Michigan Law Review

Volume 35 | Issue 5

1937

EQUITY - CONSTRUCTIVE TRUSTS - THIEVES AND EMBEZZLERS AS CONSTRUCTIVE TRUSTEES

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EQUITY — CONSTRUCTIVE TRUSTS — THIEVES AND EMBEZZLERS AS CONSTRUCTIVE TRUSTEES — During the last hundred years the constructive trust has been extended from its original sphere of operation, that of the express trust, into a variety of situations where the wrong consists of tort or crime. This important extension of remedial principles has been facilitated in some cases by describing as confidential or fiduciary certain legal relations which would not ordinarily be so considered.[1] In other cases any requirement of a confidential or trust relationship has been wholly discarded.[2] The process of extension

[1] Riehl v. Evansville Foundry Assn., 104 Ind. 70, 3 N. E. 633 (1885) (bookkeeper); Pioneer Mining Co. v. Tyberg, (C. C. A. 9th, 1914) 215 F. 501 (gang foreman); Warren v. Holbrook, 95 Mich. 185, 54 N. W. 712 (1893) (bar-tender); Preston v. Moore, 133 Tenn. 247, 180 S. W. 320 (1915) (salesman).

[2] Humphreys v. Butler, 51 Ark. 351, 11 S. W. 479 (1888); Newton v. Porter, 69 N. Y. 133 (1877); Nebraska Nat. Bank v. Johnson, 51 Neb. 546, 71 N. W. 294 (1897); Lamb v. Rooney, 72 Neb. 322, 100 N. W. 410 (1904); Aetna Indemnity

has gone so far that Justice Cardozo, in *Beatty v. Guggenheim Exploration Co.*,[3] felt justified in declaring broadly that "When property has been acquired under such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee. . . ." It has been increasingly recognized in modern cases that the constructive trust in many situations is purely a remedial device, "the formula through which the conscience of equity finds expression."[4] The argument that has been most persuasive in making this extension has been that which appeared in *Newton v. Porter*,[5] one of the first theft cases to award the constructive trust: "It would seem to be an anomaly in the law, if the owner who has been deprived of his property by a larceny should be less favorably situated in a court of equity, in respect to his remedy to recover it, or the property into which it has been converted, than one who, by an abuse of trust, has been injured by the wrongful act of a trustee to whom the possession of the trust property has been confided. . . ."

Application to equity may offer the victim of theft or embezzlement certain important advantages. For example, as an equity proceeding it may come under more favorable statutes of limitation,[6] or may be subject only to the flexible doctrine of laches. Likewise, it may enable the plaintiff to escape the risks of jury trial.[7]

Co. v. Malone, 89 Neb. 260, 131 N. W. 200 (1911); Truelsch v. Miller, 186 Wis. 239, 202 N. W. 352 (1925); 43 A. L. R. 1415 at 1422 and 1426 (1926).

[3] 225 N. Y. 380 at 386, 122 N. E. 378 (1919).

[4] Beatty v. Guggenheim Exploration Co., 225 N. Y. 380, 122 N. E. 378 (1919). But compare the language in Chambers v. Chambers, 98 Ala. 454 at 458, 13 So. 674 (1892): "An essential element of all trusts is a use in a person other than the trustee. . . . Not only was this trust wholly wanting in the case as it stood . . . they, on the facts averred, holding this property not to the use of another but for their own benefit and behoof as joint tortfeasors. . . ." This case is fairly typical of the earlier cases which tended to view the constructive trust as not merely a convenient remedial device, but rather as a technical concept closely akin to the express trust. Campbell v. Drake, 39 N. C. 94 (1845); Doyle v. Murphy, 22 Ill. 502 (1859); Pascoag Bank v. Hunt, 3 Ed. Ch. (N. Y.) 583 (1842).

[5] 69 N. Y. 133 at 139-140 (1877).

[6] Lightfoot v. Davis, 198 N. Y. 261, 91 N. E. 582 (1910); Lee v. Gram, 105 Ore. 49, 209 P. 474 (1922); Buie v. Buie, 67 Miss. 456, 7 So. 344 (1889). The applicable statutes prescribe widely varying periods of limitation for equitable actions: fifteen years in Indiana, 2 Ind. Stat. (Burns 1933), § 2-603; ten years in New York, N. Y. Code Civ. Proc. (Parson 1920), § 388; six years in Michigan, 3 Mich. Comp. Laws (1929), § 13976; five years in Illinois, Ill. Stat. (1935), c. 83, par. 16.

[7] This was apparently the reason for resorting to equity in Markworth v. State Savings Bank, 212 Iowa 954, 237 N. W. 471 (1931). But see Pascoag Bank v. Hunt, 3 Ed. Ch. (N. Y.) 583 (1842), and United States v. Bitter Root Development Co., 200 U. S. 451, 26 S. Ct. 318 (1906), to the effect that defendant's de-

A decided advantage of the constructive trust is that it ordinarily permits the recovery of the profit made by the wrongdoer.[8] Alternative legal remedies usually do not permit the recovery of this profit. When it takes the form of an increase in the value of the property converted, the common-law remedy of replevin or its modern statutory substitutes would be available. In most states, however, the defendant is allowed to file a replevin bond, and in the ensuing damage action the measure of damages frequently adopted is the value at the date of the original taking, as in trover.[9] The more recently developed remedy of quasi-contract is no more satisfactory. Despite the fact that it is ordinarily said to be a device for the prevention of unjust enrichment, the usual measure of recovery is market value,[10] rather than the enrichment of the convertor. It is to be recognized, however, that the sale of the article by the thief would enable the victim to recover a judgment for the amount of the proceeds in an action for money had and received, rather than for goods sold and delivered.[11]

privation of his right to jury trial was an affirmative reason against allowing resort to equity. It is to be noted that in all the cases cited in this and the preceding note plaintiff sought only an equitable accounting and did not trace his property into identified proceeds.

[8] Andersen, Meyer & Co. v. Fur & Wool Trading Co., (C. C. A. 9th, 1926) 14 F. (2d) 586; Shearer v. Barnes, 118 Minn. 179, 136 N. W. 861 (1912); Farmers' & Traders' Bank v. Kimball Milling Co., 1 S. D. 388, 47 N. W. 402 (1890); Falk v. Hoffman, 243 N. Y. 199, 135 N. E. 243 (1922).

The life insurance proceeds cases have sometimes been accorded special treatment because of the peculiar social function of life insurance. See 38 A. L. R. 930 (1925) and excellent discussion of the social factor in 35 YALE L. J. 220 (1925).

[9] Barnard v. Corlett, 62 Colo. 226, 161 P. 156 (1916); Florida Trust & Banking Co. v. Consolidated Title Co., 86 Fla. 317, 98 So. 916 (1923); Morrison v. Montgomery, 101 Kan. 670, 168 P. 674 (1917); Sherman v. Clark, 24 Minn. 37 (1877); Knight v. Huber Inv. Co., 102 N. J. L. 359, 132 A. 656 (1925).

For a well reasoned argument to the effect that the measure in a replevin action should not be that used in the trover action, see Allen v. Fox, 51 N. Y. 562 (1873). Various other measures have been applied. Value at issuance of the writ: Duroth Mfg. Co. v. Cauffiel, 243 Pa. 24, 89 A. 798 (1914); Brown v. Kammerman, 168 Ark. 278, 270 S. W. 86 (1925). Value at date of trial: Consolidated Nat. Bank v. Cunningham, 24 Ariz. 437, 210 P. 850 (1922); Gardner v. Brown, 22 Nev. 156, 37 P. 240 (1894); Richey v. Burnes, 83 Mo. 362 (1884); New York Guaranty & Indemnity Co. v. Flynn, 55 N. Y. 653 (1873); Morris v. Coburn, 71 Tex. 406, 9 S. W. 345 (1888). Value at time of verdict: La Vie v. Crosby, 43 Ore. 612, 74 P. 220 (1903).

[10] See Felder v. Reeth, (C. C. A. 9th, 1929) 34 F. (2d) 744, and authorities cited therein. Loss to plaintiff was in effect the measure adopted in Jacobs v. City of Seattle, 100 Wash. 524, 171 P. 662, L. R. A. 1918E 131 (1918). Head v. Porter, (C. C. Mass. 1895) 70 F. 498, suggests that recovery may be had in quasi-contract of defendant's profit through patent infringement. But compare In re Paramount Publix Corp., (D. C. N. Y. 1934) 8 F. Supp. 644. See also, 33 MICH. L. REV. 420 (1935).

[11] WOODWARD, QUASI-CONTRACTS 464 (1913).

This ability to recover profit is of double significance. It not only influences the plaintiff to seek a constructive trust but would also appear to afford a court of equity some justification for taking jurisdiction of the case. When this element is present, the legal remedy is in fact inadequate. That this is inadequacy within the terms of the traditional description of the jurisdiction of equity is the holding in *Falk v. Hoffman.*[12] The case of *King Mechanism & Engineering Co. v. Western Wheeled Scraper Co.*[13] is a decision to the contrary.

The most important advantage of the constructive trust is the tracing mechanism, which is available only in this equitable action. Tracing permits the victim to reach third parties,[14] other than bona fide purchasers, who have received the proceeds, whereas the legal remedy is confined to those who have received the stolen property itself. Of even greater significance is the fact that tracing permits recovery of an equitable claim on specific assets, which is far more valuable to the plaintiff than is an unsecured money judgment against the typically uncollectible defendant. The equitable preferences which result in such cases involve injury to general creditors and raise questions of policy to which insufficient attention has been paid.[15]

[12] 233 N. Y. 199, 135 N. E. 243 (1922). Accord, Safe Deposit & Trust Co. v. Coyle, 133 Md. 343, 105 A. 308 (1918).

[13] (C. C. A. 7th, 1932) 59 F. (2d) 546.

[14] Bank of America v. Pollock, 4 Ed. Ch. (N. Y.) 215 (1843); Newton v. Porter, 69 N. Y. 133 (1877); Massachusetts Bonding & Ins. Co. v. Josselyn, 224 Mich. 159, 194 N. W. 548 (1923); Andersen, Meyer & Co. v. Fur & Wool Trading Co., (C. C. A. 9th, 1926) 14 F. (2d) 586; Truelsch v. Miller, 186 Wis. 239, 202 N. W. 352 (1925); Shafer v. Trowbridge, 28 N. J. Eq. 595 (1877); Holmes v. Gilman, 138 N. Y. 369, 34 N. E. 205 (1893); Vorlander v. Keyes, (C. C. A. 8th, 1924) 1 F. (2d) 67; Hubbard v. Stapp, 32 Ill. App. 541 (1889); Thum v. Wolstenholme, 21 Utah 446, 61 P. 537 (1900); Dayton v. H. B. Claflin Co., 19 App. Div. 120, 45 N. Y. S. 1005 (1897).

[15] On this ground, the Pennsylvania court in the Appeal of Cross and Gault, 97 Pa. 471 at 475 (1881), denied plaintiff an equitable lien on land on which improvements had been made through improper use of guardianship funds. "Were we to establish the doctrine of equitable liens for the purpose of meeting this hard case, it would be like the letting out of water, disaster and confusion would be the result. In vain would the unfortunate judgment-creditor depend upon the dockets and records provided for his protection. Debts that he thought secure would be swept away by the insidious operation of secret equitable liens. With the utmost confidence might he bid in a tract of land to cover his judgment, only to find in the end that he had involved himself, and that perhaps hopelessly, for the benefit of someone else. Nor would a mortagee be in a much better situation, for though he is in a better position than a judgment-creditor, in that he is partially protected by the recording acts, yet he would always be exposed to the danger of having sprung upon him proof of notice of some hidden lien for which he was wholly unprepared. . . . We think, therefore, it is better for us to adhere to the old paths, with which we are well acquainted, rather than to try new ones which may lead us to unexpected disaster."

Where rules of tracing are satisfied, an important group of cases has apparently taken the position that the superiority of the equitable remedy need not be shown, either through defendant's insolvency or a more favorable measure of recovery in equity.[16] The typical explanation is that found in *Warren v. Holbrook*.[17] The court there held that admitted adequacy of the legal remedy was no obstacle to equity jurisdiction, for plaintiff was equitable owner of the funds now held by the embezzler. This explanation is hardly persuasive. Equitable ownership, if it exists, is purely a result of equity's willingness to impose a constructive trust. To reason, therefore, from equitable ownership to a constructive trust is to reason in a circle.

The single conversion situation in which inadequacy of the legal remedies need be shown in order to obtain equitable relief is that in which the defendant has the original article, rather than the proceeds.[18] The explanation usually offered is that the thief, or a successive convertor in possession of the article, has only possession of, and not title to the article.[19] That the trustee must have title to the res is recognized in cases of express trusts. It may be urged, however, that the constructive trust ought to be regarded as only a useful device, rather than a technical concept. It is to be noted that the Ninth Circuit Court of Appeals, in *Andersen, Meyer & Co. v. Fur & Wool Trading Co.*,[20] entirely ignored the fact that it was dealing with the original article and not the proceeds. A mala fide purchaser of the

[16] Of this entire group of cases, Shearer v. Barnes, 118 Minn. 179, 136 N. W. 861 (1912), is probably the most striking. There the embezzler had already transferred to the receiver of the injured corporation assets more than sufficient to cover the liability. Despite this fact, the court awarded a constructive trust on certain traceable proceeds selected by the receiver.

As to whether inadequacy of the legal remedy need be shown when a constructive trust is sought for fraud, see 14 TEX. L. REV. 252 (1936). Lightfoot v. Davis, 198 N. Y. 261, 91 N. E. 582 (1910); Fur & Wool Trading Co. v. G. I. Fox, Inc., 245 N. Y. 215, 156 N. E. 670 (1927); Andersen, Meyer & Co. v. Fur & Wool Trading Co., (C. C. A. 9th, 1926) 14 F. (2d) 586; Preston v. Moore, 133 Tenn. 247, 180 S. W. 320 (1915); Humphreys v. Butler, 51 Ark. 351, 11 S. W. 479 (1888); Thum v. Wolstenholme, 21 Utah 446, 61 P. 537 (1900); 3 BOGERT, TRUSTS AND TRUSTEES 1458 (1935), cites further authorities.

[17] 95 Mich. 185, 54 N. W. 712 (1893).

[18] Rawll v. Baker-Vawter Co., 187 App. Div. 330, 176 N. Y. S. 189 (1919). Beasley v. Allyn, 15 Phila. (Pa.) 97 (1882). But compare Krusen Land & Timber Co. v. Tampa Suburban Corp., 118 Fla. 173, 158 So. 712 (1935); Pound, "Progress of the Law—Equity," 33 HARV. L. REV. 420 at 428 (1920).

[19] 25 MICH. L. REV. 313 (1927); 3 BOGERT, TRUSTS AND TRUSTEES 1471 (1935).

[20] (C. C. A. 9th, 1926) 14 F. (2d) 586; Corn Exch. Nat. Bank v. Solicitors' Loan & Trust Co., 188 Pa. 330, 41 A. 536 (1898), awards a constructive trust under circumstances that are identical, except that the wrong is fraud, rather than theft.

stolen property was called a constructive trustee, and that in spite of an admittedly adequate legal remedy.

It is true that in a number of cases in which recovery is allowed without any showing of inadequacy of the legal remedy the relations between the parties were originally of a fiduciary or quasi-fiduciary character.[21] Since one of the traditional heads of equity jurisdiction is the existence of fiduciary relations, this factor must be given some weight. It is not likely, however, that it has greatly influenced the courts in their decisions. The constructive trust cases are noticeably liberal in their application of the fiduciary label. Even a bar-tender,[22] a gang foreman,[23] an ordinary salesman,[24] and a bookkeeper[25] have been so classified. Other cases entirely ignore the absence of any fiduciary relationship.[26] It is the Nebraska court in *Aetna Indemnity Co. v. Malone*,[27] however, that makes its position perfectly clear. "Confidential relations are not essential to the jurisdiction of a court of equity to declare and enforce a trust with respect to stolen property. . . . In contriving means to cheat an owner out of his property, a thief should not be permitted to out-strip the courts in discovering a remedy to restore it when found. . . ."

The constructive trust is to be justified largely from a social standpoint. It discourages tortious acts by removing the profit incentive. Extension of the remedy into the field of theft and embezzlement is therefore desirable. Altogether untenable is the position described by a recent commentator,[28] that the "suppression of crime is an office of

[21] Bank of America v. Pollock, 4 Ed. Ch. (N. Y.) 215 (1843) (cashier of bank); Massachusetts Bonding & Ins. Co. v. Josselyn, 224 Mich. 159, 194 N. W. 548 (1923) (administrator); Farmers' & Traders' Bank v. Kimball Milling Co., 1 S. D. 388, 47 N. W. 402 (1890) (bank president); Jones v. Carpenter, 90 Fla. 407, 106 So. 127, 43 A. L. R. 1409 (1925) (president of corporation); National Mahaiwe Bank v. Barry, 125 Mass. 20 (1878) (bank clerk); Shearer v. Barnes, 118 Minn. 179, 136 N. W. 861 (1912) (president of corporation); Thum v. Wolstenholme, 21 Utah 446, 61 P. 537 (1900) (director of bank); Hubbard v. Stapp, 32 Ill. App. 541 (1889) (bank employee); Vorlander v. Keyes, (C. C. A. 8th, 1924) 1 F. (2d) 67 (bank president); Holmes v. Gilman, 138 N. Y. 369, 34 N. E. 205 (1893) (partner); Shaler v. Trowbridge, 28 N. J. Eq. 595 (1877) (partner); 43 A. L. R. 1415 at 1425 (1926) (corporation officers).

[22] Warren v. Holbrook, 95 Mich. 185, 54 N. W. 712 (1893).

[23] Pioneer Mining Co. v. Tyberg, (C. C. A. 9th, 1914) 215 F. 501.

[24] Preston v. Moore, 133 Tenn. 247, 180 S. W. 320 (1915).

[25] Riehl v. Evansville Foundry Assn., 104 Ind. 70, 3 N. E. 633 (1885).

[26] Newton v. Porter, 69 N. Y. 133 (1877); Nebraska Nat. Bank v. Johnson, 51 Neb. 546, 71 N. W. 294 (1897); Lamb v. Rooney, 72 Neb. 322, 100 N. W. 410 (1904); Humphreys v. Butler, 51 Ark. 351, 11 S. W. 479 (1888); Truelsch v. Miller, 186 Wis. 239, 202 N. W. 352 (1925).

[27] 89 Neb. 260 at 263, 131 N. W. 200 (1911).

[28] 35 YALE L. J. 220 at 227 (1925).

the criminal law rather than the civil law; the latter should not be shaped to encompass the ends of the former." It is not to be supposed, however, that the courts give much express recognition to the functional aspect of the remedy. The Oregon court, in *Lee v. Gram*,[29] is one of the few. It suggests, moreover, that the remedy be limited to conversions involving criminal, rather than merely civil liability. The cases conform to this description, if only because in fact the existence of one without the other is statistically rare. On principle this distinction leads to broad questions of policy, whether a higher degree of culpability should be required for the use of the more severe remedy, and, if so, whether the line between civil and criminal liability should be used to describe the bounds of the remedy. Through the constructive trust in its modern development courts have undertaken to discourage theft and embezzlement and to extend traditional concepts of property ownership with the help of tracing machinery, which has apparently become available even when alternative remedies are entirely adequate.[30]

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[29] 105 Ore. 49, 209 P. 474 (1922).

[30] On the subject of thieves as constructive trustees, see further, 37 YALE L. J. 654 (1928); 12 N. C. L. REV. 400 (1934).