

6/14/60

Memorandum No. 54 (1960)

Subject: Study No. 23 - Rescission of Contracts

Attached to this memo is the proposed statute on rescission of contracts. It has been prepared upon the basis of the Commission's last instruction to abolish out-of-court rescission.

Section 1 through 4 have been approved in substance. There have been minor language changes in Sections 1 and 4 for the purpose of clarification.

Section 3406.5, added by Section 5 of this draft, is new. Under present law, if a party has the right to rescind, the date the notice is sent is important for many reasons, for ownership of goods or choses in action, risk of loss, and similar matters may be affected by the notice. This section has been inserted so that these matters will be unaffected even though unilateral out-of-court rescission is abolished.

Section 3407, approved by the Commission, has been placed in two sections. Section 3408 has been revised slightly. It now refers to the statute of limitations. Section 3409 has been broadened so that the court may require a person seeking rescission to do other acts as well as making compensation.

Section 3410 has been modified to a certain extent. "Cause of action" has been substituted for the word "claim". The provision on judgment has been modified to provide specifically that the amount to be restored to the defendant upon rescission of a release is to be set off against the plaintiff's judgment, and if the amount exceeds the plaintiff's judgment, judgment shall

be given in favor of the defendant in the amount of the excess.

Sections 11 and 12 of this draft have been approved. Section 12 has been modified slightly from the draft approved by the Commission. In subdivision (2), "is not" has been substituted for "shall not be held to have been". Section 14 has been modified slightly from the draft approved by the Commission. "But the property in the goods has passed to the buyer" has been inserted immediately before the first comma, and the phrase "if the property has passed to the buyer" has been deleted.

The remainder of the draft has not been considered in detail by the Commission.

Section 15, which amends Section 1789 of the Civil Code (Section 69 of the Sales Act), is the heart of the entire problem involved in the abolition of out-of-court rescission. Subdivision (4) of this section -- which describes how the right granted in subdivision (1) (d) is to be exercised -- describes an out-of-court rescission. It has been redrafted so that the out-of-court action affects the title to the goods but does not "rescind" the contract. Similar changes have been made in other subdivisions of this section.

Corporations Code Section 2470, which had been amended in prior drafts, is not amended in the present draft but is included for your information. It is not amended for it does not declare procedure -- how rescission is to be effected -- but declares only the substantive rights involved. Moreover, it is not concerned with the rescission of the contract but with the rescission of the transfer of the stock certificate -- the ownership.

Respectfully submitted,

Joseph B. Harvey
Assistant Executive Secretary

The people of the State of California do enact as follows:

SECTION 1. Section 1689 of the Civil Code is amended to read:

1689. [A-party] The parties to a contract may rescind the same by mutual agreement [~~in the following cases only:~~]

[~~1. -- If the consent of the party rescinding, or of any party jointly contracting with him, was given by mistake, or obtained through duress, menace, fraud, or undue influence, exercised by or with the connivance of the party as to whom he rescinds, or of any other party to the contract jointly interested with such party;~~

~~2. -- If, through the fault of the party as to whom he rescinds, the consideration for his obligation fails, in whole or in part;~~

~~3. -- If such consideration becomes entirely void from any cause;~~

~~4. -- If such consideration, before it is rendered to him, fails in a material respect, from any cause;~~

~~5. -- By consent of all the other parties; or~~

~~6. -- Under the circumstances provided for in sections 1785 and 1789 of this code].~~

SEC. 2. Section 1690 of the Civil Code is hereby repealed.

SEC. 3. Section 1691 of the Civil Code is hereby repealed.

SEC. 4. Section 3406 of the Civil Code is amended to read:

3406. The rescission of a contract may be adjudged [~~in the~~
~~application-of-a-party-aggrieved~~] in the following cases only:

~~[1--In-any-of-the-cases-mentioned-in-Section-1689]~~ (1) If the consent of the party seeking to rescind, or of any party jointly contracting with him, was given by mistake, or obtained through duress, menace, fraud, or undue influence, exercised by or with the connivance of the party as to whom he seeks rescission, or of any other party to the contract jointly interested with such party; [~~or~~]

(2) If, through the fault of the party as to whom he seeks rescission, the consideration for his obligation fails, in whole or in part;

(3) If the consideration for his obligation becomes entirely void from any cause;

(4) If the consideration for his obligation, before it is rendered to him, fails in a material respect from any cause;

~~[2]~~ (5) Where the contract is unlawful, for causes which do not appear in its terms or conditions, and the parties were not equally in fault; [~~or~~]

~~[3]~~ (6) When the public interest will be prejudiced by permitting it to stand [~~or~~]; or,

(7) Under the circumstances provided for in Sections 39, 1785, 1789, 1930, and 2314 of this code, and Sections 331,

338, 359, 447, 1904, and 2030 of the Insurance Code.

SEC. 5. Section 3406.5 is added to the Civil Code, to read:

3406.5. Whenever the rescission of a contract is adjudged pursuant to Section 3406, the contract shall be deemed to have been rescinded as of the following dates:

(1) If notice of repudiation of the contract was given in accordance with subdivision (1)(a) of Section 3408, as of the date when such notice was given.

(2) If notice of repudiation was not given in accordance with subdivision (1)(a) of Section 3408, as of the date of filing of the pleading in which the cause of action for rescission was asserted.

(3) If rescission is adjudged on the basis of the evidence produced in an action or proceeding even though a cause of action for rescission was not asserted in the pleadings and notice of repudiation was not given in accordance with subdivision (1)(a) of Section 3408, as of the date of entry of the judgment of rescission.

SEC. 6. Section 3407 of the Civil Code is amended to read:

3407. [~~RESCISSION-FOR-MISTAKE.~~] Rescission cannot be adjudged for mere mistake, unless the party against whom it is adjudged can be restored to substantially the same position as if the contract had not been made.

SEC. 7. Section 3407.5 is added to the Civil Code, to read:

A stipulation that errors of description shall not avoid a contract, or shall be the subject of compensation, or both, does not take away the

right to have rescission adjudged for fraud, nor for mistake where such mistake is in a matter essential to the inducement of the contract and is not capable of exact and entire compensation.

SEC. 8. Section 3408 of the Civil Code is amended to read:

3408. [~~COURT-MAY-REQUIRE-PARTY-RESCINDING-TO-DO-EQUITY--On-adjudging the-rescission-of-a-contract-the-Court-may-require-the-party-to-whom-such relief-is-granted-to-make-any-compensation-to-the-other-which-justice-may-require.~~]

(1) Except as provided in subdivision (2) of this section the court shall deny rescission of a contract unless the party seeking rescission has, prior to requesting such relief, complied with the following rules:

(a) Upon discovering the facts which entitle him to have rescission adjudged, and if he is free from duress, menace, undue influence or disability and is aware of his right to do so, he shall promptly notify the party as to whom he seeks rescission that he repudiates the contract because it is subject to rescission.

(b) He shall restore to the other party everything of value which he has received under the contract from such party or offer to restore the same, upon condition that the other party do likewise, unless the latter is unable or positively refuses to do so.

(2) The court shall not deny rescission of a contract because of (a) failure to give or delay in giving notice of repudiation, (b) delay in requesting the relief of rescission except as provided in Section 338 of the Code of Civil Procedure or (c) because of a failure to restore or offer to restore the benefits received under the contract, unless such

failure or delay has been substantially prejudicial to the other party or unless the party seeking relief has waived his right to have rescission adjudged.

SEC. 9. Section 3409 is added to the Civil Code, to read:

3409. On adjudging the rescission of a contract, the court may order the party to whom such relief is granted to make compensation to the other or do any other act which justice may require and may make the judgment of rescission conditional upon compliance with such order.

SEC. 10. Section 3410 is added to the Civil Code, to read:

3410. Where a release is pleaded in answer to a cause of action asserted in a pleading, the party asserting the cause of action may serve and file a responsive pleading to have the rescission of the release adjudged. If such a responsive pleading is served and filed, the court shall first determine whether the rescission of the release should be adjudged. If the party asserting the cause of action is found not to be entitled to rescission of the release, the release shall be accorded the effect to which it is entitled as a defense to the cause of action. If the party asserting the cause of action is entitled to rescission of the release, rescission of the release shall be adjudged, and the release shall be accorded no effect as a defense to the cause of action; but the court shall set off against any judgment rendered in favor of the party asserting the cause of action the amount of any benefits that were conferred upon such party in exchange for the release by the party who pleaded or introduced the release, and if such amount exceeds any judgment rendered in favor of the party asserting the cause of action, the court shall enter judgment in favor of the party who pleaded or introduced the release in the amount of such excess.

SEC. 11. Section 3411 is added to the Civil Code, to read:

3411. When a party to an action seeks to have the rescission of a contract adjudged, the issue of rescission shall be tried by the court without a jury.

SEC. 12. Section 1773 of the Civil Code is amended to read:

1773. REMEDIES OF UNPAID SELLER. (1) Subject to the provisions of this act, notwithstanding that the property in the goods may have passed to the buyer, the unpaid seller of the goods, as such, has:

* * *

(d) A right to resume the property in the goods [~~reseind-the-sale~~] as limited by this act.

SEC. 13. Section 1781 of the Civil Code is amended to read:

1781. [~~WHEN-AND-HOW-THE-SELLER-MAY-RESCIND-THE-SALE~~] (1) An unpaid seller having a right of lien or having stopped the goods in transitu, may [~~reseind-the-transfer-of-title-and~~] resume the property in the goods, where he expressly reserved the right to do so in case the buyer should make default, or where the buyer has been in default in the payment of the price an unreasonable time. The seller shall not thereafter be liable to the buyer upon the contract to sell or the sale, but may recover from the buyer damages for any loss occasioned by the breach of the contract or the sale.

(2) The [~~transfer-of-title-shall-not-be-held-to-have-been-rescinded-by an-unpaid-seller~~] right of an unpaid seller to resume the property in the goods under subdivision (1) of this section is not exercised until he has manifested by notice to the buyer or by some other overt act an intention to [rescind] exercise such right. It is not necessary that such overt act should be communicated to the buyer, but the giving or failure to give notice to the buyer of the intention to [rescind] resume the property in the goods shall be relevant in any issue involving the question whether the buyer had been in default an unreasonable time before the right [~~of rescission~~] to resume the property in the goods was asserted.

SEC. 14. Section 1785 of the Civil Code is amended to read:

1785. [~~WHEN SELLER MAY RESCIND CONTRACT OR SALE,~~] Where the goods have not been delivered to the buyer but the property in the goods has passed to the buyer, and the buyer has repudiated the contract to sell or sale, or has manifested his inability to perform his obligations thereunder, or has committed a material breach thereof, the seller may [~~totally rescind~~] resume the property in the goods by giving notice of his election so to do to the buyer and may have the rescission of the contract or the sale adjudged in accordance with Article 5 (beginning with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of this code. [~~by giving notice of his election so to do to the buyer~~]

SEC. 15. Section 1789 of the Civil Code is amended to read:

1789. REMEDIES FOR BREACH OF WARRANTY. (1) Where there is a breach of warranty by the seller, the buyer may, at his election:

* * *

(d) Rescind the [~~contract-to-sell-or-the-sale~~] transfer of the property in the goods and refuse to receive the goods, or if the goods have already been received, return them or offer to return them to the seller and recover the price or any part thereof which has been paid in an action to have the rescission of the contract to sell or the sale adjudged under Article 5 (beginning with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of this code.

(2) When the buyer has claimed and been granted a remedy in any one of these ways, no other remedy can thereafter be granted.

(3) Where the goods have been delivered to the buyer, he can not rescind the [~~sale~~] transfer of the property in the goods and have the rescission of the sale adjudged if he knew of the breach of warranty when he accepted the goods, or if he fails to notify the seller within a reasonable time of the election to rescind, or if he fails to return or offer to return the goods to the seller in substantially as good condition as they were in at the time the property was transferred to the buyer. But if deterioration or injury of the goods is due to the breach of warranty, such deterioration or injury shall not prevent the buyer from returning or offering to return the goods to the seller, [~~and~~] rescinding the transfer of the property in the goods and having the rescission of the sale adjudged.

(4) Where the buyer is entitled to rescind the [~~sale~~] transfer of the property in the goods and elects to do so, the buyer shall cease to be liable for the price upon returning or offering to return the goods. If the price or any part thereof has already been paid, the seller shall be liable to repay so much thereof as has been paid [~~,-concurrently-with-the-return-of-the-goods, or-immediately-after-an-offer-to-return-the-goods-in-exchange-for-repayment~~

~~of-the-price]~~ in an action to have the rescission of the sale adjudged under Article 5 (beginning with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of this code.

(5) Where the buyer is entitled to rescind the ~~[sale]~~ transfer of the property in the goods and elects to do so, if the seller refuses to accept an offer of the buyer to return the goods, the buyer shall thereafter be deemed to hold the goods as bailee for the seller, but subject to a lien to secure the repayment of any portion of the price which has been paid, and with the remedies for the enforcement of such lien allowed to an unpaid seller by Section 1773.

* * *

SEC. 16. Section 39 of the Civil Code is amended to read:

39. A conveyance or other contract of a person of unsound mind, but not entirely without understanding, made before his incapacity has been judicially determined, ~~[is-subject-to-rescission,]~~ may be adjudged rescinded as provided in Article 5 (beginning with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of this code.

SEC. 17. Section 1566 of the Civil Code is amended to read:

CONSENT, WHEN VOIDABLE. A consent which is not free is nevertheless not absolutely void, but may be rescinded by the parties~~[,]~~ in the manner prescribed by the Chapter on Rescission ~~[,]~~ or rescission may be adjudged under Article 5 (beginning with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of this code.

SEC. 18. Section 1930 of the Civil Code is amended to read:

1930. When a thing is let for a particular purpose the hirer must not use it for any other purpose; and if he does, he is liable to the letter for all damages resulting from such use, or the letter may ~~[treat-the-contract~~

~~as-thereby-rescinded~~ have the rescission of the contract adjudged under Article 5 (beginning with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of this code.

SEC. 19. Section 2314 of the Civil Code is amended to read:

2314. ~~RESCISSIION-OF-RATIFICATION;~~ The rescission of a ~~[-A-]~~ ratification may be ~~rescinded~~ adjudged when the ratification was made without such consent as is required in a contract, or with an imperfect knowledge of the material facts of the transaction ratified, but not otherwise.

SEC. 20. Section 331 of the Insurance Code is amended to read:

331. Concealment, whether intentional or unintentional, entitles the injured party to ~~rescind~~ repudiate the contract of insurance and to have its rescission adjudged.

SEC. 21. Section 338 of the Insurance Code is amended to read:

338. An intentional and fraudulent omission, on the part of one insured, to communicate information of matters proving or tending to prove the falsity of a warranty, entitles the insurer to ~~rescind~~ repudiate the contract of insurance and have its rescission adjudged.

SEC. 22. Section 359 of the Insurance Code is amended to read:

359. If a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to ~~rescind~~ repudiate the contract of insurance and have its rescission ~~the contract~~ adjudged from the time the representation becomes false.

SEC. 23. Section 447 of the Insurance Code is amended to read:

447. The violation of a material warranty or other material provision of a policy, on the part of either party thereto, entitles the other to ~~rescind~~ repudiate the policy and to have its rescission adjudged.

SEC. 24. Section 650 of the Insurance Code is amended to read:

650. Whenever a right to ~~rescind~~ repudiate a contract of insurance and to have its rescission adjudged is given to the insurer by any provision of this part, notice of repudiation of such right ~~may~~ must be ~~exercised~~ given ~~at any time previous~~ prior to the commencement of an action on the contract.

SEC. 25 . Section 1904 of the Insurance Code is amended to read:

1904. In marine insurance, if a representation by the insured is intentionally false in any respect, whether material or immaterial, the insurer may ~~rescind~~ repudiate the entire contract and have its rescission adjudged.

SEC. 26. Section 2030 of the Insurance Code is amended to read:

2030. An insurer is entitled to ~~rescind~~ repudiate a contract of fire insurance and to have its rescission adjudged upon an alteration in the use or condition of the subject matter insured from that to which it is limited by the policy, when such alteration is made without the consent of the insurer by means within the control of the insured, and increases the risk.

SEC. 27. Section 338 of the Code of Civil Procedure is amended to read:

338. Within three years:

* * *

8. An action to have the rescission of a contract adjudged and to recover for benefits conferred pursuant to said contract. Where the ground for rescission is fraud, or mistake, the cause of action to have a rescission adjudged shall not be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake.

SEC. 25. Section 537 of the Code of Civil Procedure is amended to read:

537. The plaintiff, at the time of issuing the summons, or at any time afterward, may have the property of the defendant attached, as security for the satisfaction of any judgment that may be recovered, unless the defendant gives security to pay such judgment, as in this chapter provided, in the following cases:

1. In an action upon a contract, express or implied, for the direct payment of money, where the contract is made or is payable in this State, and is not secured by any mortgage, deed of trust or lien upon real or personal property, or any pledge of personal property, or, if originally so secured, such security has, without any act of the plaintiff, or the person to whom the security was given, become valueless [~~if provided that~~ ~~an~~]. An action upon any liability, existing under the laws of this State, of a spouse, relative or kindred, for the support, maintenance, care or necessaries furnished to the other spouse, or other relatives or kindred, shall be deemed to be an action upon an implied contract within the term as used throughout all subdivisions of this section. An action to have the

rescission of a contract adjudged and to recover a money judgment for the value of benefits conferred under such contract shall be deemed to be an action upon an implied contract within the term as used throughout all subdivisions of this section.

* * *

SEC. 29. Section 427 of the Code of Civil Procedure is amended to read:

427. The plaintiff may unite several causes of action in the same complaint, where they all arise out of:

1. Contracts, express or implied. An action to have the rescission of a contract adjudged, shall be deemed to be an action upon an implied contract within that term as used in this subdivision of this section.

* * *

SEC. 30. Section 112 of the Code of Civil Procedure is amended to read:

112. Justice courts shall have original jurisdiction of civil cases and proceedings as follows:

(a) In all cases at law in which the demand, exclusive of interest, or the value of the property in controversy, amounts to five hundred dollars (\$500) or less, except cases at law which involve the title or possession of real estate or the legality of any tax, impost, assessment, toll or municipal fine, or actions to have the rescission of a contract adjudged;

* * *

FOR INFORMATION ONLY

Section 2470 of the Corporations Code provides:

2470. (a) Subject to the provisions of subdivision (b) of this section, the transfer of a certificate may be rescinded, and possession thereof reclaim, in any of the following cases:

(1) If the endorsement or delivery of the certificate was procured by fraud or duress.

(2) If the endorsement or delivery of the certificate was made under such mistake as to make the endorsement or delivery inequitable.

(3) If the delivery of the certificate was made without authority from the owner.

(4) If the delivery of the certificate was made after the owner's death or legal incapacity.

(b) The right to rescind the transfer of a certificate and reclaim the possession thereof does not exist in either of the following cases:

(1) If the certificate has been transferred to a purchaser for value, in good faith, without notice of any facts making the transfer wrongful.

(2) If the injured person has elected to waive the injury or has been guilty of laches in endeavoring to enforce his rights.

(c) Any court of appropriate jurisdiction may enforce specifically the right to reclaim the possession of the certificate or to rescind the transfer thereof and, pending litigation, may enjoin the further transfer of the certificate or impound it.

POSSIBLE RECOMMENDATIONS CONCERNING RESCISSION STUDY

1. Abolish out-of-court rescission. Memorandum No. 54 (1960) contains a draft statute to accomplish this.
2. Retain both judicial and out-of-court rescission but eliminate differences that have caused problems. Commissioner McDonough has a draft statute to distribute at the meeting to accomplish this.
3. Abolish judicial rescission and preserve only out-of-court rescission. This solution might not require extensive statutory change. Perhaps it might be accomplished by the repeal of the judicial rescission sections of the Civil Code, amendment of the out-of-court rescission sections to include the grounds for rescission that are not now contained in them, amendment of the notice requirement to apply the laches concept and amendment of the statute of limitations to provide that it runs from the date the ground for rescission occurred. This solution would not take rescission totally out of equity jurisdiction, for in enforcing the out-of-court rescission a party might seek such equitable relief as a constructive trust or a declaratory judgment.
4. Do nothing to change existing law. The Commission may report to the Legislature that the Commission has concluded that, because of constitutional and practical difficulties, there is nothing that can be done to improve this field through legislation.