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RECOVERY IN DECEIT ACTIONS IN CALIFORNIA

By HOMER L. McCORMICK, JR.*

Introduction

With the great boom in real estate development in California there has come both opportunity and temptation to seek a profit by the use of fraudulent misrepresentations. In order to select the best remedy for a client injured by such misrepresentations it will be important to consider carefully not only the remedies available but the types of recovery that can be expected using each.

In connection with the problems involved in making your election of remedies the recent California Supreme Court decision of *Ward v. Taggart*¹ is important in at least three respects. *First*, the case illustrates the hazard of selecting the wrong remedy. *Second*, the case spells out the Supreme Court's conception of the nature of the quasi-contractual recovery as an alternative to the recovery of damages. Of particular importance is the court's decision that the election of such a recovery does not result in waiving the tort or in precluding the recovery of punitive damages. *Third*, the case calls for a new look at the rule for measuring damages in an action for deceit in California.

The Ward Case

The basic facts in the *Ward* case were these. The principal defendant Taggart, a real estate broker, falsely represented that he had an exclusive listing of a tract of land in Los Angeles County. The plaintiff made an offer for this tract calculated at \$4,000 per acre which was refused. Subsequently, another offer at \$5,000 was made. This was accepted. An elaborate escrow was set up at Taggart's suggestion in which Taggart's associate Jordan was named seller. Jordan was also made payee of notes and beneficiary of trust deeds incidental to the deal. These escrow provisions were represented by Taggart as being necessary to take care of certain tax and encumbrance problems.

After the transaction was completed, the plaintiff learned that Taggart had never been given a listing. He had not presented or intended to present Ward's offers, but had presented his own offer at \$4,000 per acre and purchased the land. Thus, by his purchase at \$4,000 per acre and resale to Ward at \$5,000 per acre, he had made a secret profit of \$1,000 per acre or \$72,049.20. Not only did he make this profit at Ward's expense, but all the reasons given for the unusual escrow instructions were fabrications. The money paid by Ward into the escrow was used by Taggart to buy the land to accomplish his fraud.

If Ward could prove that he had been induced to enter the transaction by the fraudulent misrepresentations of Taggart, he would be presented with an election. The election arises because the courts consider the trans-

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¹ 51 Cal. 2d 736, 336 P.2d 534 (1959).

action voidable at the option of the injured party.² A true election must be made, since the remedies based on a theoretical affirmation or disaffirmance of the agreement are inconsistent.³

The injured party may affirm the transaction, keep what he has received, and sue for his damages in tort.⁴ At common law his tort action was in deceit and his recovery where property is involved was based on either the "benefit of the bargain" rule or, in minority jurisdictions, the "out of pocket" rule.⁵

The damage rule followed by some two-thirds of the U. S. jurisdictions⁶ (benefit of the bargain) is intended to put the injured party in as good a position as he would have been in had the representations been true. Although the action is in tort, the recovery sounds more like the damage rule in the typical contract action for breach of warranty.⁷ However, unlike contract actions, exemplary damages are also recoverable.⁸

The other rule followed in England⁹ and perhaps a dozen U. S. jurisdictions,¹⁰ including the Federal courts¹¹ and California¹² and which is

² Rathstein v. Janss Investment Corp., 45 Cal. App. 2d 64, 69, 113 P.2d 465, 467 (1941); Hatch v. Kulick, 211 Minn. 309, 1 N.W.2d 359 (1941). See 37 C.J.S. *Fraud* § 65 (1943); 12 CAL. JUR. 2d *Contracts* § 273 (1953); 23 CAL. JUR. 2d *Fraud and Deceit* § 10 (1955).

³ Kent v. Clark, 20 Cal. 2d 779, 783, 128 P.2d 868, 871 (1942); Carter v. Carr, 139 Cal. App. 15, 26, 33 P.2d 852, 858 (1934); Westman v. Brumm, 248 Mich. 387, 227 N.W. 764 (1929); Holcomb and Hoke Mfg. Co. v. Jones, 102 Okl. 175, 228 Pac. 968 (1924). See also 37 C.J.S. *Fraud* § 65 (1943); 23 CAL. JUR. 2d *Fraud and Deceit* §§ 51, 55 (1955); McCORMICK, DAMAGES § 121 (1935); Thurston, *Recent Developments in Restitution: 1940-1947*, 46 MICH. L. REV. 1037, 1040 (1947).

⁴ Loddell v. Miller, 114 Cal. App. 2d 328, 343, 250 P.2d 357, 367 (1952); Rathstein v. Janss Investment Corp., 45 Cal. App. 2d 64, 69, 113 P.2d 465, 467 (1941); Baker v. Carstenbrook, 78 Cal. App. 133, 248 Pac. 295 (1926). For a good discussion of the common law on this point see Hatch v. Kulick, 211 Minn. 309, 1 N.W.2d 359 (1941). See also Kent v. Clark, 20 Cal. 2d 779, 128 P.2d 868 (1942); 37 C.J.S. *Fraud* § 63 (1943); 24 AM. JUR. *Fraud and Deceit* §§ 190, 200 at 24 (1939); 5 WILLISTON, CONTRACTS § 1524 (Rev. ed. 1937); McCORMICK, DAMAGES § 121 (1935).

⁵ See PROSSER, TORTS § 91 (2d ed. 1955); McCORMICK, DAMAGES § 121 (1935).

⁶ See cases collected McCORMICK, DAMAGES 451 n.18, and see generally § 121 (1935). See also 37 C.J.S. *Fraud* § 143 at 477-478 (1939); 24 AM. JUR. *Fraud and Deceit* § 227 (1939); PROSSER, TORTS 569 (2d ed. 1955).

⁷ See 24 AM. JUR. *Fraud and Deceit* § 227 at 56 (1939); PROSSER, TORTS 569 (2d ed. 1955); McCORMICK, DAMAGES 449 (1935).

⁸ Lutfy v. Roper and Sons Motor Co., 57 Ariz. 495,, 115 P.2d 161, 165 (1941). See also 37 C.J.S. *Fraud* § 144 (1939); 24 AM. JUR. *Fraud and Deceit* § 222 (1939).

⁹ Peek v. Derry, L.R. 37 Ch. Div. 541 (1887).

¹⁰ See cases cited PROSSER, TORTS 568 (2d ed. 1955); McCORMICK, DAMAGES § 121 at 450 (1935). See also 37 C.J.S. *Fraud* § 143 at 479 (1939).

¹¹ Smith v. Bolles, 132 U.S. 125, 129 (1889); Sigafus v. Porter, 179 U.S. 116 (1900) where unaffected by *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938). See *Jacobs v. Levin*, 58 Cal. App. 2d Supp. 913, 916, 137 P.2d 500, 501 (1943), where the court says that since the *Erie R. Co.* case *supra* requires the federal courts to follow the "... state decisions of general law, the main support of the minority rule would appear to have collapsed."

¹² CAL. CIV. CODE § 3343: "One defrauded in the purchase, sale or exchange of property is entitled to recover the difference between the actual value of that which the defrauded person parted with and the actual value of that which he received, together with any additional damage arising from the particular transaction."

"Nothing herein contained shall be deemed to deny to any person having a cause of action for fraud or deceit any legal or equitable remedies to which such person may be entitled."

See *Bagdasarian v. Gragnon*, 31 Cal. 2d 744, 192 P.2d 935 (1948); *Nelson v. Marks*, 126

suggested by the *Restatement of Torts* section 549,¹³ allows recovery of the so called "out of pocket" losses. The effect of this is to disregard any profit which might have been made by the injured party and to allow only those actual damages which can be proved, plus in certain cases exemplary damages.¹⁴ This remedy sounds more like the usual tort recovery.¹⁵

The injured party is also entitled to *waive the tort and sue in assumpsit*.¹⁶ The theory is that the wrongdoer is unjustly enriched at the expense of the injured party and thus is under a moral obligation to make restitution. The courts then, by the use of a fiction, imply a promise by the wrongdoer to repay. This is in effect a debt and within reach of the common law action of *indebitatus assumpsit*.¹⁷

The remedy here involved is also termed quasi-contractual. This term is unfortunate because it has led to a confusion as to the true nature of the remedy.¹⁸ To waive the tort and seek a quasi-contractual recovery has been said to constitute an election to seek a recovery based on contract instead of one based on tort.¹⁹ In jurisdictions which consider this a true election an

Cal. App. 2d 261, 271 P.2d 900 (1954); *Rothstein v. Janss Investment Corp.*, 45 Cal. App.2d 64, 73, 113 P.2d 465, 469 (1941) (dictum); *Jacobs v. Levin*, 58 Cal. App. 2d Supp. 913, 915-918, 137 P.2d 500, 502 (1943); cf. *Lordell v. Miller*, 114 Cal. App. 2d 328, 343, 250 P.2d 357, 367 (1952) (CAL. CIV. CODE § 3343 not the measure of recovery where the plaintiff elects to disaffirm the transaction). *Contra*, *Morris v. Harbor Boat*, 112 Cal. App. 2d 882, 247 P.2d 589 (1952) (rule not used in boat sale, instead court used "benefit of bargain" rule). See also 23 CAL. JUR. 2d *Fraud and Deceit* §§ 88, 89 (1955).

¹³ RESTATEMENT, TORTS § 549 (1934): "The measure of damages which the recipient of a fraudulent misrepresentation is entitled to recover from its maker as damages . . . is the pecuniary loss which results from the falsity of the matter misrepresented including

a. the difference between the value of a thing bought, sold or exchanged and its purchase price or the value of the thing exchanged for it, and

b. Pecuniary loss suffered otherwise as a consequence of the recipient's reliance upon the truth of the representation."

¹⁴ *Eatwell v. Beck*, 41 Cal. 2d 128, 134-135, 257 P.2d 643, 647-648 (1953). See also 37 C.J.S. *Fraud* § 146 and § 103 at 409 (1939) (the burden is on the party claiming damages because of a fraudulent misrepresentation to show the amount of his damages); 23 CAL. JUR. 2d *Fraud and Deceit* § 91 (1955).

¹⁵ PROSSER, TORTS § 569 (2d ed. 1955). The "out of pocket" rule ". . . is more consistent with the purpose of tort remedies which is to compensate the plaintiff for a loss sustained rather than to give him the benefit of any contract bargain."

¹⁶ *Philpott v. Superior Ct.*, 1 Cal. 2d 512, 36 P.2d 655 (1934). See also RESTATEMENT, CONTRACTS § 488 (1932); *Corbin, Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221 (1910); 24 AM. JUR. *Fraud and Deceit* § 202 (1939). For a discussion of procedural aspects in California see *Hallidie v. Enginger*, 175 Cal. 505, 166 Pac. 1 (1917); *King, The Use of the Common Counts in California*, 14 So. CAL. L. REV. 288 (1942). See in general WOODWARD, QUASI CONTRACTS ch. 19 (1913); KEENER, QUASI CONTRACTS ch. 3 (1893).

¹⁷ WOODWARD, QUASI CONTRACTS § 270 at 438 (1913); RESTATEMENT, RESTITUTION § 1 (1937): "A person who has been unjustly enriched at the expense of another is required to make restitution to the other." See also *Corbin, Quasi-contractual Obligations*, 21 YALE L.J. 533 (1912).

¹⁸ *Philpott v. Superior Ct.*, 1 Cal. 2d 512, 525, 36 P.2d 635, 641 (1934); *Dusenka v. Dusenka*, 221 Minn. 235, 238, 21 N.W.2d 528, 530 (1946). See also WOODWARD, QUASI CONTRACTS § 270 (1913); *Corbin, Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 222-224 (1910); *Thurston, Recent Developments in Restitution: 1940-1947*, 45 MICH. L. REV. 935, 939 (1947).

¹⁹ *Smith v. Baker*, L.R. 8 C.P. 350 (1873); *Terry v. Munger*, 121 N.Y. 161, 24 N.E. 272 (1890). See *Thompson v. Howard*, 31 Mich. 309 (1875); *Corbin, Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 239-241 (1910).

adverse decision on a suit on the common counts in *indebitatus assumpsit*, for example, precludes a switch to a damage recovery against a joint tortfeasor, since the tort has been waived.²⁰ Most authorities²¹ do not, however, consider this a true election and the trend of cases supports such a view.²²

These cases and authorities state that the tort is not waived, but rather is in fact the very foundation of the action in quasi-contract.²³ Under this analysis quasi-contract becomes an alternative to the recovery of damages for deceit.²⁴

If the injured party decides not to affirm the transaction, he can disaffirm (rescind) it and seek restitution.²⁵ The word restitution is a generic term²⁶ used here to describe remedies which seek to put the injured party in as good a position as he would have been in had he never entered the transaction.²⁷

The Plaintiff's Choice

In the *Ward* case the plaintiff elected to keep the land and thus by traditional analysis affirm the transaction. Accordingly, he brought an action in tort for deceit. It would seem that the plaintiff must then prove actual damages in order to recover under the "out of pocket" rule. However instead of alleging such damages he claimed the secret profit the defendant had

²⁰ See *Terry v. Munger*, 121 N.Y. 161, 24 N.E. 272 (1890), criticized in KEENER, QUASI CONTRACTS 208-213 (1893), and Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 240 (1910). See also *Shonkweiler v. Harrington*, 102 Neb. 710, 169 N.W. 258 (1918).

²¹ RESTATEMENT, RESTITUTION ch. 7 introductory note at 525 (1937): "The election to bring an action of assumpsit is . . . (merely) the choice of one of two alternative remedies." See also KEENER, QUASI CONTRACTS 160, 208-213 (1893); WOODWARD, QUASI CONTRACTS § 271 (1913); Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 239 (1910); Deinar, *Election of Remedies*, 6 MINN. L. REV. 341 (1922); Thurston, *Recent Developments in Restitution: 1940-1947*, 45 MICH. L. REV. 935, 948-949 (1947).

²² *Ward v. Taggart*, 51 Cal. 2d 736, 336 P.2d 534 (1959); *United Australia, Ltd. v. Barclay's Bank, Ltd.* (1941) A.C. 1, 18 (1940) 4 All E.R. 20, 29 (1940) where Viscount Simon L.C. stated: "When the plaintiff 'waived the tort' and brought *assumpsit* he did not thereby elect to be treated from that time forward on the basis that no tort had been committed. Indeed, if it were to be understood that no tort had been committed, how could an action of assumpsit lie? It lies only because the acquisition of the defendant is wrongful, and there is thus an obligation to make restitution." See also Thurston, *Recent Developments in Restitution: 1940-1947*, 45 MICH. L. REV. 935, 949 (1947).

²³ *Ward v. Taggart*, 51 Cal. 2d 736, 336 P.2d 534 (1959); *United Australia, Ltd. v. Barclay's Bank, Ltd.* (1941) A.C. 1 (1940) 4 All E.R. 20 (1940); RESTATEMENT, RESTITUTION ch. 7 introductory note at 525 (1937); KEENER, QUASI CONTRACTS 160 (1893); WOODWARD, QUASI CONTRACTS § 271 (1913); Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 235 (1910).

²⁴ See Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 243-245 (1910) where Professor Corbin says this is what waiving the tort and suing in *assumpsit* really means. See also WOODWARD, QUASI CONTRACTS § 271 (1913).

²⁵ *Lobdell v. Miller*, 114 Cal. App. 2d 328, 343, 250 P.2d 357, 367 (1952). See also 77 C.J.S. *Restitution* 322 (1952); 24 AM. JUR. *Fraud and Deceit* § 190 (1939); 46 AM. JUR. *Restitution* 100 (1943); 5 WILLISTON, CONTRACTS § 1525 (Rev. ed. 1937).

²⁶ *Scott and Seavey, Restitution*, 54 L.Q. REV. 29 (1938). See also Patterson, *The Scope of Restitution and Unjust Enrichment*, 1 MO. L. REV. 223 (1936); Thurston, *Recent Developments in Restitution: 1940-1947*, 45 MICH. L. REV. 935 (1947).

²⁷ *Hatch v. Kulick*, 211 Minn. 309, 1 N.W.2d 359 (1941). See also RESTATEMENT, RESTITUTION §§ 4, 5 (1937); 77 C.J.S. *Restitution* 322 (1952).

made on the deal. His theory was that the "out of pocket" rule shouldn't apply because a fiduciary relationship existed between the parties.

The trial court sitting without a jury went along with the plaintiff's analysis and awarded judgment against both defendants for \$72,042.20, the amount of the secret profit. In addition \$36,000 in exemplary damages were awarded. The defendant appealed.

The case was heard twice in the District Court of Appeals.²⁸ In both opinions the court could find no support for the plaintiff's theory of recovery in the facts. Clearly the defendant was not Ward's agent and there was no other evidence of any other fiduciary relationship.

In the first hearing²⁹ the Appellate Court reversed the judgment as to defendant Jordan and modified it as to defendant Taggart so as to strike out exemplary damages. In doing so the court felt the plaintiff's complaint, in effect, waived the defendant's tort and relied upon a quasi-contractual theory of recovery.

On rehearing³⁰ the court decided that the problems presented by the case were such that a new trial was necessary. The trial court was directed to allow the plaintiff to amend his complaint if desired. The defendant was not satisfied with this disposition however and carried his appeal to the Supreme Court.

The Supreme Court's View

In the defendant's appeal to the Supreme Court he relied principally on the case of *Bagdasarian v. Gragnon*.³¹ This case decided in 1948 interpreted Civil Code section 3343 as laying down the "out of pocket" rule as the *exclusive* measure of recovery in deceit actions. The defendants argue that even admitting the evidence is clearly sufficient to support a finding of fraud, the only evidence on the issue of damages was that the property was worth at least \$5,000 per acre. Thus the plaintiff has proved no "out of pocket" loss and there can be no recovery in tort for the fraud.

In reply to this argument, the plaintiff contended that where secret profits are involved recovery in tort is not limited by the "out of pocket" rule. Cases cited³² in support of this argument are, however, as the court notes, situations in which some confidential or fiduciary relationship existed between the parties. Since Taggart never purported to act for the plaintiff, the court finds no such relationship existed and thus, the only damages recoverable in tort should be limited by the "out of pocket" rule to actual damages.

It would seem then that the court should reverse the lower court and,

²⁸ 325 P.2d 502 (1958); rehearing 329 P.2d 320 (1958).

²⁹ 325 P.2d 502 (1958).

³⁰ 329 P.2d 320 (1958).

³¹ 31 Cal. 2d 744, 192 P.2d 935 (1948).

³² *Crogan v. Metz*, 47 Cal. 2d 398, 303 P.2d 1029 (1956); *Savage v. Mayer*, 33 Cal. 2d 548, 203 P.2d 9 (1949); *Terry v. Bender*, 143 Cal. App. 2d 198, 300 P.2d 119 (1956); *Simone v. McKee*, 142 Cal. App. 2d 307, 298 P.2d 667 (1956); *Ramey v. Myers*, 111 Cal. App. 2d 679, 245 P.2d 360 (1952); *Adams v. Harrison*, 34 Cal. App. 2d 288, 93 P.2d 237 (1939).

at best, allow the case to be tried again so the plaintiff could prove actual damages or change his theory and seek a restitutional remedy for the amount of the secret profit.³³ The court was determined, however, to allow the plaintiff to recover. The majority, in affirming the lower court as to defendant Taggart, states that "... public policy ... does not permit one to take advantage of his own wrong. . . ."³⁴

The court states the theory upon which the plaintiff is to be allowed to recover as³⁵ "... a quasi-contractual remedy to prevent one from being unjustly enriched at the expense of another." To provide restitution Taggart was made an involuntary trustee for the \$1,000 per acre secret profit, for one³⁶ "... who gains a thing by fraud . . . (is) an involuntary trustee . . . for the benefit of the person who would otherwise have had it." Jordan, the other defendant, was not shown to have shared the "illicit profit" and therefore the judgment as to her was reversed.

The Extent of the Decision

The Supreme Court expressly finds that a fiduciary relationship did not exist between the parties in the *Ward* case. But the court says that as a real estate broker the defendant had a duty to be "honest and truthful." He violated that duty. He is made an involuntary trustee for the benefit of the plaintiff.

Does the court make him an involuntary trustee only because he is a real estate broker or is the defendant's status only incidental to the court's decision? The answer to this question is of great importance in deciding to what extent the *Ward* case will become valuable to the attorney seeking a remedy for his client in a fraud case.

In this author's opinion this case does not turn on the fact Taggart was a real estate broker and that the duty to disgorge would rest on anyone who made such a secret profit. When the case was before the District Court of Appeals that court felt it was necessary to go into the duty of Taggart in great detail. The majority opinion in the first hearing in that court of the case noted³⁷ that a real estate broker has a duty to be honest and those relying on such a broker have a right to rely on such honesty.

The appellate court cited³⁸ the Florida case of *Zichlin v. Dill*³⁹ in which a broker made a secret profit by the use of fraudulent misrepresentations. This broker was the agent of the seller, not the buyer, yet the Florida court

³³ This was the ruling in the second hearing of the *Ward* case in the District Court of Appeals, 329 P.2d 320 (1958).

³⁴ 51 Cal. 2d at 741, 336 P.2d at 537, citing CAL. CIV. CODE § 3517 (Maxims of Jurisprudence): "No one can take advantage of his own wrong."

³⁵ 51 Cal. 2d at 741, 336 P.2d at 537.

³⁶ *Id.* at 741, 336 P.2d at 537, quoting CAL. CIV. CODE § 2224 which states: "One who gains a thing by fraud, accident, mistake, undue influence, the violation of a trust, or other wrongful act, is, unless he has some other and better right thereto, an involuntary trustee of the thing gained, for the benefit of the person who would otherwise have had it."

³⁷ 325 P.2d at 505-508.

³⁸ *Id.* at 505, 506.

³⁹ 157 Fla. 96, 25 So.2d 4 (1946).

felt that because of the special position of the broker the question of caveat emptor should be cast aside and thus the plaintiff could collect the secret profit. Another case relied on by the appellate court was *Harper v. Ademetz*⁴⁰ in which the seller's agent profited at the expense of the buyer, who incidentally was the author of many books in the field of torts.⁴¹ The court ordered the agent to make restitution. Thus it seems that the trend of cases allow the recovery of profits made by a broker even though no fiduciary or confidential relationship exists between the parties.

Reading these cases and the argument of the appellate court one can not help feeling that the court's discussion in each case seems to be directed toward proving that the plaintiff *reasonably relied* on the defendant's misrepresentations because he was a broker. Judge Ashburn, who dissented in the first hearing of the *Ward* case in the District Court of Appeals,⁴² noted in that dissent that the defendant admitted that the record in the trial court would support the determination that these misrepresentations were relied upon by the plaintiff and had induced him to enter the transaction. Why then was it necessary to attempt to prove reasonable reliance?

Judge Ashburn feels that it is easy to thus introduce false elements into an uncomplicated problem and confuse the issue. He suggests that the defendant's status as a real estate broker adds nothing to the basic obligation which everyone has, to deal in an honest fashion in any business transaction. As the judge says,⁴³ "This duty of fair dealing rests upon a broker (with or without a license) as upon every man, no more and no less."

If the wording of the Supreme Court decision in the *Ward* case is carefully noted it will be seen that the court says the defendant's obligation arises from ". . . fraud *and* violations of statutory duties."⁴⁴ (Emphasis added.) Were both of these elements necessary to the court's decision? Following Judge Ashburn's opinion above they would not be and fraud alone by anyone is enough to allow a court to make one an involuntary trustee.

The Court's Dilemma

Other serious problems arise for the court in this theoretical analysis. *First*, the Supreme Court admits that the plaintiff had not elected to advance the theory of recovery used by the court. On what basis then can the court avoid such an election and change the plaintiff's theory for him? *Second*, since a quasi-contractual recovery is based on a theory of unjust enrichment is there any basis for allowing the recovery of exemplary damages? *Third*, should the court allow the recovery of the defendant's gross profit or his net profit?

⁴⁰ 142 Conn. 218, 113 A.2d 136 (1955).

⁴¹ *E.g.*, HARPER & JAMES, TORTS (1956).

⁴² 325 P.2d at 510-513.

⁴³ *Id.* at 510.

⁴⁴ 51 Cal. 2d at 743, 336 P.2d at 538.

The Election Problem

Since the plaintiff did not advance a quasi-contractual theory of recovery either in the trial court or on appeal, the court, in order to allow recovery on that basis, must change his theory for him. In doing so the court seems clearly of the opinion that seeking a damage recovery is not an election and does not preclude the seeking of quasi-contractual recovery at a later trial or on appeal.

In support of this contention the court cites paragraph two of Civil Code section 3343, which says,⁴⁵ "Nothing herein contained shall be deemed to deny to any person having a cause of action for fraud or deceit any legal or equitable remedies to which such person may be entitled."

In addition the court considers the general rule confining the parties upon appeal to the theory advanced below. However, the rationale behind this rule, states the court, is⁴⁶ ". . . that the opposing party should not be required to defend for the first time on appeal against a new theory that 'contemplates a *factual* situation the consequences of which are open to controversy and were not put in issue or presented at the trial.'" (Emphasis added.) A change in theory is permitted on appeal when ". . . a question of *law* only is presented. . . ."⁴⁷ (Emphasis added.) The court apparently feels the appeal presented no different factual situation and the facts pleaded and proved are sufficient to uphold recovery under a quasi-contractual theory of unjust enrichment.

The factual situation here involved does not require the court to state directly whether bringing an action in quasi-contract *first* would constitute an election of remedies and preclude seeking damages at a new trial or on appeal. But it would seem that no such election is made from the court's discussion of the nature of the quasi-contractual remedy as an alternative to damages for tort.

The court argues that a quasi-contractual remedy is based upon an implied in law promise to return that which is the subject of the unjust enrichment and does not arise from any agreement between the parties. This implied promise is, as the court says,⁴⁸ ". . . purely fictitious and unintentional, originally implied to circumvent rigid common law pleading. . . ." In the *Ward* case Taggart's obligation⁴⁹ ". . . arises from . . . fraud and violation of statutory duties. . . . [The] fraud is not waived, for it is the very foundation of the implied-in-law promise to disgorge."

It is significant that the court cites Corbin for this proposition, for it is

⁴⁵ See note 12 *supra*.

⁴⁶ 51 Cal. 2d at 742, 336 P.2d at 537-538, quoting in part from *Panopulos v. Maderis*, 47 Cal. 2d 337, 341, 303 P.2d 738, 741 (1956). *Accord*, *American Auto. Ins. Co. v. Seaboard Surety Co.*, 155 Cal. App. 2d 192, 200, 318 P.2d 84, 89 (1957).

⁴⁷ See note 46 *supra*.

⁴⁸ 51 Cal. 2d at 743, 336 P.2d at 538. See also 1 WILLISTON, CONTRACTS § 3A (3d ed. 1957).

⁴⁹ 51 Cal. 2d at 743, 336 P.2d at 538, citing Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 243-246 (1910).

difficult to find one who has written a more stinging indictment of the waiver theory, than the noted professor.⁵⁰

Exemplary Damages

Once the court has laid the basis for the recovery upon the tortious conduct of the defendant, little difficulty is found in affirming the judgment for exemplary damages. Although the defendant argues that the implied promise to pay is contractual in nature and under section 3294 of the Civil Code⁵¹ exemplary damages are not recoverable in contract actions, the court finds the word contract used in that section means an agreement between the parties and not an obligation imposed by law.

Thus it becomes apparent, in California at least, that the restitutional remedy of quasi-contract serves only as an alternative to compensatory damages, and the question of exemplary damages is not precluded when such an alternative is sought. The court says:⁵²

Courts award exemplary damages to discourage oppression, fraud, or malice by punishing the wrongdoer. (Citations omitted.)⁵³ Such damages are appropriate, where restitution would have little or no deterrent effect, for wrongdoers would run no risk of liability to their victims beyond that of returning what they wrongfully obtained.

The Supreme Court's ruling in this regard is a complete reversal of the District Court of Appeal's position. In both hearings of the *Ward* case the appellate court directly rules that the underlying principle in a quasi-contractual recovery rules out the recovery of exemplary damages.

In discussing the nature of the quasi-contractual recovery *supra* it was noted that its underlying principle is the doctrine of unjust enrichment. The Supreme Court itself, in laying down the theory under which the plaintiff in the *Ward* case is to be allowed to recover, stated that it was intended to prevent one from being unjustly *enriched* at the expense of another. A person is unjustly *enriched* only to the extent that he *receives*

⁵⁰ Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 235 (1910), for example states: "In all cases where a tort is waived, there is in effect no contract. The cause of action is a tort and the tort exists as the cause of action and must be proved as the cause of action from first to last. No trick or legerdemain on the part of the plaintiff can change the tort into a contract."

⁵¹ CAL. CIV. CODE § 3294 states: "In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff in addition to the actual damages may recover damages for the sake of example and by way of punishing the defendant."

⁵² 51 Cal. 2d at 743, 336 P.2d at 538. Cases cited in support: *Haigler v. Donnelly*, 18 Cal. 2d 674, 680-682, 117 P.2d 331 (1941) (Court questions exemplary damages for a count for money had and received, but allows it for alternative count of conversion); *Devers v. Greenwood*, 139 Cal. App. 2d 345, 350, 293 P.2d 834 (1956) (breach of fiduciary relationship in real estate transaction); *Foster v. Keating*, 120 Cal. App. 2d 435, 454-455, 261 P.2d 529 (1953) (inducement to enter business); *Hartzell v. Myall*, 115 Cal. App. 2d 670, 252 P.2d 676 (1953) (real estate transaction); *Taylor v. Wright*, 69 Cal. App. 2d 371, 159 P.2d 980 (1945) (stock sale).

⁵³ See McCORMICK, DAMAGES § 79 (1935); Morris, *Punitive Damages in Tort Cases*, 44 HARV. L. REV. 1173, 1185-1188 (1931).

something at the expense of another. Thus that sum of money which is allowed as exemplary damages does not represent *unjust enrichment*.⁵⁴

In *McCall v. Superior Court*⁵⁵ the Supreme Court of California said, ". . . *in assumpsit* where the tort is waived, the sum sued for is the benefit unjustly retained by the defendant; not the damage to the plaintiff. . . ." And in *French v. Robbins*⁵⁶ the same court said, "The foundation of the action of *assumpsit* . . . is the unjust enrichment of the wrongdoer. It is well settled that . . . to recover in such action, the plaintiff must show that a definite sum, to which he is justly entitled, has been received by the defendant."

What we are faced with here is a case of logical consistency versus practicality. The decision of the Supreme Court does not seem consistent with the doctrine of unjust enrichment where, as Judge Ashburn stated when the *Ward* case was before the appellate court: ". . . the idea of punishment is out."⁵⁷ However, it may be the only practical solution if we want to present the potential wrongdoer with a good reason not to give in to temptation and seek a secret profit by the use of fraudulent misrepresentations.

Gross or Net Profit

If the basis of recovery in the *Ward* case is the defendant's unjust enrichment, should deduction be allowed for the defendant's expenses in securing such enrichment? This problem arose in the *Ward* case when the defendant sought to deduct from the compensatory portion of the judgment all the costs of the transaction except those incurred in the actual accomplishment of the fraud. These expenses amounted to \$25,563.10 and represented certain commissions, escrow fees and a sum paid to secure cancellation of a listing encumbering the property. One of these commissions was paid with the plaintiff's consent to his own agent, who had assisted the plaintiff in the transaction.

Involved here is one of the most difficult issues which can arise when one seeks a restitutional recovery of profits. Following the *Ward* case through the courts, one can see the controversy the issue develops. In the trial court the deductions were not allowed and on appeal the District Court of Appeals in the majority opinion upheld this decision. The majority's approach to the problem was based on the fact the defendant was a wrongdoer and as such he was different from ordinary trustees and should not be allowed deductions.

Judge Ashburn in dissenting as to this portion of the majority opinion presented another approach to the problem. He argued that the basis of

⁵⁴ See Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221 (1910).

⁵⁵ 1 Cal. 2d 527, 532, 36 P.2d 642, 645 (1934). See also KEENER, QUASI CONTRACTS 160 (1893).

⁵⁶ 172 Cal. 670, 679, 158 Pac. 188, 191 (1916).

⁵⁷ 329 P.2d at 325. See also Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 245 (1910).

the recovery is the defendant's unjust enrichment and thus a plaintiff who sues in *assumpsit* should recover only that which belongs to him in ". . . equity and good conscience."⁵⁸ The judge however feels that the idea of punishment should be excluded. Thus he would allow the defendant to deduct the entire cost of the transaction except those items which were incurred as a means of accomplishing the fraud.

On rehearing Judge Ashburn's arguments prevailed and became the majority opinion. But when the Supreme Court was presented with the problem, the court disallowed all deductions. The test advanced by this court appears to be whether the expenses would have been *necessary* to a legitimate transaction. In addition the court, in considering separately some of the items claimed by the defendant, remarked that it is speculative whether these would have been necessary to a legitimate transaction.

It is submitted that the Supreme Court's approach leaves many questions unanswered. Very often profits result only because of skill, effort and expenditure on the part of the wrongdoer. It is obvious that the wrongdoer is only *enriched* to the extent of his net profit. If deductions for expenses are not allowed, the restitutional remedy granted in excess of the net profit is punitive in effect. Yet, as noted, Judge Ashburn argues that in a remedy consistent with the idea of restitution, punishment is out. This is also the position taken by the Restatement of Restitution which states that actions of restitution are not punitive.⁵⁹

The Measure of Damages

The *Ward* case, then, seems to clarify to some extent the use of a restitutional remedy as an alternative to the usual damage recovery in a tort case. But the net effect may be to give exactly what section 3343 of the Civil Code seems to reject, that is, what the plaintiff would recover under the "benefit of the bargain" rule.

A Flexible Approach

Justice Schauer concurring and dissenting in the *Ward* case raises two important questions both of which he had raised in his dissenting opinion in the *Bagdasarian* decision eleven years before. *First*, Justice Schauer does not agree that the "out of pocket" rule is preferable to the "benefit of the bargain" rule as a measure of damages. He quotes Professor Williston for the proposition that as a practical reason the "out of pocket" rule is unsatisfactory because:⁶⁰

⁵⁸ 325 P.2d at 511.

⁵⁹ RESTATEMENT, RESTITUTION introductory note topic 2, at 596 (1937). See also *Hart v. E. P. Dutton and Co.* 197 Misc. 274, 93 N.Y.S.2d 871, *aff'd* 277 App. Div. 935, 98 N.Y.S.2d 773 (1949), where the plaintiff alleged a libelous book and attempted to waive tort of libel and secure gross profits. The court noted the profit had been secured only by expense and effort by the publisher and the plaintiff would in effect make the publisher the plaintiff's servant during the period the profit was made. See generally Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 244-245 (1910).

⁶⁰ *Ward v. Taggart*, 51 Cal. 2d 736, 745, 336 P.2d 534, 539-540 (1959), quoting 5 WILLISTON, CONTRACTS § 1392 at 3886 (Rev. ed. 1937). Williston's arguments were also noted in *Bag-*

... a fraudulent person can in no event lose anything by his fraud. He runs the chance of making a profit if he successfully carries out his plan and is not afterwards brought to account for it; and if he is brought to account, he will lose nothing by his misconduct.

At the core of his criticism of the "out of pocket" rule is the idea that it makes no allowance for recovery for any expectation interest the injured party may have; that is, in the words of Justice Schauer,⁶¹ "... the loss of the legitimately contemplated profit of the entrepreneur must be borne wholly by the victim, and not at all by the perpetrator, of the fraud. ..."

In connection with this problem Professors Dawson and Palmer have noted⁶² that the difficulties which arise with the use of the "benefit of the bargain" rule are chiefly two; first, there is the practical difficulty of placing a money valuation on the representations which by hypothesis have never existed, and second, it is questionable whether a "contract theory of damages" is appropriate in an action which is based on tort.

In answer to Justice Schauer's argument about profits it has been said that⁶³ "[a] person is not cheated when that which he gets is worth all that he pays for it. ...". It is submitted, however, that what a thing is worth is usually based on its market value and in the market the price paid will often be influenced by the profit motive.

Until 1935 the California courts were flexible in their approach to this problem. The "benefit of the bargain" rule was used in "... clear cases and on just terms."⁶⁴ The courts appeared to have an open mind and stated⁶⁵ "neither rule has proved satisfactory."

dasarian v. Gragnon, 31 Cal. 2d 744, 765, 192 P.2d 935, 947 (1948) and in *Jacobs v. Levin*, 58 Cal. App. 2d Supp. 913, 916, 137 P.2d 500, 501 (1943). *But cf.* *McCORMICK, DAMAGES* 453-454 (1935), where the author states: "The force of this last argument, however, is somewhat weakened by the fact that in most states, exemplary damages may be given by the jury in cases of deliberate or wanton fraud." In this connection see *Thompson v. Modern School of Business and Correspondence*, 183 Cal. 112, 190 Pac. 451 (1920) and CAL. CIV. CODE §§ 1709, 3294.

⁶¹ *Bagdasarian v. Gragnon*, 31 Cal. 2d 744, 765-766, 192 P.2d 935, 947-948 (1948). See also *Fuller & Perdue, The Reliance Interest in Contract Damages*, 46 *YALE L.J.* 52, 57-66; 373, 409-410 (1936-1937).

⁶² *DAWSON & PALMER, CASES ON RESTITUTION* 235 (2d ed. 1958).

⁶³ *Pittsburg L. and T. Co. v. Northern Central Life Ins. Co.*, 140 Fed. 888, 898 (C.C.W.D. Penn. 1905), quoted in *Bagdasarian v. Gragnon*, 31 Cal. 2d 744, 192 P.2d 935 (1948) and in *Jacobs v. Levin*, 58 Cal. App. 2d Supp. 913, 916, 137 P.2d 500, 501 (1943). *Accord*, *Oliver v. Benton*, 92 Cal. App. 2d 853, 856, 208 P.2d 375, 377 (1949), where the court said one hasn't suffered an "out of pocket" loss, "... where a person gets the worth of his money although not all he was promised. The fact he may anticipate more and be falsely led to expect it or that he would have made a profit if the representations had been true does not entitle him to recover for his disappointment in not receiving that to which he was led to expect." See also *RESTATEMENT, TORTS* § 549 comment b. (1934): "... [T]he recipient of a fraudulent misrepresentation is entitled to recover ... only actual loss. ... The fact that he would have made a profit if the representations had been true does not entitle him to recover for his disappointment in not receiving the gain he was led to expect."

⁶⁴ *Hines v. Brode*, 168 Cal. 507, 511, 143 Pac. 729, 730 (1914). See also discussion *Jacobs v. Levin*, 58 Cal. App. 2d 913, 915, 137 P.2d 500, 501 (1943).

⁶⁵ *Jacobs v. Levin*, 58 Cal. App. 2d Supp. 913, 916, 137 P.2d 500, 501 (1943).

In 1935, California by legislative enactment adopted section 3343 of the Civil Code.⁶⁶ This section was interpreted by the California courts as laying down the "out of pocket" rule in this state for fraud and deceit actions.⁶⁷ Whether this was to be the exclusive rule was open to question until the *Bagdasarian* decision in 1948. In that case the Supreme Court reviewed the cases decided since 1935 and says in the majority decision:⁶⁸

It is reasonable to conclude that the statute was enacted to provide a uniform rule for all fraud cases, and we can see no reason for refusing to follow the decisions which have applied it as the exclusive measure of damages. Moreover . . . an additional or alternative measure . . . would create further confusion. . . .

Interpretation of the Statute

The *second* of Justice Schauer's criticisms is directed to the actual interpretation of section 3343 of the Civil Code. He had stated in the *Bagdasarian* decision that he had:⁶⁹

. . . read the whole enactment . . . and the history of the bill in this state . . . (and) we could justifiably hold that the purpose of the legislature was not *prohibitively to substitute* the "out of pocket" rule for the "benefit of the bargain" rule but, rather *permissively to provide* an additional or alternative remedy or measure of damages which might be applied in proper cases.

In the *Ward* case the justice notes that the decision avoids much of the evil effect of the *Bagdasarian* decision, but section 3343 of the Civil Code⁷⁰ ". . . still constitutes more of a shield for, than a sword against fraud perpetration." The solution suggested by the judge is not⁷¹ ". . . ingenious innovation and application of a constructive trust-unjust enrichment-quasi-contractual theory . . .," but rather that the legislature, or perhaps the court by overruling the *Bagdasarian* decision, might provide a remedy. The remedy of which the judge speaks is not one which would do away completely with the out-of-pocket rule but one which would allow the courts to again follow the flexible rule used prior to 1935; that is, use whichever rule the courts think necessary to do justice in the particular situation.

⁶⁶ Added Stats. 1935, ch. 536, § 1, p. 1612. See note 12 *supra*.

⁶⁷ Cases collected CAL. ANNOTATIONS RESTATEMENT TORTS § 549 (1957); *cf.* Gagne v. Bertran, 43 Cal. 2d 481, 275 P.2d 15 (1954), noted 43 CAL. L. REV. 356 (1955).

⁶⁸ 31 Cal. 2d 744, 762, 192 P.2d 935, 946 (1948); *cf.* Gagne v. Bertran, 43 Cal. 2d 481, 275 P.2d 15 (1954), noted 43 CAL. L. REV. 356 (1955), where it is stated that where the action for fraud does not involve the purchase, sale, or exchange of property, CAL. CIV. CODE § 3343 is not the exclusive measure of damages but must be read with CAL. CIV. CODE §§ 1709 and 3333. See also *Bank of America v. Greenbach*, 98 Cal. 2d 220, 240, 219 P.2d 814, 828 (1950), which construes CAL. CIV. CODE § 3343 to apply only to an action for fraud and deceit and not to an action based on rescission which is an equitable remedy.

⁶⁹ 31 Cal. 2d 744, 765, 192 P.2d 935, 947 (1948) (dissenting opinion).

⁷⁰ 51 Cal. 2d at 745, 336 P.2d at 539.

⁷¹ 51 Cal. 2d at 744, 336 P.2d at 539. See also McCORMICK, DAMAGES 454 (1935), who supports the flexible approach.

Conclusion

The *Ward* case has shown the importance of the quasi-contractual recovery as an alternative to tort damages. Although some question can be raised as to the extent of the decision in some respects, it seems clear that the election problem should not be a limitation on the use of such a remedy in California.

It is unfortunate, however, that the case does not also clear up questions which arise where a wrongdoer seeks to deduct his losses from profits gained at the expense of another. A definite rule is needed to guide the courts and lawyers in solving this problem. Such a rule should be consistent with its underlying principle, that is, if the rule is based on unjust enrichment, recovery should not exceed the actual enrichment.

One of the most important aspects of the *Ward* decision is the fact that the court allows an award of exemplary damages. It can be argued that such an award is not logically consistent with the underlying principle of a quasi-contractual remedy. But here, unlike the profit problem discussed *supra*, perhaps we are confronted with a situation where practical necessity requires such an award.

However, the dissent in the *Ward* case pointed out that the court could reach the same result by adopting a flexible approach to the rule for measuring damages in deceit actions. In this regard this writer feels that Justice Schauer's suggestion should receive careful consideration by the courts and legislature.