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For more than 40 years, courts in England and Canada have recognized an odd form of trust called a Quistclose trust. In a decision released today, the Ontario Court of Appeal seems to have killed, or at least seriously wounded, this institution in Ontario, without squarely acknowledging that it did so.

Basically Quistclose trusts occur where a creditor, A, advances money to a debtor, B, on condition that the debtor use the funds for a specific purpose, usually to purchase property, or to pay a designated obligation. In these circumstances, the House of Lords found in Barclays Bank Ltd. v. Quistclose Investments Ltd., [1970] A.C. 567 that B holds the money in trust for A until the purpose is satisfied, whereupon the relationship becomes one of debt.

Today, for the first time, the Ontario Court of Appeal squarely considered the Quistclose trust. In Ontario (Training, Colleges and Universities) v. Two Feathers Forest Products LP, 2013 ONCA 598 a government agency advanced funds to a limited partnership on the express condition that the funds be used for certain identified purposes connected to skills training . Amounts not immediately required were to be segregated into a distinct account. The agency was entitled to reclaim any amounts that were not used if at any time it determined that the limited partnership was in breach of the funding arrangements.

But the limited partnership ran into trouble and sought to dissolve. A receiver was appointed. This raised the issue as to whether the funds in the receiver's hands were impressed with a Quistclose trust. The application judge found that they were. The Court of Appeal disagreed.

In doing so, the Court of Appeal expressed significant anxiety about expanding the concept of the Quistclose trust outside the specific circumstances of the case that gave rise to it. With some justice, the Court was motivated by the significant prejudice to other creditors in an insolvency when an apparently asset-rich debtor actually turns out to hold its property on a Quistclose trust for the benefit of a lender.

While the Court of Appeal's reasons have much to commend them, the specific reasoning can be called into question. In particular, the Court was particularly moved by a stipulation in

the funding arrangement that amounts owing under the agreement were "deemed" to be debts owing to the agency. The Court of Appeal concluded that this evidenced an intention that the relationship be one of debt, not trust.

But the Court's reasoning can be questioned as being somewhat circular. Why would the parties bother to say that the amounts owing under the agreement were "deemed" to be debts? Why not just say they were debts? Indeed, why say anything at all? It seems tolerably clear that an amount "owing" is a debt without needing to say so. Normally, one only needs to "deem" X to be Y where X is otherwise not Y. Far from supporting the Court's conclusion that a debt relationship was intended, the "deeming" language to me supports the opposite conclusion, namely that the parties did not regard the obligation as being primarily a debt. Otherwise, why "deem" it to be one?

In the end, though, the result reached by the Court is probably right. The terms on which the funds were supplied by the government agency, and the purposes for which they were to be used, were sufficiently vague and expansive that recognizing a Quistclose trust risked turning the agency into a super-secured creditor who did not need to register under the PPSA to protect its position.

Going forward, therefore, we can probably only expect arguments for Quistclose trusts to succeed where the funds are being advanced in very specific circumstances for very specific purposes, most likely to be exhausted in a narrow time frame.

The Court's decision can be accessed at: http://www.ontariocourts.ca/decisions/2013/2013ONCA0598.html

It also is worth noting that the Court of Appeal was unusually busy today, releasing the decision discussed above, as well as a case concerning the jurisdiction of the Ontario courts over cross-border misrepresentations (Central Sun Mining Inc. v. Vector Engineering Inc., 2013 ONCA 601); concerning the impact of the automatic stay pending appeal under the BIA on the limitation period applicable to a motion by the trustee to attack a preference (msi Spergel Inc. v. I.F. Propco Holdings (Ontario) 36 Ltd., 2013 ONCA 550); and concerning whether a party attacking as improvident a sale under a power of sale needs to explicitly plead that the sale was conducted in bad faith (see 1427814 Ontario Limited v. 3697584 Canada Inc., 2013 ONCA 597).