

QUISTCLOSE TRUSTS – WHAT THEY ARE AND HOW TO USE THEM

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Introduction

It is often said that the law should keep up with commerce. In recent years, the Quistclose trust has arisen to do just that in Singapore. It is a powerful anti-insolvency legal mechanism that provides quasi-security over a loan advanced for a specific purpose yet few businesses know enough to take advantage of it.

To understand the potential of the Quistclose trust structure, one must first consider the principles of insolvency. In insolvency, there are generally two classes of creditors – the secured and unsecured. Secured creditors have the right to enforce their security upon an event of default and typically walk away relatively unscathed. Unsecured creditors on the other hand have to fight for what remains of the insolvent company's assets (which may not be much). This is divided up between all the unsecured creditors equally.

Now, imagine a scenario where an unsecured creditor – advancing monies for a specific purpose – is able to stand outside the realm of insolvency and have full claim over the unspent loan monies should the debtor company go bust. (The terms “lender”, “borrower”, “creditor” will be used loosely. Legally speaking, the parties in a Quistclose trust are not in a lending relationship). Alternatively, imagine a scenario where, instead of being unspent, the money is spent outside the specific purpose. Yet, the unsecured “creditor” is able to trace his money into the hands of an innocent third party and recover it. These are the potential powers the Quistclose trust affords.

Benefits of Quistclose Trust Structuring

A Quistclose trust may have application in an urgent bridging transaction where time does not permit traditional forms of security to be set up. It may also be useful where a funder participates in the restructuring of a near insolvent business.

A Quistclose trust essentially allows the unspent remainder of a sum of money advanced for a specific purpose to be returned to the lender in the event the borrower goes insolvent. This is in contrast to a loan, where the “unspent” monies form part of the pool of assets unsecured creditors fight over. Further, because of the legal quirks of a trust, monies advanced in a Quistclose trust that was not spent according to its stipulated purpose can theoretically be traced into and recovered from the hands of third parties if certain conditions are met. For example, Company A advances a sum of money to Company B for it to pay off a specific supplier debt. Instead of doing so, Company B pays Company C for some other debts it owes the latter. Company C accepts the money in full knowledge of the above circumstances. Company B then goes bankrupt. If the sum of money was a loan, Company A would effectively have to queue in line with the other unsecured creditors for what is salvageable from Company B. However, if the money was advanced on a Quistclose trust, Company A may be able to trace the misspent money to Company C and recover the

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sum from it.

What makes the Quistclose trust particularly interesting is also the fact that, unlike commercial trusts, it potentially obviates the need for a positive and express intention for the “borrower” to keep the monies on trust. Absence of intention to fully pass ownership of the monies may be sufficient (elements of which we will elaborate later on). This is considerably easier to prove and, more importantly, to negotiate. Quistclose trust structures can, therefore, be incorporated into typical loan transactions with much ease. A protective Quistclose trust can still arise even in the absence of a written contract (a situation that is not encouraged, however).

Potential Drawbacks of Quistclose Trust Structuring

The problem with Quistclose trust structures is that there has been a sparse judicial authority to elucidate them. This makes their creation and ambit of legitimacy somewhat difficult and uncertain. Nonetheless, Quistclose trust structures can prove a powerful potential backstop if there is a chance that things may turn sour. Corporate entities are often either strong-armed by circumstances or by too lucrative-to-pass-up deals into unfavourable or risky transactions. Some protection (and a very powerful one at that) – even if it lacks certainty – is better than none at all.

What local cases have provided are:

- an acknowledgement of the validity of Quistclose trusts; and
- a list of definitive (though not necessarily in themselves sufficient) elements that must be present for a Quistclose trust to be found.

What local cases are lacking are:

- an authoritative and in-depth analysis of the legal principles behind Quistclose trusts by the apex Court of Appeal; and
- a list of definitive AND sufficient elements – put forward by the apex Court of Appeal – that would unequivocally result in the creation of a Quistclose trust.

Creating A Quistclose Trust Structured Transaction

There is much debate regarding the legal principles underlying the Quistclose trust. What academics and the courts agree on, however, is that it is a valid legal mechanism that has in fact been applied multiple times in Singapore. One key issue is whether an express intention to create a commercial trust is required at contracting – or whether the absence of intention to allow the “borrower” to freely use the money is sufficient. Essentially, the issue goes to whether a Quistclose trust structure must be expressly negotiated for. Recent cases have suggested the answer may be no.

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While local courts have not pronounced on the exhaustive specifics required before which they would recognize a Quistclose trust, they have laid out certain elements which must be present (though regrettably, still not necessarily sufficient).

The first is that monies must have been advanced for a specific purpose

In the High Court case of Singapore Tourism Board v Children's Media Ltd and Others 3 SLR(R) 981, Singapore Tourism Board ("**STB**") advanced a sum of money to a United Kingdom ("**UK**") firm for the staging of a musical event in Singapore. The UK firm failed to stage the event and STB successfully argued that the sum of money held by the UK firm was on a Quistclose trust in favour of STB given the specific purpose it had advanced the money for. STB could thus recover its money. The issue, of course, is how specific must the purpose be. To this, the Court has yet to pronounce a detailed answer. The closest we get is a statement that the purpose must be "sufficiently certain for the court to determine if the purpose still capable of being carried out or if the money has been misapplied". The more general the purpose is worded, the less likely a Quistclose trust will be found.

The second is that use of the monies advanced must be contractually restricted and ideally deposited in a separate and special account (not mixed with general funds)

The Singapore High Court as recently as 2015 highlighted this in the case of The Attorney-General v The Aljunied-Hougang-Punggol East Town Council SGHC 137. A specific purpose is insufficient in itself to elevate an ordinary loan into a Quistclose trust. What is critical is that the money cannot be at the free disposal of the recipient – a proposition that is hard to push for if monies were placed in a general user account. The more restrictions on the use of money that is placed, the stronger the arguments are in favour of finding a Quistclose trust.

Beyond the above, little has been said about the nuanced elements of a Quistclose trust to provide guidance in the structuring of transactions. Although there have been other requirements mentioned (such as the certainty of the sum of monies advanced for the specific purpose and the certainty of the "**lender's**" and "**creditor's**" identity), these are uncontroversial and are capable of being clearly satisfied.

As can be seen, the Quistclose trust, in the event of disputes, maybe an additional and powerful avenue to recover monies advanced. Its inclusion should be considered in every unsecured advance of monies for specific purposes.

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