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Equitable Leins as A Remedy in Restitution in Pennsylvania

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EQUITTABLE LEINS AS A REMEDY IN RESTITUTION IN PENNSYLVANIA

When a party is entitled to restitution from another, there are several remedies which he may have. In certain cases the party is entitled to use self-help. The courts offer certain remedies. The courts may decree specific restitution, enforce a constructive trust, enforce an equitable lien, subrogate the party to the position of a prior claimant or order the payment of money by the person who received the benefit. The courts of Pennsylvania recognized all these remedies at an early date with the exception of the equitable lien. This remedy was flatly rejected by the courts because they could find no authority for recognizing it in the statutory or common law of the state. Probably, the fact that no court of equity existed in the state until recently had much to do with this. When courts with equity jurisdiction were finally established, they had only those powers which the statute conferred on them. The statute was very strictly construed and, even today, equity jurisdiction exists only so far as the statute authorizes it.

The Early Rule . . . The following cases set out the early rule as to equitable liens:

In *Hepburn* v. *Snyder,*[1] A conveyed certain land to B in exchange for B's payment of a sum of money plus B's promise to indemnify A against future liabilities that may arise out of X company of which A had been an owner. On B's failure to pay A's liabilities, A brought an action of ejectment claiming, among other things, that an equitable lien attached to the land for the amount of the liabilities. The court said, "Liens upon land are not favored or to be implied; and they are consequently to be created by plain terms . . . Equitable liens . . . have not been engrafted on the jurisprudence of Pennsylvania."

In a later case, *Appeal of Cross,*[2] the Pennsylvania Court reaffirmed this view citing the Hepburn case. W was appointed guardian of A and M, minors, without being required to give bond. He received money on behalf of his wards from time to time which he mingled with his own and invested in the erection of buildings on his farm. Upon settlement of the accounts, there was a balance due. In the interim, W had confessed several judgments and had become insolvent. A and M wanted their claim against W's estate to be preferred by way of the enforcement of a trust or a lien upon the land because improvements had been made with their money. The court held that a trust arises only where there is fraud or where payment of the purchase price with the trust funds vests title in the trustee. Then, as to a lien, the court said:

> "But it is said, the money of these beneficiaries has been used to improve this property, and they ought, therefore, to have a lien upon it to the extent of the moneys so expended. But what kind of a lien? Not a statutory

[1] Hepburn v. Snyder, 3 Pa. 72, (1846).
[2] Appeal of Anna J. Cross and A. W. Gault, Guardian, etc. 97 Pa. 471, (1881).

one, for the Act of 1832, which would give them a lien, was not pursued. A lien arising from the equitable circumstances of the case? But such a lien is unknown in Pennsylvania jurisprudence; it has not been as yet engrafted upon our legal system, and it is hoped that it never will be: *Hepburn* v. *Snyder,* 3 Pa. 72. This is, no doubt, a hard case, but were we to establish the doctrine of equitable liens for the purpose of meeting this hard case, it would be like the letting out of water, disaster and confusion would be the result. In vain would the unfortunate judgment creditor depend upon the dockets and records provided for his protection. Debts that he thought secure would be swept away by the insidious operation of secret equitable liens. With the utmost confidence might he bid in a tract of land to cover his judgment, only to find in the end that he had involved himself, and perhaps hopelessly for the benefit of someone else. Nor would a mortgagee be in a much better situation, for though he is in a better position than a judgment creditor, in that he is partially protected by the recording acts, yet he would always be exposed to the danger of having sprung upon him proof of notice of some hidden lien for which he was wholly unprepared. How easily such notice can be proved since the Act of 1869, we all understand. We think, therefore, it is better for us to adhere to the old paths, with which we are well acquainted, rather than try new ones which may lead us to unexpected disaster."

The *Hepburn* case was cited in *David Hackadorn's Appeal*[3] for the proposition that liens must be created in plain terms. The court added "The principle is not, as supposed, confined to contracts, but it is applicable to wills as to other instruments."

In *Hartman* v. *Keown,*[4] the court held a lien existed in the bailee when a bailee took an assignment of a debt, where the security for the debt was a bill of sale for the bailed property. This case, however, is not considered a change from the general rule since the bailee had possession of the subject matter of the lien.

The early rule was that the equitable lien would be recognized and enforced only if the parties expressly designated that specific property should be held as security for a debt or duty. This rule was applicable to personalty and realty; and to contracts, wills and other types of instruments.

There were two principal objections to the recognition of equitable liens in Pennsylvania. First, equity jurisdiction was conferred by statute and equitable liens were not included among the equity powers of the court. Second, as expressed in the *Cross* case,[5] an intervening third party purchaser would be harmed if an equitable lien were enforced. The first objection has never been seriously discussed. The second objection presupposes that an equitable lien is retroactive to the time the lienor's equity arose.

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3 David Hackadorn's Appeal, 11 Pa. 86, (1850).
4 Hartman v. Keown, 101 Pa. 338, (1881).
5 Appeal of Anna J. Cross, etc. supra.

This second objection gives rise to several questions. Is an equitable lien retroactive to a) the time the lienor's equity arises, or b) to the time when the lienor first claims he has a lien in the property, or c) to the time when the court decrees that a lien exists? In the *Cross* case, the court felt that a lien was retroactive to the time the lienor's equity arose. However, there are several good reasons why the equitable lien should arise at some other time. For instance, by analogy to legal liens, equitable liens should arise only after the lienor claims to have such lien. It may also be argued that the rights of innocent third parties will be prejudiced if the lien is made retroactive, that is, earlier than the courts adjudication. And, therefore, the lien should arise only after the court's adjudication.

It has been generally held that the equitable lien is retroactive to the time the lienor's equity arose. This is the early view and the view adopted by the *Restatement.*

If a lien is made retroactive, we must avoid harming innocent third party purchasers. The problem is: What constitutes notice to an innocent third party? The court, in the *Cross* case recognized the general policy of the law of protecting innocent third party purchasers. However, they felt that, since it was so easy to show that the third party had notice, the policy of the law would be defeated. Hence, the lien should not be recognized. This same problem was answered in another way in a later case.[6]

The defendant had been adjudicated weakminded in an earlier proceeding. In a suit for restitution, the defendant tried to assert the defense of incapacity to contract and to show the prior adjudication of weakmindedness was notice to the plaintiff. The court found no difficulty in solving the problem. They said that the adjudication of weakmindedness under the particular statute was not such notice as would prejudice the plaintiff's right to restitution. Perhaps, the court could have applied the same reasoning to the *Cross* case so as to give the plaintiff a remedy which he rightfully should have gotten. Apparently, the problem of the retroactive effect of liens and what constitutes notice were solved because equitable liens have been recognized and enforced in Pennsylvania since the *Cross* case. How much the old rule has been changed is still questionable.

The Modern Rule. Most of the cases in which the Pennsylvania courts have enforced equitable liens are cases where improvements have been made to one person's property with another person's money or property so as to amount to unjust enrichment.

In *Peoples National Bank of Pittsburgh* v. *Loeffert,*[7] a debtor conspired with another to defraud his creditors, furishing materials to make improvements on the other's land. The creditor obtained a judgment against the debtor. The court of equity declared this judgment to be a lien upon the land of the other that had

[6] Pulaski v. Provident, infra. note 10.
[7] Peoples National Bank of Pittsburgh and E. J. Larkins v. George Loeffert, John Loeffert and Albert L. Loeffert, 184 Pa. 164, 38 Atl. 996, (1898).

been improved. That is, a judgment against one person, was made a lien upon another person's land. The Supreme Court ruled that, while this was irregular, it would not be set aside because it did substantial justice. The court suggested a better method, that is, to ascertain the amount of the debtor's property which had become merged in the other's realty, and award a lien on the realty for that amount. Note that this is the remedy asked for in the *Cross* case just 17 years before when it had been refused.

A recent case, *Gladowski v. Felczak*,[8] further extended the rule. Here the plaintiff loaned money to an association taking a mortgage on realty as security. The proceeds of the loan were used to discharge a judgment lien on the property and the balance was used for improvements to the property. Later it was found that the conveyance to the association was void. The plaintiff asked to have his void mortgage declared a lien upon the realty. The court enforced the lien basing part of it on subrogation to the prior lienor's rights and part of it an unjust enrichment, for the improvements made. The court cited sections. 161 and 162 of the *Restatement of Restitution* as authority for these propositions.

In a lower court case, *Stathopulos* v. *Stathopulos*,[9] a beneficiary of a resulting trust to a fractional interest in realty, wanted a lien asserted for repairs and improvements he had made to the property. The court refused to enforce a lien because the plaintiff had been a volunteer.

Generally, it is stated that an equitable lien on goods sold does not arise in favor of a vendor for unpaid purchase money. The vendor can by express terms reserve an interest in the goods for unpaid purchase money, but this reservation is not implied from the sale. Certain exceptions have been made to this rule. In *Pulaski* v. *Provident*[10] the plaintiff took a purchase money mortgage on certain realty. After partial repayment, the defendant mortgagor defaulted, the plaintiff obtained a judgment upon which he sought execution. The defendant's wife claimed that defendant was weakminded and lacked the capacity to contract. Plaintiff then asked that an equitable lien be enforced on the realty based on unjust enrichment. The court held that this was a proper case for such relief citing the *Restatement of Restitution* Sections 161 and 139 as authority for this proposition.

A lower court case, *Houghton* v. *Restland*,[11] refused to enforce an equitable lien. Petitioners conveyed certain realty for cemetery purposes to a corporation, receiving therefore shares of preferred stock in the corporation. The corporation was to deposit 5% of its receipts from the sale of lots for the payment of 6%

8 Gladowski et al. v. Felczak et al., 346 Pa. 660, 31 Atl. 2d 718, (1943).
9 Stathopulos v. Stathopulos, 51 Lanc. Rev. 177, (1947).
10 General Casmir Pulaski Building and Loan Association v. Provident Trust Company of Philadelphia, 338 Pa. 198, 12 Atl. 2d 567, (1940).
11 Houghton et ux., v. Restland Memorial Park, Inc., 88 Pitt. L. J. 557, (1940) affirmed in 343 Pa. 625, 23 Atl. 2d 497, (1942). Only the lower court considered the validity of an equitable lien in its decision.

interest and for the redemption of the preferred stock. Several years later, the court appointed a liquidating receiver of the assest of the corporation. Petitioners contended that the preferred stock was not payment for the land but collateral security for payment outlined in option agreement prior to the actual sale of the land and that their claim to the land should be preferred to the general creditors of the corporation. The court refused to enforce a lien, citing *Hepburn* v. *Snyder* and *Appeal of Cross*,[12] two early cases, for the rule that equitable liens do not exist in Pennsylvania. Failure to pay the purchase price gives rise only to a cause of action in contract. This case, however, is explainable in two ways: (1) The contract purported to be complete on its face and the court does not admit parol evidence in the absence of fraud, accident, or mistake. (2) Innocent third party creditors intervened. They should not be made to suffer by equities between the original parties of which they have no notice.

A later case, *Proudley* v. *Fidelity*,[13] also denied equitable relief. In an action in assumpsit the use plaintiff ran a business whereby a person was insured by putting up 25% of the premium and use plaintiff put up 75% of the premium in exchange for notes for the loan, and a power of attorney to cancel the policy of insurance and collect the unearned premium which was to be applied to the debt. The use plaintiff attempted and the insurer refused to cancel certain policies. The use plaintiff sued the insurer for unearned premiums on the theory that payment of 75% of the purchase price (premium) gave rise to an equitable lien on the proceeds of the policies. The court refused to recognize a lien in this situation because (1) the use plaintiff was a volunteer and an equitable lien does not arise in favor of a volunteer and (2) a person who lends money to be used by a borrower to purchase property does not acquire an equitable lien in the property thereby.

The cases which are concerned with purchase money follow the general rule. In the *Pulaski* case,[14] an entirely different principle of restitution was applied. In this case, the defendant was an incompetent. Generally, when an innocent party contracts with an incompetent reasonably thinking the contract is valid, he can recover, on principles of restitution, that much of the benefit that he has conferred upon the incompetent that still remains in the hands of the incompetent.[15] This would entitle the plaintiff to sell the property which the defendant holds, since it was the proceeds of the benefit conferred remaining in the hands of the defendant. This would work a hardship upon the defendant and jeopardize his equity in the realty. Also, the sale of the realty to satisfy the judgment was not desired by either party. So the court allowed an equitable lien to be asserted on the realty to the extent of the benefit conferred. It had the effect of reinstating the mortgage. In the *Pulaski* case, a constructive trus twould not be a remedy be-

[12] Supra, notes 1 and 2.
[13] Proudley et al., v. Fidelity and Guaranty Fire Corporation, 345 Pa. 385, 29 Atl. 2d 48, (1942).
[14] Supra, note 10.

cause title had not been obtained solely with the plaintiff's money, nor was it intended that the defendant should hold the property for the benefit of the plaintiff except to secure the loan. This is not sufficient to support a constructive trust.

In several miscellaneous cases, equitable liens have been claimed. They have generally not been recognized. In *Baronofsky* v. *Weiss*,[16] the plaintiff leased certain realty and chattels. The defendant deposited certain monies to secure the return of the chattels. At the termination of the lease, the plaintiff brought replevin to recover the chattels. The defendant claimed he had a lien in the chattels to secure the return of his deposit money. The court decided that the defendant had an equitable lien that would be recognized in an action of replevin. The court cited *Ruling Case Law*[17] which says that an equitable lien is implied or declared by a court of equity out of the general considerations of right and justice as applied to the relations of the parties and the circumstances of their dealings. But here, it might have been argued that there was an implied promise to return the deposit money on return of the chattels, and that the defendant had a right to possession until the money was returned.

A lower court case, *McHugh* v. *Landherr*[18] presented an unusual situation. A had a judgment against P and a judgment against D. P had a judgment against D. A tried to execute on her judgment against D but execution was returned *nulla bona*. A tried to execute on her judgment against P and it was only partially satisfied. Then P tried to execute on his judgment against D. The sheriff found a car on which to levy, sold it to satisfy P's judgment against D and held the proceeds of the sale. A wanted the proceeds turned over to her; basing her claim on her judgment against P and claiming an equitable lien existed on the money the sheriff held. The court refused to grant A relief because (1) Funds in the hands of a sheriff are not subject to attachment and (2) Equitable liens are stirctly limited in Pennsylvania, citing *Hepburn* v. *Snyder* and *Appeal of Cross*.[19] The court said that equitable lien could arise in this situation if there was an antecedent and underlying agreement in the nature of an assignment of funds in the hands of the sheriff as security for P's debt to A. A moral obligation is not sufficient to support an equitable lien. This, of course, is the early rule.

The Restatement of Restitution. The *Restatement of Restitution* recognizes three remedies which a court of equity can give in order that an injured party may have restitution.

(1) *The Constructive Trust.*[20] This is asserted where the defendant holds legal title to property and it would be unjust to allow him to retain it. The title

15 Restatement, Restitution, § 139 (1937).
16 Baronofsky v. Weiss, 120 Pa. Super. 126, 182 Atl. 47, (1935).
17 10 RCL 351.
18 McHugh v. Landherr, 52 D & C 481, (1945).
19 Supra, notes 1 and 2.
20 Restatement, Restitution, § 160, (1937).

holder is made the constructive trustee of the property and is under an equitable duty to convey the property to the beneficiary. The constructive trust is also used in certain non-restitutionary situations such as, at the termination of an express trust, under an enforceable contract to convey land, etc. Ordinarily, the recovery allowed is the amount of the enrichment of the titleholder. Specific restitution may be allowed where the trustee is insolvent or the subject matter is unique. The constructive beneficiary's right to recovery from the trustee is prior to that of the trustee's general creditors whether or not the constructive trust is specifically enforceable.

(2) *The Equitable Lien.*[21] This is asserted where one party has a claim upon another that would result in unjust enrichment if not paid. A lien is the claim which one person has upon the property of another as a security for some debt or charge.[22] It is an alternate remedy with the constructive trust where the defendant misappropriates money or property and buys other property. Where the value of the property has fallen, the lien is more advantageous because the lienor can get the full value of his claim and if the proceeds from the sale of the property will not cover the claim, the lienor can go against the lienee. Where the value of the property has risen, the constructive trust is a better remedy because the lienor can claim his fractional interest in the property getting the amount of his claim plus any increase in value. Where improvements have been made to land an equitable lien may be enforced but not a constructive trust. Under the *Restatement,* the equitable lien is broader than a constructive trust as a restitutionary remedy for this reason. The equitable lien, if asserted on a fund, is enforced by a court order to pay the aggrieved party out of the fund. If asserted on other property, then the court orders that, on failure to pay the claim, the property is to be seized and sold to satisfy the claim. The lienholder's rights rise higher than the lienee's general creditors, as to the property upon which the lien is asserted. If the owner disposes of the property, the lien attaches to the property in the hands of the third person if he has notice of the equitable lien, or the lien can attach to the property acquired from the disposition of the original property.

(3) *Subrogation.*[23] Where the property of one person is used to discharge a claim against another person in such a way as to result in unjust enrichment, the first person is subrogated to the position of the previous claimholder. If D buys a claim against T with P's money, D becomes constructive trustee of the claim for P. If D discharges a claim that T has against D's property with P's money, D becomes lienee of the property for P (lienor-subrogee). The lienor, however, is in no better position with relation to other creditors than the prior lienor was.

The Pennsylvania Supreme Court cited the *Restatement of Restitution* in both the *Pulaski* case and the *Gladowski* case,[24] for the proposition that equitable liens

[21] Restatement, Restitution, § 161, (1937).
[22] Baronofsky v. Weiss, supra, note 16.
[23] Restatement, Restitution, § 162, (1937).
[24] Supra, notes 8 and 10.

are recognized and enforced in Pennsylvania in the situations set down in Section 161. Since this section sets down only a broad policy as to equitable liens, we cannot yet say that the doctrine of equitable liens as set out in the *Restatement of Restitution* is the law in Pennsylvania. Further, the lower courts in the *Houghton* case and the *McHugh* case,[25] have said that equitable liens exist only when they are expressly created. About all we can say is that the Pennsylvania courts have recognized equitable liens in some situations.

The principal situation in which both the *Restatement of Restitution* and the Pennsylvania courts recognize the equitable lien is where improvements have been made to property under the inducement of fraud, duress, undue influence, and mistake.

Fraud as a basis for an equitable lien is recognized in the *Loeffert* case,[26] The situation in the *Loeffert* case is not specifically in point with any situation mentioned in the *Restatement*. Section 170 refers to a plaintiff who makes improvements to another's land under the inducement of fraud, duress, undue influence or mistake. Section 206 refers to the situation where a wrongdoer uses property of another to improve his own land. In the *Loeffert* case, a person wrongfully used his own property to improve the realty of a conspirator for the purpose of defrauding third persons. Actually the court recognized that the improver had a claim against his conspirator for improvements. This claim became part of the assets upon which the improver's creditors could levy. The situation in the *Loeffert* case falls more nearly into Section 208(2).

Mistake as a basis for an equitable lien is recognized in the *Gladowski* case. The *Gladowski* case does not fall quite squarely into Section 170 because it was not the plaintiff who made the improvements to the land. The plaintiff loaned the money to the grantee of the void conveyance and it was that person who made the improvements. So actually the court had traced a benefit. To take the plaintiff out of the class of volunteer, the court said the improvements were required and desired. Several other reasons might have been given. The plaintiff conferred the benefit at the request of the grantee of the void conveyance reasonably thinking he had title. Also the membership in the grantee and grantor associations of the void conveyance were the same. A final reason may be that since the court had opened the door to restitution by subrogation, they would grant other restitutionary relief.

In Pennsylvania, a constructive beneficiary and a subrogee both can have equitable liens on the property to secure their interests in the property. But, where there is no constructive trust or subrogation, the equitable lien may nevertheless, be recognized and enforced. The *Restatement* gives several situations in which the plaintiff has alternate remedies of constructive trust or an equitable lien. For

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25 Supra, notes 11 and 18.
26 Supra, note 7.

instance, where A wrongfully uses $500 of B's money and $500 of his own money to purchase certain realty, can B claim an undivided half interest in the realty *or* an equitable lien for his $500 at B's election? The Pennsylvania decisions do not indicate that there is such an election. Where A acquires title entirely or partly with B's money, the courts enforce a constructive trust in favor of B to the fractional extent that B's money paid for the property. Where improvements have been made to property with B's money or property the Pennsylvania courts enforce an equitable lien. In other situations where the equities are heavily in favor of the plaintiff and no other remedy is available, the courts have indicated that they will enforce an equitable lien.

Advantages of an equitable lien as against a judgment lien. The question is posed: if a plaintiff is entitled to restitution for a benefit conferred upon another, when would an equitable lien be advantageous over a judgment lien? The judgment can become a lien on all the property of the lienee and the equitable lien is a lien on certain specific property only. There are several answers to this. A judgment can only become a lien after it has been docketed. The proper docketing becomes notice. An equitable lien is retroactive to the time when the equity arose. This equity is only cut off if an innocent third party purchaser intervenes. Since you claim an interest in the property, you can tie up the property so that it cannot be transferred or dissipated until your rights in the property are adjudicated.

A lien has a decided advantage where there is a possibility that the defendant may become insolvent or go out of existence before the case is decided. If the defendant becomes insolvent, or goes out of existence, then the lien becomes a preferred claim, as to the subject matter of the lien, over the general creditors of the defendant.

Another advantage is that if the plaintiff wants to obtain the property itself, he has a better chance of getting it if he has a lien. If the plaintiff has a judgment against the defendant, execution can be made on any of the defendant's property. But if the plaintiff has an equitable lien on the specific property, execution is on that specific property first. The plaintiff can then bid in on it at the execution sale.

The *Baronofsky* case[27] illustrates another advantage. In a suit for replevin, a counterclaim will not lie. But if the defendant can show a lien in the property, it will be recognized. The courts of Pennsylvania will recognize an equitable lien in the property in a suit in replevin.

Finally, a lien on specific property has the advantage that the property is not subject to an exemption claim of the debtor.

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[27] Supra, note 16.