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Supreme Court No. S

SUPREME COURT
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IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

VILLAGE NORTHRIDGE HOMEOWNERS ASSOCIATION
Plaintiff and Appellant,
v.
STATE FARM FIRE AND CASUALTY COMPANY,
Defendant and Respondent.

REVIEW AFTER A DECISION BY THE COURT OF APPEAL
SECOND DISTRICT, DIVISION EIGHT, 2ND CIV. NO. B188718
LOS ANGELES COUNTY SUPERIOR COURT NO. BC265328

PETITION FOR REVIEW

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ISSUES PRESENTED FOR REVIEW

This petition seeks review of a published Court of Appeal decision that threatens to erase 80 years of settled California law on the manner in which a party may avoid a written settlement agreement. The clarity of prior California law, undone by the Court of Appeal's opinion, compels review by this Court.

In 1920, this Court held that a party seeking to avoid a settlement agreement on grounds of fraud must rescind that agreement and return the consideration paid, as required by Civil Code section 1691. (*Garcia v.*

California Truck Co. (1920) 183 Cal. 767, 769-773 (*Garcia*).) Nine years later, this Court held that a party cannot avoid the obligation to return the consideration by "affirming" the settlement agreement and seeking damages for fraud. (*Taylor v. Hopper* (1929) 207 Cal. 102, 103-105 (*Taylor*).)

Here, the Court of Appeal held that, notwithstanding *Garcia* and *Taylor*, a plaintiff can avoid the release in a settlement agreement and sue for fraud by "affirming" the very agreement it chooses to invalidate, and at the same time, keep the settlement proceeds. The manifest injustice of this holding is apparent: the plaintiff retains the consideration paid for an empty promise (not to sue) and the defendant is deprived of both the benefit of the bargain and the money paid to obtain it.

Therefore, the issues presented for review are:

Did the Court of Appeal err in refusing to follow established precedents of this Court, *Garcia* and *Taylor*? Or, as the Court of Appeal held, do *Garcia* and *Taylor* only apply to settlements of personal injury claims?

WHY REVIEW SHOULD BE GRANTED

Finality of civil settlements is just as important to our justice system now as it was 80 years ago. For those 80 years in California, a party who desired to avoid the terms of a release in a settlement agreement based on

fraud had to rescind, return the consideration, and place the parties in the position they enjoyed prior to entering into the agreement. The Court of Appeal created an exception to that rule, eliminating the certainty and finality of civil settlement agreements. That "exception" will fundamentally change the way in which all non-personal injury claims in this State will be resolved in the future.

Every year thousands of disputes settle with written agreements legally identical to the one here. Those disputes involve the gamut of contestable issues, including personal injuries, employment rights, civil rights, contracts, copyrights, domestic rights, property rights and many others. Regardless of the type of claim and whether the dispute is settled before or after a lawsuit is filed, the desires of the parties are generally the same: the plaintiff wants money and the defendant wants to avoid or end litigation. Whether the defendant believes its liability exposure is zero or 100%, or its damage exposure is $1 or millions of dollars, it pays money for a release and waiver of known and unknown claims under Civil Code section 1542.

If the plaintiff believes it was defrauded into entering into a settlement agreement and "wants out" of the settlement agreement, *Garcia* and *Taylor* require that the consideration must be returned and the settlement agreement rescinded. As Justice Cardozo has written, a plaintiff

"may not litigate his claim for damages while clinging to the fruits of the contract he affects to disaffirm." (*Brassel v. Electric Welding Co.* (N.Y. 1924) 145 N.E. 745, 746 [Cardozo, J.].)

The Court of Appeal dramatically changed these rules for all non-personal injury cases. Relying on "policy" issues that should easily apply to *every* settlement, whether for a personal injury claim or not, the court adopted a new rule of law: parties represented by counsel can enter into a fully integrated settlement agreement with a written waiver of Civil Code section 1542. The defendant pays the plaintiff money in exchange, only, for a release. If the plaintiff later claims to learn something new, the plaintiff can simply ignore the release, sue the defendant for fraud, base its damages upon the very same claims that were released, and at the same time, keep every dollar of the settlement money! The settlement amount now becomes the "floor" for the plaintiff's damages. In the meantime, the defendant is deprived of its money and the one thing it was supposed to receive from the settlement: freedom from being sued. Moreover, the Court of Appeal explicitly held that even if the trier of fact ultimately concludes that the defendant would have prevailed on the underlying settled disputed claim, the plaintiff gets to keep the windfall! (Typed opn. at pp. 10-11, fn. 4.)

According to the Court of Appeal, *Garcia* and *Taylor* "apply only to the release of personal injury claims…" (Typed opn. at p. 2.) Remarkably,

the Court of Appeal's published decision did not cite a single California case to support that conclusion. In fact, at least two published decisions have recognized that the *Garcia/Taylor* principles apply to non-personal injury disputes.[1] The refusal to follow *Garcia* and *Taylor* because those cases involved disputed personal injury claims is an artificial distinction having no legal significance. Whether the underlying dispute is for personal injury, defamation, wrongful termination, breach of contract, property settlement agreement, or an insurance dispute, a defendant pays money to settle a *disputed* claim and "buy its peace." "Compromises of claims are often made on the basis of buying peace and prove no more than that a dispute existed." (*Cilibrasi v. Reiter* (1951) 103 Cal.App.2d 397, 399.) There is no principled reason why the settlement of a disputed automobile accident should be governed by one set of rules, but the settlement of a disputed defamation claim governed by an entirely different set of rules.

The Court of Appeal justified its ruling because the dispute in this case allegedly centered around the *amount* of money State Farm owed the plaintiff. (Typed opn. at pp. 8-9.) However, *Garcia* clearly applies to disputes over the *amount* of money owed: "where the claim is for

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[1] (*Larsen v. Johannes* (1970) 7 Cal.App.3d 491, 503 [claim against architect for professional services rendered]; *Sime v. Malouf* (1949) 95 Cal.App.2d 82, 110-111 [claim against stock broker arising out of bond purchase].)

unliquidated damages or when the settlement is made to adjust a matter in dispute, ***or where there is a controversy as to the amount owing***, and the parties agree upon a sum that shall be paid in settlement, the amount so paid must be returned if the party settled with seeks to avoid the settlement on the ground of fraud." (*Garcia*, *supra*, 183 Cal. at p. 772, emphasis added, citations omitted.) The Court of Appeal committed plain error by concluding otherwise.

Review by this Court is needed so that all parties in California who wish to settle their disputes know the "ground rules." Do *Garcia* and *Taylor* apply to *all* settlements, as was the case for the last 80-plus years, or do exceptions exist, as the Court of Appeal ruled?

Review is warranted to "settle an important question of law" and is further justified to avoid the numerous conflicts among published opinions created by the Court of Appeal, including:

Garcia and *Taylor*: The Court of Appeal's decision is directly contrary to *Garcia* and *Taylor*, which pronounced rules applicable to *all* settlement agreements, not simply to the settlement of personal injury claims. It is also contrary to numerous published cases over the past eight decades that have diligently followed *Garcia* and/or *Taylor*.[2] The gravamen

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[2] (*Larsen v. Johannes*, *supra*, 7 Cal.App.3d at p. 503 ["Without rescission, and restoration of benefits received, a party may not avoid such a contract, including the release. The contract of settlement may not be
(continued...)

of the Court of Appeal's decision is that *Garcia* and *Taylor* apply only to personal injury cases. Yet at least two published Court of Appeal decisions have applied the *Garcia/Taylor* principles to non-personal injury cases.[3]

Rescission without rescinding: In *Rosenthal v. Great Western Fin. Securities Corp*. (1996) 14 Cal.4th 394, 415 [Werdegar, J.], this Court held that if a party believes it has been fraudulently induced to enter into a contract, "in order to *escape from its obligations* the aggrieved party *must rescind*." (Italics added.) Under the plain language of Civil Code section 1691, rescission requires the return of consideration. (*Lloyd v. Williams* (1964) 227 Cal.App.2d 646, 649 ["The return of benefits under an express contact is a condition precedent to an action for rescission."].) The Court of Appeal's opinion provides a plaintiff with all of the benefits of rescission, without the requirement of return of the consideration, in violation of the principle that "he who takes the benefit must bear the burden." (Civ. Code

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[2](...continued)
rescinded partially"]; *Sime v. Malouf, supra*, 95 Cal.App.2d at pp. 110-111 ["He cannot retain the benefits of the release and sue, for to sue would violate the terms of his bargain. To hold otherwise would frustrate the very purpose of the release and destroy its effectiveness as a favored device for eliminating litigation. Hence rescission is necessary; and may be effectively accomplished only by returning the entire consideration received, for if plaintiff should fail to establish his cause of action, he would not be entitled to retain anything. The rule in such circumstances appears to be well settled."]; *Cilibrasi v. Reiter, supra*, 103 Cal.App.2d at pp. 399-400; *Montes v. Peck, supra*, 112 Cal.App. at p. 340; *Winstanley v. Ackerman* (1930) 110 Cal.App. 641, 645.)

[3] *See* footnote 1.

§ 3521.) The Court of Appeal's ruling also violates the rule against partial rescission, permitting Village Northridge to keep all the benefits of the settlement agreement but rescinding all its obligations. (*IMO Development Corp. v. Dow Corning Corp.* (1982) 135 Cal.App.3d 451, 458 [discussing rule against partial rescission].)

Partial "affirmation" of a contract: The Court of Appeal held that Village Northridge was permitted to "affirm" the settlement agreement and sue for fraud, notwithstanding the release in the settlement agreement. (Typed opn. at pp. 6-7.) This is inconsistent with *Garcia/Taylor* and is also inconsistent with cases holding that when a party "affirms" an agreement, they "affirm[] it wholly." (*Hickman v. Johnson* (1918) 36 Cal.App. 342, 348; *see also Bagdasarian v. Gragnon* (1948) 31 Cal.2d 744, 750-751; *McCauley v. Dennis* (1963) 220 Cal.App.2d 627, 633 ["In affirming he is required to accept the burdens as well as the benefits of the contract"]; *Gluskin v. Lehrfeld* (1955) 134 Cal.App.2d 804, 811 ["Plaintiff affirmed the contract of purchase with knowledge of the fraud and therefore consented to be bound by the terms of the agreement"].)

Speculative Damages: Perhaps as remarkable as its exceptional holding, is the Court of Appeal's enunciation of the remedy: The damages will be determined by "what the claim was worth and whether the [plaintiff] would have compromised a claim of that value" and "would be calculated

based on the amount for which the parties would reasonably have settled had the [plaintiff] known the actual policy limits." (Typed opn. at p. 14.) The vagaries of such an analysis are exactly the basis of this Court's holding in *Taylor* – allowing a trier of fact to attempt to divine what one party *would have* offered and another party *would have* accepted in a *post hoc* analysis years later. *Taylor* was followed by this Court on this point in 1998 in *Cedars-Sinai Med. Ctr. v. Superior Court* (1998) 18 Cal.4th 1, 14-15 [Kennard, J.] Without any basis, the Court of Appeal held that this approach would be easier in non-personal injury cases than in a personal injury case. (Typed opn. at pp. 13-14.) The Court of Appeal's pronouncement of damages for this newly-created remedy is wholly speculative and contrary to this Court's pronouncements in numerous cases, including *Taylor*, *Cedars-Sinai Med. Ctr. v. Superior Court, supra*, 18 Cal.4th at pp. 14-15, *Viner v. Sweet* (2003) 30 Cal.4th 1232, 1241 [Kennard, J.], and *Wiley v. County of San Diego* (1998) 19 Cal.4th 532, 544 ["The mental gymnastics required to reach an intelligent verdict would be difficult to comprehend much less execute."].

Waiver of Civil Code section 1542: The settlement agreement contains a written waiver of Civil Code section 1542, a standard provision for every settlement agreement in this State (whether for a personal injury claim or not). A waiver of Civil Code section 1542 is essentially a risk-

shifting mechanism, wherein the plaintiff assumes the risk that it will "discover" new facts or claims in the future, in exchange for the consideration it receives under the settlement. The Court of Appeal's decision, if not reversed, would mean that there could never be a valid waiver of Civil Code section 1542. However, numerous published decisions have held that this provision can be waived. (*San Diego Hospice v. County of San Diego* (1995) 31 Cal.App.4th 1048, 1053-1054; *Winet v. Price* (1992) 4 Cal.App.4th 1159, 1170-1172; *Larsen v. Johannes, supra*, 7 Cal.App.3d at p. 504.) Moreover, waivers of Section 1542 are expressly permitted by the Insurance Regulations. (Cal. Code Regs., tit. 10, §§ 2695.4(e)(2), 2695.7(h).)

Lastly, there is *stare decisis*. The Court of Appeal in this case declined to follow *Garcia* and *Taylor* based upon a *factual difference,* and in doing so failed to follow the *legal holdings* in those cases. The factual distinction between the settlement of disputed personal injury claims and disputed non-personal injury claims is artificial. In both types of cases, the defendant pays money to avoid or end litigation and for a release. There is no meaningful distinction between the settlement of a disputed car accident, a disputed defamation claim, or a disputed wrongful termination case. Moreover the *legal* basis for the Court of Appeal's distinction – that the dispute in this case was over the *amount* of money State Farm owed the

plaintiff – was expressly rejected by *Garcia.* (*Garcia, supra*, 183 Cal. at p. 772 [rule applies "where there is a controversy as to the amount owing"].) Indeed, particularly in personal injury cases, rear-end collisions being a primary example, the dispute is solely over the amount of damages, not liability.

It has been 46 years since this Court's seminal pronouncements on *stare decisis* in *Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450. Further guidance from this Court is necessary to articulate the principles by which a lower court may deviate from one of this Court's decisions.

Accordingly, review by this Court is needed to address the multitude of issues raised by the Court of Appeal's published decision.

FACTUAL AND PROCEDURAL HISTORY

Until the Court of Appeal's published decision,[4] this was a rather unremarkable dispute between an insurer and an insured over just one issue: the amount of the insured's loss. State Farm adjusted the plaintiff's claim twice, paying approximately $2 million for damage caused by the 1994 Northridge earthquake. Nonetheless, in 1998 the plaintiff claimed that it

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[4] The Court of Appeal's opinion omitted numerous relevant facts. State Farm petitioned for rehearing raising these omissions and, thus, the issues have been reserved for review. (Cal. Rules of Court, rule 8.500(c)(2).)

was entitled to more policy benefits and retained counsel and a public adjuster. Plaintiff's counsel and State Farm negotiated a standard settlement agreement wherein State Farm agreed to pay an additional $1.5 million in exchange for a release and a waiver of Civil Code section 1542.

A. Second Amended Complaint and Trial Court's Ruling.

The operative pleading is the second amended complaint ("SAC") filed by Plaintiff/Appellant Village Northridge Homeowners Association ("Village Northridge"). (6AA 1260-1315.) The SAC alleges three causes of action: (1) breach of contract; (2) breach of the implied covenant; and (3) fraud in the inducement of the settlement agreement. The policy attached to the SAC only includes the first page of the declarations page, which states "other limits may apply - refer to your policy." (6AA 1275.) (As with its prior pleadings, Village Northridge did not attach the backside or second page of the declarations page, or the separate endorsement, where earthquake policy limits would normally be shown.)[5]

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[5] The amount of the Section I limit does not dictate the limits for earthquake coverage. The earthquake limit was frequently shown on another section of the declarations page, the portion not provided by Village Northridge, or as part of an endorsement. State Farm was unique in the insurance industry by allowing policyholders to buy earthquake coverage in amounts lower than the limit applicable to the fire or "all risk" coverage. Because the earthquake deductible was at minimum 10% of the policy limit, an insured could reduce the deductible and the premium by buying less earthquake coverage. Here, Village Northridge elected to purchase exactly $5 million in earthquake coverage – $4,974,900 applicable to the buildings

(continued...)

The SAC alleged that following the Northridge earthquake, State Farm adjusted the claim and determined the damage to be $2,558,087. (6AA 1264-1265, ¶ 17.) State Farm allegedly "misrepresented" that Village Northridge "only" had $4,974,900 in earthquake coverage with a 10% ($497,490) deductible. (6AA 1264, ¶ 16.) In July 1995, State Farm paid Village Northridge $2,060,591.97 (the $2,558,087 loss, less the $497,490 deductible). (6AA 1265, ¶ 17.)

In April 1996, Village Northridge contacted State Farm and requested that its claim be reopened. State Farm agreed and, after inspection, paid an additional $7,466.34. (6AA 1265, ¶ 19.) State Farm did not request a release while adjusting the claim twice and paying approximately $2 million. State Farm only requested a release to resolve the parties' later dispute, as permitted by the Insurance Regulations. (Cal. Code Regs., tit. 10, §§ 2695.4(e)(2), 2695.7(h).)

In 1998, Village Northridge again requested that its claim be reopened and State Farm again agreed. (6AA 1265, ¶¶ 20-21.) State Farm disputed that any additional monies were owed. (6AA 1265, ¶ 21.)

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[5](...continued)
and $25,100 applicable to personal property and other structures, while it insured its buildings for fire and other perils for much higher policy limits.

The SAC specifically alleges the existence of the parties' settlement agreement. (6AA 1266-1267.)[6] The settlement agreement is typical of any release entered into between parties (whether for personal injury or not) who choose to settle a dispute. The settlement agreement is not a complex document reflecting the terms of the business agreement, nor does it involve the sale of anything. Its sole purpose is to end a dispute by the payment of money in exchange for the avoidance of a lawsuit.

The settlement agreement recites that State Farm had already paid $2,058,112.39, that "a dispute arose between the Association and State Farm" and further that the parties "are desirous of settling all disputes, differences and disagreements arising out of the adjustment of the Earthquake claim which now exist between the Association and State Farm, relating to any claims in contract, tort, or otherwise...and any and all claims, known or unknown arising out of the earthquake and the adjustment, presentation, handling and/or resolution of the Association's Earthquake Claim with State Farm." (6AA 1355-1356.)

The release requires Village Northridge to unconditionally release and discharge State Farm from any and all claims in any way related to the Northridge earthquake and includes a waiver of Civil Code section 1542. In exchange for a payment of $1.5 million, Village Northridge agreed to

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[6] Therefore, the settlement agreement may be considered on demurrer. (*Breneric Associates v. City of Del Mar* (1998) 69 Cal.App.4th 166, 180.)

"forever refrain and forebear from commencing, instituting, or prosecuting any lawsuit...against State Farm based on, arising out of, or in connection with any claims...and damages that are released and discharged in Paragraph 1 of this Agreement." (6AA 1357-1358, ¶¶ 3-4.)

The settlement agreement states that the parties agreed to the settlement "solely to resolve disputed and uncertain claims and to avoid the expense, inconvenience, and uncertainty of further litigation and that none of the parties to this Agreement admit to any allegations made...or to any violations of any law, rule, contract...or any liability..." The agreement specifically states it was "negotiated at arms' length between persons knowledgeable in the matters dealt with" and that each of the parties was represented by independent counsel. The agreement notes that it represents the entire agreement and there are "no promises, representations or other agreements or understandings between the parties on the subject matter hereof other than those set forth herein." (6AA 1359-1361, ¶¶ 8, 11-12.) Pursuant to Rule 8.504(e)(1)(B), a copy of the settlement agreement is attached hereto as Exhibit A.

The SAC acknowledges that Village Northridge was represented by counsel in connection with the settlement agreement. (6AA 1266.) The SAC acknowledges receipt of the $1.5 million from the settlement agreement (in addition to the $2-plus million previously paid) and alleges

that Village Northridge is "not offering to return the $1,500,000 to State Farm and offers zero apologies for the same." The SAC also alleges that Village Northridge was not rescinding the settlement agreement and, instead "affirms the release (more accurately, acknowledges its existence)." (6AA 1266-1267, ¶ 26.)

Village Northridge alleged that it actually had $11,905,500 in earthquake coverage, with a 10% deductible. (6AA 1264, ¶ 16.) If this was the applicable limit, the deductible would have been $1,190,550. The use of the lower deductible resulted in a $693,060 larger payment being made to Village Northridge.

State Farm filed a demurrer raising the failure to rescind and return the consideration. (6AA 1317-1350.) Village Northridge filed an opposition conceding that it was not rescinding. (7AA 1558-1575.) Village Northridge's opposition admitted that its "fraud" damages were nothing other than the very same Northridge earthquake claims which were released in the settlement agreement. (7AA 1572:17-1573:6 ["Under this scenario [affirm and sue] the ***plaintiff will seek damages for the fraud in the very same amount of policy benefits to which it was deprived***, less a credit for amounts paid," emphasis added].)

The trial court ruled as follows:

> Demurrer sustained without leave to amend. Only minor changes were made to the complaint. Plaintiff chooses to

> affirm the settlement agreement, keep the settlement money paid by State Farm for a release of all claim, but choose not to release the claims. They can't have it both ways.[7]

(RT C-2; 8AA 1964-1968.)

B. The Court of Appeal's Decision.

The Court of Appeal reversed (for the second time[8]) in a published decision, a copy of which is attached hereto as Exhibit B. The court stated that it reached its decision "not without difficulty." (Typed opn. at p. 6.) The gravamen of the court's holding was that *Garcia/Taylor* "only apply to the release of personal injury claims." (Typed opn. at p. 2; *see also id.* at p. 6 ["The first is the *Garcia* principle: that a plaintiff in a personal injury case cannot avoid a fraudulently induced contract of release without rescinding the contract and restoring the money paid as consideration for the release"]; p. 12 ["we cannot and do not question the continuing vitality of *Garcia* and *Taylor* as controlling statements of California law governing contracts of release in personal injury cases"].)

The court declined to follow *Garcia/Taylor* because in this case there was no dispute that State Farm owed Village Northridge "some

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[7] When read in context, the trial judge's ruling meant that Village Northridge cannot keep the settlement money and then sue for the very same claims that were released. The "can't have it both ways" comment is exactly as one court has phrased the issue. (*Taylor v. Federal Kemper Ins. Co.* (D.Ark. 1982) 534 F.Supp. 196, 199.)

[8] The Court of Appeal previously reversed the granting of summary judgment in an appeal addressing different issues.

amount of money for earthquake damages" although the parties disputed the amount. (Typed opn. at pp. 8-9.) However, the settlement agreement clearly states that the entire $1.5 million was being paid to settle a *disputed* claim (6AA 1437, 1441-1442, ¶ 8), and this distinction is squarely foreclosed by *Garcia*. (*Garcia*, *supra*, 183 Cal. at p. 772 [rule applies "where there is a controversy as to the amount owing"].)

The court further held that even if the trier of fact ultimately agrees with State Farm as to the merits of the underlying dispute, Village Northridge would be entitled to keep the overpayment, which would be approximately $4 million. (Typed opn. at pp. 10-11, fn. 4.)

The court justified its decision based upon "policy considerations . . . illustrated in a line of out-of-state cases." (Typed opn. at p. 11-13.) In doing so, the court gave the incorrect impression that these non-California cases represented the "majority" view, even though State Farm's respondent's brief demonstrated otherwise. (Typed opn. at p. 12; Respondent's Brief at pp. 37-43; *see infra* at pp. 28-29.)

State Farm filed a petition for rehearing and in response the Court of Appeal issued a modification to its opinion, holding that the first and second causes of action should be dismissed. A copy of this modification is attached as Exhibit C. Although the rehearing petition was otherwise denied, this modification effected a change in judgment. The court

summarily denied a subsequent request for modification by order dated January 25, 2008, a copy of which is attached hereto as Exhibit D.

LEGAL DISCUSSION

I. THIS COURT SHOULD REAFFIRM THAT *GARCIA* AND *TAYLOR* REMAIN VALID STATEMENTS OF CALIFORNIA LAW FOR *ALL* SETTLEMENT AGREEMENTS.

A. *Garcia* and *Taylor*.

If a party believes it has been fraudulently induced to enter into a contract, "in order to *escape from its obligations* the aggrieved party *must rescind*." (*Rosenthal v. Great Western Fin. Securities Corp., supra*, 14 Cal.4th at p. 415, italics added.)

> In the usual case of fraud, where the promisor knows what he is signing but his consent is induced by fraud, mutual assent is present and a contract is formed, which, by reason of the fraud, is voidable. *In order to **escape from its obligations** the aggrieved party must rescind, by prompt notice and offer to restore the consideration received, if any.*

(*Ford v. Shearson Lehman American Express, Inc.* (1986) 180 Cal.App.3d 1011, 1028, emphasis added.) In the SAC there are no allegations of fraud *in factum*, that is fraud in the execution of the agreement. (6AA 1260-1315.) The SAC alleges only fraud in the inducement. (6AA 1266-1267, ¶ 26; 1272, ¶ 46.)

The settlement agreement obligates Village Northridge to release its claims against State Farm and it covenants not to sue State Farm regarding the Northridge earthquake. (1AA 28, ¶ 1; 30 ¶ 4.) Therefore, if Village Northridge wants to "escape" from these contractual obligations, it "must rescind." (*Rosenthal v. Great Western Fin. Securities Corp., supra*, 14 Cal.4th at p. 415.)

The genesis of this rule is *Garcia*. In *Garcia*, the plaintiff sustained personal injuries and the defendant paid $350 in exchange for a release of all claims arising out of the accident. (*Garcia, supra*, 183 Cal. at p. 768.) Notwithstanding the release, the plaintiff sued, alleging personal injuries from the accident and claimed he was fraudulently induced to enter into the release. Like Village Northridge, the plaintiff did not rescind. (*Id.* at p. 769.)

This Court rejected plaintiff's claim and held that the plaintiff could not proceed with his claims without rescinding the release agreement. If there was fraudulent inducement which rendered the release voidable, "rescission was essential to its extinguishment and there could be no rescission without restoration of the consideration." (*Garcia, supra*, 183 Cal. at p. 769.)

Garcia specifically rejected the Court of Appeal's holding (Typed opn. at pp. 8-9) that a party can keep the money paid in exchange for a

release and still sue for fraud because it claims an entitlement to *some portion* the settlement money. This Court noted that prior to the settlement agreement, the plaintiff in *Garcia* simply had a disputed, unliquidated claim for damages which was released in exchange for $350. The plaintiff's remedy was to rescind the release and re-tender the consideration, which would revive the disputed claim for damages. But the money was "not his in any event," but was paid only in exchange for the release. (*Garcia, supra*, 183 Cal. at pp. 772-773.)

> where the claim is for unliquidated damages or when the settlement is made to adjust a matter in dispute, ***or where there is a controversy as to the amount owing, and the parties agree upon a sum that shall be paid in settlement, the amount so paid must be returned if the party settled*** with seeks to avoid the settlement on the ground of fraud. Where there is no dispute as to the sum due and the creditor is induced by fraud to accept a less amount than his whole debt, he may attack the settlement without returning what he has received.
>
> . . . .
>
> It seems clear to us that the rule relied on [that the plaintiff was owed the money any way] has no application to such a case as this, and that if in this case there was a voidable contract of release as distinguished from a contract void ab initio, *plaintiff could not avoid the same on the ground of fraudulent representations without rescinding promptly upon the discovery of the fraud and restoring the money paid as a consideration.*

(*Ibid.*, emphasis added.)

Village Northridge is in precisely the same position as the plaintiff in *Garcia*: it had an unliquidated and *disputed* claim for damages, which was resolved by an arms-length settlement agreement.[9]

Nine years after *Garcia*, this Court decided *Taylor*. In that case, the plaintiff advanced, and this Court rejected, the identical argument adopted by the Court of Appeal here. Taylor sought to avoid the consequences of the release by claiming that he was "affirming" the settlement agreement and suing for damages, rather than seeking rescission.

> If the complaint be considered as one for rescission of the compromise agreement, it clearly does not state a cause of action, for there are no allegations of a return of the consideration received, as required by section 1691 of the Civil Code of this state. *Appellant, appreciating this difficulty, contends that the complaint is not one for the equitable remedy of rescission, but for damages for fraud and that plaintiff is entitled to affirm the compromise agreement,*

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[9] In this respect, the Court of Appeal's opinion is inconsistent. On pages 8-9 of the Typed opinion, the court correctly states that Village Northridge's claim was disputed as to the *amount* owing and that "State Farm was willing to pay $1.5 million to settle that obligation." Later on page 9, the court reiterates that the $1.5 million "was disputed by State Farm and it may be that [Village Northridge] is not entitled to the entire amount." However, in the very next sentence, the Court of Appeal incorrectly states that Village Northridge was "entitled to at least some portion of that amount," presumably referencing the $1.5 million settlement. That statement is simply incorrect, has no basis in the record, and is contrary to the multiple recitals in the settlement agreement that the parties were settling a "disputed" claim. (6AA 1437-1438, 1441-1442, ¶ 8.) These recitals are binding under Evidence Code section 622 (*Plaza Freeway Ltd. Partnership v. First Mountain Bank* (2000) 81 Cal.App.4th 616, 621-622, 629), unless the settlement agreement was rescinded. (*Estate of Wilson* (1976) 64 Cal.App.3d 786, 801.)

> *retaining the money received thereunder, and sue for her damages caused by the fraud.*

(*Taylor, supra,* 207 Cal. at p. 103, italics added.)

This Court rejected the plaintiff's contention. (*Id.* at pp. 103-105.) This Court held that such a claim could not proceed because of the inherent speculation in proving such a claim. (*Id.* at p. 103.) This Court concluded: "The compromise made in the case before us was of a disputed claim, unliquidated in amount and there is no practicable measure of damages for the action sought to be maintained. The demurrer, therefore, was properly sustained without leave to amend." (*Id.* at p. 105.)

B. The Court of Appeal Erred In Refusing To Follow *Garcia* and *Taylor*.

The Court of Appeal committed plain error by refusing to follow *Garcia* and *Taylor*. Its factual distinction – that *Garcia* and *Taylor* involved personal injury claims – is an artificial distinction, having no legal significance. There is no legal distinction between disputed, unliquidated property damage and personal injury damage. The only other distinction relied upon by the Court of Appeal – that the *amount* of the claim was disputed by the parties (Typed opn. at pp. 8-9) – is squarely foreclosed by *Garcia*. (*Garcia*, *supra*, 183 Cal. at p. 772 [rule applies "where there is a controversy as to the amount owing"].)

Therefore, the Court of Appeal committed plain error which should be reversed.

C. California Should Continue To Follow The True "Majority" Rule, Exemplified By *Garcia* and *Taylor.*

At no point in these proceedings has either Village Northridge or the Court of Appeal suggested that *Garcia* and *Taylor* should be overturned. And with good reason.

Garcia and *Taylor* are not archaic decisions. They represent the fundamental basis upon which *all* civil disputes in this State have been settled over the last 80 years. Prior to the Court of Appeal's decision, no published California decision even remotely criticized *Garcia* or *Taylor*. Indeed, this Court cited *Taylor* with approval and followed its reasoning – specifically with respect to the rule against asserting tort causes of action based on speculative damages – in 1998 in *Cedars-Sinai Med. Ctr. v. Superior Court, supra*, 18 Cal.4th at pp. 14-15. Numerous other California decisions have followed *Garcia* and/or *Taylor.*[10] Witkin is in agreement. (1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 297, p. 324.)

Garcia and *Taylor* comport with common sense and the strong policy in favor of settlement. Every plaintiff may later develop "buyer's remorse." If a plaintiff can settle a disputed claim, keep the money paid, and then sue anyway, no defendant would settle a disputed claim. The "law

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[10] *See* footnote 2, *supra.*

favors settlement" (*Bush v. Superior Court* (1992) 10 Cal.App.4th 1374, 1382, 1385) and "compromises of claims are often made on the basis of buying peace and prove no more than that a dispute existed." (*Cilibrasi v. Reiter, supra*, 103 Cal.App.2d at p. 399.) If the Court of Appeal's decision is not reversed, then all settlements of actual or threatened litigation can be rendered meaningless.[11]

The Court of Appeal's opinion failed to take into account the important differences between the settlement of a *disputed* claim and the purchase/sale of a *res*. In the latter situation, fraud in the inducement allows the party to elect to rescind or affirm the agreement and sue for damages caused by the misrepresentation. In a rescission, the buyer returns the property and the seller must return the money. Rescission returns the parties to the *status quo ante*. The parties can then do whatever they could have done before that agreement was reached. If, however, the allegedly defrauded party elects to affirm and keep the property, it can then sue for damage as measured by the cost to repair the condition misrepresented by

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[11] The Court of Appeal's decision also creates an unusual anomaly. If an alleged misrepresentation of policy limits (as opposed to the existence of an insurance policy) were made in response to discovery, it would not be actionable under Civil Code section 47. (*Morales v. Cooperative of Am. Physicians, Inc.* (9th Cir. 1999) 180 F.3d 1060, 1063-1064; *Home Ins. Co. v. Zurich Ins. Co.* (2002) 96 Cal.App.4th 17, 25-26.) Similarly, if the alleged misrepresentation occurred during a mediation, then the absolute nature of the mediation confidentiality statutes (Evid. Code § 1115, *et seq.*) would render that claim non-actionable. (*Wimsatt v. Superior Court* (2007) 152 Cal.App.4th 137, 163.)

the seller. This is common when the amount in controversy is small compared to the overall value of the transaction.

But the sale of a *res* – a thing – is not analogous to the release of a disputed claim. This is where the Court of Appeal's analysis fails.[12] (Typed opn. at p. 11.) When a piece of property is bought or sold the property can be returned to restore the parties to the *status quo ante* if fraud is proven. In the case of a release, there is nothing to be returned. "In reality the releaser does not sell anything even of an intangible nature. In effect, the releasor has merely agreed for a consideration not to enforce his tort claim." (*Shallenberger, supra,* 150 N.E.2d at p. 300.) Consider how one court has characterized the issue, in a hypothetical dispute as to whether B had paid a $1,000 debt to A's deceased agent, which A and B subsequently agreed to settle for $500.

> "* * * B * * * claims that he paid the agent the whole debt. A disputes this and they finally agree to compromise the dispute, B paying $500. Afterwards A * * * claims that he was induced, by fraud, to enter into the compromise. * * * *If A can maintain his suit without first returning the $500, he will have all the game in his own hands.* ***If he wins the suit he will***

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12 (*See Montes v. Peck* (1931) 112 Cal.App. 333, 340 [contrasting a settlement agreement with a contract for the sale of real property]; *Shallenberger v. Motorists Mut. Ins. Co.* (Ohio 1958) 150 N.E.2d 295, 300 ["There is usually no analogy between the situation of one induced by fraud to release a tort claim and one induced by fraud to buy something"]; *Stefanac v. Cranbrook Educational Community* (Mich. 1990) 458 N.W.2d 56, 60 ["A compromise and release is not to be confused with the law of contract, in which equivalents are exchanged, for the very essence of a release is to avoid litigation, even at the expense of a strict right"].)

> ***retain the $500 and get $500 more. If he loses the suit * * * he will still have the $500. He will thus in effect hold B to the compromise but himself be released. Such inequality and injustice cannot be tolerated by correct principles of law.***"

(*Shallenberger, supra*, 150 N.E.2d at p. 302, emphasis added, citation omitted.) This precise injustice has been blessed by the Court of Appeal in this case.

Thus, it is not surprising that the Court of Appeal's decision fails to cite a single California case contrary to *Garcia* and *Taylor*. Prior to the Court of Appeal's decision, no published California case had ever permitted a party to "affirm" a settlement agreement, keep the settlement money, and sue for damages based on fraud.

The wisdom of *Garcia/Taylor* is exemplified by this case. Assume for the sake of argument, that the earthquake policy limit really was $11,905,500, as Village Northridge contends. Assume further that the trier of fact agrees with State Farm's position on the underlying dispute, *i.e.*, that Village Northridge only suffered $2,565,553.24 in damages. (6AA 1264-1265, ¶¶ 17, 19.) As State Farm demonstrated in its respondent's brief (at pp. 28-29) the doubling of applicable limits also doubles the amount of the deductible and reduces the net payout on the loss under that scenario, such that Village Northridge would have been overpaid by between $3.9-$4.2

million when interest is added.[13] If State Farm prevails at trial on the merits of the original dispute, Village Northridge receives a $4 million windfall – a result specifically endorsed by the Court of Appeal based upon "policy" reasons. (Typed opn. at pp. 10-11, fn. 4.)

The Court of Appeal also improperly relied upon non-California decisions to justify its ruling. (Typed opn. at pp. 11-13.) Because *Garcia* and *Taylor* are controlling, there was no reason for the Court of Appeal to consider cases from other jurisdictions (an issue raised by Village Northridge in its opening brief). (*San Francisco v. Western Air Lines, Inc.* (1962) 204 Cal.App.2d 105, 135 ["Whatever may be our disposition towards an eclectic consideration of the common law developments in other jurisdictions, we are of course bound by and must follow the rule announced by the [California] Supreme Court."].)

Moreover, the Court of Appeal improperly gave the impression that it was following the "majority" view on this issue when it was not. (Typed opn. at p. 12.) As State Farm demonstrated in its respondent's brief, only ten states follow the rule adopted by the Court of Appeal,[14] whereas twelve

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[13] Rescission generally requires the return of the consideration paid, plus interest. (*See Dunn v. Security-First Nat'l Bank* (1933) 131 Cal.App. 541, 545.)

[14] Delaware (*E.I. Du Pont de Nemours & Co. v. Florida Evergreen Foliage* (Del. 1999) 744 A.2d 457, 464); Indiana (*Automobile Underwriters, Inc. v. Rich* (Ind. 1944) 53 N.E.2d 775, 777); Kansas (*Ware*
(continued...)

states, including California, follow the *Garcia/Taylor* rule.[15] Indeed, the Court of Appeal accepted State Farm's argument that Michigan follows the *Garcia/Taylor* line of cases, meaning that 13 states follow California's position. (Typed opn. at p. 12, fn. 5.)

Therefore, there is no reason, compelling or otherwise, to revisit *Garcia* and *Taylor*, particularly given that the Legislature has specifically

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[14](...continued)
v. State Farm Mut. Auto. Ins. Co. (Kan. 1957) 311 P.2d 316, 320); Minnesota (*Mlnazek v. Libert* (Minn. 1901) 86 N.W. 100, 101-102); New Jersey (*Bilotti v. Accurate Forming Corp*. (N.J. 1963) 188 A.2d 24, 30-35); Wisconsin (*Brown v. Ocean Accident & Guar. Corp., Ltd.* (Wis. 1913) 140 N.W. 1112, 1115); Oklahoma (*Sade v. Northern Nat'l Gas Co.* (10th Cir. 1973) 483 F.2d 230, 234 [applying Oklahoma law]); Iowa (*Phipps v. Winneshiek County* (Iowa 1999) 593 N.W.2d 143, 146-147); New Mexico (*Ponce v. Butts* (N.M.Ct.App. 1986) 720 P.2d 315, 322); and South Dakota (*Railsback v. Mid-Century Ins. Co.* (S.D. 2004) 680 N.W.2d 652, 657).

[15] California (*Garcia, supra,* 183 Cal. at p. 773; *Taylor, supra*, 207 Cal. at pp. 103-105); Ohio (*Shallenberger, supra*, 150 N.E.2d at pp. 300-302); North Carolina (*Davis v. Hargett* (N.C. 1956) 92 S.E.2d 782, 786); Vermont (*Caledonia Sand & Gravel Co., Inc. v. Joseph A. Bass Co.* (Vt. 1959) 151 A.2d 312, 314-315); Alabama (*Ledbetter v. Frosty Morn Meats* (Ala. 1963) 150 So.2d 365, 371); Arkansas (*Taylor v. Federal Kemper Ins. Co., supra*, 534 F.Supp. at p. 199); South Carolina (*Dunaway v. United Ins. Co.* (S.C. 1962) 239 S.C. 407, 410 ([*Gaskins v. Southern Farm Bureau Cas. Co.* (S.C. 2003) 581 S.E.2d 169 cited by the Court of Appeal (Typed opn. at p. 12, fn. 5) does not address *Dunaway* and does not address the rescission issue at all; it merely holds that an insurance company can be sued for fraud]); Illinois (*Richardson v. Economy Fire & Casualty Co.* (Ill. 1985) 485 N.E.2d 327, 331; Kentucky (*Fox v. Hudson's Ex'x* (Ky. 1912) 150 S.W. 49, 52 [followed by *Garcia* and *Taylor*]; Idaho (*Leaper v. Vaught* (Idaho 1928) 264 P. 386, 388); Tennessee (*Gibbons v. Mutual Ben. Health & Acci. Ass'n* (Tenn. 1953) 259 S.W.2d 653, 654); and West Virginia. (*Spradling v. Blackburn* (D.W.Va. 1996) 919 F. Supp. 969, 978.)

created a fair and equitable remedy to address this problem: rescission, as governed by Civil Code section 1691.

Accordingly, this Court should grant review and reaffirm that *Garcia* and *Taylor* continue to control the settlement of any disputed claim.

II. THE COURT OF APPEAL'S NEW FRAUD CAUSE OF ACTION RUNS AFOUL OF THE RULE AGAINST SPECULATIVE DAMAGES.

Under *Garcia/Taylor*, there is no issue as to speculative damages: if fraud in the inducement is proven, the underlying dispute is litigated as if it were never settled. The jury does not speculate about what the parties *might have* settled for had they possessed different information. If fraud is proven, the jury simply evaluates the liability and damages of the underlying case. The plaintiff might get more than the rescinded settlement, or less, but that is fair because the plaintiff wanted "out of the deal" and the defendant got nothing from the now rescinded agreement.

Taylor was based precisely upon concern over speculative damages: "The difficulty in determining the amount of damages is insurmountable." (*Taylor, supra*, 207 Cal. at p. 103.) This Court described a case identical to the facts here, noting the impossibility of a jury trying to determine first the value of the underlying cause of action, and second the amount the parties would have settled for, but for the fraud. "An alleged value of the claim…is of a nature too speculative and wagering to be recognized by the law in this

action for fraud." (*Id.* at p. 104.) Those concerns have not changed in 80 years, as this Court confirmed in 1998 in *Cedars-Sinai Medical Center v. Superior Court*, *supra*, 18 Cal.4th at pp. 14-15, noting the continued validity of *Taylor*.

In stark contrast to the lack of speculation regarding damages under *Garcia* and *Taylor*, the Court of Appeal announced an entirely new rule rife with speculation and "what ifs." According to the Court of Appeal, Village Northridge's damages, if it proves fraud, will be determined by "what the claim was worth," "whether the Association *would have* compromised ... had it known there was additional millions of dollars in coverage available," and determining "the amount for which the parties *would reasonably have settled* had the Association known the actual policy limits." (Typed Opn. at pp. 13-14, italics added.)

This holding is based upon speculation and unsupported by any California case. Somehow the Court of Appeal concluded that its analysis will not require the same speculation as in a personal injury case, but again that is a distinction without merit. The plaintiffs in *Garcia* and *Taylor* could have just as easily argued to the jury about what they "would have settled for," but for the alleged fraud. The Court of Appeal drew the distinction because the "plaintiff's cause of action [in *Taylor*] would have had no value at all if the defendant was not negligent." (Typed opn. at

p. 14.) True, but here, if the parties had not settled and Village Northridge had sued State Farm, the jury may well have sided with State Farm, concluding that no additional policy benefits were owed.

The facts of this case underscore the utter speculation involved in the Court of Appeal's new-found remedy. According to Village Northridge, the $1.5 million settlement offer was presented on a "take-it or leave it basis." (2AA 283, ¶ 4.) The actual "arm's length" negotiation (6AA 1361, ¶ 11) resulted in Village Northridge accepting $1.5 million to settle, or a total payment $3.5 million of the $5 million policy limit it believed – and never questioned – was available. Thus, Village Northridge, despite alleging damages of $8 million, accepted less than half that amount and $1.5 million less than policy limits.

Now Village Northridge claims a policy limit of $11,905,000. If true, the deductible (10% of the policy limit) would be $1,190,500 instead of $500,000. Accepting the new allegation, State Farm actually overpaid by $690,500, the difference between the two deductibles.

Under the Court of Appeal's opinion, the trier of fact will have an additional conundrum. Not only will the jury need to speculate how much Village Northridge might have demanded in light of the claimed higher policy limit, it will need to speculate why State Farm would offer any more than the $1.5 million, taking into account the $690,500 increased

deductible. Unless State Farm would have offered more than $2,190,500, given the increased deductible, there would be no net difference in the amount paid. ($2,190,500 less additional deductible of $690,500 equals $1.5 million.)

Since State Farm refused to offer the $5 million policy limit in 1998, why would it now offer more in light of the increase in deductible created by Village Northridge's (disputed) claim of increased limits? The speculative nature of the inquiry is neither reduced nor increased because the jury is guessing about offers and demands in an insurance property damage case as opposed to a personal injury case. And, here it is more challenging because the "new" allegedly misrepresented facts – a higher limit and a higher deductible – would suggest that State Farm's offer would actually have been lower, not higher.

It is no secret how this will play out. Village Northridge will now claim that it would not have accepted a "penny less" than $8 million, even though it accepted $3.5 million in 1998 against a then available $5 million policy limit. State Farm will contend that, given the increased deductible, it would logically offer no more than $800,000 rather than the $1.5 million. ($1.5 million originally offered, less the increase in deductible of $690,500 equals $809,500) State Farm did not offer the policy limit when it was $5 million, so why would a higher limit matter.

This entire analysis is rife with the speculation condemned by this Court in numerous cases, including *Taylor*, *Cedars-Sinai Med. Ctr. v. Superior Court, supra*, 18 Cal.4th at pp.14-15, *Viner v. Sweet, supra*, 30 Cal.4th at p. 1241, and *Wiley v. County of San Diego*, *supra*, 19 Cal.4th at p. 544.

III. GUIDANCE IS NEEDED FROM THIS COURT ON APPLICATION OF *STARE DECISIS* TO THIS COURT'S OLDER OPINIONS.

"The decisions of this court are binding upon and must be followed by all the state courts of California." (*Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455.) "[W]e are required by the doctrine of stare decisis to follow the decisions of our Supreme Court when those decisions have given us clear and unequivocal rules to follow." (*People v. Burnham* (1986) 176 Cal.App.3d 1134, 1149.) "Any deviation from the apparently general holding" of this Court's decisions "must come from the Supreme Court itself." (*Byard v. National Auto. & Cas. Ins. Co.* (1963) 218 Cal.App.2d 622, 627.)

On the other hand, this Court's decisions need not be followed by lower courts when the facts are "fairly distinguishable." (*People v. Triggs* (1973) 8 Cal.3d 884, 891.) Guidance is needed from this Court. All cases are distinguishable on their *facts.* However, lower courts are obligated to follow the rules of *law* adopted by this Court. Here, the Court of Appeal

failed to follow *Garcia/Taylor* based upon: (a) the *factual* distinction that *Garcia* and *Taylor* involved personal injury claims, ignoring the "general holdings" of those cases; and (b) the alleged *legal* distinction that unlike a personal injury claim, here Village Northridge was allegedly entitled to *some* amount of money. (Typed opn. at pp. 7-9.) The personal injury versus non-personal injury distinction is irrelevant and *Garcia* clearly forecloses the latter legal distinction. (*Garcia*, *supra*, 183 Cal. at p. 772 [rule applies "where there is a controversy as to the amount owing"].)

State Farm respectfully submits that the Court of Appeal was compelled to affirm the trial court's ruling. The facts of this case are not "fairly distinguishable" in any meaningful manner from *Garcia/Taylor*. If reexamination of *Garcia/Taylor* was warranted, the Court of Appeal could have stated such. (*See State Farm Gen'l Ins. Co. v. Wells Fargo Bank, N.A.* (2006) 143 Cal.App.4th 1098, 1111 & fn. 10 [requesting clarification from this Court on legal issue not examined by this Court since 1938].) Lastly, although the age of *Garcia* and *Taylor* is legally irrelevant (*Dobbins v. Hardister* (1966) 242 Cal.App.2d 787, 792), we respectfully submit that the Court of Appeal more likely would have followed *Garcia* and *Taylor* if they were of more recent vintage.

CONCLUSION

For the foregoing reasons, review should be granted and the Court of Appeal's decision reversed.

DATED: February 20, 2008

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BRIEF FORMAT CERTIFICATION PURSUANT TO CALIFORNIA RULES OF COURT, RULE 8.204(c)

Pursuant to California Rules of Court, Rule 8.204(c), I certify that Respondents' Brief is

X Proportionately spaced, has a typeface of 13 points and contains 8,396 words, including footnotes.

DATED: February 20, 2008

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SETTLEMENT AGREEMENT AND RELEASE OF CLAIMS

WHEREAS, STATE FARM FIRE AND CASUALTY COMPANY, an Illinois corporation ("State Farm") issued an insurance policy to VILLAGE NORTHRIDGE HOMEOWNERS ASSOCIATION, INC., a California non-profit mutual benefit corporation (the "Association") which was assigned Policy Number 90-WD-4555-1 (the "Association's Policy"); and

WHEREAS the Association's Policy covered the structure and other improvements located at 10331 Lindley Avenue, Northridge, California 91326 (the "Property"); and

WHEREAS, the Association and State Farm agree that although the Association's Policy might been issued to "Village Northridge II Homeowners Association, Inc." there is no difference between "Village Northridge" and "Village Northridge II". The property at issue is at the address above. Therefore, for the purpose of this document, they are considered to be the same entity;

WHEREAS, subject to the terms, limitations, and restrictions of the Association's Policy, the Association's Policy provided coverage for losses caused by earthquakes;

WHEREAS, the Association submitted a claim to State Farm for damage to the structures from the Northridge earthquake of January 17, 1994, and/or its aftershocks; this claim was assigned State Farm claim number 55-R038-387 (the "Earthquake Claim"), and to date, State Farm has paid $2,068,112.39 to the Association on the Earthquake Claim;

WHEREAS, a dispute arose between the Association and State Farm concerning the scope of earthquake damage and the cost to repair the earthquake damage; and

WHEREAS, the Association and State Farm are desirous of settling all disputes, differences, and disagreements arising out of the adjustment of the Earthquake Claim which now exist between the Association and State Farm, relating to any claims in contract, tort, or

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EXHIBIT A

otherwise, arising out of the Association's Earthquake Claim and for all damages that exist as of this date and/or any and all claims, known or unknown arising out of the earthquake and the adjustment, presentation handling and/or resolution of the Association's Earthquake Claim with State Farm;

NOW, THEREFORE, in consideration of the releases, agreements, representations, and warranties contained herein, the Association and State Farm enter into this Settlement Agreement and Release of Claims ("this Agreement") and agree as follows:

1. The Association, on behalf of itself and its past, present, and future parent and affiliated corporations and entities, predecessors, successors and assigns (collectively referred to as the "Association Releasing Parties"), hereby forever, completely, and unconditionally release and discharge State Farm and its past, present, and future parent and affiliated corporations and entities, owners, directors, officers, employees, agents, representatives, heirs, beneficiaries, alter egos, attorneys, predecessors, successors, assigns, insurers, and underwriters, from any and all claims, actions, causes of action, charges, demands, contracts, covenants, liabilities, obligations, expenses (including, without limitation, attorneys' fees), and damages of every nature, kind, and description whatsoever, which the Association Releasing Parties, or any of them, has, had, may have, or claims to have, whether known, anticipated, suspected, fixed, conditional, or contingent, which arise out of or are in any way related to the Earthquake Claim. EXPRESSLY EXCLUDED from the releases and discharges set forth in this Paragraph are any claims based upon any breach of this Agreement.

2. State Farm, on behalf of itself and its past, present, and future parent and affiliated corporations and entities, owners, directors, officers, employees, agents, representatives, heirs, beneficiaries, alter egos, attorneys, predecessors, successors, assigns, insurers, and underwriters

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warrant and represent that they are not aware of any claims, or facts which may potentially lead to any claims, by State Farm against the Association and its past, present and future parent and affiliated corporations and entities, owners, directors, officers, employees, agents, representatives, heirs, beneficiaries alter egos, attorneys, predecessors, successors, members, assigns, insurers, and underwriters, relating to, arising from, or concerning the Earthquake Claim, including but not limited to any claims for breach of contract, bad faith, fraud, malicious prosecution or abuse of process. If, and only if, State Farm should ever make or file any legal claims against the Association or its past, present, and future parent and affiliated corporations, and entities, owners, directors, officers, employees, agents, representatives, heirs, beneficiaries, alter egos, attorneys, predecessors, successors, members, assigns, insurers, and underwriters which arise out of, or are in any way related to, or concern the Earthquake Claim, then the releases by the Association Releasing Parties as set forth in this Agreement shall be null and void, and any limitation period pertaining to any action which could have been filed relating to the Earthquake Claim by the Association Releasing Parties shall be tolled so as to permit the Association Releasing Parties to bring a new action based upon the same or similar facts and legal theories and/or permit the Association Releasing Parties to reopen the insurance claim with respect to the damages caused by the January 17, 1994 Northridge earthquake and its aftershocks, and/or permit the Association Releasing Parties to pursue State Farm based upon any claims arising out of the issuance of the insurance policy, the handling or adjustment of the claim for earthquake damages, or any matters related to the Earthquake Claim.

3. The Association Releasing Parties represent and warrant that they have read and understand Section 1542 of the California Civil Code, which reads as follows:

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"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."

The Association Releasing Parties acknowledge and understand that the releases and discharges set forth in Paragraph 1 of this Agreement are not "general releases," but rather apply only to claims related to the Earthquake Claim; however, they understand and agree that they are expressly and completely waiving any benefits that Section 1542, and any other laws, legal decisions, and legal principles of similar effect, might provide to them in the future; and they understand, agree, and expressly intend that Paragraph 1 of this Agreement completely, absolutely, unconditionally, and forever extinguishes any and all claims, disputes, and differences which now exist, have existed, or hereafter may arise which are described in Paragraph 1 of this Agreement, even those, if any, which they do not know about or suspect that they may have and even those, if any, which they may not learn about or discover until after they sign this Agreement.

4. The Association Releasing Parties agree that they will forever refrain and forbear from commencing, instituting, or prosecuting any lawsuit, action, or any other proceeding against State Farm based on, arising out of, or in connection with any claims, actions, causes of action, charges, demands, contracts, covenants, liabilities, obligations, expenses (including, without limitation, attorneys' fees), and damages that are released and discharged in Paragraph 1 of this Agreement.

5. The Association Releasing Parties agree and acknowledge that the Board of Directors is authorized to enter into this Agreement and settle this claim. The Association Releasing Parties understand and agree that in entering into this settlement the Association Releasing Parties are

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waiving any right to make a claim against State Farm under its directors and officers liability insurance policy alleging that the Board of Directors was negligent, or failed to act properly in entering into this Agreement or in settling this claim on the terms and conditions set forth in this Agreement.

6. Each of the parties to this Agreement warrants and represents that such party has not assigned, subrogated, or transferred, or purported to assign, subrogate, or transfer, to any person or entity the claims released and discharged in Paragraph 1 and any claims based upon the warranties and representations set forth in Paragraph 2 of this Agreement. Each of the parties to this Agreement warrants, represents, and agrees that such party will indemnify, defend, and hold the parties released, or the parties entitled to the benefits of the warranties and representations herein contained, harmless from and against any and all costs, expenses (including, without limitation, attorneys' fees), damages, and judgments, in the event any third party shall assert any of the claims released and discharged in Paragraphs 1 and any claims based upon the warranties and representations contained in Paragraph 2 of this Agreement.

7. State Farm promptly will tender to the Association a total settlement sum of ONE MILLION FIVE HUNDRED THOUSAND DOLLARS ($1,500,000.00). Said payment is in consideration of the Association Releasing Parties' releases, agreements, representations, and warranties set forth in this Agreement, and shall be payable by a check or draft payable to the order of Village Northridge Homeowners Association, Inc. Said payment will be picked up by the Association's public adjuster by no later than 5:00 p.m. on November 12, 1999; and, if the payment is not so delivered, said settlement sum shall bear interest at the rate of FIFTEEN PERCENT (15%) per annum.

8. Each of the parties to this Agreement understands and agrees that the parties to this

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Agreement enter into this Agreement solely to resolve disputed and uncertain claims and to avoid the expense, inconvenience, and uncertainty of further litigation, and that none of the parties to this Agreement admits to any allegations made in the Action, or to any violations of any law, rule, contract, covenant, or understanding, or any wrongful acts, or any liability to any other party, all of which is expressly denied; and each agrees not to state or imply the contrary to anyone.

9. Each of the parties to this Agreement agrees to take all reasonable steps to keep the terms and provisions of this Agreement confidential. Notwithstanding the foregoing, the Association Releasing Parties may disclose the terms of this Agreement to its attorneys, tax and financial advisors, directors, members, property manager, and the employees of each of them.

10. Each of the parties to this Agreement agrees to bear all of such party's respective costs, expenses, and attorneys' fees incurred in connection with the negotiation and preparation of this Agreement.

11. This Agreement has been negotiated at arms' length between persons knowledgeable in the matters dealt with herein. In addition, each of the parties hereto has been represented by independent legal counsel of such party's own choice. Accordingly, any rule of law, including, but not limited to, California Civil Code Section 1654, or any other statute, legal decision, or common law principle of similar effect, that would require interpretation of any ambiguities in this Agreement against the party(ies) that drafted it, is of no application and is hereby expressly waived. The provisions of this Agreement shall be interpreted in a reasonable manner to effect the intentions of the parties hereto and of this Agreement.

12. This Agreement constitutes the only and entire agreement between the parties on the subject matter of this Agreement, and there are no promises, representations, or other agreements or understandings between the parties on the subject matter hereof other than those set forth

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herein. The obligations set forth in this Agreement are unconditional. This Agreement may not be changed, modified, altered, or waived except by a written instrument signed by all of the parties.

13 The provisions of this Agreement are severable, and if any provision of this Agreement is found to be unenforceable, the other provisions shall remain fully valid and enforcea..e.

14. In the event of any dispute arising out of or from this Agreement, or any dispute whatsoever between the parties hereto, the parties agree first to mediate such dispute.

In the event that mediation fails to resolve the dispute, the parties irrevocably agree to a binding arbitration conducted pursuant to CCP § 1280 et. seq. In such arbitration, the prevailing party shall be entitled to an award of reasonable attorney's fees and costs as determined by the arbitrator. The parties understand that by agreeing to this provision, they are waiving the right to a jury trial and any right of appeal.

15. The laws of the State of California shall govern the validity of this Agreement, the construction of its terms, and the interpretation of the rights and duties of the parties.

16. This Agreement shall be binding upon and inure to the benefit of the parties hereto, and to their respective parent and affiliated corporations and ent[illegible], di[illegible]s, officers, employees, agents, representatives, heir[illegible] beneficia..es, alter egos, attorneys, predecessors, successors, assigns, insurers, and unde..writers, even if such parties are not signatories to this Agreement.

17. Each of the parties to this Agreement warrants, represents, and agrees that such party, in executing this Agreement, does so with knowledge of any and all rights which such party may have with respect to the provisions of this Agreement; that such party has carefully read and considered this Agreement and fully understands its contents and the significance of its contents;

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that such party is entering into this Agreement of his or its own informed and free will, based upon his or its own judgment, and without any coercion or fear of retaliation; and that such party has obtained independent legal advice with respect to this Agreement.

18. Each party warrants, represents, and agrees that this Agreement has been duly approved, executed, and delivered and constitutes the valid and binding obligation of such party, and that the individual executing this Agreement on behalf of such party has the authority to do so.

19. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

VILLAGE NORTHRIDGE HOMEOWNERS ASSOCIATION, INC.

Dated: 11/9/99 By: Bill Mae
Print Name: Bill Mae
Title: PRESIDENT

Dated: 11/9/99 By: [signature]
Print Name: BOREK C. VODARIK
Title: TREASURER

Dated: 11/9/99 By: Douglas V. Fitzgerald
Print Name: Douglas V Fitzgerald
Title: Vice President

STATE FARM FIRE AND CASUALTY COMPANY

Dated: 11/10/99 By: Chris Pozzuoli
Print Name: Chris Pozzuoli
Title: Team Manager

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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION EIGHT

VILLAGE NORTHRIDGE HOMEOWNERS ASSOCIATION, Plaintiff and Appellant, v. STATE FARM FIRE AND CASUALTY COMPANY, Defendant and Respondent.	B188718 (Los Angeles County Super. Ct. No. BC 265328)

APPEAL from a judgment of the Superior Court for the County of Los Angeles. Wendell Mortimer, Jr., Judge. Reversed and remanded.

Engstrom, Lipscomb & Lack, Jerry A. Ramsey, Brian J. Heffernan and Alexandra J. Thompson for Plaintiff and Appellant.

Robie & Matthai, James R. Robie, Kyle Kveton and Steven S. Fleischman; LHB Pacific Law Partners and Clarke B. Holland; and Crandall, Wade & Lowe and Michael J. McGuire for Defendant and Respondent.

EXHIBIT B

SUMMARY

An insurer and its insured, a homeowners association, settled disputed claims arising from the Northridge earthquake, with the insurer paying $1.5 million and the insured releasing the insurer from all claims or causes of action it had or may have arising out of its earthquake claim. Two years later, the association sued the insurer, and still later discovered the limits of its insurance policy were almost $7 million greater than had been represented by the insurer. The insurer insists that the association cannot pursue its claim unless it rescinds the settlement agreement and returns the $1.5 million, relying on Supreme Court precedents holding that a plaintiff cannot avoid a fraudulently induced contract of release without rescinding the contract and restoring the money paid as a consideration for the release. (*Garcia v. California Truck Co.* (1920) 183 Cal. 767, 773 (*Garcia*).) The association, which long ago used the $1.5 million to repair earthquake damage, insists it has the option of affirming the settlement agreement and recovering damages for the fraud. (See *Bagdasarian v. Gragnon* (1948) 31 Cal.2d 744, 750.)

We agree with the association, concluding that the Supreme Court precedents on which the insurer relies apply only to the release of personal injury claims, and not to the settlement and release of claims arising from a contract of insurance. Accordingly, the trial court erred when it sustained the insurer's demurrer on the ground the association could not "have it both ways" by keeping the settlement monies but not releasing the claims.

FACTUAL AND PROCEDURAL BACKGROUND

This is the second time this case has come to the Court of Appeal.

The lawsuit arose from the Northridge earthquake in January 1994, and was filed in December 2001, after the Legislature revived insurance claims otherwise barred by the statute of limitations. Village Northridge Homeowners Association (the Association or the insured) sued State Farm Fire and Casualty Company (State Farm or the insurer), alleging breach of contract and breach of the implied covenant of good faith and fair dealing. The complaint alleged State Farm improperly undervalued the Association's

loss, inducing it to forego proper repairs and to forego payment of amounts properly owed under the policy. The Association further alleged it "was required to sign a release and did so under compulsion and with no other option afforded to secure partial benefits owed," and that it did not agree "that the partial payments provided fully compensated [the Association] for the actual damages and loss sustained . . . ."

1. Previous trial court proceedings and appeal.

State Farm filed a motion for summary judgment, contending the release the Association executed barred its lawsuit. State Farm's declarations asserted, among other things, that the policy limits for earthquake damage were $4,974,900, with a deductible of ten percent, but it submitted no documentary confirmation of the policy limits. State Farm made various payments, totaling approximately $2,068,000, and in 1998 the Association sought additional policy benefits. State Farm reinspected the property and determined that a portion of the claimed additional damage might be earthquake related and that a portion was not. In November 1999, the parties negotiated a compromise of the claim, agreeing to payment by State Farm of $1.5 million. The Association unconditionally released State Farm from all claims, known or unknown, in any way related to the Association's earthquake claim. In late 2000, the Association contacted State Farm to reopen the claim, and State Farm declined to do so.

In its opposition to State Farm's summary judgment motion, the Association asserted that the insurance contract provided a limit of $11,905,500 with a 10 percent deductible, and that State Farm misrepresented its policy limits to the Association in the course of adjusting the claim and inducing the execution of the release. A declaration from an Association board member who signed the release stated that State Farm's offer "was made in conjunction with overt representations, written and oral, that the policy limits were $4,974,900 . . . . At the time, we had no idea that this representation regarding policy limits was untrue and we executed the subject Release under the mistaken belief that State Farm had honestly and accurately represented its policy limits to us." State Farm's $1.5 million offer was made on a "take it or leave it" basis, and "was

not the product of any 'negotiation.' " The association "was upside down financially" and "simply had no choice but to do whatever State Farm insisted in order to at least secure a portion of the policy benefits that were owed and to partially fund the massive earthquake repairs that were presented." Homeowners were individually assessed thousands of dollars to partially fund repairs but "millions of dollars of further repairs remain to be performed at this time." With the declaration, the Association submitted a copy of the policy declarations that was "recently retrieved from storage from our property manager . . . ." It showed policy limits of $11,905,500 for buildings, an earthquake endorsement and 10 percent earthquake deductible, and no indication of any different policy limits for earthquake coverage.

The trial court granted summary judgment for State Farm, ruling the Association had not demonstrated the release agreement was a product of undue influence or fraud, and that it was binding on the parties.

This court reversed the judgment, concluding material issues of disputed fact existed concerning the limits of the earthquake policy and whether the policy limits were misrepresented by the insurer during the adjustment process. (*Village Northridge Homeowners Association v. State Farm Fire & Casualty Co.* (Mar. 14, 2005, B172913) [nonpub. opn.].) Because a resolution of these issues was necessary to a determination whether the insured's release was valid and enforceable, we held summary judgment was improper.

2. Current trial court proceedings.

When the case was returned to the trial court, State Farm filed a motion for judgment on the pleadings. State Farm asserted the complaint did not state a claim upon which relief could be granted, because the Association's claims were barred by the settlement agreement and release, and the Association could not rescind the settlement agreement without first offering to restore to State Farm the consideration it paid under the agreement. The trial court granted the motion, with leave to amend, observing that the complaint did not allege fraud in the inducement or rescission, and that the

Association "need[s] to either rescind the agreement or affirm the agreement and sue for damages."

The Association then filed a first amended complaint, alleging a cause of action for fraud in addition to its original claims for breach of contract and breach of the implied covenant of good faith and fair dealing. The Association alleged it had spent the $1.5 million on partial earthquake repairs and was not offering to return the $1.5 million; acknowledged a credit in that amount in State Farm's favor against the damages sought in the lawsuit; did not seek to rescind the release; and " 'affirm[ed]' the Release, as requested by the Court, and [sought] damages . . . ," contending the release was unenforceable as the product of fraud.

State Farm demurred, asserting, inter alia, that the Association could not affirm the settlement agreement and simultaneously assert claims that were explicitly released in it. The trial court sustained the demurrer with leave to amend, stating that the Association must either rescind the settlement agreement and release or affirm the settlement agreement and release, and that "[h]ere, the release was the purpose of the settlement agreement and they are all part of the same agreement . . . ," citing *Garcia, supra*, 183 Cal. 767.

The Association filed a second amended complaint, which was not significantly different from the first, alleging the $1.5 million was a grossly deficient, partial payment toward an $8 million loss; the $1.5 million was owed under the insurance policy independent of the release; and the court had the inherent power to set aside a release procured by fraud. State Farm again demurred. The trial court sustained the demurrer without leave to amend, observing the Association chose to affirm the settlement agreement and keep the money paid by State Farm, but not to release the claims, and "[t]hey can't have it both ways."

Judgment was entered and the Association filed this timely appeal.

DISCUSSION

State Farm contends the Association's only option under California law for avoiding its release was to rescind the settlement agreement and return the $1.5 million to State Farm, and it cannot "keep the money and sue." While the question is not without difficulty, we conclude that, in the circumstances of this case, State Farm is mistaken.

In *Garcia, supra*, 183 Cal. 767, the Supreme Court made it clear that rescission is essential to the extinguishment of a contract of release in a personal injury case, and that there can be no rescission without restoration of the consideration. This is not, however, a personal injury case, in which the only purpose of the releasee's payment is to obtain a release from an inchoate tort claim. This is an insurance contract case, in which the releasee-insurer had an underlying contractual obligation to pay for damage to the insured's dwellings caused by earthquake, and in addition a statutory obligation not to misrepresent the terms of its policy.[1] (See Ins. Code, § 790.03.) Under these circumstances – and particularly where the consideration received by the releasor was long ago expended to repair the very damage the releasee-insurer contracted to cover – we conclude *Garcia* does not prevent the insured from avoiding the release without returning the consideration for which it was given.

We briefly describe the legal principles and precedents that inform our conclusion. Two general principles are relevant. The first is the *Garcia* principle: that a plaintiff in a personal injury case cannot avoid a fraudulently induced contract of release without rescinding the contract and restoring the money paid as a consideration for the release. (*Garcia, supra*, 183 Cal. at p. 773.) The second is the more general principle that, if a defrauded party is induced by false representations to execute a contract, the party has the option of (1) rescinding the contract and restoring any consideration received under it, or

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[1] "The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance. [¶] (a) Making . . . any . . . statement misrepresenting the terms of any policy issued . . . ." (Ins. Code, § 790.03, subd. (a).)

(2) affirming the contract and recovering damages for the fraud. (*Bagdasarian v. Gragnon, supra*, 31 Cal.2d at p. 750; *Hines v. Brode* (1914) 168 Cal. 507, 511-512.) We conclude the second, more general, principle applies here, permitting the Association to affirm the settlement agreement and recover damages for the fraud.

Initially, we note our recognition of the apparent incongruity, noted by the trial court, in "affirming" a contract and yet avoiding one of its principal terms: the release. The incongruity, however, is not as severe as may first appear. Indeed, because of the underlying insurance obligation, the circumstance is not unlike both (1) cases in which a settlement agreement and the mutual releases in it are considered separable, thus permitting the plaintiff to affirm the settlement and sue for fraud despite the release (*Persson v. Smart Inventions, Inc.* (2005) 125 Cal.App.4th 1141, 1154), or (2) cases, as described in *Garcia*, applying the "well-recognized rule" that one who rescinds a contract for fraud "is not required to restore that which in any event he would be entitled to retain." (*Garcia, supra*, 183 Cal. at p. 771.) While neither principle fits perfectly, either is more appropriately applied to a case in which an insurer has misrepresented policy limits to obtain a settlement than is a principle that requires the return of the insurance settlement monies as the price of a challenge to the insurer's fraud. We turn to a review of the cases and State Farm's contentions.

1. *Garcia* and *Taylor* are not controlling.

State Farm argues that *Garcia* and a similar case, *Taylor v. Hopper* (1929) 207 Cal. 102 (*Taylor*), control. In *Taylor*, the Supreme Court held that the remedy of affirming a compromise agreement, retaining the money received under it, and suing for fraud "does not exist in a case such as we are considering." (*Taylor, supra*, 207 Cal. at p. 103.) But *Taylor*, like *Garcia*, was considering a personal injury case, in which plaintiff was run over by defendants' automobile and released her claim in a compromise agreement. *Taylor* concluded the "affirm and sue" remedy did not exist because "[t]he difficulty in determining the amount of damages is insurmountable." (*Ibid.*) The court explained:

> "If the jury found a fraud had been committed upon plaintiff to induce her to give up her cause of action, how would it determine what amount, if any, she would have received from another jury had she not compromised her action, but had proceeded to trial? And how could damages in the instant case be assessed without some measure of what would have been accorded to plaintiff in the original action had she proceeded to trial? . . . 'In case the right of action had no value, she had gained by the transaction and was not injured. It had no value whatever if the true state of facts disclosed that it was an invalid and non-existing claim, or, in other words, that the defendant was not negligent . . . . An alleged value of the claim based upon . . . facts sufficient to warrant the reasonable belief of the plaintiff that she had a just claim is of a nature too speculative and wagering to be recognized by the law in this action for fraud.' " (*Taylor, supra*, 207 Cal. at pp. 103-104, italics omitted, quoting *Urtz v. New York Central etc. Co.* (1911) 202 N.Y. 170, 175-176.)

The court concluded the compromise "was of a disputed claim, unliquidated in amount and there is no practicable measure of damages for the action sought to be maintained." (*Taylor, supra,* 207 Cal. at p. 105.)

State Farm insists *Garcia* and *Taylor* are not "archaic decisions," and that their holdings "comport with common sense and the strong policy in favor of settlement." While we do not disagree with these sentiments, we cannot agree that the *Garcia/Taylor* principle applies to the settlement of a claim grounded upon an insurance contract. Indeed, *Taylor* itself demonstrates that a personal injury settlement is very different from an insurance settlement. The principal difference, of course, is the existence of an underlying liability. In *Taylor* or any other personal injury claim, there may or may not be a valid negligence claim and underlying liability on the part of the defendant. (*Taylor, supra*, 207 Cal. at p. 104 [" '[the claim] had no value whatever if the true state of facts disclosed that it was an invalid and non-existing claim, or, in other words, that the defendant was not negligent' "].) In an insurance settlement, by contrast, there is necessarily an underlying liability on the part of the insurer. While the scope of the insurer's liability may be subject to dispute, the existence of its contractual obligation to

pay for earthquake repairs is not. In other words, there is no question that State Farm actually owed the Association some amount of money for earthquake damage,[2] and was willing to pay $1.5 million to settle that obligation. This is far different from the tort claim context, in which liability for payment of the claim may or may not exist.

2. Other precedents confirm the distinction between release of a personal injury claim and settlement of an insurance claim.

The circumstances of this case are not unlike those in rescission cases where courts have applied an exception to the rule requiring restoration of the consideration paid: "A restoration is not necessary, in order to avoid the bar of a release, where there is no question as to the right of the plaintiff, arising independently of the release itself, to retain what he received." (*Sime v. Malouf* (1949) 95 Cal.App.2d 82, 111, 112 ["[r]escission and restoration are required only under equitable principles and to prevent the taking of unfair advantage"]; see *Denevi v. LGCC, LLC* (2004) 121 Cal.App.4th 1211, 1220 [victim of fraud cannot be required to undo the transaction in its entirety; "he has the right to '*retain the benefits of the contract* . . . , and make up in damages the loss suffered by the fraud' "; " '*he may affirm the contract, and simply sue for damages for the fraud*' "].) This case, of course, is not a rescission case, and would not in any event fit precisely into the exception because, as State Farm points out, the amount of the claim settled for $1.5 million was disputed by State Farm, and it may be that the Association was not entitled to the entire amount. Nonetheless, because it was entitled to

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2 State Farm suggests in its brief that its position on the underlying dispute was that Village Northridge suffered only $2,565,553.24 in damages (the amount the insurer had already paid, plus the deductible, prior to the settlement). But State Farm itself, in its summary judgment motion, expressly declared that, when the Association sought additional benefits in 1998, State Farm reinspected the property and determined "that a portion of the claimed additional damage might be earthquake related and that a portion was not."

at least some portion of that amount, the exception to the restoration rule demonstrates that the *Garcia/Taylor* rule in personal injury cases should not automatically be applied in other contexts – and particularly in the context of a fraudulently induced insurance settlement.[3]

State Farm contends that if a plaintiff can settle a disputed claim, keep the money paid and then sue on the released claim, "no defendant would pay to settle a disputed claim," and "all settlements . . . of actual or threatened litigation can be rendered meaningless." State Farm both misstates its premise and exaggerates the consequences. Correctly stated, the effect of our holding in this case is that a plaintiff could settle a disputed insurance claim, keep the money paid, and then sue for fraud (rather than on the released claim) if it was fraudulently induced to settle the claim by a misrepresentation of policy limits. The consequences of applying this principle are not dire. Indeed, to avoid them, the insurer need only avoid misrepresenting policy limits when it settles claims. We seriously doubt insureds who settle their claims can be expected thereafter to assert groundless claims of misrepresentation of policy limits on a routine basis.[4]

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[3] State Farm implies there is no longer an exception to the rule that restoration of consideration is necessary to rescind an agreement because, in 1961, California's rescission statutes were revised. The statute now states that, to effect a rescission, a party to a contract "must" restore or offer to restore the consideration (Civ. Code, § 1691), whereas it formerly provided that rescission can be accomplished "only by the use . . . of reasonable diligence to comply" with specified rules, including the rule that "[h]e must restore" everything of value. State Farm cites no authority supporting the view that this change operates to eliminate, or was in any way intended to eliminate, the principle that consideration to which the plaintiff has an independent right need not be returned. In any event, the question in this case is whether the Association may affirm and sue, not whether it may rescind.

[4] State Farm posits a scenario in this case in which (a) policy limits are found to be $11.9 million (rather than the represented $4.9 million), and (b) State Farm prevails at trial, and it is found that the Association's earthquake damages were only the presettlement amount of $2.5 million, which State Farm had previously paid. In this scenario, when eight years of interest is added on, State Farm would have "overpaid" the Association by $3.9 to $4.2 million. According to State Farm, this scenario demonstrates

State Farm points out that cases supporting the "keep the money and sue" principle do not involve the release of a disputed claim, and instead involve the sale of a res, citing *Persson v. Smart Inventions, Inc., supra*, 125 Cal.App.4th at p. 1153 [a shareholder who was fraudulently induced to sell his shares in a company was not required to rescind the stock redemption agreement and return the benefits he received under it in order to sue for fraud; the release in the agreement he was fraudulently induced to execute did not bar the claim]. *Persson* and similar cases, State Farm asserts, are different from cases such as this, where "the release was the sole object of the settlement agreement . . . ." Again, we cannot agree that State Farm's distinction is either correct or relevant. Certainly State Farm's purpose was to obtain a release from any further earthquake damage claims by the Association, but that was not the "sole object of the settlement agreement," which also resolved State Farm's liability for its underlying contractual obligation. In other words, as we have previously noted, State Farm was not simply "buying peace" (*Cilibrasi v. Reiter* (1951) 103 Cal.App.2d 397, 399), as is the case with the release of a personal injury claim, but was simultaneously satisfying an underlying contractual obligation.

3. Policy considerations and out-of-state precedents.

Policy considerations lend considerable support to our conclusion that the *Garcia/Taylor* principle – that a fraudulently induced contract of release cannot be avoided without rescinding the contract and restoring the money paid for the release – should not be applied to an insurance settlement. These considerations are illustrated in

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that the *Garcia/Taylor* principle, requiring the Association to return $1.5 million as a condition precedent to suing State Farm for fraud, "makes more sense and is more equitable to the parties." While any scenario is theoretically possible, we question the likelihood that State Farm's premises would come to pass. In any event, public policy considerations suggest that the risk of an overpayment by an insurer who is alleged to have misrepresented policy limits in obtaining a settlement is more acceptable than the risk that an insured will be deprived by fraud of the full insurance protection for which it paid.

a line of out-of-state cases holding that, even in a personal injury case, a defrauded party may elect between rescission and an independent action for damages. (E.g., *Phipps v. Winneshiek County* (Iowa 1999) 593 N.W.2d 143, 146 [election of remedies doctrine should generally be available to a defrauded party to a settlement agreement]; *Matsuura v. Alston & Bird* (9th Cir. 1999) 166 F.3d 1006, 1008, fn. 4, mod. 179 F.3d 1131 [applying Delaware law to claim that settlement of products liability suits for property damage was fraudulently induced; "the weight of authority favors according defrauded tort plaintiffs an election of remedies" citing cases].)[5] Of course, we cannot and do not question the continuing vitality of *Garcia* and *Taylor* as controlling statements of California law governing contracts of release in personal injury cases. But, as we have seen, insurance settlements are not personal injury cases, and sound reasons exist for

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5 See also *Gaskins v. Southern Farm Bureau Casualty Ins. Co.* (2003) 354 S.C. 416, 419-420 [suit against insurer for fraudulently inducing settlement of claim against insured for personal injuries; "a majority of courts now recognize a tort against an insurance company for fraudulently obtaining a release"; "[a] primary reason why courts recognize the tort is to discourage insurance companies from engaging in fraud"]; *DiSabatino v. United States Fidelity & Guaranty Co.* (D. Del. 1986) 635 F.Supp. 350, 352, 353 (*DiSabatino*) ["tort claimant has an election to stand on a fraudulently induced release and proceed on a cause of action based on fraud"; "settlement agreement involving the release of a cause of action should be treated no differently from a fraudulently induced commercial contract in which courts routinely allow an election of remedies"]; but see *Stefanac v. Cranbrook Educational Community* (1990) 435 Mich. 155, 159 [when a plaintiff has entered into a settlement agreement, tender of consideration must occur before or at the time of a suit raising a legal claim in contravention of the agreement]; *Ledbetter v. Frosty Morn Meats* (1963) 274 Ala. 491, 498 [to avoid a release, plaintiff was bound to return the consideration within a reasonable time after discovery of the alleged fraud; if she were allowed to retain the benefits and reject the burdens, "[t]here would be no rescission in toto, no restoration of the status quo, notwithstanding the plaintiff was in a position to do so"]; *Shallenberger v. Motorists Mutual Ins. Co.* (1958) 167 Ohio St. 494, 502, 504 [it is illogical to affirm an agreement not to sue for personal injuries and yet recover something on account of those injuries; plaintiff must set aside his agreement not to sue and tender back the consideration]; *Davis v. Hargett* (1956) 244 N.C. 157, 161-162, 163 [plaintiff with a tort claim of undetermined merit who settled and released claim cannot affirm the settlement and sue for fraud].

treating them differently, and permitting the defrauded releasor to affirm the agreement and sue for fraud. Prime among these reasons is that, absent an action for fraud, many plaintiffs who have been fraudulently induced to enter into a settlement agreement "otherwise would be left with no practical remedy." (*Matsuura v. Alston & Bird, supra*, 166 F.3d at p. 1008, fn. 4.) As one court has observed, "[i]n many cases, plaintiffs have spent much, if not all, of the settlement sum on necessities before discovering the fraud." (*DiSabatino, supra*, 635 F.Supp. at p. 356.) This is just such a case, where the $1.5 million settlement monies have long been spent on earthquake repairs. Moreover, a rule limiting the remedy to rescission does little to discourage fraud:

> "Simply as a matter of policy, this cause of action [alleging a settlement procured by fraud] should be deemed to exist. First, insurance companies would have everything to gain and nothing to lose by systematically defrauding tort claimants into accepting low settlement offers. In such cases the company gambles that the deceit will not be uncovered. If the fraud is uncovered, then the company only faces litigation, or the costs of reimbursement, that it would have had to confront without a settlement. . . . Moreover, such a rule would enforce a higher standard of care among insurance agents, thus helping to prevent cases of merely negligent misrepresentation." (*DiSabatino, supra*, 635 F.Supp. at pp. 355-356.)

In short, we see no good reason to extend the *Garcia/Taylor* rule to insurance settlements, and a number of good reasons not to do so.

4. The rule against speculative damages does not apply.

State Farm contends that permitting a plaintiff to affirm an insurance settlement and sue for fraud would run afoul of the rule against creating claims where damages are speculative, citing *Taylor, supra*, 207 Cal at p. 103 ["[t]he difficulty in determining the amount of damages is insurmountable"]. State Farm says fraud damages will be speculative because we do not know the value of the Association's underlying claim, and to determine that value, the trier of fact will have to determine the nature and extent of the covered losses, thus "re-litigat[ing]" the contract claim and rendering "the release

State Farm bargained for . . . totally worthless." It is true the facts of the Association's contract claim must be litigated to show the value of the claim it released – that is, that the Association had, as it alleges, a valid, covered claim for damages exceeding $8 million – in order to establish the damages caused by the fraud. As the Association observes, the issue is what the claim was worth and whether the Association would have compromised a claim of that value had it known there were additional millions of dollars in coverage available. The Association's damages would be calculated based on the amount for which the parties would reasonably have settled had the Association known the actual policy limits. We fail to see at this juncture in the appeal any impropriety or speculation in this approach; there is no uncertainty of the type *Taylor* found in a fraudulently induced personal injury settlement, where the plaintiff's cause of action would have had no value at all if the defendant was not negligent.[6] (*Taylor, supra*, 207 Cal. at p. 104; see also *DiSabatino, supra*, 635 F.Supp. at p. 355 ["[i]n any action based on fraud, the fact finder will simply measure the extent of the plaintiff's damages by examining what the agreement would have been, had the parties known the actual material facts"; the nature of injuries in a foregone tort action are relevant "only to the extent of how they would affect the value of the claim to be compromised in the context of the actual coverage provided by the defendant insurance carrier"].)

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[6] State Farm also relies on *Cedars-Sinai Medical Center v. Superior Court* (1998) 18 Cal.4th 1 (*Cedars-Sinai*), which cited *Taylor, supra*, 207 Cal. at pp. 103-105, for the principle that the court had, in the past, "considered the uncertainty of determining hypothetically whether a particular plaintiff would have prevailed on a legal claim as sufficient reason for refusing to recognize a tort remedy for other forms of wrongful conduct." (*Cedars-Sinai, supra*, 18 Cal.4th at p. 14.) In *Cedars-Sinai*, the court refused to create a separate tort cause of action for intentional spoliation of evidence, observing it would be impossible for the jury to assess the role the missing evidence would have played in the determination of the underlying action. (*Id.* at pp. 4, 14.) We cannot see any comparable impossibility in an ordinary fraud case.

To summarize: The principles established in *Garcia* and *Taylor*, holding that a plaintiff cannot avoid a fraudulently induced contract of release without rescinding the contract and restoring the money paid as a consideration for the release, do not apply to a contract for the settlement and release of insurance claims, where the insurer is alleged to have induced the settlement by misrepresenting policy limits. Instead, the principle applicable to ordinary contracts – that a party induced by fraud to execute a contract has the option of rescinding it or affirming it and recovering damages for the fraud – applies. Any other conclusion would leave a defrauded insured with no practical remedy and would do nothing to discourage fraud in the settlement of insurance claims. Accordingly, the trial court erred in sustaining State Farm's demurrer to the Association's second amended complaint.[7]

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[7] State Farm also contends the Association's second amended complaint does not plead fraud with sufficient particularity, because it does not identify who at State Farm misrepresented the policy limits, their authority to make the representation, and so on. However, the trial court did not sustain State Farm's demurrer on the ground of lack of specificity, which in any event has no merit. The objectives of the specificity requirement in a fraud pleading are to give the defendant notice of " 'definite charges which can be intelligently met,' " and to permit the court to determine whether a prima facie foundation exists for the charge of fraud. (*Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 216-217, citations omitted.) The Association's fraud claim is perfectly clear, and the facts are presumably within State Farm's own records. (See *id.* at p. 217 ["[l]ess specificity is required when 'it appears from the nature of the allegations that the defendant must necessarily possess full information concerning the facts of the controversy' "].)

DISPOSITION

The judgment is reversed and the cause is remanded to the trial court with directions to vacate its order sustaining State Farm's demurrer and to enter a new order overruling the demurrer. Village Northridge Homeowners Association is to recover its costs on appeal.

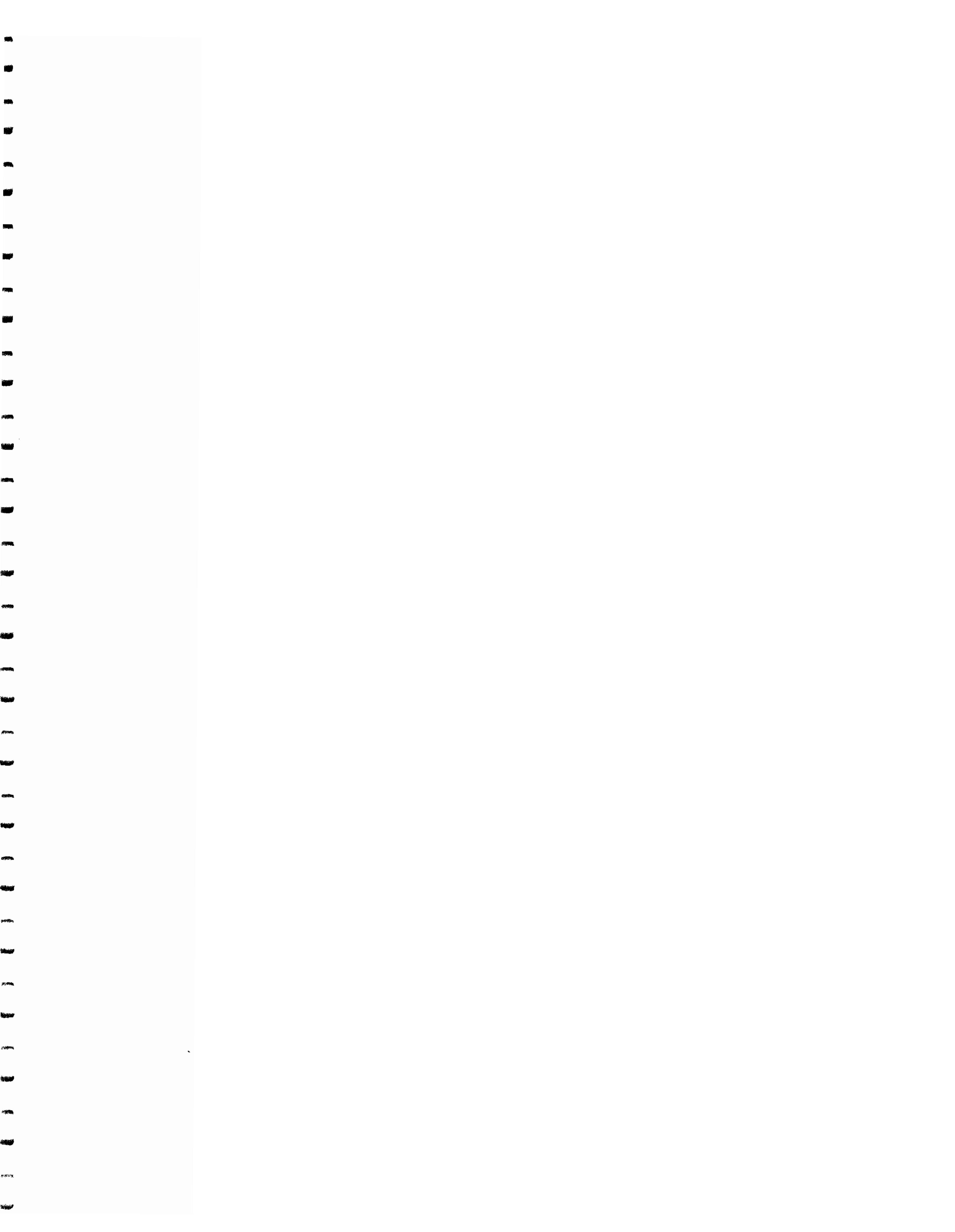
CERTIFIED FOR PUBLICATION

RUBIN, J.

We concur:

COOPER, P. J.

FLIER, J.



Filed 1/15/08

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION EIGHT

VILLAGE NORTHRIDGE HOMEOWNERS ASSOCIATION,

Plaintiff and Appellant,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant and Respondent.

B188718

(Los Angeles County Super. Ct. No. BC 265328)

ORDER MODIFYING OPINION and DENYING PETITION FOR REHEARING
[change in judgment]

IT IS ORDERED that the opinion filed in the above-captioned matter on December 17, 2007, be modified as follows:

On page 15, the final sentence of the text is deleted and the following sentence is substituted: "Accordingly, the trial court erred in sustaining State Farm's demurrer to the cause of action for fraud in the Association's second amended complaint."

On page 15, footnote 7 is modified by adding a new initial paragraph, so that the present text becomes the second paragraph of the footnote. The new first paragraph of footnote 7 reads as follows:

> "Dismissal of the Association's causes of action for breach of contract and breach of the implied covenant of good faith and fair dealing is proper. The Association has repeatedly stated, including

EXHIBIT C

in response to the court's express inquiry, that it does not seek to rescind the settlement agreement and release, but rather seeks to affirm the settlement and recover damages for fraud."

On page 16, the first sentence of the disposition is deleted and the following sentence is substituted: "The judgment is reversed and the cause is remanded to the trial court with directions to vacate its order sustaining State Farm's demurrer and to enter a new order sustaining the demurrer as to the causes of action for breach of contract and breach of the implied covenant of good faith and fair dealing and overruling the demurrer as to the cause of action for fraud."

This modification effects a change in the judgment.

The petition for rehearing is denied.

COOPER, P.J. RUBIN, J. FLIER, J.

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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION: 8

DATE: January 25, 2008

James R. Robie
Robie & Matthai
500 So. Grand Avenue
15th Floor
Los Angeles, CA 90071-2609

Northridge Earthquake Litigation
(State Farm)
Village Northridge Homeowners Association
v.
State Farm Fire & Casualty Company

B188718
Los Angeles County No. BC265328

THE COURT:

Respondent's Request for Modification of the Court's Opinion filed on January 16, 2008, is denied.

cc: File

EXHIBIT D

PROOF OF SERVICE

I declare that I am over the age of eighteen (18) and not a party to this action. My business address is 500 South Grand Avenue, 15th Floor, Los Angeles, CA 90071-2609.

On February 20, 2008, I served the foregoing document(s) described as:

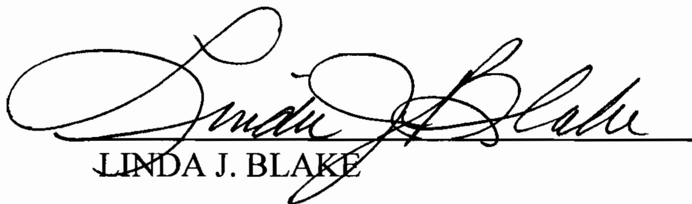
PETITION FOR REVIEW

on all interested parties in this action by placing a true copy of each document, enclosed in a sealed envelope addressed as follows:

See Attached Service List

(X) **BY MAIL:** as follows: I am "readily familiar" with the firm's practice of collection and processing of correspondence for mailing with the United States Postal Service. I know that the correspondence was deposited with the United States Postal Service on the same day this declaration was executed in the ordinary course of business. I know that the envelope was sealed and, with postage thereon fully prepaid, placed for collection and mailing on this date in the United States mail at Los Angeles, California.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on February 20, 2008, at Los Angeles, California.



LINDA J. BLAKE

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CALIFORNIA COURT OF APPEAL Second Appellate District, Division Four 300 S. Spring Street Floor 2, North Tower Los Angeles, California 90013-1213	2nd Civil No. B188718