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Constructive Trusts Based on Fraudulent Promises

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Appellate Division, Second Department, added an amendment to the Trial and Special Term Rules of the Supreme Court of Kings County,[34] which provides for a method of arbitrating certain matters in the process of litigation. It is suggested that this is a very practical amendment and one which will, if availed of, as its merit warrants, eliminate considerable time, effort and expense to litigants, lawyers and courts alike. It remains for the members of the bar to carry the spirit and purpose of such rules and of arbitration in general into practical effect.

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CONSTRUCTIVE TRUSTS BASED ON FRAUDULENT PROMISES.

Promises made with intent not to perform have been frequently treated by the courts as actual fraud. A court of equity will not, under the guise of a constructive trust, enforce a mere oral promise, void under the statute of frauds. On the other hand, equity will not permit the statute to be made a cloak for fraud, and if one person has obtained title to property of another, or in which another has an interest, by means of an intentionally false and fraudulent verbal promise to hold or dispose of it for a particular purpose, equity will not permit him to retain the property and repudiate the promise.[1] If we consider a case where *A*, having an equity of redemption in land, enters into an oral agreement with *B*, the mortgagee, that *A* will not attend the foreclosure sale, but that *B* will attend and bid in the property and hold it for *A's* benefit, our problem is whether the courts will enforce *A's* rights by way of a constructive trust, after *B* so obtains the property and pleads the statute of frauds as a bar to the enforcement of the oral agreement.

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[34] Amendment to Trial and Special Term Rules, Supreme Court, Kings County, adding new subdivision "f" to Rule 14, in effect April 1, 1932:

> "(f) The Justice assigned to Special Term, Part 2, shall on each Monday, Wednesday and Friday, between 11 A. M. and 1 P. M., hear such matters as may be brought before him under the provisions of this subdivision, which matters shall be known as 'Informal Motions.' In any action or proceeding in the second Judicial District in which the attorneys for all parties who have appeared shall appear voluntarily before such Justice for the purpose of obtaining a ruling or a decision, such Justice sitting as the court shall hear the parties informally, without presentation of affidavits, motion papers or proof, and make a ruling or decision thereupon, which, if desired by either party, may be embodied in a court order or judgment to be signed and entered."

[1] Ryan v. Dox, 25 Barb. (N. Y.) 440, *rev'd*, 34 N. Y. 307 (1866); Fletcher v. Manhattan Life Ins. Co., 114 Misc. 409, 187 N. Y. Supp. 429 (1921), *aff'd*, 197 App. Div. 484, 189 N. Y. Supp. 453 (1st Dept. 1921); Henschel v. Mamero, 120 Ill. 660, 12 N. E. 203 (1887); Gregory v. Bowlsby, 88 N. W. (Iowa) 822 (1902).

We have been unable to find a New York case exactly in point with the problem under consideration. *Lathrop* v. *Hoyt* [2] was a case in which relief was denied to the plaintiff who sued on the theory of a resulting trust, the court holding that the agreement to reconvey was void as being within the statute of frauds, and that there was no trust which could be enforced. It should be noted, however, that in that case there was no promise on the part of the owner to refrain from attending the sale, and in that respect it is distinguishable from the case under consideration.

One of the foremost writers [3] on the law of trusts maintains that a trust results from the acts and not from the agreements of the parties, or rather from the acts accompanied by the agreements, but that no trust can be set up by mere parol agreements; or, as has been said, no trust results merely from the breach of a parol contract; as, for example, if one agrees to purchase lands and give another an interest in them, and pays his own money on the sale and takes title in his own name, no trust will result. Also, if a party makes no payment and none is made for his account, either actually or constructively, he cannot claim a resulting trust.[4] Parol proof cannot be received to establish a resulting trust in lands purchased by an agent with his own funds, no money of the principal being used for the payment, as the relation of principal and agent depends upon the agreement existing between the parties, and the trust in such a case must arise from the agreement, and not from the transaction, and where a trust is to arise from an agreement, it is within the statute of frauds, and must be in writing.[5]

While it is true that parol agreements relating to real property are no more valid in equity than in law, yet courts of equity have general jurisdiction to relieve against fraud, and where a parol agreement relating to lands has been so far performed by one party that he would be defrauded unless the agreement is performed by the other, the court will grant relief against this imminent fraud and will enforce the agreement. It is the fraud and not the parol agreement which lies at the foundation of the jurisdiction in such a case.

Of course, where there is a mere oral promise, without previous interest in the subject on the part of the promisee, equity will not raise

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[2] 7 Barb. 59 (N. Y. 1849).

[3] 1 PERRY, TRUSTS AND TRUSTEES (7th ed. 1929) §134.

[4] Lathrop v. Hoyt, *supra* note 2; Cotton v. Wood, 25 Iowa 43 (1868); Bourke v. Callanan, 160 Mass. 195, 35 N. E. 460 (1893); Byers & Co. v. McEniry, 117 Iowa 499, 91 N. W. 797 (1902) (where a debtor conveyed to one of his creditors upon the latter's verbal agreement to apply the surplus to the claims of other creditors); Monson v. Hutchin, 194 Ill. 431, 62 N. E. 788 (1902).

[5] Lathrop v. Hoyt, *ibid.*; Pennock v. Clough, 16 Vt. 500 (1844); Taliaferro v. Taliaferro, 6 Ala. 406 (1844); Arnold v. Cord, 16 Ind. 177 (1861); Kennedy v. Keating, 34 Mo. 25 (1863); Minot v. Mitchell, 30 Ind. 228 (1868); Pearson v. East, 36 Ind. 27 (1871); Burden v. Sheridan, 36 Iowa 125 (1872); Nestal v. Schmid, 29 N. J. Eq. 458 (1878).

a constructive trust as a remedy for the breach of such a promise. In a case [6] illustrative of this principle, we find a verbal agreement entered into between the plaintiff and defendant by which the latter agreed to bid for the property in his own name and to enter into a contract for the purchase of said property and pay from his own funds the necessary amount for that purpose, for the joint benefit of both. The plaintiff was to reimburse one-half of the money so paid. The deed was to be taken in the name of both. The court held that the defendant having bid in the land in his own name and taken a contract thereof, but having refused to convey one-half to the plaintiff, no action would lie to compel the execution of the agreement. While it is true that in that case the plaintiff relied upon the agreement, so far that he did not himself bid or make arrangements with other parties for bidding, it is to be noted that he had no previous interest in the subject. Furthermore, part performance of a parol agreement void by the statute of frauds must be substantial to take such agreement out of the operation of the statute.

In *Wheeler* v. *Reynolds*,[7] after an exhaustive review of all the cases in point up to that time, the court refused to grant to an owner specific performance of an oral agreement by a mortgagee who, according to arrangement, was to bid in the premises at a foreclosure sale, and then sell or hold them for opportune sale, and when sold, was to deduct the amount of his mortgage debt and pay the owner the balance. The mortgagee's claim was shown to be about what the land was then worth. He took possession of the premises and paid the taxes, etc., for nine years. When this action was commenced, the land had greatly increased in value.

We think the decision in the *Wheeler* case does not trench upon the rule. From its facts we find that the owner had become insolvent and the mortgage was past due and unpaid; that he did not attend the sale, but there was no proof that he omitted to attend or to procure others to attend in reliance upon the agreement, or that, save for the agreement, he or someone in his behalf could or would have bid in the property. Certainly the alleged agreement could not be held enforceable on the ground of part performance, when there was none. Furthermore, there was no allegation or proof of fraud in the agreement or sale which would warrant a court of equity in granting relief.

Prior to the decision in the *Wheeler* case, the court had occasion to review a case [8] in which this very question was raised. There the plaintiffs, owners of the land, procured the defendant, a friend, to bid in the property under a parol agreement that he would attend the sale and bid in the land for their benefit and advantage, and take the deed as his security for the amount paid by him, they agreeing that

[6] Levy v. Brush, 31 Super. Ct. 653 (N. Y. 1869), *rev'd*, 45 N. Y. 589 (1871).
[7] 66 N. Y. 227 (1876).
[8] Ryan v. Dox, *supra* note 1.

they would not find any other person to attend the sale and bid for them. Plaintiffs relied on the agreement and made no other effort to procure the money or the assistance of friends to save or buy in the land. Plaintiffs continued in the possession of the land after the sale for six years, and during all that time had the use of the land with the knowledge and consent of the defendant, paid the taxes and periodic charges pertaining to the encumbrances thereon. The court held that the acts of part performance were clearly referable to the agreement, and were done in reliance thereon, and in partial execution thereof, and the equity rule of part performance was fully satisfied.

Whenever the condition or position of one of the parties to a transaction is such that the other may have acquired an unfair advantage more easily than in ordinary cases, a court of equity will investigate the whole matter with scrupulous care and readily presume fraud, unless the absence of fraud is clearly proved. So, if confidential agents or other fiduciaries acquire property which they have orally agreed to purchase for persons already owning some interest either in the land itself or in its purchase money, and then seek to avail themselves of the statute of frauds as an escape from performing their agreements, equity will not be slow to frown. It will not permit the statute to be thus used as an instrument of fraud. And, in favor of such an interested party, it will raise a constructive trust in the land so bought. As very well stated by Professor Reeves,[9]

> "* * * Thus, if a person buy realty under an oral agreement to convey all or part of it to one who already has an interest therein, such as a mortgagor whose land is being sold on foreclosure, or a part owner of property sold for partition, equity will hold the purchaser a trustee for him who has such interest. * * * But beyond this, equity adheres to the statute of frauds, and where the contracting parties are strangers, will not enforce an oral agreement to convey realty to one who has no existing interest in it at the time of its purchase by the other party, and who has done no act of part performance and has parted with nothing of value pursuant to his contract with the purchaser."

It is submitted that where one vested with interest in land, relying upon the verbal promise of another that he will purchase it at a judicial sale for the benefit of the former who agrees to take no other steps to protect his own interest, carries out this agreement on his part and allows the promisor to acquire the land at such sale, a subsequent denial of the promise and a refusal to carry it into execution is such a fraud as will convert the purchaser into a trustee

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[9] 1 REEVES, A TREATISE OF THE LAW OF REAL PROPERTY (1909) §395.

ex maleficio; [10] and especially is this true where, the agreement being made known at the sale, there is no competition and the land is obtained at a low price.[11] But an oral agreement by a purchaser at a judicial sale to take the deed in his own name and convey to another cannot be enforced against the purchaser as a trustee *ex maleficio* to prevent the perpetration of a fraud, where neither party had any interest in the property, or where no money was advanced to the purchaser or anything else done in partial performance of the agreement.

The respective claims of mortgagor and mortgagee in courts of common law and of equity afford a notable instance of the rise of a trust through the mere existence of the relationship. But the relationship is not so far analogous to that between a trustee and *cestui que trust* as to preclude the mortgagee's purchasing at the foreclosure sale. The mortgagee is under no obligation to protect the equity of redemption of the mortgagor. He may deal with the mortgagor himself in respect to the mortgaged estate, subject only to the qualification that the courts will look upon their transactions with jealousy and set aside a purchase made by the mortgagee, when by the influence of his position or by constructive fraud, he has gained an unconscionable advantage, and has purchased the equity of redemption for a less price than others would have given.[12]

It is our opinion, in the problem under review, that the courts should enforce the rights of the owner of the equity of redemption by way of a constructive trust, as the owner has performed his part of the oral agreement out of which the trust arises, and it would work a fraud to permit the mortgagee to escape under cover of the statute. While we agree that the mere breach of an oral agreement is not in general enough to take a case out of the statute, we have here a real interest in the subject matter prior to the arrangement, and the owner, relying upon the verbal promise of the mortgagee to buy in the property for the benefit of the former, was induced to refrain from taking other measures to protect his interest.

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[10] Peppard Realty Co., Inc. v. Emdon, 241 N. Y. 588, 150 N. E. 566 (1925) (holding that where defendant was employed orally to procure money to enable plaintiff to bid in his property at foreclosure sale, and property was bid in by another acting for defendant, who transferred bid to defendant, defendant took title as trustee for plaintiff and could not set up statute of frauds to defraud plaintiff). Myers v. Grey, 122 N. Y. Supp. 1079, *aff'd,* 146 App. Div. 923, 131 N. Y. Supp. 1130 (2d Dept. 1911) (holding that an agreement to purchase at a mortgage foreclosure sale and hold the property for the mortgagor's benefit until advances made for purchasing were repaid is enforceable in equity, although it does not comply with the statute of frauds).

[11] Ryan v. Dox, *supra* note 1.

[12] 2 JONES, A TREATISE ON THE LAW OF MORTGAGES OF REAL PROPERTY (8th ed. 1928) §878.