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California Supreme Court Eases Admissibility of Oral Statements in Contract Fraud Disputes

By Melissa S. Lor

California, like most jurisdictions, prohibits parties to integrated contracts from introducing "parol evidence" — this is, evidence of prior written or verbal agreements made by a party to a contract — if those alleged agreements are inconsistent with the terms of the contract. In fact, this prohibition, known as the parol evidence rule, is codified in California: "Terms set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement." Cal. Proc. Code § 1856(a); *see also* Cal. Civ. Code § 1625 ("The execution of a contract in writing … supersedes all the negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument.").

The parol evidence rule contains an explicit exception where a party to a contract alleges fraud in the formation of the contract. See Cal. Proc. Code § 1856(g) ("This section does not exclude … evidence [for the purpose of] establish[ing] illegality or fraud."). However, for the good part of a century, this "fraud exception" to California's parol evidence rule was narrowly curtailed. In 1935 the California Supreme Court, in *Bank of America v. Pendergrass*,[1] held that parol evidence is admissible to prove that a party procured a contract through fraud, but is not admissible to contradict any of the terms of the contract. That remained the law in California for decades — until the recent decision handed down by the California Supreme Court in *Riverisland Cold Storage v. Fresno-Madera Prod. Credit Ass'n* ("*Riverisland*").[2]

The plaintiffs in *Riverisland*, Lance and Pamela Workman, owed more than $775,000 to a credit association. In restructuring the debt, the Workmans signed a three-month forbearance agreement with modified payments, pledging eight separate parcels of land as security to the credit association. After the Workmans failed to make the required payments, the credit association sought foreclosure. The foreclosure proceedings were dismissed when the Workmans eventually repaid the loan through sale of some of their properties. However, the Workmans then sued the credit association for fraud and negligent misrepresentation, alleging that the association's vice president promised two weeks prior to execution of the agreement that the association would extend the loan for two years in exchange for just two properties as collateral. Based on the vice president's verbal assurances, the Workmans acknowledged they signed the agreement without reading it.

Arguing that the parol evidence rule prohibited the plaintiffs from presenting the evidence at the heart of their claims — the alleged pre-contractual oral representations by the vice president — the credit association moved for summary judgment, and the trial court, relying on the *Pendergrass* rule, granted the motion. The Court of Appeal reversed, holding that the *Pendergrass* rule did not apply to the alleged representations in the *Riverisland* case.

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1. *Bank of America v. Pendergrass*, 4 Cal. 2d 258 (Cal. 1935).

2. *Riverisland Cold Storage, Inc., et al. v. Fresno-Madera Prod. Credit Ass'n* (Cal. Jan. 14, 2013) (Corrigan, J.), Case No. S190581.

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On appeal, the California Supreme Court did not simply decide whether the *Pendergrass* rule applied to the case before it, but rather reconsidered the rule in its entirety and, ultimately, overruled it. In so doing, the Court explained that "[t]he *Pendergrass* limitation finds no support in the language of the statute codifying the parol evidence rule and the exception for evidence of fraud. It is difficult to apply. It conflicts with the doctrine of the Restatements, most treatises, and the majority of our sister-state jurisdictions. Furthermore, while intended to prevent fraud, the rule established in *Pendergrass* may actually provide a shield for fraudulent conduct. [Therefore], we now conclude that *Pendergrass* was ill-considered, and should be overruled."

After the *Riverisland* decision, the Workmans will now be able to offer into evidence the executive's alleged verbal promises in order to controvert the contents of their written agreement with the credit association. The Court, however, declined to rule on the issue of whether a party who admittedly fails to read a written contract can be found to have reasonably relied on alleged oral statements that do not appear in or are contradicted by the terms of the contract.

In light of the *Riverisland* decision, parties to contracts may now more readily offer evidence of oral statements to prove that a written contract was procured by fraud. Therefore, banks, commercial lenders, and other financial institutions, would be well-advised to implement and follow a practice of memorializing in detail all pre-contractual discussions with borrowers. ◆

To learn more about the impact of the Riverisland case on issues of parol evidence, or, if you have any questions related to the admissibility of oral statements in contract disputes, please contact an attorney in our Financial Services Litigation Practice Group:

Stephen J. Shapiro, Co-Chair
215-751-2259
sshapiro@schnader.com

Christopher H. Hart, Co-Chair
415-364-6707
chart@schnader.com

Melissa S. Lor
415-364-6748
mlor@schnader.com

www.schnader.com