



# Weekly Law Resume

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Edited by David Blinn and Mark Hazelwood



WEEKLY LAW RESUME™

Issue By: Ray Coates

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## Settlement - Rescission - Right to Sue

*Village Northridge Homeowners Association v. State Farm Fire and Casualty Company*  
Supreme Court of California (August 30, 2010)

An insured executed a full and complete release of a claim and kept the money the insurer paid in settlement without rescinding the release and then sued the same insurer for fraudulently inducing the insured to settle for less than the claim was worth under the policy. The Supreme Court examined this case to determine if this procedure was allowed.

This case arose out of the 1994 Northridge earthquake. State Farm paid Village Northridge \$2,068,000 for damages arising from the earthquake. As time passed, additional claims were made and additional payments were made while a compromise settlement was attempted of the remainder. Finally, State Farm paid an additional \$1.5 million, pursuant to a release of all known or unknown claims related to the earthquake. It included a Civil Code § 1542 waiver of all unknown claims.

In late 2000, Village Northridge asked State Farm to reopen the claim. State Farm refused. Village Northridge then sued State Farm for breach of contract and breach of the implied covenant. Village Northridge insisted it did not need to rescind the settlement agreement and did not intend to do so. It sought to affirm the release as a partial payment and seek additional damages. The trial court granted State Farm's motion for summary judgment. The Court of Appeal reversed, indicating there were triable issues of fact as to whether the release was enforceable. Village Northridge then filed a second amended complaint, substantially the same as the first. The trial court sustained a demurrer without leave to amend. The Court of Appeal again reversed. State Farm petitioned the Supreme Court for review, which was granted.

The Supreme Court reversed the Court of Appeal. Village Northridge alleged State Farm

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committed fraud in inducing it to settle by misrepresenting the policy limits. The Court stated the general rule is that if a party seeks to void a release, he must rescind the agreement. This requires prompt notice and an offer to restore consideration. The Court of Appeal held that Village Northridge could keep the settlement proceeds and sue for fraud as is allowed in general fraud actions. The Supreme Court held that procedure does not apply to a settlement and release of a disputed claim.

Here, the payment by State Farm was to settle and release all claims. Allowing Village Northridge to sue without rescinding the contract would defeat that purpose. It would further violate Civil Code § 1691, which provides for notice and restoration of consideration before rescission can be sought. In a rescission trial, the court can adopt a flexible approach and allow the rescission trial to proceed, even if there is no restoration of consideration, if it feels it is equitable to do so. This rule has now been adopted by § 1693 of the Civil Code. This allows plaintiffs who are unable to restore the consideration received in the original settlement and release to delay the restoration of consideration until final judgment, consistent with equitable principles. Village Northridge rejected that approach.

In adopting this rule, the Court saw no need to impose a new rule on insurers. It noted that an insurer is not a fiduciary. Settlements are to be favored. A settlement is considered presumptively valid and the parties to the agreement are bound by it until it is rescinded. For that reason, the Court of Appeal's judgment was reversed and the matter remanded to the trial court for further consideration.

## COMMENT

The Supreme Court decision will allow insurers to continue the practice of using a release as a settlement device. For those who claim fraud against their insurers in the process of settlement, their relief will be by rescission under the rules set forth by California statutes.

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