

3/11/60

Memorandum No. 21 (1960)

Subject: Study No. 23 - Rescission of Contracts

The proposed statute on rescission of contracts is presented here again.

The Sales Act problem was discussed with Mr. Byron Sher of the Stanford faculty. He pointed out that substantive rights would be altered if all incidents of the present out-of-court rescission were abolished. The risk of loss if the goods are destroyed, the nature of the claim against the possessor of the goods if he becomes bankrupt and similar questions are decided at the present time upon the basis of the out-of-court rescission. These questions depend upon the ownership of the goods, and the present out-of-court rescission has the effect of shifting this ownership in many instances.

If these incidents of out-of-court rescission were left unaltered by a proposed revision, Mr Sher indicated that he would still like to study the matter further to determine whether the proposed amendment of the Sales Act might have some unanticipated and undesirable results. Without further study, he does not wish to indicate whether the abolition of out-of-court rescission is desirable or not at the present time.

There are several ways the Commission can proceed: (1) It can go ahead upon the present theory that out-of-court rescission should be abolished and draft a statute which, in the Commission's opinion, will carry out this theory. This can be submitted as a tentative recommendation to the State Bar and to various experts in the sales field. If the defects they point out are minor, the defects can be remedied and a statute submitted to the 1961 session.

(2) It can complete its work on the basic rescission sections and have a study prepared on the feasibility of abolishing out-of-court rescission as provided for in the Sales Act, Corporations Code and Insurance Code. Because of the delays necessarily involved in having a study prepared, this would mean that any attempt to present a statute dealing with more than the basic rescission sections would have to be abandoned.

This approach does not seem satisfactory, for it would involve the submission of the rescission statute to the Legislature on a piecemeal basis. It may be that if the abolition of out-of-court rescission is not feasible in these specific areas, the Commission might wish to change its approach to the whole problem. This would be both difficult and embarrassing if a statute had already been submitted to the Legislature.

(3) The entire rescission study can be deferred until a study is prepared upon these matters. This would mean the abandonment of the goal of presenting a statute to the 1961 session.

Again, this approach does not seem to be the most satisfactory, for it may develop that the problems are not insuperable and can be taken care of by minor adjustments of the statutes.

If the first approach is followed, and the defects pointed out cannot be remedied by minor revision, the Commission may then order a study or reconsider its approach to the entire problem. But there is no reason to assume that the problems will be insuperable, and to pursue the first course will enable the Commission to submit a statute and recommendation to the Legislature at this session if the problems prove to be minor ones.

Upon the supposition that the first approach will be pursued, the proposed statute has been revised. The first 9 sections deal with rescission generally,

and have been revised in accordance with the action taken at the February meeting. Sections 6 and 7 contain major revisions and should be again considered by the Commission. Section 1773 of the Civil Code has been revised to conform with the revision of Section 1781 which was approved at the February meeting. Both of these sections deal with the remedies of an unpaid seller against the goods. They are concerned with the rescission of the transfer of title rather than rescission of a contract. Section 1781 merely sets forth the procedure under which the right described in Section 1773 can be exercised. As revised, these sections preserve the right of the unpaid seller to resume the property in the goods.

The remaining sections of the Sales Act dealing with rescission have been revised. Section 1785 deals with the remedies of a seller for breach of contract. The attempt has been made to preserve the seller's right to reclaim the ownership of the goods. This will be important in bankruptcy cases, for a seller would want his goods back rather than an unsecured claim against the buyer. However, if further relief is sought as an incident of rescission, judicial rescission would have to be obtained. The existing Sales Act requirement of notice has been retained.

Section 1789 deals with the rights of a buyer for breach of warranty. Subsection (1) sets forth a buyer's four alternatives. Rescission is in subdivision (d). Subsections (3), (4) and (5) set forth the terms and conditions under which the right granted in (1)(d) can be exercised. In revising these sections, an attempt has been made to preserve the right of the buyer to shift the risk of loss and other incidents or ownership back to the seller. Rights dependent on judicial relief--such as the seller's liability to return the consideration received--have been made subject to an action for rescission.

The requirement of prompt notice that is in the present Sales Act has been preserved. This is because prompt notice is a condition precedent to the buyer's right to any affirmative relief after acceptance of the goods under Section 1769, and it did not seem advisable to make an exception of the remedy of rescission.

The remaining sections are as presented with Memo No. 20 (1960) (the section numbers have been reduced because of the elimination of one proposed section) and may be considered on the basis of the comments attached to that memo.

Respectfully submitted,

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Assistant Executive Secretary

(#23)

EXHIBIT I

Rev. 3/11/60

-2/12/60

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 to a contract may rescind the same

[~~on 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~~ 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, on 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; [ex,]

(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 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;

~~[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; [ex,]

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

(7) Under the circumstances provided for in Sections 39, 1785, 1789, 1930, and 2314 of this code, Section 2470 of the Corporations Code, and Sections 331,

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

SEC. 5. Section 3407 of the Civil Code is amended to read:

3407. ~~[RESCISSION-FOR-MISTAKE.]~~ (1) 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.

(2) 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. 6. 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, if he is free from duress, menace, undue influence or disability and is aware of his right to do so, he must promptly notify the party as to whom he seeks rescission that he repudiates his obligation under the contract because it is subject to rescission.

(b) He must 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 (a) because of a failure to give or delay in giving notice of repudiation, (b) because of a delay in requesting the relief of rescission 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. 7. Section 3409 is added to the Civil Code, to read:

3409. 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.

SEC. 8. Section 3410 is added to the Civil Code, to read:

3410. Where a release is pleaded in answer to a claim asserted in a pleading, the party asserting the claim may serve and file a reply stating a claim to have the rescission of the release adjudged. If such a reply is served and filed, the court shall first determine whether the rescission of the release should be adjudged. If the party asserting the claim is found not to be entitled to rescission of the release, the release shall be accorded such effect as it may be entitled as a defense to the claim. If the party asserting the claim 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 claim; but the court shall enter a separate judgment in favor of the party



who pleaded or introduced the release in the amount of the value of any benefits which were conferred by said party upon the party asserting the claim in exchange for the release.

SEC. 9. 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. 10. 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 [~~reacind-the-sale~~] as limited by this act.

SEC. 11. 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 [~~reacind-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 shall not be held to have been 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. 12. 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, 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 if the property has passed to the buyer 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. 13. 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. 14. 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. 15. 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. 16. 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-reseinded]~~ 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. 17.. Section 2314 of the Civil Code is amended to read:

2314. [~~RESCISSIION-OF-RATIFICATION.~~] The rescission of a [A] ratification may be [reseinded] adjudged when 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. 18. Section 2470 of the Corporations Code is amended to read:

2470. (a) Subject to the provisions of subdivision (b) of this section, rescission of the transfer of a certificate may be [reseinded] adjudged, and possession thereof [~~reelained~~] recovered, 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 [~~reseind~~] have the rescission of the transfer of a certificate adjudged and [~~reelaim~~] to recover 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]~~ recover the possession of the certificate or to ~~[reclaim]~~ have the rescission of the transfer thereof adjudged and, pending litigation, may enjoin the further transfer of the certificate or impound it.

SEC. 19. Section 331 of the Insurance Code is amended to read:

331. Concealment, whether intentional or unintentional, entitles the injured party to ~~[reclaim]~~ have the rescission of insurance adjudged.

SEC. 20. 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 ~~[reclaim]~~ have the rescission of the insurance adjudged.

SEC. 21. 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 ~~[reclaim]~~ have the rescission of the contract adjudged from the time the representation becomes false.

SEC. 22. 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 ~~[repealed]~~ have the rescission of the policy adjudged.

SEC. 23. Section 650 of the Insurance Code is amended to read:

650. Whenever a right to ~~[repealed]~~ have the rescission of a contract of insurance adjudged is given to the insurer by any provision of this part, notice of intention to exercise such right ~~[may]~~ must be ~~[exercised]~~ given ~~[at-any-time-previous]~~ prior to the commencement of an action on the contract.

SEC. 24. 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 ~~[repealed]~~ have the rescission of the entire contract adjudged.

SEC. 25. Section 2030 of the Insurance Code is amended to read:

2030. An insurer is entitled to ~~[repealed]~~ have the rescission of a contract of fire insurance 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. 26. 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. 27. 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 [~~;-provided;-that~~ and] . An action upon any liability, existing under the laws of this State, of a spouse, relative or kindred, for the support, maintenance, care or necessities 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. 28. 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. 29. 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 for the rescission of a contract;

\* \* \*