from both Kerr and Pecore v. Pecore, 2007 SCC 17 (CanLII), 2007 SCC 17, [2007] 1 S.C.R. 795, two recent appeals decided unanimously or by firm majorities. These decisions represent just the most recent endorsements of longstanding doctrine. There is no concrete evidence that the purchase money resulting trust is unworkable or has lead to untenable results: Fraser, at para. 83. Nor has Mr. Nishi shown that the purchase money resulting trust has been "attenuated or undermined by other decisions of this or other appellate courts" (R. v. B. (K.G.), 1993 CanLII 116 (SCC), [1993] 1 S.C.R. 740, at p. 778).**

…

B. Did a Resulting Trust Arise for the Benefit of Rascal?

[29] Rascal's contribution to the purchase of the property was made without consideration and Rascal and Mr. Nishi are not related. Therefore, the legal presumption of resulting trust applies: Pecore at paras. 24 and 27. This is because in such circumstances equity presumes bargains rather than gifts: Pecore, at para. 24. In the context of a purchase money resulting trust, the presumption is that the person who advanced purchase money intended to assume the beneficial interest in the property in proportion to his or her contribution to the purchase price: see Waters' Law of Trusts in Canada, at p. 401.

[30] However, the presumption of resulting trust can be rebutted if the recipient of the property proves, on a balance of probabilities, that the person who advanced the funds intended a gift: Pecore, at paras. 24 and 44. The relevant intention is the intention of the person who advanced the funds at the time of the contribution to the purchase price: Pecore, at para. 59. Therefore, for Mr. Nishi to rebut the presumption in this case, he must prove that Rascal intended to make a gift at the time that Rascal made a contribution to the purchase price, in May 2001.

[31] In my view, the trial judge was correct to conclude that the presumption was rebutted in this case. In his May 28, 2001 fax, Mr. Heringa indicated that the contribution to the purchase price and his intention to pay $25,000 of the mortgage was made "without any conditions or requirements, and these instructions are irrevocable" (A.R., at p. 117). As will be discussed below, a contribution to the purchase price without any intention to impose conditions or requirements is a legal gift. While Mr. Heringa argued that there was either an agreement to transfer a portion of the land to him or an intention for him to hold a beneficial interest, the trial judge preferred the evidence of Mr. Nishi (para. 40).

[32] The Court of Appeal held that the trial judge's findings (1) that there was no issue of a gift and (2) that Mr. Heringa's intention to obtain an interest in the property was obvious, meant that the presumption of resulting trust had not been rebutted. In my view, the Court of Appeal erred in the inferences it drew from the trial judge's reasons on these two key issues.

(1) The Meaning of "Gift"

[33] The trial judge found that there was "no issue of a gift" (para. 42). The Court of Appeal took this statement to mean that the presumption of resulting trust was therefore not rebutted, because to rebut it would require Mr. Nishi to prove that the contribution was a gift. In my respectful view, the Court of Appeal erred by taking this statement in isolation as conclusive of the trial judge's reasoning.

[34] In the trial judge's reasons, immediately following his statement about there being "no issue of a gift", he states: "[t]he presumption of a resulting trust is rebuttable by the title holder showing that the payment was not intended to create a beneficial interest" (para. 42). This demonstrates that the trial judge understood the test for rebutting the presumption to be based on the absence of intention to create a beneficial interest for the transferor. There would have been no need for the trial judge to continue his analysis beyond his statement about there being no issue of a gift, if the trial judge had not been of the opinion that an intention to create a beneficial interest in the transferor was the test for determining whether the presumption of resulting trust had not been rebutted.

[35] The conclusion of the trial judge was that Mr. Nishi had satisfied the burden on him of rebutting the presumption of resulting trust. In so concluding, the reasons of the trial judge appear to suggest that he distinguished between a gift and absence of an intention by the transferor to hold a beneficial interest after the advance. Although he made such a distinction, his conclusion that there was no intention to create a beneficial interest in the property for Rascal is legally the same as saying that there was an intention to make a gift to Nishi. The trial judge erred in distinguishing between a gift and intention to create a beneficial interest for the transferee but that error was inconsequential.

[36] Indeed, the trial judge's error may well be explained by reference to the academic authorities as some authorities have phrased the test for rebutting the presumption of resulting trust using language about intention not to hold the beneficial interest in the property. For example, Snell's Equity describes the type of evidence required to rebut the presumption as "any evidence tending to indicate that A's intention was that B should take the beneficial interest in the property acquired with A's purchase money" (J. McGhee, ed., Snell's Equity (32nd ed. 2010), at para. 25-012). Similarly, Oosterhoff on Trusts describes the presumption of resulting trust as "a presumption that the apparent donor did not intend to give the beneficial ownership of the assets to the recipient" (A. H. Oosterhoff et al., eds., Oosterhoff on Trusts: Text, Commentary and Materials (7th ed. 2009), at p. 640).

[37] In my view, these formulations are simply another way of describing whether the transferor's intention was to create a legal gift. There is no second category of intention that rebuts the presumption. Pecore and Kerr did not recognize a different category of intention, other than intention to make a gift, that would rebut the presumption. This is consistent with other authorities such as Waters' Law of Trusts where the proof required to rebut the presumption is intention "to make a gift of the property" (p. 401; see also pp. 406 and 409). In Canada, our jurisprudence is that there is no difference between the intention to make a gift and the intention that the transferor not hold a beneficial interest. In other words, in the case of a gratuitous transfer, there is a gift at law when the evidence demonstrates that, at the time of the

transfer, the transferor intended the transferee to hold the beneficial interest in the property being purchased.

[38] Reviewing the trial judge's reasons in their full context confirms that he understood that Rascal's intention at the time of the advance was to make a legal gift — i.e. to contribute to the purchase price without taking a beneficial interest in the property. As the trial judge found, Rascal's contribution to the purchase price was motivated by recognition of the costs that it had imposed on Kismet, the company owned by Ms. Plavetic, his friend. As I will explain, this intention, to make good on Rascal's obligations to Kismet by way of a payment to Mr. Nishi, is not inconsistent with a finding of a legal gift. Moreover, as was clear from the May 28, 2001 fax, Rascal's stated intention was to make the advance without any conditions such as obtaining a beneficial interest in any portion of the land.

[39] The trial judge's comment that the there was "no issue of a gift" was made in the context of reviewing Mr. Nishi and Ms. Plavetic's perspective on the purpose of the payment:

In this case, there is no issue of a gift. Neither Mr. Nishi nor Ms. Plavetic considered the plaintiff's contribution to be a gift. [para. 42]

Mr. Nishi and Ms. Plavetic did not see the payment as a gift, because as the trial judge went on to describe, Rascal acknowledged its responsibility for a debt to Kismet related to the tax arrears arising from Rascal's topsoil operation. However, it made no sense for Rascal to make that payment directly to Kismet since Kismet was subject to other liabilities and was essentially defunct. If Rascal had made the payment to Kismet, it would not have assisted Mr. Heringa's friends to obtain title to the property. Making the contribution to the purchase price, therefore, enabled Rascal to live up to its moral commitment in a way that practically benefited Mr. Heringa's friends. It also left open the possibility that in the future they might agree to a second mortgage or a transfer of a portion of the property to Rascal.

[40] Indeed, Mr. Heringa's instructions to his staff on payment of his contribution towards the mortgage on the property refer to the amount of the tax arrears ($110,679.74) down to the penny. The necessary implication is that Mr. Heringa viewed the payments as connected with that moral obligation. If Mr. Heringa's intention at that time was for Rascal to take a beneficial interest in the property, the moral obligation would not have been fulfilled since Rascal would have used the payment to obtain a corresponding interest in the land and not to make good on its moral obligation. In other words, for these parties, one payment cannot be used both to discharge the moral obligation and to obtain a beneficial interest in the land. The two intentions are incompatible.

(2) Evidence of Rascal's Intention

[41] Evidence that arises subsequent to a gratuitous transfer can be admissible to show the true intention of the transferor: Pecore, at para. 59. However, it is the intention of the transferor at the time of transfer that is determinative. The difficulty with subsequent evidence is that it may well be self-serving or the product of a change in intention on the part of the transferor: Pecore, at para. 59.

[42] The trial judge commented on Rascal's intention twice in his reasons. When discussing whether there was an agreement between Rascal and Mr. Nishi to convey part of the property to Rascal, the trial judge stated that "[Mr. Heringa's] intention and desire to secure an interest was obvious, but Mr. Nishi would not agree" (para. 39). Later in his reasons, the trial judge stated that he "specifically accepted the evidence of Mr. Nishi that there was no intention to have any interest in favour of Rascal created in the land" (para. 47). In my view, neither of these statements is inconsistent with the trial judge's conclusion that the presumption of resulting trust was rebutted.

[43] The trial judge's first statement was made in the context of discussing whether Mr. Heringa and Mr. Nishi had formed a contract that conveyed an interest in the land to Mr. Heringa. The trial judge stated:

His intention and desire to secure an interest was obvious, but Mr. Nishi would not agree. As a result, I conclude that there was no agreement whereby Mr. Heringa was to be given an interest or ownership position in the land. [Emphasis added; para. 39.]

Mr. Heringa's desire to obtain an agreement whereby half of the property would be conveyed to him was clear from the content of the May 25, 2001 fax in which he asked for an agreement to transfer and convey the bottom portion of the land to Rascal. However, Mr. Heringa withdrew this request in his May 28, 2001 fax by stating that there were to be no conditions or requirements attached to the financial support.

[44] Rascal argued before this Court that the trial judge's finding that Mr. Heringa's "intention and desire to secure an interest was obvious" constitutes a finding of fact as to Rascal's intention to hold a beneficial interest in the property as a result of the advance. However, the trial judge's findings with respect to the presence of an intention and desire to enter a contract should not be applied to the issue of resulting trust, when the trial judge did not choose to do so. The trial judge obviously did not consider his finding of an intention to contract to be determinative of intention for the purpose of the resulting trust analysis. Mr. Heringa withdrew this request in his May 28, 2001 fax by stating that there were to be no conditions or requirements attached to the financial support. It was open for the trial judge to organize his factual findings in this manner.

[45] With respect to the trial judge's second statement — that he "accepted the evidence of Mr. Nishi that there was no intention to have any interest in favour of Rascal created in the land" — the trial judge was speaking not just of Mr. Nishi's evidence as to his own intention at the time but also Mr. Nishi's evidence as to Mr. Heringa and Rascal's intention at that time. This follows

from his discussion of Rascal's acknowledgement of its responsibility for the debt (para. 45).

[46] At trial, it was Rascal's position that at the time of the contribution to the purchase price, Mr. Heringa and Rascal's intention was for Rascal to retain the beneficial interest in proportion to that contribution. The trial judge essentially concluded that Mr. Heringa's evidence at trial about Rascal's intention at the time of the transfer could not be relied upon. Consistent with the caution of this Court in Pecore, this is a quintessential example of why after-the-fact evidence should be viewed with skepticism, because it often demonstrates a change in intention, not the intention at the time of the advance. It was open to the trial judge to reach this conclusion and it was well supported by the evidence, particularly Mr. Heringa's May 28, 2001 fax. The trial judge's decision is not in error and ought to be restored.

THE 'QUISTCLOSE TRUST'

These types of trusts are very contentious indeed, and many would say that although they may be considered to be pragmatic, they undermine the certain application of insolvency law.

Using trust principles, we regard a person who would otherwise be considered a lender (and a lender who has acted quite unwisely) to be the beneficiary of a resulting trust. That is, the lender is regarded as the settlor of a resulting trust in his or her own favour that is coupled with the donation to the trustee of a power to appoint the money for a particular purpose – thus, the lender remains the beneficiary of a resulting trust *until such time the money advanced for a particular purpose is actually used for that purpose,* and, thereafter, a debt crystallizes. Magic.

Barclays Bank v Quistclose Investments Ltd
[1968] 3 All ER 651

Rolls Razor Limited was collapsing. Quistclose Investments Ltd. made a loan of money to Rolls Razor for the express purpose of making a dividend payment on the company's shares. Before the payment could be made, Rolls Razor went into liquidation. The money was in the company's bank account with Barclays Bank Ltd. The bank claimed to be able to set-off the money against Rolls Razor's debt to the bank. Lord Wilberforce held that the money was held under a resulting trust for Quistclose. The principle accepted was that **the payment of money from A to B in a commercial context for a particular purpose was held on a resulting trust until the purpose was complete, and thereafter a loan would be recognized as having arisen.** Thus B was trustee until such time as he became a debtor to A, at which point A's interest becomes a legal rather than an equitable one.

Lord Wilberforce:

(a) Precedent:

> That arrangements 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, has been recognised in a series of cases over some 150 years…

(b) Policy:

> The transaction, it was said, between the respondents and Rolls Razor Ltd., was one of loan, giving rise to a legal action of debt. This necessarily excluded the implication of any trust, enforceable in equity, in the respondents' favour: a transaction may attract one action or the other, it could not admit of both. My Lords, I must say that I find this argument unattractive. Let us see what it involves. It means that

> the law does not permit an arrangement to be made by which one person agrees to advance money to another, on terms that the money is to be used exclusively to pay debts of the latter, and if, and so far as not so used, rather than becoming a general asset of the latter available to his creditors at large, is to be returned to the lender. The lender is obliged, in such a case, because he is a lender, to accept, whatever the mutual wishes of lender and borrower may be, that the money he was willing to make available for one purpose only shall be freely available for others of the borrower's creditors for whom he has not the slightest desire to provide. I should be surprised if an argument of this kind - so conceptualist in character - had ever been accepted. In truth it has plainly been rejected by the eminent judges who from 1819 onwards have permitted arrangements of this type to be enforced, and have approved them as being for the benefit of creditors and all concerned. There is surely no difficulty in recognising the co-existence in one transaction of legal and equitable rights and remedies: when the money is advanced, the lender acquires an equitable right to see that it is applied for the primary designated purpose... I can appreciate no reason why the flexible interplay of law and equity cannot let in these practical arrangements, and other variations if desired: it would be to the discredit of both systems if they could not. In the present case the intention to create a secondary trust for the benefit of the lender, to arise if the primary trust, to pay the dividend, could not be carried out, is clear and I can find no reason why the law should not give effect to it.

(c) The Effect on Third Parties:

> the bank had actual notice and was not prejudiced.

Quistclose has been accepted as a valid trusts device in Ontario, e.g. *Del Grande v.McCleery* (2000), 31 E.T.R. (2d) 50 (Ont. C.A.; *Niedner Ltd. v. Lloyd's Bank of Canada* (1990), 74 O.R. (2d) 574 (H.C.J.)]

Carreras Rothmans v Freeman Mathews Treasure
[1985] Ch 207 (discussed in Twinsectra Ltd v Yardley)

The plaintiff manufactured cigarettes and tobacco which it advertised in newspapers and magazines. The defendant was an advertising agency employed by the plaintiff. The plaintiff paid the defendant an annual fee in monthly installments and amounts equivalent to invoices received from publishers for the advertisements it placed on behalf of the plaintiff. The plaintiff paid the money in time for the defendant to pay the publishers when the debts became due for payment, which was usually at the end of the month.

Like in Quistclose, the defendant was in financial difficulties. The plaintiff suggested that a special bank account should be opened into which the plaintiff would deposit the money to be paid to the publishers. This was set out in a

letter in July; that the money would be placed in the account and the defendant would use the money to pay June invoices that were due at the end of July. The defendant drew the cheques necessary to pay the publishers on that account but before the cheques were cashed, the defendant went into liquidation (on August 3). The trustee in the liquidation stopped payment on the cheques.

The publishers threatened not to run the plaintiff's advertisements unless they were paid. The plaintiff agreed to pay the third parties and took assignments of the debts owed by the defendant to those third parties. After investigation, it was clear that the defendant had used funds that had been advanced to it as per the normal practice for its own purposes rather than pay the publishers. The plaintiff told the third parties that they should have enforced their rights in contract (recovered their debts) at that time and that it would not pay those debts (as it already advanced money for that purpose to the defendant. The plaintiff sought the money in the special account. The trustee argued that the July letter was unenforceable as a result of public policy.

Peter Gibson J held:

> The July agreement was plainly intended to vary the contractual position of the parties as to how, as the contract letter put it, payments made by the plaintiff to the defendant for purely onwards transmission, in effect, to the third party creditors, would be dealt with. If one looks objectively at the genesis of the variation, the plaintiff was concerned about the adverse effect on it if the defendant, which the plaintiff knew to have financial problems, ceased trading and the third party creditors of the defendant were not paid at a time when the defendant had been put in funds by the plaintiff. The objective was accurately described by Mr. Higgs in his informal letter of 19 July as to protect the interests of the plaintiff and the third parties. For this purpose a special account was to be set up with a special designation. The moneys payable by the plaintiff were to be paid not to the defendant beneficially but directly into that account so that the defendant was never free to deal as it pleased with the moneys so paid. The moneys were to be used only for the specific purpose of paying the third parties and as the cheque letter indicated, the amount paid matched the specific invoices presented by the defendant to the plaintiff. The account was intended to be little more than a conduit pipe, but the intention was plain that whilst in the conduit pipe the moneys should be protected. There was even a provision covering the possibility (though what actual situation it was intended to meet it is hard to conceive) that there might be a balance left after payment and in that event the balance was to be paid to the plaintiff and not kept by the defendant. It was thus clearly intended that the moneys once paid would never become the property of the defendant. That was the last thing the plaintiff wanted in view of its concern about the defendant's financial position. As a further precaution the bank was to be put on notice of the conditions and purpose of the account. I

> infer that this was to prevent the bank attempting to exercise any rights of set off against the moneys in the account.
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> ...
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> It is of course true that there are factual differences between the Quistclose case and the present case. The transaction there was one of loan with no contractual obligation on the part of the lender to make payment prior to the agreement for the loan. In the present case there is no loan but there is an antecedent debt owed by the plaintiff. I doubt if it is helpful to analyse the *Quistclose* type of case in terms of the constituent parts of a conventional settlement, though it may of course be crucial to ascertain in whose favour the secondary trust operates (as in the *Quistclose* case itself) and who has an enforceable right. In my judgment **the principle in all these cases is that equity fastens on the conscience of the person who receives from another property transferred for a specific purpose only and not therefore for the recipient's own purposes, so that such person will not be permitted to treat the property as his own or to use it for other than the stated purpose.** Most of the cases in this line are cases where there has been an agreement for consideration so that in one sense each party has contributed to providing the property. **But if the common intention is that property is transferred for a specific purpose and not so as to become the property of the transferee, the transferee cannot keep the property if for any reason that purpose cannot be fulfilled.** I am left in no doubt that the provider of the moneys in the present case was the plaintiff. True it is that its own witnesses said that if the defendant had not agreed to the terms of the contract letter, the plaintiff would not have broken its contract but would have paid its debt to the defendant, but the fact remains that **the plaintiff made its payment on the terms of that letter and the defendant received the moneys only for the stipulated purpose. That purpose was expressed to relate only to the moneys in the account. In my judgment therefore the plaintiff can be equated with the lender in *Quistclose* as having an enforceable right to compel the carrying out of the primary trust.**

Given that the plaintiff had paid the third parties, they had no claim to the money. The plaintiff prevailed over the creditors based on the principle in Quistclose. However, it appears that the trust was not rationalized as a resulting trust but more as a constructive trust (‘equity fastens on the conscience of the person...’) and the beneficial interest in the money pending its use for the stated purpose was unclear. The matter was resolved in the following case.

Twinsectra Ltd v Yardley
[2002] AC 64

Here, a loan was provided by Twinsectra Ltd. to companies owned by Yardley for the acquisition of specific property. Yardley's solicitor was Leach who declined to give the undertaking required by Twinsectra that the loan funds would be released only for the purposes stipulated in the loan agreement. However, he was able to direct his client to another solicitor, Sims, who was prepared to give the undertaking. Relying on this, Twinsectra transferred the funds to the client account at Sims' firm. On Leach's instructions, Sims subsequently paid out the funds to the Yardley companies in the knowledge that they were not going to be used for the specific purpose stipulated by Twinsectra. Sims also used the fund to settle Leach's professional fees due from Yardley. When Twinsectra found out about the fraud they proceeded against Yardley in contract and deceit and also against Leach for breach of trust. Questions thus arose as to the position where a fiduciary misdirects property which is subject of a Quistclose trust.

Lord Hoffman said:

> **78** This has been the subject of much academic debate. The starting point is provided by two passages in Lord Wilberforce's speech in the Quistclose case [1970] AC 567...
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> **79** These passages suggest that there are two successive trusts, a primary trust for payment to identifiable beneficiaries, such as creditors or shareholders, and a secondary trust in favour of the lender arising on the failure of the primary trust. But there are formidable difficulties in this analysis, which has little academic support. What if the primary trust is not for identifiable persons, but as in the present case to carry out an abstract purpose? Where in such a case is the beneficial interest pending the application of the money for the stated purpose or the failure of the purpose? There are four possibilities: (i) in the lender; (ii) in the borrower;
> (iii) in the contemplated beneficiary; or (iv) in suspense.
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> **80** (i) *The lender.* In "The Quistclose Trust: Who Can Enforce It?" (1985) 101 LQR, 269, I argued that the beneficial interest remained throughout in the lender. This analysis has received considerable though not universal academic support...
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> **81** On this analysis, the Quistclose trust is a simple commercial arrangement akin (as Professor Bridge observes) to a retention of title clause (though with a different object) which enables the borrower to have recourse to the lender's money for a particular purpose without entrenching on the lender's property rights more than necessary to enable the purpose to be achieved. The money remains the property of the lender unless and until it is applied in accordance with his directions, and insofar as it is not so applied it

must be returned to him. I am disposed, perhaps pre- disposed, to think that this is the only analysis which is consistent both with orthodox trust law and with commercial reality. Before reaching a concluded view that it should be adopted, however, I must consider the alternatives.

82 (ii) *The borrower.* It is plain that the beneficial interest is not vested unconditionally in the borrower so as to leave the money at his free disposal. That would defeat the whole purpose of the arrangements, which is to prevent the money from passing to the borrower's trustee in bankruptcy in the event of his insolvency. It would also be inconsistent with all the decided cases where the contest was between the lender and the borrower's trustee in bankruptcy, as well as with the Quistclose case itself...

83 The borrower's interest pending the application of the money for the stated purpose or its return to the lender is minimal. He must keep the money separate; he cannot apply it except for the stated purpose; unless the terms of the loan otherwise provide he must return it to the lender if demanded; he cannot refuse to return it if the stated purpose cannot be achieved; and if he becomes bankrupt it does not vest in his trustee in bankruptcy. If there is any content to beneficial ownership at all, the lender is the beneficial owner and the borrower is not.

84 In the present case the Court of Appeal adopted a variant, locating the beneficial interest in the borrower but subject to restrictions. I shall have to return to this analysis later.

85 (iii) *In the contemplated beneficiary.* In the Quistclose case itself [1970] AC 567, as in all the reported cases which preceded it, either the primary purpose had been carried out and the contest was between the borrower's trustee in bankruptcy or liquidator and the person or persons to whom the borrower had paid the money; or it was treated as having failed, and the contest was between the borrower's trustee-in- bankruptcy and the lender. It was not necessary to explore the position while the primary purpose was still capable of being carried out and Lord Wilberforce's observations must be read in that light.

86 The question whether the primary trust is accurately described as a trust for the creditors first arose in In re Northern Developments (Holdings) Ltd (unreported) 6 October 1978, where the contest was between the lender and the creditors. The borrower, which was not in liquidation and made no claim to the money, was the parent company of a group one of whose subsidiaries was in financial difficulty. There was a danger that if it were wound up or ceased trading it would bring down the whole group. A consortium of the group's banks agreed to put up a fund of more than

£500,000 in an attempt to rescue the subsidiary. They paid the money into a special account in the name of the parent company for the express purpose of "providing money for the subsidiary's unsecured creditors over the ensuing weeks" and for no other purpose. The banks' object was to enable the subsidiary to continue trading, though on a reduced scale; it failed when the subsidiary was put into receivership at a time when some £350,000 remained unexpended. Relying on Lord Wilberforce's observations in the passages cited above, Sir Robert Megarry V- C held that the primary trust was a purpose trust enforceable (inter alios) by the subsidiaries' creditors as the persons for whose benefit the trust was created.

87 There are several difficulties with this analysis. In the first place, Lord Wilberforce's reference to In re Rogers 8 Morr 243 makes it plain that the equitable right he had in mind was not a mandatory order to compel performance, but a negative injunction to restrain improper application of the money; for neither Lindley LJ nor Kay LJ recognised more than this. In the second place, the object of the arrangements was to enable the subsidiary to continue trading, and this would necessarily involve it in incurring further liabilities to trade creditors. Accordingly the application of the fund was not confined to existing creditors at the date when the fund was established. The company secretary was given to understand that the purpose of the arrangements was to keep the subsidiary trading, and that the fund was "as good as share capital". Thus the purpose of the arrangements was not, as in other cases, to enable the debtor to avoid bankruptcy by paying off existing creditors, but to enable the debtor to continue trading by providing it with working capital with which to incur fresh liabilities. There is a powerful argument for saying that the result of the arrangements was to vest a beneficial interest in the subsidiary from the start. If so, then this was not a Quistclose trust at all.

88 In the third place, it seems unlikely that the banks' object was to benefit the creditors (who included the Inland Revenue) except indirectly. The banks had their own commercial interests to protect by enabling the subsidiary to trade out of its difficulties. If so, then the primary trust cannot be supported as a valid non- charitable purpose trust: see In re Grant's Will Trusts, Harris v Anderson [1980] 1 WLR 360 and cf In re Denley's Trust Deed [1969] 1 Ch 373.

89 The most serious objection to this approach is exemplified by the facts of the present case. In several of the cases the primary trust was for an abstract purpose with no one but the lender to enforce performance or restrain misapplication of the money. In Edwards v Glyn (1859) 2 E & E 29 the money was advanced to a bank to enable the bank to meet a run. In In re

EVTR, Gilbert v Barber [1987] BCLC 646 it was advanced "for the sole purpose of buying new equipment". In General Communications Ltd v Development Finance Corpn of New Zealand Ltd [1990] 3 NZLR 406 the money was paid to the borrower's solicitors for the express purpose of purchasing new equipment. The present case is another example. **It is simply not possible to hold money on trust to acquire unspecified property from an unspecified vendor at an unspecified time. There is no reason to make an arbitrary distinction between money paid for an abstract purpose and money paid for a purpose which can be said to benefit an ascertained class of beneficiaries, and the cases rightly draw no such distinction. Any analysis of the Quistclose trust must be able to accommodate gifts and loans for an abstract purpose.**

90 *(iv) In suspense.* As Peter Gibson J pointed out in Carreras Rothmans Ltd v Freeman Matthews Treasure Ltd [1985] Ch 207, 223 the effect of adopting Sir Robert Megarry V-C's analysis is to leave the beneficial interest in suspense until the stated purpose is carried out or fails. The difficulty with this (apart from its unorthodoxy) is that it fails to have regard to the role which the resulting trust plays in equity's scheme of things, or to explain why the money is not simply held on a resulting trust for the lender.

91 Lord Browne-Wilkinson gave an authoritative explanation of the resulting trust in Westdeutsche Landesbank Girocentrale v Islington Borough Council [1996] AC 669, 708c and its basis has been further illuminated by Dr Robert Chambers in his book Resulting Trusts published in 1997. Lord Browne- Wilkinson explained that a resulting trust arises in two sets of circumstances. He described the second as follows: "Where A transfers property to B on express trusts, but the trusts declared do not exhaust the whole beneficial interest. " The Quistclose case [1970] AC 567 was among the cases he cited as examples. He rejected the argument that there was a resulting trust in the case before him because, unlike the situation in the present case, there was no transfer of money on express trusts. But he also rejected the argument on a wider and, in my respectful opinion, surer ground that the money was paid and received with the intention that it should become the absolute property of the recipient.

92 The central thesis of Dr Chambers's book is that a resulting trust arises whenever there is a transfer of property in circumstances in which the transferor (or more accurately the person at whose expense the property was provided) did not intend to benefit the recipient. It responds to the absence of an intention on the part of the transferor to pass the entire beneficial interest, not to a positive intention to retain it. Insofar as the transfer does not exhaust the entire beneficial

interest, the resulting trust is a default trust which fills the gap and leaves no room for any part to be in suspense. An analysis of the Quistclose trust as a resulting trust for the transferor with a mandate to the transferee to apply the money for the stated purpose sits comfortably with Dr Chambers' thesis, and it might be thought surprising that he does not adopt it.

93 *(v) The Court of Appeal's analysis.* The Court of Appeal were content to treat the beneficial interest as in suspense, or (following Dr Chambers's analysis) to hold that it was in the borrower, the lender having merely a contractual right enforceable by injunction to prevent misapplication. Potter LJ put it in these terms [1999] Lloyd's Rep Bank 438, 456, para 75:

"The purpose imposed at the time of the advance creates an enforceable restriction on the borrower's use of the money. Although the lender's right to enforce the restriction is treated as arising on the basis of a 'trust', the use of that word does not enlarge the lender's interest in the fund. The borrower is entitled to the beneficial use of the money, subject to the lender's right to prevent its misuse; the lender's limited interest in the fund is sufficient to prevent its use for other than the special purpose for which it was advanced."

This analysis, with respect, is difficult to reconcile with the court's actual decision in so far as it granted Twinsectra a proprietary remedy against Mr Yardley's companies as recipients of the misapplied funds. Unless the money belonged to Twinsectra immediately before its misapplication, there is no basis on which a proprietary remedy against third party recipients can be justified.

94 Dr Chambers's "novel view" (as it has been described) is that the arrangements do not create a trust at all; the borrower receives the entire beneficial ownership in the money subject only to a contractual right in the lender to prevent the money being used otherwise than for the stated purpose. If the purpose fails, a resulting trust in the lender springs into being. In fact, he argues for a kind of restrictive covenant enforceable by negative injunction yet creating property rights in the money. But restrictive covenants, which began life as negative easements, are part of our land law. Contractual obligations do not run with money or a chose in action like money in a bank account.

95 Dr Chambers's analysis has attracted academic comment, both favourable and unfavourable. For my own part, I do not think that it can survive the criticism levelled against it by Lusina Ho and P St J Smart: "Reinterpreting the Quistclose Trust: A Critique of Chambers' Analysis" (2001) 21 OJLS 267. It

provides no solution to cases of non- contractual payment; is inconsistent with Lord Wilberforce's description of the borrower's obligation as fiduciary and not merely contractual; fails to explain the evidential significance of a requirement that the money should be kept in a separate account; cannot easily be reconciled with the availability of proprietary remedies against third parties; and while the existence of a mere equity to prevent misapplication would be sufficient to prevent the money from being available for distribution to the creditors on the borrower's insolvency (because the trustee in bankruptcy has no greater rights than his bankrupt) it would not prevail over secured creditors. If the bank in the Quistclose case [1970] AC 567 had held a floating charge (as it probably did) and had appointed a receiver, the adoption of Dr Chambers's analysis should have led to a different outcome.

96 Thus all the alternative solutions have their difficulties. But there are two problems which they fail to solve, but which are easily solved if the beneficial interest remains throughout in the lender. One arises from the fact, well established by the authorities, that the primary trust is enforceable by the lender. But on what basis can he enforce it? He cannot do so as the beneficiary under the secondary trust, for if the primary purpose is fulfilled there is no secondary trust: the precondition of his claim is destructive of his standing to make it. He cannot do so as settlor, for a settlor who retains no beneficial interest cannot enforce the trust which he has created.

97 Dr Chambers insists that the lender has merely a right to prevent the misapplication of the money, and attributes this to his contractual right to specific performance of a condition of the contract of loan. As I have already pointed out, this provides no solution where the arrangement is non- contractual. But Lord Wilberforce clearly based the borrower's obligation on an equitable or fiduciary basis and not a contractual one. He was concerned to justify the co-existence of equity's exclusive jurisdiction with the common law action for debt. Basing equity's intervention on its auxiliary jurisdiction to restrain a breach of contract would not have enabled the lender to succeed against the bank, which was a third party to the contract. There is only one explanation of the lender's fiduciary right to enforce the primary trust which can be reconciled with basic principle: he can do so because he is the beneficiary.

…

100 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, which I find unconvincing for the reasons I have endeavoured to explain, 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 in so far as he does not it is held on a resulting trust for the lender from the outset. Contrary to the opinion of the Court of Appeal, it is the borrower who has a very limited use of the money, being obliged to apply it for the stated purpose or return it. He has no beneficial interest in the money, which remains throughout in the lender subject only to the borrower's power or duty to apply the money in accordance with the lender's instructions. When the purpose fails, the money is returnable to the lender, not under some new trust in his favour which only comes into being on the failure of the purpose, but because the resulting trust in his favour is no longer subject to any power on the part of the borrower to make use of the money. 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.