LHB PACIFIC LAW PARTNERS LLP

April 19, 2010

Honorable Justices
California Supreme Court
350 McAllister St.
San Francisco, CA 94102-7303

Re: *Village Northridge v. State Farm Fire & Cas. Co.*
Case No. S161008
Supplemental Letter Brief Submitted Pursuant to the Court's March 30, 2010 Order

Honorable Justices:

By order dated March 30, 2010, this Court requested further briefing on the following issue:

> Should the Court overrule *Garcia v. California Truck Co.* (1920) 183 Cal. 767, 773, and *Taylor v. Hopper* (1929) 207 Cal. 102, 105?

State Farm Fire and Casualty Company ("State Farm") submits the answer is, "No."

I. Introduction

Fairness never gets old. There are some ninety-year old cases that, read today, seem quaint. The subjects are obsolete, or technology has eliminated the underlying problem. But the facts and circumstances of *Garcia v. California Truck Co.* (1920) 183 Cal. 767 ("*Garcia*") and *Taylor v. Hopper* (1929) 207 Cal. 102 ("*Taylor*"), are as relevant today as they were in the 1920's. Cars may go faster and medical bills may be higher, but the scenarios in *Garcia* and *Taylor* are

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repeated every day at mediators' offices, and in the hallways of every Superior Court: parties still settle disputes, for the same reasons they did ninety years ago – to avoid the expense and uncertainty of trial.

The stories in *Garcia* and *Taylor* are the stories of today. Consider, for instance, the facts of *Taylor*. The plaintiff filed suit for money damages. The parties settled their dispute, with the defendant paying the plaintiff a sum of money in return for dismissal of the plaintiff's suit. Plaintiff then filed a second suit, contending that the defendant induced her to settle for a "grossly inadequate" amount by making false statements during the negotiation of the settlement, and by taking advantage of her "necessities and distress." *Taylor*, *supra*, 207 Cal. at pp. 102-03.

The circumstances in *Taylor* are substantively identical to those here. The settling plaintiff Village Northridge Homeowners Association ("Village Northridge") uses the *allegation* of fraud to escape the finality of a prior settlement agreement. The defendant State Farm is stripped of the "peace" purchased in the settlement agreement by the *accusation* of fraud. Furthermore, because this case is positioned at the demurrer stage, this Court – like the Court in *Taylor* – must determine the proper remedy *before* any fraud has been proven. At this point in the litigation, the specter of fraud exists solely within the contentions of the Village Northridge complaint; it has not been established by testimony nor confirmed by any finder of fact. Not surprisingly, State Farm (like the *Taylor* defendant before it) vehemently disputes Village Northridge's claims.

The dilemma now facing this Court is the same as that in *Taylor* and *Garcia* ninety years ago: What is the most equitable and expeditious means to allow parties in this situation to resolve their disputes? For the past century, beginning with Civil Code section 1691 and followed by *Garcia* and *Taylor*, California's courts and Legislature have provided a singular answer: rescission. Nothing has occurred to render *Garcia* and *Taylor* less relevant or applicable. These two cases address and resolve the fundamental unfairness of any attempt to create "settle and sue" as an alternative remedy. The sound reasoning of this Court in rejecting the "settle and sue" approach remains as valid today as the moment these cases were decided, bolstered by fifty years of legislative codification in the form of Civil Code sections 1691, 1692, and 1693.[1]

The rule in *Garcia* and *Taylor*, and confirmed in sections 1691-1693, has been the bedrock for settlement agreements in California for nearly one-hundred years. There has been no outcry from parties or the courts of this state, censuring

[1] All further statutory references are to the Civil Code, unless otherwise indicated.

or otherwise suggesting that these sound precedents have become unworkable or inappropriate. Overturning such well-established case law, in violation of the principle of stare decisis, would undo the finality of settlement agreements in California and promote the filing of additional lawsuits. Far worse, it would be grossly unfair.

I. The Principles of Stare Decisis Present a Formidable Obstacle to Any Request To Overturn Existing Case Law.

The requirement of rescission, as set forth in *Garcia* and *Taylor*, has been part of California law for over a century. Such deep-rooted law cannot be set aside lightly, and should not be overruled at all.

"Principles of stare decisis present a formidable obstacle" to any request that the Supreme Court reconsider legal precedent. *People v. Garcia* (2006) 39 Cal.4th 1070, 1080. This doctrine "'is based on the assumption that certainty, predictability and stability in the law are the major objectives of the legal system; i.e., that parties should be able to regulate their conduct and enter into relationships with reasonable assurance of the governing rules of law.'" *Ibid.*, quoting 9 Witkin, Cal.Procedure (3d ed. 1985) Appeal, § 758, at p. 726. "[R]eexamination of precedent may become necessary when subsequent developments indicate an earlier decision was unsound, or has become ripe for reconsideration." *Moradi-Shalal v. Fireman's Fund Ins. Companies* (1988) 46 Cal.3d 287, 296. But, "[i]t is, of course, a fundamental jurisprudential policy that prior applicable precedent usually must be followed even though the case, if considered anew, might be decided differently by the current justices." *Id.* at p. 297.

The weight of precedence is particularly important where the issue under consideration is inextricably integrated in a greater body of law. See *People v. Latimer* (1993) 5 Cal.4th 1203, 1214, construing *Quill Corp. v. North Dakota* (1992) 504 U.S. 298 [Supreme Court refused to overrule a decision that had "engendered substantial reliance" and had "become part of the basic framework of a sizeable industry"]. For instance, where the decision to be reconsidered has become a "pervasive" part of a complex and comprehensive statutory scheme, "stare decisis mandates adherence to it." *Latimer, supra*, 5 Cal.4th at pp. 1214-16. "'*Stare decisis* has added force when the legislature, in the public sphere, and citizens, in the private realm, have acted in reliance on a previous decision, for in this instance overruling the decision would dislodge settled rights and expectations or require an extensive legislative response.'" *Latimer, supra*, 5 Cal.4th at pp. 1213-14, quoting *Hilton v. South Carolina Public Railways Comm'n* (1991) 502 U.S. 197, 202.

Disentangling *Garcia* and *Taylor* from the extensive case and statutory authority governing the rescission of settlement agreements, and discarding a century-old rule of law upon which countless settlement agreements have been based, present "formidable obstacles" to overruling precedent. In the words of this Court, this is "a rightly onerous task." *Trope v. Katz* (1995) 11 Cal.4th 274, 288.

II. Overturning *Garcia* and *Taylor* Would Undermine California's Public Policy Favoring Settlement Agreements and the Legislative Intent Behind Rescission Procedure.

A. *Garcia* and *Taylor* Form the Foundation of California Policy Favoring the Settlement of Civil Disputes.

Garcia and *Taylor* are well-considered opinions entirely consistent with California's rescission statutes. If *Garcia* and *Taylor* are overturned, both the Legislature's intent in enacting the 1961 amendments to the rescission statutes and the greater public policy in favor of civil settlements will be irreparably thwarted.

California has a strong policy favoring settlement of civil litigation. See *In re Marriage of Assemi* (1994) 7 Cal.4th 896, 910; *Neary v. Regents of University of California* (1992) 3 Cal.4th 273, 277. "'[I]t is the policy of the law to discourage litigation and to favor compromises of doubtful rights and controversies, made either in or out of court.' Settlement agreements 'are highly favored as productive of peace and goodwill in the community, and reducing the expense and persistency of litigation.'" *Stambaugh v. Superior Court (Pacific Gas & Electric Co.)* (1976) 62 Cal.App.3d 231, 235-36 (cit. om.). This policy has never been more important than it is now, given the current financial crisis facing our courts.

Consistent with this policy, the finality of settlement agreements must be safeguarded where possible. In fact, settlement agreements are considered "presumptively valid, and the plaintiff remains bound by the bargain he made until he actually rescinds it." *Myerchin v. Family Benefits, Inc.* (2008) 162 Cal.App.4th 1526, 1536.

Prior to 1961, there were two ways in which a party alleging fraud could rescind a prior settlement agreement. The first was "unilateral" or "out-of-court rescission," which could be effected by notice to the non-rescinding party, combined with an offer to restore all consideration received under the settlement agreement. *Runyan v. Pacific Air Industries, Inc.* (1970) 2 Cal.3d 304, 311-12. This process was codified in 1872 as Civil Code section 1691. See *Id.* at p. 311; *Garcia*, *supra*, 183 Cal. at p. 769. The second was "judicial rescission": an

equitable action for specific judicial relief for the wrong giving rise to the right of rescission. *Runyan, supra*, 2 Cal.3d at p. 312.

In 1920, this Court in *Garcia* applied section 1691 to bar the plaintiff's action for damages, where there had been a prior contract of release, no rescission of the settlement contract, and no attempt to tender to the defendant the amount previously paid under the release. In its opinion, the Court confirmed that section 1691 was explicit that there can "be no rescission without restoration of the consideration." *Garcia, supra*, 183 Cal. at p. 769. In so holding, the Court stated: "We are aware of no good reason why this express statutory provision is not as fully applicable to a contract of release of claim for damages for personal injuries as to any other contract. ... [A]n examination of the cases shows that this is generally accepted as true, *especially in the presence of such a statutory provision as we have in this state*." *Id.* at pp. 769-70 (emphasis added).

Nine years later, this Court in *Taylor* again applied section 1691 to find that the plaintiff's complaint failed to state a cause of action, where it did not allege that the plaintiff had returned the consideration paid by the settling defendant. *Taylor, supra*, 207 Cal. at p. 103. The Court opined that the plaintiff could not state a claim for fraud without first rescinding the settlement agreement, because such a claim would be "too speculative and wagering to be recognized by the law." *Id.* at p. 104. In doing so, the Court specifically rejected the "affirm and sue" model as a viable way of challenging a settlement agreement.

B. The Legislative History Behind the 1961 Comprehensive Revisions To the Rescission Statutes Confirm *Garcia* and *Taylor*.

In the nearly ninety years since *Garcia* and *Taylor*, no California court has abrogated their rulings. In that same time, the Legislature has not only never disavowed those cases, but has instead reaffirmed the restoration requirement and taken steps to streamline rescission procedure. In 1961, the Legislature made numerous changes to the statutory provisions relating to rescission, including: the amendment of section 1691, the addition of sections 1692 and 1693, and the repeal of former sections 3406-3408 [dealing with "judicial rescission"]. *Runyan, supra*, 2 Cal.3d at pp. 312-13. These amendments abolished the concept of dual rescission, and replaced it with a single "notice-and-offer" procedure, whereby all rescissions required the rescinding party to tender the consideration as a pre-condition of setting aside the contract. See Commission's Recommendations and Study relating to Rescission of Contracts (1960) in 3 Cal. Law Revision Com. Rep. (1961), p. D-6 ("Law Revision Commission Report").

During the process leading up to the amendments, the California Law Revision Commission ("Commission") debated the wisdom and equity of the restoration requirement. In fact, the original version of section 1692 was written to materially weaken this condition precedent: "[N]otwithstanding the provisions of section 1691 of this code ... rescission shall not be denied because of a failure to restore or to offer to restore the benefits received under such contract...." Cal. Law Rev. Com., Memorandum re Rescission of Contracts (A), "Subject: Summary of Revisions Agreed Upon by Commission," July 1, 1958, pp. 4-5.

Eventually, the Commission rejected these ideas and concluded that, according to "settled" California law, "a pre-action notice of rescission and an offer of restoration is a condition to both the action to obtain a rescission and the action to enforce an out-of-court rescission." Law Revision Commission Report, p. D-29. Its final recommendation thus left intact section 1691's restoration requirement, even adding the language: "When notice of rescission has not otherwise been given or an offer to restore the benefits received under the contract has not otherwise been made, the service of a pleading in an action or proceeding that seeks relief based on rescission shall be deemed to be such notice or offer or both." Id., at p. D-10.

In order to provide plaintiffs with a remedy in case restoration could not be immediately made, the Commission proposed the following language in section 1693 (later adopted into law):

> A party who has received benefits by reason of a contract that is subject to rescission and who in an action or proceeding seeks relief based upon rescission shall not be denied relief because of a delay in restoring or in tendering restoration of such benefits before judgment unless such delay has been substantially prejudicial to the other party; but the court may make a tender of restoration a condition of its judgment.

Law Revision Commission Report, p. D-10.

The Commission's report to the Governor and to the Legislature also recognized the concerns unique to the rescission of releases:

> The courts have permitted [a plaintiff who was allegedly fraudulently induced to execute a release] to sue on the underlying cause of action and have the consideration received for the release offset against the judgment recovered against the defendant. This procedure may be quite unfair to a defendant if the plaintiff does not

> recover a judgment as large as the consideration he received or if the plaintiff fails to establish any cause of action. In such cases, the defendant has been deprived of the benefit of his bargain without a restoration of the payment made.

Law Revision Commission Report, at p. D-8. To deal with this issue, the Commission suggested that a separate section be added to the Code of Civil Procedure. Under the Commission's proposed CCP secton 598, the trial court would first determine the validity of the release. If the settlement contract was found invalid, the consideration paid to the plaintiff would be set-off against any future judgment. Id., at pp. D-8, D-13-14.

As reflected in the Commission's reports and the adopted statutory language, the Legislature decided ***against*** excusing rescinding plaintiffs from the requirement to offer restoration. It is abundantly clear that the problems attendant to the rescission of releases were at the forefront of the Legislature's overhaul of rescission procedure, and that the idea of allowing a setoff was presented. It is also apparent that the Commission's recommendation of CCP section 598 was rejected – in doing so, the Legislature declined to endorse the setoff proposal, instead expressing its intent to treat settlement agreements and releases like any other contract subject to section 1691. But, as a compromise, section 1693 was enacted to manage any inequity resulting from the inability to immediately tender consideration.

The 1961 amendments are the byproduct of an extensive study and years-long effort by the Commission and the Legislature to craft a fair and practicable rescission structure. *Taylor* and *Garcia* are the foundation for this structure. To overrule these cases would directly contravene legislative intent and existing statutory law.

C. The Doctrine of Stare Decisis Applies to Preserve *Garcia* and *Taylor*.

The weight of judicial and legislative history arising from *Garcia* and *Taylor* prevents Village Northridge from successfully arguing that stare decisis does not apply. The burden on a party seeking to overturn precedent is "roughly proportional to a number of factors, including the age of the precedent, the nature and extent of public and private reliance on it, and its consistency or inconsistency with other related rules of law." *Trope, supra*, 11 Cal.4th at p. 288.

Almost fifty years have passed since the 1961 amendments, more than ninety years since the *Garcia* and *Taylor* rulings, and more than one hundred thirty

years since section 1691 was first enacted. During that time, millions of Californians have entered into settlement agreements, relying on the fact that rescission of such agreements would entail the return of any consideration. California courts have adjudicated those agreements according to the dictates of section 1691 and its related statutes – as correctly interpreted in *Garcia* and *Taylor* – without incident, until the Court of Appeal's decision in this matter.

There is no reason to believe that reexamination of *Garcia* and *Taylor* – this Court's well-reasoned primogenitur of current rescission structure – is necessary. No published Court of Appeal decision has demonstrated that the *Garcia-Taylor* rule, embodied in the statutory remedy of rescission, creates problems for litigants in dealing with post-settlement disputes. Rather, *Garcia* and *Taylor* have been repeatedly followed by California Courts of Appeal, most recently by the Fourth District Court of Appeal in *Myerchin*, *supra*, 162 Cal.App.4th 1526. Plainly, *Garcia* and *Taylor* have not become "unsound" or become otherwise "ripe for reconsideration." *Moradi-Shalal*, *supra*, 46 Cal.3d at p. 296.

For example, compare the stability of the *Garcia-Taylor* rule with the firestorm surrounding the "*Royal Globe* rule" overturned in *Moradi-Shalal*. In the nine years between the *Royal Globe* decision and *Moradi-Shalal*, the "*Royal Globe* rule" was rejected by the vast majority of other states, criticized by scholarly commentary, and abrogated by the Legislature. *Moradi-Shalal*, *supra*, 46 Cal.3d at pp. 297-304. Given that *Royal-Globe* "generated confusion and uncertainty regarding its application," this Court concluded the case should be overruled. *Id.* at p. 304.

Garcia and *Taylor* have not engendered the controversy of *Royal Globe*, and were in fact fortified by the Legislature in 1961. In its amendments to the rescission statutes, the California Legislature confirmed the continued necessity of restoration to the rescission process, even as applied to settlement agreements. The significance of stare decisis is even greater when legislative reliance is potentially implicated. *Latimer*, *supra*, 5 Cal.4th at pp. 1213-14. Where, as here, there exists manifold "precedent applying authoritative, settled statutory construction that ha[ve] been central to the analysis and holdings of these decisions" and the Legislature has done nothing to contradict these decisions, "[t]he principles underlying the doctrine of stare decisis apply with special force." *Barner v. Leeds* (2000) 24 Cal.4th 676, 685, fn. 2. As the Legislature has declined to speak out against the *Garcia-Taylor* rule, stare decisis suggests that this Court should also decline.

Overruling *Garcia* and *Taylor* would undermine the simplified rescission procedure contemplated by the Legislature, countermand enduring precedent, and interfere with time-honored California policy. Even out-of-state authorities do not provide adequate justification.[2] In view of the overwhelming judicial and legislative history, *Garcia* and *Taylor* should be upheld.

III. Overturning *Garcia* and *Taylor* Would Create a Process That Would Be Both Inequitable and Impractical.

As a practical matter, eliminating the fundamental rescission rules in *Garcia* and *Taylor* would result in an inequitable and impractical settlement process.

First, allowing a rescinding plaintiff to retain the consideration paid under a settlement agreement would, in essence, assume that the plaintiff will ultimately prevail – e.g. that the settling defendant was liable – at the *pleading stage*. As the Commission itself recognized, this assumption is not only tautological, but "quite unfair" to the defendant. Law Revision Commission Report, p. D-8. This prejudice to the non-rescinding party was recently explained by the Court of Appeal in *Myerchin*:

> Myerchin's arguments [that failure to restore is not prejudicial] are unpersuasive. ... [T]he merits of Myerchin's original contract claim were disputed, and his self-serving contention that he was entitled to be paid [the amount demanded] in his original complaint is just that – a contention. It does not constitute substantial evidence that Family Benefits would actually be required to pay him ... if the settlement agreement were rescinded.

Myerchin, *supra*, 162 Cal.App.4th at p. 1535, fn. 4.

In essence, excusing a rescinding plaintiff from the restoration requirement permits the plaintiff to recover on its claim *before* any finding of liability on the part of the defendant. The plaintiff in this scenario will have received money from the defendant *without having to prove either the underlying case or the fraud*! Such a situation would be completely nonsensical, and could not be considered fair under any circumstances, particularly in light of section 1693.

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[2] As explained in State Farm's Opening Brief on the merits, the states are relatively evenly split between the *Garcia-Taylor* rule and the "affirm and sue" method. (Opening Brief at pp. 36-38.)

Second, a setoff, as Village Northridge proposes, fails to alleviate the prejudice to the non-rescinding defendant. As discussed above, the Legislature contemplated this option and decided against it. Perhaps the Commission, like the *Myerchin* court, appreciated that the plaintiff's "undeserved *gain*" of the settlement funds could only handicap the defendant:

> [N]o litigant would gratuitously agree to transfer money to its opponent while the dispute remains unresolved. Hence, Myerchin's ability to treat Family Benefits' money as his own during the pendency of the very litigation that money was intended to settle necessarily increases the resources he can use to shoulder the burdens of that litigation – and consequently prejudices the interests of Family Benefits.

Myerchin, *supra*, 162 Cal.App.4th at p. 1535, fn. 4; see also *Moradi-Shalal*, *supra*, 46 Cal.3d at p. 312 [allowing post-settlement suits would give "an unwarranted and unfair advantage" to the plaintiff "who could settle, retain the benefits of settlement, and then sue the insurer for additional compensation after failing to negotiate a larger settlement on the underlying claim."].

Third, not returning the parties to their pre-settlement status deprives the non-rescinding defendant of the benefit of its bargain. A defendant who settles an underlying disputed claim, like State Farm here, agrees to pay money in exchange for freedom from litigation arising from that claim. *Myerchin*, *supra*, 162 Cal.App.4th at p. 1535. Where there is an action for fraud in the inducement of the settlement agreement, the defendant has no choice but to litigate the exact claim it paid to extinguish, even if no fraud is ever shown. If the consideration is not returned, the defendant would quite literally have paid money and received nothing in return.

This Court adopted similar reasoning in *Moradi-Shalal.* There, the Court recognized the problems created by a rule that, by its nature, turned one dispute into two: first the fight over the dispute, then the fight over the settlement of the dispute.

> Another problem with allowing the proposed post-settlement litigation is that it would deprive the settling parties of a major advantage of settlement. Establishing the insured's actual liability after settlement would involve litigation of the very issue that the insured and the insurer attempted to avoid litigating. Whether the claimant wins or loses on the liability issue, he has succeeded in forcing the insurer and insured to litigate the claim they had

> previously concluded by settling. Allowing such a post-settlement trial on the insured's liability would diminish any advantage to be gained by either the insured or the insurer in settling the underlying claim. Indeed, it would *penalize* the insurer for choosing to settle a claim rather than pursing it to a final judgment, by subjecting the insurer to subsequent litigation on the liability issue it has already settled.

Moradi-Shalal, supra, 46 Cal.3d at p. 312.

Moradi-Shalal's concerns mirror those that would arise should this Court overturn *Garcia* and *Taylor*. Litigants, especially defendants, will be compelled to incorporate the likelihood of a second lawsuit for fraud in the price of every settlement. Under the system suggested by Village Northridge, all the risks of settlement will be borne by defendants, and plaintiffs will have little to lose in settlement. Plaintiffs can create a "floor" for damages by settling, then seek more money by simply *alleging* fraud in a rescission suit. With no restoration requirement, plaintiffs may keep the settlement money even if they ultimately *lose*!

In the meantime, defendants lose the peace purchased with the original settlement agreement, and are forced to expend resources defending against both the underlying dispute and the fraud claim. If the defendant prevails in the end, it will be obliged to expend even more resources to collect *its own money* back from the plaintiff. In such a situation, where a series of lawsuits could result despite their best efforts, defendants will have little or no motive to settle.

Additionally, the Court must consider the implications of overturning *Garcia* and *Taylor* for settling *plaintiffs*. If a settling party is permitted to "affirm and sue," outside the boundaries of rescission law, then a settling defendant could allege fraud in the execution of the settlement agreement as easily as the settling plaintiff. In that circumstance, the settlement amount would be converted into a "ceiling." This is more than a mere speculative hypothetical – at least one published appellate decision has rejected a defendant's attempt to use "affirm and sue" to challenge a settlement agreement for fraud. *Triplett v. St. Armour* (Mich. 1993) 507 N.W.2d 194, 196-97.

The current rescission structure, as developed by case law and the Legislature, contemplates a remedy for both the plaintiff and the defendant. It recognizes that, at a point in the proceedings where fraud remains in dispute, the most reasonable approach returns the parties to where they last walked the same

path – e.g. on either side of the underlying dispute prior to settlement. The parties would then be free to litigate both the prior claim and the alleged fraud.

Equity, legislative policy, judicial precedent, and just plain common sense dictate that *Garcia* and *Taylor* must be upheld. To hold otherwise would be damaging to the civil litigation system, and interfere with the strong policy in favor of settlement.

IV. As Discussed in *Garcia* and *Taylor*, Rescission is the Only Fair Remedy.

Unable to avoid the application of *Garcia* and *Taylor*'s rescission requirement, Village Northridge attempts to argue that it is not rescinding the settlement agreement, but is rather affirming the agreement and suing on the independent ground of fraud. This specious argument was squarely addressed in *Taylor*, and should be squarely rejected by this Court as it was there:

> It seems clear upon principle that such a remedy does not exist in a case such as we are considering. The difficulty in determining the amount of damages is insurmountable. ...
>
> 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.

Taylor, *supra*, 207 Cal. at pp. 103-05; see *Cedars-Sinai Medical Center v. Superior Court (Bowyer)* (1998) 18 Cal.4th 1, 14-15 [citing *Taylor* with approval for this same issue].

This Court acknowledged in *Taylor* and later in *Moradi-Shalal*, that any trial of fraud in the inducement of a settlement agreement will, as a practical matter, demand that the parties litigate the merits of the settled dispute. This is because the alleged fraud carries with it no independent measure of actual damages. Assuming the presence of fraud, which State Farm disavows, the only damages that could possibly arise from a rescission for fraud claim is the amount that plaintiff *would have* settled for (and that defendant *would have* paid) if the allegedly concealed information had been revealed. And – even if such an amount could be actually proven and not simply fabricated *post-hoc* – the maximum award would be the value of the underlying claim plus any consequential damages.

As the defendant – even if innocent – will be forced to surrender the only benefit it gained under the settlement agreement, a system such as that suggested by Village Northridge will always result in inequity for the defendant who will

have no choice but to fully litigate the merits of the underlying case. The defendant will "in either case lose *the sole benefit* it had contracted for in the settlement – avoidance of the uncertainty and expense of this litigation." *Myerchin, supra*, 162 Cal.App.4th at pp. 1534-35. Accordingly, the only fair method to handle such challenges is to rescind and restore the parties to their pre-settlement positions.

Any unease about inequity in requiring a financially-strapped plaintiff to return the consideration is already addressed by section 1693, which allows a rescinding plaintiff to delay in restoring benefits before judgment unless substantial prejudice is shown by the defendant. In this way, the Legislature ensured that a plaintiff would not be barred from choosing rescission or from pursuing its fraud claim, due solely to its inability to immediately tender the settlement funds.[3]

Section 1693 was enacted precisely to provide plaintiffs like Village Northridge with a remedy, by removing solvency from the rescission equation. Village Northridge maintains that it is unable to tender restoration because the money has already been spent on repairs. To the extent this is true, Village Northridge could have relied upon section 1693 to rescind the settlement agreement without immediate tender of consideration, with a statutory mandate that the money would be returned if it failed to prove entitlement to greater recovery. Instead of choosing the remedy provided by the law, it circumvented the existing statutory scheme and "affirmed and sued" – an option plainly foreclosed by *Taylor*.

No unresolved public policy concern warrants the subversion of *Garcia* and *Taylor*, or the forging of an "affirm and sue" exception. The Legislature's enactment of section 1693, in conjunction with its endorsement of section 1691, unambiguously conveyed that it was unwilling to entirely absolve plaintiffs from the restoration requirement; and section 1693 provided sufficient remedy for a plaintiff financially unable to achieve restoration prior to judgment. Furthermore, in discarding the "setoff" option in favor of section 1693, the legislative intent was to place the risk with the rescinding party. Despite the opportunity, the Legislature wrote no exception for plaintiffs who "need the money," and this Court should not create one.

Requiring rescission of any settlement agreement ensures basic fairness, regardless of whether fraud is ever proven, without creating any undue burden on

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[3] State Farm notes that none of the "affirm and sue" decisions from other states involve a statutory system comparable to California's section 1693.

either party. It places the parties in the position they would have enjoyed but for the rescinded agreement. Equity will allow the fact-finder to first determine if the agreement should be rescinded at all, or the defendant can accept the tender of consideration and move immediately to litigate the underlying dispute. At that point, both the underlying claim and the alleged fraud can be adjudicated without prejudice to either party. If the plaintiff prevails, it "shall be awarded complete relief" including restitution and consequential damages. Civ. Code, § 1692. If the defendant prevails, it may be awarded "any other relief to which he may be entitled under the circumstances." Ibid.

V. Overruling *Garcia* and *Taylor* Would Create Inconsistencies With Other Substantive Areas of California Law.

Overturning *Garcia* and *Taylor* would create inconsistencies with other substantive areas of California law. For example, the settling plaintiff's waiver of section 1542 is a crucial component of most settlement agreements. Absent such a waiver, the plaintiff could continually seek recovery for additional damages by alleging discovery of supposedly "new" facts. See *Jefferson v. Dep't of Youth Authority* (2002) 28 Cal.4th 299, 306-07. Should this Court sanction the "affirm and sue" method by overruling *Garcia* and *Taylor*, a settling plaintiff could in essence nullify its own section 1542 waiver – even while standing on the shoulders of the intact settlement agreement – by couching the discovery as the result of "fraud."

A similar problem relates to a settlement agreement's integration clause, which generally provides that the written contract represents the parties' complete and final agreement, superseding all promises not contained in the agreement, and that the parties will not rely on any express or implied representations other than those set forth in the agreement. In California, the law has long been that a party cannot allege a fraud claim contrary to the terms of a written, integrated agreement. See *Casa Herrera, Inc. v. Beydoun* (2004) 32 Cal.4th 336, 344-36; *Bank of America Nat. Trust & Savings Ass'n v. Pendergrass* (1935) 4 Cal.2d 258, 263-64. Without *Garcia* and *Taylor*'s repudiation of "affirm and sue," a settling plaintiff could avoid this rule, and pursue a fraud claim contrary to the express terms of the "affirmed" settlement agreement.

In affirming a contract, a party must agree to be bound by the *entire* agreement – including any section 1542 waivers or integration clauses. See e.g. *Hines v. Brode* (1914) 168 Cal. 507, 512, superseded by statute on other grounds; *Williamson v. Clapper* (1948) 88 Cal.App.2d 645, 653. A plaintiff can only properly avoid these contraventions of law with rescission, because once a

contract is rescinded all obligations therein are extinguished. *Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal.4th 394, 415; Civ. Code, § 1688.

The doctrine of rescission has been developed in such a way as to allow the parties and the courts to adjudicate disputes about settlement agreements, within the confines of the greater body of contract law. There is no reason to now stray from this canon by upending *Garcia* and *Taylor*.

VI. The Facts Of This Case Do Not Warrant Overruling *Garcia* and *Taylor*

The facts and posture of this case may be the best argument for maintaining the *Garcia-Taylor* rule. The Court in *Taylor* could not have better summarized the position now taken by Village Northridge: "Appellant ... 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, retaining the money received thereunder, and sue for her damages caused by the fraud." *Taylor, supra*, 207 Cal. at p. 103. The *Taylor* Court recognized that such an argument – like Village Northridge's here – is no more than a fallacy.

Village Northridge initiated this case in 2001 by filing a suit for breach of contract and bad faith, the causes of action specifically released in the 1999 settlement and release. (This original complaint never mentioned the release or asserted any fraud.) Following the Court of Appeal's reversal of the trial court order granting summary judgment, Village Northridge amended its complaint to allege a cause of action for fraud. Village Northridge claimed that (six years after the claim and two years after the settlement agreement) it "learned" its policy limits were $12 million, based on a declarations page it possessed the entire time. (2AA 284, ¶6.) But, it denied it was seeking rescission, instead purporting to affirm the agreement and sue for only fraud damages – an argument explicitly precluded by *Taylor*. When challenged, Village Northridge was unable to adequately explain which parts of the agreement it was "affirming" and which parts were "fraudulently induced."

State Farm demurred to the amended complaint, contending that Village Northridge appeared to be rescinding the settlement agreement without truly rescinding. The trial court agreed, and sustained State Farm's demurrer. Village Northridge appealed.

The Court of Appeal held in Village Northridge's favor. The court declined to follow *Garcia* and *Taylor*, but did not conclude that the sound reasons articulated in those cases did not apply to modern civil jurisprudence. The Court of Appeal did, however, concede that the original two causes of action that began

the case could not stand, as Village Northridge could not affirm the compromise and simultaneously sue on the causes of action it had already released.

But the dismissal of the breach of contract and bad faith causes of action did not dispose of the fundamental problem created by Village Northridge's failure to rescind. Village Northridge wishes to affirm the release, but under its approach there is nothing left *to* affirm. It has received a $1.5 million payment for its claims – its entitlement to which State Farm has always unequivocally disputed – but seeks to deny State Farm the settlement agreement's protection. Meanwhile, the money State Farm paid remains with Village Northridge, funding its litigation – win, lose, or draw.

Village Northridge will undoubtedly argue that the problem currently facing the parties can be easily avoided by not misrepresenting facts during the negotiations on a settlement. First, State Farm steadfastly rejects the contention that any misrepresentation ever occurred, and has explained why the earthquake limit is not as Village Northridge claims.

Second, as discussed in its previous briefs, Village Northridge's policy limits have no relevance to the amount for which the parties settled. If a plaintiff can vitiate an earlier agreement by simply alleging irrelevant misrepresentations, without needing to at least offer to return the consideration received, what would prevent a plaintiff from rolling the dice in every case? How could any defendant hope to prevent this type of allegation as the basis for a later attempt to undo a settlement? No defendant would take its chances in this post-settlement lottery.

Third, this Court in *Garcia* and *Taylor* correctly refused to fashion a remedy that was contingent upon the defendant's eventual liability. The concern then, as well as now, was to devise a remedy that would be appropriate regardless of the truth of the fraud allegation. The Court in both *Taylor* and *Garcia* understood this problem ninety years ago, and created remedies that left both parties with reasonable options.

California's rules governing the rescission of settlement agreements are long-standing, with good reason. In ninety years, no Court of Appeal has suggested that *Garcia* and *Taylor* should be overruled. In the many rounds of briefing submitted by Village Northridge, not once did it substantively challenge the legal analysis in those cases, nor did it contend that the *Garcia-Taylor* rule had become unworkable, unfair, or antiquated. Instead, it simply ignored the rule, and argued that an exception applied.

This Court needs look no further than recent cases like *Myerchin*, to perceive the danger to the civil settlement process posed by the removal of *Garcia* and *Taylor*. Without these cases, the settlement process will become mired with uncertainty, where plaintiffs unhappy with their deal can always opt to "affirm and sue" rather than rescind; and defendants must face the significantly increased chance they will be forced to litigate the exact issues they paid to settle, without return of any settlement funds. The settlement process would become impractical and ineffectual, and the cost of litigation would skyrocket.

Californians currently have a fair and reasonable solution to any real problem created by fraud in the inducement of a settlement agreement – rescission. Village Northridge avoided that remedy, for the simple reason that rescission results in fairness for both parties, and "affirm and sue" creates opportunity for one party and prejudice for the other. However, the desires of one party should not form the basis of overturning a method of resolving conflicts that has withstood the test of time.

For these reasons, and those set forth in State Farm's briefs on the merits, *Garcia* and *Taylor* should not be overruled. Doing so would upset ninety years of established case law and a pervasive statutory scheme, and disrupt the long-standing settlement procedure in this state. Under these circumstances, stare decisis must apply to sustain their precedence.

We thank the Court for its attention to this matter.

Very truly yours,

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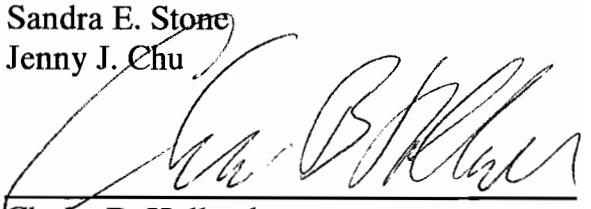

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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF ALAMEDA

I, the undersigned, declare that I am, and was at the time of service of the papers herein referred to, over the age of eighteen years and not a party to the within action or proceeding. My business address is the law firm of LHB Pacific Law Partners, LLP, 5858 Horton Street, Suite 370, Emeryville, California.

On the April 19, 2010, I served the following:

SUPPLEMENTAL LETTER BRIEF SUBMITTED PURSUANT TO THE COURT'S MARCH 30, 2010 ORDER

On the following person(s) in this action:

SEE ATTACHED SERVICE LIST

[X] (BY OVERNIGHT DELIVERY) By placing the document(s) listed above for overnight delivery, in a box or other facility regularly maintained by an express service courier, or delivered to an authorized courier or driver authorized by that express service courier with delivery fees paid or provided for, and addressed as set forth above.

I declare under penalty of perjury, under the laws of the State of California and the United States of America that the foregoing is true and correct.

DATED: April 19, 2010

Tina Felder

SERVICE LIST

Village Northridge HOA v. State Farm Fire, et al.
2nd Civil No. B188718

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