

1971

Hal E. Holmstead v. Abbott G. M. Diesel, Inc. : Respondent's Brief

Utah Supreme Court

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Recommended Citation

Brief of Respondent, *Holmstead v. Abbott M. Diesel, Inc.*, No. 12257 (Utah Supreme Court, 1971).
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In the Supreme Court of the State of Utah

HAL E. HOLMSTEAD,

Plaintiff and Respondent,

vs.

ABBOTT G. M. DIESEL, INC.

Defendant and Appellant,

Case No.
12257

RESPONDENT'S BRIEF

Appeal from Order of the Fourth District Court
for Utah County
Honorable Joseph E. Nelson, Judge

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FILED

JUN 25 1971

Clerk, Supreme Court, Utah

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HAL E. HOLMSTEAD,

Plaintiff and Respondent,

vs.

ABBOTT G. M. DIESEL, INC.

Defendant and Appellant,

Case No.
12257

BRIEF OF RESPONDENT

NATURE OF CASE

This is an action for damages for personal injuries caused by the negligence of defendant's agent.

DISPOSITION IN LOWER COURT

The trial court denied defendant's Motion for Summary Judgment. Thereafter, this Court granted defendant's Petition for Intermediate Appeal.

RELIEF SOUGHT ON APPEAL

Plaintiff seeks a determination that a covenant not to sue executed in favor of defendant's agent does not release defendant.

STATEMENT OF FACTS

Plaintiff agrees with defendant's statement of facts except for (1) defendant's statement of plaintiff's theory of liability and (2) defendant's conspicuous omission of the circumstances surrounding the execution of the covenant not to sue defendant's agent, Gideon Allen.

Defendant states that, "Plaintiff . . . seeks to hold defendant liable under the doctrine of master and servant or respondent superior. No independent [sic] or active negligence is alleged on the part of" defendant. As plaintiff's argument below will more fully support, it is his position that since defendant, a corporation, can act *only* through its agents, the liability of defendant is not dependent or derivative but primary.

Defendant's silence concerning the circumstances surrounding execution of the covenant not to sue, on the effect of which the outcome of this appeal rests, is disingenuous at best. Since this is an intermediate appeal, there are no facts of record relating to the execution of the covenant beyond the mere fact of its execution. However, in the record of *Holmstead vs. Allen*, Civil No. 34120, which has been included in this record, the court found that the covenant was entered into with the consent and approval of defendant's counsel, that he, as well as plaintiff's counsel, plaintiff, defendant's agent and the latter's insurer all understood and intended that the covenant was to contain an express

reservation of rights against plaintiff. The record in that case further shows that the omission of such a reservation was inadvertant and resulted from a mutual mistake of the parties to the covenant. Defendant's subsequent assertion of the covenant as a defense is an attempt to take belated advantage of that mistake contrary to an understanding among counsel as to the purpose and effect of the covenant.

The facts which defendant will show at the trial (and did show in the case of *Holmstead v. Allen*, are these: During the first several months of 1969, counsel for the plaintiff engaged in a series of negotiations in an effort to settle plaintiff's claim short of litigation. The insurance carrier for defendant's agent, Gideon Allen, indicated a willingness to settle for the limits of Allen's coverage. Negotiations with defendant's counsel and insurance carrier were, however, unsuccessful.

On April 16, 1969, counsel for plaintiff wrote to Fred Smith, casualty adjuster for Gideon Allen's insurance company, to confirm an earlier telephone conversation agreeing to settle for the limits of Allen's coverage. The letter stated:

"In this regard, it would be our intent to reserve our right against Abbott G. M. Diesel and to give a covenant not to sue or execute against your insured."

Plaintiff filed the present action on April 17, 1969. Counsel for defendant requested time to file his answer while he attempted to negotiate a settlement involving the insurance carriers for both defendant and defendant's agent. He was unsuccessful in this effort and so informed plaintiff.

During the period between the filing of this action on April 17, 1969, and the filing of defendant's answer on July 12, 1969, counsel for the parties to this action had several conversations in the course of which Harold G. Christensen, counsel for defendant, recommended, in view of his failure to obtain a settlement, that plaintiff settle separately with Allen and his insurance carrier. (See exhibits, etc., in *Holmstead v. Allen*.) It was understood by both parties to these discussions with defendant's counsel that such settlement would reserve plaintiff's rights against defendant by means of an express reservation in the covenant not to sue.

On July 7, 1969, plaintiff executed a covenant not to sue in favor of Gideon Allen. As evidenced by the letter of April 16, 1969, from plaintiff's counsel to Allen's carrier and pursuant to the understanding reached orally between counsel for plaintiff and defendant, such covenant was intended by the parties thereto to contain an express reservation of plaintiff's rights against defendant. However, through a mutual mistake of fact resulting from a clerical error the reservation was omitted

from the covenant not to sue. Mr. Mel Clement, the adjuster handling the final settlement for Allen's carrier, confirmed the plaintiff's version of the facts surrounding the execution of the covenant. (See letter of December 8, 1969, from Mel Clement, Exhibit 2 in *Holmstead v. Allen.*)

When it later became apparent that counsel for defendant, contrary to the understanding previously arrived at, intended to plead the covenant not to sue in its own defense, plaintiff brought a separate action against Gideon Allen and his insurer to have the covenant not to sue reformed to include a reservation of rights against defendant in conformity with the true intent of the parties. The merits of the action to reform being well known to all concerned, Gideon Allen and his insurer made no attempt to defend and a decree of reformation was entered on default, the effect of which was to include in the covenant a reservation of plaintiff's rights against defendant.

In its brief on appeal, defendant argues that the decree of reformation is not binding upon it because it was not made a party to that action. Although plaintiff regards this contention as wholly without merit, he has filed a subsequent action for reformation of the covenant naming as defendants therein the present defendant and its insurer. It is interesting that defendant resisted vigorously, and successfully, a motion to stay this appeal until a decision is reached in the second action for re-

formation of the covenant, which if heard would make this point on appeal moot.

ARGUMENT

I

DEFENDANT WAS NOT A NECESSARY PARTY TO THE ACTION TO REFORM THE COVENANT NOT TO SUE.

The defendant contends that the decree of reformation, which amended the covenant not to sue by reserving plaintiff's rights against defendant, is not binding on defendant because defendant was not made a party to the action for reformation.

The conditions upon which a person is deemed to have a sufficient interest in the subject matter or outcome of litigation to require that he be made a party thereto are stated in Rule 19, Utah Rules of Civil Procedure, as follows:

“. . . [P]ersons having a joint interest shall be made parties and be joined on the same side as plaintiffs or defendants.”

The rule is, of course, identical with the former Federal Rule 19, concerning which it was held that the purpose of the rule was to adopt the former equity rule that all persons materially interested, either legally or beneficially, in the subject matter of the suit, be made parties to it. *United States v. Petrosky*, 2 F.R.D. 422 (W.D. Mich. 1942)

The question thus becomes one initially of the nature of defendant's alleged interest in the covenant not to sue and secondly of whether such an interest is sufficiently material to require that defendant be made a party to the action for reformation.

It is apparent that if defendant has any interest at all in the covenant it is as some sort of third party beneficiary since defendant is not an immediate party there-to and gave no consideration therefor. It is hornbook law that if such a third party beneficiary is either a "creditor" or a "donee" beneficiary of the contract, that is, one for whose benefit the contract was *intended*, he may sue upon the contract to enforce his rights thereunder.

"As a general proposition, the determining factor as to the rights of a third-party beneficiary is the intention of the parties who actually made the contract. The real test is said to be whether the contracting parties intended that a third person should receive a benefit which might be enforced in the courts." 17 *Am. Jur. 2d* 727, Contracts § 304(1964).

On the other hand, the principle "is not so far extended as to give to a third person who is only indirectly and incidentally benefited by the contract the right to sue upon it." *Ibid.*, § 307.

The leading Utah case of *Kelly v. Richards*, 95 Utah 560, 83 P.2d 731 (1938), is in accord with the foregoing. There it was held that an agreement between stockholders of an automobile dealer and an

automobile manufacturer, whereby the stockholders were to advance certain sums to the dealer and the manufacturer was to grant a distributorship to the dealer, was *intended* for the benefit of the parties and not the dealer and that the receiver of the dealer corporation had no enforceable interest in the agreement even though it would have yielded a substantial benefit to the dealer.

“ . . . [A]n incidental beneficiary has no rights under the contract. . . . [B]efore a third party can sue for a breach of a contract to which he was not a party he must show that the contract was intended to benefit him directly. . . .” 83 P.2d 736.

A more recent case refusing to enforce the interest of an incidental third-party beneficiary is *Mason v. Tooele City*, 484 P.2d 153(1971); *cf. Schwinghammer v. Alexander*, 21 Utah 2d 418, 446 P.2d 414 (1968).

From these authorities it is clear that Rule 19 does not require joinder of an incidental beneficiary in an action between the parties to the contract to terminate or modify their rights and obligations.

“In general, a third party does not become indispensable to an action to terminate a contract simply because its rights or obligations under an entirely separate contract will be *seriously affected* by the termination. Thus, although the setting aside of a lease would make impossible the performance of a contract between the lessee and another, it was held that the third person was only a proper party and could be joined or

not at the option of the plaintiff. Similarly, in a suit by A to declare its obligations under a contract with B as terminated, C, whose obligations to B under another contract and who will be affected by the status of A's obligations, is not an indispensable party." 3*A Moore's Federal Practice* 2349-50, para. 19.10 (1967). (Citing cases; emphasis added.)

Since defendant, as an incidental beneficiary, has no legally enforceable interest in the covenant not to sue, it is apparent that it was not a necessary party to the action to reform the covenant.

It should be pointed out, furthermore, that defendant took no action in reliance on the unreformed covenant which operated to its detriment and that no question of estoppel arises. Defendant is no worse off than if the covenant as originally executed had included the reservation.

It is, therefore, the covenant *as reformed* which determines the respective rights and obligations of the parties.

II

THE DECREE OF REFORMATION WAS VALID AND PROPER.

Defendant attacks the validity of the decree of reformation on the ground that parol evidence is inadmissible to vary the terms of a written instrument.

It is a universally received rule of law, however,

that the parol evidence rule does not apply in cases of mutual mistake. 30 *Am. Jur. 2d* 172, Evidence § 1037 (1967):

“Parol evidence to show such mutual mistake . . . may be introduced in an action in equity to reform the written contract because of the mutual mistake.”

Thus, the fact that a release was entered into through mutual mistake may be shown by parol evidence. *Lion Oil Ref. Co. v. Albritton*, 21 F.2d 280 (8th Cir. 1927).

III

A COVENANT NOT TO SUE AN AGENT WITH EXPRESS RESERVATION OF RIGHTS AGAINST THE CORPORATE PRINCIPAL DOES NOT RELEASE THE CORPORATE PRINCIPAL.

Although it is widely held that a release of one joint tortfeasor releases all, 45 *Am. Jur.* 699, Release § 35 (1943), it is well settled that a mere covenant not to sue has no such effect on those jointly liable, *Ibid.*, § 4:

“By the great weight of authority, a covenant not to sue . . . one joint tort-feasor is held not to amount to a release, and therefore such an agreement is held not to discharge the other joint . . . tort-feasors.” pp. 676-77.

Particularly is this so where there is an express reservation of rights against the other joint tort-feasor.

By statute in Utah (the Uniform Joint Obligations

Act) it is provided that the release of one joint obligator "shall not discharge co-obligors against whom the obligee in writing and as part of the some transaction as the release or discharge expressly reserves his rights . . ." § 15-4-4 U.C.A. (Repl. vol. 1962). Although no Utah case has considered whether section 4 of the Uniform Obligations Act applies to covenants not to sue as well as releases, the Wisconsin courts have so decided on identical language. *State Farm Mut. Auto Ins. Co. v. Continental Gas. Co.*, 264 Wis. 493, 59 N.W. 2d 425 (1953). The Utah statute was held to apply to a covenant not to sue in *United States v. First Security Bank of Utah*, 208 F.2d 424, 42 A.L.R. 2d 951 (10th Cir. 1953).

In light of the foregoing authorities it would seem obvious enough that the covenant not to sue executed in favor of defendant's agent, Gideon Allen, but expressly reserving plaintiff's rights against defendant is effective according to its terms. Defendant contends, however, that the above stated rules apply only in the case of joint tort-feasors, that its liability is merely secondary, arising solely by reason of the doctrine of respondeat superior, and that a covenant not to sue one primarily liable does release one who is secondarily liable, notwithstanding the reservation of rights against the one secondarily liable.

Defendant's position, however, (1) misconceives the nature of a corporation's liability for the acts of its ag-

ents, (2) is inconsistent with the better reasoned authorities and (3) disregards principles of sound statutory construction.

The Constitution of the State of Utah provides that “all corporations . . . shall be subject to be sued, in all courts, in like cases *as natural persons*.” Art. XII, § 4 (Emphasis added.) A corporation is, however, an *artificial* person and can act *only through its agents*. If corporations are to be subject to suit “in all courts, in like cases as natural persons” it follows inexorably, from the language of the Constitution, that corporations must be held *primarily* liable for the acts of their agents. Hypertechnical distinctions between the “primary” liability of an agent and the “secondary” liability of his principal supposed to result from the doctrine of respondeat superior are wholly inappropriate in the context of a corporate principal and its employee. If a corporation is only “secondarily” liable for the acts of its agents one may well ask, when is a corporation “primarily” liable? Indeed, how then are corporations “subject to be sued . . . as natural persons”? The distinction is clearly intolerable both in logic and justice.

For that reason, no doubt, the better reasoned cases give effect to the intention of him who, in executing a covenant not to sue an employee, expressly reserves his rights against the corporate principle. A leading case is *Ellis v. Jewett Rhoades Motor Co.*, 29 Cal. App. 2d 395, 84 P.2d 791 (1938), in which the corporate de-

fendant defended on the ground that a covenant not to sue its employee, whose negligence had caused plaintiff's injuries, released the corporate principle. The court expressly rejected the theory that the covenant not to sue the servant exonerated his master.

Similarly, applying the Uniform Joint Obligations Act, a New York court in *Wilson v. New York*, 131 N.Y. Supp. 2d 47, held that a municipal corporation was liable for an assault by its police officer where the plaintiff had released the latter under an instrument expressly reserving rights against the municipality.

Even in cases where the principal is a natural person some courts have been reluctant to make artificial distinctions between "primary" liability of the agent and "secondary" liability of the principal. Thus in *Boucher v. Thomsen*, 328 Mich. 312, 43 N.W. 2d 866, 20 A.L.R. 2d 1038 (1950), the court held that the owner of an automobile might be liable for the negligence of a garage employee who was testing out the automobile although the plaintiff had agreed not to pursue his rights against the garage and its employee. The court recognized that the car owner might be entitled to reimbursement from the garage owner and his employee, but found that the express language of the covenant left no question as to the intention of the parties, and that their intention was controlling.

And in *Hunt v. Ziegler*, 271 S.W. 936, (Tex. Civ. App.), aff'd. 280 S.W. 546 (Tex. Com. App. 1925) the

court refused to recognize an attempted distinction between joint tort-feasors and master and servant, finding the distinction superficial.

Although the Utah courts have never passed upon the precise issue raised by defendant, the question was answered on Utah law by the Tenth Circuit in *United States v. First Security Bank of Utah*, 208 F.2d 424, 42 A.L.R. 2d 951 (10th Cir. 1953). This was an action under the Federal Tort Claims Act to recover for injuries sustained as a result of the negligence of the driver of a United States mail car. The plaintiffs executed covenants not to sue in favor of the mail carrier, expressly reserving their rights against the government. Holding that plaintiffs' action against the government was not barred by the covenant, the court reasoned as follows:

"It is generally recognized . . . that a covenant not to sue one or more tort-feasors with express reservation of the right to proceed against others does not bar an action against other joint tort-feasors . . . While [a master and servant] may not be joint tort-feasors in the sense that their joint acts caused an injury, *a majority of courts* hold that their liability is joint and several and each is liable to the full extent of the injuries and they may be joined in an action in the same manner as joint tort-feasors. The law of joint tort-feasors relating to releases and covenants not to sue is applicable." 42 A.L.R. 2d 958. (Emphasis added.)

These authorities accord with a fundamental policy of subordinating technical legal doctrine to the clearly expressed and understood intentions of the parties, a policy embodied in the Uniform Joint Obligations Act. Defendant's sophistries, to the effect that it *might* be able to recover over from its employee *if* under Utah law it is regarded as a surety, disregard sound principles of statutory construction.

By statute in Utah legislation in derogation of the common law is to be liberally construed. Section 68-3-2 U.C.A. (Repl. vol. 1968). One must consider, therefore, the policy of the statute. Considerable light is shed on that policy by the following comment at 73 A.L.R. 2d 407-408(1960), criticizing the rule that the release of one joint tort-feasor releases all:

"The rule has been vigorously attacked by law writers. It has been described as merely a 'surviving relic of the Cokian period of metaphysics.' It tends to defeat the fair expectations and intentions of the parties to the release. It may be noted that all but one of the Continental legal systems have flatly rejected the rule. . . .

"The harshness of the original common-law rule has resulted in legislation abrogating the rule. . . . such as the Uniform Joint Obligations Act. . . .

"In the absence of statutory regulation, the modern trend is toward a rule which abrogates the strict comon-law release rule and makes the

intention of the parties to a releast the test of its effect as a release of joint tort-feasors not parties thereto. . . .”

The Uniform Joint Obligations Act has been adopted in Nevada, New York, Utah and Wisconsin. Only New York has considered the effect of Section 4 on a covenant not to sue an agent reserving rights against his principal, holding that the principal is not released thereby. *Wilson v. New York*, 131 N.Y. Supp. 2d 47; *Wilson v. Econom*, 288 N.Y. Supp. 2d 381, 56 Misc. 2d 272.

One could hardly imagine a case better calculated to illustrate the very evils against which the statute and the modern trend of decisions is directed than the present one. If ever there was a resort to “Cokian metaphysics” to “defeat the fair expectations and intentions of the parties” it is defendant’s brief on appeal.

The decision of the Court in this case will forge new law in the state of Utah. Plaintiff urges that the Court follow the modern trend of decisions, as exemplified by *United States v. First Security Bank of Utah*, 208 F.2d 424, 42 A.L.R. 2d 951 (10th Cir. 1953), and give heed to the policy of the Uniform Joint Obligations Act. Defendant suffers nothing but, perhaps, the loss of an unearned advantage from the rule that a covenant not to sue an agent may reserve rights against a principal. A contrary holding would have the harshest of results for plaintiff.

IV

EVEN WITHOUT AN EXPRESS RESERVATION OF RIGHTS AGAINST THE CORPORATE PRINCIPAL A COVENANT NOT TO SUE AN AGENT DOES NOT RELEASE THE CORPORATE PRINCIPAL.

If the Court should decide that the decree of reformation is not binding on defendant, it is plaintiff's position that even without the reservation of plaintiff's rights against defendant the covenant not to sue does not release defendant.

As argued above, Point III:

“By the great weight of authority, a covenant not to sue . . . one joint tort-feasor is held not to amount to a release, and therefore such an agreement is held not to discharge the other joint . . . tort-feasors.” 45 *Am. Jur.* 676-77, Release § 4 (1943).

To hold otherwise in this case the Court would have to employ the discredited distinction between “primary” and “secondary” liability of a corporation and its agents, respectively. For the reasons set forth in his argument under Point III, above, plaintiff urges the Court not to do so.

Valuable authority is found in the recent Nevada case, *Whittlesea v. Farmer*, 469 P.2d 57, (Nev. 1970), in which the court, observing the similarity between a covenant not to sue and a covenant not to execute, held that a covenant not to execute in favor of one joint tort-feasor did not release a second joint tort-feasor even

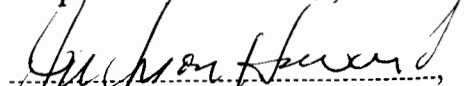
though plaintiff's rights against the latter were not expressly reserved.

CONCLUSION

The covenant not to sue executed by plaintiff in favor of defendant's employee was validly reformed to include an inadvertantly and mistakenly omitted reservation of plaintiff's rights against defendant. By the better view, that reservation is effective according to the intent of the parties. Furthermore, defendant was aware of that intention and led plaintiff to believe that it would defend on the merits of the case. Even if it should be held that the reservation is invalid as against defendant, the modern view is that a covenant not to sue operates only in favor of the parties thereto and cannot be asserted by one who is jointly liable notwithstanding the absence of an express reservation of rights against him.

Plaintiff requests that this case be returned to the district court for trial on the merits.

Respectfully submitted,



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