

August 4, 1960

Memorandum No. 66 (1960)

Subject: Study No. 23 - Rescission

At the last meeting of the Commission, there was distributed to the Commissioners an alternative rescission statute to the one presently being considered by the Commission. Attached to this memorandum is a draft statute which integrates the suggested alternative with existing law.

The alternative has been suggested because the statute now being considered in certain respects does not accomplish what the Commission set out to do. The basic defect in the present draft is that it preserves two distinct types of judicial relief for no apparent purpose. Thus, some of the difficulties the Commission discovered in the existing law are preserved. For instance, there is the problem of jury trial. Under the present draft, the problems that now exist in determining whether the parties are entitled to a jury or not will be preserved. Whether the defendant can obtain a jury or not will depend on how the plaintiff casts his complaint -- without regard to the substantive relief desired. If the plaintiff wants a simple money judgment, apparently a jury trial would be available if the plaintiff proceeded under Section 1692 but would not be available if the plaintiff proceeded under Section 1693. Of course, this defect might be remedied by providing a jury in all cases. But it is submitted that the remedy is no better than the defect. No one should have a right to a jury when traditional equitable relief is sought such as an accounting, a declaratory judgment or a constructive trust. The right to a

jury trial should be dependent upon the nature of the wrong and the relief requested as it is in other cases.

There is a jurisdiction problem, too. A justice court would have jurisdiction over rescission actions brought under Section 1692 as C.C.P. Section 112 is presently amended. It may be questioned whether it is wise to confer jurisdiction upon these courts over actions which may require the giving of equitable relief such as an accounting, a declaratory judgment or a constructive trust. On the other hand, justice courts apparently will not have jurisdiction over actions brought under Section 1693 even though a money judgment is all the relief required. The court in which the proceeding should be tried should not be dependent on how the plaintiff casts his complaint, it should be dependent upon the substantive relief he is seeking. If he seeks equitable relief, he should be required to sue in a higher court regardless of the fact that he has given an out of court notice of "rescission" instead of an out of court notice of "intention to bring an action to rescind."

There is the statute of limitations problem. Under the present draft, the statute would apparently begin to run on causes of action arising under Section 1692 when the notice is sent -- and under Section 1694 the court is permitted to grant the relief sought even though no notice was sent. The statute would apparently begin to run on actions arising under Section 1693 when the ground for rescission arose (or in the case of fraud or mistake, was discovered).

There are other minor problems indicated by the study not solved by the present statute such as the use of the common counts in pleading. Of course, some of these problems might be solved by amendment of the

present draft. However, it seems that there will always be difficulty as long as two procedures are retained for obtaining identical remedies to relieve identical wrongs. In a code state in which there is supposed to be but "one form of action," it is submitted that the Commission should not recommend two forms of action for obtaining the same relief.

Therefore, the alternative draft was prepared (using much of the language of the present proposed statute) to eliminate the duality in procedure and thus to eliminate the problems that arise from the duality. Coincidentally, this approach has resulted in a much abbreviated statute.

The approach taken in the alternative statute is to eliminate the judicial rescission. Rescission may be accomplished only by giving notice and offering to restore the benefits received under the contract. Any pleading in which the right to rescind is asserted is a notice of rescission. Thus, all rescission actions will be to enforce rescission, and the procedural rights of the parties will not depend on how the complaint is cast or on the form of the notice -- these rights will depend exclusively on the nature of the substantive relief requested. This is as it should be in a code state. The laches standard has been applied to the notice and restoration requirement, but the statute of limitations runs from the date the ground for rescission arose -- or, in the case of fraud or mistake, was discovered.

This approach makes it unnecessary to amend all of the statutes scattered throughout the codes dealing with rescission. The amendments that had been proposed were needed to accommodate these sections to the judicial rescission procedure. As the judicial rescission procedure is totally eliminated in this draft, the need for these amendments has also

been eliminated.

Considering the details of the alternative statute, please note that existing law relating to out of court rescission is being amended, not repealed. The unamended sections (Civil Code Sections 1688 and 1690) that will be retained have been integrated into this draft for information purposes.

Section 1689. This amendment retains most of the language approved by the Commission at the June meeting. Some minor but non-substantive revision was made to retain existing language so that the amendment of the section would not be too extensive. In subdivision 1, there is underscored language which the Commission has not finally decided to retain (see supplement to Memorandum 61).

Section 1689.5. This section has been approved by the Commission.

Section 1690. The Commission had not reached this section as it appeared in the other draft.

Section 1691. This is the heart of the alternative proposal. It retains existing law on out of court rescission, but adds that a pleading asserting the right of rescission is a notice of rescission. The section is made subject to Section 1693 which attaches the laches concept.

Section 1692. Subdivision (1) merely makes it plain that any form of relief, legal or equitable, may be requested upon the basis of a rescission that has been effected under Section 1691. If a plaintiff mistakes his remedy, subdivision (2) provides that a court may grant the plaintiff any other form of relief to which he may be entitled. This is to take care of the situation in which a plaintiff may not know whether the status quo can be restored until after an accounting has been completed. Subdivision (3)

is taken from a New York Statute which was recommended by the New York Law Revision Commission. It declares the rule that a rescinding plaintiff may recover the consideration given and may also recover any consequential damages which he may have suffered. This is the rule in California at the present time. (1 Witkin, Summary of California Law 329 (7th Ed.)) Of course, he would not be entitled to recover the consideration and damages based on the loss of the benefit of the bargain, for this would amount to a double recovery.

Subdivision (4) may be unnecessary. However, it was placed here to make it unnecessary to amend the various provisions of the Code of Civil Procedure dealing with joinder, attachment, jurisdiction and the like.

Section 1693. Subdivision (1) merely states the laches concept as it applies to the notice requirement. Subdivision (2) relates the laches concept to the requirement of restoration and empowers the court to adjust the equities between the parties.

Section 1694. This is the special provision relating to releases. It is as contained in the previous draft, except that references in that draft to actions for judicial rescission have been deleted.

SEC. 7. This repeals the existing law relating to judicial rescission.

SECS. 8 & 9. These amend the statute of limitations to provide that rescission actions must be filed within the required time after the ground for rescission arises. The four year statute for written contracts and the two year statute for oral contracts were chosen so that a party's right to rescind a contract would not be cut off before the opposing party's right to enforce the contract.

Respectfully submitted,

Joseph B. Harvey  
Assistant Executive Secretary

An act to amend Sections 1689 and 1691 of the Civil Code, to add Sections 1689.5, 1692, 1693 and 1694 to the Civil Code, to amend Sections 337 and 339 of the Code of Civil Procedure, and to repeal Article 5 (beginning with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of the Civil Code, all relating to rescission of contracts.

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

[This is 1688. A contract is extinguished by its rescission. existing law and is not here amended.]

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

1689. A [~~party-to-a~~] contract is subject to rescission [~~may-rescind the-same~~] in the following cases [~~only~~]:

1. If the consent of the party [~~rescinding~~] who desires rescission, 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~~] rescission is desired, or of any party to the contract jointly interested with such party; provided that a contract is not subject to rescission for mere mistake, unless the party against whom rescission is sought can be restored to substantially the same position as if the contract had not been made;

2. If [~~,-through-the-fault-of-the-party-as-to-when-he-rescinds,~~] the consideration for [~~his~~] the obligation of the party who desires rescission fails, in whole or in part, through the fault of the party as to whom

rescission is desired;

3. If [~~such~~] the consideration for the obligation of the party who desires rescission becomes entirely void from any cause;

4. If [~~such~~] the consideration for the obligation of the party who desires rescission, before it is rendered to him, fails in a material respect, from any cause;

5. [~~By consent of all the other parties~~] If the contract is unlawful for causes which do not appear in its terms or conditions, and the parties are not equally in fault; [or]

6. If the public interest will be prejudiced by permitting the contract to stand; or

7. Under the circumstances provided for in Sections 39, 1785 [and] , 1789, 1930 and 2314 of this code, Section 2470 of the Corporations Code, Sections 331, 338, 359, 447, 1904 and 2030 of the Insurance Code or any other statute providing for rescission.

SEC. 2. Section 1689.5 is added to the Civil Code, to read:

1689.5. A party to a contract may rescind the same by consent of all the other parties.

[This section is amended] 1690. 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 of rescission 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. 3. Section 1691 of the Civil Code is amended to read:

1691. [~~Rescission, when not effected by consent, can be accomplished only by the use, on the part of the party rescinding, of reasonable diligence to comply with the following rules~~] (1) Subject to Section 1693, if a contract is subject to rescission under Section 1689, a party aggrieved may rescind the contract by:

~~[1.--He must rescind]~~ (a) Giving notice of rescission to the party as to whom he rescinds promptly [7] upon discovering the facts which entitle him to rescind [7] if he is free from duress, menace, undue influence [7] or disability [7] and is aware of his right to rescind; and

~~[2.--He must restore]~~ (b) Restoring to the other party everything of value which he has received from him under the contract [7] or ~~must~~ offering to restore the same upon condition that ~~such~~ the other party ~~shall~~ do likewise, unless the latter is unable or positively refuses to do so.

(2) A pleading in an action or proceeding that asserts the right to rescind or seeks relief based on rescission is a notice of rescission within the meaning of subdivision (1) of this section.

SEC. 4. Section 1692 is added to the Civil Code, to read:

1692. (1) When a contract has been rescinded in whole or in part pursuant to Section 1689.5 or Section 1691, any party to the contract may (a) bring an action to recover any money or thing owing to him by any other party to the contract as a consequence of such rescission or for any other relief to which he may be entitled under the circumstances or (b) assert such rescission by way of defense, counterclaim or cross-complaint.

(2) If, in an action based upon rescission, the court determines that



the contract is not subject to rescission, the court may grant the aggrieved party any other relief to which he may be entitled under the circumstances.

(3) A claim for damages shall not be deemed inconsistent with a claim based upon rescission. In an action based upon rescission, the aggrieved party shall be allowed to obtain complete relief in one action, including restitution of benefits, if any, conferred by him as a result of the transaction, and any consequential damages to which he is entitled; but such complete relief shall not include duplication of items of recovery.

(4) An action based upon rescission shall be deemed an action arising out of contract.

SEC. 5. Section 1693 is added to the Civil Code, to read:

1693. (1) When relief based upon rescission is claimed in an action or proceeding, such relief shall not be denied because of a failure to give or delay in giving notice of rescission unless such failure or delay has been substantially prejudicial to the other party.

(2) A party who has received benefits by reason of a contract that is subject to rescission and who, in an action or proceeding or by way of defense, counterclaim or cross-complaint seeks relief based upon rescission shall not be denied relief because of a failure to tender or delay in tendering restoration of such benefits before judgment unless such failure or delay has been substantially prejudicial to the other party; but the court may make a tender of restoration a condition of its judgment, and may otherwise in its judgment so adjust the equities between the parties that unjust enrichment is avoided.

SEC. 6. Section 1694 is added to the Civil Code, to read:

1694. 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 alleging the rescission of the release pursuant to Section 1691. If such a responsive pleading is served and filed, the court shall first determine whether the release has been rescinded. If the release is held to be valid it shall be accorded the effect to which it is entitled as a defense to the cause of action. If the release is found to have been rescinded, 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 or value 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. 7. Article 5 (commencing with Section 3406) of Chapter 2 of Title 3 of Part 1 of Division Fourth of the Civil Code is hereby repealed.

SEC. 8. Section 337 of the Code of Civil Procedure is amended to read:

337. Within four years.

\* \* \*

3. An action based upon the rescission of a contract in writing; provided, however, that the time shall begin to run from the date the facts

which entitle the aggrieved party to rescind occurred. Where the ground for rescission is fraud or mistake, the time shall not begin to run until the discovery by the aggrieved party of the facts constituting the fraud or mistake.

SEC. 9. Section 339 of the Code of Civil Procedure is amended to read:

339. Within two years.

\* \* \*

3. An action based upon the rescission of a contract not in writing; provided, however, that the time shall begin to run from the date the facts which entitle the aggrieved party to rescind occurred. Where the ground for rescission is fraud or mistake, the time shall not begin to run until the discovery by the aggrieved party of the facts constituting the fraud or mistake.