Commentary

Akin v. Certain Underwriters At Lloyd's, London

A Policyholder Contesting An Insurer's Unilateral Rescission Must Choose Between Disaffirming Or Enforcing The Policy

By
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Introduction

In a case of first impression, *Akin v. Certain Underwriters at Lloyd's, London*, 140 Cal.App.4th 291 (May 16, 2006), the California Court of Appeal (Fourth Appellate District, Division Two) recently held that a policyholder suing for damages under California's rescission statute, California Civil Code Section 1692 ("Section 1692"), was barred from recovering contract or bad faith damages arising from her insurer's unilateral rescission of her homeowner's policies. The appellate court held that rescission damages are limited to a premium return and whatever else is necessary to restore the *status quo ante*. Even if the policyholder alleges the insurer rescinded in bad faith, bad faith damages are not available.

The Policyholder's Claim

Plaintiff Jeanne Akin ("Akin") sued for improper rescission under Section 1692 against Defendants Certain Underwriters of Lloyd's, London ("Underwriters"). (140 Cal.App.4th at 294.) Plaintiff had two homeowner's policies with Underwriters. (*Id.* at 294.) Akin claimed that water leaks caused damage to her home on two separate occasions. (*Id.* at 294.) Akin submitted insurance claims to Underwriters, who denied her claims and rescinded her policies. (*Id.* at 294.) Akin alleged that Underwriters acted in bad faith in rescinding her policies and denying her claims. (*See id.* at 294-295.)

Before suing for rescission damages, Akin first filed a Complaint and First Amended Complaint ("FAC") alleging breach of contract and insurance bad faith. (140 Cal.App.4th at 294-295.) The trial court sustained Underwriters' demurrers to both pleadings based on the subject homeowner's policies' one-year limitations period. (*Id.* at 294-295.) The court rejected Akin's argument that following the rescission, Underwriters waived and were estopped from relying on the contractual time-bar. (*Id.* at 294-295.) (*See also* FAC ¶ 17.) Rather, since Akin's policies were rescinded on March 8, 2002, her one year time period in which to sue on the policies expired on March 8, 2003, almost a year before she filed this suit on March 4, 2004. (*Id.* at 294-295.) After the First Amended Complaint, Akin was granted leave to amend but barred from refiling the bad faith and contract claims. (*Id.* at 295.)

To avoid the contractual limitations period, Akin styled her Second Amended Complaint ("SAC") as

alleging a claim for "Improper Rescission — Breach of Statutory Duties pursuant to Civil Code section 1692." Section 1692 provides:

> When a contract has been rescinded in whole or in part, any party to the contract may seek relief based upon such rescission by (a) bringing 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) asserting such rescission by way of defense or cross-complaint.
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> If in an action or proceeding a party seeks relief based upon rescission and the court determines that the contract has not been rescinded, the court may grant any party to the action any other relief to which he may be entitled under the circumstances.
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> A claim for damages is not inconsistent with a claim for relief based upon rescission. The aggrieved party shall be awarded complete relief, 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 relief shall not include duplicate or inconsistent items of recovery.
>
> If in an action or proceeding a party seeks relief based upon rescission, the court may require the party to whom such relief is granted to make any compensation to the other which justice may require and may otherwise in its judgment adjust the equities between the parties.

In the Second Amended Complaint, Akin alleged Underwriters breached the policies "by failing and refusing to timely pay benefits under the policies and improperly rescinding the policies." (SAC ¶ 9.) Even though she sued for improper rescission, Akin prayed for traditional contract and bad faith damages under the policies, including insurance benefits allegedly owed, emotional distress damages, attorney's fees incurred in obtaining the benefits due under the policies, and punitive damages. (SAC ¶¶ 10-16.) Pointedly, she did not ask for a return of her premiums paid to Underwriters. (*See* SAC.)

Underwriters challenged the pleading for failing to state a proper claim for rescission damages. Underwriters posited that under Section 1692, Akin was limited to damages restoring her to her former position had she not entered into the contract. But Akin sought damages under the policies rather than under Section 1692, and hence her action was barred by the policies' one-year contractual limitations period. (140 Cal.App.4th at 295.)

Akin countered that Section 1692 states a party to a rescinded contract may bring "an action to recover any money or thing owing to him by any other party as a consequence of such rescission or for any other relief to which he may be entitled"; "[a] claim for damages is not inconsistent with a claim for relief based upon rescission"; and that "[t]he aggrieved party shall be awarded complete relief," including restitution "and any consequential damages". (Feb. 3, 2005 Opposition to Demurrer at 2-3.) Since she claimed to sue under Section 1692 rather than the policies, she said a three-year statute of limitations applied rather than the contractual period. (*Id.* at 4.)

The trial court sustained Underwriters' demurrer to the Second Amended Complaint without leave to amend. (140 Cal.App.4th at 295.)

The Appeal

On appeal, Akin claimed that Section 1692 expressly provides for an action to set aside a wrongful rescission and recover "complete relief," including policy benefits and bad faith damages; in her view, merely being restored to the *status quo ante* would not make her whole. (Opening Brief at 2, 8-16.) Akin also contended that equity precluded Underwriters from invoking the contractual limitations period because the rescission voided all of the policy terms *ab initio*. (Nov. 9, 2005 Appellant's Opening Brief at 2-3, 16-20.)

The court of appeal upheld the trial court's judgment for Underwriters. (140 Cal.App.4th at 294, 300.) The court said "plaintiff's claim is nothing more than a claim for breach of contract disguised as an action for rescission." (*Id.* at 296.) While a plaintiff generally is entitled to damages under Section 1692, "the

remedy intended by the statute is rescission damages, i.e., damages that would restore the plaintiff to the position that she would have been in if had she not entered the contract." (*Id.*) The conduct complained of by Akin — nonpayment of insurance benefits — is not compensable in a rescission action under Section 1692. (*Id.*) Rather, the putative policyholder is limited to seeking a return of premium payments and being restored to the position she held before purchasing the policy:

> In the context of an insurance case, an action for damages for breach of contract may entitle the aggrieved party to payment of benefits under the policies. But an action for rescission only permits the aggrieved party to the return of his premiums and whatever else may be required to restore the parties to the status quo ante. In an action for rescission, the parties are treated as though the policy of insurance never existed. (*Id.* at 298; internal citations omitted.)

In explaining the rescission doctrine, the court distinguished between an action based on disaffirmance versus affirmance of the policies:

> Plaintiff's request for payment under the policies is inconsistent with a claim for rescission damages under *section 1692*. Rescission extinguishes the policies. Plaintiff's claim, however, seeks to affirm the policies and obtain recover under their provisions. (*Id.* at 298.)
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> *Section 1692* authorizes a claim "based upon . . . rescission" or the disaffirmance of the contract. The statute does not authorize a claim based on the affirmance of the contract. Furthermore, while the statute entitles the aggrieved party to complete relief, it specifically precludes the party from receiving inconsistent items of recovery. "The remedy based upon the existence of the contract to purchase is inconsistent with the remedy based upon its nonexistence." Damages may not be recovered on the theory that the contract exists and additionally on the theory that the contract is at an end." Even if the party seeks inconsistent remedies, it is the court ultimately who determines to which she is entitled. (*Id.* at 297; internal citations omitted.)

Additionally, since Akin's claim was "no more than an action for breach of contract under a different name," the court held she barred by the contractual one-year limitations period. (140 Cal.App.4th at 299.) The court was not swayed by Akin's plea to "adjust the equities" under Section 1692: "[T]he limitations period is not determined by defendant's conduct, but by plaintiff's cause of action. Although defendant rescinded the policies, plaintiff still attempts to revive them and recover benefits under their provisions." (*Id.*)

Akin is consistent with the seminal case on insurance rescission, *Imperial Casualty & Indemnity Co. v.* Sogomonian, 198 Cal.App.3d 169 (1988). In *Sogomonian*, the court explained that a policyholder lacks any rights under an insurance policy that has been rescinded. Rescission is a "retroactive" termination of the insurance policy that "will avoid liability even on *pending* claims." (*Id.* at 182; emphasis in original.) "[R]escission effectively renders the policy totally unenforceable from the outset so that there was never any coverage and no benefits are payable." (*Id.*.) The *Sogomonian* court rejected the putative policyholders' argument that their "right to recover damages transcends rescission of the policy":

> But what of the circumstance where the dispute between the insurer and the insured goes beyond the issue of coverage and results in the rescission of the entire contract of insurance? ¶"A contract is extinguished by rescission." The consequence of rescission is not only the termination of further liability, but also the restoration of the parties to their former positions by requiring each to return whatever consideration has been received. Here, this would require the refund by Imperial of any premiums and the repayment by the defendants of any proceed advance which they may have received. The policy would be "extinguished" *ab initio*, as though it never existed. In other words, defendants, in law, never were insureds under a policy of insurance. That status cannot exist in a vacuum, but must necessarily depend upon the existence of a valid policy

> of insurance. (*Id.* at 184, internal citations omitted.) . . . . ¶We therefore hold that upon a rescission of a policy of insurance, based upon a material concealment or misrepresentation, all rights of the insured thereunder (except the right to recover any consideration paid in the purchase of the policy) are extinguished . . . . (*Id.* at 184.)

In *Kransco v. American Empire Surplus Lines Ins. Co.*, 23 Cal.4th 390, 408 (2000), the California Supreme Court cited *Sogomonian* with approval, explaining that where an insurance policy is rescinded there are no duties owed by the insurer. There is every reason to believe the Supreme Court would approve of *Akin*.

Conclusions

Akin v. Underwriters establishes important law in the context of insurance rescission that insurers and policyholders should note. From an insurer's perspective, in any policyholder challenge to a rescission it is critical to discern whether the policyholder seeks affirmance or disaffirmance of the policy. If the suit is brought under Section 1692 for rescission damages, bad faith and contract damages are not available and the policyholder is limited to being restored to his or her pre-contracting position, *i.e.*, a premium refund. If a pleading is ambiguous about the nature of the claim it should be challenged since an election of remedies at the onset is required: claims for rescission damages and claims on the policy are mutually exclusive. From a policyholder's perspective, it is necessary to take stock of one's rights and remedies on receiving notice from the insurer of a policy rescission. If the policy has an internal limitations period it will apply to any type of action complaining about the nonpayment of insurance benefits. ■