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Rescinding a release: Is payback necessary?

A new Court of Appeal decision confronts a first-impression question: What obligations remain when a class-action release is rescinded after settlement funds have already been paid?

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An employer learns that workers are considering legal action against it. They were allegedly underpaid, deprived of compliant meal or rest periods, exposed to unsafe conditions, or otherwise not treated in accordance with applicable laws.

When the matter involves one or two employees, the stakes aren't necessarily high for the employer. It is likely to seek early resolution of claims by paying off the workers before they hire attorneys, or after, but before a lawsuit is filed. The prospect of lengthy and costly litigation, coupled with a potential verdict and an award of substantial attorney's fees to their attorneys, is often not in the company's best interest, and the issue can be quickly put to bed.

But when large numbers of workers are affected, the calculus is different. The employer, facing a potentially costly class-action lawsuit, is sometimes highly motivated to resolve all claims out of court. The class-action complaint has already been filed but the class hasn't yet been certified. The employer uses a "Pick Up Stix" approach, reaching out to each affected employee and offering to settle their claims for a specific dollar amount in exchange for a full release. (The strategy of obtaining individual releases from putative class members was held to be valid by the court of appeal in *Chindarah v. Pick Up Stix, Inc.*, 171 Cal. App. 4th 796 (2009))

If the employer is successful and a large percentage of the employees agree to individual releases, this can pull the rug from under the class-action case and substantially diminish the value of the case. But all bets may be off if the employer made false or inaccurate statements or engaged in other improper acts to encourage class members to sign their settlement agreements. The company may have withheld critical information or threatened to demote or fire workers who wouldn't sign the release. If the releases were obtained through fraud or duress, employees may be able to get out of their deal even if they've been paid by the employer.

A recently decided Court of Appeal decision examines for the first time the obligations of an employer and an employee when a release has been rescinded but money has already been paid to class members.

The new case

On Jan. 14, 2026, the Court of Appeal for the 4th Appellate District issued its decision in *Merchant of Tennis, Inc. v. Superior Court of San Bernardino County* (E085766) (Merchant). In May 2022, former employee Jessica Garcia filed a third amended consolidated class-action complaint against her former employer, the Merchant of Tennis, for failure to pay wages and other employment-related violations under federal and state law.

In May and June of 2024, Merchant entered into approximately 954 individual settlement agreements (ISAs) with employees, requiring them to give up their wage and hour claims in exchange for cash payments. Merchant paid these former and current employees more than $875,000 in exchange for their release of claims.

Garcia moved for class certification in May 2024 and, on Nov. 12, 2024, filed a motion to invalidate the ISAs between Merchant and the putative class members, asserting

they were obtained through coercion and fraud. Although it did not grant in full the motion to invalidate, the trial court agreed that the settlement agreements were "voidable at the election of each settling putative class member," because they were procured through fraud or duress.

Rescission rights

California Civil Code Section 1689 provides that a contract may be rescinded if the consent of the rescinding party was given by mistake or "obtained through duress, menace, fraud, or undue influence." Rescission is also appropriate "if the public interest will be prejudiced by permitting the contract to stand."

When an employee signs away the right to file a lawsuit against an employer who has allegedly violated the Labor Code, a court will consider the context in which the release was obtained. Was the employee fully advised of his or her rights? Did he or she have sufficient information to make an informed decision? Was the consideration sufficient to compensate the employee for relinquishing the right to sue?

The motion filed by Garcia asserted that Merchant had procured the agreements based on fraud and coercion, that it had included false statements concerning the scope of the litigation, the claims released, and the percentage employees would likely recover in a class-action lawsuit. She also asserted that Merchant had coerced the class members into signing arbitration agreements after the class-action complaint was filed.

Repayment obligations

According to Section 1693 of the Civil Code, upon discovering facts that may entitle a party to rescind an agreement, that person must notify the other party of an intent to rescind and must "[r]estore 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 the other party do likewise, unless the latter is unable or positively refuses to do so."

But when must repayment be made? At trial, Merchant asked that potential class members be advised that they would not need to pay the money back immediately but could "be required to refund to [Merchant] all or some of the settlement amount you received based on what happens at trial in this action."

On appeal, Merchant argued that those who had accepted money when signing the ISA should be obligated to pay it back in full before commencing the class-action lawsuit. Citing Civil Code Section 1691, Merchant asserted that California rescission law required immediate repayment of consideration received by employees if an agreement was rescinded.

The Court of Appeal, however, cited this language from Section 1693: "A party who has received benefits by reason of a contract that is subject to rescission and who in an action or proceeding seeks relief based upon rescission shall not be denied relief because of a delay in restoring or in tendering restoration of such benefits before judgment unless such delay has been substantially prejudicial to the other party; but the court may make a tender of restoration a condition of its judgment."

Merchant, the appellate court said, had not provided evidence at trial that it would suffer "substantial prejudice" if repayment was delayed, and "the trial court was concerned that those employees who entered into the ISAs would not be able to pay back the money and would be discouraged from joining the class action lawsuit."

Trial courts, said the appellate panel, "have broad authority and a 'duty to exercise control over the class action to protect the rights of all parties, and to prevent abuse which might undermine the proper administration of justice.'" (Citing *Howard Gunty Profit Sharing Plan v. Superior Court* (2001) 88 Cal.App. 4th 572, 581.)

Curative notice

California law provides that payment must be returned when a contract is rescinded, but it does not dictate when such repayment must be made. This information would be conveyed to parties considering rescission through a curative notice. Until this case, there have been no published cases directly addressing rescission of settlements or the proper form for curative notices in class-action lawsuits.

The parties in Merchant could not agree on the language to be included in the curative notice, and each provided to the trial court its own curative notice letter. At trial, Merchant asked for language stating, "You could also be required to refund to [Merchant] all or some of the settlement amount you received based on what happens at trial in this action." Garcia argued that advising potential class members that they may owe the settlement money back would dissuade them from joining the class-action lawsuit.

Equitable principles

While acknowledging Garcia's concern that employees might be discouraged from joining the class-action lawsuit, the appellate court ruled that the plain language of the rescission statutes did not authorize the trial court to forgive repayment before the class-action litigation had commenced. It held that, because Merchant requested in the notice only language that payment may be required at the end of the litigation, a delay until judgment was appropriate.

The curative notice, the court ruled, should include language stating that if a class member chose to rescind an ISA, he or she could be held responsible under the law for repayment of the consideration received from Merchant at the conclusion of litigation. It went on to say that the trial court "maintains discretion to adjust the equities between parties under Section 1692 at the time of judgment," suggesting that repayment of some or all of the earlier compensation might be waived in the interest of fairness.

What it all means

Current and former Merchant employees were handed a potential "Get Out of Jail" card because their settlement agreements were subject to rescission. Had those agreements been fairly and properly obtained, repayment of their compensation would not be an issue. Merchant's actions opened the door to rescission by the employees.

This underscores the importance of providing workers with fair and accurate information about their cases, to avoid any argument that they engaged in fraud or duress. Employees who make informed decisions to forego litigation should have no basis for revoking those agreements.

Although the workers who rescinded their agreements assumed the risk that they could be liable for repayment of settlement money if they lost at trial, the employer faced the risk of not getting its money back right away and possibly not getting it back at all—even if it prevailed in court. Merchant reminds us that the court ultimately has discretion to not order employees to repay settlement money even if the employer is successful in litigation.

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