

## Title

A message to the Divorce Bar: The constructive trust and the resulting trust are creatures of and regulated by general principles of equity, not the Uniform Trust Code

## Text

The constructive trust is a tool developed by equity to assist the judiciary in temporarily securing property that is the source of someone's unjust enrichment, pending transfer of the property to its rightful owner. One who procures property by fraud, duress, or undue influence, or acquires it due to mistake is unjustly enriched. One who acquires property by virtue of someone else's fraud, duress, undue influence, or mistake also is unjustly enriched, unless he is a BFP.

The judicial imposition of a resulting trust, on the other hand, facilitates the return of legal title from the purported trustee of a trust that has failed *ab initio* back to the would-be settlor. In the case of a failure in mid-course, the express trustee morphs into a resulting trustee charged with returning legal title to the settlor, reversionary interests, whether legal or equitable, always being vested.

The constructive trust and the resulting trust are said to be "involuntary" trusteeships. As we discuss in the material featured in the appendix immediately below, sometimes it is not all that clear whether the constructive trust or the resulting trust is the appropriate procedural equitable remedy, especially when it comes to innocent unjust enrichment.

Let us assume that ex-wife deeds a parcel of real estate to ex-husband with the *present* intention that ex-husband take the legal title, as trustee, not outright. No mention, however, is made of that intention in any property-transfer documentation. Is the trust enforceable or does the property belong to the transferee outright and free of trust? On similar facts, one Washington appellate court, looking only to the state's statutory trust law, answered outright and free of trust in that the ex-wife had not formally memorialized her entrustment intentions at the time of transfer, nor had the ex-husband formally declared himself an express trustee of the property. See *K & W Children's Trust v. Estate of Fay*, 503 P.3d 569 (Washington 2022).

I dissent. There had been a transfer of legal title. There was/is credible extrinsic evidence that ex-wife had had a present intention to have a trust impressed on the real estate at the time of transfer. By taking title to the real estate as if it were free of trust in contravention of what the ex-wife had intended, the ex-husband had been unjustly enriched. The regimes of constructive trust and resulting trust, each a creature of equity, not statute, have traditionally been exempt from the statute of frauds' application to land entrustments, specifically its requirement that there be a memorializing writing. Ergo: With or without ex-husband's consent, by operation of law as enhanced by equity, he at the time of transfer had taken legal title to the real estate as a constructive trustee, and in so doing, had been saddled with a duty to transfer it on to a willing and able express trustee of the court's selection.

The other possibility was that he had been a resulting trustee of a trust that had failed *ab initio*. That being the case, the trial court should have ordered that the legal title be transferred back to the ex-wife outright and free of trust.

The constructive trust and the resulting trust are compared/contrasted in §7.2.3.1.6. of *Loring and Rounds: A Trustee's Handbook* (2022), which section is reprinted in its entirety in the appendix immediately below. The Handbook's 2022 Edition is available at <https://law-store.wolterskluwer.com/s/product/loring-rounds-a-trustees-handbook-2022e-misb/01t4R00000OVWE4QAP>.

## Appendix

### **§7.2.3.1.6 Constructive Trust** [from *Loring and Rounds: A Trustee's Handbook* (2022), available at <https://law-store.wolterskluwer.com/s/product/loring-rounds-a-trustees-handbook-2022e-misb/01t4R00000OVWE4QAP>.]

**Constructive trust doctrine.** A general discussion of constructive trust doctrine is contained in §3.3 of this handbook, which the reader is advised to consult before proceeding further. A constructive trust is an express trust which doubles as a procedural equitable remedy, that is to say its purpose is to support the substantive equitable remedy of restitution for unjust enrichment.<sup>140</sup> The Restatement of Restitution (1937) is not in accord, suggesting that a constructive trust is something other than a true trust.<sup>141</sup> For the same reason, neither is the Restatement (Third) of Restitution and Unjust Enrichment in accord.<sup>142</sup>

The substantive equitable remedy of restitution is covered in §7.2.3.3 of this handbook. The wrong of unjust enrichment is taken up in §8.15.78 of this handbook. “Where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises.”<sup>143</sup>

*Unauthorized fiduciary self-dealing.* As we discuss in greater detail in §6.1.3 of this handbook, there are many ways that a trustee can unjustly enrich himself from the trust property in breach of the duty of loyalty such that the judicial imposition of a constructive trust is warranted.<sup>144</sup> Here are a few:

- Purchase by trustee for his own account of property entrusted to him as fiduciary;<sup>145</sup>

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<sup>140</sup>See generally Charles E. Rounds, Jr., *Relief for IP Rights Infringement Is Primarily Equitable: How American Legal Education Is Short-Changing the 21st Century Corporate Litigator*, 26 Santa Clara Computer & High Tech L.J. 313 (2010).

<sup>141</sup>Restatement of Restitution §160, cmt. a.

<sup>142</sup>See Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. b.

<sup>143</sup>Restatement of Restitution §160.

<sup>144</sup>See generally Restatement of Restitution §190.

<sup>145</sup>Restatement of Restitution §192.

- Sale of trustee’s individual property to himself as fiduciary;<sup>146</sup>
- Purchase by trustee of property that he should purchase for the beneficiary;<sup>147</sup>
- Renewal of lease by trustee for his personal benefit;<sup>148</sup>
- Purchase by trustee for his own account of an encumbrance upon property held by him as fiduciary;<sup>149</sup>
- Bonus or commission received by trustee;<sup>150</sup>
- Sale of entrusted property in breach of trust;<sup>151</sup>
- Competition by trustee;<sup>152</sup> and
- Exploiting confidential information for personal purposes.<sup>153</sup>

*Third-party acquisition of the legal interest, i.e., of the entrusted property.* A constructive trust can also be judicially imposed as a procedural equitable remedy on property wrongfully in the hands of a third party to a trust relationship. “Where a fiduciary in violation of his duty to the beneficiary transfers property or causes property to be transferred to a third person, the third person, if he gave no value or if he had notice of the violation of duty, holds the property upon a constructive trust for the beneficiary.”<sup>154</sup> If the third party were a good faith purchaser for value (BFP) of the entrusted property, there would be no unjust enrichment and thus there could be no imposition of a constructive trust on the property that had been transferred out. The rights of a BFP are considered in §8.15.63 of this handbook. If circumstances warrant, however, a constructive trust could be judicially imposed on the proceeds from the sale of entrusted property to a

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<sup>146</sup>Restatement of Restitution §193.

<sup>147</sup>Restatement of Restitution §194.

<sup>148</sup>Restatement of Restitution §195 (providing that a person holding as trustee a leasehold interest who in violation of his duty to the beneficiary obtains a renewal of the lease for himself holds the new lease upon a constructive trust for the beneficiary).

<sup>149</sup>Restatement of Restitution §196.

<sup>150</sup>Restatement of Restitution §197 (providing that where a trustee in violation of his duty to the beneficiary receives or retains a bonus or commission or other profit, he holds what he receives upon a constructive trust for the beneficiary).

<sup>151</sup>Restatement of Restitution §198 (providing that where a trustee in violation of his duty to the beneficiary disposes of property entrusted to him as fiduciary, he holds any property received in exchange upon a constructive trust for the beneficiary).

<sup>152</sup>Restatement of Restitution §199 (providing that where a trustee acquires property by competing with the beneficiary, *i.e.*, with the “trust,” in violation of his duty to the beneficiary, he holds the property upon a constructive trust for the beneficiary).

<sup>153</sup>Restatement of Restitution §200 (providing that where a trustee in violation of his duty to the beneficiary acquires property through the use of confidential information, he holds the property so acquired upon a constructive trust for the beneficiary).

<sup>154</sup>Restatement of Restitution §201(1).

BFP.<sup>155</sup>

*Acquisition of equitable interest by fraud, duress, or undue influence.* One who acquires a legal or equitable property interest incident to a trust relationship by fraud, duress, or undue influence that is perpetrated against the settlor, the trustee, or a beneficiary is unjustly enriched. A remedy tailor-made for such situations is the constructive trust. Why, then, a need for the tort of intentional interference with inheritance or acquisition by inter vivos transfer, at least in the trust context? This is a topic that is taken up in §7.2.3A of this handbook.

*Mistake-based acquisition of equitable interest.* A gratuitous entrustment occasioned by mistake also may be grounds for the imposition of a constructive trust, even when the terms of the trust are unambiguous. But evidence of the mistake must be clear and convincing.<sup>156</sup>

**Creditors of the constructive trustee.** It is said that “[t]he preference that the constructive trust claimant acquires over general creditors of the defendant is usually the object of the...[procedural]...remedy.”<sup>157</sup> The restitution claimant will generally prevail over a judgment creditor, “though not over a secured creditor who qualifies as a bona fide purchaser of the assets in question.”<sup>158</sup> Otherwise the judgment creditor would be unjustly enriched. “The practical advantages of asset-based restitution are particularly apparent when the claimant obtains restoration of appreciated property without the need to prove its value.”<sup>159</sup>

**The claimant’s property must be identifiable and titled in the one who is unjustly enriched.** The procedural equitable remedy of constructive trust is only available, however, if the specific property at issue is identifiable, that is capable of either being followed *in specie* or followed (traced) into its product,<sup>160</sup> and if the property has not found its way into the hands of a good faith purchaser for value (BFP).<sup>161</sup> The one who is unjustly enriched needs to have the legal title to the identifiable property, not just the possession of the property. Otherwise, the claimant will have to resort to some other remedy.<sup>162</sup> Thus, the constructive trust coupled with an equitable restitution order would not be a suitable judicial vehicle for recovering stolen property *in specie* directly from its thief, the thief having possession of but not legal title to the property. All is not necessarily lost, however. The mere fact that title never left the claimant ought not to prevent the claimant from recovering the property *in specie* from the thief via an action at law for

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<sup>155</sup>Restatement of Restitution §198, cmt. a.

<sup>156</sup>See *In re the Ishida-Waiakamilo Legacy Trusts*, 398 P.3d 658 (Haw. 2017).

<sup>157</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. a. See also cmt. d.

<sup>158</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. d.

<sup>159</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. i.

<sup>160</sup>See generally §7.2.3.1.2 of this handbook (following *in specie*); §7.2.3.1.3 of this handbook (following property into its product or tracing); Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. g.

<sup>161</sup>See generally Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. m; §8.15.63 of this handbook (the BFP).

<sup>162</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. f.

replevin.<sup>163</sup>

**The constructive trustee will generally be called upon to render an equitable accounting.** The procedural equitable remedy of constructive trust may be coupled with the procedural equitable two-pronged remedy of a judicial specific performance order to the constructive trustee to account to the claimant for net profits accruing to the constructive trustee incident to the constructive trustee's unjustifiable use of the identified property over time, "in the same manner as a trustee's accounting under an express trust, for the purpose of determining...net liability in restitution."<sup>164</sup>

**Joint ownership in constructive trust.** What about joint ownership in constructive trust? Say an express trustee purchases identifiable property for personal purposes for \$20,000. It turns out that \$10,000 of the purchase price was obtained in breach of trust from the trust estate. The value of the property doubles. The express trustee is a constructive trustee of 50 percent of the property for the benefit of the beneficiaries of the express trust. The express trust is the equitable owner of the property acquired in the proportion that its asset contribution bears to the total amount invested.<sup>165</sup> Thus, the current market value of the express trust's share of the property is \$20,000.<sup>166</sup> "A case in which the claimant's funds supply a portion of the purchase price must be distinguished from one in which the claimant's funds are used to enhance the value of the property the defendant owns."<sup>167</sup> In the latter case, the claimant's remedy is likely to be an equitable lien, a topic we take up in §7.2.3.1.4 of this handbook.

**The constructive trust versus the resulting trust.** Sometimes it is not all that clear whether the constructive trust or the resulting trust is the appropriate procedural equitable remedy for innocent unjust enrichment. Sometimes it may not matter. Assume the owner of an identifiable item of property transfers it by mistake to *B* in trust. Assume that the legal title to the property metaphorically just falls into *B*'s lap. No express trust beneficiaries are designated or ascertainable. The transferor then dies. Finally, assume that *B* would be unjustly enriched were he to retain title to the property. In other words, title to the item should somehow find its way into the hands of the executor of the transferor's probate estate. But what procedural vehicles are available to the court for bringing about such a result? The resulting trust might be one, a topic we take up generally in §4.1.1.1 of this handbook. *B* is judicially determined to hold the item upon a resulting trust for the benefit of the executor.<sup>168</sup> The constructive trust is another. The transfer of legal title having been the product of a unilateral mistake on the part of the transferor, that is to say there having been no intention on the part of the transferor to make a gift of the item to *B*, the court declares *B* a constructive trustee of the item for the benefit of the executor. "Liability in restitution is often independent of fault."<sup>169</sup> In either case, the court follows up with an equitable specific performance order compelling *B* to transfer title to the executor.

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<sup>163</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. f.

<sup>164</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. l. *See, e.g.,* Jimenez v. Lee, 547 P.2d 126 (Or. 1976).

<sup>165</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. n.

<sup>166</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, illus. 32.

<sup>167</sup>Restatement (Third) of Restitution and Unjust Enrichment §55, cmt. n.

<sup>168</sup>*See, e.g.,* Stephenson v. Spiegle, 429 N.J. Super. 378, 58 A.3d 1228 (App. Div. 2013) (endorsing the resulting trust option).

<sup>169</sup>Restatement (Third) of Restitution and Unjust Enrichment §1, cmt. f.

