Question 3

In 2004, Mary and Frank orally agreed to jointly purchase a small storefront space in City for $80,000. Mary contributed $40,000 of her own money. Frank contributed $40,000 he had embezzled from his employer, Tanner. Mary and Frank agreed to put the property in Frank's name alone because Mary had creditors seeking to enforce debts against her. They further agreed that Frank would occupy the property, which he planned to use as an art studio and gallery. They also agreed that, if and when he vacated the property, he would sell it and give her one half of the net proceeds. He then occupied the property.

In 2005, Tanner discovered Frank's embezzlement and fired him.

In 2012, Frank sold the property, obtaining $300,000 in net proceeds. Frank offered to repay Mary her $40,000 contribution, but Mary demanded $150,000.

Mary and Tanner each sued Frank for conversion.

At trial, the court found Frank liable to both Mary and Tanner for conversion.

1. What remedy or remedies can Mary reasonably obtain against Frank for conversion, what defenses (if any) can Frank reasonably raise, and who is likely to prevail? Discuss.

2. What remedy or remedies can Tanner reasonably obtain against Frank for conversion, what defenses (if any) can Frank reasonably raise, and who is likely to prevail? Discuss.

ANSWER A TO QUESTION 3

(1) <u>Mary v. Frank</u>

Mary's Remedies. There are several possible remedies Mary can obtain for the tort of conversion.

Tort of Conversion. The tort of trespass to chattels or conversion occurs when the defendant wrongfully interferes with the plaintiff's right to possess property. This tort constitutes the trespass of chattels when the interference is not so severe as to constitute conversion. The damages for trespass to chattel are the cost of repairing the property. The tort of conversion occurs when the interference with the plaintiff's personal property is substantial and severe. The damages for conversion are the fair market value of the property at the time and place of conversion.

In this case, Frank is guilty of converting Mary's 1/2 interest in the storefront space as his own. He is liable for conversion, and the damages would be 1/2 of the fair market value of the storefront space at the time of conversion. In this case, the conversion occurred when Frank failed to give Mary her 1/2 of the net proceeds. Thus, under tort law, her damages would be 1/2 of the fair market value of the storefront space when Frank failed to give Mary her 1/2 of the proceeds. If the sale of the storefront space for $300,000 was close enough in time to the conversion, then a court can find that Mary is owed $150,000 for the conversion.

Purchase Money Resulting Trust. A purchase money resulting trust occurs when one party purchases property, but another party supplies the consideration. The other party must have supplied consideration before the purchasing party obtains title. In such a situation, the court imposes a resulting trust on the purchasing party, construing her as a trustee holding the property in trust for the beneficiary, which is the party who supplied consideration. Because the resulting trust is a remedy implied at law, the requirements to create a valid trust are not required.

In this case, there is a purchase money resulting trust between Mary and Frank. They orally agreed to purchase a storefront space for $80,000, and each agreed to contribute $40,000. The title was placed in Frank's name alone, but Mary supplied one-half of the consideration required to purchase the storefront space. If Mary can show that she contributed the $40,000 before Frank took tile, then she is entitled to a purchase money resulting trust as a remedy. Mary can likely show that she contributed money before Frank took title, since the full purchase price of real property is usually conveyed before the deed to title is transferred.

Pro Rata Resulting Trust. Where the party who supplied consideration for the purchase of real property did not provide the total consideration, but only partial consideration, the court will construe a resulting trust in an interest pro rata to the amount of consideration supplied by the party.

In this case, Mary only supplied one-half of the consideration for the storefront space. Thus, she will be construed as having a 1/2 interest in the storefront space. However, the storefront space itself has been sold. Equitable rights to property are cut off by a sale to a bona fide purchaser who pays value and has no notice of prior wrongdoing. There is no indication in this case that Frank did not sell the property to a bona fide purchaser. Thus, because Frank already sold the storefront space, Mary will be deemed as having a 1/2 interest in the net proceeds from the sale. Under a pro rata share of a purchase money resulting trust, her remedy would be $150,000, which is 1/2 of the $300,000 in net proceeds that Frank obtained for selling the property.

Constructive Trust. Similar to the resulting trust, a court can impose a constructive trust on the defendant, which construes the defendant as holding property in trust for the plaintiffs. This remedy applies where the defendant has wrongfully obtained title to the plaintiff's property, and the defendant's retention of such property would result in unjust enrichment. The plaintiff can trace the property to another form, as long as the trust res can be identified. Additionally, the plaintiff is entitled to any increase in value in the property to avoid unjust enrichment to the defendant. Where the property has been commingled with other funds and withdrawals have reduced the account's balance below the plaintiff's claim, the plaintiff is entitled to the next lowest intermediate balance.

In this case, Mary would argue that she obtained a 1/2 interest in the storefront property when she contributed $40,000 for its purchase. This 1/2 interest was wrongfully appropriated by Frank when he sold the house and retained all proceeds except for the $40,000 he was willing to give Mary. Additionally, Frank's retention of the 1/2 interest would amount to unjust enrichment because he only contributed 1/2 of the purchase price himself (and those funds were embezzled). Furthermore, Mary can trace her 1/2 interest to $300,000 in net proceeds that Frank obtained from selling the property, she is entitled to the increase in value under the remedy of constructive trust, and there is no indication that the funds have been commingled with other funds or withdrawn to a balance lower than $150,000. Frank would argue that he is entitled to a greater interest because he did more work by occupying the property, improving it, and selling it. However, Frank is likely to lose this argument because of the oral agreement he had with Mary. Mary is likely entitled to a constructive trust, compelling Frank to pay her $150,000.

Equitable Lien. Similar to a constructive trust, a court can impose an equitable lien on the defendant's property in favor of the plaintiff. This remedy is appropriate where the defendant misappropriated the plaintiff's property under circumstances giving rise to a debt or obligation owed to the plaintiff, the property can be traced to the defendant, and the defendant's retention of the property would result in unjust enrichment. Like the constructive trust, the defendant can trace the property to another form as long as the res can be identified. However, unlike the constructive trust, the plaintiffs are not entitled to any increase in value in the property under an equitable lien. Where the property has been commingled with other funds and withdrawals have reduced the account's balance below the plaintiff's claim, the plaintiff is entitled to the next lowest intermediate balance.

The analysis for whether Mary would be entitled to an equitable lien is the same as the analysis conducted above for a constructive trust because Frank's misappropriation of

Mary's 1/2 interest in the property gave rise to a debt owed to Mary for that amount. However, under the remedy of equitable lien, the court would impose an equitable lien in the amount of $150,000 in Mary's favor on the net proceeds that Frank received.

Specific Performance & Replevin. Specific performance and replevin are remedies where the defendant retains possession of the property in question. They do not apply here since Frank no longer owns the storefront property.

Damages. When a plaintiff also sues for conversion, she may be able to obtain damages for lost use of the property during the time it is wrongfully appropriated by the defendant. Mary here may be able to obtain additional damages if a substantial amount of time has passed between the conversion and her ability to obtain a remedy in court.

Frank's Defenses.

Statute of Frauds. The statute of frauds requires that any interest in real property, other than a lease for one year or less, be in a writing, signed by the party to be bound and identifying the related material terms and conditions. In this case, Mary and Frank's oral agreement pertained to an interest in real property; thus, it must be in writing in order to be enforced. Frank will most likely be able to raise the defense of statute of frauds to defeat Mary's remedies. If this is this case, Mary may be able to argue that she is entitled to restitutionary damages instead of the remedies above. Restitutionary damages grant damages in the amount that the defendant is unjustly enriched by.

Unclean Hands. Unclean hands are a defense where the plaintiff has engaged in misconduct related to the transaction sued upon. In this case, Frank would likely argue that Mary had unclean hands in the transaction because she agreed to put the title in Frank's name alone to avoid creditors who were seeking to enforce debts against her. He would argue that her avoidance of her creditors is misconduct, is related to their agreement to purchase the storefront space, and thus, bars Mary from obtaining a remedy. However, Frank's argument is likely to fail because Mary's decision to put the title in Frank's name alone was unlawful, and her motivation to avoid creditors was not illegal. Thus, Mary's right to remedies would not be barred by unclean hands.

(2) <u>Tanner v. Frank</u>

<u>Tanner's Remedies.</u>

Tort of Conversion. See rule above. In this case, Frank committed conversion when he wrongfully appropriated $40,000 from Tanner, rendering him liable for damages to Tanner.

Purchase Money Resulting Trust. See rule above. In this case, although Tanner was unaware of it at the time, it contributed $40,000 to the purchase of a small storefront space in City, which was then titled to Frank. If it can show that it contributed this $40,000 before Frank obtained title, then Tanner is entitled to a purchase money resulting trust as a remedy. It is likely that Tanner can show this, since title to property is usually transferred to the buyer after the buyer conveys the full purchase price.

Pro Rata Resulting Trust. See rule above. Since Tanner contributed only 1/2 of the consideration for the property, it is entitled to a 1/2 interest in the property. As noted above, a sale to a bona fide purchaser cuts of equitable rights to title, and there is no indication that Frank did not sell the property to a bona fide purchaser. Because Frank already sold the property, Tanner has a 1/2 interest in the $300,000 in net proceeds from the sale.

Constructive Trust. See rule above. In this case, Tanner would argue that it obtained a 1/2 interest in the storefront property when it unknowingly contributed $40,000 to its purchase. The 1/2 interest was wrongfully appropriated by Frank when he embezzled it from Tanner in 2004. Frank's retention of the 1/2 interest contributed by Tanner would result in unjust enrichment because the $40,000 did not belong to Frank, and Frank supplied no consideration from his own funds to the purchase of the property.

Furthermore, Tanner can trace its 1/2 interest to the $300,000 in net proceeds that Frank obtained from selling the property, it is entitled to the increase in value under the remedy of constructive trust, and there is no indication that the funds have been commingled with other funds or withdrawn to a balance lower than $150,000. Thus, Tanner is likely entitled to a constructive trust in 1/2 of the $300,000 in net proceeds, which is $150,000.

Equitable Lien. See rule above. The analysis for whether Tanner would be entitled to an equitable lien is the same as the analysis conducted above for a constructive trust because Frank's embezzlement of $40,000 from Tanner gave rise to an obligation to repay Tanner. However, under the remedy of equitable lien, the court would impose an equitable lien in the amount of $150,000 in Tanner's favor on the net proceeds that Frank received.

Frank's Defenses.

Laches. Laches applies where the plaintiff has unreasonably delayed in bringing a lawsuit, and that unreasonable delay prejudices the defendant. The time for laches begins running when the plaintiff first learns of the injury. In this case, Frank would argue that he initially embezzled the $40,000 in 2004, and Tanner discovered the embezzlement in 2005, but that Tanner did not bring suit until 2012, which prejudiced Frank. While the seven years that Tanner waited between learning of its injury and filing suit amounts to an unreasonable delay, there is no evidence that Frank's ability to defend himself has been prejudiced. Thus, Tanner cannot successfully raise this defense, unless he can show that he has been prejudiced in his ability to defend himself.

ANSWER B TO QUESTION 3

What remedy or remedies can Mary reasonably obtain against Frank for conversion, what defenses (if any) can Frank reasonably raise, and who is likely to prevail?

Mary's Remedies

Mary has several avenues she can pursue to try and recover damages from Frank.

Constructive Trust

The most promising remedy Mary can pursue against Frank is a constructive trust. A constructive trust is an equitable remedy whereby a court requires a person who wrongfully acquired title to property to hold that property as a forced trustee and to return it to its rightful owner. Although it will not defeat a bona fide purchaser, it does allow tracing. Moreover, a constructive trust will allow a person to recover any increase in value of the property. This remedy is generally only allowed when money damages would be inadequate.

Here, Mary will argue that she and Frank both owned the property and that he converted the property they owned when he sold it to another person. Because it appears that a bona fide purchaser bought the property, Mary will not be able to recover the house.

Tracing

However, a constructive trust allows a party to trace their converted property. Here, Mary gave Frank $40,000, this went into a home, and then the home was sold for $300,000. Mary will be able to argue that the money she put into the home can be traced to the home and then to the sale and that a constructive trust of one-half of the sale price should be placed on the $300,000 proceeds that Frank gained from selling the property. This is likely Mary's best argument because a constructive trust will make Frank the trustee and require him to pay the increased money over Mary's $40,000.

Money Damages Inadequate

Mary will likely also be able to show that general tort damages are inadequate. Under general tort recovery from conversion, the individual is entitled to receive the market value of the item that was converted at the time it was converted. It could be argued that the $40,000 was converted when Frank took the property, leaving Mary entitled to only $40,000. Accordingly, damages would not be sufficient. Moreover, there is the risk, that without forcing Frank to be the trustee, he could spend the money, become insolvent, and leave Mary without any remedy.

Equitable Lien

Mary could also argue that an equitable lien should be placed on Frank's bank account. An equitable lien is also an equitable remedy whereby a person who acquires the personal property of another can have a court put a lien on that property. It is generally most useful when the property of another has been used to improve some other property or where the property has decreased in value and the owner of the property is seeking a deficiency judgment.

Here, Mary may argue that she should be entitled to an equitable lien, but this would be substantially less attractive than a constructive trust. For one thing, the value of the property, which can be traced, has increased significantly and can be secured through a constructive trust. For another thing, under the equitable lien theory tracing is not allowed. Thus, Mary would not be able to trace her money to the value of the increased value of the property that is now in the form of cash proceeds. Accordingly, this theory is less attractive to Mary.

Damages

As mentioned previously, Mary could be entitled to damages for conversion. But traditional tort damages for conversion allow recovery for the value of the property at the time it was converted. Here, it could be argued that the property was converted at the time that Frank took possession of the home. This would potentially limit Mary's recovery to $40,000.

Restitution

Mary could also argue that she is entitled to restitution. Restitution is a remedy that is available to prevent a party from being unjustly enriched at the expense of another. Here, it could be argued that a court should split the $300,000 that Frank received from the sale in half because if it was not for the contribution that Mary made, he would not have purchased the property and would not have later sold it at an enormous profit. For these reasons, restitution for the $150,000 that Frank made in the subsequent sale may also be a viable option.

Frank's Defenses

Frank is likely to assert several defenses.

Adverse Possession

Frank may argue that he adversely possessed the property after occupying it for 8 years by himself and thus gained title to the full share. This will fail because he had Mary's permission to occupy the property.

Laches

Laches is a defense that arises because a party takes such a long time to bring a cause of action that it materially prejudices the opposing party. This defense will likely fail. There is no indication that Mary waited an exceedingly long time to sell the property.

Statute of Frauds

Frank may also argue that Mary's agreement is barred by the statute of frauds. The statute of frauds is a defense that a party cannot assert to prevent a claim that a contract existed. It is applicable to an alleged contract to purchase or sell land, which must be in writing, signed by the grantor and include a purchase price. But this defense will likely not apply here. While the underlying issue involves an agreement regarding land, Mary is not suing to force the sale or purchase of property; rather, she is suing for money that was converted. Accordingly, this defense will likely not stand.

Unclean Hands

Frank's best argument will probably be unclean hands. The doctrine of unclean hands applies, especially in the equity context, to prevent a party from recovering where that party was involved in bad behavior relating to the underlying transaction. Here, Mary entered the agreement with Frank and put the property in his name for the purpose of avoiding creditors who were seeking to enforce debts against her. Accordingly, Frank could argue that Mary cannot recover in equity here because her own bad conduct was involved.

Who will likely prevail?

Under these facts, unless the court deems that Mary's conduct of trying to avoid creditors will bar her under the doctrine of unclean hands, she is likely to prevail. She will most likely seek a constructive trust or restitution for the additional money gained from the sale.

What remedy or remedies can Tanner reasonably obtain against Frank for conversion, what defenses, if any can Frank reasonably raise, and who is likely to prevail?

Tanner's Remedies

Tanner, like Mary, has several remedies it can seek against Frank.

Constructive Trust

See above definition. Tanner will argue that a constructive trust should be imposed because the money that Frank embezzled from them was used to purchase the property. Embezzlement consists of unlawfully obtaining title to the property of another by a person in lawful possession. Based on the facts here, Frank embezzled the $40,000 from Tanner and thus obtained title to it.

Tracing

Under a constructive trust, tracing is allowed. Here, Tanner will argue that the $40,000 was spent to purchase the property so title can be traced to the property, and when the property was sold, $150,000 of the $300,000 sale price can be traced to the original $40,000. While it may be argued that a constructive trust does not apply here because this is an instance where the property of another was used to improve other property, that is likely not the case. The $40,000 was used to purchase property that was kept in Frank's name and then sold with the proceeds going to Frank.

No adequate damages remedy

A problem may arise for Tanner in this instance if Frank can show that an adequate damages remedy would just be forcing him to pay back the $40,000 that he had converted. This problem may prevent Tanner from successfully having a constructive trust set up to recover the $150,000.

Equitable Lien

See above definition. An equitable lien may also be an option, but as mentioned previously, funds cannot be traced using an equitable lien. As a consequence, the money that was taken from Tanner would not be able to be traced to the home and then to the bank account. Accordingly, this option is not viable.

Damages

Tanner may just argue that it is entitled to damages for the money take. As mentioned, damages for conversion are the market value of the property at the time it was converted. Here, Tanner will be able to show that it is entitled to the $40,000 that was taken from it.

Restitution

Tanner may also argue that it is entitled to either the $40,000 or the $150,000 under a theory of unjust enrichment. It would be clearly entitled to $40,000 under this theory, but it may be able to argue that Frank would be unjustly enriched as a result of his fraudulent action if he is able to keep the money he made in addition to the $40,000 that he stole.

Frank's Defenses

Laches

Frank's best defense against Tanner is Laches. See above definition. Here, Frank may be able to argue that Tanner found out about the embezzlement in 2005, but did nothing until 2012. On the other hand, Tanner may argue that it was not aware that Frank had any money to make a lawsuit worthwhile until it found out that the house was sold for a significant profit. Because this is an equitable defense, a court will likely side with Tanner and not the wrongdoers.

Who will likely prevail?

Tanner will likely prevail on a theory of damages for the conversion limiting recovery to $40,000 or restitution under which the recovery for unjust enrichment of Frank could be up to $150,000. Either way, Frank's laches defense will likely not work.