Court File No.: CV-15-11192-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF SECTION 101 OF THE *COURTS OF JUSTICE ACT,* R.S.O. 1990, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF VICTORIAN ORDER OF NURSES FOR CANADA, VICTORIAN ORDER OF NURSES FOR CANADA – EASTERN REGION, AND VICTORIAN ORDER OF NURSES FOR CANADA – WESTERN REGION

BOOK OF AUTHORITIES

(Motion Returnable January 19, 2016)

January 15, 2016

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TO: The Service List

TAB 1

138 However, the point regarding vicarious liability and exemplary damages was not the basis on which the strike-out application was made, was not dealt with in the courts below and was not addressed by counsel before your Lordships. The views I have expressed should, therefore, be regarded as provisional and the point left for decision at a later stage in the proceedings. A

139 In the result I would, for the reasons given in paragraph 122 above, with reluctance, allow this appeal. My reluctance is the consequence of my opinion that, on the vicarious liability point, this exemplary damages claim is bound to fail. B

Appeal allowed with costs.

Solicitors: Sharpe Pritchard for Smith Partnership, Leicester; Winckworth Sherwood for County Solicitor, Leicester. C

M G

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House of Lords

Twinsectra Ltd *v* Yardley and others

E

[2002] UKHL 12

2001 Oct 15, 16, 17, 18;
2002 March 21

Lord Slynn of Hadley, Lord Steyn, Lord Hoffmann, Lord Hutton and Lord Millett

Trusts — Resulting trust — Dishonesty — Lender requiring solicitor's undertaking before making loan — Third party solicitor undertaking that loan moneys only to be used for acquisition of property by borrower — Third party solicitor paying moneys to borrower's solicitor — Borrower's solicitor treating loan moneys as at free disposal of client — Some moneys not used in acquisition of property — Whether undertaking creating trust — Whether borrower's solicitor dishonestly assisting in breach of trust F

The first solicitor was acting for a client in connection with the purchase of land. To complete the purchase the client needed to borrow £1m. A lender was found but it was only willing to make the loan if repayment was secured by a solicitor's personal undertaking. The first solicitor was unwilling to give such an undertaking so the client approached the second solicitor who represented himself as acting for the client and received the money after his firm gave an undertaking that "(1) The loan moneys will be retained by us until such time as they are applied in the acquisition of property on behalf of our client. (2) The loan moneys will be utilised solely for the acquisition of property on behalf of our client and for no other purposes. (3) We will repay to you the said sum of £1m together with interest". The second solicitor sought assurances from the client that the money would be used in the acquisition of property and received them through the first solicitor. He then released the money to the first solicitor as instructed by the client. The first solicitor regarded the money as G H

A held on account for the client and paid it out upon the client's instructions. He took no steps to ensure that the money was only applied in the acquisition of property and a substantial part of it was used by the client for other purposes. The second solicitor went bankrupt and the loan was not repaid. The lender commenced proceedings against, inter alios, the first solicitor alleging that he had dishonestly assisted in the second solicitor's breach of trust. The judge found that the undertaking had not created a trust and dismissed the action. He also found that the first solicitor had not B been dishonest although he had deliberately shut his eyes to the implications of the undertaking. The Court of Appeal reversed both those findings and gave judgment against the first solicitor for the proportion of the loan which had not been applied in the acquisition of property.

On appeal by the first solicitor—

Held, (1) that paragraphs 1 and 2 of the undertaking made it clear that the money was not to be at the free disposal of the client and that the second solicitor was not to C part with the money except for the stated purpose; that a power to apply the money in "the acquisition of property" was sufficiently certain for the creation of a trust; that the fact that the lender had not intended to create a trust was irrelevant; and that, accordingly, the second solicitor had held the money on trust for the lender subject to a power to apply it by way of a loan to the client in accordance with the undertaking with the result that the money remained the lender's money until such time as it was so applied (post, paras 2, 7, 12–17, 25, 71–72, 75, 100–103).

D (2) Allowing the appeal (Lord Millett dissenting), that for a person to be liable as an accessory to a breach of trust he had to have acted dishonestly by the ordinary standards of reasonable and honest people and have been himself aware that by those standards he was acting dishonestly; that the judge had applied that test, and had found that the first solicitor had honestly believed that the undertaking given to the lender was not his concern and that, once in his hands, he could treat the loan money as at the free disposal of the client; that the first solicitor had been aware of all the E facts and could not be said to have been dishonest by deliberately failing to make inquiries for fear of finding out something he did not want to know; and that in the light of the judge's findings, based on an assessment of the first solicitor in the witness box, the Court of Appeal should not have substituted its own finding of dishonesty against him (post, paras 4–8, 20–24, 32, 35–36, 38, 41–43, 49–51).

Royal Brunei Airlines Sdn Bhd v Tan [1995] 2 AC 378, PC applied.

Decision of the Court of Appeal [1999] Lloyd's Rep Bank 438 reversed in part.

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The following cases are referred to in the opinions of their Lordships:

Abbey National plc v Solicitors Indemnity Fund Ltd [1997] PNLR 306
Agip (Africa) Ltd v Jackson [1990] Ch 265; [1989] 3 WLR 1367; [1992] 4 All ER 385
Aktieselskabet Dansk Skibsfinansiering v Brothers [2001] 2 BCLC 324
Australian Elizabethan Theatre Trust, In re (1991) 102 ALR 681
Automatic Woodturning Co Ltd v Stringer [1957] AC 544; [1957] 2 WLR 203; G [1957] 1 All ER 90, HL(E)
Baden v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA (Note) [1993] 1 WLR 509; [1992] 4 All ER 16
Baden's Deed Trusts, In re [1971] AC 424; [1970] 2 WLR 1110; [1970] 2 All ER 228, HL(E)
Barclays Bank plc v Weeks Legg & Dean [1999] QB 309; [1998] 3 WLR 656; [1998] 3 All ER 213, CA
H *Barnes v Addy* (1874) LR 9 Ch App 244
Beaman v ARTS Ltd [1949] 1 KB 550; [1949] 1 All ER 465, CA
Boscawen v Bajwa [1996] 1 WLR 328; [1995] 4 All ER 769, CA
Bristol and West Building Society v Mothew [1998] Ch 1; [1997] 2 WLR 436; [1996] 4 All ER 698, CA
British Motor Trade Association v Salvadori [1949] Ch 556; [1949] 1 All ER 208

Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd [1985] Ch 207; [1984] 3 WLR 1016; [1985] 1 All ER 155 A
Cowan de Groot Properties Ltd v Eagle Trust plc [1992] 4 All ER 700
Denley's Trust Deed, In re [1969] 1 Ch 373; [1968] 3 WLR 457; [1968] 3 All ER 65
EVTR, In re, Gilbert v Barber [1987] BCLC 646, CA
Edwards v Glyn (1859) 2 E & E 29
General Communications Ltd v Development Finance Corpn of New Zealand Ltd [1990] 3 NZLR 406 B
Gibert v Gonard (1884) 54 LJ Ch 439
Goldcorp Exchange Ltd, In re [1995] 1 AC 74; [1994] 3 WLR 199; [1994] 2 All ER 806, PC
Grant's Will Trusts, In re, Harris v Anderson [1980] 1 WLR 360; [1979] 3 All ER 359
Grupo Torras SA v Al Sabah [1997] CLC 1553
Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd [2001] UKHL 1; [2001] 2 WLR 170; [2001] 1 All ER 743, HL(E) C
Mortgage Express Ltd v S Newman & Co [2000] PNLR 298; [2000] Lloyd's Rep PN 745, CA
Northern Developments (Holdings) Ltd, In re (unreported) 6 October 1978, Sir Robert Megarry V-C
Quistclose Investments Ltd v Rolls Razor Ltd [1970] AC 567; [1968] 3 WLR 1097; [1968] 3 All ER 651, HL(E)
R v Ghosh [1982] QB 1053; [1982] 3 WLR 110; [1982] 2 All ER 689, CA D
Rogers, In re, Ex p Holland & Hannen (1891) 8 Morr 243, CA
Rose v Rose (1986) 7 NSWLR 679
Royal Brunei Airlines Sdn Bhd v Tan [1995] 2 AC 378; [1995] 3 WLR 64; [1995] 3 All ER 97, PC
Sefton v Tophams Ltd [1965] Ch 1140; [1965] 3 WLR 523; [1965] 3 All ER 1, CA
Thomson (DC) & Co Ltd v Deakin [1952] Ch 646; [1952] 2 All ER 361, CA
Toovey v Milne (1819) 2 B & Ald 683
United Bank of Kuwait Ltd v Hammoud [1988] 1 WLR 1051; [1988] 3 All ER 418, CA E
Walker v Stones [2001] QB 902; [2001] 2 WLR 623; [2000] 4 All ER 412, CA
Westdeutsche Landesbank Girozentrale v Islington London Borough Council [1996] AC 669; [1996] 2 WLR 802; [1996] 2 All ER 961, HL(E)

No additional cases were cited in argument. F

APPEAL from the Court of Appeal

This was an appeal by the sixth defendant, a solicitor in sole practice as Paul Leach & Co, from a decision by the Court of Appeal (Potter LJ, Sir Iain Glidewell and Sir David Hirst) dated 28 April 1999 allowing an appeal by the plaintiff lender, Twinsectra Ltd, from part of a decision of Carnwath J, sitting in the Queen's Bench Division on 20 December 1996, by which, inter alia, he dismissed the plaintiff's claim against the sixth defendant. The first to fifth defendants, Francis John Yardley, Yardley Commercial Vehicles Ltd, Maltsword Ltd, YC Sales Ltd and Maltsword Properties Ltd, were not parties to the appeal to the House. G

The facts are stated in the opinion of Lord Millett.

David Oliver QC, Justin Fenwick QC and *Sue Carr* for the solicitor. H
Romie Tager QC and *Tony Oakley* for the lender.

The main submissions of counsel appear sufficiently in the opinions of their Lordships.

A Their Lordships took time for consideration.

21 March 2002. **LORD SLYNN OF HADLEY**

1 My Lords, my noble and learned friend Lord Hoffmann has referred to the facts relevant to the issues which arise on this appeal and I gratefully adopt them.

2 The first main issue is whether the moneys received by Sims and Roper B were held in trust. The judge found that they were not; the Court of Appeal held that they were. For the reasons given by Lord Hoffmann I agree firmly with the Court of Appeal.

3 The second issue I have found more difficult. The judge found that Mr Leach had shut his eyes to the problems or the implications of what happened, yet he acquitted him of dishonesty. The Court of Appeal in a C careful analysis by Potter LJ concluded that deliberately shutting his eyes in this way was dishonesty within the valuable analysis by Lord Nicholls of Birkenhead in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378.

4 There are conflicting arguments. Prima facie shutting one's eyes to problems or implications and not following them up may well indicate dishonesty; on the other hand prima facie it needs a strong case to justify the Court of Appeal reversing the finding as to dishonesty of the trial judge who D has heard the witness and gone in detail into all the facts.

5 The real difficulty it seems to me is whether in view of these two conflicting arguments the case should go for a retrial with all the disadvantages that entails or whether one of the arguments was sufficiently strong for your Lordships to accept it and to conclude the question. In the end I am not satisfied that the Court of Appeal were entitled to substitute E their assessment for that of the trial judge. Despite my doubts as to the implications to be drawn on a finding of "shutting one's eyes" it seems to me clear that the judge was very conscious of Lord Nicholls's analysis and I do not think he can possibly have left out of account the question whether Mr Leach knew or realised that what he was doing fell below the required standards when he deliberately shut his eyes e g to the implications of the undertaking given by Mr Sims. Mr Leach may have been naive or misguided F but I accept that the judge after hearing lengthy evidence from Mr Leach was entitled to conclude that he had not been dishonest.

6 Accordingly it would be wrong to send the matter for retrial and for these brief reasons and the reasons given by Lord Hutton I would allow the appeal.

G **LORD STEYN**

7 My Lords, I agree that the law is as stated in the judgments of my noble and learned friends Lord Hoffmann and Lord Hutton. In particular I agree with their interpretation of the decision in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378. In other words, I agree that a finding of accessory liability against Mr Leach was only permissible if, applying what Lord Hutton has called the combined test, it were established on the H evidence that Mr Leach had been dishonest.

8 After a trial Carnwath J was not satisfied that Mr Leach had been dishonest. I agree with Lord Hutton's reasons for concluding that the Court of Appeal was not entitled to reverse the judge on the central issue of dishonesty. I too would allow the appeal.

LORD HOFFMANN

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9 My Lords, Paul Leach is a solicitor practising in Godalming under the name Paul Leach & Co. Towards the end of 1992 he acted for a Mr Yardley in a transaction which included the negotiation of a loan of £1m from Twinsectra Ltd. Mr Leach did not deal directly with Twinsectra. Another firm of solicitors, Sims & Roper of Dorset ("Sims"), represented themselves as acting on behalf of Mr Yardley. They received the money in return for the following undertaking:

B

"1. The loan moneys will be retained by us until such time as they are applied in the acquisition of property on behalf of our client. 2. The loan moneys will be utilised solely for the acquisition of property on behalf of our client and for no other purpose. 3. We will repay to you the said sum of £1m together with interest calculated at the rate of £657·53 per day . . . such repayment to be made [within four calendar months after receipt of the loan moneys by us]."

C

10 Contrary to the terms of the undertaking, Sims did not retain the money until it was applied in the acquisition of property by Mr Yardley. On being given an assurance by Mr Yardley that it would be so applied, they paid it to Mr Leach. He in turn did not take steps to ensure that it was utilised solely for the acquisition of property on behalf of Mr Yardley. He simply paid it out upon Mr Yardley's instructions. The result was that £357,720·11 was used by Mr Yardley for purposes other than the acquisition of property.

D

11 The loan was not repaid. Twinsectra sued all the parties involved including Mr Leach. The claim against him was for the £357,720·11 which had not been used to buy property. The basis of the claim was that the payment by Sims to Mr Leach in breach of the undertaking was a breach of trust and that he was liable for dishonestly assisting in that breach of trust in accordance with the principles stated by Lord Nicholls of Birkenhead in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378.

E

12 The trial judge (Carnwath J) did not accept that the moneys were "subject to any form of trust in Sims's and Roper's hands". I do not imagine that the judge could have meant this to be taken literally. Money in a solicitor's client account is held on trust. The only question is the terms of that trust. I should think that what Carnwath J meant was that Sims held the money on trust for Mr Yardley absolutely. That is the way it was put by Mr Oliver, who appeared for Mr Leach. But, like the Court of Appeal, I must respectfully disagree. The terms of the trust upon which Sims held the money must be found in the undertaking which they gave to Twinsectra as a condition of payment. Clauses 1 and 2 of that undertaking made it clear that the money was not to be at the free disposal of Mr Yardley. Sims were not to part with the money to Mr Yardley or anyone else except for the purpose of enabling him to acquire property.

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G

13 In my opinion the effect of the undertaking was to provide that the money in the Sims client account should remain Twinsectra's money until such time as it was applied for the acquisition of property in accordance with the undertaking. For example, if Mr Yardley went bankrupt before the money had been so applied, it would not have formed part of his estate, as it would have done if Sims had held it in trust for him absolutely. The undertaking would have ensured that Twinsectra could get it back. It

H

A follows that Sims held the money in *trust* for Twinsectra, but subject to a *power* to apply it by way of loan to Mr Yardley in accordance with the undertaking. No doubt Sims also owed fiduciary obligations to Mr Yardley in respect of the exercise of the power, but we need not concern ourselves with those obligations because in fact the money was applied wholly for Mr Yardley's benefit.

B 14 The judge gave two reasons for rejecting a trust. The first was that the terms of the undertaking were too vague. It did not specify any particular property for which the money was to be used. The second was that Mr Ackerman, the moving spirit behind Twinsectra, did not intend to create a trust. He set no store by clauses 1 and 2 of the undertaking and was content to rely on the guarantee in clause 3 as Twinsectra's security for repayment.

C 15 I agree that the terms of the undertaking are very unusual. Solicitors acting for both lender and borrower (for example, a building society and a house buyer) commonly give an undertaking to the lender that they will not part with the money save in exchange for a duly executed charge over the property which the money is being used to purchase. The undertaking protects the lender against finding himself unsecured. But Twinsectra was not asking for any security over the property. Its security was clause 3 of the D Sims undertaking. So the purpose of the undertaking was unclear. There was nothing to prevent Mr Yardley, having acquired a property in accordance with the undertaking, from mortgaging it to the hilt and spending the proceeds on something else. So it is hard to see why it should have mattered to Twinsectra whether the immediate use of the money was to acquire property. The judge thought it might have been intended to give E some protective colour to a claim against the Solicitors Indemnity Fund if Sims failed to repay the loan in accordance with the undertaking. A claim against the fund would depend upon showing that the undertaking was given in the context of an underlying transaction within the usual business of a solicitor: *United Bank of Kuwait Ltd v Hammoud* [1988] 1 WLR 1051. Nothing is more usual than for solicitors to act on behalf of clients in the acquisition of property. On the other hand, an undertaking to repay a F straightforward unsecured loan might be more problematic.

16 However, the fact that the undertaking was unusual does not mean that it was void for uncertainty. The charge of uncertainty is levelled against the terms of the power to apply the funds. "The acquisition of property" was said to be too vague. But a power is sufficiently certain to be valid if the court can say that a given application of the money does or does not fall G within its terms: see *In re Baden's Deed Trusts* [1971] AC 424. And there is no dispute that the £357,720·11 was not applied for the acquisition of property.

17 As for Mr Ackerman's understanding of the matter, that seem to me irrelevant. Whether a trust was created and what were its terms must depend upon the construction of the undertaking. Clauses 1 and 2 cannot be ignored just because Mr Ackerman was not particularly interested in them.

H 18 The other question is whether Mr Leach, in receiving the money and paying it to Mr Yardley without concerning himself about its application, could be said to have acted dishonestly. The judge found that in so doing he was "misguided" but not dishonest. He had "shut his eyes" to some of the problems but thought he held the money to the order of Mr Yardley without

restriction. The Court of Appeal reversed this finding and held that he had been dishonest. A

19 My noble and learned friend, Lord Millett considers that the Court of Appeal was justified in taking this view because liability as an accessory to a breach of trust does not depend upon dishonesty in the normal sense of that expression. It is sufficient that the defendant knew all the facts which made it wrongful for him to participate in the way in which he did. In this case, Mr Leach knew the terms of the undertaking. He therefore knew all the facts which made it wrongful for him to deal with the money to the order of Mr Yardley without satisfying himself that it was for the acquisition of property. B

20 I do not think that it is fairly open to your Lordships to take this view of the law without departing from the principles laid down by the Privy Council in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378. For the reasons given by my noble and learned friend, Lord Hutton, I consider that those principles require more than knowledge of the facts which make the conduct wrongful. They require a dishonest state of mind, that is to say, consciousness that one is transgressing ordinary standards of honest behaviour. I also agree with Lord Hutton that the judge correctly applied this test and that the Court of Appeal was not entitled, on the basis of the written transcript, to make a finding of dishonesty which the judge who saw and heard Mr Leach did not. C D

21 The ground upon which the Court of Appeal reversed the judge's finding was that he had misdirected himself in law. His finding about Mr Leach shutting his eyes to problems meant that he did not appreciate that a person may be dishonest without actually knowing all the facts if he suspects that he is about to do something wrongful and deliberately shuts his eyes to avoid finding out. As Lord Nicholls said in the *Royal Brunei* case, at p 389, an honest person does not "deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless". So the Court of Appeal said that, when the judge said that Mr Leach was not dishonest, he meant that he was not "consciously dishonest". But the finding about shutting his eyes meant that in law he had nevertheless been dishonest. E F

22 I do not believe that the judge fell into such an elementary error. He had himself quoted the passage I have cited from the opinion of Lord Nicholls in the *Royal Brunei* case a little earlier in his judgment. He could not possibly have overlooked the principle. That said, I do respectfully think it was unfortunate that the judge three times used the expression "shut his eyes" to "the details", or "the problems", or "the implications". The expression produces in judges a reflex image of Admiral Nelson at Copenhagen and the common use of this image by lawyers to signify a deliberate abstinence from inquiry in order to avoid certain knowledge of what one suspects to be the case: see *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd* [2001] 2 WLR 170, 179, per Lord Hobhouse of Woodborough, and Lord Scott of Foscote, at pp 207–210. But, as my noble and learned friend Lord Millett points out, there were in this case no relevant facts of which Mr Leach was unaware. What I think the judge meant was that he took a blinkered approach to his professional duties as a solicitor, or buried his head in the sand (to invoke two different animal images). But neither of those would be dishonest. G H

A 23 Mr Leach believed that the money was at the disposal of Mr Yardley. He thought that whether Mr Yardley's use of the money would be contrary to the assurance he had given Mr Sims or put Mr Sims in breach of his undertaking was a matter between those two gentlemen. Such a state of mind may have been wrong. It may have been, as the judge said, misguided. But if he honestly believed, as the judge found, that the money was at Mr Yardley's disposal, he was not dishonest.

B 24 I do not suggest that one cannot be dishonest without a full appreciation of the legal analysis of the transaction. A person may dishonestly assist in the commission of a breach of trust without any idea of what a trust means. The necessary dishonest state of mind may be found to exist simply on the fact that he knew perfectly well that he was helping to pay away money to which the recipient was not entitled. But that was not C the case here. I would therefore allow the appeal and restore the decision of Carnwath J.

LORD HUTTON

25 My Lords, I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Hoffmann and Lord Millett. For the reasons which they give I agree that the undertaking given by Mr Sims to D Twinsectra Ltd ("Twinsectra") created a trust, and I turn to consider whether the Court of Appeal was right to hold that Mr Leach is liable for assisting in Mr Sims's breach of trust. Carnwath J held that the undertaking did not create a trust, but he also held that Mr Leach had not been dishonest. The Court of Appeal reversed his findings and held that the undertaking gave rise to a trust and that Mr Leach had acted dishonestly and was liable as an E accessory to Mr Sims's breach of trust.

26 My Lords, in my opinion, the issue whether the Court of Appeal was right to hold that Mr Leach had acted dishonestly depends on the meaning to be given to that term in the judgment of Lord Nicholls of Birkenhead in *Royal Brunei Airlines Snd Bhd v Tan* [1995] 2 AC 378. In approaching this question it will be helpful to consider the place of dishonesty in the pattern of that judgment. Lord Nicholls considered, at pp 384 and 385, the position of F the honest trustee and the dishonest third party and stated that dishonesty on the part of the third party was a sufficient basis for his liability notwithstanding that the trustee, although mistaken and in breach of trust, was honest. He then turned to consider the basis on which the third party, who does not receive trust property but who assists the trustee to commit a breach, should be held liable. He rejected the possibility that such a third G party should never be liable and he also rejected the possibility that the liability of a third party should be strict so that he would be liable even if he did not know or had no reason to suspect that he was dealing with a trustee. Therefore Lord Nicholls concluded that the liability of the accessory must be fault-based and in identifying the touchstone of liability he stated, at p 387H: "By common accord dishonesty fulfils this role." Then, at pp 388 and 389, he cited a number of authorities and the views of commentators and H observed that the tide of authority in England had flowed strongly in favour of the test of dishonesty and that most, but not all, commentators also preferred that test.

27 Whilst in discussing the term "dishonesty" the courts often draw a distinction between subjective dishonesty and objective dishonesty, there are

three possible standards which can be applied to determine whether a person has acted dishonestly. There is a purely subjective standard, whereby a person is only regarded as dishonest if he transgresses his own standard of honesty, even if that standard is contrary to that of reasonable and honest people. This has been termed the "Robin Hood test" and has been rejected by the courts. As Sir Christopher Slade stated in *Walker v Stones* [2001] QB 902, 939:

"A person may in some cases act dishonestly, according to the ordinary use of language, even though he genuinely believes that his action is morally justified. The penniless thief, for example, who picks the pocket of the multi-millionaire is dishonest even though he genuinely considers the theft is morally justified as a fair redistribution of wealth and that he is not therefore being dishonest."

Secondly, there is a purely objective standard whereby a person acts dishonestly if his conduct is dishonest by the ordinary standards of reasonable and honest people, even if he does not realise this. Thirdly, there is a standard which combines an objective test and a subjective test, and which requires that before there can be a finding of dishonesty it must be established that the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realised that by those standards his conduct was dishonest. I will term this "the combined test".

28 There is a passage in the earlier part of the judgment in *Royal Brunei* which suggests that Lord Nicholls considered that dishonesty has a subjective element. Thus in discussing the honest trustee and the dishonest third party [1995] 2 AC 378, 385 he stated:

"These examples suggest that what matters is the state of mind of the third party . . . But [the trustee's] state of mind is essentially irrelevant to the question whether the *third party* should be made liable to the beneficiaries for breach of trust."

29 However, after stating, at p 387H, that the touchstone of liability is dishonesty, Lord Nicholls went on, at p 389, to discuss the meaning of dishonesty:

"Before considering this issue further it will be helpful to define the terms being used by looking more closely at what dishonesty means in this context. Whatever may be the position in some criminal or other contexts (see, for instance, *R v Ghosh* [1982] QB 1053), in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard."

30 My noble and learned friend Lord Millett has subjected this passage and subsequent passages in the judgment to detailed analysis and is of the opinion that Lord Nicholls used the term "dishonesty" in a purely objective sense so that in this area of the law a person can be held to be dishonest even though he does not realise that what he is doing is dishonest by the ordinary standards of honest people. This leads Lord Millett on to the conclusion that in determining the liability of an accessory dishonesty is not necessary and that liability depends on knowledge.

A 31 In *R v Ghosh* [1982] QB 1053, Lord Lane CJ held that in the law of theft dishonesty required that the defendant himself must have realised that what he was doing was dishonest by the ordinary standards of reasonable and honest people. The three sentences in Lord Nicholls's judgment, at p 389B–C, which appear to draw a distinction between the position in criminal law and the position in equity, do give support to Lord Millett's view. But considering those sentences in the context of the remainder of the B paragraph and taking account of other passages in the judgment, I think that in referring to an objective standard Lord Nicholls was contrasting it with the purely subjective standard whereby a man sets his own standard of honesty and does not regard as dishonest what upright and responsible people would regard as dishonest. Thus after stating that dishonesty is assessed on an objective standard he continued, at p 389:

C "At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly D concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each E individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour."

Further, at p 391, Lord Nicholls said:

"Ultimately, in most cases, an honest person should have little F difficulty in knowing whether a proposed transaction, or his participation in it, would offend the normally accepted standards of honest conduct. Likewise, when called upon to decide whether a person was acting honestly, a court will look at all the circumstances known to the third party at the time. The court will also have regard to personal attributes of the third party, such as his experience and intelligence, and the reason why he acted as he did."

G 32 The use of the word "knowing" in the first sentence would be superfluous if the defendant did not have to be aware that what he was doing would offend the normally accepted standards of honest conduct, and the need to look at the experience and intelligence of the defendant would also appear superfluous if all that was required was a purely objective standard of dishonesty. Therefore I do not think that Lord Nicholls was stating that in H this sphere of equity a man can be dishonest even if he does not know that what he is doing would be regarded as dishonest by honest people.

33 Then, at p 392F–G, Lord Nicholls stated the general principle that dishonesty is a necessary ingredient of accessory liability and that knowledge is not an appropriate test:

"*The accessory liability principle*

"Drawing the threads together, their Lordships' overall conclusion is that dishonesty is a necessary ingredient of accessory liability. It is also a sufficient ingredient. A liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly. 'Knowingly' is better avoided as a defining ingredient of the principle, and in the context of this principle the *Baden* [1993] 1 WLR 509 scale of knowledge is best forgotten."

I consider that this was a statement of general principle and was not confined to the doubtful case when the propriety of the transaction in question was uncertain.

34 Lord Nicholls stated, at p 387B–C, that there is a close analogy between "knowingly" interfering with the due performance of a contract and interfering with the relationship between a trustee and a beneficiary. But this observation was made in considering and rejecting the possibility that a third party who did not receive trust property should never be liable for assisting in a breach of trust. I do not think that in referring to "knowingly" procuring a breach of contract Lord Nicholls was suggesting that knowingly assisting in a breach of trust was sufficient to give rise to liability. Such a view would be contrary to the later passage, at p 392F–G, dealing directly with this point.

35 There is, in my opinion, a further consideration which supports the view that for liability as an accessory to arise the defendant must himself appreciate that what he was doing was dishonest by the standards of honest and reasonable men. A finding by a judge that a defendant has been dishonest is a grave finding, and it is particularly grave against a professional man, such as a solicitor. Notwithstanding that the issue arises in equity law and not in a criminal context, I think that it would be less than just for the law to permit a finding that a defendant had been "dishonest" in assisting in a breach of trust where he knew of the facts which created the trust and its breach but had not been aware that what he was doing would be regarded by honest men as being dishonest.

36 It would be open to your Lordships to depart from the principle stated by Lord Nicholls that dishonesty is a necessary ingredient of accessory liability and to hold that knowledge is a sufficient ingredient. But the statement of that principle by Lord Nicholls has been widely regarded as clarifying this area of the law and, as he observed, the tide of authority in England has flowed strongly in favour of the test of dishonesty. Therefore I consider that the courts should continue to apply that test and that your Lordships should state that dishonesty requires knowledge by the defendant that what he was doing would be regarded as dishonest by honest people, although he should not escape a finding of dishonesty because he sets his own standards of honesty and does not regard as dishonest what he knows would offend the normally accepted standards of honest conduct.

37 In cases subsequent to the *Royal Brunei* case there has been some further consideration of the test to be applied to determine dishonesty (the cases being helpfully discussed in an article by Mr Andrew Stafford QC on

A "Solicitors' liability for knowing receipt and dishonest assistance in breach of trust" (2001) 17 PN 3. For the reasons which I have given I consider that in *Abbey National plc v Solicitors Indemnity Fund Ltd* [1997] PNLR 306 Steel J applied the correct test. In that case, at p 310, she referred to the test set out in *R v Ghosh* [1982] QB 1053 and to Lord Nicholls's judgment in the *Royal Brunei* case [1995] 2 AC 378 and observed that it was to the effect that B honesty is to be judged objectively, and she continued:

> "What in this case, did, Mr Fallon do, and was he acting as a reasonable and honest solicitor would do? In that case it was laid down that individuals are not free to set their own standards. Mr Fenwick on behalf of the defendant says that if I find that by those standards Mr Fallon was dishonest that would be enough. I need to consider what he did and C ask the question: Was he acting as an honest person should? Was what he did dishonest by the standards of a reasonable and honest man or a reasonable and honest solicitor? Having read that case, however, it seems to me that the judgment does not set down a wholly objective test for civil cases. Lord Nicholls particularly refers to a conscious impropriety. The test there, it seems, does embrace a subjective approach, and I have to look at the circumstances to see whether they were such that Mr Fallon D must have known that what he did was by the standards of ordinary decent people dishonest. I accept totally that individuals should not be free to set their own standards, but there is in my view a subjective element both in civil and in criminal cases."

38 Therefore I turn to consider the judgment of Carnwath J and the Court of Appeal on the basis that a finding of accessory liability can only be E made against Mr Leach if, applying the combined test, it were established on the evidence that he was dishonest.

39 At the trial Mr Leach was cross-examined very closely and at length about his state of mind when he paid to Mr Yardley the moneys transferred to him by Mr Sims. The tenor of his replies was that he paid the moneys to his client because his client instructed him to do so. Thus in the course of F that cross-examination counsel for Twinsectra put the following questions to him:

> "*Q*. That is not what you said in your pleading which is what I am putting to you. In your pleading you said that with the exception of the Glibbery payment every other payment was made by you in the belief that the money was going to be used for the acquisition of property by G companies of Mr Yardley. *A*. I had no reason to disbelieve that it was not. As I said, I believed my client. He borrowed the money. I followed his instructions.
>
> "*Q*. £200,000 was being transferred to Y C Sales, you did not believe for a moment that that company was going to use it to acquire property, did you? *A*. My Lord, I merely followed my client's instructions.
>
> "*Carnwath J*. I think there is a difference. I mean I understand you are H saying that, but there is a difference between saying: 'I simply paid it in accordance with my client's instructions,' and saying, as is said in the pleading: 'I paid it in the belief it was going to be used on the acquisition of property.' Now, if your evidence that the former was true and the latter was not then fair enough, but I think Mr Tager is entitled to ask you

whether it is right positively to state that you paid the moneys in the belief that they were being applied in the acquisition of property. *A.* I merely believed in the sense that the moneys my client had borrowed were being used for the purpose for which he borrowed them. I actually didn't consider the point.

"*Q.* No, so it is probably that pleading goes rather farther than your own recollection? *A.* Yes, I think it is probably . . .

"*Mr Tager.* You were putting forward a case in your pleading that Mr Sims had confirmed with you on 23 December that it was going to be used for property. You asked your client if that was so and you got him to confirm the details. The money comes in, you pay it out and you believe each time that that is how the money was used. *A.* I had no reason to disbelieve my client.

"*Carnwath J.* I think I am clear what the witness is saying, Mr Tager."

40 Carnwath J stated:

"I do not find Mr Leach to have been dishonest, but he was certainly misguided. He found himself in a difficult position. His retainer for Mr Yardley on the Apperley Bridge transaction was very important to his practice (at a time when large conveyancing jobs were few), and offered the prospect of similar work in the future. When asked to review the documentation on the Nigerian venture, he was understandably reluctant to prejudice his relationship with his client. I do not accept his evidence that he paid no regard to the details. He was specifically asked to review the terms. He must have realised that it was a very unusual venture, and that the returns of the kind offered were very unlikely to be associated with a wholly legitimate business transaction . . . His attitude to the Twinsectra loan was not dissimilar. When asked to give the undertaking himself, he regarded it as a very unusual request, and one outside the normal course of a solicitor's practice. This did not lead him to advise Mr Yardley against it, but rather to distance himself from any responsibility for its terms. He told Mr Sims that they were a matter for him. This unease ought to have put him on notice of the need for caution when dealing with the money received under the undertakings. He was clearly aware of their terms. Indeed, his pleaded defence asserts (paragraph 25(4)) that he believed their 'substance . . . to be that the advance would be applied in the acquisition of property' and that he had received them on the footing that they would be so applied. Yet, in evidence, he frankly admitted that he had regarded the money as held simply to the order of Mr Yardley, without restriction. Again, I have to conclude that he simply shut his eyes to the problems. As far as he was concerned, it was a matter solely for Mr Sims to satisfy himself whether he could release the money to Mr Yardley's account."

Later in the judgment after holding that the undertaking given by Mr Sims did not create a trust the judge stated, at p 73:

"*Were any of the defendants knowing recipients or accessories?*

"The above conclusion makes it unnecessary to resolve the more difficult question whether any of the defendants (that is, the Yardley

A companies, or Mr Leach) had the necessary state of mind to make them liable under these headings. For these purposes the companies must realistically be taken to have had the same knowledge and state of mind as Mr Yardley. I have already given my views as to the extent to which I regard him as having acted dishonestly. In Mr Leach's case, I have found that he was not dishonest, but that he did deliberately shut his eyes to the implications of the undertaking. Whether in either case this would be B sufficient to establish accessory liability depends on the application of the *Royal Brunei* principles to those facts. Although that case was concerned with 'knowing assistance' rather than 'knowing receipt', I would find it very difficult, in the light of the current state of the authorities to which I have referred, to define the difference in the mental states required; and I doubt if there is one."

C

41 It would have been open to the judge to hold that Mr Leach was dishonest, in that he knew that he was transferring to Mr Yardley or to one of his companies moneys which were subject to an undertaking that they would be applied solely for the acquisition of property and that the moneys would not be so applied. But the experienced judge who was observing Mr Leach being cross-examined at length found that Mr Leach, although D misguided, was not dishonest in carrying out his client's instructions.

42 The judge did not give reasons for this finding or state what test he applied to determine dishonesty, but I think it probable that he applied the combined test and I infer that he considered that Mr Leach did not realise that in acting on his client's instructions in relation to the moneys he was acting in a way which a responsible and honest solicitor would regard as E dishonest. The judge may also have been influenced by the consideration that as he did not find that Mr Sims's undertaking created a trust Mr Leach would not have realised that he was dealing with trust property.

43 It is only in exceptional circumstances that an appellate court should reverse a finding by a trial judge on a question of fact (and particularly on the state of mind of a party) when the judge has had the advantage of seeing the party giving evidence in the witness box. Therefore I do not think that it F would have been right for the Court of Appeal in this case to have come to a different conclusion from the judge and to have held that Mr Leach was dishonest in that when he transferred the moneys to Mr Yardley he knew that his conduct was dishonest by the standards of responsible and honest solicitors.

44 This was the view taken by the Court of Appeal in *Mortgage Express* G *Ltd v S Newman & Co* [2000] Lloyds Rep PN 745 where the issue before the court was not dissimilar to the issue in the present case. In that case it was alleged that the defendant, a solicitor, had dishonestly taken part in a mortgage fraud. In the High Court [2000] PNLR 298 the judge found that the defendant had not consciously suspected a mortgage fraud. Nevertheless he found that she had deliberately refrained from making enquiries and giving advice which an ordinary honest and competent solicitor would have H made and given in all the circumstances, and that she had no excuse for doing so other than the fact that she had taken a highly restricted and blinkered view of the duties that she owed to her clients. The judge considered that the explanation for this behaviour was to be found in what she had been told by an insurance and mortgage broker, Mr Baruch, at the

outset of the whole transaction, which was that a particular client was not the kind of client who required to be advised of the matters of which a purchaser would normally be advised. The judge found that the solicitor had not been dishonest. He said, at pp 321, 322:

"Her fault thus lay in her grossly defective appreciation of the nature of the duties she owed to Mortgage Express and a determination *at the outset* not to concern herself with any matters which were not strictly within the tunnel of her vision. If she honestly believed that it was proper for her to take such a restricted view of her duties, and did not in fact come to suspect that a mortgage fraud was being committed, then in my judgment, however gross the negligence she was not guilty of a dishonest or fraudulent omission within the meaning of rule 14(f). I have concluded that, unreasonable as it was for her to hold it, the view that she held of the very restricted ambit of her duties to Mortgage Express was honestly held . . . My conclusion is that her whole approach to this problem was from the outset both naive and well below the standards which should be expected of her profession, but was not dishonest."

45 The Court of Appeal held that the judge's finding that the defendant's conduct was explained by instructions given to her by Mr Baruch was not one which he could have come to on the pleadings and the evidence and that therefore his judgment must be set aside. The plaintiff had submitted that in the absence of a conclusion as to the Baruch instructions, it was clear that the judge would have held that the defendant had been dishonest. Therefore the plaintiff submitted that the Court of Appeal should so hold. The Court of Appeal acknowledged the logic of this submission but observed that it did not take into account the important fact that the judge had concluded that the defendant had not been dishonest after having seen her cross-examined over one and a half days, and Aldous LJ (with whose judgment Tuckey and Mance LLJ agreed) stated, at p 752, para 38:

"It would not be right for this court to conclude that Ms Newman was dishonest when the judge had concluded to the contrary, albeit upon a basis which I have held to be flawed. A conclusion as to whether Ms Newman acted honestly can only be reached after seeing Ms Newman give her evidence."

46 However, in the present case, the Court of Appeal considered that it was entitled to differ from the judge and to find that Mr Leach had been dishonest on the ground that the judge had deliberately refrained from considering a particular aspect of the case, namely "Nelsonian" dishonesty. In his judgment, Carnwath J cited the following passage from the judgment of Lord Nicholls in the *Royal Brunei* case [1995] 2 AC 378, 389:

"an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless."

Later in his judgment after holding that the undertaking did not create a trust the judge continued with the passage which I have already set out under

A the heading: "Were any of the defendants knowing recipients or accessories?"

47 Delivering the judgment of the Court of Appeal and after referring to the passage in the judgment of Carnwath J, citing Lord Nicholls, Potter LJ stated [1999] Lloyd's Rep Bank 438, 462, paras 102–103:

B "Bearing in mind the inclusion within Lord Nicholl's definition of dishonesty of the position where a party deliberately closes his eyes and ears, it can only be assumed that at that point, when the judge referred to Mr Leach as 'not dishonest', he was referring to the state of conscious, as opposed to 'Nelsonian', dishonesty, and it is plain that he deliberately refrained from resolving the latter question on the basis that it was unnecessary to do so.

C "103. Had the judge undertaken that task, Mr Tager submits that he could only have been driven to one conclusion, namely that Nelsonian dishonesty was established."

48 At the conclusion of a detailed and careful consideration of the submissions advanced by the respective counsel Potter LJ concluded the portion of the judgment relating to Mr Leach by stating, at p 465, D paras 109–110:

"It seems to me that, save perhaps in the most exceptional circumstances, it is not the action of an honest solicitor knowingly to assist or encourage another solicitor in a deliberate breach of his undertaking. At the very least it seems to me that Mr Leach's conduct amounted, in the words of Lord Nicholls to 'acting in reckless disregard E of others' rights or possible rights [which] can be a tell-tale sign of dishonesty'.

"110. I do not consider that the points taken by Mr Jackson are sufficient to negative that tell-tale sign in this case. I have already dealt with his submissions (1) and (3). So far as his submission (2) is concerned, for reasons already given it does not seem to me that the fact that Mr Leach was acting for Mr Yardley can of itself excuse the former's F refusal to consider the rights or possible rights of Twinsectra which came to his notice. Nor do I consider that the question whether Mr Leach acted dishonestly in the Nelsonian sense depends on whether he appreciated that what was anticipated was a 'mere' breach of undertaking or that it constituted a breach of trust. In such a case the vice seems to me to rest in deliberately closing his eyes to the rights of Twinsectra, whether legal or equitable, as the beneficiary of the undertaking, and his deliberate failure G to follow matters up or take advice for fear of embarrassment or disadvantage."

49 I agree with Lord Hoffmann that it is unfortunate that Carnwath J referred to Mr Leach deliberately shutting his eyes to the problems and to the implications of the undertaking, but like Lord Hoffmann I do not think it probable that having cited the passage from the H judgment of Lord Nicholls [1995] 2 AC 378, 389F the judge then overlooked the issue of Nelsonian dishonesty in finding that Mr Leach was not dishonest. I also consider, as Lord Millett has observed, that this was not a case where Mr Leach deliberately closed his eyes and ears, or deliberately did not ask questions, lest he learned something he would rather not know—

he already knew all the facts, but the judge concluded that nevertheless he had not been dishonest. I also think that Potter LJ applied too strict a test when he stated, at p 465, para 109: "It seems to me that, save perhaps in the most exceptional circumstances, it is not the action of an honest solicitor knowingly to assist or encourage another solicitor in a deliberate breach of his undertaking." This test does not address the vital point whether Mr Leach realised that his action was dishonest by the standards of responsible and honest solicitors. In the light of the judge's finding, based as it clearly was, on an assessment of Mr Leach's evidence in cross-examination in the witness box before him, I consider the Court of Appeal should not have substituted its own finding of dishonesty.

50 As I have stated, Carnwath J did not give reasons for his finding that Mr Leach was not dishonest and did not state the test which he applied to determine dishonesty. Therefore the question arises whether a new trial should be ordered. An argument of some force can be advanced that there should be a retrial, and in *Mortgage Express Ltd v Newman & Co* [2000] Lloyd's Rep PN 745, the Court of Appeal ordered a new trial, although with considerable reluctance. However the present case can be distinguished from the *Mortgage Express* case on the ground that in that case the judge appears to have based his decision on a factual matter (Mr Baruch's instructions) which was not before him in evidence. In the present case the evidence was fully deployed before the judge and he saw Mr Leach rigorously cross-examined at length as to his state of mind. Whilst the judge did not define the test of dishonesty which he applied, I think it probable, as I have stated, that he applied the right test, i e the combined test, and did not apply a purely subjective test. In these circumstances I consider that it would not be right to order a retrial. Whilst the decision whether a new trial should be ordered will largely depend on the facts of the particular case, I find support for this view in the judgment of the House in *Automatic Woodturning Co Ltd v Stringer* [1957] AC 544, 555. In that case the Court of Appeal had ordered a new trial on the issue of negligence, but the order was set aside and Lord Morton of Henryton stated:

> "My Lords, I cannot think that this order would have been made if the Court of Appeal had fully appreciated that Oliver J, after hearing all the evidence, had expressed his view that the appellants had not been guilty of negligence at common law. There is no indication in the record that the learned judge had not fully considered the evidence when he expressed this view."

51 For the reasons which I have given I would allow Mr Leach's appeal and set aside the judgment of the Court of Appeal.

LORD MILLETT

52 My Lords, there are two issues in this appeal. The first is concerned with the nature of the so-called "*Quistclose* trust" and the requirements for its creation. The second arises only if the first is answered adversely to the appellant. It is whether his conduct rendered him liable for having assisted in a breach of trust. This raises two questions of some importance. One concerns the extent of the knowledge of the existence of a trust which is required before a person can be found civilly liable for having assisted in its breach. In particular, is it sufficient that he was aware of the arrangements

A which created the trust or must he also have appreciated that they did so? The other, which has led to a division of opinion among your Lordships, is whether, in addition to knowledge, dishonesty is required and, if so, the meaning of dishonesty in this context. For reasons which will appear a third question, concerned with the ingredients of the equitable claim tendentiously described as being in respect of the "knowing receipt" of trust property, is no longer alive. The much needed rationalisation of this branch B of the law must, therefore, await another occasion.

(1) The facts

53 The appellant, Mr Leach, is a solicitor. At the material time he was in sole practice. In October 1992 he was instructed by a Mr Yardley to act in the purchase of residential land at Apperley Bridge, Bradford. The terms of C the sale required the payment of £950,000 on exchange of contracts. Exchange took place on 23 December 1992 with the use of moneys obtained from Barclay's Bank.

54 Mr Yardley was an entrepreneur with a number of irons in the fire. He was involved in several ongoing property transactions besides the purchase of the site at Apperley Bridge, but his interests were not confined to D the purchase and development of property. He carried on business through a series of one-man companies.

55 Delays occurred in securing the necessary finance from Barclay's Bank, and by December 1992 Mr Yardley was actively seeking an alternative source of funds. In due course he obtained an offer of a short-term loan of £1m from the respondent, Twinsectra Ltd.

56 Twinsectra was only prepared to make the loan if repayment was E secured by a solicitor's personal undertaking, a most unusual requirement. Mr Leach refused to give such an undertaking. Mr Yardley then approached another solicitor, a Mr Sims, who was a member of a two-partner firm. Mr Sims had been involved in some dealings on his own behalf with Mr Yardley as a result of which he owed Mr Yardley $1·5m. He agreed to give the requisite undertaking.

F 57 By this time Barclays Bank had agreed to provide the finance for Apperley Bridge, and the loan from Twinsectra was no longer needed. Mr Yardley and Mr Sims decided to proceed with it nevertheless. They agreed between themselves that Mr Sims would take up the loan on his own account and use it to repay his personal indebtedness to Mr Yardley. Mr Sims's undertaking to repay the loan, originally intended to be by way of guarantee of Mr Yardley's liability to repay the money he was borrowing G from Twinsectra, would (as between himself and Mr Yardley) be given by Mr Sims as principal debtor. Mr Yardley knew that if Twinsectra were told of the change the loan would be at risk. The judge found that his failure to tell Twinsectra was dishonest but that he was not liable in deceit for falsely holding Mr Sims out as his solicitor. In the judge's view the representation was essentially true, since Mr Sims had authority to act as Mr Yardley's agent to conclude the loan agreement on his behalf. The Court of Appeal H reversed this finding because it did not meet the gravamen of Twinsectra's complaint. This was not that it was misled about the extent of Mr Sims's authority to bind Mr Yardley to the contract of loan. It was that it would not have made the loan if it had known that Mr Sims was no longer acting for Mr Yardley as his client in a property transaction, for in those

circumstances he could not properly give a solicitor's undertaking: see *United Bank of Kuwait Ltd v Hammoud* [1988] 1 WLR 1051. The judge found that on this aspect of the case Mr Leach, too, was not dishonest, but that he was "certainly misguided". A

58 The undertaking was drafted by Twinsectra's solicitors and was signed by Mr Sims on 24 December. It was in the following terms:

"Dear Sirs, B

"In consideration of your providing a loan in the sum of £1m (one million pounds) to a client of this firm for the purpose of temporary bridging finance in the acquisition of property to be acquired by such client, we hereby personally and irrevocably undertake that:

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

"2. The loan moneys will be utilised *solely* for the acquisition of property on behalf of our client *and for no other purpose*. C

"3. We will repay to you the said sum of £1,000,000 together with interest calculated at the rate of £657·53 per day from the date you instruct your bankers to transfer the loan moneys to our client account, such repayment to be made on the earlier of: (a) the expiry of four calendar months from the date upon which you instruct your bankers to transfer the loan moneys to our client account or (b) the seventh day following our giving written notice to your solicitors of intention to make such repayment. D

"4. We will pay to your solicitors upon receipt by us of the loan moneys their charges in connection with the loan in the sum of £1,000 plus VAT and disbursements.

"We confirm that this undertaking is given by us in the course of our business as solicitors and in the context of an underlying transaction on behalf of our clients which is part of our usual business as solicitors." (Emphasis added). E

59 The judge found that the letter was fundamentally untrue. Mr Sims was not acting for any client in any relevant property transaction and there was no "underlying transaction on behalf of their clients" still less one which was "part of the usual business of solicitors". While Mr Sims obviously knew this, however, it cannot be assumed that Mr Leach did so. The judge found that Mr Leach "should have been aware" of it if he had thought about it at all (though even this seems somewhat speculative); but he did not find that he was. F

60 Mr Sims had previously on 23 December forwarded a draft of the proposed undertaking to Mr Leach which Mr Leach placed on his file. It did not differ from the final version in any respect material to these proceedings, which are based exclusively on paragraphs 1 and 2 of the undertaking. Those paragraphs were unchanged in the final version, the only substantive amendments being to paragraph 3. G

61 In the letter which accompanied the draft undertaking Mr Sims sought Mr Leach's confirmation on a number of points. These included the following: "The matter that concerns me is paragraph 1 which strictly means that my firm has to retain this sum until another property has been acquired. Is the £1m to be used for another purchase?" Mr Sims's concern arose from the fact that, by pre-arrangement with Mr Leach, he intended to pay the H

A money as soon as it was received to Mr Leach as Mr Yardley's solicitor, and realised that this would put him in breach of paragraph 1 of the undertaking. He evidently thought that this would not matter so long as the money was applied in the acquisition of property. Mr Leach clearly understood the reason for Mr Sims's concern, even if (as may be the case) he knew nothing of the arrangement by which Mr Sims had agreed with Mr Yardley that the payment would be treated as discharging his own personal debt.

B 62 Mr Leach spoke to Mr Sims by telephone and discussed the proposed undertaking. He told Mr Sims that he would obtain confirmation from Mr Yardley as to the purpose of the loan. As for Mr Sims's undertaking to retain the money, "that was a matter for him" and he "appreciated his difficulty". He told Mr Sims that the moneys would be held by his firm in a separate account "until they are required by Mr Yardley". It was, however, C for Mr Sims to decide as he was giving the undertaking and must be satisfied with its wording.

63 Mr Leach then spoke to Mr Yardley and was told that the money would be used in connection with property acquisitions at Stourport, Apperley Bridge and Droitwich. Mr Leach duly faxed Mr Sims and told him that he had spoken to Mr Yardley and could confirm that the money was to be used for the purchase of property. Mr Leach sent a copy of the fax to D Mr Yardley and asked for his instructions to be confirmed by fax. He told Mr Yardley that he would notify him as soon as the moneys were received "so that the funds may be utilised in connection with the purchase of the property you have notified to me". Mr Yardley faxed his confirmation.

64 All this took place on 23 December before the undertaking was finally signed by Mr Sims on the following day. On the same day, and in E anticipation of the receipt of the money from Twinsectra, Mr Sims gave the necessary instructions to his bank to make telegraphic transfers of the bulk of the money to Mr Leach's firm. They were implemented on 29 December.

65 Mr Leach received £949,985 on 29 December 1992 and a further sum of £14,810 on 19 January 1993. The money was credited to a client account. Over a period between 29 December 1992 and 31 March 1993 the money was disbursed in accordance with the instructions of Yardley or one F of his co-directors. Three of the payments totalling £580,875 were applied in the acquisition of property at Stourbridge, Droitwich and Apperley Bridge. The judge held that these payments were within the spirit if not the letter of the undertaking and his finding was upheld by the Court of Appeal. It has not been challenged before us. Three sums totalling £22,000 were retained by Mr Leach in payment of his conveyancing fees. These were the G subject of a claim in "knowing receipt". Other sums totalling £357,720·11 were applied on Mr Yardley's instructions otherwise than in connection with the acquisition of property and in breach of paragraph 2 of the undertaking. These were the subject of a claim for "dishonest assistance".

(2) The judgments below

H 66 The judge found that the undertaking did not create a trust and accordingly dismissed the action. As a result he did not need to make a specific finding of Mr Leach's state of mind in relation to the disbursements. But in summarising his conclusions he stated that he had found that "he was not dishonest, but that he did deliberately shut his eyes to the implications of the undertaking".

67 The Court of Appeal allowed Twinsectra's appeal. They held that paragraphs 1 and 2 of the undertaking created a *Quistclose* trust or a trust analogous thereto (which they described as "an express purpose trust") and upheld a tracing claim for proprietary relief against Mr Yardley's companies, which were in administration. They reversed the judge's conclusion that Mr Leach had not been dishonest, holding that the judge's conclusions were consistent only with a finding of what they described as "Nelsonian dishonesty", and gave judgment against him for £379,720·11 and interest.

(3) Was there a Quistclose trust?

68 Money advanced by way of loan normally becomes the property of the borrower. He is free to apply the money as he chooses, and save to the extent to which he may have taken security for repayment the lender takes the risk of the borrower's insolvency. But it is well established that a loan to a borrower for a specific purpose where the borrower is not free to apply the money for any other purpose gives rise to fiduciary obligations on the part of the borrower which a court of equity will enforce. In the earlier cases the purpose was to enable the borrower to pay his creditors or some of them, but the principle is not limited to such cases.

69 Such arrangements are commonly described as creating "a *Quistclose* trust", after the well known decision of the House in *Quistclose Investments Ltd v Rolls Razor Ltd* [1970] AC 567 in which Lord Wilberforce confirmed the validity of such arrangements and explained their legal consequences. When the money is advanced, the lender acquires a right, enforceable in equity, to see that it is applied for the stated purpose, or more accurately to prevent its application for any other purpose. This prevents the borrower from obtaining any beneficial interest in the money, at least while the designated purpose is still capable of being carried out. Once the purpose has been carried out, the lender has his normal remedy in debt. If for any reason the purpose cannot be carried out, the question arises whether the money falls within the general fund of the borrower's assets, in which case it passes to his trustee in bankruptcy in the event of his insolvency and the lender is merely a loan creditor; or whether it is held on a resulting trust for the lender. This depends on the intention of the parties collected from the terms of the arrangement and the circumstances of the case.

70 In the present case Twinsectra contends that paragraphs 1 and 2 of the undertaking which Mr Sims signed on 24 December created a *Quistclose* trust. Mr Leach denies this and advances a number of objections to the existence of a trust. He says that Twinsectra lacked the necessary intention to create a trust, and relies on evidence that Twinsectra looked exclusively to Mr Sims' personal undertaking to repay the loan as its security for repayment. He says that commercial life would be impossible if trusts were lightly inferred from slight material, and that it is not enough to agree that a loan is to be made for a particular purpose. There must be something more, for example, a requirement that the money be paid into a segregated account, before it is appropriate to infer that a trust has been created. In the present case the money was paid into Mr Sims' client account, but that is sufficiently explained by the fact that it was not Mr Sims' money but his client's; it provides no basis for an inference that the money was held in trust

A for anyone other than Mr Yardley. Then it is said that a trust requires certainty of objects and this was lacking, for the stated purpose "to be applied in the purchase of property" is too uncertain to be enforced. Finally it is said that no trust in favour of Twinsectra could arise prior to the failure of the stated purpose, and this did not occur until the money was misapplied by Mr Yardley's companies.

B

Intention

71 The first two objections are soon disposed of. A settlor must, of course, possess the necessary intention to create a trust, but his subjective intentions are irrelevant. If he enters into arrangements which have the effect of creating a trust, it is not necessary that he should appreciate that they do so; it is sufficient that he intends to enter into them. Whether C paragraphs 1 and 2 of the undertaking created a *Quistclose* trust turns on the true construction of those paragraphs.

72 The fact that Twinsectra relied for its security exclusively on Mr Sims's personal liability to repay goes to Twinsectra's subjective intention and is not relevant to the construction of the undertaking, but it is in any case not inconsistent with the trust alleged. Arrangements of this kind D are not intended to provide security for repayment of the loan, but to prevent the money from being applied otherwise than in accordance with the lender's wishes. If the money is properly applied the loan is unsecured. This was true of all the decided cases, including the *Quistclose* case itself.

The effect of the undertaking

E 73 A *Quistclose* trust does not necessarily arise merely because money is paid for a particular purpose. A lender will often inquire into the purpose for which a loan is sought in order to decide whether he would be justified in making it. He may be said to lend the money for the purpose in question, but this is not enough to create a trust; once lent the money is at the free disposal of the borrower. Similarly payments in advance for goods or services are paid for a particular purpose, but such payments do not ordinarily create a F trust. The money is intended to be at the free disposal of the supplier and may be used as part of his cashflow. Commercial life would be impossible if this were not the case.

74 The question in every case is whether the parties intended the money to be at the free disposal of the recipient: *In re Goldcorp Exchange Ltd* [1995] 1 AC 74, 100 per Lord Mustill. His freedom to dispose of the money G is necessarily excluded by an arrangement that the money shall be used *exclusively* for the stated purpose, for as Lord Wilberforce observed in the *Quistclose* case [1970] AC 567, 580:

> "A necessary consequence from this, by a process simply of interpretation, must be that if, for any reason, [the purpose could not be carried out,] the money was to be returned to [the lender]: the word 'only' H or 'exclusively' can have no other meaning or effect."

In the *Quistclose* case a public quoted company in financial difficulties had declared a final dividend. Failure to pay the dividend, which had been approved by the shareholders, would cause a loss of confidence and almost certainly drive the company into liquidation. Accordingly the company

arranged to borrow a sum of money "on condition that it is used to pay the forthcoming dividend". The money was paid into a special account at the company's bank, with which the company had an overdraft. The bank confirmed that the money "will only be used for the purpose of paying the dividend due on 24 July 1964". The House held that the circumstances were sufficient to create a trust of which the bank had notice, and that when the company went into liquidation without having paid the dividend the money was repayable to the lender.

75 In the present case paragraphs 1 and 2 of the undertaking are crystal clear. Mr Sims undertook that the money would be used *solely* for the acquisition of property *and for no other purpose;* and was to be retained by his firm until so applied. It would not be held by Mr Sims simply to Mr Yardley's order; and it would not be at Mr Yardley's free disposition. Any payment by Mr Sims of the money, whether to Mr Yardley or anyone else, otherwise than for the acquisition of property would constitute a breach of trust.

76 Mr Leach insisted that such a payment would, no doubt, constitute a breach of contract, but there was no reason to invoke equitable principles merely because Mr Sims was a solicitor. But Mr Sims's status as a solicitor has nothing to do with it. Equity's intervention is more principled than this. It is unconscionable for a man to obtain money on terms as to its application and then disregard the terms on which he received it. Such conduct goes beyond a mere breach of contract. As North J explained in *Gibert v Gonard* (1884) 54 LJ Ch 439, 440:

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

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

The nature of the trust

77 The latter two objections cannot be so easily disposed of. They call for an exploration of the true nature of the *Quistclose* trust, and in particular the location of the beneficial interest while the purpose is still capable of being carried out.

78 This has been the subject of much academic debate. The starting point is provided by two passages in Lord Wilberforce's speech in the *Quistclose* case [1970] AC 567. He said, at p 580:

A "That arrangements of this character for the payment of a person's creditors by a third person, give rise to a relationship of a fiduciary character or trust, in favour, as a primary trust, of the creditors, and secondarily, if the primary trust fails, of the third person, has been recognised in a series of cases over some 150 years."

Later, at p 581, he said:

B "when the money is advanced, the lender acquires an equitable right to see that it is applied for the primary designated purpose (see *In re Rogers* (1891) 8 Morr 243 where both Lindley LJ and Kay LJ recognised this) . . ."

79 These passages suggest that there are two successive trusts, a primary C trust for payment to identifiable beneficiaries, such as creditors or shareholders, and a secondary trust in favour of the lender arising on the failure of the primary trust. But there are formidable difficulties in this analysis, which has little academic support. What if the primary trust is not for identifiable persons, but as in the present case to carry out an abstract purpose? Where in such a case is the beneficial interest pending the application of the money for the stated purpose or the failure of the purpose? D There are four possibilities: (i) in the lender; (ii) in the borrower; (iii) in the contemplated beneficiary; or (iv) in suspense.

80 (i) *The lender.* In "The Quistclose Trust: Who Can Enforce It?" (1985) 101 LQR, 269, I argued that the beneficial interest remained throughout in the lender. This analysis has received considerable though not universal academic support: see for example Priestley LJ "The Romalpa E Clause and the Quistclose Trust" in *Equity and Commercial Relationships*, edited by P D Finn (1987), pp 217, 237; and Professor Michael Bridge "The Quistclose Trust in a World of Secured Transactions" (1992) 12 OJLS 333, 352; and others. It was adopted by the New Zealand Court of Appeal in *General Communications Ltd v Development Finance Corpn of New Zealand Ltd* [1990] 3 NZLR 406 and referred to with apparent approval by Gummow J in *In re Australian Elizabethan Theatre* Trust (1991) 102 F ALR 681. Gummow J saw nothing special in the *Quistclose* trust, regarding it as essentially a security device to protect the lender against other creditors of the borrower pending the application of the money for the sated purpose.

81 On this analysis, the *Quistclose* trust is a simple commercial arrangement akin (as Professor Bridge observes) to a retention of title clause (though with a different object) which enables the borrower to have recourse G to the lender's money for a particular purpose without entrenching on the lender's property rights more than necessary to enable the purpose to be achieved. The money remains the property of the lender unless and until it is applied in accordance with his directions, and insofar as it is not so applied it must be returned to him. I am disposed, perhaps pre-disposed, to think that this is the only analysis which is consistent both with orthodox trust law and with commercial reality. Before reaching a concluded view that it should be H adopted, however, I must consider the alternatives.

82 (ii) *The borrower.* It is plain that the beneficial interest is not vested unconditionally in the borrower so as to leave the money at his free disposal. That would defeat the whole purpose of the arrangements, which is to prevent the money from passing to the borrower's trustee in bankruptcy in

the event of his insolvency. It would also be inconsistent with all the decided cases where the contest was between the lender and the borrower's trustee in bankruptcy, as well as with the *Quistclose* case itself: see in particular *Toovey v Milne* (1819) 2 B & Ald 683; *In re Rogers, Ex p Holland & Hannen* (1891) 8 Morr 243 (supra).

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

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

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

86 The question whether the primary trust is accurately described as a trust for the creditors first arose in *In re Northern Developments (Holdings) Ltd* (unreported) 6 October 1978, where the contest was between the lender and the creditors. The borrower, which was not in liquidation and made no claim to the money, was the parent company of a group one of whose subsidiaries was in financial difficulty. There was a danger that if it were wound up or ceased trading it would bring down the whole group. A consortium of the group's banks agreed to put up a fund of more than £500,000 in an attempt to rescue the subsidiary. They paid the money into a special account in the name of the parent company for the express purpose of "providing money for the subsidiary's unsecured creditors over the ensuing weeks" and for no other purpose. The banks' object was to enable the subsidiary to continue trading, though on a reduced scale; it failed when the subsidiary was put into receivership at a time when some £350,000 remained unexpended. Relying on Lord Wilberforce's observations in the passages cited above, Sir Robert Megarry V-C held that the primary trust was a purpose trust enforceable (inter alios) by the subsidiaries' creditors as the persons for whose benefit the trust was created.

87 There are several difficulties with this analysis. In the first place, Lord Wilberforce's reference to *In re Rogers* 8 Morr 243 makes it plain that the equitable right he had in mind was not a mandatory order to compel performance, but a negative injunction to restrain improper application of the money; for neither Lindley LJ nor Kay LJ recognised more than this. In the second place, the object of the arrangements was to enable the subsidiary to continue trading, and this would necessarily involve it in incurring further liabilities to trade creditors. Accordingly the application of the fund was not

A confined to existing creditors at the date when the fund was established. The company secretary was given to understand that the purpose of the arrangements was to keep the subsidiary trading, and that the fund was "as good as share capital". Thus the purpose of the arrangements was not, as in other cases, to enable the debtor to avoid bankruptcy by paying off existing creditors, but to enable the debtor to continue trading by providing it with working capital with which to incur fresh liabilities. There is a powerful B argument for saying that the result of the arrangements was to vest a beneficial interest in the subsidiary from the start. If so, then this was not a *Quistclose* trust at all.

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

89 The most serious objection to this approach is exemplified by the facts of the present case. In several of the cases the primary trust was for an abstract purpose with no one but the lender to enforce performance or D restrain misapplication of the money. In *Edwards v Glyn* (1859) 2 E & E the money was advanced to a bank to enable the bank to meet a run. In *In re EVTR, Gilbert v Barber* [1987] BCLC 646 it was advanced "for the sole purpose of buying new equipment". In *General Communications Ltd v Development Finance Corpn of New Zealand Ltd* [1990] 3 NZLR 406 the money was paid to the borrower's solicitors for the express purpose of E purchasing new equipment. The present case is another example. It is simply not possible to hold money on trust to acquire unspecified property from an unspecified vendor at an unspecified time. There is no reason to make an arbitrary distinction between money paid for an abstract purpose and money paid for a purpose which can be said to benefit an ascertained class of beneficiaries, and the cases rightly draw no such distinction. Any analysis of the *Quistclose* trust must be able to accommodate gifts and loans F for an abstract purpose.

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

91 Lord Browne-Wilkinson gave an authoritative explanation of the resulting trust in *Westdeutsche Landesbank Girpcentrale v Islington Borough Council* [1996] AC 669, 708C and its basis has been further illuminated by Dr Robert Chambers in his book *Resulting Trusts* published in 1997. Lord Browne-Wilkinson explained that a resulting trust arises in H two sets of circumstances. He described the second as follows: "Where A transfers property to B *on express trusts*, but the trusts declared do not exhaust the whole beneficial interest." The *Quistclose* case [1970] AC 567 was among the cases he cited as examples. He rejected the argument that there was a resulting trust in the case before him because, unlike the

situation in the present case, there was no transfer of money on express trusts. But he also rejected the argument on a wider and, in my respectful opinion, surer ground that the money was paid and received with the intention that it should become the absolute property of the recipient.

92 The central thesis of Dr Chambers's book is that a resulting trust arises whenever there is a transfer of property in circumstances in which the transferor (or more accurately the person at whose expense the property was provided) did not intend to benefit the recipient. It responds to the absence of an intention on the part of the transferor to pass the entire beneficial interest, not to a positive intention to retain it. Insofar as the transfer does not exhaust the entire beneficial interest, the resulting trust is a default trust which fills the gap and leaves no room for any part to be in suspense. An analysis of the *Quistclose* trust as a resulting trust for the transferor with a mandate to the transferee to apply the money for the stated purpose sits comfortably with Dr Chambers' thesis, and it might be thought surprising that he does not adopt it.

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

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

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

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

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

A (2001) 21 OJLS 267. It provides no solution to cases of non-contractual payment; is inconsistent with Lord Wilberforce's description of the borrower's obligation as fiduciary and not merely contractual; fails to explain the evidential significance of a requirement that the money should be kept in a separate account; cannot easily be reconciled with the availability of proprietary remedies against third parties; and while the existence of a mere equity to prevent misapplication would be sufficient to prevent the B money from being available for distribution to the creditors on the borrower's insolvency (because the trustee in bankruptcy has no greater rights than his bankrupt) it would not prevail over secured creditors. If the bank in the *Quistclose* case [1970] AC 567 had held a floating charge (as it probably did) and had appointed a receiver, the adoption of Dr Chambers's analysis should have led to a different outcome.

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

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

98 The other problem is concerned with the basis on which the primary trust is said to have failed in several of the cases, particularly *Toovey v Milne* 2 B & A 683 and the *Quistclose* case itself [1970] AC 567. Given that the money did not belong to the borrower in either case, the borrower's G insolvency should not have prevented the money from being paid in the manner contemplated. A man cannot pay some only of his creditors once he has been adjudicated bankrupt, but a third party can. A company cannot pay a dividend once it has gone into liquidation, but there is nothing to stop a third party from paying the disappointed shareholders. The reason why the purpose failed in each case must be because the lender's object in making the money available was to save the borrower from bankruptcy in the one H case and collapse in the other. But this in itself is not enough. A trust does not fail merely because the settlor's purpose in creating it has been frustrated: the trust must become illegal or impossible to perform. The settlor's motives must not be confused with the purpose of the trust; the frustration of the former does not by itself cause the failure of the latter. But

if the borrower is treated as holding the money on a resulting trust for the lender but with power (or in some cases a duty) to carry out the lender's revocable mandate, and the lender's object in giving the mandate is frustrated, he is entitled to revoke the mandate and demand the return of money which never ceased to be his beneficially.

99 There is a further point which is well brought out in the judgment of the Court of Appeal. On a purchase of land it is a commonplace for the purchaser's mortgagee to pay the mortgage money to the purchaser's solicitor against his undertaking to apply it in the payment of the purchase price in return for a properly executed conveyance from the vendor and mortgage to the mortgagee. There is no doubt that the solicitor would commit a breach of trust if he were to apply it for any other purpose, or to apply it for the stated purpose if the mortgagee countermanded his instructions: see *Bristol and West Building Society v Mothew* [1998] Ch 1, 22. It is universally acknowledged that the beneficiary of the trust, usually described as an express or implied trust, is the mortgagee. Until paid in accordance with the mortgagee's instructions or returned it is the property of the mortgagee in equity, and the mortgagee may trace the money and obtain proprietary relief against a third party: *Boscawen v Bajwa* [1996] 1 WLR 328. It is often assumed that the trust arises because the solicitor has become the mortgagee's solicitor for the purpose of completion. But that was not the case in *Barclays Bank plc v Weeks Legg and Dean* [1999] QB 309, 324, where the solicitor's undertaking was the only communication passing between the mortgagee and the solicitor. I said:

> "The function of the undertaking is to prescribe the terms upon which the solicitor receives the money remitted by the bank. Such money is trust money which belongs in equity to the bank but which the solicitor is authorised to disburse in accordance with the terms of the undertaking but not otherwise. Parting with the money otherwise than in accordance with the undertaking constitutes at one and the same time a breach of a contractual undertaking and a breach of the trust on which the money is held."

The case is, of course, even closer to the present than the traditional cases in which a *Quistclose* trust has been held to have been created. I do not think that subtle distinctions should be made between "true" *Quistclose* trusts and trusts which are merely analogous to them. It depends on how widely or narrowly you choose to define the *Quistclose* trust. There is clearly a wide range of situations in which the parties enter into a commercial arrangement which permits one party to have a limited use of the other's money for a stated purpose, is not free to apply it for any other purpose, and must return it if for any reason the purpose cannot be carried out. The arrangement between the purchaser's solicitor and the purchaser's mortgagee is an example of just such an arrangement. All such arrangements should if possible be susceptible to the same analysis.

100 As Sherlock Holmes reminded Dr Watson, when you have eliminated the impossible, whatever remains, however improbable, must be the truth. I would reject all the alternative analyses, which I find unconvincing for the reasons I have endeavoured to explain, and hold the *Quistclose* trust to be an entirely orthodox example of the kind of default trust known as a resulting trust. The lender pays the money to the borrower

A by way of loan, but he does not part with the entire beneficial interest in the money, and in so far as he does not it is held on a resulting trust for the lender from the outset. Contrary to the opinion of the Court of Appeal, it is the borrower who has a very limited use of the money, being obliged to apply it for the stated purpose or return it. He has no beneficial interest in the money, which remains throughout in the lender subject only to the B borrower's power or duty to apply the money in accordance with the lender's instructions. When the purpose fails, the money is returnable to the lender, not under some new trust in his favour which only comes into being on the failure of the purpose, but because the resulting trust in his favour is no longer subject to any power on the part of the borrower to make use of the money. Whether the borrower is obliged to apply the money for the stated purpose or merely at liberty to do so, and whether the lender can C countermand the borrower's mandate while it is still capable of being carried out, must depend on the circumstances of the particular case.

Certainty

101 After this over-long exposition, it is possible to dispose of the remaining objections to the creation of a *Quistclose* trust very shortly. D A trust must have certainty of objects. But the only trust is the resulting trust for the lender. The borrower is authorised (or directed) to apply the money for a stated purpose, but this is a mere power and does not constitute a purpose trust. Provided the power is stated with sufficient clarity for the court to be able to determine whether it is still capable of being carried out or whether the money has been misapplied, it is sufficiently certain to be enforced. If it is uncertain, however, then the borrower has no authority to E make any use of the money at all and must return it to the lender under the resulting trust. Uncertainty works in favour of the lender, not the borrower; it cannot help a person in the position of Mr Leach.

When the trust in favour of the lender arises

102 Like all resulting trusts, the trust in favour of the lender arises when F the lender parts with the money on terms which do not exhaust the beneficial interest. It is not a contingent reversionary or future interest. It does not suddenly come into being like an 18th century use only when the stated purpose fails. It is a default trust which fills the gap when some part of the beneficial interest is undisposed of and prevents it from being "in suspense".

G *Conclusion*

103 In my opinion the Court of Appeal were correct to find that the terms of paragraphs 1 and 2 of the undertaking created a *Quistclose* trust. The money was never at Mr Yardley's free disposal. It was never held to his order by Mr Sims. The money belonged throughout to Twinsectra, subject only to Mr Yardley's right to apply it for the acquisition of property. H Twinsectra parted with the money to Mr Sims, relying on him to ensure that the money was properly applied or returned to it. Mr Sims act in paying the money over to Mr Leach was a breach of trust, but it did not in itself render the money incapable of being applied for the stated purpose. In so far as Mr Leach applied the money in the acquisition of property, the purpose was achieved.

(4) Knowing (or dishonest) assistance A

104 Before turning to the critical questions concerning the extent of the knowledge required and whether a finding of dishonesty is a necessary condition of liability, I ought to say a word about the distinction between the "knowing receipt" of trust money and "knowing (or dishonest) assistance" in a breach of trust; and about the meaning of "assistance" in this context.

105 Liability for "knowing receipt" is receipt-based. It does not depend B on fault. The cause of action is restitutionary and is available only where the defendant received or applied the money in breach of trust for his own use and benefit: see *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 291–292; *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, 386. There is no basis for requiring actual knowledge of the breach of trust, let alone dishonesty, as a condition of liability. Constructive notice is sufficient, and may not even be necessary. There is powerful academic support for the proposition that the C liability of the recipient is the same as in other cases of restitution, that is to say strict but subject to a change of position defence.

106 Mr Leach received sums totalling £22,000 in payment of his costs for his own use and benefit, and Twinsectra seek their repayment on the ground of knowing receipt. But he did not receive the rest of the money for his own benefit at all. He never regarded himself as beneficially entitled to D the money. He held it to Mr Yardley's order and paid it out to Mr Yardley or his companies. Twinsectra cannot and does not base its claim in respect of these moneys in knowing receipt, not for want of knowledge, but for want of the necessary receipt. It sues in respect of knowing (or dishonest) assistance.

107 The accessory's liability for having assisted in a breach of trust is quite different. It is fault-based, not receipt-based. The defendant is not E charged with having received trust moneys for his own benefit, but with having acted as an accessory to a breach of trust. The action is not restitutionary; the claimant seeks compensation for wrongdoing. The cause of action is concerned with attributing liability for misdirected funds. Liability is not restricted to the person whose breach of trust or fiduciary duty caused their original diversion. His liability is strict. Nor is it limited to those who assist him in the original breach. It extends to everyone who F consciously assists in the continuing diversion of the money. Most of the cases have been concerned, not with assisting in the original breach, but in covering it up afterwards by helping to launder the money. Mr Leach's wrongdoing is not confined to the assistance he gave Mr Sims to commit a breach of trust by receiving the money from him knowing that Mr Sims should not have paid it to him (though this is sufficient to render him liable G for any resulting loss); it extends to the assistance he gave in the subsequent misdirection of the money by paying it out to Mr Yardley's order without seeing to its proper application.

The ingredients of accessory liability

108 The classic formulation of this head of liability is that of Lord H Selborne LC in *Barnes v Addy* (1874) LR 9 Ch App 244, 251. Third parties who were not themselves trustees were liable if they were found "either making themselves trustees de son tort, or actually participating in any fraudulent conduct of the trustee to the injury of the cestui que trust". In the next passage of his judgment, at p 252, he amplified this by referring to those

A who "assist with knowledge in a dishonest and fraudulent design on the part of the trustees".

109 There were thus two conditions of liability: the defendant must have assisted (i) with knowledge (ii) in a fraudulent breach of trust. The second condition was discarded in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378. Henceforth, it was sufficient that the defendant was accessory to any breach of trust whether fraudulent or not. The question for B present decision is concerned with the first condition. Since that case it has been clear that actual knowledge is necessary; the question is whether it is sufficient, or whether there is an additional requirement of dishonesty in the subjective sense in which that term is used in criminal cases.

110 Prior to the decision in *Royal Brunei Airlines Sdn Bhd v Tan* the equitable claim was described as "knowing assistance". It gave a remedy C against third parties who knowingly assisted in the misdirection of funds. The accessory was liable if he knew all the relevant facts, in particular the fact that the principal was not entitled to deal with the funds entrusted to him as he had done or was proposing to do. Unfortunately, the distinction between this form of fault-based liability and the liability to make restitution for trust money received in breach of trust was not always observed, and it was even suggested from time to time that the requirements of liability D should be the same in the two cases. Authorities on one head of liability were applied in cases which concerned the other, and judges embarked on sophisticated analyses of the kind of knowledge required to found liability.

111 Behind the confusion there lay a critical issue: whether negligence alone was sufficient to impose liability on the accessory. If so, then it was unnecessary to show that he possessed actual knowledge of the relevant E facts. Despite a divergence of judicial opinion, by 1995 the tide was flowing strongly in favour of rejecting negligence. It was widely thought that the accessory should be liable only if he actually knew the relevant facts. It should not be sufficient that he ought to have known them or had the means of knowledge if he did not in fact know them.

112 There was a gloss on this. It is dishonest for a man deliberately to shut his eyes to facts which he would prefer not to know. If he does so, he F is taken to have actual knowledge of the facts to which he shut his eyes. Such knowledge has been described as "Nelsonian knowledge", meaning knowledge which is attributed to a person as a consequence of his "wilful blindness" or (as American lawyers describe it) "contrived ignorance". But a person's failure through negligence to make inquiry is insufficient to enable knowledge to be attributed to him: see *Agip (Africa) Ltd v Jackson* [1990] G Ch 265, 293.

113 In his magisterial opinion in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, every word of which merits close attention, Lord Nicholls firmly rejected negligence as a sufficient condition of accessory liability. The accessory must be guilty of intentional wrongdoing. But Lord Nicholls did not, in express terms at least, substitute intentional wrongdoing as the condition of liability. He substituted dishonesty. Dishonesty, he said, was a H necessary and sufficient ingredient of accessory liability. "Knowingly" was better avoided as a defining ingredient of the principle, and the scale of knowledge accepted in *Baden v Sociétié Générale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA (Note)* [1993] 1 WLR 509 was best forgotten. His purpose, as he made clear, was to get

away from the refinements which had been introduced into the concept of knowledge in the context of accessory liability. A

The meaning of dishonesty in this context

114 In taking dishonesty to be the condition of liability, however, Lord Nicholls used the word in an objective sense. He did not employ the concept of dishonesty as it is understood in criminal cases. He explained the sense in which he was using the word [1995] 2 AC 378, 389: B

"Whatever may be the position in some criminal or other contexts (see, for instance, *R v Ghosh* [1982] QB 1053), in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard. At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour. In most situations there is little difficulty in identifying how an honest person would behave. Honest people do not intentionally deceive others to their detriment. Honest people do not knowingly take others' property. Unless there is a very good and compelling reason, an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless." C D E F

Dishonesty as a state of mind or as a course of conduct? G

115 In *R v Ghosh* [1982] QB 1053, Lord Lane CJ drew a distinction between dishonesty as a state of mind and dishonesty as a course of conduct, and held that dishonesty in section 1 of the Theft Act 1968 referred to dishonesty as a state of mind. The question was not whether the accused had in fact acted dishonestly but whether he was aware that he was acting dishonestly. The jury must first of all decide whether the conduct of the accused was dishonest according to the ordinary standards of reasonable and honest people. That was an objective test. If he was not dishonest by those standards, that was an end of the matter and the prosecution failed. If it was dishonest by those standards, the jury had secondly to consider whether the accused was aware that what he was doing was dishonest by H

A those standards. That was a subjective test. Given his actual (subjective) knowledge the accused must have fallen below ordinary (objective) standards of honesty and (subjectively) have been aware that he was doing so.

116 The same test of dishonesty is applicable in civil cases where, for example, liability depends upon intent to defraud, for this connotes a B dishonest state of mind. *Aktieselskabet Dansk Skibsfinansiering v Brothers* [2001] 2 BCLC 324 was a case of this kind (trading with intent to defraud creditors). But it is not generally an appropriate condition of civil liability, which does not ordinarily require a guilty mind. Civil liability is usually predicated on the defendant's conduct rather than his state of mind; it results from his negligent or unreasonable behaviour or, where this is not sufficient, from intentional wrongdoing.

C 117 A dishonest state of mind might logically have been required when it was thought that the accessory was liable only if the principal was guilty of a fraudulent breach of trust, for then the claim could have been regarded as the equitable counterpart of the common law conspiracy to defraud. But this requirement was discarded in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378.

D 118 It is, therefore, not surprising that Lord Nicholls rejected a dishonest state of mind as an appropriate condition of liability. This is evident from the opening sentence of the passage cited above, from his repeated references both in that passage and later in his judgment to the defendant's conduct in "acting dishonestly" and "advertent conduct", and from his statement that "for the most part" (ie not always) it involves "conscious impropriety". "Honesty," he said, "is a description of a type of E conduct assessed in the light of what a person actually knew at the time." Usually ("for the most part"), no doubt, the defendant will have been guilty of "conscious impropriety"; but this is not a condition of liability. The defendant, Lord Nicholls said, at p 390E, was "required to act honestly"; and he indicated that Knox J had captured the flavour of dishonesty in *Cowan de Groot Properties Ltd v Eagle Trust plc* [1992] 4 All ER 700, 761 F when he referred to a person who is "guilty of commercially unacceptable conduct in the particular context involved". There is no trace in Lord Nicholls' opinion that the defendant should have been aware that he was acting contrary to objective standards of dishonesty. In my opinion, in rejecting the test of dishonesty adopted in *R v Ghosh* [1982] QB 1053, Lord Nicholls was using the word to characterise the defendant's conduct, not his G state of mind.

119 Lord Nicholls had earlier drawn an analogy with the tort of procuring a breach of contract. He observed, at p 387B–C, that a person who knowingly procures a breach of contract, or who knowingly interferes with the due performance of a contract, is liable in damages to the innocent party. The rationale underlying the accessory's liability for a breach of trust, he said, was the same. It is scarcely necessary to observe that dishonesty is H not a condition of liability for the common law cause of action. This is a point to which I must revert later; for the moment, it is sufficient to say that procuring a breach of contract is an intentional tort, but it does not depend on dishonesty. Lord Nicholls was not of course confusing knowledge with dishonesty. But his approach to dishonesty is premised on the belief that it is

dishonest for a man consciously to participate in the misapplication of money. A

120 This is evident by the way in which Lord Nicholls dealt with the difficult case where the propriety of the transaction is doubtful. An honest man, he considered, would make appropriate enquiries before going ahead. This assumes that an honest man is one who would not knowingly participate in a transaction which caused the misapplication of funds. But it is most clearly evident in the way in which Lord Nicholls described the conduct of the defendant in the case under appeal. The question was whether he was personally liable for procuring or assisting in a breach of trust committed by his company. The trust was created by the terms of a contract entered into between the company, which carried on the business of a travel agency, and an airline. The contract required money obtained from the sale of the airline's tickets to be placed in a special trust account. The company failed to pay the money into a special account but used it to fund its own cashflow. Lord Nicholls described the defendant's conduct, at p 393: B C

> "In other words, he caused or permitted his company to apply the money in a way he knew was not authorised by the trust of which the company was trustee. Set out in these bald terms, the defendant's conduct was dishonest." D

There was no evidence and Lord Nicholls did not suggest that the defendant realised that honest people would regard his conduct as dishonest. Nor did the plaintiff put its case so high. It contended that the company was liable because it made unauthorised use of trust money, and that the defendant was liable because he caused or permitted his company to do so despite his knowledge that its use of the money was unauthorised. This was enough to make the defendant liable, and for Lord Nicholls to describe his conduct as dishonest. E

121 In my opinion Lord Nicholls was adopting an objective standard of dishonesty by which the defendant is expected to attain the standard which would be observed by an honest person placed in similar circumstances. Account must be taken of subjective considerations such as the defendant's experience and intelligence and his actual state of knowledge at the relevant time. But it is not necessary that he should actually have appreciated that he was acting dishonestly; it is sufficient that he was. F

122 This is the way in which Lord Nicholls's use of the term "dishonesty" was understood by Mance LJ in *Grupo Torras SA v Al-Sabah* [1999] CLC 1553. It is also the way in which it has been widely understood by practitioners: see William Blair QC, "Secondary Liability of Financial Institutions for the Fraud of Third Parties" (2000) 30 Hong Kong Law Journal 74; Jeremy Chan "Dishonesty and Knowledge" (2001) 31 Hong Kong Law Journal 283; Andrew Stafford QC, "Solicitors' liability for knowing receipt and dishonest assistance in breach of trust" (2001) 17 PN 3. Mr Blair QC, at p 83, welcomed the "more pragmatic and workable test of objective dishonesty". Mr Stafford QC, at p 14, invited your Lordships to: G H

> "2. Reiterate that honesty is an objective standard and that individuals are not free to set their own standards of proper conduct.
>
> "3. Direct that trial judges should reach specific conclusions as to whether an honest person, having the same knowledge, experience and

A attributes as the defendant, would have appreciated that what he was doing would be regarded as wrong or improper . . .

"5. Direct that if the hypothetical honest person would have appreciated that what he was doing was wrong or improper, then it is appropriate to conclude that the defendant acted dishonestly.

"6. Deprecate attempts to over-refine degrees of knowledge and tests B of dishonesty."

This is almost entirely objective. The only subjective elements are those relating to the defendant's knowledge, experience and attributes. The objective elements include not only the standard of honesty (which is not controversial) but also the recognition of wrongdoing. The question is whether an honest person would appreciate that what he was doing was C wrong or improper, not whether the defendant himself actually appreciated this. The third limb of the test established for criminal cases in *R v Ghosh* [1982] QB 1053 is conspicuously absent. But there is no trace of it in Lord Nicholls's opinion in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 either.

123 Judges have frequently used the word dishonesty in civil cases in an D objective sense to describe deliberate wrongdoing, particularly when handling equitable concepts such as concealed fraud. In *Beaman v ARTS Ltd* [1949] 1 KB 550 the defendants were sued for conversion. They had stored packages for the plaintiff. The plaintiff found herself stranded in enemy occupied Europe during the war and was unable to communicate with the defendants. The defendant's manager, who was about to be called up and was anxious to close the business down for the duration, opened the E packages. Finding their contents to be of little or no value, he considered himself justified in giving them away to the Salvation Army, though he kept one package for himself. The trial judge (Denning J) expressly acquitted the manager of dishonesty or moral turpitude. Reversing the judge, Lord Greene MR described the defendant's conduct as reprehensible. They would, he said, at p 561:

F

"no doubt be shocked to hear their conduct described as fraudulent. *That is, however, quite immaterial.* Mr Ingram, who misappropriated one of the plaintiff's cases for his own use, was no doubt shocked when counsel described his action as stealing. *No amount of self-deception can make a dishonest action other than dishonest*; nor does an action which is essentially dishonest become blameless because it is committed with a G good motive" (emphasis added).

This is as clear a statement of principle as can be imagined. Neither an honest motive nor an innocent state of mind will save a defendant whose conduct is objectively dishonest. Mr Ingram was not criminally dishonest, since it never entered his head that other people would regard his conduct as dishonest. But equity looks to a man's conduct, not to his state of mind.

H 124 The Law Commission must plead guilty of the same usage. In their Report on Limitation of Actions (Law Com No 270) they propose replacing the expression "deliberate concealment" in section 32(1)(b) of the Limitation Act 1980 by "dishonest concealment". They explain this concept, at paragraph 3.137 of their Report as follows:

"We are of the view that our proposals in relation to 'concealment' should only apply where the defendant has been guilty of 'unconscionable conduct'—*or in other words, if the concealment can be said to be 'dishonest' . . . the claimant must show that the defendant was being dishonest in [concealing information]*. We do not consider that the concealment could be described as 'dishonest' unless the person concealing it is aware of what is being concealed and does not wish the claimant to discover it . . . by covering up shallow foundations the builder . . . cannot be said to have been guilty of 'dishonest concealment' unless he was aware that his work was defective or negligent, and does not want the claimant to discover this . . ." (Emphasis added.)

In the context it is clear that the Law Commission are indicating requirements which are not only necessary but sufficient. It would be self-defeating to require the plaintiff to establish subjective dishonesty: many people would see nothing wrong, and certainly nothing dishonest, in seeking to avoid legal liability by refraining from disclosing their breach of duty to a potential plaintiff.

125 The modern tendency is to deprecate the use of words like "fraud" and "dishonesty" as synonyms for moral turpitude or conduct which is morally reprehensible. There is much to be said for semantic reform, that is to say for changing the language while retaining the incidents of equitable liability; but there is nothing to be said for retaining the language and giving it the meaning it has in criminal cases so as to alter the incidents of equitable liability.

Should subjective dishonesty be required?

126 The question for your Lordships is not whether Lord Nicholls was using the word dishonesty in a subjective or objective sense in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378. The question is whether a plaintiff should be required to establish that an accessory to a breach of trust had a dishonest state of mind (so that he was subjectively dishonest in the *R v Ghosh* sense); or whether it should be sufficient to establish that he acted with the requisite knowledge (so that his conduct was objectively dishonest). This question is at large for us, and we are free to resolve it either way.

127 I would resolve it by adopting the objective approach. I would do so because:

(1) Consciousness of wrongdoing is an aspect of mens rea and an appropriate condition of criminal liability: it is not an appropriate condition of civil liability. This generally results from negligent or intentional conduct. For the purpose of civil liability, it should not be necessary that the defendant realised that his conduct was dishonest; it should be sufficient that it constituted intentional wrongdoing.

(2) The objective test is in accordance with Lord Selborne's statement in *Barnes v Addy* LR 9 Ch App 244 and traditional doctrine. This taught that a person who knowingly participates in the misdirection of money is liable to compensate the injured party. While negligence is not a sufficient condition of liability, intentional wrongdoing is. Such conduct is culpable and falls below the objective standards of honesty adopted by ordinary people.

(3) The claim for "knowing assistance" is the equitable counterpart of the economic torts. These are intentional torts; negligence is not sufficient and

A dishonesty is not necessary. Liability depends on knowledge. A requirement of subjective dishonesty introduces an unnecessary and unjustified distinction between the elements of the equitable claim and those of the tort of wrongful interference with the performance of a contract.

128 If Mr Sims's undertaking was contractual, as Mr Leach thought it was, then Mr Leach's conduct would have been actionable as a wrongful interference with the performance of the contract. Where a third party with B knowledge of a contract has dealings with the contract breaker which the third party knows will amount to a breach of contract and damage results, he commits an actionable interference with the contract: see *D C Thomson & Co Ltd v Deakin* [1952] Ch 646, 694; *Sefton v Tophams Ltd* [1965] Ch 1140, where the action failed only because the plaintiff was unable to prove damage.

C 129 In *British Motor Trade Association v Salvadori* [1949] Ch 556 the defendant bought and took delivery of a car in the knowledge that it was offered to him by the vendor in breach of its contract with its supplier. There is a close analogy with the present case. Mr Leach accepted payment from Mr Sims in the knowledge that the payment was made in breach of his undertaking to Twinsectra to retain the money in his own client account until required for the acquisition of property.

D 130 In *Sefton v Tophams Ltd* the defendant bought land in the knowledge that the use to which it intended to put the land would put the vendor in breach of his contractual obligations to the plaintiff. Again the analogy with the present case is compelling. Mr Leach knew that by accepting the money and placing it at Mr Yardley's free disposal he would put Mr Sims in breach of his contractual undertaking that it would be used E only for the purpose of acquiring property.

131 In both cases the defendant was liable for any resulting loss. Such liability is based on the actual interference with contractual relations, not on any inducement to break them, so that it is no defence that the contract-breaker was a willing party to the breach and needed no inducement to do so. Dishonesty is not an ingredient of the tort.

132 It would be most undesirable if we were to introduce a distinction F between the equitable claim and the tort, thereby inducing the claimant to attempt to spell a contractual obligation out of a fiduciary relationship in order to avoid the need to establish that the defendant had a dishonest state of mind. It would, moreover, be strange if equity made liability depend on subjective dishonesty when in a comparable situation the common law did not. This would be a reversal of the general rule that equity demands higher G standards of behaviour than the common law.

133 If we were to reject subjective dishonesty as a requirement of civil liability in this branch of the law, the remaining question is merely a semantic one. Should we return to the traditional description of the claim as "knowing assistance", reminding ourselves that nothing less than actual knowledge is sufficient; or should we adopt Lord Nicholls' description of the claim as "dishonest assistance", reminding ourselves that the test is an H objective one?

134 For my own part, I have no difficulty in equating the knowing mishandling of money with dishonest conduct. But the introduction of dishonesty is an unnecessary distraction, and conducive to error. Many judges would be reluctant to brand a professional man as dishonest where he

was unaware that honest people would consider his conduct to be so. If the condition of liability is intentional wrongdoing and not conscious dishonesty as understood in the criminal courts, I think that we should return to the traditional description of this head of equitable liability as arising from "knowing assistance".

Knowledge

135 The question here is whether it is sufficient that the accessory should have actual knowledge of the facts which created the trust, or must he also have appreciated that they did so? It is obviously not necessary that he should know the details of the trust or the identity of the beneficiary. It is sufficient that he knows that the money is not at the free disposal of the principal. In some circumstances it may not even be necessary that his knowledge should extend this far. It may be sufficient that he knows that he is assisting in a dishonest scheme.

136 That is not this case, for in the absence of knowledge that his client is not entitled to receive it there is nothing intrinsically dishonest in a solicitor paying money to him. But I am satisfied that knowledge of the arrangements which constitute the trust is sufficient; it is not necessary that the defendant should appreciate that they do so. Of course, if they do not create a trust, then he will not be liable for having assisted in a breach of trust. But he takes the risk that they do.

137 The gravamen of the charge against the principal is not that he has broken his word, but that having been entrusted with the control of a fund with limited powers of disposal he has betrayed the confidence placed in him by disposing of the money in an unauthorised manner. The gravamen of the charge against the accessory is not that he is handling stolen property, but that he is assisting a person who has been entrusted with the control of a fund to dispose of the fund in an unauthorised manner. He should be liable if he knows of the arrangements by which that person obtained control of the money and that his authority to deal with the money was limited, and participates in a dealing with the money in a manner which he knows is unauthorised. I do not believe that the man in the street would have any doubt that such conduct was culpable.

The findings below

138 Mr Leach's pleaded case was that he parted with the money in the belief, no doubt engendered by Mr Yardley's assurances, that it would be applied in the acquisition of property. But he made no attempt to support this in his evidence. It was probably impossible to do so, since he was acting for Mr Yardley in the acquisition of the three properties which had been identified to him on 23 December, and must have known that some of the payments he was making were not required for their acquisition. In his evidence he made it clear that he regarded the money as held by him to Mr Yardley's order, and that there was no obligation on his part to see that the terms of the arrangements between Twinsectra and Mr Sims were observed. That was Mr Sims' responsibility, not his.

139 The judge found that Mr Leach was not dishonest. But he also found as follows:

A "He was clearly aware of [the terms of the undertaking]. Indeed, his pleaded defence asserts . . . that he believed their 'substance . . . to be that the advance would be applied in the acquisition of property' and that he had received them on the footing that they would be so applied. Yet, in evidence, he frankly admitted that he had regarded the money as held simply to the order of Mr Yardley, without restriction. Again, I have to conclude that he simply shut his eyes to the problems. As far as he was
B concerned, it was a matter solely for Mr Sims to satisfy himself whether he could release the money to Mr Yardley's account."

140 The Court of Appeal thought that the judge's two conclusions (i) that Mr Leach was not dishonest and (ii) that he "simply shut his eyes to the problems" (or, as he put it later in his judgment "deliberately shut his eyes to the implications") were inconsistent. They attempted to reconcile the
C two findings by saying that the judge had overlooked the possibility of wilful blindness. Potter LJ put it in these terms [1999] Lloyd's Rep Bank 438, 465, para 108:

"Mr Leach clearly appreciated (indeed he recorded) that an undertaking in the form proposed created difficulties for Mr Sims (as Mr Sims himself recognised) yet, as from that point . . . [he] deliberately
D closed his eyes to those difficulties in the sense that he treated them as a problem simply for Mr Sims and not for himself or his client."

Conclusion

141 I do not think that this was a case of wilful blindness, or that the judge overlooked the possibility of imputed knowledge. There was no need
E to impute knowledge to Mr Leach, for there was no relevant fact of which he was unaware. He did not shut his eyes to any fact in case he might learn the truth. He knew of the terms of the undertaking, that the money was not to be at Mr Yardley's free disposal. He knew (i) that Mr Sims was not entitled to pay the money over to him (Mr Leach), and was only prepared to do so against confirmation that it was proposed to apply the money for the
F acquisition of property; and (ii) that it could not be paid to Mr Yardley except for the acquisition of property. There were no enquiries which Mr Leach needed to make to satisfy himself that the money could properly be put at Mr Yardley's free disposal. He knew it could not. The only thing that he did not know was that the terms of the undertaking created a trust, still less a trust in favour of Twinsectra. He believed that Mr Sims' obligations to Twinsectra sounded in contract only. That was not an
G unreasonable belief; certainly not a dishonest one; though if true it would not have absolved him from liability.

142 Yet from the very first moment that he received the money he treated it as held to Mr Yardley's order and at Mr Yardley's free disposition. He did not shut his eyes to the facts, but to "the implications", that is to say the impropriety of putting the money at Mr Yardley's disposal. His explanation was that this was Mr Sims' problem, not his.

H 143 Mr Leach knew that Twinsectra had entrusted the money to Mr Sims with only limited authority to dispose of it; that Twinsectra trusted Mr Sims to ensure that the money was not used except for the acquisition of property; that Mr Sims had betrayed the confidence placed in him by paying the money to him (Mr Leach) without seeing to its further application; and

that by putting it at Mr Yardley's free disposal he took the risk that the money would be applied for an unauthorised purpose and place Mr Sims in breach of his undertaking. But all that was Mr Sims's responsibility.

144 In my opinion this is enough to make Mr Leach civilly liable as an accessory (i) for the tort of wrongful interference with the performance of Mr Sims's contractual obligations if this had been pleaded and the undertaking was contractual as well as fiduciary; and (ii) for assisting in a breach of trust. It is unnecessary to consider whether Mr Leach realised that honest people would regard his conduct as dishonest. His knowledge that he was assisting Mr Sims to default in his undertaking to Twinsectra is sufficient.

Knowing receipt

145 Each of the sums which Mr Leach received for his own benefit was paid in respect of an acquisition of property, and as such was a proper disbursement. He thus received trust property, but not in breach of trust. This was very properly conceded by counsel for Twinsectra before your Lordships.

Conclusion

146 I would reduce the sum for which judgment was entered by the Court of Appeal by £22,000, and subject thereto dismiss the appeal.

Appeal allowed.

Solicitors: Fairmays; Wallace & Partners.

BLS

TAB 2

Most Negative Treatment: Reversed
Most Recent Reversed: Ontario (Minister of Training, Colleges and Universities) v. Two Feathers Forest Products LP | 2013 ONCA 598, 2013 CarswellOnt 13601, 6 C.B.R. (6th) 129, 311 O.A.C. 147, 91 E.T.R. (3d) 167, 117 O.R. (3d) 227, 235 A.C.W.S. (3d) 587 | (Ont. C.A., Oct 2, 2013)

2012 ONSC 5077
Ontario Superior Court of Justice

Ontario (Minister of Training, Colleges and Universities) v. Two Feathers Forest Products LP

2012 CarswellOnt 11809, 2012 ONSC 5077, [2012] W.D.F.L. 5869, 221 A.C.W.S. (3d) 239

Her Majesty the Queen in Right of Ontario as Represented by the Minister of Training, Colleges and Universities, Applicant and Two Feathers Forest Products LP, Pikangikum First Nation, Eagle Lake First Nation, 1670761 Ontario Inc., Wabigoon Lake Forest Products LP, Wabigoon Lake Ojibway First Nation and Pricewaterhousecoopers Inc., Respondents

J.S. Fregeau J.

Heard: June 4, 2012
Judgment: September 24, 2012
Docket: CV-12-017

Counsel: Ronald Carr, for Applicant
Richard W. Schwartz, for Respondent, Pricewaterhousecoopers Inc.
Douglas J. Keshen, for Respondents, Eagle Lake First Nation and Pikangikum First Nation

Subject: Estates and Trusts; Insolvency; Family; Property; Civil Practice and Procedure; Contracts; Public

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Estates and trusts --- Trusts — Express trust — Creation — Three certainties — Miscellaneous

Province established fund for project-based skills training for residents of northern Ontario, administered by Minister of Training, Colleges and Universities — Limited partnership, with three First Nations limited partners and numbered company as general partner, applied for funding to provide skills training at its mills and plant — Minister entered into agreement with partnership, setting out terms and conditions and authorizing use of up to $3.6 million, and then advanced approximately $1.9 million — Two of limited partners commenced application to dissolve limited partnership and have receiver and interim manager appointed, and Minister was not named in application or given notice of it — Receiver was appointed, and it traced funds advanced by Minister, succeeding in having about $1 million returned to receiver to hold pending order of court — Minister applied for orders declaring that funds were impressed with trust in favour of Minister and did not form part of assets of limited partnership, and that Minister had priority ahead of creditors and receiver — Application granted in part — Minister established that required elements of trust existed at time agreement was entered into with concurrent certainties of intention, subject matter and object — Funds were provided only for specific purpose of carrying out project, and agreement specified that any unspent funds were to be returned if partnership did not comply with terms or if project could not be carried out — Parties intended to enter into trust relationship, as Minister placed restrictions on use of funds and demanded compliance with restrictions failing which funds had to be returned, and partnership accepted these terms — Sum currently held was impressed with trust in favour of Minister, such that Minister had priority over creditors of partnership — Agreement had been terminated, as partnership's filing for appointment of receiver constituted event of default and Minister's request that receiver consent to termination of agreement constituted effective notice of termination.

Bankruptcy and insolvency --- Property of bankrupt — Trust property — Miscellaneous

Province established fund for project-based skills training for residents of northern Ontario, administered by Minister of Training, Colleges and Universities — Limited partnership, with three First Nations limited partners and numbered company as general partner, applied for funding to provide skills training at its mills and plant — Minister entered into agreement with partnership, setting out terms and conditions and authorizing use of up to $3.6 million, and then advanced approximately $1.9 million — Two of limited partners commenced application to dissolve limited partnership and have receiver and interim manager appointed, and Minister was not named in application or given notice of it — Receiver was appointed, and it traced funds advanced by Minister, succeeding in having about $1 million returned to receiver to hold pending order of court — Minister applied for orders declaring that funds were impressed with trust in

favour of Minister and did not form part of assets of limited partnership, and that Minister had priority ahead of creditors and receiver — Application granted in part — Minister established that required elements of trust existed at time agreement was entered into with concurrent certainties of intention, subject matter and object — Sum currently held was impressed with trust in favour of Minister, such that Minister had priority over creditors of partnership — Funding received by partnership from Minister was subject to administration of court pursuant to order appointing receiver of all assets, undertakings and properties of partnership — Plain reading of order led to conclusion that judge exercised jurisdiction to charge receiver's remuneration against trust funds.

Bankruptcy and insolvency --- Receivers — Fees and expenses

Province established fund for project-based skills training for residents of northern Ontario, administered by Minister of Training, Colleges and Universities — Limited partnership, with three First Nations limited partners and numbered company as general partner, applied for funding to provide skills training at its mills and plant — Minister entered into agreement with partnership, setting out terms and conditions and authorizing use of up to $3.6 million, and then advanced approximately $1.9 million — Two of limited partners commenced application to dissolve limited partnership and have receiver and interim manager appointed, and Minister was not named in application or given notice of it — Receiver was appointed, and it traced funds advanced by Minister, succeeding in having about $1 million returned to receiver to hold pending order of court — Minister applied for orders declaring that funds were impressed with trust in favour of Minister and did not form part of assets of limited partnership, and that Minister had priority ahead of creditors and receiver — Application granted in part — Sum currently held was impressed with trust in favour of Minister, such that Minister had priority over creditors of partnership — Funding received by partnership from Minister was subject to administration of court pursuant to that order appointing receiver of all assets, undertakings and properties of partnership — Order stated that receiver's charge for fees and disbursements was first charge on property in priority to all trusts, and plain reading led to conclusion that judge exercised jurisdiction to charge receiver's remuneration against trust funds — Minister was not party to application before judge and did not have opportunity to make submissions on this point, but as interested party, Minister could apply to vary or amend that order.

Table of Authorities

Cases considered by *J.S. Fregeau J.*:

Barclays Bank Ltd. v. Quistclose Investments Ltd. (1968), [1968] 3 All E.R. 651, [1970] A.C. 567, [1968] 3 W.L.R. 1097 (U.K. H.L.) — considered

Cliffs Over Maple Bay Investments Ltd., Re (2011), 2011 CarswellBC 803, 2011 BCCA 180, 67 E.T.R. (3d) 1, [2011] 8 W.W.R. 285, 18 P.P.S.A.C. (3d) 11, 17 R.C.L.R. (5th) 60, 77 C.B.R. (5th) 1, 304 B.C.A.C. 116, 513 W.A.C. 116 (B.C. C.A.) — considered

Continental Bank of Canada v. Boekamp Manufacturing Inc. (1990), 1990 CarswellOnt 3172 (Ont. H.C.) — considered

Del Grande v. McCleery (1998), 1998 CarswellOnt 2062, 5 C.B.R. (4th) 36, 40 B.L.R. (2d) 202, 24 E.T.R. (2d) 30 (Ont. Gen. Div.) — followed

Del Grande v. McCleery (2000), 2000 CarswellOnt 57, 127 O.A.C. 394, 31 E.T.R. (2d) 50 (Ont. C.A.) — followed

Ling v. Chinavision Canada Corp. (1992), 10 O.R. (3d) 79, 1992 CarswellOnt 704 (Ont. Gen. Div.) — considered

Niedner Ltd. v. Lloyds Bank Canada (1990), 1990 CarswellOnt 403, 72 D.L.R. (4th) 147, 74 O.R. (2d) 574, 38 E.T.R. 208 (Ont. H.C.) — considered

Ontario (Securities Commission) v. Consortium Construction Inc. (1992), 14 C.B.R. (3d) 6, 9 O.R. (3d) 385, 93 D.L.R. (4th) 321, 11 C.P.C. (3d) 352, 57 O.A.C. 241, 1992 CarswellOnt 176 (Ont. C.A.) — considered

Twinsectra Ltd. v. Yardley (2002), [2002] 2 All E.R. 377, [2002] 2 W.L.R. 802, 2002 UKHL 12, [2002] 2 A.C. 164 (U.K. H.L.) — considered

Statutes considered:

Securities Act, R.S.O. 1980, c. 466

s. 17 — considered

s. 17(4) — considered

APPLICATION by Minister of Training, Colleges and Universities for orders with respect to funds advanced to limited partnership now in receivership.

J.S. Fregeau J.:

Nature of the Application

1 The Applicant, her Majesty the Queen in Right of Ontario as represented by the Minister of Training, Colleges and Universities ("MTCU" or "the Applicant") requests an order:

1. Declaring that an agreement between MTCU and Two Feathers Forest Products LP ("Two Feathers") dated February 14, 2011 (the "Agreement") is terminated;

2. Declaring that funds in the amount of $1,006,684.47 disbursed pursuant to the Agreement by MTCU to Two Feathers are impressed with a trust in favour of MTCU and do not form part of the assets of Two Feathers;

3. Declaring that MTCU has priority over the sum of $1,006,684.47 and any accrued interest thereon ahead of the creditors of Two Feathers, including priority to the interests of Pricewaterhousecoopers Inc. ("PWC"), in their capacity as interim receiver and receiver manager of Two Feathers; and

4. Requiring PWC to pay to MTCU the sum of $1,006,684.47 and any accrued interest thereon.

Background

2 In 2010, the Province of Ontario established the Northern Training Partnership Fund ("NTPF"), a funding vehicle to support project-based skills training for residents of Northern Ontario. This skills training program is administered by MTCU.

3 Two Feathers is a limited partnership consisting of three First Nations limited partners — Pikangikum First Nation, Eagle Lake First Nation and Wabigoon Lake Ojibway First Nation — and a general partner, 1670761 Ontario Inc. Two Feathers was formed in 2007 to develop and operate a planer mill and manufacturing plant in Dryden, Ontario and a saw mill in Red Lake, Ontario.

4 In 2010, Two Feathers submitted a funding application to the NTPF. This application contained a proposal entitled "Two Feathers Value-Added Training Initiative", a plan to provide skills training to Aboriginal and non-Aboriginal residents of Northern Ontario for employment in its Dryden and Red Lake facilities.

5 MTCU accepted Two Feathers' application. On February 14, 2011, the agreement defining the terms and conditions of the funds advanced by MTCU to Two Feathers was signed. Pursuant to the agreement, MTCU was to advance funds to a maximum amount of $3,600,000.00 and Two Feathers was to carry out the project in accordance with the terms and conditions of the agreement.

6 MTCU advanced funds to Two Feathers in the total amount of $1,895,870.00 in three instalments:

March 21 2011 $402,540.00
May 14, 2011 $746,665.00
July 31, 2011 $746,665.00

7 On September 30, 2011, two of the limited partners of Two Feathers, Pikangikum First Nation and Eagle Lake First Nation, commenced an amended Application to dissolve the limited partnership and to have PWC appointed as a receiver and manager of Two Feathers on an interim basis. MTCU was not named in this application and did not have notice of it.

8 On October 13, 2011, the Honourable Justice J. McCartney ordered the appointment of PWC as interim receiver and manager of all the assets, undertakings and properties of Two Feathers.

9 PWC's first report as receiver and manager of Two Feathers, released in November 2011, traced the $1,895,870.00 advanced by MTCU. The sum of $1,580,000.00 had been paid to Wabigoon Lake Forest Products LP ("WLFP"). From these funds, WLFP had paid WTG Finland OY Ltd. ("WTG") $563,911.25 for the supply of a planer mill.

10 The balance of $1,006,684.47 paid by Two Feathers to WLFP was ultimately returned to PWC who have agreed to hold these funds pending an order of this court.

The Issues on the Application

1. Are the funds advanced by MTCU to Two Feathers impressed with a trust in favour of the Province of Ontario?

2. In the event that it is determined that the funds are impressed with a trust, are they nevertheless subject to the Receiver's charging provision contained in paragraph 17 of the October 13, 2011 order of McCartney J.?

3. Has the agreement been terminated?

4. If the funds held by PWC are subject to a trust in favour of MTCU, should Eagle Lake and Pikangikum be awarded costs from those funds for costs incurred by them in bringing the Application for dissolution and the appointment of PWC?

Position of the Applicant

11 MTCU submits that the funds advanced to Two Feathers pursuant to the agreement are impressed with a trust in favour of Ontario. MTCU submits that the terms of the agreement provide for a specific purpose for the funds, such as to impress a trust. MTCU submits that a plain reading of the terms of the agreement, together with a consideration of all circumstances leading to its signing, disclose a mutual intention to treat the money advanced as trust funds.

12 MTCU further submits that the funds advanced are identifiable and that the objects of the agreement are clear. Finally, MTCU submits that the terms and circumstances of the agreement provided sufficient notice of the trust to Two Feathers.

13 The Applicant also submits that the agreement is at an end and that they are entitled to a declaration to that effect.

14 MTCU submits that where money is advanced by a lender for a specific purpose, it gives rise to fiduciary obligations on the part of the recipient. The lender retains the beneficial interest in the money advanced, and if the specific purpose for which the money was advanced is not or cannot be achieved, the money does not become the property of the recipient. The money is held by the recipient in a resulting trust for the lender, called a *Quistclose* trust, and is returnable to the lender.

15 MTCU submits that the *Quistclose* trust has been recognized in Ontario. It is submitted that the Ontario Court of Justice (General Division) case of *Dal Grande v. McCleery*, [1998] O.J. No. 2656 (Ont. Gen. Div.) articulated a two part test for a *Quistclose* trust at para. 12:

> 1. Whether the terms of the loan were such as to impress upon the loan sum a trust in favour of the lender if the specific purpose of the loan was not achieved or fulfilled; and,
>
> 2. Whether the party receiving the loan proceeds had notice of the trust or of the circumstances giving rise to the trust so as to bind such party.

16 MTCU acknowledges that in order to establish a *Quistclose* trust, a lender must also establish the general requirements for a trust, being certainty of intention, subject matter and object. MTCU submits that there was sufficient certainty of intention, subject matter and object in the agreement such as to give rise to a trust.

17 In addressing certainty of intention, MTCU submits that the intentions of the parties are obvious from a plain reading of the terms of the agreement. It is submitted that the terms of the agreement state that the funds were for a specific identified purpose and were returnable to MTCU if the purpose failed. MTCU submits that the terms of the agreement confirm that funds advanced were not at the free disposal of the recipient.

18 Referring to specific sections of the agreement in support of this latter point, MTCU submits that:

- Two Feathers is obligated to "use the funds only for the purpose of carrying out the project" (Article 4.4 (b));

- The funds may only be spent in accordance with the budget approved by the Ministry (Article 4.4(c));

- The Ministry is not obligated to continue payment of instalments of the funds unless it was satisfied with the progress of the project (Article 4.3 (b));

- The Ministry may adjust the amount of funding based on its assessment of the project (Article 4.3 (c));

- Two Feathers is precluded from changing the Project, timelines or its budget without the prior written consent of the Ministry (Article 4.6);

- Two Feathers is precluded from selling, leasing or otherwise disposing of assets worth over $1,000.00 acquired with the funds without prior written consent of the Ministry (Article 5);

- The Ministry is empowered to enter Two Feathers' premises, investigate and audit the use of the funds (Article 7.3);

- Two Feathers is deemed to default on the Agreement if it breached a material requirement in its spending of the funds or carrying out of the project, or if it fails to properly report to the Ministry (Article 14.1).

19 In additional support of its submission that there is sufficient certainty of intention in the agreement to support a trust, MTCU submits that, pursuant to Article 14.2 of the agreement, in the event of default by Two Feathers, the Ministry may;

- suspend the payment of funds;

- reduce the amount of funds;

- cancel all further instalments;

- demand repayment of any funds remaining in Two Feather's possession;

- demand repayment of an amount equal to any funds used improperly; and/or

- demand repayment of all funds provided.

20 MTCU further draws to the court's attention that, pursuant to the agreement, MTCU may demand the return of any unspent funds at the end of the year and Two Feathers is required to return all unspent funds remaining in its possession or under its control upon the expiry of the agreement.

21 MTCU submits that, based on a plain reading of the entire agreement and of these terms specifically, the parties clearly intended the funds to be solely for the purpose of carrying out the Project and were to be returned if that was not possible. MTCU submits that there is nothing in the agreement to suggest an intention on the part of either MTCU or Two Feathers that the funds were to be at the free disposal of Two Feathers, or that they unconditionally became part of Two Feather's property.

22 MTCU submits that the subjective intention of MTCU and Two Feathers at the time the agreement was signed is irrelevant. It is submitted that if a party enters into arrangements which have the effect of creating a trust, it need not be established that this party appreciated the result, as long as it is established that he intended to enter into the arrangements with full knowledge and appreciation of them.

23 In addressing certainty of subject matter, MTCU submits that the subject matter of the trust is the funding advanced to Two Feathers that was not properly expended on the project. Of the maximum funding amount of $3,600,000.00, $1,895,070.00 was advanced by MTCU to Two Feathers prior to the September 8, 2011 application for dissolution. MTCU submits that, of this amount, the $563,911.25 that was advanced to acquire a planer mill which was never delivered was an improper expenditure. The amount of $1,006,684.47 was not spent and is currently being held by the respondent PWC.

24 At the hearing of this application, the Applicant expressly stated that MTCU, at this time and for the purposes of this Application, is seeking the return of the sum of $1,006,684.47 held by PWC, while "reserving their rights" in regard to the $563,911.25 that the Applicant suggests was improperly expended for the acquisition of the planer mill.

25 MTCU submits that there is no evidence that these specific funds were ever commingled with other assets of Two Feathers. PWC, after being appointed interim receiver, readily identified and located the subject funds. MTCU submits that both the manner of funding and its application are certain.

26 MTCU submits that the specific object of both the Agreement and the funds advanced is readily ascertainable. This object was the on-the-job skills training project put forward in Two Feather's application, which was accepted by MTCU. Pursuant to the terms of the agreement, MTCU was to provide funds to the recipient for the "purpose of carrying out the project". The "project" is comprehensively described in Schedule "A" of the agreement. MTCU submits that the object of the agreement is unambiguous.

27 In addressing the issue of whether the recipient of the loan proceeds had notice either of the trust or of the circumstances giving rise to the trust so as to bind such party, MTCU submits that the express terms of the agreement required Two Feathers to use the funds only to carry out the project and to repay any amounts not used to carry out the project. MTCU submits that Two Feathers was therefore on notice that the funds were not at its free disposal, and that a failure to carry out the specific purposes of the agreement would result in a requirement to repay the funds.

28 MTCU submits that they have established the general requirements of a trust (certainty of intention, subject matter and object). MTCU further submits that they have satisfied the two-prong test for a *Quistclose* trust, as set out in *Del Grande*.

29 In the result, MTCU submits that the sum of $1,006,684.47 advanced by MTCU pursuant to the agreement and held by PWC, is impressed with a trust in favour of MTCU. MTCU submits that, as a result, these funds do not form part of the estate of Two Feathers and are not available for distribution to the creditors.

30 MTCU seeks a declaration that the agreement is at an end. PWC has declined to consent to the termination of the agreement.

31 MTCU submits that Article 14.2 of the Agreement permits MTCU to terminate the Agreement in the event of default by Two Feathers. MTCU submits that one or more events of default have occurred, including an inability to continue with the project, application for the appointment of a receiver and the fact that Two Feathers has ceased to operate. MTCU submits that, based on the terms of the agreement and the circumstances of Two Feathers, Two Feathers is in default and that the Applicant is entitled to a declaration that the agreement is at an end.

32 MTCU disputes that the funds held by PWC are, even if found to be impressed with a trust in favour of MTCU, nevertheless subject to the Receiver's charging order set out in paragraph 17 of the October 13, 2011 order of McCartney J.

33 MTCU submits that they were not a party to, nor served with, the Application before McCartney J. As a result, MTCU had no opportunity to file material or impact the provisions of this order.

34 The Applicant submits that paragraph 1 of this order appoints PWC receiver "of all assets, undertakings and properties ..." of Two Feathers. MTCU suggests that if this court finds that funds advanced by MTCU pursuant to the agreement were not properly expended on the project and are held on a trust in favour of MTCU, then the funds never became the property of Two Feathers. In turn, it is submitted that those are funds over which the receiver has no authority and which are not subject to the Receiver's charging order.

35 MTCU also submits that paragraph 3 of the October 13, 2011 order is inconsistent with the submission that the funds provided to Two Feathers by MTCU, pursuant to the agreement, are subject to the Receiver's

charging order. Paragraph 3 of this order requires PWC to "make commercially reasonable efforts to preserve the ongoing training program for which funding has been received from (MTCU) by way of written agreement dated February 14, 2011, including the transfer or assignment of such training program and funding agreement to such other third persons as may be appropriate."

36 MTCU submits that paragraph 3 in the order appointing the Receiver is implicit recognition that funding received by Two Feathers pursuant to the agreement, and not spent, does not form part of "the assets, undertakings and properties" of Two Feathers". The requirement placed on PWC, namely to make commercially reasonable efforts to preserve the program, "including the transfer or assignment of such training program and funding agreement to ...third persons..." is submitted to be inconsistent with the funds being subject to the Receiver's Charging order in paragraph 17 and consistent with the funds being outside of the estate of Two Feathers.

Position of the Respondent PWC Inc.

37 PWC submits that the funds advanced by MTCU to Two Feathers pursuant to the agreement are not impressed with a trust, specifically a *Quistclose* trust. PWC submits that these funds form part of the estate of Two Feathers and should be shared amongst Two Feathers' creditors.

38 In the alternative, should it be determined that the funds are impressed with a *Quistclose* trust, PWC submits that the funds are nevertheless subject to the Receiver's charging provision contained in paragraph 17 of the October 13, 2011 Order of McCartney J.

39 PWC takes no position on whether or not this court should declare the agreement between MTCU and Two Feathers terminated.

40 PWC submits that MTCU is requesting that this court recognize a *Quistclose* trust in circumstances where a trust was not intended and which is distinguishable from other situations in which such a trust has been found to exist. To do so would, in the submission of PWC, stretch "the principles of the law in an unintended direction."

41 PWC submits that the concept of a *Quistclose* trust first arose in the House of Lords decision in *Barclays Bank Ltd. v. Quistclose Investments Ltd.*, [1968] 3 All E.R. 651, [1968] 3 W.L.R. 1097 (U.K. H.L.), a case where the House of Lords found a clear intention between the lender and recipient that funds loaned were for the express purpose of paying an already approved and declared share dividend which the recipient could not meet. The purpose for which the money was advanced, the payment of the dividend, could not be completed and the court ordered the money returned to the lender.

42 PWC submits that the case at bar is distinguishable because of MTCU having granted funds to Two Feathers for a purpose other than paying existing creditors or obligations.

43 PWC acknowledges that the application of the *Quistclose* trust has been expanded subsequent to the *Quistclose* decision, but submits that this has only occurred in egregious circumstances requiring a court of equity to "step in and right a wrong".

44 PWC submits that Two Feathers was not in any sort of financial emergency when the agreement was signed and the funds were not provided by MTCU as any sort of a financial rescue.

45 PWC also submits that the funds advanced by MTCU to Two Feathers were not a loan but a grant. If the project had been completed successfully, the funds would not have been repayable to MTCU. PWC suggests that only upon default did the funding become a debt due from Two Feathers to MTCU.

46 PWC submits that cases where a *Quistclose* trust have been found are fact specific and characterized by a lender providing funds in the form of a loan for a specific purpose and or providing funds to a creditor third party on behalf of a debtor. If the purpose of the loan was completed, the lender's remedy was in debt only.

47 PWC also submits that, in addition to failing to establish the existence of a *Quistclose* trust in the circumstances of this case, MTCU has failed to establish the existence of certainty of intention, conceding that certainty of subject ($1,006,604.47) and certainty of object (provision of project-based skills training to residents of Northern Ontario) are present.

48 In addressing certainty of intention, PWC concedes that MTCU does not have to prove a subjective intention to enter into a trust arrangement. It is submitted that the intention of the parties must be determined from the agreement and other relevant documents.

49 PWC submits that the funds were provided to Two Feathers for the purpose of "helping residents of Northern Ontario participate and benefit from emerging economic activities." However, PWC submits that Two Feathers was allowed great flexibility as to how this purpose was to be achieved, suggesting that certainty of intention is lacking.

50 PWC submits that a review of various provisions of the agreement support the proposition that a trust arrangement was not subjectively intended nor, viewing the matter objectively, can it be said that the terms of the agreement have the effect of creating a trust.

51 PWC submits that the word "trust" appears nowhere in the agreement. Article 17, dealing with repayment, provides that if Two Feathers owes any funds to MTCU "such monies shall be deemed to be a debt

due and owing to" MTCU. PWC submits that in this critical section of the agreement dealing with repayment, the Applicant fails to reference the word "trust" and seeks recovery in debt.

52 PWC also submits that the agreement did not require Two Feathers to place funds received in a segregated account. Failure to require the deposit of funds advanced into a segregated account is said to militate against the finding that funds advanced are impressed with a trust.

53 Finally, PWC submits that, even if the funds were impressed with a trust, they are nevertheless subject to the Receiver's charging provision in paragraph 17 the order of McCartney J.

54 PWC concedes that "Ontario was not present when the Order was pronounced", but submits that Ontario neither appealed the order nor applied to vary or amend it, as any "interested party" was entitled to do, pursuant to paragraph 30 of the order. PWC submits that paragraph 17 of the order specifically contemplates trust claims and clearly states that the Receiver's charge has priority over them.

55 PWC submits that Justice McCartney had the jurisdiction to make a Receiver's charging order over trust funds if the funds form part of the assets which are subject to the administration of the court. PWC submits that Justice McCartney exercised his discretion properly and granted the order which, on a plain reading, gives the Receiver a first charge on "the property in priority to all...trusts..." As such, PWC submits that even if the funds are found to be impressed with a *Quistclose* trust, they would still be subject to the Receiver's charge in the Order.

Position of the Respondents Eagle Lake First Nation and Pikangikum First Nation

56 The Respondents, Eagle Lake First Nation ("Eagle Lake") and Pikangikum First Nation ("Pikangikum"), two of the limited partners in Two Feathers who commenced the application to dissolve the limited partnership, submit that the funds advanced to Two Feathers by MTCU pursuant to the agreement are impressed with a *Quistclose* trust.

57 Eagle Lake and Pikangikum further submit that they should be entitled to recover all of their "actual and reasonable costs, including legal fees" incurred in connection with the administration and protection of the trust funds from the funds held by PWC. Eagle Lake and Pikangikum also take the position that the reasonable costs and expenditures of PWC should be recoverable from what they submit are the trust funds.

58 Eagle Lake and Pikangikum expressly adopt the submissions of MTCU with regard to the existence of a *Quistclose* trust in favour of MTCU. These Respondents submit that the agreement establishes that it was the intention of the parties that the funds advanced to Two Feathers were not at their free disposal, but rather were to be used exclusively for on-the-job skills training purposes. Eagle Lake and Pikangikum submit that the purpose for which the funds were advanced was not achieved, is no longer achievable and that the limited partnership has become "wholly dysfunctional". In these circumstances, Eagle Lake and Pikangikum submit that the funds held by PWC are impressed with a trust in favour of MTCU.

59 Eagle Lake and Pikangikum submit that they moved prudently and expeditiously to have a receiver appointed to protect partnership property and assets during dissolution. These Respondents submit that their actions preserved and protected partnership property and assets, including the $1,006,684.47 being held by PWC, which are the subject of this Application.

60 These Respondents submit that they have acted as prudent trustees in protecting trust assets, a process which it is submitted was undertaken at considerable cost to them. Eagle Lake and Pikangikum submit that the costs they have incurred in preserving, protecting and recovering trust assets should be paid from the funds held by PWC.

The Quistclose Trust

61 Two seminal cases from the United Kingdom have established and developed the concept of the *Quistclose* trust.

62 In *Barclays Bank Ltd. v. Quistclose Investments Ltd.*, Rolls Razor Ltd. was in financial difficulty, with significant overdraft with their bank, Barclay's. Barclay's declined to extend further credit to allow Rolls to pay a dividend that was due to Rolls' shareholders. Rolls obtained the necessary financing from Quistclose, who advanced the financing to Rolls subject to the condition that it be used only to pay the dividend. The money to pay the dividend was advanced to Rolls and placed in a separate account at Barclay's.

63 Rolls became insolvent prior to the dividend being paid. Barclay's seized the money allocated for the share dividend and applied it against Rolls' overdraft. Quistclose demanded the return of the money from Barclay's, claiming it was advanced for a specific purpose and therefore impressed with a trust. As the purpose for which the money was lent did not occur, Quistclose argued that the money ought to be returned to it.

64 The House of Lords accepted the submission of Quistclose. Lord Wilberforce found that both Rolls and Quistclose intended that the money was to be used for the express purpose of paying the dividend and that Barclay's knew of that purpose. As the purpose for which the money was advanced could not be completed, the money was to be returned to Quistclose. In arriving at this conclusion, Lord Wilberforce acknowledged, at pages 10-11:

> [A]rrangements...for the payment of a person's creditors by a third person, give rise to a relationship of a fiduciary character or trust, in favour, as a primary trust, of the creditors, and secondarily, if the primary trust fails, of the third person, has been recognized in a series of cases over some 150 years.

65 Through its analysis, the House of Lords established the existence of the *Quistclose* trust in a case where a lender advanced money to a borrower specifically for the purpose of paying the borrower's creditors.

66 The concept of a *Quistclose* trust was reviewed by the House of Lords and its rationale and application extended in *Twinsectra Ltd. v. Yardley*, [2002] 2 All E.R. 377, [2002] 2 W.L.R. 802 (U.K. H.L.).

67 In *Twinsectra*, Yardley, a businessman, required funding to purchase some property. Twinsectra was prepared to provide the money to Yardley in the form of a short term loan, but only if Yardley's solicitor personally undertook to repay the loan. Yardley's first solicitor declined to give such an undertaking, but his second solicitor agreed to do so. The undertaking required that the money be used only for the acquisition of the property by Yardley and for no other purpose. Some of the money lent by Twinsectra was used to purchase property, and some was used for other purposes. The second solicitor who provided the undertaking went bankrupt and the loan from Twinsectra went into default.

68 Twinsectra successfully argued that the money lent to Yardley was impressed with a *Quistclose* trust. Lord Millet explained the trust in the following way, at paragraphs 68 and 69:

69 Money advanced by way of a loan normally becomes the property of the borrower. He is free to apply the money as he chooses, and save to the extent to which he may have taken security for repayment the lender takes the risk of the borrower's insolvency. But it is well established that a loan to a borrower for a specific purpose where the borrower is not free to apply the money for any other purpose gives rise to fiduciary obligations on the part of the borrower which a court of equity will enforce. In the earlier cases the purpose was to enable the borrower to pay his creditors or some of them, but the principle is not limited to such cases.

70 When the money is advanced, the lender acquires a right, enforceable in equity, to see that it is applied for the stated purpose, or more accurately to prevent its application for any other purpose. This prevents the borrower from obtaining any beneficial interest in the money, at least while the designated purpose is still capable of being carried out. Once the purpose has been carried out, the lender has his normal remedy in debt. If for any reason the purpose cannot be carried out, the question arises whether the money falls within the general fund of the borrower's assets, in which case it passes to his trustee in bankruptcy in the event of his insolvency and the lender is merely a loan creditor; or whether it is held on a resulting trust for the lender. This depends on the intention of the parties collected from the terms of the arrangement and the circumstances of the case.

71 *Twinsectra* appears to establish that a *Quistclose* trust may be found where money is advanced on a restrictive basis for a specific purpose. *Twinsectra* was not a case where money was advanced to pay the creditors of the borrower.

72 Whether such a trust will be found will depend on a court's finding as to the intention of the parties at the point in time when the agreement is entered into. Lord Millet also makes it clear that the principle upon which the *Quistclose* trust is based is not limited to cases where the purpose of the loan is for the borrower to pay its creditors.

73 Lord Millet provides some instruction with respect to ascertaining the intention of the parties at paragraphs 71, 73 and 74:

74 A settlor must, of course, possess the necessary intention to create a trust, but his subjective intentions are irrelevant. If he enters into arrangements which have the effect of creating a trust, it is not necessary that he should appreciate they do so, it is sufficient that he intends to enter into them.

75 A *Quistclose* trust does not necessarily arise merely because money is paid for a particular purpose. A lender will often inquire into the purpose for which a loan is sought in order to decide whether he would be justified in making it. He may be said to lend the money for the purpose in question, but this is not enough to create a trust; once lent the money is at the free disposal of the borrower. Similarly payments in advance for goods or services are paid for a particular purpose, but such payments do not ordinarily create a trust. The money is intended to be at the free disposal of the supplier and may be used as part of his cash flow.

76 The question in every case is whether the parties intended the money to be at the free disposal of the recipient."

77 In *Twinsectra*, the House of Lords held that the money loaned to Yardley was subject to a *Quistclose* trust. The court found that the money was never at Yardley's free disposal; the beneficial interest in the money remained with Twinsectra throughout, subject to Yardley's right to apply the money for the acquisition of property. Funds not used for the purchase of property were expended in breach of the trust and were ordered returned to Twinsectra.

The Quistclose Trust in Canada

78 In *Niedner Ltd. v. Lloyds Bank Canada* (1990), 74 O.R. (2d) 574 (Ont. H.C.), decided after *Quistclose* but prior to *Twinsectra*, Ewaschuk J. cited the principle set out in *Quistclose* with approval. Ewaschuk J. then defined the *Quistclose* trust in his own words at page 579:

> A *Quistclose* trust is created when A lends money to B for the specific purpose of enabling B to pay its creditors or a specific class of them. The money is then impressed with a trust and cannot be reached by third parties other than the beneficiaries of the trust. Assuming the purpose of the trust should fail, the money reverts back to the settlor of the trust.

79 While this Ontario decision would restrict the finding of a Quistclose trust to situations where money was lent to pay creditors of a borrower, it was decided prior to *Twinsectra*, which held, at paragraph 68, that "the principle is not limited to such cases".

80 In *Ling v. Chinavision Canada Corp.* (1992), 10 O.R. (3d) 79 (Ont. Gen. Div.), a third party had lent money to the defendant pursuant to an agreement in writing that required that the money be used for the repayment of the defendant's debt. The plaintiff sought access to the money. Roberts J. accepted the concept of a *Quistclose* trust and held that the money was not the property of the defendant, but was held in trust for the lender.

81 Citing *Continental Bank of Canada v. Boekamp Manufacturing Inc.*, [1990] O.J. No. 1043 (Ont. H.C.), Roberts J. held that the money advanced was impressed with a trust which prevented the money from being paid to any other creditors. The Court found that the existence of a *Quistclose* trust depended on the intention of the parties at the time the funds were advanced at page 84:

> The case of *Barclay's Bank v. Quistclose Investments Ltd.* is authority that (i) money lent does not necessarily negative the existence of a trust for repayment if the reason for which it was lent can no longer be fulfilled and (ii) money lent for specific purpose can be impressed with a trust that the money lent is to be used only for the specific purpose and repaid if not so used.

82 The case of *Del Grande v. McCleery*, [1998] O.J. No. 2606 (Ont. Gen. Div.) aff'd [2000] O.J. No. 61 (Ont. C.A.), also decided prior to the expansion of the rationale and application of the *Quistclose* trust in *Twinsectra*, provides further guidance as to whether a *Quistclose* trust will be found in a particular fact situation.

83 At issue in *Del Grande* was the proper characterization of a deposit of $200,000.00 advanced under a "shotgun" clause in a shareholders agreement. It was agreed by all counsel that the issue would be governed by the application of the criteria or principles enunciated in *Quistclose*. *Del Grande* found that *Quistclose* established two conditions that must be established for this trust to be found at para. 11:

> Two questions arise, both of which must be answered favourably to the respondents if they are to recover the money from the bank. The first is whether as between the respondents and Rolls Razor Limited, the terms upon which the loan were made were such as to impress upon the (funds) a trust in their favour in the event of the dividend not being paid. The second is whether, in that event, the bank had such notice of the trust or of the circumstances giving rise to it as to make the trust binding upon them. per Lord Wilberforce, at p. 579.

84 MacKenzie J. in *Del Grande* extrapolated from these principles and restated the criteria at para. 12:

> 1. Whether the terms of the loan were such as to impress upon the loan a trust in favour of the lender if the specific purpose of the loan was not achieved or fulfilled;
>
> 2. Whether the party receiving the loan proceeds had notice of the trust or of the circumstances giving rise to the trust so as to bind such party.

85 On the question of notice, MacKenzie J. found that the House of Lords held that Barclay's had "clear and unequivocal notice" that the loan proceeds were to be used for a specific purpose.

86 In the case before him, MacKenzie J. found that there was insufficient evidence to prove the requisite intention to establish what he referred to as a "sole or unique purpose trust". At paragraph 16, MacKenzie J. stated:

> Although (Mrs. Del Grande's) expectations may well have been that the use of such funds would result in the acquisition of the shares, there is no evidence before me to establish that such expectations were translated into an express or implied intention that unless such $200,000.00 sum was in fact utilized in due course for the acquisition of the shares, it was to be returned to her.

87 The British Columbia Court of Appeal discussed the concept of the *Quistclose* trust in the recent decision of *Cliffs Over Maple Bay Investments Ltd., Re*, 2011 BCCA 180, 17 B.C.L.R. (5th) 60 (B.C. C.A.). This court described the *Quistclose* trust to be "a purpose trust of a very special kind". The court, at paragraph 57, cited *Waters' Law of Trusts in Canada (3rd ed. 2005)* at page 565:

> These trusts occur when moneys are loaned by a lending institution expressly for the purpose for which the borrower intends to use the loan. The lender advances the monies on the condition that they are to held "on trust" by the borrower until the time for expenditure upon the purpose takes place. At that point in time, having the authority of the loan agreement, the borrower applies the money to the purpose and becomes a debtor vis-à-vis the lender. If the contemplated expenditure upon the purpose does not occur, the monies are held in trust by the borrower for the lender — that is, ahead of all the unsecured creditors of the borrower.

Analysis

88 The Applicant bears the onus of proving, on a balance of probabilities, that the required elements of a *Quistclose* trust existed at the time the agreement was entered into and that the certainties of intention, subject matter and object were concurrently present.

89 For reasons that follow, I am satisfied that the Applicant has discharged this onus and that the sum of $1,005,684.47 held by PWC is impressed with a trust in favour of MTCU.

90 MTCU and Two Feathers entered into the agreement effective February 14, 2011. Pursuant to Article 1.2 of the agreement, all schedules, the guidelines and the Audit and Accountability requirements are included within the agreement. The "Project" is defined in Article 1.2 as the undertaking described in Schedule "A" of the agreement. The "Proposal" is defined in Article 1.2 as the proposal submitted by Two Feathers in its application for the NTPF funding attached as Schedule "F" to the agreement.

91 Schedule "A", entitled "Project Description", sets out the background and objective of the Project and addresses the "On-the-Job Component" of it. The purpose of the Project is to support project-based skills training to assist Northern Ontario residents participate in and benefit from emerging economic development opportunities. The objective was identified as assisting these residents attain skills and sustain employment in the resource related sectors of the Northern Ontario economy.

92 Pursuant to the provisions of Schedule "A", Two Feathers was required to carry out the Project in accordance with their proposal and to ensure that the Project had the agreed upon on-the-job component.

93 Article 4 of the agreement establishes the terms and conditions of the provision of the allotted funds and the intended use of the funds by Two Feathers.

94 Pursuant to Article 4.1, MTCU provided the funding for "the purpose of carrying out the Project". Pursuant to Article 4.3, MTCU is not obligated to provide funds unless it is "satisfied with the progress of the Project". Two Feathers' use of the funds is restricted by Article 4.4 of the agreement, which requires Two Feathers to carry out the Project in accordance with the terms and conditions of the agreement, use the funds only for the purpose of carrying out the Project and spend the funds only in accordance with the budget attached as Schedule "B" to the Agreement.

95 Article 4.5(a) precludes Two Feathers from making any changes to the Project or budget without prior approval of MTCU. Article 4.6 requires Two Feathers to place any funds not immediately required in an interest bearing account and Article 4.7 allows MTCU to adjust future funds advanced by any interest earned on the funds by Two Feathers or to demand Two Feathers pay any interest earned on the funds to MTCU.

96 Article 12.1 allows MTCU to terminate the agreement at any time on 30 days notice to Two Feathers. If MTCU choses to do so, Article 12.2 allows the Ministry to demand the return of any funds remaining in the possession or under the control of Two Feathers.

97 Article 14 of the agreement, entitled "Event of Default, Action upon Default..." grants certain rights to MTCU if, "in the opinion of the Ministry", Two Feathers breaches any material requirement of the agreement, including failing to carry out the project or ceasing to operate. If default occurs, MTCU may cancel further instalments of funds and/or demand the repayment of funds remaining in the possession or control of Two Feathers.

98 Pursuant to Article 16.1 of the agreement, Two Feathers is required to return to MTCU any funds remaining in its possession or control upon expiry of the agreement.

99 I am satisfied, based on my reading of the entire agreement, that it was not the intention of either MTCU or Two Feathers that funds advanced to Two Feathers pursuant to the terms and conditions of the agreement were to be at the free disposal of the recipient. Two Feathers' application for the funding was accepted based on their proposal, with the proposal being incorporated into the agreement. The provision of funds was for the specific purpose of carrying out the Project and only for the purpose of carrying out the Project. MTCU was not required to advance any funds unless satisfied that the Project was being carried out as described.

100 Two Feathers was precluded from making unilateral changes to the Project or the approved Budget. Article 7.3 allows MTCU to conduct inspections, audits and/or investigations to ensure compliance with the agreement and Two Feathers' expenditure of funds. MTCU could terminate the agreement without cause and demand the return of unspent funds.

101 The express terms of the agreement provides MTCU with both the right and mechanisms to ensure that the funds were applied for the stated purpose and to prevent the application of the funds for improper purposes. MTCU is entitled to suspend future instalments of funds and demand the return of unspent funds if Two Feathers was not in compliance with the agreement.

102 The fact that the word "trust" does not appear in the agreement, and that Article 17 of the agreement stipulates that monies owing to MTCU by Two Feathers "shall be deemed to be a debt due and owing to..." MTCU is not, in my opinion, determinative of the intention of the parties as to whether the funds were to be at the free disposal of Two Feathers once advanced by MTCU.

103 *Twinsectra* suggested that the subjective intentions of the parties are "irrelevant" if the parties intend to enter into arrangements "which have the effect of creating a trust". I find that MTCU and Two Feathers entered into this agreement with the intention that the use or application of the funds advanced was restricted to a specific purpose. The parties agreed that MTCU could monitor the project to ensure compliance with the agreement. If compliance was lacking, or if the project could not be carried out, or if Two Feathers ceased to operate, any unspent funds were to be returned to MTCU. This is not consistent with a suggestion that funds advanced were at the free disposal of Two Feathers. It is, in my opinion, consistent with the finding of an express or implied intention that unless the funds advanced were utilized for the purpose of carrying out the project, they were to be returned to MTCU.

104 Of note, two of the limited partners of Two Feathers, Eagle Lake and Pikangikum, chose to respond to this Application for the purpose of supporting the position of MTCU and the imposition of a trust on the funds held by PWC.

105 It was the clear position of these limited partners of Two Feathers that funds advanced to Two Feathers pursuant to the agreement were to be used exclusively for on-the-job skills training purposes, and that they were not the property of the limited partnership to be used as their free disposal or as part of the cash flow of Two Feathers.

106 I received these submissions with caution and attach limited weight to them in this decision. This position was coupled with a request by these parties that the costs they incurred in the Application for dissolution of Two Feathers, heard by McCartney J., be paid from the subject funds held by PWC. This position was advanced despite the provisions of paragraph 29 of Justice McCartney's order, which states that the parties to that Application were to bear the respective costs of the motion brought to appoint the receiver. In the result, I find the position of Eagle Lake and Pikangikum to be self-serving.

107 I am also satisfied that the three certainties — intention, subject and object — have been established on a balance of probabilities. Viewed objectively, I am satisfied that the parties intended to enter into a trust arrangement. MTCU placed restrictions on the use of the funds and demanded compliance with these restrictions failing which they included in the agreement a requirement that funds be returned. Two Feathers accepted the express terms of the agreement.

108 PWC conceded that certainty of subject — the $1,006,684.47 currently held by it — is present. In regard to certainty of object, Two Feathers' Proposal for the on-the-job skills training project was part of the application accepted by MTCU. The Proposal was carried forward and formed part of the agreement. The agreement set out the funding that would be provided for the purpose only of satisfying the mutually agreed upon objective.

109 Based on the terms and conditions of the agreement dated February 14, 2011, I am satisfied that the sum of $1,006,684.47 currently held by PWC is impressed with a trust in favour of the Applicant, MTCU. It follows that MTCU has priority over the sum of $1,006,684.47 and any accrued interest thereon ahead of the creditors of Two Feathers.

The Receiver's Charging Order

110 PWC submits that, if the sum of $1,006,684.47 held by them is impressed with a *Quistclose* trust, as has been found, then these funds are nevertheless subject to the Receiver's charge in paragraph 17 of McCartney J.'s order of October 13, 2011.

111 As this Application is neither an appeal of McCartney J.'s order, nor an application to vary or amend it, it is not my role to determine whether McCartney J. had jurisdiction to make an order granting the Receiver's charge priority over trust assets, except to the extent that a discussion of this jurisdiction aids in interpreting his order. Nor is it my role, assuming McCartney J. had such jurisdiction, to determine if he exercised it properly in the circumstances of the Application before him.

112 The issue before me, assuming McCartney J. had jurisdiction to grant such priority to the Receiver's charge, is whether he in fact exercised this jurisdiction and did in fact grant the Receiver's charge priority over what have been found to be trust assets. The resolution of this issue requires a discussion of the jurisdictional issue and an interpretation of the relevant terms of the order.

113 In *Ontario (Securities Commission) v. Consortium Construction Inc.* (1992), 9 O.R. (3d) 385 (Ont. C.A.), the Ontario Court of Appeal reviewed the general law as to the recovery of the costs of a receivership. Carthy J.A. found clear authority for the proposition that, in limited circumstances, a court can attach more than the equity of the debtor to meet the expenses of the receivership. After reviewing cases dealing specifically with trust assets, Carthy J.A. concluded at page 389, "I am satisfied that these authorities amply ground an authority to make an order imposing upon trust assets in receivership, although the discretion should be sparingly exercised".

114 Galligan J.A., in a concurring opinion, noted that the case before the court in *Consortium* was not an ordinary receivership, the receiving order having been made pursuant to s. 17 of the Securities Act R.S.O. 1980. Galligan J.A. was of the opinion that the issue of whether there was jurisdiction to make an order charging trust funds, which were not the property of Consortium, with the remuneration of the receiver, could be decided upon a consideration of s. 17 of the Securities Act. Given same, Galligan J.A. felt it was not necessary to decide the issue of whether "under general principles of insolvency law a receiver and manager *is entitled* to be compensated for its general administration out of trust property that comes into its possession or control". (See pg.397)

115 Galligan J.A. went on to state on page 397: "It is, I think, well established that a court has the inherent power to allow a receiver and manager to recover its proper remuneration, expenditures and disbursements *out of any assets which are subject to the administration of the court.*"[Emphasis added] And further, at page 398, His Honour noted:

> If the trust funds form part of the assets which are subject to the administration of the court, it would seem to me to follow necessarily that the court has the power, in its discretion, to charge those assets with the receiver and manager's proper remuneration.

116 The submission was made in *Consortium*, as it was in the case before me, that because the funds were held in trust for other persons, they did not constitute property of Consortium which was subject to the

administration of the court. Galligan J.A. did not address this submission as he held that s.17(4) of the Securities Act expressly provided that the receiver was the receiver of all or any part of property held by it in trust for others and that the trust funds were therefore "clearly...subject to the administration of the court". (See pg 399)

117 If McCartney's J's order is interpreted such that the $1,006,684.47 held by PWC is an asset subject to the administration of the court pursuant to the order, it follows that the court's power to allow a receiver to recover fees out of assets which are subject to its administration would allow McCartney J. to charge PWC's remuneration against these trust funds.

118 Paragraph 1 of McCartney J.'s order appoints PWC as Receiver of "...all of the assets, undertakings and properties of (Two Feathers) acquired for or used in relation to the partnership...including assets held by any of the partners...for and/or on account of the partnership and all proceeds thereof (the "Property")."

119 Paragraph 3 of this order, dealing specifically with the agreement, states that PWC "shall...make commercially reasonable efforts to preserve the ongoing training program for which funding has been received from (MTCU) by way of written agreement dated February 14, 2011, including the transfer or assignment of such training program and funding agreement to such other third persons as may be appropriate".

120 Paragraph 12 of McCartney J.'s order requires that any funds or payments received or collected by the Receiver "...from any source whatsoever...shall be held by the receiver to be paid in accordance with the terms of this Order or any further order of this Court".

121 Paragraph 17 of this Order provides that PWC is to be paid their reasonable fees and disbursements and that PWC is granted a Receiver's charge "on the Property as security for such fees." This paragraph further states that "the Receiver's charge shall form a first charge on the property in priority to all security interests, trusts, liens, charges and encumbrances."

122 Paragraph 30 of McCartney J.'s order provides that any "interested party may apply to this Court to vary or amend this Order."

123 A reading of the relevant paragraphs of McCartney J.'s order persuades me that it was his intention that the funding received by Two Feathers, $1,006,684.47 of which was recovered by PWC, was to be subject to the administration of the court pursuant to the order which appointed PWC receiver of "all of the assets, undertakings and properties" of Two Feathers. This funding is, in the specific context of this order, included in the definition of Property in paragraph 1 of the order.

124 Paragraph 17 of this order clearly states that the Receiver's charge as security for fees and disbursements is to be a first charge "on the Property in priority to all...trusts." A plain reading of this leads me to the conclusion that McCartney J. exercised his jurisdiction and charged PWC's remuneration against these trust funds.

125 I remain troubled by the fact that MTCU was not a party to the application before McCartney J. and therefore did not have an opportunity to make submissions on this point prior to McCartney J. exercising his discretion, a discretion which the Ontario Court of Appeal suggested in *Consortium* should be "sparingly exercised", presumably on notice to all interested parties. Whether McCartney J. would have exercised this jurisdiction differently, had MTCU made appropriate submissions and after hearing evidence as to what energy and efforts PWC undertook to recover this substantial amount of money, is not for me to decide.

126 Pursuant to paragraph 30 of the order of McCartney J., "any interested party" which would obviously include MTCU, may apply to vary or amend that order. Should MTCU take the position that McCartney J. would have exercised his discretion differently had they been able to make appropriate submissions before him, they may apply to amend or vary his order accordingly, subsequent to the release of this decision.

127 I find that the sum of $1,006,684.47 held by PWC and impressed with a trust in favour of MTCU, is subject to the specific provisions of the Receiver's charging order contained in paragraph 17 of the October 13, 2011, order of McCartney J. Subject to variation or amendment of that order, PWC has priority over the sum of $1,006,684.47 held by them, ahead of MTCU, for the reasonable fees and disbursements of the receiver and counsel to the receiver.

Has the Agreement been Terminated?

128 I find that the Agreement has been terminated. Article 14 of the agreement stipulates that, among other things, Two Feathers filing for the appointment of a receiver or ceasing to operate constitute events of default. Article 14.2(h) allows MTCU, upon an event of default occurring, to "terminate the Agreement immediately upon giving Notice to..." Two Feathers.

129 By letter dated December 12, 2011, MTCU provided notice to PWC of its intention to terminate the agreement pursuant to the provisions of Article 14 and requested that PWC consent to same. PWC declined to do so. In the circumstances, I find this to be effective notice of termination and declare the agreement to be at an end.

Costs Sought by Eagle Lake and Pikangikum

130 Paragraph 29 of the October 13, 2011 Order of McCartney J. clearly states that the parties in that proceeding, two of whom are Eagle Lake and Pikangikum, "shall bear their respective costs ..." of the motion brought by them to have PWC appointed as the Receiver of the assets and properties of Two Feathers. Given

same, I am puzzled as to why these parties would appear on this Application and request costs allegedly incurred in the Application before McCartney J.

131 The request of Eagle Lake and Pikangikum for costs is dismissed.

Costs of this Application

132 If the parties are unable to agree on the disposition of costs of this Application, they may make written submissions, not to exceed 5 pages including their respective Bills of Costs. The Applicant's costs submissions are to be filed within 15 days of the release of these reasons. The cost submissions of the Respondent Two Feathers shall be filed within 15 days thereafter. The costs submissions of Eagle Lake and Pikangikum, if any, shall be filed within 15 days thereafter.

Application granted in part

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TAB 3

CASE VIEWS:
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RELATED RESOURCES
Canadian Guide to Uniform Legal Citation
Abridgment digests and classifications for all levels of this case

Ontario (Minister of Training, Colleges and Universities) v. Two Feathers Forest Products LP

2013 CarswellOnt 13601, 2013 ONCA 598, 117 O.R. (3d) 227, 235 A.C.W.S. (3d) 567, 311 O.A.C. 147, 368 D.L.R. (4th) 714, 6 C.B.R. (6th) 129, 91 E.T.R. (3d) 167

Her Majesty the Queen in Right of Ontario as Represented by the Minister of Training, Colleges and Universities, Applicant (Respondent) and Two Feathers Forest Products LP, Pikangikum First Nation, Eagle Lake First Nation, 1670761 Ontario Inc., Wabigoon Lake Ojibway First Nation and Pricewaterhousecoopers Inc., Respondents (Appellant)

Feldman, Lauwers, Strathy JJ.A.

Heard: June 4, 2013
Judgment: October 2, 2013
Docket: CA C56138

Proceedings: reversing *Ontario (Minister of Training, Colleges and Universities) v. Two Feathers Forest Products LP* (2012), 2012 ONSC 5077, 2012 CarswellOnt 11809 (Ont. S.C.J.)

Counsel: Richard W. Schwartz, for Appellant
Ronald E. Carr, Eric Wagner, for Respondent

Subject: Estates and Trusts; Family; Insolvency

Related Abridgment Classifications
For all relevant Canadian Abridgment Classifications refer to highest level of case via History

Headnote

Estates and trusts --- Trusts --- Purpose trust — Miscellaneous

Limited partnership was formed to operate planer plant and saw mill — Partnership applied to government fund run by respondent ministry for skills training grant, for prospective employees — Agreement for funding was made — Shortly after agreement, partnership was dissolved — Appellant receiver was appointed and traced funds advanced to partnership — Ministry applied to find that original grant funds were impressed with trust — Ministry was successful on application as funds were found not to have been used for specific purpose — Receiver appealed from application judge's finding — Appeal allowed — Finding by application judge was of specific trust called Quistclose trust — Intention of both parties had to be that funds would be held for specific purpose — Parties in this case did not intend that funds would be held in trust for ministry's benefit — Unused funds were intended to be debt to ministry, not trust funds — Partnership had considerable freedom to use funds at their discretion — Agreement allowed for "other"funds to be used to set up business, and only small portion was specifically designated for job training — Funds were obtained as basic source of funding for long term project, not to make specific payment or purchase — Principle of Quistclose trust was not yet established in Canadian law, and circumstances that allowed for it in English cases were not present here — Original application was dismissed.

Estates and trusts --- Trusts --- Express trust — Creation — Three certainties — Miscellaneous

Limited partnership was formed to operate planer plant and saw mill — Partnership applied to government fund run by respondent ministry for skills training grant, for prospective employees — Agreement for funding was made — Shortly after agreement, partnership was dissolved — Appellant receiver was appointed and traced funds advanced to partnership — Ministry applied to find that original grant funds were impressed with trust — Ministry was successful on application as funds were found not to have been used for specific purpose — Receiver appealed from application judge's finding — Appeal allowed — Finding by application judge was of specific trust called Quistclose trust — Intention of both parties had to be that funds would be held for specific purpose — Parties in this case did not intend that funds would be held in trust for ministry's benefit — Unused funds were intended to be debt to ministry, not trust funds — Partnership had considerable freedom to use funds at their discretion — Agreement allowed for "other"funds to be used to set up business, and only small portion was specifically designated for job training — Funds were obtained as basic source of funding for long-term project, not to make specific payment or purchase — Principle of Quistclose trust was not yet established in Canadian law, and circumstances that allowed for it in English cases were not present here — Original application was dismissed.

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Venture Capital USA Inc. v. Yorkton Securities Inc. (2005), 2005 CarswellOnt 7072, 2005 CarswellOnt 7073, 349 N.R. 199 (note), 215 O.A.C. 400 (note) (S.C.C.) — referred to

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

Personal Property Security Act, R.S.O. 1990, c. P.10

Generally — referred to

Words and phrases considered:

Quistclose trust

The *Quistclose Investments Ltd.* trust concept was originally drawn by Lord Wilberforce with narrowly defined parameters in the *Barclays Bank Ltd.* decision. In particular, the fiduciary relationship arose where money was lent in emergent circumstances to allow a debtor to pay a certain creditor or group of its creditors in order to keep the debtor in business. If the funds could not be used for that purpose, then the funds were returned to the lender. Those parameters were, however, significantly broadened some thirty years later, when the House of Lords found a *Quistclose Investments Ltd.* trust arose in *Twinsectra Ltd. v. Yardley*, [2002] 2 A.C. 164 (U.K. H.L.).

APPEAL by receiver from judgment reported at, *Ontario (Minister of Training, Colleges and Universities) v. Two Feathers Forest Products LP* (2012), 2012 ONSC 5077, 2012 CarswellOnt 11600 (Ont. S.C.J.), ordering receiver to pay funds labeled as trust monies to respondent ministry.

Feldman J.A.:

Introduction

1 The issue in this case is whether grant monies that were advanced by the respondent, Ontario's Minister of Training Colleges and Universities (the "Ministry"), to a First Nations limited partnership in northern Ontario, but not spent before the partnership sought to dissolve and appoint an interim receiver, were subject to a "*Quistclose* trust" [1] for the benefit of the Ministry. The application judge held that they were trust monies and that the receiver should therefore pay the monies to the Ministry. The receiver appeals. For the reasons that follow, I agree with the receiver that the monies are not subject to a *Quistclose* trust and are therefore available to be distributed in the receivership.

Facts

2 Two Feathers Forest Products was a limited partnership consisting of three First Nations limited partners and a general partner. It was formed in 2007 to develop and operate two plants, a planer mill and manufacturing plant in Dryden, Ontario and a saw mill in Red Lake, Ontario. In 2010, Two Feathers applied to the Northern Training Partnership Fund, recently established by the respondent Ministry to support project-based skills training for northern Ontario residents, for a grant to provide skills training for Aboriginal and non-Aboriginal residents of northern Ontario in its two proposed plants.

3 The application was accepted and a detailed written agreement for the advance of the funds was executed, effective February 14, 2011 (the "funding agreement"). In September, 2011, after the Ministry had advanced a total of $1,895,870.00 under the funding agreement in three instalments, one in March, one in May and one in July, two of the limited partners applied to dissolve Two Feathers. The appellant was appointed interim receiver and manager in October, 2011.

4 The appellant traced the funds that had been advanced by the Ministry and found that $1,550,000.00 was paid to the third limited partner, Wabigoon Lake Forest Products LP (WLFP). From those funds, $563,911.25 had been used to purchase a planer mill. The balance was intended to be used to lease premises for the mill but was still in the hands of WLFP. Ultimately those monies were returned to the appellant pending the disposition of this court application.

5 The application judge found that the Ministry had satisfied the onus to prove that the original grant funds were impressed with a trust, known as a *Quistclose* Trust, in the hands of Two Feathers and the funds were therefore now being held by the interim receiver for the benefit of the Ministry.

6 To make that finding, the application judge examined the provisions of the funding agreement in detail. The funds were to be used only for the purpose of carrying out the project. The project is defined in Article 1.2 of the funding agreement to mean the undertaking as set out in Schedule "A".[2] In addition to a requirement that it implement on-the-job training, the project is defined in the funding agreement with reference to Two Feathers' proposal to the Ministry (the "proposal"). The proposal describes a specialized lumber manufacturing and export business where skills training would take place. It sets out specified amounts of proposed funding in three categories. The request was for $160,920 and $288,060 for on-the-job and classroom training, respectively. The larger portion of the funding, $3,026,000, was designated for "[o]ther," which it further describes as "[c]lassroom and equipment lease."[3]

7 The funding agreement restricted Two Feathers to using the funds only in accordance with that agreement, Two Feathers had to segregate any funds not immediately required into an interest bearing account, and the amount of any interest earned would be deducted from any further funds advanced under the funding agreement. The Ministry was not obliged to advance the funds unless it was satisfied with the progress of the project. It could also terminate the funding agreement on 30 days' notice and demand return of any unused funds still in the possession or under the control of Two Feathers. Similarly, if the Ministry considered that Two Feathers breached the agreement, it could demand repayment of any remaining funds. Likewise, on the expiry of the funding agreement, Two Feathers was required to return any unused funds. In

respect of the repayment or return of funds already advanced, Article 17 provides that monies owing to the Ministry by Two Feathers "shall be deemed to be a debt due and owing to" the Ministry.

8 The application judge concluded, based on his review of the entire funding agreement, that the funds advanced and not yet spent by Two Feathers were held subject to a *Quistclose* trust for the benefit of the Ministry and must be returned to the Ministry by the interim receiver. He based his conclusion on the following findings: 1) There was no intention that Two Feathers would be able to freely dispose of the advanced funds; rather, the funds were to be used only for the specific purpose of carrying out the project. To that end, the Ministry had the ability and the mechanisms to ensure that the funds were used only for that purpose and to have the funds returned if they were not being so used. 2) The three certainties of a trust, certainty of intention, certainty of subject matter and certainty of object, had been established on a balance of probabilities. The object of the trust was the on the job skills training to be provided in the project.

Analysis

A. History of the Quistclose Trust

9 The genesis of the concept of the "*Quistclose* trust" was the House of Lords' decision in *Barclays Bank Ltd. v. Quistclose Investments Ltd.* (1968), [1970] A.C. 567 (U.K. H.L.). In that case, the trust arose in the following way: Rolls Razor was a client of Barclays Bank that was in financial difficulties and had exceeded its allowed overdraft at the bank by a significant margin. In order to try to recover financially, Rolls Razor found a lender who agreed to lend it one million pounds but on the condition that Rolls Razor obtain funds from another source to pay its shareholders the dividend of £209,719 8s. 6d, which it had already declared and which was to be paid within a short time. Quistclose became that source, agreeing to lend Rolls Razor the sum necessary to pay the dividend, on the condition that the funds would be used only for that purpose and that they would be held in a special account, newly opened for that purpose, until the dividend was paid.

10 One of the directors of Rolls Razor then made an oral agreement with its bank manager at Barclays, confirmed by the letter that Rolls Razor later sent to the bank with Quistclose's cheque. They agreed that the cheque was to be deposited into a special account and was to be used only to pay the declared dividend. Unfortunately, the company was unable to raise the further funds it needed to remain in business, and decided to voluntarily liquidate. Contrary to the agreement that the Quistclose loan would only be used to pay the shareholders' dividend, the bank then set off the balance in the special account against part of the debit balance owed to it.

11 Quistclose sued the bank for return of the funds. Lord Wilberforce explained that in order for Quistclose to be able to claim the funds from the bank, it had to meet two requirements. First, it had to establish that the funds were impressed with a trust in its favour if the funds were not used to pay the dividend, and second, that "the bank had such notice of the trust or of the circumstances giving rise to it as to make the trust binding upon them" (at p. 579).

12 Lord Wilberforce had no trouble finding that the mutual intention of Rolls Razor, the borrower, and Quistclose, the lender, was that the funds were to be used only to pay the declared dividend and were not to form part of the assets of Rolls Razor. He concluded that a necessary consequence of their mutual intention was that if the dividend could not be paid, then the funds were to be returned to Quistclose. He stated that it had long been recognized that this type of arrangement created a fiduciary obligation to hold the funds in trust:

> That arrangements of this character for the payment of a person's creditors by a third person, give rise to a relationship of a fiduciary character or trust, in favour, as a primary trust, of the creditors, and secondarily, if the primary trust fails, of the third person, has been recognised in a series of cases over some 150 years (at p. 580).

13 He referred to five historical cases, at pp. 580-81, all of which involved monies loaned for the purpose of paying a specific group of the borrower's creditors in order to stave off bankruptcy: *Toovey v. Milne* (1819), 2 B. & A. 683; *Edwards v. Glynn* (1859), 121 E.R. 12; *In re Rogers, Ex parte Holland and Hannen* (1891), 8 Morr. B.C. 243; *Drucker Ex. p. Basden (No. I), Re*, [1902] 2 K.B. 237 (Eng. C.A.); *In re Hooley, Ex parte Trustee*, [1915] H.B.R. 181.

14 Turning to the notice issue, Lord Wilberforce was satisfied that the bank had notice that the monies were provided by a third person as a loan, and were to be used only to pay the dividend. This information was sufficient to constitute notice of the trust. Therefore, the bank could not claim the money for its own benefit: at p. 582.

15 The *Quistclose* trust concept was originally drawn by Lord Wilberforce with narrowly defined parameters in the *Barclays Bank Ltd.* decision. In particular, the fiduciary relationship arose where money was lent in emergent circumstances to allow a debtor to pay a certain creditor or group of its creditors in order to keep the debtor in business. If the funds could not be used for that purpose, then the funds were returned to the lender. Those parameters were, however, significantly broadened some thirty years later, when the House of Lords found a *Quistclose* trust arose in *Twinsectra Ltd. v. Yardley*, [2002] 2 A.C. 164 (U.K. H.L.).

16 In that case, Twinsectra agreed to lend £1 million to Y for the purpose of purchasing property, but on three conditions: 1) that Y's solicitor undertake to hold the funds until they were used by Y to purchase property; 2) that Y's solicitor undertake that the funds would only be used for that purpose; and 3) that Y's solicitor would guarantee repayment of the loan. When Y's solicitor would not give the guarantee, Y found another solicitor who agreed to give the undertakings and the guarantee. However, that solicitor essentially ignored his undertaking and paid the money over to Y's solicitor who allowed Y to use the money freely and not

to purchase property. The loan was not repaid and the solicitor who gave the guarantee went bankrupt. In the action against Y's solicitor, one of the issues was whether Y's solicitor could be held responsible as a party to a breach of trust. As a threshold matter, therefore, the House of Lords first had to determine whether the circumstances of the loan gave rise to a *Quistclose* trust.

17 Both Lord Hoffmann and Lord Millett wrote on the issue. Lord Hoffmann stated that the trust and its terms were found in the undertaking contained in the first two conditions of the loan. Y was not free to dispose of the money as he wished but only to purchase property. The effect of the undertaking was that the money remained Twinsectra's until it was used to buy property. Therefore, the solicitor who held the money held it in trust for the lender, Twinsectra, subject to a power to apply it as a loan to Y in accordance with the terms of the undertaking. Whether the subject funds were "at the free disposal" of the recipient is one of the essential identifying elements of a *Quistclose* trust.

18 Lord Hoffmann addressed the two problems that the trial judge believed prevented him from finding a *Quistclose* trust in the circumstances. The first was that the terms of the undertaking were too vague — no particular property was identified. Dealing with this point, Lord Hoffmann agreed that the undertaking was an unusual one: Twinsectra was not seeking any security over the property to be purchased, so that there was nothing to prevent Y from subsequently mortgaging the property and using the money for whatever he wished. Lord Hoffmann's response was that as long as a court could say whether the money was used for the described purpose, then the purpose was not too vague and not void for uncertainty.

19 The second objection was that Twinsectra did not intend to create a trust based on the undertakings because its security was the solicitor's guarantee. To that Lord Hoffmann responded that the lender's intention was irrelevant:

> Whether a trust was created and what were its terms must depend upon the construction of the undertaking (at para. 17).

20 Lord Millett's main focus was to properly characterize the operation of the *Quistclose* trust under trust principles by conducting an analysis of the locus of the legal and beneficial interest in the trust property.[4] He concluded that the monies are always held on a resulting trust for the lender who never parts with the entire beneficial interest in them and that it is the lender who is the person who can enforce the trust. He rejected the theory that anyone but the lender can enforce the trust, including the persons who are the primary objects of the trust, such as a subgroup of the borrower's creditors. In the context of that analysis, he addressed the question whether a *Quistclose* trust's primary purpose must be to benefit a subset of identified creditors as in the *Barclays Bank Ltd.* case itself. He rejected that premise, referring to cases where his characterization of the purpose of the loan was not to benefit a group of people but to purchase equipment or to enable a bank to meet a run and where only the lender could oversee its enforcement. He concluded that, as in the *Twinsectra Ltd.* circumstances, a *Quistclose* trust "must be able to accommodate gifts and loans for an abstract purpose" (at para. 89).

21 Lord Millett also reviewed the three certainties required for a trust: certainty of intention, of subject-matter and of objects, at paras. 71, 101. On the issue of the significance of certainty of the objects of the trust, Lord Millett agreed with Lord Hoffmann, pointing out as well that if the objects were not sufficiently certain, the result in law is that the monies revert back to the lender under a resulting trust - the same result as when the purpose cannot be carried out. (para. 101)

22 One could conclude that after *Twinsectra Ltd.*, any time monies are advanced on an undertaking to use the monies only for a stated purpose, which can be an abstract purpose, then regardless of the subjective intention of the person providing the funds and of the nature of the purpose, there is a resulting trust for the lender. This represents a significant expansion of the *Quistclose* trust, which had been narrowly described in the *Barclays Bank Ltd.* case.

23 As I have concluded that the requirements for a *Quistclose* trust have not been met in this case, I do not need to decide to what extent that expansion should be adopted in Ontario. However, when that decision does have to be made, the court will have to consider a number of commercial consequences, one of the most significant of which is the potential effect on the creditors of the borrower (or grantee) of the subject funds. For example, as in this case, where funds are advanced to a business with no registration under the *Personal Property Security Act*, R.S.O. 1990, c. P-10, creditors will have no notice, and in many cases no knowledge, that they are dealing with a debtor whose money is subject to a trust and not available to general creditors.[5]

B. Was There a Quistclose Trust in This Case?

24 The House of Lords authorities are clear that on the issue of the intention to create a trust, it is not the subjective intention of the lender (here the granter) but the intention of the two parties, discerned from the terms of the loan (here the grant). As Lord Millett put it:

> A settlor must, of course, possess the necessary intention to create a trust, but his subjective intentions are irrelevant. If he enters into arrangements which have the effect of creating a trust, it is not necessary that he should appreciate that they do so; it is sufficient that he intends to enter into them (*Twinsectra Ltd.*, at para. 71).

25 The application judge came to the factual conclusion - based on all of the terms of the funding agreement that had the effect of a) limiting Two Feathers' use of the funds, and b) providing that the unused funds be returned to the Ministry - that Two Feathers did not receive the funds for its free disposal but only for

the purpose of carrying out the project. He then followed with the legal conclusion that: "Viewed objectively, I am satisfied that the parties intended to enter into a trust arrangement."

26 However, a close examination of the terms of the funding agreement shows that the parties did not intend that Two Feathers would hold the funds in trust for the Ministry. In particular, the funding agreement specifically provides that any unused funds constitute a debt owing to the Ministry, not trust funds, and that Two Feathers had significant freedom to use the majority of the funds. As a result, in my view, the application judge erred in law in finding that the funds were held on a *Quistclose* trust.

27 First, the funding agreement specifically identifies the nature of the relationship between the parties respecting the funds while they are in the hands of Two Feathers but not yet expended - the critical time - as one not of trust, but of debtor/creditor. Article 17.1 provides that any monies under the funding agreement that the recipient, Two Feathers, owes to the Ministry "shall be deemed to be a debt due and owing to the Ministry by the Recipient".

28 If the grant monies that Two Feathers has not yet spent constitute a debt that Two Feathers owes to the Ministry, they cannot be held by Two Feathers on trust for the Ministry. While the courts in a number of the *Quistclose* trust cases state that it is not necessary for the parties to use the word "trust" when creating their agreement, no court has said that when the parties have explicitly characterized their legal relationship in one way, the court will override their agreement and characterize it another way.

29 To be clear, there was an argument made in *Barclays Bank Ltd.* that because the transaction between Quistclose and Rolls Razor was one of loan creating the legal obligation of debt, that excluded the implication of a trust, enforceable in equity. The House of Lords rejected that argument. The loan only arose once the funds were used for the designated purpose - until that time, the funds were held by the borrower on trust for the lender, and did not become the property of the borrower.

> There is surely no difficulty in recognising the co-existence in one transaction of legal and equitable rights and remedies: when the money is advanced, the lender acquires an equitable right to see that it is applied for the primary designated purpose.... when the purpose has been carried out (i.e., the debt paid) the lender has his remedy against the borrower in debt (*Barclays Bank*, at p. 581).

30 In this case, the transaction is one of grant, not loan. However, before the funds are actually expended for the purposes of the grant, or if they are left over and not needed for the agreed purposes, the parties agreed that they constituted, not a trust, but a debt owed by Two Feathers to the Ministry. To be a debt, the property in the funds belongs to the debtor, i.e., to Two Feathers, unlike a trust where only the legal title is held by the trustee, with the beneficial title in the trust beneficiary.

31 The application judge stated that:

> [t]he fact that the word "trust" does not appear in the agreement, and that Article 17 of the agreement stipulates that monies owing to [the Ministry] by Two Feathers "shall be deemed to be a debt due and owing to..." [the Ministry] is not, in my opinion, determinative of the intention of the parties as to whether the funds were to be at the free disposal of Two Feathers once advanced by [the Ministry].

32 I agree with the application judge that agreeing that monies owed back to the Ministry are deemed to be a debt does not determine whether they are at the free disposal of Two Feathers. However, the effect of this characterization of the granted funds that have to be returned to the Ministry if they are not sent or needed for the project, is that until Two Feathers pays those funds back, it holds them as a debt due to the Ministry, not in trust for the Ministry. To override the express agreement of the parties, that any funds owed back to the Ministry under the agreement constitute a debt and for the court instead to imply a trust, would be contrary to the "cardinal rule" of interpreting written commercial contracts that the parties "have intended what they said": *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, 2007 ONCA 205 (Ont. C.A.), at para. 24; *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325 (Ont. C.A.), leave to appeal to S.C.C. refused, [2005] S.C.C.A. No. 334 (S.C.C.), at para. 26.

33 The second error is the application judge's conclusion that the funds were not at the free disposal of Two Feathers, and it arises from an examination of Schedule "B" to the funding agreement. Schedule "B" is the budget that governs the actual spending requirement for the grant funds. It covers the three fiscal years of the term of the agreement, 2010-2011, 2011-2012 and 2012-2013. As discussed above, of the sum of $3,535,000, the total maximum amount to be granted, only $449,000, was to be spent on on-the-job and in class training costs, while the vast majority of the funds, $3,026,000, are designated only as "other" in Schedule "B". In the proposal, the "other" funds were described as being for "[c]lassroom and equipment lease".

34 Since specific funds are designated in Schedule "B" for the actual costs of training, which was the purpose of the grant from the Ministry, the vast majority of the "other" funds appear to be available over the term of the funding agreement to set up the business more generally, including lease and equipment costs for the whole business.

35 As a result, although the funding agreement requires that Two Feathers spend the grant money on the project, in fact, the budget in Schedule "B" gives Two Feathers significant discretion to spend the largest part of those monies. Contrary to the conclusion reached by the application judge, those monies were essentially "at the free disposal" of Two Feathers.

36 Finally, the circumstances of the grant transaction in this case do not have many of the characteristics that caused a trust to be found in either of the two seminal cases. It was not a situation where the limited partnership needed immediate funding to stave off bankruptcy; the funds were not needed to make a specific

payment, whether to a group of creditors or to make a specific purchase; instead, they were obtained as a basic source of business funding for a long-term project.

37 Nor were the funds advanced based on a short or quickly drawn contractual arrangement. Instead, they were the subject of a detailed government-approved funding agreement, fully executed by both parties that prescribed all aspects of the funding relationship between them. It is difficult to see the basis for implying a trust where a sophisticated party, such as a provincial ministry, provides funding by means of a commercial agreement in which its contractual rights and remedies are carefully and extensively defined.

38 This court has not yet applied the *Quistclose* trust concept.[5] However, the British Columbia Court of Appeal in *Cliffs Over Maple Bay Investments Ltd., Re*, 2011 BCCA 180, 17 B.C.L.R. (5th) 60 (B.C. C.A.), recently reversed a decision o a motion judge that had implied a *Quistclose* trust in circumstances where funds were loaned to be used for a general, long-term purpose, as in this case. There, funds were advanced by a debtor in possession lender in the context of a *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, order "[t]o facilitate further construction of [a] golf course and development of [a series of] home lots and source an irrigation solution for the golf course": at para. 56. In rejecting the implication of a *Quistclose* trust for a number of reasons, the British Columbia Court of Appeal stated:

> In short, although it is obvious that Cliffs agreed as a matter of contract that the funds would be used for the general purpose stated, I disagree that this restriction gives rise to any inference of an intention on the part of both parties ...to create the specialized vehicle that is a *Quistclose* trust...(at para. 69).

39 To summarize my analysis, the Ministry entered into a detailed funding agreement with Two Feathers setting out the terms under which the Ministry granted funding for Two Feathers to provide on-the-job skills training to residents of northern Ontario. Although the funds provided were intended to be used only for the purpose described in the funding agreement, there is no basis to infer a mutual intention that the funds were to be held on trust for the Ministry. To the contrary, under the budget attached to the funding agreement, the recipient, Two Feathers, had significant discretion to spend the majority of the funds as long as it was for the general purpose stated, as in the *Cliffs Over Maple Bay Investments Ltd., Re* case. And most importantly, Article 17 of the funding agreement defines the relationship between the parties with respect to any funds that have to be returned to the Ministry under the agreement as a debt, not a trust.

Conclusion

40 In my view, the application judge erred in law in concluding that in these circumstances, the court could imply a *Quistclose* trust. I would therefore allow the appeal, set aside the order of the application judge and dismiss the application with costs, fixed at $15,000.00, inclusive of disbursements and HST.

P. Lauwers J.A.:

I agree.

G.R. Strathy J.A.:

I agree.

Appeal allowed; application of ministry dismissed.

Footnotes

1 *Barclays Bank Ltd. v. Quistclose Investments Ltd.* (1968), [1970] A.C. 567 (U.K. H.L.).

2 Schedule "A" is comprised of the following "Project Description":

"Background. The purpose of the Project is to provide support to project-based skills training to help Aboriginal and non-Aboriginal Northern Ontarians participate in and benefit from emerging economic development opportunities. The Province of Ontario announced this new initiative under the project of 'Jobs and Growth in Northern Ontario'.

Objective. The objective of this initiative is to help Aboriginal and non Aboriginal Northern Ontarians
• [A]ttain workplace skills and sustain employment in the resource related sectors of mining, energy and greener economy, forestry, environment, bio-economy, tourism and agriculture by providing employers in Northern Ontario with skilled workers for current and future needs.

• Develop innovative collaborations and models of delivery that are tailored to specific circumstances and needs of the community.

• [E]nhance and add value to resources, programs and services already available in the community.

The Recipient shall carry out the Project in accordance with the Proposal.

The Ministry shall provide up to 75% of the overall eligible costs of approved projects. Project partners will provide3 a minimum of 25% of the overall funding of approved projects. The Ministry funding shall not exceed $15,000 per participant for each year of the Project.

On the-Job Component. The Recipient shall ensure that the Project has an on the job component, including as part of a pre-apprenticeship type program must comply with all

Court File No. CV-15-11192-00CL

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF VICTORIAN ORDER OF NURSES FOR CANADA

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST
(Proceeding Commenced at Toronto)

BOOK OF AUTHORITIES
(Motion Returnable January 19, 2016)

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