# California Supreme Court Weakens Integration Provisions In Contracts

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In *Riverisland Cold Storage v. Fresno-Madera Production Credit Union*, the California Supreme Court dealt a serious blow to the enforceability of integrated written contracts (that is, written contracts that are the final expression of the terms of the parties' agreement) by eliminating a long-standing limitation on the fraud exception to the parol evidence rule.

The parol evidence rule upholds the integrity of integrated contracts. That rule provides that "the terms contained in an integrated agreement may not be contradicted by prior or contemporaneous agreements," and such evidence is "irrelevant as a matter of law." *Casa Herrera v. Beydoun*.

Put another way, when a "writing becomes the final contract between the parties, [it] may not be contradicted by even the most persuasive evidence of collateral agreements. Such evidence is legally irrelevant." *EPA Real Estate Partnership v. Kang*. This rule "prohibits the introduction of extrinsic evidence – oral or written – to vary or contradict the terms of an integrated written instrument." *Id.*

However, for nearly as long as the parol evidence rule has protected the integrity of integrated contracts, there has existed a "fraud exception," which allows parties to attempt to invalidate contracts if they can show that they were induced to enter into the contract by false promises in the negotiations leading up to signing the contract.

Recognizing the danger that this fraud exception poses to the ability of parties to rely on the written terms of their contracts, California law, for over 75 years, has severely limited this fraud exception.

Specifically, in 1935, the California Supreme Court in *Bank of America v. Pendergrass* ruled that parties may not argue in court that they were induced to enter into a contract based on promises that are "directly at variance" with the terms of the integrated agreement.

In *Pendergrass*, the plaintiff sought to introduce into evidence an oral promise allegedly made by the bank to induce him to sign a promissory note. The alleged promise was that he need not pay under the promissory note until certain funds were received from the sale of a crop. Because the alleged promise directly contradicted the terms of the note calling for repayment, the alleged promise was therefore barred by the parol evidence rule.

And California courts have been following *Pendergrass* ever since. But on January 14, 2013, the California Supreme Court decided *Riverisland*.

In *Riverisland*, a bank entered into an integrated contract with a borrower to restructure the debt and forebear on collection efforts for three months. It was undisputed that the borrowers did not read the contract and simply signed it. The borrowers defaulted, and the bank recorded a notice of default. The borrowers eventually brought the loan current and the bank dismissed the foreclosure proceedings.

The borrowers then sued the bank for fraud, arguing that during the negotiations leading up to the signing of the forbearance agreement, a bank representative told them that the forbearance period would be two years -- not three months. The bank filed and the trial court granted a motion for summary judgment in favor of the bank. The trial court, relying on *Pendergrass*, held that the borrowers were prevented from making this argument because it was directly at odds with the express terms of the deal.

The California Supreme Court felt differently, believed that the *Pendergrass* rule could be used to “shield fraudulent conduct,” overruled *Pendergrass*, and held that the borrowers should have been allowed to argue that the actual agreement was to forebear for two years -- not merely the three months expressly provided in the written contract signed by the borrowers.

The result is that the bank must now go back to the trial court for a trial on whether the bank fraudulently induced the borrower to enter into a forbearance agreement for the delayed repayment of the initial loan.

While the *Riverisland* decision makes it easier for parties to get out of written contracts they no longer find attractive, it is by no means a free pass, and the *Riverisland* court “stressed” that parties must still prove all the elements of fraud, including intent to deceive and reliance on the fraudulent promise.

In the wake of *Riverisland*, companies might consider making the important contractual provisions especially conspicuous, by highlighting them bold, in all capital letters, or having the other party initial those provisions separately. These steps can help reduce the other party’s ability to argue that the deal was really something entirely different than what the parties signed.