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July 31, 2018

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450 N. Street
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RE: Draft LTA – Change In Ownership – Rescission

Dear Ms. Schultz:

I am submitting the following comments regarding the draft Letter To Assessors No. 2018/023 (LTA), regarding the nature and implications of contractual rescission in regards to changes in ownership. Generally, the LTA does an excellent job of articulating the nature and consequences of *unilateral* rescission on changes in ownership. However, I believe some issues need to be addressed in several areas specific to rescission by mutual consent.

For Property Tax Purposes:
In several places the LTA references the nature and implications of rescission "for property tax purposes." (See ex., pg. 5, ln. 9-10, ln. 25-26). While perhaps this language is not intended to imply a divergence between contract law and property tax law, it could be interpreted otherwise and therefore should be revised. Whether or not a valid a rescission occurs is a matter of contract law. When a valid rescission occurs as a matter of contractual law, there are no separate or unique rules that apply in order to determine whether the rescission is also valid for property tax purposes. Certainly, when presented with a rescission claim the Assessor has the obligation to determine whether a rescission has in fact occurred, at least where there is no court order deeming it so. However, if the circumstances supporting a valid contractual rescission are present, the rescission is valid in every respect as to the rights of the parties in regard to that contract. The LTA seems to imply that there might exist a circumstance in which a contract of sale is rescinded for one purpose but not another, which would be in error.

Rescission by Mutual Consent: A Return to Status Quo
The LTA properly recognizes that a contract may be rescinded if all the parties consent, or unilaterally under certain circumstances. Civil Code section 1689 provides as much. Subdivision (a) expressly provides that a contract may be rescinded if all parties thereto consent, while subdivision (b) sets forth those circumstances in which a party may unilaterally rescind a contract. And, as the LTA notes, Civil Code section 1691 explicitly requires the restoration of the parties (or at least an offer thereof) for unilateral rescission. However, the

LTA then departs from the express provisions of the Civil Code, stating that "Although the Civil Code contains no similar explicit requirement for mutual rescission [restoration of the parties to the status quo], case law is supportive of a requirement to return the parties to the *status quo* for mutual rescission." (*Emphasis added*). As support for this proposition, the LTA cites *Green v. Darling* (1925) 73 Cal.App. 700, 704, *Dugan v. Phillips* (1926) 77 Cal.App. 268, 278, and *Larsen v. Johannes* (1970) 7 Cal.App.3d 491, 503.

The LTA does not define what constitutes "status quo," though later sections suggest this means "restored to their original positions." (See pg. 5, ln. 35). Nevertheless, the departure from the express statutory language regarding mutual rescission is not actually supported by the case law generally or those cases specifically cited in the LTA, and consequently the LTA unnecessarily implies that returning the parties to "their original positions" is a *pre-condition* to the Civil Code's authorization of rescission by mutual consent. That is inconsistent with the law.

First, we begin with the statute. Civil Code section 1689(a) expressly and unequivocally provides that a contract can be rescinded by mutual consent. Because the statutory law controls the nature of the rights and obligations of contract, case law which appears to contract or alter the scope of that law, or add conditions not reasonably inferred from the text of the statute, should be viewed with some skepticism. Particularly, when such requirements are imputed from other provisions as is the case here. The Civil Code expressly requires restoration under section 1691 which addresses unilateral rescission; no such requirement exists under section 1689, which also provides for rescission effected by mutual consent.

There are valid reasons for the Civil Code's differing requirements for mutual and unilateral rescission. Where a party seeks unilateral rescission as a matter of right to an otherwise valid contract, they in essence are asking the court to abrogate existing rights and obligations in exercise of its equitable powers. This is not a light undertaking by the court, for obvious reasons. It naturally follows that restoration in this context becomes necessary before judicial relief is provided; it helps ensure fair outcomes. "Equity is equality" and "One who seeks equity must do equity" are traditional maxims reflective of this. Consequently, Civil Code section 1691 expressly provides for both prompt notice of rescission and restoration in the context of a unilateral rescission. It should be noted, however, that Civil Code section 1691 itself acknowledges that, under certain circumstances, perfect restoration is not required for unilateral rescission.

Court cases seldom stem from matters involving rescission by mutual consent as those matters rarely evolve into disputes necessitating litigation. While footnote 6 of the LTA identifies three cases where the court discussed mutual rescission, in order to properly understand the context of the courts' discussion it is first important to understand that a mutual rescission is a meeting of the minds which itself must be a valid contract. *Tuso v. Green* (1924) 194 Cal. 574, 582 ("A rescission when effected by mutual consent is a new contract, to effect which there must be a meeting of the minds."); *Harriman v. Tetik* (1961) 56 Cal.2d. 805, 810 ("Mutual rescission involves formation of new contract, and issues include same questions of law and fact

regarding offer and acceptance that occur in any other problem of contract formation."). Mutual consent to rescind is not an exercise in equity, but merely a recognition that the parties to an agreement have expressed an intent to rescind (there is a "meeting of the minds" to rescind) that is supported by adequate consideration.

In *Green v. Darling*, the question before the Court was whether the allegations pled by the plaintiff were sufficient to constitute a cause of action supporting the lower court's finding of mutual rescission. The plaintiff had pled that the contract was rescinded, and that all restoration had been returned. The defendant argued his stipulation to restoration was not alleged, and was necessary to support the allegation of mutual rescission. The Court disagreed, noting that the plaintiff's allegations claimed the rescission agreement itself required restoration, and therefore the law required restoration as a consequence of the parties' agreement to rescind. Because the allegations pled that the terms of the contract governing the mutual rescission required restoration and that restoration was made, the lower court's finding of mutual rescission was affirmed. The LTA's quotation of *Greeen* is therefore out of context. *Green* held that restoration was required under the parties' agreement to mutually rescind; not that restoration is *per se* required for a valid mutual rescission.

Dugan v. Phillips, concerned enforcement of an arbitration award, which the court analogized to mutual rescission as a means of rationalizing the validity of the award. Similar to *Green*, the arbitration award at issue happened to provide for restoration. The sentence in *Dugan* quoted by the LTA is actually cited by the *Dugan* Court to *Green* and *Hooke v. Great Western Lumber Co.* (1921) 54 Cal. App. 681. As discussed above, *Green* is inapposite to the demand of restoration as a precondition to rescission by mutual consent. *Hooke* is also inapposite. *Hooke* expressly recognized that mutual oral rescission is valid and binding *without restoration*, so long as supported by sufficient consideration. *Hooke* did not hold, nor could it, that restoration of consideration is the only means by which mutual rescission can be effected.

Larson v. Johannes, the final case cited by the LTA in footnote 6, explicitly recognizes that returning parties to their original condition is often (as it was there) an impossibility, but nevertheless does not frustrate the valid rescission by mutual consent.

Each of the cases cited by the LTA involved situations where one party believed it had grounds to rescind the contract, which ultimately led to a mutual rescission by agreement. The disputes arising therefrom all centered around the grounds of the mutual rescission agreements, and not the *per se* validity of mutual rescissions.

The LTA does not cite to or discuss *Aderholt v. Wood* (1924) 66 Cal.App. 666, a case squarely addressing mutual rescission of a contract for the sale of land. In *Aderholt*, the Court of Appeal noted:

> The authorities cited by respondent, however, all relate to the rescission of contracts in cases in which the vendor was at fault. In such a case the rule is without conflict that equity will restore the parties to *statu quo*. This principle is announced in section 3408

> of the Civil Code and has been approved in numerous cases. The theory of these cases is that, where one party rescinds an executory contract on account of the default of the other, he is entitled to recover his outlay under the contract, but at the same time he must restore to the other party whatever of value he has obtained under it. Section 1691 of the Civil Code expressly provides that rescission can be accomplished only in such manner *except where effected by consent*. This exception is the important part in the consideration of cases such as presented in this record. If the parties by consent rescind an executory contract they thereby make a new contract and their rights and obligations thereunder are to be determined by all the rules relating to ordinary contracts. It is not improper and it is not unusual for parties to contracts of this nature to cancel them and to release each other from all mutual obligations. Where the statutes do not provide that in such cases the vendee shall recover the payments made under the contract and where the contract of cancellation is silent on the matter, the intentions of the parties may be determined by reference to the conversations and communications had between them leading up to the execution of the contract of cancellation. *Aderholt*, 66 Cal. App. at 669-70 (emphasis added).

As these cases make clear, an agreement to mutually rescind must be tested by the terms required for every other agreement; a meeting of the minds in regard to rescinding the agreement and sufficient consideration in support thereof. If the parties' agreement to mutually rescind requires that they be restored to status quo, then the rescission will only be valid upon such restoration. However, restoration to status quo is not a *per se* requirement to mutual rescission. The LTA adds conditions to mutual rescission that are not required under the Civil Code or applicable case law and should be revised accordingly.

Rescission or New Contract:
The section of the LTA entitled "Restoration of Status Quo: Rescission or New Contract" implies that a rescission by mutual consent that does not return the parties to their "status quo" (their original positions) constitutes a new contract. While an agreement to transfer property back to the former owner may in certain circumstances constitute a new contract for the sale of the property, *Aderholt* makes clear that a mutual rescission can occur absent a restoration to status quo. This is because an agreement to rescind is an agreement in and of itself, the terms of the agreement will control whether it is a new contract (which must necessarily preserve the vitality of the initial agreement) or one of rescission (where the parties express a desire to vitiate their rights and obligations under the initial agreement). While appropriate to direct Assessors to consider whether an agreement constitutes a rescission or a new contract for the sale of the property, the LTA implies that a rescission by mutual consent that does not return the parties to their status quo (their original positions) is *ipso facto* a new contract for a buyback of the same property. Adding restoration to a prior status quo is an arbitrary condition that is not supported by the statute or the case law, and the LTA should be revised accordingly.

Reasonable Time / Accepting of Benefits:
This section of the LTA recites both the Civil Code and several cases for the proposition that a rescission is effectual only if acted upon promptly, and within a reasonable period of time.

Both the Civil Code and case law cited support this general proposition, but only with respect to the *right to unilateral rescission*. The LTA erroneously extends these concepts to rescission by mutual consent, when no such requirement exists under the Civil Code or relevant case law.

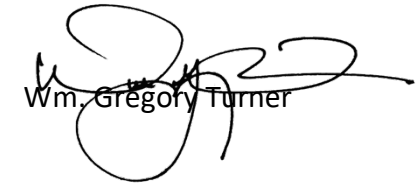
In the context of unilateral rescission, time plays an important role. Unilateral rescission is forged in equity, and since the common law era the Courts have recognized that "Equity aids the vigilant, not those who slumber on their rights." Mutual rescission is not forged in equity, but the law of contract. If the parties by mutual consent agree to rescind an earlier contract, the terms of that rescission agreement will be tested by other traditional rules with respect to the validity of contracts. The concern for the Assessor in the context of a rescission by mutual consent is only the legitimacy of the contract to rescind. Was there an agreement to rescind, a meeting of the minds, and was that agreement to rescind supported by adequate consideration? Certainly, the facts of a particular matter may raise questions concerning the legitimacy of the agreement to rescind. But, these are only factors in ascertaining the legitimacy of the rescission agreement, to avoid a sham, a fraud, or other malfeasances; not preconditions to be met before effectuating the parties' intent.

As presented by the LTA, complete restoration and a limited duration of time act as *per se* bars to effectuating the legitimate intent of the parties to a contract to mutually rescind. Under the currently drafted language the Assessor may feel compelled, or at least strongly encouraged, to deny rescissions by mutual consent on the technical absence of complete restoration or a duration of time having elapsed that some might deem unreasonable.

The time at which a mutual rescission occurs, the circumstances giving rise to the mutual rescission, and the terms of the mutual rescission itself may all be relevant factors in determining whether a mutual rescission is valid. I understand the desire to provide Assessors with guidance in making these determinations, but such guidance should not be presented as frim, strict, and unwaivable requirements that find no support in the Civil Code or applicable case law.

I am happy to provide alternative language for the LTA at the appropriate time.

Warm regards,



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