SUPREME COURT

LHB PACIFIC LAW PARTNERS LLP

SUPREME COURT
FILED
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Frederick K. Ohlrich Clerk
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April 29, 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 Reply Brief Submitted Pursuant to the Court's March 30, 2010 Order

Honorable Justices:

Village Northridge Homeowners Association's ("Village Northridge") letter brief falls far short of accomplishing the "onerous task" of demonstrating why this Court should overrule established precedent. *Trope v. Katz* (1995) 11 Cal.4th 274, 288.

A. Village Northridge Has Failed To Articulate Any Reason Not to Apply Stare Decisis and Uphold *Garcia* and *Taylor*.

The decision to overturn precedential case law is an important one. It must be made with full consideration of existing law and legislative history, guided by the strict principles of stare decisis. A party cannot demand the overruling of binding law lightly, or without thoughtful deliberation of the consequences. It must give deference to stare decisis' "persuasive force," and provide the Court with "special justification" to support the "departure from precedent." *Golden Gateway Center v. Golden Gateway Tenants Ass'n* (2001) 26 Cal.4th 1013, 1022.

The supplemental letter brief submitted by Village Northridge wholly fails to address any of these issues. Instead, Village Northridge provided this Court with a hyperbolic, anecdotal, and irrelevant invective against the "business community." Its brief ignores the body of California case law developed over the last ninety years, from *Garcia v. California Truck Co.* (1920) 183 Cal. 767 ("*Garcia*") and *Taylor v. Hopper* (1929) 207 Cal. 102 ("*Taylor*") to *Myerchin v. Family Benefits, Inc.* (2008) 162 Cal.App.4th 1526. It also ignores the statutory

scheme enacted by the California Legislature. It even ignores and misconstrues the trial court's rulings below.

Instead, Village Northridge attempts to rationalize its position by vilifying State Farm – against whom *no fraud has been proven* – and by hypothesizing that *Garcia* and *Taylor* "undermine the tort of fraud, the integrity of our business community and standard of jurisprudence as we know it." But, for all of Village Northridge's sound and fury, it has demonstrated no good reason for this Court to disregard stare decisis and abandon *Garcia* and *Taylor*. The remedy for fraud as set forth in those cases, and codified in the Civil Code, has been the law in California for nearly a century. Contrary to the prophecy of doom described in Village Northridge's brief, this procedure has repeatedly been used by both litigants and courts without incident for decades.

Village Northridge forgets that the question posed by this Court is not about the weighing of two purportedly equal rescission rules – the *Garcia-Taylor* rule versus the "New York rule." The issue is whether current California law is no longer valid, and must be "reassessed." Precedent is not easily set aside. As the party seeking to overturn *Garcia* and *Taylor*, it is Village Northridge's burden to overcome the "formidable obstacle" of demonstrating that these cases have become ripe for reconsideration. Its brief, which relies solely on unsubstantiated fear-mongering, does not meet this burden.

B. The *Garcia-Taylor* Rule Does Not Require Rescinding Parties to Relinquish Any Remedies Available Under the Law.

In its brief, Village Northridge argues that the *Garcia-Taylor* rule is "inconsistent with the very tort and remedy for fraud," because the restoration requirement bars a rescinding party from challenging the settlement agreement if that party cannot tender the consideration. This is not only untrue, it demonstrates a basic misunderstanding of California rescission law.

As discussed in State Farm's supplemental letter brief, the California Legislature has already considered how to contend with rescinding parties who are unable to restore at the outset. To address precisely the type of concern raised by Village Northridge, the Legislature created a remedy for insolvent plaintiffs: Civil Code section 1693.[1] Pursuant to that statute, a plaintiff is not precluded from seeking rescission of a settlement agreement, even if it does not immediately tender the settlement funds, so long as the defendant is not substantially

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

prejudiced. Civ. Code, §1693; *In re Marriage of Balcof* (2006) 141 Cal.App.4th 1509, 1525. In this way, a plaintiff who has already spent the settlement monies can still attack the settlement on grounds of fraud, but the defendant remains protected because the court may make tender of restoration a condition of its judgment. Civ. Code, § 1693.

The holdings of *Garcia* and *Taylor* are entirely equitable, and in no way "shield the perpetrator of a fraud." Under California law, if the rescinding plaintiff proves the fraud and the underlying liability, it will be awarded any and all damages which it is entitled to under the law. In fact, under *Garcia* and *Taylor*, a plaintiff is only prevented from challenging the settlement agreement by its own refusal to tender the money received. Where, as here, defendant's liability and plaintiff's right to the money is disputed, equity does not require or support plaintiff's retention of such a windfall.

C. *Garcia* And *Taylor* Are Consistent With California Law.

Garcia and *Taylor* have survived as precedent in this state for ninety years, and remain consistent with California rescission and contract law. For most of the last century, the procedure in California for handling these types of fraud cases has been to require rescission. Neither the courts nor the Legislature have abrogated or otherwise disapproved of this process, or of *Garcia* and *Taylor*. In fact, the Court of Appeal cited and applied the *Garcia-Taylor* rule as recently as 2008 in *Myerchin, supra*, 162 Cal.App.4th 1526. The Legislature also confirmed and codified the rule in 1961, in the form of Civil Code sections 1691, et seq. In doing so, the Legislature determined that rescission requires the return of consideration.

Village Northridge refers the Court to the North Carolina case of *Davis v. Hargett* (N.C. 1956) 92 S.E.2d 782, as a cautionary example of the "gross inequity that can potentially result" from the continued employment of California's law. Village Northridge does not explain why it believes *Davis* to be unfair, or why any inequity is not addressed by section 1693.

In *Davis*, the plaintiff sued for fraud and duress related to the execution of a settlement agreement. Like Village Northridge, the *Davis* plaintiff sought to affirm the settlement agreement without rescinding. *Id.* at p. 784-85. The North Carolina Supreme Court unanimously rebuffed this attempt to "affirm and sue," reasoning that the plaintiff could not simultaneously affirm the settlement agreement and recover damages for the difference in value between the true worth of his original claim and the consideration actually received. *Id.* at p. 785. The *Davis* opinion explained:

> [P]laintiff had a damage claim based on tort, of undetermined merit and for an unliquidated amount. ... What he did, and all that he did, was to compromise his original claim or cause of action for $5,000; and the $5,000 was paid to him as agreed. Admittedly, he is entitled to recover no more under the settlement agreement. There has been no breach thereof. His allegations are to the effect that, while he was fully aware of the terms of the agreement when made, he did not make such agreement of his own free will. When the duress was removed, he had the right to affirm it or to rescind it, one or the other. Under the facts here, these remedies were inconsistent, requiring an election. He made the election [to affirm it] and is bound thereby.

Id. at p. 786. In other words, the North Carolina Supreme Court came to precisely the same conclusion as this Court in *Garcia* and *Taylor*: for a party seeking to avoid a settlement agreement, in which one party paid money solely for a release, "affirm and sue" is not a viable remedy; the only available remedy is rescission.

Village Northridge also relies upon a second non-California case, *Matsuura v. Alston & Bird* (9th Cir. 1999) 166 F.3d 1006, as amended, 179 F.3d 1131. *Matsuura* was a per curiam diversity case in which the Ninth Circuit applied Delaware law. In the absence of controlling authority from the Delaware Supreme Court, the Ninth Circuit followed the Delaware District Court decision in *DiSabatino v. United States Fidelity & Guaranty Co.* (D.Del. 1986) 635 F.Supp. 350. *Matsuura, supra*, 166 F.3d at p. 1008. The Ninth Circuit's analysis of the issue is largely relegated to a footnote, in which the court noted that California law was different than Delaware's on the "affirm and sue" issue. *Id.* at p. 1008, fn. 4.

At the end of the opinion in *Matsuura*, the Ninth Circuit observed, in *dicta*, the importance of encouraging settling litigants to rely upon each other's representations. *Id.* at p. 1012. State Farm agrees with this principle, and asserts that settling parties are amply protected by this state's rescission procedure. State Farm further notes that, if policy limits were truly important to Village Northridge, it could have included a representation in the settlement agreement reciting those limits. After all, the settlement agreement was drafted by Village Northridge's *own* counsel. (1AA 62, ¶¶ 9-14; 142, ¶¶ 2-4; 2AA 331-333.) But Village Northridge did not do so.

There is no indication that the *Garcia-Taylor* rule is either confusing or contradictory to California's modern jurisprudence. Rather, it seems that it is Village Northridge who is perplexed. The trial court in the instant case did not

direct appellant to "affirm and sue," as Village Northridge is interpreting that phrase. The trial court, like this Court in *Garcia/Taylor*, concluded that an allegedly defrauded plaintiff must rescind and cannot "affirm and sue" to obtain more money for the underlying claim.

In the end, Village Northridge elected to attempt "affirm and sue" – not because that was its only recourse – but because that approach gave it an advantage that rescission did not. Indeed, California rescission law provided Village Northridge with the exact same ability to seek redress for fraud, as did "affirm and sue." Village Northridge refused to rescind because it recognized that the only practical difference between rescission and "affirm and sue," from the plaintiff's perspective, is the restoration requirement. Because Village Northridge *never* intended to return the consideration paid – even if it ultimately lost – it could not rescind. Unfortunately for Village Northridge, this tactic was expressly foreclosed by the Legislature in the 1961 revisions of the rescission statutes. So, it is Village Northridge who has acted contrary to California law, clearly intending to insulate the money paid by State Farm regardless of the outcome.

D. There Is No Reason to Supplant California's Rescission Procedure With the "New York Rule."

The rescission procedure used in California for the past one hundred years has co-existed peacefully with the tort of fraud, and has been used by thousands of litigants. In the face of this legal history, there is no legitimacy to Village Northridge's suggestion that New York – ironically, the birthplace of some of the more egregious financial transgressions highlighted by Village Northridge – deters fraud more effectively than California.

As a threshold matter, Village Northridge ignores the fact that none of the "affirm and sue" states have rescission statutes comparable to California's, such as the conditional judgment provision of section 1693. Thus, courts from other states confronted with the equity issue face a circumstance where a plaintiff who is unable to return the consideration may truly have no available remedy other than "affirm and sue." By contrast, in California, the return of consideration can be deferred and made part of the judgment, if appropriate. Civ. Code, § 1693.

At common law, even New York adhered to the *Garcia-Taylor* rule. In 1924, Justice Cardozo authored *Brassel v. Electric Welding Co.* (N.Y. 1924) 145 N.E. 745, which held that the plaintiff could not rescind for mistake unless he first tendered the money received. *Id.* at p. 746 [the plaintiff "may not litigate his claim for damages while clinging to the fruits of the contract which he affects to

disaffirm."]; see also *Gilbert v. Rothschild* (N.Y. 1939) 19 N.E.2d 785, 787-88 ["The release was not void, but voidable. In such a case, the general release is an absolute bar to the action unless rescinded, and rescission can be effective only by returning or tendering back the consideration received."]. This was the law in New York until 1946, when the New York Legislature amended its statutory scheme to allow a party to sue for fraud in the inducement of any contract without having to return the consideration paid. *Ciletti v. Union Pac. R. Co.* (2d Cir. 1952) 196 F.2d 50, 51.

This new legislatively-created "New York rule" was considered by California's Law Revision Commission in connection with the 1961 revisions to the rescission statutes, but was ultimately rejected in favor of section 1693. Commission's Recommendations and Study relating to Rescission of Contracts (1960) in 3 Cal. Law Revision Com. Rep. (1961), p. D-35, citing *Ploof v. Somers* (N.Y. 1953) 123 N.Y.S.2d 5. Obviously, the Legislature did not deem New York's "affirm and sue" method necessary or desirable.

This state's long-lived procedure for addressing the rescission of settlement agreements – including the *Garcia-Taylor* rule, sections 1691-1693, and the tort of fraud itself – ensure the integrity of those contracts. Village Northridge is not the first plaintiff to have cried foul over a settlement, and will not be the last. But "settlement agreements should not normally be set aside and [ ] once a settlement agreement is reached a party cannot disavow it merely because he has had 'a change of heart.'" *Li v. Recellular, Inc.* (E.D.Mich., April 16, 2010, No. 09-cv-11363) 2010 WL 1526379, *7 (internal quotations omitted). California has developed a successful and workable system of dealing with these disputes, and need not follow the minority rule of its sister states for instruction.

E. *Garcia* and *Taylor* Remain Valid.

The California Legislature used the 1961 amendments to restructure and simplify rescission procedure. Its efforts resulted in, and were patently intended to create, a rule of rescission applicable to all contracts. Although it could have written exceptions into the code for settlement agreements, it ultimately declined to do so. As a result, California has a rule of law that applies generally to all rescissions, and that requires all rescinding plaintiffs to restore consideration.

Village Northridge's supplemental letter brief, asking this Court to overrule *Garcia* and *Taylor* and to weaken the rescission process in which they are

embedded, fails to honestly and critically consider the implications of its request.[2] Prior to its supplemental brief, Village Northridge never argued that *Garcia* and *Taylor* should be overturned, not even in its answer to the petition for review. On the contrary, it apparently recognized the anomalous nature of the "exception" it sought. (Answer Brief on the Merits, p. 5 [suggested de-publication of the Court of Appeal opinion as "the most appropriate method of limiting the impact of [that] decision"].) Even now Village Northridge has nothing worse to say about *Garcia* and *Taylor*, other than that they are "weak" cases with "uncompelling fact pattern[s]."

But, precedential case law cannot be jettisoned simply because one party believes its facts to be "compelling." This Court's decision on this issue will be far-reaching, and will impact not only the rescission of settlement agreements, but future settling parties' willingness to enter into settlement agreements. Considering all the circumstances, Village Northridge's result-oriented argument is not persuasive to justify overruling *Garcia* and *Taylor*.

We thank the Court for its attention to this matter.

Very truly yours,

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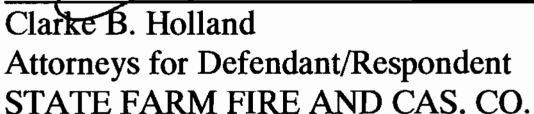

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STATE FARM FIRE AND CAS. CO.

[2] The Ford case referenced in Village Northridge's brief is about jury misconduct, and is (as Village Northridge admits) unrelated to the matter before this Court. See *Ford Motor Co. v. Castillo* (Tex. 2009) 279 S.W.3d 656.

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 29, 2010, I served the following:

SUPPLEMENTAL LETTER REPLY 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 MAIL: By sealing the envelope and placing it for collection and mailing with postage fully prepared in accordance with ordinary business practices.

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 29, 2010

Shawn R. Church

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