Trusts & Equity
Fall Term 2023

Lecture Notes – No. 10

VIII. RESULTING TRUST

A. THE CONCEPT

In comparison to express trusts that arise exclusively upon the intention of the settlor, *resulting trusts* and *constructive trusts* 'arise by operation of law'. They are not private trusts but rather legal responses to some precipitating event or state of affairs; they are *reactive*, although there may not necessarily be any form of wrongdoing involved.

Resulting trusts are not disassociated from intention altogether – we may look to the intention of the settlor in dispossessing himself or herself although that intention may be presumed, rebuttably or irrebuttably.

Constructive trusts are much different and are imposed without reference to the parties' intentions; indeed, they are imposed against the wishes of the settlor (now trustee).

According to the orthodox classification there are two main categories of resulting trust based upon either the *presumed intent* of the settlor (which may be rebutted, for example in the case of a gratuitous transfer that is properly a gift) or that arise *automatically* in response to certain types of events (e.g. where an express trust fails because not all proprietary interests are accounted for in the settlement, or, where the trust is voided for illegality).

In **Re Vandervell's Trusts (No. 2) [1974] Ch. 269; cb, p.556**, Megarry J described the orthodox view of the two types of resulting trusts:

> (a) **The first class of case is where the transfer to B is not made on any trust ... there is a rebuttable presumption that B holds on resulting trust for A.** The question is not one of the automatic consequences of a dispositive failure by A, but one of presumption: the property has been carried to B, and **from the absence of consideration and any presumption of advancement B is presumed not only to hold the entire interest on trust, but also to hold the beneficial interest for A absolutely.** The presumption thus establishes both that B is to take on trust and also what that trust is. **Such resulting trusts may be called "presumed resulting trusts".**
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> (b) The second class of case is where the **transfer to B is made on trusts which leave some or all of the beneficial interest undisposed of. Here B automatically holds on resulting trust for A to the extent that the beneficial interest has not been carried to him or others.** The resulting trust here does not depend on any intentions or presumptions, but is the automatic consequence of A's failure to dispose of what is vested in him. Since ex hypothesi the transfer is on trust, the resulting trust does not establish the trust but merely carries back

> to A the beneficial interest that has not been disposed of. **Such resulting trusts may be called "automatic resulting trusts".**

Megarry J. was reversed in the Court of Appeal on a formalities point, but no doubt was cast on this analysis, which had long been thought to be definitive.

Lord Browne-Wilkinson's later classification in ***Westdeutsche v Islington BC* [1996] 2 All ER 961** is similar, but not identical, to Megarry J.'s:

> (A) where A makes a voluntary payment to B or pays (wholly or in part) for the purchase of property which is vested either in B alone or in the joint names of A and B, there is a presumption that A did not intend to make a gift to B: the money or property is held on trust for A (if he is the sole provider of the money) or in the case of a joint purchase by A and B in shares proportionate to their contributions. It is important to stress that this is only a presumption, which presumption is easily rebutted either by the counter-presumption of advancement or by direct evidence of A's intention to make an outright transfer: see Underhill and Hayton, *Laws of Trusts and Trustees,* 15th ed., pp. 317 et seq.; *Vandervell v IRC* [1967] 2 AC 291, 312 et seq.; *In re Vandervell's Trusts (No. 2)* [1974] Ch. 269, [1974] 3 All ER 205, at page 288 et seq. of the former report.
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> (B) Where A transfers property to B on express trusts, but the trusts declared do not exhaust the whole beneficial interest: ibid. and *Quistclose Investments Ltd. v Rolls Razor Ltd (In Liquidation)* [1970] AC 567, [1968] 3 All ER 651. Both types of resulting trust are traditionally regarded as examples of trusts giving effect to the common intention of the parties. A resulting trust is not imposed by law against the intentions of the trustee (as is a constructive trust) but gives effect to his presumed intention.
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> Megarry J in *In re Vandervell's Trusts (No.2)* suggests that a resulting trust of type (B) does not depend on intention but operates automatically. I am not convinced that this is right. If the settlor has expressly, or by necessary implication, abandoned any beneficial interest in the trust property, there is in my view no resulting trust: the undisposed-of equitable interest vests in the Crown as bona vacantia: see *In re West Sussex Constabulary's Widows, Children and Benevolent 1930) Fund Trusts* [1971] Ch. 1, [1970] 1 All ER 544.

The distinction between the traditional classification and this new one is in respect of the role of intention in giving rise to a resulting trust. Thus, whereas the orthodox classification would not use intention at all in certain circumstances (the 'automatic' resulting trust that arises where all beneficial interests are not completely disposed of in a transaction for example), Lord Browne-Wilkinson's formulation looks to intention to rationalise the trust (all trusts are presumed resulting trusts).

The most recent decision of the Supreme Court of Canada, **Kerr v. Baranow 2011 SCC 10,** which we will consider in its own context, is disappointing in that the Court chose not to comment on the current state of thinking on nature of the resulting trust in Canada.

Hodgson v Marks
[1971] Ch 892 (CA)

Here the widow Hodgson transferred her house to her lodger who sold it to Marks (and who mortgaged it in favour of a third party financial institution). The dynamics between the parties are readily apparent from the trial judge's description of the lodger: he 'was a very ingratiating person, tall, smart, pleasant, self-assured, 50 years of age, apparently dignified by greying hair and giving the impression to one of the defendants' witnesses of a retired colonel.' The widow thought that her nephew would put the lodger out on her death and so she intended to, in essence, leave him a life interest - but of doing so, she merely transferred title and assumed a trust limiting the lodger's interest was effective (which it wasn't, for lack of formalities). At trial, the judge allowed an oral trust to be proved. On appeal, it was held that a resulting trust arose. The further transfer to the innocent party Marks was ineffective as the lodger had no beneficial interest to sell (*nemo dat quod non habet*, 'no one can give what he does not have').

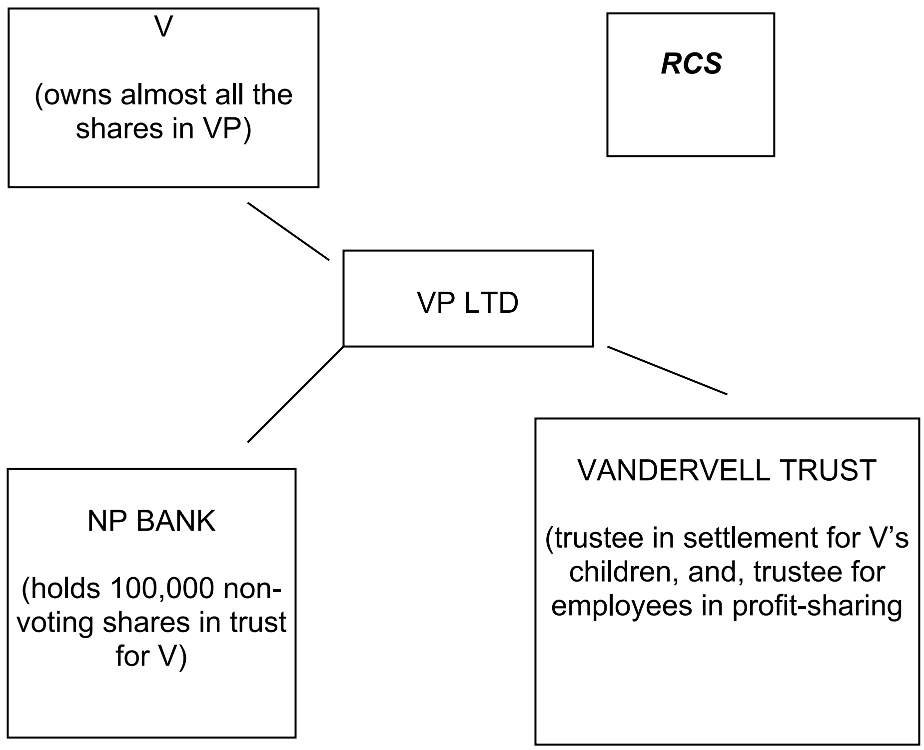
The judgement seems wrong. The widow *did* intend to benefit the lodger (but not to the extent he claimed) and *did* intend for title to vest in him. The trust is really more consistent with a constructive than a resulting trust: that is, the lodger acted deceitfully.

B. RESULTING TRUST AS A RESPONSE TO THE FAILURE OF EXPRESS TRUSTS

Where an express trust fails there is an *automatic resulting trust*. We presume that the settlor intended the subject-matter to return to him or her rather than being retained. Later we will consider whether the better explanation is one predicated on unjust enrichment with a judicially constituted trust merely being the remedial vehicle.

Vandervell v. IRC
[1966] Ch 261; cb, p.556

Vandervell wished to make a gift to the Royal College of Surgeons in order to endow a Chair of Pharmacology. They needed about £150,000. He was equitable owner of a substantial number of shares in Vandervell Products Ltd, a private limited liability company which he controlled (which made, among other things, Vanwall racing cars). The legal interest in Vandervell's shares was held by a bank as nominee. In order to endow the Chair, he arranged with the bank orally (presumably to avoid tax on dispositions) to transfer both legal and equitable interests in these shares to the Royal College of Surgeons (RCS), giving a trustee company (Vandervell Trustees Ltd., which he controlled) an option to re-purchase them for £5,000 (well under the value of the shares). This enabled the RCS to receive dividends of some £266,000 (£157,000 net after tax), but since, as a charity, RCS was not liable to pay income tax, it hoped to claim the tax back. Because of the option to re-purchase, Vandervell did not irrevocably relinquish control of Vandervell Products. Vandervell Trustees Ltd had the legal interest in the option. But where was the equitable interest? If it remained in Vandervell himself, he would be liable to surtax, on the basis of s. 415 of the Income Tax Act 1952.



Plan:

1. V to transfer VP's shares (legal and equitable interests) to RCS, but VP to have an option to repurchase for £5000.

2. VP to declare dividends sufficient to endow the chair. RPC hoped to be not liable for tax on this amount; received some £266,000 gross, £157,000 after tax.

3. RCS to grant the option, which would be exercised after dividends paid.

Timeline:

1958:	Arrangement for the donation executed: NP told to transfer the shares, RPC executed deed of option to VT. However, option did not say who VT would hold the shares for (V?).
1958-1961:	Dividends paid by VP.
1961:	IR assess V to sur-tax on the dividends paid to RCS on the basis that he did not completely divest himself absolutely of the shares.

House of Lords, [1967] 2 A.C. 291:
Issue: Whether the transfer of the shares to RCS was effective notwithstanding that it was not in writing.

3:2 for IR.

The HL accepted the argument of the IR; that is, as there was no beneficiary stipulated in the option, VT would hold on resulting trust for V rather than the children who were Bs of the VT. Thus, V had failed to divest himself completely.

1961: VT exercises the option and purchased the shares. Funds drawn from the VT trust settlement.

1962-1964: Dividends of £769,580 paid on the shares to VT, for the benefit of V's grandchildren.

1965: V transfers all his legal and equitable rights under the shares and option to VT for the benefit of the children.

1967: V dies; no provision made for children.

IR assess V's estate with sur-tax payable on the payment of the dividends during 1962-1964, on the basis that V retained beneficial ownership until the 1965 trust settlement. The Executor of V's estate sues VT seeking the dividends.

[1974] 1 All ER 47 (Ch); appeal allowed, [1974] 3 All ER 205 (CA):

Issue: Whether the VT held on a resulting trust for V subject to an equitable lien of £5000.

At trial, held by Megarry J for the Executor.

On appeal, appeal allowed on the basis that the fact that VT paid for the shares with the settlement money that belonged to the beneficiaries, held dividends for the children, and paid tax were all indicative of a trust in favour of the children. The exercise of the option = the creation of the trust; as the option was personal property, the trust need not be in writing.

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What else to know? Solicitors who draft trusts improperly may be liable for the costs of the clean up due to their own negligence. At the very least, LawPro (the professional insurer) reports that a sizeable number of claims occur in drafting wills and trusts arising from (i) failure to know the law and (ii) failure to investigate the facts. Both factors come together in complex trust settlements.

C. PRESUMED RESULTING TRUSTS: TRUST OR GIFT?

Where S transfers property to T without intending T to take that property beneficially, and where there is no presumption of advancement, there arises a *presumed* resulting trust over that property in favour of S.

Re Barrett
(1914), 6 OWN 267

The will contained a clause which read:

> 'I hereby give to my daughter, Sarah Frances Barrett, whatever sum or sums of money may be to my credit in any bank or upon my person or in my domicile at the time of my decease *for the purpose of enabling my said daughter to meet the immediate current expenses in connection with housekeeping*.'

The sum left in the estate for distribution was over $17,000 (adjusting for inflation, that's about $400,000 in current dollars).

Per Meredith CJO:

> It is very probable that if the testator had contemplated when he made his will that so large a sum as $17,200 would be at his credit in his bank at the time of his decease he would have made a different provision as to the disposition of it from that contained in para. 26, but that, in my opinion, affords no reason for putting a construction on the language of the testator different from that which would be placed upon it if the fund amounted to no more than $500. **My learned brother's view was that the legatee is not entitled to the fund absolutely, but that a trust is created, and that all money not needed for the purpose which the testator mentioned 'belongs to the estate as a resulting trust.' I am with respect unable to agree with this view and am of opinion that the clear words of gift to the daughter are not cut down or controlled by the statement of the testator as to purpose or object of the gift.**

This was then an attempt to interpret the will in a manner that revealed a modest gift with a remainder that would fall into residue in the manner in which a resulting trust operates. It really isn't a use of resulting trust principles at all, but does illustrate the use of the intention of the settlor to guide the legal characterization of the beneficial rights in the money.

The Presumption Of Advancement

The presumption of resulting trust becomes a difficult issue when it meets its oppositional counter-part, the presumption of advancement. Here the equities are reversed unless the presumption of advancement doesn't apply on its own terms or because it has been abolished by statute. In such cases, one presumes that transfer of the beneficial interest was the probable intention of the transferor.

The presumption of advancement in its original form held that a gratuitous transfer between a man and his wife or natural child or one to whom he stands *in loco parentis* is presumed to be a gift; it allows the donee to “advance” or get-on in life.

The original rationale of the advancement rule is somewhat difficult to pin down – most continue to think that the basis is the satisfaction of the legal obligation of support between a man and his wife and children, especially in a time where they were economically dependent upon the man and he alone either held title to family property. One must remember that in early times in England a married woman held no property in her own name, and, the head of the family held title of the family estate to maintain the integrity of land-based wealth in a pre-industrial society. There were compelling social and economic interests in concentrating ownership of the property that was the larger family’s wealth in one person’s hands, and both the law of property in the common law courts and the application equity in Chancery reflected these dynamics. Would that satisfaction of legal obligations was the explicit rationale of the presumption of advancement in the older cases; unfortunately, the cases are inconsistent in approach and lead to little certainty in justifying doctrine. Indeed, this was decidedly an inquiry into gifting, not compelling support payments, and gratuitous transfers were recognised as advancements in a number of situations that are problematic for this elegant explanation of the equitable doctrine - for example, where the donee was of legal age and even independent of his father, or was already provided for, or was illegitimate, or where the *loco parentis* principle was liberally applied to a wider class of people that would not be the object of any enforceable legal obligation. No uniform principle can be found in the cases.

Pecore v Pecore
2007 SCC 17

A father placed his assets into a joint bank account with one of his three children (Paula). His other children were more financially secure than this child, and indeed one of the others was estranged from the father. The father acted, at least in part, based on the advice of a financial advisor who told him that probate fees would not be charged on jointly-held assets as they would operate outside the Will after his death. The father regarded the assets as his own during his lifetime, even representing himself as the ‘real owner’ to the Canada Revenue Agency in respect of tax liability (attempting to stave off liability for capital gains tax if the CRA chose to view the transaction as a present disposition of these capital assets to Paula). Paula had access to the account but only with notice to her father. At his death, a dispute arose between Paula and her quadriplegic ex-partner Michael, who was named as a residuary legatee in the father’s Will. Were the assets part of the estate or were the assets owned in law and equity by Paula?

In **Madsen Estate v Saylor, 2007 SCC 18,** the mother and father had mirror Wills providing for a gift over to the survivor, and if there was no surviving spouse then the remaining estate was to be divided equally between the two classes of children and grandchildren. The mother died first and her assets passed to the father. The father later opened a joint bank account and a joint investment account with one of his three daughters (Patricia). The father declared and paid the taxes on the income. He controlled the account during his lifetime which was only used for his benefit. Eventually the father died, Patricia claimed the assets as her own, and her siblings naturally disagreed and brought an action against her in her role as executor of the father’s estate. Were the assets part of the estate or were the assets owned in law and equity by Patricia?

The issue of the operation of the presumption of advancement was of course central to both *Pecore* and *Saylor*; and the question was really one that asked whether the presumption ought to operate in present social circumstances - *does it aid in determining what the transferor probably intended?* Rothstein J, for the majority in *Pecore v Pecore*, held it is not helpful where the child in not a minor:

> … given that a principal justification for the presumption of advancement is parental obligation to support their dependent children, it seems to me that the presumption should not apply in respect of independent adult children… [moreover] parental support obligations under provincial and federal statutes normally end when the child is no longer considered by law to be a minor… Indeed, not only do child support obligations end when a child is no longer dependent, but often the reverse is true: an obligation may be imposed on independent adult children to support their parents in accordance with need and ability to pay… [further] it is common nowadays for ageing parents to transfer their assets into joint accounts with their adult children in order to have that child assist them in managing their financial affairs. There should therefore be a rebuttable presumption that the adult child is holding the property in trust for the ageing parent to facilitate the free and efficient management of that parent's affairs.

Should the presumption apply, then, to dependant adult children based on the justification of a legal obligation of support owed to the adult child? No, held the majority of the Court, certainty and pragmatism argues to the contrary. Rothstein J held:

> The question of whether the presumption applies to adult dependent children begs the question of what constitutes dependency for the purpose of applying the presumption. Dependency is a term susceptible to an enormous variety of circumstances. The extent or degree of dependency can be very wide ranging. While it may be rational to presume advancement as a result of dependency in some cases, in others it will not. For example, it is not difficult to accept that in some cases a parent would feel a moral, if not legal, obligation to provide for the quality of life for an adult disabled child. This might especially be the case where the disabled adult child is under the charge and care of the parent.
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> As compelling as some cases might be, I am reluctant to apply the presumption of advancement to gratuitous transfers to "dependent" adult children because it would be impossible to list the wide variety of the circumstances that make someone "dependent" for the purpose of applying the presumption. Courts would have to determine on a case-by-case basis whether or not a particular individual is "dependent", creating uncertainty and unpredictability in almost every instance. I am therefore of the opinion that the rebuttable presumption of advancement with regards to gratuitous transfers from parent to child should be preserved but be limited in application to transfers by mothers and fathers to minor children.

> There will of course be situations where a transfer between a parent and an adult child was intended to be a gift. It is open to the party claiming that the transfer is a gift to rebut the presumption of resulting trust by bringing evidence to support his or her claim.

Rebutting the Presumption of Resulting Trust

Whatever view one takes of the nature of the intent presumed, it is clear that its rebuttal in the form of proof of donative intent on the normal civil standard (including satisfaction of corroboration requirements under the provincial *Evidence Act* RSO 1990, c.E.23, s.13 on the same standard) or a counter-presumption of donative intent ('the presumption of advancement') is well settled.

In *Attorney for Robertson v Hayton* (2003), 4 E.T.R. (3d) 115, para 31-32 (Ont. Sup. Ct. Lofchik J recently summed up the position nicely:

> The standard of proof for intention to donate is high. The donee must show that that transaction was a gift by proving a clear and unmistakable intention on the part of the donor to make a gift to the donee. In weighing the conflicting evidence it is not sufficient that the preponderance of evidence may turn the scale slightly in favour of the gift. **The preponderance must be such as to leave no reasonable room for doubt as to the donor's intention. It should be inconsistent with any other intention or purpose. If it falls short of going that far then the intention of gift fails.** *Johnstone v. Johnstone* (1913), 12 D.L.R. 537; *Kibsey Estate v. Studsky*, [1990] M.J. No. 112 (Man. C.A.) at 3; *Scott Estate v. Scott*, [2002] A.J. No. 459 (Q.B.) at para. 52 and 53; *Olson v. Olson*, [1996] O.J. No. 3964 (Gen. Div.) at paras 55-56.
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> When a person transfers his own money into his own name jointly, with that of another person, there is prima facia a resulting trust for the transferor. This is a presumption of law, which is rebuttable by oral or written evidence or other circumstances tending to show that there was in fact, an intention of giving beneficially to the transferee. **Something more than a mere transfer is required to destroy the presumption of a resulting trust and an intimation of such an intent must appear on the document itself, or as a result of evidence which reveals the intention to benefit the transferee. The burden is on the person asserting a beneficial transfer to establish such a fact**. *Co-operative Trust Co. of Canada v. Mellof*, [1996] S.J. No. 188 (Q.B.) paras 35-36; *McLear v. McLear Estate*, [2000] O.J. No. 2570 (Ont. Sup. Ct.)

Proof of donative intent is a matter of evidence; simply put, it is a question of fact that may be proved from the documentation setting up the conveyance, the circumstances surrounding the transaction, or the previous or contemporaneous conduct of the parties.

Kent v. Kent
2020 ONCA 390 (Ont. C.A.)

Grandmother purchased a home and transferred title to herself and her daughter as joint tenants. The daughter and her husband and children moved into the home with the grandmother a number of years later; some years later the grandmother died. The daughter died but her husband continued to reside with the grandmother. The grandmother re-registered the property in her own name and then as joint tenants with the husband and the two children. After the grandmother died, the husband asserted a 2/3 interest in the property arguing that the joint tenancy was severed based on a provision in the Family Law Act:

per Gillese J.A.:

Was the Property a Matrimonial Home?

[42] I do not accept Gordon's submission that in allowing him, Janice, and their children to live on the Property together with her, beginning in 2008, Marian made the Property their matrimonial home and thereby removed any consideration of resulting trust.

[43] Determining whether the Property was Janice and Gordon's matrimonial home begins with a consideration of s. 18 (1) of the FLA. It will be recalled that s. 18(1) provides that:

Every property in which a person has an interest and that is … ordinarily occupied by the person and his or her spouse as their family residence is their matrimonial home.

[44] Although the application judge made no express finding on the matter, it appears beyond dispute that Janice and Gordon occupied the Property as their family residence, beginning in 2008 when they, together with their children, moved onto the Property and began living there with Marian. Thus, in determining whether the Property was Janice and Gordon's matrimonial home, we must decide whether either Janice or Gordon had "an interest" in the Property within the meaning of s. 18(1).

[45] Did Janice have an interest in the Property within the meaning of s. 18(1) of the FLA? In my view, she did not.

[46] Janice became a joint tenant of the Property with Marian as a result of the 1996 Transfer. As I have explained, the 1996 Transfer raised the presumption of resulting trust and, on the findings of the application judge, the presumption was not rebutted. Thus, the 1996 Transfer had the effect of placing Janice on title to the Property in the capacity of a trustee. As this court stated at para. 45 of Spencer v. Riesberry, 2012 ONCA 418, it is self-evident that the duties and powers of a trustee are not an interest in the property within the meaning of s. 18(1) of the FLA because those powers and duties are held not in a personal capacity but in the fiduciary role of a trustee. Consequently, the 1996 Transfer did not give Janice an interest in the Property within the meaning of s. 18(1).

[47] Did Gordon have an interest in the Property within the meaning of s. 18(1) of the FLA? In my view, he did not. In reaching this conclusion, I reject Gordon's submission that s. 26(1) of the FLA gave him such an interest. Recall that s. 26(1) reads as follows:

If a spouse dies owning an interest in a matrimonial home as a joint tenant with a third person and not with the other spouse, the joint tenancy shall be deemed to have been severed immediately before the time of death.

[48] It is correct that when Janice died, she appeared on title to the Property as a joint tenant with Marian, a third person. However, as I have just explained, as Janice was on title to the Property in the capacity of a trustee, she did not have an interest in the Property within the meaning of s. 18(1) of the FLA. Thus, when Janice died, she did not own an interest in a matrimonial home as a joint tenant with Marian, a third person. Consequently, s. 26(1) does not apply and Gordon cannot claim an interest in the Property pursuant to it.

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 (HL)

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.

...

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...
>
> **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.

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...

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.