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Westfall v. Motors Insurance Corporation, 374 P.2d 96 (Mont. 1962)

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practice of self-censorship,[25] the possibility of depriving a publisher and the public of the right to communicate without prior restraint has not been eliminated.

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PUNATIVE DAMAGES FOR THE FRAUDULENT PROCUREMENT OF A RELEASE ARE PROHIBITED BY STATUTE.—Plaintiff purchased a used automobile for $495. As a downpayment he was allowed $200 for a 1937 truck and a 1949 automobile. The balance was financed by a conditional sales contract, which was assigned to a finance company. As part of the same transaction the conditional sales vendor purchased a dual-interest insurance policy from the defendant company. This policy provided that in the event of a collision or upset, the plaintiff and the finance company, as their interests might appear, would receive the actual cash value of the automobile at the time of the loss, less $50. Ten days after the purchase plaintiff was involved in an accident. At that time $330 was owing to the finance company. Upon notification of the accident, the defendant's adjuster conducted an investigation and submitted a report to the defendant company ascertaining the total loss to the insured to be $330. Subsequently a release was submitted to the plaintiff for his signature. By the provisions of the release the plaintiff, in consideration of payment of $330 to the finance company, discharged the defendant from further liability. Although the plaintiff read this instrument, the jury found that he executed it in reliance on the representation made to him by the defendant's adjuster that there would be "something" left over for him, either the interest in the policy or another car. The finance company received $330, and the plaintiff $9.81 representing hte unearned premiums of the policy. Plaintiff, contending that he did not receive the "something" promised him by the adjuster, brought this action proceeding on a tort theory based on fraud. The jury awarded him $115 compensatory damages and $750 punative

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[25]The end result of the proceeding will possibly be a greater threat of self-censorship practice than before. The fear that causes self-censorship is still a delay with consequential financial loss, but it is magnified by subjecting the publisher to a hearing where suspicious circumstances will be paraded before the Hearing Examiner in an effort to show that he had knowledge. This is not considered by the majority in the instant case.

It is reasonable to suppose that this publisher or any similar publisher does not really fear economic loss with ultimate deprivation of constitutionally protected advertising. The magazines are designed for homosexuals and are sold to them to the extent of the precise limits tolerated by our obscenity law. This should provide a basis for finding scienter from the circumstances. In the Smith case the Court recognized that personal knowledge is not necessary and that circumstantial knowledge would satisfy the requirement. Smith v. California, 361 U.S. 147, 154 (1959).

Here, however, Justices Harlan and Stewart would not find scienter satisfied by the circumstances. This is not in keeping with the modern trend advocated by Paul and Schwartz. They would root the test for obscenity in a study of commercial exploitation and conduct of the individuals. Looking to the circumstances would force the conduct of the individual into the foreground, and a new, more effective basis for determining obscenity would be provided. PAUL & SCHWARTZ, FEDERAL CENSORSHIP—OBSCENITY IN THE MAILS 214 (1962). See dissenting opinions of Mr. Chief Justice Warren in Roth v. United States, 354 U.S. 476 (1957) and Kingsley Book Co. v. Brown, 354 U.S. 436 (1957).

damages. On appeal to the Montana Supreme Court, *held,* reversed and remanded. The trial court erred in assuming this to be a tort action and refusing to instruct the jury on the law of release. Punative damages may not be assessed in this case because this is an action based on contract. *Westfall v. Motors Insurance Corporation,* 374 P.2d 96 (Mont. 1962) (Mr. Justice Adair, dissenting).

The Montana Supreme Court concluded that a release is a contract and as such is subject to recission for fraud or mistake of fact the same as other contracts. The court further concluded that since the plaintiff alleged that the release was procurred through fraud, an issue of fact was raised to be decided by the jury under proper instruction. If the jury should find that there was sufficient fraud to avoid the release, they could then decide whether the defendant breached the insurance contract. Much of the court's opinion is devoted to the law of release and voidability. This seems to indicate that the court would have the plaintiff avoid the release and sue for the breach of contract, despite the fact that he predicated his action on fraud. The law is well established that when more than one remedy is available, the injured party may select the one which he wishes to pursue.[1] When a party, as in the instant case, has been fraudulently induced to execute a contract, he may either rescind and be restored to his former position, or affirm and sue for damages resulting from the fraud.[2] However, the court in the instant case quite irregularly permitted the defendant to select the plaintiff's cause of action, for it was the defendant who first asserted that the plaintiff predicated his action upon a "voidable release."[3]

The court was thus led to the conclusion that this was an action for the breach of an obligation arising from contract and, as such, refused to permit the assessment of punative damages because of section 17-208 of the Revised Codes of Montana,[4] 1947, which provides:

> In any action for a *breach of an obligation not arising from contract*, where the defendant has been guilty of oppression, fraud, or malice, actual or presumed, the jury in addition to the actual damages, may give damages for the sake of example, and by way of punishing the defendant.[5]

Apparently this was the first time the Montana Supreme Court found it necessary to construe this statute. To assist them in this matter the court looked to the case of *Crogan v. Metz,*[6] in which the California Supreme Court construed an almost identical statute.[7] That case involved an action by a client against real estate brokers to recover secret profits. The ap-

[1]Griffiths v. Thrasher, 95 Mont. 210, 26 P.2d 995 (1933); Beebe v. James, 91 Mont. 403, 8 P.2d 803 (1932).
[2]*Ibid.*
[3]Instant case at 98. Defendant contended this was an action upon a voidable release and at the trial offered instruction to that effect; however, the district court refused to instruct on the question of release and proceeded on a tort theory based on fraud.
[4](Hereinafter REVISED CODES OF MONTANA will be cited R.C.M.).
[5](Emphasis added.)
[6]47 Cal. 2d 398, 303 P.2d 1029 (1956).
[7]CALIFORNIA CIVIL CODE § 3294. This statute is identical to R.C.M. 1947, § 17-208 except for the substitution of the words "express or implied" for the words "actual or presumed".

pellate court was satisfied that the evidence was sufficient to warrant a finding by the jury that the defendant was guilty of fraudulently misrepresenting the price of certain property. In so doing, the defendant induced the plaintiff to purchase the property at a higher price than the vendor was asking, thus permitting him to retain the difference. The jury awarded the plaintiff punative damages, but the appellate court reversed. The Montana Supreme Court adopted the following language from that decision:[8]

> (A)n award [for punative damages] may not be granted in an action based on a breach of contract even though the defendant's breach was willful or fraudulent.

This seems to be a most proper application of the statute to the facts of the *Crogan* case, but not to the facts of the instant case. In the *Crogan* case the plaintiff framed his complaint in three counts, but on two different theories, the first and third based on fraud, and the second in the nature of the common count for money had and received. The court recognized that the plaintiff had the right to elect his remedy, but as he had not elected it became a matter for the judge or jury.[9] Further, when an appeal it taken from such a judgment the reviewing court may disregard the theory elected by the trial court, if on another theory the case may be disposed of without retrial.[10] It was contended that the trial court committed prejudicial error in refusing to admit certain evidence relevant to the theories set forth in the counts based on fraud. However, the appellate court found it unnecessary to answer this question by electing to affirm on count two, which was based on contract. Thus, the breach of an agent's contractual duty was the only action sustainable under the pleadings. However, in the instant case the plaintiff elected not to rescind but to affirm the contract, and proceeded on a tort theory based on fraud.

The court in the instant case was led to the conclusion that if the plaintiff suffered any injury, it was from defendant's failure to perform the insurance contract by misrepresenting the value of the demolished automobile.[11] It appears that the court failed to recognize that the plaintiff alleged two frauds, (1) the fraudulent misrepresentation of the value of the automobile, and (2) the fraudulent promise of the adjuster that there would be "something" left over for the plaintiff. The second fraud is that which induced the plaintiff to sign the release. If the defendant had not committed the second fraud and had in fact given the plaintiff that which had been promised him, he would have had no cause of action on any theory. The fraudulent promise of the defendant's adjuster is a breach, not of an obligation arising from contract, but of an obligation imposed by law.[12] Plaintiff's action is *not based* on contract, as it was not that which

[8]Instant case at 99.
[9]*Supra* note 6, 303 P.2d at 1032.
[10]*Ibid.*
[11]Instant case at 100.
[12]R.C.M 1947, § 58-102 states: "An obligation arises either from:
1. The contract of the parties; or,
2. The operation of law.
An obligation arising from operation of law may be enforced by civil action or proceeding or in the manner provided by law."
See Harper v. Interstate Brewery Co., 168 Or. 26, 120 P.2d 757, 762 (1942) in which the court inquired into the nature of the right which was invaded to determine whether the wrongdoer was subject to an action in tort or in contract.

was written in the release that injured him, but rather it was the fraudulent promise of the defendan't adjuster upon which plaintiff relied to his detriment. Following this reasoning it would seem that the case is taken out of the prohibitory provisions of R.C.M. 1947, Section 17-208, and punative damages should have been permitted even though the action *incidentally* involved a breach of contract. In the case of *Garden City Floral v. Hunt*,[13] the Montana Supreme Court said:[14]

> Ordinarily, where there is no duty except such as the contract creates, the plaintiff's remedy is for breach of contract, but when the breach of duly alleged arises out of a liability *independently* of the personal obligation undertaken by contract, it is a tort.

R.C.M. 1947, Section 58-601 provides that "Every person is bound, *without contract*, to abstain from injuring the person or property of another, or infringing upon any of his rights."[15] Clearly the plaintiff had the right not to be defrauded, and the fraudulent promise of the defendant's adjuster is just as clearly a breach of this statutory duty. In principle, the California case of *Ward v. Taggart*[16] is applicable here. That case involved a fraudulent scheme in which the vendor's asking price for some real property was fraudulently misrespresented to the plaintiff. Plaintiff purchased the property at the misrepresented price. Upon discovery of the fraud he brought suit for compensatory and punative damages. As a defense to the assessment of punative damages the defendant sought to invoke statutory provisions [17] which prohibit the assessment of punative damages in an action based on contract, and cited the *Crogan*[18] case in support of his position. That case was distinguished[19] by the court however, and punative damages were held to be properly assessable. In the language of Mr. Justice Traynor, speaking for the majority[20] of the court:[21]

> (S)ection [3294 of the California Civil Code] authorizes exemplary damages "in an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice***." The word "contract" is used in this section in its ordinary sense to mean an agreement between the parties, not an obligation imposed by law despite the absence of any such agreement. Taggart's obligation does not arise from any agreement between him and plaintiffs. It arises from his fraud and violation of statutory duties. His fraud is not waived, for it is the very foundation of the implied-in-law promise to disgorge.

This construction and application does not seem to violate either the letter or the spirit of the statute, but rather it increases its effectiveness

[13]126 Mont. 537, 255 P.2d 352 (1953).
[14]*Ibid*, 126 Mont. at 543 (emphasis added.) *cf* Foster v. Keating, 120 Cal. App. 2d 435, 261 P.2d 529 (1953); Murphy Auto Sales, Inc., v. Coomer, 123 Ind. App. 2d 121, 112 N.E.2d 589 (1953).
[15](Emphasis added.)
[16]51 Cal. App. 2d 736, 336 P.2d 534 (1959).
[17]*Supra* note 7.
[18]*Supra* note 6.
[19]*Supra* note 16, 336 P.2d at 538.
[20]Mr. Justice Schauer concurred in the result, but dissented on issues not revelant here.
[21]*Supra* note 19.

as a deterrent to the specified wrongful acts of oppression, fraud and malice. It does not appear, however, that the Montana court thought that there was any compelling reason to punish in the instant case. Plaintiff cited the case of *Hobbs v. Smith*,[22] in which the Oklahoma court awarded punative damages when the defendant, knowing his hogs were diseased, sold them to the plaintiff in violation of a penal statute. The court in the instant case summarily dismissed that case saying that ". . . perhaps the compulsion to punish and make an example of the defendant is greater in the Hobbs case than it is in this case."[23] This seems to indicate that the Montana court would permit the assesment of punative damages, under the facts of the instant case, if they believed the fraud was sufficiently gross, despite their interpretation of R.C.M. 1947, Section 17-208. If this is true the court is left with an additional task of classifying fraud into degrees; that which would permit punative damages, and that which would prohibit them.

It does not seem that proper consideration was given to the *Hobbs* case. The Oklahoma court concluded that they were in harmony with the common law and the great weight of authority in holding that:[24]

> (A)lthough the relation between the parties may have been established by contract, express or implied, if the law imposes certain duties because of the existance of that relation, the contract obligation may be waived, and an action in tort maintained for the violation of such imposed duties.

The court in the instant case does not refer to this proposition although it seems most relevant to plaintiff's position. It then seems by implication that the plaintiff does not have the right to waive the contract and sue in tort. This is contrary to the weight of authority.[25] Any other position leads to the conclusion that there was no tort upon which plaintiff could predicate his action. This is fallacious as it was established by the jury in the trial court that the defendant was guilty of fraud.

In as much as the court does consider the *Hobbs* case, it expresses the opinion that the compulsion to punish the defendant may have been greater in that case than in the instant one. However, considering the purwhether he committed the fraud or not. The general practice of the courts pose of punative damages as punishment for a civil wrong and as a deterrent to others, the reverse seems true. In the *Hobbs* case, the defendant not only assumed a risk of liability in actual damages in excess of anything he could hope to profit through the commission of fraud,[26] but he was also subject to punishment for the violation of a penal statute. In the instant case, however, the defendant, in absence of punative damages, assumed no risk by his misconduct, as the judgment against him would be the same

[22]27 Okl. 830, 115 Pac. 347 (1911).
[23]Instant case at 99.
[24]*Supra* note 22, 115 Pac. at 350.
[25]Hobbs v. Smith, 27 Okl. 830, 115 Pac. 347 (1911) (See cases cited therein). No cases have been found which overrule this proposition.
[26]The defendant there was liable for the damages caused as a result of the spreading of the disease to the plaintiff's hogs as well as those which he had sold, and further for the expenses incurred in disinfecting plaintiff's pens. It is conceivable that a large number of hogs may be infected before the buyer discovers the disease. Apparently the defendant would be liable for any damages which naturally flowed from his wrongful act.

is to award punative damages in those cases in which the defendant assumes no risk in perpetrating the fraud.[27] The purpose of such an award is to discourage oppression, fraud or malice.[28]

Although the court indicates to the contrary, it seems that there were very impelling reasons to assess punative damages in the instant case. Statutory provisions permit the jury to assess punative damages in any action, except for breach of contract, where the defendant has been guilty of fraud. As the statute indicates, this is done for the purpose of punishing the defendant and to set an example for others. Here the defendant was guilty of fraud. The fraud was an invasion of a right of the plaintiff given by law. In the absence of punative damages the plaintiff has no remedy for the invasion of this right. It is an anomaly for the law to give a right for which it gives no remedy.[29] The mere fact that the plaintiff may recover for the breach of a contractual obligation should not be a defense, either to the breach of an obligation imposed by law, or the assesment of punative damages when such breach is proved.

The instant case presents a matter of general public concern. The number of transactions in which releases are involved is increasing daily. It seems that a primary purpose of the law is to protect the members of society from the invasion of their rights; in this case; from the fraudulent procurement of releases. It is submitted that the decision in the instant case does not achieve this purpose.

Regardless of whether plaintiff elected to sue for breach of the contract, or to proceed on a tort theory, he had to prove exactly the same elements. R.C.M 1947, section 58-509 provides: "An obligation is extinguished by a release therefrom given to the debtor by the creditor, upon a new consideration, or in writing, with or without new consideration." Thus the release consituted a bar to recovery on either a contract or tort theory unless plaintiff could first prove fraud in the procurement of the release. Plaintiff did prove fraud in the procurement of the release, and also proved breach of the insurance contract. Although plaintiff proved all of the elements necessary to recover on either theory of law, the court limited his recovery to damages sustained because of the breach of the contract. Further, the court imposed this limitation even though plaintiff had elected to proceed on a tort theory. The court's limitation is contra to established principles of law, *i.e.*, that when more than one remedy is available, the injured party may select the one he wishes to pursue.[30]

As a practical matter, this decision invites the perpetration of fraud. Even though there may have been a breach of contract, if the plaintiff fails to convince the jury that the release was procured by fraud, defendant is not obligated to pay for the breach. If the plaintiff does prove fraud in the procurement of the release, and then proves breach of the contract, defendant is liable only in damages for the breach of contract, since the court has, in the instant case, limited the plaintiff's cause of action to breach of contract. Since defendant will in any case not be liable for punative damages, defendant has really assumed no risk of loss by the

[27] *Supra* note 19, and cases cited therein.
[28] *Ibid.*
[29] I AM. JUR. *Actions* § 9 (1936).
[30] Griffiths v. Thrasher, 95 Mont. 210, 26 P.2d 995 (1933); Beebe v. James, 91 Mont. 403, 8 P.2d 803 (1932).

commission of the fraud. As previously noted, the general practice is to allow punative damages where the defendant has assumed no risk in perpetrating the fraud.[81]

As a further inducement to the perpetration of fraud, the possibility of gain is provided. Practically speaking, the defrauded party may find the cost of bringing suit prohibitive. On the other hand, an insurance company generally retains a permenant legal staff and can well afford the cost of defending those suits which are prosecuted. As a consequence, many victims of fraud will not prosecute, thus permitting the wrongdoer to profit without the necessity of successfully defending a suit. It is submitted that, where punative damages are a probable risk to a party, it might be found economically impractical to engaged in fraudulent activities. In order to circumvent the above problems, it seems that the plaintiff should properly have been allowed to proceed in tort and punative damages should have been allowed.

For the foregoing reasons, it is urged upon the court that it reconsider the position taken in this case.

MYRON E. PITCH

CONTRACT CLAUSE PROVIDING FOR ARBITRATION OF FUTURE DISPUTES IS NOT ENFORCEABLE IN MONTANA.—Plaintiff entered into an agreement with defendant whereby plaintiff agreed to lease land from defendant and run steers on it for a period of four years. Defendant was to supply 600 steers per year and at the end of each year, the steers were to be sold and the proceeds divided. This was done without incident for two years, but during the third year, defendant placed on the land 120 heifers in addition to the steers. A dispute arose over whether the heifers were to be handled under the terms of the agreement. Finally defendant sold both the heifers and the steers without the knowledge or consent of the plaintiff and appropriated the proceeds. Plaintiff remained on the land until the termination of the lease but no more cattle were run under the agreement. After some futile discussion between the parties, plaintiff instituted this suit for his share of the disputed proceeds and the profit he would have made had they continued as the contract stipulated. One of the defenses asserted related to paragraph six of the contract which reads: "Any difference between the parties under this lease that cannot be settled after thorough discussion, shall be submitted for arbitration by a committee of three disinterested persons, one selected by each party here to and the third by the two thus selected, and their decision shall be accepted by both parties." Defendant contended that plaintiff had refused to arbitrate and was thus barred from proceeding with the suit. The court ruled against defendant on all counts and judgment was entered for the plaintiff. On appeal to the Montana Supreme Court, *held*, affirmed. The rights of parties to free access to the courts cannot be interfered with and any such interference is void as viola-

[81] 51 Cal. App. 2d 736, 336 P.2d 534, 538 (1959).