

Date of Meeting: July 18-19, 1958

Date of Memo: July 1, 1958

Memorandum No. 1

Subject: Study #23 - Rescission of Contracts.

I enclose two memoranda on this subject and a copy of a letter received from Mr. Levit explaining his proposed revision of subdivision 2 of Section 1692 of the Civil Code.

If the Commission is satisfied with the revisions agreed upon at the June meeting, as set forth in Memorandum (A), no further action need be taken on this study, so far as I can see, save for considering a proposed recommendation on the matter which will be presented at the September meeting. However, if some or all of the questions raised in Memorandum (B) are thought to be well taken further discussion of the Commission's recommendations will be necessary at the July meeting.

Respectfully submitted,

John R. McDonough, Jr.
Executive Secretary

7/2/8 New

July 1, 1958

Memorandum re Rescission of Contracts (A)

Subject: Summary of Revisions Agreed Upon
by Commission

At the June 1958 meeting the Commission decided to recommend certain changes in the Civil Code and the Code of Civil Procedure to eliminate problems, pointed out in the research consultant's study, which presently exist in the law of this State with respect to rescission of contracts. These changes, identified as such, are set out below. Where the change takes the form of an amendment of an existing code section ^{it} is set forth in strike-out and underline.

There are also set out below those sections of the Civil Code relating to rescission of contracts as to which no recommended change is presently contemplated by the Commission. Thus, what follows is all of the statutory law of the State relating to rescission of contracts as it would stand if the recommendations decided upon by the Commission at the June meeting were enacted and no other change in existing law were made.

PROVISIONS OF CIVIL CODE

[Present
law]

§ 1688. RESCISSION EXTINGUISHES CONTRACT. A contract is extinguished by its rescission.

[As amend-
ed per
Commission
Action
6/58]

§ 1689. ~~A-party-to-a-contract-may-rescind-the~~
same A contract may be rescinded in the following cases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; provided that rescission cannot be had for mere mistake, unless the party against whom he rescinds 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 whom he rescinds, the consideration for his the obligation of the party rescinding fails, in whole or in part;

3. If sueh the consideration for the obligation of the party rescinding becomes

entirely void from any cause;

4. If such the consideration for the obligation of the party rescinding before it is rendered to him, fails in a material respect, from any cause;

5. By consent of all the ~~ether~~ parties; or

6. Under the circumstances provided for in Sections 1785 and 1789 of this code;

7. 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

8. When the public interest will be prejudiced by permitting the contract to stand.

[Present law]

§ 1690. WHEN STIPULATIONS AGAINST RIGHT TO RESCIND DO NOT DEFEAT IT. 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.

[Present law]

§ 1691. RESCISSION, HOW EFFECTED. 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. He must rescind promptly, upon discovering the facts which entitle him to rescind, if he is free from duress, menace, undue influence, or disability, and is aware of his right to rescind; and,

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

[New. Added
per Com-
mission
Action
6/58]

§ 1692. Where a party to an action, by complaint, cross-complaint, answer, counterclaim, or other appropriate pleading, seeks to have the rescission of a contract adjudged therein, whether such relief would formerly have been denominated legal or equitable and notwithstanding the provisions of Section 1691 of this code:

1. The rescission shall not be denied because of a failure to give or delay in giving notice of rescission or because of delay in asserting the right of rescission, unless such failure or delay has been substantially prejudicial to the other party;

[Slight modification proposed by Mr. Levit since June meeting (see accompanying letter) shown in strike-out and underline]

2. The rescission shall need not be denied because of a failure to restore or to offer to restore the benefits received under such contract; but the court may as a condition to rescission, order require the party to whom rescission is granted to make restoration and any other compensation to the other party which justice ~~may require.~~ requires.

[New. Added by Commission 6/58]

§ 1692.5 Any party to an action shall be entitled to a jury trial upon the issue of rescission; but trial by jury shall not preclude the court from requiring restoration or compensation as a condition of the judgment of rescission.

CODE OF CIVIL PROCEDURE

[As amended per Commission Action 6/58]

§ 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 involving the rescission of a contract whether formerly denominated legal or equitable and cases at law which involve the title or possession of real estate or the

legality of any tax, impost, assessment, toll
or municipal fine,....

§ 337. Within four years. 1. An action upon any contract, obligation or liability founded upon an instrument in writing, except as provided in section 336a of this code; provided, that the time within which any action for a money judgment for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage, may be brought shall not extend beyond three months after the time of sale under such deed of trust or mortgage.

2. An action to recover (1) upon a book account whether consisting of one or more entries; (2) upon an account stated based upon an account in writing, but the acknowledgment of the account stated need not be in writing; (3) a balance due upon a mutual, open and current account, the items of which are in writing; provided, however, that where an account stated is based upon an account of one item, the time shall begin to run from the date of said item, and where an account stated is based upon an account of more than one item, the time shall begin to run from the date of the last item.

[As amend-
ed per
Com-
mission
Action
6/58]

3. An action to have the rescission of a contract in writing adjudged, whether such action would formerly have been denominated legal or equitable. When the ground relied upon is fraud or mistake the cause of action shall not be deemed to have accrued until the aggrieved party discovered the facts constituting the fraud or mistake.

§ 339. Within two years. 1. An action upon a contract, obligation or liability not founded upon an instrument of writing, other than that mentioned in subdivision two of section three hundred thirty-seven of this code; or an action founded upon a contract,

obligation or liability, evidenced by a certificate or abstract or guaranty of title of real property, or by a policy of title insurance; provided, that the cause of action upon a contract, obligation or liability evidenced by a certificate, or abstract or guaranty of title of real property or policy of title insurance shall not be deemed to have accrued until the discovery of the loss or damage suffered by the aggrieved party thereunder.

2. An action against a sheriff, coroner, or constable upon a liability incurred by the doing of an act in his official capacity and in virtue of his office, or by the omission of an official duty including the non-payment of money collected upon an execution. But this subdivision does not apply to an action for an escape.

[As amended per Commission Action 6/58]

3. An action to have the rescission of a contract not in writing adjudged, whether such action would formerly have been denominated legal or equitable.

When the ground relied upon is fraud or mistake the cause of action shall not be deemed to have accrued until the aggrieved party discovered the facts constituting the fraud or mistake.

[As amended per Commission Action 6/58]

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

1. Contracts, express or implied; provided, that an action to have the rescission of a contract adjudged, whether such relief would formerly have been denominated legal or equitable, shall be deemed to be an action upon an implied contract within that term as used in this subdivision of this section....

[As amended per
Commission
Action
6/58]

§ 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 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 and 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.

whether such relief would formerly have been
denominated legal or equitable, shall be
deemed to be an action upon an implied contract
within the term as used throughout all sub-
divisions of this section....

Respectfully submitted,

John R. McDonough, Jr.
Executive Secretary

July 2, 1958

Memorandum re Rescission of Contracts (B)

Subject: Critique of Recommendations Agreed
Upon at the June 1958 Meeting

I have set forth in an accompanying memorandum (A) the law of this State relating to rescission of contracts as it would stand if the recommendations decided upon by the Commission at the June 1958 meeting were adopted. For reasons which are set forth in some detail below I believe that these recommendations are not an adequate solution to the problems with which the Commission is here concerned. Experience in stating my views on this subject does not lead me to suppose that they are likely to be found persuasive but I deem it my duty as the Commission's Executive Secretary to point out respectfully what seem to me to be the shortcomings of any of its proposed recommendations before they are submitted to the Legislature. ^{As} ~~as~~ I understand, the Commission contemplates in making these recommendations that there will in the future, as in the past, be three ways in which a person deeming himself entitled to rescind a contract may proceed:

(1) He may persuade the other party to agree to a mutual rescission, each party promising to restore to the other party what he has received under the contract;

(2) He may undertake to effect a unilateral out-of-court rescission;

(3) He may bring a legal proceeding to obtain a judgment rescinding the contract and awarding such ancillary relief to the parties as may be warranted.

If the third course of action is pursued, resort to a legal action will, of course, be necessary. If the second course of action is pursued it will probably be necessary, particularly if the other party has received benefits under the contract for he is unlikely to restore them voluntarily. Legal action may even be necessary if the first course of action is pursued - e.g., if the other party reneges on the mutual rescission or a dispute arises as to what is to be restored to whom, ^{And} ~~and~~ in the case of either a mutual rescission or a unilateral out-of-court rescission a party to the contract may want to bring an action to obtain, in effect, a declaratory judgment that the contract is in fact at an end rather than to have the possibility of a suit for breach of contract hanging over his head until the Statute of Limitations has run.

It is clear from the research consultant's report that the existence of these several possible courses of actions and kinds of lawsuits which are presently available when a rescission situation is presented has created many problems. Indeed, this is the very reason for the present study. The Commission's solution for these problems is to continue all existing ~~rights~~ ^{rights} and remedies but eliminating ^e the various differences between them which have been the principal

sources of difficulty. Thus, under the Commission's recommendations the grounds upon which one or another of the three possible courses of action may be taken are intended to be made uniform (C.C. § 1689); the requirements with respect to notice and offer to restore are intended to be made the same in all cases (C.C. § 1691 ^{as} ~~is~~ considerably modified if not emasculated by § 1692); provision is intended to be made for the right to a jury trial whatever form of legal relief is sought (C.C. § 1692.5); justice courts are intended to be deprived of jurisdiction to give any kind of relief in a rescission situation (C.C.P. § 112); the Statute of Limitations is intended to be made uniform whatever type of relief is sought (C.C.P. §§ 337, 339); an action to obtain any kind of relief is intended to be made joinable with other contract actions (C.C.P. § 427 (1)) and attachment is intended to be made available whenever a money judgment is sought (C.C.P. § 527 (1)).

I believe that these intended changes have been largely accomplished in legal contemplation through the recommendations agreed upon at the June meeting, in the sense that I think the Supreme Court would so conclude in a well briefed and argued case in which the Court's attention was called to the Commission's recommendation and study on this subject. But given the fact that the matter will often not come up for decision in such happy circumstances and taking into account the long history of confusion in this area, pointed out in the research consultant's report,

I am much concerned that the Commission has not made its intended reform and clarification of the law relating to rescission clear on the face of the relevant provisions of the Civil Code and the Code of Civil Procedure as they will exist if its recommendations are adopted. (see Memorandum (A)). The principal problems which I see in the statutory scheme set forth in Memorandum (A) are these:

1. Many of the contemplated code sections refer to an action to have the rescission of a contract "adjudged." This is a term introduced by Mr. Sullivan; he intended it to describe only an action to obtain a decree rescinding a contract and giving ancillary relief - the equivalent of the present "equitable" action. The Commission uses the term, however, to refer not only to such an action but to refer also to an action to recover back benefits bestowed on a rescindee (the equivalent of the present "legal" action), an action to obtain a declaratory judgment that a contract has been rescinded and, indeed, any action which may arise out of a rescission situation. I believe that this ambiguous use of an undefined term is likely to cause confusion and I am not persuaded that addition at various points of the phrase "whether formerly denominated legal or equitable" removes the problem.

2. Under the Commission's recommendations, the situation will continue to exist that the result of a lawsuit will turn in some cases on what kind of relief is sought. You may recall the discussion which Mr. Levit and I had in this connection at

the June meeting on the Statute of Limitations point, arising out of the fact that a cause of action for "legal" relief arises at a different time than does a cause of action for "equitable" relief. We agreed that on the facts of the particular hypothetical case we were discussing the result would turn on whether the plaintiff was bringing under the new statutes to be recommended by the Commission the equivalent of the present "legal" or the present "equitable" action; we disagreed as to the desirability of this situation continuing to exist. I have the feeling that other situations probably will exist under the statutory scheme set forth in Memorandum (A) in which choice of remedy will control result.

3. As Memorandum (A) shows, there will be no code section which describes what kind of action may be brought or what kind of relief sought in a rescission situation if the Commission's recommendations are adopted. Therefore, except to us who know what we intend or to one who reads our recommendation and study carefully (assuming the maximum as to its clarity) I believe it is going to be difficult for lawyers and judges, let alone laymen, to tell which, if any, of the presently available remedies are open to a party who believes that a contract is subject to rescission. Civil Code Sections 3406-3408 are repealed; from this one might infer that the "equitable" right to a decree of rescission is abolished. This inference would be supported by reference to Section 1691 which can easily be read on its face to say that rescission can only be effected

or at least initiated by a unilateral out-of-court act of rescission ("he must rescind promptly"). Yet the inference would appear to be dispelled by reference to Section 1692, the only section which refers to legal proceedings which may be brought in a rescission situation, which speaks in terms of an action to have the rescission of a contract "adjudged." Indeed, since Section 1692 is the only code section which refers to a legal proceeding it might be thought to negative the possibility that unilateral out-of-court rescission continues to be available under the new statutory scheme.

All in all, I believe that the statutes set forth in Memorandum(A) fall rather wide of the mark which I had supposed the Commission set itself in taking on this assignment - that of not only getting the law reformed substantively but)the law in this area with such clarity (of stating) that both lawyers and judges would be able to see from the statutes themselves what the law is and what the available avenues of recourse are - even those lawyers and judges who are most hurried and least acute.

My own conclusions on the matter are these:

1. The existing duality ought to have been eliminated. I would have preferred the Sullivan solution - i.e., abolish the so-called unilateral out-of-court rescission and limit the avenues of recourse in a rescission situation to two: (1) rescission by mutual agreement and (2) rescission decreed by a court. Short of the Sullivan solution I would take the

other two-avenue approach: (1) rescission by mutual agreement and (2) rescission by unilateral out-of-court action, the latter followed in most cases by a legal action to enforce it.

2. If all of the existing rights of action and remedies are to be continued, I believe that the statutes should spell this out very explicitly so that he who runs may read with understanding. This was the approach which I made in drafting Item D which was before you at the June meeting. At the very minimum I would now substitute for Civil Code Sections 1691 and 1692 as drafted by the Commission and set forth in Memorandum(A), the following four sections:

1691. When a contract is subject to rescission under Section 1689 a party aggrieved may rescind the contract as to himself by manifesting his intention to do so to the other parties to the contract. Subject to the provisions of Section 1691.3 he must

(1) Rescind promptly upon discovering the facts which entitle him to rescind if he is free from duress, menace, undue influence, or disability, and is aware of his right to rescind; and

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

1691.1. When a contract has been rescinded in whole or in part by the mutual agreement of some or all of the parties to the contract or by the action of a party pursuant to Section 1691, any party to the contract may bring an action for a declaratory judgment that such rescission has been effected and to recover any money or thing owing to him by any other party to the contract as a consequence of such rescission and for any other relief to which he may be entitled under the circumstances.

1691.2. When a contract is subject to rescission under Section 1689 a party aggrieved may bring an action to have the contract rescinded as to himself by the judgment of the court and to recover any money or thing owing to him by any other party to the contract as a consequence of such rescission and for any other relief to which he may be entitled under the circumstances. Subject to the provisions of Section 1691.3, he must

1. Give the other parties to the contract notice of his intention to bring such an action promptly upon discovering the facts which entitle him to do so if he is free from duress, menace, undue influence, or disability; and

2. Restore to the other party everything of value which he has received from under the contract 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.

1691.3. When an action is brought pursuant to Section 1691.1 or Section 1691.2

1. Relief shall not be denied because of a failure to give or delay in giving notice of rescission or because of delay in asserting the right of rescission, unless such failure or delay has been substantially prejudicial to the other party;

2. Relief need not be denied because of a failure to restore or to offer to restore benefits received under such contract but the court may, as a condition to granting relief to the plaintiff require him to make restoration and any other compensation to the other party which justice requires.

1692. A person having a right of action under Section 1691.1 or Section 1691.2 may assert the same by way of defense, counter-claim or cross-complaint.

If this substitution were made I would then cast the amendments of the various Code of Civil Procedure Sections in terms of cross-references to Civil Code sections 1691.1 and 1691.2 rather than having them speak in terms of an "action to have the rescission of a contract adjudged, whether formerly denominated legal or equitable."

Respectfully submitted,

John R. McDonough, Jr.
Executive Secretary