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# ABANDONING THE *QUISTCLOSE* TRUST IN INSOLVENCY


## Abstract

The majority of academic commentary on the *Quistclose* trust has focused on its juridical nature in an attempt to understand it through orthodox trust principles. This article focuses instead on the less discussed normative and practical aspects of the *Quistclose* trust. Through a consideration of the leading cases giving rise to *Quistclose* relief, it is shown that the trust cannot be justified as a device to give effect to party intention. Instead, in light of commercial realities, it is better understood as a proprietary remedy for lenders. Since the effect of *Quistclose* relief is to allow the lender to bypass pari passu distribution in insolvency, there must be some normative justification for granting proprietary relief to lenders in these scenarios rather than restricting them to their remedy in debt. This article argues that there is none, and the result of maintaining the *Quistclose* trust is to unjustly distinguish between equally deserving creditors of the insolvent company.


## I Introduction

Since the House of Lords' decision in *Barclays Bank Ltd v Quistclose Investments Ltd* ('*Quistclose Investments*'),[1] courts have held that when A advances money, on loan or otherwise, to B for a specific purpose, and that purpose fails, the money is held on trust by B for A.[2] The decision has generated significant debate,

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1 [1970] AC 567 ('*Quistclose Investments*').

2 *Quistclose Investments* (n 1) was not the first case to grant this result: see, eg, *Toovey v Milne* (1819) 2 B & Ald 683; 106 ER 514; *Edwards v Glyn* (1859) 2 El & El 29; 121 ER 12; *Gilbert v Gonard* (1885) 54 LJ Ch 439; *Re Rogers* (1891) 8 Morr 243; *Re Drucker* [1920] 2 KB 237; *Re Watson; Ex parte Schipper* (1912) 107 LT 783; *Re Hooley* [1915] 84 LJ KB 181; *Re Nanwa Gold Mines Ltd* [1955] 1 WLR 1080 ('*Re Nanwa*'). *Quistclose Investments* (n 1) was, however, the first instance of the House of Lords' approval of these principles and has been described as the most authoritative: see Justice LJ Priestley, 'The Romalpa Clause and the Quistclose Trust' in PD Finn (ed), *Equity and Commercial Relationships* (LawBook, 1987) 217, 230.

not least due to the consequences of granting this form of proprietary relief to A in the case of B's insolvency.[3] This declaration allows A to step out of B's insolvency and thus gain effective priority[4] over B's unsecured creditors.[5] Although strictly speaking, a court's declaration of the existence of a proprietary interest does not impact the priority of claimants under any statutory scheme, it removes these assets from the pool of assets available for distribution to unsecured creditors under the relevant legislation. As a matter of practice, the impact on all parties is the same. In light of these significant consequences, this article focuses on the typical *Quistclose Investments* scenario where money is advanced on loan and the failure of purpose is due to the borrower's insolvency.

In his seminal article on the *Quistclose* trust, CEF Rickett suggested two competing philosophies underlying the trust, deemed the 'pure trusts law philosophy' and the 'remedial trusts law philosophy', noting that 'the future development and use of the *Quistclose* analysis will be determined by whichever philosophy gains the ascendancy'.[6] Since its publication in 1991, the preferred view in most jurisdictions has been the 'pure trusts law philosophy',[7] whereby the *Quistclose* trust is treated as institutional and compatible with orthodox trust principles. Throughout this article, the term 'institutional' is used to refer to trusts arising independently of any equitable remedial discretion exercised by the court. An 'institutional' trust', as the term is used here, therefore refers to express and resulting trusts which arise due to a party's intention to create a trust or lack of intention to pass beneficial title respectively. It would also encompass some sui generis trusts which are declared by the court without the exercise of any remedial discretion. This is in contrast to 'remedial' trusts

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3 Throughout this article, corporate insolvency language is used for ease of expression. However, the material impact of a court's declaration of a *Quistclose* trust is the same in circumstances of both corporate insolvency and personal bankruptcy. The money advanced does not form part of the assets available for distribution in insolvency and the lender is granted a proprietary interest in the form of a trust over the money lent, which is not yet used for the purpose specified: *Twinsectra Ltd v Yardley* [2002] 2 AC 164 ('*Twinsectra*'). Whilst there are some differences between the treatment of *Quistclose* trusts in personal bankruptcy and corporate insolvency — for example, as they relate to unlawful preferences — these are irrelevant for the purposes of this article.

4 For the purposes of this article, the term 'priority' is used in its practical sense when discussing the order of payments of creditors, regardless of whether their priority in distribution is a function of statute, a security interest, or grant of proprietary relief. This is in contrast to William Swadling's argument that the term 'priority' should be limited to discussion of creditors' claims under the relevant statutory insolvency scheme: William Swadling, 'Policy Arguments for Proprietary Restitution' (2008) 28(4) *Legal Studies* 506, 523–5.

5 The term 'unsecured creditors' is used throughout this article to include both voluntary creditors such as traditional lenders, and involuntary creditors such as tort claimants.

6 CEF Rickett, 'Different Views on the Scope of the Quistclose Analysis: English and Antipodean Insights' (1991) 107 (October) *Law Quarterly Review* 608, 608.

7 Emily Hudson, 'A Normative Approach to the *Quistclose* Trust' (2017) 80(5) *Modern Law Review* 775, 778–83.

including the remedial constructive trust, which involve an exercise of discretion in equity's remedial jurisdiction and are typically operative from the date of judgment rather than the happening of some event.[8] The argument advanced in Part III and IV of this article is that in cases involving insolvency, the declaration of a *Quistclose* trust has not reflected orthodox trust principles, and it is incorrect to view the *Quistclose* trust as a proprietary interest giving effect to the intention of the settlor. Instead, modern commercial realities and the practical application of the trust prove that the trust is better understood as remedial in nature.

In light of this finding, another potentially more difficult problem arises. Contemporary private law scholarship has attempted to develop a principled, normative basis for the award of proprietary remedies.[9] Thus, if *Quistclose* trusts are indeed proprietary remedies, conferring effective priority over the borrower's unsecured creditors, there must be some justification for granting this form of proprietary relief to lenders rather than restricting them to their contractual remedy in debt. Part V of this article suggests that there is none; the benefits achieved by maintaining the remedy fail to justify the prejudice caused to the borrower's other unsecured creditors. As such, the only suitable solution to maintain principle in the law of remedies is to abandon the *Quistclose* trust as a form of proprietary relief in insolvency.

## II *Quistclose* Trusts: General Principles and Regulation

The *Quistclose* trust arises in specific circumstances. When A advances money,[10] on loan or otherwise,[11] to B for a specific, identified purpose and B is unable to, or fails

8 See also Simon Evans, 'Defending Discretionary Remedialism' (2001) 23(4) *Sydney Law Review* 463; Michael Bryan, 'Constructive Trusts: Understanding Remedialism' in Jamie Glister and Pauline Ridge (eds), *Fault Lines in Equity* (Hart, 2012) 215.

9 Elise Bant, 'Trusts, Powers and Liens: An Exercise in Ground-Clearing' (2009) 3(3) *Journal of Equity* 286, 286–9; Elise Bant and Michael Bryan, 'A Model of Proprietary Remedies' in Elise Bant and Michael Bryan (eds), *Principles of Proprietary Remedies* (Thomson Reuters, 2013) 211, 214–17.

10 Courts have historically limited *Quistclose* analysis to money advances: see *Guardian Ocean Cargoes Ltd v Banco do Brasil SA* [1994] 2 Lloyd's Rep 152 (Saville LJ). See also Robert Chambers, 'Restrictions on the Use of Money' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) 77, 77. Cf Sarah Worthington, *Proprietary Interests in Commercial Transactions* (Clarendon Press, 1996). Worthington argues that any property transfer could be understood as giving rise to a *Quistclose* trust if other conditions are met: at 64.

11 This includes for pre-payment of goods and services: see, eg, *Re Kayford Ltd (in liq)* [1975] 1 All ER 604 ('*Kayford*'); *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd (in liq)* [1985] Ch D 207, 222 (Gibson J). There is some argument that *Kayford* and cases in its line of authority should not strictly be seen as *Quistclose* cases and instead should be explained in a separate analysis: see Rickett (n 6) 609; Gerard McCormack, 'Conditional Payments and Insolvency: The Quistclose Trust' (1994) 9(1) *Denning Law Journal* 93, 93 n 2.

to, perform that purpose, courts have held that the money advanced is held on trust by B for A. A court's declaration of the existence of a *Quistclose* trust thus confers on A a proprietary interest in the money instead of leaving them to their purely personal remedy in debt.

To better understand the nature of the *Quistclose* trust, it is important to appreciate the specific facts that formed the background of the House of Lords' decision. Briefly, Rolls Razor Ltd, at the time experiencing financial difficulties, declared a dividend in favour of its shareholders on 2 July 1964, with payment anticipated to occur on 24 July. To meet this newly created debt, Rolls Razor entered into an agreement to borrow money from Quistclose Investments on the condition that the money was to be used exclusively for payment of the dividend. The money was borrowed by Rolls Razor and deposited at Barclays Bank in a separate account, with notice given to Barclays Bank of the agreement with Quistclose Investments. On 17 July 1964, the directors of Rolls Razor resolved to put Rolls Razor into voluntary liquidation. The result of liquidation was an inability to pay the dividend until all other debts were paid since the shareholders were postponed to the unsecured creditors. Barclays Bank then sought to use the money in the separate dividend account to set-off pre-existing debts it was owed by Rolls Razor. Quistclose Investments brought an action against Barclays Bank, claiming that the money advanced was held on trust by Rolls Razor.[12]

At first instance, Plowman J limited the relationship between Quistclose Investments and Rolls Razor to a contractual debtor-creditor relationship without any further equitable obligations.[13] The Court of Appeal overturned Plowman J's decision, declaring that the money was held on trust and therefore separate from the general assets of Rolls Razor.[14] Since Barclays Bank was aware of their agreement, they were prevented from raising the bona fide purchase defence and thus could not effect a valid set-off of Rolls Razor's debts.[15] The Court of Appeal's decision was affirmed by the House of Lords.

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12 *Quistclose Investments* (n 1) 567–70 (Lord Wilberforce).

13 *Barclays Bank Ltd v Quistclose Investments Ltd* [1967] Ch 910, 929–31 (Plowman J).

14 *Barclays Bank Ltd v Quistclose Investments Ltd* [1968] 1 Ch 540.

15 Michael Bryan, 'The Liability of the Recipient: Restitution at Common Law or Wrongdoing in Equity?' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Lawbook, 2005) 327, 332–3. Cf *Thomson v Clydesdale Bank Ltd* [1893] AC 282. Glister argues that in situations involving insolvency set-off such as *Quistclose*, the good faith purchaser defence has no role to play. Instead, the statutory rules should prevail. Glister, however, acknowledges the House of Lords' acceptance of the applicability of the defence in *Quistclose Investments* (n 1): Jamie Glister, 'Trust Money and the Combination of Bank Accounts' (2018) 134 (July) *Law Quarterly Review* 478, 497.

The classification of the *Quistclose* trust as either express, resulting, constructive, or sui generis[16] has consumed most academic and judicial debate since the initial decision recognising its existence.[17] The preferred view in Australia seems to be that the *Quistclose* trust can be explained on express trust principles.[18] Importantly, however, this is not unanimous, and in the absence of a decision of the High Court of Australia providing clarification,[19] some superior courts still prefer a resulting trust analysis in line with Lord Millett's decision in *Twinsectra Ltd v Yardley* ('*Twinsectra*').[20]

The circumstances in *Quistclose Investments*, whereby a lender advances money for use in paying other creditors, provides the most common fact scenario which has given rise to a *Quistclose* trust.[21] However, courts have also found the existence of *Quistclose* trusts where money is advanced for other purposes, including to purchase equipment,[22] subscribe for shares,[23] pre-purchase goods,[24] and upon failure of a

16 The position that the *Quistclose* trust is a sui generis trust is the least common of these views: see, eg, Jennifer Payne, '*Quistclose* and Resulting Trusts' in Peter Birks and Francis Rose (eds), *Restitution and Equity Volume 1: Resulting Trusts and Equitable Compensation* (Routledge, 2000) 77.

17 Hudson (n 7) 775. Glister argues that there is no single 'correct answer' to this question and the classification of the trust is dependent on the circumstances: JA Glister, 'The Nature of *Quistclose* Trusts: Classification and Reconciliation' (2004) 63(3) *Cambridge Law Journal* 632, 633 ('Nature of *Quistclose* Trusts').

18 See, eg, *Salvo v New Tel Limited* [2005] NSWCA 281, [32]–[53] (Spigelman CJ) ('*Salvo*'); *Legal Services Board v Gillespie-Jones* (2013) 249 CLR 493, 523–7 [112]–[127] (Bell, Gageler and Keane JJ) ('*Legal Services Board*'); *Raulfs v Fishy Bite* [2012] NSWCA 135, [44]–[55] (Campbell JA) ('*Fishy Bite*'); Michael Bryan et al, *A Sourcebook on Equity & Trusts in Australia* (Cambridge University Press, 2016) 505.

19 The nature of the *Quistclose* trust was discussed by the High Court of Australia in *Legal Services Board* (n 18). However, the discussion of the classification was made in obiter, and as Elise Bant suggests, the nomenclature of *Quistclose Investments* (n 1) added nothing of value to the Court's analysis; the circumstances clearly gave rise to an express trust. It still remains unclear how the High Court will apply *Quistclose Investments* (n 1) where the circumstances are not so amenable to straightforward express trust analysis: Elise Bant, 'Thieving Lawyers: Trust and Fidelity in the High Court: *Legal Services Board v Gillespie-Jones*', *Opinions on High* (Blog Post, 16 August 2013) <https://blogs.unimelb.edu.au/opinionsonhigh/2013/08/16/bant-gillespie-jones/>.

20 *Twinsectra* (n 3). See, eg, *Salvo* (n 18) [76]–[78] (Handley JA); *McManus RE Pty Ltd v Ward* (2009) 74 NSWLR 662, 667 [25] (Palmer J); *Adam v Hasabo* [2019] NSWSC 1167, [252] (Robb J).

21 Richard Hedlund and Amber Lavinia Rhodes, 'Loan or Commercial Trust? The Continuing Mischief of the Quistclose Trust' (2017) 4(1) *Conveyancer and Property Lawyer* 254, 260–2.

22 *Re EVTR Ltd* (1987) 3 BCC 389 ('*Re EVTR*').

23 *Re Associated Securities Ltd* [1981] 1 NSWLR 742.

24 *Kayford* (n 11).

managed investment scheme.[25] The unifying feature of all these circumstances is a finding that the money, once advanced, was 'earmarked' for some specific purpose.[26] Whilst the law has tended to treat all circumstances giving rise to the trust similarly, as Richard Hedlund and Amber Rhodes note, there is no clear justification for this uniform approach.[27]

A court's declaration of a *Quistclose* trust, transforming a loan arrangement into a trust relationship, has been described by Lord Millett as the 'single most important application of equitable principles in commercial life'.[28] This is no more evident than in situations where the failure of purpose is a result of insolvency. By 'ring-fencing' the money advanced,[29] it is said that the lender does not take the risk of the borrower's insolvency, and is thus entitled to proprietary restitution of the money advanced upon a failure of purpose.[30] The *Quistclose* trust thus confers effective priority to the lender over the borrower's unsecured creditors by removing the money from the pool of assets available to the liquidator,[31] and as a matter of practice, allows the lender to

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25 *Bellis v Challinor* [2015] EWCA Civ 59.

26 Hedlund and Rhodes (n 21) 254. Some commentators have argued that there is no reason in principle to limit the purposes for which *Quistclose* trusts will arise: see, eg, JD Heydon, MJ Leeming and SK Jacobs, *Jacobs' Law of Trusts in Australia* (LexisNexis Butterworths, 8th ed, 2016) 15 [2]–[16]; Robert Chambers, 'Conditional Gifts' in Norman Palmer and Ewan McKendrick (eds), *Interests in Goods* (Taylor & Francis Ltd, 1st ed, 1993) 429, 445; James Alexander Glister, 'Quistclose Trusts: Theory and Context' (MJur Thesis, Durham University, 2003) 10–11 ('Quistclose Trusts'). Cf *Re Associated Securities Ltd and the Companies Act* [1981] 1 NSWLR 742, 749–50 (Needham J); *Re Miles* (1988) 20 FCR 194, 199 (Pincus J) ('*Re Miles*'); William Swadling, 'A New Role for Resulting Trusts?' (1996) 16(1) *Legal Studies* 110, 122. Whilst there has been significant discussion on the types of purposes giving rise to *Quistclose* trusts, the required degree of specificity or clarity of the purpose is still unclear: see Robert Chambers, *Resulting Trusts* (Oxford University Press, 1997) 86; *Twinsectra* (n 3) 192 [99] (Lord Millett).

27 Hedlund and Rhodes (n 21) 254.

28 Lord Millett, 'Foreword' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) vii, vii.

29 The term 'ring-fencing' refers to the separation of some of a company's financial assets from the rest, typically in order to ensure they are not available for distribution in the case of the company's insolvency.

30 *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072, 1074 (Lord Templeman). This is not to say that the *Quistclose* trust is currently understood as a proprietary response to unjust enrichment due to a failure of consideration. Such a classification of the *Quistclose* trust has been rejected in Zhuang WenXiong, 'The (*Quistclose*) Resulting Trust as a Proprietary Response to Unjust Enrichment: A Bridge Too Far?' (2014) 26(2) *Singapore Academy of Law Journal* 649, 675–81.

31 As is true for all equitable proprietary interests: see Ben McFarlane and Robert Stevens, 'The Nature of Equitable Property' (2010) 4(1) *Journal of Equity* 1, 1; *Bankruptcy Act 1966* (Cth) s 116(2)(a) ('*Bankruptcy Act*'); *Re Stansfield DIY Wealth Pty Ltd (in liq)* (2014) 291 FLR 17; Peter Watts, 'Constructive Trusts and Insolvency' (2009) 3(3) *Journal of Equity* 250, 252–4.

receive the entirety of their money advanced less any recovery costs.[32] The lender is transformed from an unsecured creditor participating in pari passu distribution from the pool of assets not subject to security interests, to a beneficiary under a trust.[33] Lord Millett described this result as 'the whole purpose of [*Quistclose*] arrangements … to prevent the money from passing to the borrower's [liquidator] in the event of his insolvency'.[34] This classification also provides lenders with the ability to make *Barnes v Addy*-type claims in particular circumstances involving third party liability for breach of trust.[35]

The regulation of *Quistclose* trusts in Australia remains potentially problematic. *Quistclose* trusts are explicitly excluded from registration under the *Personal Property Securities Act 2009* (Cth) ('*PPSA*').[36] Section 8(1)(h) states that the *PPSA* does not apply to

> a trust over some or all of an amount provided by way of financial accommodation, if the person to whom the financial accommodation is provided is required to use the amount in accordance with a condition under which the financial accommodation is provided.[37]

Prioritising certainty by subjecting *Quistclose* trusts to an express exclusion from the *PPSA* remains problematic for two reasons. First, the factual scenarios giving rise to their existence are still evolving and whether money can be said to be held on *Quistclose* trust often requires judicial determination.[38] Second, the lack of registration requirements has the potential to result in situations of 'ostensible ownership', whereby the true equitable ownership of the money advanced is unknown to

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32 If some money advanced has been correctly applied, this is not recoverable; only the portion which is yet to be applied prior to the failure of purpose is recoverable: see *Re EVTR* (n 22).

33 Malcolm Cope, *Proprietary Claims and Remedies* (Federation Press, 1997) 2–6. The impact on recovery is tremendous; in the context of personal bankruptcies in Australia, in 2018–19, unsecured creditors received an average of 1.84 cents per dollar owed: see 'Rate of Return', *Australian Financial Security Authority* (Web Page) <https://www.afsa.gov.au/about-us/statistics/rate-return>.

34 *Twinsectra* (n 3) 187–8 [82] (Lord Millett).

35 *Barnes v Addy* (1874) LR 9 Ch App 244. See also Heydon, Leeming and Jacobs (n 26) 12 [2]–[14]. Briefly, *Barnes v Addy* held that third parties could be held liable for breach of trust in two circumstances, either where they knowingly received trust property in breach of trust conditions or knowingly assisted in the breach of trust.

36 Glister provides an overview of the regulation of trusts under the *PPSA*: Jamie Glister, 'The Role of Trusts in the *PPSA*' (2011) 34(2) *University of New South Wales Law Journal* 628.

37 *Personal Property Securities Act 2009* (Cth) s 8(1)(h) ('*PPSA*').

38 Ying Khai Liew, 'The Wider Ambit of the *Quistclose* Doctrine' (2015) 9(1) *Journal of Equity* 66, 72–3.

third parties.[39] Together, the impact of these two problems may leave creditors unaware of the existence of a *Quistclose* lender's equitable interest either when they are lending or once they are participating in distribution during insolvency proceedings. This 'ostensible ownership' issue for trusts is generally understood as problematic,[40] and in light of the express exclusion in s 8(1)(h) of the *PPSA*, these concerns are exacerbated in the specific circumstances giving rise to *Quistclose* trusts.

## III Intention: The Classical Justification

Since the decision in *Quistclose Investments*, there remains some debate concerning whether *Quistclose* arrangements are better explained under a pure trusts law philosophy or remedial trusts law philosophy.[41] The prevailing view, held by both courts and academic lawyers, is one that prefers pure trusts law philosophy, characterising *Quistclose* trusts as facilitative devices which give effect to the lender's intention.[42] If this view is correct, Jamie Glister suggests that '[a]s long as the necessary intention to create a trust can be inferred from the parties' agreement, there is no reason to deny them the relationship that they objectively intended'.[43] However, since declaring the existence of a *Quistclose* trust in commercial settings requires a departure from the curial reticence against imposing trustee obligations on a party to a commercial contract,[44] the requisite intention must be clearly ascertainable. Whilst Australian courts have reflected this position by expressing concerns about adopting a liberal approach to finding intention,[45] the absence of significant Australian case law applying *Quistclose Investments* leaves the position unclear.

The problems with understanding the degree and nature of intention required to justify a *Quistclose* trust are many, not least due to disagreement between academics and inconsistent application by courts. Courts in their application of

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39 Jeffrey Helman, 'Ostensible Ownership and the Uniform Commercial Code' (1978) 83(1) *Commercial Law Journal* 25, 25.

40 See Michael JR Crawford, 'The Case against the Equitable Lien' (2019) 42(3) *Melbourne University Law Review* 813, 823–4; Arthur Chan, 'The Tree That Was Not Meant to Be: The Quistclose Trust Moving On from the Twinsectra Model and Why It May Never Be an Established Transactional Arrangement' (2015) 9(1) *Hong Kong Journal of Legal Studies* 1, 23–4 ('The Tree That Was Not Meant to Be'); *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 704–5 (Lord Browne-Wilkinson) ('*Westdeutsche Landesbank Girozentrale*').

41 Rickett (n 6) 608.

42 Craig Rotherham, *Proprietary Remedies in Context: A Study in the Judicial Redistribution of Property Rights* (Bloomsbury, 2002) 160–1; Liew (n 38) 81; *Salvo* (n 18) [32]–[53] (Spigelman CJ); *Legal Services Board* (n 18) 523–7 [112]–[127] (Bell, Gageler and Keane JJ); *Fishy Bite* (n 18).

43 Glister, 'Nature of *Quistclose* Trusts' (n 17) 645.

44 *Polly Peck International plc v Nadir [No 2]* [1992] All ER 769, 782 (Scott LJ).

45 See, eg, *Re Miles* (n 26) 198–9 (Pincus J).

*Quistclose Investments* have considered the intention of the lender alone,[46] the borrower alone,[47] and mutual intention.[48] Whilst Lord Wilberforce understood the circumstances in *Quistclose Investments* as evincing a mutual intention to create a trust, Fiona Burns notes that the concept of mutual intention is not necessarily applicable in every case invoking *Quistclose Investments*.[49] In any case, it remains unclear why the intention of the borrower is relevant in any express or resulting trust analyses.[50] Whilst in most commercial lending situations, a written contract will stipulate the nature of money advanced, including the relationship between the debtor and creditor, and therefore there will be some mutual intention evinced in the contract, it is only the settlor's intention which is relevant to the creation of a trust over their rights.[51] Therefore, the role of mutual intention remains unclear. Glister has argued directly against the existence of a mutual intention requirement and instead suggested that the intention of the transferor and recipient should be considered separately.[52] Further, whilst intention plays different roles in express and resulting trust analyses of *Quistclose Investments*, the differences are immaterial in the context of commercial loan cases; Glister suggests that an investigation of party intention under either an express or resulting trust model will lead to the same result.[53] In light of this confusion, if intention is used to justify a proprietary claim for the return of money, the nature of the intention required to be shown must warrant this result. Whilst courts have tended to place significant weight on the segregation of funds to draw inferences of intention,[54] this requirement is not

46 See, eg, *George v Webb* [2011] NSWSC 1608, [210] (Ward J).

47 See, eg, *Kayford* (n 11) 607 (Megarry J). Relying on the intention of the borrower seems to lead to absurd results; the customers in *Kayford* (n 11) did not transfer the money with the intention or knowledge it would be held on trust, but it was nonetheless done so due to the actions of the supplier, arguably in an unlawful preference: at 607. See also William Goodhart and Gareth Jones, 'The Infiltration of Equitable Doctrine into English Commercial Law' (1980) 43(5) *Modern Law Review* 489, 496–7.

48 *Quistclose Investments* (n 1) 580 (Lord Wilberforce).

49 Fiona R Burns, 'The Quistclose Trust: Intention and the Express Private Trust' (1992) 18(2) *Monash University Law Review* 147, 161.

50 McCormack attempts to reconcile this with the perspective that considers the intention of the settlor. He argues that since intention is considered objectively, what the lender intended must have been accepted by the borrower when entering into the loan agreement: see McCormack (n 11) 112. See also Rickett (n 6) 618.

51 Heydon, Leeming and Jacobs (n 26) 50 [502].

52 Jamie Glister, 'Mutual Intention and *Quistclose* Trusts' (2012) 6(3) *Journal of Equity* 221.

53 Ibid 236.

54 See, eg, *Re Goldcorp Exchange Ltd (in receivership)* [1995] 1 AC 74, 100 (Lord Mustill); *Re Nanwa* (n 2) 1084 (Harman J). Interestingly, the House of Lords did not place *significant* weight on the fact that the loan was paid into a separate bank account: *Quistclose Investments* (n 1) 571 (Lord Wilberforce); Michael Bryan and M P Ellinghaus, 'Fault Lines in the Law of Obligations: *Roxborough v Rothmans of Pall Mall Australia Ltd*' (2000) 22(4) *Sydney Law Review* 636, 664.

necessarily determinative,[55] and is better viewed as informing performance rather than creation of the trust.[56] Similarly, as Sue Tappenden emphasises, a stipulation on the use of funds provides no insight into the intention of the lender,[57] and many cases have involved a money transfer subject to a condition that was not held to create a trust.[58] Robert Chambers argues that the intention required to be proven to justify imposing a *Quistclose* trust is not a positive intention to retain the beneficial title, but rather the absence of the lender's intention to benefit the borrower by keeping the beneficial ownership of the money for any purpose other than the one specified.[59] In the two-party scenarios that dominate *Quistclose* cases, James Penner describes the distinction articulated by Chambers as 'almost scholastic in its unreality'.[60] He notes:

> What, in a two party case where *A* transfers property to *B*, genuinely distinguishes *A*'s intention that he retain the beneficial interest from *A*'s intention only that *B* should not have it? … [I]t seems clear that the exclusion of an interest for one party necessarily dictates that it rests with the other.[61]

Sarah Worthington argues instead that there must be a positive intention to create a trust but recognises that it is typically inferred by courts.[62] The difference between the two perspectives is immaterial as it applies to the scenarios concerned in this article for two reasons. First, most scenarios that satisfy one requirement will also satisfy the other. Second, and more importantly, neither of these requirements are clearly available on the facts of the leading *Quistclose* trust cases.

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55 Glister argues that placing undue weight on the segregation of funds conflates the intention to segregate and the fact of segregation when inferring intention to create a trust, which is assessed prospectively at the time of the advance: see Jamie Glister, '*Twinsectra v Yardley*: Trusts, Powers and Contractual Obligations' (2002) 16(4) *Trust Law International* 223, 230; Glister, 'Quistclose Trusts' (n 26) 5. See also *Kayford* (n 11) 607 (Megarry J).

56 *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liq)* (2000) 202 CLR 588, 605–6 [34]–[35] (Gaudron, McHugh, Gummow and Hayne JJ); Glister, 'The Role of Trusts in the *PPSA*' (n 36) 641.

57 Sue Tappenden, 'Commercial Equity: The *Quistclose* Trust and Asset Recovery' (2009) 2(3) *Journal of Politics and Law* 11, 13.

58 See, eg, *Re Osoba* [1979] 1 WLR 247.

59 Chambers, *Resulting Trusts* (n 26) 84–5. There is some argument that technically there cannot be a transfer of legal title whilst retaining beneficial title, since, at the time of transfer, there is no separate beneficial ownership. Prior to the transfer, the lender does not hold separate legal and beneficial title but rather has full ownership. The separation occurs upon a transfer of complete title and an instant transfer-back of beneficial title: see *Re Bond Worth Ltd* [1980] Ch 228, 244–7 (Slade J).

60 James Penner, 'Lord Millett's Analysis' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) 41, 53 n 37.

61 Ibid (emphasis in original).

62 Worthington (n 10) 51–2.

### 1 *Quistclose Investments*

Consider the case of *Quistclose Investments* itself. Quistclose Investments was not an independent entity. Instead, its shares were owned by John Bloom, who remained chairman of Rolls Razor.[63] Prior to the advance from Quistclose Investments, attempting to avoid the need to invest his own funds, Bloom had been in negotiations with Sir Isaac Wolfson to gain financing for Rolls Razor. However, as a pre-condition of Wolfson's financing, Rolls Razor was required to pay all pre-declared dividends.[64] These facts, Emily Hudson argues, are more indicative of an intention for Bloom to hastily enter into loan contracts in order to keep the potential for Wolfson's financing on foot rather than form any trust relationship.[65] Further, to find a mutual intention, the Court also looked to the documentation exchanged between the three parties, Quistclose Investments, Rolls Razor, and Barclays Bank. These documents provided instructions, including the purpose of the loan and the requirement to separate funds into a newly opened account.[66] However, as Hudson notes, this documentation was simply sighted by Quistclose Investments; the documentation was made to record communications between Rolls Razor and Barclays Bank.[67] The Court, however, failed to consider the significance of this difference, and instead imputed mutual intention as if the documentation was indicative of Quistclose Investment's intention.[68] It remains unclear how, on these facts alone, there was sufficient evidence to show that Quistclose Investments did not intend to transfer the beneficial title to money to Rolls Razor in *all* situations *except* when it was used for the payment of the declared dividend. As Michael Smolyansky argues, there is a degree of artificiality in finding that the complex, two-pronged trust arrangement found by Lord Wilberforce is simply inferred from the mutual intention of the parties on these facts.[69] It remains unlikely that an intention to create a trust or retain beneficial title can be inferred without relying on assumptions about the behaviour of rational, independent corporate entities, which is not descriptive of the parties involved in *Quistclose Investments*.[70]

### 2 *Twinsectra*

*Twinsectra* provides an even clearer example of the failure of the lender to demonstrate an intention not to part with the beneficial title or create a trust over the money

63 Robert Stevens, 'Rolls Razor Ltd' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) 1, 5.

64 Ibid; *Quistclose Investments* (n 1) 568 (Lord Wilberforce).

65 Hudson (n 7) 784.

66 *Quistclose Investments* (n 1) 580 (Lord Wilberforce).

67 Hudson (n 7) 784–5.

68 Ibid 785.

69 Michael Smolyansky, 'Reining in the *Quistclose* Trust: A Response to *Twinsectra v Yardley*' (2010) 16(7) *Trusts & Trustees* 558, 559.

70 Hudson (n 7) 785.

advanced.[71] There, Yardley sought bridging finance of £1 million from a bank for the purchase of land. Concerned by delays, Yardley sought alternate financing from Twinsectra, who provided the loan, requiring only a solicitor's personal undertaking to repay the loan.[72] Unable to obtain this undertaking from his usual lawyer, Yardley approached another solicitor, Sims, who willingly agreed to the personal undertaking. Sims provided a written agreement to retain the money until it was applied for the purchase of property by Yardley, noting 'the loan monies will be utilised for the acquisition of property on behalf of our client [Yardley] and for no other purposes'.[73] The money was then transferred by Sims to Yardley and used by Yardley for various purposes outside the agreement, including to pay pre-existing creditors. Soon after this misuse of money, Sims went bankrupt, and Twinsectra was never repaid their loan.[74] Twinsectra brought proceedings claiming the money advanced was held on *Quistclose* trust.

Detailed consideration of these facts points against any intention to form a trust or retain beneficial title. First, there was no requirement to segregate the money advanced like in *Quistclose Investments*, nor any use of the language of trusts. Whilst neither of these are required, they suggest a failure on the part of Twinsectra to take steps to create a trust over the money advanced.[75] As Smolyansky suggests, if a trust was truly intended, it is inconceivable that a commercial lending entity such as Twinsectra simply omitted any mention of a retention of title limitation.[76] Second, the purpose described in the contract, 'acquisition of property', was vague and failed to identify the specific land discussed in negotiations. This implies no requirement for Twinsectra to constrain the use of funds in any material way and instead suggests that the money was treated as a typical unsecured loan guaranteed by Sims.[77] This is compounded in light of the high interest rate of 24%, reflecting the riskiness of the loan for Twinsectra. Arguably, if Twinsectra retained beneficial ownership, the loan would be significantly less risky, and a 24% interest rate would not be justified;[78] Yardley could have sought cheaper financing elsewhere. Lastly, and possibly the clearest indication of a lack of requisite intention, was the trial judge's finding that Twinsectra believed the loan was 'secured' solely by Sims' personal undertaking and not any form of security over property or through a trust.[79] Given Twinsectra was a commercial lender, it is difficult to argue that it intended to retain beneficial title or create a trust over the money advanced, but failed to make this explicit in the loan agreement. Instead, all indicia point to an unsecured loan protected by a high interest rate and a solicitor's personal undertaking.

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71 Ibid.

72 *Twinsectra* (n 3) 168 [9]–[10] (Lord Hoffmann).

73 Ibid 168 [9] (Lord Hoffmann).

74 Ibid 168 [10]–[11] (Lord Hoffmann).

75 Hudson (n 7) 787.

76 Smolyansky (n 69) 561–2.

77 Hudson (n 7) 787.

78 Smolyansky (n 69) 562.

79 *Twinsectra Ltd v Yardley* [2000] Lloyd's Rep PN 239, 255 (Potter LJ).

### 3 *Re EVTR*

Lastly, consider *Re EVTR Ltd* ('*Re EVTR*').[80] Mr Barber, a previous employee of EVTR, provided financial assistance to EVTR for the purchase of equipment. EVTR was, at the time, experiencing financial difficulties. Barber paid £60,000 to EVTR's solicitor and provided in writing an instruction that the money should only be released for the 'sole purpose of buying new equipment'.[81] EVTR used Barber's money, alongside other financing, to purchase equipment, but before the transaction was completed, a receiver was appointed.[82]

In deciding that the money was held on *Quistclose* trust by EVTR for Barber, two different approaches were adopted. Lord Justice Bingham invoked the language of fairness, noting that it would 'strike most people as very hard if Mr Barber were in this situation to be confined to a claim as an unsecured creditor of the company'.[83] The judgment avoided many doctrinal concerns about the intention of the parties to the transaction and seems to extend *Quistclose* trust analysis beyond a pure trusts law understanding,[84] and into the realm of constructive trusts.[85] Michael Bridge argues that the court's imposition of a *Quistclose* trust in the case was a direct attempt to ensure Barber retained some remedy against EVTR, due to the Court's perceived unfairness of requiring him to join unsecured creditors in distribution.[86] The more conventional approach of grounding the *Quistclose Investments* declaration in intention was adopted by Dillon LJ.[87] However, similar to the above analysis of *Twinsectra*, a number of factors point against a finding of intention. First, Barber was advised by accountants and even monitored EVTR through regular board meeting attendance. Initially, the transaction was structured for Barber to purchase the equipment himself and lease it to EVTR, although changes in circumstances necessitated the latter arrangement be adopted.[88] It would seem odd that in light of this, Barber had an intention to retain beneficial title or create a trust but failed to take active steps to make this explicit.[89] Second, the trial judge found that it was in Barber's contemplation that upon advancing the money, he would be a 'loan creditor of the company' and that he failed to give any thought to his position if the purpose of

80 *Re EVTR* (n 22) 390–2 (Dillon LJ).

81 Ibid 392 (Dillon LJ).

82 Ibid 391–2 (Dillon LJ).

83 Ibid 394 (Bingham LJ).

84 Justice Bingham, as he then was, expressed similar observations of the operation of *Quistclose* trust in *Neste Oy v Lloyd's Bank Plc* [1983] 2 Lloyds Rep 658, 665–6 (Bingham J).

85 Hudson (n 7) 797–9.

86 Michael Bridge, 'The *Quistclose* Trust in a World of Secured Transactions' (1992) 12(3) *Oxford Journal of Legal Studies* 333, 354.

87 *Re EVTR* (n 22) 393–4 (Dillon LJ).

88 Ibid 390 (Dillon LJ).

89 Smolyansky (n 69) 561–2.

the loan failed.[90] This seems to contradict any finding that Barber actually intended to create a trust, particularly when he held a belief that he would be an unsecured creditor and did not take steps to take security or explicitly declare a trust. Lastly, prior to advancing money, Barber also participated in a capital restructure of EVTR, purchasing £40,000 worth of shares in a holding company tasked with taking over EVTR.[91] Thus, given he was willing to take on risk in the company through equity ownership, it can be inferred that he did not actively consider the possibility of a failure of purpose and the need to protect his debt position using a trust.

Thus, it is clear that courts' analyses of *Quistclose* trusts do not reflect orthodox trust law principles. The only way these principles have been maintained is, as Hudson suggests, by hiding a normative judgment that the money advanced should be returned behind a liberal and potentially unprincipled approach to finding intention through an unrealistic interpretation of the facts.[92] As Elise Bant and Michael Bryan assert, 'if on a proper construction of a loan agreement the parties have allocated the risk of borrower failure, a court has no business imposing on them its own assumptions as to risk-sharing'.[93] Perhaps, therefore, the better view is to recognise the explanation of *Quistclose* trusts provided by remedial trusts law philosophy, which would allow courts to be explicit in their normative discussion, rather than apply unprincipled standards to ensure particular fact scenarios fit within orthodox trust principles when they are not suitable.

## IV Institutional or Remedial?

In light of the proven difficulties of finding intention in *Quistclose Investments* scenarios, a significant question arises: are *Quistclose* trusts, as they apply to lenders upon a borrower's insolvency, really institutional, or are they better understood as remedial? The prevailing view, under both the express and resulting trust models, characterises *Quistclose* trusts as institutional.[94] That is, the trust arises upon the happening of some event,[95] not at the date of judgment. In this Part, I argue that the institutional approach fails to recognise the practical nature of the *Quistclose* trust, particularly as it is currently invoked by lenders in an attempt to bypass pari passu distribution upon the borrower's insolvency. In these circumstances, the *Quistclose*

90 *Re EVTR Ltd* (1987) 3 BCC 382, 388 (Michael Wheeler QC).

91 *Re EVTR* (n 22) 390 (Dillon LJ).

92 Hudson (n 7) 783–91.

93 Elise Bant and Michael Bryan, 'Constructive Trusts and Equitable Proprietary Relief: Rethinking the Essentials' (2011) 5(3) *Journal of Equity* 171, 196 ('Constructive Trusts and Equitable Proprietary Relief').

94 Hudson (n 7) 778–83.

95 Under Lord Wilberforce's two express trust analysis, the first trust arises when money is advanced and the second arises upon a failure of purpose. Lord Millett's resulting trust analysis suggests the one and only trust arises upon a failure of purpose, and that no trust exists after money has been advanced while the purpose is still capable of being performed: Smolyansky (n 69) 559, 562.

trust has no utility as an institutional trust and is much better understood in substance as remedial. This is not to say that the strict legal characterisation of the trust should be as a remedial constructive trust,[96] but rather that its practical impact in cases of insolvency should be understood as achieving a similar result. I recognise at the outset, the taxonomical concerns that may arise by drawing parallels between the *Quistclose* trust and a remedial constructive trust *only* in situations of insolvency. However, the purpose of doing so is not to provide any substantive discussion in the well-trodden classification debate,[97] but rather to recognise that any normative arguments for or against the maintenance of the trust in insolvency should be considered in light of its reality as a grant of proprietary relief.[98] This is because, as Rhodes emphasises, 'there is a fundamental difference between rights which are *upheld* on insolvency and rights which are … *imposed* on a party at a later point in time'.[99]

The prevailing view of *Quistclose* trusts fails to recognise their practical nature. Commercial realities suggest that there is rarely ever an intention to create an express trust in cases where a *Quistclose Investments* analysis is invoked.[100] This is evident in the fact that commercial loan documents in *Quistclose* trust cases rarely, if ever, use the language of trusts.[101] Whilst use of the language of trusts is not a prerequisite for the creation of a trust,[102] it is difficult to argue that sophisticated lenders who consider the risks of insolvency in lending practice have overlooked the need to include specific language where a trust is actually intended to be created.[103]

Further, as Ewan McKendrick suggests, lenders are almost always in a better situation if they choose to take traditional forms of security, such as a mortgage or charge, instead of relying on a *Quistclose* trust as a form of quasi-security.[104] Similarly, Doug Fawcett, discussing the application of *Quistclose Investments* in Canadian jurisprudence, suggests that lenders should structure transactions so as to

96 The constructive trust approach to classification has received far less attention than the express/resulting debate. However, it has received some acceptance in New Zealand and the United States: see *Dines Construction Ltd v Perry Dines Corp Ltd* (1989) 4 NZCLC 65, 298 (Ellis J); *In re Jones* 50 Bankr 911, 921–3 (Michael A McConnell) (Bankr ND Tex, 1985). There exists only limited discussion of the classification of *Quistclose* as constructive in Australia: see *Smith v Western Australia* [2009] WASC 189, [78] (McKechnie J).

97 See generally Glister, 'Nature of *Quistclose* Trusts' (n 17).

98 See below Part V.

99 Amber Lavinia Rhodes, 'The Quistclose Trust's Detrimental Effect on Commercial Transactions' (2013) 27(4) *Trust Law International* 179, 181 (emphasis in original).

100 Ewan McKendrick, 'Commerce' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) 145, 148; Liew (n 38) 69.

101 McKendrick (n 100) 150–1.

102 *Re Armstrong* [1960] VR 202; *Byrnes v Kendle* (2011) 243 CLR 253, 290 [114]–[115] (Heydon and Crennan JJ) ('*Byrnes*').

103 Hudson (n 7) 795.

104 McKendrick (n 100) 148.

avoid over-reliance on *Quistclose*-style quasi-security.[105] As such, the value of the *Quistclose* trust is not as an institutional trust but rather as a proprietary remedy for a lender to gain priority in the case of a borrower's insolvency. Empirical analysis highlights this phenomenon: *Quistclose Investments* is invoked predominantly when a lender attempts to recover money advanced in a priority dispute with an insolvent borrower's unsecured creditors.[106] McKendrick thus describes *Quistclose* trusts in the context of modern commercial practice as 'residual device(s)'.[107] Further, not all failures of purpose provide a reason for lenders to invoke *Quistclose Investments*. Where the failure of purpose is not a function of insolvency and the borrower remains solvent, lenders will be satisfied with a personal remedy for payment of debt.[108] There is no need in these situations to attempt to make the difficult argument of applying *Quistclose Investments* to the specific circumstances.

The confusion relating to the location of the beneficial interest in a *Quistclose Investments* transaction limits the utility of the trust prior to insolvency. Commentators have argued that the beneficial ownership of money advanced in a *Quistclose Investments* transaction remains with the lender,[109] passes to the borrower,[110] or extends to the third parties who are identified in the purpose of the transaction.[111] Even if the better view is that the beneficial ownership remains with the lender, the lender's rights as a beneficiary under the trust are extremely limited. The lender is in no position to require the transfer back of the trust property under *Saunders v Vautier* principles.[112] This would clearly be inconsistent with the original loan contract under which money was advanced.[113] Resultantly, the value of a *Quistclose* trust only arises

105 Doug Fawcett, 'Quistclose Trust: Security (or Additional Security) for a Loan Transaction' (2013) 32(2) *Estates, Trusts & Pensions Journal* 138, 154–5.

106 McKendrick (n 100) 146. The other key category of cases where *Quistclose Investments* is raised is in taxation and entitlement cases: see, eg, *Morley-Clarke v Jones (Inspector of Taxes)* [1986] Ch 311.

107 McKendrick (n 100) 152.

108 RM Goode, 'Is the Law Too Favourable to Secured Creditors?' (1983) 8(1) *Canadian Business Law Journal* 53, 56.

109 Bridge (n 86) 352.

110 Chambers, *Resulting Trusts* (n 26) 73–8.

111 PJ Millett, 'The Quistclose Trust: Who Can Enforce It?' (1985) 101 (April) *Law Quarterly Review* 269, 290.

112 (1841) 4 Beav 115; 49 ER 282. Briefly, the rule in *Saunders v Vautier* notes that beneficiaries may require a trustee to transfer trust property to them at any time and thereby terminate the trustee-beneficiary relationship. For a general discussion on the conflicting perspectives of the applicability of *Saunders v Vautier* powers in *Quistclose* scenarios, see Chan, 'The Tree That Was Not Meant to Be' (n 40) 8–11.

113 William Swadling, 'Orthodoxy' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) 9, 28; Cope (n 33) 47–8. Glister, however, argues that this analysis fuses contractual and proprietary obligations and that separating these with the caveat that proprietary obligations trump contractual obligations provides a better understanding: Glister, 'Quistclose Trusts' (n 26) 20–5. Similar arguments are expressed in Janet Ulph, 'Equitable Proprietary Rights in Insolvency: the Ebbing

upon failure of purpose due to insolvency, by allowing lenders to gain priority over unsecured creditors.[114] Prior to insolvency, as Donovan Waters notes, the trust is simply 'a holding device pending the taking effect of the loan or sale'.[115] Essentially, the trust has no value until either the loan money is applied successfully, where the trust will fall away, or the loan money is misapplied, where the Court will deem it to be held on trust for the lender.

Rhodes argues that the court's declaration of the existence of a *Quistclose* trust is only useful insofar as it clarifies to third parties the existence of an equitable proprietary interest over the money from the date of judgment.[116] This is particularly so under the *Twinsectra* resulting trust model. A finding of implied intention to justify imposing a resulting trust requires the court to retrospectively define the nature of the loan arrangement well after the money is initially advanced. Whilst Rhodes notes that there is no inherent problem with equity imposing proprietary interests after the original disposition of property,[117] *Quistclose* scenarios are uniquely unsuited to this grant since they fail to locate the beneficial interest during the period between money transfer and judicial proceedings. Rhodes' characterisation would allow parties such as Barclays Bank (in *Quistclose Investments* itself) to set-off against money later declared to be held on *Quistclose* trust, given it would not be characterised as trust property until judicial intervention. Such an understanding would thus be inconsistent with the availability of claims against third parties for breach of *Quistclose* trusts. However, as a matter of form, the practical impact in scenarios involving insolvency is simply that which flows after judgment by preferring the *Quistclose* lender to the borrower's other unsecured creditors. This conclusion, as to the remedial nature of *Quistclose* trusts highlights its similarities with the remedial constructive trust as understood in modern Australian jurisprudence. Justice Deane in *Muschinski v Dodds* ('*Muschinski*'), discussing the nature of constructive trusts stated:

> [T]he constructive trust can properly be described as a remedial institution which equity imposes regardless of actual or presumed agreement or intention (and subsequently protects) to preclude the retention or assertion of beneficial ownership of property to the extent that such retention or assertion would be contrary to equitable principle.[118]

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Tide?' [1996] (September) *Journal of Business Law* 482, 494. However, the better view seems to be that whilst the lender is in theory absolutely entitled to require the return of the money, the presence of the borrower's power to apply the money would trump this *Saunders v Vautier* (n 112) entitlement. The only way to avoid this would be for the lender to reserve an express power to require return of the money advance: see Peter Birks, 'Retrieving Tied Money' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) 121, 126.

114 Glister, 'Quistclose Trusts' (n 26) 27.

115 Donovan WM Waters, 'Trusts in the Setting of Business, Commerce, and Bankruptcy' (1983) 21(3) *Alberta Law Review* 395, 417.

116 Rhodes (n 99) 183.

117 Ibid 184.

118 (1985) 160 CLR 583, 614 ('*Muschinski*').

The scope of 'contrary to equitable principle' is necessarily broad to grant the court discretion when determining whether particular circumstances justify imposing a constructive trust.[119] Justice Deane's use of the term 'remedial institution' is however apt to confuse, particularly in light of the significant debate on constructive trusts using the terms 'remedial' and 'institutional' as two opposing perspectives.[120] However, Deane J notes that this dichotomy is misleading, and that the practical impact on parties remains the same.[121] The discretion of a court when imposing a constructive trust essentially means it is always remedial, as its impact on parties to litigation, as well as third parties, is only understood after judicial intervention.[122] Peter Birks thus describes the court's order as an exercise of a strong discretion to grant a proprietary right to a party who prior to judgment, did not have one.[123]

Justice Deane's comments highlight the similar impact of a court granting relief through both *Quistclose* trusts and remedial constructive trusts. In particular, the distribution of assets in insolvency is directly affected by a court's declaration of a *Quistclose* trust. The impact on the borrower's liquidator, the lender, and other third-party creditors results directly after the court's decision.[124] Alexandra Whelan thus groups *Quistclose* trusts together with the remedial constructive trust, noting that they both have the effect of granting a proprietary right in the insolvent party's property after the commencement of the insolvency process where one did not exist before insolvency.[125] Similar to Rhodes' argument, such an understanding of *Quistclose* trusts would be inconsistent with principles of third party liability for breach of a *Quistclose* trust occurring before judicial intervention. In that sense, Whelan's argument is best understood as explaining the practical impact on, as opposed to the strict legal characterisation of, the parties involved in insolvency proceedings insofar as it relates to asset distribution.

Whilst courts currently do not purport to exercise any discretion when granting a *Quistclose* trust as they do for other equitable remedies, Smolyansky suggests that they in fact do exercise discretion but hide this behind the liberal application of tests to determine intention.[126] He argues that fashioning relief in *Quistclose Investments* scenarios is not an exercise grounded in intention but rather an enforcement of a policy

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119 GE Dal Pont, 'The High Court's Constructive Trust Tricenarian: Its Legacy from 1985–2015' (2015) 36(2) *Adelaide Law Review* 459, 466–7.

120 Ibid 466.

121 *Muschinski* (n 118) 614.

122 Ibid 614 (Deane J); *Westdeutsche Landesbank Girozentrale* (n 40) 714–15 (Lord Browne-Wilkinson).

123 Peter Birks, 'Proprietary Remedies' in John P Lowry and Loukas A Mistelis (eds), *Commercial Law: Perspectives and Practice* (LexisNexis Butterworths, 2006) 185, 185.

124 Robert Stevens, 'Insolvency' in William Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart, 2004) 153, 153–4.

125 Alexandra M Whelan, 'Proprietary Rescission and the Impact of Insolvency' (2012) 23(1) *Journal of Banking and Finance Law and Practice* 3, 7.

126 Smolyansky (n 69) 567. Here, 'tests to determine intention' refers to the factors the court considers when determining whether the settlor demonstrated an intention to create an express trust.

which encourages corporate rescue and lending to firms on the brink of insolvency.[127] Whilst courts do not express this rationale for *Quistclose* trusts, the circumstances which typically give rise to *Quistclose* trust relief align with his suggestion.[128] Thus, Smolyansky asserts that *Quistclose* trusts operate in accordance with general understandings of unconscionability: a court exercises its discretion and declares a trust since it would be unconscionable for unsecured creditors, who would have benefitted if the firm remained solvent as a result of the *Quistclose* advance,[129] to assert beneficial title and retain the money in the general pool of assets.[130] In that sense, the declaration of a *Quistclose* trust is similar to the constructive trust in *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd*.[131] There, a payment was mistakenly made to an insolvent firm due to a clerical error. The High Court of England and Wales granted proprietary relief in the form of a constructive trust to prevent the unconscionable retention of money by the firm's unsecured creditors.[132] Smolyansky suggests *Quistclose* trusts operate in a similar manner.[133] Whether *Quistclose* trusts can be understood under these principles in Australia is unclear, since Australian courts have tended to avoid imposing constructive trusts in commercial dealings and have expressed the need for a cautious approach to ordering a remedial constructive trust.[134]

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127 Ibid 566.

128 Ibid 566–7.

129 They would have benefitted because they would be more likely to receive complete repayment of their debt.

130 Smolyansky (n 69) 567.

131 [1981] Ch 105 ('*Chase Manhattan*').

132 Ibid 119–20, 127–8 (Goulding J). Justice Goulding provided little justification for imposing proprietary relief in the circumstances. Some have argued that it is better characterised as a constructive trust as a restitutionary remedy for unjust enrichment, rather than to cure unconscionability: see, eg, Bryan et al, *A Sourcebook on Equity & Trusts in Australia* (n 18) 544–5. In any case, WenXiong has argued against any classification of the *Quistclose* trust as a proprietary response to unjust enrichment due to a failure of consideration: see WenXiong (n 30) 675–81. Therefore, the utility of comparing *Chase Manhattan* (n 131) and *Quistclose Investments* (n 1) comes from treating both as responses to unconscionability: Smolyansky (n 69) 567.

133 Smolyansky (n 69) 567.

134 David Wright, 'Third Parties and the Australian Remedial Constructive Trust' (2014) 37(2) *University of Western Australia Law Review* 31, 37–9. Wright identifies the High Court of Australia's hesitation to rely on equitable remedies in commercial settings in *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, 45–6 [129] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ) ('*John Alexander's Clubs*'). There, the High Court emphasised the need to consider the appropriateness of equitable intervention in scenarios where parties have arrived at a commercial agreement, and also to consider the interests of third parties in such transactions. See also, Nicholas Allton, 'The Boundaries of Proprietary Claims' (1997) 13(1) *Queensland University of Technology Law Journal* 276, 287–8. See generally Justice of Appeal PA Keane, 'The 2009 WA Lee Lecture in Equity: The Conscience of Equity' (2010) 84(2) *Australian Law Journal* 92, 111, where Justice of Appeal Keane argued extra-curially against equitable intervention in commercial dealings due to the inconsistent goals of equity and commercial practices.

There may be some argument that unlike remedial constructive trusts, a court's retrospective imposition of a trust in *Quistclose* scenarios impacts parties differently, particularly in a scenario where creditors have lent money between the period of the *Quistclose* advance and the court's remedial grant. However, as a matter of practice, in circumstances where the failure of purpose is a result of a borrower's insolvency, such concerns are unfounded, as they relate to unsecured creditors,[135] for two reasons. First, money advanced by a lender invoking a *Quistclose* trust is typically for the purpose of corporate rescue.[136] It is therefore uncommon to encounter a situation where further money is lent by a creditor after a *Quistclose* advance. Second, as long as money is lent prior to trial, pari passu distribution creates no prejudice to the new lender. In the absence of any registration requirement for *Quistclose* trusts,[137] the later lender is in no different position to the unsecured creditors who lent money prior to the *Quistclose* advance.[138] Whilst this may not be a just result, as a matter of form, there is no reason in law to prefer or differentiate the new lender from pre-existing unsecured creditors. As such, the impact on all parties involved flows directly from judicial declaration of a *Quistclose* trust.

Therefore, in considering any normative justifications for retaining the *Quistclose* trust in private law taxonomy, it must be justified in light of its remedial nature. As Rickett has argued, 'were "the remedial trusts law philosophy" to become dominant … [we must ask] "*why* is the remedy to be imposed?"'.[139]

## V The Absence of a Principled Basis to Maintain *Quistclose* Trusts

Once accepted, as I have argued in Part IV, that the *Quistclose* trust, at least in situations of insolvency, should be considered remedial rather than institutional, there must be a principled basis for maintaining its existence given that it cannot be justified through intention.[140] The High Court of Australia in *Bathurst City Council*

135 The position when considering some secured creditors is more complex, due to the operation of the *PPSA* (n 37) and *Corporations Act 2001* (Cth) ('*Corporations Act*'). Insolvency provisions in the *Corporations Act* may apply to some secured creditors in the same manner as unsecured creditors where the former have failed to comply with the requirements under *PPSA* (n 37) ss 19–21. See also *PPSA* (n 37) s 267 which identifies the point in time when personal property of a debtor vests in an administrator or liquidator and the nature of the property which is subject to these provisions.

136 McKendrick (n 100) 148.

137 *PPSA* (n 37) s 8(1)(h); Glister, 'The Role of Trusts in the *PPSA*' (n 36) 640–1.

138 Excepting the circumstance where further money is advanced under an existing security interest: see *PPSA* (n 37) s 58.

139 Rickett (n 6) 617 (emphasis in original).

140 As Hanoch Dagan suggests, private law should reflect a balance between instrumentalist and autonomist views. Private law rights and remedies must be justified, at least to some extent, on some normative basis: see Hanoch Dagan, 'The Limited Autonomy of Private Law' (2008) 56(3) *American Journal of Comparative Law* 809,

*v PWC Properties Pty Ltd* ('*Bathurst*') emphasised this requirement, particularly in light of the invasiveness of proprietary relief in insolvency.[141] There, the majority emphasised the need to, before granting a remedial trust, consider other efforts to avoid 'a result whereby the plaintiff gains a beneficial proprietary interest which gives an unfair priority over other equally deserving creditors of the defendant'.[142]

This Part considers the grant of proprietary relief in *Quistclose* situations in light of Bant and Bryan's model of proprietary remedies. In particular, I focus on their fourth and fifth propositions concerning discretionary factors that may defeat or qualify proprietary relief, which involves considering policy arguments.[143] Specifically, I consider efficiency in lending, incentivising corporate rescue, and the coherence of *Quistclose* trusts with the objectives of statutory insolvency schemes as potential normative justifications. Importantly, it is not enough that maintaining the *Quistclose* trust in insolvency achieves one of these justifications, for example by encouraging corporate rescue. Instead, the utility achieved by maintaining *Quistclose* trusts must outweigh the prejudice caused by prioritising the lender over other unsecured creditors to justify removing assets from the pool available for distribution in insolvency.[144] This is because the unsecured creditors are the 'true' defendants in cases arguing priorities in insolvency; they are not typical third parties and the

810–18; François Du Bois, 'Social Purposes, Fundamental Rights and the Judicial Development of Private Law' in Donal Nolan and Andrew Robertson (eds), *Rights and Private Law* (Hart, 2012) 89, 98–100.

141 (1998) 195 CLR 566, 585 [42] (Gaudron, McHugh, Gummow, Hayne and Callinan JJ) ('*Bathurst*'). This concern has been raised prior to *Bathurst* including in *Re Osborn; Ex parte Trustee of Property Osborn v Osborn* (1989) 25 FCR 546. The High Court has also considered the prejudicial effect on innocent third parties generally when imposing proprietary relief: see *Giumelli v Giumelli* (1999) 196 CLR 101, 125 [49]–[50] (Gleeson CJ, McHugh, Gummow and Callinan JJ).

142 *Bathurst* (n 141) 585 [42] (Gaudron, McHugh, Gummow, Hayne and Callinan JJ). The High Court made similar comments in the more recent case of *John Alexander's Clubs* (n 134) 45 [128] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ). Concerns have also been expressed in the United Kingdom: see, eg, *Borden (UK) Ltd v Scottish Timber Products Ltd* [1979] 3 All ER 961, 973 (Templeman LJ).

143 Bant and Bryan, 'A Model of Proprietary Remedies' (n 9) 216–17; Elise Bant and Michael Bryan, 'Defences, Bars and Discretionary Factors' in Elise Bant and Michael Bryan (eds), *Principles of Proprietary Remedies* (Thomson Reuters, 2013) 185, 200–7. The first three propositions in the model focus predominantly on the nature of property and ensuring any proprietary remedy results in specific restitution of the original asset or substituted assets if relevant, as well as any secondary profits earned by the defendant in use of the assets. These are less relevant given *Quistclose* relief always concerns money transferred, which is either specifically identifiable or substituted in the form of other money. The sixth proposition simply notes that the defendant has an obligation to preserve the plaintiff's asset in the period between becoming aware of the plaintiff's entitlement and final court orders. This is similarly not a concern in *Quistclose* scenarios for the reasons identified in Part IV on the timing of a claim of *Quistclose* relief.

144 Goode (n 108) 66; Goodhart and Jones (n 47) 494.

insolvent borrower's role is purely procedural.[145] Only if the utility to lenders clearly outweighs the prejudice to unsecured creditors should the *Quistclose* trust remain in the taxonomy of proprietary remedies in insolvency. This is particularly so after the High Court of Australia's separation of right and remedy in *Bathurst*, evincing a greater willingness to consider the impact on all relevant parties of imposing a particular form of proprietary relief.[146]

It is important at this stage to clarify why this remains a concern in light of Australian courts' apparent approval of the 'acceptance of risk' theory.[147] The theory justifies granting proprietary relief to a lender on the assumption that other unsecured creditors have accepted the risk that the borrower may grant proprietary interests which could reduce the assets available for distribution in insolvency.[148] However, the theory cannot apply in scenarios giving rise to *Quistclose* relief. First, it does not explain why a *Quistclose* lender should gain priority over involuntary creditors, such as tort claimants, who are unable to bargain for security.[149] Second, the theory assumes that creditors are aware of circumstances in which a claimant will gain priority through proprietary relief.[150] This is evidently not the case in situations of *Quistclose* relief; the application of tests to determine its availability yields inconsistent results.[151]

There exists very limited jurisprudence which attempts to discern a normative justification for maintaining *Quistclose* trusts. The discussion of the underlying justification for the *Quistclose* trust is limited to concepts of fairness, best expressed by Bingham LJ in *Re EVTR*. There, Bingham LJ justified the imposition of a *Quistclose* trust by relying on the unfairness of forcing the lender in that case to participate in pari passu distribution alongside other unsecured creditors. However, this reasoning is 'consequentialist'; it justifies the result by considering the consequences of an award of *Quistclose* relief rather than through a process of deductive reasoning.[152] If, as Lord Millett described in *Twinsectra*, the purpose of the *Quistclose* arrangement is 'to prevent the money from passing to the borrower's [liquidator] in the event

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145 Crawford (n 40) 820.

146 David Wright, 'Proprietary Remedies and the Role of Insolvency' (2000) 23(2) *University of New South Wales Law Journal* 143, 169.

147 *Australian Securities Commission v Melbourne Asset Management Nominees Pty Ltd* (1994) 49 FCR 334, 358–9 (Northrop J). David Stevens argues that a grant of equitable relief reflects a court's judgment on the transactional allocation of risk: David Stevens, 'Restitution, Property and Cause of Action in Unjust Enrichment: Getting By with Fewer Things' (1989) 39(3) *University of Toronto Law Journal* 258, 290–2.

148 David M Paciocco, 'The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors' (1989) 68(2) *Canadian Bar Review* 315, 324–5.

149 Goode (n 108) 57.

150 *Clout v Markwell* [2001] QSC 91, [21] (Atkinson J); Wright, 'Third Parties and the Australian Remedial Constructive Trust' (n 134) 47.

151 See above Part III.

152 Bant and Bryan, 'Constructive Trusts and Equitable Proprietary Relief' (n 93) 196; Cope (n 33) 10.

of his insolvency',[153] it is unsuitable to justify *Quistclose* trusts on fairness grounds to protect the lender in insolvency, particularly given intention requirements are not satisfied.[154] There must be some other normative basis on which to retain *Quistclose* trusts in private law remedial taxonomy.[155] This Part shows there is none.

### A *Efficiency*

Some commentators have argued that one fundamental role of *Quistclose* trusts is to provide security or quasi-security for lenders.[156] Thus, the argument would go, if lenders could confidently structure transactions using *Quistclose* trusts as security, they would be more likely to lend.[157] This would lead to increased competition in lending and thus promote more efficient capital markets.[158] At the outset, it is important to qualify this argument. Some scholars have suggested that security does not actually promote efficiency in lending, and that the cost savings accruing to borrowers who grant security must be paid through increased interest rates demanded by unsecured lenders.[159] However, this argument usually relies on the Modigliani-Miller theory[160] of capital structure which operates only in perfect capital markets.[161] This theory assumes perfect pricing of credit, but empirical observations highlight the flaws in this assumption typically arising out of differences in risk tolerance for creditors.[162] In contrast, the main proponents of secured lending argue that credit markets are never perfectly informed, and therefore efficiency gains are possible through the use of secured loans for two reasons.[163] First, security reduces the need to monitor the borrower's behaviour once money is lent; the cost savings accrued by lenders are

153 *Twinsectra* (n 3) 187–8 [82] (Lord Millett).

154 See above Part III.

155 Ulph (n 113) 486; Dagan (n 140) 813–18.

156 See, eg, Brandon Dominic Chan, 'The Enigma of the Quistclose Trust' (2013) 2(1) *University College London Journal of Law and Jurisprudence* 1, 3–7; Paul U Ali, 'Quistclose Trusts in Lending: Trust or Security Interest?' (2005) 23(1) *Company and Securities Law Journal* 325, 326–34. There is some argument that *Quistclose* trusts are not strictly security interests as they secure no independent obligation; the obligation is repayment of the 'security' itself: see Stevens, 'Insolvency' (n 124) 154–5. Lionel Smith argues generally that interests under a trust should not be considered 'security' in the traditional form, but concedes that they often perform the same function: Lionel Smith, 'Security' in Andrew Burrows (ed), *English Private Law* (Oxford University Press, 3rd ed, 2013) 307, 351 [5.107].

157 Goode (n 108) 56.

158 Cf Keane (n 134) 111.

159 Alan Schwartz, 'Security Interests and Bankruptcy Priorities: A Review of Current Theories' (1981) 10(1) *Journal of Legal Studies* 1, 7–9.

160 See generally Franco Modigliani and Merton H Miller, 'The Cost of Capital, Corporation Finance and the Theory of Investment' (1958) 48(3) *American Economic Review* 261.

161 Bridge (n 86) 337–8.

162 James J White, 'Efficiency Justifications for Personal Property Security' (1984) 37(3) *Vanderbilt Law Review* 473, 494–502.

163 Schwartz (n 159) 9–21.

passed on to borrowers through lower interest rates.[164] Second, the borrower's grant of security signals to the market that the prospects of a company's projects are strong and will produce predictable profits, thus making the borrower willing to grant security over their assets.[165] If indeed these two advantages of secured lending are accepted to increase efficiency in capital markets, it is clear that they do not apply to *Quistclose* trusts as they are currently regulated, as explained below.

Before discussing the ability for the *Quistclose* trust to achieve efficiencies through reduced monitoring costs and a signalling effect, a number of concerns arise due to the timing of a grant of *Quistclose* proprietary relief. Given that *Quistclose* trusts are invoked primarily as a last resort in insolvency proceedings,[166] the time available for the transaction to send any signal to the market is negligible. That is, a court's grant of *Quistclose* relief is proceeded by the distribution of assets in insolvency. No further lending takes place and therefore the efficiency gains derived from the signalling effect are negligible. Second, the inconsistent application of the intention tests in *Quistclose* trust cases[167] minimises any certainty for lenders in claiming security. This has the effect of neutralising any efficiency gains until insolvency proceedings, at which point no further lending occurs anyway.

Similar arguments can be levelled against the perceived monitoring cost savings, even if it is assumed that the circumstances which would give rise to *Quistclose* proprietary relief are sufficiently clear and can be acted upon by lenders. This is because the vast majority of lending giving rise to *Quistclose* relief, particularly where the failure of purpose is caused by insolvency, occurs in corporate rescue attempts.[168] As such, the loan is intended to be a form of short-term debt, to allow the borrower to return to normal operations.[169] The short-term nature of this debt means the cost savings gained by not being required to monitor the borrower's activities only accrue over a short time period. In contrast, traditional forms of security are typically used in long-term lending situations, such that the savings accrued over the period of the loan are significant.[170] Thus, it is difficult to argue that the minor monitoring cost

164 Ibid 9–14; Goode (n 108) 56.

165 Schwartz (n 159) 14–21. Whilst this remains a common argument, empirical evidence of lending practice shows that theoretically security is more often granted by younger, riskier firms and thus is indicative of a lack of creditworthiness, since lenders are only lending money with extra protections: see Sheng-Syan Chen, Gillian HH Yeo and Kim Wai Ho, 'Further Evidence on the Determinants of Secured Versus Unsecured Loans' (1998) 25(3–4) *Journal of Business Finance & Accounting* 371, 374–7.

166 McKendrick (n 100) 146.

167 See above Part III.

168 McKendrick (n 100) 148.

169 Bridge (n 86) 348, 361; Deepa Parmar, 'The Uncertainty Surrounding the Quistclose Trust' (Pt 2) (2012) 9(3) *International Corporate Rescue* 202, 206–7.

170 This is particularly so given the costs incurred by the lender to facilitate the process of encumbering an asset, such as registration under any personal property securities legislation. Cost savings through reduced monitoring must at least cover this cost for the loan to be commercially viable: see Goode (n 108) 60.

savings gained from lending on the assumption of a grant of *Quistclose* proprietary relief are enough to justify removing these assets from the pool available for distribution to unsecured creditors. This is particularly true given the evidence which suggests that lenders do not regard themselves as secured lenders with a *Quistclose* proprietary interest until a court rules in their favour.[171]

The unique circumstances giving rise to *Quistclose* trusts also minimise any efficiencies from the signalling effect. The signalling effect relies on a message being sent to the market that a company trusts its prospects enough to encumber its revenue generating assets with the risk of security.[172] This is not the same situation as that which results in *Quistclose* relief. Unlike traditional security over pre-existing assets of the borrower, the encumbered asset is the money advance itself.[173] Any signal sent that the borrower is willing to encumber loan moneys is likely to have a negligible impact on other creditors' perceptions of the company. There is no encumbrance over the assets of the firm as it existed prior to the money advance.

Potentially more concerning however, is the scope for 'ostensible ownership' problems due to the current regulation of *Quistclose* trusts.[174] The signalling effect assumes that the information which is being used to signal a firm's prospects is widely accessible by credit markets. However, this certainly is not the case for *Quistclose* trusts in Australia,[175] and likely not for other jurisdictions either.[176] Without any registration, credit markets are unaware of the characterisation of money as trust assets rather than forming part of the freely available assets of the borrower.[177] This has the potential to create inefficiencies in capital markets as lenders overestimate the creditworthiness of a firm. Whilst in the short-term this will actually drive down interest rates, the long-term impact is significant.[178] As lenders experience insolvency proceedings in which the court declares that some of the money they believed was available for distribution is actually held on *Quistclose* trust, their confidence in their ability to calculate risk will decrease. The obvious long-term result is an over-pricing of credit, as lenders adjust their risk tolerance to reflect a more conservative approach.[179] Thus, the efficiency gains from signalling effects are minimal, or potentially negative, and

171 Fawcett (n 105) 154–6.

172 Schwartz (n 159) 14–15.

173 Stevens, 'Insolvency' (n 124) 154–5; Glister, 'Quistclose Trusts' (n 26) 89–90; Chan, 'The Tree That Was Not Meant to Be' (n 40) 25.

174 See Helman (n 39).

175 *PPSA* (n 37) s 8(1)(h).

176 Glister, 'The Role of Trusts in the *PPSA*' (n 36) 641–3.

177 Lusina Ho and Phillip Smart, 'Quistclose and Romalpa: Ambivalence and Contradiction' (2009) 39(1) *Hong Kong Law Journal* 37, 49; Chan, 'The Tree That was Not Meant to Be' (n 40) 23–4.

178 Christopher Viney and Peter Phillips, *Financial Institutions, Instruments and Markets* (McGraw Hill Education, 8th ed, 2015) 460–1.

179 See generally Zvi Bodie, Alex Kane and Alan J Marcus, *Investments* (McGraw Hill Education, 10th ed, 2014) 349–80.

do not justify the grant of proprietary relief which confers effective priority over the borrower's unsecured creditors.

### B *Incentivisation*

The award of *Quistclose* trust relief has been argued by some commentators to reflect an underlying instrumentalist policy of incentivising corporate rescue and protecting parties who lend to companies facing the threat of insolvency.[180] Smolyansky suggests that the ongoing difficulty with understanding *Quistclose* trusts within pure trusts law philosophy results from a failure of judges to articulate this underlying policy goal of granting proprietary relief in the circumstances.[181] He suggests that judges have adopted creative and somewhat artificial reasoning to find intention to declare the existence of a *Quistclose* trust. However, this instead reflects their attempts to reach a fair and just outcome by protecting lenders who endeavour to prevent a borrower's insolvency.[182] Similarly, Ulph suggests that the judiciary has facilitated equitable intervention in *Quistclose* scenarios more willingly than other scenarios such as those involving retention of title[183] due to the benefits of encouraging corporate rescue.[184] Smolyansky argues that the priority granted to the *Quistclose* lender over other unsecured creditors is also warranted due to the nature of the transaction. He suggests that those creditors stand to gain if the *Quistclose* advance prevents a borrower's insolvency, yet they have not provided any consideration. As such, the unsecured creditors are no worse off if the *Quistclose* lender is granted proprietary relief; and in fact, retention by the unsecured creditors of the advance would represent a windfall profit at the expense of the *Quistclose* lender.[185]

On its face, incentivising corporate rescue seems to be a sound policy goal on which to ground proprietary relief. The impact of a company's insolvency extends beyond unsecured creditors and impacts employees, customers, suppliers, and others.[186] Thus, attempts by the law to prevent these consequences should be encouraged and lenders should be protected in circumstances where their efforts do not succeed.[187] Corporate rescue at the very least maintains the status quo and avoids lengthy

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180 Smolyansky (n 69) 566–7; Rebecca Clarke, 'The Quistclose Trust: A Welcome Facilitator of Corporate Rescue?' (2017) 26(1) *Nottingham Law Journal* 130, 140–1; Parmar (n 169) 202.

181 Smolyansky (n 69) 566–7.

182 Ibid 567.

183 Commonly known as *Romalpa* clauses after the United Kingdom Court of Appeal's decision in *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd* [1976] 2 All ER 552.

184 Ulph (n 113) 495–6.

185 Smolyansky (n 69) 567.

186 Elizabeth Warren, 'Bankruptcy Policy' (1987) 54(3) *University of Chicago Law Review* 775, 787–8.

187 RP Austin, 'Commerce and Equity: Fiduciary Duty and Constructive Trust' (1986) 6(3) *Oxford Journal of Legal Studies* 444, 455; McCormack (n 11) 97–8.

and costly insolvency proceedings.[188] Incentivisation only works if lenders are guaranteed protection over their loans in these circumstances.[189] However, the utility of corporate rescue is not unchallenged. The common objection is one of efficiency, the core of the argument being that the resources from the failing company could be more efficiently deployed in another venture.[190] The other argument hinges on the notion that since third-party stakeholders such as unsecured creditors, employees, and suppliers are expected to bear losses when a firm fails outside of insolvency, it is unclear why they should be protected inside insolvency; rights should be the same both inside and outside of insolvency.[191] Thus it is argued that incentivisation of pre-insolvency transactions should not be a goal of the law. In any case, even assuming that incentivising corporate rescue is a worthy objective, this does not provide a sound basis for granting *Quistclose* relief and priority over other unsecured lenders, for the reasons discussed below.

Smolyansky's argument that unsecured creditors are no worse off if *Quistclose* relief is granted relies on the 'swollen assets' thesis of restitution, which attempts to justify the priority of unjust enrichment plaintiffs. The thesis posits that where the plaintiff has not taken on the risks of insolvency and their money advance has enriched the defendant, the lender should be granted priority through proprietary relief.[192] In that sense, the defendant's assets have been 'swollen' by the plaintiff's payment. The first concern with the application of this theory to *Quistclose* scenarios is evident in its

188 Thomas H Jackson posits that this remains the common view of insolvency policy: Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986) 24–7; Warren (n 186) 787–8; Smolyansky (n 69) 567.

189 Smolyansky (n 69) 566.

190 Warren (n 186) 800–4.

191 Douglas G Baird, 'Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren' (1987) 54(3) *University of Chicago Law Review* 815, 817; Jackson (n 188) 25–7; Anthony Duggan, 'Constructive Trusts from a Law and Economics Perspective' (2005) 55(2) *University of Toronto Law Journal* 217, 244–5. Whilst this argument was developed in the United States context, which in some cases allows failing firms to choose between federal or state bankruptcy schemes, with some states maintaining a 'first-in-best-dressed' model, its value broadly holds in Australia: Crawford (n 40) 813. The argument essentially maintains that only those property rights respected outside of insolvency should be maintained within insolvency; it is not for courts to *create* property rights inside of insolvency for any reason, including pursuing policy goals; courts should only *uphold* property rights which already existed outside of insolvency.

192 Rotherham (n 42) 81–2; Cope (n 33) 9–10; John Glover, 'Equity, Restitution and the Proprietary Recovery of Value' (1991) 14(2) *University of New South Wales Law Journal* 247, 276–7. Bant and Bryan also propose a model based on the swollen assets thesis for the award of constructive trusts. They argue that judges need not consider the impact of an award in insolvency, but more specifically the question of whether the lender assumed the risk of the borrower's insolvency: see 'Constructive Trusts and Equitable Proprietary Relief' (n 93) 196–7. Andrew Burrows has criticised this justification of priority: Andrew Burrows, *The Law of Restitution* (Butterworths, 2nd ed, 2002) 69–75.

first condition. It is extremely difficult to argue that lenders, who advance money on loan, often with high interest rates,[193] did not contemplate the risk of insolvency,[194] particularly when the transaction was itself an attempt at corporate rescue.[195] Further, since upon a correct application of money, the lender would anyway transform into an unsecured creditor,[196] a suggestion that they did not take the risk of insolvency cannot be sustained. Even if there were circumstances that would suggest the lender did not take the risk, this would not distinguish their position from involuntary creditors such as tort claimants.[197] Another concern is Smolyansky's suggestion that the creditors are no worse off if the money is returned to the *Quistclose* lender since the transfer has 'swollen' the assets of the borrower.[198] The problem with this argument, as Michael Crawford notes, is that it is circular.[199] It can only be accepted if we assume what the thesis sets out to prove: that the unsecured creditors have no entitlement to the *Quistclose* payment in the first place.[200]

A lender's subjective knowledge that they will be protected by *Quistclose* trust relief is necessary if its grant is to be justified as incentivising corporate rescue. However, for at least two reasons, this is not the case. First, Smolyansky suggests that courts' use of intention to justify *Quistclose* trusts has created a situation in which their grant remains inherently uncertain.[201] As such, it is difficult to suggest that lenders are advancing money in corporate rescue situations on the assumption that they will be protected by courts in the case of the borrower's insolvency. If lenders recognised the availability of protection over assets through a trust, and subjectively wished to structure a transaction to make use of this protection, they would demonstrate a subjective intention to create a trust.[202] In such a case, any argument based on *Quistclose Investments* would not be necessary, and instead the transaction would be governed by orthodox express trust principles or a traditional security interest.

193 For example, the 24% interest rate on the money advanced in *Twinsectra* (n 3).

194 See Paciocco (n 148) 342–5 which argues that a written contract provides a clear indication of the lender's assumption of risk. This is another basis on which the *Kayford* (n 11) line of cases has been distinguished, given the money advance was provided by customers for pre-purchase of goods, who arguably cannot be said to have taken the risks of the insolvency: see McCormack (n 11) 103–4.

195 See *Quistclose Investments* (n 1).

196 Smith (n 156) 351 [5.108]. In *Quistclose Investments* (n 1), for example, the result would have been one of 'credit substitution': see McCormack (n 11) 98.

197 Crawford (n 40) 848–50.

198 Smolyansky (n 69) 567. Emily L Sherwin makes a similar argument in the context of constructive trusts, that the borrower's other creditors are unjustly enriched by the money advance and proprietary restitution is justified when the plaintiff can point to the specific asset which has enriched the creditors: see Emily L Sherwin, 'Constructive Trusts in Bankruptcy' [1989] (2) *University of Illinois Law Review* 297, 332–6.

199 Crawford (n 40) 849.

200 Ibid; Sherwin (n 198).

201 Smolyansky (n 69) 560–2, 564, 566–7.

202 Hudson (n 7) 802.

Second, there is no empirical analysis to suggest that lenders do in fact rely on the protections afforded by *Quistclose* trusts to incentivise corporate rescue.[203] Rather, some leading cases seem to suggest other reasons motivating the transaction. For example, in *Twinsectra* the incentive would likely have been the 24% interest rate rather than any subjective belief of asset protection under a *Quistclose* trust.[204]

Last, even if the incentivisation of corporate rescue transactions is to be promoted, it seems contrary to the separation of powers to encourage courts to undertake this task. The promotion of policy goals in lending remains within the bounds of the legislature.[205] Arguably, it is not for courts to be motivated in the grant of proprietary relief by some overarching policy objective of incentivising beneficial behaviour.[206] If incentivising these transactions warrants granting priority over a company's unsecured creditors, this should be determined by Parliament and not courts.[207]

### C *Coherence*

The High Court of Australia has on a number of occasions, including in consideration of *Quistclose* relief,[208] emphasised the need to ensure coherence in the law.[209] The concept of coherence as applied in High Court jurisprudence is complex, and has been subject to significant academic debate.[210] The core of the principle is that a plaintiff should not be granted relief if doing so would undermine or stultify overriding principles or policies of the law.[211] The purpose of blocking relief is to

203 Ibid 801; Clarke (n 180) 140.

204 Hudson (n 7) 803.

205 Ulph (n 113) 505–6.

206 A number of commentators hold this view. One of the most vocal is former Australian High Court judge, Justice Dyson Heydon: see, eg, Justice Dyson Heydon, 'Judicial Activism and the Death of the Rule of Law' (2004) 10(4) *Otago Law Review* 493, 504–14; Birks (n 123) 189.

207 Bant and Bryan, 'Constructive Trusts and Equitable Proprietary Relief' (n 93) 196.

208 *Legal Services Board* (n 18) 525–6 [119]–[123] (Bell, Gageler and Keane JJ). This was in the context of the potential for a *Quistclose* trust to create rights and obligations inconsistent with the *Legal Profession Act 2004* (Vic) ss 3.3.2, 3.3.14.

209 See, eg, *Miller v Miller* (2011) 242 CLR 446, 479–82 [93]–[102] (French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ); *Equuscorp Pty Ltd v Haxton* (2012) 246 CLR 498, 518 [33]–[34] (French CJ, Crennan and Kiefel JJ).

210 See generally Bant, 'Thieving Lawyers: Trust and Fidelity in the High Court: *Legal Services Board v Gillespie-Jones*' (n 19); Andrew Fell, 'The Concept of Coherence in Australian Private Law' (2018) 41(3) *Melbourne University Law Review* 1160; Michael Gillooly, 'Legal Coherence in the High Court: String Theory for Lawyers' (2013) 87(1) *Australian Law Journal* 33; Elise Bant, 'Statute and Common Law: Interaction and Influence in Light of the Principle of Coherence' (2015) 38(1) *University of New South Wales Law Journal* 367.

211 Since this concept is not the focus of this article, I adopt a broad definition in line with that expressed in Fell (n 210) 1167–79.

ensure the development of the common law, including equitable doctrine, promotes rather than undermines consistency in the law's underlying normative reasons.[212]

A grant of *Quistclose* relief in situations of a borrower's insolvency provides an interesting problem for the principle of coherence. Since a declaration of a *Quistclose* trust results in effective priority for the lender over other unsecured creditors, it bypasses pari passu distribution rules under insolvency statutory schemes.[213] Smolyansky argues that the grant of *Quistclose* relief directly conflicts with orthodox insolvency law principles and policy, in particular the purpose of pari passu distribution.[214] He suggests that courts mask this potential conflict with insolvency law by justifying a grant of *Quistclose* relief as an exercise in respecting intention rather than a choice to prefer one creditor over others due to their perceived merits.[215] In doing so, courts have transplanted principles of equitable relief based on two-party scenarios into insolvency situations concerning multiple stakeholders.[216] Worthington thus argues:

> Equity's rules for determining the rights *as between claimant and defendant* may often legitimately suggest that an identifiable asset or item of wealth should be specifically delivered to the claimant rather than being left in the hands of the defendant. But this analysis cannot tell us — it is not designed to tell us — whether, *as between the creditor and all the debtor's* [unsecured] *creditors*, the creditor should be entitled to the specific asset via a mechanism that ensures insolvency priority and avoids the *pari passu* rule. That assessment has to be made on the basis of other considerations that are specific to the insolvency context.[217]

To assess the validity of Smolyansky's arguments, it is important to understand the rationale behind the current insolvency scheme, and in particular, the choice of pari passu distribution as opposed to another method of debt collection. Insolvency law necessarily must balance two competing tensions: the need to respect the merits of creditors whilst minimising the costs associated with debt collection.[218] In the absence of a system for collective debt enforcement, creditors are left to bring claims

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212 Ibid 1163–4; Bant, 'Thieving Lawyers: Trust and Fidelity in the High Court: *Legal Services Board v Gillespie-Jones*' (n 19).

213 See *Corporations Act* (n 135) ss 501, 555, 556; *Bankruptcy Act* (n 31) s 108.

214 Smolyansky (n 69) 564.

215 Ibid 563–4.

216 Sarah Worthington, 'Proprietary Remedies and Insolvency Policy: The Need for a New Approach' in John Lowry and Loukas Mistelis (eds), *Commercial Law: Perspectives and Practice* (LexisNexis Butterworths, 2006) 191, 191.

217 Ibid 203 (emphasis in original). Similar arguments were raised by Lord Browne-Wilkinson concerning 'wholesale importation into commercial law of equitable principles inconsistent with … the orderly conduct of business affairs': *Westdeutsche Landesbank Girozentrale* (n 40) 704, citing *Barnes v Addy* (n 35) 251, 255 (Lord Selborne LC); *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana* [1983] 2 AC 694, 703–4 (Lord Diplock).

218 Jackson (n 188) 9–11.

individually. The result is significant costs for all parties, including the insolvent company, which reduces the funds available for all creditors. A system of individual debt enforcement is plagued by the 'common pool' problem and the prisoners dilemma; a 'first-in-first-served' system would result in an inefficient and counter-productive distribution of assets.[219] By requiring groups of creditors to act as a collective unit, rather than as individuals, the group as a whole is in a better position, albeit some individual creditors will be worse off.[220] The necessary consequence however, is a system of rough justice which prefers a straightforward, efficient, and cost-effective distribution of assets at the expense of perfect, individualised justice, in which a creditor's individual merits are considered.[221] The current system adopted in Australia, and many other jurisdictions, is pari passu distribution whereby unsecured creditors are entitled to a pro rata share in the assets remaining after all superior claims are satisfied.[222] The question to be asked therefore, is whether equitable intervention through a grant of proprietary relief is justified in *Quistclose* scenarios, in light of its effects of allowing an otherwise unsecured creditor to bypass pari passu distribution.[223] Crawford argues that any award of these types of devices, including *Quistclose* trusts, which grant priority on the basis of an individual creditor's 'deserts' are fundamentally inconsistent with the distributive justice goals of insolvency distribution.[224] Pari passu distribution necessarily represents a compromise which would be undermined by individual attempts to claim priority through the *Quistclose* trust.[225] If this system is to be changed to allow individual claims based on 'desert' this should be an objective for the legislature, not the judiciary.[226]

Clearly, attempts to invoke a *Quistclose* trust to gain priority appear to be inconsistent with the goals of insolvency legislation. They seem to revert to a system of individual debt enforcement and result in a removal of assets available to unsecured creditors. In that sense, they potentially undermine coherence in the law, by encouraging courts to grant remedies which directly contradict the goals of pari

219 Ibid 10–11.

220 Ibid 13–16.

221 Richard Calnan, *Proprietary Rights and Insolvency* (Oxford University Press, 2nd ed, 2016) 41 [1.166].

222 Michael Murray and Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (Thomson Reuters, 9th ed, 2016) 38; Smolyansky (n 69) 564.

223 Worthington, 'Proprietary Remedies and Insolvency Policy: The Need for a New Approach' (n 216) 194–5.

224 Crawford (n 40) 850–1.

225 Ibid 851. Similar concerns have been expressed about equitable proprietary claims broadly: see *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25, 43–5 (Templeman LJ).

226 Hanoch Dagan, 'Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred' (2004) 78(3) *American Bankruptcy Law Journal* 247, 275–6; Bant and Bryan, 'Constructive Trusts and Equitable Proprietary Relief' (n 93) 196.

passu distribution.[227] However, this would suggest that all trusts, not only those in *Quistclose* scenarios, would come under scrutiny due to their ability to grant the beneficiary effective priority. However, there remains a distinction between circumstances giving rise to *Quistclose* trusts and other types of trusts. First, express trusts are created in situations where clear evidence of intention to create a trust can be ascertained.[228] Second, resulting trusts are imposed by the law where it is clear that the provider of property did not intend to benefit the recipient.[229] Neither of these situations are involved in *Quistclose* trust cases.[230] Express and resulting trusts can thus be justified as institutions to respect party autonomy. Remedial constructive trusts on the other hand, respond to unconscionability. Smolyansky argues that this provides the justification for granting effective priority over unsecured creditors in *Quistclose* trust cases since the money advance swells the assets of the borrower.[231] However, as discussed earlier, this argument fails to justify priority over involuntary creditors. In any case, this does not reflect the position of the *Quistclose* trust as it is currently understood by courts. If courts were indeed responding to unconscionable conduct, there would be no benefit in maintaining the *Quistclose* label and attempting to discern the common facts giving rise to proprietary relief analogous to *Quistclose Investments*; the circumstances would simply give rise to a remedial constructive trust. However, this would seem to require a broader approach to unconscionability to be adopted by Australian courts, since remedial constructive trust cases have typically only been granted in domestic settings and not in situations involving commercial parties transacting at arms-length.[232] Therefore, the distinction between circumstances giving rise to *Quistclose* trusts as opposed to other trusts justifies their separate treatment.

In the absence of unconscionability,[233] a positive intention to create a trust, or a negative intention to pass beneficial title, there must be some reason in the circumstances giving rise to *Quistclose* relief which justifies its grant in conflict with insolvency law policy. However, there is nothing particularly unique about the circumstances of a *Quistclose* advance. In fact, Stevens suggests that some circumstances may actually involve an unlawful preference to the subjects of the loan,

227 Judicial concern over transactions undermining the goals of insolvency law can be traced to at least 1873: see *Re Jeavons; Ex parte Mackay* (1873) LR 8 Ch App 643, 647 (James LJ).

228 *Byrnes* (n 102) 290 [114]–[115] (Heydon and Crennan JJ).

229 *Anderson v McPherson [No 2]* [2012] WASC 19, [103] (Edelman J); Chambers, *Resulting Trusts* (n 26) 1–5.

230 See above Part III.

231 Smolyansky (n 69) 567.

232 Allton (n 134) 287–8.

233 Crawford has argued that unconscionability, at least that of the borrower, does not provide a sound basis for awarding proprietary relief in what is essentially a dispute between the lender and the borrower's third-party creditors: see Crawford (n 40) 842–3, discussing *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072, 1073–6 (Lord Templeman).

typically creditors or shareholders.[234] As such, it is difficult to find a reason why *Quistclose* lenders should be granted a proprietary remedy in conflict with the system of collective debt enforcement under insolvency law. This is particularly so given all the other potential methods through which the lender could protect their interest, including high interest rates, traditional security over assets, personal guarantees, and others. Some of these methods are already taken advantage of in *Quistclose* trust cases.[235] Thus, maintaining *Quistclose* relief seems to undermine coherence and conflict with the objectives of the statutory insolvency framework.

## VI Conclusion

This article has attempted to extend the analysis of the *Quistclose* trust beyond its well-considered, yet still contentious, juridical nature. It has focused on asking why we should maintain a grant of proprietary relief in the circumstances which have given rise to *Quistclose* trusts in the first place. This is particularly important given the practical operation of the trust as remedial rather than institutional. The answer provided in this article is that there is no normative justification which warrants a grant of proprietary relief to *Quistclose* lenders, conferring on them effective priority over the borrower's unsecured creditors. The utility achieved in maintaining *Quistclose* trusts does not outweigh the prejudice caused to unsecured creditors by removing assets from the pool available for distribution to them in insolvency.

This article does not suggest an alternative to the *Quistclose* trust precisely for the reason that there is none. The approach to be favoured is one which abandons proprietary relief for lenders in *Quistclose* scenarios and leaves the lender to their personal remedy in debt. The maintenance of *Quistclose* trusts in modern private law remedial taxonomy cannot be justified for any normative reason and can only be preserved under the guise of consistency with precedent. However, as Crawford has asserted, '[i]n the law of remedies, as elsewhere, whilst there is merit in being consistent, there is no merit in being consistently wrong'.[236]

234 Stevens, 'Insolvency' (n 124) 160–2.

235 For example, the high interest rate and solicitor's undertaking in *Twinsectra* (n 3).

236 Crawford (n 40) 857.