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Intra-Group Transfer and *Quistclose* Trust in Hong Kong



In the recent case of *China Life Trustees Limited v China Energy Reserve and Chemicals Group Overseas Company Limited and Others* [2024] HKCFA 15, the Court of Final Appeal finally had the opportunity to consider with the infamous *Quistclose* trust after almost 50 years from its birth. The CFA considered (1) the requisite intention for the creation of a *Quistclose* trust ("**Issue 1**") and (2) whether an intra-group transfer shall preclude or indicate absence of any such intention ("**Issue 2**").

Facts

Two special purpose vehicles were set up within the same corporate group (the "**Group**"), they are: **SPV1** for issuance of bonds maturing in 2022 denominated in HKD (the "**2022 Bonds**") and **SPV2** for issuance of bonds maturing in 2018 denominated in USD (the "**2018 Bonds**"). SPV1 and SPV2 shared the same bank account (the "**Account**") in the name of SPV1, which was divided into 2 sub-accounts denominated in HKD (for the 2022 Bonds) and USD (for the 2018 Bonds).

SPV2 was short of funds when the 2018 Bonds matured. The Group, through its treasury company, injected USD120 million (the "**Funds**") into the USD sub-account. Despite this effort, the Funds were insufficient and SPV2 was in default, triggering a cross-default of the 2022 Bonds. The 2022 Bonds holder therefore obtained a judgment against SPV1 and a garnishee order over the Funds remaining in the Account. SPV1 appealed, contending that the Funds were clothed with a *Quistclose* trust, and sought to set aside the garnishee order.

This argument was rejected by the Court of Appeal, but upheld by the Court of Final Appeal which found a *Quistclose* trust in the present case.

Quistclose Trust

The term *Quistclose* trust is derived from the 1970 House of Lords case of *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567, whereby A advanced a loan to B solely for a specific purpose, when the specific purpose failed, B would hold the money on trust for A. It protects the lender against the borrower's insolvency as the money does not fall within the borrower's estate. It also provides the lender a right to recover or trace the money into the hands of any third party. The nature of *Quistclose* trust has been the subject of much academic debate. On one hand, Lord Wilberforce in *Quistclose* described it as a "*primary trust*" in relation to the specific purpose, and if the "*primary trust*" fails, a "*secondary trust*" back to A. On the other hand, in a subsequent House of Lords case of *Twinsectra v Yardley* [2002] 2 AC 164, Lord Millett described it as "*an entirely orthodox example of the kind of default trust known as a resulting trust*".

Despite the unsettled nature of *Quistclose* trust, for the purpose of the present case, the Court of Final Appeal seems to agree that the true categorisation would "*rarely be significant*"¹. It seemed however possible that the categorisation of "express trust" confused the Court of Appeal which wrongly denied the existence of a *Quistclose* trust (see further below)².

Issue 1

The Court of Final Appeal held that the requisite intention to create a *Quistclose* trust will be established, when the objective factual evidence shows that the transferor intended the transfer to be for a specific purpose and no other, with the transferee agreeing to or acquiescing in that restriction. It flows as a matter of logic and legal consequence that the subject property was not to be added to the transferee's general assets or to be at his free disposal.

There is no requirement that there should be an express stipulation or indication that the transferor intends to reserve a beneficial interest. In the Court of Appeal's decision which was overturned, the judges were at pains to look for an express intention by the Group to retain a beneficial interest. This appears to have been on the basis that the recent Privy Council case of *Prickly Bay Waterside Ltd v British American Insurance Company Ltd* [2022] 1 WLR 2087³, required that the intention to retain a beneficial interest needed to be express or objectively ascertainable from the facts. The CFA's view was that the essence of a *Quistclose* trust was that property was transferred for a specific purpose.

On the fact, the Funds were paid in USD and to the USD sub-account. At the time of transfer, the 2022 Bonds were not due. The Group's senior management was mobilising the Group resources with the urgent and sole purpose of meeting SPV2's obligations under the 2018 Bonds. This was sufficient to find that a *Quistclose* trust existed.

Issue 2

The Court of Appeal has commented that the nature of intra-group transfers between sister companies provides a novel context for the application of the principles in *Quistclose* trust.

¹ See paragraph 45 of the judgment (Ribeiro PJ), paragraph 120 of the judgment (Gummow NPJ)

² See paragraph 118 of the judgment (Gummow NPJ)

³ See paragraphs 46 – 53, 82 – 91 of the judgment (Ribeiro PJ), paragraphs 121 – 122 of the judgment (Gummow NPJ)

The Court of Final Appeal recognised the commercial reality that in a pressing financial crisis like the present case, when the senior management were trying their best to adopt "fire-fighting" measures and mobilising Group resources wherever they could be found, fellow subsidiaries would not act as if they were conducting arm's length transactions, and hence would not be expected to spell out the intended purpose. The Court of Appeal has lost sight of this key consideration and wrongly held the view that the Group decided to park the Funds in SPV1 at SPV1's free disposal subjecting the Funds to the risk of exposure to SPV1's creditors.

Therefore, the intra-group nature of the transfer in the present case did not negate the requisite intention as found under Issue 1.

Key Takeaway

While it is safer to spell out the requisite intention to retain a beneficial interest in the relevant property transferred for a specific purpose in order to ensure that the property would be subject to a *Quistclose* trust, the absence of the same will not be fatal to the trust. The Court will look at the objective factual evidence that the transferor transfers the property for a specific purpose and for that purpose only, rather than requiring an express manifestation of intention that a beneficial interest in the property be retained. The same principle applies to intra-group transfers even where there is understandably a close financial relationship and a likelihood of less robust documentation. As it is common within corporate groups that certain entities provide financing to group entities while others are the operating arm and/or special purpose vehicles, creditors may find issues or arguments on *Quistclose* trust come up more often when carrying out enforcement proceedings against entities of a corporate group.

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