COPY

NO. S190581

IN THE SUPREME COURT
OF THE
STATE OF CALIFORNIA

RIVERISLAND COLD STORAGE, INC., LANCE WORKMAN, PAM WORKMAN, LAURENCE A. WORKMAN, CAROL WORKMAN AND WORKMAN FAMILY LIVING TRUST,
Plaintiffs and Respondents,
vs.
FRESNO-MADERA PRODUCTION CREDIT ASSOCIATION,
Defendant and Petitioner

SUPREME COURT
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On Review of a Decision of the California Court of Appeal
Fifth Appellate District
Case No. F058434

ANSWER BRIEF ON THE MERITS

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I.
INTRODUCTION

Plaintiffs Riverisland Cold Storage, Inc., Lance Workman, Pam Workman, Laurence A. Workman, Carol Workman and the Workman Family Living Trust (together, "Plaintiffs"), respectfully offer this brief in answer to the Opening Brief on the Merits ("Opening Brief") of defendant Fresno-Madera Production Credit Association ("Defendant").

Notwithstanding Defendant's arguments, the decision in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn.* (2011) 191 Cal. App. 4th 611, is well-grounded in existing law, creates no confusion, makes no new law and poses no conflict with the principles that this Court laid down in *Bank of America v. Pendergrass* (1935) 4 Cal. 2d 258, barring the admission of false promises preceding the execution of an integrated written agreement, where those promises contradict the terms of that agreement.

The *Riverisland* decision is but the latest in a long line of cases recognizing a clear and simple rule that affords relief where there has been fraud in the execution (also known as fraud *in factum*, fraud in the inception or fraud in the making), that is, where one party presents an agreement to another party for execution while misrepresenting its contents.

Finding this sort of misrepresentation to constitute admissible, actionable fraud is no leap of jurisprudence. The Legislature and the

California courts have long recognized it as such. In fact, rather than being an exception to the parol evidence rule, it represents a fundamental problem that prevents the formation of a valid contract in the first place.

Admitting evidence of this sort serves an important purpose. It can helps prevent the unscrupulous from taking advantage of others, as happened in this case, by luring them into executing agreements containing terms substantially different from, and more onerous than, what they thought they were signing.

Confusing this simple, important and dispositive principle with an irrelevant and different question, the Defendant focuses largely on how or whether a court may distinguish pre-contract statements that are promises, which are inadmissible under *Pendergrass*, from pre-contract factual misrepresentations, which are admissible under that holding. Not only does this case fail to raise that issue, but the Defendant exaggerates the difficulty of distinguishing between promises of *future* actions and a statement of *present* fact.

Moreover, if this Court feels compelled to go beyond the holding here, there are ample reasons to overrule *Pendergrass*: The clear weight of decisions from other jurisdictions and scholarly analysis support a fairer rule that would admit evidence of pre-contract promissory fraud (or fraud in

the inducement), as the Legislature intended, while adopting safeguards against its misuse.

II.
STATEMENT OF FACTS / PROCEDURAL HISTORY

The Plaintiffs borrowed money from Defendant for their agricultural business. (Clerk's Transcript, volume 1 ("CT 1"), pp. 11; 50-51.) On March 29, 2007, after the loan had gone into default, Plaintiffs and Defendant entered into the written forbearance agreement giving rise to this appeal (*Id.*, pp. 11-37; 96-122), by which the Defendant agreed to refrain from collection while the Plaintiffs made specified payments and provided additional security for the debt (*Id.*, pp. 11-12).

They discussed the terms of this agreement in early March of 2007, when Mr. Ylarregui, Defendant's Senior Vice President and a good friend of Lance Workman, had lunch with him. (CT 2, p. 354.) Mr. Ylarregui described an agreement that would include a two-year forbearance period and the use of two parcels of land as collateral. (*Ibid.*)

Later that month, Mr. Ylarregui asked Mr. Workman and his wife Pamela to come into his office to sign the loan documents. (*Id.* at p. 354.) They met with him for this purpose on March 29. (*Id.* at p. 355.) During this meeting, Mr. Ylarregui "told [Mr. and Mrs. Workman] that [they] had the two years['] time, and [in] exchange for that the association was taking the two pieces of property." (*Id.* at p. 355.) They did not discuss using the

Workman residence or any other property as collateral. (*Ibid.*)

Mr. Ylarregui "slid [a] package [of loan documents] across the desk, and it had these little tabs that said sign here, yellow tabs. He reached across and flipped the page, [and the Plaintiffs] signed. [They] just went through like that flipping the pages." (*Id.* at p. 355.)

Mr. Ylarregui represented at that meeting "[t]hat the [two pieces of property] were [the only] collateral." (*Id.* at p. 249.) He "said 'sign here.' He showed [them] where to sign, and [said] that it was for two years." (*Id.* at p. 349.) The Plaintiffs "trusted David," so when he said, "sign here and here, [they] just signed where he told [them] to sign." (*Ibid.*) When asked about these statements, Mr. Ylarregui claimed he could not recall what he said. (*Id.* at p. 408.)

Despite his specific contemporaneous representations regarding the contents of the agreement, the 26-page, single-spaced agreement (including exhibits) in fact called for a six month (not two-year) period of forbearance, and listed some eight (not two) parcels of land, including the Workmans' home, as collateral, and identified them only in lengthy unsigned exhibits to the agreement, rather than in the body above the signature page. (CT 1 at pp. 13, 18, 34-37.)

In fact, by the date they actually signed the agreement, it gave Plaintiffs less than ninety days in which to repay the loan, and while the

security it provided for was worth over $2.5 million, the loan balance was less than $900,000. (CT 2, pp. 388, 393, 409, 415-65.)

When the Plaintiffs failed to make the payments required by the agreement, the Defendant recorded a notice of default. (CT 1, pp. 63; 125; 161-63.) Plaintiffs later repaid the loan (*id.* at p. 125), but they had to sell their property at severely reduced prices because of the Defendant's notices of foreclosure (CT 2, pp. 341-42).

In April of 2008, Plaintiffs filed their complaint alleging causes of action that included fraud, negligent misrepresentation, rescission and reformation. (*Id.*, pp. 1-37.) They based these claims upon Ylarregui's representations before and at the time of their execution of the forbearance agreement. Plaintiffs alleged that the Defendant's fraud and misrepresentation with respect to these material terms damaged their credit, and that its resulting notice of foreclosure had interfered with their ability to sell their real property. (*Id.*, p. 4:10-14.)

The trial court granted the Defendant's summary judgment motion (CT 1, pp. 46-275), finding that Plaintiffs had breached the agreement and that the parol evidence rule foreclosed consideration of the Defendant's misrepresentations so as to raise an issue of fact. (*Id.* at pp. 492-507.)

Reversing the summary judgment as to the causes of action above, the Court of Appeal held that the parol evidence rule's fraud exception

applies "where the party seeking admission of the parol evidence has alleged that the other party misrepresented the content of the written contract and thereby induced execution of the contract." (*Riverisland, supra*, 191 Cal. App. 4th at p. 625.) It held that the Plaintiffs' "extrinsic evidence of the alleged misrepresentations made by defendant's representative" at the time they executed the agreement "should have been admitted in opposition to defendant's motion for summary judgment." (*Ibid.*)

Now this Court has decided to review the following issue: "Does the fraud exception to the parol evidence rule permit evidence of a contemporaneous factual misrepresentation as to the terms contained in a written agreement at the time of execution, or is such evidence inadmissible under *Bank of America National Trust & Savings Association v. Pendergrass* (1935) 4 Cal. 2d 258, 263, as 'a promise directly at variance with the promise of the writing'"?

III.
ARGUMENT

A. SUMMARY OF ARGUMENT

Under statute and long-established case law, the fraud exception to the parol evidence rule *does* admit evidence of a contemporaneous factual misrepresentation as to the terms contained in a written agreement, or fraud in the execution; such statements are not viewed as "promise[s] directly at

variance with the promise of the writing." The Court of Appeal's decision was entirely consistent with this rule. Because the Plaintiffs had a potentially valid claim for such fraud, the Court of Appeal correctly reversed the summary judgment here. There is, therefore, no occasion to apply or reconsider the *Pendergrass* holding, as that case dealt with a separate issue, namely, fraud in the *inducement* of a contract.

However, if this Court nonetheless chooses to reconsider *Pendergrass*, there are many good reasons to overrule that decision and articulate a better and more sound approach: The California Legislature has specifically recognized a right to relief from promissory fraud or fraud in the inducement; the Courts of Appeal and this Court have struggled for decades with *Pendergrass* and sought to avoid its harsh application; the majority of courts in other states have chosen not to follow that approach; and the commentators have roundly criticized *Pendergrass* and urged the adoption of more reasoned approaches to the problem of promissory fraud.

B. THE PAROL EVIDENCE RULE

The Legislature has set forth the parol evidence rule in two statutes: (1) Civil Code section 1625, which provides, "The execution of a contract in writing ... supersedes all the negotiations or stipulations concerning its matter which preceded or accompanied" its execution; and (2) Code of Civil Procedure section 1856, under which the "[t]erms 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."

With regard to an integrated contract, i.e., "a complete and final embodiment of the terms of an agreement" (*Masterson v. Sine* (1968) 68 Cal. 2d 222, 225), the rule generally prohibits using "extrinsic evidence, whether oral or written, to vary, alter or add to the terms of an integrated written instrument" (*Alling v. Universal Manufacturing Corp.* (1992) 5 Cal. App. 4th 1412, 1433).

The rule, which "is not a rule of evidence but … one of substantive law" (*Estate of Gaines* (1940) 15 Cal. 2d 255, 264), prevents a "complete and final contract between the parties" from being "contradicted by evidence of purportedly collateral agreements," since such evidence "cannot serve to prove what the agreement was, this being determined as a matter of law to be the writing itself.'" (*Alling, supra*, 5 Cal. App. 4th at p. 1434.) Notable for its absence in this policy, is any endorsement of one contracting party's contemporaneous, fraudulent misrepresentations to the other, of the material terms of a proposed agreement.

C. THE FRAUD EXCEPTION

In Code of Civil Procedure section 1856, the Legislature carved out some exceptions to the parol evidence rule, one of which is found in

subdivision (g): "This section does not exclude other evidence ... to establish ... fraud." Under this exception, "parol evidence of fraudulent representations is admissible ... to show that a contract was induced by fraud." (*Richard v. Baker* (1956) 141 Cal. App. 2d 857, 863.)

D. THE *PENDERGRASS* AND *FLEURY* DECISIONS

In *Bank of America v. Pendergrass* (1935) 4 Cal. 2d 258, this Court found the fraud exception not to encompass parol evidence of an oral promise made with no intent to perform, where that promise directly contradicted the written agreement's terms. The defendants there had asserted that the plaintiff had committed "fraud in the inducement," thus barring his suit on a promissory note. Specifically, they claimed to have executed the note based upon plaintiff's representation, with no intent to perform, that the plaintiff "would 'extend' or 'postpone' all payments for the period of one year" if they signed it. (*Id.* at p. 263.)

This Court found this proposed evidence to be inadmissible because it was "in direct contravention of the unconditional promise contained in the note to pay the money on demand" (*ibid.*), reasoning further:

> [P]arol evidence of fraud to establish the invalidity of the instrument ... must tend to establish some independent fact or representation, some fraud in the procurement of the instrument or some breach of confidence concerning its use, and not a promise directly at variance with the promise of the writing." ...

> 'It is reasoning in a circle, to argue that fraud is made out, when it is shown by oral testimony that the obligee contemporaneously with the execution of a bond, promised not to enforce it. Such a principle would nullify the rule: for conceding that such an agreement is proved, or any other contradicting the written instrument, the party seeking to enforce the written agreement according to its terms, would always be guilty of fraud.'

(*Ibid.*)

Accordingly, although the decision is terse and cryptic, *Pendergrass* has been read generally as carving out a distinction between (1) evidence of "fraud in the procurement of the instrument or some breach of confidence concerning its use," which is admissible, and (2) evidence of "a promise directly at variance with the promise of the writing," which is not. Notably, this Court did not address in *Pendergrass* the situation here, where one party allegedly misrepresented the *contents* of an agreement.

Significantly, two years later, and notwithstanding *Pendergrass*, this Court issued its decision in *Fleury v. Ramacciotti* (1937) 8 Cal. 2d 660, holding that parol evidence may be admitted to show that a contracting party made fraudulent representations regarding the *contents* of a written agreement, to induce its execution, *even as to terms contradicting the contents of the agreement*: "[A]lthough a written instrument may supersede prior negotiations and understandings leading up to it, fraud may always be shown to defeat the effect of an agreement." (*Id.* at p. 661-62.) That principle is vital to the outcome of this appeal, and it clearly survived the

holding in *Pendergrass*. *Fleury* has never been overruled or distinguished by this Court.

E. CONTEMPORANEOUS MISREPRESENTATIONS OF THE CONTENTS OF AN AGREEMENT ARE ADMISSIBLE NOTWITHSTANDING THE PAROL EVIDENCE RULE.

Fraud in the *inducement* of a contract occurs "'where the promisor knows what he is signing but his consent is induced by fraud." (*Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal. 4th 394, 415.) In that situation (ignoring for the moment any issues raised by *Pendergrass*), "'mutual assent is present and a contract is formed, which, by reason of the fraud, is *voidable*.'" (*Ibid.*, emphasis original.)

In the case of fraud in the *execution*, as alleged here, where a party has been misled as to the content of what he is signing, the contract lacks mutual assent and is therefore *void* and "subject to rescission at the election of the person deceived." (*Speck v. Wylie* (1934) 1 Cal. 2d 625, 627, emphasis added, quoting Restatement of the Law – Agency, section 259.)

The California Legislature has made it clear that evidence of fraud in the execution is admissible notwithstanding the parol evidence rule: "A party to a contract may rescind the contract . . . . [i]f the consent of the party rescinding . . . was . . . obtained through . . . fraud . . . exercised by . . . the connivance of the party as to whom he rescinds ...." (Civ. Code, § 1689, subd. (b) (1); *Rosenthal, supra,* 14 Cal. 4th at p. 415.)

Civil Code section 1689, as applied by the California courts in a long and substantial body of decisions, shows clearly that the Legislature intended the term "fraud" to include fraud in the execution of a contract and to afford relief to the defrauded party. (See, e.g., *Simmons v. Ratterree Land Co.* (1932) 217 Cal. 201, 208; *Security-First Nat. Bank v. Earp* (1942) 19 Cal. 2d 774, 777-78; *Cobbledick-Kibbe Glass Co. v. Pugh* (1958) 161 Cal. App. 2d 123, 127-28; *Kane v. Mendenhall* (1936) 5 Cal. 2d 749, 758; *Wright v. Lowe* (1956) 140 Cal. App. 2d 891, 897; *Kloehn v. Prendiville* (1957) 154 Cal. App. 2d 156, 162.)

This rule is not disputed here. Defendant itself concedes that "where the plaintiff is deceived as to the character or nature of the document he signs," "mutual intent is lacking and the contract is void because it was never formed." (Opening Brief at pp. 9, 15.) This vital rule that prevents a gross form of fraud, i.e., luring people into signing documents that are different from what they are supposed to be.

The court in *Pacific State Bank v. Greene* (2003) 110 Cal. App. 4th 375, explained why the holding in *Pendergrass* does not apply to fraud in the execution: (1) "The language of [Code of Civil Procedure section 1856, subd. (g)] is unqualified and does not limit the misrepresentations covered;" (2) "[I]t is not necessary to extend *Pendergrass* to cover factual misrepresentations over the content of the writing in order to safeguard the

vitality of the parol evidence rule;" and (3) "[A] further extension of *Pendergrass* would unduly restrict the statutory exception for fraud." (*Id.* at p. 392.)

The court further explained why such fraud does not run afoul of the parol evidence rule, even as to terms that conflict with an agreement:

> In the case of promissory fraud, an earlier or contemporaneous promise is proffered in variance with the promises in the agreement; evidence of such a contrary promise goes to the heart of that which the parol evidence rule is intended to protect against. But a claim of a mischaracterization of the content of the physical document to be signed is more narrow in time and circumstance: It can only occur at the time of signing.... And the need to prove the element of reasonable reliance in order to successfully make out a misrepresentation claim also protects against abuse: In light of the general principle that a party who signs a contract "cannot complain of unfamiliarity with the language of the instrument," the defrauded party must show a reasonable reliance on the misrepresentation that excuses the failure to familiarize himself or herself with the contents of the document.

(*Id.* at p. 393.)

The court acknowledged that "there can occasionally be a fine line between a promise that induces an agreement and a misrepresented fact concerning the physical content of an agreement at the time of signing" (*id.* at p. 392), but concluded the *Pendergrass* limitation on the fraud exception "must not be expanded so as to undermine the vitality of statutory fraud exception itself." (*Id.*, p. 396.) As with *Fleury, supra,* 8 Cal. 2d 660, this decision remains good law.

Accordingly, nothing in *Pendergrass* requires excluding evidence of fraud in the execution, even as to terms contradicting the contents of an agreement.

F. PLAINTIFFS WERE ENTITLED TO PROVE FRAUD IN THE EXECUTION

Defendant's contemporaneous misrepresentations as to the contract's contents fell squarely within the exception for fraud in the execution. The terms of the contract were materially different from those that Defendant represented at the time of its execution. It was not the contract that Defendant claimed it to be. It drastically shortened the term of the forbearance and encumbered many more properties, including the Plaintiff's home, than the Defendant represented. It called for far more security than the indebtedness to which it applied.

A similar type of deception occurred in *Pacific State Bank v. Greene, supra,* 110 Cal. App. 4th 375, where the defendant claimed she had agreed to guarantee one loan of a borrower and that, on the day she signed the agreement, the bank's representative stated the guarantee related only to that loan; the loan number and amount were even specified at the top of the guarantee agreement. (*Id.* at p. 378.) However, the fine print defined the guarantee to include "'*all of* Borrower's liabilities, obligations, debts, and indebtedness to Lender,'" which actually included four loans. (*Id.* at pp. 380-81, emphasis added.)

Reversing summary judgment in favor of the bank, the Court of Appeal held that, even though its alleged misrepresentation was directly contrary to the express terms of the contract, the evidence was admissible under the statutory exception for fraud, even as to terms contradicting the contents of the agreement. (*Id.* at pp. 385-87, citing Code Civ. Proc., § 1856, subd. (g).)

Similarly, in *Fleury v. Ramacciotti* (1937) 8 Cal. 2d 660, this Court reached the same conclusion where a defendant signed a promissory note without reading it, in reliance on the other party's representation that it included a provision preventing that party from entering a deficiency judgment against him. (*Id.* at p. 661.)

The holdings in *Greene* and *Fleury* remain good law and are on all fours with the situation here. The *Greene* court's reasoning, quoted further above, sums up perfectly why the Court of Appeal's ruling in this case neither makes new law nor conflicts with *Pendergrass*: There is a simple distinction between excluding evidence of inconsistent promises leading up to the execution of an integrated agreement, and allowing evidence of contemporaneous misrepresentations as to the contents of such an agreement, as occurred here, even where they conflict with the terms of the agreement.

Also, the misrepresented contents were clearly material. "The test of materiality of the alteration is whether it changes the rights or duties of the parties, or either of them." (*Consolidated Loan Co. v. Harman* (1957) 150 Cal. App. 2d 488, 491.) "A misrepresentation is judged to be 'material' if 'a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question,' and as such materiality is generally a question of fact unless the 'fact misrepresented is so obviously unimportant that the jury could not reasonably find that a reasonable man would have been influenced by it.'" (*In re Tobacco II Cases* (2009) 46 Cal. 4th 298, 326, citations omitted.)

For purposes of rescission, "[t]he test of materiality is that the contract sought to be rescinded would not have been made if the representation had been absent." (*Shirreffs v. Alta Canyada Corp.* (1935) 8 Cal. App. 2d 742, 748; accord, *Wood v. Kalbaugh* (1974) 39 Cal. App. 3d 926, 932.) "[T]he test . . . cannot be stated in the form of any definite rule, but must depend upon the circumstances of the transaction itself," and "the question is frequently for the jury whether the statement made might justifiably induce the action taken." (Prosser, Law of Torts (4th ed. 1971) section 108, p. 719.)

The statements here, regarding the term of the forbearance and the identity of the secured property, were clearly material, as they directly

affected the rights and duties of the parties. At the very least, there is a triable issue of fact as to how a reasonable person would view those terms.

1. Defendant cannot excuse its Fraud by faulting Plaintiffs for trusting its Vice President.

The fact that the Plaintiffs did not read every term of the contract before signing it does not bar their claim, despite Defendant's arguments at pages 36-37 of the Opening Brief. Defendant's representative and Vice President, their trusted friend, specifically told them to sign it at the indicated places rather than read it. Defendant cannot fault them for taking him at his word.

And even if one were erroneously to find any fault here, "'[n]egligence in failing to discover the falsity of a statement is no defense when the misrepresentation is intentional rather than negligent,'" (*Sullivan v. Dunnigan* (1959) 171 Cal. App. 2d 662, 668, quoting Prosser, Law of Torts, pp. 402, 748; Rest., Torts, § 540; see also *Kantlehner v. Bisceglia* (1951) 102 Cal. App. 2d 1, 3 ["whether the failure to read a document is such negligence as to bar relief is ordinarily a question for the trier of fact. ... Particularly is this true where the failure to read is induced by reliance upon the fraudulent representations of the other party"].)

For example, in *Cobbledick-Kibbe Glass Co. v. Pugh* (1958) 161 Cal. App. 2d 123, because the seller had deceived the buyer by tendering a contract without warning him that it contained language contrary to the

seller's oral representations, the seller could not use that provision to bar the buyer's fraud action in which he claimed reliance on the inconsistent oral representations, because "respondent was fraudulently induced to execute the contract." (*Id.* at p. 128.) "[E]ven if respondent was careless, his very carelessness might well have been induced by his dealings with appellant's representative." (*Id.* at p. 127.)

In *Gridley v. Tilson* (1927) 202 Cal. 748, 752, this Court recognized a defense to a contract where a party "was prevented by the agent from reading the limiting clause or was otherwise tricked into signing the document without reading it."

In *Simmons v. Ratterree Land Co.* (1932) 217 Cal. 201, 208, this Court explained, "[a]lthough a purchaser may not offer as a defense against the provisions of a contract that he failed to read it, *if his failure to read is due to fraud or trickery of the seller or his agent, the rule is otherwise* ... [In such a case,] there is fraud in the actual execution of the written contract." (Emphasis added.)

In *Security-First Nat. Bank v. Earp* (1942) 19 Cal. 2d 774, 777-78, where the defendants signed an instrument without reading it in reliance on the representation of the plaintiff's employee, this Court held: "His negligence in failing to read the contract does not bar his right to relief if he was justified in relying upon the representations" as to its contents.

In *Fleury v. Ramacciotti, supra*, 8 Cal. 2d 660, this Court granted relief to a defendant who signed a promissory note without reading it, in reliance on the other party's representation that it included a provision preventing that party from entering a deficiency judgment against him. (*Id.* at p. 661.) It rejected the plaintiff's claim that Ramacciotti could not prove fraud "because of his carelessness in failing to read the renewal note," in light of the rule that "where failure to read an instrument is induced by fraud of the other party, the fraud is a defense even in the absence of fiduciary or confidential relations." (*Id.* at p. 162.)

Another formulation of the rule appears in *Kane v. Mendenhall* (1936) 5 Cal. 2d 749, 758: "Where one signs an instrument without reading it in reliance on representations as to its contents in fact false, the instrument may be avoided where a confidential relation exists between the parties." In fact, even the Defendant here admits, "a plaintiff can still present evidence of fraud in the inducement when it involves 'some breach of confidence.' An example of this kind of fraud might be where the defendant is in a fiduciary relationship to the plaintiff and by reason of this special relationship, *plaintiff may be entitled to rely on defendant's statements of what the writing contains without reading it.*" (Opening Brief at p. 9, emphasis added.)

Such a confidential relationship clearly existed here. While the "existence of [a] confidential relationship between the parties ... presents a question of fact, ... confidential relations 'may be said to exist whenever trust and confidence is reposed by one person in the integrity and fidelity of another'" (*Kloehn v. Prendiville* (1957) 154 Cal. App. 2d 156, 160-61), and Defendant's vice president was a trusted friend of Plaintiffs'. Also, under Commercial Code section 1203, "[e]very contract or duty within this code imposes an obligation of good faith in its performance or enforcement." Good faith is defined as "honesty in fact in the conduct or transaction concerned" (Comm. Code, § 1201, subd. (19)), and there is an implied covenant of good faith and fair dealing in commercial transactions under the California Uniform Commercial Code. (*E. F. Hutton & Co. v. City National Bank* (1983) 149 Cal. App. 3d 60, 73 n. 10, 74.) Accordingly, even if some special relationship were required, it existed here.

Defendant's few cases in opposition compel no other approach, and are clearly distinguishable. In *Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal. 3d 699, 707, the terms fraud and misrepresentation do not even appear, and that case did not consider these issues. In *Rowland v. Paine Webber, Inc.* (1992) 4 Cal. App. 4th 279, 286, the court itself observed that there were "no facts tending to show ... fraud." And in *Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal. 4th 394,

this Court took pains to limit its holding to only those cases where a party sought "to avoid an arbitration agreement contained in [a] contract," and acknowledged that other rules apply in cases outside that specific arena. (*Id.* at p. 423.)

Accordingly, it is no defense to say that the Plaintiffs were at fault for trusting their friend, Defendant's own Vice President, and simply signing the agreement as he urged them to with false contemporaneous representations, while even going so far as to use "Sign Here" tabs to speed up the process.

2. Plaintiffs did not bear the Burden of showing Reasonable Reliance.

Defendant now argues, for the very first time, that "the Workmans submitted no evidence showing that their reliance on PCA's alleged statements and failure to read the agreement before signing it were reasonable." (Opening Brief at p. 11.) However, Defendant (1) failed to make that argument in support of its summary judgment motion; (2) proffered to the trial court no "undisputed material facts" or evidence to support such an argument; (3) failed to raise that argument before the Court of Appeal; and (4) never asked this Court to review the issue. (See CT 1, pp. 46-83, as well as Defendant's Respondent's Brief, pp. 9-26.) Accordingly, Defendant has waived this contention, and cannot raise it at

this very late date. (See *Munro v. Regents of University of California* (1989) 215 Cal. App. 3d 977, 988 [a party may not raise on appeal issues not raised in the trial court]; Code Civ. Proc. § 437c, subd. (b) (1) [requiring undisputed facts to support summary judgment motion]; *Village Nurseries, L.P. v. Greenbaum* (2002) 101 Cal. App. 4th 26, 47 [same]; Code Civ. Proc. § 437c, subd. (m) (2) [requiring additional briefing and sometimes even remand for additional discovery for affirmance on any basis other than those upon which trial court granted summary adjudication motion]; *Sunset Drive Corp. v. City of Redlands* (1999) 73 Cal. App. 4th 215, 226 [waiver by failure to raise argument in appellate brief].)

And in any event, as this Court has held, "a presumption, or at least an inference, of reliance arises wherever there is a showing that a misrepresentation was material."'" (*In re Tobacco II Cases* (2009) 46 Cal. 4th 298, 326, citations omitted. See also 12 Williston on Contracts (3d ed. 1970) § 1515, p. 480; Rest.2d, Contracts, § 167.)

Also "[a] fraudulent state of mind includes not only knowledge of falsity of the misrepresentation but also an "'*intent to . . . induce reliance*'" on it." (*Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal. 4th 951, at p. 976, emphasis added, quoting *Lazar v. Superior Court* (1996) 12 Cal. 4th 631, 638.) This Court has explained further:

> A misrepresentation is judged to be "material" if "a reasonable man would attach importance to its existence or

> nonexistence in determining his choice of action in the transaction in question" (Rest.2d Torts, § 538, subd. (2) (a); see also *Barnhouse v. City of Pinole* (1982) 133 Cal. App. 3d 171, 188, fn. 5 [183 Cal. Rptr. 881]), and as such materiality is generally a question of fact unless the "fact misrepresented is so obviously unimportant that the jury could not reasonably find that a reasonable man would have been influenced by it." (Rest.2d Torts, § 538, com. e, p. 82.) *Thus, the Engallas need only make a showing that the misrepresentations were material, and that therefore a reasonable trier of fact could infer reliance from such misrepresentations, in order to survive this summary-judgment-like proceeding, absent evidence conclusively rebutting reliance.* (*Cf. Security Pac. Nat. Bank v. Associated Motor Sales* (1980) 106 Cal. App. 3d 171, 179-180 [165 Cal. Rptr. 38] [presumption which shifts the burden of proving evidence entitles plaintiff to summary judgment if defendant fails to produce evidence to rebut the presumption].)

(*Engalla, supra,* 15 Cal. 4th at pp. 976-77, emphasis added. See also *Hinesley v. Oakshade Town Center* (2005) 135 Cal. App. 4th 289, 299 [on summary judgment, *a defendant bears the burden* to rebut a plaintiff's claim of materiality "by showing no reasonable reliance"].)

Plaintiffs have already established that the misrepresented contractual terms in question were material. Accordingly, the burden shifted to Defendant to show that Plaintiff did not rely upon them. Defendant did not even attempt to make such a showing in its summary judgment motion with facts, argument or citation to authority. Having failed to meet this burden, Defendant has no basis now to urge reversal on this ground.

G. MUCH OF THE "CONFUSION" RESULTING FROM *PENDERGRASS* INVOLVES A SIMPLE FAILURE TO DISTINGUISH FRAUD IN THE INDUCEMENT FROM FRAUD IN THE EXECUTION

Plaintiffs have already demonstrated that the *Riverisland* decision finds ample support in not only this Court's post-*Pendergrass* decision of *Fleury*, but abundant statutory and case law. There is no need to go further to resolve this appeal. Nonetheless, Plaintiffs will now turn to the "confusion" that Defendant emphasizes in its brief, with regard to both the application of *Pendergrass* and the distinction between the two types of contractual fraud.

In the seven decades that have passed since *Pendergrass* came down, that holding has been widely criticized (see *Continental Airlines, Inc. v. McDonnell Douglas Corp.* (1989) 216 Cal. App. 3d 388, 418-20; 2 B.E. Witkin, California Evidence § 1000, at 946-47 (3d ed. 1986); Sweet, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. 877 (1961)), but never overruled, and the intermediate appellate courts have attempted to reconcile and apply it in a variety of contexts. Many of those cases involved fraud in the inducement, but a few courts have mistakenly attempted to apply *Pendergrass* in the context of fraud in the execution, sometimes without even acknowledging the difference between the two situations.

In a case that did involve fraudulent inducement, the court in *Cobbs v. Cobbs* (1942) 53 Cal. App. 2d 780, excluded parol evidence showing that even though a spouse had refused to include in property settlement agreements a provision that payments would stop if she remarried, she had orally agreed to this term: As to a "claim of fraud arising from a promise made without intent to perform[,] oral evidence cannot be ... used to directly contradict the terms of a written instrument." (*Id.* at p. 782-86.)

Similarly, the court in *Coast Bank v. Holmes* (1971) 19 Cal. App. 3d 581, 591, considered evidence that a bank had induced the defendant to execute a note by promising falsely that it would not foreclose on his property. It noted that under California law:

> [A] tenuous distinction has been drawn between an oral promise which is consistent with the written agreement and one which is at variance with a matter covered by the writing. (Witkin, Cal. Evidence (2d ed. 1966) pp. 684-685.) Evidence of a false promise inconsistent or at variance with the terms of the written agreement has been held to be inadmissible as being in violation of the parol evidence rule. [Citations.] But a false promise which is independent of or consistent with matters covered by the agreement has been held to be admissible.

While claiming to honor this "tenuous" rule, the court made an interesting distinction: It found the evidence inadmissible to reform the contract, but allowed it in as evidence of a failure of consideration and fraud. (*Id.* at p. 592.)

Other fraud-in-the-inducement cases along these general lines include:

- *Regus v. Gladstone Homes, Inc.* (1962) 207 Cal. App. 2d 872, 877 [Rejecting parol evidence that, before the parties entered into a written contract that transferred 345 feet of land fronting a road, the defendants promised orally that the plaintiffs would receive 370 feet];
- *Marani v. Jackson* (1986) 183 Cal. App. 3d 695, 702 [Parol evidence ruled barred evidence of an oral agreement which predated and contradicted an integrated written contract, as to the terms of a brokerage commission];
- *Price v. Wells Fargo Bank* (1989) 213 Cal. App. 3d 465, 483 [Parol evidence ruled barred evidence of an alleged oral promise which predated and contradicted an integrated written contract, as to the interest rate on a real estate loan; court noted that the plaintiffs knew the contents of the agreement they signed, and that "[t]he parol evidence rule in general does not preclude proof of fraudulent oral misrepresentations"]; and

- *Alling v. Universal Mfg. Corp.* (1992) 5 Cal. App. 4th 1412, 1436-37 [Court rejected parol evidence that would have showed fraudulent inducement].

Beyond these cases, a few courts seem to have missed the distinction between fraud in the inducement and fraud in the execution. For example, in *Bank of America v. Lamb Finance Co.* (1960) 179 Cal. App. 2d 498, the court rejected under *Pendergrass* evidence that a party had misrepresented the terms of a contract. (The defendant had signed a guarantee of a promissory note, and testified that a representative of the plaintiff bank had informed her at the time she signed, that she was not guaranteeing the note with any of her personal property; he had said it was only a corporate note.) The court failed to distinguish between promises made without intent to perform and factual misrepresentations as to the content of the written contract. (*Id.* at p. 502.) The parties did not raise, and the court did not discuss, this vital distinction.

The court in *Wang v. Massey Chevrolet* (2002) 97 Cal. App. 4th 856, also overlooked this simple distinction, where the defendant blatantly misrepresented the contents of a vehicle lease agreement. (*Id.* at pp. 863, 873, 876.)

Defendant asserts that this Court reached a similar conclusion in *Casa Herrera, Inc. v. Beydoun* (2004) 32 Cal. 4th 336, and "reaffirmed [the

principle] that pre-contract statements about contract terms are not admissible if they conflict with the terms of the writing" (Opening Brief at p. 2), but that significantly overstates the holding in *Casa Herrera*. There, this Court considered only whether a favorable judgment based upon the parol evidence rule *in a prior lawsuit* was a termination on the merits for purposes of a malicious prosecution lawsuit: "Because the parol evidence rule effectively immunizes appellant from liability for prior or contemporaneous statements at variance with the written sales contract, the Court of Appeal's decision tends to show appellant's innocence of fraud." (*Id.* at p. 347.)

The court that applied the parol evidence rule in the prior case was not this Court; it was the Court of Appeal for the Fourth Appellate District, Division One. This Court simply noted that the rule had been applied in the prior action. The validity of that conclusion was not before it, and this Court neither reaffirmed nor renounced *Pendergrass*, much less applied its holding to fraud in the execution cases.

In passing, this Court noted that in *Pacific State Bank v. Greene, supra*, 110 Cal. App. 4th 375, "the Court of Appeal [had] recognized an exception to [the parol evidence] rule for 'misrepresentations of fact over the content of an agreement at the time of execution,' stating, "[e]ven *assuming that such an exception exists*, it does not apply here because there

is no allegation that appellant misrepresented the contents of the written sales agreement." (*Id.* at p. 347, fn. 6, emphasis added.) It thus declined to address, much less resolve, that issue or overrule its own holding in *Fleury* supporting this exception and the long line of cases applying it since then.

Finally, in *Casa Herrera*, this Court recited the general parol evidence principle that generally, "the terms contained in an integrated written agreement may not be contradicted by prior or contemporaneous *agreements*" (*id.* at p. 344, emphasis added), but it did not go farther, as Defendant would suggest, to say that the courts should simply ignore a party's attempts to defraud the other party to a contract, by falsely depicting its contents at the time of its execution. Therefore, *Casa Herrera* is of no aid to Defendant.

In sum, despite a few cases overlooking the basic difference between types of contractual fraud, the courts that have actually acknowledged the distinction, such as *Greene*, have concluded correctly that *Pendergrass* is, on its face, inapplicable to claims of fraud in the execution. That fact is dispositive of this appeal.

H. DEFENDANT EXAGGERATES THE DIFFICULTY OF DISTINGUISHING PROMISES FROM FACTUAL STATEMENTS

On a related matter involving fraud in the inducement, Defendant argues through most of its brief that the California courts have great

difficulty distinguishing promises from factual statements under *Pendergrass*. (See Opening Brief at pp. 15-26.) That distinction is not relevant to the outcome of this appeal, involving fraud in the execution. But even if it were relevant, much of this "confusion" seems to originate with Defendant itself.

For example, as discussed above, the Court of Appeal here considered a situation where the defendant allegedly misrepresented material terms of the proposed contract at the time of its signing. The same can be said of *Fleury* and *Greene*. They were all fraud in the inception cases, not fraud in the inducement cases. They simply do not illustrate the basic problem that Defendant perceives. Using *fraud in the execution* cases to show confusion in the *fraud in the inducement* context is a basic *non sequitur*.

And even *Continental Airlines, Inc. v. McDonnell Douglas Corp.* (1989) 216 Cal. App. 3d 388, which Defendant describes as the "poster boy" of this supposed confusion (Defendant's petition for review at p. 17), made a rational distinction between pre-contract oral promises and misstatements of fact: Statements that "'[t]he fuel tank will not rupture under crash load conditions'" were promises that contradicted the language of the contract, and thus inadmissible to prove promissory fraud under *Pendergrass*. (*Id.* at pp. 418, 421, italics omitted.) By contrast, statements

that "'[t]he landing gear, flaps and wing engines/pylons are designed for wipe-off without rupturing the wing fuel tank'" and "the main landing gear is designed to break away from the wing structure without rupturing fuel lines or the integral wing fuel tank" were properly admitted as specific factual misrepresentations. (*Id.* at pp. 422-24.)

Defendant perceives no difference between the two types of statements (see Opening Brief at p. 22), but they are readily distinguishable: The former statement (that the fuel tank would not rupture *in the future*) was a manifest guarantee or promise of performance, while the latter ones (that the aircraft had been designed *in the past* with certain physical features) were obvious factual representations.

The difference is not nearly as confusing as Defendant claims. Our trial and appellate judges are competent to distinguish *promises* (commitments to future action or inaction) from *misrepresentations* (statements of past or present fact), regardless of how cleverly some lawyers might try to couch them.

And even if this Court chooses to clarify or even abolish that distinction in fraud-in-the-inducement cases, such a pronouncement would cast no doubt upon the Court of Appeal's holding here, as it rests upon fraud in the execution: contemporaneous misrepresentations of the contents of the contract to be signed.

I. THERE ARE COMPELLING REASONS FOR THIS COURT TO RECONSIDER THE HOLDING IN *PENDERGRASS*

Plaintiffs have already shown why the decision at issue here is easy to reconcile with *Pendergrass*, as it simply reaffirmed a long-accepted rule admitting evidence of fraud in the execution. As the *Riverisland* court itself concluded:

> We agree with *Greene* and *Continental* that parol evidence of a prior promise made without any intention of performing it that directly contradicts the provisions of the written contract must be distinguished from parol evidence of a contemporaneous factual misrepresentation of the terms contained in a written agreement submitted for signing. ... Misrepresentation of the terms of the written contract, in order to induce the other party to sign it, constitutes "fraud in the procurement of the instrument," which *Pendergrass* and *Fleury* recognized as an appropriate circumstance for application of the fraud exception to the parol evidence rule.
>
> ...
>
> The Supreme Court has not extended the *Pendergrass* rule to fraud committed by misrepresenting the content of a written agreement in order to induce another to sign it. Relief based on this type of fraud would not be available in every case. It would be available only when one party made a false statement about the terms contained in the contract after the written contract was prepared, and the other party reasonably relied on that statement and was thereby induced to sign the written contract without discovering that the actual provisions were not as represented. As pointed out in *Continental*, the evidence would not be admitted to alter, vary or add to the provisions of an integrated agreement; rather, it would be admitted to prove the written contract was not the actual, integrated agreement of the parties.
>
> We conclude that the *Pendergrass* court did not intend its limitation on the fraud exception to the parol evidence rule to extend beyond evidence of promissory fraud. Like the

> *Greene* court, we decline to apply its limits where the party seeking admission of the parol evidence has alleged that the other party misrepresented the content of the written contract and thereby induced execution of the contract. Plaintiffs' extrinsic evidence of the alleged misrepresentations made by defendant's representative should have been admitted in opposition to defendant's motion for summary judgment. That evidence raised a triable issue of material fact that prevented entry of summary judgment in favor of defendant on the first four causes of action of the complaint.

(*Riverisland, supra,* 191 Cal. App. 4th 61, at pp. 624-25, citation omitted.)

There is no reason for this Court to go further to resolve this appeal. Nothing in the *Riverisland* decision contravenes *Pendergrass*. Nonetheless, if this Court feels that a reexamination of *Pendergrass* is appropriate, or if one were to conclude erroneously that the false statements at issue here were a form of fraud in the inducement, there are good reasons to overrule *Pendergrass* and articulate a better approach to the issue of promissory fraud.

First of all, as Professor Corbin has noted, a contract's merger clause alone cannot preclude admission of extrinsic evidence of fraud in the inducement: "It is in no case denied that oral testimony is admissible to prove fraud, illegality, accident or mistake. This is so, *even though the testimony contradicts the terms of a complete integration in writing*." (3 A. Corbin, Corbin on Contracts, § 580 at 431 (1960), emphasis added.)

> If a written document, mutually assented to, declares in express terms that it contains the entire agreement of the parties, and that there are no antecedent or extrinsic

> representation, warranties, or collateral provisions that are not intended to be discharged and nullified, this declaration is conclusive [only] as long as it has itself not been set aside by a court on the grounds of fraud . . . [P] Such a provision as this, even though it is contained in a complete and accurate integration, does not prevent proof of fraudulent representations by a party to the contract . . . Such evidence may directly contradict the writing; but at the same time it shows the whole writing to be void or voidable, including the statement by which representations . . . are denied.

(3 Corbin on Contracts, § 578 (4th ed. 1986), at pp. 402-07 (footnotes omitted).)

"The rule against contradicting integrated writings prohibits attempts to contradict the agreements, not false statements of the facts" (*Id.* (1994 supplement), at p. 545), and a clause which provides that "there were no warranties or representations made" is "an assertion of fact . . . no more binding on [a party to the contract] than if the contract asserted that Dewey won the election of 1948 instead of Truman." (*Id.*) (See also 1 Witkin, Summary of California Law, Contracts, § 410 (9th ed. 1987), at pp. 368-69 ["A party to a contract who has been guilty of fraud in its inducement cannot absolve himself from the effects of his fraud by any stipulation in the contract, either that no representations have been made, or that any right which might be grounded upon them is waived. Such a stipulation or waiver will be ignored, and parol evidence of misrepresentations will be admitted, for the reason that fraud renders the whole agreement voidable, including the waiver provision"]; *Ron Greenspan Volkswagen, Inc. v. Ford*

Motor Land Dev. Corp. (1995) 32 Cal. App. 4th 985, 994 ["a contract clause [purporting to disclaim any prior misrepresentations] does not bar an action for fraud"].)

The Restatement (Second) of Contracts also allows parol evidence of contradictory prior representations to establish fraud or as grounds for reformation, specific performance or other remedies:

> Agreements and negotiations *prior to* or contemporaneous with the adoption of a writing are admissible in evidence to establish
>
> ...
>
> (d) illegality, fraud, duress, mistake, lack of consideration, or other invalidating cause;
>
> (e) ground for granting or denying rescission, reformation, specific performance, or other remedy.

(Rest. (Second) Contracts § 214.)

The authors of the Restatement offer these observations and examples:

> What appears to be a complete and binding integrated agreement may be a forgery, a joke, a sham, or an agreement without consideration, or it may be voidable for fraud, duress, mistake, or the like, or it may be illegal. Such invalidating causes need not be and commonly do not appear on the face of the writing. They are not affected even by a "merger" clause. ...
>
> [Illustrations:]
>
> A and B make an integrated agreement by which A promises to complete an unfinished building according to certain plans and specifications, and B promises to pay A $2,000 for so

> doing. It may be shown that, by a contract made previously with B, A had promised to erect and complete the building for $10,000; that he had not fully completed it though paid the whole price. This evidence is admissible to show that there is no consideration for B's new promise, since A is promising no more than he is bound by his original contract to perform.
>
> A and B make in integrated agreement by which A promises to sell and B promises to buy a large quantity of rifles. It may be shown that A and B had previously agreed that the rifles when bought by B should be used in fomenting a rebellion in violation of law.

(Comment, Rest. (Second) Contracts § 214; 6 Corbin on Contracts § 25.20 (Rev. Ed. 2010), at p. 280 ["The best reason for allowing fraud and similar undermining factors to be proven extrinsically is the obvious one: if there was fraud, or a mistake or some form of illegality, it is unlikely that it was bargained over or will be recited in the document. To bar extrinsic evidence would be to make the parol evidence rule a shield to protect misconduct or mistake"].)

Even this Court has had to work over the years to avoid applying the holding in *Pendergrass* to every situation. For example, in *Simmons v. California Institute of Technology* (1949) 34 Cal. 2d 264, involving false promises as to the use of royalty income, this Court made "a distinction ... between ... a parol promise ... which by its very nature is superseded by the final writing, inconsistent with it, and a promise made with no intention of performing the same, not inconsistent with the writing, but which was the inducing cause thereof." (*Id.* at p. 274, quoting *Cobbs v. Cobbs* (1942) 53 Cal. App. 2d 780, 783.) The Court struggled to admit what were clearly fraudulent promises to invalidate a contract, even though the fraudulent promise was no more reprehensible than the one in *Pendergrass*:

> [It] was directed to the matter of the use of the money, whereas the terms of the memorandum dealt with nothing more than the form of the payment of it. These promises by Dr. Clark as to the use of the royalties were the fraudulent inducement, or motive, for the contract, but they were not incorporated in or superseded by the terms of the agreement as to payment. The two are not inconsistent or "at variance," inasmuch as they deal with wholly different matters.

(*Id.* at p. 783.)

Also, while reluctantly applying *Pendergrass*, the court in *Coast Bank v. Holmes* (1971) 19 Cal. App. 3d 581, 591, found the distinction between different forms of promissory fraud as "tenuous" and "inconsistent" with tort principles, and pointed out that "recent decisions liberalizing the parol evidence rule cast some doubt on [its] continued vitality." (*Id.* at p. 592; see also *Glendale Fed. Sav. & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 Cal. App. 3d 101, 161.)

The Ninth Circuit has also shown some inclination to avoid *Pendergrass*. For example, in *Bell v. Exxon Co.* (9th Cir. 1978) 575 F.2d 714, it held:

> Although parol evidence is not available to vary the express terms of a written agreement, it is admissible to show fraudulent inducement to enter into a contract, *Bank of America v. Lamb Finance Co.*, 179 Cal. App. 2d 498, 3 Cal. Rptr. 877 (1960), "and this is true 'even though the contract recites that all conditions and representations are embodied therein,'" *Morris v. Harbor Boat Building Co.*, 112 Cal. App. 2d 882, 888, 247 P.2d 589, 593 (1952), as it does in this case.

(*Id.* at pp. 715-16.)

Decisions from other jurisdictions also recognize the admissibility of fraud in the inducement, even when they are false promises. As the court noted in *Airs Int'l v. Perfect Scents Distributions* (N.D. Cal. 1995) 902 F. Supp. 1141, 1146:

> California courts are in the minority in allowing the introduction of parole evidence only when the alleged fraud does not vary the terms of an integrated writing. "The majority rule admits the parol or extrinsic evidence even though it conflicts with the terms of the integrated written instrument." (*Touche Ross, Ltd. v. Filipek*, 7 Haw. App. 473, 778 P.2d 721, 728 (1989); see, *Pinnacle Peak Developers v. TRW Investment Corp.*, 129 Ariz. 385, 631 P.2d 540 (Ariz. App. 1980) (collecting cases); e.g., *Howell v. Oregonian Publishing Co.*, 85 Ore. App. 84, 735 P.2d 659 (1987). The California approach, and the *Pendergrass* decision in particular, has been "severely criticized by scholarly commentators", *Price v. Wells Fargo Bank*, 213 Cal. App. 3d 465, 261 Cal. Rptr. 735, 746, rev. denied (1989), most saliently in an oft-cited law review article, Sweet, "Promissory Fraud and the Parole Evidence Rule", 49 Cal.L.Rev. 877 (1961).

As the court in *Pinnacle Peak Developers v. TRW Inv. Corp.* (Ariz. Ct. App. 1980) 631 P.2d 540, 545, noted:

> A number of courts appear to follow the Restatement of Contracts § 238 (1932), n1 and allow evidence of promissory fraud, notwithstanding the parol evidence rule. See, e.g., *Ott v. Midland-Ross Corp.*, 600 F.2d 24, 28 n.4 (6th Cir. 1979); *United States v. 1,557.28 Acres of Land in Osage County, Kansas*, 486 F.2d 445 (10th Cir. 1973); *Pena v. Tampa Federal Savings and Loan Ass'n*, 363 So.2d 815 (Fla. App. 1978); Shanahan v. Schindler, 63 Ill.App.3d 82, 20 Ill. Dec. 239, 379 N.E.2d 1307 (1978); *NAG Enterprises, Inc. v. All State Industries, Inc.*, 407 Mich. 407, 285 N.W.2d 770 (1979); *Watkins v. Lorenz*, 264 Minn. 471, 119 N.W.2d 482 (1963); *Dodds v. Gibson Products Co. of W. Montana*, 593 P.2d 1022

(Mont. 1979); *Warshaw v. Hassid*, 41 A.D.2d 652, 340 N.Y.S.2d 666 (1973); *Marshall v. Keaveny*, 38 N.C. App. 644, 248 S.E.2d 750 (1978); *National Building Leasing, Inc. v. Byler*, 252 Pa. Super. 370, 381 A.2d 963 (1977); *Empire & Associates, Inc. v. Texas Contractors Rentals, Sales & Supplies, Inc.*, 567 S.W.2d 578, ref. n.r.e. (Tex.Civ.App.1978); *Negyessy v. Strong*, 136 Vt. 193, 388 A.2d 383 (1978); and *George Robberecht Seafood, Inc. v. Maitland Bros. Co.*, 220 Va. 109, 255 S.E.2d 682 (Va. 1979).

...

Other courts exclude evidence of promissory fraud which contradicts the terms of the written agreement on the basis of the parol evidence rule. See, e.g., *Bank of America National Trust & Savings Ass'n v. Pendergrass*, 4 Cal.2d 258, 48 P.2d 659 (1935); *Regus v. Gladstone Holmes, Inc.*, 207 Cal.App.2d 872, 25 Cal. Rptr. 25 (1962); *Greenwald v. Food Fair Stores Corp.*, 100 So.2d 200 (Fla., 1958); *Simmons v. Wooten*, 241 Ga. 518, 246 S.E.2d 639 (1978); *Jack Richards Aircraft Sales, Inc. v. Vaughn*, 203 Kan. 967, 457 P.2d 691 (1969); *Loughery v. Central Trust Co.*, 258 Mass. 172, 154 N.E. 583 (1927); *Dahmes v. Industrial Credit Co.*, 261 Minn. 26, 110 N.W.2d 484 (1961); *Hoff v. Peninsula Drainage Dist.* # 2, 172 Or. 630, 143 P.2d 471 (1943); *Kilgore v. Hix*, 205 Tenn. 564, 327 S.W.2d 474 (1959); and *Beers v. Atlas Assur. Co.*, 215 Wis. 165, 253 N.W. 584 (1934).

In sum, "the majority rule admits the parol or extrinsic evidence even though it conflicts with the terms of the integrated written instrument." (*Touche Ross, Ltd. v. Filipek* (Haw. Ct. App. 1989) 778 P.2d 721, 728. See also *Tusch Enters. v. Coffin* (Idaho 1987) 740 P.2d 1022, 1030 ["The parol evidence rule ... does not apply to averments of fraud, misrepresentation, mutual mistake or other matters which render a contract void or voidable"]; *Abbott v. Abbott* (Neb. 1970) 174 N.W.2d 335, 337 ["The parol evidence

rule does not prevent reception or consideration of evidence to prove promissory fraud"].)

Perhaps the most extensive discussion of the promissory fraud issue and critique of the *Pendergrass* approach, appears in Professor Sweet's oft-cited article, Sweet, *Promissory Fraud and the Parol Evidence Rule*, 49 Calif. L. Rev. 877 (1961) ("*Promissory Fraud*"), in which he described a number of problems underlying and arising out of the holding in *Pendergrass*, insofar as it excludes evidence of promissory fraud.

Professor Sweet pointed out first that viewed properly, fraud is not an *exception* to the parol evidence rule. Instead, it is a fundamental problem that prevents a valid contract from *existing in the first place*. (*Id.* at p. 877. See also *Dellcar & Co. v. Hicks* (N.D. Ill. 1988) 685 F. Supp. 679, 681 ["Both parties make reference to the fraud 'exception' to the parol evidence rule. As should be plain, this is a *non sequitur*. A showing that one was fraudulently induced into executing a contract assumes no valid contract exists, whereas application of the rule requires the existence of a valid contract"].)

Professor Sweet went on to note that the *Pendergrass* case arose from a situation where the plaintiff bank allegedly had orally informed the defendant farmer that he could wait until after his crops had come in before starting payments on his loan, when in reality the bank simply wanted him

to execute a note so they could foreclose on his property before then. He argued that this sort of chicanery should have been admitted to invalidate the contract, for several reasons:

- The decisions leading up to the *Pendergrass* decision did not support this approach; while they reached a variety of different holdings in various contexts, "there was nothing in them that would indicate a stronger rule in promissory fraud cases." (*Promissory Fraud* at pp. 881-83, citing decisions such as *Lompoc Valley Bank v. Stephenson* (1909) 156 Cal. 350; *Harrison v. McCormick* (1891) 89 Cal. 327; and *Consolidated Lumber Co. Frew* (1916) 32 Cal. App. 118.)

- The *Pendergrass* approach finds no support in the language of Civil Code sections 1572 and 1710, which both define fraud to include a "promise made without any intention to perform it." (*Promissory Fraud*, 49 Calif. L. Rev. at p. 880.)

- In an earlier decision, *Langley v. Rodriguez* (1898) 122 Cal. 580, this Court specifically recognized "a promise made without any intention of performing it" as a type of "actual fraud" that would be admissible despite the contrary terms of a subsequent written contract. (*Promissory Fraud, supra,* 49 Calif. L. Rev. at p. 882, citing *Langley, supra,* 122 Cal. at p. 581-82.)

- The authorities upon which the *Pendergrass* court relied did not support its holding. The primary case it cited, *Towner v. Lucas' Ex'r* (1857) 54 Va. (13 Gratt.) 705, a Virginia case, did not involve promissory fraud, and the passage from Wigmore upon which this Court relied, and which cited the Virginia case, likewise was not cited "to support his view that only evidence of actual fraud is exempted from the parol evidence rule." (*Promissory Fraud, supra,* 49 Calif. L. Rev. at p. 884, citing 9 Wigmore Evidence § 2439 (3d. Ed. 1940).)

In sum, Professor Sweet concluded that in *Pendergrass*, "[w]e have ... the court establishing a rule contrary to its own precedents, relying on

position of Wigmore that is contrary to the statute law in California, and citing as authority a case that does not deal with this same question." (*Promissory Fraud, supra*, 49 Calif. L. Rev. at p. 885.) He then considered some developments after the decision came down:

- The Courts of Appeal have had substantial difficulty applying the *Pendergrass* holding, some have ignored it, and some have striven to distinguish it and thus avoid its holding. (*Promissory Fraud, supra,* 49 Calif. L. Rev. at pp. 885-87, citing decisions such as *Richard v. Baker* (1956) 141 Cal. App. 2d 857; *Shyvers v. Mitchell* (1955) 133 Cal. App. 2d 569; *Palm v. Smither* (1942) 52 Cal. App. 2d 500; *Dillon v. Sumner* (1957) 153 Cal. App. 2d 639; and *Morris v. Harbor Boat Bldg. Co.* (1952) 112 Cal. App. 2d 882.)

- The majority of decisions from other jurisdictions have followed the "general rule" to the effect that "a promise made without the intent to perform it is fraud," and "most of the cases, in accord with the *Restatement*, allow evidence of promissory fraud, despite the [parol evidence] rule." (*Promissory Fraud, supra*, 49 Calif. L. Rev. at pp. 887-89, citing Prosser, Law of Torts 564 (2d Ed. 1955); Restatement, Contracts § 473 (1932); Restatement, Torts § 530 (1938), and numerous cases from various jurisdictions.)

Professor Sweet then discussed alternatives approaches to the *Pendergrass* holding. He rejected an approach that would allow a claim of promissory fraud to support only an action for rescission and restitution (but not tort damages) because, among other reasons, it is not always possible to restore the *status quo ante*, third party rights may have arisen, and those remedies alone may not be a sufficient deterrent to fraud. (*Promissory Fraud, supra*, 49 Calif. L. Rev. at pp. 899-900.)

Ultimately, he suggested that the possible remedies should include, as appropriate, rescission, reformation, specific performance and damages, but all with the safeguard that they be supported with clear and convincing evidence of fraud. (*Id.* at pp. 902-03.) He went on to endorse a multi-factor analysis of a promissory fraud claim, all treating "relief from fraud" as "the primary issue," rather than just one narrow exception to the parol evidence rule:

- "Does the evidence tend to support the charge that the fraudulent promise was made?"
- "What is the reputation of the alleged defrauding party for fair dealing?"
- "Is there any plausible reason given for the discrepancy between the claimed agreement and the writing?"
- "What is the relative bargaining power of the parties?"
- "Is it reasonable to expect the parties to have protected themselves in the writing?"
- "How compatible are the alleged oral promises and the writing?"

(*Promissory Fraud, supra*, 49 Calif. L. Rev. at p. 905.)

Professor Sweet also proffered these additional considerations:

- "What attitude is the court taking in balancing the competing social policies embodied in the law of fraud and the parol evidence rule?"
- "Is there a special need for security of writings in any given commercial transaction?"
- "How drastic a remedy is requested?"

- "Will the rights of third parties or the public be adversely affected by giving effect to the promise?"

(*Id.* at pp. 905-06.)

He urged the use of these factors as a means to (1) make "sounder predictions of whether the proffered evidence should be admitted and support a finding of fraud;" (2) "help to reconcile that many cases that ignore the parol evidence rule," because that rule "is not material to the question of promissory fraud;" and (3) "combine liberal admission of evidence [of fraud] with a heavy burden of proof." (*Id.* at pp. 906-07.)

Professor Sweet concluded with a strong condemnation of the rule in *Pendergrass*: It was "conceived in error, is unjustifiable, and should be overruled. The California experience demonstrates that even where a restrictive rule is adopted, many devices will develop to avoid its impact. Even so, it is capable of preventing the victim of fraud from obtaining relief." (*Id.* at p. 907.) Instead, he urged, "[o]nce the evidence is admitted and the fraud is shown by clear and convincing evidence, the defrauded party should have available a flexible arsenal of remedies. If justice requires, the false promise should be enforced. The focus should be placed upon the right to relief from fraud and the policies supporting that right, rather than on fraud as a minor aspect of the parol evidence rule." (*Promissory Fraud, supra*, 49 Calif. L. Rev. at pp. 907.)

To Professor's Sweet's criticisms, Plaintiffs can add only, "amen." The policies and statutes underlying fraud remedies deserve substantially more recognition and implementation than they found in the *Pendergrass* approach, which essentially deprived them of vigor and relegated fraud to the status of a dubious exception to the parol evidence rule, inspiring the Courts of Appeal to perform awkward intellectual gymnastics to avoid giving such a serious problem short shrift.

A simpler approach to the problem appears in Note, *Parol Evidence: Admissibility to Show that a Promise was Made without Intention to Perform It*, 38 Cal. Law Rev. 535 (1950), where the author pointed out the difficulty of reconciling the principle that promissory fraud may invalidate an agreement (see Civ. Code §§ 1572 and 1689), with the *Pendergrass* approach excluding fraudulent promises at variance with the writing. (*Id.* at p. 535.) The author argued that the issue should not be the admissibility of the evidence, but rather its credibility, which depends on the facts and circumstances of the particular case:

> [I]t is inconsistent to have one rule that proof of fraud vitiates the entire writing and another rule excluding evidence of fraud when it consists of a promise without intention of performance because it contradicts the writing.
>
> The parol evidence rule should not preclude the admissibility of evidence of all the circumstances preceding the execution of the writing. In deciding whether the writing is invalid, the court should consider the relative bargaining power of the parties, their relationship at the time of the execution of the

> writing, the previous negotiations on the point where the writing conflicts with the alleged oral promise, and their subsequent behavior so far as it shows reliance on the oral promise at the time of execution of the writing and whether the promise was made with no intention of performance.

(*Id.* at pp. 538-39, footnotes omitted.)

Defendant raises with this Court many arguments regarding contractual certainty and the danger of false claims, but the correct forum for such arguments is the Legislature, which enacted the statutes defining fraud and making it an explicit exception to the parol evidence rule. And as the court reasoned in *Betz Laboratories, Inc. v. Hines* (3d Cir. 1981) 647 F.2d 402, 408, "the parol evidence rule presupposes a contract binding on the party offering extrinsic evidence, and a contract tainted by fraud is void or voidable at the option of the injured party. Moreover, the possibility of perjury is insufficient to justify a restrictive approach when there exists the additional requirement that fraud be proved by clear and convincing evidence. Thus, there is a counterbalance to any uncertainty caused by the absence of a writing." (See also Civ. Code §§ 1567, subd. (3), 1568, 1689, subd. (b) (1) [fraud vitiates consent and supports rescission].)

There is ample cause to overrule *Pendergrass* and at long last give effect to the legislative intent embodied in Civil Code sections 1572 and 1689, by allowing proof of promissory fraud as a fundamental obstacle to contractual formation, with proper safeguards against false allegations.

IV.
CONCLUSION

As Defendant itself notes, "[i]t was never intended that the parol evidence rule should be used as a shield to prevent proof of fraud." (Opening Brief at p. 14, citing *Ferguson v. Koch* (1928) 204 Cal. 342, 347.) Viewed correctly, the decision of the Court of Appeal presents this Court with no new issues to resolve: Existing statutes and case law clearly support the Court of Appeal's admission of evidence of fraud in the execution. The subject misrepresentations were material and Plaintiff reasonably relied upon them.

Nonetheless, should this Court choose to go beyond the four corners of the *Riverisland* decision, it has good reason to overrule *Pendergrass* and adopt in its place a more reasoned approach that joins the Legislature and countless courts, scholars and commentators, finding it to be unjust and against public policy to prevent a party from showing that a contract was procured through fraud.

In this regard, "[t]he ways of fraud are infinite in their diversity, and if into any one of them all the law refuses to follow for the rescue of victims, it will be in the direction of that one that fraudulent devices will specially tend. It can never be either wise or safe to mark out specific boundaries within which deceits shall be dealt with, but beyond which they shall have impunity; but each case must be considered on its own facts, and

every case will have peculiarities of its own, by which it may be judged." (T. Cooley, *A Treatise on the Law of Torts* (J. Lewis ed., 3d ed. 1906), p. 934.)

More than a century after those words were written, they remain true. Some elements of the human race will always be drawn by safe havens for fraud. Yet, if it so chooses, this Court now has a vehicle to curtail the haven long afforded by the *Pendergrass* rule (despite the best efforts of the courts and commentators) of one pernicious form of fraud, that of false promises. It can use this case to give a long-stifled voice to fraud victims, while articulating safeguards to prevent the abuse of such an important recourse.

Dated: August 17, 2011

Respectfully submitted,

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CERTIFICATE OF WORD COUNT
[Cal. Rules of Court, Rule 8.204 (c)]

The text of this brief consists of 11,674 words, as counted by the word-processing program used to prepare it.

Dated: August 17, 2011

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PROOF OF SERVICE BY MAIL

Riversisland Cold Storage, Inc. v. Fresno-Madera Production, et al.
No. S190581

I declare that I am employed in the County of Los Angeles, California. I am over the age of eighteen years and not a party to the within cause; my business address is 2 North Lake Avenue, Suite 550, Pasadena, California 91101. On August 18, 2011, I served the enclosed:

ANSWER BRIEF ON MERITS

[X] **BY MAIL:** I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice, it would be deposited with the U.S. Postal Service on that same day, with postage thereon fully prepaid at Pasadena, California, in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

on the interested parties as follows:

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on August 18, 2011, at Pasadena, California.

Yvonne Allfie