

Barclays bank v quistclose law equity essay

Law



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Case Study Barclays Bank v Quistclose (1970) AC 567 Introduction Quistclose case, as it is generally called, represents the concept of commercial form of trust. According to Lord Millet in Twinsectra case says, " a Quistclose resulting trust arises when a settlor parts with assets on terms which do not exhaust the beneficial interest, the trust arises to prevent a gap or suspense in beneficial interest as there is no gap and beneficial interest is not kept in suspense the settlor must have retained beneficial interest." In this case, it was established that in commercial transactions, entrustment of property during the course of business transactions cannot be treated as gift. The principle established in this case is the equity requiring that person receiving a property from another person for a specific purpose cannot treat it as his or her own and should use it only for that specific purpose. Also the transferee cannot keep that property if that specific purpose cannot be fulfilled, as interpreted by Peter Gibson J. In Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd (1985) Ch 207 This landmark decision has led to the concept of Quistclose trust, which has become a form of trust as a way of protection to the lender. Facts of the case Quistclose lent money to a company Rolls Razor Ltd for a specific purpose of payment of dividends to its shareholders at a time when the company was having overdrawn facilities from Barclays Bank. Eventually, Quistclose went into liquidation when Quistclose sought to recover the money it lent lying in a separate account meant for that purpose, with the dividends remaining unpaid. Barclays Bank, which held that money of the customer Rolls Razor in a separate account. The bank contended that the funds lying in that account should be set off against the company's overdraft account since the funds belonged beneficially to the borrower company. The events prior to the insolvency of <https://assignbuster.com/barclays-bank-v-quistclose-law-equity-essay/>

Rolls Razor Ltd need to be examined. The company had earned a considerable profit for the year 1963 as per the audited statement and an interim dividend of 80% that had already been paid. On 14th May 1964, the company decided to pay the final dividend of 120% that worked out to £209, 719 8s 6d net of tax deduction. As it had no liquid resources and its overdraft with Barclays Bank had reached a level of £485, 000 against the limit of £250, 000, the bank informed the company its inability to meet its requirement of fund for the payment of final dividend. In the AGM of the company held on 2nd July 1964, payment of final dividend of 120% was approved. The company managed to obtain a loan of £209, 719, 8s and 6 d from Quistclose Investments Ltd to meet its commitment of dividend payment on condition that the payment would only be used for the payment of the said dividend amount. Since the cheque was drawn on Barclays Bank, where the lender was having its overdraft account, it opened an Ordinary Dividend No 4 account and credited the proceeds of the cheque received from Quistclose Investment Ltd on 17th July 1964. The company could not raise further resources, and it decided to put the company into voluntary liquidation on the same day with due notice to the bank, when then amalgamated all the accounts of the borrower company except the dividend No 4 account. On 5th August 1964, Quistclose demanded repayment from the borrower without any notice to the bank. When the resolution for liquidation was made on 27th August 1964, bank set off the balance in dividend account No 4 against the money owed by Rolls Razors Ltd in part. This led to the Quistclose[1]demanding the bank for repayment of the money appropriated by it. The issue of the case Quistclose needed to demonstrate that it had proprietary right over the money as otherwise it was liable to be

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used to discharge borrower's overdraft with the bank. In other words, the borrower had held the money as a resulting trust for Quistclose, the lender. The House of Lords raised two issues: whether there was understanding between the respondents that the amount of £209, 719, 8s and 6 d should be held in trust in favour of Quistclose in the event of non-payment of dividend and whether the bank had notice of such a trust or the bank knew of circumstances that would make the trust binding upon them too. The reason for the decisionThe House of Lords decided in favour of the lender Quistclose for the reason that such an arrangement for payment of creditors (here shareholders) by a third party (Quistclose) gave rise to a fiduciary relationship or trust in favour of the creditors failing, that is, in favour of the third party. This principle has been recognized in lots of cases prior to this decision. Among this cases are, Edwards v Glynn (1859) 121 E. R and in Sherwood v Walker (1843) 49 E. R in Toovey v Milne (1819) it was held that the assignee of the bankrupt company was not entitled to recover money repaid by the bankrupt, which it had held on trust resulting from a failure to repay certain debts for repayment of which the money was paid to the bankrupt company. The reasoning was that " money advanced for the specific purpose did not become part of the bankrupt estate". The effect of the decisionThe Quistclose Trust has become a special purpose trust by which it has been recognized that a fund held by a person for specific purpose is money held on trust. If the money is paid for specific purpose, the holder of the money becomes a debtor or settler. Eventually, if the specific purpose fails, it becomes a resulting trust in favour of the settlor. It is difficult to classify the Quistclose type of trusts. It was argued in the case that there was a primary express trust which when failed became a resulting trust. It is <https://assignbuster.com/barclays-bank-v-quistclose-law-equity-essay/>

argued that this idea becomes problematic since in the subsequent cases such as *Re EVTR* (1987) BCLC 646.[2] The cases lacked human beneficiaries and hence the resulting trust was not permitted even though the trust had been to accomplish a specific purpose. To cure this, it was suggested in *Twinsectra v Yardley* (2002) AC 164 that it should be assumed that there was a resulting trust from the beginning where the borrower held money for the lender and that there was no existence of primary express trust. Michael Smolyansky argues that they are not even resulting trust but constructive trusts. He states that decision in *Twinsectra Ltd v Yardley* is an approach that is a serious error in law and a subversion of fundamental aspects of insolvency law. He is of this view even though it seeks to end the doctrinal controversy surrounding the Quistclose trust by saying that in an unsecured loan advanced for a specific purpose, it is to be assumed that the borrower keeps the money on resulting trust for the lender. In *Twinsectra*, the money lent to Yardley was not spent for the specific purpose for which it was advanced. Yardley's second solicitor who was responsible for the misuse is also potentially liable besides Yardley. Lord Millet in minority view made it clear that the contractual limitation on the use of money lent also created a Quistclose trust. In 2006 in the decision on *Templeton Insurance Ltd v Pennington's Solicitors LLP* (2006) EWHC 685, Quistclose doctrine was invoked. The case involved money that was lent by the plaintiff to the clients of defendants for the purchase of a brown field site with the condition that the money would be held by the defendants on their undertaking, that the money would be used for the purchase of that land alone, and in the event it could not be[3] achieved, the money should be held in the bank account of the defendants clients. The decision affirmed the existence of the Quistclose

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trust in the arrangement. There are numerous examples of similar instances wherein the requirement was that the contract must identify the particular use of the money lent. In *Re Northern Developments Holdings Ltd*, Quistclose trust was upheld as the money was advanced for the express purpose of payment to unsecured creditors of the subsidiary and for no other purpose. In *General Communications Ltd and Development Finance Corporation of New Zealand Ltd (1990) 3 NZLR 406* a Quistclose trust was found as the condition of the loan that was to be used for the purchase of new equipment. However, Quistclose trust would not be invoked in cases where money has been advanced to borrower on an outright basis without any such condition for a specific purpose, as held in *Abou-Rahmah and Others v Abacha and Others (2005) EWHC 2662 (QB)*. Conclusion In spite of the criticisms, Quistclose trust still remains an authority. The money paid for a specific purpose should be treated as held in trust until the specific purpose is met. It is therefore logical that the money is refundable to the giver if the specific purpose is not met. To be precise, wherever the lender retains his title, his or her money held in trust cannot be appropriated in the insolvency proceedings or by any other claimant in the capacity of a creditor other than the one who lent. Quistclose has the resemblance of garnishee rights wherein the court would order a bank of a debtor to pay from the account of the debtor money owed to a creditor. It is for the obvious reasons that the money lies in the debtor's account representing money lent to him or her or money earned through money lent to him. According to Lord Millet in *Twinsectra Ltd v Yardley* which says " if an otherwise unsecured loan is made for a specific purpose, and for no other purpose, then it may be inferred that the borrower holds the money on resulting trust for the lender, The trust is subject, however to the

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borrowers mandate to apply the funds towards the agreed upon purpose." [4] Reform In 2002 the law commission published consultation paper on company charges and registration of security interest, on how to reform the current law, and in 2004 come with a proposal to reform the law. The recommended proposals are: a new system of electronic notice filing to replace the current paper system that is being use at the moment, removing the 21 day time limit for registration and court applications for late registration will also to be removed. Extending the list of registrable charges that the list of charges that need to be registered is out of date and the company acts 1985 omits some charges which are often used. And finally clearer priority rules by the company acts 1985 that the act fail to lay down clear rules about what happens when two or more creditors have registered charges over the same property.