

Question 6

Angela hired Mark, a real estate broker, to help her find a house to buy.

A week later, Mark contacted Angela and told her that he had found the perfect house for her. She asked him what he knew about the house. He said that the house had been owned for some years by Carol, who had kept it in pristine condition. When she visited the house, Angela noticed what appeared to be animal droppings on the deck. Carol assured her that they were only bird droppings, had never appeared previously, and would be removed before closing. Carol added that she never had any problem with any kind of "pests." Angela made an offer of \$500,000 for the house, and Carol accepted.

After closing, Angela spent \$10,000 to move her household goods to the house. A few weeks after moving into the house, Angela made several discoveries. First, the house suffered from a seasonal infestation of bats, which urinated and defecated on the deck. Second, Carol was in fact Mark's cousin, had owned the house for about a year, and had been desperate to sell it because of the bats. Mark was aware of all of these facts.

After the sale, Mark evenly split the proceeds with Carol and invested his \$250,000 in stocks that are now worth \$750,000.

At trial, Angela has established that Mark and Carol are liable to her in tort and contract.

1. What remedy or remedies may Angela obtain against Carol? Discuss.
2. What remedy or remedies may Angela obtain against Mark? Discuss.

QUESTION 6: SELECTED ANSWER A

1. Angela v. Carol

Rescission

Angela (A) may seek to have the contract with Carol (C) for the sale of the house rescinded. There must be grounds for the rescission and no defenses preventing it. A asked C about animal droppings she saw on the back deck and C assured A that they were only bird droppings and had never appeared previously. C then added, on her own, that she never had any problem with pests. These statements amount to a material misrepresentation of fact by C to A. A material misrepresentation is grounds for rescission if the seller made a misrepresentation of a fact that a reasonable buyer would have relied on and the buyer did in fact rely on the statements. While generally the doctrine of caveat emptor applies to omissions, there is implied in every land contract a duty not to make material misrepresentations. Generally the failure to mention a material fact is not actionable, though in some instances a court may hold the seller liable for known latent defects. However, here, C affirmatively represented, of her own accord, the fact that there were no problems with pests. And C also misrepresented the fact that the droppings were from bats that seasonally infest the house. These assurances made by C to A are of the type reasonably relied on by a buyer, since a buyer can't inspect a house for a whole year, she must rely on the seller's representation regarding seasonal conditions. Here, A did in fact rely on the misrepresentation. Thus, A has grounds for rescission.

C may try to bring the defenses of laches or unclean hands, however, A did nothing wrong to make her hands unclean and she discovered the infestation within weeks of the sale. This short period of time did not unfairly prejudice C so laches does not apply either.

Compensatory Damages

Compensatory damages aim to make the plaintiff whole, to put them in the position they would have been in had the contract been fully and properly performed. Here, A expected to own a house free of infestation. With the contract rescission, A has a right to the return of the price paid for the house plus any consequential and incidental damages. Consequential damages are those damages specific to the plaintiff that were foreseeable at the time the contract was entered. Incidental costs are those associated with dealing with the breach. Here, A is entitled to a return of the purchase price (\$500,000) plus the costs associated with moving her household goods into the house since it was foreseeable at the time of contract that she would need to move her items (\$10,000) plus any other incidental damages incurred in dealing with the breach (for instance, moving out costs or protecting her personal property from damage from the bats).

Punitive Damages

Punitive damages are not awarded in contracts claims. However, C's misrepresentations likely raise to the level of fraud and are thus actionable under tort law. In that case, C may be liable for penal damages for fraud. See discussion below regarding Mark's liability for penal damages.

Restitutionary Damages

Alternatively, A may recover restitutionary damages from C. Restitutionary damages seek to prevent the defendant from being unjustly enriched. The plaintiff may recover the reasonable value of the benefit received by the defendant. Here, C was unjustly enriched when she received the full contract price of \$500,000 for a house she knew to be seasonally infested with bats. A could recover the benefit to C of the contract price. However, the house was likely worth something, just not the full contract price. So any restitutionary recovery will likely look at the fair market value of the house as is (with

infestation) and award A the difference between the contract price and the fair market value.

Note that A may not recover both compensatory and restitutionary damages and thus will likely elect compensatory as the larger amount of damages.

Constructive Trust / Equitable Lien

A may get a constructive trust or an equitable lien over the compensatory or restitutionary money damages due to her. (See rules below)

2. Angela v. Mark

Angela may have entered into a contract with Mark (M) for his brokerage services but more likely he was held liable in tort for fraud. Fraud is the intentional misrepresentation of a past or present fact, made with the intent that the other rely on it and the other does reasonably rely. M was C's cousin, he knew of the bat infestation and that C was desperate to sell the house. He told A that the house was in pristine condition and he stood by while C represented that the house was free of any infestation. M also received half the proceeds from the house.

Compensatory Damages

See rule above. A may recover the full cost of the house as well as the cost of moving in (\$510,000), which represents the position she would have been in if the tort had not occurred. If M had not committed a fraud and induced A to purchase the house, she would not have spent the money to purchase and move in to the bat infested house.

Punitive Damages

If a defendant acts wantonly, willfully or maliciously, the plaintiff may also recover punitive damages as long as she recovers either compensatory or nominal damages as well (and sometimes restitutionary). Punitive damages seek to punish the defendant for his willful wrongdoing. Here, M was related to C and knew of the poor condition of the house. He knew that the house was infested and that C was desperate to sell because of the bats. This knowledge made M's actions in showing the house to A, representing that it was in pristine condition and not warning A of the bats willful. Thus, A will likely recover punitive damages for M's willful conduct.

Note: As mentioned above, C may also be liable for fraud and her active misrepresentations could also be found to be willful and malicious. Thus, A may also recover punitive damages from C in connection with the compensatory or restitutionary damages owed by C.

Restitutionary Damages

See rule above. M has been unjustly enriched since he received half the proceeds from the sale to A which was based on his fraud. He may have also received a broker's fee, also an unjust enrichment. A is entitled to the reasonable value of this benefit. Here, M received a \$250,000 benefit. Thus, A may recover \$250,000.

Constructive Trust / Equitable Lien

A constructive trust is a court order that the defendant hold the property in trust for the benefit of the plaintiff and return the property to the plaintiff, along with any enhanced value. If the property is no longer available but may be traced to another form, as long as it can be traced with certainty, the plaintiff may still recover the value of the property by tracing. Here, A may seek a constructive trust on M's \$250,000. M invested the money in stocks that are now worth \$750,000. Because the original \$250,000 can be

clearly traced to the stocks, A may recover the full, enhanced value of the property. Thus A is entitled to the stocks which are now worth \$750,000.

An equitable lien is a court-imposed security interest in the property which must be sold and the proceeds returned to the plaintiff. If the sale results in less money than is owed, the plaintiff may get a deficiency judgment and a lien on the defendant's other property to secure that judgment. However, the plaintiff may not recover any enhanced value in the property. Tracing may also be used to ensure return of the property. Here, A could get an equitable lien on the stocks (traceable from the money M received) and force a sale of the stocks in order to receive the \$250,000 of restitutionary damages she is owed. She would not be entitled to the full \$750,000 under an equitable lien.

Thus, A will seek a constructive trust in order to recover the restitutionary damages owed to her.

QUESTION 6: SELECTED ANSWER B

1. Angela's remedies against Carol.

The issue is to what remedies Angela is entitled to obtain against Carol for Carol's liability in tort and contract.

In contract

Damages for breach of contract can either be legal or equitable.

Legal Remedies

Damages

The typical measure of damages in contract is the expectation measure. That is, the non-breaching party to a contract is entitled to be put in the same position that she would have been in had the other party not breached the contract. Here, at the end of the contract, Angela expected to be in possession of a house that was in "pristine condition" that did not have a bat infestation.

Presumably, the seasonal bat infestation reduced the market value of the house and Angela would not have paid \$500,000 for the house had she known of it. Therefore, in order to protect Angela's expectation, she is entitled to receive the difference between \$500,000 contract price and the market value of the house at the time of closing.

Angela is not entitled to her \$10,000 of moving expenses as damages because she would have had to spend that amount if the house was in the condition she expected it to be, regardless of the bats.

Finally, Angela has not suffered any consequential damages from the purchase

of the house (losses that are foreseeable at the time of contract) and punitive damages are not recoverable in contract.

Restitution

Angela may also recover on a restitution theory. Restitution is a remedy that is used to avoid unjust enrichment from a party's wrongdoing. Here, due to Carol's misrepresentations, she was able to sell the house at a price above its market value. Therefore, Angela may recover the difference in the contract price and the fair market value of the house at the time of closing.

Again, Angela is not entitled to the \$10,000 in moving expenses in restitution because those moving expenses were paid to a mover, not to Carol.

Equitable Remedies

Rescission

Rescission of a contract is an equitable remedy whereby the contract is rescinded as if it never happened. Essentially, the party seeking rescission must argue that the contract was never formed because there was no meeting of the minds. If the contract here is rescinded, Angela would receive her \$500,000 purchase price while Carol would be put back in possession of the house. Grounds for rescission include: mistake and misrepresentation.

There are two types of mistake: Mutual Mistake and Unilateral Mistake. Mutual mistake exists where both parties to a contract are mistaken as to a fact that substantially affects the basis of their bargain. Here, Carol was not mistaken about any facts with regard to the contract--she knew of the bat infestation and its effects.

Angela will be able to successfully argue unilateral mistake. Unilateral mistake is not typically a grounds for rescission. However, when the non-mistaken party knows of the mistake of the other party and proceeds with knowledge in the face of that mistake, the mistaken party may rescind the contract. Here, because Angela did not know of the bat infestation, and Carol both knew of the infestation and knew that Angela did not know of it, unilateral mistake is applicable and Angela may rescind on that ground.

In addition to the ground of unilateral mistake, Angela may rescind on grounds of misrepresentation. Misrepresentation occurs when a party makes a material misrepresentation, with the intent that the other party rely on the statement, the reliance is justified, the other party does indeed rely on the statement and that party suffers damage. Here, Carol misrepresented that she had never seen the droppings before and that they were bird droppings. She intended for Angela to rely on the statement and Angela did indeed rely on the statement and suffer damages. The only issue is whether Angela's reliance was justified. Considering that Mark said that Carol kept the home pristine and Angela was assured by Carol, the homeowner, regarding the condition of the house, Angela's reliance was likely justified. Carol may be able to argue that Angela should have hired an independent appraiser of the house instead of relying on her statement, but this argument will fail because Angela's reliance was justified given Mark's corroboration of the condition of the house.

Therefore, the equitable remedy of rescission is warranted on grounds of unilateral mistake and misrepresentation and Angela should be entitled to her \$500,000, and the house will be returned to Carol.

In Tort

Legal Remedies

Damages

Angela may sue Carol for damages in the amount that Carol's misrepresentation cost her. Therefore, she should be able to recover the amount that will be required to fix the bat infestation and any damage already caused by the bats.

In addition, Angela may be able to recover punitive damages from Carol because of Carol's outrageous lies and conduct. Not only did Carol lie about the droppings and that she had never seen them before, she had been desperate to sell the house and was Mark's cousin, with whom she perpetrated a fraud on Angela. Typically, punitive damages are limited to a cap of less than ten times the actual damages.

Equitable Remedies

Constructive Trust

A constructive trust is a restitutionary equitable remedy. If a constructive trust is imposed, the defendant must return the property to the plaintiff. A constructive trust will be imposed when 1) the defendant holds title to property, 2) title was acquired by the defendant's wrongful conduct, and 3) retention of the property would result in the unjust enrichment of the defendant. Typically, the plaintiff will pursue a constructive trust when the value of the property increases while the defendant has held the property.

Here, Carol holds the proceeds from the sale, she acquired it with wrongful conduct as discussed above, and retention of the proceeds would result in unjust enrichment. However, the legal remedies described above are adequate to remedy Angela's harm. Therefore, the court should not grant this remedy.

Equitable Lien

An equitable lien is also a restitutionary equitable remedy. If an equitable lien is imposed, the plaintiff will acquire a security interest in the property and the property will be subject to an immediate court ordered sale, and the plaintiff will be entitled to the

proceeds. An equitable lien will be granted upon the same conditions as a constructive trust.

Angela will be able to show the conditions for imposition of an equitable lien have been met. However, the legal remedies described above are adequate to remedy Angela's harm. Therefore, the court should not grant this remedy.

2. Angela's remedies against Mark.

Equitable Remedies

Constructive Trust

The requirements of a constructive trust are listed above. Because the source of the funds used to purchase the stock is directly traceable to his unjust enrichment from the transaction, Angela will be able to force Mark to turn over the stock to her in a constructive trust. She will be entitled to keep the entire value of the stock.

Equitable Lien

Angela will be able to show she is entitled to an equitable lien. The court will trace the proceeds that Mark used to purchase the stock to his unjust enrichment from his involvement in the transaction, and Angela will be granted a security interest in the property. Then, the stock will be subject to sale and Angela will be entitled to receive Mark's \$250,000.

Legal Remedies

Replevin-

Damages-