

## Constructive Trusts

They are a potential remedy for wrongful pre-death transfers, abuse of confidential relationships and nonprobate diversion of assets. A look at the possibilities and issues

Probate litigation has changed drastically in the last several decades, particularly as nonprobate transfers have become an increasingly important way of moving assets from one generation to the next. For such transfers involving wrongdoing, though, traditional arguments of lack of intent to make a gift, lack of capacity and undue influence are—by themselves—not always enough to get the job done. It may be particularly appropriate and useful also to assert constructive trust claims.

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Setting aside nonprobate transfers can be an uphill battle, both legally and practically. With will contests, the law is defined,<sup>1</sup> and the probate estate is usually easily accessible to the contesting party; this is not as often the case with nonprobate transfers. There are many other difficulties, as well. For example, a standard of clear-and-convincing evidence frequently applies to setting aside joint-tenancy bank accounts.<sup>2</sup> The statute of limitations is more often an issue when a decedent has, before death, established a joint tenancy or beneficiary designation. In those cases, it can be difficult to determine if the transfer was done as a matter of convenience to facilitate lifetime assistance or if it was done with the requisite testamentary intent. The assets subject to dispute are not as determinable or recoverable.

Many attorneys have a blind spot when it comes to nonprobate transfers: They don't see how such transfers can be effectively disputed. But they sometimes can be. A constructive trust can serve as a very effective weapon. Unfortunately, court opinions on constructive trusts have neither been neither conceptually consistent nor clear. The constructive trust legal scheme is not yet well-defined, because of its piecemeal and scattered development. But this is an emerging area in trusts-and-estates litigation. Practitioners are well advised to learn all they can about when and how to use constructive trusts.

## TRENDS

Several recent trends have contributed to the growing importance and utility of constructive trust claims. There has been a dramatic increase in the availability and use of nonprobate transfers.<sup>3</sup> That is because the law has simplified nonprobate transfers and probate administration; it has reduced formalities and allowed greater latitude in the use of powers of attorney and living trusts.<sup>4</sup> Also significant is the increase in the volume of assets passing at death through retirement arrangements, particularly individual retirement accounts (IRAs), by the use of beneficiary designations.

Meanwhile, the aging of the population and breakdowns in family relationships have made contested trusts-and-estates cases more likely. As people live longer and become more susceptible to disabling diseases, such as Alzheimer's and macular degeneration, they more often suffer from diminished capacity for longer periods of time. Their increased need for caregivers in later life has created new opportunities for others to abuse their confidence.

Society's frequently mistaken desire to avoid "probate" also has created a fertile environment for abuse of the elderly. The legal system has had to contend with increasingly sophisticated predators who take advantage of the changing legal landscape of reduced formalities and attorneys' diminished involvement in the process. Traditionally, attorneys' presence in probate matters provided a buffer against fraud, undue influence and abuse of diminished capacity. But now, with the grow-

ing numbers of nonprobate transfers, there are greater problems of proof and recovery as well as more opportunities for predators to cover their tracks.

## APPLICATIONS

Constructive trusts are particularly suited to protect against improper lifetime transfers. This happens not just with diminished capacity and abuse of confidential relationships, but also with informal arrangements such as joint tenancy with right of survivorship for bill paying, financial management and informal estate planning.

Constructive trusts have a special, but frequently overlooked utility when property is transferred outright or into joint tenancy with right of survivorship during an elderly person's lifetime in such a way as to disinherit the natural objects of that elder's bounty or otherwise change his existing estate plan. In recent years, these circumstances seem to arise as often as situations involving a potential will contest.

It has become extremely common for the elderly to place property into joint tenancy with right of survivorship, or in the name of a single child or other trusted person, under the misguided belief that such an informal arrangement is the best way to provide for asset management and avoid conservatorship in the event of incapacity. The better alternative is to use a durable power of attorney, but people often neglect this option.

Sometimes, there is the intention and an implicit understanding that the person holding title will use the property for the benefit of the transferor during the transferor's lifetime and/or that the property will be shared with other intended beneficiaries after the transferor dies. Usually, transferees act honorably and share the property with the transferor or other beneficiaries. But it also often happens that transferees decide not to honor transferors' intentions and instead assert unrestricted claims of ownership to the property. The original transfer may, but does not necessarily have to have been the result of undue influence, mistake or fraud. Generally, it does involve a transferee abusing a "confidential relationship" with the transferor. Then again, the transferor may have intended to make a

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complete gift and not intended for the transferee to share the property with others.

With such transfers, many attorneys assume there is little chance of remedy after a transferor has died, absent substantial evidence that the transferor lacked legal capacity to make the transfer or clearly lacked the intention to make a gift. Yet the same attorneys would attack such a transfer if it were made under the decedent's will, claiming fraud, undue influence or lack of testamentary capacity. But the situation is not hopeless; constructive trusts can come to the rescue.

Another overlooked potential use of constructive trusts arises in the Medicaid arena. Generally, the assets that a potential Medicaid recipient transfers to relatives are subject to inclusion in the government's calculation of the donor's assets if the transfer was made within five years of an application for Medicaid benefits. While intra-familial transfers often are unattended by the formal documentation associated with transactions made with nonrelatives, Medicaid still might view the property as the applicant's asset. For example, a mother decided to sell her home to her son 20 years ago; the son paid his mother monthly, and was responsible for the taxes, upkeep and insurance on the property; yet no formal transfer was made. One remedy for avoiding the inclusion of the house within the mother's assets as a resource for Medicaid purposes would be to seek judicial imposition of a constructive trust on the home in favor of the son.

Constructive trusts also might be helpful in the tax arena. Consider the tax issues associated with improperly administered charitable remainder trusts (CRTs) and grantor retained annuity trusts (GRATs), or with family limited partnerships (FLPs) when inadequate or disproportionate distributions have been made. In *Estate of Atkinson v. Commissioner*,<sup>5</sup> an annuity trust was deemed an invalid CRT and thus the estate did not qualify for a deduction for the bequest of a chari-

table split-interest. The CRT was set aside because the required 5 percent annual distributions had not been paid to the decedent during the decedent's lifetime and because the trust corpus had to be invaded to pay both the estate tax attributable to a secondary beneficiary's interest, pursuant to a settlement of her dispute, and the administration expenses and retirement of decedent's debts. Based on *Atkinson*, it has been suggested that GRATs, when the annuity has not been paid, also are susceptible to being set aside. It may be that imposing a constructive trust on unpaid income would be a good option for such circumstances.

The Internal Revenue Service's guidelines on FLPs cite matters such as disproportionate distributions, commingling, inclusion of personal use property, and failure to transfer assets to the FLP as grounds for applying Internal Revenue Code Section 2036 to deny valuation discounts. But it may be that a post-death constructive trust could be imposed in favor of the other FLP partners as to their pro rata share of distributions, when the distributions previously had been disproportionate, or as to assets that should either have been transferred in the partnership or excluded, to address these problems.

The ability to impose a constructive trust on the assets of a decedent held by a party as a matter of convenience, even when the transferee does not dispute the rights of the transferor, can produce tax benefits. For example, it should result in an increased tax basis in the assets at death under IRC Section 1014. Further, the transfer of assets from the original transferee to the intended recipients should not be a taxable gift, even if it is in excess of the \$12,000 annual exclusion. Of course, another option may be to establish the existence of a retained interest under IRC Section 2036, particularly if the asset transferred was the transferor's residence

or the transferor continued to receive income from the asset.

## RELATED CONCEPTS

Generally, the court decisions on constructive trusts suffer from a lack of analytical precision both in distinguishing concepts and in differentiating the imposition of a constructive trust as a remedy versus its operation as a separate cause of action.<sup>6</sup> For example, compare the assertion in *American Jurisprudence 2d* that "[t]he issue is not whether the property was acquired in a wrongful manner, but the wrongfulness of its retention"<sup>7</sup> with its later statement that "[t]he Courts do not seem inclined to debate whether the Defendant transferee or the disappointed donee is more deserving of the property than the other . . . it seems that the disappointed Plaintiff's primary burden, besides showing the confidential relationship, is to show a rational expectancy based on the transferor's intention, entitled to equitable protection."<sup>8</sup>

Thus, even when it cannot be shown that a transferor lacked legal capacity or the intent to make a gift, the operation of the remedy to impose a constructive trust or other concepts can be brought to bear on situations involving abuse of confidential relationships and/or undue influence in connection with probate litigation.

A constructive trust claim, when based on a confidential relationship, is akin to an action to establish undue influence in the making of a will. However, rather than seeking to invalidate a will, the plaintiff may be seeking to recover property passing outside of a will that would have gone to the plaintiff under the decedent's will.

It may be possible to show undue influence in connection with the original transfer.<sup>9</sup> However, if the existence of a confidential relationship has been established, a transaction may be set aside and a constructive trust imposed simply because that relationship has been abused; it is not necessary for the abuse to be the cause of the original

conveyance. The abuse of the confidential relationship can be merely the failure to honor the transferor's intentions with respect to the original transfer, which would not have been made but for the confidential relationship.<sup>10</sup>

After a transferor's death, some basis must exist for the court to conclude that the decedent intended for the property to go to the plaintiff (that is to say, there is a defeated expectancy.) Courts will look for some wrongdoing, undue influence or other participation by the defendant in procuring this defeat of the expectancy, or some other basis for assuming that the decedent initially intended the transferee to share the property with others; that is to say, the transfer was intended as an informal property management and/or estate-planning device with a disposition inconsistent with the transferor's overall estate plan.

In the probate area, courts have enforced an oral trust on the grounds of "remedy of specific restitution" as distinct from the remedy of a constructive trust based on abuse of a confidential relationship.<sup>11</sup> This approach assumes some sort of agreement between the parties. In such circumstances, the statute of frauds and the parol evidence rule would not be impediments to the enforcement of an oral trust with regard to personal property, but would operate as a bar to proof of a trust obligation with respect to real estate, giving rise to the utility of the constructive trust concept in situations where a remedy might not otherwise be available.<sup>12</sup> It has generally been recognized that the statute of frauds does not prevent the declaration of a constructive trust. Further, in most states the parol evidence rule will not bar testimony regarding the parties' intentions.<sup>13</sup>

Thus, a constructive trust claim is useful in circumstances where imposition of an oral trust might otherwise not have been appropriate and where lack of capacity or undue influence could not otherwise be proven. However, imposition of a trust relationship need

not be based on an express agreement between the deemed settlor and trustee, as appears to be true in connection with application of the "resulting trust" concept.<sup>14</sup> In fact, the defendant may have had an understanding and intent opposite that of the decedent's at the time of the conveyance or other action causing the property to pass to the defendant.

However, the concept of resulting trusts, as an "intent rectifying" remedy has been applied in similar circumstances. It is frequently stated that constructive trusts are not "intent-rectifying" trusts like resulting trusts, but are "fraud-rectifying" trusts—"fraud" in this context meaning any kind of wrongdoing (including breach of a promise to hold property for the benefit of others), not just intentionally false representations.<sup>15</sup> In operation, this distinction does not seem to really explain the difference between these concepts as applied by the courts. "Wrongdoing" may mean nothing more than that the property did not go to the intended party.<sup>16</sup>

## THE RELATIONSHIP

Traditionally, a "master-slave" relationship is required for a presumption of undue influence based on a confi-

dential relationship.<sup>17</sup> A confidential relationship exists when, on one side, a confidence is reposed and, on the other side, there is the resultant superiority and influence.<sup>18</sup> Sometimes the court used the terms confidential relationship and fiduciary relationship interchangeably although legally they are not synonymous.

Conclusive evidence of a confidential relationship may be established through a combination of a close personal relationship, a decedent's (transferor's) poor health, a defendant's control or dominance over the decedent, the decedent's physical infirmities, the decedent's need for emotional support, and the decedent's changeable and confused mental state, thereby shifting the burden to the defendant to show that there was no undue influence. If the decedent made the transfer without legal advice<sup>19</sup> and the defendant was active in the procuring the transfer, the presumption may apply.<sup>20</sup>

On the other hand, it is not necessary to show loss of mental capacity, fraud in procuring the transfer, or inability to handle business affairs for the court to impose a constructive trust in favor of the intended recipient of the property in issue.<sup>21</sup>



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Constructive trusts have been imposed even in the absence of evidence that the dominant party suggested the transfer or otherwise acted to impose his will on the dependent party.<sup>22</sup> This is particularly true when there is evidence that the transferor used the transfer as an informal estate-planning device; for example, intending a trusted child to share with other children.

A transferor's mental confusion or mental impairment will support a constructive trust claim even if the transferor has legal mental capacity. However, even a decedent who had the capacity to handle his own business affairs may, because of circumstances causing total dependence on the transferee, make a transfer subject to imposition of a constructive trust on grounds of undue influence, fraud or breach of fiduciary duty.

In holding that a family relationship alone probably will not give rise to a confidential relationship in a case involving a will contest, the Pennsylvania Superior Court stated: "A confidential relationship for purposes of undue influence exists 'whenever circumstances make it certain that the parties did not deal on equal terms but that on one side there was an over-mastering influence, and on the other, dependence or trust, justifiably reposed.'"<sup>23</sup> According to the Pennsylvania Supreme Court, the term "influence" does not encompass every line of conduct capable of convincing a self-directing person to dispose of property in one's favor.<sup>24</sup> The court went on to explain that the law requires that the influence be control "acquired over another that virtually destroys [that person's] free agency."<sup>25</sup>

Most recently, the Pennsylvania Supreme Court defined conduct constituting influence as consisting of "imprisonment of the body or mind, fraud, or threats, or misrepresentations, or circumvention, or inordinate flattery or physical or moral coercion,

to such a degree as to prejudice the mind of the testator, to destroy his free agency and to operate as a present restraint upon him in the making of a will," in holding that a parent-child relationship does not establish the existence of a confidential relationship nor does the fact that the proponent has a power of attorney where the decedent wanted the proponent to act as attorney-in-fact.<sup>26</sup>

Nevertheless, a family relationship is a factor the courts consider.<sup>27</sup> Circumstances of age, and failing health and dependence on a family member for assistance give rise to a confidential or fiduciary relationship (the courts have used the terms as if they were interchangeable in this context) justifying the imposition of a constructive trust.<sup>28</sup> Yet these characteristics are by no means necessary elements, and there is no set formula by which the existence of a confidential relationship may be determined for purposes of imposing a constructive trust.<sup>29</sup>

A claim by children from a prior marriage against a surviving spouse for "undue influence" is difficult to prove, given the courts' recognition that one spouse naturally has influence over the other.<sup>30</sup> However, proof of diminishing capacity and other circumstances creating greater susceptibility to influence by a spouse may operate in such circumstances to support imposition of a constructive trust.

### SHIFTING THE BURDEN

In cases involving a confidential relationship to the transferor, the burden of going forward shifts to the defendant to establish that the transaction was not the result of undue influence.<sup>31</sup> Once the defendant presents evidence of the absence of undue influence, the defendant has, accordingly, burst the bubble, so that the presumption of undue influence drops out of the case.<sup>32</sup> Then, the burden of going forward to prove undue influence shifts back to plaintiff.<sup>33</sup>

The shifting of the burden of proof appears designed to create a more level playing field in situations where transfers are made by persons susceptible to manipulation by persons in a position to exercise and conceal such manipulation. It is unclear from existing case law what proof will suffice and what practical impact the shifting of the burden of going forward will have, as opposed to a shifting of the burden of proof.

### OUTER LIMITS

The uses of the remedy of the imposition of a constructive trust are limitless and its parameters are as yet undefined by the courts. As recognized by the New York Court of Appeals, "[i]ts applicability is limited only by the inventiveness of men who find new ways to enrich themselves unjustly by grasping what should not belong to them."<sup>34</sup>

While availability of the constructive trust remedy is not limited to the transferor, courts should be more willing to impose a constructive trust strictly on grounds of unjust enrichment (without findings of fraud, confidential relationship or duress) if it is the original owner of the property who will recover, as opposed to third-party intended beneficiaries.

A constructive trust may be imposed in favor of one who would have been the donee or devisee of the property against the transferee who obtained the property by undue influence and thus prevented the gift to the intended donee from being accomplished.<sup>35</sup> A constructive trust arises in favor of one who, but for the undue influence of the transferee (the constructive trustee), would have received the property.<sup>36</sup> There appears to be a general consensus supporting the view that a constructive trust should be imposed, even though the wrongful conduct by which the title was acquired, was that of a third party and not the donee (deemed trustee).<sup>37</sup> Thus, the doctrine should be applicable to the wide variety of nonprobate transfers

taking effect at death or coming into question after death, because of their impact on third parties (such as life insurance and pension benefits, beneficiary designations, payable-on-death accounts, any assets held in joint tenancy, transfers into inter vivos trusts and lifetime outright transfers.)

As an example of the concept's potentially broad utility in situations attorneys frequently view as hopeless, a constructive trust has been imposed on life insurance proceeds paid in violation of a separation agreement, regardless of the fact that the designated recipient was innocent and without notice.<sup>38</sup> A constructive trust was imposed on the full proceeds of life insurance purchased with property embezzled from a trust in *Lackey v. Lackey*.<sup>39</sup>

More recently, in *Faulknier v. Shafer*,<sup>40</sup> a court imposed a constructive trust for the benefit of the first wife when her former husband failed to maintain a life insurance policy with her as the beneficiary as ordered by the final divorce decree. When the husband died, the insurance proceeds were paid to the second wife, and the first wife filed suit. The court held that the imposition of a constructive trust was equitable, because the property was given to the defendant in breach of the husband's obligation to the plaintiff. Accordingly, the court ruled that equity will impose a constructive trust upon "that property in the hands of the recipient even though (1) the transfer is not the result of breach of a fiduciary duty or an actual or constructive fraud practiced upon the plaintiff, and (2) the donee or devisee had no knowledge of the wrongdoing or breach of contract."

On the other hand, in *Wilharms v. Wilharms*,<sup>41</sup> the court held that there must be some evidence of wrongdoing, and not merely an allegation that a former spouse wrongly changed the beneficiary designation on his life insurance policy.

In certain instances, the imposition of a constructive trust may be a better remedy than a claim against the pro-

bate estate, which may be insolvent. For example, the appeals court in *Murphy v. Glenn*<sup>42</sup> affirmed the imposition of a constructive trust on a revocable trust to enforce a contract to will. In dicta, the Colorado appeals court also noted that the lower court could have, in the alternative, declared the transaction to defeat the effect of the contract to will (in this case, the creation and funding of an inter vivos trust), void ab initio, resulting in the assets passing in probate pursuant to the agreed upon estate plan.<sup>43</sup> Similarly, the court in *Nile v. Nile*<sup>44</sup> upheld a constructive trust on a revocable trust to secure a post-divorce settlement agreement.

A constructive trust has also been found to be appropriate when, as a result of a mistake in a transaction, one party is unjustly enriched at the expense of another. Thus, in *In re Estate of Tolin*,<sup>45</sup> a constructive trust was imposed when testator failed to effectively revoke a codicil because of mistake of fact. In *Logie v. J.P. Morgan*,<sup>46</sup> a constructive trust was imposed when a bank failed to follow the depositor's instructions to title an account as a survivorship account.

Demonstrating the possible outer limits of the concept, in *Allen v. Dalk*,<sup>47</sup> the Florida Supreme Court refused to impose a constructive trust to validate a witnessed and notarized, but unsigned will, despite the testator's "probable" intention to execute that will.

The intended devisees of a will were able to impose a constructive trust on the decedent's estate even when the assertion of traditional grounds for invalidation of the existing will (that is to say, incapacity and undue influence) seem inappropriate or unlikely to be successful, if decedent was wrongfully prevented from executing a will in the intended devisees' favor.<sup>48</sup>

Demonstrating the potentially broad application of constructive trusts in probate, one trial court, in an eviction action, imposed a constructive trust on property, recognizing the right of a disabled third party to a life estate in

property transferred during lifetime by the parent of the third party.<sup>49</sup>

Clearly, the constructive trust remedy is a flexible tool in the probate arena.

Still, the limits of the constructive trust should be recognized. Courts should consider the importance of protecting the recipient of the property from potentially unfounded or tenuous claims. Also, courts should draw the line in using the doctrine to grant relief in cases where the intended beneficiary's rights were defeated because of the transferor's intentional failure to get the job done right or there is no evidence of actual undue influence. For example, if a joint tenancy account had been created several years before death by a strong willed decedent with a friend she knew for most of her life, this would not normally be an appropriate situation for application of the concept. This would not be the type of "new best friend" situation involving susceptibility to undue influence as to which imposition of a constructive trust is particularly appropriate. Constructive trusts should not be used to remedy every injustice or botched inter vivos gift or testamentary disposition—or to give every disgruntled heir a right to sue.

## SPECIAL ISSUES

First, imposition of a constructive trust is an equitable remedy and technically not a separate cause of action, although court opinions have lacked clarity and precision in this regard. A number of different causes of action can be, and have been, asserted in cases involving the imposition of a constructive trust. These include undue influence, breach of fiduciary duty, failure to lodge a will, fraudulent and negligent misrepresentation, tortious interference with inheritance rights,<sup>50</sup> abuse of process, tortious misfeasance and nonfeasance, and civil conspiracy. Such causes of action also support a claim for punitive damages. A confidential or fiduciary relationship exists, as the court in *Circle T Corp. v. Deerfield* put it, when "there is special confidence reposed in one who in equity

and good conscience is bound to act in good faith and with due regard to interests of one reposing the confidence."<sup>51</sup> In some cases the cause of action has been stated simply as unjust enrichment.

Second, the standard of proof is uncertain as to constructive trust claims. When property is titled in joint tenancy, the difficulty of setting aside the transfer is increased by most states' laws, which require clear and convincing evidence to establish that joint tenancy with right of survivorship was set up as a matter of convenience only and not to vest rights of ownership in the survivor.<sup>52</sup>

However, because the imposition of a constructive trust is not necessarily dependent upon proof of the "intention of the decedent at the time the account was created," the clear and convincing evidence standard is not always applicable to a constructive trust claim, and the standard of proof required varies among the states.<sup>53</sup> In the Colorado case of *Page v. Clark*, the court used a preponderance of evidence standard whereas in the Mississippi case of *Calcote v. Calcote* the court imposed the clear and convincing standard.<sup>54</sup>

## REMEDIES

In post-death situations, the courts have sometimes simply awarded the disputed assets to the decedent's heirs<sup>55</sup> and devisees.<sup>56</sup> No precise rule exists for determining the amount of a plaintiff's additional monetary damages recovery in conjunction with a constructive trust claim, because the circumstances vary so significantly.<sup>57</sup> It is frequently appropriate to have an accounting of income, and/or proceeds from asset sales, in cases founded on breach of fiduciary duty.<sup>58</sup> The decree establishing the constructive trust can require that the defendant deliver possession of the property to the plaintiff, as well as the profits received, after taking an accounting.<sup>59</sup>

Several questions can arise as to the appropriate measure of damages. Would recovery of a nonprobate asset claimed by the residuary devisees of an estate be subject to administration expenses and

claims of the decedent's estate? What if the defendant did not file a formal claim against the estate? Should the court recognize equitable offsets available to the defendant (that is to say, for services in caring for a sick transferor rendered by the defendant) or in managing the property? Would a spouse's elective share or the family and exempt property allowances be valid offsets to a constructive claim against a surviving spouse by children of a prior marriage? Also, what are the estate tax consequences of the claim (for example, its impact on a marital deduction)? Settlements of such cases can sometimes be structured to greatly reduce tax liabilities by recognizing lifetime transfers or transfers to spouses.

Punitive damages have been awarded for a breach of fiduciary duty.<sup>60</sup> Thus, punitive damages may be awarded based on the existence of a fiduciary relationship in a constructive trust action. The breach of a fiduciary obligation that includes the elements of malice, oppression, fraud or similar reprehensible conduct will support an award of exemplary damages.

A constructive trust claim is an equitable remedy, although breach of fiduciary duty or fraud causes of action, upon which a constructive trust claim can be based, are legal, not equitable claims. Consequently, punitive damages in some states are impermissible, but a limited number of states do allow punitive damages, particularly in instances involving fraud and malice.<sup>61</sup>

In connection with the imposition of a constructive trust in the nonprobate context, the court can hold a defendant liable for damages for breach of fiduciary duty, as well as entering an order for the transfer of specific property under a constructive trust theory, as it did in the Arizona case of *Turley v. Ethington*.<sup>62</sup> In *Turley*, plaintiff partners of a partnership agreement successfully withstood a motion to dismiss by the defendant partners. The court granted the plaintiffs the opportunity to prove that defendants purchased property on behalf of the partnership, but failed to

convey a portion of the profits or real property to them, in order to pursue the imposition of a constructive trust, as well as monetary damages.<sup>63</sup> Contrast this result with the Florida case of *Meltzer*, supra, in which the court applied the law of partnerships rather than impose a constructive trust.

## STUMBLING BLOCKS

There are difficulties in asserting constructive trust claims, among them problems with statute of limitations, dead man's statutes and discovery.

- *Statute of Limitations*—Unique issues arise for a constructive trust claim with respect to the statute of limitations. One question is whether the statute of limitations begins to run at the time of the original transfer. The time of accrual of a constructive trust claim, based on breach of fiduciary duty and fraud, has consistently been recognized to be a question to be resolved by the trier of fact. In *Nevarez v. Nevarez*,<sup>64</sup> the court held that a constructive trust claim accrues at the time of discovery of the defendant's breach of trust, not the initial transfer. The court in *Johnston v. Cigna* recognized that for statute of limitation purposes, it is necessary to make a specific inquiry into the context of a confidential or fiduciary relationship: "[F]acts which would ordinarily require investigation may not excite suspicion, and the same degree of diligence is not required."<sup>65</sup> The court also said, "Justified reliance on representations made within the ambit of such a fiduciary relationship lessens the duty or reasonable inquiry imposed on the claimant under the constructive trust as to the facts which underlie his claim."<sup>66</sup>

It may be particularly appropriate to apply the doctrine of equitable estoppel as a bar to a statute of limitations defense. Frequently, potential plaintiffs are dissuaded from commencing legal actions to protect their rights to assert constructive trust claims because transferees give assurances of their intention to recognize the rights of the transferor (or the transferor's ben-

eficiaries) in the property or make intentional efforts at concealing the transfer. Such assurances not only can form the factual basis for the imposition of a constructive trust in the first instance, but also can be held to estop the transferee from asserting the statute of limitations as a defense.<sup>67</sup> At least two courts have held that the statute of limitations runs on a resulting trust claim when the trust has been repudiated.<sup>68</sup>

It has been held that the statute of limitations runs on a resulting trust claim when the trust has been repudiated.<sup>68</sup>

- *Dead Man's Statute*—In states that have a Dead Man's Statute, plaintiffs with constructive trust claims often face tough tactical decisions. To shift the burden of proof to the defendant in constructive trust claims, it is sometimes necessary for a plaintiff to offer self-serving testimony about the decedent's statements about an intention to make a gift. But if a Dead Man's Statute applies, the plaintiff may not be able to satisfy this burden.

Eighteen states retain some form of a Dead Man's statute: Arkansas, Colorado, Idaho, Indiana, Illinois, Louisiana, Maryland, New Jersey, New York, Pennsylvania, South Carolina, Tennessee, Texas, Vermont, Washington, Wisconsin, West Virginia and Wyoming. Twelve of these have statutes that absolutely bar testimony from an interested witness about conversations or transactions with the deceased. The others have more limited Dead Man statutes that disallow testimony regarding oral communications with the decedent while permitting testimony regarding transactions; still others permit testimony if there is other corroborative evidence of the conversation in question.

Whether a Dead Man's Statute is applicable to proceedings for the probate or contest of wills or to set aside probate depends upon a particular statute's language.<sup>69</sup> For example, the court in *Askins v. Easterling*,<sup>70</sup>

## DEFINITION

### How the authorities explain constructive trusts

Broadly speaking, a constructive trust is an equitable device used to compel one who unfairly holds property to convey it to that person to whom it justly belongs. The concept has been applied in a broad variety of circumstances, generally, to prevent unjust enrichment, including in bankruptcy, divorce and business ventures.

In the bankruptcy context, a property owner, Climax, argued for a constructive trust in its favor on funds traced from payments made by Climax when Climax paid to release a mechanic's lien against its property after the contractor, Specialized Installers, failed to pay its subcontractor, Avery. Specialized Installers then filed for bankruptcy in *In re Specialized Installers, Inc.* The opinion stated that a constructive trust is a remedy "devised to prevent unjust enrichment and compel restitution of property that in equity and good conscience does not belong to the defendant...[i]t does not require an intent to create a trust," and "neither actual fraud nor the existence of a fiduciary relationship need be shown."

In the divorce context, when there is evidence that a spouse engaged in a scheme to financially benefit himself, an equitable duty has been found to exist and a constructive trust has been imposed.

*Loring: A Trustee's Handbook*, gives a good general description of the concept: "The constructive trust is a remedy available for certain breaches of an express trust. . . . It also is an equitable remedy employed by the courts to avoid unjust enrichment, to include affording a remedy for certain breaches of contract: If a person comes into possession of real or personal property as a result of fraud, undue influence, or some other such intentional wrong (with a few minor exceptions), he will hold the property not for himself or the perpetrator of the wrong but as a constructive trustee for the person who, but for the wrong, would have received the property. As this applies even to transfers of land upon an oral trust, the remedial constructive trust is said to be an exception to the statute of frauds. If the transferee is in a confidential relationship with the transferor, the element of fraud or undue influence need not even be present, nor the element of procurement for that matter. There need only be unjust enrichment that is incident to a confidential relationship."

Similarly, *The Law Of Trusts Abridgment* states: "A constructive trust arises when a person who holds 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 may arise, however, even though the acquisition of the property was not wrongful. It arises when the retention of the property would result in the unjust enrichment of the person retaining it....But where the property would have passed to a third person but for the wrong, the wrongdoer may be compelled to surrender the property to the third person, rather than to surrender it to the person from whom he obtained it or to his estate."

Generally, a confidential or fiduciary relationship, warranting the imposition of a constructive trust for abuse of such relationship, may arise when one has justifiably reposed confidence in another. A constructive trust arises "when a person, cloaked with some fiduciary character, gains some advantage for himself, or when there exists some professional or confidential relationship, [or] family ties . . . which might have impelled or induced [the plaintiff] to relax the care and vigilance it would and should have ordinarily exercised in dealing with a stranger."

—David W. Kirch

interpreting the Colorado law, held that the Dead Man's Statute did not apply when the parties were sued or defended as grantor and grantee and not as heirs, which is frequently the case in constructive trust litigation. However, in *Lappan v. Lovette*,<sup>71</sup> that court reached the opposite conclusion based upon Alabama's law.

- *Discovery*—Most of the records regarding the assets transferred (frequently bank or brokerage accounts) may in the defendant's possession and control. Thus, for a plaintiff to prove damages, it's necessary to draft carefully worded document production requests. The defendant may claim he does not have any records relevant to the plaintiff's case, requiring the plaintiff to obtain releases of information from financial institutions, providers of medical services (regarding the transferor's physical and mental condition) and other third parties. The more time that passes, the more those records will be difficult—if not impossible—to obtain. Questions may arise as to the availability of the testamentary exception to the attorney-client and physician-patient privileges.

Income tax records can be an extremely helpful source of evidence, particularly if the defendant has not reported income from assets he is now claiming were transferred as a gift, and/or income was reported on the transferor's return. In practice, a decedent's last will and testament, prior to the transfers in question, or declaration to third parties, may provide proof of an expectancy, depending on other circumstances. The same is true of payments of income to the transferor or plaintiffs.<sup>72</sup> The decedent's estate-planning documents should be reviewed for any inconsistency between who actually received the property and who the decedent intended to receive it upon the transferor's death.

In one instance, a child claimed rights of survivorship into joint tenancy bank account. When it was revealed that the child had been given a power of attorney and had sometimes added "POA" after her signature on checks from the account, the case was quickly settled on terms favorable to another child. Shared income from the assets with the transferor or a deceased transferor's other beneficiaries also is strong evidence supporting the imposition of a constructive trust.

## TACTICS

Judge or jury? Probate court or not? Which jurisdiction's law applies? Are attorneys' fees recoverable, and if so, how should they be calculated? How to protect the disputed assets during litigation? These are some of the key tactical issues to decide in suits with constructive trust claims.

- *Right to a jury trial and punitive damages*—Because the imposition of a constructive trust is an equitable remedy, it might be assumed that there's no right to a jury trial.<sup>73</sup> But when the primary purpose of an action is to recover compensatory damages for tortious breach of fiduciary duty, courts have held that a plaintiff's claim is legal, rather than equitable.<sup>74</sup>

For example, in *Virdanco, Inc. v. MTS Int'l*, the appellate court found that a plaintiff was entitled to punitive damages when the breach of fiduciary duty was attended by wanton and willful conduct.<sup>75</sup> Thus, the cause of action asserted as the basis for imposition of a constructive trust may justify a jury trial (as well as punitive damages.)

As a practical matter, to avoid reversal on appeal and because it is unclear if there is a right to a jury trial in constructive trust cases, trial courts in some states can exercise discretion to try any issue with an advisory jury. The court can have the jury hear the entire case, but treat the jury's verdict as advisory only as to equi-

table issues, with the jury answering special interrogatories and using a special verdict form on all issues. Of course, a jury trial is more complicated and expensive, and a judge may be better able to sort out the complicated legal concepts involved.

- *Choice of Forum*—Most probate attorneys would probably prefer to have a court of probate jurisdiction hear a constructive trust case. Such an approach can often avoid the more restrictive and cumbersome procedures and discovery imposed by various state rules of civil procedure and will often place a case on a faster track to resolution. For the same reasons, a defendant may prefer the case be tried in a court of general jurisdiction, as a civil nonprobate matter.

In some states, courts of probate jurisdiction have been held to have exclusive jurisdiction over constructive trust claims.<sup>76</sup> If a decedent's estate has been opened, it may make sense to commence an action in the estate proceeding to recover property that the decedent had transferred during his lifetime or that the decedent had set up to pass as nonprobate property (that is to say, joint tenancy with the right of survivorship.) It would be helpful to have the cooperation of the estate's executor or personal representative. Also noteworthy, many states provide limited access to creditors to recover multiparty bank accounts and other nonprobate assets.<sup>77</sup>

- *Conflicts of Law*—Generally, a deceased person's domicile determines the prevailing probate law; however, this is not always so. If the property in question, particularly real property, is located in another state, courts occasionally defer to the law of the property's situs.<sup>78</sup> Practitioners therefore must be aware of the potential for conflicts of law that may affect property for which a constructive trust is being sought—particularly if the property is located in a state other than the one in which the decedent was domiciled.

- *Recovery of Attorneys' Fees*—An

award of attorneys' fees is generally appropriate in cases of breach of fiduciary duty, regardless of the capacity in which the fiduciary is acting and regardless of whether the fiduciary is an individual or corporation.<sup>79</sup> The right to fees is not limited to actions involving express trusts.<sup>80</sup> Generally, the action must relate to a breach of trust involving property held for another in a fiduciary capacity.

A person acting in a fiduciary capacity who denies that capacity should not be entitled to any offset for compensation for services.<sup>81</sup> A contingent fee agreement, which includes attorneys' fees<sup>82</sup> in the calculation of the recovery to which a percentage fee is applied, is an appropriate basis for calculating the awarded attorneys' fees. Fees based on the time, if more, also may be appropriate.<sup>83</sup>

• *Protecting the Asset During Litigation*—Procedurally, when dealing with assets such as bank accounts and life insurance proceeds, a bank or insurance company might be named as a party or convinced to institute an interpleader action, as a means of protecting the “res” (property) while the matter is litigated.

When real property is the disputed subject matter of a constructive trust proceeding, be sure to file a notice of lis pendens, pursuant to the appropriate state statute, in the appropriate county.<sup>84</sup> This is true even if the situs of the property is outside the court's jurisdiction.<sup>85</sup>

It may be possible to arrange for a deposit of funds or other personalty, subject to imposition of a constructive trust, into the registry of the court. When the recipient holding the contested assets is the personal representative, a temporary restraining order may be useful to preserve those contested assets.<sup>86</sup>

## BE CREATIVE

Because constructive trusts are remedial, their application is probably limited only by a counsel's imagina-

tion. One thing is certain: practitioners should consider using this tool in those not infrequent cases when courts struggle to avoid an obviously unfair or unjust result that the law otherwise seems to compel. ■

### Endnotes

1. See Colorado Jury Instructions on will contests.
2. Colorado Revised Statutes (C.R.S.) Section 15-15-212(5).
3. For example, Colorado has statutorily authorized the beneficiary deed. C.R.S. Section 15-15-401 *et seq.*
4. See the Uniform Probate Code.
5. *Estate of Atkinson v. Commissioner*, 115 T.C. 26, 34 (July 26, 2000), *aff'd*, 309 F.3d 1290 (11th Cir. 2002).
6. *Longley v. Patton*, 264 Ala. 235 (Ala. 1956).
7. 31 *American Jurisprudence 2d*, (1962) “Proof of Facts,” (discussing constructive trusts based on confidential relationship between parties involved in the transfer of property), at p. 237.
8. *Ibid.*, at pp. 262-263; *Skidmore v. Back*, 512 S.W.2d 223 (Mo. App. 1974).
9. *Cole v. Adkins*, 358 So.2d 447 (Ala. 1978) and *Eads v. Dearing*, 874 P.2d 474 (Colo. Ct. App. 1993), *cert. denied*, 94 S.C. 145 (Feb. 10, 1994).
10. *Restatement (Second) of Trusts* (1959), Section 45.
11. *Orella v. Johnson*, 38 Cal. 2d 693, 242 P.2d 5 (1952).
12. *Powell on Real Property*, LexisNexis, 2006, at p. 597.
13. *Dombek v. Reiman*, 298 A.D.2d 876 (N.Y. App. Div. 2002).
14. See *Jones v. Royal Builders of Bloomington Normal, Inc.*, 350 N.E.2d 485 (Ill. App. Ct. 1976), *citing Jones v. McCollen*, 227 N.E.2d 788 (Ill. App. Ct. 1967). 15. George Gleason Bogert, *Trusts*, 6th ed., at p. 287 (1987); *In re Marriage of Heizman*, 596 P.2d 61 (Colo. 1979).
16. *Faulknier v. Shafer*, 563 S.E.2d 755, 759 (Va. 2002). (“[C]onstructive trusts can arise even when property has been acquired fairly and without any improper means.”) See *Mancuso v. United Bank of Pueblo*, 818 P.2d 732 (Colo. 1991), *Bassett v. Bassett*, 110 N.M. 559 (N.M. 1990), and 76 *Am. Jur. 2d* (1962) “Trusts,” Section 132 (discussing the difference between constructive and resulting trusts).
17. *Barnes v. Barnes*, 66 Me. 286 (1876);

See also *Sanford v. Coleman*, 418 So.2d 856 (Ala. 1982).

18. *Prescott v. Kreher*, 123 So.2d 721 (Fla. Dist. Ct. App. 1960).
19. See *Walsh v. Bucalo*, 620 A.2d 21 (Pa. Super. 1993).
20. See American College of Trust and Estate Counsel (ACTEC) Fiduciary Litigation Committee, “Evidentiary Issues Involving Pre-Execution Practice and Drafting,” 27 *ACTEC J.* 246 (2001) (listing the circumstances in which the courts have found undue influence).
21. See *First Nat'l Bank v. Curran*, 206 N.W.2d 317 (Iowa 1973).
22. *Ibid.*
23. *In re Estate of Jakiella*, 510 A.2d 815, 817-818 (Pa. Super. 1986); see also *In re Estate of Clark*, 334 A.2d 628, 461 Pa. 52 (1975).
24. *In re Estate of Ziel*, 359 A.2d 728 (Pa. 1976).
25. *Ibid.*
26. *Estate of Angle*, 777 A.2d 114 (Pa. Super. 2001)
27. *O'Neil v. Morrison*, 233 N.W. 708 (Iowa 1930); *Meyer v. Schwartz*, 638 P.2d 821 (Colo. App. 1981).
28. *Smith v. Ellison*, 15 P.3d 67 (Or. Ct. App. 2000); *Simpson v. Daily*, 496 A.2d 126 (R.I. 1985).
29. 79 *Am. Jur. 3d*, “Proof of Fact,” (discussing constructive trusts based on confidential relationship between parties involved in transfer of property), at p. 269.
30. *Hodges v. Hodges*, 692 S.W.2d. 361 (Mo. App. S.D. 1985).
31. *Judkins v. Carpenter*, 537 P.2d 737 (Colo. 1975); *Anderson v. Edwards*, 625 P.2d 282 (Alaska 1981).
32. James R. Wade, *Wade/Parks—Colorado Law of Wills, Trusts, and Fiduciary Administration*, Section 4.20, 5th ed., Continuing Legal Education in Colorado, Inc. 2004, *citing Judkins*, *supra* note 31.
33. *Judkins*, *supra* note 31; *Davis v. Foulkrod*, 642 So.2d 1129 (Fla. Dist. Ct. App. 1994).
34. *Latham v. Father Divine*, 85 N.E.2d 168 (N.Y. 1949).
35. *Eads v. Dearing*, 874 P.2d 474 (Colo. App. 1993), *cert. denied*, 94 S.C. 145 (Feb. 10, 1994).; Austin Wakeman Scott, *The Law of Trusts* (abridgement), Sections 461-464, 770, 771.
36. *Restatement of the Law of Restitution*, at p. 169, Comment (1937); *Restatement (Second) of Trusts* (1959), at p. 45.

37. *Corporation of the President of The Church of Jesus Christ of Latter Day Saints v. Jolley*, 467 P.2d 984 (Utah 1970) (upholding the imposition of a constructive trust upon two cars purchased for the defendant by her boyfriend who had embezzled the funds used to buy the vehicles); see *Restatement of the Law of Restitution*, illustrations 17b and 18, at p.754.
38. *Rogers v. Rogers*, 473 N.E.2d 226 (N.Y. 1984).
39. *Lackey v. Lackey*, 691 So.2d 990 (Miss. 1997).
40. *Faulkner v. Shafer*, 563 S.E.2d 755 (Va. 2002).
41. *Wilharms v. Wilharms*, 287 N.W. 2d 779 (Wis. 1980).
42. *Murphy v. Glenn*, 964 P.2d 581 (Colo. App. 1998).
43. *Ibid.*
44. *Nile v. Nile*, 734 N.E.2d 1153 (Mass. 2000).
45. *In re Estate of Tolin*, 622 So.2d 988 (Fla. 1993)
46. *Logie v. J.P. Morgan*, 716 So.2d 319 (Fla. Dist. Ct. App. 1998)
47. *Allen v. Dalk*, 826 So.2d 245 (Fla. 2002).
48. *Pope v. Garrett*, 211 S.W.2d 559 (Tex. 1948) (imposing a constructive trust on property of intestate in favor of intended devisee (a nonrelative) when heirs of intestate, by physical force, prevented the will signing); *Latham*, *supra* note 34 (imposing a constructive trust for the benefit of intended devisees after devisees of existing will prevented testatrix by false representation, undue influence, physical force, and ultimately murder, from executing a new will leaving property to others).
49. *Montavo v. Moza, City and County of Denver, State of Colorado*, Denver Probate Court, Case No. 95 PR 2061.
50. See Steven K. Mignogna, "On the Brink of Tortious Interference with Inheritance," *Probate and Property* March/April 2002.
51. *Circle T Corp. v. Deerfield*, 444 P.2d 404 (Colo. 1968); *Staude v. Heinlein*, 110 N.E.2d 228 (Ill. 1953).
52. Uniform Probate Code (UPC) Section 6-214; See also *In re Estate of Oney*, 641 P.2d 725 (Wash. Ct. App. 1982) and *In re Estate of Branhart*, 563 P.2d 972 (Colo. Ct. App. 1977), *aff'd*, 574 P.2d 500 (Colo. 1978) (finding that joint tenancy may be set aside when created solely for the donor's convenience and no right of survivorship was intended); *Caputo v. Nouskhajian*, 871 So.2d 266 (Fla. Dist. Ct. App. 2004); *Davis v. Foulkrod*, 642 So.2d 1129 (Fla. Dist. Ct. App. 1994) (holding that donative intent not needed for joint accounts to pass to survivor).
53. *Page v. Clark*, 592 P.2d 792 (Colo. 1979); *Calcote v. Calcote*, 583 So.2d 197 (Miss. 1991).
54. *Calcote*, *ibid.*
55. See *Judkins*, *supra* note 31.
56. See *Weeks v. Esch*, 568 P.2d 494 (1977).
57. *Ibid.*, at p. 496; *Longley v. Patton*, 86 So.2d 820 (Ala. 1956).
58. See *Eads*, *supra* note 9.
59. *Dietz v. Nietz*, 70 N.W.2d 281 (Minn. 1955); *Bogert*, *supra* note 14, p. 259 (1987).
60. See *Gould v. Starr*, 558 S.W.2d 755 (Mo. Ct. App. 1977) (\$50,000.00); *Werschull v. United California Bank*, 85 Cal. App. 3d 981 (1978) (\$550,000.00); *Vale v. Union Bank*, 88 Cal. App. 3d 330 (1979); and *Adam v. Harris*, 564 S.W.2d 152 (Tex. App. 1978) (\$20,000.00).
61. *Kaitz v. District Ct.*, 650 P.2d 553 (Colo. 1982); *Medasys Acquisition Corp. v. SDMS, P.C.*, 55 P.3d 763 (Ariz. 2002) and *Adams v. Coates*, 626 A.2d 36 (Md. 1993).
62. *Turley v. Ethington*, 146 P.3d 1282 (Az. Ct. App. 2006).
63. *Ibid.*
64. *Nevarez v. Nevarez*, 202 Cal. App. 2d 596 (1962); see also *Dep't of Revenue v. Puget Sound Power & Light Co.*, 694 P.2d 7 (Wash. 1985); *Lucas v. Abbott*, 601 P.2d 1376 (Colo. 1979).
65. *Johnson v. Cigna*, 916 P.2d 643 (Colo. Ct. App. 1996).
66. *Ibid.*
67. *Ralston Oil & Gas Co. v. July Corp.*, 719 P.2d 334 (Colo. App. 1985); *East Providence Credit Union v. Geremia*, 239 A.2d 725 (R.I. 1968).
68. *Kearney v. Mechanics Nat. Bank of Worcester*, 180 N.E.2d 667 (Mass. 1962); *First Nat'l Bank of Denver v. Harry W. Rabb Found.*, 479 P.2d 986 (Colo. App. 1970).
69. 95 *Corpus Juris Secundum*, Section 223.
70. *Askins v. Easterling*, 347 P.2d 126 (Colo. 1959).
71. *Lappan v. Lovette*, 577 So. 2d 893 (Ala. 1991).
72. For more on tortious interference and the constructive trust, see Martin L. Fried, "The Disappointed Heir: Going Beyond the Probate Process to Remedy Wrongdoing or Rectify Mistake," *Real Prop., Prob. & Tr. J.* Summer 2004, at p. 357 (discussing the interplay of the tort of tortious interference with inheritance and the imposition of constructive trusts in the context of will contests involving decedents' estates).
73. *Tull v. United States*, 481 U.S. 412 (1987).
74. *Virdanco, Inc. v. MTS Int'l*, 820 P.2d 352 (Colo. Ct. App. 1991). Fraud has been held to be a claim triable by a jury. *Citicorp Acceptance Co. Inc. v. Sittner*, 772 P.2d 655 (Colo. Ct. App. 1989).
75. *Virdanco*, *ibid.*
76. *Mitchem v. First Interstate Bank of Denver*, 802 P.2d 1141 (Colo. Ct. App. 1990); *Gonzalez v. Superior Court*, 570 P.2d 1077 (Ariz. 1977).
77. *Estate of Van Winkle*, 757 P.2d 1134 (Colo. Ct. App. 1988); *Colella v. N. Easton Sav. Bank*, 4 Mass. L. Rptr. 518 (Mass. Supp. 1995). See also C.R.S. Section 15-15-103.
78. See *Barboza v. McLeod*, 853 N.E.2d 192 (Mass. 2006) (holding that the situs of the property, in this case a joint bank account, was determinative in deciding the applicable law).
79. *Liles v. Liles*, 711 S.W.2d 447 (Ark. 1986); *Buder v. Sartore*, 774 P.2d 1383 (Colo. 1989); and *Allard v. Pacific Nat. Bank*, 663 P.2d 104 (Wash. 1983).
80. *Heller v. First Nat'l Bank*, 657 P.2d 992 (Colo. Ct. App. 1982).
81. *Cloud v. U.S. Nat. Bank of Oregon*, 570 P.2d 350, 280 Or. 83 (Or. 1977).
82. *Schoonmaker v. Lawrence Brunoli*, 828 A.2d 64 (Conn. 2003).
83. *Blanchard v. Bergeron*, 489 U.S. 87, 109 S.Ct. 939 (1989).
84. *Finger Hut Corp. v. Suburban National Bank*, 460 N.W.2d 63 (Minn. Ct. App. 1990) (holding that although constructive trust is not in itself construed as lien, it establishes equitable lien for enforcement of trust which raises cause of action within lis pendens statute).
85. *Kerns v. Kerns*, 53 P.3d 1157 (Colo. 2002) (filing a notice of lis pendens held appropriate because a constructive trust is an equitable remedy "affecting the title to real property" regardless of the jurisdiction where the action is brought, in this case, Minnesota).
86. UPC Section 6-12-607.

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