

[Take the Money or Rescind -- Not Both](#)

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In *Village Northridge Homeowners Association v. State Farm Fire and Casualty Company* (decided August 30, 2010), the [California Supreme Court](#) rejected an insured's attempt to sue [State Farm](#) for fraud in inducing settlement of the insured's property damage claim. The insured alleged the settlement was procured by State Farm's undervaluing of the earthquake loss and misrepresentation of the policy limits to be only \$4,979,900, while the limits were allegedly \$11,905,500.

While the settlement agreement between State Farm and the insured released all known and potential claims related to the Northridge Earthquake damage claims, the insured insisted it need not seek to rescind the settlement agreement but could instead elect to affirm the settlement and release, and also then sue for fraud damages.

As noted by the Court, the insured "seeks to affirm those parts of the agreement that benefit it, but to invalidate a major part of the agreement that benefits State Farm." This is a rescission remedy and the party seeking to rescind must restore benefits received under the contract. [Civ. Code § 1688](#) et seq.

The Court recognized that other jurisdictions, relying on common law principles, have allowed a party challenging a settlement to "affirm and sue" for fraud in the inducement without restoring benefits.

In significant contrast, the California Legislature has spoken in this area and specifically rejected the "affirm and sue" principle.

Instead, the Civil Code requires the aggrieved party to rescind and restore consideration received in their original settlement and release with the caveat that any actual return of benefits may be delayed until final judgment unless it substantially prejudices the defendant. [Civ. Code § 1693](#).

The Court rejected public policy arguments that an "affirm and sue" principle was necessary to combat fraud in settlements. In closing, the Court stated:

The Legislature has created a fair and equitable remedy to address the alleged fraud problem: rescission of the release, followed by suit. When restoration is impossible because the settlement monies have been spent, the financially constrained parties can turn to section 1693 to delay restoration until judgment, unless the defendants can show substantial prejudice. Our statutory scheme therefore effectively ensures that plaintiffs who may have been defrauded in the settlement process will be allowed access to the courts."