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HE SAID SHE SAID: PAROL EVIDENCE OF FRAUD IS ADMISSIBLE TO PROVE THE INVALIDITY OF A CONTRACT—RIVERISLAND COLD STORAGE, INC. V. FRESNO-MADERA PRODUCTION CREDIT ASS’N

Kathryn Albergotti† and Sascha Yim††

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Like the common sense advice parents give their kids: “get it in writing,” the parol evidence rule generally does not permit the trier of fact to consider “he said, she said” testimony in a dispute regarding a written contract. On its face it seems intuitive—you are bound by the terms of your written contract. Any statements made prior to the contract and any oral statements made contemporaneously with a written contract are inadmissible to contradict the terms of such written contract. It is a rule of substantive law that results in the exclusion of extrinsic evidence. But sometimes there are valid reasons to look at prior written promises and/or contemporaneous oral promises; thus there are exceptions to the parol evidence rule.

California governs the admission of parol evidence by codification of the common law. The California Code of Civil Procedure (“Civil Code”) provides that terms set forth in a written contract cannot be contradicted by evidence of a prior agreement or a contemporaneous oral agreement. The Civil Code further provides that the execution of a contract in writing supersedes any other negotiations or stipulations related to the contract’s subject matter.

3. Id. § 1625.
In California, the exceptions to the parol evidence rule are also codified. Civil Code section 1856, subdivision (f) “establishes a broad exception to the operation of the parol evidence rule” and allows for the inclusion of evidence “[w]here the validity of the agreement is the fact in dispute.” Civil Code section 1856, subdivision (g) establishes the fraud exception. These two subdivisions of the statute together allow parol evidence of fraud to prove the invalidity of a contract. This note will further examine the exception that parol evidence of fraud is admissible to prove the invalidity of the agreement.

In 1935, the California Supreme Court in Bank of America v. Pendergrass severely limited the admissibility of oral evidence of fraud. In Pendergrass, the defendants were behind in their payments on a bank note, and a new secured note was executed. Shortly thereafter the bank foreclosed on the secured property. The defendants alleged that the bank had fraudulently induced them to sign the new secured note by orally agreeing to give them one year before they would have to make any payments. The new secured note did not contain this alleged promise and, in fact, was payable on demand. The court refused to admit the evidence of the alleged oral promise, holding that evidence to prove fraud could not be “directly at variance with the promise of the writing.”

This narrow interpretation of the fraud exception became known as the “Pendergrass rule,” or the “Pendergrass limitation.” The Pendergrass rule has been criticized, narrowly construed, and distinguished, but for the most part has been followed by California courts for seventy-five years.

In January 2013, for the first time in seventy-five years, the California Supreme Court revisited the Pendergrass rule in

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5. CAL. CIV. PROC. CODE § 1856(f).
6. Id. § 1856(g).
7. 48 P.2d 659, 662 (Cal. 1935).
8. Id. at 660.
9. Id. at 661.
10. Id. at 659.
11. Id.
12. Id. at 661.
Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Ass’n, a case with very similar facts to Pendergrass. In Riverisland, borrowers also alleged that they were induced to enter into a loan through oral misrepresentations made by the loan officer. The trial court, following the precedent of Pendergrass, granted the lender’s motion for summary judgment. The court of appeals reversed, but did so by distinguishing Pendergrass. The California Supreme Court affirmed the court of appeals and explicitly overruled Pendergrass.

Riverisland is a landmark decision which undoubtedly will have a widespread effect on the relationships and interactions between borrowers and lenders. Very few borrowers actually read their loan documents. Rather, borrowers often rely on the statements or promises made by their loan officers in entering into the transaction. Frequently, these promises are not in fact contained in the loan documents. After Riverisland, lenders will no longer be able to rely on the Pendergrass rule as a defense when making false oral promises to borrowers that contradict the terms in the loan agreements.

Riverisland will also impact other contracts, such as leases. In the shopping center business there are sometimes lengthy negotiations of a non-binding letter of intent prior to entering into a lease. Often there are terms in the letter of intent which do not make it into the lease. Also, landlord leasing agents usually give a considerable amount of information to a prospective tenant, often by email, which information also may not be reflected in the lease. After Riverisland, the trier of fact will have more opportunity to hear this extrinsic evidence, which will bring up issues as to the elements of fraud, such as whether the tenant, which may be as sophisticated as the landlord, justifiably relied on this extrinsic evidence. This is the situation in Thrifty Payless, Inc., v. Americana at

15. Id. at 318.
16. Id.
17. Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass’n, 119 Cal. Rptr. 3d 380, 391 (Ct. App. 2013), aff’d, 291 P.3d 316 (Cal. 2013). The Court of Appeal, Fifth Dist., No. F058434, reversed the trial court on the basis that Pendergrass is limited to cases of promissory fraud, holding that false statements about the contents of the agreement itself are factual misrepresentations beyond the scope of the Pendergrass rule. Id. This is an example of the tenuous distinctions which courts have been forced make in order to get around the Pendergrass rule.
18. See Riverisland, 291 P.3d at 324.
20. See id.
Brand, L.L.C., a case which followed Riverisland and which is discussed in this note.

There are several elements necessary to sustain a fraud action. This note primarily focuses on the first step in such an action, the admissibility of evidence. It then briefly discusses potential future issues proving fraud raised by the Riverisland decision and practices which may be adopted by businesses to protect themselves from a claim of fraud based on statements not reflected in the written contract.

II. HISTORY

A. The Parol Evidence Rule

The parol evidence rule, in general, “prohibits the introduction of any extrinsic evidence to alter, vary, or add to the terms of an integrated written agreement.” An integrated agreement is a writing or writings constituting a final expression of one or more terms of an agreement. Under the parol evidence rule, “the terms of a writing intended by the parties as a final expression of their agreement cannot be contradicted by evidence of either a prior agreement or a contemporaneous oral agreement.”

B. The Codification of the Parol Evidence Rule in the California Statutes

California, which is a Field Code state, has statutes that “purport[] to govern the admission of parol evidence by codifying the common law.” The parol evidence rule is codified in the Civil Code. Section 1856, subdivision (a) provides that the “[t]erms set forth in a writing intended by the parties as a final expression of

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25. The phrase “Field Code” state refers to states whose civil codes are based off of David Dudley Field’s code of civil procedure. See David Dudley Field, ENCYCLOPEDIA BRITANNICA ONLINE ACADEMY EDITION, http://www.britannica.com/EBchecked/topic/206193/David-Dudley-Field/ (last visited Nov. 3, 2013). New York enacted the Field Code in 1848, and thereafter the code was adopted in whole or in part by many other U.S. states, including California. See id.
26. 6 CORBIN ET AL., supra note 1, § 25.27.
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.” Section 1625 of the Civil Code further provides that “[t]he execution of a contract in writing, whether the law requires it to be written or not, supersedes all the negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument.”

C. The Parol Evidence Rule—Case Law

California case law has had a significant impact on the substance and interpretation of the codified parol evidence rule. In its application and treatment of the rule, case law in California has shifted considerably over the years, resulting in a shift in the overall reach of the rule. The case law has been across the board; from basically gutting the parol evidence rule and allowing the trier of fact considerable discretion in hearing extrinsic evidence, to being very restrictive in the collateral evidence that it will allow the judge/jury to hear. Corbin states: “[W]hile the statute is often cited . . . it does not seem to have had that big an effect on the California case law, perhaps because of its general terms. The provisions quoted are widely accepted, but their application gives courts considerable leeway.”

“In 1968 Chief Justice Roger Traynor . . . wrote three opinions that . . . eviscerate[d] the parol evidence rule.” But in the forty-five years since then, the California Supreme Court has retreated significantly from this position, becoming increasingly restrictive in allowing the trier of fact to hear extrinsic evidence.

28. Id. § 1625.
29. 6 Corbin et al., supra note 1, § 25.27.
30. Id. (citing Masterson v. Sine, 436 P.2d 561 (Cal. 1968); Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641 (Cal. 1968); Delta Dynamics, Inc. v. Arioto, 446 P.2d 785 (Cal. 1968)). Corbin states:

Among these three opinions, it could fairly be said that they hold that evidence of collateral contracts should be introduced fairly easily, that there is no such thing as plain meaning, and that parol evidence should be freely reviewed by the trial judge and sent to the jury if it is ‘reasonably susceptible’ of the meaning proposed for the words in the written contract.

Id.
31. Id.
In 2004, Casa Herrera, Inc. v. Beydoun affirmed the validity and necessity of the parol evidence rule, stating that “the parol evidence rule . . . results in the exclusion of evidence because extrinsic evidence of the terms of the written contract is irrelevant and cannot be relied upon.” The court went on to reiterate that the purpose of the rule is to ensure “that the parties’ final understanding, deliberately expressed in writing, shall not be changed.” Casa Herrera illustrates how California courts sought to uphold the parol evidence rule.

In the 2013 case of Julius Castle Restaurant, Inc. v. Payne, the court called the parol evidence rule a “longstanding, well-known principle that promotes fairness and predictability by encouraging parties to specify the entirety of their agreements in writing.” The court in Julius Castle Restaurant cited Masterson v. Sine, where the rule was described as a policy “based on the assumption that written evidence is more accurate than human memory,” and ‘the fear that fraud or unintentional invention by witnesses interested in the outcome of the litigation will mislead the finder of facts.’

The courts’ favoring of the parol evidence rule shows a willingness to support what are perceived to be fair and predictable outcomes. Where parties have reduced their understandings of an agreement to a written contract, it does indeed seem fair and predictable to rely only on what is contained within that written contract as evidence of the parties’ agreement. However, the courts’ strict application of the parol evidence rule may not have always allowed enough flexibility in cases where the facts fell slightly short of fraud.

D. The Exception: Permitting Parol Evidence of Fraud to Establish the Invalidity of the Instrument

There is a specific exception to the parol evidence rule that makes parol evidence of fraud admissible when used to prove the invalidity of the contract itself. Section 1856, subdivision (f) of the Civil Code “establishes a broad exception to the operation of the parol evidence rule.” Subdivision (f) provides that “[w]here the

32. 83 P.3d 497, 502 (Cal. 2004).
33. Id. at 503 (citing 2 B. E. Witkin, California Evidence: Documentary Evidence § 63, at 183 (4th ed. 2000)).
34. 157 Cal. Rptr. 3d at 850.
35. Id. (quoting Masterson, 436 P.2d at 564).
36. Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass’n,
validity of the agreement is the fact in dispute, this section does not exclude evidence relevant to that issue."37 The court in Riverisland stated that “this provision rests on the principle that the parol evidence rule, intended to protect the terms of a valid written contract, should not bar evidence challenging the validity of the agreement itself.”38 The court, citing Civil Code section 1856, subdivision (g), which provides that “[t]his section does not exclude other evidence . . . to establish . . . fraud,”39 stated that “[e]vidence to prove that the instrument is void or voidable for . . . fraud . . . is admissible.”40

The fraud exception to the parol evidence rule is a common sense one. A party who has acted fraudulently in inducing its counterpart to enter into a written contract should not be afforded the benefit of the parol evidence rule in attempting to defend its fraud. In other words, where the validity of the agreement itself is at issue, parol evidence can be admissible. The court’s application of this exception established the circumstances under which such evidence would be admissible. The circumstances under which the fraud exception would be permissible have similarly shifted in recent years.

E. The Pendergrass Rule

Seventy-five years ago in Bank of America v. Pendergrass,41 the court took considerable leeway in applying the parol evidence rule by severely narrowing the fraud exception. In 1928, the defendants in Pendergrass took over a lettuce ranch that was “subject to a trust deed securing a note in favor of the Bank of Italy subsequently becoming the Bank of America.”42 The bank also held an unsecured note from the defendants.43 In 1932, the principal on both notes remained unpaid and the parties entered into negotiations over the unpaid notes.44 The defendants alleged that

37. CAL. CIV. PROC. CODE § 1856(f) (West, Westlaw through 2013 Reg. Sess. and 1st Extraordinary Sess.).
38. Riverisland, 291 P.3d at 319.
39. CAL. CIV. PROC. CODE § 1856(g).
40. Riverisland, 291 P.3d at 319.
42. Id. at 660.
43. Id.
44. Id. at 660–61.
the bank promised them (orally) that if they would execute a new note secured by a chattel mortgage, crop mortgage, and all the property owned by the defendants which at that time was unencumbered, “they would not be required to make any payments on their indebtedness, either interest or principal, until this money came in from the 1932 crop,” and the bank would extend or postpone all payments for one year. This oral promise was not set forth in the loan documents, and the new note, in fact, was payable on demand. Within a short time after the execution of the new note and mortgages, the bank seized all the property covered by the mortgages. The defendants alleged that the note was fraudulently obtained based on the oral promise to forgive payments for one year, after which payments would be made out of crop sales. The bank did not honor this oral promise and the defendants further alleged that it had no intention of honoring such a promise.

The court reversed in part and sent the case back on remand, holding that testimony as to the alleged oral promise of the bank would not be allowed on remand. The court reasoned that the alleged oral promise of the bank was “in direct contravention of the unconditional promise [of the borrower] contained in the note to pay the money on demand.” It further held that “the rule which permits parol evidence of fraud to establish the invalidity of the instrument . . . [cannot be] a promise directly at variance with the promise of the writing.”

_Pendergrass_ established a strict adherence to the parol evidence rule in disallowing the application of the fraud exception. In holding that the fraud exception cannot be applied where an oral promise is in direct contradiction to a promise contained in a written contract, the court severely limited the fraud exception’s reach. So long as a potentially fraudulent oral statement was specifically addressed in the written contract, the counterparty to the contract could not raise an allegation of fraud. While this seems to reflect common sense (and clearly affirm the adage “read before...

45. _Id._ at 661.
46. _Id._ at 659.
47. _Id._ at 661.
48. _Id._ at 660–61.
49. _See id._ at 661–62.
50. _See id._ at 659, 661.
51. _Id._ at 661.
52. _Id._
you sign”) it may not necessarily account for inequality of bargaining power and other disparities between two parties to a contract.

F. Reactions to Pendergrass

Despite much criticism, Pendergrass survived for over seventy-five years with the courts of appeal generally following the decision, “albeit with varying degrees of fidelity.”

The primary ground for attacking Pendergrass has been that it is inconsistent with section 1856, subdivisions (f) and (g) of the Civil Code which, taken together, provide that parol evidence of fraud may be introduced to establish that a contract is invalid, and state no limitations. The Restatement provides that evidence is admissible for the purpose of proving fraud, without restriction. Most of the treatises agree that evidence of fraud is an exception to the parol evidence rule with limitation and the majority of other jurisdictions follow this traditional rule.

In Riverisland, the court engages in a lengthy criticism of Pendergrass, ranging from the fact that “its limitation on . . . fraud may itself further fraudulent practices” to the “tenuous” distinction between promises deemed inconsistent with the writing and those deemed consistent.

“In 1977 the California Law Revision Commission ignored Pendergrass when it proposed modifications to the statutory


55. RESTATEMENT (SECOND) OF CONTRACTS § 214(d) cmt. c–d (1971).


58. Id. at 320–21.
In designing revisions to the statute, the Commission identified three cases for consideration by the legislature and “[c]onspicuously omitted . . . any mention of *Pendergrass* and its . . . limitation on the fraud exception.” The Commission’s proposed revisions, which were adopted by the legislature and which were based on *Coast Bank v. Holmes*—a case strongly critical of *Pendergrass*—left the statutory exceptions relating to the validity of the agreement and fraud substantively unchanged.

*Pendergrass* also had supporters and was not completely without backing in the treatises and law reviews. In *Price v. Wells Fargo Bank* the court observed that the “broad doctrine of promissory fraud may allow parties to litigate disputes over the meaning of contract terms armed with an arsenal of tort remedies inappropriate to the resolution of commercial disputes.” A fairly recent law review comment, while critical of *Pendergrass*, nevertheless favored limiting the fraud exception’s scope for sophisticated parties.

III. RIVERISLAND

In January 2013, the Supreme Court of California overturned the seventy-five year old *Pendergrass* rule in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association*. The plaintiffs in *Riverisland*, ranchers Lance and Pamela Workman, fell behind in their loan payments to the defendant, and the parties agreed to a restructured debt agreement (“Debt Agreement”). The Debt Agreement, dated March 26, 2007, pledged eight separate parcels of real property as additional collateral and provided that if the Workmans made certain

59.  *Id.* at 321.
60.  *Id.*
64.  *Price*, 261 Cal. Rptr. at 746.
66.  291 P.3d at 316.
67.  *Id.* at 317.
specified payments, the Credit Association would take no enforcement action until July 1, 2007. The Workmans did not make the required payments, and on March 1, 2008, the Credit Association started foreclosure proceedings—which were later dismissed when the Workmans repaid the loan. The Workmans then filed an action seeking damages for fraud and negligent misrepresentation and asking for rescission and reformation of the Debt Agreement.

The Workmans alleged that before the Debt Agreement was signed, David Ylarregui, a Vice President of the Credit Association, told them that the Credit Association would extend the loan for two years in exchange for two ranches being pledged as additional collateral. The Workmans further alleged that Ylarregui reaffirmed these terms at the time the Debt Agreement was signed. As noted, the terms of the Debt Agreement provided for approximately three months, not two years, of forbearance and had eight, not two, parcels of real property as collateral. The Workmans did not read the Debt Agreement before they signed it.

The Credit Association moved for summary judgment on the basis that the parol evidence rule barred the admission of any oral evidence which contradicted the terms of the written debt agreement. The Workmans argued that the evidence of the oral promise was admissible under the fraud exception to the parol evidence rule.

Relying on the Pendergrass rule that “the fraud exception does not allow parol evidence . . . at odds with the terms of the written agreement,” the trial court granted summary judgment. The court of appeals reversed and distinguished this case from Pendergrass by reasoning that Pendergrass is limited to cases of promissory fraud (i.e., actions where a defendant fraudulently induces the plaintiff

68. Id.
69. Id. at 318.
70. Id.
71. Id.
72. Id.
73. Id.
74. Id.
75. Id.
76. Id.
77. Id.
to enter into a contract), and that this was a case of actual fraud (i.e., a promise without any intention of performing it). 78

The California Supreme Court “overrule[d] Pendergrass and its progeny, and reaffirm[ed] the venerable maxim stated in Ferguson v. Koch: ‘[I]t was never intended that the parol evidence rule should be used as a shield to prevent the proof of fraud.’” 79 The court noted that, prior to Pendergrass, cases “routinely stated without qualification that parol evidence was admissible to prove fraud,” 80 that “[h]istorically, this unconditional rule was applied in cases of promissory fraud,” 81 and that two years after Pendergrass, the court again “fell back on the old rule in a promissory fraud case.” 82 The ruling was based on the fact that Pendergrass was “plainly out of step with established California law” and was “an aberration.” 83 The court reached this conclusion after a discussion of Pendergrass and the subsequent reactions, 84 stating:

There are multiple reasons to question whether Pendergrass has stood the test of time. It has been criticized as bad policy. Its limitation on the fraud exception is inconsistent with the governing statute, and the Legislature did not adopt that limitation when it revised section 1856 based on a survey of California case law construing the parol evidence rule. Pendergrass’s divergence from the path followed by the Restatements, the majority of other states, and most commentators is cause for concern, and leads us to doubt whether restricting fraud claims is necessary to serve the purposes of the parol evidence rule. Furthermore, the functionality of the Pendergrass limitation has been called into question.

78. Id. at 318 n.3 (citing CAL. CIV. PROC. CODE § 1572(4) (West, Westlaw through 2013 Reg. Sess. and 1st Extraordinary Sess.) (defining actual fraud as “[a] promise made without any intention of performing it”); Lazar v. Superior Court, 909 P.2d 981, 985 (Cal. 1996) (“An action for promissory fraud may lie where a defendant fraudulently induces the plaintiff to enter into a contract.”); 5 B.E. WITKIN, WITKIN LEGAL INST., SUMMARY OF CALIFORNIA LAW § 781, at 1131–32 (10th ed. 2005)).

79. Riverisland, 291 P.3d at 324 (third alteration in original) (citation omitted) (quoting Ferguson v. Koch, 268 P. 342, 347 (Cal. 1928)).

80. Id. at 323.

81. Id.

82. Id. (citation omitted).

83. Id. at 324.

84. Id. at 322–25.
by the vagaries of its interpretations in the Courts of Appeal.\textsuperscript{85}

IV. CASES AFTER RIVERISLAND


In \textit{Julius Castle Restaurant Inc. v. Payne}, Julius Castle Restaurant, Inc. (“tenant”) leased from Payne (“landlord”) a historic San Francisco restaurant which had been closed for almost a year.\textsuperscript{86} The tenant’s principal was a sophisticated restaurateur with over thirty-five years of experience in the restaurant business.\textsuperscript{87} After “extensive negotiations,” the parties signed a lease and agreement “for the purchase of the restaurant’s assets.”\textsuperscript{88} Subsequent to the restaurant opening, the landlord and tenant argued over the repair of faulty equipment.\textsuperscript{89} When the restaurant failed after six months, a lawsuit ensued.\textsuperscript{90}

One of the tenant’s causes of action was based on the landlord’s alleged oral misrepresentations that the restaurant facility and equipment were in good condition and assurances that the landlord would take care of anything not in good condition.\textsuperscript{91} The terms of the lease directly contradicted these alleged oral statements, providing that the tenant had inspected the premises and all improvements, and that the tenant acknowledged that the premises and all improvements were in good condition, order, and repair.\textsuperscript{92} The lease also contained an integration or merger clause, which provided that the lease (and contract for sale of the restaurant’s assets) constituted the sole agreement between the landlord and tenant with respect to the premises, and that any

\textsuperscript{85} Id. at 322.
\textsuperscript{86} 157 Cal. Rptr. 3d 839, 841 (Ct. App. 2013).
\textsuperscript{87} Id.
\textsuperscript{88} Id. at 844.
\textsuperscript{89} See id. at 845–48.
\textsuperscript{90} Id. at 841.
\textsuperscript{91} Id. at 842.
\textsuperscript{92} Id. at 841–42.
representations regarding the premises not expressly set forth in the lease were void. 93

Based on Riverisland, the trial court admitted the parol evidence of the alleged oral misrepresentations, and the jury found in favor of the tenant on the misrepresentation claims. 94 The appellate court concluded that, in light of Riverisland, the parol evidence was properly admitted at trial under the statutory exception for fraud.

On appeal, the landlord argued that “even under Riverisland, the fraud exception to the parol evidence rule is not applied to agreements entered into by sophisticated parties after extensive negotiations.” 96 In support of its argument, the landlord asserted that the supreme court in Riverisland relied on authorities holding forth a rule that “sophisticated parties can rarely invoke the fraud exception.” 97 The appellate court disagreed, stating:

While the court may have cited to authorities that discuss a potential exception for sophisticated parties, defendants’ premise is unsupported by the language of the opinion itself. To the contrary, the court decisively overruled Pendergrass . . . the court did not shield sophisticated parties from the reach of its holding . . . . In our view . . . our high court sought . . . to create certainty and consistency by eliminating altogether the judicially created exception to section 1856, subdivision (g). We also note that the plaintiffs in Riverisland appear to have been relatively sophisticated business people.

The landlord also argued on appeal that Riverisland is “strong medicine” and should be applied only in “contracts of adhesion where there is a disparity in bargaining power.” 99 The appellate court also disagreed with this argument, stating that “[a]gain, the court did not limit its holding to contracts of adhesion and we decline to read such a limitation into the decision.” 100 The appellate court advised that “[i]n the post-Riverisland world, parties would be

93. Id. at 842.
94. Id. at 849.
95. Id. at 852–53.
96. Id. at 852 (internal quotation marks omitted).
97. Id.
98. Id.
99. Id. at 853.
100. Id.
better served in addressing the heightened burden of proving fraud in a civil action.”

B. Bertino & Associates v. R L Young, Inc.: The United States District Court for the District of New Jersey, Applying California Law, Holds That the Parol Evidence Rule Does Not Apply to Subsequent Agreements.

In August of this year, in Bertino & Associates v. R L Young, Inc., the U.S. District Court for the District of New Jersey, applying California law, cited Riverisland in holding that the parol evidence rule does not apply to oral agreements made subsequent to the final written agreement.

On July 6, 2010, Bertino and Young entered into a written agreement (“Agreement”) “whereby Bertino agreed to provide [to Young] certain consulting [s]ervices” related to the expansion of Young’s business (“Services”). The Agreement provided for a one-year term, renewable annually, “unless either party terminated.” Bertino alleged that he and Young had actually agreed to a five-year term, but that he signed the Agreement anyway based on oral assurances made by Mike Kurz, Young’s Chief Financial Officer, that “as long as Young’s expansion . . . was successful, the Agreement[]” would be for five years. Bertino further alleged that Kurz reiterated these same assurances after the Agreement was signed.

The Agreement provided that it would be “governed by the laws of the State of California.” It also contained an integration or merger clause, which provided that the Agreement was the entire agreement between the parties concerning the Services, that it superseded all previous contracts concerning the subject matter, and that no modification or waiver of the Agreement would be effective unless in writing signed by the parties. “On July 6, 2011, the Agreement automatically renewed for another one-year

101. Id. at 852.
103. Id. at *2 (internal quotation marks omitted).
104. Id. at *5.
105. Id.
106. Id. at *19.
107. Id. at *6.
108. Id.
On “March 23, 2012, Young informed Bertino that it intended to terminate the Agreement effective April 1, 2012,” and Young did terminate the Agreement.

In the resulting lawsuit, one of Bertino’s claims was that the term was for five years, based on the fact that Young had orally agreed, both before and after Bertino executed the Agreement, that the term would be five years. “Young argue[d] that the Agreement’s integration clause precludes, as a matter of law, any conclusion that the term . . . was five years” based on such oral statements. The Bertino court, citing Riverisland and California’s parol evidence rule, held that evidence of the five-year term would not be barred at this stage of the proceedings. The court based its holding on the conclusion that the parol evidence rule bars evidence of oral agreements reached before or simultaneously with the written agreement, and this was a subsequent agreement.


In a case decided in July 2013, Groth-Hill Land Co. v. General Motors L.L.C., the defendants argued that the plaintiffs were barred from raising alleged oral promises which contradicted the terms of the written contracts. This case involved two plaintiffs, both defunct, family-owned General Motors car dealerships. The dealerships fell into financial difficulties in 2008 and became delinquent on their inventory loans with one of the defendants,
Ally Financial Inc. ("Ally"), a division of General Motors.\(^{119}\) Ally provided the inventory financing to the dealerships.\(^{120}\)

In the promissory fraud claim, the plaintiffs alleged that one of the defendants, Kevin Wrate, the director of sales for Ally, made false oral promises to them on the phone.\(^{121}\) According to the plaintiffs, Wrate said that Ally would not terminate its inventory financing plan with them if the plaintiffs executed personal guarantees for their delinquent inventory loans.\(^{122}\) Such guarantees were to be secured by pledging certain real property to Ally and selling property with the proceeds going to Ally.\(^{123}\)

The defendants claimed that the parol evidence rule barred the evidence of the oral promises by Wrate, “which directly contradict the terms of the written agreements” between the parties.\(^{124}\) The court agreed, stating that the “[p]laintiffs do not attack the validity of the written agreements.”\(^{125}\) The court, citing Riverisland,\(^{126}\) stated that the “[p]laintiffs are correct that a fraud exception to the parol evidence rule permits the use of extrinsic evidence to attack the validity of an integrated written agreement.”\(^{127}\) However, the court distinguished this case from Riverisland, stating that the “[p]laintiffs in their promissory fraud claim do not attack the validity of [the agreements]” but instead “seek to recover based on promises [the Defendant] allegedly made to them over the phone, promises which run counter to the terms of the written contracts.”\(^{128}\) The court stated that “[t]he fraud exception to the parol evidence rule does not apply in these circumstances; the parol evidence rule does.”\(^{129}\) Accordingly, the court found that the promissory fraud claim was based on these alleged oral promises and dismissed the claim with prejudice.\(^{130}\)

\(^{119}\) Id. at *3–4.
\(^{120}\) Id. at *2–4.
\(^{121}\) Id. at *43–44.
\(^{122}\) Id.
\(^{123}\) Id.
\(^{124}\) Id. at *44.
\(^{125}\) Id. at *47.
\(^{126}\) Id. at *48 (citing Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass’n, 291 P.3d 316, 318–19 (Cal. 2013)).
\(^{127}\) Id.
\(^{128}\) Id. at *48–49.
\(^{129}\) Id. at *49.
\(^{130}\) See id.
D. Thrifty Payless, Inc. v. Americana at Brand, L.L.C.: *Extrinsic Evidence Is Admissible to Establish Fraud or Intentional or Negligent Misrepresentation in the Face of the Lease’s Integration Clause.*

*Thrifty Payless, Inc. v. Americana at Brand, L.L.C.*, 131 decided in August 2013, involved a shopping center landlord who allegedly made fraudulent prior written promises to a retail tenant that contradicted the terms of the lease.

Plaintiff Thrifty Payless (“tenant”) d/b/a Rite Aid was a tenant of Americana at Brand’s (“landlord”) shopping center in Glendale, California. 132 Prior to the development of the shopping center and the execution of the lease, the parties negotiated the basic terms to be included in the lease through an exchange of a letter of intent (LOI). 133 The LOI stated the landlord’s per square foot estimate of the tenant’s probable pro rata share of property taxes, insurance, and common area maintenance (CAM), and estimated CAM at $14.50 per square foot. 134 In the final draft of the LOI, the tenant crossed out the estimate and wrote in, “Budget to be provided to tenant prior to lease execution.” 135 Prior to the execution of the lease, the landlord provided the tenant with a detailed breakdown of CAM in a letter which stated, “I have . . . attached our preliminary CAM budget for your eyes only, so that you may be armed with necessary explanations as to CAM costs. Please remember that the costs reflected are purely estimated values.” 136 The breakdown showed CAM estimated at $14.35 per square foot. 137 The fully executed lease provided that the tenant would pay its pro rata share of CAM, and did not mention the estimates set forth in the LOI or the breakdown letter. 138 The first year that the tenant was obligated to pay its share of taxes, insurance, and CAM, the tenant’s share of these expenses was more than double the amount set forth in the LOI and the breakdown letter. 139 The
tenant sued the landlord seeking damages and rescission, and alleging, among other things, fraud.140

Based on the integration clause in the lease, the landlord argued that all prior negotiations, including the LOI and the breakdown letter, were inadmissible.141 The tenant countered that the prior writings were admissible to show fraud, notwithstanding the integration clause.142 On the issue of the parol evidence rule, the court cited Riverisland143 and stated that “an established exception to the [parol evidence] rule allows a party to present extrinsic evidence to show that the agreement was procured by fraud.”144 The court stated,

Here, under Riverisland, extrinsic evidence is admissible to establish fraud or negligent misrepresentation in the face of the lease’s integration clause. Thus, [the tenant] can allege both intentional and negligent misrepresentations based upon [the landlord]’s grossly inaccurate estimates.

Further, [the tenant] had adequately pleaded facts to show its reliance was reasonable given the parties’ previous dealings . . . and because [the landlord] had superior knowledge and information . . . .145

The court held that “[t]he trial court therefore erred in sustaining [the landlord]’s demurrer to [the tenant]’s . . . causes of action for fraud and negligent misrepresentation, and [the tenant] should be permitted to amend its complaint to set forth additional facts supporting these claims.”146

V. THE POST-RIVERISLAND WORLD

Riverisland will undoubtedly inspire due care in regard to oral statements when entering into a written contract. Before Riverisland, loan officers eager to close more loans may have felt protected in making oral misrepresentations, confident in the knowledge that very few borrowers actually read their loan

140.  Id. at 722–23.
141.  Id. at 724.
142.  Id.
143.  Id. at 726 (citing Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass’n, 291 P.3d 316 (Cal. 2013)).
144.  Id.
145.  Id. at 727–28 (citation omitted).
146.  Id. at 728.
documents. Given that at least the first barrier to proving fraud, the admissibility of the extrinsic evidence, has now been lessened, lenders may be more reluctant to undertake such a practice.

As allegations of contemporaneous oral and prior written misrepresentations—which may not have been admissible previously—will be increasingly considered, Riverisland may result in more cases addressing the justifiable reliance element of fraud. Courts may now be confronted with the issue of whether it is reasonable to rely on prior written or contemporaneous oral representations directly contradicted by, or not addressed at all, in the written agreement.

The California Supreme Court in Riverisland discussed the difficulty in establishing promissory fraud and the requisite element of proof of intent not to perform. The court stated “[i]t is insufficient to show an unkept but honest promise, or mere subsequent failure of performance.” The court stressed that “promissory fraud, like all forms of fraud, requires a showing of justifiable reliance on the defendant’s misrepresentation.” The court, noting that the defendants alleged that “the Workmans failed to present evidence sufficient to raise a triable issue on the element of reliance, given their admitted failure to read the contract,” declined to address the issue of reliance in the first instance, as neither the trial court nor the court of appeals reached the issue of reliance.

The court in Julius Castle Restaurant stated that “[a] party claiming fraud in the inducement is still required to prove they relied on the parol evidence and that their reliance was reasonable.” The court noted that “[i]n the present case, the burden was on plaintiffs to prove that, notwithstanding both the Lease’s integration clause and the ‘as is’ language with respect to the restaurant equipment, they reasonably relied on Payne’s prior oral assurances in entering into the agreements.”

While the court in Julius Castle Restaurant rejected the argument that the fraud exception to the parol evidence rule

147. Riverisland, 291 P.3d at 325.
148. Id. at 325 (citing Tenzer v. Superscope, Inc., 702 P.2d 212 (Cal. 1985)).
149. Id. (citing Lazar v. Superior Court, 909 P.2d 981, 984 (Cal. 1996)).
150. Id.
152. Id.
should not be “applied to agreements entered into by sophisticated parties after extensive negotiations,” it left open the issue of how much weight the trier of fact may give to the relative sophistication of the parties and extent of negotiations in determining justifiable reliance. The court advised that “in the post-Riverisland world, parties would be better served in addressing the heightened burden of proving fraud in a civil action.” One of the elements in the heightened burden of proving fraud is whether the party claiming that it relied on the fraudulent parol evidence was justified in such reliance. This element takes on a different light when all parties are experienced in the business being transacted and all parties use skillful lawyers who negotiate the agreement over a considerable time and co-draft numerous revisions.

Even in situations where the parties are equally sophisticated and where experienced lawyers conduct extensive negotiations and co-draft the contract, one party may have more experience in the particular matter at issue or may have information to which the other party does not have access. Under these circumstances, it may be justifiable for the party without such particular experience or access to such information to rely on prior writings or contemporaneous oral representations.

In Thrifty Payless, Inc. v. Americana at Brand, L.L.C., the party claiming fraud was Thrifty/Payless, Inc. d/b/a Rite Aid, a multi-billion dollar company with over three thousand drug stores: clearly a sophisticated business operator. Most likely both the landlord and tenant used experienced real estate attorneys, with particular expertise in shopping center leases and CAM issues, to negotiate the lease. The LOI was negotiated over a three-month period. The time between the final LOI and the final lease, which contained a merger/integration clause, was about nine months. Thus, both parties were equally sophisticated business entities whose experienced attorneys not only read the lease but most likely co-drafted it. The issue came down to Americana’s particular

153.  Id. at 852.
154.  Id. at 853.
155.  Id. at 852.
156.  Witkin, supra note 78, at 1121.
160.  Id.
expertise in developing and managing shopping centers and access to specific knowledge about this project and similar projects built by Americana to which Thrifty did not have access.

Thrifty asserted that “its reliance was reasonable based on Americana’s superior knowledge and experience building and operating shopping centers of similar size and scope; because Americana was familiar with the level of common area services to be provided, the terms of other leases contemporaneously being negotiated, the insurance policies to be obtained.” The court, citing Furla v. Jon Douglas Co., stated that “[a] statement couched as an opinion, by one having special knowledge of the subject, may be treated as an actionable misstatement of fact.” The court found: Thrifty had adequately pleaded facts to show its reliance was reasonable given the parties’ previous dealings . . . and because Americana had superior knowledge and information: Americana likely had a better understanding of how the property would be assessed for tax purposes and what insurance coverage would cost; such knowledge would form the basis of its share of calculations for its tenants, and as an owner and manager of other shopping malls, could better calculate the cost of running the common facilities. Since Americana had all or most of the information regarding the unfinished shopping center, Thrifty was not in a position to discover for itself a close approximation of the ultimate common costs.

Landlords may want to be more careful when making statements in a LOI or in e-mails that are not ultimately incorporated into the lease, but that tenants may claim they relied upon. In Thrifty Payless, the estimates were so far from the actual CAM amounts as to lead credence to the claim of fraud. Landlords may also want to look carefully at the language of the integration/merger clause. There may be ways to draft these clauses to give them more weight.

Some shopping center owners have implemented strategies for dealing with potential allegations of oral or written representations made outside of the lease by having tenants sign a separate statement, outside of the lease, confirming that the leasing

161. Id. at 723.
162. Id. at 727 (citing Furla v. Jon Douglas Co., 76 Cal. Rptr. 2d 911, 917 (Ct. App. 1998)).
163. Id. at 728.
representatives have not made any promises or representations concerning sales volumes, occupancy, exclusives, tax estimates, estimates of common area maintenance costs (where they are not fixed), and similar matters not addressed in the lease. This type of separate statement may be helpful to the trier of fact in determining the veracity of a “he said she said” claim made by a tenant. The trier of fact should give more weight to such a separate statement than to a merger/integration clause, which is usually in the boilerplate portion of the lease and may not be focused upon in the lease negotiation process. If there is a merger or integration clause in the agreement, any such separate statement should probably be dated after the date of the lease so that it is clearly a subsequent writing. The following is an example of what such a separate statement might look like in a shopping center leasing transaction:

TENANT CERTIFICATION
The undersigned (“Tenant”) has entered into a lease prior to the date hereof (“Lease”), with ______________ (“Landlord”), for premises particularly described in the Lease (“Premises”) which Premises are located in a shopping center particularly described in the Lease (“Center”). The business terms of the Lease were negotiated solely with __________ as a representative of Landlord (“Landlord Representative”). Tenant certifies to Landlord that neither the Landlord Representative nor any other representative, agent or employee of Landlord represented, promised or implied any of the following (except as expressly provided in the Lease): (i) that Tenant would be given an exclusive use in the Center, or (ii) that Landlord would not lease space in the Center to a competitor of Tenant or to another tenant with the same or similar use as Tenant; or (iii) that a certain tenant would become or remain an occupant of the Center, or (iv) that the number of occupants open at the Center would remain at a certain level, or (v) that Tenant will be able to achieve a certain sales amount, or (vi) that taxes and/or common area charges would be at a specified amount (Tenant acknowledging that estimates of same may not reflect actual amounts).
VII. APPLICATION TO MINNESOTA

Riverisland has lessened the initial barrier to bringing a fraud case to trial in California by allowing, in more instances, extrinsic evidence of fraud to be heard by the trier of fact. The issue of reasonable reliance on that extrinsic evidence will be litigated more often in California, and these cases may have an impact on Minnesota law. In determining reasonable reliance, it is likely that courts will consider the weight to give an integration/merger clause, the sophistication of the parties, the experience and superior knowledge of the parties in the particular area at issue, and the inequality of bargaining power. Riverisland and the cases following or distinguishing Riverisland may impact the way the business community in Minnesota handles the contract negotiation process. Businesses in Minnesota may want to adopt new policies to protect themselves from a claim of fraud based on statements not reflected in the written contract, such as the separate tenant certification set forth above.

While the full extent and impact of Riverisland remains to be seen, it is a pivotal case that already has affected business as usual in California and will likely affect business in Minnesota as well.