Constructive Trusts and Restitutionary Liens in North Carolina

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I. THE NATURE AND ORIGINS OF THE CONSTRUCTIVE TRUST

A. *Tracing the Res: A Remedy for Breach of an Express Trust*

1. *Tracing Trust Property into the Trustee's Personal Assets.*— When an express trust has been created and impressed on specific property and thereafter the terms of the trust have been breached by a wrongful transfer of the trust property by the trustee, the beneficiary of the trust may recover the property, its proceeds, or its product in the hands of the unfaithful trustee.[1] As the equitable owner, the beneficiary may enforce a constructive trust or an equitable lien against the trustee's assets to the extent that he is able to identify those assets with the proceeds of the trust property.[2] But if the trustee sells or otherwise disposes of trust property and subsequently dissipates the proceeds, the beneficiary, not being able to identify the trust property or its product in the hands of the trustee, loses his proprietary claim to any specific assets of the trustee and becomes a mere general creditor, entitled to no priority over other general creditors of the trustee.[3] The various rules which have been used in deciding whether or not any specific assets of the trustee have been sufficiently identified as trust property or its product to permit the beneficiary to claim a proprietary interest in them are sometimes extraordinarily complex in their application.[4] These rules

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[1] Barnard v. Hawks, 111 N.C. 333, 339, 16 S.E. 329, 331 (1892); Edwards v. Culberson, 111 N.C. 342, 16 S.E. 233 (1892); RESTATEMENT, TRUSTS § 292 (1935); RESTATEMENT, RESTITUTION § 202, illustration 1 (1937); SCOTT, TRUSTS §§ 292, 514 (1956).

[2] Edgecombe Nat'l Bank & Trust Co. v. Barrett, 238 N.C. 579, 78 S.E.2d 286 (1953); Peoples Nat'l Bank v. Waggoner, 185 N.C. 297, 117 S.E. 6 (1923); Virginia-Carolina Chem. Co. v. McNair, 139 N.C. 326, 51 S.E. 949 (1905); 4(2) BOGERT, TRUSTS & TRUSTEES § 921 (1951); RESTATEMENT, RESTITUTION § 215 (1937).

[3] SCOTT, TRUSTS § 521.1 (1956).

[4] *E.g., In re* Kountze Bros., 79 F.2d 98 (2d Cir. 1935); Edgecombe Nat'l Bank & Trust Co. v. Barrett, 238 N.C. 579, 78 S.E. 730 (1953); RESTATEMENT, RESTITUTION §§ 202-12 (1937).

have been the subject of a considerable body of writing and are precluded by space limitations from this discussion.[5] The trustee may have entered into fifty different transactions of sale and reinvestment of the original trust property or its proceeds and yet not disturb the beneficiary's proprietary interest therein. It is only necessary that the *res* be identified and traced step by step from product to product in the hands of the trustee. As aptly put by the counsel for a trust beneficiary in one case: "We are entitled to pursue the hunt for so long as we can track the fox, and not until we lose the trail are we obliged to abandon the chase, call off the dogs and go home."[6]

2. *Tracing the Res or Its Product Into the Hands of Third Parties.*—The beneficiary of an express trust may also follow wrongfully transferred trust property or its product into the hands of third parties. This right to follow trust property or its product to a third person is cut off when the trail leads to a bona fide purchaser.

In general, one who pays value, without notice of the interest of the beneficiary, for property held by the trustee is a bona fide purchaser. Transfer to him of trust property will cut off the beneficiary's equity in it. The rules defining who is and who is not a bona fide purchaser are as numerous as the situations in which conflicting claims to trust property arise. It is sufficient merely to allude to some of them here.[7] The purchaser of trust property at a judicial sale in execution of a judgment against the trustee is not a bona fide purchaser.[8] A fortiori, an assignee for the benefit of

[5] 4(2) BOGERT, TRUSTS & TRUSTEES § 921 (1951); LEE, NORTH CAROLINA LAWS OF TRUSTS 144-50 (1963); SCOTT, TRUSTS § 508 (1956). The leading case in Knatchbull v. Hallett, 13 Ch. Div. 696 (1879) described and applied in Powell v. Missouri-Ark. Land & Mining Co., 99 Ark. 553; 134 S.W. 299 (1911).

[6] Erickson v. Starling, 233 N.C. 539, 541, 64 S.E.2d 832, 834 (1951); RESTATEMENT, RESTITUTION § 202(b) (1937).

[7] A brief discussion of the law of bona fide purchaser in North Carolina appears in LEE, NORTH CAROLINA LAW OF TRUSTS 151-59 (1963). See also RESTATEMENT, RESTITUTION, §§ 172-76 (1937).

[8] "A judgment creditor, or even a purchaser at an execution sale, acquires no greater lien or interest in the property of the judgment debtor than the latter had at the time the judgment lien became effective. Such was the direct holding in *Bristol v. Hollyburton*, 93 N.C. 387." Stacy J., in Spence v. Foster Pottery Co., 185 N.C. 218, 222, 127 S.E. 32, 34 (1923) also said:

> A sale under *fieri facias* is the prescribed mode in which the law carries into effect . . . [a money judgment]. The mandate gives no authority to the officer to seize any other estate than the estate of the debtor, and the vendee under the execution acquires no other estate

creditors or a trustee in bankruptcy for the trustee under an express trust is not a bona fide purchaser.[9] A judgment creditor of the trustee cannot enforce a lien against property the latter holds in trust.[10] An assignee for the benefit of the creditors and a judgment creditor with a lien are not considered to be bona fide purchasers of the assets of the trustee because they give up nothing of value for either the assignment or the lien. Similarly, if a trustee transfers the trust property to secure an antecedent personal debt, the authorities generally agree that the creditors of the trustee have given nothing in consideration of the transfer of the property to them as security. Therefore, they are not purchasers for value and the beneficiary of the trust may recover the trust property from them.[11] But if the transferees or lienees of the trust property have surrendered old security which they held against a personal debt owed to them

than the law directed to be seized for this purpose. The vendee represents the judgment creditor, but is not regarded a purchaser from the proprietor. The well-known doctrine of equity which refuses to enforce a trust against a purchaser for a valuable consideration, and without notice, applies only in cases of sales *between parties*, not to vendees under executions.

Gaston, J., in Freeman v. Hill, 21 N.C. 389, 392 (1836). *Accord* Southerland v. Fremont, 107 N.C. 565, 572, 12 S.E. 237, 239 (1890); Potts v. Blackwell, 56 N.C. 449, 453 (1857).

RESTATEMENT, TRUSTS § 309 (1935) states the more prevalent rule that a purchaser for value without notice of the equity of the beneficiary in trust property sold at a judicial sale for the benefit of a creditor of the trustee takes free of the equity of the beneficiary.

[9] Wallace v. Cohen, 111 N.C. 103, 106, 15 S.E. 892, 893 (1892).

[10] Jackson v. Thompson, 214 N.C. 539, 200 S.E. 16 (1938); Spence v. Foster Pottery Co., 185 N.C. 218, 117 S.E. 32 (1923); RESTATEMENT, TRUSTS § 308 (1935).

[11] "There is no doubt that a mortgagee or trustee of land conveyed to secure a preexisting debt or liability is a purchase for value within the statutes of 13 and 27 Elizabeth [conveyances with intent to defraud creditor, N.C. GEN. STAT. § 39-15 (1950), and conveyances with intent to defraud purchasers, N.C. GEN. STAT. § 39-16 (1950), respectively]; but it would seem, says *Pearson, J.* in *Potts v. Blackwell*, 56 N.C. 449, 'that they take subject to any equity that attached to the property in the hands of the debtor, and cannot discharge themselves from it on the ground of being purchasers without notice, in like manner as a purchaser at execution sale takes subject to any equity against the debtor without reference to question of notice.' This doctrine is also declared in *Small v. Small*, 74 N.C., 16, where it is said that the 'creditor who takes a deed of trust is not out of pocket one cent; so he stands in the shoes of the debtor, and takes subject to any equity binding the land in the hands of the debtor.' This is further sustained in *Day v. Day*, 84 N.C. 408 and other cases, and cannot now be regarded as an open question in this State." Shepherd, J. in Southerland v. Fremont, 107 N.C. 565, 572, 573, 12 S.E. 237, 239 (1880). *Accord* Wolfe v. Smith, 215 N.C. 286, 1 S.E. 815 (1939).

by the trustee and have taken the trust property as new security; or if the transferees actually give an extension of time in which the trustee may pay his debt to them; or if the transferees give up anything of substantial value or incur a substantial detriment in consideration of the trust property transferred to them by the trustee; or if there has been a substantial change in circumstances such that it would be inequitable to deprive the transferees of the trust property, such transferees will prevail against the beneficiary of the trust.[12]

B. *Tracing the Res in Cases of Unjust Enrichment*

Professor Dawson states that the extension of the tracing principle of the constructive trust to cases other than those involving express trusts is by all odds the most important contribution of equity for the prevention of unjust enrichment. "It emerged from the fog of eighteenth century equity and in its more modern applications it is much more recent than the remedy of quasi-contract."[13] By 1743 the common law courts were using the tracing technique, originally developed for the enforcement of express trusts in Chancery, in actions at law for money had and received.[14] This use of the "machinery of a trust" for the purpose of affording redress in cases of fraud became widespread in law as well as in equity during the nineteenth century.[15] Such a remedy was often adumbrated a trust *ex maleficio* or *ex delicto*.[16] Judge Story defined the scope of the remedy as follows:

> Whenever the property of another has been wrongfully misapplied or a trust fund converted into another species of property, if its identity can be traced it will be held in its new form liable to the rights of the original owner or *cestuis qui trust*.[17]

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[12] American Nat'l Bank v. Dew, 175 N.C. 79, 94 S.E. 708 (1917); Branch v. Griffin, 99 N.C. 173, 5 S.E. 393 (1888); 4(1) BOGERT, TRUSTS & TRUSTEES § 890 (1951), LEE, NORTH CAROLINA LAW OF TRUSTS 155 (1963).

[13] DAWSON, UNJUST ENRICHMENT 26 (1951).

[14] *Id.* at 26.

[15] See BISPHAM, PRINCIPLES OF EQUITY 92 (6th ed. 1899), where the phrase "machinery of a trust" is used.

[16] *E.g.*, Edwards v. Culberson, 111 N.C. 342, 344, 16 S.E. 233 (1892).

[17] STORY, EQUITY JURISPRUDENCE § 1258 (1838). See also Whitley v. Foy, 59 N.C. 34, 78 Atl. 236 (1860). According to Dawson, the New York courts "had allowed tracing into a substitute asset on rescission of a contract for fraud." DAWSON, UNJUST ENRICHMENT 28 n.18 (1951).

At first some courts balked at labeling as trustee a person who neither expressed nor evinced an intent to assume a trust obligation. The counter argument was that an owner should not be worse situated in court because the defendant had acted wrongfully from the outset by forcefully or stealthily absconding with the property against the owner's will than he would be if the defendant had gotten possession and title to the assets by breach of confidence or deceit.[18] This latter argument ultimately prevailed. In *Newton v. Porter*,[19] the New York court concluded that the constructive trust remedy could be used to reach *the product* of goods larcenously taken. Other states followed suit and dispensed with any requirement of breach of an antecedent fiduciary obligation to warrant declaration of a constructive trust. This is the point which most clearly marks the transformation of the equitable remedy of constructive trust into a generalized remedial device, with tracing as its most prominent feature.[20]

II. The Role of the Constructive Trust in North Carolina Law

A. *When a Fiduciary Relation Exists*

The constructive trust has long been recognized in North Carolina.[21] It is an available remedy wherever a trustee or fiduciary acquires property in his own name in exchange for trust property. He holds the acquired property subject to a constructive trust even though he intended to wrongfully convert the trust funds to his own use.[22]

The Uniform Fiduciary Statute as adopted in North Carolina provides:

> Fiduciary includes a trustee under any trust, express or implied, resulting or constructive, executor, administrator, guardian,

[18] *Compare* Campbell v. Drake, 39 N.C. 94 (1844) *with* Pascoag Bank v. Hunt, 3 Edw. Ch. 385 (N.Y. 1842). Both cases dealt with an employee's taking of his employer's funds. In *Campbell* plaintiff attempted unsuccessfully to trace his funds into realty that the wrongdoing employee had purchased. In *Hunt*, plaintiff successfully traced funds into a bond and mortgage that the defalcator had bought with the bank's money.

[19] 69 N.Y. 133 (1877).

[20] Dawson, Unjust Enrichment 28 (1951).

[21] Whitley v. Foy, 59 N.C. 34, 78 Am. Dec. 236 (1860); Bateman v. Latham, 56 N.C. 35 (1856); Black v. Ray, 21 N.C. 443 (1836).

[22] Bispham's, Principles of Equity 125-26 (6th ed.) quoted with approval in Avery v. Stewart, 136 N.C. 426, 435, 48 S.E. 775, 778 (1904). Restatement, Restitution § 198 (1937).

> conservator, curator, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public or private, public officer or any other person acting in a fiduciary capacity for any person, trust or estate.[23]

North Carolina courts have held that an attorney who misappropriates funds of a client[24] or a partner who uses partnership funds for private purposes[25] is accountable as constructive trustee. In *Jarrett v. Green*[26] an administrator wrongfully sold shares of stock from the estate. A constructive trust was impressed upon the shares sold to a buyer who had notice of the administrator's breach of his fiduciary duty. In a recent case, *Morehead v. Harris*,[27] a purchase by an administrator on his own account at a sale of property in the decedent's estate was held to be voidable at the election of the heirs, irrespective of actual fraud, because of the "danger of actual fraud when the same person is buyer and seller."

The fiduciary relationships set forth in the statute are not all-inclusive for the purpose of determining what relationships may justify the declaration of a constructive trust. For example, where one of two co-sureties quitclaimed property which had been mortgaged to both co-sureties by the principal debtor as security against any contingent obligation they might have to assume, the court held that the second co-surety had been deprived wrongfully of the security by the quitclaim, and that a constructive trust was engrafted upon the quitclaimed property in favor of the second co-surety.[28]

The extension of the constructive trust tracing technique to cases involving the misuse by all kinds of fiduciaries of property entrusted to them as described above was only a slight extension of the remedy from its original employment in cases of misuse of trust property by trustees under express trusts. The next step logically was the application of the tracing technique in cases involving disloyalty of fiduciaries to whom no property was entrusted at the time of the creation of the fiduciary relationship.

1. *Principal and Agent.*—If *P* and *A* agree that *A, for a fee,* will purchase *X*'s wheelbarrow for *P*, an agency is created but not a trust because of the absence of trust property or *res*. But, if *A*

[23] N.C. GEN. STAT. § 32-2 (Supp. 1965).
[24] Egerton v. Logan, 81 N.C. 172 (1879).
[25] McGurk v. Moore, 234 N.C. 248, 251, 67 S.E.2d 53, 55 (1951).
[26] 230 N.C. 104, 52 S.E.2d 223 (1949).
[27] 262 N.C. 330, 137 S.E.2d 174 (1964).
[28] Southerland v. Fremont, 107 N.C. 565, 12 S.E. 237 (1890).

acquires the wheelbarrow later, he will hold it in trust for *P*, and if *A* subsequently disposes of the wheelbarrow to *C*, a donee or a purchaser with notice of *P*'s claim, *P* can (1) reclaim the wheelbarrow from *C*, or (2) can ratify the transfer to *C* and recapture the proceeds from *A*, or (3) can seek damages in an action for conversion.[29]

In *Anderson Cotton Mills v. Royal Mfg. Co.*,[30] the selling agent of the plaintiff purchased cotton waste from plaintiff on its own account and either resold or processed the waste, earning a profit thereby. The court said: "It is a recognized principle of law that the agent who violates his duty may be regarded—at the election of the principal—as trustee with respect to the property."[31] In *Newby v. Atlantic Coast Realty Co.*[32] a realtor agreed with the plaintiff to bid in land—on which the plaintiff had previously acquired an option to purchase—for the purpose of reselling the land for their mutual benefit. The realtor did acquire the land but resold it on his own account. It was held that the plaintiff (1) could recover damages for breach of contract, (2) could follow any fund received by the realtor for the land, or (3) could recover the land from the realtor's vendees *if* they were not bona fide purchasers for value. In a similar case, *Avery v. Stewart*,[33] Avery had at one time requested Stewart to purchase Blackacre for him with the oral agreement that for an "accommodation" of one hundred dollars Stewart was to hold title to the land until Avery had paid Stewart the purchase price, plus interest, within a three-year period. Neither Avery nor Stewart had any prior interest in the land. The court did not characterize the agreement between Avery and Stewart as a parol or oral express trust.[34] The

[29] See RESTATEMENT, RESTITUTION § 194 (1937).
[30] 221 N.C. 500, 20 S.E.2d 818 (1942).
[31] *Id.* at 509, 20 S.E.2d at 823.
[32] 182 N.C. 34, 108 S.E. 323 (1921).
[33] 136 N.C. 426, 48 S.E. 775 (1904).
[34] However, the headnote to the case as reported in 136 N.C. at 426 refers to the agreement to purchase and hold the property in question as a "parol" trust. A parol trust is commonly thought to be an oral, express trust. See Witherington v. Herring, 140 N.C. 495, 53 S.E. 303 (1906) and Atkinson v. Atkinson, 225 N.C. 120, 129, 33 S.E.2d 666, 673 (1945). But "parol" trust may include not only oral, express trusts but implied trusts as well, referring to the origin and nature of proof rather than to the incidents and results. Gorrell v. Alspaugh, 120 N.C. 362, 366, 27 S.E. 85, 87 (1897). Therefore, the term "parol trust" may encompass (1) oral trusts, *i.e.*, trusts by a valid trust agreement not evidenced by a writing, Beam v. Bridges, 108 N.C. 276, 13 S.E. 112 (1891); Shelton v. Shelton, 58 N.C. 292 (1859); Keaton v. Cobb, 16 N.C. 443 (1830); or (2) resulting trusts,

court concluded, however, that Stewart, who had later purchased the land in question in his own name, held it as "trustee *ex maleficio*."[35]

In *Avery* there was no evidence that Avery had ever paid Stewart the agreed "accommodation" of one hundred dollars for Stewart's promise to purchase and hold the land for Avery. Similarly, in *Newby* there was no evidence of any consideration for the realty company's promise to purchase and hold the land for Newby. The general rule is that if a promise to hold after acquired property is not enforceable as a contract because it is neither under seal nor supported by good consideration, the beneficiaries of the promise get no rights in the property if the promisor should subsequently acquire it unless he has manifested an intent to create such a trust after he has acquired it.[36] Although the court in *Avery* did not discuss the enforceability of the contract between Avery and Stewart, Avery's promise to pay one hundred dollars would appear to have been good consideration for Stewart's promise to purchase and hold. Similarly, in the *Newby* case, inasmuch as Atlantic Realty was a broker, a promise by Newby to pay the customary brokerage fees might have been inferred and deemed to have been consideration for the realty company's promise to purchase and hold the land for Newby.

However, with respect to some gratuitous agency agreements, North Carolina does not follow the general rule that the beneficiary of a gratuitous promise to purchase property acquires no rights in the property subsequently acquired by the promisor. In North Carolina, when one person buys land from a stranger pursuant to a

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i.e., trusts in which the intention of the settlor that the transferee of the property should hold it in trust is proved by reference to the extrinsic circumstances of the transaction, see, *e.g.*, Nissen v. Baker, 198 N.C. 433, 152 S.E. 34 (1930); Kelly Springfield Tire Co. v. Lester, 190 N.C. 411, 130 S.E. 45 (1925); Harris v. Harris, 178 N.C. 7, 100 S.E. 125 (1919) (where proof of the intention of the parties that the land was to be held in trust was a remark made by the alleged trustee to a stranger that he and his brother owned the land together); or (3) constructive trusts, Gorrell v. Alspaugh 120 N.C. 362, 27 S.E. 85 (1897). When used in this broad sense, "parol" trust merely signifies that the trust was not created by a writing and, in order to prove that the apparent legal owner holds as trustee, the evidence must be clear, cogent, and convincing. McCorkle v. Beatty, 226 N.C. 338, 342, 38 S.E.2d 102, 105 (1946); Henley v. Holt, 221 N.C. 274, 277, 20 S.E.2d 62, 63 (1942); Peterson v. Taylor, 203 N.C. 673, 674, 166 S.E. 800, 801 (1932); Avery v. Stewart, 136 N.C. 426, 48 S.E. 775 (1904).

[35] 136 N.C. at 438, 48 S.E. at 779.

[36] LEE, NORTH CAROLINA LAW OF TRUSTS 21-22 (1963); RESTATEMENT (SECOND), TRUSTS §§ 75-76 (1959); SCOTT, TRUSTS § 86 (1956).

gratuitous promise to do so and to hold for another person until the latter pays the purchase price, "the purchaser becomes a trustee for the party for whom he purchased the land and equity will enforce such an agreement."[37] Likewise, where one buys land sold under a foreclosure or execution sale after he has gratuitously promised the former owner that he would do so and hold legal title for the owner until the owner can make repayment, he will hold title to such land in trust for the original owner.[38] The rationale of these cases is equitable estoppel in that the promisee's reliance upon the other party's promise to purchase and hold the land for the promisee is said to induce the promisee to refrain from taking further action to procure the property for himself.[39] The promisee's action therefore is *ex delicto*, in the nature of an action for deceit or fraud and not *ex contractu*.[40]

[37] Paul v. Neece, 244 N.C. 565, 568, 94 S.E.2d 596, 598 (1956); Lefkowitz v. Silver, 182 N.C. 339, 109 S.E. 56 (1921).

[38] Roberson v. Pruden, 242 N.C. 632, 89 S.E.2d 250 (1955); Embler v. Embler, 224 N.C. 811, 32 S.E.2d 619 (1945); Cunningham v. Long, 186 N.C. 525, 120 S.E. 81 (1923). Earlier cases are gathered in Edwards & Van Hecke, *Purchase Money Resulting Trusts in North Carolina*, 9 N.C.L. REV. 177, 184 n.59 (1930).

[39] Thus, RESTATEMENT, RESTITUTION § 181 (1937) states:

> Where the owner of an interest in land which is about to be sold to satisfy a claim refrains from preventing the sale or otherwise protecting his interest, because of an oral promise of another to buy in the interest and reconvey it to the owner, and the agreement is unenforceable because of the Statute of Frauds, and the other buys in the interest and refuses to perform his promise, he holds it upon a constructive trust for the owner.

Comment *e* to section 181 reads as follows:

> *e. Inducing the owner to refrain from preventing sale.* The rule stated in this Section is applicable where the owner was induced by the oral promise of the purchaser to refrain from preventing the sale. It is applicable not only where the owner had cash available for redeeming the land and preventing the sale and was induced not to redeem by the oral promise of the purchaser, but also where the owner could have borrowed the money from others and thus have prevented the sale.

[40] In Avery v. Stewart, 136 N.C. 426, 440-41, 48 S.E. 775, 780 (1904) the Court said:

> If the plaintiff had known that the defendant intended to betray him by a false promise, and thus to deceive him into the adoption of a course of action which otherwise he would not have taken, he would not have placed any trust in the defendant, but he would have arranged with some other and more reliable person, in order to secure the same benefit.

This holding implies that an intent to deceive or defraud must exist when the promise to purchase is made; however, the constructive trust according to the *Restatement* will be enforced not only where the purchaser did not intend to perform his promise to pay when he gave it and therefore was

2. *Principal Debtor and Surety.*—In *Speight v. Branch Banking & Trust Co.*[41] a surety had mortgaged her own property to secure the debt. The principal debtor defaulted in order to cause his creditor to foreclose the mortgage on the surety's property. Then the principal debtor purchased the surety's property at the foreclosure sale. Although there was no trust *res* which the principal debtor had disposed of, the court declared that he had acquired the property of his surety upon a constructive trust for the latter's benefit because of their fiduciary relationship. A like result was reached in *Kelly v. Davis*[42] although the circumstances differed slightly.

3. *Employer-Employee.*—Another group of cases in which the trust *res* seems to be lacking, or at best is extraordinarily difficult to identify when the contract is made, is that in which the fiduciary has acquired special knowledge or trade secrets which he employs adversely to his fiduciary obligation. Thus, in *Funchion v. Somerset Knitting Co.*[43] a sales director of a knitting company used technical information acquired from the company of which he was an officer to develop, market and patent a hosiery trimming device in competition with his own company. The court said:

> It is an accepted principle in equity that an agent who wrongfully acquires rights or property of his principal in violation of his trust to his principal will be declared a trustee of his principal and compelled to account for all gains from such conduct (citing cases) . . . . If a patent issues on plaintiff's application, in equity and good conscience it belongs to Somerset and the plaintiff will be compelled to assign his rights in accordance with the law of this circuit. *Reynolds v. Whitin Machine Works*, 167 F.2d 78 (4th Cir. (N.C.) 1948).[44]

In *Reynolds*, plaintiff's salesman and the other defendant, a competing corporation, conspired to obtain technical information from the plaintiff. This information was incorporated into improvements in new machines produced and sold by the defendant. In this instance, however, the court refused to engraft a constructive trust

guilty of fraud, but also where, at the time he made the promise, he intended to perform it but subsequently changed his mind and refused to perform, or where he died without having refused to perform but his successors in interest refuse to perform. RESTATEMENT, RESTITUTION, § 181, comment *d* (1937).

[41] 209 N.C. 563, 183 S.E. 734 (1936).
[42] 211 N.C. 1, 188 S.E. 853 (1936).
[43] 158 F. Supp. 57 (M.D.N.C. 1958).
[44] *Id.* at 62-63.

on the proceeds of the sales of the improved machines because the plaintiff had not identified either the particular information which constituted the trust *res* or its product as incorporated into the improved machines with sufficient precision to permit the declaration of a constructive trust.

Not every employment relation creates a fiduciary relationship sufficient to support a constructive trust on profits earned by an employee from information gained from his employment. For example, in *Amerada Petroleum Corp. v. Burline*,[45] an employee of an oil company acquired information concerning oil properties which he used for speculative purposes for his own profit. He previously had agreed to hold any oil property acquired in trust for his employer at the latter's election to purchase. The defendant was an ordinary employee with no duties relating to the acquisition of oil rights and without access to confidential information. In view of these facts, the court held that the employee was under no fiduciary duty to the employer and that without proof of positive fraud, the mere breach of an oral agreement to hold land in trust does not give rise to a constructive trust.[46] Similarly, a defalcating clerk in a grocery store has been held to be a non-fiduciary of the store owner.[47] In determining whether an employee is a fiduciary of his employer, the courts will explore the employment relationship. In *Funchion*, the disloyal employee was a corporate officer; in *Reynolds*, he was an ordinary salesman. A constructive trust was declared in the former case, but not in the latter. Confidence and trust was proved in the former case but not in the latter; albeit, in the latter case the court chose not to rest its decision on the lack of a fiduciary relation but chose instead to rely on plaintiff's inability to trace his property.

4. *Fiance-Fiancee and Confidential Family Relationships: Undue Influence.*—Antenuptial property transfers are a fruitful source of litigation in which the constructive trust has been found to be a useful remedy. Sometimes the defendant induces the plaintiff to part with purchase money by a promise to marry which the promisor has

[45] 231 F.2d 862 (10th Cir. 1956).

[46] See Note, 55 MICH. L. REV. 608 (1957).

[47] Campbell v. Drake, 39 N.C. 94 (1845). The clerk was guilty of actual fraud. According to later cases, when positive fraud is involved, a mere employee may be charged as constructive trustee. Fiduciary relationship is irrelevant. See Edwards v. Culberson, 111 N.C. 342, 16 S.E. 233 (1892).

no intention of performing.[48] In other cases a prospective groom purchases land in the name of his bride-to-be who thereafter refuses to marry him, not because she changed her mind, but because she was already married;[49] or a newly-wed takes title to property with his wife as tenants by the entirety only to learn that she is married to a man still living.[50]

Undue influence frequently, if not always, includes misrepresentations made by the wrongdoer and is generally classed under the head of fraud. When such influence is "exercised for a sordid purpose it is palpably fraudulent."[51] It usually is an abuse or violation of a confidential or fiduciary relationship. Thus, in *Little v. Bank of Wadesboro*,[52] the plaintiff was the devisee under his uncle's will, subject to his father's appointment as managing trustee of the property. In response to persistent threatening and intimidation by his father at a time when the plaintiff was an alcoholic and drug addict, the plaintiff was coerced into conveying the property to a younger brother. In its opinion the Court said:

> While undue influence in an action to set aside a deed does not necessarily include moral turpitude . . . when the deed is the result of a dominant influence exercised over the mind of another, so that the mind of the grantor is . . . supplanted and the deed expresses the will of the actor procuring the result, the deed so obtained is not improperly termed fraudulent.[53]

In an appropriate case a devise as well as a conveyance may be set aside, and a constructive trust may be impressed upon property obtained by undue influence. In *Bohannon v. Trotman*,[54] the plaintiff succeeded in having a constructive trust declared on property devised and bequeathed under a will to others on the ground that they had exercised undue influence over the testator. The case is noteworthy because a constructive trust was impressed on property in which the plaintiff had only an expectancy at the time the undue influence was exercised on the testator.[55]

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[48] Edwards v. Culberson, 111 N.C. 342, 16 S.E. 233 (1892).
[49] Wood v. Massingill, 243 N.C. 625, 91 S.E.2d 588 (1956).
[50] Lawrence v. Heavner, 232 N.C. 557, 61 S.E.2d 697 (1950).
[51] Plemmons v. Murphy, 176 N.C. 671, 678-79, 97 S.E. 648, 651 (1918).
[52] 187 N.C. 1, 121 S.E. 185 (1924).
[53] *Id.* at 5, 121 S.E. at 187, quoting Myatt v. Myatt, 149 N.C. 137, 62 S.E. 887 (1908).
[54] 214 N.C. 706, 200 S.E. 852 (1939).
[55] See Greensboro Bank v. Scott, 184 N.C. 312, 114 S.E. 475 (1922), where the court also enforced a constructive trust in favor of the holder of

Wherever a fiduciary relation exists between two or more persons, the court will not hesitate to call a person chargeable with a breach of duty to account. In *Anderson Cotton Mills v. Royal Mfg. Co.*,[56] the court said:

> If a factor or agent or other person in a fiduciary position acquires *any pecuniary advantage* to himself through the medium of his fiduciary character, he is accountable as a constructive trustee for those profits to his employer or other person whose interests he was bound to advance.[57]

If there is a fiduciary or confidential relationship between the parties established by an agreement or otherwise, there need have been no trust *res* in existence at the time the fiduciary relationship was created in order to support a subsequent constructive trust. It is enough if the fiduciary or confidant has acquired any pecuniary advantage to himself through his special relationship. Hence, a constructive trust in North Carolina is primarily a tool to enforce fiduciary duty.

B. *When No Fiduciary or Confidential Relationship Exists: Fraud and Constructive Fraud in Equity*

It used to be said that the best hint as to the substantive jurisdiction of chancery was given by the words "fraud, accident, and breach of confidence."[58] Except for the tort action of deceit, the courts of law exercised almost no affirmative jurisdiction in these areas for hundreds of years after the old action at law of account had fallen into disuse in the fifteenth century.[59] Deceit—common law fraud—is an oral misrepresentation or a course of conduct calculated to create a misapprehension or to induce an erroneous con-

a mere contingency interest in the property. But in that case the beneficiary of the constructive trust had promised to refrain from doing something he had a right to do in exchange for the property he sought to possess. In the instant case the plaintiff had given no consideration, other than filial affection, for the unrealized legacy.

[56] 221 N.C. 500, 20 S.E.2d 818 (1942).

[57] *Id.* at 511, 20 S.E.2d at 824. (Emphasis added.)

[58] MAITLAND, EQUITY 8 (1909).

[59] AMES, CASES ON TRUSTS 1-8 (1898); DAWSON, CASES ON RESTITUTION 65 n.12 (1958). But much of that jurisdiction has been reasserted by courts of law even in jurisdictions where actions at law and equity are still differentiated. Today, the obligation of a fiduciary not to make a personal profit out of the fiduciary relationship can be enforced in quasi-contract. Waters v. Boyden, 275 Mass. 564, 176 N.E. 610 (1931).

clusion or inference that induces a person to act or forebear from acting with reference to property or a legal right to his detriment.[60] The action is in tort and proof of all of the elements is difficult. Usually, mere non-disclosure of a fact would not support the action.[61] The rule was *caveat emptor*.[62] Only loss-of-bargain money damages —the difference between the value of the property as represented by the defendant and its actual value—were awarded. It was not until the middle of the eighteenth century that an action at law *quasi ex contractu* for a "restitutionary" money judgment could be brought by a party seeking affirmative relief from a simple contract because of alleged overreaching of the other party, for conduct equivalent to or short of deceit, that resulted in his acquisition of a benefit which it would be unjust for him to retain.[63] Even then, only equity could give affirmative relief to a party who was bound by his seal, except in those cases wherein the fraud went to the nature of instrument sealed by the obligor (fraud in the *factum* as distinguished from fraud in the inducement.)[64] In addition to the limitations imposed by the common law courts on the granting of affirmative relief from fraudulent transactions, stringent restrictions were placed on the interposition of the defense of fraud or mistake in actions at law. *Caveat emptor* was a rule of common law, and a defense to an action in contract based on fraud, undue influence or

[60] Mitchell v. Strickland, 207 N.C. 141, 143, 176 S.E. 468, 470 (1934). A more detailed definition of legal fraud appears in the RESTATEMENT, RESTITUTION § 8 (1937).

[61] *E.g.*, Iron City Nat'l Bank v. Anderson, Du Pay & Co., 194 Pa. 204, 44 Atl. 1066 (1899). The law of North Carolina has been otherwise for many years. Case v. Edney, 26 N.C. 93 (1843); Cobb v. Fogalman, 23 N.C. 440 (1841). The tendency today is to permit recovery for fraud from one who is under a moral obligation to disclose but is silent. PROSSER, TORTS 712 (3d ed. 1964).

[62] Of course, if the seller gave an express warranty, an action in assumpsit for breach thereof would lie. For an account of the development of the law of deceit and breach of warranty, see 3 HOLDSWORTH, HISTORY OF ENGLISH LAW 377-82 (1924); 1 STREET, FOUNDATIONS OF LEGAL LIABILITY 377-82 (1906).

[63] Moses v. MacFerlan, 2 Burr. 1005, 1012, 97 Eng. Rep. 676, 680 (1760). The development of the action *quasi ex contractu* to prevent unjust enrichment may be found in Ames, *History of Assumpsit*, in 3 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 261 (1909).

[64] Thus Chitty states: "The law has prescribed different forms of action on different securities. Thus assumpsit cannot in general be supported when there has been an express contract under seal or of record which relates to the same subject matter and is still in force; but the party must proceed in debt or covenant when the contract is under seal." 1 CHITTY, PLEADING 103 (1805).

mistake was triable in most jurisdictions only in equity.[65] Hence, in the courts of chancery there developed through the centuries a substantial body of "uncommon" law relating to deceptive and unfair conduct ranging from common law deceit to mere overreaching by one party because of the other's ignorance or mistake.

Fraud or constructive fraud in equity practice came to mean a breach of legal or equitable duty, regardless of moral guilt of the fraud-feasor, that the chancellor declared fraudulent because of its tendency to deceive others, violate public or private confidence, or injure public interests. Neither actual dishonesty of purpose nor intent to deceive is an essential element of constructive fraud.[66] Constructive fraud embraces different grades of wrong. It embraces contracts illegal and therefore void at law as well as in equity; transactions voidable in equity because of public policy; and transactions which merely raise a presumption of wrong and throw upon the party benefited by the transaction the burden of proving his innocence and the absence of fault.[67] One of the kinds of censorious conduct comprehended by the term "constructive fraud" is breach of a fiduciary relationship such as has been described previously. For example, in *Morehead v. Harris*[68] when the administrator purchased property from the decedent's estate, an action for damages could not have been brought because the court did not find that he had in fact harmed the estate. Nevertheless, a constructive trust was fastened onto the property purchased by the administrator. It was enough that there was "danger of harm." In *Speight v. Branch Banking & Trust Co.* the court said of the conduct of a surety: "There is latent perhaps, but none the less real, the necessary element of that unconscious conduct which equity calls constructive fraud."[69]

[65] Kelly v. Hurt, 74 Mo. 561, 570 (1881); New York v. Holzberger, 44 Misc. 509, 90 N.Y. Supp. 63 (Sup. Ct. 1904). In England equity had exclusive jurisdiction of such defenses until the Common Law Procedure Act, 17 & 18 Vict. c. 125 (1845). A defendant who raised an equitable defense in an action at law could petition equity to enjoin the action until the equitable right had been determined. If the petition was granted, a "common" injunction would go out to the law court. 2 McINTOSH, NORTH CAROLINA PRACTICE AND PROCEDURE 403 (1956).

[66] Priddy v. Kernersville Lumber Co., 258 N.C. 653, 658, 129 S.E.2d 256, 261 (1963); McCLINTOCK, EQUITY 215 (1956).

[67] Balthrop v. Todd, 145 N.C. 112, 58 S.E. 996 (1907); 3 SYMONS, POMEROY'S EQUITY 626 (1941).

[68] 262 N.C. 330, 335, 137 S.E.2d 174, 180 (1964).

[69] 209 N.C. 563, 566, 183 S.E. 734, 736 (1936).

C. *The Constructive Trust: A Remedy for Wrongdoing by a Non-Fiduciary*

In *Peoples Nat'l Bank v. Waggoner*,[70] the defendants connived with the bookkeeper of the bank to conceal overdrafts on their account in order to permit them to purchase mules for resale in their business as livestock dealers. The court held that the funds fraudulently obtained were impressed with a constructive trust and that the bank could follow them into the product, the mules. The court quoted the following excerpt from *Singer Mfg. Co. v. Summers*.[71]

> Where a man's property has been obtained by actionable fraud or covin, the owner can follow and recover it from the wrongdoer as long as he can identify or trace it. And the right attaches not only to the wrongdoer himself but to anyone to whom the property has been transferred otherwise than in good faith and for valuable consideration, and applies not only to specific property but to choses in action.[72]

Another relatively common type of case of fraudulently induced arm's length transfer is that in which an insolvent buyer induces a merchant to sell him goods upon his representations of solvency. Goods or their product so obtained may be impressed with a constructive trust.[73]

In these latter two cases and those which follow immediately, a transfer of property from the plaintiff to the defendant has been induced by the fraudulent representation of the latter under circumstances which might support an action in tort for deceit. The parties are dealing at arm's length; there is no pretense of a fiduciary relation. Therefore, in certain cases the remedy of constructive trust may be applied where there is no underlying trust or fiduciary relationship provided there has been an unjust enrichment of the wrongdoer.[74]

1. *Insolvent Debtor-Creditor.*—A constructive trust is apt to be

[70] 185 N.C. 297, 117 S.E. 6 (1923).
[71] 143 N.C. 102, 55 S.E. 522 (1906).
[72] 185 N.C. at 301, 117 S.E. at 8.
[73] Wallace, Elliot & Co. v. Cohen, 111 N.C. 103, 15 S.E. 892 (1892); Des Farges v. Pugh, 93 N.C. 31 (1885); See UNIFORM COMMERCIAL CODE § 2-702. N.C. GEN. STAT. § 25-2-702.
[74] *Cf.* RESTATEMENT, RESTITUTION § 160 which states, "Where a person holds title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises."

declared whenever a non-fiduciary, insolvent debtor has transferred property in fraud of his creditors in violation of section 39-15 of the General Statutes of North Carolina[75] which declares that certain transfers of property shall be void as to creditors. Thus, in *Michael v. Moore*,[76] the defendant's husband had himself been a defendant some years earlier in a suit for malicious prosecution. During the pendency of this earlier suit he had mortgaged his property and handed over the proceeds to his wife who in turn had used the money to improve her separate property. When the plaintiff sought to enforce the judgment in this action against the wife, the court declared that the proceeds of the mortgage so invested are "regarded as a personal fund fraudulently withdrawn from the husband's creditors"[77] and held the wife's property subject to an equitable lien in an amount equal to the increase in value of the property.[78]

2. *Vendors and Sellers as Constructive Trustees Under Executory Sales Contracts.*—At times the courts refer to the vendor in possession of land under an executory contract to convey as "trustee" for the purchaser because the vendor must not commit waste nor diminish the estate and must convey it to the purchaser when the latter tenders performance according to the terms of the contract.[79] The trust terminology reflects the fiction of equitable conversion whereby the execution of the contract of sale of realty "converts" the vendor's interest from realty to personalty, and the purchaser's money or promise to pay into the equitable interest in the land.[80] It is but a short step to the further conclusion that the

[75] (1950).

[76] 157 N.C. 462, 73 S.E. 104 (1911).

[77] *Id.* at 467, 73 S.E. at 106.

[78] *Id.* at 469-70, 73 S.E. at 107. The court applied the rule that a constructive trust would be applied only to that portion of the *res* or its product which was clearly identifiable. This could only be the net increase in value of the wife's property after the improvements had been made, irrespective of the amount of her husband's money invested in the improvements. See, New Amsterdam Cas. Co. v. Waller, 196 F. Supp. 780 (M.D.N.C. 1961), *reversed on other grounds*, 301 F.2d 839 (4th Cir. 1962); Fulp v. Fulp, 264 N.C. 20, 140 S.E.2d 708 (1965); Henderson v. Hoke, 21 N.C. 119 (1835).

[79] *E.g.*, House v. Dexter, 9 Mich. 246 (1861) "[Equity] considers the vendor as to the land a trustee for the purchaser. . . ." In Chandler v. Cameron, 229 N.C. 62, 47 S.E.2d 528, (1948), a tenant in common who, without knowledge or authorization of his co-tenants, contracted to convey standing timber on the entire tract to another and later acquired an additional interest in the tract was said by the court to hold the standing timber on the after acquired interest in trust for the original purchaser.

[80] Woodward v. Ball, 188 N.C. 505, 125 S.E. 10 (1924).

vendor holds title and possession in trust for the purchaser. The validity of this conclusion is questionable,[81] but there is no doubt that a vendor who subsequently conveys title to land under contract to a grantee other than the contract purchaser holds the *proceeds* of such subsequent conveyance for the contract purchaser and the latter is entitled to any profits or income occurring therefrom.[82] In other words, the remedy for a wrongful transfer of title to land already under contract to be sold is the declaration of a constructive trust on the proceeds even though the vendor, strictly speaking, is not a trustee of the land for the purchaser.

As between the buyer and seller of *goods*, the general rule was that title did not pass from the seller to the buyer under a contract of sale until the contract had been fully executed; that is, until all of the stipulations in the contract were performed or performance with readiness and ability was tendered and refused,[83] or as the parties otherwise manifestly intended.[84] Under the Uniform Commercial Code, however, a buyer of goods "identified" to an executory contract of sale obtains a "special property" in them,[85] and if (1) he

[81] The rights and duties of the vendor with respect to the land under contract are not those of a trustee under an express trust or a resulting trust. The vendor still "has a personal interest in the land; he is entitled to its rents, issues and profits until the date of performance; he holds the title as security for the payment of the purchase price; the proceeds of the insurance effected by him he holds for his own benefit. . . . The vendee, on the other hand, is a mere debtor. He holds no specific property for the vendor, and his sole obligation . . . is to pay the purchase money on the conveyance of the vendor's title." Stone, *Equitable Conversion by Contract*, 13 COLUM. L. REV. 369, 372-73 (1913).

[82] Taylor v. Kelly, 56 N.C. 233, 240 (1857).

[83] C. B. Coles & Sons Co. v. Standard Lumber Co., 150 N.C. 183, 63 S.E. 736 (1909).

[84] Watts v. Norfolk Southern R.R., 183 N.C. 12, 110 S.E. 582 (1922); Richardson v. Woodruff & Sons, 178 N.C. 46, 100 S.E. 173 (1919). See 46 AM. JUR., SALES, §§ 411-15 (1943).

[85] UNIFORM COMMERCIAL CODE § 2-501; N.C. GEN. STAT. § 25-2-501, provides for identification as follows:

> (1) . . . . In the absence of specific agreement identification occurs
>
> (a) when the contract is made if it is for the sale of goods already existing and identified;
>
> (b) if the contract is for the sale of future goods other than those described in the paragraph (c), when goods are shipped, marked, or otherwise designated by the seller as goods to which the contract refers;
>
> (c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after whichever is longer."

has paid a part of the purchase price and (2) the seller becomes insolvent within ten days after receipt of the first installment on their price, the buyer, on making tender of the balance of the purchase price, may enforce the contract specifically and obtain the goods from the seller.[86] With respect to the seller and his creditors on the one hand and a buyer on the other, the "special property" right created by the Code could well be called an "equitable conversion" whereby the buyer's obligation to pay is converted into a special property in the goods themselves in a way analogous to equitable conversion under contracts for the sale of realty. In the event an insolvent seller has disposed of the goods under contract by selling them again to a third person, the buyer's special property in the goods thus wrongfully resold should permit the buyer to impress a constructive trust upon the proceeds of such sale identifiable as such in the hands of the seller so an to give the disappointed buyer a claim upon these proceeds in preference to general creditors of the seller, even those whose claims were prior in point of time; or, in the alternative, should permit the aggrieved buyer to recover the goods themselves from any transferee who is not a bona fide purchaser.[87]

This right of the buyer to a "special property" in goods still in possession of the seller but identified to a sales contract is in derogation of the common law[88] and of the general rules laid down in the

[86] UNIFORM COMMERCIAL CODE § 2-502; N.C. GEN. STAT. § 25-2-502. Section 1-201 (23) provides, "(23) A person is insolvent who either has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law."
Such a broad definition of insolvency would appear to facilitate the application of section 2-502 by lessening the evidence required to establish a *prima facie* case that the seller was in fact insolvent within ten days after payment of the first installment. However, to date section 2-502 has not been litigated. See UNIFORM COMMERCIAL CODE ANNOTATED § 2-502; Kennedy, *Reclamation of Goods Sold by a Bankrupt Seller*, 14 RUTGERS L. REV. 556 (1960); Note, 104 U. PA. L. REV. 91 (1955).

[87] See Note, 104 U. PA. L. REV. 91, 101 (1955).

[88] At common law it was thought that the buyer and seller, by agreeing to allow the seller to remain in possession of the goods after they had been identified to the contract and part of the purchase price paid had created the appearance that the seller still owned the goods—a circumstance likely to prejudice any creditor who might rely on this apparent ownership. "Possession with the appearance of ownership renders the property liable for the debts of the possessor to those who gave him credit on the faith of it." Ryall v. Rowles, 1 Ves. Sr. 348, 27 Eng. Rep. 1074 (1749). See 1 GLENN, FRAUDULENT CONVEYANCES & PREFERENCES §§ 341-43c (1940). The UNI-

Uniform Commercial Code prescribing when the title of property in the goods passes from seller to buyer.[89] Hence, it is reasonable to assume that, except as provided in section 2-502 of the Code, the buyer of goods under a wholly or partly executory contract of sale can have no claim against an insolvent, defaulting seller other than an action for money damages.[90]

3. *Constructive Trust—A Remedy for Accident and Mistake.*— Breach of fiduciary duty, fraud, and undue influence imply moral turpitude, but a constructive trust may also be imposed when title

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FORM COMMERCIAL CODE § 2-402(1); N.C. GEN. STAT. § 25-2-402(1), recognizes the common law rule. It provides:

> (1) A creditor of the seller may treat a sale or an identification of goods to a contract of sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

This section is intended to relax the common law in many states that a retention of possession by the seller is per se fraudulent as to creditors. This, however, has not been the rule in North Carolina where retention of possession by the seller is only prima facie fraud, that is, it is sufficient evidence to carry the case to the jury on the issue of the seller's fraud. Howell v. Elliott, 12 N.C. 76 (1826). See Note, 104 U. PA. L. REV. 91, 97 (1955).

[89] UNIFORM COMMERCIAL CODE § 2-401; N.C. GEN. STAT. § 25-2-401. Paragraph (1) states in part, "(1) Title to goods cannot pass under a contract of sale prior to their identification to the contract, and, unless otherwise explicitly agreed, the buyer acquires by their identification a special property as limited by this act . . . ." Comment 3 states: "The *special property* of the buyer in goods is *excluded from the security interest.*" (Emphasis added.) A grasp of the distinction between a property interest and a security interest is essential to an understanding of the law of constructive trust. A constructive trust conceptually is a remedy for the invasion of a proprietary or property interest. It is not a device for enforcing a lien or other security interest. See text accompanying notes 108-119.

[90] The writer is aware that the UNIFORM COMMERCIAL CODE § 2-716(1) states, "(1) Specific performance may be decreed where goods are unique or in other proper circumstances." Comment 4 of the Code states that this section is intended to give the buyer rights to the goods comparable to the seller's rights to the price. In turn, the seller's rights to the price under an executory contract of sale are enforceable only by an action for money damages. He has no property interest in any particular funds in the hands of the buyer. Hence, the writer believes that section 2-716(1) of itself merely gives the buyer a personal action against the seller for recovery of the specific goods and gives the buyer no interest in the proceeds of the sale of the goods to a third party. If the buyer has transferred the goods to a third person including an assignee for the benefit of creditors or a trustee in bankruptcy, this section does not give the buyer the right to follow the goods and recover them and therefore section 2-716(1) is not a basis for the declaration of the seller as a constructive trustee for the buyer.

has passed by accident or mistake. For example, in *Greensboro Bank v. Scott*,[91] an uncle agreed to pay his nephew $10,000 if he abstained from alcohol for five years. Two years later the uncle purchased a house for the nephew and his wife with the understanding that the purchase was in lieu of the $10,000 obligation. The uncle took the title in his own name to hold it, apparently, until the five-year period was up. But before the five-year period had expired, the uncle died. In an action against the uncle's heirs, the court held that the uncle held the land under an implied trust although the nephew had only a contingent right in the property when the uncle died. The accident of death whereby the trust property descended by law to the estate's heirs could not defeat the nephew's contingent interest in his uncle's property.[92]

Similarly, when property is transferred or money paid by mistake, a constructive trust may be impressed upon the property in the hands of the transferee. Thus, when the holder of a mortgage note endorsed the note to the plaintiff and assigned the mortgage to the defendant and thereafter the debtor-mortgagor made payment to the mortgage holder in kind instead of to the plaintiff, the holder of the note, it was held that money received by the mortgage holder from the sale of the goods delivered to him, by mistake of the mortgagor, was held on constructive trust for the benefit of the holder of the note.[93]

Quite often "mistake" appears to be another name for unprovable fraud when title is said to have been taken "by mistake" in the name of a person other than the one paying the purchase price. Thus, in *Spence v. Foster Pottery Co.*[94] a trust was impressed on property in favor of the wife when the husband and wife each furnished one-half of the consideration but the deed was made out to the husband only "by mistake" contrary to their intention. In one case, an alleged "mistake" in a deed appears to have been in fact a later change of mind; yet a constructive trust was declared.[95]

[91] 184 N.C. 312, 114 S.E. 475 (1922).

[92] The court considered that the nephew's promise to abstain was good consideration for the uncle's promise to convey and thus there was in effect an agreement similar to that in *Avery* where the purchaser agreed to hold the property until the other party paid the purchase price. In the instant case the purchase price was the nephew's abstention from the use of alcohol for 5 years.

[93] Walton Co. v. Davis, 114 N.C. 104, 19 S.E. 159 (1894).

[94] 185 N.C. 218, 117 S.E. 32 (1923).

[95] See, *e.g.*, Bowen v. Darden, 241 N.C. 11, 84 S.E.2d 289 (1954).

D. *Defenses to the Declaration of a Constructive Trust*

1. *Dissipation of the Res.*—When the trust *res* under an express trust has been dissipated and neither it nor its product can be identified or traced, an implied trust can not be impressed on any of the trustee's assets.[96] The same rule holds good when a constructive trust is sought to be impressed upon property which has been transferred because of fraud, constructive fraud or mistake. Thus, in *Reynolds v. Whitin Mach. Works*,[97] the plaintiff sought to recover the profits in *specie* from a competitor who used confidential information, known only to the plaintiff and obtained from the plaintiff's employee, in constructing and building an improved machine. It was held that the proceeds of the sale of the machines were not so clearly traceable to the original trust *res*—the technical information obtained from the plaintiff's employee—as to justify the engrafting of a trust. Similarly, in *Carrow v. Weston*[98] where defendant's testator had given a worthless check to the plaintiff for logs which, along with other logs belonging to the testator, were converted into lumber, the court held that the logs were not traceable into any particular fund held by the defendant administratrix and refused to impress a constructive trust in favor of the defrauded seller on any of the assets of the estate.

2. *Legal Title to Res Not Held by Constructive Trustee.*—Some confusion had arisen in the past concerning the appropriateness of the declaration of an implied trust because of a preoccupation with the traditional distinction between void and voidable title.[99] The preoccupation persists today. For example, in *Carrow v. Weston*, the court said:

> If no title passed to Weston (the purchaser of the logs who gave a worthless check in payment), no title passed to the administratrix. She stands in the shoes of her intestate. . . . *If we were to assume that the logs came into her possession as the result of Weston's wrongful conversion thereof, the question would then*

[96] See note 3 *supra* and accompanying text.
[97] 167 F.2d 78 (4th Cir. 1948).
[98] 247 N.C. 735, 102 S.E.2d 134 (1958).
[99] *E.g.*, in Henderson v. Hoke, 21 N.C. 119, 150 (1835), Ruffin, C.J., stated: "If the plaintiff relies on his legal title then his relief is at law; but if he establishes a trust, and attaches it to a particular estate, apparently vested in the defendant under legal title it will be different. The subject then is one of equitable jurisdiction . . . ."

> *arise as to whteher technically either Weston or the administratrix would be deemed a constructive trustee.* Ordinarily a constructive trustee has legal title as well as possession.[100]

The court decided the case on other grounds as we have seen; however, the comment raises an old ghost which had slept long.

Prior to the enactment of the Uniform Commercial Code one who gave a worthless check for merchandise in a transaction intended by the parties to be a cash sale got no title to the goods. His status was that of a thief or converter. His title was void, not voidable, and he could pass no property to a third person, even to a bonafide purchaser, providing the aggrieved party was not estopped from asserting his claim.[101] In the early case of *Campbell v. Drake*,[102] it was held that funds abstracted from a store by a clerk could not be followed into the land which had been purchased with the money on the ground that a thief could not be a trustee. The effect of this decision was to preclude an owner from recovering the product of the stolen goods in the hands of the thief, whereas he might do so if the wrongdoer had gained possession by fraud or mistake, an anomalous result. *Campbell v. Drake* was discussed at length in *Edwards v. Culberson*,[103] and, although it was not expressly overruled, it was thoroughly discredited by the later opinion, and the court has not since made the creation of a constructive trust contingent upon the notion that legal title must pass to the wrong-

[100] 247 N.C. 735, 739, 102 S.E.2d 134, 138. (Emphasis added.)

[101] Handley Motor Co. v. Wood, 237 N.C. 318, 75 S.E.2d 312 (1953) and cases there cited. In the Handley case the purchaser of an auto gave a worthless check in payment. The court said:

> It is a general, well-established principle that no one can transfer a better title than he has. No person can by his sale . . . transfer to another ownership in a thing in which has not the right of property, except in the case of cash . . . [and bearer paper] transferable by delivery in the ordinary course of business to a person taking the same *bona fide* and paying value for it. . . . The purchaser of property wrongfully taken by his vendor can no more perfect title to property purchased than the vendor himself, and an innocent purchaser for value can acquire no better title than the vendor had.

And the court awarded judgment against a bona fide purchaser from the original fraudulent purchaser.

Under the UNIFORM COMMERCIAL CODE § 2-403 N.C. GEN. STAT. § 25-2-403, a bona fide purchaser from a buyer who has given a worthless check acquires good title to the goods. However, a thief, *vi et armis*, can pass no title to a bona fide purchaser.

[102] 38 N.C. 94 (1844).

[103] 111 N.C. 342, 344, 16 S.E. 233, 234 (1892).

doer.[104] For example, in the recent case of *Wall v. Ruffin*[105] the defendants executed a deed thinking that it was a mortgage because of misrepresentations of the grantee. This was fraud in the *factum*, and the deed would have been void at common law and have conveyed no title. However, the court held that a bona fide purchaser from the defrauding grantee might bring ejectment against the duped grantors. The latter then might bring an action against the person who had duped them to have a constructive trust impressed upon the money he had received from the purchaser of the land. The court quite properly ignored the old distinction between fraud in the *factum* and fraud in the inducement of a deed, and looked instead to the equities of the parties.[106] A constructive trust may be impressed on property in the hands of another under circumstances that would result in his unjust enrichment if he were to retain it.[107]

3. *Failure of Beneficiary of Constructive Trust to Comply with the Recording Acts.*—A failure to comply with the recording acts is sometimes asserted as a defense to the enforcement of a constructive trust. It has been repeatedly held, however, that neither constructive nor resulting trusts are subject to the requirements of the recording acts because they are not in writing.[108] The beneficiary is not required to give notice of his claim to the trust property, but if the beneficiary of a trust by his words or conduct induces a third person to believe that he has no interest in the property held by the

[104] The Court said: "(T)here is no good reason why the owner of property taken and converted by one who has no right to its possession should be less favorably situated in a court of equity, in respect of his remedy . . . than one who by the abuse of trust has been injured by the wrongful act of the trustee to whom possession the trust property has been confined." *Id.* at 344, 16 S.E. at 234.

[105] 261 N.C. 720, 136 S.E.2d 116 (1964).

[106] See Briley v. Roberson, 214 N.C. 295, 199 S.E. 73 (1938). *Cf.* Troxler v. New Era Bldg. Co., 137 N.C. 51, 49 S.E. 58 (1904).

[107] RESTATEMENT, RESTITUTION § 160 (1937). But a converter, having no title, never holds the converted chattel itself on a constructive trust; only the proceeds are so held by him. See Comment, *A Thief as Constructive Trustee*, 37 YALE L.J. 654 (1928).

[108] See, *e.g.*, Spence v. Foster Pottery Co., 185 N.C. 218, 220-21, 117 S.E. 32, 33 (1923) where the Court states:

> (I)f these estates are to be preserved, it must be held that parol trusts, and those enacted by operation of law such as are recognized in this jurisdiction do not come within the meaning and purview of the Connor Act. No doubt these trusts were purposely omitted from its terms for the reason that, being incapable of registration because not in writing, it was considered unfair and subversive of right to destroy them in favor of one who had acquired his title with full knowledge of their existence (or, the Court might have added, without payment of value).

trustee, and he knows or has reason to know that a third person is extending or is likely to extend credit to the trustee in reliance upon the trustee's apparent ownership, and a person does extend credit in reliance thereon, the beneficiary is estopped from claiming a beneficial interest against the general creditors of the trustee.[109] Unless the beneficiary is thus estopped, his unrecorded claim is superior to that of a mortgagee who merely takes and records a mortgage but gives up nothing in return and therefore is not a purchaser for value.[110] Of course, a third party who extends additional credit or incurs some detriment in consideration of the mortgage is a bona fide purchaser and cuts off the equity of the trust beneficiary.[111]

E. *Restitutionary Interests in Property Differentiated from Security Interests*

In determining whether compliance with recording statutes is necessary to the perfecting of a claim against another's assets, the distinction between a beneficiary under a constructive trust whose claim is essentially restitutionary or proprietary, and that of a creditor whose claim to the assets of the debtor is for security for the underlying debt created by agreement of the parties becomes of critical importance. When a *creditor* takes or retains legal title to or is given a lien against property in the possession of the debtor as security for the payment of the debt, the North Carolina General Statutes require that all such reservations of interests by the creditor be in writing and be recorded as required by law to be valid against subsequent purchasers for value and lien creditors.[112] Neither an unregistered mortgage, conditional sales contract or a mere oral lien

[109] Jackson v. Thompson, 214 N.C. 539, 200 S.E. 16 (1938). See also SCOTT, TRUSTS § 313 (1956).

[110] Southerland v. Fremont, 107 N.C. 565, 12 S.E. 237 (1890); Day v. Day, 84 N.C. 408 (1881); Small v. Small, 79 N.C. 16 (1876).

[111] See note 12 *supra* and accompanying text.

[112] Recordation is required by the General Statutes of North Carolina as follows:

a. Deeds of trusts and mortgages of real and personal property by section 47-20 (1950).
b. Conditional sales contracts by section 47-23 (1950).
c. Bailments for sale contracts by section 45-53 (1950).
d. Factors liens by sections 44-71 through 44-73 (1950).
e. Agricultural liens by section 44-52 (Supp. 1965).
f. Assignments of accounts receivable by section 44-78 (1950).

can create an equity enforceable against subsequent purchasers for value with notice of the prior unrecorded security interest.[113]

A lien ordinarily arises out of a prior or contemporaneous contractual relationship of the parties. An "equitable" lien, according to the most common usage of the term, is the interest of a creditor in the debtor's tangible property created by an "equitable" mortgage —a term variously applied to the following transactions: (1) a promise to give a legal mortgage on certain property in the future; (2) an agreement, not executed so as to create a legal mortgage, that certain property is presently to stand as security; and the converse situations—(3) an absolute deed given on the grantee's promise to reconvey when a certain debt is paid. These three are imperfect or formally defective security transactions arising from a *mutually intended* debtor-creditor relationship.[114] Under North Carolina law such equitable security interests in realty or personalty are not enforceable against subsequent purchasers for value because no notice of the equitable mortgage or lien, however full and formal, will take the place of registration.[115]

A pledgee's interest in the pledged property likewise is a security interest rather than a proprietary one. In a New York case,[116] a debtor set aside certain securities he owned to secure his drawings against Kessler and Company. These securities were in an envelope in his safe marked, "Escrow account of Kessler and Co." When the debtor went bankrupt several years later, Kessler and Company asserted a claim to these securities against the trustee in bankruptcy. The United States Supreme Court said the right of the creditor,

[113] Eno Inv. Co. v. Protective Chems. Lab., 233 N.C. 294, 63 S.E.2d 637 (1951) (realty mortgage); M. & J. Fin. Corp. v. Hodges, 230 N.C. 580, 55 S.E. 836 (1934) (oral lien); General Motors Acceptance Corp. v. Mayberry, 195 N.C. 508, 142 S.E. 767 (1928) (conditional sales contract).

[114] Apart from any requirement of the Statute of Frauds, N.C. GEN. STAT. §§ 22-1 to -4 (1965), a lien or mortgage not in writing, either legal or equitable, arising out of a debtor-creditor relationship between the lienor and the lienee is valid between the parties without registration. McCreary Tire & Rubber Co. v. Crawford, 253 N.C. 100, 116 S.E.2d 491 (1960); Coggin v. Hartford Acc. & Indem. Co., 9 F. Supp. 785 (M.D.N.C. 1935); *reversed,* Hartford Acc. & Indem. Co. v. Coggin, 78 F.2d 471 (4th Cir. 1935); *cert. denied,* Coggin v. Hartford Acc. & Indem. Co., 296 U.S. 620 (1935).

[115] New Home Bldg. Supply Co. v. Nations, 259 N.C. 681, 131 S.E.2d 425 (1963); Lawson v. Key, 199 N.C. 664, 155 S.E. 570 (1930); Duncan v. Gulley, 119 N.C. 552, 155 S.E. 244 (1930).

[116] Sexton v. Kessler, 225 U.S. 90 (1912).

Kessler, to the securities depended upon whether the setting aside by the bankrupt debtor was a sufficient delivery of collateral to the creditor to perfect a pledge under the common law of New York. Justice Holmes described this informal "security transaction" as giving rise to an "equitable lien" in favor of Kessler which was enforceable against the debtor's trustee in bankruptcy.[117]

F. *Equitable "Restitutionary" Liens*

The voluntary segregating of collateral by the debtor in *Kessler* and the resulting "equitable lien" in favor of Kessler and Company exemplifies the more common usage of "lien" among lawyers and businessmen as descriptive of the interest a creditor may have in specific assets of his debtor. But the term "equitable lien" is also used to describe an interest of an aggrieved party in property which a wrongdoer is unjustly withholding from him. Underlying the former connotation of lien is an agreement that the debtor-creditor relationship will exist, whereas there is no such agreement underlying the latter use of the term. When the term "equitable lien" is used in this latter sense, it is analogous to a constructive trust in that both arise contrary to the intention of the burdened party and are basically unlike the voluntary giving of security or attempt to do so as in *Kessler*, and there is no *agreement* that the debtor-creditor relationship shall exist.

For example, section 202 of the *Restatement of the Law of*

[117] At common law the rules making a transfer effective as a pledge were: (1) the property pledged had to be delivered to the pledgee; (2) if the pledged property was returned to the pledgor, it could not be mixed with other property of the pledgor; (3) if the pledged property consisted of notes, accounts or other evidence of indebtedness, and the pledgee returned such notes or accounts to the hands of the pledgor for collection, the funds arising from the collection of the pledged property had to be kept separate and distinct and intact. Bundy v. Commercial Credit Corp., 202 N.C. 604, 609, 163 S.E. 676 (1932); Milling Co. v. Stevenson, 161 N.C. 510, 77 S.E. 676 (1913); Bizzell v. Roberts, 156 N.C. 272, 72 S.E. 378 (1911); Rose v. Coble; 61 N.C. 517 (1868). A pledge or assignment of accounts receivable must now be recorded pursuant to N.C. GEN. STAT. § 44-78 (1950, Supp. 1965) to be good as against creditors or subsequent purchasers for value of the pledgor or assignor. But when the indebtedness due the pledgor is evidenced by notes as in *Sexton*, a pledge of these notes if perfected by delivery to the pledgee followed by delivery back to the pledgor for collection with segregation of the proceeds in an account separate and distinct from the pledgor's other funds would be good against creditors and subsequent purchasers for value without recording. Bundy v. Commercial Credit, 202 N.C. 604, 163 S.E. 676 (1932).

Restitution permits the beneficiary of a constructive trust to enforce an "equitable lien" upon the property "as security for his claim against the trustee, holding the trustee personally liable for the balance of his claim" where the property wrongfully acquired by the trustee is or becomes less valuable than the trust property used in acquiring it.[118] For example, suppose *T* is trustee for *B* under an express trust of 10,000 dollars. In breach of trust, *T* purchases Blackacre with the money, taking title in his own name. *B* can require *T* to convey Blackacre to him if Blackacre is worth more than 10,000 dollars at the time the breach is discovered. On the other hand if Blackacre is worth only 5,000 dollars, *B* may enforce an "equitable lien" against Blackacre by demanding a judicial sale and receiving the proceeds therefrom, and may hold *T* personally liable for the balance of the 10,000 dollar claim. The "equitable lien" defined by section 202 does not arise out of any consensual, debtor-creditor relationship like the "equitable lien" in *Kessler*, nor does it arise in the usual course of business transactions on credit. Like the constructive trust, the section 202 lien is restitutionary, arising by implication of law to prevent the unjust enrichment of one of the parties, and usually is contrary to the intention of one or both parties. Like the constructive trust, its enforceability does not depend upon recordation.

Another circumstance calling for the declaration of an equitable lien to prevent unjust enrichment is the case in which the wrongdoer has not acquired title to all or part of the *product* of the assets of the aggrieved party. In cases where the wrongdoer has used the plaintiff's property to make improvements to realty or chattels to which the wrongdoer already had title, the aggrieved party is said

[118] RESTATEMENT, TRUSTS § 202 (1935) reads as follows:
(1) Where the trustee by the wrongful disposition of trust property acquires other property which is or becomes *more valuable* than the trust property used in acquiring it, the beneficiary is entitled to reach the property so acquired and thus to secure the profit which arises with the transaction. (2) Where, on the other hand, the property acquired is or becomes *less valuable* than the trust property used in acquiring it, the beneficiary can hold the trustee personally liable for the value of the property so used, and *can enforce an equitable lien* upon the property so acquired as security for his claim against the trustee, holding the trustee personally liable for the balance of his claim. (3) Since the transaction is in breach of trust, the trustee is accountable for profits and chargeable with losses arising therefrom. (Numerals and emphasis added.)

to have an "equitable lien" on the property and is not considered to be the beneficiary of a constructive trust.[119]

In *Fulp v. Fulp*,[120] for example, the plaintiff wife had contributed one-half of the construction costs of additions to a dwelling house from her personal funds with the understanding that her husband would convey to her an undivided one-half interest in the property. When the work was completed in 1952, the husband refused to convey. Husband and wife separated in May 1959 and the wife brought suit against her husband in December 1959 to have a resulting or constructive trust declared, or in the alternative to recover the money allegedly invested in the property.

The court held that when the husband refused to convey he became liable to the wife for all the money he had received from her under the oral contract because such an obligation was enforceable in an action in assumpsit for money he had received.[121] Furthermore the court said: "Because they were not strangers, plaintiff was entitled not only to a judgment for the money advanced but also to the remedy of an *equitable lien.*"[122]

The court cited *Etheridge v. Cochran*[123] and *Bowling v. Bowling*[124] in support of this statement, cases in which the court had declared a constructive trust rather than an equitable lien. The court also stated:

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[119] RESTATEMENT, RESTITUTION § 170 (1937), "Where a person makes improvements upon property of another or otherwise increases its value, being induced by fraud, duress, undue influence or mistake of such a character that he is entitled to restitution, he is entitled to an equitable lien upon the property." Comment (a) makes this rule applicable where a person pays for services or supplies materials.

[120] 264 N.C. 20, 140 S.E.2d 708 (1965).

[121] *Id.* at 23, 140 S.E.2d at 712.

[122] *Id.* at 23, 140 S.E.2d at 712. (Emphasis added.) The implication of the court's statement is that plaintiff would have no lien apart from the confidential nature of the relationship between the husband and wife. Compare RESTATEMENT, RESTITUTION § 161 (1937). "Where property of one person can by a proceeding in equity be reached by another as security for a claim on the ground that otherwise the former would be unjustly enriched, an equitable lien arises."

[123] 196 N.C. 681, 146 S.E. 711 (1929). When a wife receives checks from her parents as a personal gift and she indorses them to her husband, there is a presumption that he receives the money in trust for her in the absence of evidence that it was intended as a gift.

[124] 252 N.C. 527, 114 S.E.2d 228 (1960). Where land held by the entireties is sold and the purchase price is by checks made payable to both husband and wife, and the wife endorses the checks and turns them over to her husband who invests the proceeds in other property, he holds the property in trust where there is no evidence that the land held by the entireties was purchased with his own funds.

> Since she is able to trace the money into the improvements which the defendant made on the land any judgment obtainable would qualify as an equitable lien. *Trust Co. v. Barrett*, 238 N.C. 579, 78 S.E.2d 730; *Edwards v. Culberson*, 111, N.C. 342, 16 S.E. 233.[125]

Again in each of the cases cited the court had declared a constructive trust. The court in *Fulp* recognized that the purpose of the "equitable lien" in that case and the "constructive trust" declared in the cases it cited in support of plaintiff's equitable right in defendant's property was the same: to give the plaintiff an enforceable claim against specific property into which plaintiff could trace her funds. In a previous case it had expressly equated the owner of property improved with another's funds with a constructive trustee.[126] One important difference between the two analogous interests of the defrauded party is the method of enforcement. A constructive trust on realty normally is enforced by a judgment transferring the trust property to the beneficiary.[127] An equitable lien on realty of the kind declared in *Fulp* is enforced—if the court thinks such action best satisfies the equities of all concerned—by a judicial sale of the property and apportionment to the lienholder of the proceeds of the sale according to the amount of his interest in the property sold.[128] But in origin and in purpose the constructive trust and "restitutionary" equitable lien are twin remedies.

The use of the term "equitable lien" to describe both (1) an imperfect or formally defective security transaction such as an equitable mortgage or an undelivered pledge of personalty as in *Sexton v. Kessler*,[129] and (2) the proprietary interest of a person entitled to relief of the kind described in section 202 of the Restatement of the Law of Restitution or to an equitable lien when one's funds are wrongfully used to improve property belonging to another is confusing to say the least.[129a] The *intent of the parties* to create a debtor-

[125] 264 N.C. at 24, 140 S.E.2d at 712.

[126] Michael v. Moore, 157 N.C. 462, 468-69, 73 S.E. 104, 106-07 (1911).

[127] RESTATEMENT, RESTITUTION § 160, comments *e, f* (1937).

[128] RESTATEMENT, RESTITUTION § 161, comment *b*. (1937). Another difference between a restitutionary lien and a constructive trust was pointed out by the Court in a quotation from POMEROY, EQUITY JURISPUDENCE §§ 165, 166, 1234 n.5 (5th ed. 1941) to the effect that an equitable lien does not entitle the holder to use or profits of the property charged and hence was not a trust strictly speaking. *But see* RESTATEMENT, RESTITUTION § 202(3) (1937) quoted *supra* note 118.

[129] 225 U.S. 90 (1912).

[129a] A restitutionary equitable lien also arises: (1) Where the conversion.

creditor relationship or to give or withhold security for a debt is always a determining factor in establishing an "equitable lien" of the first category[130] and such equitable liens must be recorded. Therefore they must be distinguished from the constructive trust and the "equitable lien" of the second category which are imposed by law *without regard to intent*, in order to prevent unjust enrichment. This second category is not subject to recording statutes. One author has suggested that "imposed lien" or "restitutionary lien" would be more suggestive for the latter type with which this paper is exclusively concerned.[131] Since usage of "equitable lien" is inveterate, the lawyer can only be on guard each time the term is used to ascertain whether "equitable lien" means a creditor's security or a restitutionary remedy analogous to a constructive trust.

G. *Claims of Creditors of a Holder of Property Subject to a Constructive Trust or Restitutionary Equitable Lien*

More often than not the holder of the trust property in cases of constructive trust is a man hard pressed for funds, if not actually insolvent. The wrongful or erroneous transfer of the property to the present holder which the plaintiff seeks to undo often has been motivated by the insistent demands of the wrongdoer's bill collectors and money lenders. Hence, once the property has been transferred to the wrongdoer, either by fraud or mistake, the question of whether the transferor or the creditors of the wrongdoer shall have priority to the property often arises.

1. *General Creditors of Wrongdoer.*—If some of the general creditors of an insolvent debtor have brought a general creditor's action, it is well settled that they acquire no priority over other general creditors thereby, nor will the action interfere with existing security or restitutionary liens.[132] Furthermore, an assignee for the

RESTATEMENT, RESTITUTION § 203 (1937). (2) Where proceeds from the sale of property converted are held by a third party who was a donee of the property without notice of the wrong. RESTATEMENT, RESTITUTION § 204 (1937).

[130] Ferguson v. Blanchard, 220 N.C. 1, 16 S.E.2d 414 (1939); O'Briant v. Lee, 214 N.C. 723, 200 S.E. 865 (1939). See OSBORNE, MORTGAGES §§ 24, 69, 85 (1951).

[131] Lacy, *Constructive Trusts and Equitable Liens in Iowa*, 40 IOWA L. REV. 107, 119 (1954).

[132] Taylor v. Lauer, 127 N.C. 157, 37 S.E. 197 (1900); Hancock Bros. v. Wooten, 107 N.C. 9, 12 S.E. 199 (1890); Bronson v. Wilmington Life. Ins. Co., 85 N.C. 411 (1881).

benefit of creditors who is appointed a few days after the assignor-debtor misrepresents his solvency to a seller of goods and has obtained the goods because of the seller's reliance on the debtor's misrepresentations is not protected against the claims of the defrauded seller.[133] The latter is not a "security lien" holder but is a beneficiary of a constructive trust, and has a preferred claim to the goods or their product, if identifiable, in the hands of the insolvent buyer's assignee or trustee for the benefit of general creditors.

2. *Judgment Creditors of Wrongdoer.*—The same preference for the beneficiary of a constructive trust or restitutionary lien follows if one of the general creditors reduces his claim to judgment and attempts to execute it by levying against property which is subject to such trust or lien. In *Jackson v. Thompson*[134] the defendant had purchased land with his wife's money but had not recorded her title. Hence, he held the lands either on a resulting trust or subject to a constructive trust being declared. The plaintiff sought to levy on this land by way of execution of a money judgment against the defendant, alleging that he had loaned money to the defendant, the apparent owner of the land, on the strength of his holdings. The court said:

> There was no recorded deed to the judgment debtor which might have gone into the estimate of the defendant's solvency; and *even if there had been, the relation of a mere judgment creditor toward the property of his debtor is not of such a character as to effect or defeat the rights of the cestuis qui trustent.* The reason for this rule is stated in Guaranty State Bank v. Pratt . . . : 'A judgment creditor is in a very different position from one who has bought and paid, or who has loaned money on the face of a recorded title, and he is not a bona fide purchaser, for the reason that he has parted with nothing to acquire his lien . . . and for that reason *equity* does not regard the judgment creditor, but *assists those who have invested in,* and therefore have a substantial interest in, the real estate.'[135]

3. *Trustees in Bankruptcy of Wrongdoer.*—A trustee in bank-

[133] Wallace, Elliot & Co. v. Cohen, 111 N.C. 103, 15 S.E. 892 (1892). See also UNIFORM COMMERCIAL CODE § 2-702, N.C. GEN. STAT. § 25-2-702, which gives the seller a right to reclaim goods from a buyer who has made a fraudulent misrepresentation as to his solvency if the seller demands the goods within ten days after receipt.

[134] 214 N.C. 539, 200 S.E. 16 (1938).

[135] *Id.* at 543, 200 S.E. at 18. (Emphasis added.) *Accord,* Kelly Springfield Tire Co. v. Lester, 190 N.C. 411, 130 S.E. 45 (1925).

ruptcy stands in the shoes of the debtor[136] and also has the status of a judgment creditor with a lien on behalf of all of the unsecured creditors of the bankrupt dating from the date the petition is filed.[137] As the debtor's alter ego the trustee takes title to his assets subject to all equities and defenses existing against the bankrupt at the time of the filing of the petition and comes into no less, but no better, right or title than the bankrupt had.[138] This rule is clearly inferable from the fact that under section 70(a) of the Bankruptcy Act, the trustee takes "only title of the bankrupt" and comes into that title only "by operation of law."[139] Therefore, he is not a bona fide purchaser but a successor in title. However, the trustee in bankruptcy is more than a mere successor in title; he is also a representative of the court and acts on behalf of the general creditors.[140] Section 70(c) of the Act provides:

> The trustee, as to all property whether or not coming into possession or control of the court upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of the bankruptcy, shall be deemed vested as of such date with all the rights, remedies and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor exists.[141]

The bankruptcy court looks to the law of the state to determine whether the trustee in bankruptcy in his status as a judgment lien holder on behalf of the general creditors takes precedence over one claiming as a beneficiary of a resulting trust or as a possible beneficiary of a constructive trust or restitutionary lien. For the trustee in bankruptcy takes title subject to "all defenses and equities existing against the bankrupt"—he is privy to his bankrupt's fraud and is bound by its consequences.[142] Hence, a contract which is subject

[136] 30 Stat. 565 (1898), 11 U.S.C. § 110 (1964), provides in pertinent part as follows: "(a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition. . . ."

[137] Chattanooga Nat'l Bank v. Rome Iron Co., 102 Fed. 755 (N.D. Ga. 1900); 3 REMINGTON, BANKRUPTCY 324-28 (Henderson ed. 1957) (hereinafter cited as REMINGTON).

[138] Higgs v. Renfro, 195 Okla. 545, 159 P.2d 749 (1945).

[139] 30 Stat. 565 (1898), 11 U.S.C. § 110 (1964).

[140] Chattanooga Nat'l Bank v. Rome Iron Co., 102 Fed. 755, 759-60 (N.D. Ga. 1900).

[141] 30 Stat. 565 (1898), 11 U.S.C. § 110(c) (1964).

[142] *In re* Kimbrough-Veasey Co., 292 Fed. 757 (N.D. Ga. 1923).

to reformation against the bankrupt under state law is subject to reformation against the trustee.[143] And, if a defrauded seller's rights are superior to those of a judgment creditor or an assignee for the benefit of creditors under state law, as in fact they are under the decisions of the North Carolina Supreme Court,[144] then the seller may reclaim the goods from the trustee in bankruptcy.[145]

One authority states:

> Where the bankrupt holds property in trust for the benefit of another, equitable title is in such other notwithstanding legal title is in the trustee, and it is very doubtful whether any title whatever vests in the bankruptcy trustee, as the bankruptcy court is a court of equity dealing primarily in the equities of the situation. It is not within the scope of bankruptcy jurisdiction to administer an express trust, but such court will recognize and give force and effect to resulting and constructive trusts in property held by the bankrupt and even to obligations in the notice of a trust. . . . Whatever obligations of this kind attach to property coming into the hands of the bankruptcy trustee are good as against him and must be observed.[146]

However, if the bankrupt holds property as a constructive trustee, the beneficiary may not retake his property with the connivance of the bankrupt constructive trustee[147] or by claim and delivery because, from the date of the filing of the petition, the bankrupt is considered to go out of possession of his assets although the trustee in bankruptcy has not yet been appointed.[148] Likewise, neither may a beneficiary under an implied trust nor a creditor of the bankrupt attach or garnish a bankrupt's property.[149] After the trustee in bankruptcy is appointed, the bankrupt holds possession for the trustee in bankruptcy in a manner similar to the possession of a servant for his master.[150] The claims of persons claiming as beneficiaries of implied trusts or restitutionary liens impressed on property in the hands of the bankrupt, being in the nature of adverse claims, may require a

[143] Zartman v. First Nat'l Bank, 216 U.S. 134 (1910).
[144] See note 133 *supra* and accompanying text.
[145] *In re* Gold, 210 Fed. 410 (7th Cir. 1913).
[146] 3 REMINGTON 346. The author quotes *In re* Milne, 185 Fed. 244 (2d Cir. 1910) in support of his statement.
[147] Operators' Piano Co. v. First Wisconsin Trust Co., 283 Fed. 904 (7th Cir. 1922).
[148] Kinmouth v. Braeutigam, 63 N.J. Eq. 103, 52 Atl. 226 (1902).
[149] Acme Harvester Co. v. Beekman Lumber Co., 222 U.S. 300 (1911).
[150] Murphy v. John Hofman Co., 211 U.S. 562 (1909).

plenary suit against the trustee in bankruptcy to establish the asserted rights.[151]

Even though the trustee in bankruptcy holds title and possession of the bankrupt's assets subject, generally, to the equities of those claiming as beneficiaries of constructive trusts or restitutionary liens on the assets, might not the trustee in bankruptcy defeat the constructive trusts by resorting to section 60 of the Bankruptcy Act?[152] Section 60 declares that the recognition of "equitable liens" where available means of perfecting legal liens shall not have been employed is contrary to the policy of the act that forbids the granting of a preference to a general creditor by giving him a security interest in the debtor's property after the latter has become or is about to become insolvent. However, this provision is operable only *"If a transfer is for security,*[153] and it has been construed as not applicable to restitutionary liens such as that provided for in section 202 of the Restatement of the Law of Restitution or to constructive trusts because neither of these two remedies arise out of a security transaction.[154]

It follows that if a transaction of the kind calling for the declaration of a constructive trust or restitutionary lien is the basis of a claim against a bankrupt, such claim takes preference over the claims of general creditors in so far as the trust *res* is concerned. In other words, if the claim on a specific asset arises out of accident, mistake, or fraud or constructive fraud of the bankrupt, the Federal Bankruptcy Act does not forbid the giving of a preference to the claimant. However, the fact that a constructive trust or restitutionary lien is not a forbidden preference under the Bankruptcy Act does not mean that the bankruptcy court will invariably grant this type of relief. It will temper the remedy so as to do substantial equity with due regard for rights of all the claimants to the bankrupt's assets.[155]

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[151] See 5 REMINGTON § 2134.

[152] 64 Stat. 22 (1950), 11 U.S.C. § 6(a) (1964).

[153] 64 Stat. 22 (1950), 11 U.S.C. § 6(a)(6) (1964).

[154] Danais v. M. De Matteo Constr. Co., 102 F. Supp. 874 (D.N.H. 1952) (equitable lien on money due from sub-contractors in favor of surety who made good on contractor's default "not the equitable lien spoken of in the statute.") See Lacy, *Constructive Trusts and Equitable Liens in Iowa,* 40 IOWA L. REV. 107, 129, (1954).

[155] Speight v. Branch Banking & Trust Co., 209 N.C. 563, 183 S.E. 734 (1936); Edwards v. Culberson, 111 N.C. 342, 16 S.E. 233 (1892).

H. *Statute of Limitations*

Considerable doubt has arisen from time to time concerning the applicable statute of limitations in cases giving rise to a constructive trust under North Carolina law. There are many *obiter dicta* to the effect that a resulting or constructive trust; *i.e.*, an implied trust, as distinguished from an express trust, is governed by the ten-year[156] and not the three-year[157] statute of limitations.[158] An example of such dicta is *Teachey v. Gurley*[159] in which the court actually decided that an *express, oral* trust had been undertaken by the defendant, and consequently that the cause of action for breach of trust did not exist and the statute of limitations did not start to run until the defendant-trustee had repudiated the express trust to the knowledge of the beneficiary. Nevertheless, the court stated the following dictum relating to trusts implied by law.

> Actions to enforce constructive or resulting trusts are based on the original wrongful or tortious act of the person holding title by reason of which equity impresses a trust upon his title. No contract relation exists. A cause of action arises when the wrong is committed. Therefore the statute of limitations immediately begins to run, and *the ten-year statute applies* unless sooner barred under the doctrine of laches.[160]

On one occasion sixty years ago the court actually applied the ten-year statute in an action giving rise to the declaration of an implied

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[156] N.C. GEN. STAT. 1-56 (1953).

[157] N.C. GEN. STAT. 1-52 (1953).

[158] *E.g.*, Norton v. McDevit, 122 N.C. 755, 30 S.E. 24 (1898) where the court's reference to the ten-year statute was dictum because the beneficiary of the implied trust was in possession, and a statute of limitations does not run against the beneficiary of trust who is in possession of property as his own. See Mask v. Tiller, 89 N.C. 423 (1883). Similar references in Bowen v. Darden, 241 N.C. 11, 84 S.E.2d 289 (1954); Wolfe v. Smith, 215 N.C. 286, 1 S.E.2d 815 (1939); and Wise v. Raynor, 200 N.C. 567, 157 S.E. 853 (1931) also are dicta because the beneficiary was in possession. Other references to the ten-year statute of limitations may be found in Jarrett v. Green, 230 N.C. 104, 52 S.E.2d 223 (1949); Creech v. Creech, 222 N.C. 656, 24 S.E.2d 642 (1943); and Teachey v. Gurley, 214 N.C. 288, 199 S.E. 83 (1938). But in the three latter cases the beneficiary had in fact brought the action within three years from the date of notice that the defendant had breached his trust, and so the plaintiff's action was timely under N.C. GEN. STAT. § 1-52 (1953) which permits the bringing of an action within three years of the discovery of the fraud or mistake by the plaintiff.

[159] 214 N.C. 288, 199 S.E. 83 (1938).

[160] *Id.* at 293-94, 199 S.E. at 87-88. (Emphasis added.)

trust. In *Norcum v. Savage*[161] an action was allowed to be brought more than five years after the statute of limitations had begun to run against the plaintiffs.[162] But more recently, the supreme court had looked to the nature of the cause of action. If the action had arisen out of a breach of trust by a fiduciary or by one in whom the aggrieved party had justifiably reposed special confidence which resulted in the former's superiority or influence on the other, the period of limitations, as in cases of fraud, would start on the day that the breach of fiduciary duty is discovered, or with reasonable diligence would have been discovered,[163] and would run for three years; *i.e.*, the period of limitation for the tort of deceit and for breach of simple contract.

The Court of Appeals for the Fourth Circuit in a recent decision so interpreted the North Carolina law. In *New Amsterdam Cas. Co. v. Waller*[164] a judgment creditor sought to impress a constructive trust on the product of funds in possession of the debtor's wife which the debtor had transferred to her four years before in fraud of the plaintiff. After finding that the plaintiff was chargeable with

[161] 140 N.C. 472, 53 S.E. 289 (1906).

[162] The facts in *Norcum* merit summarizing. The plaintiffs' mother had paid for the property and had taken the original deed in her name, which deed had been lost or stolen. The plaintiffs' father, wrongfully or mistakenly then had taken title in his own name to the property by a second deed from the original grantor's heirs. The court held that the plaintiffs' father thereafter held the land as trustee for the plaintiffs' mother, subject to his life estate by the curtesy. The father's misconduct or mistake in taking title in himself occurred prior to 1869, but the plaintiffs were under a disability to sue by reason of their minority, and later by reason of coverture until the Act of 13 February 1899 removed this latter disability. By that date their father had died, and the land had passed, apparently by devise, to the half sisters of the plaintiffs. There is no question that on February 13, 1899 the plaintiffs knew of their father's wrongdoing and had the capacity to bring an action against their half sisters to recover the property. But they waited five years before commencing the action. On these facts the court said at 140 N.C. 472, 474, 53 S.E. 289-90: "The action so far as it seeks to have a trust declared and a conveyance made by the defendants would be barred only by the . . . lapse of ten years . . . which time began to run against the plaintiffs . . . on 13 February 1899."

[163] Vail v. Vail, 233 N.C. 109, 63 S.E.2d 202 (1951). But mere registration of a deed adverse to plaintiff's interests is not notice of defendant's wrongdoing. In Little v. Bank of Wadesboro, 187 N.C. 1, 121 S.E. 185 (1924), plaintiff sought to have a deed set aside which he himself had made seven years before because of undue influence of his father. His father had died only a year before the action was brought. The plaintiff had judgment, but on appeal a new trial was ordered to ascertain whether the father's undue influence had ceased more than three years before the commencement of the action and, if so, the plaintiff's action was barred.

[164] 301 F.2d 839 (4th Cir. 1962).

notice of the fraudulent transfer, Judge Haynsworth, speaking for the court, said:

> In a number of North Carolina cases there may be found expressions, such as 'a resulting or constructive trust, as distinguished from an express trust, is governed by the ten-year statute of limitations' (citing *Bowen v. Darden, Teachey v. Gurley,* and *Jarrett v. Green*).[165] Such references in a single breath to constructive trusts and resulting trusts are found in opinions dealing with resulting trusts. It is clear the action to enforce a resulting trust is governed by the 10-year statute. . . .[166]

Then the court held that the nature of the wrongful act, not the remedy which the plaintiff was seeking determined the statute of limitations. In *Little v. Bank of Wadesboro*[167] it had been decided that undue influence was tantamount to fraud, and that the three-year statute of limitations applied in an action to set aside a deed. There-

[165] See cases cited note 155 *supra.*

[166] 301 F.2d at 844. The distinction between resulting trusts and constructive trusts is more easily stated than applied in some situations. A purchase money resulting trust arises when one person pays the consideration for the transfer of the property but the title is taken in the name of another. See Edwards & Van Hecke, *Purchase Money Resulting Trusts in North Carolina,* 9 N.C.L. REV. 177 (1939). A given set of facts may rise to either a resulting or constructive trust or both. For example, Husband has access to Wife's funds. He purchases Blackacre with them, taking title in the name of T Corporation which he owns and controls. Under the law of North Carolina the T Corporation would hold Blackacre upon a resulting trust in favor of the wife proportionate to her involuntary contribution to the purchase price. (See Norton v. McDevit, 122 N.C. 755, 30 S.E. 24 (1898) where a resulting trust was found upon the idea of "mistake or bad faith" in not taking the deed to the party paying for the property.) But obviously neither Husband nor Wife actually intended that T Corporation should hold the land as trustee, and such an intention can no more be implied or inferred from the circumstances than it can be inferred from the fact that there was no expression whatsoever of such intention. If T Corporation holds the land as trustee, it must do so simply because that is the jural relationship which courts have declared shall result from the facts like those stated. Therefore, it would appear that T Corporation holds title to Blackacre "independent of any actual or presumed intent of the parties," and that the facts give rise to a constructive trust instead of, or in addition to, a resulting trust. This relatively simple hypothetical situation illustrates an ambiguity in the definitions of resulting and constructive trusts under North Carolina law so clearly apparent that prudent counsel today pray for the declaration of *either* a constructive trust or a resulting trust or both in an action in which they think an implied trust should be declared. Bowen v. Darden, 241 N.C. 11, 84 S.E.2d 289 (1954); Jarrett v. Green, 230 N.C. 104, 107, 52 S.E.2d 223 (1949) (Counsel for plaintiff requested a resulting or constructive trust). In Creech v. Creech, 222 N.C. 656, 24 S.E.2d 642 (1943), plaintiff requested a parol or resulting trust.

[167] 187 N.C. 1, 121 S.E. 185 (1924).

fore, the same three-year statute was held to apply in an action to declare a constructive trust where the wrongful act was fraud of creditors. Thus, inasmuch as fraud, constructive fraud, and mistake are the grounds for impressing a constructive trust on property which has wrongfully been transferred, it would appear that the Court of Appeals for the Fourth Circuit, when applying North Carolina law, would not impress a constructive trust if more than three years have elapsed since the aggrieved party has received actual notice of the fraud or mistake.

However, the North Carolina Supreme Court in *Fulp v. Fulp*[168] apparently has rejected the Fourth Circuit's interpretation of North Carolina law. It will be remembered that, in accordance with the prevailing view, the court in *Fulp* decided that the defendant held title to the disputed property subject to a restitutionary lien in favor of the plaintiff because the defendant had breached his promise to convey an undivided one-half interest in the property to the plaintiff after she had paid one-half of the construction costs of an improvement to the dwelling out of her personal funds.[169] The court also held that the three-year limitation perior for simple contract actions applied in this case because the action arose out of a breach of contract.[170] Up to this point the North Carolina court seemed to be of the same opinion as the Fourth Circuit; that is to say, the nature of the wrongful act and not the remedy sought determines the statute of limitations. However, the court went on to say:

> Were the plaintiff the *certui qui trust* of . . . a constructive trust, the ten-year statute would apply, G.S. 1-56 . . . and, she sharing the defendant's possession, the statute would not have begun to run against her until the separation of the parties on May 31, 1959, some seven years after the breach of promise by the husband to convey title to the wife in consideration of her contribution to the cost of the alterations. *The ten-year statute applies* when the title to property is at issue, not where, as here, the action is merely for breach of contract. . . .[171]

The court's reference to the ten-year statute adds yet another to a long list of similar dicta.[172]

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[168] 264 N.C. 20, 140 S.E.2d 708 (1965).
[169] See note 122 *supra.*
[170] 264 N.C. 26; 140 S.E.2d 714.
[171] *Id.* at 26, 140 S.E.2d at 714. (Emphasis added.)
[172] See note 158 *supra.*

Having decided that the three-year statute of limitations applicable to Mrs. Fulp's action against her husband, the court observed that plaintiff was aware of her husband's breach of contract more than three years prior to the commencement of the action and therefore her action was barred. Thus, the case stands as precedent for two rules:

(1) Where a restitutionary lien is the appropriate remedy for a legal wrong, the applicable statute of limitations will be determined by the nature of the wrongful act.

(2) Where the holder of a restitutionary lien is in possession of the property subject to the lien, the period of limitations will run against him—as it did against Mrs. Fulp—from the date the cause of action accrues.

The dicta in *Fulp* are as follows:

(1) Where a constructive trust is the appropriate remedy, the ten-year statute of limitations may be applied.[173]

(2) Where the beneficiary of a constructive trust is in possession of the trust property the statute of limitations will not begin to run until he goes out of possession.[174]

From the rules of decision and the dicta, the following conclusion appears warranted:

The determination of the statute of limitations appropriate to an action brought for the purpose of obtaining a restitutionary, equitable remedy will depend upon which of the two such remedies—equitable lien or constructive trust—is appropriate.

If this conclusion is correct, the Fourth Circuit incorrectly interpreted North Carolina law in the *New Amsterdam Cas.*[175] case in which it was said that the nature of the underlying wrongful act, not the remedy sought, determines what is the appropriate statute of limitations.

Fulp was a classical "equity" case in that it involved an oral contract to convey realty from husband to wife. The wife waited for seven years after knowing of her husband's breach before she in-

[173] *Accord,* Norcum v. Savage, 140 N.C. 472, 53 S.E. 287 (1906); *but see* Vail v. Vail, 233 N.C. 109, 63 S.E.2d 202 (1851) and Little v. Bank of Wadesboro, 187 N.C. 1, 121 S.E. 185 (1924).

[174] *Accord,* Bowen v. Barden, 241 N.C. 11, 17, 84 S.E.2d 289, 294 (1954) and cases cited therein.

[175] 187 N.C. 1, 121 S.E. 185 (1924).

voked the aid of equity.[176] But during these seven years their marriage was a happy one for aught else that appears. Can it be said that the wife was chargeable with laches because she failed to bring an action against her husband while she was sharing his house, bed, and board? She was so charged. Equity followed the law, and refused to pass on the merits of plaintiff's claim.

The court, in justice and equity and in recognition of the similarity of the equitable restitutionary remedies, the constructive trust and equitable lien, might well have declared that where the holder of an equitable lien, restitutionary in purpose, is in possession or shares in the possession of the property, the court will apply the same rule concerning the running of the statute of limitations as it does when the beneficiary of a constructive trust is in possession of the trust property. In neither case should the statute begin to run until the holder or beneficiary goes out of possession.

With respect to the dictum that the ten-year statute may apply when the remedy sought is a constructive trust, only cautious acceptance is justified. Until the court actually allows an action to be brought from four to ten years after the wrongdoing has been discovered by a plaintiff out of possession and thereby demonstrates that *Norcum v. Savage* is still good law,[177] prudent counsel should assume that the period of limitation in cases where an equitable restitutionary remedy is sought is the period prescribed for the wrongful act, be it a breach of contract or a tort, in spite of the dictum in *Fulp v. Fulp*.

I. Conclusion

The *Fulp* opinion gives new life to the idea that a constructive trust in some kind of mystical "estate" analogous to the beneficial interest in express trust property, but created by law upon the happening of certain wrongful acts, and which, if not perfected by adjudication within ten years from the date of its creation, inexplicably ceases to exist. An equitable restitutionary lien, on the other hand, seems to be merely a remedy that, in the opinion of the supreme court, is available only as long as the underlying cause of action may be brought. When both are viewed merely as equitable

[176] See note 120 *supra* and accompanying text.
[177] See notes 161-62 *supra* and accompanying text.

remedies like specific performance, reformation, or injunction, the aura of mystery surrounding constructive trusts and restitutionary equitable liens disappears. These latter two remedies ought to continue to play an effective and understandable role in North Carolina jurisprudence as they have since they "emerged from the fog of equity." The remedial nature of the constructive trust was emphasized in *New Amsterdam Cas. Co. v. Waller*:

> *A constructive trust is merely a procedural device* by which a court of equity may rectify certain wrongs. It is suggestive of a power which a court of equity may exercise in an appropriate case, but *it is not a designation* of the cause of action which justifies the exercise of that power.[178]

The ruling case law of North Carolina, viewed as a whole and discounting many contrary dicta, such as that in *Fulp v. Fulp*, supports Judge Haynsworth's notion that whatever the cause of action may be—fraud, mistake, undue influence, conversion, or breach of a trust or other fiduciary agreement—in an appropriate case, a constructive trust may be impressed to remedy a substantive wrong. In the words of Judge Cardozo:

> A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.[179]

Or as stated in the *Restatement of the Law of Restitution*:

> Where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises.[180]

As we have seen, the essence of the remedy of the constructive trust and the restitutionary lien is the tracing of the *res* or its product and its recovery in *specie* by the so-called beneficiary of the constructive trust or lien. Thus one who succeeds in persuading a court to declare a constructive trust or restitutionary lien has thereby

[178] 301 F.2d 839, 842 (4th Cir. 1962). (Emphasis added.)

[179] Beatty v. Guggenheim Exploration Co., 225 N.Y. 380, 386, 122 N.E. 378, 380 (1919) as quoted in New Amsterdam Cas. Co. v. Waller, 196 F. Supp. 780, 791 (M.D.N.C. 1961).

[180] RESTATEMENT, RESTITUTION § 160 (1937).

converted his claim against the wrongdoer into a proprietary claim against specific assets and, in effect, has persuaded the court to give him a preference over others whose claims are not secured by specific assets of the wrongdoer. A court will temper this remedy so as to do substantial equity in accordance with all of the facts and with all of the conflicting claims in mind,[181] remembering that "equity assists those who have invested in and therefor have substantial interest" in the property as distinguished from those who have not invested but have only an imperfect security interest in it.[182]

"A court of equity (such as a superior court of North Carolina) adopts its relief to the exigencies of the case at hand."[183] Estoppel and laches may be called upon to avoid doctrinaire adherence to rules which would do violence to justice in the particular case. In investigating allegations of unjust enrichment, courts of equity ought to disregard mere technicalities and artificial rules and look only at the general characteristics of the case, going at once to essential morality and merit.[184] The constructive trust and restitutionary lien are equitable remedies like injunction or specific performance which the court in the exercise of its sound discretion may decree in order to do substantial justice between the parties when one of them holds property which in justice and equity should be possessed by the other in whole or in part. They are two of the multitude of devices which lend flexibility to the rule of law. The knowledgeable attorney will appreciate that their scope and limitations are not always precise. Therein lies their value as tools of equity.

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[181] See cases cited note 155 *supra.*

[182] Jackson v. Thompson, 214 N.C. 539, 543, 200 S.E. 16, 18 (1938).

[183] Martha v. Curby, 90 N.Y. 378 (1882), quoted in Sprinkle v. Wellborn, 140 N.C. 163, 177, 52 S.E. 666, 671 (1905).

[184] Michael v. Moore, 157 N.C. 462, 468, 73 S.E. 104, 106 (1911).