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Constructive Trust and Equitable Lien: Status of the Conscious and the Innocent Wrongdoer in Equity

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CONSTRUCTIVE TRUST AND EQUITABLE LIEN: STATUS OF THE CONSCIOUS AND THE INNOCENT WRONGDOER IN EQUITY

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GENERAL CONSIDERATIONS

The field of restitution, broadly considered, involves all those situations in which a person who holds property (or has consumed it) must deliver it (or its value) to the claimant in order to prevent the unjust enrichment of the holder. In this sense the ancient common law writs for the recovery of chattels or their value (detinue, replevin, and trover) and land (ejectment) are perceived to be restitutionary in character. A more modern development in the law courts, the allowance of quasi-contractual relief upon the common counts in general assumpsit, rests upon the same basis. In a leading English case, Lord Mansfield states the true basis of the latter obligation.

> If the defendant be under an obligation, from the ties of natural justice to refund, the law implies a debt, and gives this action founded in the equity of the plaintiff's case, as it were upon a contract ('quasi ex contractu') as the Roman law expresses it. . . . This kind of equitable action, to recover back money, is very beneficial, and therefore much encouraged. It lies only for money which, ex aequo et bono, the defendant ought to refund.[1]

Contract sounded in promise but quasi-contract had its roots in the notion of unjust enrichment.

It is, of course, old learning that the Courts of Chancery quickly and energetically concerned themselves with restitution and it became a major field of equity jurisprudence. It is with the most prominent of the equitable remedies against unjust enrichment, the constructive trust and the equitable lien, that this paper deals. While the constructive trust and the equitable lien are derived from the same basic jurisprudential considerations, their operation is quite different. Furthermore, in some instances the plaintiff has at his option the enforcement of a constructive trust or an equitable lien, in other situations he may enforce one but not the other, while in some situations he may enforce neither one. Specifically, this paper will address itself to the factors that determine which, if any, of these remedies is available, and incidentally address itself to the consequences of the allowance of a particular remedy.[2]

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1. Moses v. Macferlan, 2 Burr. 1005, 1008, 97 Eng. Rep. 676, 677 (K.B. 1760).

2. While this paper will not deal with them, Equity grants two other remedies which may be restitutionary in character:

Numerous attempts have been made to define the nature of the constructive trust. The *Restatement* declares that "where a person holding property is subject to an equitable duty to convey it on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises."[3] Obviously in one sense the "definition" is but a starting point since we are still faced with the substantive problem of what constitutes an unjust enrichment. However, even on this score, the definition focuses attention on the central point involved, that the constructive trust is a purely procedural device to effect a result and is not to be confused with the substantive issues determining its invocation. Furthermore, it is quite clear that the constructive trust is thus sharply distinguished from the express trust.

> An express trust is a fiduciary relationship with respect to property, arising as a result of an intention to create it and subjecting the person in whom title is vested to equitable duties to deal with it for the benefit of others. On the other hand, a constructive trust arises where a person holding the 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 is not based on the intention of the parties but is imposed in order to prevent one of them from being unjustly enriched at the expense of the other, while an express trust arises because the parties intended to create it.[4]

Over and over again the cases and the writers emphasize the remedial character of the constructive trust. Judge Cardozo writes that "a constructive trust is a formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity

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A. Right of Subrogation: Where property of one person is used in discharging an obligation owed by another or a lien upon the property, under such circumstances that the other would be unjustly enriched by the benefit thus conferred, the former is entitled to be subrogated to the position of the obligee or lien holder. RESTATEMENT (SECOND), TRUSTS § 202, comment *g* (1957). See also Title Guarantee & Trust Co. v. Haven, 169 N.Y. 487, 89 N.E. 1082 (1909).

B. Equitable Accounting: Several cases have extended the traditional equitable accounting to cover the case of a thief, *Lightfoot v. Davis,* 198 N.Y. 261, 91 N.E. 582 (1910); and a receiver of stolen goods, *Fur-Wool Trading Co. v. Fox,* 245 N.Y. 215, 156 N.E. 670 (1927).

Furthermore, a plaintiff who comes into Equity for the purpose of tracing will not be left to his legal remedy if he proves unable to trace. Equity, having acquired jurisdiction, will retain it for the purpose of giving a personal judgment. Fur-Wool Trading Co. v. Fox, *supra.* See also Anderson Meyer & Co. v. Fur & Wool Trading Co., 14 F.2d 586 (9th Cir. 1927); SCOTT, TRUSTS § 522 (2d ed. 1956); Comment, *The Thief as Constructive Trustee,* 37 YALE L.J. 654 (1928). Compare United States v. Bitter Root Development Co., 200 U.S. 451 (1905).

3. RESTATEMENT (SECOND), TRUSTS § 160 (1957).

4. SCOTT, TRUSTS § 462.1. See Meinhard v. Salmon, 249 N.Y. 545, 547, 164 N.E. 542 (1928).

converts him into a trustee."[5] And Dean Pound describes the constructive trust as "specific restitution of a received benefit in order to prevent unjust enrichment."[6]

It seems that there is no little uncertainty as to the nature of the equitable lien. A common law judge has described it as "intensely undefined", and an eminent federal judge has labelled it "mysterious".[7] Careful analysis has at least delimited the two main areas in which the equitable lien is imposed. The first and most common example of its use is stated by Professor Pomeroy:

> The doctrine may be stated in its most general form, that every express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property, real or personal, or fund, therein described or identified, a security for the debt or other obligation, or whereby the party promises to convey or assign the property as security, creates an equitable lien upon the property so indicated, which is enforceable against the property not only in the hands of the original contractor, but his heirs, administrators, executors, voluntary assignees and purchasers or encumbrancers with notice.[8]

The classic examples of an equitable lien are rooted in consent, and considered an application of the equitable doctrine of specific performance and the doctrine that equity does that which ought to be done.[9]

Secondly, an equitable lien also arises upon general considerations of justice (*ex aequo et bono*) in order to prevent unjust enrichment. Thus, Mr. Chief Justice (then Dean) Stone writes that equitable liens may be classified into "the equitable mortgage or lien which is quasi-contractual in its origin and the equitable mortgage which is based on the concensus or agreement of the parties to it. The former is based on the duty and power of equity to compel restitution. . . ."[10] It is the "restitutionary" equitable lien with which we are concerned.

At the outset the theory of the constructive trust must not be confused with that of the equitable lien. The constructive trust proceeds upon the

5. Beatty v. Guggenheim Exploration Co., 225 N.Y. 380, 386, 122 N.E. 378 (1919).

6. Pound, *Progress of the Law,* 33 HARV. L. REV. 420, 421 (1920). As to the point at which the constructive trust arises compare SCOTT, TRUSTS § 462.4 (2d ed. 1956) and cases therein cited with the opinion of Judge Parker in *International Refugee Organization v. Maryland Drydock Co.,* 179 F.2d 281, 287 (5th Cir. 1950), and BOGERT, TRUSTS § 77 (2d ed. 1942).

7. Brunshon v. Allard, 2 El. & El. 19, 121 Eng. Rep. 8 (K.B. 1859) (Erle, J.); Sammet v. Mayer, 108 F.2d 337 (2d Cir. 1939) (Clark, J.).

8. 3 POMEROY, EQUITY JURISPRUDENCE § 1235 (1905). See excellent discussion in *In re* Interborough Consol. Corp., 288 Fed. 334 (2d Cir. 1923).

9. Compare Stone, *Equitable Mortgage in New York,* 20 Colum. L. REV. 519, 521 (1920) with Daggett v. Rankin, 31 Cal. 321 (1866) and 3 POMEROY, EQUITY JURISPRUDENCE § 1235 (3d ed. 1905).

10. Stone, *op. cit. supra,* note 9 at 521.

rationale that the specific res must be considered in equity as the property of the plaintiff and not of the title holder. The decree entered recognizes this and orders the defendant constructive trustee to deliver up the property. On the other hand, a lien is the right to have specific property subjected to the payment of the debt since the property is viewed as belonging to the defendant but subject to a security interest on behalf of the plaintiff.[11] Now the property subject to the lien or trust may have a value in excess of or below the amount of the plaintiff's claim. Thus, the choice of remedy will often be determinative of the amount of the recovery. Hence we must examine the considerations which govern the availability of these remedies. While there are a number of ways in which to approach the problem, it seems to me that the cases may best be viewed for our purposes, not in terms of the particular types of claims involved but in relation to the types of defendants involved, specifically the moral status of the defendant. At any rate, we shall proceed within that framework.

THE CONSCIOUS WRONGDOER

Where *D* consciously converts the property of *P* it is clear that the common law actions of replevin and trover would lie. In addition many states allow *P* to proceed in quasi-contract to recover the value of the converted property. Furthermore, at common law, a bona fide purchaser from a converter is also a converter since his transferor, *D*, could not pass the legal title to the newly acquired property even though the transfer was procured under circumstances making it voidable. *P* may now bring a bill in equity to have *D* declared a constructive trustee of the property and an order will be entered compelling *D* to deliver up the res to *P*. However, it is generally held that *P* may not impress a trust upon the property and obtain a personal deficiency judgment against the converter should the value of the res be less than the amount of *P's* claim.[12] In such a case *P*

11. Hanney v. Colwell, 314 Ill. App. 203, 41 N.E.2d 123, 124 (1942); Shipley v. Metropolitan Life Ins. Co., 25 Tenn. App. 452, 158 S.W.2d 739, 741 (1941). It is interesting to note that many courts and writers still mouth the old doctrine that such a lien is not a property right. It would seem, however, that any post-Hohfeldean should consider the right to subject a particular piece of property to the payment of a debt as a valuable property right. Equitable liens are distinguished from equitable assignments in *In re* Stiger, 202 Fed. 791 (D.N.J. 1913), *aff'd*, 209 Fed. 148 (3d Cir. 1913), *aff'd per curiam*, 239 U.S. 629 (1915).

12. The theory is that *P* has "adopted" the transaction by claiming the res as his property and thus it would be inconsistent for him to proceed against *D* as a wrongdoer. See Hewitt v. Hayes, 205 Mass. 356, 91 N.E. 332 (1910); M'Garity v. Simpson, 148 Ga. 146, 95 S.E. 968 (1918). And it has been held that the doctrine of election of remedies would prevent an action for damages and an attempt to obtain specific restitution from a third person. Carter v. Gibson, 61 Neb. 207, 85 N.W. 45 (1901). *But see* Title Insurance & Trust Co. v. Ingersoll, 158 Cal. 474, 111 Pac. 360 (1910) for a contrary philosophy. For a general criticism of the doctrine of election of remedies see *Clark, Code Pleading* § 77 (1931).

would proceed upon a different theory by seeking a personal judgment against *D*, and an order declaring that the res be subject to an equitable lien as security for repayment. "The beneficial owner," writes Jessel, M.R., in the leading case on the subject, "has a right to elect either to take the property purchased, or to hold it as security for the amount of the trust money laid out in the purchase; or as we generally express it, he is entitled at his election either to take the property, or have a charge on the property for the amount of the trust money."[13] Obviously, where *D* is solvent, trover or an action in quasi-contract should yield the same economic result as the equitable lien suit in equity.

A traditional situation illustrating the use of the constructive trust and equitable lien against an intentional wrongdoer may be seen in those cases involving the plaintiff whose moneys have been fraudulently used by another in the purchase of real property. It is the general rule here that a constructive trust will arise in favor of the person whose money was wrongfully used and it is irrelevant whether the relationship between the parties was that of a fiduciary or stranger.[14] Thus, under orthodox equity jurisprudence, the cestui may have the title to the property transferred to himself if it is in the hands of the wrongdoer or any person not a bona fide purchaser for value.[15] Two early American cases held that a constructive trust will not arise from the wrongful use of money in the purchase of real estate where the fraudulent party could be punished criminally for theft.[16] But these cases are generally held to be unsound, and have been repudiated by other courts.[17] Indeed, they are no longer authority even in their own jurisdictions.[18] Furthermore, it is well settled that one who purchases realty in such circumstances as would entitle the imposition of a trust *in invitum* cannot defeat that right on the ground that it is homestead property and exempt from the claims of creditors.[19] The reason is obvious: *P* claims as owner, not as creditor.

While the remedy most generally invoked in these cases is that of constructive trust, an equitable lien may also be impressed in a proceeding

13. *In re Hallet's Estate,* 13 Ch. D. 696, 709 (1879). While this case dealt with property acquired by expenditure of trust moneys, its principle has been held applicable whether there was a fiduciary relationship or not. See 4 SCOTT, TRUSTS § 508 (2d ed. 1956); see also cases in note 14 *infra.*

14. Humphreys v. Butler, 51 Ark. 351, 11 S.W. 479 (1889); Preston v. Moore, 133 Tenn. 247, 180 S.W. 320 (1915).

15. Cisewski v. Cisewski, 129 Minn. 284, 152 N.W. 642 (1915).

16. Pascoag Bank v. Hunt, 3 Ed. Ch. (N.Y.) 583 (1842); Campbell v. Drake, 39 N.C. 4 (1845).

17. See, *e.g.,* Riel v. Evansville Foundry Ass'n, 104 Ind. 70, 3 N.E. 633 (1885).

18. Bank of America v. Pollack, 4 Ed. Ch. (N.Y.) 215 (1843); Newton v. Porter, 69 N.Y. 133 (1891); Edwards v. Cuberson, 111 N.C. 342, 16 S.E. 233 (1892).

19. "It would shock one's sense of what is equitable." Preston v. Moore, 133 Tenn. 247, 180 S.W. 320 (1915); see also cases collected in Annots., 43 A.L.R. 1415, 1446 (1926); 47 A.L.R. 371 (1927); and 48 A.L.R. 1269 (1928).

to recover the amount of money fraudulently used and to have a court of equity treat the property as security for repayment.[20]

Since in this situation *P* has an option to enforce a trust or a lien, the basis for his decision will be an economic one. If the res is above the value of the money originally misused, *P* will seek to impress a constructive trust since he will be entitled to the property itself.[21] Where, however, the value of the res is below the amount of the claim, *P* will seek a personal judgment for the amount of the claim with a lien against the property as partial security for repayment. Where the res is below the value of the claim, but *D* is insolvent, *P* would still enforce a lien rather than a trust since he would receive the value of the property *plus* a claim for the deficiency.

Where the wrongdoer merely improves his property with the funds it seems that *P* will not be allowed to enforce a constructive trust against the land but will be confined to an equitable lien.[22] This means that *P* can recover only the amount of the debt, and not the value of any appreciation. Courts fear giving *P* too great a windfall. On principle, however, the result is hard to justify. If *D* converts $1,000 of *P's* money and adds to it $1,000 of his own money and purchases realty which subsequently appreciates in value, *P* is entitled to a one-half share in the appreciated property. However, if *D* purchases land with his own $1,000, and subsequently uses the converted $1,000 to improve the land and the land appreciates in value, *P* may impress a lien on the property for only $1,000. It would seem that here also *P* should be entitled to claim a one-half share since the underlying principle of the constructive trust and equitable lien is to shift the risk of market losses upon the wrongdoer while at the same time preventing him from claiming any benefits from an upswing in the market.

Where the wrongdoer uses the money to improve the land of a third person, *P* may enforce a lien on the property, at least where the third person knew that the improvements were made with *P's* money.[23] (Where the third person had no notice but cannot qualify as a bona fide purchaser the problem is more difficult and in fact is to be determined in light of the general considerations applied to the "innocent wrongdoer").[24]

20. E. Bowman & Son Co. v. Henn, 239 Mass. 200, 131 N.E. 334 (1921); Day v. Roth, 18 N.Y. 448 (1848). See Annot., 43 A.L.R. 1415, 1442 (1926).

21. *But see* Greene v. Greene, 56 S.C. 193, 34 S.E. 249 (1899). This case limited the recovery to the amount of the money converted. McIver, C. J., dissented.

22. Finley v. Hughes, 106 F. Supp. 355 (E.D.S.C. 1952); 4 SCOTT, TRUSTS, § 512 (2d ed. 1956). For a careless enunciation of the rule see 43 A.L.R. 1415 at 1418 (1926)— a sweeping statement, citing no cases in its support, implying that constructive trusts will be allowed even in improvement cases.

23. Gray v. Huffaker, 176 Cal. 516, 169 Pac. 1038 (1917); Cunningham v. Kinnerk, 230 Mo. App. 749, 74 S.W.2d 1107 (1934).

24. 4 SCOTT, TRUSTS § 514.2 (2d ed. 1956). *Compare* RESTATEMENT (SECOND), TRUSTS § 120, comment *b* (1957) *with* § 108.

A much more difficult problem involves the fraudulent use of another's money for the payment of insurance premiums on the life of the wrongdoer. Where the funds have been so misappropriated the courts will allow some sort of recovery against the proceeds. The question is whether recovery will be limited to the amount of the money wrongfully used to pay the premiums or whether the entire proceeds may be made available to the claimant.[25] The leading case on the subject is one in which the husband gave his wife several insurance policies the premiums of which were paid with misappropriated partnership funds. The New Jersey Court held that the entire proceeds were impressed with the trust—and this represents the decided weight of authority.[26] The general rationale has been to treat the situation as identical with any other case of a wrongdoer's use of the claimant's money in obtaining property.[27] Indeed, some courts seem to feel that a contrary result would violate the natural order of things. Thus we read that "without a disregard of those fundamental rules of equity jurisprudence there is no logical or rational way of escape from the conclusion of the court below that, when the insured paid with funds of the bank . . . he became a trustee *ex maleficio*."[28]

Numerous distinctions have been urged to differentiate the life insurance cases from the more usual case of the wrongful use of another's money to obtain property. On the whole, they have not proved to the courts to be compelling. For example, it has been argued that, since the claimant ordinarily has no insurable interest in the life of the wrongdoer, had he taken out the policy and paid the premiums he would have been unable to collect because it would have been a gambling contract. *Ergo,* he should not be allowed to collect the proceeds here. However, this is clearly a *non sequitur* since in this case the insurance contract is a valid one and public policy is against allowing a wrongdoer or his successor in interest to profit from the wrongful use of another's money.[29] The fact that insurance proceeds are

25. Insurance is an aleatory contract and involves uncertainty as to the amount of profit or loss. If the insured dies promptly, a large profit results, but if he lives beyond his life expectancy, he may have paid more than his beneficiary will receive. This discussion, of course, assumes an excess of proceeds over premiums—a "prompt" death.

26. Shaler v. Trowbridge, 28 N.J.Eq. 595 (1877); Holmes v. Gilman, 138 N.Y. 369, 34 N.E. 205 (1893); 4 SCOTT, TRUSTS § 508.4 (2d ed. 1956). The cases are collected in 24 A.L.R.2d 672 (1952). For an early article see Williston, *Can an Insolvent Debtor Insure His Life for the Benefit of His Wife,* 25 AM. L. REV. 185 (1891).

27. 4 SCOTT, TRUSTS § 508.4 (2d ed. 1956). And where a part of the premiums have been paid with misappropriated funds, a constructive trust *pro tanto* will be impressed. Massachusetts Bonding and Ins. Co. v. Josselyn, 224 Mich. 159, 194 N.W. 548 (1923).

28. Per Sanborn, C. J., in Vorlander v. Keyes, 1 F.2d 67, 70 (8th Cir. 1924). See the opinion of Peckham, J., in Holmes v. Gilman, *supra* note 26 at 384, 34 N.E. at 209.

29. 4 SCOTT, TRUSTS § 508.4 (2d ed. 1956).

exempt by statute in nearly all states from the claims of creditors cannot be urged as a bar to recovery since the claim here is as owner, not creditor.[30] And while it may be true that the beneficiary of the policy is frequently the wife or minor child, it may be answered that the wife in no way stands in a different position than that of an innocent transferee and should not receive the protection afforded to a bona fide purchaser.

Nonetheless, the majority view is not a unanimous one. In some states it has been held that recovery will be limited to the amount of money misappropriated and used to pay premiums.[31] I submit that where the beneficiary of the policy is the wife or the minor child recovery should be limited to a charge against the proceeds for the amount of the money wrongfully used in premium payments.[32] Life insurance has its origin in a desire to protect the interests of the family, and the law has recognized its great social value by affording it special treatment. Nearly all states exempt the proceeds of life insurance in the hands of the wife or dependent from the claims of decedent's creditors.[33] Statutes and case law in many states allow an insolvent debtor to purchase insurance to a reasonable amount for the protection of dependents.[34] The so-called incontestability clause, required by statute in many states, is another example of the social interests to be protected within an insurance system.[35] While in these situations there has been no wrongful use of another's property or money, it is nonetheless clear that life insurance because of its very nature is often given special treatment.

The effect of a constructive trust is often to give a benefit or windfall to *P*. While ordinarily this may be justified on the rationale that there is a public policy against allowing a wrongdoer to benefit by his misuse of property, it would seem that here the countervailing public policy is stronger. Professor Scott states the case when he writes:

> Where the wrongdoer takes out a policy of insurance payable to his wife, it is extremely harsh to deprive her of all interest in the policy even though the proceeds were in fact paid with misappropriated money. If the wrongdoer had funds of his own which he might have applied to the payment of the premiums, it may be somewhat accidental whether he happens to use his own funds or those which he had misappropriated. If he had otherwise expended the mis-

30. See note 19, *supra*.

31. Tolman v. Crowell, 288 Mass. 397, 193 N.E. 60 (1934); and see Exchange St. Bank v. Poindexter, 137 Kan. 101, 19 P.2d 705 (1933), where recovery was allowed to the limit of the misappropriated funds, although not all the funds were used in the payment of premiums.

32. See the excellent discussion in Comment, 35 Yale L.J. 220 (1925).

33. See, e.g., MASS. ANN. LAWS ch. 175, § 125 (1955). 4 SCOTT, TRUSTS § 508.4 (2d ed. 1956).

34. Washington Central Bank v. Hume, 128 U.S. 195 (1888). Comment, 35 YALE L.J. 220 (1925).

35. VANCE, INSURANCE § 97 (3rd ed. 1951).

> appropriated funds and had used his own funds in paying the premiums, the claimant would have no interest in the policy, and the widow would have taken the whole of the proceeds.[36]

He writes further that: "Although the result is somewhat harsh . . . if a trust is not imposed the wrongdoer might well be tempted to misappropriate money in the hope of increasing his estate thereby."[37] The deterrence rationale has been questioned and has not gone unchanged. It depends on the assumption that the wrongdoer is concerned with and motivated by a detailed knowledge of the legal aspects of his acts. "Whether or not this permitting a recovery on the policy will encourage wrongdoing is after all only a matter of conjecture."[38] And even if there is some basis for the general philosophy of deterrence, it is here outweighed by other considerations, calling for an exception to the general rule. Indeed, one writer has gone further and categorically rejected the basic rationale of deterrence: "The suppression of crime is the office of the criminal law rather than the civil law; the latter should not be shaped to encompass the ends of the former. And if the decisions are to be sustained because of the effect on crime, it would seem that the increase should go to the state as a penalty."[39]

By way of summary we see that the argument in favor of limiting recovery to the amount of the premiums paid comes to this:

> The defrauded person's recovery of the trust res, in cases of constructive trust has been aptly termed a 'windfall', and in cases of ordinary investment of trust property there seems to be no reason why he should not get it in the absence of a better claim. But since in life insurance the increase over the misappropriated funds invested as premiums would go to a person who gives nothing in return for it, it is suggested that his claim has not as great equitable strength as that of the dependent beneficiary. Moreover, the investment of part of the stolen funds in insurance lulls the dependents into a feeling of security, and prevents them from taking out the insurance in some legitimate way.[40]

It is, perhaps, in the tracing of property into money that one sees most clearly the extent to which the Chancellor has gone to protect the position of the defrauded party as against the conscious wrongdoer—and his creditors.

At one time it was considered impossible to follow misappropriated property into money. It was thought that when misappropriated property was sold for money the owner was not entitled to follow the proceeds because, as it was said, "money has no earmarks."[41] It was, of course, never

36. 4 SCOTT, TRUSTS § 508.4 (2d ed. 1956).
37. *Ibid.*
38. Comment, 35 YALE L.J. 220 at 227 (1925).
39. *Ibid.*
40. *Ibid.*
41. 4 SCOTT, TRUSTS § 508.2 (2d ed. 1956). See also § 515.

denied that in theory the constructive trust and the equitable lien necessitated the existence of a specific res.[42] By the first part of the 19th century Lord Ellenborough was able to hold that the claimant's right to trace ceased only when the wrongdoer mingled the money into a general indistinguishable mass.[43] In 1880, in a prominent English case, the Master of the Rolls ruled that where a fiduciary, whether a trustee or not, wrongfully mixes the money of his principal with his own, the principal is entitled to a charge on the entire mass.[44] One year later the United States Supreme Court accepted this result in what has become the leading American case on the subject.[45] And the principle of the case, the allowance of the charge against the entire mass, has not been limited to situations where the wrongdoer is a fiduciary.[46]

Thus we have it that if the claimant's own money is mingled with the money of the wrongdoer it does not prevent tracing and the imposition of a charge.[47] Such a result is obviously a fair one. There is no reason why any person whose money has been wrongfully taken by another and mingled with the wrongdoer's money should not be entitled to a charge on the mass. While the claimant cannot point to any specific property, this is no reason to deny the charge since this is the fault of the wrongdoer. Nor can this be considered unfair to the creditors of the wrongdoer since while they may be entitled to payment it cannot be asserted that they are entitled to payment out of property wrongfully appropriated.[48]

While it is no longer open to question that it is sufficient to trace money into a bank account in order to place an equitable charge upon the whole mass, a further question arises when there are withdrawals from the commingled mass (typically the bank account). It is here that we run into a potential conflict with the rule that there must be a specific traceable res. Here Equity creates certain presumptions in respect to the order of withdrawal, in order to aid the claimant. Where money is withdrawn it is presumed that it is from the funds of the wrongdoer. "Where a man does

42. "So long as it can be identified as either the original property of the cestui or the product of it equity will follow it; and the right of reclamation attaches to it until detached by the superior equity of a bona fide purchaser for a valuable consideration without notice. . . . But the right of pursuing it fails when the means of ascertainment fail." Per Lewis, J., Thompson's Appeal, 22 Pa. 16, 17 (1853); Little v. Chadwick, 151 Mass. 109, 110-11, 23 N.E. 1005 (1890).

43. Taylor v. Plumer, 3 M. & S. 562, 105 Eng. Rep. 721 (K.B. 1815).

44. *In re* Hallet's Estate, 13 Ch. D. 696 (1879).

45. National Bank v. Insurance Co., 104 U.S. 54 (1881).

46. St. Louis & San Francisco Ry. Co. v. Spiller, 274 U.S. 304 (1927). This is the rule—at least in the United States.

47. Cases are collected in 26 A.L.R. 3 (1923), 35 A.L.R. 747 (1925), 55 A.L.R. 1275 (1928), 102 A.L.R. 372 (1936).

48. 4 SCOTT, TRUSTS § 515 (2d ed. 1956); *In re* Liebman, 189 Misc. 282, 60 N.Y.S. 2d 482 (1945).

an act which may be rightfully performed," said Jessel, M.R., "he cannot say that the act was done wrongly."[49] It is only after the private funds are exhausted that the trust funds will be presumed invaded.[50] It is interesting to note, however, that this doctrine is not pushed to its logical conclusion. If the wrongdoer subsequently withdraws a portion of the mingled funds less than the amount claimed, and invests it in securities which later appreciate in value and then depletes the remainder of the funds, the plaintiff has been allowed to take the investments made with the first withdrawals. "It is in my opinion equally clear," said Joyce, J., "that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, he cannot maintain that the investment which remains represents his money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust."[51] Thus if the presumption is advantageous to the cestui he may invoke it; if it is not, it will not be applied.[52]

While the results of the commingled fund cases are by and large satisfactory, it would seem that the theoretical basis of the decisions shows a certain amount of confusion, especially in failing to distinguish between the constructive trust and the equitable lien. First one label, then the other, is tossed around in an attempt to reach a desirable result, and the courts become lost in vague and artificial presumptions in the hope of extricating themselves from what they remotely realize to be conceptual difficulties in their solutions. Certainly the presumptions as to withdrawal are pure fictions as to the intent of the wrongdoer and add nothing to our analysis. "There is no reason to believe that the wrongdoer who was dishonest in mingling the funds should suddenly become honest in making the withdrawals. There is no reason why the claimant's rights should be less where the wrongdoer has continued to be dishonest than where he has turned honest."[53]

A more cogent rationale for the cases has been advanced by Professor Scott.

> The claimant has an equitable lien upon the mingled fund, and when a part of the fund is withdrawn he has an equitable lien upon the part withdrawn and on the part which remains. . . . [If] the part which is withdrawn is preserved and the part which remains

49. *In re* Hallet's Estate, *supra* note 44.

50. Numerous cases are collected in 102 A.L.R. 375 (1936). There is no presumption that subsequent deposits go to the restoration of invaded trust funds. James Roscoe (Bolton) Ltd. v. Winder, [1915] 1 Ch. D. 62; Hewitt v. Hayes, 205 Mass. 356, 91 N.E. 332 (1910). See 4 SCOTT, TRUSTS §§ 516, 517 (2d ed. 1956).

51. *In re* Oatway, [1903] 2 Ch. D. 356, 360.

52. But some courts have followed the presumptions literally. Orr v. Rose, 169 Okl. 387, 37 P.2d 300 (1934); 4 SCOTT, TRUSTS § 517.1 (2d ed. 1956).

53. 4 SCOTT, TRUSTS § 517 (2d ed. 1956). And see the opinion of Judge L. Hand in Pumean v. Granfield, 184 Fed. 480, 484 (C.C.S.D.N.Y. 1911); and *In re* A. O. Brown & Co., 189 Fed. 432, 434 (S.D.N.Y. 1911).

> is subsequently dissipated, the claimant has an equitable lien upon the part which remains. . . . It is impossible and unnecessary to determine whether the claimant's money is included in the part which remains.[54]

Such a view leads Professor Scott to disagree with the result reached in a leading Michigan case.[55] There the withdrawals reduced the deposit to an amount not greater than the amount of claimant's money. The balance was subsequently invested in securities which appreciated greatly in value. A trust was fastened upon the securities by applying the fictitious presumptions as to the order of withdrawals. In disapproving of the case, Professor Scott argues that the cestui should be entitled to a lien on the proceeds to the amount of the funds misappropriated, but if he seeks to enforce a constructive trust, he should be entitled only to a pro rata share of the proceeds; *i.e.*, when the purchase is out of mingled property a constructive trust on the acquired property should be in proportion to the amount the claimant's money bore to the entire fund. If the bank account still had the remaining funds in it, a lien would exist on it for the balance of the claim. This view seems satisfactory both on policy and theoretical grounds.

A review of the cases dealing with the conscious wrongdoer can leave little doubt as to the disfavor with which he is viewed in Chancery. Every attempt is made to deprive him of any gains related to his wrongdoing while the risks of the market are invariably cast upon him. By way of contrast to the position of the conscious wrongdoer, we may note the position of the bona fide purchaser before the courts of equity.[56] He is the most favored of creatures, and it is said that equity will not raise its hands against him. He takes free and clear of all equitable claims. "The doctrine of bona fide purchaser may have the effect of cutting off a constructive trust already existing, and it may have the effect of preventing a constructive trust from arising."[57] The ancient rules have been declared by statute in many states.[58]

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54. 4 SCOTT, TRUSTS § 517 (2d ed. 1956).

55. Massachusetts Bonding and Ins. Co. v. Josselyn, 224 Mich. 159, 194 N.W. 548 (1923).

56. RESTATEMENT, RESTITUTION §§ 172, 176 (1937); RESTATEMENT (SECOND), TRUSTS §§ 284-94, 316-20, 408 (1957); 4 SCOTT, TRUSTS § 284 (2d ed. 1956). Numerous cases illustrating the rule are collected in 4 SCOTT, TRUSTS § 284 at note 11 (2d ed. 1956).

57. 4 SCOTT, TRUSTS § 474 (2d ed. 1956). The rule is applied to choses in action. While the transferee takes subject to the defenses of the obligor, he does not take subject to the equitable claims of third persons. Wagner v. Central Banking & Security Co., 249 F. 145 (4th Cir. 1918); RESTATEMENT, CONTRACTS § 167 (1) (1932); 4 CORBIN, CONTRACTS pp. 892-908 (1950), especially at p. 900.

As to whether the rule applies to a tranferee for value concerns only purchasers of the legal estate. *Compare* Duncan Townsite Co. v. Lane, 245 U.S. 308, 312 (1917) *with* 3 SCOTT, TRUSTS § 285 (2d Ed. 1956).

58. "No trust concerning land, whether implied by law or declared by parties shall

It is important to realize exactly the powerful position of the bona fide purchaser. While the case is basically one of distributing a loss between two innocent parties (the equitable title-holder and the bona fide purchaser), the bona fide purchaser need not assert that he has changed his position in respect to the res. In this his position differs sharply from that of the innocent wrongdoer. The doctrine of bona fide purchaser has its roots in considerations of commercial convenience, the interest of certainty in commercial transactions transcending the claims of the equitable title holder to protection.

INNOCENT WRONGDOER

In a very real sense the innocent wrongdoer stands before the Chancellor midway between the conscious wrongdoer and the bona fide purchaser. While not so favored as the bona fide purchaser, his good conscience will be sufficient to avoid some of the consequences which are inflicted on the conscious wrongdoer. We shall examine the two situations in which the innocent wrongdoer may, on the same set of facts, find himself in a more advantageous position than his consciously wrongful counterpart. These situations involve: (A) the case of the innocent converter who exchanges the converted property for other property and (B) the innocent wrongdoer and the defense of change of position.

Conversion is, of course, an intentional tort. It consists in so dealing with a chattel that "if there be an outstanding inconsistent property interest in it, the same will be invaded."[59] It is unnecessary that the defendant be aware of the existence of such an interest.[60] Thus, leading writers on the law of tort tell us: "In the sense that a converter is liable notwithstanding he acted under a reasonably mistaken belief in his right to do so, conversion, like trespass, is independent of fault. Liability is absolute."[61] Nor is it a defense to an action for conversion that the property was purchased for a valuable consideration without notice of the legal interests being invaded. As Lord Ellenborough said: "Certainly a man is guilty of conversion who takes my property by assignment from another who has no authority to dispose of it; for what is that but assisting that other in carrying his wrongful act into effect."[62] This is the orthodox view.

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defeat the title of a purchaser for value for a valuable consideration without notice of the trust. . . ." MASS. ANN. LAWS ch. 203, § 3 (1955). Other statutes are collected in 3 SCOTT, TRUSTS § 284 note 12 (2d ed. 1956).

59. 1 HARPER & JAMES, TORTS § 2.10 (1956). As to what property may be subject to an action for conversion see § 2.13.

60. RESTATEMENT, TORTS, § 222, comment *d* (1939). "Absence of bad faith can never excuse a trespass. . . . Everyone must be sure of his legal right when he invades the possession of another." Per Cooley J., in Cubit v. O'Delt, 51 Mich. 347, 351, 16 N.W. 679 (1883).

61. *Supra*, note 59.

62. M'Combie v. Davies, 6 East. 538, 102 Eng. Rep. 1393, 1394 (K.B. 1805). But

While it is clear that *D* as an innocent wrongdoer may not assert his good faith as a defense to an action for conversion, there remains the further question as to the situation where he has in good faith exchanged the converted property for other property. As we have seen, the complainant may impress either a trust or a lien against the newly acquired property when dealing with the conscious wrongdoer. It is believed that by throwing the risks of the market upon the wrongdoer and by preventing him from benefiting from a rise in the market, it will act as a deterrent to such conduct. Such considerations are not applicable to the case of the person who takes a chattel believing that he has a right to it (or purchases it from a converter). There is no reason to give the "windfall" to the claimant. Thus the rule is said to be that

> where a person converts the property of another without notice of the facts which make him a converter and being still without such notice exchanges it for other property, the other is entitled to an equitable lien upon the property received in exchange to secure his claim for restitution, but is not entitled to enforce a constructive trust of the property.[63]

Thus if *D* innocently converts a chattel, by purchasing it from a converter, and sells it and then uses the proceeds to purchase stock or a life insurance policy, *P* can enforce a lien against the shares or the proceeds of the policy up to the value of the chattel converted, but *P* cannot claim the shares or the entire proceeds of the policy by way of a constructive trust.[64]

It is interesting to note here that this doctrine is applied not only in the case of a purchaser without notice of converted property, but also to the situation of a donee receiving title to property without notice that a third person has the beneficial interest in the property. The innocent donee who has acquired the legal title is not technically a converter of the property. However, since he is not a good faith purchaser for value, he holds the property as a constructive trustee for the equitable owner. While there are important differences between an innocent donee of the legal title and an innocent purchaser from a converter in respect to the defense of change of position which we shall examine below, in this situation both are allowed to keep any profit made as a result of an exchange of the res.[65]

It is stated as "black letter" law that should the innocent converter

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the rule has been increasingly limited when arising in the commercial context. See notes 74-77 and accompanying text.

63. RESTATEMENT (SECOND), TRUSTS § 203 (1957); Dixon v. Caldwell, 15 Ohio St. 412, 86 Am. Dec. 487 (1864); Lening v. Baker, 329 Mass. 63, 66 (1952). See 4 SCOTT, TRUSTS § 509 (2d ed. 1956).

64. RESTATEMENT (SECOND), TRUSTS § 203, illustrations 1 and 2 (1957).

65. Wheeler v. Kutland, 23 N.J. Eq. 13 (1872); RESTATEMENT (SECOND), TRUSTS § 204 (1957); 4 SCOTT, TRUSTS § 510 (2d ed. 1956). See RESTATEMENT (SECOND), TRUSTS § 292 (1957).

learn of the true ownership of the property before he has disposed of it, he has a duty to return it to the true owner. Should he exchange the property after such notice, he is a conscious wrongdoer and thus not entitled to retain any profit on the transaction.[66] The justification for this result is not immediately apparent. The *Restatement* says that "when a converter receives knowledge of the facts, he is in the same position as one who took the property with knowledge. . . ,"[67] but this is but a statement of the conclusion and not a reason for it. Perhaps the same policy considerations should be allowed to govern this situation as govern the case of the conscious wrongdoer. Superficially, however, the considerations involved do not seem to be identical. The fruits of the transfer are taken away from the conscious wrongdoer, it is said, in order to act as an additional deterrent to this type of conduct; but, *ex hypothesi,* the original behavior of the innocent converter is not subject to this rationale. It would seem, however, that the "philosophy of deterrence" is applicable in yet another way. It is not desirable that a vendor of property, aware of the defects on his title, should be allowed to defraud his vendee. Equitably, then, it would seem that such a vendor should not be allowed to retain any profit he realizes on the sale. But under this rationale the person we are trying to protect is the vendee. Should not he, and not the original claimant, have the exclusive right to obtain any profit made by the vendor? It would seem that under present case law the result is determined by whether the original claimant or the vendee brings an action first. While this counter-argument has force to it, it is submitted that the position of the *Restatement* is a satisfactory one since, by allowing two different people to deprive the now not-so-innocent converter of his profits, it greatly reduces the converter's chance of making any profit as a result of his wrongdoing. Such a view would seem to be consistent with the "philosophy of deterrence."

One final situation should be noted. The rule protecting the innocent converter as to any profits which might result from a good faith exchange of the property should not be confused with the situation where the profit would have accrued to the claimant irrespective of any intervening action.[68] Thus if a person innocently converts bonds or shares of stock he would be liable to the true owner for the interest or dividends he received. These are the direct product of the property and in no sense the result of an exchange of property.

We now turn to the availability of the defense of change of position to the innocent wrongdoer. Suppose that *D* has received property which in

66. RESTATEMENT (SECOND), TRUSTS § 202; 4 SCOTT, TRUSTS § 509 (2d ed. 1956).
67. RESTATEMENT (SECOND), TRUSTS § 202, comment *d* (1957).
68. *Id.* at § 203, comment *d*; 4 SCOTT, TRUSTS § 509 (2d ed. 1956).

good conscience he is under a duty to restore, but before notification of that fact he changes his position in respect to the property so that it would be inequitable to require him to make restitution. The *Restatement* says that "the right to enforce a constructive trust may be terminated as a result of the defendant's change of position."[69] It is clear that such defense is not available to the conscious wrongdoer since there is no equity in his claim.[70]

While we are primarily concerned with restitution in equity, the scope and importance of this defense can be appreciated only by an analysis of the situations in which the defense is available. Change of position as a defense is not limited to bills to impress constructive trusts but may be asserted as a defense to quasi-contractual actions at law.[71] The classic non-equity example of this defense is in an action in quasi-contract to recover money paid to *D* by mistake where the mistake is of such a nature as to allow restitution. The amount of recovery is limited to the extent that the innocent defendant has so changed his position that it would be unfair to compel him to restore the funds he no longer has. In a leading case, *D* received $10,000 worth of bonds under the mistaken impression that he was the true heir at law.[72] Subsequently the true heir brought an action in assumpsit to recover the value of the bonds. At the time of trial, *D* had only $5,000 worth left, the rest having been spent, partly on the purchase price for a house, partly as living expenses while out of work, and partly for the care of an ill wife. A judgment of the lower court was modified to limit recovery to the extent of the remaining bonds because of the defendant innocent wrongdoer's change of position. While the last two items probably are not within the orthodox notion of what constitutes a change of position, a court sympathetic to the hardships of the defendant so construed them.

As between parties to a contract it would seem that an irrevocable change of position by the defendant is not a defense to an action brought to recover money paid under a mistake. If the rule were applied in contract cases there would seldom be any recovery since it is usual that the payee would incur liabilities which he would not have done, except for the receipt of the money.[73]

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69. RESTATEMENT (SECOND), TRUSTS § 178 (1957).

70. *Id.* at § 202; 3 SCOTT, TRUSTS § 210 (2d ed. 1956)—to the effect that a person who receives money in a fiduciary capacity and misappropriates it cannot assert the defense.

71. Smith v. Rubel, 140 Or. 422, 13 P.2d 1078 (1932); National Bank v. Miner, 167 Cal. 532, 140 Pac. 27 (1914); *contra,* Koontz v. Central National Bank, 51 Mo. 275 (1873).

72. Moritz v. Horsman, 305 Mich. 627, 9 N.W.2d 868 (1943).

73. Clark v. Bradley, — Tex. Civ. App. —, 270 S.W. 1050 (1925). It would seem that the *Restatement* is dealing with non-contractual situations in repayment of money under a mistake. RESTATEMENT (SECOND), TRUSTS § 142, comment *b* (1957). *But cf.* Lake Gogebic Lumber Co. v. Burns, 331 Mich. 315, 49 N.W.2d 310 (1951).

While it is clear that the defense of change of position is available both in law and in equity, such a defense is not without its limitations. It is fundamental among these that the defense can be asserted only by those who originally obtained that mysterious legal concept, "title".[74] Therefore the innocent converter or the person who in good faith purchases property from a converter is not allowed to maintain the defense. It is said that a purchaser must look to his title at his peril. Morally, however, it would seem that the same considerations are involved in the three following situations: (a) a bona fide purchaser of the legal title, (b) an innocent donee of the legal title, (c) a bona fide purchaser from a converter. If we assume that *P* is also "an innocent" we have essentially the problem of deciding upon which of two innocent parties we shall throw the loss. Yet note how different are the results. In the first situation the purchaser for value wins despite the fact that he need show no change of position with respect to the res; in the second case, the innocent donee, although he has not paid value, will not be required to make restitution if he can show a change in position with respect to the res; in the last case, however, the loss is thrown upon the purchaser despite the fact that he has paid value for the property *and* can show a change of position with respect to the res. Obviously such a result cannot be explained in terms of an abstract theory of justice.

The traditional rationalization of these rules is usually explained in terms of commercial necessity. "The justification for protection accorded the bona fide purchaser is found in the belief that the mercantile convenience of stable transactions outweighs the need to protect certain types of interests in property or the right to undo transactions for mistake. It is not therefore material that the purchaser has not in fact changed his position."[75] But this rationale is not quite accurate. Under this theory it must be asserted that the protection of the purchaser who fails to acquire the legal title is of less importance to the orderly conduct of business than is the protection of the interests of the legal title holder. Yet the drive has been to push the claims of legal title holder out of the commercial world. England developed the doctrine of the "market overt".[76] American courts seized upon the doctrine of "apparent authority", when possible, to protect the commercial purchaser against the legal title holder.[77] The early Factors Acts were

74. "Change of Position is a defense if (a) the conduct of the recipient in obtaining, retaining, or dealing with subject matter was tortious." RESTATEMENT (SECOND), AGENCY § 69 (3) (a) and § 142 (3) (a) (1958).

75. Scott, *Restitution from an Innocent Transferee Who is not a Purchaser for Value,* 62 HARV. L. REV. 1002, 1008 (1949).

76. This position was never accepted by the American courts. Dame v. Baldwin, 8 Mass. 517 (1812).

77. See RESTATEMENT (SECOND), AGENCY § 8 (1958) for an explanation of the doctrine.

also designed to reduce the protection afforded to the legal title holders.[78] The idea of defending the interests of the legal title holder is an old one and probably received its genesis in a non-commercially oriented society. Consider also the development of the law of Negotiable Instruments as a further illustration. To the extent that it is in conflict with commercial necessities, it has been forced to yield.

It has been suggested that the thrust of these various developments has been to confine the protection of the legal title holder to the non-commercial world and it is felt that here his interest appears to warrant more protection than that of the innocent purchaser. In the non-commercial context it would seem that the interests of property security should prevail against what is considered to be atypical, deviational behavior.

This argument, however, does not of its own force account for allowing the defense of change of position to an innocent donee of the legal title. Mr. Gordon Scott writes that "[No] . . . strong reasons of policy favor either party in the case where the beneficiary seeks restitution from an innocent donee of trust property, who has subsequently changed his position."[79] He feels that the situation is precisely analogous to the case of payment by mistake with a subsequent change of position by the payee. Since we are outside the commercial context where the policy in favor of protecting the bona fide purchaser is clear, the position of the *Restatement* would seem to be sound. Mr. Scott concludes that

> in the absence of any compelling reason of policy, the problem becomes one simply of judicial administration. The loss falls in the first instance on the plaintiff. By seeking restitution he is attempting to shift the loss to the defendant who made no promise, received no benefit, and is no more at fault. The equities being equal there is no reason why the courts should enable such a claim to prevail. . .[80]

as against a change in position. It would seem that this view is a sound one. However, is not the same logic applicable to the case of the good faith purchaser from a converter? On these premises should not the defense of change of position be available to him also?

We have thus far discussed the situations where the defense of change of position will be available as well as the theoretical and policy considerations involved in the assertion of the defense. We must now examine more closely just what a Court of Conscience will accept as a change of position

78. 1 HARPER & JAMES, TORTS § 2.17 n. 17 (1958).
79. SCOTT, *op. cit. supra* note 75 at page 1008, n. 30.
80. SCOTT, *op. cit. supra* note 75 at page 1008.

discharging the defendant (either fully or *pro tanto*) from a duty of restitution.[81]

It is of course necessary that the defendant must have change in position subsequent to the acquisition of the res. However, this alone is not sufficient. The rule is that we do not compel restitution where it would be inequitable to do so, where it would work an undue hardship upon the defendant. That is the crux of the matter. Several typical situations will illustrate the point.

Where the defendant has made an expenditure of the res or its proceeds no hard and fast general rule may be postulated. It would seem that the proper result can be achieved only by examining the purposes and uses made of the res. If *D* has used the res or its proceeds to discharge a debt or any other legal obligation (e.g., support), it would seem clear that the defense has not been made out.[82] The defendant has in no way changed his position in reliance upon receiving the res. The same logic should apply as well where the expenditures have been made for ordinary and necessary living expenses; it would not work a hardship on *D* to compel him to make restitution.[83] He cannot say he has a right to deplete another's property for his own subsistence. But to the extent that *D* has been induced to live beyond his ordinary means, the situation seems to be different. To compel restitution here seems to work a hardship on *D*. Thus Lord Mansfield wrote: "I think it would be contrary to *aequum et bonum* if he were obliged to pay it back. For see how it is. If the sum be large it probably alters his habits of life; he increases his expenses; he has spent it over and over again, perhaps he could not repay it all or not without great distress."[84]

Closely related to the question of an expenditure by *D* is the situation in which *D* pays out the res or its product to a third person either as a gift or because he believes he has a duty to do so. If it is paid under the reasonable belief that there is a duty to do so this should be a complete defense.[85] If compelled to make restitution to the plaintiff, *D* must bear the risk of recovery from the distributee. While *D* might collect from the distributee

81. For an excellent general survey of the problem see SCOTT, *op. cit. supra note* 75 at pages 1011-18. See RESTATEMENT (SECOND), AGENCY § 142, comment *b* (1958).

82. RESTATEMENT (SECOND), AGENCY § 142, illustration 6 (1958).

83. Bridgeport Hydraulic Co. v. Bridgeport, 103 Conn. 249, 130 Atl. 164 (1925); Old Colony Trust Co. v. Wood, 321 Mass. 519, 74 N.E.2d 141 (1947); RESTATEMENT (SECOND), AGENCY § 142 comment *b*, illustration 2 (1958).

84. Brisbane v. Dacres, 5 Taunt. 143, 162, 128 Eng. Rep. 641 (C.P. 1813); Moritz v. Horsman, 305 Mich. 627, 9 N.W.2d 868 (1943). Contrast Picotte v. Mills, 200 Mo. App. 127, 203 S.W. 825 (1918).

85. The cases are split. *Compare* Baylis v. Bishop of London, 1 Ch. D. 127 (C.A. 1913) and Houston & T.C. Ry. v. Hughes, 63 Tex. Civ. App. 514, 133 S.W. 731 (1911) *with* Title Ins. & Trust Co. v. McCracken County, 263 Ky. 302, 92 S.W.2d 89 (1936) and Haubert v. Navajo Refining Co., 129 Okla. 195, 264 Pac. 151 (1928). See RESTATEMENT (SECOND), AGENCY § 142, illustrations 4 and 5 (1958).

by a lawsuit or perhaps even under a simple request, there is no reason why the burden of doing this should be placed on him rather than upon the plaintiff.[86]

In the case of the gift the situation is more difficult. Conflicting considerations are at work. Despite the fact that *D* could show that had he been informed of the true state of affairs he would not have made the gift, he still has disposed of the property in accordance with his desires. How such a benefit is to be evaluated is not clear. The case law on the subject is often not decisive.[87] Mr. Scott suggests that

> a court might properly consider the element of hardship in the particular case, in view of the size of the gift and the financial situation of the defendant. If the defendant, a man of small means, has shared with his friends or with a charity, a large legacy mistakenly paid to him, it is an obvious hardship to compel him to repay it from his own funds. It is true that if consideration is given to the factors of a particular case, it is at the expense of predictability, but the situation is not one in which the demands of commercial intercourse call for the rigid application of a rule.[88]

Still a different situation is presented where *D* has exchanged the res for other property which subsequently has declined in value. To compel restitution of the full amount of the claim would frequently be inequitable. The typical example is where *D* has acquired by exchange stocks or bonds which have declined in value. If *D* shows that but for the receipt of the original property he would not have purchased the securities, this should be a defense and recovery should be limited to the present value of the securities.[89] However, *D* must be able to show that the change of position was a result of the transaction for which restitution is sought. If he would have suffered the loss irrespective of the transaction, (e.g., if he would have purchased the stock regardless of receiving an amount of money by mistake), then he is not entitled to the defense. He may not speculate on the market at the plaintiff's expense.[90]

If *D* loses the res or it is stolen from him, then this should, on principle, be a complete defense. And the degree of negligence on the part of *D* should make no difference since it would be unreasonable to assert that *D*

86. SCOTT, *op. cit. supra* note 75 at page 1015.

87. Truesdell v. Bourke, 29 App. Div. 95, 51 N.Y.S. 409 (1898) seems squarely on point. *Compare* Holby v. Missionary Soc'y of Protestant Episcopal Church, 180 U.S. 284 (1901), and Seagle v. Barreto, 231 N.Y. 586, 132 N.E. 899 (1921) *with* E. R. Squibb & Sons v. Chemical Foundation, 93 F.2d 475 (2nd Cir. 1937).

88. SCOTT, *op. cit. supra,* note 75 pp. 1016-17. See RESTATEMENT (SECOND), AGENCY § 142, illustrations 7 and 8 (1958).

89. RESTATEMENT (SECOND), AGENCY § 202 (1958); 3 SCOTT, TRUSTS § 292 (2d ed. 1956). See Smith v. Rubel, 140 Or. 422, 13 P.2d 1078 (1932) which, in different circumstances, limited the amount of recovery in respect to bonds received by mistake.

90. SCOTT, *op. cit. supra,* note 75 at page 1011.

had a duty of care with respect to the res when he was unaware of any other interest in the property. "The basis of the liability of an innocent defendant is the benefit which he retains at the plaintiff's expense, and not the lack of care with which he treats property he believes to be his own."[91]

Finally, it should be clear that no special considerations are important should *D* be insolvent. *P* is not entitled to any special priority simply because of the fact of an intervening insolvency. Even should *D* be put into bankruptcy proceedings where *P* would be in a contest not with *D,* but with the creditors of *D,* it is clear that the same considerations should obtain.

The defense of change of position by an innocent donee may be made the focal point for an interesting and enlightening contrast between the English and the American courts on the whole subject of restitution. The English courts have not been overly sympathetic to claims for restitution. Lord Summer describes restitution as "the vague jurisprudence which is sometimes attractively styled as justice between man and man," and Lord Scrutton speaks of it as "well meaning sloppiness of thought."[92] In place of the frank recognition of the moral basis of restitution, so ably espoused by Lord Mansfield, the English courts seem to have become exceedingly enmeshed in allowing technical rules to govern recovery or its absence.[93]

This entire English attitude toward restitution is dramatically illustrated in a recent case involving the issue of change of position by an innocent donee.[94] A testator directed his executors to apply his vast fortune to such "charitable or benevolent" objects as they might see fit. Without an application for instructions the executors paid over £200,000 to 139 charities. Subsequently, on a suit by a remote next of kin, the House of Lords declared the bequest void for uncertainty. Compromising their claims against the executors, the next of kin instituted suit to recover from the charities the amount paid to them. The next of kin asserted both a personal claim against the charities and a right to follow the res. The Court of Appeal affirmed the view of the trial court holding that a quasi-contractual recovery would not lie, upon the wholly irrelevant ground that the mistake in payment was one of law. Even if one does not accept the view that, as Lord

91. SCOTT, *op. cit. supra,* note 75 at page 1014. See RESTATEMENT (SECOND), AGENCY § 142, comment *b* (1958).

92. Baylis v. Bishop of London, *supra,* note 85; Holt v. Markham, [1923] 1 K.B. 504, 513 (C.A. 1922). "In *Moses v. Macferlan* Lord Mansfield definitely crossed the all too narrow bridge which leads from the sound soil of implied contract to the shifting quicksand of natural equity." Chafee, Book Review, 48 HARV. L. REV. 523, 526 (1935). This view is severely criticized by Professor Chafee (page 526).

93. See Sinclair v. Brougham, [1914] A.C. 398 where recovery in quasi-contract was disallowed because an express contract would have been ultra vires.

94. *In re* Diplock, [1948] 1 Ch. 465 (C.A.). For an excellent discussion of the case see Chafee, Book Review, 36 CORNELL L.Q. 170 (1950). The case is also discussed by SCOTT, *op. cit. supra,* note 70. *Cf.* Scott, *Trusts for Charitable and Benevolent Purposes,* 58 HARV. L. REV. 548 (1945).

Westbury states, "the mistake doctrine should be confined to the general . . . ordinary law of the community . . . , [in] the sense of denoting a private right that maxim has no application,"[95] the decision on this point is clearly erroneous. It seems impossible to argue that because the executors made a mistake of law this should determine the rights of the beneficial owners of the property.[96] However, the Court of Appeal deemed this to be a suit in equity and was able to rule that there was a personal liability on the part of the charities to the next of kin. The fact that some of the charities may have irrevocably changed their positions was not even mentioned by the Court in charging the charities personally. And this seems to be in line with the English authority on the matter.[97]

Since the charities were solvent the Court of Appeals need not have considered the alternative claim of a right to follow the money. But the court said that irrespective of personal liability, the claimants were entitled to a tracing order. Apparently the "English courts are willing to remedy unjust enrichment with a tracing order, as if it were a separate cause of action, at the same time that they reject quasi-contractual relief for very narrow reasons."[98] However, as Professor Chafee points out, tracing encounters numerous obstacles since it is not based upon a frank acknowledgment that it has its roots in unjust enrichment.

> It is not enough to get a judgment for the amount which has been unjustly received; the plaintiff must show that the recipient has the money or its demonstrable product. Thus the National Institute for the Deaf knocked out the tracing order because it put all its Diplock money into its general bank deposit and then drew out all of the balance at the close of the day before the next of kin attacked the bequest. Subsequent deposits gave the Institute plenty of money to cover a refund but the Court of Appeals . . . held that all the money was gone beyond recall.[99]

The injustice and artificality of the English rule are apparent.

> Suppose $100,000 had been paid to a hospital out of a supposed valid bequest. The hospital thereupon spends $100,000 on a new wing, which it would never have built otherwise. It makes the actual payments for the wing by using up pre-existing (and separate) bank deposits. The $100,000 from the bequest is there . . . but the hospital needs it badly for current expenses. The English

95. Cooper v. Phibbs, L.R. 2 H.L. 149, 170 (1867).
96. Chafee, *op. cit. supra,* note 94 at 174; Scott, *op. cit. supra,* note 75 at footnote 18.
97. Baylis v. Bishop of London, [1913] 1 Ch. 127 (C.A. 1912); R. E. Jones, Ltd. v. Waung and Gitlow, Ltd., [1926] A.C. 670 (which seemed to require an estoppel as well as a change of position.) But see Holt v. Markham, [1923] 1 K.B. 504 (C.A. 1922); Chafee, Book Review, 48 HARV. L. REV., 528 (1935).
98. Chafee, *op. cit. supra,* note 92 at 175.
99. *Ibid.*

> decision would turn it all over to the next of kin under a tracing order, leaving the hospital without a cent of cash. . . . Yet if the hospital puts the gift into a special account and pays for the wing from that account the English tracing order would fail.[100]

If we assume that the bequests would have been invalid in this country, it would seem that the case would present no special problems to an American court. The central issue would have been the good faith change of position by the innocent donee.[101] Did the expenditures of money by the various charities constitute a change of position? While the answer to this question may not be an easy one, the problem is clearly presented and not clouded by the artificial gobbledygook characteristic of the English approach to the subject. Perhaps an American court would find that the defense of change of position was inapplicable to the expenditures of charities. More likely, it would find that some expenditures were of the type protected by the defense while others were not. At any rate where a change of position was found, there would be no recovery; where such a change was not found and the defense could not be made out, recovery would be allowed. And since the defendants were solvent the claim to trace would be unimportant. "There is usually no need for a tracing order with us, except to enable a special claimant to reach particular property to the exclusion of the general creditors of an insolvent obligor."[102]

CONCLUSION

By way of summary, then, we see that the law as developed in the United States has escaped the narrow technicalities that mark English restitutionary practice. The American courts have focused squarely upon the character of the defendant involved. The bona fide purchaser has always enjoyed favor before the chancellors. Equity will not lift its hand against him. But the Court of Conscience deals severely with the conscious wrongdoer; where its jurisdiction attaches, it will deprive him of all profits of the transaction while throwing upon his shoulders the risks of the market wherever possible. The innocent wrongdoer has been viewed by the American courts as standing midway between the bona fide purchaser and the conscious wrongdoer. Though not given the sweeping protection af-

100. *Id.* at 176. I have altered this quotation by the insertion of the clause in parentheses and several quotations have been condensed. This has been done to avoid making the decisions in the illustration turn on whether the rule in *Clayton's Case* or the rule found in *Hallet's Estate* is applied to withdrawals from commingled funds.

101. The defense of payment as a result of mistake of law would have been overruled. *Cf.* CHAFEE, EQUITABLE REMEDIES, pp. 648-81 (1939).

102. Chafee, *op. cit. supra,* note 94 at 175. And this would have eliminated the very costly necessity of having certified public accountants examine the books of all 139 charities.

forded the bona fide purchaser, he has been treated sympathetically. In no event is he required to make good more than the amount of the plaintiff's loss, and in some instances not even this is demanded. Thus the American courts have followed the bold lead of Lord Mansfield and have fashioned their remedial doctrines so as to allow restitution where in equity and good conscience it ought to be allowed.