Supreme Court No. S161008

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

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

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

REPLY BRIEF ON MERITS

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REPLY BRIEF ON MERITS

INTRODUCTION

The answer brief is based entirely upon a false premise, *i.e.*, that Village Northridge has no "practical remedy" to address its purported fraud claim. This premise is demonstrably false. Our Legislature provided Village Northridge with an adequate remedy: rescission. (Civ. Code § 1688, *et seq.*)[1] Even Village Northridge's position that it did not want to return the consideration it received from State Farm is addressed under

[1] All Section references are to the Civil Code unless otherwise indicated.

the second paragraph of Section 1693. Village Northridge, however, wants to "affirm" the settlement agreement so that it *never*, under *any* circumstances, has to give back the consideration it received; thus, effectively converting a $1.5 million settlement into the "floor" for its unliquidated and disputed damages. This has not been the law in California for over 80 years, is contrary to the rescission statutes, and would undermine those statutes because, under Village Northridge's view, no one would ever seek rescission. Instead, allegedly defrauded parties would *always* "affirm and sue" because there is absolutely no downside.

However, any available remedies under the rescission statutes are purely academic as Village Northridge has repeatedly stated its intention *not* to rescind the settlement agreement, a position repeated in its answer brief. (Answer Brief ["AB"] 1, 15, 40.) Village Northridge does not dispute that by repeatedly "affirming" the settlement agreement, it has waived the right to seek rescission. As a result, the requirements for rescission are not before this Court.

Given that Village Northridge has an adequate remedy under the rescission statutes, but wants instead a better remedy with no downside – a remedy that exists neither at common law nor by statute – it is clear that the Court of Appeal erred in reversing the trial court's order sustaining State Farm's demurrer without leave to amend.

The Court of Appeal refused to follow *Garcia* and *Taylor* for two reasons:

(1) *Garcia* and *Taylor* purportedly "apply only to the release of personal injury claims." (Typed Opn. at p. 2; *see also id.* at pp. 6, 10, 12 ["we cannot and do not question the continuing validity of *Garcia* and *Taylor* as controlling statements of California law governing contracts of release in personal injury cases"); and

(2) only the amount of the claim was disputed by the parties. (Typed Opn. at pp. 8-9.)

Now in its answer brief, Village Northridge agrees with State Farm that the Court of Appeal's distinction between personal injury and non-personal injury claims is "artificial" and that the Court of Appeal erred in making that distinction. (AB 4-5.) Village Northridge also now concedes that the "amount owing [for its earthquake damage] is in dispute (as was the case in *Garcia*)." (AB 4, 16.) *Garcia* plainly requires rescission and the return of consideration whether liability or the amount of damages are in dispute. (*Garcia v. California Truck Co.* (1920) 183 Cal. 767, 772 (*Garcia*) [rule applies "where there is a controversy as to the amount owing"].) Given that Village Northridge now concedes that the two bases upon which the Court of Appeal failed to follow *Garcia* and *Taylor* are invalid, it is apparent that the Court of Appeal erred in not following *Garcia* and *Taylor*. (*Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455.)

Instead of relying upon the rationale given by the Court of Appeal for its decision, Village Northridge instead argues that the Court of Appeal's decision should be affirmed for three reasons: (1) Village Northridge claims an "independent" entitlement to the $1.5 million settlement money and, thus, a return of consideration is not required; (2) Village Northridge asks this Court to make an exception to *Garcia/Taylor* for first-party

insurance claims involving alleged misrepresentations of policy limits; and (3) Village Northridge asks this Court to abandon 80 years of California jurisprudence, represented by *Garcia* and *Taylor*, and follow the minority rule, based primarily upon a single district court decision from Delaware.

Each of these contentions is without merit and must be rejected. Village Northridge did not have any "independent right" to the settlement money. Indeed, Village Northridge now concedes that the "amount owing is in dispute (as was the case in *Garcia*)." (AB 4; *see also* AB 16 [same]; 22, 49.) As noted, *Garcia* applies whether liability or the amount of damages are in dispute. (*Garcia, supra*, 183 Cal. at p. 772.) Therefore, the "independent basis" rule is facially inapplicable to this case.

There is also no reason to create a first-party insurance exception to *Garcia/ Taylor*. *Garcia* and *Taylor* are common law rules of general applicability. No case has ever created any "exception" to their common sense holdings, which comport with the strong policy in favor of settlement of civil disputes. Nor does Village Northridge dispute that the Insurance Regulations specifically permit insurers to obtain releases from insureds in first-party cases, particularly, as here, where the insurance claim is disputed. (Cal. Code Regs., tit. 10, §§ 2695.4(e)(2), 2695.7(h).) Similarly, Village Northridge's reliance on Insurance Code section 790.03 is misplaced. This Court has repeatedly held that Insurance Code section 790.03 does not create a private right of action. (*Waller v. Truck Ins. Exch.* (1995) 11 Cal.4th 1, 35; *Moradi-Shalal v. Fireman's Fund Ins. Cos.*

(1988) 46 Cal.3d 287, 305.) Given that no private right of action exists, that statute should not be used to justify an entirely new tort remedy ("keep the money and sue") foreign to California law.

Lastly, of all the minority rule cases cited by Village Northridge, only one – *DiSabatino v. United States Fidelity & Guar. Co.* (D.Del. 1986) 635 F.Supp. 350 (*DiSabatino*) – has any meaningful analysis of the issue. State Farm's opening brief explained in detail why *DiSabatino's* analysis does not apply here and the answer brief does nothing to refute State Farm's showing. There is no reason for this Court to abandon 80 years of well-established California law, particularly where the California Legislature has addressed this issue and created a fair and equitable remedy: rescission. On the contrary, adopting the minority rule advocated by Village Northridge creates gross inequities for the defendant, inequities understood by this Court in *Garcia* and *Taylor*, and understood by the majority of states to address the issue. In addition, the minority approach advocated by Village Northridge creates clear and obvious problems regarding the issue of speculative damages.

The Court of Appeal's decision was error and should be reversed and the trial court's ruling reinstated. This Court should reaffirm that *Garica* and *Taylor* apply to the settlement of all disputed claims.

ARGUMENT

I. VILLAGE NORTHRIDGE CONCEDES OR FAILS TO DISPUTE SIGNIFICANT ISSUES WHICH REQUIRES REVERSAL OF THE COURT OF APPEAL'S DECISION.

Village Northridge's answer brief has either explicitly conceded, or implicitly conceded by omission,[2] the following issues:

Personal injury vs. non-personal injury: This was the *sine qua non* of the Court of Appeal's decision. (Typed Opn. at pp. 2, 6, 10, 12.) Now, Village Northridge agrees with State Farm that this distinction was "artificial." (AB 4-5.)

Settlement of a disputed claim: Village Northridge now agrees with State Farm that it was settling a *disputed* claim. (AB 4, 16, 22, 49.) Indeed, Village Northridge's own damages model (AB 49) is premised upon there being a dispute whether Village Northridge suffered $2.5 million or $8 million in damage as a result of the Northridge earthquake.

Village Northridge has made an irrevocable election to "affirm" the settlement agreement and has waived the right to seek rescission: Village Northridge does not dispute that by repeatedly "affirming" the settlement agreement, it can no longer seek

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[2] (*See Sehulster Tunnels/Pre-Con v. Traylor Brothers, Inc.* (2003) 111 Cal.App.4th 1328, 1345, fn. 16 [failure to address point in opposing brief "is equivalent to a concession;" collecting cases]; *Warren-Gutrhie v. Health Net* (2000) 84 Cal.App.4th 804, 816 [failure to address issue in opposing brief "has conceded the issue on appeal"], disapproved on other grounds, *Cronus Investments, Inc. v. Concierge Services* (2005) 35 Cal.4th 376, 393, fn. 8.)

rescission thereof. (*Hjorth v. Bernstein* (1941) 44 Cal.App.2d 561, 565; 5 Witkin, Summary of California Law (10th ed. 2005) Torts, § 829, pp. 1201-1202; Opening Brief ["OB"] 44-47.) As this Court has held:

> It has been said that citation of authorities is unnecessary in support of the doctrine well established in this state that an *affirmance of the contract at a time subsequent to the discovery of the falsity of the representations inducing its execution forecloses the exercise of the right of rescission.*

(*Neet v. Holmes* (1944) 25 Cal.2d 447, 458, italics added.) Nor does Village Northridge dispute that by engaging in six-plus years of litigation, to the prejudice of State Farm, it has waived its right to seek rescission. (OB 45-47.) Therefore, the only issue before this Court is whether Village Northridge can "affirm" the settlement agreement, keep the $1.5 million, and sue for additional damages.

Settlement agreement vs. sale of a *res*: State Farm's opening brief explained in great detail the differences between a settlement agreement – which is governed by *Garcia* and *Taylor* – and the sale of a *res*, the only scenario which permits a defrauded party to "affirm" and sue for damages. (OB 27-31.) The answer brief makes no attempt whatsoever to address this important distinction. Nor has it cited a single California case that permitted a plaintiff to "affirm" a settlement agreement of a disputed claim.

Civil Code Section 1542: As noted in the opening brief, every civil settlement agreement entered into in this State (for as long as memory exists) has contained a waiver of Section 1542. Village Northridge makes no attempt to attempt to explain why the Court of Appeal's decision does not undermine the ability of parties to effectively waive

Section 1542. (OB 51-54.) To the contrary, Village Northridge now contends that it only learned the extent of its earthquake damages *after* the settlement agreement (AB 1), which is precisely the scenario a waiver of Section 1542 is designed to address.

Rule against partial rescission and partial "affirmance": Village Northridge does not dispute that, whether a party rescinds or "affirms" a contract, it cannot selectively pick and choose which provisions of the contract it likes and discard the balance. (OB 31-36.) Here, it is clear that Village Northridge wants to keep the $1.5 million, while disregarding virtually every other provision of the settlement agreement. Under either a rescission or "affirmance" theory, it cannot do so.

Overpayment by State Farm: Village Northridge does not dispute that unless it proves that it had over $4.7 million in earthquake damage, that it would end up owing State Farm money as an overpayment. Indeed, Village Northridge's own damages model (AB 49) confirms the accuracy of State Farm's calculations. Village Northridge's answer brief remains silent on the issue of why it should be entitled to keep such an overpayment, if it is permitted to relitigate the merits of the disputed claims that it released in exchange for $1.5 million.

Representation by counsel: Village Northridge does not dispute that it was represented by counsel in connection with the settlement agreement. (1 AA 62, ¶¶ 9-14; 142, ¶¶ 2-4; 2 AA 331-344.)[3]

II. BECAUSE VILLAGE NORTHRIDGE CONCEDES THAT ITS INSURANCE CLAIM WAS DISPUTED, IT CANNOT RELY UPON THE "INDEPENDENT BASIS" EXCEPTION TO *GARCIA/TAYLOR*. MOREOVER, THE RELEASE *WAS* THE SOLE OBJECT OF THE SETTLEMENT AGREEMENT.

Village Northridge now concedes that it was settling a *disputed* claim with State Farm and that the "amount owing is in dispute (as was the case in *Garcia*)." (AB 4, 16.) Notwithstanding its concession it was settling a disputed claim, Village Northridge nonetheless inconsistently asserts it does not have to return the consideration paid because it has an "independent entitlement" to the $1.5 million settlement. (AB 12-17.) This argument is disingenuous and must be rejected.

As explained by this Court in *Garcia*, when there is a dispute as to the amount owing, a party seeking not to be bound by a settlement agreement must return the consideration paid. (*Garcia, supra*, 183 Cal. at p. 772 [rescission and return of consideration is required "when the settlement is made to adjust a matter in dispute, or where there is a controversy as to the amount owing;" citations and quotations omitted].) Village Northridge relies upon an exception to that rule "a party is not required to restore

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[3] Village Northridge claims that the settlement agreement was drafted by State Farm's counsel. (AB 7.) In fact, just the opposite is true: it was drafted by Village Northridge's counsel. (2 AA 331-343.)

that which in any event he would be entitled to retain." (*Id.* at p. 771.) However, that exception applies only when it is "without dispute" that the money "absolutely belonged" to the rescinding party. (*Id.* at p. 772; *see also Sime v. Malouf* (1949) 95 Cal.App.2d 82, 111 (*Sime*) [exception to rule applies only when entitlement to consideration is "undisputed"].) Even Village Northridge admits that this exception only applies "where there is *no dispute* over the settling party's entitlement to the consideration." (AB 2, italics added.)

Village Northridge also advances the novel argument that the release was not the "sole" object of the release. (AB 14.) This is pure sophistry. State Farm obtained nothing from the settlement agreement *except* the release. Village Northridge received nothing from the settlement agreement *except* $1.5 million and parted with nothing except its release of State Farm. By any reasonable definition, the release was the "sole" object of the settlement agreement.

In a case involving virtually identical facts, Village Northridge's position was recently rejected by Division Three of the Fourth Appellate District in *Myerchin v. Family Benefits, Inc.* (2008) 162 Cal.App.4th 1526 (*Myerchin*). In *Myerchin*, a dispute arose over how much money the plaintiff (Myerchin) was entitled to pursuant to a written contract with the defendant (Family Benefits). To avoid litigation, Myerchin and Family Benefits entered into a settlement agreement. Family Benefits made agreed payments and Myerchin agreed to dismiss a lawsuit that had just been filed. Myerchin took the

payments, but refused to dismiss the suit, claiming he had been fraudulently induced to enter into the settlement agreement. Family Benefits filed a motion for summary judgment, which the trial court granted.

Family Benefits, like State Farm here, argued that Myerchin had not rescinded the settlement agreement and could not "*both* retain its benefits and disregard its obligations while continuing to pursue the litigation." (*Id.* at p. 1530, italics in original.) Tellingly, the underlying dispute between the parties, both in this case and in *Myerchin*, was how much money the plaintiff was owed pursuant to a written contract. And, just as Village Northridge, Myerchin claimed an entitlement to the entire amount of the settlement of the underlying dispute over the written contract. The court easily rejected Myerchin's contention:

> As to Myerchin's second point, *the merits of his original contract claim were disputed, and his self-serving contention that he was entitled to be paid the full $200,000 he sought from Family Benefits in his original complaint is just that—a contention.* It does not constitute substantial evidence that Family Benefits would actually be required to pay him $200,000 if the settlement agreement were rescinded.

(*Myerchin, supra*, 162 Cal.App.4th at p. 1536, fn. 4, italics added.)

The Court of Appeal also rejected Myerchin's claim – identical to Village Northridge's offer to give State Farm an "offset" for the settlement amount (AB 42) – that he should be permitted to keep the settlement proceeds, litigate the merits of his claims, and then make an election whether to keep the settlement proceeds or "enforcing a 'conditional' rescission judgment by *returning* the settlement funds – a decision he

would presumably make depending upon whether he recovers a *greater amount* on his original contract claim." (*Myerchin, supra*, 162 Cal.App.4th at p. 1535, italics in original.) "[W]e can hardly imagine a scenario more prejudicial to Family Benefits than the one proposed by Myerchin. . . . [¶] Family Benefits would, in either case, lose the *sole benefit* it had contracted for in the settlement – avoidance of the uncertainty and expense of litigation." (*Id.* at pp. 1534-1535, italics in original.) "Every day that Myerchin delayed in his rescission . . . is a day that Family benefits was denied the benefit of its bargain." The Court of Appeal cited *Garcia, Taylor* and *Sime* to support its conclusion. (*Id.* at p. 1535.)

There is no difference between the facts here and those in *Myerchin*, except the plaintiff in *Myerchin* at least called what he was seeking rescission. In both cases, the underlying dispute involved a disagreement over contract benefits, the plaintiffs both argued that the settlement agreements were unenforceable due to fraud, the plaintiffs both kept the proceeds of the settlement, but pursued the very claims allegedly released, and both plaintiffs tried to convince the court that they could keep the money until after the litigation and could engineer the lawsuit so that at the end of the day the settlement amount already in their pockets became their "floor" for damages, *i.e.*, the worst case scenario, with no possibility of ever having to return any settlement money. This Court in *Garcia* and *Taylor*, and the Court of Appeal in *Sime*, *IMO Development Corp. v. Dow Corning Corp.* (1982) 135 Cal.App.3d 451(*IMO*), and now *Myerchin,* all uniformly

recognize that California does not allow a party to a settlement agreement to "keep the money and sue." Only the Court of Appeal below came to a different conclusion.

Myerchin and *IMO* both stand for fundamentally the same proposition. A party cannot "pick and choose" which provisions of a contract it wishes to maintain while discarding those provisions it does not like. This is true regardless of the label the plaintiff uses: "rescission" or "affirming." Here, Village Northridge wants the benefits of the settlement agreement – its right to retain the $1.5 million settlement – while disregarding every other material term of the agreement, primarily the release, waiver of Section 1542, and covenant not to sue.

Lastly, Village Northridge continues to rely upon *Persson v. Smart Inventions, Inc.* (2005) 125 Cal.App.4th 1141 (*Persson*) to support its position. *Persson* is simply an "affirm and sue" case involving the sale of a *res* (stock in a company). As noted, Village Northridge's answer brief does not dispute that cases involving the sale of a *res* are different from settlement agreement cases because the *defendant* gets to retain the consideration it bargained for. In *Persson*, the defendant negotiated and paid for shares of stock in the subject company. Through the course of the litigation, the defendant retained the stock, and the control of the company that came along with it. In stark contrast to *Persson*, here, if Village Northridge's position prevails, State Farm will be deprived of the one and only thing it obtained in the settlement agreement: freedom from being sued.

Persson involved a shareholder dispute among the two shareholders of a company. The other shareholder decided to buy-out Persson's shares. Persson sold his shares pursuant to a contract for $1.6 million. Thus, the purpose of the contract was the purchase and sale of the shares. (*Persson, supra,* 125 Cal.App.4th at pp. 1147-1149.) The contract also contained standard mutual release provisions, which were severable, since they were "not . . . among the essential objects of the contract. . . ." (*Id.* at p. 1154.) (Here, in contrast, the release was the sole object of the settlement agreement -- a specific release of the Northridge earthquake claims (¶ 1) in addition to a general release (¶ 3). (1AA 28-30, ¶¶ 1-3).)

Persson later sued, claiming his agreement was fraudulently induced. Persson prevailed at trial and Nokes appealed, claiming that the alleged fraud was barred by the release contained in the agreement. *Persson* went out of its way to distinguish the facts of that case from cases, such as this, where the very object of the contract is for one party to obtain a release. First, the court noted that the rule against partial rescission was not implicated because setting aside the release provision in the stock purchase agreement would "not result in unjust enrichment." The stock at issue still existed and had value to the defendant who bargained for it.

> Quite the opposite is true. The ruling merely sets aside mutual releases *which were not in any event among the essential objects of the contract....*

(*Persson, supra*, 125 Cal.App.4th at p. 1154, emphasis added.) Here, the release is unquestionably the "essential object" of the settlement agreement. If Village Northridge is permitted to retain the $1.5 million, without giving effect to the release, then it will be unjustly enriched and State Farm will be deprived of all benefit from the settlement agreement.

Persson noted the continued viability of *Garcia* in the context of a settlement agreement, the sole purpose of which is a release:

> *In Garcia, however, the release of the personal injury claims was the sole object of the contract, for which the consideration was paid.* The money paid in exchange for the release was plaintiff's only in the event that there had been a valid release of the claim for damages that he was then endeavoring to assert, and which would constitute a complete bar to his action. *Consequently, plaintiff was required to return the money if he wished to assert the very claim he was paid to release. This, however, is not a case in which the release is the object of the contract.*

(*Persson, supra*, 125 Cal.App.4th at pp. 1154-1155, emphasis added, citations and quotations omitted.)

Here, the sole purpose of the settlement agreement was to resolve contested damage repairs from the Northridge earthquake, as recognized by the binding recitals in the settlement agreement. Thus, *Garcia/Taylor* control, not *Persson*.

Therefore, Village Northridge did not have an "independent right" to the settlement proceeds, such that the exception to *Garcia/Taylor* applies.

III. THERE IS NO REASON TO CREATE A FIRST-PARTY INSURANCE EXCEPTION TO *GARCIA/TAYLOR.*

Reduced to its essence, Village Northridge's primary argument is that this Court should create a first-party insurance exception to *Garcia/Taylor*. (AB 4-5, 51-54.) However, this issue is not before this Court. The issues presented in State Farm's petition for review are:

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

(Petition for Review at p. 2.) Although Village Northridge filed an answer to the petition for review, its answer did not include any additional issues for the Court to grant review, as permitted by Rule 8.500(a)(2) of the California Rules of Court. Thus, the "issue presented" contained on page 1 of Village Northridge's answer brief is not properly before this Court. (Cal. R. Ct., rule 8.516; *see PLCM Group, Inc. v. Drexler* (2000) 22 Cal.4th 1084, 1094, fn. 3; Eisenberg, et al., California Practice Guide: Civil Appeals and Writs (The Rutter Group 2007) ¶ 13:58.)[4]

However, even if this Court should decide to address this issue, there is no reason to create a first-party insurance exception to *Garcia/Taylor*, which set rules of general

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[4] Equally perplexing is Village Northridge's request that this Court depublish the Court of Appeal's opinion. (AB 5.) The Court of Appeal's decision became depublished as a matter of law when this Court granted review. (Cal. R. Ct., rule 8.1105(e)(1).)

applicability. Plainly, 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.) No case has ever created an exception to *Garcia/Taylor* based upon the identify of one party to the settlement agreement.

Village Northridge relies upon Insurance Code section 790.03 ("Section 790.03") to justify its position. (AB 51.) However, this Court's seminal decision in *Moradi-Shalal v. Fireman's Fund Ins. Cos.* (1988) 46 Cal.3d 287, 305 (*Moradi-Shalal*), held that there is no private right of action under Section 790.03. *Moradi-Shalal*'s holding was reiterated by this Court in *Waller v. Truck Ins. Exch., supra,* 11 Cal.4th at p. 35. Following *Moradi-Shalal*, numerous attempts were made to circumvent *Moradi-Shalal* by alleging Section 790.03 as the basis to form a cause of action under Business & Professions Code section 17200. However, this Court, as well as lower courts, held that *Moradi-Shalal* cannot be so circumvented. (*Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, 283; *Textron Financial Corp. v. National Union Fire Ins. Co.* (2004) 118 Cal.App.4th 1061, 1070 ["parties cannot plead around *Moradi-Shalal's* holding by merely relabeling their cause of action as one for unfair competition"].) Applying the same reasoning, Village Northridge should not be permitted to use Section 790.03 to create an entirely new tort remedy: "keep the money and sue."

Village Northridge also relies upon the insurance regulation requiring insurers to disclose policy limits to claimants. (AB 52, citing Cal. Code Regs., tit. 10, §§ 2695.4(a),

(b).) State Farm has no issue with that regulation. To the contrary, State Farm contends that it *did* accurately convey the policy limits to Village Northridge and it is Village Northridge and its counsel that simply misunderstand their own insurance policy. But because this is a demurrer, that factual dispute cannot be resolved. What is relevant, however, is that the very same insurance regulation goes on to permit insurers to obtain releases from both first- and third-party claimants, including a release of Section 1542. (Cal. Code Regs., tit. 10, § 2695.4(e).) These same regulations also provide that insurers do not have a duty to explain to claimants the impact of a Section 1542 release when the claimant is represented by counsel (*ibid.*), because the Insurance Regulations recognize the arms-length basis for the negotiation of settlements and releases of contested claims, particularly where the claimant is represented by counsel.

Reference to a quasi-fiduciary relationship between an insurer and an insured does not add substance to Village Northridge's position. (AB 4, 18.) "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.) An insurer may give its own interests consideration equal to that it gives the interests of its insured. (*Chateau Chamberay Homeowners Ass'n v. Associated Int'l. Ins. Co.* (2001) 90 Cal.App.4th 335, 347.) As recognized by the Insurance Regulations discussed above, there is no prohibition upon an insurer obtaining a release and a Section 1542 waiver from an insured, particularly when the insured is represented by counsel.

There is simply no reason to create a first-party insurance exception to *Garcia/Taylor* and numerous reasons not to do so, particularly given that the Legislature has already created an adequate remedy: rescission.

IV. THIS COURT SHOULD NOT ADOPT THE MINORITY RULE.

A. There Is No Reason To Adopt The Minority Rule, And Abandon 80-Plus Years of California Law, When The California Legislature Has Already Adopted An Adequate Remedy: Rescission.

State Farm agrees with Village Northridge in one respect: this Court should not decide whether to continue to follow the majority *Garcia/Taylor* rule, or follow the minority view, based solely upon the number of states that follow the respective rule.[5] (*See Grafton Partners L.P. v. Superior Court* (2005) 36 Cal.4th 944, 962, 965 [declining to follow the New York majority rule regarding jury waivers].) However, it must be noted that Village Northridge does not dispute the substantial legal showing State Farm made demonstrating that existing California law – *Garcia/Taylor* – represents the majority rule nationwide.[6] Thus, a majority of states, in addition to California, already

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[5] Moreover, whether to overturn *Garcia/Taylor* is not within the scope of the issues presented for review.

[6] Query why Village Northridge continues to characterize the *DiSabatino* line of cases as the "majority" rule (AB 17, 19, 28), when State Farm has clearly demonstrated that it is not. The Ninth Circuit in *Matsuura v. Alston & Bird* (9th Cir. 1999) 166 F.3d 1006, *modified*, 179 F.3d 1131, fn. 4 (*Matsuura*), stated that the rule was supported by the "weight of authority." The "majority" label was then used *Phipps v. Winneshiek County* (Iowa 1999) 593 N.W.2d 143, 146 (*Phipps*). However, neither case lists the full number of authorities cited in State Farm's opening brief. Moreover, both *Matsuura* and *Phipps* cite *Taylor* and acknowledge that the law is different in California.

decline to follow the *DiSabatino* minority rule. Village Northridge also does not address, in any meaningful fashion, the rationale behind the majority rule, discussed in State Farm's opening brief. (OB 25, fns. 12-13; 29-31; 38, fn. 20.)

Garcia/Taylor, combined with the rescission statutes, already provide a fair and adequate remedy for a plaintiff purportedly defrauded into entering into a settlement agreement. It also protects the accused defendant from having to forfeit money it never owed should the plaintiff not prevail on the merits of the underlying dispute.

Section 1691 provides that the consideration "must" be returned, subject to Section 1693. The first paragraph of Section 1693 provides that a delay in returning the consideration shall not be grounds to deny rescission, "unless such delay has been substantially prejudicial to the other party." (Civ. Code § 1693 [first paragraph].) Here, Village Northridge does not dispute that its six-plus year delay has been prejudicial to State Farm and waives its right to rescind. (*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* (1999) 74 Cal.App.4th 1211, 1226; *Doctor v. Lakeridge Construction Co.* (1967) 252 Cal.App.2d 715, 720-721 [three years of litigation waived right to rescind].)

If Village Northridge had elected to rescind, it might have been able to seek relief under the second paragraph of Section 1693, which reads:

> A party who has received benefits by reason of a contract *that is subject to rescission* and who in an action of proceeding *seeks relief based upon*

> *rescission* shall not be denied relief because of a delay in restoring or in tendering restoration of such benefits before judgment *unless such delay has been substantially prejudicial to the other party*; but the court may make a tender of restoration a condition of its judgment.

(Civ. Code § 1693 [second paragraph], italics added.) Had Village Northridge rescinded the settlement agreement – which State Farm virtually begged it to do – then the trial court could have dealt with the issue of how to apply the second paragraph of Section 1693. What Village Northridge should not be permitted to do is "affirm" the settlement agreement, seek the same damages as if it was rescinded, without facing the *potential* of having to give the settlement money back. But all of this is academic because of Village Northridge's consistent, repeated and unequivocal assertions that it is "affirming" the settlement agreement and *not* seeking rescission – a position continued in its answer brief. (AB 1, 15, 40.)

Contrary to the hollow cries in the answer brief that Village Northridge had no "practical remedy" (AB 5, 39, 49), our Legislature has provided one: rescission! Indeed, under our rescission statutes, a plaintiff can obtain full relief, including all consequential damages. (Civ. Code § 1692 [third paragraph].) Yet, Village Northridge deliberately choose not to pursue that course of action because, as explained in State Farm's opening brief (OB 46-47), had it elected to rescind, it would have faced the potential that it would have to pay money to State Farm in any one of three scenarios:

(a) if State Farm agreed to mutual rescission (Civ. Code §§ 1689(a), 1691);

(b) if State Farm prevailed on the rescission claim (Civ. Code § 1692 [second paragraph]; or

(c) if Village Northridge prevailed on its rescission claim, but lost on the merits of the disputed claim, *i.e.*, the amount of the earthquake loss. If Village Northridge did not prove over $4.7 million in earthquake damage, it would owe State Farm money.[7] (OB 53, fn. 26.)

The likelihood that Village Northridge could not prove earthquake damage in excess of what is has already been paid (approximately $4.7 million when its deductible is included) is precisely why Village Northridge avoided rescission and, instead, sought to overturn 80-plus years of established California law.

Therefore, there is no reason for this Court to overturn 80-plus years of established California law, represented by *Garcia/Taylor*, and adopt the minority rule.

B. The Balance Of The Non-California Cases Cited By Village Northridge Do Not Provide Any Basis For This Court To Follow The Minority Rule.

None of the remaining cases from other jurisdictions cited by Village Northridge provide any reason for this Court to depart from *Garcia/Taylor*. Indeed, many of the cases cited by Village Northridge are no longer even good law in their own jurisdictions.

Kordis v. Auto Owners Ins. Co. (Mich. 1945) 18 N.W.2d 811 (AB 28-29), is no longer a valid expression of Michigan law. In 1990, the Supreme Court of Michigan held

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[7] Indeed, Village Northridge's damage model on page 49 of its answer brief confirms the accuracy of State Farm's calculations.

that a party to a release must rescind the release and return the consideration before suing in contravention of the agreement. (*Stefanac v. Cranbrook Educational Community* (Mich. 1990) 458 N.W.2d 56, 60-63 ["It is a well-settled principle of Michigan law that settlement agreements are binding until rescinded for cause. Further, tender of consideration received is a condition precedent to the right to repudiate a contract of settlement"].) Three years later in *Triplett v. St. Amour* (Mich. 1993) 507 N.W.2d 194, the majority opinion noted *Kordis* but stated that there was "no occasion to speak to the question of its continued validity." (*Id.* at p. 197, fn. 6.) Even the Court of Appeal acknowledged that *Stefanac* represents Michigan law on this issue. (Typed Opn. at p. 12, fn. 5.)

Mutual Sav. Life Ins. Co. v. Osborne (Ala. 1943) 15 So.2d 713, 718 (*Osborne*) (AB 44-45) was overturned *sub silentio* in *Ledbetter v. Frosty Morn Meats* (Ala. 1963) 150 So.2d 365, 371 (*Ledbetter*) ["So, in the case at bar, we hold that...plaintiff was bound, as a condition precedent to avoiding the release, to return the consideration therefore within a reasonable time after discovery of the alleged fraud . . ."]; *see also Boles v. Blackstock* (Ala. 1986) 484 So.2d 1077, 1083 [same].) Again, the Court of Appeal, by citing *Ledbetter,* acknowledges that *Osborne* is no longer a controlling statement of Alabama law. (Typed Opn. at p. 12, fn. 5.)

Nor does *Gaskins v. Southern Farm Bureau Cas. Ins. Co.* (S.C. 2003) 581 S.E.2d 169 (*Gaskins*) help Village Northridge's position. *Gaskins* does not address rescission at

all; it merely holds that an insurance company can be sued for fraud. Like *Matsuura* and *Phipps*, *Gaskins* cites *Taylor* and acknowledges that the law is different in California. (*Id.* at p. 419, fn. 1.) Moreover, *Gaskin* did not address the earlier decision of the South Carolina Supreme Court in *Dunaway v. United Ins. Co. of Am.* (S.C. 1962) 123 S.E.2d 353, 354, in which the court held that "[t]he general principle that one who seeks to avoid the effect of a release must first return or tender the consideration paid therefor has been consistently applied in this State to claims under insurance policies." (*See also Hyman v. Ford Motor Co.* (D.S.C. 2001) 142 F.Supp.2d 735, 747 ["The general rule in South Carolina is that when a party seeks to set aside a release, he must first return any consideration received by him for the release."]; *State Farm Mut. Auto. Ins. Co. v. Turner* (S.C.Ct.App. 1990) 399 S.E.2d 22, 23 ["it is well settled that one who seeks to avoid the effects of a release must first return or tender consideration paid therefore."].)

Without these cases, Village Northridge is essentially left clinging to *DiSabatino.*[8] State Farm addressed *DiSabatino* extensively in its opening brief (OB 38-40) and explained why the policy issues that *DiSabatino* relied upon to justify its position have no relevance in this case.[9] Village Northridge has not addressed State Farm's analysis and, thus, that analysis need not be repeated.

Village Northridge claims that this Court should not continue to adhere to *Garcia* and *Taylor* because those cases, and other majority-rule cases, involve "disgruntled personal injury plaintiffs who seek to avoid releases on the simple basis that they felt they did not get enough money in their settlement." (AB 18.) This argument is nonsensical. Village Northridge explicitly concedes that there is no basis to draw a distinction between personal injury and non-personal injury claims. (AB 4-5.) Moreover, if Village Northridge is not a plaintiff that feels "it did not get enough money in their settlement"

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[8] As discussed in the opening brief, *Matsuura* is a diversity case applying Delaware law. Under *Erie*, the Ninth Circuit accepted *DiSabatino* as representing Delaware on this issue. The Ninth Circuit's discussion is relegated largely to a footnote and does little more than simply follow *DiSabatino*. (*Matsuura, supra,* 179 F.3d at 1131, fn. 4.) Much of *Matsuura* involves Delaware law on the scope of releases, an issue not present in this case, because Village Northridge concedes its Northridge earthquake claims are within the scope of the release. (3 AA 907:6-7.) Similarly, *Phipps* does little other than mimic *DiSabatino's* reasoning. (*Phipps, supra,* 593 N.W.2d at p. 146.)

Moreover, none of the cases which have followed *DiSabatino* had existing contrary precedent within the jurisdiction. In contrast, California law has been clear for 80-plus years.

[9] It should be noted that, based upon State Farm's research, Delaware has no rescission statute that provides a comparable remedy to Sections 1691-1693.

then what exactly is it? Presumably if the settlement was for $15 million, instead of $1.5 million, we would not be here.

Therefore, none of the cases from other jurisdictions provides any basis for this Court to abandon *Garcia* and *Taylor*.

V. VILLAGE NORTHRIDGE'S DAMAGES ARE EITHER BASED ENTIRELY UPON THE UNDERLYING DISPUTE THAT WAS SETTLED OR ARE BASED UPON SPECULATION AS TO WHAT THE PARTIES MIGHT HAVE SETTLED FOR.

The answer brief states it best: "Who knows what Village Northridge would have done had it known that another seven million dollars was available under its policy." (AB 34-35.) This statement proves the point made in State Farm's opening brief that Village Northridge's "settlement value" claim is inherently speculative. (OB 48-51.) Village Northridge claims that expert testimony would be admissible to demonstrate the "settlement value" of its case. (AB 48.) However, expert testimony is not admissible to demonstrate the ultimate outcome of what a case would have been, even within a "trial within a trial" format for legal malpractice actions. (*Piscitelli v. Friedenberg* (2001) 87 Cal.App.4th 953, 972-973 [expert testimony inadmissible to prove what the outcome of an underlying arbitration would have been].) Applying the same reasoning, Village Northridge should not be able to rely upon expert testimony to demonstrate what the parties allegedly would have settled for.

Village Northridge also dismisses Justice Kennard's decision in *Cedars-Sinai Med. Ctr. v. Superior Court* (1998) 18 Cal.4th 1. It is true that the issue in that case was

reevaluate their conclusions; (5) hire a claims handling expert; (6) hire an expert contractor or architect to determine the scope and propriety of post-earthquake repairs performed by Village Northridge; (7) depose the contractors who performed the post-earthquake repairs for Village Northridge; (8) serve written discovery, including obtaining Village Northridge's homeowner's association's documentation reflecting unit owner complaints about alleged damage; (9) ascertain whether to depose unit owners and/or tenants who lived at Village Northridge prior to 1994 to determine whether any purported earthquake damage was actually the result of pre-existing construction defects; and (10) depose the property management companies and personnel who worked for Village Northridge from 1990-1998. Indeed, in a comparable Northridge earthquake case involving a homeowner's association, State Farm incurred over $4 million just in costs, exclusive of attorney's fees. (Request for Judicial Notice Ex. 1.)

Now, under Village Northridge's "fraud" claim, State Farm will have to relitigate exactly the same issues in order to disprove materiality and damages. (OB 53, fn. 26.) *Myerchin* rejected the identical argument advanced by Village Northridge. (*Myerchin, supra*, 162 Cal.App.4th at pp. 1534-1535 [permitting party to relitigate merits of settled claim would deprive settling party of the "*sole benefit* it had contracted for in the settlement – avoidance of the uncertainty and expense of litigation"].)

To permit Village Northridge to retain the $1.5 million settlement, while at the same time litigating the merits of the very claims that were released, is manifestly unfair and would undermine the finality of all civil settlements in this State.

VI. VILLAGE NORTHRIDGE'S SECTION 1688 ARGUMENT IS WHOLLY MISPLACED AND IMPROPERLY RAISED FOR THE FIRST TIME BEFORE THIS COURT.

For the first time in the course of this litigation, in its answer brief Village Northridge suggests that State Farm is attempting to use the settlement agreement to exempt itself from claims of fraud and it cites Sections 1667 and 1668 in support. (AB 53.) State Farm has never argued that the settlement agreement was a defense to a claim of fraud. To the contrary, State Farm readily acknowledges that Village Northridge could have pursued a claim for rescission based upon fraud. (Civ. Code § 1689(b)(1).) However, Sections 1667 and 1668 have no application to the facts of this case. As Witkin explains:

> A party to a contract who has been guilty of fraud in its inducement cannot absolve himself or herself from the effects of his or her fraud by any stipulation in the contract, either that no representations have been made, or that any right that might be grounded upon them is waived. Such a stipulation or waiver will be ignored, and parol evidence of misrepresentations will be admitted, for the reason that fraud renders the whole agreement voidable, including the waiver provision.

(1 Witkin, Summary of California Law (10th ed. 2005) Contracts, § 304, p. 330.)

There is no stipulation in the settlement agreement that Village Northridge waives any claims of fraud in the inducement to settle, and State Farm raises no such defense.

Those statutes only preclude agreements that contractually release parties for liability for future intentional wrongs. No such release exists in this case. (*See Farnham v. Superior Court* (1997) 60 Cal.App.4th 69, 77.)

Accordingly, Sections 1667 and 1668 are entirely irrelevant to this case.

VII. VILLAGE NORTHRIDGE'S RAMBLINGS ABOUT THE POLICY LIMIT ARE IRRELEVANT.

Again, Village Northridge continues to misstate the record about the purported misrepresentation of policy limits. As set forth in State Farm's opening brief (OB 55-58), State Farm recognizes that this is a review of a demurrer ruling and, thus, Village Northridge's misrepresentation claim must be accepted as true no matter how specious. However, it is absurd for Village Northridge to contend that State Farm's arguments regarding the policy limits violate the parol evidence rule (AB 12) or that State Farm's argument is not supported by citations to the record. (AB 50.) In fact, what State Farm stated in its opening brief is:

> 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.

(OB 56-57.) Therefore, according to the plain language – and not parol evidence – of the earthquake endorsement (6AA 1314, ¶ 4), a copy of which is attached as Exhibit A,

Village Northridge's earthquake limits is determined by State Farm's "records." Within one week of the Northridge earthquake State Farm printed its "records" showing the applicable earthquake coverages. Attached as Exhibit B is a copy of the document reflecting those records as of January 21, 1994.[10] The coverage lines denoted "QB" reflect the amount of earthquake coverage. Not surprisingly, the three "QB" lines of coverage total exactly $5 million, not $12 million. In connection with the earlier motion for summary judgment, State Farm also established that Village Northridge had almost exactly $5 million in earthquake coverage. (1AA 61, ¶ 5.) Therefore, there is no substantive merit to Village Northridge's policy misrepresentation limit arguments.

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[10] Contrary to Village Northridge's assertions, this document was produced by State Farm in discovery as part of the claim file. (2 AA 243, ¶¶ 6-7.)

CONCLUSION

For the foregoing reasons, and those set forth in State Farm's opening brief, this Court should reverse the Court of Appeal's decision, reinstate the trial court's ruling, and reaffirm that *Garcia* and *Taylor* apply to all settlements of disputed claims.

DATED: June 27, 2008

ROBIE & MATTHAI
A Professional Corporation
JAMES R. ROBIE
STEVEN S. FLEISCHMAN

LHB PACIFIC LAW PARTNERS, LLP
CLARKE B. HOLLAND
SANDRA E. STONE

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

EXHIBIT A

FE-6307
(1/

EARTHQUAKE AND VOLCANIC ERUPTION ENDORSEMENT

1. Under **SECTION I LOSSES NOT INSURED**, references to earthquake, volcanic eruption, volcanic explosion, and volcanic effusion are deleted. Such insurance as is afforded by Section I of the policy is extended to insure for accidental direct physical loss caused by earthquake, volcanic eruption, volcanic explosion, and volcanic effusion unless:

   a. the loss is otherwise insured under the policy; or

   b. the loss is limited in **SECTION I PROPERTY SUBJECT TO LIMITATIONS.**

2. All earthquake shocks, volcanic eruptions, volcanic explosions or volcanic effusions that occur within any 72-hour period will constitute a single loss. The expiration of this policy will not reduce the 72-hour period.

3. We do not insure for loss caused by or resulting from any earthquake, volcanic eruption, volcanic explosion or volcanic effusion that begins before the inception of this endorsement.

   But, if this endorsement replaces earthquake insurance that excludes loss that occurs after the expiration of the policy, we will pay for loss or damage by earthquake, volcanic eruption, volcanic explosion or volcanic effusion that occurs on or after the inception of this endorsement, if the series of earthquake shocks, volcanic eruptions, volcanic explosions or volcanic effusions began within 72 hours prior to the inception of this insurance.

4. The deductible for loss caused by earthquake, volcanic eruption, volcanic explosion or volcanic effusion is the amount determined by applying the deductible percentage (%) shown on the Declarations, separately, to each of the following:

   a. the amount of insurance on each covered building or structure as shown in our records; or

   b. the amount of insurance on the business personal property of each covered building as shown in our records.

   No deductible applies to the **SECTION I EXTENSION OF COVERAGE** Extra Expense.

   We will pay only that portion of the loss which exceeds the separate deductibles calculated above. The minimum deductible for each occurrence is $250.

All other policy provisions apply.

EXHIBIT B

Requested by: SUSAN JOHNSON 01/21/94 04:16:16

STATE FARM FIRE AND CASUALTY COMPANY
CURR DATE 01/20/94 POLICY # 92-27-9547-6
INSURED VILLAGE NORTHRIDGE II HOA
C/O ROSS MORGAN & COMPANY INC

LOAN # LOAN #

	FLMP SCSPTA	CLASS	AMOUNT	LIAB	RSK NO	ITM	STA CL
13	AS	361	176622	61	1		
15	DO	300		61	1		
17	QB	360	4630400		1		
19	QB	360	169800		1		
21	SL	300	1	61	1		

	FLMP SCSPTA	CLASS	AMOUNT	LIAB	RSK NO	ITM	STA CL
14	AS	361	171668	61	1		
16	IL	300		61	1		
18	QB	360	174700		1		
20	QC	360	25100		1		

FORMS TITLE FORMS TITLE

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PROOF OF SERVICE

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

On June 27, 2008, I served the foregoing document(s) described as:

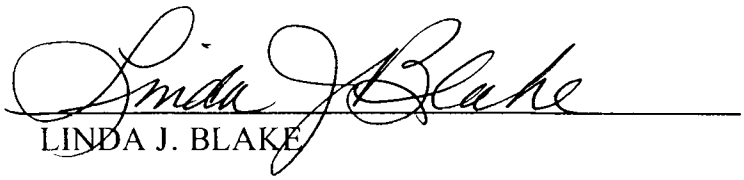
REPLY BRIEF ON MERITS

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

See Attached Service List

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

I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on June 27, 2008, at Los Angeles, California.



LINDA J. BLAKE

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Hon. Wendell Mortimer, Jr. LOS ANGELES COUNTY SUPERIOR COURT Central Civil West Courthouse Department 307 600 S. Commonwealth Ave. Los Angeles, CA 90005	Judge of the Superior Court Case No. BC 265328
CALIFORNIA COURT OF APPEAL Second Appellate District, Division Eight 300 S. Spring Street Los Angeles, CA 90012	2d Civ. No. B188718