Third Time's the Charm: The Coming Impact of the Restatement (Third) Restitution and Unjust Enrichment in Bankruptcy

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*Three things are to be helpt in conscience,*

Fraud, accident, and things of confidence.*

I. INTRODUCTION

Bankruptcy courts have frequently been characterized as courts of equity. Often this characterization has accompanied unusually relaxed interpretation or application of a provision of the Bankruptcy Code. At least since Aristotle, the term equity (epieikeia) can connote something like purposeful interpretation or mitigation of otherwise harsh results (mitigatio
That is not, however, equity’s principal meaning when understanding the powers of courts of equity. Courts of equity historically applied the law of equity and, notwithstanding John Selden’s libel—equity is a rogish thing because its rules vary with the length of the chancellor’s foot—equity in England was as “lawful” as the common law. The law of equity, like the common law, covered a large range of topics—trusts and estates, injunction, contracts, specific performance, unjust enrichment, restitution, and disgorgement. The law of equity was not limited to particular remedies. Like the common law, equity’s remedies encompassed money damages—but it also included many more. Importantly, the law of equity was substantive as well as remedial; it recognized primary rights as well as secondary rights of rectification.

rather, equity accounts for the particular facts of any given situation and applies general laws to a specific case”).


6. See Rogers, supra note 3, at 1387 (discussing confusion created by use of the term equity to describe both fairness and the phenomenon of the legal system administered by the Courts of Equity).

7. JOHN SELDEN, TABLE-TALK: BEING THE DISCOURSES OF JOHN SELDEN 54–55 (2nd ed.1696) (“Equity is a Roguish Thing, for Law we have a Measure, know what to trust to, Equity is according to the Conscience of him that is Chancellor, and as that is larger or narrower, so is Equity. ‘Tis all one as if they should make the Standard for the Measure, we call a Chancellor’s Foot, what an uncertain Measure would this be? One Chancellor has a long Foot, another a short Foot, a Third an indifferent Foot: ‘Tis the same thing in the Chancellor’s Conscience.”).

8. See Zahnd, supra note 4, at 264 (“Equity does not vary with the length of the Chancellor’s foot.”); see also H. Brent McKnight, How Shall We Then Reason? The Historical Setting of Equity, 45 MERCER L. REV. 919 (1994) (describing the tumultuous pre-English Revolutionary setting in which Selden made his famed quip). See generally Lawrence B. Solum, Equity and the Rule of Law, in THE RULE OF LAW: NOMOS XXXVI 120 (Ian Shapiro ed., 1994).


10. See id.

11. See id.

The idea of a "law of equity" jars the contemporary ear. When not thinking of equity as *epieikeia* or *mitigatio iuris*, most lawyers, judges, and academics identify equity with remedies; the tail wagged by the dog of substantive law. Remedies like injunction and specific performance comprise the bulk of the leading casebooks on equitable remedies. If equity once boasted a substantial substantive content, what was it and why has it been reduced to remedies? The answer to the first question is found in the title of the Restatement (Third) of Restitution and Unjust Enrichment. Unjust (or unjustifiable) enrichment provides the conceptual core of this body of law. As the converse of tort law, which identifies unjustified harms to another, unjust enrichment recognizes unjustified benefits to another, at least to the extent that they come at the claimant's expense. The answer to the second question—why equity has been reduced to remedies—is historical and pedagogical. Historically, equity in America as an independent aspect of civil jurisdiction, often with separate courts, ceased to exist over the course of a century. Anglo-American law abolished the writ system and merged courts of law and equity beginning with the Field Code in 1848 and culminating in Virginia in 2006. Pedagogically, American legal education has, over the course of the twentieth century, focused on a limited number of substantive fields of law to the exclusion of unjust enrichment—contributing to a lack of understanding of the law of equity.

Notwithstanding the merger of law and equity, and in spite of the long-standing failure of law schools to teach the law of equity, in the mid-1990's the American Law Institute appointed Andrew Kull as the reporter for the Restatement (Third) of Restitution and Unjust Enrichment (R3RUE). With seven drafts completed and final approval received at the 2010 meeting of the American Law Institute, we can expect to see the R3RUE begin to

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15. See Laycock, supra note 12, at 164 (describing evolution of "remedies" from its first identification with the forms of action in the nineteenth century to its use as a synonym for civil procedure in the first half of the twentieth century to the modern view of remedies as what a "court will do to correct or prevent the violation of legal rights that gives rise to liability").


17. RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT (2011) [hereinafter R3RUE].
affect the legal landscape in the near future. It is that impending impact in bankruptcy that constitutes the burden of this article.

Part II will briefly summarize the substantive law of equity as expressed in the R3RUE. It will address the substantive core of law of equity that characterizes the concept of unjust enrichment. Unjust enrichment is grounded in distinct categories of operative facts, such as: benefits conferred by mistake or without request, pursuant to a voidable contract, or as a result of wrongful interference with a claimant’s rights. Part III will survey the remedial aspects of the R3RUE comprising the four so-called proprietary remedies—constructive trust, equitable lien, subrogation, and the paired set of rescission and restitution. In turn, Parts IV–VII will focus on each of these four remedies in greater depth and examine whether and how courts operating under bankruptcy law have applied them. Part VIII concludes with some specific observations of how the R3RUE can and should affect the development of the law of equity in bankruptcy by firmly recognizing a place for certain of the proprietary remedies.

II. THE LAW OF EQUITY

Tracking the original 1937 Restatement of Restitution, the R3RUE begins with the comprehensive statement that “[a] person who is unjustly enriched at the expense of another is subject to liability in restitution.” The breadth of this assertion seems to belie any belief that there is a law of equity. The phrase “unjustly enriched” could be construed to open the door to a judge’s free-floating moral inquiry into what is fair. The comments to section one of the R3RUE and the following sections make clear that this is not what unjust enrichment means. “Unjust enrichment” is a term of art. An

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20. R3RUE § 1.

21. Kull, James Barr Ames, supra note 19, at 318 (“[T]here were some who feared that the natural choice for a title would be misunderstood; that if it published a ‘Restatement of Unjust Enrichment,’ the American Law Institute would be seen as endorsing an open-ended charter of liability, to be invoked in any case where ‘enrichment’ and ‘injustice’ might be thought to coincide.”).
early comment in the R3RUE observes that the “concern of restitution” is not with unjust enrichment in the broad, moral sense but with the “narrower set of circumstances giving rise to what might more appropriately be called unjustified enrichment.” Unjust enrichment as expressed in the R3RUE is not the application of the untrammeled conscience of a judge or jury, but rather the shorthand expression of a finite set of legally cognizable claims.

Claims sounding in unjust enrichment arose historically in both law and equity. One branch of restitution for unjust enrichment can be traced to claims at law called quasi-contract and the common counts. The other principal antecedent of claims for unjust enrichment can be found in the remedies fashioned by courts of equity. As described below, however, the challenges of applying the remedies for unjust enrichment in bankruptcy arise from the equitable side of the field, not the legal.

Persons are regularly enriched by many activities that do not render retention unjust. For example, some years ago I lived next door to a wonderful percussionist and was greatly enriched by listening to him play a variety of instruments. Retention of that enrichment without payment was not unjust. What makes the retention of certain benefits unjust is the lack of a recognized legal basis. “To be the subject of a claim in restitution, the benefit conferred must be something in which the claimant has a legally protected interest, and it must be acquired or retained in a manner that the law regards as unjustified.” Thus, it is generally the case that benefits wrongfully obtained are unjustly retained. Gains obtained by fraud or duress are obvious examples. Yet, even when receipt of benefits is not wrongful, retention of certain benefits non-consensually received may be unjust. Benefits received by mistake are the paradigmatic example. Listening to music over the fence was neither wrongful nor unjust.

Section two of the R3RUE describes these limiting principles in broad brush: “[t]he fact that a recipient has obtained a benefit without paying for it does not of itself establish that the recipient has been unjustly enriched.” For example, “[a] valid contract defines the obligations of the parties as to

22. R3RUE § 1 cmt. b.
23. Id. § 4 cmt. b.
25. Id.
26. See infra Part III.
27. R3RUE § 2 cmt. b. The same comment goes on to observe that “the fact that we derive advantage from the efforts and expenditures of others is not ‘unjust enrichment’ but one of the advantages of civilization.” Indeed, such a voluntary sharing of benefits is one of the very means by which humanity reaches its end or purpose. See C. Scott Pryor, Principled Pluralism and Contract Remedies, 40 MCGEORGE L. REV. 723, 742–43 (2009).
28. R3RUE § 2(1).
matters within its scope, displacing to that extent any inquiry into unjust enrichment.”29 Deferring to recognized forms of exchange, restitution recognizes the superiority of contract’s ex ante value-setting function over a court’s reexamination efforts even if, in retrospect, the values exchanged are substantially disproportionate.30 Similarly, a claim in unjust enrichment generally cannot be used to foist an exchange on an unwilling party.31 But for certain emergencies, foregoing an opportunity to contract will defeat a claim of unjust enrichment.

Chapters 2–6 of the R3RUE classify the factual circumstances or predicates that have been recognized in American common law as amounting to unjustified enrichment.32 Thus, Chapter 2 (sections 5–19) addresses situations where the claimant confers a benefit involuntarily, e.g., by mistake,33 as a result of fraud,34 duress,35 or the exercise of undue influence,36 while incapacitated,37 or by one without of authority.38 Chapter 3 (sections 20–30) deals with unrequested benefits obtained without a prior agreement to pay, e.g., protecting another’s life, health,39 or property;40 performing the duties of another person;41 performing a joint obligation42 (and sometimes even performing another’s independent obligation43); and

29. See id. § 2(2). So too, a gift: “A valid gift is not a source of unjust enrichment . . . .” Id. § 2 cmt. b.
30. See RESTATEMENT (SECOND) OF CONTRACTS § 79 (1981) (“If the requirement of consideration is met, there is no additional requirement of . . . (b) equivalence in the values exchanged . . . .”).
31. See R3RUE § 2(4) (“Liability in restitution may not subject an innocent recipient to a forced exchange: in other words, an obligation to pay for a benefit that the recipient should have been free to refuse.”).
32. See id. at chs. 2–6.
33. See R3RUE § 5 (“Invalidating Mistake”); see infra Appendix A. Sections 6–12 of the R3RUE lay out with specificity the methods of invalidating mistakes that are regularly recognized by the courts.
34. See R3RUE § 13 (“Fraud and Misrepresentation”); see infra Appendix A.
35. See R3RUE § 14 (“Duress”); see infra Appendix A.
36. See R3RUE § 15 (“Undue Influence”); see infra Appendix A.
37. See R3RUE § 16 (“Incapacity of Transferor”); see infra Appendix A.
38. See R3RUE § 17 (“Lack of Authority”); see infra Appendix A.
39. See R3RUE § 20 (“Protection of Another’s Life or Health”); see infra Appendix A.
40. See R3RUE § 21 (“Protection of Another’s Property”); see infra Appendix A.
41. See R3RUE § 22 (“Performance of Another’s Duty”); see infra Appendix A.
42. See R3RUE § 23 (“Performance of a Joint Obligation (Indemnity and Contribution)”); see infra Appendix A.
43. See R3RUE § 24 (“Performance of an Independent Obligation (Equitable Subrogation)”); see infra Appendix A.
providing property or services as part of a cohabiting relationship. In Chapter 4 (sections 31–39), the R3RUE deals with the restoration of benefits conferred pursuant to a voidable contract, e.g., as a result of an agreement’s indefiniteness or the parties’ failure to comply with the Statute of Frauds; when a contract is illegal or otherwise violates public policy; where the recipient of contract benefits is incompetent; where a contract has been discharged because of mistake or impracticability; or where a material breacher has provided contract benefits to the other party. Chapter 5 (sections 40–45) addresses cases where one party has received benefits through wrongful interference with the rights of the claimant, e.g., by trespass, misappropriation, infringement, breach of fiduciary duty, or homicide. Finally, the R3RUE concludes its description of examples of unjustified enrichment with a set of residual cases in Chapter 6 (sections 46–48).

The organizing rubrics animating the chapters of the R3RUE are to some extent arbitrary. Yet the principles and rules of the R3RUE provide a far more serviceable result than the first Restatement of Restitution. In large part, it is because of the R3RUE’s clarity that it can be expected to have an impact on the jurisprudence of bankruptcy courts.

### III. EQUITY’S PROPRIETARY REMEDIES

The remedial provisions of the R3RUE compose Chapter 7. Prominent among them are the quartet of constructive trusts, equitable liens, subrogation, and the paired set of rescission and restitution—what

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44. See R3RUE § 28 (“Unmarried Cohabitants’”); see infra Appendix A.
45. See R3RUE § 31 (“Unenforceability’’); see infra Appendix A.
46. See R3RUE § 32 (“Illegality’’); see infra Appendix A.
47. See R3RUE § 33 (“Incapacity of Recipient’’); see infra Appendix A.
48. See R3RUE § 34 (“Mistake or Supervening Change of Circumstances’’); see infra Appendix A.
49. See R3RUE § 36 (“Restitution to a Party in Default’’); see infra Appendix A.
50. See R3RUE § 40 (“Trespass, Conversion, and Comparable Wrongs’’); see infra Appendix A.
51. See R3RUE § 41 (“Misappropriation of Financial Assets’’); see infra Appendix A.
52. See R3RUE § 42 (“Interference with Intellectual Property and Similar Rights’’); see infra Appendix A.
53. See R3RUE § 43 (“Fiduciary or Confidential Relation’’); see infra Appendix A.
54. See R3RUE §§ 45–46.
55. See id. §§ 46–48.
57. See R3RUE ch. 7.
58. See R3RUE § 55 (“Constructive Trust’’); see infra Appendix A. See infra Part IV.
59. See R3RUE § 56 (“Equitable Lien’’); see infra Appendix A. See infra Part V.
60. See R3RUE § 57 (“Subrogation as a Remedy’’); see infra Appendix A. See infra Part VI.
61. See R3RUE § 54 (“Rescission and Restitution’’); see infra Appendix A. See infra Part VII.
the R3RUE refers to collectively as rights to "restitution via rights in identifiable property." More simply, each of these can be called proprietary remedies. Of additional significance in the event of insolvency is section 60 of the R3RUE, which articulates a rule of priority to resolve conflicts between the claimant to a proprietary remedy and a creditor who holds an unsecured claim. And of significance in all cases are the tracing rules of sections 58 and 59 of the R3RUE, as well as the defenses described in Chapter 8.

More than the substantive bases of unjust enrichment, the proprietary remedies play a significant role in bankruptcy. If recognized in an insolvency proceeding, proprietary remedies effectively remove property from the estate and thus reduce what is available for other creditors. Two leading policies typical of all forms of insolvency law may thus appear to conflict. On the one hand, the principle of pari passu requires that all similarly-situated creditors of a debtor be accorded equal treatment. On the other, the nature of property prohibits satisfaction of the claims of creditors with property belonging to someone other than the debtor. For simplicity, this can be characterized as the principle of property.

62. R3RUE § 54 cmt. a.
63. Id. § 60 ("Priority"); see infra Appendix A.
64. R3RUE § 60.
65. See, e.g., id. § 62 ("No Unjust Enrichment"); id. § 63 ("Unclean Hands"); id. § 64 ("Passing On"); id. § 65 ("Change of Position"); id. § 66 ("Bona Fide Purchaser"); id. § 67 ("Bona Fide Physician"); id. § 70 ("Laches"). These defenses to claims for restitution are traditionally cast as affirmative defenses, but they could equally as well be understood to traverse an element of claimant's substantive claim.
67. Id.
68. See Carl S. Bjerre, Secured Transactions Inside Out: Negative Pledge Covenants, Property and Perfection, 84 CORNELL L. REV. 305, 309 (1999) ("The first of these principles, which I call the 'pari passu principle,' provides that unsecured creditors rank equally with each other in right to payment, regardless of the temporal order in which they extend credit . . . ."). See also Pepper v. Litton, 308 U.S. 295, 306 (1939) ("The mere fact that an officer, director, or stockholder has a claim against his bankrupt corporation or that he has reduced that claim to judgment does not mean that the bankruptcy court must accord it pari passu treatment with the claims of other creditors. Its disallowance or subordination may be necessitated by certain cardinal principles of equity jurisprudence.").
What constitutes a claim is rarely at issue in matters involving unjust enrichment; bankruptcy courts have little difficulty in allowing claims that are described under the substantive rules of the R3RUE. But, what constitutes “property of another” has proved problematic. The fuzzy edge of what constitutes property, particularly the effects of the quartet of proprietary remedies, has troubled American bankruptcy courts.

Anthony Duggan aptly characterizes the source of the “property problem” when he observes that the distinction between personal and proprietary rights in a common law system “is not a straightforward exercise because equity blurs the boundaries.” With regard to the principle of pari passu, the treatment of claims arising under the rubrics of contract and tort has presented some significant challenges. With regard to the principle of property, courts have been careful to ensure that creditors’ claims are not satisfied with property to which the debtor does not hold legal title. Yet, these challenges pale in comparison to the conceptual variations and outright contradictions that courts express when addressing questions of equitable title. Whether courts choose to follow or reject the R3RUE, its relevant remedial sections offer a resource to correct misstatements of the law, and, what’s more, provide an analytic framework by which to evaluate the competing principles of insolvency law.

IV. CONSTRUCTIVE TRUST

A. From Equity

The most potent of the proprietary remedies is the constructive trust. As with all proprietary remedies, constructive trust “supplement[s] the

70. See supra text accompanying notes 33–54. See also the broad definition of “claim” in the Bankruptcy Code. 11 U.S.C. § 101(5).
71. See Duggan, supra note 66, at 1232.
72. Id.
73. See, e.g., Patterson v. Shumate, 504 U.S. 753 (1992) (concluding that assets held in ERISA-qualified pension plan were not property of the estate).
74. A debtor’s bankruptcy estate is composed of the debtor’s legal and equitable interests in property as of the commencement of the case. 11 U.S.C. § 541 (2006). The estate may also be enhanced by the avoidance provisions of the Bankruptcy Code. Id. §§ 544–48. These provisions permit the avoidance of certain pre-bankruptcy transfers that effectively reduce the amount available for distribution to unsecured creditors. Broadly speaking, these powers go beyond the common law to augment the legal and equitable interests of the debtor that existed at the filing of bankruptcy.
75. See supra notes 67–69 and accompanying text.
76. See Duggan, supra note 66, at 1251, 1267 (discussing court decisions concerning equitable title).
77. See infra text accompanying notes 93–114.
78. See discussion supra Part III.
personal liability of the defendant with significant rights in rem.\textsuperscript{79} In two parts, section 55 of the R3RUE provides that:

(1) If a defendant is unjustly enriched by the acquisition of title to identifiable property at the expense of the claimant or in violation of the claimant's rights, the defendant may be declared a constructive trustee, for the benefit of the claimant, of the property in question and its traceable product.

(2) The obligation of a constructive trustee is to surrender the constructive trust property to the claimant, on such conditions as the court may direct.\textsuperscript{80}

Application of the remedy of constructive trust is triggered only when one of the substantive bases of unjust enrichment described in Part I has been established: the first step is to establish that the recipient has been unjustly enriched by the acquisition of specific property, the test of unjust enrichment being found in the applicable rules of Chapters 2–6.\textsuperscript{81} Notwithstanding broad judicial language,\textsuperscript{82} the decision to impose a constructive trust on property is not the application of a court's moral judgment.\textsuperscript{83} The legal rights for which the remedy of constructive trust may be appropriate are limited to those cases of unjustified enrichment recognized by the law, whether common law or equity or both.\textsuperscript{84}

The substantive predicate of unjust enrichment is only one of two required for the remedy of constructive trust. The second predicate concerns the nature of the unjust enrichment: it must entail the acquisition of title to identifiable property.\textsuperscript{85} Simply enhancing the value of another's assets is
insufficient to ground a claim in constructive trust (although it may be
enough for an equitable lien\(^86\)). Even proof of a causal relationship between
enriching actions and increased value of a specific item of defendant’s
property is insufficient; one who seeks a constructive trust must prove that
the defendant acquired legal title to the identified asset as a result of the
unjust enrichment.\(^87\)

Demonstrating the presence of unjust enrichment and acquisition of title
to identifiable property defines the universe of substantive predicates for
constructive trust in the two-party scenario.\(^88\) But how should the law
resolve the implications of the presence of a third party, e.g., unsecured
creditors of an insolvent defendant? When, if ever, should the unjust
enrichment claimant be entitled to assert constructive trust in identifiable
property against a debtor’s other creditors? While the second element of the
claim—the debtor’s acquisition of title to identifiable property—remains
the same, the claimant must additionally establish that the debtor’s creditors
will be unjustly enriched at the claimant’s expense in order to obtain a
constructive.\(^89\) In short, the debtor should not be able to rob Peter to pay
Paul.\(^90\)

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86. See infra text accompanying notes 175-85.
87. See R3RUE § 55 illus. 15. Illustration 15 presents the same facts as Illustration 14, except
that the court finds that the value of particular assets in Father’s business has been significantly
enhanced by Son’s efforts. Id. While this relationship of cause and effect does not entitle Son to
claim a share of ownership via constructive trust, it satisfies the requirements of section 56 R3RUE
for the remedy of equitable lien. Id. The court might therefore grant Son an equitable lien on the
assets in question, to secure Son’s unjust enrichment claim against Father. Id.; see also supra text
accompanying note 85.
88. See supra notes 85–87.
89. See R3RUE § 55 cmt. d.
90. Id. (“Priority in this three-way contest may be explained without reference to formal notions
of title. Even if A’s suit for restitution is formally asserted against B as defendant, A’s implicit
claim—to justify in equitable terms the remedy of constructive trust—is that B’s unsecured creditor
C will be unjustly enriched, at A’s expense, if B’s debt to C is satisfied from assets that B obtained
from A by fraud. The intuitive objection is that a debtor should not be allowed to rob Peter to pay
Paul.”).
B. Into Bankruptcy

The oft-repeated refrain that bankruptcy courts are not roving commissions to do equity has obscured what it is that bankruptcy courts are to do with the law of equity. Confusion reigns among equity as ἐπιεικεία, equity as mitigatio iuris, equity as the basis of substantive rights, and equity as the source of certain remedies. Nowhere is this confusion better demonstrated than in the treatment of constructive trust in bankruptcy.

1. Recognition

The relationship in bankruptcy between the proprietary remedy of constructive trust and the claims of general creditors has been bubbling at the surface since the 1994 decision in In re Omegas Group, Inc. The Sixth Circuit concluded that with few exceptions a bankruptcy court could not impose a constructive trust on assets of the bankruptcy estate. Unless there had been a final judgment imposing a constructive trust before the bankruptcy filing, virtually no facts would warrant the imposition of one afterward. The court asserted that a constructive trust is "anathema" to bankruptcy because it violates the principle of pari passu. That a proprietary remedy might vindicate the principle of property received short shrift because, according to the court, "[a] constructive trust is a legal fiction, a common-law remedy in equity that may only exist by the grace of judicial action." The court justified its failure to substantiate this conclusion with only cursory reference to the law of Kentucky with the

92. See supra notes 3–9 and accompanying text.
94. Id. at 1452.
95. Id. at 1449.
96. Id. at 1452 ("Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending debtor.").
97. Id. at 1449.
remarkable comment that "just because something is so under state law does not necessarily make it so under the Bankruptcy Code." 98

Andrew Kull responded four years later with a lengthy article attacking the Omegas decision. 99 Rather than reviewing Kull's critique, this article will focus on how the facts and law reported in Omegas would be analyzed under the R3RUE. The first question is whether Omegas, the debtor, was unjustly enriched at the expense of claimant Datacomp. In other words, do the facts identified by the court support any of the substantive bases for unjust enrichment described in the R3RUE? According to the Sixth Circuit's version of the facts, Datacomp and the debtor Omegas entered into an arrangement to finance Omegas's purchase of IBM computers in violation of Omegas's (and Datacomp's) existing contracts with IBM. 100 Under their agreement, Datacomp ordered computers from Omegas and prepaid for them. 101 However, it never received the computers because Omegas subsequently cancelled its orders from IBM while keeping Datacomp's payments, and then filed bankruptcy. 102 Datacomp brought an adversary action asserting that Omegas had obtained payment for the computers from Datacomp by fraud and asking the court to impose a constructive trust on the amounts so paid. 103

Section 13 of the R3RUE states that "[a] transfer induced by fraud ... is subject to rescission." 104 Indeed, contract law has long provided that a defrauded party has the power to avoid a contract induced by fraud. 105 The facts found by the bankruptcy court, however, do not clearly indicate fraud

98. Id. at 1450. The court's failure to cite the leading Supreme Court decision is telling. See Butner v. United States, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.").

99. Andrew Kull, Restitution in Bankruptcy: Reclamation and Constructive Trust, 72 AM. BANKR. L.J. 265 (1998). Kull was also the Reporter for the R3RUE. But see Rogers, supra note 3, at 1404-05 (criticizing Kull's conclusions with respect to the effect of tracing rules extending priority of a proprietary claimant to proceeds).

100. Omegas, 16 F.3d at 1445-46. Omegas had reached its credit limit with IBM's financing arm and was in danger of financial collapse. Id. at 1445. Rather than purchasing directly from IBM as it ordinarily had done, Datacomp agreed not only to buy IBM computers from Omegas but to pay for them in advance of delivery. Id. at 1446. Fortified with the prepayments from Datacomp, Omegas was to pay down its line of credit with IBM and continue in business. Id. Of course, it ultimately did neither.

101. Id. at 1446.

102. Id.

103. Id.

104. See R3RUE § 13 (2011).

105. See RESTATEMENT (SECOND) OF CONTRACTS § 164 (1981) ("When a Misrepresentation Makes a Contract Voidable: 1) If a party's manifestation of assent is induced by either a fraudulent or a material misrepresentation by the other party upon which the recipient is justified in relying, the contract is voidable by the recipient.").
by Omegas; both parties went in with their eyes wide open. Additionally, the extensive performance under the contract substantially weakens any claim for rescission and restitution; by the time of bankruptcy it was too late to unscramble the egg. In brief, the facts in Omegas would not have warranted rescission by Datacomp even had Omegas never filed bankruptcy.

However, even if Omegas defrauded Datacomp, the nature of Datacomp’s performance—payment of money to Omegas—is not the sort for which a proprietary remedy like constructive trust is appropriate. Constructive trust is a remedy for unjust enrichment by which the defendant acquires “legal title to specifically identifiable property,” not one by which it receives fungible funds. In addition, the majority in Omegas ignored the tracing issues raised by the commingling of Datacomp’s payments with other funds in Omegas bank account. Given the cash-poor nature of most debtors immediately before bankruptcy, the lowest intermediate balance in Omegas bank account would likely have been zero. Finally, while the court mentions the doctrine of unclean hands, it fails to explain that the law of equity consistently bars a claimant from a proprietary remedy when it too engaged in inequitable conduct. The facts in Omegas never warranted a constructive trust for Datacomp.

In its haste to expunge constructive trust from bankruptcy, the Sixth Circuit failed to take seriously the law of equity. That law, summarized in the R3RUE, suggests that Omegas was not unjustly enriched at Datacomp’s

106. *Omegas*, 16 F.3d at 1446. On the one hand, the trial court found that “Datacomp entered into the agreement . . . as ‘in a sense a joint venture’ . . . .” *Id.* On the other, Omegas continued to invoice Datacomp for computers even after it had cancelled the corresponding orders from IBM. *Id.* The bankruptcy court applied a constructive trust only to payments received by Omegas after cancellation—even though that time was well after the parties entered into their contract. *Id.*

107. See infra text accompanying notes 330–52.

108. See R3RUE § 55 cmt. a.

109. See supra text accompanying notes 85–87.

110. See *Omegas*, 16 F.3d at 1454 (Guy, J., concurring) (“The trustee emphasizes that . . . Omegas commingled Datacomp’s money with over $1,600,000 of money it received from other sources.”). Section 59 of the R3RUE provides for the typical lowest intermediate balance test tracing rule in such a situation. R3RUE § 59 (“Tracing into or Through a Commingled Fund”); see infra Appendix A. The First Circuit has applied this rule to deny application of a constructive trust where unjustly obtained funds had been completely dissipated. See *Conn. Gen. Life Ins. Co. v. Universal Ins. Co.*, 838 F.2d 612 (1st Cir. 1988).

111. See *Omegas*, 16 F.3d at 1448 (“Omegas also argues that the fishy nature of Datacomp’s attempt to keep getting IBM computers at a favorable rate through Omegas’s still-valid IR agreement renders Datacomp’s hands ‘unclean,’ thus preventing it from seeking the equitable remedy of constructive trust.”).

112. See R3RUE § 63 (“Equitable Disqualification (Unclean Hands)’”); see infra Appendix A.
expense and that, even if it were, neither the right of rescission nor the remedy of constructive trust was warranted. Subsequent decisions by the Sixth Circuit\footnote{See, e.g., Poss v. Morris (In re Morris), 260 F.3d 654 (6th Cir. 2001) (holding relief from automatic stay appropriate to permit existing state court action to determine whether claimant had enforceable claim from conveyance of property pursuant to settlement agreement to proceed to judgment with substantive references to relevant Ohio law of unjust enrichment); Kitchen v. Boyd (In re Newpower), 233 F.3d 922 (6th Cir. 2000) (determining bankruptcy court erred by holding that embezzled funds were property of the bankruptcy estate but was correct to reject application of constructive trust to their proceeds); McCafferty v. McCafferty (In re McCafferty), 96 F.3d 192 (6th Cir. 1996) (holding wife's interest in husband's award by state court was a constructive trust and not a debt dischargeable in husband's bankruptcy).} and lower courts\footnote{See, e.g., SCS Gen. Contractors, Inc. v Wells Fargo Bank, N.A., (In re Barnhill's Buffet, Inc.), 421 B.R. 602, No. 07-08948, 2009 Bankr. LEXIS 4335 (B.A.P. 6th Cir. 2009); Whitmore Lake Pub. Schs. v. CMC Telecom, Inc. (In re CMC Telecom, Inc.), 383 B.R. 52 (Bankr. E.D. Mich. 2008); Corzin v. Decker, Vonau, Sybert & Lackey, Co. (In re Simms Constr. Servs. Co.), 311 B.R. 479 (B.A.P. 6th Cir. 2004).} in the Sixth Circuit suggest a quiet stand-down from the broad assertion in \textit{Omegas} that there can be no constructive trusts in bankruptcy. Nonetheless, the \textit{Omegas} opinion privileges the principle of \textit{pari passu} at the expense of the principle of property.

Other circuit courts have been more lenient in permitting application of constructive trust in bankruptcy. Applying New Jersey law, the Second Circuit blessed the application of a constructive trust on a debtor's inventory of air conditioners stored in New Jersey in violation of its security agreement.\footnote{See Omegas, 16 F.3d at 1451 ("We think that § 541(d) simply does not permit a claimant in the position of Datacomp to persuade the bankruptcy court to impose the remedy of constructive trust for alleged fraud committed against it by the debtor . . . .").} In contrast with the opinion in \textit{Omegas} that would have denied a constructive trust even for fraud,\footnote{See \textit{Howard's Appliance} Corp.,874 F.2d at 94 ("Howard must have known that, under the terms of the security agreement, it was obligated to keep its Sanyo merchandise at its Nassau County location, and that by storing its inventory in New Jersey, it would frustrate Sanyo's interest in those goods."). The debtor's relocation of its inventory from New York to New Jersey caused perfection of Sanyo's security interest to lapse under Article 9 of the Uniform Commercial Code as it then existed. See id. at 91 n.3. Today under revised Article 9, with respect to a corporate debtor, Sanyo's security interest would attach and remain perfected regardless of the location of the inventory. See U.C.C. §§ 9-301, 9-307 (2010).} \textit{Howard's Appliance} found sufficient grounds for constructive trust upon little more than breach of contract.\footnote{See supra text accompanying notes 33-54 (identifying cases of unjust enrichment) and 338-40 (observing that application of a proprietary remedy is inappropriate where parties have voluntarily entered into subsisting contracts).} The R3RUE would not countenance a proprietary remedy on the facts of \textit{Howard's Appliance}. Without a valid substantive claim of unjust enrichment, there is no predicate for a constructive trust. Fifteen years later the Second Circuit cut back on the over-breadth of \textit{Howard's Appliance} in
First Central Financial. First Central Financial involved a breach of an agreement for the allocation of tax refunds between a parent and subsidiary corporation. Though the court correctly observed that "a constructive trust is an equitable remedy intended to be ‘fraud-rectifying’ rather than ‘intent-enforcing’," it went on to comment in dicta that the principle of pari passu provided an additional reason not to find a constructive trust in a bankruptcy proceeding.

The Third and Fourth Circuits have applied the law of equity in a straightforward way to recognize the constructive trust remedy when founded on an instance of unjust enrichment. In Columbia Gas, the Federal Energy Regulatory Commission required the debtor to collect refunds from gas suppliers and rebate them to customers, as well as to collect research surcharges from customers and turn them over to a federally designated non-profit entity that researched production and transportation of natural gas. Columbia Gas was a mere conduit. Even the Sixth Circuit would probably have held that the debtor had no interest in these funds. In any event, the Third Circuit held that both were excluded from the bankruptcy estate. It then applied the lowest intermediate balance test to

120. Id. at 211 ("FCFC is the parent corporation of FCIC, a New York insurance company. In the 1980s, the two companies executed a tax allocation agreement which prescribed how tax charges and refunds were to be apportioned between FCFC and FCIC.").
121. Id. at 216 (quoting Bankers Sec. Life Ins. Soc'y v. Shakerdge, 49 N.Y.2d 939, 940 (N.Y. 1980)).
122. Id. at 217 ("The tension between constructive trust law and bankruptcy law is another reason to proceed with caution.... [O]ur obligation to apply New York constructive trust law does not diminish the need to 'act very cautiously' to minimize conflict with the goals of the Bankruptcy Code." (citations omitted)).
124. Id. at 1053 ("Pursuant to Order 528, five upstream pipelines that supplied gas to Columbia filed new rate schedules which allocated $134 million less in buyout or buydown costs to Columbia than under the purchase deficiency method. Columbia, in turn, filed tariff provisions with FERC to flow through these refunds to its downstream customers. These refunds, together with approximately $26 million in refunds arising from other overcharges for gas and transportation services, comprise the customer refunds that Columbia seeks to exclude from its bankruptcy estate and pay to its customers.").
125. Id. ("GRI is financed predominantly through FERC-approved surcharges on gas delivered through regulated pipelines. Pursuant to this regulatory mechanism, each pipeline, including Columbia, collects a separately identified charge from its customers and then remits this money to GRI within fifteen days.").
126. See supra note 95.
127. Columbia Gas, 997 F.2d at 1062 ("[W]e hold that the customer refunds already received and
trace the amount of funds held in constructive trust and limit recovery by the putative beneficiaries. Conversely, collection of unpaid amounts owed by Columbia to its suppliers, even though ultimately paid by Columbia's customers, was not enhanced by an administrative order and was thus purely contractual and not entitled to a constructive trust. In *Mid Atlantic Supply*, the Fourth Circuit applied the "mere conduit" reasoning to a check jointly payable to a subcontractor and supplier for the purchase of materials. The subcontractor would be unjustly enriched by mistake, according to the court, if it were allowed to retain the check. Sections 7 and 8 of the R3RUE support this conclusion. Under the circumstances of the parties' agreement, retention of possession of the check by the subcontractor would be a mistake because an unintended payee would end up with the money. And constructive trust was an appropriate remedy for the unjust enrichment that would have resulted from such a mistake.

The Fifth, Seventh, Ninth, and Eleventh Circuits have also recognized that claims based on unjust enrichment can be remedied by

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those to be received are excluded from Columbia's bankruptcy estate. The argument for the GRI surcharges being held in trust is even stronger than the argument for the customer refunds."

128. See id. at 1060.

129. *Columbia Gas*, 997 F.2d at 1064 ("When Columbia filed for bankruptcy, the $3.3 million in its general account was insufficient to satisfy its pre-petition obligations to its customers and GRI. The bankruptcy court found that this amount represents the lowest intermediate balance in the general account, and no party has challenged this finding as clearly erroneous. Therefore, Columbia may distribute only the $3.3 million on a pro rata basis to its customers and GRI to satisfy its pre-petition obligations. The remainder of its pre-petition obligations to its customers and GRI will be unsecured debt.").

130. Id. at 1063 ("The obligations owed to upstream pipelines clearly are debts. Columbia owes the upstream pipelines money for goods and services they have provided to Columbia. Although Columbia's customers pay the charges of the upstream suppliers dollar-for-dollar through Columbia's rates . . . . Columbia does not act as a conduit or a collecting agent for the upstream suppliers. The upstream pipelines are in the same position as every other unsecured creditor.").


132. Id. at 1127 ("The check in this case, though made payable jointly to Mid-Atlantic and TRACO, was thus intended as a payment to TRACO by Lawson for the windows . . . . The district court correctly found on these facts that there was a constructive trust in favor of TRACO under the law of Virginia, that equitable title and right of possession in the check and its proceeds (subject to the exception later noted) belonged to TRACO, and that there was accordingly a constructive trust in favor of TRACO . . . .")

133. R3RUE § 7 ("Mistaken Performance of Another's Obligation"); see infra Appendix A.

134. R3RUE § 8 ("Mistaken Discharge of Obligation or Lien"); see infra Appendix A.

135. See R3RUE § 6 cmt. b ("A mistaken payor has a claim in restitution when money is mistakenly transferred to someone other than the intended recipient.").

136. See supra text accompanying note 81. The claimant would have been able to assert a proprietary claim as to the traceable proceeds of the check had the subcontractor succeeded in negotiating it. R3RUE § 50 ("Innocent Recipient"); see infra Appendix A.

137. See Vineyard v. McKenzie (In re *Quality Holstein Leasing*), 752 F.2d 1009 (5th Cir. 1985)
imposition of a constructive trust in bankruptcy. But for the decision of the Sixth Circuit in *Omegas*, bankruptcy courts have been authorized to impose a constructive trust when appropriate for claims founded on unjust enrichment. The cautionary language employed by some courts is unnecessary; the principle of property, properly cabined by the limiting rules of the R3RUE, is not contrary to the principle of *pari passu*. A claimant’s interest in property, whether legal or equitable, can be preserved and should not be taken to satisfy the claims of others.

2. Avoidance

Regardless of a claimant’s success in obtaining a constructive trust in bankruptcy, the benefits will be short lived if the trustee has the power to avoid it. Section 544 of the Bankruptcy Code provides distinct powers to avoid certain interests in both personal property and real estate.141 To the extent that the avoidance powers ultimately rest on state common law, the R3RUE’s restatement of that law will be significant. To the extent that statutes reflect the relevant state or federal law, the R3RUE’s effect will be marginal.142
In short, § 544(a)(1) of the Bankruptcy Code provides that the bankruptcy trustee stands in the shoes of a judicial lien creditor as of the commencement of the case. While section 9–317 of the U.C.C. provides a rule that addresses the priority of judicial lien creditors with respect to personal property, it does so only with respect to a competitor who holds a security interest, not a claimant entitled to a proprietary remedy. But for the R3RUE, resolution of a competition between holders of a proprietary remedy and judicial lien creditors could only be found in the vagaries of state execution law. Tracking the majority of cases decided under execution statutes and the common law, section 60(1) of the R3RUE makes it clear that one who holds "a right to restitution from identifiable property [in the hands of a recipient] is superior to the competing rights of a creditor of the recipient who is not a . . . purchaser." A creditor, even one who has levied and obtained a judicial lien on some item of personal property, is subordinate to a proprietary interest. By contrast, the interest of a purchaser, even one who has obtained only a security interest in some item of personal property, is superior to a proprietary interest. A bankruptcy

most notably, by the various state recording acts, by Article 9 of the Uniform Commercial Code, and by federal bankruptcy law. The provisions of this section are accordingly subject to be altered, or altogether displaced, by applicable statute law.

143. See U.C.C. § 9–317 (2011) ("Interests that Take Priority Over or Take Free of Security Interest or Agricultural Lien: (a) [Conflicting security interests and rights of lien creditors] A security interest or agricultural lien is subordinate to the rights of: (1) a person entitled to priority under Section 9–322; and (2) except as otherwise provided in subsection (e), a person that becomes a lien creditor before the earlier of the time: (A) the security interest or agricultural lien is perfected; or (B) one of the conditions specified in Section 9–203(b)(3) is met and a financing statement covering the collateral is filed."); see also R3RUE § 60 cmt. e ("A restitution claimant who seeks to assert an unrecorded security interest will typically be seeking a remedy via subrogation, as a means of rectifying a transaction affected by fraud or mistake. The cases make it clear that § 9–317 does not displace the law of subrogation; rather, the law of subrogation supplements the priorities established by Article 9.").

144. See R3RUE §60; see also Osin v. Johnson, 243 F.2d 653, 657 (D.C. Cir. 1957) (holding that the right of victim of fraud to constructive trust in property conveyed to defendant is superior to a "judgment creditor possessing a statutory lien.").

145. See R3RUE § 60 cmt. a ("Restitution is advantageous to the claimant because the common law (including the elements of both law and equity that make up this part of the law of restitution) gives priority in insolvency to the rights of an owner over the rights of a creditor . . . "). But see R3RUE § 60 cmt. b ("Because a judicial lien creditor may be given the rights of a bona fide purchaser by statute, the foregoing statements describe the outcome where no statute expands the lien creditor's rights."). In any event, a claimant who cannot establish its interest in identifiable property is entitled to a monetary claim against the defendant that ranks equally with other general creditors. See R3RUE § 60(3).

146. See R3RUE § 66 ("Bona Fide Purchaser"); see infra Appendix A.

147. See R3RUE § 60(1), see infra Appendix A; see also Osin, 243 F.2d at 656 ("[T]he relationship between appellant [claimant] and Johnson [defendant] did not give appellant a claim superior to that of the trust holders who occupy the position of bona fide purchasers." (citing Colo. Coal & Iron Co. v. United States, 123 U.S. 307, 314 (1887))).
trustee standing in the shoes of only a judicial lien creditor will thus not be able to avoid a constructive trust.

However, § 544(a)(3) of the Bankruptcy Code enhances the avoiding powers of the bankruptcy trustee. With the passage of the Bankruptcy Reform Act of 1978, Congress gave the trustee the powers of a bona fide purchaser of real estate with respect to certain transfers. While section 60(1) of the R3RUE draws no distinction between personal property and real estate—a proprietary remedial interest has priority over a creditor with a judgment lien but is subordinate to a purchaser in both cases—judicial application of the avoiding powers and the vagaries of state recording laws have complicated matters. A leading example of this complication is the decision of the Seventh Circuit in Belisle v. Plunkett where the court applied § 544(a)(3) to avoid a constructive trust. Several years before filing bankruptcy, Oliver Plunkett had obtained funds from a group of investors and used the funds to purchase real estate in the U.S. Virgin Islands in the name of the partnership. Plunkett fraudulently took the interests in his own name and ultimately filed bankruptcy. Judge Easterbrook acknowledged that, due to his fraud, Plunkett held the real estate as a constructive trustee for the investors, but went on to hold that the bankruptcy trustee, armed with the powers of a bona fide purchaser

150. See R3RUE § 60 cmt. b (“[I]t is undisputed that A’s rights in X must be superior to those of anyone who asserts an interest in X merely as B’s general creditor.”). This is the case even if B’s general creditor obtains a judgment lien. Id. (“When the question is adjudicated as a matter of common law and equity, unmodified by statute, the answer uniformly given is that a judicial lien creditor is not a purchaser for value . . . .”).
151. See id. (“[I]t is likewise beyond question that A’s right to restitution of X—though iron-clad in a contest between A and B—will yield to the right of a transferee from B who purchases an interest in X for value and without notice.”).
152. 877 F.2d 512 (7th Cir. 1989).
153. Id. at 516.
154. Id. at 513 (“Through the spring and summer of 1979 Plunkett formed five partnerships to raise the money for the acquisition. After getting the cash, Plunkett closed the deal in October 1979—in his own name, despite using partnership funds.”).
155. Id.
156. Id. (“Plunkett bamboozled the partners and used for his own benefit the leasehold acquired with partnership funds. Virgin Islands law imposes a constructive trust on the leasehold and its fruits.”).
under § 544(a)(3) of the Bankruptcy Code, could avoid the unrecorded proprietary interests of the claimants.157

Courts in the Ninth Circuit have also concluded that constructive trust can be avoided under § 544(a)(3) of the Bankruptcy Code. In Seaway Express58 a bank held a perfected security interest in its debtor's accounts.159 The debtor exchanged one of its accounts for real estate in violation of the security agreement.160 The bank was aware of the exchange but took no action to record any interest in the real estate.161 After the debtor's filing under Chapter 11, the bank claimed an interest in the price of the real estate as "proceeds" of its borrower's accounts under Article 9, and as the beneficiary of a constructive trust on the real estate.162 The bank lost at all levels on both claims.163 With respect to a constructive trust, the Ninth Circuit did not decide whether one existed on these facts,164 but held that the trustee could avoid it under § 544(a)(3) in any event.165 The court advanced two reasons for its conclusion. First, it cited Plunkett without further analysis.166 Second, it rejected the bank's argument that it had done all it could; it should not be mulcted, the bank had claimed, when it had no means to perfect its interest in the real estate without the debtor's cooperation.167 In

157. Id. at 515: A bona fide purchaser from Plunkett would have taken ahead of the partners under local law. . . . One of Plunkett's creditors, extending $100,000 against a collateral assignment of the leasehold, actually obtained a position superior to that of the partners. The Trustee claimed the same position for the estate . . . . See also Bridge v. Midlantic Nat'l Bank (In re Bridge), 18 F.3d 195, 204 (3d Cir. 1994) (finding that under § 544(a)(3) of the Bankruptcy Code a trustee has power to avoid a claimant's right to the remedy of equitable subrogation).


159. Id. at 1126.

160. Id.

161. Id.

162. Id. at 1127.

163. Id.


165. In re Seaway Express Corp., 912 F.2d at 1128-29 ("When a creditor claims an inchoate equitable interest in real property owned by the debtor at the commencement of the case, which interest is not evidenced by a recorded instrument and not yet granted by a state court, the trustee as bona fide purchaser prevails.").

166. Id. at 1129-30 ("Although the section [544(a)(3)] empowers the trustee to avoid transfers, by its terms it also applies if no transfer has taken place." (quoting Belisle v. Plunkett, 877 F.2d 512, 515 (7th Cir. 1989))).

167. Id. at 1127.
response, the Ninth Circuit pointed to Washington law and observed that the bank could have sought the appointment of a “commissioner to file the deed of trust on its behalf.”\textsuperscript{168} The bank’s failure to employ a legal remedy when it knew about the debtor’s transaction suggests that the trustee could have effectively employed the defense of laches.\textsuperscript{169}

Other courts have rejected \textit{Plunkett}, holding that the trustee’s avoiding powers under § 544(a)(3) of the Bankruptcy Code do not reach a constructive trust.\textsuperscript{170} On such an account the avoiding powers are inapplicable because a proprietary remedy arises upon a transfer \textit{to} the debtor and the avoiding powers reach only transfers \textit{by} the debtor.\textsuperscript{171} Thus, the court in \textit{Rodolakis v. Pedone}\textsuperscript{172} explicitly rejected the reasoning in \textit{Plunkett} and concluded that a trustee “can only avoid a transfer of real estate previously made by the Debtor . . . .”\textsuperscript{173} The opaque language of § 544(a)(3) of the Bankruptcy Code that creates this confusion has been analyzed

\textsuperscript{168} Id. at 1129. Comment e to Section 60 of the R3RUE addresses the general effect of recording acts on the priority of holders of proprietary remedies. \textit{See} R3RUE § 60 cmt. e. The comment begins by observing that “statutes of this kind are rarely significant to the priority contests that are the subject of the present section.” \textit{Id.} “The transaction that underlies a typical restitution claim will frequently be outside the scope of standard recording-act provisions” because recording acts are designed to subordinate unrecorded interests of grantees to the creditors of grantors. \textit{Id.} Restitution claims are typically the opposite: “[I]t is Grantor (the restitution claimant) who seeks to avoid the transaction, while it is Grantee’s lien creditors who seek to confirm it. The language of a typical recording act will not accommodate such a claim.” \textit{Id.} Comment e also remarks that recording acts have frequently been held inapplicable to equitable interests generally. \textit{Id.} However, comment e goes on to concede that recording acts may cut off the proprietary remedies of grantees in the face of competing claims of lien creditors of the grantor. \textit{Id.} Such grantees, like the bank in \textit{Seaway}, have easy access to recording act protection.

\textsuperscript{169} \textit{See} R3RUE § 70(2) (“[T]he relief to which the claimant would otherwise be entitled may be barred if (a) the claimant has unreasonably delayed bringing or prosecuting the action, after the claimant had notice of the facts . . . .”)


\textsuperscript{171} Briefly, the introductory paragraph of § 544(a) of the Bankruptcy Code lays out the trustee’s general power to “avoid any transfer of property of the debtor” while § 544(a)(3) speaks specifically to the power of a “bona fide purchaser of real property” with respect to “such transfer.” \textit{Plunkett} concluded that “such transfer” referred broadly to any transfer over which a bona fide purchaser would have priority; \textit{Rodolakis}, on the other hand, held that “such transfer” was limited to only the set of those transfers described in the introductory paragraph, i.e., transfers \textit{by} and not \textit{to} the debtor.


\textsuperscript{173} \textit{Id.} at 743. \textit{See also} Vineyard v. McKenzie (In re Quality Holstein Leasing), 752 F.2d 1009, 1015 (5th Cir. 1985) (“[W]e find that the courts below erred in concluding that section 544 empowers a bankruptcy trustee to retain for the benefit of the estate property that the debtor obtained by fraud and upon which state law has imposed a valid constructive trust.”); Mills v. Brown (In re Brown), 182 B.R. 778, 782 (Bankr. E.D. Tenn. 1995) (“[Section] 544(a)(3) limits the bankruptcy trustee to avoiding transfers of real property made by the debtor . . . .”)

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elsewhere, but the consensus favors preserving a proprietary remedy in the face of avoidance by the trustee.\textsuperscript{174}

The R3RUE cannot effect interpretation of federal law. However, comments to the rule of priority in section 60 of the R3RUE articulate the historical common law basis for limiting the trustee's avoiding powers and Congress has not clearly legislated to the contrary. Application of R3RUE should thus change the result in \textit{Plunkett} but not in \textit{Seaway}.

\section*{V. EQUITABLE LIEN}

\subsection*{A. From Equity}

The remedy of equitable lien has received less attention than constructive trust. Claimants often seem to plead it simply as an alternative to its remedial cousin.\textsuperscript{175} Success with constructive trust gives a claimant the entire "bundle of sticks" of ownership, while an equitable lien represents less than the whole.\textsuperscript{176} On the other hand, the tight requirement between unjust enrichment and the defendant's acquisition of title to identifiable property is relaxed when the claimant seeks only an equitable lien.\textsuperscript{177} Moreover, from a practical point of view, even a claimant who could prevail on constructive trust might prefer an equitable lien if the property is worth less than the claim or might decline in value.\textsuperscript{178}

While recognition of a constructive trust removes property from the

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\textsuperscript{174} See, e.g., Kull, supra note 99; see also Gregg C. Gumbert, Note & Comment, \textit{The Trustee as a Bona Fide Purchaser of Real Property in Bankruptcy: Making Sense of Section 544(a)(3)}, 15 BANKR. DEV. J. 121 (1998).

\textsuperscript{175} See, e.g., Wilde v. Wilde, 576 F. Supp. 2d 595, 605 (S.D.N.Y. 2008) ("When a constructive trust extends only to a portion of the property [acquired with trust funds], it is generally known as an equitable lien." (citing RESTATEMENT (FIRST) OF RESTITUTION §§ 210, 161 cmt. a (1937); RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 56 (Tentative Draft No. 5, 2007)).

\textsuperscript{176} See R3RUE § 56 cmt. b ("Constructive trust transfers ownership of specific property from the holder of legal title to a person with a paramount equitable claim. By contrast, equitable lien (as the name indicates) gives the claimant a security interest in property held by the defendant, rather than ownership.").

\textsuperscript{177} See id. ("[C]onstructive trust requires that the transaction giving rise to unjust enrichment be one in which the holder acquires title to the property in question or its traceable antecedents, in violation of the claimant's rights; whereas equitable lien requires only that the holder's unjust enrichment be traced into, or otherwise identified with, the property in which the claimant asserts a security interest.").

\textsuperscript{178} See id. ("The choice between the remedies depends on the present value of the assets in question. Because constructive trust gives the claimant ownership of an asset (or a share therein), the value of the remedy fluctuates with the value of the asset. By contrast, equitable lien secures payment of a liability that is fixed in amount: namely, the defendant's unjust enrichment at the expense of the claimant, as determined by the rules of §§ 49-53. Constructive trust is the natural choice for a case in which a wrongdoer has acquired an asset that has appreciated in value, while equitable lien will be more favorable if the value of the asset has declined.").
\end{flushleft}
bankruptcy estate, imposition of an equitable lien simply secures the defendant’s obligation to pay money—a claim—with a lien on an identifiable asset.\footnote{179} The property remains part of the bankruptcy estate subject to the power of the claimant to seek adequate protection of its interest,\footnote{180} and the claimant is ultimately entitled to the value of its lien on liquidation\footnote{181} or in reorganization.\footnote{182}

As with constructive trust, the claimant must establish an underlying claim in unjust enrichment before turning to the remedy of equitable lien.\footnote{183} Section 56 of the R3RUE provides that

(1) If a defendant is unjustly enriched by a transaction in which

(a) the claimant’s assets or services are applied to enhance or preserve the value of particular property to which the defendant has legal title, or more generally

(b) the connection between unjust enrichment and the defendant’s ownership of particular property makes it equitable that the claimant have recourse to that property for the satisfaction of the defendant’s liability in restitution,

the claimant may be granted an equitable lien on the property in question.\footnote{184}

Unlike the second element of a constructive trust—that the defendant obtain title to identifiable property—an equitable lien requires only that the claimant establish a “nexus between the transaction giving rise to the

\footnote{179} R3RUE § 56 cmt. b (“Constructive trust transfers ownership of specific property from the holder of legal title to a person with a paramount equitable claim. By contrast, equitable lien (as the name indicates) gives the claimant a security interest in property held by the defendant, rather than ownership.”).
\footnote{180} See, e.g., U.S. Fid. & Guar. Co. v. Maxon Eng’g Servs., Inc. (In re Maxon Eng’g Servs., Inc.) 332 B.R. 495 (Bankr. D.P.R. 2005) (stating that movant holding equitable lien is entitled to adequate protection).
\footnote{181} See, e.g., Lewis v. Diethorn, 893 F.2d 648 (3d Cir. 1990) (holding that payment on account of an equitable lien not avoidable as preference).
\footnote{183} See R3RUE § 56 (“(2) An equitable lien secures the obligation of the defendant to pay the claimant the amount of the defendant’s unjust enrichment as separately determined. Foreclosure of an equitable lien is subject to such conditions as the court may direct.”). See supra text accompanying notes 33–54.
\footnote{184} R3RUE § 56(1).}
liability in unjust enrichment and the property in which the claimant seeks remedial rights. 185 The connection between the predicate act and property of the defendant is attenuated with the reduction of the required relationship. Anticipating treatment of equitable liens in bankruptcy, the principle of pari passu becomes stronger as the principle of property is expressed in weaker terms.

B. Into Bankruptcy

1. Recognition

Some have classified equitable liens as a subset of constructive trusts. 186 Even though constructive trusts have been met with a mixed reception in bankruptcy, no reported circuit court case has held that bankruptcy courts may not impose an equitable lien as a remedy for unjust enrichment. 187 Equitable liens have been applied by bankruptcy courts to provide a remedy to a claimant whose assets have been spent to improve property of the defendant. 188 An equitable lien has been imposed on exempt unencumbered property to trace the proceeds of insurance wrongfully diverted from a mortgagee, 189 and on an innocent co-tenant’s interest in property improved with funds obtained by the other co-tenant’s fraud. 190 An equitable lien has also been used for the insurer whose insurance proceeds were paid by mistake to an insured who subsequently filed bankruptcy, 191 and for a former

185. Id. § 56 cmt. a.
186. See, e.g., In re Marriage of Allen, 724 P.2d 651, 658 (Colo. 1986) (en banc) (“When imposed to prevent unjust enrichment, an equitable lien is a special and limited form of a constructive trust.”). This position is something of an overstatement. See Fulp v. Fulp, 140 S.E.2d 708, 712 (N.C. 1965) (“An equitable lien, or encumbrance, is not an estate in land, nor is it a right which, in itself, may be the basis of a possessory action. It is simply a charge upon the property, which charge subjects the property to the payment of the debt of the creditor in whose favor the charge exists.”).
187. See, e.g., Provencher v. Berman, 699 F.2d 568, 570 (1st Cir. 1983) (“In such a situation [where a conscious wrongdoer has used commingled funds to buy property], the innocent party can choose either to enforce a lien on the property for the value of the estate’s funds or to enforce a constructive trust on the property. This is a virtually universal rule ....”); see also Levy v. Kozyak (In re Fin. Federated Title & Trust, Inc.), 347 F.3d 880 (11th Cir. 2003) (affirming order of bankruptcy court imposing equitable lien against otherwise exempt homestead property acquired with proceeds of fraud); Goldberg v. N.J. Lawyer’s Fund (In re Goldberg), 932 F.2d 273 (3d Cir. 1991).
190. See, e.g., Fin. Federated Title & Trust, 347 F.3d 880; In re Mesa, 232 B.R. 508 (Bankr. S.D. Fla. 1999).
spouse whose unsecured claim to proceeds due on sale of the marital residence would be discharged in the bankruptcy of the other spouse. 192

2. Avoidance

The Third Circuit affirmed avoidance of an equitable lien in real property in *Midlantic National Bank v. Bridge*. 193 The claimant bank refinanced its borrower’s mortgage. 194 The closing agent recorded a satisfaction of the original mortgage but failed to record the new mortgage securing the financed debt. 195 The borrower/mortgagor then filed bankruptcy. 196 The circuit court affirmed Midlantic’s claim to an equitable lien 197 but concluded that a subsequent purchaser for value would take free of the lien under New Jersey law. 198 Section 544(a)(3) of the Bankruptcy Code provides that the trustee has the more extensive powers of a bona fide purchaser for value as of the filing. 199 Thus, the trustee had the power to avoid Midlantic’s equitable lien on the debtor’s real property.

The court’s decision (and New Jersey law) is consistent with section 56 of the R3RUE. As comment f observes, “[t]he modern equitable lien is usually [but not exclusively] employed as a remedy for unjust enrichment.” 200 In the *Midlantic* case, the defendant was not enriched because he still owed Midlantic repayment of the money lent. 201 However, to the extent that his property was no longer subject to a recorded mortgage, the likelihood of the bank recovering the debt was diminished. 202

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194. Id. at 197.

195. Id.

196. Id. at 198.

197. Id. at 201 (“[When] a creditor’s new security . . . prove[s] to be defective due to fraud or some kind of mistake, . . . the doctrine of equitable subrogation can operate to subrogate the new creditor to the position of the lender whose lien was discharged and permits the new creditor to assert its right to priority against subsequent claimants.”).

198. Id. at 204 (“We therefore conclude that, under New Jersey law, the rights of the trustee, as a hypothetical bona fide purchaser of real property for value without notice, prevail over the rights of Midlantic, as the holder of an unrecorded equitable lien, and prevent the operation of equitable subrogation in this case.”).

199. See supra text accompanying notes 148-51.

200. R3RUE § 56 cmt. f.

201. See *In re Bridge*, 18 F.3d at 197.

202. Id. at 197-98.
erroneous elimination of the encumbrance thus indirectly enriches a
debtor.\textsuperscript{203} Subsequent enrichment of third parties such as creditors is even
clearer.\textsuperscript{204} Unencumbered title to a debtor’s property increases the assets
available for their payment.\textsuperscript{205} Yet, section 66 of the R3RUE observes that
good-faith purchasers for value take “free of equitable interests that a
restitution claimant might have asserted.”\textsuperscript{206} Given that § 544(a)(3) of the
Bankruptcy Code provides the bankruptcy trustee with the status of such a
purchaser, the \textit{Midlantic} court correctly affirmed the avoidance of the
bank’s equitable lien.\textsuperscript{207}

Other courts have avoided equitable liens in bankruptcy as preferential
transfers.\textsuperscript{208} The bankruptcy court in \textit{Cedar Funding} held that the equitable
liens of hundreds of investors in mortgages originated by the debtor did not
protect their equitable interests from avoidance by the trustee.\textsuperscript{209} According
to the court, assignments of fractional interests in the mortgages recorded
within the ninety-day preference period were avoidable notwithstanding any
pre-existing equitable lien held by the assignees.\textsuperscript{210} Had the court held that
the investors had constructive liens from the outset, the later-conveyed
mortgages would not have improved their positions.\textsuperscript{211} In effect, they simply
would have exchanged their equitable proprietary interests for legal ones and
would not have received more than they would have had there been no
mortgages; thus, no preferential transfer.\textsuperscript{212}

\textit{Cedar Funding} drew support for its conclusion from dicta of the district
court in \textit{Cadle Co. v. Mangan}.\textsuperscript{213} The labyrinthine facts of \textit{Cadle} reveal just
how difficult it is to collect a judgment from a recalcitrant debtor.\textsuperscript{214}
Distilled to a minimum, Cadle had a judgment against Charles Flanagan. However, shortly before filing bankruptcy, Flanagan at last paid Cadle with the proceeds of a loan from his father. When the trustee sued to recover the payment as a preference, Cadle claimed the payment had been fully secured by an equitable lien on the underlying stock. Even though the court concluded that Cadle did not have an equitable lien under Connecticut law, citing the first Restatement of Restitution, it went on to hold in dicta that in any event equitable liens do not "relate back" to the time of the predicate wrongdoing but instead only to the time of enforcement. Because Cadle, despite his best efforts, had not successfully enforced his equitable lien before the preference period, the judgment against Flanagan was never secured and the payment to Cadle was an avoidable preference.

Use of the phrase "equitable lien" by the courts in *Midlantic, Cedar Funding*, and *Cadle* exposes a latent ambiguity. Equitable lien may refer to either a remedy for an uncompleted and thus unperfected secured transaction or to a remedy for unjust enrichment. Section 56 of the

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215. *Id.* at 14.
216. *Id.* at 14–15.
217. *Id.* at 15.
218. *Id.* at 21–22 ("The narrower argument that Appellants make is that had they received a perfected judicial lien absent Flanagan's misconduct, then, for preference purposes, the perfection of the lien itself would be unavoidable as a transfer, as it would have come into existence prior to the 90-day preference period, and Flanagan's subsequent payment of $99,542.87 would be unavoidable because it would not have improved Cadle's position.").
219. *Id.* at 22 (citing *RESTATEMENT (FIRST) OF RESTITUTION* § 161 (1937) ("Where property of one person can by a proceeding in equity be reached by another as security for a claim on the ground that otherwise the former would be unjustly enriched, an equitable lien arises."). For the modern statement of the rule, see R3RUE § 56 (2011).
220. *Cadle Co.*, 316 B.R. at 23 (quoting *NORTON BANKRUPTCY LAW AND PRACTICE* 2d § 57:29) ("The appropriate conclusion is that, for purposes of Code § 547, an equitable lien is transferred when steps to declare or enforce it are taken and without the benefit of any relation-back principle. As a result, if the lien is enforced within the relevant preference period, and other elements of a preference are present, it will typically constitute an avoidable transfer for an antecedent debt.").
221. *Id.*
222. See infra notes 231–34 and accompanying text.
223. See R3RUE § 56 cmt. e ("Equitable lien as a means to establish intended security. One of the most characteristic uses of equitable lien is to readjust transactions that have miscarried—because of mistake, inattention, or wrongful interference—depriving the claimant of an intended element of security. Employed in this way, an equitable lien takes the place of the consensual lien that the claimant would have obtained if the transaction had gone as originally planned.").
224. See R3RUE § 56 cmt. a ("As with all of the asset-based remedies in restitution, moreover, the claimant must establish a nexus between the transaction giving rise to the liability in unjust
R3RUE § 56 explicitly authorizes both applications, but the principle of pari passu presents the stronger case when the claimant neglected to protect its proprietary interest through available legal means. Indeed, the comprehensive scope of Article 9 of the Uniform Commercial Code effectively preempts any place for equitable perfection of security interests in personal property. Even though room remains under state law for equitable perfection with respect to an interest in real estate, the principle of pari passu—but buttressed by the trustee’s avoiding powers under § 544(a)(3) of the Bankruptcy Code—warrants the avoidance of such an equitable lien in bankruptcy.

Conversely, where a claimant has established a predicate for a claim of unjust enrichment rather than a simple failure to perfect a legal interest, the remedy of equitable lien should be available notwithstanding the defendant’s bankruptcy. Courts should resolve issues related to the avoidability of equitable liens as a remedy for unjust enrichment as they do constructive trusts.

enrichment and the property in which the claimant seeks remedial rights.

225. Id.
226. See id. § 56 cmt. e ("Any such use of the equitable lien [to establish intended security] is potentially in conflict with the formal arrangements by which consensual liens are normally created and perfected. Before a court will impose an equitable lien to rescue a claimant who has failed to take appropriate steps to obtain security, it must be satisfied that the remedy will not undermine the relevant statutory scheme."); see also Naja, L.L.C. v. Jack’s Co. (In re Dynamic Group, L.L.C.), 441 B.R. 841 (Bankr. W.D. Ky. 2011) (filing lis pendens preserved equitable lien of unperfected land contract vendor); Hassett v. Revlon, Inc. (In re O.P.M. Leasing Servs., Inc.), 23 B.R. 104, 119 (Bankr. S.D.N.Y. 1982) ("[A]n equitable lien will not be upheld as against a trustee where all available means of perfecting a legal lien were not employed by the would-be secured creditor.").
227. See, e.g., U.C.C. § 9–101 cmt. 1 (2011) ("As did its predecessor, it [Revised Article 9] provides a comprehensive scheme for the regulation of security interests in personal property and fixtures."). But see infra text accompanying notes 273–96 for the role of subrogation with respect to existing perfected security interests.
228. It would have done less violence to the law of unjust enrichment had the Cedar Funding court permitted avoidance of the equitable lien under § 544(a)(3) of the Bankruptcy Code, rather than as a preference. See Neilson v. Aguirre (In re Cedar Funding, Inc.), Bankr. No. 08–52709–MM, 2010 WL 1346365 (Bankr. N.D. Cal. Apr. 5, 2010). Contrary to the court’s holding, comment e to section 56 of the R3RUE observes that "[i]ke a constructive trust, an equitable lien is effective at the time of the transaction that gives rise to it, not when its existence is subsequently declared by the court.” The debtor’s assignments of interests in the underlying mortgages occurred long before the preference period. See id. For discussion of the legitimate application of § 544(a)(3) in such a situation, see supra text accompanying notes 172–73 discussing Seaway Express.
229. See, e.g., Lui-M Corp. v Garland Corp. (In re Garland Corp.), 6 B.R. 452, 455 (Bankr. D. Mass. 1980) (applying Florida law) ("There is [legal] authority for granting an equitable lien when legal rights are lost as a result of fraud."); see also Mulhern v. Albin, 163 F.2d 41 (8th Cir. 1947) ("The bankruptcy court was empowered to distribute to creditors of the bankrupt only such interest in property as the bankrupt had. Where, as in this case, she had only a legal title to the lands accruing to her through fraudulent conduct . . . the bankruptcy court may not refuse to recognize the equitable lien . . . .").
230. See supra Part IV.
VI. SUBROGATION

A. From Equity

The third proprietary remedy described in the R3RUE is subrogation. Ambiguous use of the term “subrogation” makes it important to distinguish between the claim and the remedy, each going by the same name.

1. Subrogation as a Claim—Equitable Subrogation

Section 24 of the R3RUE describes the claim of equitable subrogation. Like the better-known remedies of indemnity and contribution, equitable subrogation reallocates ultimate responsibility from one who paid a debt to another whom the law deems should have paid it. Unlike indemnity and contribution, however, equitable subrogation applies when the claims against the obligors arise from different bases of liability. Comparison of several illustrations makes this distinction clear. When two persons are jointly liable on a note, payment by one creates a claim against the other by operation of law; thus, when two obligors are liable on the same claim and one pays, the claimant’s remedy is labeled indemnification. Illustration 1 to section 23 of the R3RUE provides an example:

A becomes an accommodation endorser on a note for $10,000 payable to B, issued by C and D as co-makers. A signs at the sole

231. See R3RUE § 57 (“Subrogation as a Remedy”); see infra Appendix A.
232. See id. § 24 cmt. b (“The ambiguous term ‘subrogation’”).
233. Id. § 24 (“Performance of an Independent Obligation (Equitable Subrogation)”; see infra Appendix A.
234. See id. § 23 (“Performance of a Joint Obligation (Indemnity and Contribution)”; see infra Appendix A.
235. See R3RUE § 24 cmt. b (“[A] claim under this section is independent of contract . . . . It arises, rather, as a function of the obligors’ respective positions vis-à-vis the third-party obligee and of the events giving rise to the obligee’s underlying claim. It rests on the equitable principle, expressed in innumerable decisions, that seeks ‘to compel the ultimate discharge of a debt by him who in equity and good conscience ought to pay it.’”).
236. See id. § 24 cmt. d (“The most frequent claim within § 24 is one that arises between independent obligors. Here both claimant and defendant are liable to the third-party obligee, but on different grounds; the claimant asserts (as in cases of indemnity) that the defendant’s obligation was in some relevant sense primary and its own merely secondary.”).
237. See id. § 23.
238. Id. § 23 cmt. a.
request of C and without the knowledge of D. The note being unpaid at maturity, A pays B $10,000. A has a claim to indemnity in the amount of $10,000, enforceable against C and D or either of them. (See U.C.C. § 3-419(e) (rev. 1990).) C’s liability to indemnify A is simultaneously explained in terms of contract and in terms of restitution, while D’s liability to A is in restitution exclusively.239

All the claims of payee B against A, C, and D arise from the same underlying obligation, the promissory note. Thus, indemnity is the form of A’s remedy against C and D. Conversely, Illustration 1 to section 24 of the R3RUE gives an example of claims against two obligors whose legal bases are distinct:

Vendor sells Blackacre to Purchaser with a warranty against encumbrances. Purchaser’s title is insured by Title Co. Blackacre is subject to an undisclosed encumbrance that diminishes its value. Title Co. compensates Purchaser for the loss. Title Co. (whose obligation to Purchaser derives from the insurance contract) has a claim under this section against Vendor (whose obligation to Purchaser derives from the deed).240

Even though there is no preexisting legal relationship between Vendor and Title Co., the law has long insisted241 that Vendor would be unjustly enriched were Title Co. not able to compel it to share in the liability each owed to Purchaser.242 Such compulsory sharing is labeled equitable subrogation.243

2. Subrogation as a Claim—A “Better Right”

As Justice Black observed years ago, “probably there are few doctrines better established than that a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be

239. R3RUE § 23 cmt. a, illus. 1 (italics added).
240. See id. § 24 cmt. a, illus. 1.
241. See, e.g., In re Lentz’s Accounts, Wallace’s Appeal, 5 Pa. 103 (Pa. 1847).
   The title insurer discharged its liability under its title insurance policy by payment to the purchasers of the amount agreed upon between them as to the value of the part taken, and thereupon the title insurer became subrogated to the rights of the purchasers against the sellers for breach of warranty.
For a recent case that failed to credit the role of equitable subrogation, see Wilder Corp. of Del. v. Thompson Drainage & Levee Dist., 658 F.3d 802, 807 (7th Cir. 2011) (Posner, J.) (dicta).
243. See R3RUE § 24.
reimbursed.” 244 Section 48 of the R3RUE states the substantive basis in unjust enrichment for the subrogation claim by the surety or other third party who discharges the obligation of a primary obligor; in short, the surety has what the R3RUE characterizes as a “better right.” 245 Not only does payment by the claimant create a right against the primary obligor under the principle of equitable subrogation, 246 but the same payment generates a claim against a third party who would receive or retain payment due to the primary obligor because of the claimant’s payment. 247 In a typical case, a surety’s intervention permits a project to be completed notwithstanding the default of the primary obligor. The surety’s action thus satisfies a condition to a duty of a third party (typically the owner) to pay. The payment should, the law of equity has long held, be made to the surety even if the third party did not expressly so promise. 248 The surety has a “better right” than the primary obligor to get it or than the third party to keep it. 249 By extension, the “better right” of the surety vis-à-vis both the primary obligor and the third party has priority over the obligor’s secured creditor 250 and trustee in bankruptcy. 251

244. Pearlman v. Reliance Ins. Co., 371 U.S. 132, 136–37 (1962). Justice Black went on to comment that “there is a security interest in a withheld fund . . . to which the surety is subrogated . . . .” Id. at 137.

245. R3RUE § 48 (“Payment to Defendant to Which Claimant Has a Better Right”); see Appendix A.

246. See supra text accompanying notes 241–45; infra text accompanying notes 247–50.

247. See R3RUE § 48 cmt. a (“In its application to many cases, the rule of § 48 is best understood and explained as the logical converse to the rules of §§ 23–24 governing indemnity, contribution, and equitable subrogation. Enrichment under the latter headings derives from the claimant’s discharge of an obligation for which the defendant is primarily responsible, while enrichment under § 48 derives from the defendant’s receipt of a payment to which the claimant is primarily entitled.”); see also R3RUE § 57 cmt. e (“‘When A’s money is used to discharge B’s obligation to C, the most visible effect of subrogation is to clothe A with C’s former rights against B and B’s property. Subrogation extends to another important mode of substitution, permitting A to enforce not only C’s rights against B but B’s rights in the transaction as well, such as obligations of performance owed to B by C or other parties . . . .’” (italics added)).

248. Pearlman, 371 U.S. at 136 (“Traditionally sureties compelled to pay debts for their principal have been deemed entitled to reimbursement, even without a contractual promise . . . .”).

249. See R3RUE § 48.

250. See First Indem. of Am. Ins. Co. v. Modular Structures, Inc. (In re Modular Structures, Inc.), 27 F.3d 72 (3d Cir. 1994) (holding that payments due from obligor were neither “accounts” of the defaulting debtor/primary obligee nor property of the estate and thus were properly payable to surety); see also R3RUE § 48 illus. 28 (“Farmer grows corn on land leased from Landlord. Farmer’s operations are financed by Bank, which holds a perfected security interest in Farmer’s growing crops and their proceeds. By statute, Landlord has a lien on the products of the leased acreage securing Farmer’s obligation to pay rent. (The statute provides that a crop lien of the kind held by Landlord is not a ‘security interest’ within the local version of U.C.C. Article 9 and that it is ‘paramount to all other liens or claims’ upon such products and their proceeds.) Farmer sells his corn crop to Elevator for $25,000. Elevator pays farmer with a check payable to Farmer and Bank jointly; Farmer

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Similar conclusions follow outside the typical suretyship context, although the fact-driven analysis of "better right" makes it more difficult to predict judicial conclusions. Thus, in *Rinn v. First Union*, the district court held that a refinancing but unperfected secured creditor should be subrogated to the still-filed interest of the discharged secured creditor and prevail over the bankruptcy trustee. But the bankruptcy court in *Vieira v. Pearce* found that, unlike the debtor in *Rinn*, the debtors had not agreed to deliver a first secured position to their refinancing creditor whose late recording rendered its mortgage avoidable as a preference. The bankruptcy court in *Pearce* therefore concluded that the refinancing creditor did not have a "better right" than the primary obligor and mortgagor. The determination of the "better right" necessary to establish a claim against a defendant other than the primary obligor is not a free-floating exercise of moral inquiry; the right must be one "that is both recognized, and accorded priority over the interest of the defendant, under the law of the jurisdiction." Given the usual ability of the claimant to protect itself, the principle of *pari passu* should inform the analysis of the bankruptcy court and generally supersede such an atypical claim of subrogation.
3. Subrogation as a Remedy

Subrogation as a remedy is described in section 57 of the R3RUE. Like constructive trust and equitable lien, this remedy requires both an instance of unjust enrichment and a "transactional nexus" with identifiable property of the defendant. Unlike constructive trust and equitable lien, however, the remedy of subrogation does not arise out of the acquisition of identifiable property or even the improvement of specific property, but rather from the use of the claimant's property "to satisfy an obligation of the defendant or [to discharge] a lien on the defendant's property." The defendant's enrichment in such a case is not by gaining new assets, but from a reduction in liabilities secured by old ones. The latter is no less a type of enrichment than the former.

Moreover, unlike constructive trust and equitable lien, subrogation as a remedy is not necessarily limited to remedying substantive claims of unjust enrichment. Subrogation by contract is the most commonly employed form of the remedy, particularly in contracts of insurance. Subrogation is also part of the law of suretyship apart from any substantive basis in unjust enrichment. This Article, however, will consider only the implications of subrogation as a remedy for a substantive claim of unjust enrichment.

258. Id. § 57 ("Subrogation as a Remedy"); see infra Appendix A.
259. See R3RUE § 57 cmt. a ("Subrogation (using the word in its remedial sense) is one of the methods of asset-based restitution that may be available to a claimant who can establish both (i) unjust enrichment at the expense of the claimant, and (ii) a transactional nexus making it appropriate that the claimant obtain restitution via rights in identifiable property of the defendant."); see also id. ("Unjust enrichment for which subrogation is an available remedy may be established by any of the substantive rules of this Restatement that describe the transaction in question."); see also supra text accompanying notes 35-56.
260. R3RUE § 57 cmt. a.
261. See id. § 1 cmt. d ("A saved expenditure or a discharged obligation is no less beneficial to the recipient than a direct transfer.").
262. See id. § 24 cmt. b ("A contractual subrogation provision is typically a term in an insurance contract by which the policyholder agrees that the insurer, on paying a loss, shall be entitled to assert the policyholder's right of recovery against persons responsible. The effect to be given to such a provision is a matter of contract and insurance law."); see also RESTATEMENT (THIRD) SURETYSHIP & GUAR. § 28 (1996) (distinguishing between contracts of indemnity and other forms of insurance).
263. See R3RUE § 57 cmt. a ("Subrogation is even more prominent in the law of suretyship, where a right to subrogation—whether based on unjust enrichment or otherwise—is one of the classic incidents of the relationship between principal and surety."); see also U.C.C. § 3-419(f) ("An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party."); U.C.C. §3-419 cmt. 5 ("Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the
Subrogation as a remedy can intersect with a defendant's insolvency proceedings in two important respects. First, subrogation to security can affect recoveries when more than two parties are involved.\textsuperscript{264} When there is a single claimant and only one defendant, a claimant's discharge of a lien on the defendant's property can be remedied equally well by payment of the amount discharged or by substituting the claimant to the position of the discharged lienor.\textsuperscript{265} But the relationships are more complex when there are junior lienholders.\textsuperscript{266} Payment of the amount discharged will always satisfy the claimant. However, when the defendant is insolvent and unable to pay, only subrogation to the lien of the discharged lienor will be an adequate remedy. Illustration 8 to section 57 of the R3RUE describes such a scenario:

Blackacre has been mortgaged in succession to $A$ and to $B$. Taxes on the property are delinquent: $A$ pays the amount due to prevent a tax sale. When $A$ commences foreclosure proceedings, the court determines that $A$'s mortgage was improperly recorded, with the result that $B$'s later mortgage has first priority. Because the present value of Blackacre is insufficient to cover the mortgage debt to $B$, $A$'s payment of taxes has preserved the value of $B$'s mortgage instead of his own. $A$ has a claim in restitution to prevent $B$'s unjust enrichment at $A$'s expense (§ 8(2)). The remedy is by subrogation to the tax lien that $A$'s funds were used to discharge.\textsuperscript{267}

$A$'s payment of the property taxes clearly enriched the owner of Blackacre. And if Blackacre’s owner doesn’t pay, $A$ has a claim in unjust enrichment against him.\textsuperscript{268} But what of $B$—has $A$'s payment of taxes on Blackacre enriched her? The answer is equally yes. Had $A$ not paid the taxes, $B$’s recovery would have been reduced pro tanto. $B$ has thus been enriched, but the question remains whether this enrichment is unjust. According to section 8(2) of the R3RUE, it would be unjust due to $A$’s mistake about the status of its mortgage.\textsuperscript{269} Thus, unless $B$ pays $A$, $A$ will be subrogated to the priority of the discharged tax lien.

Second, the law of equity provided that a claimant entitled to subrogation is also entitled to “the priority of a preferred but unsecured

\footnotesize{accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument."}.

\textsuperscript{264} See generally R3RUE § 57.

\textsuperscript{265} See supra note 269 and accompanying text.

\textsuperscript{266} See, e.g., Stein v. Simpson, 230 P.2d 816, 820 (Cal. 1951) (en banc) (acknowledging junior lienholder's right to redeem property and be subrogated to the benefits of the senior lienholder).

\textsuperscript{267} R3RUE § 57 illus. 8 (italics added).

\textsuperscript{268} R3RUE § 26 (“Protection of Claimant’s Property”); see infra Appendix A.

\textsuperscript{269} R3RUE § 8 (“Mistaken Discharge of Obligation or Lien”); see infra Appendix A.
creditor." 270 Outside of bankruptcy this rule may remain the case, but § 507(d) of the Bankruptcy Code provides otherwise for cases arising under Title 11. 271 Thus, apart from subrogation to security, subrogation as remedy for unjust enrichment will have little impact in bankruptcy. 272

B. Into Bankruptcy

Subrogation as a remedy historically has presented little difficulty in bankruptcy. 273 Both constructive trust and equitable lien subject property to which the debtor holds unencumbered legal title to an equitable proprietary claim. 274 Subrogation, by contrast, substitutes a third party to the rights held by another. 275 By definition, the debtor's estate is made no worse, although the opportunity for its enhancement is foregone. 276 Recognition of this well-recognized principle of property continues in the R3RUE.

Section 57 of the R3RUE 277 provides a rule for subrogation to the collateral position of a discharged lienor. As with the other proprietary remedies, the claimant must establish that the defendant has been unjustly enriched. 278 Subrogation may also follow the result of the application of the law of equitable subrogation in section 24 of the R3RUE 279 or the "better right" analysis of section 48 of the R3RUE 280 but, in any case, is chiefly

270. See R3RUE § 57 cmt. c.
271. 11 U.S.C. § 507(d) (2006) ("An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection (a)(1), (a)(4), (a)(5), (a)(6), (a)(7), (a)(8), or (a)(9) of this section is not subrogated to the right of the holder of such claim to priority under such subsection."). However, a subrogated creditor may be subrogated to the non-dischargeable status of the creditor's claim. See, e.g., Reitzel v. DeLong (In re DeLong), 228 B.R. 406 (Bankr. N.D. Ohio 1998).
272. See R3RUE § 57 cmt. d ("As a matter of equitable principle the claimant is entitled via subrogation to every advantage afforded by the creditor's previous rights against the defendant, but this starting hypothesis is subject to qualification in important respects. The standard example of a further advantage that might be acquired via subrogation—apart from security and priority, normally the most important—is the benefit of a favorable statute of limitations; but the claimant may be denied this advantage if the court concludes that it derives from the status of the former creditor, rather than from the nature of the former obligation.").
274. See generally R3RUE § 55 (constructive trusts); id. § 56 (equitable liens).
275. See id. § 57(1)(a).
276. See id. § 57 cmt. (a).
277. See supra note 267.
278. See R3RUE § 57 cmt. a ("The first requirement of the subrogation remedy, as here described, is that a liability in unjust enrichment be established by rules stated elsewhere in this Restatement.").
279. See discussion supra Part VI.A.1.
280. See discussion supra Part VI.A.2.
significant when the obligor defendant is insolvent. It is the benefit of a collateral position to which the claimant is subrogated by the rule of section 57 of the R3RUE thus, if the defendant is able to pay, subrogation is moot. In other words, when the defendant whose position has been improved by the claimant’s discharge of an obligation or lien cannot pay, the claimant takes over whatever collateral rights the third party lienor had in the assets of the defendant.

The remedy of subrogation thus diminishes the opportunity of unsecured or junior secured creditors to be paid in full. Only a conclusion that such innocent third parties themselves would otherwise be unjustly enriched can justify this result. A comment to section 57 of the R3RUE asserts that “[s]ubrogation of the claimant is not prejudicial to the other creditors because its purpose and effect is to confirm the several claims against the defendant’s property in their intended priorities.” Yet it is not self-evident why “other creditors” should not benefit from the unrecorded or unperfected intentions of the claimant and defendant. A better justification for the effects of subrogation on other creditors can be found by looking to the substantive law of unjust enrichment rather than searching for undisclosed intentions. Section 8(2) of the R3RUE identifies a blanket rule of unjust enrichment that will provide many claimants seeking subrogation with the substantive predicate of a claim vis-à-vis other creditors. Funds paid to discharge a lien will generate a claim of unjust enrichment against other creditors if the claimant intended to obtain a priority interest in property and failed to get it because of “a mistake about title to the encumbered property, the existence of intervening liens, or other relevant circumstances.” Only mistake, not wrongdoing by the defendant, is required, and even negligence by the claimant does not make a defendant’s enrichment just.

Such a broad basis for unjust enrichment against innocent creditors

281. See R3RUE § 57 cmt. e.
282. See id. § 57 cmt. a (“Subrogation becomes a meaningful remedy principally when the restitution claimant is in competition with general creditors of the defendant, and when the obligation that was satisfied with the claimant’s money enjoyed some form of priority over the claims of general creditors. In the great majority of cases, the reason for subrogation is that the claimant’s funds have been applied to satisfy a secured claim...”).
283. See id. § 57 cmt. b.
284. Id.
285. See supra text accompanying note 269.
287. See R3RUE § 5(4); see also id. § 5 cmt. f (“Because the primary function of restitution for benefits conferred by mistake is to rectify the consequences of error and inadvertence, any suggestion that restitution should be available only in cases of non-negligent mistake would be flatly inconsistent with the decided cases.”).
reveals the extent of the predisposition of the law of equity for the principle of property. However, section 57(3) of the R3RUE cuts back on the scope of potential unjust enrichment with a “balancing-of-the-equities” rule: “The remedy of subrogation may be qualified or withheld when necessary to avoid an inequitable result in the circumstances of a particular case.” The principal example of a result sufficiently inequitable to block subrogation is one where “other creditors” relied on the absence of a properly filed or recorded lien. Generalizing, this is the application of the well-recognized rule that a bona fide purchaser, which includes a secured creditor, takes free of all legal or equitable claims, including claims of subrogation. The proprietary remedy recognized by equity may be trimmed by equity.

Subrogation claims have generally met with success in the bankruptcy setting. The Eleventh Circuit has applied subrogation as a remedy to prevent avoidance of the interest of a refinancing mortgagee while the Third Circuit went so far as to subrogate real estate purchasers to the position of the mortgagee whose lien had been paid by the purchase-money lender. Numerous cases have also implicitly subrogated bulk assignees of security interests to the position of the originally perfected secured party.

288. See Restatement (First) of Restitution § 162 (1937) (stating virtually identical rule).
289. See R3RUE § 57 cmt. b, illus. 11 (“Company borrows $50,000 from Bank to buy a new truck, giving Bank a security interest which Bank duly perfects. Three years later, with the Bank loan in default, Company borrows $35,000 from Trust Co. on the security of the truck and uses the proceeds of the new loan to repay Bank. Bank’s security interest is discharged of record, but Trust Co. neglects to perfect its security interest. Six months later the Trust Co. loan is in default with a balance of $30,000; Company is insolvent; the court appoints Receiver to dispose of Company’s assets. After the truck is sold at auction for $20,000, Receiver and Trust Co. assert competing claims to the proceeds in the hands of Receiver. Trust Co.’s unperfected security interest is subordinate to the interest of Receiver as “lien creditor” (U.C.C. §§ 9-317(a)(2), 9-102(a)(52) (rev. 2000)), but Trust Co. may be subrogated to the prior lien of the Bank loan that its funds were used to discharge. Subrogation in such circumstances will not be permitted to prejudice third parties, such as subsequent lienors or creditors who rely on a misleading record title (§ 57(3)); see also Rinn v. First Union Nat’l Bank of Md., 176 B.R. 401 (Bankr. D. Md. 1995). The subrogated claimant is, of course, generally subject to any defenses that the primary obligor has against the third party lienor. See R3RUE § 57 cmt. f.
290. See R3RUE § 66; see also id. § 66 cmt. a.
291. See id. § 57(3).
However, a series of cases from the bankruptcy courts of Vermont and at least one other state have denied subrogation under circumstances clearly within the scope of the R3RUE. These decisions limit subrogation to cases of debtor misconduct rather than unjust enrichment generally, and elevate the principle of *pari passu* over the principle of property without regard to the law of equity. Equity's long-standing predisposition in favor of the proprietary remedy of subrogation suggests that these courts misbalanced matters.

VII. RESTITUTION (AND RESCISSION) IN CONTRACT LAW

A. From the Common Law

Restitution (sometimes paired with rescission) represents a remedy for three distinct aspects of contract law. When describing a contracts remedy, the term "restitution" is notoriously ambiguous. Moreover, the circumstances wherein restitution is appropriately understood as a proprietary remedy are cabined by significant limitations. A review of the scope of restitution as a contractual remedy may be helpful. Following that review is a consideration of the factors that the R3RUE deems relevant for imposition of restitution as a proprietary remedy and why the R3RUE fails to overcome the principle of *pari passu* in bankruptcy.

1. As an Alternative to Expectation

The term "restitution" is commonly used to describe a monetary remedy for breach of contract. Restitution measures the damages of the aggrieved party when it is unable to establish expectation damages and has no provable reliance damages. Recovery of one's full expectation represents the goal...
of modern contract law. Yet, even when proof of the benefit of the bargain is impossible, the aggrieved party is entitled, at the least, to get back her money (or the value of any other benefit conferred). The common law has long recognized that parties aggrieved by a breach of contract who could not prove the benefit of their bargain (the expectation measure of damages) could nonetheless elect to recover damages measured by the value of what the breacher had received. In an effort to reduce ambiguity, section 38 of the R3RUE describes this alternative measure of contract damages without using the term “restitution.”

§ 38. Performance-Based Damages

(1) As an alternative to damages based on the expectation interest (Restatement Second, Contracts § 347), a plaintiff who is entitled to a remedy for material breach or repudiation may recover
damages measured by the cost or value of the plaintiff’s performance.\textsuperscript{305}

Although labeled restitution in the Restatement (Second) of Contracts, such a claim has never reflected anything more than an alternative measure of contract damages and has never entailed a proprietary remedy.\textsuperscript{306} Regardless of the label for this measure of recovery, it is simply a measure of contract damages and does not entail any of the proprietary remedies.\textsuperscript{307} In bankruptcy, the principle of \textit{pari passu} trumps any lingering implications of the principle of property when an aggrieved party simply elects performance-based damages over the expectation measure.\textsuperscript{308} In other words, the claim of an aggrieved contract party is not enhanced by a proprietary remedy simply because it cannot prove—or elects not to seek— the value of its defeated expectation.\textsuperscript{309}

2. As a Remedy for Material Breach

Second, the contract law concept of material breach\textsuperscript{310} (and repudiation\textsuperscript{311}) permits an aggrieved party not only to proceed against the breacher for damages\textsuperscript{312} but also to be freed from the obligation to carry out

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305. Section 38 of the R3RUE goes on to provide clarity for measuring performance-based damages:

(2) Performance-based damages are measured by

(a) uncompensated expenditures made in reasonable reliance on the contract, including expenditures made in preparation for performance or in performance, less any loss the defendant can prove with reasonable certainty the plaintiff would have suffered had the contract been performed (Restatement Second, Contracts § 349); or

(b) the market value of the plaintiff’s uncompensated contractual performance, not exceeding the price of such performance as determined by reference to the parties’ agreement.

(3) A plaintiff whose damages are measured by the rules of subsection (2) may also recover for any other loss, including incidental or consequential loss, caused by the breach.

R3RUE § 38.

306. See id.

307. See id. § 38 cmt. a ("Though called ‘restitution’ it [the performance-based measure of recovery] is simply an award of damages."). For a detailed comparison of the R3RUE and the Restatement (Second) of Contracts at this point, see Joseph M. Perillo, Restitution in a Contractual Context and the Restatement (Third) of Restitution & Unjust Enrichment, 68 WASH. & LEE L. REV. 1007 (2011).

308. See supra notes 71–73 and accompanying text.

309. See R3RUE § 38.

310. See RESTATEMENT (SECOND) OF CONTRACTS § 241 (listing factors relevant to determining whether breach was material).

311. See id. § 250.

312. Id. § 236 (uncured and unwavied material breach gives aggrieved party claim for damages for total breach).
its unperformed contract duties.\footnote{313} Discharge under the circumstances of a material breach gives the aggrieved party the remedy which the common law historically called rescission.\footnote{314} The aggrieved party is entitled to full compensation for the benefit of its bargain,\footnote{315} but because it is often difficult to value the expectation interest after a material breach at an intermediate stage of contract performance, the aggrieved party may seek restitution of any benefit it has conferred on the breaching party.\footnote{316} Paralleling the alternative remedy of restitution for a simple breach of contract,\footnote{317} section 37 of the R3RUE\footnote{318} specifies the availability of rescission and monetary restitution for material breach. Like the aggrieved party's choice to pursue performance-based damages for an ordinary breach of contract, the victim of a material breach has the option to seek such damages.\footnote{319} Given that

\footnote{313} See \textit{id.} § 237 (describing effect of material breach as failure of condition); \textit{id.} § 225(2) (providing that failure of condition discharges contractual obligations of aggrieved party). Contract law does, however, recognize a limited duty to perform on the part of the aggrieved party when the parties' reciprocal performances can be paired as "agreed equivalents." See \textit{id.} § 240. See generally \textit{JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS} § 11.18(a) (6th ed. 2009).

\footnote{314} See U.C.C. § 2–106(4) (2004) (cancellation as a remedy); \textit{id.} § 2–608 ("Revocation of Acceptance in Whole or in Part"). The Restatement (Second) of Contracts avoided the term rescission but the drafters of the R3RUE have brought it back into the restatement lexicon. \textit{See, e.g.,} R3RUE §§ 1 cmt. c, 37(a).

\footnote{315} The Restatement (Second) of Contracts calls this "damages for total breach." \textit{See RESTATEMENT (SECOND) OF CONTRACTS} § 243 ("Effect of a Breach by Non-Performance as Giving Rise to a Claim for Damages for Total Breach"): (1) With respect to performances to be exchanged under an exchange of promises, a breach by non-performance gives rise to a claim for damages for total breach only if it discharges the injured party's remaining duties to render such performance, other than a duty to render an agreed equivalent under § 240.

\footnote{316} \textit{See, e.g.,} U.S. v. Algernon Blair, Inc., 479 F.2d 638 (4th Cir. 1973); \textit{see also RESTATEMENT (SECOND) OF CONTRACTS} § 373 ("Restitution When Other Party Is In Breach"): (1) Subject to the rule stated in Subsection (2), on a breach by non-performance that gives rise to a claim for damages for total breach or on a repudiation, the injured party is entitled to restitution for any benefit that he has conferred on the other party by way of part performance or reliance.

\footnote{317} \textit{See supra} text accompanying notes 312–14.

\footnote{318} R3RUE § 37 ("Rescission For Material Breach"); \textit{see infra} Appendix A.

\footnote{319} \textit{Id.} A comment to section 37 of the R3RUE also notes that this will be a "relatively uncommon remedy," presumably because even a short lapse of time generally makes it difficult to unwind contractual performance. R3RUE § 37 cmt. a. Restitution for material breach or repudiation also requires the claimant to restore anything it has received, which may further reduce its utility: So long as it is possible as a practical matter to order that the plaintiff's performance be restored \textit{in specie}, it will usually be easier to do so than to calculate damages for breach or to compel the defendant to complete the interrupted exchange. A plaintiff who would rather unwind a partly-completed exchange than force it ahead is given the election to do so—though only when unwinding is a practical alternative.

\textit{Id.}
restitution for a material breach is merely a limited monetary remedy, however, the principle of *pari passu* should control in insolvency proceedings.

3. As the Result of Rescission

There is a third use of the term restitution in the realm of contracts, one which the drafters of the R3RUE believe entails a proprietary remedy. It is employed where the aggrieved party has a right to restitution of benefits conferred on the other party after successfully exercising a power to avoid a contract. In other words, restitution as a remedy for rescission of a “non-contract.” The power to avoid an otherwise formally valid contract typically arises due to a defect in one of the contracting parties as a result of a defective process of contracting, or because a contract is unenforceable for a reason arising apart from the bargain itself. Elsewhere I have characterized such grounds under the rubrics of the existential, the situational, and the normative. The Restatement (Second) Contracts explicitly acknowledges the remedy of restitution when a contract is rescinded because of mistake or unenforceable because of the Statute of Frauds. On the other hand, it recognizes that restitution is generally not available when public policy prohibits performance of a contract.

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320. See R3RUE ch. 4, Introductory Note, at 479 (“Claims of this kind are logically part of the law of restitution, not contract, because they supply a remedy based on the defendant’s unjust enrichment in cases where contract law explicitly denies a claim.”).

321. Id. Here too contract law creates ambiguity by using avoidance and rescission as virtual synonyms.

322. The heading for a short series of specific grounds of avoidance is incapacity. See RESTATEMENT (SECOND) OF CONTRACTS § 12 (“Capacity To Contract”).

323. In this area, courts have identified at least five specific grounds for avoidance. See RESTATEMENT (SECOND) OF CONTRACTS § 152 (mutual mistake); id. § 153 (unilateral mistake); id. § 164 (misrepresentation); id. § 175 (duress); id. § 177 (undue influence).

324. Two grounds exemplify non-contractual reasons to bar enforcement of a bargain: the Statute of Frauds and public policy. See RESTATEMENT (SECOND) OF CONTRACTS § 110 (Statute of Frauds); id. § 178 (public policy). Section 31 of the R3RUE also includes contracts that fail for indefiniteness in this category. R3RUE § 31 cmt. d.


326. See RESTATEMENT (SECOND) OF CONTRACTS § 158 (“Relief Including Restitution”):

(1) In any case governed by the rules stated in this Chapter, either party may have a claim for relief including restitution under the rules stated in §§ 240 and 376.

327. See RESTATEMENT (SECOND) OF CONTRACTS § 375 (“Restitution When Contract Is Within Statute of Frauds: A party who would otherwise have a claim in restitution under a contract is not barred from restitution for the reason that the contract is unenforceable by him because of the Statute of Frauds unless the Statute provides otherwise or its purpose would be frustrated by allowing restitution.”).

328. See RESTATEMENT (SECOND) OF CONTRACTS § 197 (“Restitution Generally Unavailable: Except as stated in §§ 198 and 199, a party has no claim in restitution for performance that he has
Restitution for other occasions of rescission is covered by the catch-all provision of the Restatement (Second) of Contracts.\textsuperscript{329}

It is here—where restitution is the remedy for “non-contracts”—that the potential for proprietary remedies is stronger. On the one hand, it is difficult to conceptualize a place for the principle of property where restitution is deployed simply as a remedy for breach of contract.\textsuperscript{330} The primacy of the principle of pari passu in such situations is reinforced by the nature of the risk assumed whenever contract is employed. The law presumes that contract parties are routinely taking a risk that their counterparty will not perform subject to the legal “backstop” of monetary damages.\textsuperscript{331} There is little reason to afford an aggrieved contract party a proprietary remedy when he has voluntarily assumed a risk of non-performance. But, on the other hand, the same calculus does not obtain where there is no contract or, more accurately, when a contract has been rescinded. The status of ownership of property may well have characterized the position of one or both of the parties before entering into the failed contract. If so, the R3RUE provides for a presumption that it should continue (or resume) with respect to that property after (or upon) avoidance.

4. As a Remedy for Rescission

The efforts of the drafters of the R3RUE to address the multifaceted use of the term “restitution” in connection with all three aspects of contract law explains the complexity of section 54 of the R3RUE.\textsuperscript{332} The length of section 54 is double that of the rules for application of the other proprietary remedies—constructive trust,\textsuperscript{333} equitable lien,\textsuperscript{334} and subrogation.\textsuperscript{335}
The complexity of section 54 of the R3RUE speaks to its multiple applications.336 Where a claimant is unable to prove the benefit of its bargain, only fairness and judicial economy justify restitution of the benefits provided to the defendant.337 The warrant for a proprietary remedy fails to overcome the principle of pari passu when there is no substantive claim of unjust enrichment.338 Additionally, even a breaching defendant may be prejudiced when an aggrieved party seeks to rescind a subsisting contract due to material breach and obtain restitution in lieu of expectation damages.339 Thus, even in the context of the parties to the contract, breach alone—even if material—does not entail a proprietary remedy in the face of countervailing interests. It follows that the principle of pari passu will have priority in an insolvency context. Notwithstanding a claimant’s inability to collect monetary damages due to the defendant’s insolvency, the assumption of the risk of non-performance inherent in contract minimizes the warrant for a proprietary remedy—an assumption that forms the backdrop to the baseline remedial provision of the Bankruptcy Code that address executory contracts.341

336. See id. § 54 cmt. b:

[T]he complex rules traditionally associated with the remedy of rescission and restitution derive mostly from transactions in which (i) the parties are bound by a valid and enforceable contract, (ii) the claimant prefers rescission to damages, yet (iii) rescission is potentially prejudicial to the other party, costly in terms of judicial resources, or both.

337. See id. § 54 cmt. e:

[W]hen rescission affords an alternative remedy for breach of a valid and enforceable contract (as permitted by the rule of § 37)—a breach, in other words, that might be remedied by damages or specific performance—the effect and the justification of the rescission remedy are significantly different. Rescission in such a case permits the injured party to make a fundamental election, choosing to go backward (to the status quo ante) instead of forward (by enforcement of the contractual exchange). . . . Unlike the case of rescission for fraud or mistake, the justification of rescission as an alternative remedy for breach is not the avoidance of unjust enrichment, but a concern with fairness to the injured party combined with remedial economy.


339. R3RUE § 54 cmt. c ("Rescission of a valid and enforceable contract overturns legitimate contractual expectations on which both parties may have significantly relied."); see also Kull, Rescission and Restitution, supra note 338, at 577 ("If the contract calls for a complex and inherently irreversible performance . . . and if the parties have already performed for a number of years, it is probably idle to think in terms of rescission—simply because it is impossible to unscramble the egg.").

340. See R3RUE § 54 cmt. c ("Rescission as an alternative remedy for material breach—if unrestricted by the requirement of counter-restitution—would thus give the plaintiff in effect an option on the defendant’s performance, rather than enforceable rights under a bilateral obligation.").


Except as provided in subsections (b)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—
By contrast, where the substantive law of contracts permits avoidance of the contract, assignment of the risk of non-performance to the claimant is not as easily justified. Limiting the recovery of such a claimant by the principle of _pari passu_ is in tension with the power to rescind. A proprietary remedy is appropriate where there is no subsisting contract and the defendant has been unjustly enriched. Logically, the principle of property might be deemed to protect the proprietary remedy even in the face of the defendant’s insolvency. However, even in situations where a contract may be avoided, the voluntary nature of the claimant’s circumstances weakens the justification for a proprietary remedy. In other words, courts treat parties to “non-contracts” as if they had assumed the risk of nonperformance inherent in contracts generally when creditors of the defendant would pay the price.

But for the limited rights of reclamation under section 2–702 of the Uniform Commercial Code, a seller who has sold goods on credit does not

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(1) If such contract or lease has not been assumed... immediately before the date of the filing of the petition.

Other subsections of § 365 of the Bankruptcy Code provide special protections for certain aggrieved non-debtor contract parties. 11 U.S.C. § 365. None, however, provide a proprietary remedy for avoidable contracts. _Id._

342. See R3RUE § 54 cmt. c.

343. See _id._ § 54.

344. See _id._ (observing that section 54 of R3RUE liberalizes the requirement of counter-restitution when the claimant’s entry into a contract has been procured by fraud or mistake “because the underlying exchange is ineffective to determine the parties’ respective entitlements.”); see also _id._ § 54 cmt. d:

_Rescission of defective agreements._ When it extricates the claimant from a defective agreement, rescission reverses a transfer that lacks an adequate legal basis and prevents the unjustified enrichment that would otherwise result on either side. Concern for the stability of the contractual exchange has no relevance to such a case, because there is no valid exchange to protect. Specific restitution is required to the extent feasible... .

345. _Cf._ R3RUE § 54(4)(c) (denying restitution for rescission where “rights of innocent third parties” would be “prejudiced”), with R3RUE § 66 (denying restitution in connection with other proprietary remedies only if there is a subsequent purchaser for value); see also _id._ § 54 cmt. k:

[I]f a claimant were permitted to entertain for any significant period an election between enforcement and avoidance—against a background of potentially fluctuating values—the availability of rescission would give the claimant, in effect, an unpaid option on the defendant’s performance. ... The opportunistic use of rescission is barred, within traditional doctrine, by a rule that a claimant seeking to rescind must give notice of the election to do so with reasonable promptness after learning of the grounds for rescission.

346. See _RESTATEMENT (SECOND) OF CONTRACTS_ § 372 cmt. b (1981) (“A court may also refuse specific restitution if it would otherwise cause injustice as where, for example, it would result in a preference over other creditors in bankruptcy.”).

347. U.C.C. § 2–702 (2011) (“Seller’s Remedies on Discovery of Buyer’s Insolvency”):

(1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for
have the power to cancel a contract and reacquire transferred property upon the buyer's insolvency.\textsuperscript{348} Even less does the common law of contracts provide a restitutionary remedy on account of a contract party’s insolvency.\textsuperscript{349} Without the right of rescission, there cannot be a right of specific restitution and, hence, no predicate for a proprietary remedy: there has been no \textit{unjust} enrichment.\textsuperscript{350} The aggrieved contract party has a claim in damages and may be able to suspend its performance\textsuperscript{351} but retains no interest in specific property sold to the now-insolvent party.\textsuperscript{352} In other words, the common law lets the risk of insolvency fall to the solvent counter-party, not the creditors of the debtor.

\textbf{B. Into Bankruptcy}

While the restitutionary measure of recovery resulting from rescission has received limited recognition in bankruptcy, the proprietary remedy has received none.\textsuperscript{353} As an example of the first situation, bankruptcy courts in Ponzi-scheme cases have regularly recognized an offset measured by the restitutionary interest.\textsuperscript{354} The typical scenario is an action by the trustee of the now-bankrupt Ponzi scheme to recover payouts to investors as fraudulent transfers under § 548 of the Bankruptcy Code.\textsuperscript{355} At least in the Ninth

\begin{itemize}
\item cash including payment for all goods theretofore delivered under the contract, and stop delivery under this Article (Section 2-705).
\item (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer’s fraudulent or innocent misrepresentation of solvency or of intent to pay.
\item (3) The seller’s right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this Article (Section 2-405). Successful reclamation of goods excludes all other remedies with respect to them.
\end{itemize}

\textsuperscript{348} See R3RUE § 37(2) (“Rescission as a remedy for breach of contract is not available against a defendant whose defaulted obligation is exclusively an obligation to pay money.”). See \textit{generally} Knox v. Phoenix Leasing, Inc., 35 Cal. Rptr. 2d 141 (Cal. Ct. App. 1994).

\textsuperscript{349} The common law of contracts provides for specific restitution in limited circumstances. See RESTATEMENT (SECOND) OF CONTRACTS § 372; see \textit{generally} \textit{Perillo}, supra note 331, at § 15.5.

\textsuperscript{350} See \textit{generally} RESTATEMENT (SECOND) OF CONTRACTS § 372.

\textsuperscript{351} See RESTATEMENT (SECOND) OF CONTRACTS § 252(1) (“Where the obligor’s insolvency gives the obligee reasonable grounds to believe that the obligor will commit a breach . . . the obligee may suspend any performance for which he has not already received the agreed exchange until he receives assurance . . . ”). Contract parties can protect themselves by retaining or taking a security interest to secure the obligor’s duty of payment or performance. See U.C.C. § 9-201.

\textsuperscript{352} See RESTATEMENT (SECOND) OF CONTRACTS § 252 cmt. a.

\textsuperscript{353} See \textit{generally} Duggan, \textit{supra} note 66.


\textsuperscript{355} See, e.g., Perkins v. Haines, 661 F.3d 623, 626–27 (11th Cir. 2011).
Circuit, the existence of a Ponzi scheme conclusively establishes that the debtor made a transfer with "actual intent to hinder, delay or defraud" its creditors.356 Thus, the trustee is entitled to recover all distributions from the debtor to the scheme’s transferees.357 However, § 548(c) of the Bankruptcy Code provides a defense to the extent that a good-faith transferee gave "value" to the debtor.358 Bankruptcy courts have concluded that a transferee’s initial investment to the scheme may qualify as value.359 Because such an investment is typically induced by fraud, the transferee could have rescinded it and would have been entitled to a claim for restitution of the amount of the investment.360 Courts have concluded that this restitution claim should be deemed to be “reasonably equivalent value” for an equivalent portion of any distributions received from the scheme.361

This analysis is consistent with the R3RUE. Section 13 of the R3RUE justifies a claim of rescission to the extent of an innocent claimant’s investment in a Ponzi scheme.362 It also warrants restitution as a remedy.363 Conversely, claims of unjust enrichment against even innocent transferees from a Ponzi scheme are authorized in section 58 of the R3RUE.364 In addition, section 59 of the R3RUE provides that multiple restitution claimants from an insolvent fraudster must share pro-rata to the extent of their restitution claims.365 Sharing is a shortcut when restitution claims are 

357. See, e.g., Donell v. Kowell, 533 F.3d 762, 771 (9th Cir. 2008).
   (c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.
359. See Perkins, 661 F.3d at 627; see also Donell, 533 F.3d at 772.
360. See, e.g., Barclay v. Mackenzie (In re AFI Holding, Inc.), 525 F.3d 700, 708 (9th Cir. 2008).
361. Donell, 533 F.3d at 772 (“Payments up to the amount of the initial investment are considered to be exchanged for ‘reasonably equivalent value,’ and thus not fraudulent, because they proportionally reduce the investors’ rights to restitution.” (citation omitted)).
363. Id.
364. R3RUE § 58 (“(2) A claimant entitled to restitution from property or its traceable product may assert the same rights against any subsequent transferee who is not a bona fide purchaser (§ 66) or a bona fide payee (§ 67).”).
365. Id. § 59 (“(4) If a fund contains the property of multiple restitution claimants (such as the victims of successive fraud by the recipient): (a) Each claimant’s interest in the fund and any product thereof is determined by the proportion that such claimant’s contributions bear to the balance of the
indistinguishable; however, the R3RUE provides a number of fine-grained rules by which to distinguish among competing restitution claims. In fact, the R3RUE’s principle-based rules can usefully supplement purely statutory judicial analysis of complex Ponzi-scheme cases. The law of equity provides a backdrop to the generalities of the Bankruptcy Code.

The fourth propriety remedy identified by the R3RUE—rescission and restitution—arises from an avoidable contract. The absence of reported bankruptcy cases recognizing restitution simply on account of the power to avoid is telling. Despite its apparent breadth, section 54 of the R3RUE must be coupled with something more, like a constructive trust, when third parties are involved. With respect to creditors, a claimant must establish an independent ground for rescission. The right of restitution vis-à-vis the defendant, and that the creditors would be unjustly enriched. Moreover, a claimant must convince the court that it could not have employed a security device to recover property when it seeks to reverse a transfer of property over the objections of the defendant’s creditors.

While section 2–702 of the Uniform Commercial Code authorizes a limited right of reclamation of goods sold to an insolvent buyer, in bankruptcy such restitutionary claims have been uncritically treated as debts and not as proprietary interests. The failure of bankruptcy courts to

fund upon each contribution and withdrawal, but only if the accounting necessary to this calculation can be established without using the presumptions or marshaling rules of § 59(2). (b) If the evidence does not permit the court to distinguish the interests of multiple restitution claimants by reference to actual transactions, such claimants recover ratably from the fund and any product thereof in proportion to their respective losses.

See id. § 59 cmt. g (“Granting the obvious equity of treating like cases alike, it is important to recognize the many ways in which claimants who are similarly situated—insofar as they are equally innocent victims of equivalent wrongdoing—may nevertheless obtain widely different relief in restitution. The law of unjust enrichment does not impose a rule of contribution or loss-sharing between the victims of common or related injuries, and individual outcomes will frequently depend on the circumstances that determine whether a particular claimant’s assets (or their traceable product) may be identified in the property available for distribution.”).


See supra text accompanying notes 341–54.

See R3RUE § 54 cmt. a (“[A] claimant who seeks to reacquire an asset in priority to the defendant’s creditor will usually ask the court to decree a rescission in conjunction with some further remedy such as constructive trust.”).

See id.

R3RUE § 54 cmt. a (“Even if the defendant’s breach involves something beyond a failure to pay money, a court will refuse to grant the claimant a retroactive priority—to the prejudice of third parties—that might have been acquired by contract, employing the ordinary modes of security.”).

See supra note 347.

See, e.g., Wyle v. C.H. Rider & Family (In re United Energy Corp.), 944 F.2d 589, 595 (9th
apparently even parties to consider the possibility of the proprietary remedy of rescission and restitution speaks to a point made earlier: restitution, even on account of an avoidable contract, is simply an alternative to promote judicial efficiency. The close nexus between the right of rescission and contract warrants subordinating this equitable principle of property to the principle of pari passu.

VIII. CONCLUSION

The R3RUE is not the law of equity; however, it will go far to clarify the law of equity in many states. Cases addressing the predicates of unjust enrichment and its remedies are generally old and often their presuppositions are unexplained. The decline of formal study of equity has left most judges and practicing lawyers without knowledge of what constitutes unjust enrichment. The R3RUE makes that nearly lost body of knowledge accessible. Sooner or later the effects of this clarification will be observed in bankruptcy jurisprudence.

The moralistic cast of decisions in equity from the nineteenth and early twentieth centuries jars the modern ear. Reconceptualization of unjust enrichment as unjustified enrichment—and the provision of reasonably clear rules to identify when it exists—will allay the contemporary fear of overt morality in the private law sphere. The R3RUE will make assertions that equity’s proprietary interests are “mere remedies” untenable.

The four proprietary remedies for unjust enrichment are clarified in the R3RUE. More importantly, and with the exception of rescission and restitution, the R3RUE states a cogent basis for three of the proprietary remedies in bankruptcy; it also provides a clear rule for tracing and a well-defined statement of defenses. Equally with the common law’s recognition of legal interests in property, the law of equity warrants recognition of the principle of property. The countervailing bankruptcy principle of pari passu should not, without evidence of clear congressional intent to the contrary, simply be assumed to have priority.

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374. See supra text accompanying notes 346–49.
375. One might argue that the contemporary phobia of morality is exaggerated. As James Rogers puts it, "Perhaps part of the reason that the law of restitution can get away with expressing its basic concept in such starkly moralistic language is a fairly simple point. The basic principle of the law of restitution is simple." See Rogers, supra note 3, at 1393–94.
376. See Dewsnup v. Timm, 502 U.S. 410, 419 (1992) ("When Congress amends the bankruptcy laws, it does not write 'on a clean slate.'").
Of the four proprietary remedies, reconfiguration of constructive trust should have the greatest impact in bankruptcy. The judicial penchant of characterizing constructive trust as a "mere" remedy should be eliminated. Courts should jettison rhetorical flourishes suggesting that constructive trust is inconsistent with the policy of bankruptcy. Equitable liens and subrogation should find themselves on firmer analytical footing, and precedent avoiding any of the proprietary remedies should be reconsidered. Notwithstanding the R3RUE, however, bankruptcy courts are unlikely to recognize the paired set of rescission and restitution as creating a proprietary remedy. The nexus of the pair to contract, with contract's inherent element of risk, will continue to warrant priority for the principle of pari passu.

While the law of equity remains a living part of state common law jurisprudence, contemporary American bankruptcy law and practice threaten to submerge equity's proprietary remedies in a pool of ignorance. If nothing else, the R3RUE will provide a rope for equity's rescue.
IX. APPENDIX A—SELECTED PROVISIONS OF THE RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT

R3RUE § 4. Restitution May Be Legal or Equitable or Both

(1) Liabilities and remedies within the law of restitution and unjust enrichment may have originated in law, in equity, or in a combination of the two.

(2) A claimant otherwise entitled to a remedy for unjust enrichment, including a remedy originating in equity, need not demonstrate the inadequacy of available remedies at law.

R3RUE § 5. Invalidating Mistake

(1) A transfer induced by invalidating mistake is subject to rescission and restitution. The transferee is liable in restitution as necessary to avoid unjust enrichment. Particular instances of restitution for mistake are described in §§ 6–12 and 34.

(2) An invalidating mistake may be a misapprehension of either fact or law. There is invalidating mistake only when

   (a) but for the mistake the transaction in question would not have taken place; and

   (b) the claimant does not bear the risk of the mistake.

(3) A claimant bears the risk of a mistake when

   (a) the risk is allocated to the claimant by agreement of the parties;

   (b) the claimant has consciously assumed the risk by deciding to act in the face of a recognized uncertainty; or

   (c) allocation to the claimant of the risk in question accords with the common understanding of the transaction concerned.

(4) A claimant does not bear the risk of a mistake merely because the mistake results from the claimant’s negligence.
R3RUE § 7. Mistaken Performance of Another’s Obligation

Mistaken performance of another’s obligation gives the performing party a claim in restitution against the obligor to the extent of the benefit mistakenly conferred on the obligor.

R3RUE § 8. Mistaken Discharge of Obligation or Lien

(1) Mistaken discharge by an obligee of an obligation or the security therefor [sic] gives the obligee a claim in restitution by reinstatement of the rights mistakenly surrendered.

(2) If the use of the claimant’s funds to discharge a lien confers an unintended benefit on another person as the result of the claimant’s mistake about title to the encumbered property, the existence of intervening liens, or other relevant circumstances, the claimant is entitled to restitution via subrogation to the discharged lien (§ 57(1)(a)) as necessary to prevent unjust enrichment.

R3RUE § 13. Fraud and Misrepresentation

(1) A transfer induced by fraud or material misrepresentation is subject to rescission and restitution. The transferee is liable in restitution as necessary to avoid unjust enrichment.

(2) A transfer induced by fraud is void if the transferor had neither knowledge of, nor reasonable opportunity to learn, the character of the resulting transfer or its essential terms. Otherwise the transferee obtains voidable title.

R3RUE § 14. Duress

(1) Duress is coercion that is wrongful as a matter of law.

(2) A transfer induced by duress is subject to rescission and restitution. The transferee is liable in restitution as necessary to avoid unjust enrichment.

(3) If the effect of duress is tantamount to physical compulsion, a transfer induced by duress is void. If not, a transfer induced by duress conveys voidable title.

R3RUE § 15. Undue Influence

(1) Undue influence is excessive and unfair persuasion, sufficient to overcome the free will of the transferor, between parties who
occupy either a confidential relation or a relation of dominance on one side and subservience on the other.

(2) A transfer induced by undue influence is subject to rescission and restitution. The transferee is liable in restitution as necessary to avoid unjust enrichment.

R3RUE § 16. Incapacity of Transferor

(1) A transfer by a person lacking requisite legal capacity is subject to rescission and restitution unless ratified. The transferee is liable in restitution as necessary to avoid unjust enrichment.

(2) Except as otherwise provided by statute:

(a) A transfer by a minor confers voidable title.

(b) When a transfer is challenged on the ground of mental capacity:

(i) if at the time of the transfer the transferor’s incapacity has been adjudicated and is continuing, the transfer is void;

(ii) if the transferor’s incapacity is only adjudicated thereafter, the transfer confers voidable title.

(c) When a transfer is challenged on the ground that a transferor such as a municipal corporation or government agency has acted outside the scope of its statutory authority:

(i) a transfer wholly beyond the powers of the transferor is void;

(ii) a transfer which is potentially within the scope of the transferor’s powers, but which is invalid for defective authorization or execution, confers voidable title.

(3) If the transferee has dealt with the transferor in good faith on reasonable terms, then notwithstanding the transferor’s incapacity

(a) rescission and restitution leaves the transferor liable in restitution for benefits received in the transaction, as provided in §§ 33 and 54; and
(b) the court may qualify or deny the right to rescission to avoid an inequitable result (§ 54(6)).

R3RUE § 17. Lack of Authority

A transfer by an agent, trustee, or other fiduciary outside the scope of the transferor’s authority, or otherwise in breach of the transferor’s duty to the principal or beneficiary, is subject to rescission and restitution. The transferee is liable in restitution to the principal or beneficiary as necessary to avoid unjust enrichment.

R3RUE § 20. Protection of Another’s Life or Health

(1) A person who performs, supplies, or obtains professional services required for the protection of another’s life or health is entitled to restitution from the other as necessary to prevent unjust enrichment, if the circumstances justify the decision to intervene without request.

(2) Unjust enrichment under this section is measured by a reasonable charge for the services in question.

R3RUE § 21. Protection of Another’s Property

(1) A person who takes effective action to protect another’s property from threatened harm is entitled to restitution from the other as necessary to prevent unjust enrichment, if the circumstances justify the decision to intervene without request. Unrequested intervention is justified only when it is reasonable to assume the owner would wish the action performed.

(2) Unjust enrichment under this section is measured by the loss avoided or by a reasonable charge for the services provided, whichever is less.

R3RUE § 22. Performance of Another’s Duty

(1) A person who performs another’s duty to a third person or to the public is entitled to restitution from the other as necessary to prevent unjust enrichment, if the circumstances justify the decision to intervene without request.

(2) Unrequested intervention may be justified in the following circumstances:

(a) the claimant may be justified in paying another’s money
debt if there is no prejudice to the obligor in substituting a liability in restitution for the original obligation;

(b) the claimant may be justified in performing another’s duty to furnish necessaries to a third person, to avoid imminent harm to the interests of the third person; and

(c) the claimant may be justified in performing another’s duty to the public, if performance is urgently required for the protection of public health, safety, or general welfare.

(3) There is no unjust enrichment and no claim in restitution by the rule of this section except insofar as the claimant’s intervention has relieved the defendant of an otherwise enforceable obligation.

R3RUE § 23. Performance of a Joint Obligation (Indemnity and Contribution)

(1) If the claimant renders to a third person a performance for which claimant and defendant are jointly and severally liable, the claimant is entitled to restitution from the defendant as necessary to prevent unjust enrichment.

(2) There is unjust enrichment in such a case to the extent that

(a) the effect of the claimant’s intervention is to reduce an enforceable obligation of the defendant to the third person, and

(b) as between the claimant and the defendant, the obligation discharged (or the part thereof for which the claimant seeks restitution) was primarily the responsibility of the defendant.

R3RUE § 24. Performance of an Independent Obligation (Equitable Subrogation)

(1) If the claimant renders to a third person a performance for which the defendant would have been independently liable to the third person, the claimant is entitled to restitution from the defendant as necessary to prevent unjust enrichment.

(2) There is unjust enrichment in such a case to the extent that

(a) the claimant acts in the performance of the claimant’s
independent obligation to the third person, or otherwise in the reasonable protection of the claimant’s own interests; and

(b) as between the claimant and the defendant, the performance in question (or the part thereof for which the claimant seeks restitution) is primarily the obligation of the defendant.

R3RUE § 26. Protection of Claimant’s Property

If the claimant incurs necessary expense to protect an interest in property and in so doing confers an economic benefit on another person in consequence of the other’s interest in the same property, the claimant is entitled to restitution from the other as necessary to prevent unjust enrichment.

R3RUE § 28. Unmarried Cohabitants

(1) If two persons have formerly lived together in a relationship resembling marriage, and if one of them owns a specific asset to which the other has made substantial, uncompensated contributions in the form of property or services, the person making such contributions has a claim in restitution against the owner as necessary to prevent unjust enrichment upon the dissolution of the relationship.

(2) The rule of subsection (1) may be displaced, modified, or supplemented by local domestic relations law.

R3RUE § 31. Unenforceability

(1) A person who renders performance under an agreement that cannot be enforced against the recipient by reason of

(a) indefiniteness, or

(b) the failure to satisfy an extrinsic requirement of enforceability such as the Statute of Frauds,

has a claim in restitution against the recipient as necessary to prevent unjust enrichment. There is no unjust enrichment if the claimant receives the counterperformance specified by the parties’ unenforceable agreement.

(2) There is no claim under this section if enforcement of the agreement is barred by the applicable statute of limitations, nor in any other case in which the allowance of restitution would defeat
the policy of the law that makes the agreement unenforceable. Restitution is appropriate except to the extent that forfeiture is an intended or acceptable consequence of unenforceability.

**R3RUE § 32. Illegality**

A person who renders performance under an agreement that is illegal or otherwise unenforceable for reasons of public policy may obtain restitution from the recipient in accordance with the following rules:

1. Restitution will be allowed, whether or not necessary to prevent unjust enrichment, if restitution is required by the policy of the underlying prohibition.

2. Restitution will also be allowed, as necessary to prevent unjust enrichment, if the allowance of restitution will not defeat or frustrate the policy of the underlying prohibition. There is no unjust enrichment if the claimant receives the counterperformance specified by the parties' unenforceable agreement.

3. Restitution will be denied, notwithstanding the enrichment of the defendant at the claimant's expense, if a claim under subsection (2) is foreclosed by the claimant's inequitable conduct (§ 63).

**R3RUE § 33. Incapacity of Recipient**

1. A person who renders performance under an agreement that is unenforceable by reason of the other party's legal incapacity has a claim in restitution against the recipient as necessary to prevent unjust enrichment. There is no unjust enrichment if the claimant receives the counterperformance specified by the parties' unenforceable agreement.

2. Restitution under this section is available only to a person who has dealt with the recipient in good faith on reasonable terms.

3. Notwithstanding the unjust enrichment of the recipient, restitution may be limited or denied if it would be inconsistent with the protection that the doctrine of incapacity is intended to afford in the circumstances of the case.
R3RUE § 34. Mistake or Supervening Change of Circumstances

(1) A person who renders performance under a contract that is subject to avoidance by reason of mistake or supervening change of circumstances has a claim in restitution to recover the performance or its value, as necessary to prevent unjust enrichment. If the case is one in which the requirements of § 54 can be met, the remedy of rescission and restitution permits the reversal of the transaction without the need to demonstrate unjust enrichment.

(2) For purposes of subsection (1):

(a) the value of a nonreturnable contractual performance is measured by reference to the recipient’s contractual expectations; and

(b) the recipient’s liability in restitution may be reduced to allow for loss incurred in reliance on the contract.

R3RUE § 36. Restitution to a Party in Default

(1) A performing party whose material breach prevents a recovery on the contract has a claim in restitution against the recipient of performance, as necessary to prevent unjust enrichment.

(2) Enrichment from receipt of an incomplete or defective contractual performance is measured by comparison to the recipient’s position had the contract been fully performed. The claimant has the burden of establishing the fact and amount of any net benefit conferred.

(3) A claim under this section may be displaced by a valid agreement of the parties establishing their rights and remedies in the event of default.

(4) If the claimant’s default involves fraud or other inequitable conduct, restitution may on that account be denied (§ 63).

R3RUE § 37. Rescission for Material Breach

(1) Except as provided in subsection (2), a plaintiff who is entitled to a remedy for the defendant’s material breach or repudiation may choose rescission as an alternative to enforcement if the further requirements of § 54 can be met.

(2) Rescission as a remedy for breach of contract is not available
against a defendant whose defaulted obligation is exclusively an obligation to pay money.

R3RUE § 40. Trespass, Conversion, and Comparable Wrongs

A person who obtains a benefit by an act of trespass or conversion, by comparable interference with other protected interests in tangible property, or in consequence of such an act by another, is liable in restitution to the victim of the wrong.

R3RUE § 41. Misappropriation of Financial Assets

A person who obtains a benefit by misappropriating financial assets, or in consequence of their misappropriation by another, is liable in restitution to the victim of the wrong.

R3RUE § 42. Interference with Intellectual Property and Similar Rights

A person who obtains a benefit by misappropriation or infringement of another’s legally protected rights in any idea, expression, information, image, or designation is liable in restitution to the holder of such rights.

R3RUE § 43. Fiduciary or Confidential Relation

A person who obtains a benefit

(a) in breach of a fiduciary duty,

(b) in breach of an equivalent duty imposed by a relation of trust and confidence, or

(c) in consequence of another’s breach of such a duty,

is liable in restitution to the person to whom the duty is owed.

R3RUE § 48. Payment to Defendant to Which Claimant Has a Better Right

If a third person makes a payment to the defendant to which (as between claimant and defendant) the claimant has a better legal or equitable right, the claimant is entitled to restitution from the defendant as necessary to prevent unjust enrichment.

R3RUE § 50. Innocent Recipient
(1) An "innocent recipient" is one who commits no misconduct in the transaction concerned (§ 51) and who bears no responsibility for the unjust enrichment in question (§ 52).

(2) If nonreturnable benefits would be susceptible of different valuations by the standards identified in § 49(3), the liability of an innocent recipient is determined as follows:

(a) Unjust enrichment from unrequested benefits is measured by the standard that yields the smallest liability in restitution.

(b) Unjust enrichment from requested benefits is measured by their reasonable value to the recipient. Reasonable value is normally the lesser of market value and a price the recipient has expressed a willingness to pay.

(c) Reasonable value may be measured by a more restrictive standard if the validity of the recipient's assent is in question (§ 49(3)(d)); if the claimant has not performed as requested (§ 36); or if prevailing prices include an element of profit that the court decides to withhold from the claimant.

(3) The liability in restitution of an innocent recipient of unrequested benefits may not leave the recipient worse off (apart from the costs of litigation) than if the transaction giving rise to the liability had not occurred.

(4) The liability in restitution of an innocent recipient of unrequested benefits may not exceed the cost to the claimant of conferring the benefits in question, supplemented when appropriate by the rules of § 53.

(5) An innocent recipient may be liable in an appropriate case for use value or proceeds, but not for consequential gains (§ 53).

R3RUE § 54. Rescission and Restitution

(1) A person who has transferred money or other property is entitled to recover it by rescission and restitution if

(a) the transaction is invalid or subject to avoidance for a reason identified in another section of this Restatement, and

(b) the further requirements of this section may be satisfied.

(2) Rescission requires a mutual restoration and accounting in
which each party

(a) restores property received from the other, to the extent such restoration is feasible,

(b) accounts for additional benefits obtained at the expense of the other as a result of the transaction and its subsequent avoidance, as necessary to prevent unjust enrichment, and

(c) compensates the other for loss from related expenditure as justice may require.

(3) Rescission is limited to cases in which counter-restitution by the claimant will restore the defendant to the status quo ante, unless

(a) the defendant is fairly compensated for any deficiencies in the restoration made by the claimant, or

(b) the fault of the defendant or the assignment of risks in the underlying transaction makes it equitable that the defendant bear any uncompensated loss.

(4) Rescission is appropriate when the interests of justice are served by allowing the claimant to reverse the challenged transaction instead of enforcing it. As a general rule:

(a) If the claimant seeks to reverse a transfer induced by fraud or other conscious wrongdoing, the limitation described in subsection (3) is liberally construed in favor of the claimant.

(b) If the claimant seeks rescission instead of damages as a remedy for material breach of contract (§ 37), the limitation described in subsection (3) is employed to prevent injustice to the defendant from the reversal of a valid and enforceable exchange.

(c) If rescission would prejudice intervening rights of innocent third parties, the remedy will on that account be denied.

(5) Restitution or a tender of restitution by the claimant is not a prerequisite of rescission if affirmative relief to the claimant can be reduced by (or made subject to) the claimant's reciprocal obligation of restitution.
(6) Prejudicial or speculative delay by the claimant in asserting a right of rescission, or a change of circumstances unfairly prejudicial to the defendant, justifies denial of the remedy.

R3RUE § 55. Constructive Trust

(1) If a defendant is unjustly enriched by the acquisition of title to identifiable property at the expense of the claimant or in violation of the claimant's rights, the defendant may be declared a constructive trustee, for the benefit of the claimant, of the property in question and its traceable product.

(2) The obligation of a constructive trustee is to surrender the constructive trust property to the claimant, on such conditions as the court may direct.

R3RUE § 56. Equitable Lien

(1) If a defendant is unjustly enriched by a transaction in which

(a) the claimant's assets or services are applied to enhance or preserve the value of particular property to which the defendant has legal title, or more generally

(b) the connection between unjust enrichment and the defendant's ownership of particular property makes it equitable that the claimant have recourse to that property for the satisfaction of the defendant's liability in restitution,

the claimant may be granted an equitable lien on the property in question.

(2) An equitable lien secures the obligation of the defendant to pay the claimant the amount of the defendant's unjust enrichment as separately determined. Foreclosure of an equitable lien is subject to such conditions as the court may direct.

(3) A claimant who would be entitled to ownership of particular property via constructive trust (§ 55) may elect to obtain an equitable lien on the property instead.

(4) The remedy of equitable lien is also a means to restrict the claimant's recovery, in cases where restitution via personal liability or constructive trust would exceed limits set by § 50 or § 61.
R3RUE § 57. Subrogation as a Remedy

(1) If the defendant is unjustly enriched by a transaction in which property of the claimant is used to discharge an obligation of the defendant or a lien on the defendant’s property, the claimant may obtain restitution

   (a) by succeeding to the rights of the obligee or lienor against the defendant or the defendant’s property, as though such discharge had not occurred, and

   (b) by succeeding to the collateral rights of the defendant in the transaction concerned.

(2) Recovery via subrogation may not exceed reimbursement to the claimant.

(3) The remedy of subrogation may be qualified or withheld when necessary to avoid an inequitable result in the circumstances of a particular case.

R3RUE § 59. Tracing into or Through a Commingled Fund

(1) If property of the claimant is deposited in a common account or otherwise commingled with other property so that it is no longer separately identifiable, the traceable product of the claimant’s property may be identified in

   (a) the balance of the commingled fund or a portion thereof, or

   (b) property acquired with withdrawals from the commingled fund, or a portion thereof, or

   (c) a combination of the foregoing,

in accordance with the further rules stated in this section.

(2) If property of the claimant has been commingled by a recipient who is a conscious wrongdoer or a defaulting fiduciary (§ 51) or equally at fault in dealing with the claimant’s property (§ 52):
(a) Withdrawals that yield a traceable product and withdrawals that are dissipated are marshaled so far as possible in favor of the claimant.

(b) Subsequent contributions by the recipient do not restore property previously misappropriated from the claimant, unless the recipient affirmatively intends such application.

(c) After one or more withdrawals from a commingled fund, the portion of the remainder that may be identified as the traceable product of the claimant's property may not exceed the fund's lowest intermediate balance.

(3) If property of the claimant has been commingled by an innocent recipient (§ 50), the claimant's property may be traced into the remaining balance of the commingled fund and any product thereof in the manner permitted by § 59(2), but restitution from property so identified may not exceed the amount for which the recipient is liable by the rules of §§ 50 and 53.

R3RUE § 60. Priority

(1) Except as otherwise provided by statute and by § 61, a right to restitution from identifiable property is superior to the competing rights of a creditor of the recipient who is not a bona fide purchaser or payee of the property in question. Acquisition of a judicial lien (by attachment, garnishment, judgment, execution, or the like) does not make the lien creditor a purchaser of the property subject to lien.

(2) Priority between a restitution claimant and a third-party purchaser or payee is determined by the rules of §§ 66–67.

(3) A claimant who is entitled to restitution but who is unable to identify specific property from which restitution is available has a remedy via money judgment that ranks equally with the claims of general creditors.

R3RUE § 63. Equitable Disqualification (Unclean Hands)

Recovery in restitution to which an innocent claimant would be entitled may be limited or denied because of the claimant's inequitable conduct in the transaction that is the source of the asserted liability.
R3RUE § 66. Bona Fide Purchaser

A purchaser for value and without notice acquires the legal interest that the grantor holds and purports to convey, free of equitable interests that a restitution claimant might have asserted against the property in the hands of the grantor.