SUPREME COURT COPY

Supreme Court No. S161008

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

SUPREME COURT
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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

OPENING BRIEF ON THE MERITS

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OPENING BRIEF ON THE MERITS

STATEMENT OF ISSUES PRESENTED

Did the Court of Appeal err in refusing to follow established precedents of this Court, *Garcia v. California Truck Co.* (1920) 183 Cal. 767, 769-773 (*Garcia*) and *Taylor v. Hopper* (1929) 207 Cal. 102, 103-105 (*Taylor*)? Or, as the Court of Appeal held, do *Garcia* and *Taylor* only apply to settlements of personal injury claims?

INTRODUCTION

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.[1] (*Garcia, supra,* 183 Cal. at pp. 769-773.) 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, supra*, 207 Cal. at pp. 103-105.)

Village Northridge has charted a course designed to ignore this 80 years of settled California common law. The roots of the conflict are undisputed and unremarkable. After the 1994 Northridge earthquake, Village Northridge made a claim. State Farm investigated the claim, which resulted in a determination that it would cost about $2.5 million to repair earthquake damage. Without requesting a release, State Farm paid over $2 million after subtracting the agreed $500,000 deductible. Once repairs began, Village Northridge sought and received an additional payment of $7,500.

In 1998, Village Northridge retained the services of a public adjuster and sought additional monies. State Farm agreed to discuss the issues.

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[1] Unless otherwise indicated, all future Section references are to the Civil Code.

Although State Farm disagreed with Village Northridge's position, State Farm understood there was potential for litigation over the reasonable cost to repair the damage. To avoid such litigation, State Farm and Village Northridge, each represented by counsel, negotiated a settlement and full release for an additional $1.5 million.

In 2001, Village Northridge sought to first ignore the existence of the release and then sought to void it. When that tactic failed, Village Northridge claimed to "affirm" the release, but sought to ignore all of its terms – save for its acceptance of the $1.5 million. We are here because Village Northridge convinced the Court of Appeal that it could effectively rescind the release, but not really rescind, and simultaneously "affirm" the release (and sue for fraud) without actually "affirming" anything about the release. This is not a case where a party wants to have its cake and eat it too; it wants to eat the cake, pretend it never got it, and then eat another.

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. Here, the Court of Appeal limited these rules to apply only to personal injury claims, thereby eliminating the certainty and finality of all other civil settlement

agreements. If adopted by this Court, the Court of Appeal's decision will fundamentally change the way in which all non-personal injury claims in this state will be resolved.

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 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 settlement agreement be rescinded. *Garcia* and *Taylor* comport with common sense and the strong policy in favor of settlement.

The Court of Appeal dramatically changed these rules for all non-personal injury cases. Relying on "policy" issues that easily apply to *every* settlement, whether for a personal injury claim or not, the court adopted a

new rule of law summarized as follows: parties can enter into a fully-integrated written settlement agreement with a waiver of Section 1542. The defendant pays the plaintiff money in exchange solely 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" or "down payment" 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: not being sued. Moreover, under the Court of Appeal's decision, the parties must re-litigate the merits of the very dispute that was settled and, even if the trier of fact ultimately concludes that the defendant would have prevailed on the underlying dispute, 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.) 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, 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 (*Cilibrasi*).) 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 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 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.

This Court should reaffirm that *Garcia* and *Taylor* apply to the settlement of *all* disputed claims. The Court of Appeal's decision should be reversed and the trial court's order sustaining State Farm's demurrer without leave to amend should be affirmed.

STATEMENT OF FACTS
AND PROCEDURAL HISTORY

A. The Original Complaint, Summary Judgment Motion and First Appeal.

Plaintiff/Appellant Village Northridge Homeowners Association ("Village Northridge") filed its complaint on December 28, 2001, alleging causes of action for breach of contract and breach of the implied covenant of good faith and fair dealing. (1AA 3-10.)[2] The complaint does not mention fraud or the settlement agreement.

State Farm filed an answer. (1AA 19-36.) The twentieth affirmative defense was "release," based upon a written "settlement agreement and release of claims" (hereafter, the "settlement agreement") entered into between State Farm and Village Northridge, a copy of which was attached to the answer. (1AA 25-34.) The settlement agreement is a simple and straightforward document: in exchange for $1.5 million, Village Northridge released all of its claims arising out of the Northridge earthquake and covenanted not to sue State Farm. (*Ibid.*) The terms of the settlement agreement are described below and, pursuant to Rule 8.520(h), a copy is attached as Exhibit A.

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[2] The Court of Appeal's opinion omitted numerous relevant facts. State Farm petitioned for rehearing raising these omissions and reserving them for review. (Cal. Rules of Court, rule 8.500(c)(2).)

State Farm filed a motion for summary judgment based on the settlement agreement. (1AA 37-54.) In support of its motion, State Farm established that Village Northridge's insurance policy had limits for earthquake coverage of $4,974,900, with a 10% deductible. (1AA 61, ¶¶ 4-5; 77-114.) The motion also demonstrated that Village Northridge was represented by counsel in connection with the settlement agreement, which was drafted by *its* counsel. (1AA 62, ¶¶ 9-14; 142, ¶¶ 2-4; *see also* 2AA 331-333.)

Village Northridge's opposition raised three issues: (1) whether the settlement agreement was illusory; (2) whether Code of Civil Procedure section 340.9 rendered the settlement agreement unenforceable; and (3) whether State Farm misrepresented the policy limits to Village Northridge. (1AA 211-236.) In support of its opposition, Village Northridge submitted a declaration which attached an incomplete copy of a declarations page which was "retrieved from storage from our property manager." (2AA 284, ¶ 6.) The declarations page showed that there is $11,905,500 in Section I (fire) coverage, that a 10% earthquake deductible applies, but also indicates that "other limits and exclusions may apply." (2AA 287.) (The declaration did not attach the backside or second page of the declarations page.)[3]

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[3] The amount of the Section I limit does not dictate the limits for (continued...)

The trial court granted the motion (2AA 399-403) and Village Northridge appealed. In an unpublished decision, Division Eight reversed, holding: (1) the settlement agreement was *not* void under Code of Civil Procedure section 340.9; (2) the settlement agreement was *not* void as illusory; (3) but the purported misrepresentation of policy limits created a triable issue of fact as to the materiality of the alleged misrepresentation, even thought Village Northridge settled for *less than* policy limits. (3AA 536-550.)

B. Motions for Judgment on the Pleadings and for a Separate Trial Following Remand.

Following remand, State Farm filed a motion for judgment on the pleadings. The basis for the motion was that the complaint did not state a claim for rescission of the settlement agreement. (3AA 570-592.) In its opposition, Village Northridge admitted that the claims asserted in the complaint (breach of contract and implied covenant) *were within the scope of the release in the settlement agreement.* (4AA 906:22-23; 907:6-7

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[3] (...continued)
property damage due to earthquake. The earthquake limit was frequently shown on another section of the declarations page, the portion not provided by Village Northridge, or as part of a separate 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. Here, Village Northridge elected to purchase exactly $5 million in earthquake coverage – $4,974,900 applicable to the buildings 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.

["Plaintiff concedes that the claims it asserts are encompassed within the subject matter of the release"].) Village Northridge also repeatedly stated that it had not rescinded the settlement agreement and "has no intention of seeking to rescind. . . ." (4AA 905-907; 908:18-19 ["Plaintiff *does not* seek rescission. End of discussion on rescission."]; 909:19-910:10.)

State Farm also filed a motion for a separate trial, under Code of Civil Procedure sections 597-598, on what State Farm believed was Village Northridge's claim to rescind the settlement agreement. (3AA 551-563.) Village Northridge opposed State Farm's motion (4AA 918-923), again making clear that it was ***not*** seeking rescission. (*See* 4AA 920:9-10 ["The motion is based on fantasy – there is *not* a rescission claim at issue. End of story."].)

On August 9, 2005, the trial court granted the motion for judgment on the pleadings, ruling:

> Motion for Judgment on the pleadings is granted with 20 days leave to amend. The Court of Appeal's decision held that there were triable issues of fact as to the enforceability of the release contained in the settlement agreement. However, the present complaint does not allege fraud in the inducement or rescission of the settlement agreement. Plaintiffs need to either rescind the agreement or affirm the agreement and sue for damages.

The motion for a separate trial was denied without prejudice. (4AA 956-957.)

C. First Amended Complaint.

The first amended complaint ("FAC"), alleges the same two original claims (breach of contract and of the implied covenant) and added a third cause of action for fraud. (4AA 968-1022.) The FAC alleges the existence of the settlement agreement; Village Northridge's representation by counsel; its receipt of the $1.5 million; that "Plaintiff is not offering to return the $1,500,000 to State Farm and offers zero apologies for the same;" and stated that "Plaintiff does not seek to rescind the Release. Plaintiff 'affirms the Release,' as requested by the Court, and seeks damages...." (4AA 973-974, ¶¶ 22-26.)

State Farm filed a demurrer based on the failure to rescind the settlement agreement. (5AA1024-1050.) Village Northridge's opposition, again, contended that it was not seeking rescission (5AA 1208:15) and that, instead, it could "affirm" the settlement agreement and sue for damages. (5AA 1206-1225.) State Farm filed a reply arguing that having elected to affirm the settlement agreement, Village Northridge waived its right to seek rescission. (5AA 1226-1241.)

The trial court's tentative decision, which became the court's ruling, was to sustain the demurrer, with leave to amend, pursuant to *Garcia* because the "release was the purpose of the settlement agreement." (5AA 1248; RT B-7.) At the hearing, counsel for Village Northridge stated that it

was "never going to give the money back, and I don't want to intimate that we are. It's spent. It's gone." (RT B-6.)

D. Second Amended Complaint.

The operative pleading is the second amended complaint ("SAC"). (6AA 1260-1316.) 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 again includes only the first page of the declarations page, which states "other limits may apply - refer to your policy."[4] (6AA 1275.)

The SAC alleges 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 $2,060,591.97 (the $2,558,087 loss, less the $497,490 deductible). (6AA 1265, ¶ 17.)

In April 1996, Village Northridge requested that its claim be reopened. State Farm agreed and, after inspection, paid an additional $7,466.34. (6AA 1265, ¶ 19.) Thus, State Farm did not request a release while adjusting the claim twice and paying over $2 million. State Farm

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4 *See* pages 8-9, footnote 3, *supra*.

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).)[5]

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.)

The SAC specifically alleges the existence of the parties' settlement agreement. (6AA 1266-1267.) 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

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[5] "Claimant" is defined in the regulations to include both a first- or third-party claimant. (Cal. Code Regs., tit. 10, § 2695.2(c).)

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 Section 1542. In exchange for a payment of an additional $1.5 million,[6] Village Northridge agreed to "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 also contains a release by Village Northridge of any claim it may have against State Farm alleging that its officers and directors were negligent. (6AA 1358-1359, ¶ 5.)[7]

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[6] The $1.5 million reflects the unfortunate economic realities of modern-day litigation. But for the settlement, had Village Northridge brought suit, State Farm would have been forced to incur millions of dollars in attorney's fees and costs to defend against a claim of this size (Village Northridge is a 146-unit condominium complex). In defending against a comparable Northridge earthquake claim, which resulted in a defense verdict, State Farm filed a cost bill for $4,068,938.51 (later reduced to $3,820,501.37). (Request for Judicial Notice, Exh. 1.)

[7] The insurance policy provided for officers and directors coverage. (6AA 1275.) Because many repairs had already taken place, there was the potential that the Village Northridge board could be exposed to claims that it spent the original claim payments unwisely. (*See Oak Park Calabasas Condominium Assn. v. State Farm Fire & Cas. Co.* (2006) 137 Cal.App.4th 557 [claim made against homeowners association's board of directors for

(continued...)

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 counsel. (6AA 1266.) 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.)

The SAC acknowledges receipt of the $1.5 million from the settlement agreement (in addition to the $2-plus million previously paid); that Village Northridge is "not offering to return the $1,500,000 to State Farm and offers zero apologies for the same"; and that Village Northridge is not rescinding the settlement agreement and, instead "affirms the release (more accurately, acknowledges its existence)." (6AA 1266-1267, ¶ 26.)

Village Northridge alleges that it actually had $11,905,500 in earthquake coverage, with a 10% deductible. (6AA 1264, ¶ 16.) If this was

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[7] (...continued)
unwisely using insurance proceeds to fund Northridge earthquake repairs].)

the applicable limit, the deductible would have been $1,190,550, instead of the $497,490 State Farm used. Thus, 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. (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 *identical* to its contract claims that 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" [7AA 1572:26-27], 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 claims, but chose not to release the claims. They can't have it both ways.

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

E. The Court of Appeal's Second Decision.

The Court of Appeal reversed. 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 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.)

State Farm filed a petition for rehearing. In its answer, Village Northridge conceded that its breach of contract and breach of implied covenant claims had to be dismissed. The Court of Appeal then issued a modification to its opinion dismissing those causes of action.

STANDARD OF REVIEW

A demurrer ruling is reviewed de novo. (*Betancourt v. Storke Housing Investors* (2003) 31 Cal.4th 1157, 1162-1163.)

ARGUMENT

I. CALIFORNIA LAW HAS BEEN CLEAR FOR 80-PLUS YEARS THAT A PARTY MUST RESCIND A SETTLEMENT AGREEMENT AND CANNOT "KEEP THE MONEY AND SUE."

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.* (1996) 14 Cal.4th 394, 415 (*Rosenthal*) (Werdegar, J.), italics added, citations omitted.)

> In the usual case of fraud, where the promissor 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, citations omitted.) In the SAC there are no allegations of fraud *in factum*, that is fraud in the execution of the agreement. (6AA 1260-1316.) 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, 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 money 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 damages 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 simply 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 a settlement payment. The plaintiff's remedy was to rescind the release and

tender the consideration received, which would revive the disputed claim for damages. But the money was "*not his in any event*," and was paid only in exchange for the release. (*Garcia, supra*, 183 Cal. at pp. 772-773, italics in original.)

> 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*[8] claim for damages, which was resolved by an arms-length settlement agreement.

Nine years later, this Court decided *Taylor*. In *Taylor*, 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, 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:

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[8] There are 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 is rescinded. (*Estate of Wilson* (1976) 64 Cal.App.3d 786, 801.)

"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.)

Garcia and *Taylor* are not archaic decisions. This Court cited *Taylor* with approval and followed its reasoning – specifically with respect to the rule against asserting claims based on speculative damages – in 1998 in *Cedars-Sinai Med. Ctr. v. Superior Court* (1998) 18 Cal.4th 1 (Kennard, J.) (*Cedars-Sinai*):

> In the past, we have 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. (*Taylor v. Hopper* (1929) 207 Cal. 102, 103-105 [refusing to recognize a cause of action for fraudulent inducement of a settlement of a legal claim because, given the uncertainty of whether the plaintiff would have prevailed on the legal claim, "there is no practicable measure of damages for the action sought to be maintained"] . . .

(*Cedars-Sinai, supra*, 18 Cal.4th at pp. 14-15.) Numerous other California decisions have also followed the *Garcia/Taylor* principles.[9] Witkin is in

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9 (*See Larsen v. Johannes* (1970) 7 Cal.App.3d 491, 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 rescinded partially"]; *Sime v. Malouf* (1949) 95 Cal.App.2d 82, 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."]; *Cilibrasi, supra,* 103 Cal.App.2d at pp. 399-400;
(continued...)

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. 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. The "law favors settlements" (*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, supra*, 103 Cal.App.2d at p. 399, citations omitted.) If the Court of Appeal's opinion were the law, then all settlements of non-personal injury disputes can be rendered meaningless.

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 (which State Farm disputes) and, further, that Village Northridge is free to relitigate its released claims. 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.) In that case, Village Northridge would have been overpaid by over $3.9 million:

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[9] (...continued)
Montes v. Peck (1931) 112 Cal.App. 333, 340; *Winstanley v. Ackerman* (1930) 110 Cal.App. 641, 645.)

1.	Total Claim	$ 2,565,553.00
2.	Deductible on $11.9 million limits	$ (1,190,000.00)
3.	Total Due to Village Northridge	$ 1,335,553.00
4.	Amount State Farm has paid to date	$ 3,560,591.00
5.	Amount overpaid by State Farm	$ 2,185,038.00
6.	Interest on overpaid amount (10% simple for 8 years)	$ 1,748,024.00
	Total overpaid:	$ 3,933,062.00

Similarly, if State Farm is entitled to the return of the consideration it paid for the release, Village Northridge owes State Farm almost $4.2 million:

1.	Return of money paid pursuant to the settlement agreement	$ 1,500,000.00
2.	10% simple interest for 8 years.[10]	$ 1,200,000.00
3.	Return of overpayment on claim based on State Farm's use of lower deductible.[11]	$ 693,060.00
4.	10% simple interest on deductible overpayment from July 1995.	$ 762,366.00
	Total owing to State Farm:	$ 4,155,426.00

Thus, if State Farm prevails at trial on the merits of the dispute that was settled, Village Northridge receives a windfall of between $3.9 to $4.2 million. Under the Court of Appeal's opinion, Village Northridge would

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[10] 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; *Security Trust & Sav. Bank v. Southern P.R. Co.* (1931) 214 Cal. 81, 88.)

[11] *See* pages 15-16, *supra*.

keep this windfall! (Typed Opn. at pp. 10-11, fn. 4.) Moreover, if State Farm's demurrer is not sustained without leave to amend, State Farm will be forced to incur significant attorney's fees preparing for and defending against Village Northridge's claims, thus, depriving State Farm of what it bargained and paid for: not being sued.[12] The simple fact is that State Farm may prevail on the merits of the claims asserted, meaning Village Northridge would not be entitled to any relief. Under the Court of Appeal's opinion, Village Northridge would still get to retain the $1.5 million of settlement proceeds (and the use of those monies for a decade), while State Farm receives nothing from the settlement agreement.[13]

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[12] Indeed, one way to look at the Court of Appeal's decision is that it could be used by a plaintiff to fund litigation against a settling defendant. (*See Swan v. Great N. R.W. Co.* (N.D. 1918) 168 N.W. 657, 660 [rule adopted by the Court of Appeal would permit a plaintiff to "use the very money which he received as a consideration for the compromise to prosecute the subsequence action" for fraud].)

[13] (*See Sime v. Malouf, supra*, 95 Cal.App.2d at p. 111 ["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*;" italics added]; *Shallenberger v. Motoritsts Mut. Ins. Co.* (Ohio 1958) 150 N.E.2d 295, 301 (*Shallenberger*) ["It may be that plaintiff's release was not induced by any fraud. If it was not, neither defendant nor its insured should be required to go to all the trouble and expense of preparing for and trying an action to recover in effect on account of the damages for which that release was given, as they would be required to do if the demurrer to plaintiff's petition in the instant case should be overruled"].)

This analysis shows precisely why the *Garcia/Taylor* rule makes more sense and is more equitable to the parties. Moreover, adopting the Court of Appeal's ruling would effectively nullify the entire statutory scheme governing rescission (Civ. Code §§ 1690, *et seq.*), since it would be folly for a plaintiff ever to rescind because there is no "downside" to "affirming" and seeking damages.

B. The Court of Appeal Erred in Limiting *Garcia/Taylor* Only to Personal Injury Cases.

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. There is no legal distinction between disputed, unliquidated property damage and personal injury damage. Indeed, the most common claims in this state – car accidents – typically have both a personal injury and a property damage component. (*See, e.g., Spear v. Cal. State Automoblie Ass'n* (1992) 2 Cal.4th 1035, 1037.)

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"].)

Village Northridge has attempted to justify the Court of Appeal's ruling based upon the rule that where a party seeks rescission (which

Village Northridge has never done), it does not have to return any consideration that was undisputedly owed to that party. However, that rule only applies "where there is ***no dispute as to the sum due*** . . . ." (*Garcia, supra*, 183 Cal. at p. 772, emphasis added.) Here, Village Northridge settled a *disputed* claim. Village Northridge had no more entitlement to the $1.5 million in settlement proceeds than did the plaintiffs in *Garcia* and *Taylor*. Moreover, the settlement agreement contains binding recitals stating that the parties were settling a *disputed* claim and that those recitals are conclusive under Evidence Code section 622.[14]

C. The Rule Permitting a Party to "Affirm" a Contract and Sue for Damages Only Applies to the Sale of a *Res* and Does Not Apply to Settlement Agreements.

The Court of Appeal relied upon the rule that a party that believes it was defrauded into entering into an agreement has the option of rescinding or "affirming the contract and recovering damages for the fraud." (Typed Opn. at pp. 6-7.) However, that rule only applies to the sale of a *res* and has never been applied, prior to the Court of Appeal's decision, to a settlement agreement resolving a *disputed* claim.

The genesis of this rule is *Bagdasarian v. Gragnon* (1948) 31 Cal.2d 744, 750 (*Bagdasarian*) and *Hines v. Brode* (1914) 168 Cal. 507, 512 (*Hines*). (Typed Opn. at pp. 217.) However, those cases involved the sale

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14 *See* page 21, footnote 8, *supra*.

of a *res* – a thing – and did not involve the settlement of a disputed claim. Thus, *Hines* spoke in terms that "the *vendee* would have his action for damages" based upon "affirmance of the contract." (*Hines, supra*, 168 Cal. at p. 512, italics added.) Neither case cited *Garcia* or *Taylor* or otherwise remotely suggested that their holdings applied to settlement agreements of *disputed* claims. Thus, it is not surprising that *Bagdasarian* has been cited a total of only eight times for the proposition that a defrauded party may elect to "affirm" the contract and sue for damages, and all those decisions involve the sale of a *res,* not a settlement agreement.[15] Similarly, Witkin describes the "affirm and sue" option as permitting the "injured party . . . to retain the benefits of the contract, *e.g.,* ***the property purchased***, and make up in damages the loss suffered by the fraud." (5 Witkin, Summary of California Law (10th ed. 2005) Torts, § 828, p. 1201, emphasis added.)

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15 *See Denevi v. LGCC* (2004) 121 Cal.App.4th 1211, 1220 (*Denevi*) [real property]; *Jue v. Smiser* (1994) 23 Cal.App.4th 312, 315 [house]; *Storage Services v. C.R. Oosterbaan* (1989) 214 Cal.App.3d 498, 511 [real property]; *Brockway v. Heilman* (1967) 250 Cal.App.2d 807, 811 [sale of business]; *Buist v. C. Dudley DeVelbiss Corp.* (1960) 182 Cal.App.2d 325, 333 [real property]; *Dillon v. Sumner* (1957) 153 Cal.App.2d 639, 645 [medical equipment and personal property]; *Collins v. Kobold* (1956) 146 Cal.App.2d 868, 870 [lease of house]; *Friedberg v. Weissbuch* (1955) 135 Cal.App.2d 750, 756 [lease and purchase agreement for real property].

The two cases cited by the Court of Appeal – *Denevi* and *Persson v. Smart Inventions, Inc.* (2005) 125 Cal.App.4th 1141 (*Persson*) – both involved the sale of a *res* and did not involve the release of a disputed claims. Indeed, *Persson* explicitly held that under *Garcia* when money is paid specifically in exchange for a release, the defrauded party's sole option is to rescind under *Garcia.* (*Id.* at pp. 1154-1155.)

The distinction between a settlement agreement and the sale of a *res* is recognized by case law:

> In cases like those above cited [*Garcia*] if the plaintiff desires to go back to his original cause of action for tort, *it is essential that he effect a rescission of the contract which purports to bar his cause of action.* In other words, if he wants to sue on the original tort, he can neither stand on the release agreement nor act in violation thereof, but must move to set it aside. *But in such a case as this, involving fraud in the sale of real property, it is well settled that a plaintiff may either rescind or stand on his contract and sue for damage.*

(*Montes v. Peck, supra*, 112 Cal.App. at p. 340, italics added.) Other cases cited by the Court of Appeal are in agreement. (*See 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"]; *Shallenberger, supra*, 150 N.E.2d at p. 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."]; *Davis v. Hargett* (N.C. 1956) 92 S.E.2d 782, 786 [contrasting the sale of property with the release of disputed claim].)

The sale of a *res* is not analogous to the release of a disputed claim and this is where the Court of Appeal's analysis fails. (Typed Opn. at p. 11.) When a piece of property is sold, equivalents are exchanged (typically money for property) and, if rescission is sought, the equivalents can be

returned to restore the parties to the *status quo ante.* (*Akin v. Certain Underwriters at Lloyd's London* (2006) 140 Cal.App.4th 291, 298 (*Akin*).) If, however, the allegedly defrauded party (usually the buyer) elects to "affirm" and keep the property it purchased, *then the other party still retains the consideration that it bargained for, usually money.* The defrauded party then simply sues for damage as measured by the cost to repair the condition misrepresented by the seller. This is common when the amount in controversy is small compared to the overall value of the transaction, *e.g.*, the purchaser of a house sues the seller for fraudulently representing the roof did not leak. However, in the case of a release, there is nothing to be returned and nothing for the other party to retain; the other party bargained simply to "buy its peace" and avoid litigation. "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***

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 was blessed by the Court of Appeal, which converted a $1.5 million compromise settlement into a "floor" for Village Northridge's damages.

The obverse is also true. Under the Court of Appeal's reasoning, a defrauded *defendant* in an underlying action could also seek to "affirm" a settlement agreement and seek damages from the underlying plaintiff. In that situation, the defendant would always be better off seeking to "affirm" because the settlement amount would be converted into a "ceiling" and there is no downside to the defendant. The one case to consider such an issue, ruled that the defrauded defendant could not "affirm" the settlement and sue for fraud. (*Triplett v. St. Amour* (Mich. 1993) 507 N.W.2d 194, 196-197.)

D. A Party Must Either "Affirm" or Rescind the Entire Agreement and Cannot Selectively Pick the Portions of the Agreement That It Likes and Discard Those It Does Not.

A party cannot "affirm" a settlement agreement resolving a disputed claim where the release is the sole object of the contract, because when a

party "affirms" a contract, it "affirm[s] it wholly." (*Hines, supra*, 168 Cal. at p. 512.)

> It is true that if a party affirms a contract with knowledge of the fraud, *he affirms it wholly* . . . . But in neither case does he affirm it as a contract made in good faith. *He consents to be bound by the provisions of the agreement* but does not thereby release or waive his claim for damages arising from a fraud collateral to the agreement.

(*Hickman v. Johnson* (1918) 36 Cal.App. 342, 348, emphasis added.)[16]

To date, although Village Northridge claims it is "affirming" the settlement agreement, nothing could be further from the truth. Indeed, Village Northridge is disavowing virtually every material provision of the agreement including: (a) the release and covenant not to sue (¶¶ 1, 3-4); (b) its agreement to accept $1.5 million (and not more) in exchange for a release of its Northridge earthquake claims (¶ 7); (c) the recitals that it was represented by counsel (¶¶ 11, 17); (d) recitals that it was settling a disputed claim (¶ 8); (e) the integration clause (¶ 12); and (f) the agreement that if there was a dispute, the parties would first go to mediation and then arbitration (¶ 14). (6AA 1355-1362.) There is not a single obligation in the settlement agreement that Village Northridge *is* abiding by, except, of

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16 *See also Bagdasarian, supra*, 31 Cal.2d at pp. 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"]; *Williamson v. Clapper* (1948) 88 Cal.App.2d 645, 653; *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"].

course, its entitlement to $1.5 million. In reality, Village Northridge is trying to avoid all its obligations while holding State Farm to its payment obligation. This cannot be allowed to stand.

In the proceedings below, Village Northridge admitted that its purported "fraud" damages are the same as for its breach of contract and breach of implied covenant claims (7AA 1572-1573; 4AA 922: 19) – the very same claims it concedes were covered by the release. (4AA 906.) One court has commented:

> ...how can plaintiff logically seek to recover the same damages, if he does, from the negligent party's insurance carrier as he would be able to recover from the negligent party *while at the same time affirming the release which releases all parties from such damages?* ***He can't have it both ways. In the Court's view, he cannot accept money and sign a release, affirm the release and keep the money, and then sue the insurance carrier seeking the same damages.***

(*Taylor v. Federal Kemper Ins. Co.* (W.D.Ark. 1982) 534 F.Supp. 196, 199, emphasis added.)

In evaluating this issue, courts look at the reality of what the plaintiff is seeking, not the label attached to it. (*Akin*, *supra*, 140 Cal.App.4th at p. 297 ["the terminology employed by the parties is not controlling"].) State Farm cannot overemphasize the extent to which the facts of this case resemble those in *IMO Development Corp. v. Dow Corning Corp.* (1982) 135 Cal.App.3d 451 (*IMO*). IMO and Dow entered into a complex agreement for the sale of land and financing for its development. Dow,

which owned the land, agreed to assist IMO to obtain financing, but not to co-sign any loan agreement. Disputes arose over the parties' respective obligations under the contract.

IMO and Dow entered into a second agreement "to settle all disputes arising from the first agreement." (*IMO, supra*, 135 Cal.App.3d at pp. 455-456.) IMO took title to the property and accepted a short-term loan, but then sued Dow to recoup damages it believed occurred because of Dow's failure to assist in the financing under the first agreement. As in this case, IMO sued for breach of contract of the first agreement and alleged that the second agreement "was invalid and thus unenforceable because it was allegedly obtained under economic distress." (*Id.* at p. 456.) And, as in this case, IMO alleged that Dow would honor the first agreement "*only if* IMO would waive any claims it had against Dow." (*Ibid.*, italics in original.)

Dow moved for judgment on the pleadings, arguing that the remedy effectively being sought was a partial rescission and that such remedy did not exist. As in the instant case, IMO never used the term rescission in its pleading and carefully rejected the notion that it wanted to rescind. In fact, IMO wanted to maintain the benefits of the release. The trial court granted judgment on the pleadings, which was upheld on appeal:

> It is well settled that 'a contract entered into by reason of...duress or economic compulsion may be rescinded by the

> injured party. *However, it is axiomatic that in such an instance the entitled party must rescind the entire contract and may not retain the rights under it which he deems desirable and repudiate the remainder....* The rationale underlying the rule is that retention of only the benefits constitutes unjust enrichment and binds the parties to terms not contemplated within the agreement.

(*Id.* at p. 458, italics added, citations omitted.)

IMO argued that "it was free of the obligations contained in the waiver of claims provision." (*Id.* at p. 458.) The court certainly recognized the right of IMO to rescind the agreement based upon the allegations in the complaint, just as State Farm has never disputed that Village Northridge's remedy is to seek rescission. But, the court recognized that "in view of the allegations of the pleadings, we conclude the trial court properly determined that IMO in effect sought a partial rescission of the contract, and because no such remedy is recognizable" the complaint failed to state a cause of action. (*Ibid.*)

Here, the Court of Appeal's decision effectively creates an entirely new remedy never before seen under California law. It gives Village Northridge all of the benefits of rescission – not being bound by the settlement agreement – without the burdens of rescission, in violation of the principle that "he who takes the benefit must bear the burden." (Civ. Code § 3521.) It also violates the rule against partial rescission, because it permits Village Northridge to select which provisions of the settlement

agreement to rescind and which to affirm. (*Simmons v. California Institute of Technology* (1949) 34 Cal.2d 264, 275; *IMO, supra*, 135 Cal.App.3d at p. 458.)[17] At the same time, the Court of Appeal's decision also violates the rule against partial affirmance. (*Hines, supra*, 168 Cal. at p. 512; *Hickman v. Johnson, supra*, 36 Cal.App. at p. 348.) Thus, no matter how one looks at it, the Court of Appeal's ruling violates one or more of these principles and should be reversed.

E. There Is No Reason to Adopt the Minority View Relied Upon the Court of Appeal.

The Court of Appeal 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. (*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

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[17] Even when a contract *is* rescinded, a court cannot use the rescission statutes to rewrite the terms of the agreement. (*Hedging Concepts, Inc. v. First Alliance Mort. Co.* (1996) 41 Cal.App.4th 1410, 1422 [Section 1692 "does not provide authority for judicial restructuring of the agreed terms of the contract"].)

Opn. at p. 12.) Only twelve states follow the rule adopted by the Court of Appeal,[18] whereas sixteen states, including California, follow the *Garcia/Taylor* rule.[19]

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[18] Delaware (*E.I. Du Pont de Nemours & Co. v. Florida Evergreen Foliage* (Del. 1999) 744 A.2d 457, 464); Hawaii (*Exotics Hawaii-Kona, Inc. v. E. I. du Pont de Nemours & Co.* (Haw. 2007) 172 P.3d 1021, 1033; Indiana (*Automobile Underwriters, Inc. v. Rich* (Ind. 1944) 53 N.E.2d 775, 777); Iowa (*Phipps v. Winneshiek County* (Iowa 1999) 593 N.W.2d 143, 146-147); Kansas (*Ware 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 Mexico (*Ponce v. Butts* (N.M.Ct.App. 1986) 720 P.2d 315, 322); New Jersey (*Bilotti v. Accurate Forming Corp.* (N.J. 1963) 188 A.2d 24, 30-35); Oklahoma (*Sade v. Northern Nat'l Gas Co.* (10th Cir. 1973) 483 F.2d 230, 234); South Dakota (*Railsback v. Mid-Century Ins. Co.* (S.D. 2004) 680 N.W.2d 652, 657; Washington (*Gregg v. Beezer* (Wash. 1927) 252 P. 692, 695-696); and Wisconsin (*Brown v. Ocean Accident & Guar. Corp., Ltd.* (Wis. 1913) 140 N.W. 1112, 1115).

[19] California (*Garcia, supra,* 183 Cal. at p. 773; *Taylor, supra*, 207 Cal. at pp. 103-105); Michigan (*Stefanac, supra*, 458 N.W.2d at pp. 58, 60-63); Ohio (*Shallenberger, supra*, 150 N.E.2d at pp. 300-302); Nebraska (*Doe v. Golnick* (Neb. 1996) 556 N.W.2d 20, 23; West Virginia (*Spradling v. Blackburn* (D.W.Va. 1996) 919 F.Supp. 969, 978, fn. 19); North Dakota (*Swan v. Great N. Rwy. Co., supra*, 168 N.W. at pp. 658-661); North Carolina (*Davis v. Hargett, supra*, 92 S.E.2d at p. 786); Vermont (*Caledonia Sand & Gravel Co., Inc. v. Joseph A. Bass Co.* (Vt. 1959) 151 A.2d 312, 314-315); Oregon (*Hadley v. Hadley* (Or. 1916) 155 P. 195, 196); 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) 123 S.E.2d 353, 354 ([*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 & Cas. 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); and Tennessee (*Gibbons v. Mutual Ben. Health & Acci. Ass'n* (Tenn.

(continued...)

Moreover, many of the majority decisions from other jurisdictions contain detailed and thoughtful analyses of the issue and conclude, consistent with *Garcia/Taylor*, that rescission is the only available remedy.[20] In contrast, of all the non-California minority cases cited by the Court of Appeal, only one – *DiSabatino v. United States Fidelity & Guar. Co.* (D.Del. 1986) 635 F.Supp. 350, 353-353 (*DiSabatino*) – contains any meaningful analysis.[21] *DiSabatino* is an outcome determinative decision that relied on a series of policy judgments in order to justify its decision. A careful analysis shows, however, that none of these policies are implicated in this case.

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19 (...continued)
1953) 259 S.W.2d 653, 654).

Missouri intermediate appellate courts are divided on the issue. Compare *Mackley v. Allstate Ins. Co.* (Mo.Ct.App. 1978) 564 S.W.2d 634, 636, and *Bockover v. Stemmerman* (Mo.Ct.App. 1986) 708 S.W.2d 179, 181, with *Roth v. La Societe Anonyme Turbomeca Fr.* (Mo.Ct.App. 2003) 120 S.W.3d 764, 772.

20 *See Stefanac, supra*, 458 N.W.2d at pp. 58-63; *Shallenberger, supra*, 150 N.E.2d at pp. 300-302; *Swan, supra*, 168 N.W. at pp. 658; *Davis v. Hargett, supra*, 92 S.E.2d at p. 786.

21 *Matsuura v. Alston & Bird* (9th Cir. 1999) 166 F.3d 1006, 1008, fn. 8, mod. 179 F.3d 1131, is a diversity case applying Delaware law. The court's discussion is relegated largely to a footnote and does little more than simply follow *DiSabatino*. (*Ibid.*) *Phipps v. Winneshief County, supra*, 593 N.W.2d at p. 146, simply mimics *DiSabatino's* reasoning. *Gaskins v. Southern Farm Bureau Cas. Co., supra*, 581 S.E.2d 169, only holds that an insurance company can be sued for fraud and does not address the rescission issue at all. Nor does it address *Dunaway v. United Ins. Co., supra*, 123 S.E.2d at p. 354, which is in line with *Garcia/Taylor*.

First, *DiSabatino* stated that the "lapse of time" may prejudice a plaintiff where the statute of limitations runs. (*DiSabatino, supra*, 635 F.Supp. at p. 354.) This is not a concern here because under California law, the accrual of fraud claims is delayed until discovery (*Gryczman v. 4550 Pico Partners, Ltd.* (2003) 107 Cal.App.4th 1, 5) and our Legislature took the extraordinary step of reviving certain Northridge earthquake claims. (Code Civ. Proc. § 340.9.)

Second, *DiSabatino* rejected the argument that damages under a "keep the money and sue" scenario would be difficult to prove. (*DiSabatino, supra*, 635 F.Supp. at pp. 354-355.) However, this is not the law in California and this Court in *Cedars-Sinai* reaffirmed *Taylor* on this very point. (*Cedars-Sinai, supra*, 18 Cal.4th at pp. 14-15.)

Third, *DiSabatino* claimed that its rule was needed because otherwise "insurance companies would have everything to gain and nothing to lose by systematically defrauding tort claimants into accepting low settlement offers." (*DiSabatino, supra*, 635 F.Supp. at p. 355.) Obviously, *DiSabatino* (which was discussing a third-party claim) is not familiar with first-party "bad faith" law in California. California law provides an insured with a plethora of available remedies; Village Northridge elected to settle. (*See* pages 43-44, *infra*.)

DiSabatino overlooked the misconduct its holding created: It encourages claimants to sue, even after settling. Without the finality and certainty associated with settlements, why would any defendant settle?

> If there is any one thing which the law favors above another, it is the prevention of litigation, by the compromise and settlement of controversies. [¶] We fail to see how overruling defendant's demurrer in the instant case could do anything but run counter to such a policy.

(*Shallenberger*, *supra*, 150 N.E.2d at p. 302.)

Accordingly, the non-California cases cited by the Court of Appeal provide no basis to create an exception to *Garcia/Taylor*.

F. There Is No Reason to Create Any Exception to *Garcia/Taylor*.

There is no reason to create an exception to *Garcia/Taylor* based upon purported misrepresentations of policy limits. Alleged misrepresentations as to policy limits[22] are more far more likely to occur in third-party cases, such as automobile accident cases, where plaintiffs often settle based upon representations of the defendant's insurance coverage. Although difficult to quantify numerically, insurance undoubtedly plays a role in the litigation and settlement of a majority of civil cases filed in this state, particularly automobile accident cases. Also, there can easily be disputes regarding the amount of the defendant's insurance coverage in

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[22] State Farm vigorously disputes that there was any alleged misrepresentation of policy limits. (See Section VI, *infra*.) However, because this is a demurrer, the allegation must be accepted as true.

third-party cases. (*See, e.g., Home Ins. Co. v. Zurich Ins. Co.* (2002) 96 Cal.App.4th 17, 25-26 (*Home Ins.*) [dispute over primary versus excess coverage in third-party case].)

Moreover, the Court of Appeal's decision 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 Section 47. (*Morales v. Cooperative of Am. Physicians, Inc.* (9th Cir. 1999) 180 F.3d 1060, 1063-1064; *Home Ins.*, *supra*, 96 Cal.App.4th at pp. 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.) Thus, the rule created by the Court of Appeal would only apply to pre-lawsuit settlements.

With respect to first-party cases, such as this one, the insured purchases its own insurance and presumably knows *its own* policy limits. (2AA 284, ¶ 6.) Indeed, beginning with Justice (then Judge) Kennard's decision in *Jones v. Grewe* (1987) 189 Cal.App.3d 950, 954, it is well-accepted that, absent circumstances not present here, the *insured* is solely responsible for obtaining adequate amounts of insurance coverage, and neither the insurer nor its agent is liable for any shortfall in coverage. (*See*

Fitzpatrick v. Hayes (1997) 57 Cal.App.4th 916, 927; *Gibson v. Government Employees Ins. Co.* (1984) 162 Cal.App.3d 441, 446; *Shultz Steel Co. v. Hartford Acc. & Indem. Co.* (1986) 187 Cal.App.3d 513, 518.)

Nor is there any reason to create an exception where one party is an insurer. State Farm adjusted and paid the claim *twice* before requesting a release to resolve a *disputed* claim. The Insurance Regulations specifically permit an insurer to seek a release and waiver of Section 1542 from an insured. (Cal. Code Regs., tit. 10, §§ 2695.4(e)(2), 2695.7(h).) Given these Regulations, there is no reason to create a special rule for the settlement of insurance claims. Settlement agreements are "governed by the legal principles applicable to contracts generally." (*Folsom v. Butte County Assn. of Governments* (1982) 32 Cal.3d 668, 677, citation omitted.) Just as this Court has held that "we do not rewrite any provision of any contract [including an insurance policy], for any purpose" (*Rosen v. State Farm Gen'l Ins. Co.* (2003) 30 Cal.4th 1070, 1073), there is no reason to create an insurance exception to a common law principle of contract law, particularly in this case where both sides were represented by counsel and the insurer's conduct is permitted by the Insurance Regulations.

The Court of Appeal cited Insurance Code section 790.03(a) to justify its decision. (Typed Opn. at p. 6 & fn. 1.) However, "section 790.03 confers no private right of action for damages." (*Waller v. Truck Ins. Exch.*

(1995) 11 Cal.4th 1, 35, citing *Moradi-Shalal v. Fireman's Fund Ins. Cos.* (1988) 46 Cal.3d 287, 305.) Given that a purported violation of this statute is not independently actionable, it should not be used to create an entirely new tort remedy.

Village Northridge's position also distorts the insurer/insured relationship:

> While an insurer must give as much consideration to the interests of its insured as it does to its own, *it is not required to disregard the interests of its shareholders and other policyholders when evaluating claims*. . . . In other words, an insurer is entitled to give its own interests consideration when evaluating the merits of an insured's claim.

(*Chateau Chamberay Homeowners Ass'n v. Associated Internat. Ins. Co.* (2001) 90 Cal.App.4th 335, 347, italics added, citations and quotations omitted.) "An insurer is not a fiduciary, and owes no obligation to consider the interests of its insured above its own," (*Morris v. The Paul Revere Life Ins. Co.* (2003) 109 Cal.App.4th 966, 973), and an insurer may give its own interests consideration equal to that it gives the interests of its insured. (*Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 818-819.) Thus, there is nothing in the insured/insured relationship to justify a departure from *Garcia/Taylor*.

Insurers and insureds often have disputes over the *amount* of the insured's loss. (*See, e.g., Wilson v. 21st Century Ins. Co.* (2007) 42 Cal.4th 713.) In case of a dispute, the insured has several options. It can invoke its

statutory right to seek an appraisal to determine the amount of the loss. (Ins. Code § 2071; *Jefferson Ins. Co. v. Superior Court* (1970) 3 Cal.3d 398, 402.) Or the insured can sue the insurer for breach of contract and/or breach of the implied covenant of good faith and fair dealing and seek consequential and punitive damages. Or the insured and the insurer can sit across the table from one another and settle the claim, precisely as happened here – and precisely as happens every day across the state. But there is nothing unique about the settlement of such claims to create an exception to *Garcia/Taylor*.

Nor is there any reason to create an exception to *Garcia/Taylor* because our Legislature has already provided for an adequate remedy: rescission. Under the rescission statutes, a defrauded plaintiff can obtain "complete relief, including restitution of benefits . . . and any consequential damages to which he is entitled." (Civ. Code § 1692 [third paragraph].)

In short, there is no reason to create any exception to *Garcia/Taylor*, particularly in this case where two parties, each represented by counsel, negotiated an arm's-length settlement agreement.

II. BECAUSE VILLAGE NORTHRIDGE HAS REPEATEDLY "AFFIRMED" THE SETTLEMENT AGREEMENT, ITS CLAIMS ARE BARRED AND IT HAS WAIVED ITS RIGHT TO SEEK RESCISSION.

Village Northridge's second amended complaint explicitly alleges that it is "affirming" the settlement agreement and disavows any intention to

rescind the settlement agreement. (6AA 1266-1267, ¶ 26.) Village Northridge made numerous similar explicit statements throughout the course of this litigation and did so again in response to direct questioning from the Court of Appeal. (January 15, 2008 modification at fn. 7.)

By electing to affirm, Village Northridge has made a binding, irrevocable election and can no longer rescind the settlement agreement. (5 Witkin, Summary of California Law (10th ed. 2005) Torts, § 829, pp. 1201-1202 ["The remedies of affirmance and rescission are inconsistent, involving different types of recovery, and the defrauded party must elect to proceed on one theory or another.... If, however, the defrauded party elects to affirm and recover damages, and fails to establish his or her right, the rule is different. Having affirmed the contract, he or she cannot thereafter attempt to rescind"].)

> [A] party induced to enter into a transaction by fraud, affirms the transaction when *he brings an action for damages* and because of the affirmance loses any right to disaffirm subsequently . . . .

(*Hjorth v. Bernstein* (1941) 44 Cal.App.2d 561, 565, italics added, citations omitted.)[23]

In addition, Village Northridge has also waived its right to rescind by engaging in six-plus years of litigation, to the prejudice of State Farm which

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[23] *See also Saret-Cook v. Gilbert, Kelly, Crowley & Jennett* (1999) 74 Cal.App.4th 1211, 1226; *Helm v. K.O.G. Alarm Co.* (1992) 4 Cal.App.4th 194, 204; *Gutterman v. Gally* (1933) 131 Cal.App. 647, 653-654.

has been forced to file one motion for summary judgment, three pleading motions, and two full appeals, including review by this Court. (*Citicorp Real Estate, Inc. v. Smith* (9th Cir. 1998) 155 F.3d 1097, 1103-1104 [applying California law; three years of delay and litigation]; *Saret-Cook v. Gilbert, Kelly, Crowley & Jennett, supra*, 74 Cal.App.4th at p. 1226; *Doctor v. Lakeridge Construction Co.* (1967) 252 Cal.App.2d 715, 720-721 [three years of litigation waived right to rescind].)

This is not an inadvertent act by Village Northridge, but is instead a deliberate strategy designed to avoid the possibility that it would ever have to repay any money to State Farm. Had it offered to rescind the settlement agreement, Village Northridge would have been exposed to having to pay State Farm under one of many scenarios:

1. Given that State Farm has already been deprived of much of the benefits of the settlement agreement (freedom from being sued), State Farm might agree to mutual rescission of the settlement agreement, which would require Village Northridge to return the $1.5 million, plus interest. (Civ. Code §§ 1689(a), 1691.) Village Northridge would then have to prove its breach of contract and breach of the implied covenant claims and, if it failed to do so, it would not be entitled to the settlement monies back.

2. If Village Northridge *lost* on its fraud/rescission claim, then the court could grant State Farm "any other relief to which [it] may be entitled under the circumstances." (Civ. Code § 1692 [second paragraph].) In that circumstance, State Farm would claim an entitlement to attorney's fees to compensate it for having to defend itself.

3. Even if Village Northridge *won* on the fraud/rescission issue, it may lose on the merits of the disputed claim, *i.e.*, the amount of its earthquake loss. In that scenario, Village Northridge would owe State Farm approximately $4 million, as outlined on page 24. Or it could owe any smaller amount, depending upon the trier of fact's conclusion as to the amount of its earthquake loss.

In short, if Village Northridge elected to rescind, it likely would be required to compensate State Farm. Village Northridge made a knowing and calculated decision not to pursue rescission and instead to "affirm" the settlement agreement in order to ensure that the $1.5 million settlement remains its "floor" for recovery.

Village Northridge has made a binding election to "affirm" the settlement agreement and has waived the right to seek rescission. As a consequence, State Farm agrees with the Court of Appeal decision in one respect: this Court does not necessarily have to address the issue of whether a return of consideration is required in order to rescind. (Typed Opn. at p. 10, fn. 3.) However, should this Court decide to reach the issue, State Farm contends that the return of consideration is mandatory under the plain language of Section 1691. (*Neet v. Holmes* (1944) 25 Cal.2d 447, 457, 458; *Garcia, supra*, 183 Cal. at p. 773; *Taylor, supra*, 207 Cal. at p. 103; *Lloyd v. Williams* (1964) 227 Cal.App.2d 646, 649.)

III. THE COURT OF APPEAL'S RULING RUNS AFOUL OF THE RULE AGAINST SPECULATIVE DAMAGES.

Under *Garcia/Taylor*, there is no issue as to speculative damages: if fraud 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; it 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, italics in original.) Those concerns have not changed in 80 years, as this Court confirmed in 1998 in *Cedars-Sinai, supra*, 18 Cal.4th at pp. 14-15, reaffirming *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.)[24]

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 on the merits, 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

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[24] Expert testimony cannot be used to purport to demonstrate the ultimate issue of what the parties would have settled for. (*Piscitelli v. Friedenberg* (2001) 87 Cal.App.4th 953, 972-973.)

$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 1360, ¶ 11) resulted in Village Northridge accepting $1.5 million to settle, for a total of $3.5 million of the $5 million policy limits it believed 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.

Under the Court of Appeal's opinion, the trier of fact will have an additional conundrum. Since State Farm refused to offer the $5 million policy limit in 1998, why would it now offer more in light of the increased in deductible created by Village Northridge's claim of increased limits? The speculative nature of this inquiry is the same whether the trier of fact is guessing about imagined offers/counteroffers in a property damage case or 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 might actually have been *lower*, not higher.

It is no secret how this will play out. Village Northridge will claim that it would not have accepted a "penny less" than $8 million, even though it accepted $3.5 million in 1998 against what it believed was a $5 million policy limit. State Farm will contend that, given the allegedly-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.)

This entire analysis is rife with the speculation condemned by this Court in numerous cases, including *Taylor*, *Cedars-Sinai*, *supra*, 18 Cal.4th at pp. 14-15, *Viner v. Sweet* (2003) 30 Cal.4th 1232, 1241, and *Wiley v. County of San Diego* (1998) 19 Cal.4th 532, 544.

IV. THE RULE ADOPTED BY THE COURT OF APPEAL WOULD MEAN THAT THERE COULD NEVER BE A VALID WAIVER OF SECTION 1542.

Under the Court of Appeal's decision, there can never be an effective waiver of Section 1542 in non-personal injury civil cases. Section 1542 reads:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor.

(Civ. Code § 1542.) Because defendants generally settle cases on the basis of "buying peace" (*Cilibrasi, supra,* 103 Cal.App.2d at p. 399), it is well-accepted that parties can waive the provisions of this statute in order to ensure the finality of civil settlements. (*See Jefferson v. Department of Youth Authority* (2002) 28 Cal.4th 299, 306-307 [interpreting release with waiver of Section 1542; "If courts did not follow this rule, it would be virtually impossible to create a general release that .... actually achieved its

literal purpose" and "parties that offer payment on the reasonable expectation that all claims are settled" would "face continuing litigation"]; *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.) Indeed, virtually every settlement agreement entered into in this state in the last several decades has contained a waiver of Section 1542.

A waiver of 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. However, under the Court of Appeal's decision, parties represented by counsel can settle a disputed claim, waive Section 1542, and then, years later, if the plaintiff claims to have "learned something new,"[25] it can still sue the defendant for damages, without having to return the consideration that it received from the defendant for the very purpose of *not* suing the defendant.

The only response in the Court of Appeal's decision is that to avoid this consequence, a defendant "need only avoid misrepresenting policy

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[25] In this case, Village Northridge claims to have "learned" after the settlement agreement that it purportedly had $12 million in policy limits. Village Northridge claims to have "learned" this new fact, by finding a declarations page in storage. (2AA 284, ¶ 6.) Presumably, Village Northridge had that declarations page in its possession at the time of the settlement agreement.

limits when it settles claims." (Typed Opn. at p. 10.) While that may sound convenient, in reality it means that the defendant must defend and prevail on the merits of a fraud claim. That, in turn, requires relitigation of the very claim that was settled in order to prove (or disprove) materiality and damages.[26] And where the defendant prevails on the fraud claim, proving the loss to be worth less than the settlement, under the Court of Appeal's decision the plaintiff nonetheless keeps the windfall (*i.e.*, the settlement money). (Typed Opn. at pp. 10-11, fn. 4.) Win or lose, the defendant always loses. The scheme created by the Court of Appeal's decision ignores the reality that defendants pay money, in exchange for a release and waiver of Section 1542, precisely in order to *avoid litigation*.[27] Forcing a defendant to defend and prevail on the merits of fraud litigation still deprives the defendant of what it bargained for: *not* being sued.

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[26] Under Village Northridge's version of events, it had $12 million in policy limits, meaning it had a $1.2 million deductible (10%). State Farm has already paid Village Northridge approximately $3.5 million. Thus, Village Northridge will have to prove that it suffered more than approximately $4.7 million ($1.2 million [deductible] + $3.5 million [amount already paid]) in earthquake damage in order to prove that the purported misrepresentation was material and that it suffered any damage. State Farm, in turn, will contend that Village Northridge only had $2.5 million in damage. This is *precisely* the dispute that was resolved by the settlement agreement. Yet the Court of Appeal's decision readily acknowledges that the merits of the underlying claim will have to be relitigated under its holding. (Typed Opn. at p. 14.)

[27] Note that *Taylor* was decided on demurrer.

Village Northridge also claims that because it alleges that it spent the money on earthquake repairs that it should be permitted to keep the $1.5 million without rescission. Of course, the same was true with respect to the plaintiffs in *Garcia* and *Taylor*: undoubtedly they too had already spent the settlement proceeds. Indeed, a personal injury plaintiff who spends the settlement proceeds on medical bills or surgery has a far more compelling plea to keep settlement proceeds than a 146-unit condominium complex.

The Court of Appeal's decision undermines the ability for settling parties to effectively and meaningfully waive Section 1542. *Garcia* and *Taylor* should be reaffirmed and this Court should uphold the ability to effectively waive Section 1542.

V. THE COURT OF APPEAL VIOLATED *STARE DECISIS* BY NOT FOLLOWING *GARCIA/TAYLOR.*

"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 as to what it means to be "fairly distinguishable." 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"].)

VI. BECAUSE THIS IS A DEMURRER RULING, VILLAGE NORTHRIDGE'S FRAUD ALLEGATIONS MUST BE ACCEPTED AS TRUE, NO MATTER HOW FALSE THEY ARE.

This is a demurrer ruling and, as such, State Farm recognizes that Village Northridge's fraud allegations must be accepted as true, no matter how specious they are. If the past is any indication, Village Northridge's answering brief will be thick on hyperbole unrelated to the legal issues involved, rather than attempting to reconcile the Court of Appeal's decision

with existing California law. Specifically, Village Northridge continues to attack State Farm's position regarding the policy limits. Although it is not relevant to the underlying legal dispute, State Farm's position on earthquake limits is clear and can be understood with reference to supporting documents.

The gravamen of Village Northridge's fraud claim is that State Farm allegedly represented that it had approximately $5 million in earthquake coverage when, according to Village Northridge, it actually had $12 million. For this, Village Northridge relies upon a declarations page attached to its complaint. (6AA 1264, ¶ 16; 1275.) However, Village Northridge's earthquake coverage was *not* determined or specified by this declaration page; it was determined by its policy. Hence, the declaration page very clearly states: "Other Limits and Exclusions May Apply -- Refer to Your Policy." (6AA 1275.)

State Farm's earthquake endorsement, policy form FE-6307.1, sets forth the applicable deductible and provides that the amount of the deductible "is the amount determined by applying the deductible percentage(%) shown in the Declarations, separately to each of the following: a. the amount of insurance on each covered building or structure *as shown in our records*..." (6AA 1314, ¶ 4, emphasis added.) Thus, the

endorsement notes that the amounts of coverage are not set forth in the declarations page, but are instead governed by State Farm's records.

The problems with Village Northridge's fraud claim do not end with its incorrect reliance upon the declarations page. In order to prove fraud, Village Northridge must also prove that the alleged misrepresentation related to a *material* fact (*City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith* (1998) 68 Cal.App.4th 445, 481), and that it *actually* relied upon the misrepresentation. (*Mirkin v. Wasserman* (1993) 5 Cal.4th 1082, 1088.) Here, Village Northridge settled for a total of approximately $3.5 million (the original $2 million in payments, plus the settlement of $1.5 million). However, even under State Farm's version of events, Village Northridge had $5 million in policy limits, meaning that Village Northridge settled for $1.5 million *less than* policy limits. In other words, this was not, and never was, a policy limits settlement, meaning representations about the policy limits were not *material* to the settlement.

Moreover, the declarations page Village Northridge relies upon is dated November 1, 1993 (6AA 1275) and appears to have been in Village Northridge's possession since that time. (2AA 284, ¶ 6.) The declarations page was only two months old at the time of the Northridge earthquake (January 17, 1994). How can Village Northridge believe that it had $12 million in earthquake coverage in November 1993, forget that fact from

January 1994 until October 2003, and then suddenly claim a *material* misrepresentation was made in 1998 that it *actually relied upon*?

Although perhaps not directly relevant to the issues at hand, State Farm wanted to make this Court aware of its position on the alleged merits of the "fraud" claim.

CONCLUSION

For the foregoing reasons, this Court should reaffirm that *Garcia* and *Taylor* apply to *all* settlement agreements. The Court of Appeal's decision should be reversed and the trial court's order sustaining State Farm's demurrer without leave to amend should be affirmed.

DATED: April 25, 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 the Opening Brief On The Merits is

X   Proportionately spaced, has a typeface of 13 points and contains 13,930 words, including footnotes.

DATED: April 25, 2008

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By: ______________________
JAMES R. ROBIE
Attorneys for Defendant and Respondent STATE FARM FIRE AND CASUALTY COMPANY

EXHIBIT A

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-4559-1 (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 $2,058,112.39 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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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

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 enforceable.

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 entities, directors, officers, employees, agents, representatives, heirs, beneficiaries, executors, attorneys, predecessors, successors, assigns, insurers, and underwriters, 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 Maez
Title: President

Dated: 11/9/99

By: [signature]
Print Name: Borek C. Volarik
Title: Treasurer

Dated: 11/9/99

By: [signature]
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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