# Is The *Pendergrass* Rule Greener On The Other Side?: The Need For Strict Limits On Promissory Fraud Claims After *Riverisland*.

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## I. OVERVIEW.

In 1935, the California Supreme Court held in *Bank of America Nat'l Trust & Sav. Ass'n v. Pendergrass*, 48 P.2d 659 (Cal. 1935) (*Pendergrass*) that when parol evidence is offered to prove a contract is tainted by fraud, the evidence "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*." *Id.* at 661 (emphasis added). The Court held that a party to a promissory note could not introduce evidence that the other side orally made fraudulent promises (promises it never intended to perform), because those purported promises directly contradicted the note's express terms. *Id.* at 661-62. In essence, the Court applied parol-evidence-rule principles to a tort claim for promissory fraud.

The *Pendergrass* rule was California law for almost eight decades, from before World War II through 2012. In 2013, however, the California Supreme Court overruled *Pendergrass* in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Ass'n*, 291 P.3d 316 (Cal. 2013) (*Riverisland*). The decision caught most practitioners and pundits by surprise — many assumed that the Court granted review to address a loophole in the *Pendergrass* rule that distinguished between promissory fraud and factual misrepresentations regarding an agreement's contents.[2] Instead, the Court tossed the *Pendergrass* rule on the legal trash-heap. Not only did it reject the rule, it expressly overruled several Court of Appeal decisions that described the rule as promoting sound public policy.[3] It also implicitly overruled decades of additional decisions that had applied

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[2] In *Pacific State Bank v. Green*, 1 Cal. Rptr. 3d 739 (Cal. Ct. App. 2003), the Court of Appeal construed the *Pendergrass* rule as barring only pre-contract promises that directly contradict a contract's written terms, not factual misrepresentations about what terms are in a contract. *Id.* at 752. The Court of Appeal in *Riverisland* had applied *Green*'s limitation of the *Pendergrass* rule to admit evidence that the defendant misrepresented a loan forbearance agreement would last two years and include only two orchards as additional security, when the contract actually specified a shorter period and additional collateral. *See Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Ass'n*, 119 Cal. Rptr. 3d 380, 382, 389-90 (Cal. Ct. App. 2011), opinion superseded.

[3] *See Riverisland*, 291 P.3d at 322, discussing the following "defenders" of the *Pendergrass* rule: *Price v. Wells Fargo Bank*, 261 Cal. Rptr. 735, 746-47 (Cal. Ct. App. 1989) (bank's alleged fraudulent promise "to beat the terms" of another bank impermissibly varied the interest rates in integrated loan agreement), *Duncan v. The McCaffrey Group, Inc.,* 133 Cal. Rptr. 3d 280, 303 (Cal. Ct. App. 2011) (alleged fraudulent promise that development would contain only custom homes impermissibly contradicted development agreement reserving right

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the rule to bar fraud claims resting on alleged false promises that contradicted written contract terms.[4] Seventy-eight years of case law rendered irrelevant in an instant. We are now in uncharted waters.

Why uncharted waters? Because the *Riverisland* decision raises more questions than answers, shifting the public-policy debate it purported to resolve to new battlegrounds: the proper standards for *proving Pendergrass*-type promissory fraud claims and the proper *remedies* for such claims. Although over four years have passed since the *Pendergrass* rule's abrogation, the questions left open by *Riverisland* remain unanswered.

*Riverisland* merely establishes that promissory fraud claims are not categorically barred whenever an alleged promise contradicts the terms of a written contract. But *Riverisland* declined to resolve what standards of proof will govern the case-by-case analysis that now necessarily determines the viability of *Pendergrass*-type fraud claims. In particular, the Court expressly refused to resolve whether the *Riverisland* plaintiff's failure to read the disputed contract would impact his ability to prove he justifiably relied on the alleged false promise, a required element of any fraud claim. *See Riverisland*, 291 P.3d at 325. Until the Supreme Court conclusively resolves the myriad proof questions that *Riverisland* leaves unresolved and pushes to center stage, we will not know whether the *Riverisland* regime better serves California public policy than the *Pendergrass* rule.

As shown below, the grass will be greener if courts impose uniform, strict standards for proving *Pendergrass*-type promissory fraud claims that accommodate the public policy predicates for the *Pendergrass* rule. *Riverisland* concluded, among other things, that the *Pendergrass* rule swept too broadly by immunizing fraud and by spawning a host of

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[3](...continued)
to build tract homes), *Banco Do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. 870, 892 (Cal. Ct. App. 1991) (alleged fraudulent pre-contract promise to provide $2 million dollar line of credit impermissibly contradicted integrated guaranty agreement).

[4] *See, e.g., Wang v. Massey Chevrolet*, 118 Cal. Rptr. 2d 770, 774 (Cal. Ct. App. 2002) (pre-contract promise that defendant could pay off loan in two months or any time without a prepayment penalty and that loan did not differ from lease; loan contract contained substantial early-payment penalty); *Alling v. Universal Manufacturing Corp.*, 7 Cal. Rptr. 2d 718, 734 (Cal. Ct. App. 1992) (pre-contract promise to fund a particular business plan; integrated purchase agreement gave defendant "sole right to determine" what resources to invest); *West v. Henderson*, 278 Cal. Rptr. 570, 572-73 (Cal. Ct. App. 1991) (pre-contract representations that lease would be for 5 years, certain party would be guarantor, and business sign would be erected; integrated lease provided for 15-year term, specified different party as guarantor, and required landlord's written consent to any sign); *Continental Airlines, Inc. v. McDonnell Douglas Corp.*, 264 Cal. Rptr. 779, 794, 796 (Cal. Ct. App. 1989) (pre-contract promise that fuel tank "will not rupture"; contract stated fuel tank was "not likely to rupture"); *Bernstein v. Financial Indem. Co.*, 69 Cal. Rptr. 543, 546-47 (Cal. Ct. App. 1968) (pre-contract representations that agency would not be terminated; integrated contract stated agency was terminable at will); *Bank of America Nat'l Trust & Sav. Ass'n v. Lamb Finance Co.*, 3 Cal. Rptr. 877, 880-81 (Cal. Ct. App. 1960) (pre-contract representation guarantee would not cover plaintiff's personal property; integrated note plaintiff signed as guarantor covered that property); *Kronsberg v. Milton J. Weshow Co.*, 47 Cal. Rptr. 592, 595-96 (Cal. Ct. App. 1965) (pre-contract representations that particular individual would conduct auction and that a particular loan commitment had been obtained; integrated agreement only specified that a corporation would conduct the auction and that the loan commitment was to "a qualified borrower"); *Cobbs v. Cobbs*, 128 P.2d 373, 375 (Cal. Ct. App. 1942) (pre-contract promise not to enforce alimony contract if plaintiff remarried; integrated alimony agreement permitted enforcement despite remarriage); *see also Brinderson-Newberg Joint Venture v. Pacific Erectors*, 971 F.2d 272, 277, 281 (9th Cir. 1992) (pre-contract assurances that contract only required picking and setting of equipment contradicted written agreement requiring complete erection of equipment).

confusing, contradictory decisions by courts facing factual scenarios where the rule seemed too harsh. Those, without question, are legitimate concerns. In essence, *Riverisland* reasonably replaced the harshness of an overly broad categorical bar with a case-by-case approach that avoids a blanket immunity for pre-contract fraud.

But eliminating that categorical bar also potentially creates problems. Businesses cannot assess their business risks accurately if they cannot rely on written contract terms as defining their rights and obligations. Once a contract turns out to be a bad bargain, a strong incentive exists for disgruntled parties to fabricate inconsistent pre-contract promises or to misremember pre-contract negotiations. Memories are fallible. Oral evidence is more suspect than documentary evidence. Fraud is not a one-way street. That's why, in a perfect world, contracting parties will always put *in writing* all deal terms and all representations on which they are relying — an ideal the now-defunct *Pendergrass* rule furthered.

Business interests and California public policy will suffer if courts couple *Riverisland*'s liberal rule for admitting fraud evidence with liberal standards for *proving* fraud that encourage unfounded fraud claims and discourage parties from reading contracts. Until the Supreme Court resolves the proof and remedy issues left open by *Riverisland*, the decision may engender the same appellate inconsistency and confusion that plagued California under the *Pendergrass* rule. So *Riverisland* is merely the beginning chapter, not the end, to what may be a long story as these issues percolate through the appellate process.

The standards that will ultimately emerge from the appellate crucible cannot be predicted with certainty. Over four years have passed since *Riverisland*'s issuance, and appellate courts have said next to nothing about the issues that the Supreme Court left unresolved. Instead, this article offers a personal view as to where the courts *should* head: In short, the *Pendergrass* rule may be gone, but its policy predicates should not be forgotten. Courts can — and should — accommodate the legitimate policy considerations that supported the rule within the case-by-case evidentiary analysis that governs promissory fraud claims after *Riverisland*, particularly the requirement of justifiable reliance. They can further accommodate public-policy concerns by restricting the remedies available for *Pendergrass*-type fraud claims. Public policy compels a *balanced* approach — one that rejects the harshness of the *Pendergrass* rule's categorical bar but equally recognizes that a free-for-all approach of sending all promissory fraud claims to juries is just as dangerous.

To achieve such balance, it is necessary to understand both sides of the scale. Section II below thus analyzes the *Pendergrass* rule from a policy perspective, both the good *and* the bad. Section III discusses how those competing concerns can be accommodated and reconciled in this post-*Pendergrass* world. And, finally, Section IV offers tips for negotiating contracts and litigating fraud claims in a world bereft of the

*Pendergrass* rule. Informed by these considerations, the *Pendergrass* rule can indeed be greener on the other side.

## II. THE *PENDERGRASS* RULE: A POLICY PERSPECTIVE.

### A. Policy Considerations Supporting The *Pendergrass* Rule.

The *Pendergrass* decision was thin on policy analysis, particularly for a case of such importance. *See Pendergrass*, 48 P.2d at 661-62. But make no mistake: The *Pendergrass* rule was a policy choice.

As defenders of the rule have explained, the Supreme Court "made a very defensible policy choice which favored the considerations underlying the parol evidence rule over those supporting a fraud cause of action." *Banco Do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. at 892; *accord, Duncan v. The McCaffrey Group*, 133 Cal. Rptr. 3d at 296-97 (the *Pendergrass* rule is "properly characterized . . . as a rational policy choice . . . by the Supreme Court when faced with a conflict between contract principles and tort principles"); *Price v. Wells Fargo Bank*, 261 Cal. Rptr. at 746 (*Pendergrass* "represents a rational policy choice" and "is based on an entirely defensible decision favoring the policy considerations underlying the parol evidence rule over those supporting a fraud cause of action").

The parol evidence rule, codified in Code of Civil Procedure section 1856, prohibits the introduction of extrinsic evidence — including evidence of prior or contemporaneous oral agreements — to vary, alter or add to the terms of an integrated written agreement. *Riverisland*, 291 P.3d at 319.[5] But the statutory fraud exception provides that the parol evidence rule "does not exclude other evidence . . . to establish . . . fraud." Cal. Civ. Proc. Code § 1856(g).

In *Pendergrass*, the Supreme Court concluded that this fraud exception would sweep too far if used to permit evidence of false promises that squarely contradict a contract's express terms. Although the decision's public-policy analysis is sparse, the Court did recite parol evidence precedent for the principle that allowing such promissory fraud claims would "'open the door to all evils that the parol evidence rule was designed to prevent.'" *Pendergrass*, 48 P.2d at 662 (citation omitted). The Court also noted that when a party makes promises in conjunction with a contract's execution, the other side can guard against fraud by insisting that the contract contain those promises. *Id.*

[5] An integrated written agreement is "a complete and final embodiment of the terms of an agreement," an instrument intended to be a final expression of the parties' agreement. *Masterson v. Sine*, 436 P.2d 561, 563 (Cal. 1968); *accord, Riverisland*, 291 P.3d at 318. Under Code of Civil Procedure section 1856, the "[t]erms set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms included therein may not be contradicted by evidence of a prior agreement or of a contemporaneous oral agreement." *Id.*, subd. (a).

That, however, essentially sums up the Court's entire policy analysis. Not exactly earthshaking. As a result, subsequent courts had to pick up the slack in terms of explaining the policy predicates for the *Pendergrass* rule, as explained below:

***The Pendergrass rule helped prevent plaintiffs from transforming contract disputes into fraud claims.*** In *Banco Do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. 870, Justice Croskey explained that letting parties to integrated contracts claim promissory fraud based upon promises that the parol evidence rule would render unenforceable in contract would "encourage attempts to convert contractual disputes into fraud litigation." *Id.* at 892. The *Pendergrass* rule thus helped prevent the "tortification" of contract disputes: "The Supreme Court [in *Pendergrass*] concluded that in this situation contract principles should be paramount to avoid injecting tort principles into the commercial context, where such principles do not readily fit." *Duncan v. The McCaffrey Group*, 133 Cal. Rptr. 3d at 297.

Although fraud claims require more than just proof of a misrepresentation or false promise, those additional elements provide only a limited check against the tortification of contract disputes. Those elements, such as intent and reliance, "can so easily be inferred from any broken promise that promissory fraud may in fact open the door to attempts to enforce oral promises through tort causes of action under the guise of a promise made without intention to perform." *Price v. Wells Fargo Bank*, 261 Cal. Rptr. at 746. This allows "parties to litigate disputes over the meaning of contract terms armed with an arsenal of tort remedies inappropriate to the resolution of commercial disputes." *Id.* As one professor has put it, while "in theory it is harder to prove promissory fraud than to prove breach of contract, in practice the distinctions between the two causes of action break down. The fraud exception swallows the parol evidence rule." Eric A. Posner, *The Parol Evidence Rule, The Plain Meaning Rule, And The Principles of Contractual Interpretation*, 146 U. Pa. L. Rev. 533, 536 (1997-1998) (*The Parol Evidence Rule*).

***The Pendergrass rule promoted the legal certainty that businesses need to operate efficiently and predict business risk and litigation accurately.*** The *Pendergrass* rule also supported a key purpose of the parol evidence rule: to foster commercial certainty and stability. *See, e.g.*, 11 Williston on Contracts, Parol Evidence Rule, §33:1, p. 556 (4th ed. 2015) ("'The stability of our economic transactions and the contract law upon which they are founded demand strict application of the parol evidence rule'"). The need for commercial stability is a well-recognized policy goal in California.[6] As Justice Croskey summarized in defending the *Pendergrass* rule and strict applications of the parol evidence rule:

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[6] *See, e.g., Freeman & Mills, Inc. v. Belcher Oil Co.*, 900 P.2d 669, 674-80 (Cal. 1995) (repeatedly emphasizing the importance of predictability in contractual relationships); *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.*, 869 P.2d 454, 460 (Cal. 1994) (important to "encourage contractual relations and commercial activity" by enabling parties to calculate the financial risks of their relationship); *Foley v. Interactive Data Corp.*, 765 P.2d 373, 389 (Cal. 1988) ("predictability about the cost of contractual relationships plays an important role in our commercial system"); *Harris v. Atlantic Richfield Co.*, 17 Cal. Rptr. 2d 649, 656 (Cal. Ct. App. 1993) ("predictability of the consequences of actions related to contracts is important to commercial stability").

- "Parties to a business or commercial transaction . . . should be able to clearly express their intent as to the nature and scope of their legal relationship and then be able to rely on that expression."

- "If, as in this case, they agree that their entire understanding is completely set forth in a particular writing then they are both entitled and required to live with the agreed terms."

- "[I]t is the essence of the judicial function to contribute to legal certainty and reasonable predictability in the affairs of our citizens rather than to suggest that such goals are not attainable."

- "The courts simply cannot permit clear and unambiguous integrated agreements . . . to be rendered meaningless by the oral revisionist claims of a party who, at the end of the game, does not care for the result."

*Banco Do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. at 893.[7]

***The Pendergrass rule guarded against fictitious fraud claims***. When substantial sums are at stake, witnesses have an incentive to be dishonest or to remember contract negotiations inaccurately. The *Pendergrass* rule thus furthered the important public policy goal of "discourag[ing] interested witnesses to a contract from committing fraud, perjury, or unintentional invention by making statements that the contract did not actually represent the agreement of the parties." *Brinderson-Newberg Joint Venture v. Pacific Erectors*, 971 F.2d at 277; *see* Kevin E. Davis, *Promissory Fraud: A Cost-Benefit Analysis*, 2004 Wis. L. Rev. 535, 540 (2004) (*Promissory Fraud*) (theory that promissory fraud claims should not be permitted where based on promises barred by the parol evidence rule rests on concerns about frustrating the policy "objectives of minimizing litigation costs and discouraging putative promisees from advancing fraudulent claims").[8]

This policy concern is not just about plaintiffs *intentionally* fabricating stories of fraudulent promises. It is equally, and probably more, about the inherent fallibility of

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[7] U.S. Supreme Court Justice Ginsburg echoed these sentiments, while sitting on the Court of Appeals:

> Were we to permit plaintiffs' use of the defendants' prior representations (and defendants' nondisclosure of negotiations inconsistent with those representations) to defeat the clear words and purpose of the Final Agreement's integration clause, "contracts would not be worth the paper on which they are written.". . . The [fraud-in-the-inducement] exception . . . must not be stretched or inflated in a way that "would severely undermine the policy of the parol evidence rule, which is grounded in the inherent reliability of a writing as opposed to the memories of contracting parties."

*One-O-One Enter, Inc. v. Caruso*, 848 F.2d 1283, 1287 (D.C. Cir. 1988).

[8] *See also Masterson v. Sine*, 436 P.2d at 564 (any parol evidence rule must accommodate "the fear that fraud or unintentional invention by witnesses interested in the outcome of the litigation will mislead the finder of facts"); Eric A. Posner, *supra*, *The Parol Evidence Rule,* 146 U. Pa. L Rev. at 567 (the parol evidence rule "discourages a promisee from claiming that a promisor orally made promises that were in fact never made").

memories and the likelihood of unintentional false recollections. False memories are easily developed. *See, e.g.*, Lawrence M. Solan, *The Written Contract As Safe Harbor For Dishonest Conduct*, 77 Chi.-Kent L. Rev. 87, 95 (2001-2002) ("the fact that the actual words remain with us only briefly is uncontroversial"). People's memories can play tricks on them: "People are terrible at recalling exactly what was said, but are somewhat better at recalling the gist of what was said. However, they recall gist as filtered through mental models that may distort the truth about what actually happened." *Id.* at 93. People can "re-create the reality of what was said in self-serving ways so that they no longer believe that they have forgotten; they are not lying, but surely are not saying anything true[.]" *Id.* at 114. As Professor Korobkin aptly puts it:

> Even in a world of scrupulously honest nondrafting parties, costs associated with false claims of precontractual representations would still exist. Research demonstrates that memory retrieval is not like rewinding and playing a videotape. It is, instead, a constructive process that draws in part on the expectations, biases, and worldviews of the individual attempting to remember. As a consequence, memories, even if intensely believed, are often imprecise and sometimes entirely inconsistent with the events that actually occurred. Parties can be mistaken in their recollections of what exactly was or was not said over the course of a negotiation.

Russell Korobkin, *The Borat Problem In Negotiation: Fraud, Assent, And The Behavioral Law And Economics Of Standard Form Contracts*, 101 Cal. L. Rev. 51, 73-74 (2013) (*The Borat Problem*).

The risk of self-serving, faulty recollections is particularly heightened when a contract turns out to be a bad deal. It is far easier on the psyche to conclude that you were duped or misled into agreeing to a contract gone awry than to conclude you were foolish or took excessive risks. And it is easy to recall as "promises" comments that truly were never meant as promises. For example, a passing remark about the prospect of a future $150,000 salary *if all goes well*, can be recollected — after all does not go well — as a flat-out promise to pay $150,000. The mind can easily shade comments about hopes and possibilities into outright promises. The inherent fallibility of memories is one of the very reasons California law encourages parties to put their agreements in writing and seeks to enforce those writings. *See, e.g.*, *Masterson v. Sine*, 436 P.2d at 564 (any parol evidence rule must accommodate the policy that "written evidence is more accurate than human memory").

In a perfect world, juries would provide the only check needed to shield defendants from fictitious claims of false promises. But the world is not perfect. "[L]iability for fraud is imposed by imperfect institutions and is likely to affect many actors who have not been directly responsible for any deliberate deception." *Kevin E. Davis*, *supra*, *Promissory Fraud*, 2004 Wis. L. Rev. at 550. Juries tend to sympathize with parties seeking to avoid the harsh impact of contract terms, especially less sophisticated parties.

*See, e.g.*, *Masterson v. Sine*, 436 P.2d at 564 (noting Professor McCormick, in McCormick, Evidence, § 210 (1954), "has suggested that the party urging the spoken as against the written word is most often the economic underdog, threatened by severe hardship if the writing is enforced" and that the parol evidence rule arose to allow courts "to control the tendency of the jury" to base its findings on "sympathy and without a dispassionate assessment of the probability of fraud or faulty memory").

In Professor McCormick's colorful words, jurors feel "sympathy for a party whom the shoe of the written contract pinches." Charles T. McCormick, *The Parol Evidence Rule As A Procedural Device For Control Of The Jury*, 41 Yale L. J. 365, 368 (1932); *see also id.* at 366 ("The average jury will, other things being equal, lean strongly in favor of the side which is threatened with possible injustice and certain hardship by the enforcement of the writing"). The *Pendergrass* rule, accordingly, helped prevent "sympathetic juries from releasing parties from bad bargains." *Brinderson-Newberg Joint Venture v. Pacific Erectors*, 971 F.2d at 277.

***The Pendergrass rule facilitated contract negotiations.*** When parties know the final written terms of their integrated contract will be enforced, they do not need to document each and every aspect of the preceding negotiations. But when they know extrinsic evidence of pre-contract promises and representations may be admitted in a subsequent lawsuit, as *Riverisland* allows for fraud claims, "each party has an incentive to propose self-serving terms during the negotiations, even though each knows that the other party will reject the terms. The record of the self-serving terms creates a chance that a court [that does not strictly apply the parol evidence rule] will erroneously enforce those terms should a dispute arise." Eric A. Posner, *supra*, *The Parol Evidence Rule*, 146 U. Pa. L Rev. at 564-65.

The *Pendergrass* rule's demise thus creates a "peril to justice and to the stability of business transactions" about which Professor McCormick warned long ago: "[T]he possibility that earlier and tentative oral agreements which were part of the preliminary parleying, but were actually understood by both parties to be abandoned when omitted in the final written agreement, will be strongly asserted by one party at the trial as having been intended to stand alongside the writing." Charles T. McCormick, *supra*, *The Parol Evidence Rule As A Procedural Device For Control Of The Jury*, 41 Yale L. J. at 367.

To preclude this potential peril in a *Riverisland* world, parties should document the rejection of requested promises during negotiations, even where the subsequently executed contract squarely contradicts those proposals. The *Pendergrass* rule made this contract-negotiation burden unnecessary.

### B. Policy Considerations Undermining The *Pendergrass* Rule.

So what about the other side of the coin, the policy considerations *undermining* the *Pendergrass* rule?

*Riverisland* provides the best roadmap. But on the key public policy issue — what's good and bad about the *Pendergrass* rule — *Riverisland* is surprisingly thin, somewhat reminiscent of the conclusory analysis in *Pendergrass* itself. *Riverisland* did not specifically address many of the policy predicates for the *Pendergrass* rule. Instead, it primarily discussed procedural considerations — for example, that the rule was difficult to apply and was an outlier that the California legislature never codified. Although the Supreme Court concluded, for the reasons summarized below, that the *Pendergrass* decision "was ill-considered," 291 P.3d at 317, that is not the same thing as saying its public-policy predicates are infirm. Here's the basis for *Riverisland*'s holding:

***The Pendergrass rule did not track the governing California statutes and was a minority rule.*** The Supreme Court emphasized that the *Pendergrass* rule "finds no support in the language of the statute codifying the parol evidence rule and the exception for evidence of fraud." *Riverisland*, 291 P.3d at 317. Code of Civil Procedure section 1856(f) provides that the parol evidence rule does not bar evidence relevant to whether a contract is void or voidable because of fraud, mistake, or any other invalidating cause. *Id.* at 319. In addition, subsection (g) states, without limitation, that the parol evidence rule does not exclude other evidence to establish fraud. *Id.* The *Pendergrass* rule directly contradicts this unqualified language. *Id.* In addition, in 1978 the California Legislature implicitly rejected the *Pendergrass* rule by revising the parol evidence statutes to conform to several Supreme Court decisions but choosing not to qualify the broad language allowing fraud and agreement-validity evidence. *Id.* at 321-22.

Not only does the *Pendergrass* rule conflict with the governing statutes, it "conflicts with the doctrine of the Restatements, most treatises, and the majority of our sister-state jurisdictions." *Riverisland*, 291 P.3d at 317; *see id.* at 320 ("[t]he majority of other jurisdictions follow th[e] traditional rule" that "evidence of fraud is not affected by the parol evidence rule").

***The parol evidence rule applies to enforceable contracts, not contracts invalidated by fraud.*** The Supreme Court also concluded that the *Pendergrass* rule "is inconsistent with the principle, reflected in the terms of [Code of Civil Procedure] section 1856, that a contract may be invalidated by a showing of fraud." *Riverisland*, 291 P.3d at 320. The parol evidence rule rests on the notion that the parties expressed all the contract terms in their integrated contract, but "fraud undermines the essential validity of the parties' agreement." *Id.* at 324. "When fraud is proven, it cannot be maintained that the parties freely entered into an agreement reflecting a meeting of the minds." *Id.* So if the integrated contract does not reflect a meeting of the minds, the factual predicate for applying the parol evidence rule does not exist.

***The Pendergrass rule was difficult to apply and spawned a host of confusing and conflicting decisions.*** The Supreme Court also emphasized that the *Pendergrass* rule "is difficult to apply." *Riverisland*, 291 P.3d at 317. While the rule bars evidence of promises "directly at variance with the promise of the writing," it allows evidence that tends "to establish some independent fact or representation, some fraud in the procurement of the instrument, or some breach of confidence concerning its use." *Pendergrass*, 48 P.2d at 661. The distinction between the two camps is far from clear, and that difficulty spawned decades of inconsistent and confusing decisions.

Some courts simply refused to acknowledge the rule, while others drew fine distinctions between inconsistent and consistent promises. *Riverisland*, 291 P.3d at 321 n.7. Other courts scaled back the rule's application by concluding it applied only to false promises and not factual misrepresentations, such as misrepresentations about a contract's contents. *See id.*; *see also Continental Airlines, Inc. v. McDonnell Douglas Corp.*, 264 Cal. Rptr. at 795-99 (rule barred evidence of brochure stating that fuel tank "will not rupture" in crash but did not bar false representations that aircraft was designed to react in specific manner during crash); *Edwards v. Centex Real Estate Corp.*, 61 Cal. Rptr. 2d 518, 535 (Cal. Ct. App. 1997) (rule did not bar factual misrepresentations that induced plaintiff to enter the contract); *Pacific State Bank v. Greene*, 1 Cal. Rptr. 3d at 744-45 (rule did not apply to bank employee's representation that contract lacked a term it actually included).[9]

Consequently, while *Pendergrass* purported to establish a bright-line rule, in practice it did nothing of the sort. Courts found myriad ways to circumvent its application when they wanted to avoid a seemingly harsh result. *Riverisland*, 291 P.3d at 324 (the *Pendergrass* rule "has led to instability in the law, as courts have strained to avoid abuses of the parol evidence rule").

***The Pendergrass rule could shield fraudulent conduct.*** Last, but certainly not least, the Supreme Court concluded that "while intended to prevent fraud, the rule established in *Pendergrass* may actually provide a shield for fraudulent conduct." *Riverisland*, 291 P.3d at 317; *see also id.* at 320 (the *Pendergrass* rule's "limitation on evidence of fraud may itself further fraudulent practices"). "'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.'" *Id.* (quoting 6 Corbin on Contracts (rev. ed. 2010) § 25.20[A], p. 280).

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[9] *See generally* Alicia W. Macklin, *The Fraud Exception To The Parol Evidence Rule: Necessary Protection For Fraud Victims Or Loophole For Clever Parties*, 82 S. Cal. L. Rev. 811-12, 819-33 (2008-2009) (discussing cases and concluding there were "two main difficulties" with the *Pendergrass* rule: "first, the lack of clarity in distinguishing between misrepresentations of fact (speaking to the physical content of the document or to an existing fact) and promissory fraud in general; and, second, the lack of clarity in distinguishing between promises that are consistent with or independent of the written agreement and those that vary or contradict the terms of the contract, and why this second standard differs from the [parol evidence rule] standard of 'vary or *add to* the terms of [the] . . . written agreement'") (emphasis in original).

The Supreme Court therefore chose to "reaffirm the venerable maxim . . . [that] '[i]t was never intended that the parol evidence rule should be used as a shield to prevent the proof of fraud.'" *Riverisland*, 291 P.3d at 324 (citation omitted). In terms of public-policy rationales, this is the big ticket item: The *Pendergrass* rule had to go because it could shield, and perhaps even encourage, fraud if strictly applied.

## III. AFTER *RIVERISLAND*, CALIFORNIA COURTS SHOULD ACCOMMODATE THE LEGITIMATE PUBLIC-POLICY PREDICATES FOR THE *PENDERGRASS* RULE WITHIN THE CASE-BY-CASE EVIDENTIARY ANALYSIS THAT GOVERNS UNDER *RIVERISLAND*.

Litigants already have attempted to water down *Riverisland* by claiming the *Pendergrass* rule remains alive — or should remain alive — in some limited form. The defendants in *Julius Castle Restaurant Inc. v. Payne*, 157 Cal. Rptr. 3d 839, 852-53 (Cal. Ct. App. 2013) (*Julius Castle*), for example, argued that *Riverisland* should apply only to contracts of adhesion and the *Pendergrass* rule should still govern sophisticated parties who negotiate extensively. *Julius Castle* rejected the attempt, concluding that *Riverisland* "decisively overruled *Pendergrass*" and that its "blunt language . . . did not shield sophisticated parties from the reach of its holding." *Id.* at 852.

*Julius Castle* got it right. *Riverisland*'s language is not reasonably susceptible to carve-outs. The Supreme Court's point was unequivocal: If the claim alleges promissory fraud, not breach of contract, the parol evidence rule is inapplicable and the evidence is admissible.[10] Under *Riverisland*, the *Pendergrass* rule is dead in California. Unless the California legislature enacts the rule statutorily, or the Supreme Court changes its mind yet again, fraud evidence that directly contradicts written contract terms is admissible in California courts.

As shown below, *Riverisland* replaces the categorical *admissibility* bar of the *Pendergrass* rule with a case-by-case analysis of whether the requisite fraud elements exist. (§ II.A, *post*.) This does not mean that all promissory fraud claims based on promises that contradict written contract terms are now viable. Instead, the public-policy battleground now shifts from a threshold admissibility bar to the standards for *proving* a *Pendergrass*-type promissory fraud claim. (§II.B, *post*.) After *Riverisland*, public policy dictates that courts and juries apply a balanced approach to evaluating promissory fraud claims — one that accommodates the legitimate policy predicates for the *Pendergrass* rule, such as preventing fictitious fraud claims and promoting commercial certainty, without denying recovery for actual fraud. (§ II.C, *post*.) Although the sophistication of

[10] The Supreme Court specifically noted in *Riverisland* that one law review article "while critical of *Pendergrass*, favors limiting the scope of the fraud exception and advocates an even stricter rule for sophisticated parties." *Riverisland*, 291 P.3d at 322 (citing Alicia W. Macklin, *supra*, *The Fraud Exception To The Parol Evidence Rule: Necessary Protection For Fraud Victims Or Loophole For Clever Parties,* 82 S. Cal. L. Rev. at 812-13) (arguing the fraud exception to the parol evidence rule should not be applied to sophisticated lawyer-represented parties negotiating deals). But the Court did not adopt that article's reasoning nor provide any foundation for reading such a limitation into the statutory language or California case law.

parties and similar considerations do not trigger an admissibility bar, they still retain vital importance in the case-by-case evaluation that governs the viability of *Pendergrass*-type promissory fraud claims under *Riverisland*.

### A. *Riverisland* Replaces The Overbroad Categorical Admissibility Bar Of The *Pendergrass* Rule With A More Flexible, Case-By-Case Analysis.

The problem with the *Pendergrass* rule was not that its public-policy predicates were wrong: Its concerns about fictitious fraud claims and the need for commercial certainty were well-founded. The problem, rather, was that the categorical bar swept too broadly and was difficult to apply. As a result, the rule potentially immunized fraud when its purpose was to prevent fraud, and it created confusion and uncertainty when its purpose was to provide certainty. In essence, *Pendergrass* imposed a bright-line rule to resolve policy concerns that are not susceptible to a bright line. As one Court of Appeal put it decades ago, the *Pendergrass* rule "compromises the policies of tort law, but a contrary rule would compromise those of the parol evidence rule." *Price v. Wells Fargo Bank*, 213 Cal. Rptr. at 746. There is no perfect solution. Either way, something must give.

In *Riverisland*, the California Supreme Court chose to elevate tort law policy over the parol evidence rule. It is difficult to fault that choice when one considers some of the fraud claims that the *Pendergrass* rule technically foreclosed. Although *Riverisland* cites no specific examples, the justices likely had in mind the scenarios that Professor Sweet recited in his renowned article criticizing the *Pendergrass* rule, an article that *Riverisland* cites repeatedly. *Riverisland*, 291 P.3d at 320-21, 324. Professor Sweet discussed five "common transactions in which the parties reach an oral understanding directly at variance with the writing," transactions for which the *Pendergrass* rule technically would bar the fraud evidence:

> "1. Owner and builder orally agree that the building will cost $100,000, but sign a written contract that specifies a price of $125,000, so that the owner can get a larger building loan.
>
> 2. A bank official tells an individual that she will never be asked to pay a guaranty she is about to sign, but that it is needed to satisfy the bank examiners.
>
> 3. An insurance adjuster asks an accident victim to sign a release obligating the insurance company to pay her $500, but orally promises that she will receive $5,000. The stated purpose is to prevent other injured persons from learning the amount of the settlement.
>
> 4. A bank official tells a corporate officer that no personal liability will result from a loan to the corporation, even though the loan indenture states the

contrary. The reason given is a reluctance to retype the contract or to use a different form.

5. A new salesman is hired under a written contract that he will receive a commission of five per cent, but with an oral understanding that he will get six per cent, ostensibly to prevent other salesmen from learning that he is receiving a larger commission."

Justin Sweet, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. 877, 893-94 (1961).

A categorical bar to these types of claims seems wrong. In each of these contexts, the prospective plaintiffs did exactly what — from a policy perspective — you would want contracting parties to do:

- They specifically negotiated the contract terms;
- They fully read and understood the terms of the contract being signed;
- They specifically raised the discrepancy between the oral promises and the written terms; and
- They received, in response to their inquiry, a rational (but false) explanation for why the written terms differed from the oral promises.

Rather than foreclosing such fraud claims by categorically barring evidence of the alleged false promise, their viability is best addressed on a case-by-case basis through the fraud element of justifiable reliance. In other words, the question is whether the defrauded party reasonably relied on the defrauding party's explanations that the written terms differed from the oral promises for a reason and that the written terms would not be enforced. Applied in these contexts, the *Pendergrass* rule's categorical bar was unjust and bad policy.

The *Pendergrass* rule also swept too broadly because many cases are worlds apart from the paradigm on which the rule rested. The rule assumed that parties can and will protect themselves by insisting that any written contract terms match the oral promises. Not only is that paradigm shattered when, as in Sweet's examples, a defrauding party provides an ostensibly sensible reason for the divergence, it also assumes a level of negotiation and contract clarity that is often absent.

Commercial transactions are not always conducted between sophisticated parties represented by sophisticated counsel, who scrutinize each and every word in a contract. Standardized forms are often used with little to no negotiation, and written terms that contradict oral promises can be buried deep within a lengthy contract brimming with

boilerplate. The *Pendergrass* rule opened the door to sellers misleading consumers with oral representations that contradicted a written form agreement, knowing that the consumer would not likely read the entire contract or negotiate the language. As Professor Sweet concludes:

> The argument that a party can protect himself by insisting on written promises shows a remarkable lack of awareness of the facts of everyday commercial life. It should be apparent that inequality of bargaining power and the standardized form contract are the rule today, rather than the exception. Promises made without the intention on the part of the promisor that they will be performed are unfortunately a facile and effective means of deception.

Justin Sweet, *supra*, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. at 896.

Since many contractual settings do not reflect the paradigm on which the *Pendergrass* rule rested, it is difficult to fault the latter-day Supreme Court for rejecting the categorical bar. In fact, such considerations likely drove the courts that evaded the *Pendergrass* rule when it was in force. *Compare Pacific State Bank v. Greene*, 1 Cal. Rptr. 3d at 753 (finding *Pendergrass* rule inapplicable where the "fine print of a definition" undermined other contract provisions that seemingly conformed to the alleged pre-contract promises) *with Duncan v. The McCaffrey Group*, 133 Cal. Rptr. 3d at 303 (applying *Pendergrass* rule, and refusing to apply *Greene* exception, because "the language about which plaintiffs now complain was not hidden in the fine print, but was highlighted for them specifically as evidenced by their initials being placed next to the paragraph").

Scholars have concluded that seemingly disparate applications of the parol evidence rule can often be reconciled by examining the status of the parties; courts tend to apply the parol evidence rule strictly when the contracting parties are sophisticated but circumvent it when faced with unequal bargaining power, such as consumer contracts. *See, e.g.*, Robert Childress & Stephen J. Spitz, *Status In The Law Of Contract*, 47 N.Y.U. L. Rev. 1, 6-7 (1972). As one court concluded after analyzing fraud cases across the country, "[t]he application of the parol evidence rule moves along a continuum based on the extent of the contradiction and the relative strength and sophistication of the parties and their negotiations." *Pinnacle Peak Developers v. TRW Investment Corp.*, 631 P.2d 540, 548 (Ct. App. Ariz. 1980).

Thus, to some degree *Riverisland's* rejection of the *Pendergrass* rule's categorical admissibility bar reflects what California courts were already doing in practice: They were not applying the categorical bar as a categorical bar. When motivated by the circumstances of the particular case, they found multiple ways to avoid the harshness of the *Pendergrass* rule. As a result, although the viability of *Pendergrass*-type claims now

depends on a case-by-case analysis as to whether the evidence meets the elements for proving promissory fraud, that may not be as earth-changing as might seem at first blush. It merely shifts the public-policy predicates for the *Pendergrass* rule to a different battle-ground: the standards for *proving* promissory fraud.

### B. The Post-*Riverisland* Battle-Ground: The Standards For Proving Fraud, In Particular Justifiable Reliance.

As *Riverisland* removes the *Pendergrass* rule's categorical admissibility bar for alleged fraudulent promises that contradict a contract's written terms, the viability of *Pendergrass*-type promissory fraud claims now rests on the standards for *proving* fraud. *See Julius Castle*, 157 Cal. Rptr. 3d at 852 (concluding that, instead of arguing about admissibility, "[i]n the post-*Riverisland* world, parties would be better served in addressing the heightened burden of proving fraud in a civil action").

A plaintiff alleging promissory fraud must prove *each* of the following: "'(a) misrepresentation (false representation, concealment, or nondisclosure); (b) knowledge of falsity (or 'scienter'); (c) intent to defraud, i.e., to induce reliance; (d) justifiable reliance; and (e) resulting damage.'" *Lazar v. Superior Court*, 909 P.2d 981, 984 (Cal. 1996). "[O]ne element absent is fatal to recovery." *Okun v. Morton*, 250 Cal. Rptr. 220, 235 (Cal. Ct. App. 1988).

Although these elements have long been standard requirements for proving fraud, that does not mean — and should not mean — that everything should be "business as usual" after *Riverisland*. For over seven decades, the *Pendergrass* rule allowed courts to weed out questionable promissory fraud claims before they had to be evaluated under the standards for proving fraud. After *Riverisland*, those elements become crucially important whenever a plaintiff alleges a fraudulent promise that contradicts written contract terms. The public-policy predicates for the *Pendergrass* rule remain valid, particularly the goals of preventing fictitious fraud claims and fostering commercial certainty. Courts must avoid coupling *Riverisland*'s liberal rule for admitting promissory fraud evidence with liberal standards for *proving* promissory fraud. Public policy still mandates rigorous scrutiny of *Pendergras*s-type fraud claims.

Professor Sweet recognized as much in his blistering critique of the *Pendergrass* rule, which the Supreme Court embraced in *Riverisland.* Professor Sweet did not advocate abrogating the *Pendergrass* rule and then liberally sending promissory fraud claims to juries. Rather, he concluded public policy would be served best by permitting the evidence but applying a *heavy burden of proof* to protect against fictitious claims:

> This liberality [in admitting evidence of fraud] must be balanced, of course, *by better procedural devices to protect parties against false allegations of fraud*. Unfounded and misleading charges of fraud have been a too frequent adjunct of the parol evidence rule. Both parties will be better protected if the

> courts, aware of the nature of the action as one for fraud, combine liberal admission of evidence *with a heavy burden of proof*.

Justin Sweet, *supra*, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. at 907 (emphasis added).

The Supreme Court did state in *Riverisland* that "promissory fraud is not easily established." *Riverisland*, 291 P.3d at 325. It "stress[ed] that the intent element of promissory fraud entails more than proof of an unkept promise or mere failure of performance." *Id.* If the plaintiff "'adduces no further evidence of fraudulent intent than proof of nonperformance of an oral promise, he will never reach a jury.'" *Id.* (quoting *Tenzer v. Superscope, Inc.*, 702 P.2d 212, 219 (Cal. 1985)).

Unfortunately, this principle provides only limited protection against fictitious *Pendergrass*-type promissory fraud claims because those claims, by definition, involve fraudulent promises that contradict a contract's written terms. Consequently, *Pendergrass*-type fraud claims always involve more than just nonperformance: The plaintiff can wield the inconsistent contract terms as evidence that the defendant never intended to perform the oral promise. The *Riverisland* Court of Appeal recognized this problem. *See Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Ass'n*, 119 Cal. Rptr. 3d at 391 (recognizing that the *Pendergrass* court was concerned that "the party seeking to admit the evidence could always argue that the failure to include the prior oral promise in the written contract was evidence of an intention not to perform it"). But the Supreme Court's decision ignores this issue.

*Riverisland* also stressed that "promissory fraud, like all forms of fraud, requires a showing of justifiable reliance on the defendant's misrepresentation." *Riverisland*, 291 P.3d at 325 (citing *Lazar v. Superior Court*, 909 P.2d at 985). Undoubtedly, this is the main public-policy battleground after *Riverisland*. *See Julius Castle*, 157 Cal. Rptr. 3d at 852-53 (after *Riverisland*, "[a]ttention will now focus on the justifiable reliance element of fraud"). "Justifiable reliance" is the primary fraud element where the policy predicates for the *Pendergrass* rule still can — and should — come into play.[11]

Even before *Riverisland,* courts recognized that an inconsistency between written terms and alleged oral promises presented not just a *Pendergrass* admissibility issue but also a "justifiable reliance" issue. Courts held, in multiple contexts, that plaintiffs *as a matter of law* could not claim they justifiably relied on alleged fraudulent representations that contradicted clear and conspicuous contract terms. For example, certain employment

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[11] Pre-*Riverisland* cases establishing loopholes in the *Pendergrass* rule touted the "justifiable reliance" requirement as a way to prevent opening the floodgates for fictitious fraud claims. *See Pacific State Bank v. Greene*, 1 Cal. Rptr. 3d at 752 (distinguishing factual misrepresentations from promises for purposes of applying the *Pendergrass* rule, but commenting that the justifiable-reliance element "protects against abuse" because "[i]n 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").

cases held that employees, as a matter of law, could not claim justifiable reliance on alleged fraudulent representations that directly contradicted the express terms of their employment contract, such as oral promises of continuing employment contrary to an "at will" employment contract.[12] Similarly, some insurance cases held that insureds could not claim justifiable reliance on alleged misrepresentations that contradicted an insurance policy's clear and conspicuous terms, even if they never read the policy.[13]

But the line-drawing was far from clear. Some insurance cases refused to apply bright-line rules even where the insured had failed to read the policy.[14] Other courts found triable justifiable-reliance issues where an insured had never read his insurance policy, so long as the meaning of policy terms was disputed and the insurance agent actively misled the insured as to the effect of the terms.[15] The propriety or scope of such distinctions remains unclear. *See*, e.g, *Broberg v. Guardian Life Ins. Co. Of Am.*, 90 Cal. Rptr. 3d

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[12] *See Slivinsky v. Watkins-Johnson Co.*, 270 Cal. Rptr. 585, 587, 589 (Cal. Ct. App. 1990) (summary judgment for defendant employer on fraud claim; plaintiff's reliance on alleged fraudulent oral assurances during prehire interviews that her employment would be "long-term," "indefinite" and "permanent" and subject to termination only for cause, was "simply not justifiable because the representations contradict the parties' integrated employment agreement which provided that the employment was at will"); *Marketing West, Inc. v. Sanyo Fisher (USA) Corp.*, 7 Cal. Rptr. 2d 859, 863-64 (Cal. Ct. App. 1992) (as a matter of law, no reasonable reliance on employer's purportedly fraudulent representations to employees that the contracts they were about to sign were pro forma and meaningless and that employment would be terminated only for cause, because the representations "are contradicted by" integrated written agreements stating employees could be terminated without cause); *Camp v. Jeffer, Mangels, Butler & Marmaro*, 41 Cal. Rptr. 2d 329, 341 (Cal. Ct. App. 1995) (no reasonable reliance as a matter of law on employer's false representation of job security because representation of continuing employment contradicted employee's written acknowledgment of at-will employment).

Some employment cases involving non-fraud claims likewise found justifiable reliance lacking as a matter of law where the alleged promise contradicted written employment terms. *See, e.g.*, *Shapiro v. Wells Fargo Realty Advisors*, 199 Cal. Rptr. 613, 622 (Cal. Ct. App. 1984) (demurrer sustained to employee's claim for breach of implied-in-fact contract; employee "could not have reasonably relied" on implied promise that "contradicted the express provisions of" the written agreement that made him an at-will employee), *overruled on other grounds in Foley v. Interactive Data Corp.*, 765 P.2d 373 (Cal. 1988); *Malmstrom v. Kaiser Aluminum & Chemical Corp.*, 231 Cal. Rptr. 820, 830 (Cal. Ct. App. 1986) (summary judgment to employer on implied-contract claims because "[t]he record contains no evidence to show his reliance on the representations of permanent employment in Florida was justified" and "reliance on representations that contradict a written agreement is not reasonable").

[13] *See Hadland v. NN Investors Life Ins. Co.*, 30 Cal. Rptr. 2d 88, 93, 95 (Cal. Ct. App. 1994) (insured, as matter of law, could not claim justifiable reliance on an insurance agent's misrepresentations that a policy provided "full protection" and "as good or better" coverage as another policy, because those misrepresentations "were patently at odds with the express provisions of the written contract"); *Hackethal v. Nat'l Cas. Co.*, 234 Cal. Rptr. 853, 858 (Cal. Ct. App. 1987) (insured's reliance on agent's pre-contract representations was "*unjustifiable* as a matter of law" given the language of the governing insurance policy) (original emphasis).

[14] For example, *Clement v. Smith*, 19 Cal. Rptr. 2d 676 (Cal. Ct. App. 1993), rejected any rule that "would automatically defeat any [insurance] agent's liability for misrepresentation"; it concluded that although "[c]ertainly an insured cannot remain intentionally ignorant of the terms of his or her policy . . .[,] [a]bsent some notice or warning, an insured should be able to rely on an agent's representations of coverage without independently verifying the accuracy of those representations by examining the relevant policy provisions." *Id.* at 679 (holding substantial evidence indicated insured reasonably relied on agent's unequivocal assurances of coverage).

[15] *See, e.g.*, *Williams v. Hilb, Rogal & Hobbs Ins. Services of California, Inc.*, 98 Cal. Rptr. 3d 910, 921 (Cal. Ct. App. 2009) (triable justifiable reliance issue existed where an insurance agent held herself out as having special expertise in the area of insurance sought by the insured); *Paper Savers, Inc. v. Nacsa*, 59 Cal. Rptr. 2d 547, 556 (Cal. Ct. App. 1996) (if the insurance agent "[held] himself out as an advisor" and interpreted the coverage "in a way different from what the language of the policy indicated" the agent may be liable despite the insured's failure to read the policy; an agent assumes a special duty to an insured when he or she induces the insured to buy the policy based upon a misrepresentation of coverage); *Butcher v. Truck Ins. Exchange*, 92 Cal. Rptr. 2d 521, 536 (Cal. Ct. App. 2000) (*Hadland* line of cases regarding conclusive impact of insured's failure to read policy does not apply where the insurance agent actively misled the insured about the scope of provided coverage); *Fanucci v. Allstate Ins. Co.*, 638 F. Supp. 2d 1125, 1141-43 (N.D. Cal. 2009) (relying on *Clement* and *Paper Savers* to find triable justifiable-reliance issues even though insurance policy facially excluded the coverage claimed by insured).

225, 233 (Cal. Ct. App. 2009) (majority finding triable justifiable-reliance issues); *id.* at 238-39 (Woods, J., dissenting) (dissent finding clear and conspicuous policy language precluded justifiable reliance as a matter of law).

The Supreme Court declined the opportunity in *Riverisland* to clarify justifiable-reliance law, even thought the facts in *Riverisland* presented a classic justifiable-reliance question. The *Riverisland* plaintiffs claimed that a credit association's vice president misled them into believing they were signing a loan modification agreement that extended their loan for only two years and that collateralized only two particular properties. 291 P.3d at 318. In truth, the agreement contained only a three-month forbearance and the plaintiffs separately signed and initialed each page of a security agreement that collateralized eight properties. *Id.* at 317. Plaintiffs claimed that, in reliance on the vice president's representations, they never read the agreements and merely signed and initialed where told to do so. *Id.* at 318.

The Supreme Court acknowledged the defendant's argument that plaintiffs' failure to read the contracts precluded plaintiffs from showing justifiable reliance. *Riverisland*, 291 P.3d at 325. But, emphasizing that the lower courts had not addressed the issue, the Court "decline[d] to decide this question in the first instance." *Id.* The Court did note its prior holding in *Rosenthal v. Great Western Fin. Securities Corp.*, 926 P.2d 1061, 1078 (Cal. 1996) (*Rosenthal*), that a party's "negligent failure to acquaint oneself with the contents of a written agreement precludes a finding that the contract is void for fraud *in the execution*." *Riverisland*, 291 P.3d at 325 n.11 (emphasis added). But, acknowledging that *Rosenthal* never reached the validity or parameters "of *a more lenient rule* that has been applied when equitable relief is sought for fraud *in the inducement of* a contract," the Court expressly refused to "explore the degree to which failure to read the contract affects the viability of a claim of fraud in the inducement." *Id*. (emphasis added).

So, although *Riverisland*'s abrogation of the *Pendergrass* rule pushed the justifiable-reliance element to center stage, the Supreme Court never resolved how courts should apply that element in evaluating *Pendergrass*-type fraud claims. *Riverisland* sheds no light on when courts should deem justifiable reliance to be absent as a matter of law or what factors a trier of fact should consider. The next section addresses those unresolved proof issues.

### C. After *Riverisland*, *Pendergrass*-Type Promissory Fraud Claims Should Be Subjected To A Heavy Burden Of Proof That Evaluates Claims On A Continuum Of Factual Factors — Factors That May Defeat Justifiable Reliance As A Matter Of Law.

#### 1. The continuum of justifiable-reliance factors.

This section illuminates various factors that courts and juries should consider in evaluating the justifiable-reliance element for *Pendergrass*-type promissory fraud claims after *Riverisland*. Some of those factors, such as a sophisticated party being represented by counsel in a heavily-negotiated and high-value transaction, weigh heavily toward a claim being deemed non-viable as a matter of law because of an inability to show justifiable reliance. But the weight afforded any factor depends on the existence or non-existence of other factors. For example, evidence that a contract was negotiated extensively and that the alleged fraudulent promise directly contradicts the written contract terms strongly indicates a lack of justifiable reliance. Yet that factor may be tempered by evidence that the parties discussed the discrepancy and the defendant provided a reasonable excuse for the divergence. Thus, the various factors must be balanced and evaluated collectively on a continuum.[16]

Courts should use the justifiable-reliance element to weed out frivolous claims and to prevent plaintiffs from using fraud claims to end-run clear and conspicuous contract terms that turned out to be a bad deal. If a case reaches trial, a trier of fact should consider the same factors in evaluating the evidence.

##### a. *The nature of the alleged misrepresentations: Pre-contract promises or mere misrepresentations of fact?*

The nature of the alleged misrepresentation matters. The *Pendergrass* rule concerned "promises" at variance with the written contract, in contrast to "some independent fact or representation, some fraud in the procurement of the instrument, or some breach of confidence concerning its use." *Pendergrass*, 48 P.2d at 661. The fact that such distinctions are slippery was a legitimate reason to abandon the *Pendergrass* rule in favor of flexibility. But the distinction between false "promises" and other types of misrepresentations remains a valid justifiable-reliance consideration.

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[16] *Julius Castle* is the only published California appellate decision that, as of the writing of this article, discusses in any detail what factors courts should consider in evaluating promissory fraud claims after *Riverisland*. Relying largely on Professor Sweet's article, *Julius Castle* concludes that "[a]mong the questions to ask are: What are the plausible reasons for the alleged discrepancy between the claimed oral promises and the signed writing? Is there compatibility between the oral representations and the written document? What is the evidence relating to whether the document was read and considered before signing?" *Julius Castle*, 157 Cal. Rptr. 3d at 853 (citing Justin Sweet, *supra*, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. at 905). While those are proper considerations, they are only part of the relevant story.

That is because contracts are all about documenting promises. If the alleged misrepresentations claimed by the plaintiff are in the nature of "promises," as opposed to mere misrepresentations of fact, a plaintiff who signed a contract containing terms contrary to those promises faces a higher justifiable-reliance hurdle. The very reason people sign contracts is to define the promises that bind each party.

For example, if a prospective employer orally promises $200,000 a year salary, plus a 6% commission on sales, but the employee signs a contract stating $150,000 a year plus 5% commissions, it will be difficult for the employee to show justifiable reliance. Those are the types of terms one would reasonably expect a written contract to specify and to do so prominently. If the plaintiff never read the contract despite a reasonable opportunity to do so, the plaintiff will need a reasonable excuse, for example, proof that the plaintiff read prior drafts consistent with the oral promises but the employer switched versions at the end when no changes were expected. And, if the plaintiff admitted to reading the contract, he would need a reasonable excuse for signing a contract with terms that contradicted the prior promises, such as failing to spot inconsistencies buried in boilerplate or the defendant providing a reasonable explanation for the discrepancy between the written terms and oral promises. Professor Sweet emphasized the latter scenarios in his article critiquing the *Pendergrass* rule; for example, an employer fraudulently telling a salesman that he will get a 6% commission as orally promised but that his contract must state 5% to prevent other salesmen from discovering his larger commission. Justin Sweet, *supra*, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. at 893-94.

In contrast, if the alleged misrepresentation inducing the plaintiff to sign the contract can be characterized legitimately as a misrepresentation *of fact*, instead of a "promise," justifiable reliance is easier to show. Contracts, particularly integrated ones, can be expected to document relevant "promises," but they will not necessarily address all related factual issues that might induce someone to enter a contract.

For example, even if an employment contract accurately stated promised salary and commission terms, a employer may have induced the employee to sign by falsely representing that the employer obtained governmental approval of a new product that will generate substantial commissions. Yes, a contract could theoretically contain a conspicuous statement that government approval of the product had *not* been obtained or promised. But it is far more likely that the employer could point only to a general integration clause or a general disclaimer against reliance on representations outside the contract. Such boilerplate will not, standing alone, bar a fraud claim.[17]

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[17] *See, e.g.*, *McClain v. Octagon Plaza, LLC*, 71 Cal. Rptr. 3d 885, 893 (Cal. Ct. App. 2008) ("'A party to a contract who has been guilty of fraud in its inducement cannot absolve himself or herself from the effects of his or her fraud by any stipulation in the contract, either that no representations have been made, or that any right that might be grounded upon them is waived'") (quoting 1 B.E. Witkin, Summary of Cal. Law, Contracts, § 304, p. 330 (10th ed. 2005)); *Hinesley v. Oakshade Town Ctr.*, 37 Cal. Rptr. 3d 364, 372 (Cal. Ct. App. 2005) (listing cases; "A party may claim fraud in the inducement of a contract containing a provision disclaiming any fraudulent misrepresentations . . . . Fraud in the inducement renders the entire contract voidable, including any provision in the

(continued...)

So, while the distinction between "promises" and factual misrepresentations is no longer dispositive as it was under the *Pendergrass* rule, the nature of the alleged misrepresentation remains a key factor for purposes of determining justifiable reliance. Courts and juries must assess whether the misrepresentation concerned a "promise," the sort of statement that a contract reasonably could be expected to cover? Or was it more in the nature of a peripheral representation of fact, something that might impact a plaintiff's decision to enter into a contract but would not necessarily be an express contractual term? *See, e.g.*, *Seeger v. Odell*, 115 P.2d 977, 979 (Cal. 1941) (*Seeger*) (fraud claim viable where plaintiffs executed a lease based upon a misrepresentation of fact that their land had been sold at an execution sale).

**b. *The strength of the evidence that the alleged pre-contract promises actually occurred.***

Whether the alleged pre-contract promises actually occurred is a credibility question typically reserved for a trier of fact. But given the inherent risk of fictitious claims (whether purposeful or because of faulty memory), courts should not automatically punt claims to a jury. Weak evidence that the misrepresentation actually occurred, coupled with weak justifiable-reliance evidence, raises a red policy flag. So while the strength of the misrepresentation evidence is not technically a justifiable-reliance consideration, it should be considered in conjunction with the justifiable-reliance element in determining whether triable issues exist.

In evaluating the strength of the evidence regarding whether an alleged misrepresentation actually occurred, courts (and a trier of fact if the case survives summary judgment) should consider multiple factors: Who is testifying that the misrepresentation occurred? Is it just the plaintiff or do other witnesses, such as lawyers or meeting attendees, corroborate plaintiff's story? Do any written documents (e-mail exchanges, letters, draft contracts, etc.) contain language or suggested terms that support plaintiff's story? Is the plaintiff credible? Does the defendant fit the profile of a defrauder? Have other plaintiffs made similar fraud allegations? Is the defendant part of an industry with a dubious track record? Other relevant credibility questions include: "'When did the plaintiffs first raise the claim that some contrary oral representation had been made?'" and "'What were the circumstances under which such claims were first raised?'" Krause-Leemon, *Parol Evidence In A Post-Riverisland World*, L.A. Daily Journal, p. 3 (June 18, 2013).

Ultimately, if the credibility issue boils down to a classic "he said/she said" scenario, where the only witnesses are the plaintiff alleging the misrepresentation and the

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[17](...continued)
contract providing the written contract is, for example, the sole agreement of the parties, that it contains their entire agreement and that there are no oral representations (integration/no oral representations clause).").

disputing defendant, and there is no relevant documentary evidence, the public-policy concerns undergirding the *Pendergrass* rule mandate that courts seriously evaluate whether a triable issue exists. Given the inherent fallibility of memories, the risk of fictitious claims is highest when the issue reduces to the word of one witness against another, particularly when the contract exposes the plaintiff to substantial financial exposure. Courts should avoid merely labeling all fraud issues credibility questions for the jury. If the evidence that a misrepresentation occurred is weak, the plaintiff's justifiable-reliance evidence should be scrutinized intensely. Where the evidence of both is weak, courts should pull the plug on the fraud claim as a matter of law.

**c.** ***The sophistication of the parties and relative bargaining power.***

Whether a plaintiff justifiably relied on a representation depends on the plaintiff's particular circumstances. A plaintiff claiming justifiable reliance is not "'held to the standard of precaution or of minimum knowledge of a hypothetical reasonable man.'" *Alliance Mortgage Co. v. Rothwell*, 900 P.2d 601, 609 (Cal. 1995) (quoting *Seeger*, 115 P.2d at 980-81). Rather, the question is "'whether the person who claims reliance was justified in believing the representation *in the light of his own knowledge and experience*.'" *Id.* (emphasis added) (quoting *Gray v. Don Miller & Associates, Inc.*, 674 P.2d 253, 255 (Cal. 1984)).

Thus, in "determining whether one can reasonably or justifiably rely on an alleged misrepresentation, the knowledge, education and experience of the person claiming reliance must be considered." *Guido v. Koopman*, 2 Cal. Rptr. 2d at 440-41 (Cal. Ct. App. 1991). Conduct that might constitute fraud in one context may not be fraudulent when directed to a different person: "'The test of the representation is its actual effect on the particular mind, whether it is a strong and circumspect mind, or one weak and too relying.'" *Feckenscher v. Gamble*, 85 P.2d 885, 892 (Cal. 1939) (citations omitted); *accord*, *Blankenheim v. E.F. Hutton & Co.*, 266 Cal. Rptr. 593, 601 (Cal. Ct. App. 1990) ("'What would constitute fraud in a given instance might not be fraudulent when exercised toward another person. The test of the representation is its actual effect on the particular mind . . .'").

"If the conduct of the plaintiff in the light of his own intelligence and information was manifestly unreasonable, . . . he will be denied a recovery." *Seeger*, 115 P.2d at 981; *accord*, *Alliance Mortgage, Co.*, 900 P.2d at 609; *Thrifty Payless, Inc. v. The Americana at Brand LLC*, 160 Cal. Rptr. 3d 718, 726 (Cal. Ct. App. 2013); *see, e.g.*, *Wagner v. Benson*, 161 Cal. Rptr. 3d 516, 521-22 (Cal. Ct. App. 1980) (evidence of plaintiffs' past investments was relevant to whether they reasonably relied on bank's misrepresentations about current investment).

The law therefore treats sophisticated business persons differently for justifiable-reliance purposes than unsophisticated consumers. Sophisticated parties bring their depth

of knowledge and experience to the bargaining table. They are more likely to understand the express words and nuances of a contract, more likely to negotiate terms and retain an attorney, and more likely to take steps to protect themselves from false promises. Thus, the prospect of a plaintiff showing justifiable reliance decreases as plaintiff's sophistication level increases, and the likelihood of the plaintiff showing justifiable reliance increases as plaintiff's sophistication level drops.

This does not mean that sophisticated parties can never show justifiable reliance. The issue always depends on a case's specific facts. *See, e.g.*, *Thrifty Payless, Inc. v. Americana at Brand, LLC*, 160 Cal. Rptr. 3d at 728 (holding, for demurrer purposes, that Thrifty Payless "had adequately pleaded facts to show its reliance [on The Americana at Brand] was reasonable given the parties' previous dealings (through an affiliate of Americana) and because Americana had superior knowledge and information" about the specific mall); *Blankenheim v. E.F. Hutton & Co.*, 266 Cal. Rptr. at 600 (finding triable "justifiable reliance" issue even though plaintiff-investors were "well educated and were experts in the accounting and taxation areas," as they were not necessarily experts in all areas relevant to the investment).

**d.** ***The extent of any negotiations and the extent to which the parties were represented by counsel.***

The next question is whether the contract was presented on a take-it-or-leave-it basis or terms were negotiated. Parties negotiating contract terms tend to pay more attention to the written terms than nondrafting parties who are simply handed a form contract with little to no room to negotiate. Russell Korobkin, *supra*, *The Borat Problem*, 101 Cal. L. Rev. at 78. It is generally unrealistic to expect parties to wade through and grasp each and every detail of a form contract that they did not draft, particularly a lengthy contract brimming with boilerplate. In such contexts, the nondrafter — particularly an unsophisticated party — is more likely to rely on the other party's representations or assurances as to what the contract contains or means.

The situation fundamentally differs when the contract terms are negotiated. A reasonable negotiator needs to read and understand the terms of a draft contract. So it is reasonable to deem sophisticated parties as acting unjustifiably when they fail to read terms and then claim they were misled by pre-contract promises. But this principle is not absolute: "Even sophisticated parties can be surprised by written terms that are inconsistent with prior representations, especially when agreements include substantial boilerplate and broad disclaimers." Russell Korobkin, *supra*, *The Borat Problem*, 101 Cal. L. Rev. at 91.

And "[e]ven 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." Kathryn Albergotti & Sascha Yim, *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*, 40 Wm. Mitchell L. Rev. 135, 156 (2013). The clearer and more obvious the contradiction, however, the greater the plaintiff's difficulty in showing justifiable reliance.

Whether the parties retained attorneys or sophisticated negotiating agents is also highly relevant. When terms are negotiated, the parties are more likely to retain counsel or some other negotiating expert. In those contexts, the attorney's or agent's sophistication is imputed to the client. If the attorney or negotiating agent reasonably should have spotted any discrepancy between the contract terms and alleged pre-contract promises, a plaintiff cannot avoid the justifiable-reliance problem simply by claiming personal ignorance of the terms. Even in contexts where a party might not be expected to pore over the details of a lengthy contract, it is reasonable to expect the attorney to do so. That's the attorney's job.

As a result, parties represented by counsel in heavily-negotiated deals face an uphill battle in claiming justifiable reliance on oral promises that contradict a contract's written terms. Before *Riverisland*, some scholars urged that even if the *Pendergrass* rule were overbroad, its admissibility bar should be applied strictly to *all* cases involving "sophisticated parties" "assisted by lawyers in drafting their agreement" and "engaged in lengthy negotiations." Alicia W. Macklin, *supra*, *The Fraud Exception To The Parol Evidence Rule: Necessary Protection For Fraud Victims Or Loophole For Clever Parties,* 82 S. Cal. L. Rev. at 810. The rationale was that in such circumstances it "is doubtful that any substantial agreement would be made outside of the document." *Id.*; *see also id.* at 832 ("With sophisticated parties . . . written agreements are thoroughly negotiated and contain the entire agreement that each party, represented by teams of lawyers, intended to enter. To argue that sophisticated parties would have made a completely independent agreement outside the writing seems incredulous."). The concern was that merely applying a stricter burden of proof would not sufficiently protect sophisticated parties as they "should not be encumbered with litigation costs to fight fabricated or misrepresented evidence of fraud." *Id.* at 839.

*Riverisland* puts an end to that theory by making it a burden of proof issue. But the concepts are valid justifiable-reliance considerations. Justifiable reliance is a tougher sell where sophisticated parties represented by counsel in heavily-negotiated deals claim reliance on allegedly fraudulent promises that contradict written contract terms. Not only is it unreasonable for such plaintiffs to sign such contracts, it is reasonable to expect them to use the contract to document *all* promises and prevent any disputes about other promises. Again, the principle is not absolute. Sophisticated parties represented by counsel might conceivably be able to establish reasonable explanations for why the contract did not address the alleged misrepresentation or for not spotting the inconsistency in the written contract. But they will face greater difficulty in establishing the requisite "reasonableness" than unsophisticated parties who lacked an attorney.

### e. *The deal's nature: A high or low value transaction?*

Context matters. A patient walking into a doctor's office for a routine check-up is far less likely to scrutinize the various disclaimers and conditions in the standard intake agreement than a patient getting ready for open heart surgery. A consumer reviewing an on-line license agreement for software usage is far less likely to read the agreement before clicking "agreed," than a consumer making a $50,000 on-line purchase. *See* Russell Korobkin, *supra*, *The Borat Problem*, 101 Cal. L. Rev. at 78 (noting that a study of over 45,000 households concluded that less than 0.22% of online shoppers actually read the license agreement before clicking "agreed").

Every transaction entails an opportunity cost. If the transaction is of low value to a party, in terms of either financial ramifications or personal interest, that party is less likely to retain counsel, to bother negotiating terms, or to devote substantial time to reviewing the contract, particularly a long and cumbersome one. But in a high value transaction, such as a complex business deal with huge sums of money at stake, plaintiffs can be expected to take reasonable steps to protect themselves. It also reasonable for public policy to mandate circumspection when the stakes are high.

So, justifiable reliance on inconsistent pre-contract representations is easier to show in low-value transactions than in high-value ones.

### f. *The degree of conflict between the written terms and alleged oral promises.*

When a plaintiff asserts a *Pendergrass*-type claim, by definition the alleged pre-contract promises will conflict with written contract terms. But the degree of conflict can vary, and that degree is hugely important to evaluating justifiable reliance.

If the conflict is clear and irreconcilable, a party — whether sophisticated or unsophisticated — faces a high hurdle in establishing a reasonable basis for ignoring the written terms. For example, if an employee claims he was promised a $150,000 salary but the contract specifies $100,000, the conflict is crystal clear. If the plaintiff admits reading the irreconcilable terms before signing the contract, the plaintiff will need a legitimate excuse for ignoring the terms, such as proof that the defendant reasonably (but fraudulently) assured the plaintiff that it would not enforce the written terms. If the plaintiff denies reading the contract, he will need a reasonable excuse for failing to do so (as discussed further below).

Triable issues emerge, however, as the conflict between the alleged fraudulent misrepresentations and the contract terms becomes less obvious. If the misrepresentation can be viewed as *supplemental* to, and not directly at variance with, the written contract terms, triable justifiable-reliance issues typically exist. *See Broberg v. Guardian Life Ins. Co. of Am.*, 90 Cal. Rptr. 3d at 233-34 (finding triable justifiable-reliance issue because

misrepresentations that insurance policy would generate enough income to pay its own premiums did not contradict policy provision that premiums were payable for life; "nothing in the policy itself was inconsistent with the misrepresentation on which the lawsuit is based"); *Dias v. Nationwide Life Ins. Co.*, 700 F. Supp. 2d 1204, 1217-19 (E.D. Cal. 2010) (denying summary judgment because the alleged misrepresentation was not "'directly at variance'" with the insurance policy; "[w]hen the misrepresentations are not inconsistent with the terms of an insurance policy, reliance on the misrepresentations may still be 'justifiable'").

The contract terms — and thus the alleged inconsistency — can be ambiguous. In making this assessment, courts and juries should avoid 20-20 hindsight. Terms that might seem irreconcilably inconsistent at the time of the lawsuit may not have been so obviously inconsistent when the plaintiff signed the contract. *See* Russell Korobkin, *supra*, *The Borat Problem*, 101 Cal. L. Rev. at 78-79. Nondrafting parties reviewing a contract are vulnerable to "confirmation bias," which is the inherent tendency to interpret ambiguous information in a manner consistent with their understanding of the contract and to "pay more attention to supportive as opposed to counterindicative information." *Id.* at 79.

The movie *Borat:Cultural Learnings of America for Make Benefit Glorious Nation of Kazakhstan* is instructive. The movie featured Sacha Baron Cohen playing a Kazakstani television reporter traveling through the United States. What made the movie entertaining (to those who found it so) was Cohen's outrageous dealings with Americans who actually thought he was a foreign journalist making a documentary for an Eastern European audience. Russell Korobkin, *supra*, *The Borat Problem*, 101 Cal. L. Rev. at 55. After the movie came out, multiple individuals who looked buffoonish or boorish in the movie sued the studio for allegedly misrepresenting that they would be in a documentary with a foreign journalist, not a movie with actors. The plaintiffs, however, had signed short releases establishing their consent to participating in a "documentary-style film" that would use "entertaining contents and formats." *Id.* at 54-55. The discrepancy between a documentary and an "entertaining"and "documentary-style" *film* might jump off the page with hindsight, particularly with the movie's outlandish nature running as a backdrop. But at the time plaintiffs signed the releases, the difference was not so obvious. If someone actually told plaintiffs the film was a documentary by a foreign journalist, confirmation bias and the inherent desire not to assume the worst would have reduced plaintiffs' ability to spot the inconsistencies in the releases. *Id.* at 80-81.

So although the conflict between pre-contract representations and written contract terms may seem obvious at time of trial, courts and juries must focus on what plaintiffs likely would have spotted *when they signed the contract*. Justifiable reliance cannot rest on 20-20 hindsight. A promise to pay $150,000 versus a promise to pay $100,000 presents an unequivocal, irreconcilable conflict. But a promise about a documentary versus a "documentary-style" film is not so obvious. A plaintiff's ability to show justifiable reliance decreases as the conflict between the alleged fraudulent misrepresentations

becomes more obvious and irreconcilable. And it increases as the inconsistency becomes more ambiguous and uncertain.

**g. *The clarity and conspicuousness of the written terms.***

A similar question is whether the inconsistent contract terms are hidden in boilerplate, buried within a lengthy document, or otherwise difficult to spot. Generally speaking, contracting parties are bound by "clear and conspicuous" contract provisions, even if they did not read them. *Mission Viejo Emergency Medical Associates v. Beta Healthcare Group*, 128 Cal. Rptr. 3d 330, 337-38 (Cal. Ct. App. 2011) (listing cases); *see also Malcolm v. Farmers New World Life Ins. Co.*, 5 Cal. Rptr. 2d 584, 589 n.6 (Cal. Ct. App. 1992) (insureds must read their policies and therefore are bound by "'clear and conspicuous provisions in the policy even if evidence suggests that the insured did not read or understand them'"); *Hadland v. NN Investors Life Ins. Co.*, 30 Cal. Rptr. 2d at 95 (insured who never read policy could not claim justifiable reliance on misrepresentation contradicted by policy's clear and conspicuous language).

A contract term is not conspicuous if "'it appears only after [many] long and complicated page[s] of fine print . . . .'" *Haynes v. Farmers Ins. Exchange*, 89 P.3d 381, 389 (Cal. 2004) (citation omitted). To be conspicuous and clear, the term "'must be positioned in a place and printed in a form which would attract a reader's attention,' and its substance 'must be stated in words that convey the proper meaning to persons expected to read the contract.'" *Id.* at 393 (Baxter, J., dissenting) (citation omitted); *see Broberg v. The Guardian Life Ins. Co. of Am.*, 90 Cal. Rptr. 3d at 233 (finding disclaimers not so clear and obvious as to preclude reasonable reliance as matter of law, given "the placement of the disclaimers (buried in a sea of same-sized, capitalized print), coupled with the absence of any cautionary language on the first page of the policy illustration, which contains the deceptive language and figures").

**h. *Did the plaintiff read the contract before signing*?**

The last, but certainly not least, justifiable-reliance factor is whether the plaintiff read the contract. The impact of a plaintiff's failure to read a contract is a hugely important public-policy issue: The law should encourage parties to read their contracts. *See, e.g.*, *Taff v. Atlas Assur. Co.*, 137 P.2d 483, 487 (Cal. Ct. App. 1943) ("It is a duty of the insured to read his policy"). Thus, "'[t]he general rule is that, when a person with the capacity of reading and understanding an instrument signs it, he is, *in the absence of fraud and imposition*, bound by its contents, and is estopped from saying that its provisions are contrary to his intentions or understanding.'" *Palmquist v. Mercer*, 272 P.2d 26, 30 (Cal. 1954) (emphasis added) (citation omitted). So the question becomes: What happens when the signatory who has not read the contract claims there was "fraud and imposition"? *Riverisland* left this issue unresolved.

The Supreme Court in *Riverisland* embraced its prior holding in *Rosenthal*, 926 P.2d at 1078, that a party's "negligent failure to acquaint oneself with the contents of a written agreement precludes a finding that the contract is void for fraud *in the execution*." *Riverisland*, 291 P.3d at 325 n.11 (emphasis added). But the Court added that it has traditionally applied "*a more lenient* rule" when "equitable relief is sought for fraud *in the inducement* of a contract," and it then refused to "explore the degree to which failure to read the contract affects the viability of a claim of fraud in the inducement." *Id.* (emphasis added).

*Riverisland*, thus, re-affirms *Rosenthal*'s rule that a plaintiff's negligent failure to read a contract will preclude a claim for fraud in the execution. But *Riverisland* does not illuminate how the failure to read a contract impacts fraud-in-the-inducement claims. Nor is the distinction between "fraud in the execution" and "fraud in the inducement" entirely clear when *Pendergrass*-type claims are involved, as those plaintiffs often claim they did not realize what they signed. Since *Riverisland* re-affirmed *Rosenthal*, it makes sense to start with *Rosenthal* in analyzing the proper failure-to-read standard for *Pendergrass*-type claims.

### h.1 *Rosenthal* and the fraud-in-the-execution distinction.

In a fraud-in-the-execution claim, "the fraud goes to the inception or execution of the agreement, so that the promisor is deceived as to the nature of his act, and actually does not know what he is signing, or does not intend to enter into a contract at all, mutual assent is lacking, and [the contract] is *void*. In such a case it may be disregarded without the necessity of rescission." *Rosenthal*, 926 P.2d at 1073 (internal quotation marks omitted) (emphasis in original).

By contrast, fraud in the inducement "occurs when the promisor knows what he is signing but his consent is *induced* by fraud, mutual assent is present and a contract is formed, which, by reason of the fraud, is *voidable*. In order to escape from its obligations the aggrieved party must *rescind*." *Rosenthal*, 926 P.2d at 1073 (internal quotation marks omitted) (emphasis in original).

Put another way, a fraud-in-the-execution claim must involve a fraud "so fundamental that [the plaintiffs] were deceived as to the basic character of the documents they signed" and the circumstances thus warrant "a judicial determination they never assented to any contract." *Rosenthal*, 926 P.2d at 1079-80.

In *Rosenthal*, investment representatives allegedly told plaintiffs to sign a document that was a mere formality required to open an investment account, when the document actually contained an arbitration agreement. *Rosenthal*, 929 P.2d at 1066. Plaintiffs never read the document, so the question was whether they could justifiably rely on the representatives' misrepresentations "without themselves ascertaining the nature of the documents they signed." *Id.* at 1076. Plaintiffs claimed the assertion of fraud legally

excused their failure to read the contract; defendants claimed that plaintiffs "had a reasonable opportunity to know the terms of the client agreements" and therefore their neglect precluded their claims. *Id.* The Court distinguished between fraud in the inducement, which makes a contract *voidable*, and fraud in the execution, which makes a contract *void*. *Id.* at 1073. It concluded that a "misrepresentation does not render the contract *void* unless the misled party, before making the agreement, *lacked a reasonable opportunity to learn its terms*." *Id.* at 1077 (first emphasis in original, second emphasis added).

The Supreme Court did not hold that the failure to read a contract absolutely precludes a fraud-in-the-execution claim. Rather, the failure to read must be *unreasonable*, i.e., *negligent*:

> California law . . . requires that the plaintiff, in failing to acquaint himself or herself with the contents of a written agreement before signing it, not have acted *in an objectively unreasonable manner*. One party's misrepresentations as to the nature or character of the writing do not negate the other party's apparent manifestation of assent, if the second party had "reasonable opportunity to know of the character or essential terms of the proposed contract." (Rest.2d Contracts, § 163.) If a party, with such reasonable opportunity, fails to learn the nature of the document he or she signs, *such "negligence"* precludes a finding the contract is void for fraud in the execution.

*Rosenthal*, 926 P.2d 1078 (emphasis added); *see also id.* at 1078-79 ("one party's *unreasonable* reliance on the other's misrepresentations, resulting in a failure to read a written agreement before signing it" does not allow a plaintiff to avoid the contract under the fraud-in-the-execution doctrine) (emphasis in original); *id.* at 1079 (statements that the document being signed was unimportant "even if falsely and fraudulently made, do not void a written contract, because it is generally unreasonable, in reliance on such assurances, to neglect to read a written agreement before signing it").

The facts in *Rosenthal* help explain the distinction between a "reasonable" and "unreasonable" opportunity to read a contract. The Supreme Court rejected fraud-in-the execution claims of plaintiffs who merely relied on representations that the document was a mere formality and there was no need to read it, concluding such assurances did not deprive them "of the reasonable opportunity to discover the character and essential terms of the agreement." 926 P.2d at 1079; *see also id.* at 1081. It also rejected the claims of plaintiffs who claimed they felt rushed or pressured into signing the document, as there was no evidence of defendants specifically saying or doing anything to hurry or pressure them. *Id.* at 1079 n.12. The Court further emphasized that the plaintiffs did not claim anyone concealed the arbitration clause or affirmatively misrepresented its existence or meaning. *Id.* at 1080.

The Supreme Court did, however, approve fraud-in-the-execution claims by plaintiffs who (a) either spoke little English, could not read English, or were legally blind; and (b) claimed the defendants fraudulently translated the document for them. *Id.* at 1081-83. It found those fact allegations created triable issues that fraud deprived those plaintiffs "of a reasonable opportunity to learn the character and essential terms of the documents they signed." *Id.* at 1082; *see also id.* at 1083.[18]

### h.2 The potential standard for *Pendergrass*-type claims.

*Rosenthal* and *Riverisland* (by discussing *Rosenthal* with approval) teach that if a plaintiff sues for fraud in the execution or otherwise claims the contract is *void*, the plaintiff's failure to read the contract will usually defeat the claim. To claim justifiable reliance in that context, the plaintiff must meet the high hurdle of showing the absence of a reasonable opportunity to read the contract.

Thus, in order to know whether the presence of a reasonable opportunity to read the contract is a defense, defendants confronting *Pendergrass*-type promissory fraud claims must first determine whether plaintiffs are claiming fraud in the execution. For example, if the parties exchanged and read prior drafts containing the alleged false promises but the defendant substituted a document with different terms at the time of signing, the plaintiff arguably would be claiming fraud in the execution. *See* Restatement (Second) of Contracts § 163 cmt. b, illus. 2 (1981). Fraud in the execution is not limited to circumstances where the plaintiff did not intend to contract; it also applies where the plaintiff believes "he is assenting to a contract entirely different from the proposed contract." *Id.*, § 163 cmt. a.

*Rosenthal* further teaches that the goal of preventing or redressing fraud does not always trump the dual goals of encouraging plaintiffs to read contracts and preventing fictitious fraud claims. The debate over a plaintiff's failure to read a contract entails the same inherently-conflicting public-policy concerns underlying the debate over the *Pendergrass* rule: "There has always been a sharp struggle in the courts between the desire to repress fraud upon the one hand, and on the other to discourage negligence and the opportunity and invitation to commit perjury." *California Trust Co. v. Cohn*, 7 P.2d 297, 300 (Cal. 1932) (*Cohn*). *Rosenthal* establishes that the goal of redressing fraud does not always carry the day. Where a plaintiff alleges fraud in the execution or claims the contract is void, the plaintiff's unreasonableness in failing to read the contract will defeat a showing of justifiable reliance.

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[18] The Court confirmed its narrow construction of this reasonableness exception by rejecting the claims of other plaintiffs who also claimed a limited understanding of English. *Rosenthal*, 926 P.2d at 1083. It concluded those plaintiffs could not claim reasonable reliance because there was no evidence that: (a) plaintiffs told defendants they could not read the contracts; (b) the parties had a prior relationship; and (c) defendants purported to read the document or explain it orally. *Id.*

But *Rosenthal* and *Riverisland* fail to delineate the impact in the fraud-in-the-inducement context of a plaintiff's failure to read the contract. *Riverisland* couched the Court's prior fraud-in-the-inducement precedent as espousing a "more lenient rule," without elaborating what that rule is or should be. *Riverisland*, 291 P.3d at 325 n.11. The Court also refused to wade into the issue in *Rosenthal*. *See Rosenthal*, 926 P.2d at 1078 ("We therefore conclude that, *whatever validity* the rule stated in *Lynch*, *Strotz* and Witkin [that a plaintiff's failure to read a contract is excusable where the plaintiff relies on misrepresentations] *may have* when the plaintiff seeks equitable relief for fraud in the inducement of a contract, *and whatever the exact parameters of that rule might be*, the rule is not a correct statement of the test to be applied when the plaintiff seeks a judicial determination the contract is void for fraud in the execution") (emphasis added).

To determine the parameters of this so-called "more lenient rule" applicable in the fraud-in-the-inducement context, one must examine other Supreme Court precedent.

***Supreme Court fraud-in-the-inducement precedent***: In claiming California courts have applied a "more lenient rule" for fraud in the inducement, *Riverisland* cited two Supreme Court cases, *Cohn*, 7 P.2d 297, and *Fleury v. Ramacciotti*, 67 P.2d 339 (Cal. 1937) (*Fleury*), which construed *Cohn*. *See Riverisland*, 291 P.3d at 325 n.11. Unfortunately, *Cohn* and its progeny are less than clear:

- In *Cohn*, 7 P.2d 297, cross-complainants alleged that the cross-defendant made certain oral promises and then "falsely and fraudulently represented" that the written contract contained those same promises; in reliance on those representations, the cross-complainants signed the contract "without reading it." *Id.* at 298. The trial court entered a judgment of dismissal after sustaining a demurrer; the Supreme Court reversed with directions to overrule the demurrer. *Id.* at 301. The Supreme Court surveyed prior misrepresentation-claim precedent regarding a plaintiff's failure to read a contract, and concluded that this issue "has apparently perplexed the courts; for an examination of the authorities discloses a contrariety of opinions thereon both here and in other jurisdictions" and "[t]o distinguish or reconcile the many decisions on this point is an impossibility." *Id.* at 300. But the Court concluded that "it is safe to say that the failure to read a written instrument which it is sought to have reformed need *not necessarily* constitute a bar to relief." *Id.* (emphasis added). The Court then made a general pronouncement indicating that the impact of the failure to read depends on whether the plaintiff acted reasonably given the case's specific facts:

> Whether or not such a failure [to read the contract] amounts to *such grossly and inexcusably negligent conduct as to preclude relief by way of reformation*, depends upon the peculiar circumstances of each case. The failure to read an instrument prior to its execution is an act to be explained, and, where the testimony sufficiently explains such failure, it is removed from the case just as other acts of failure might be removed.

*Id*. (emphasis added). But the Court muddied the waters by adding it was:

> inclined to the view, therefore, that where the failure to familiarize one's self with the contents of a written contract prior to its execution is traceable *solely to carelessness or negligence*, reformation *as a rule* should be denied; but that where such failure, and perhaps negligence, is induced, as alleged and admitted by the demurrer in this case, by *the false representations and fraud of the other party to the contract that its provisions are different from those set out*, the courts, even in the absence of a fiduciary or confidential relationship between the parties, should reform . . . the instrument so as to cause it to speak the true agreement of the parties.

*Id*. (emphasis added).

• Five years later, the Supreme Court, in *Fleury*, 67 P.2d at 340, rejected the principle that "only where confidential relations exist between the parties is one who negligently fails to read an instrument entitled to avoid it for fraud." The plaintiff and defendant in *Fleury* were intimate friends and business associates. *Id.* at 339. After plaintiff sued to foreclose a mortgage, the trial court allowed defendant to avoid foreclosure, concluding a deficiency judgment was improper because defendant relied on plaintiff's representation that the note was drawn to prevent a deficiency judgment. *Id.* In affirming the judgment, the Court followed *Cohn* as declaring 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 340.

• Five years after *Fleury*, the Court construed *Fleury* and *Cohn* in *Security-First National Bank of Los Angeles v. Earp*, 122 P.2d 900 (Cal. 1942), as standing for the principle that a plaintiff's "negligence in failing to read the contract does not bar his right to relief *if he was justified in relying upon the representations*." *Id.* at 902 (emphasis added) (citations omitted). The plaintiffs, who had a ten-year business relationship with defendant and had negotiated contracts with defendant previously, were fraudulently told that the document being signed was merely a renewal of a prior mortgage. *Id.* The Supreme Court held that the failure to read the renewal contract under those circumstances did not defeat a showing of justifiable reliance: "Since [the plaintiffs] were already familiar with the terms of the old mortgage, they were justified in assuming that there was no necessity for reading the instrument that was represented to them as a renewal of that mortgage." *Id.* The Court drew a distinction between that situation and contexts where "there were no fraudulent representations as to the contents of the contracts in question" and the plaintiff's misconception "was attributable solely to his failure to read it." *Id.*[19]

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[19] In addition to its own precedent, the Supreme Court in *Riverisland* mentioned *Lynch v. Crittenden & Co.*, 22 Cal. Rptr. 2d 636, 639 (Cal. Ct. App. 1993), in stating that courts apply a "more lenient rule" for fraud-in-the-inducement claims. See *Riverisland*, 291 P.3d at 325 n.11. *Lynch*, however, involved allegations similar to the fraud-in-the-execution claims at issue in *Rosenthal*. In *Lynch*, the plaintiff signed various brokerage forms without

(continued...)

Additional Supreme Court precedent indicates that the impact of a plaintiff not reading a contract may depend on whether the case involves a context where courts have derived special rules to protect certain types of plaintiffs, such as insureds. For example, in *Glickman v. New York Life Ins. Co.*, 107 P.2d 252 (Cal. 1940), the Supreme Court held that an insured's failure to read his insurance policy did not necessarily defeat his claim that the insurer fraudulently misrepresented his rights under the policy. It concluded that the rule presuming parties are familiar with contract terms "'should not be strictly applied to insurance policies'" because "'[i]t is a matter almost of common knowledge that a very small percentage of policyholders are actually cognizant of the provisions of their policies'"; the "'insured usually confides implicitly in the agent securing the insurance, and it is only just and equitable that the company should be required to call specifically to the attention of the policyholder'" any unusual or obscure provisions. *Id.* at 255 (citation omitted); *accord Haynes v. Farmers Ins. Exchange*, 89 P.3d at 390. This does not mean that an insured can necessarily escape the consequences of failing to read clear and conspicuous policy terms.[20] But it does mean courts in certain contexts may be more forgiving of a plaintiff's failure to read and shun bright-line rules.[21]

There are additional Supreme Court pieces to the analytical puzzle:

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[19](...continued)
reading them, relying on the stockbroker's misrepresentations that the forms were a formality that did not affect legal rights, when they actually included an arbitration agreement; the stockbroker discouraged plaintiffs from reading the documents, relying on their long friendship. 22 Cal. Rptr. 2d at 638. In concluding the plaintiff's failure to read the contract did not bar the fraud claim, the Court of Appeal made a frequently-cited pronouncement that "[t]he general rule in California is that even in the absence of a fiduciary relationship plaintiff's failure to read a contract is excusable where reliance is placed on the misrepresentations of the other party." *Id.* at 639. *Rosenthal*, however, criticized this language, and comparable language in Witkin and in *Strotz v. Dean Witter Reynolds, Inc.*, 272 Cal. Rptr. 680 (Cal. Ct. App. 1990), as stating "the rule of excuse too broadly" because a "misrepresentation does not render the contract *void* unless the misled party, before making the agreement, lacked a reasonable opportunity to learn its terms." *Rosenthal*, 926 P.2d at 1077 (emphasis in original).

[20]
> Failing to read a policy (or its table of contents) is not sufficient reason to hold a clear and conspicuous policy provision unenforceable. To hold otherwise would turn both contract and insurance law on its head. Insurers are not required to sit beside a policy holder and force them to read (and ask if they understand) every provision in an insurance policy. Nor are policy holders permitted to accept the benefits under the policy while denying the existence of inconvenient terms.

*Mission Viejo Emergency Medical Associates v. Beta Healthcare Group*, 128 Cal. Rptr. 3d at 338; *see also Taff v. Atlas Assur. Co.*, 137 P.2d at 487 ("In order to be relieved of the result of his failure to read his policy the insured must have exercised that degree of care ordinarily exercised by a reasonably prudent person under the same circumstances"; the insurer's failure to issue a policy covering a risk plaintiff thought was covered is not fraud absent allegations "that defendant knew or should have known that plaintiff would not examine the policy or that defendant took affirmative action to prevent such examination").

[21] *See, e.g.*, *Clement v. Smith*, 19 Cal. Rptr. 2d at 679 ("[w]hen dealing with a contract as adhesive as the typical insurance policy, we are unwilling to impose on the insured so onerous a burden as would automatically defeat any agent's liability for misrepresentation"; insureds should be allowed to rely on an agent's representations of coverage absent some "notice or warning" to the contrary, because insureds are understandably reluctant "to commence a study of the policy terms" as few insurance terms "can be clearly and completely understood by persons untrained in insurance law"); *Paper Savers, Inc. v. Nacsa*, 59 Cal. Rptr. 2d at 556 ("[e]ssentially, the issue whether an insured has a duty to read his policy and whether in not reading his policy he is, nonetheless, bound by its terms, is a complex one and not one that can be stated baldly without an analysis of the surrounding facts").

• Cases that do not specifically involve a plaintiff's failure to read a contract often contain broad pronouncements that "[n]egligence on the part of the plaintiff in failing to discover the falsity of a statement is no defense when the misrepresentation was intentional rather than negligent." *Seeger*, 115 P.2d at 980.

> As a general rule negligence of the plaintiff is no defense to an intentional tort. The fact that an investigation would have revealed the falsity of the misrepresentation will not alone bar his recovery, and it is well established that he is not held to constructive notice of a public record which would reveal the true facts. . . . If the conduct of the plaintiff in the light of his own intelligence and information was manifestly unreasonable, however, he will be denied a recovery. "He may not put faith in representations which are preposterous, or which are shown by facts within his observation to be so patently and obviously false that he must have closed his eyes to avoid discovery of the truth . . . ."

*Id.* at 980-81 (citations omitted). In *Seeger*, for example, defendants induced plaintiff to enter a lease by fraudulently misrepresenting that land had been sold at an execution sale. *Id*. at 980. The Supreme Court held that plaintiff's ability to have discovered the statement's falsity through a record search did not bar relief, because the misrepresentation was "not such that its falsity must have been *so obvious* to the plaintiffs as to preclude any justifiable reliance thereon by them." *Id.* at 981 (emphasis added).

• The Supreme Court has also stated, in the context of *non-wilful* misrepresentations, that "[a] defendant who misrepresents the facts and induces the plaintiff to rely on his statements should not be heard in an equitable action to assert that the reliance was negligent unless plaintiff's conduct, in the light of his intelligence and information, is *preposterous or irrational*." *Van Meter v. Bent Constr. Co.*, 297 P.2d 644, 648 (Cal. 1956) (emphasis added).

***The Restatement***: The Restatement also sheds potential light on how the California Supreme Court might resolve the "failure to read" question left open by *Riverisland*. In determining the standard for fraud-in-the-execution claims, *Rosenthal* relied heavily on the Restatement of Contracts. *See Rosenthal*, 926 P.2d at 1076-79. California courts will likely do the same for fraud in the inducement.

With respect to a plaintiff's failure to read a contract, the Restatement distinguishes between claims that (a) the contract is *void* because fraud negated a party's consent, Restatement (Second) of Contracts § 163, and (b) the contract is *voidable* and therefore subject to rescission or reformation, Restatement (Second) of Contracts § 164.

Restatement of Contracts section 163 provides that "[i]f a misrepresentation as to the character or essential terms of a proposed contract induces conduct that appears to be a manifestation of assent by one who neither knows nor has a reasonable opportunity to

know of the character or essential terms of the proposed contract, his conduct is not effective as a manifestation of assent." Restatement (Second) of Contracts § 163. The comments to this section confirm that it addresses fraud *in the execution*, not fraud in the inducement, and that the rule does not apply if the recipient had a reasonable opportunity to know the character of the contract (as *Rosenthal* holds). Restatement (Second) of Contracts § 163 cmt. a.

In situations where a party had a reasonable opportunity to read the contract and therefore cannot claim fraud in the execution based on fraudulent promises, the Restatement of Contracts allows a party to potentially argue that those promises make the contract voidable. *See, e.g.*, Restatement (Second) of Contracts § 163 cmt. b, illus. 3 (if a party fraudulently prepares a writing containing terms that differ from agreed-upon promises and tells the other side it contains the agreed-upon terms, a reasonable opportunity to read the contract will preclude a fraud-in-the-execution claim but the contract still may be voidable under Restatement section 164). But the plaintiff must establish justifiable reliance: Section 172, entitled "When Fault Makes Reliance Unjustified," provides that a defrauded plaintiff's "fault in not knowing or discovering the facts before making the contract does not make his reliance unjustified *unless it amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing*." Restatement (Second) of Contracts § 172 (emphasis added). That section's comments explain that this principle reflects the requirement that "[t]he recipient's reliance on the misrepresentation must be justified in order to entitle him to avoidance (§ 164) or reformation (§ 166)." *Id.*, cmt. a. Thus, the plaintiff "is not entitled to relief if his reliance was unreasonable in the light of his particular circumstances . . .[,] [b]ut the mere fact that he could, by the exercise of reasonable care, have avoided the mistake caused by the misrepresentation does not bar him from relief." *Id.*

So, under the Restatement, the mere fact that the plaintiff might have avoided the mistake by reading the contract does not necessarily *preclude* a fraud-in-the-inducement claim for rescission or reformation. But that does not mean a plaintiff's failure to read a contract *never* defeats a showing of justifiable reliance. Rather, the Restatement indicates that the issue depends on each case's particular facts. *See* Restatement (Second) of Contracts § 172 cmt. a (recipient's fault makes reliance unjustified "where he has failed to act in good faith and in accordance with reasonable standards of fair dealing"); *id.*, cmt. b ("[i]n determining whether the recipient of a misrepresentation has conformed to the standard of good faith and fair dealing, account is taken of his peculiar qualities and characteristics, including his credulity and gullibility, and the circumstances of the particular case").

***Putting all the pieces together***: So what happens when all this precedent goes into the legal sausage grinder? Given the uncertainty in the case law, there is room for disagreement. But the case law makes two things clear.

First, if the plaintiff lacked a reasonable opportunity to discover the document's true nature, such as being prevented by a physical or mental impairment, the failure to read the contract will *not* bar a fraud claim. Such circumstances will likely support a claim that the contract is *void* for fraud in the execution.

Second, even if the plaintiff failed to utilize a reasonable opportunity to review the contract, that neglect will *not necessarily* defeat a fraud-in-the-inducement claim to rescind or reform the contract as voidable. In that sense, the fraud-in-the-inducement standard is "more lenient" than the fraud-in-the-execution standard, as *Riverisland* states. *Riverisland*, 291 P.3d at 325 n.11. But there is no "absolute leniency." Case law shows that the failure to read a contract can preclude a showing of justifiable reliance for a fraud-in-the-inducement claim, depending on the case's particular facts.

So where is the line between when a plaintiff's failure to read a contract will defeat a fraud-in-the-inducement claim and when it won't? Supreme Court precedent and the Restatement are awash in different buzzwords:

- Whether the failure to read the contract was "grossly and inexcusably negligent conduct," *Cohn*, 7 P.2d at 300, "traceable solely to carelessness or negligence," *id.*, or "induced by fraud of the other party," *Fleury*, 67 P.2d at 340;

- Whether the plaintiff's misunderstanding was "attributable solely to his failure to read [the contract]," *Security-First National Bank*, 122 P.2d at 902;

- Whether the plaintiff's conduct was "manifestly unreasonable," *Seeger*, 115 P.2d at 981, "preposterous or irrational," *Van Meter*, 297 P.2d at 648, or "unreasonable in the light of [plaintiff's] particular circumstances," Restatement (Second) of Contracts § 172 cmt. a, or amounted to "a failure to act in good faith and in accordance with reasonable standards of fair dealing," Restatement (Second) of Contracts § 172; or

- Whether the misrepresentations were "patently or obviously false," *Seeger*, 115 P.2d at 981.

In trying to formulate the correct standard, it is important not to overstate the general principle that the plaintiff's negligence "in failing to discover the falsity of a statement is no defense when the misrepresentation was intentional" unless the falsity was "so obvious" as to preclude justifiable reliance. *Seeger*, 115 P.2d at 980, 981. That principle makes sense in cases like *Seeger* that do not involve a plaintiff's failure to read a contract. But, when applied to a situation where the plaintiff unreasonably failed to read a contract, the concept sweeps too broadly. In that context, the concept that a plaintiff's negligence is "no defense" to an intentional tort butts heads with the competing public-policy principle that parties have an obligation to read contracts and are bound by clear and conspicuous terms.

Courts should not permit plaintiffs to avoid their objectively unreasonable failure to read a contract simply by claiming fraud in the inducement, rather than fraud in the execution. In considering when a plaintiff's conduct should bar recovery for intentional misrepresentation, *Seeger* discusses whether the plaintiff's conduct was manifestly unreasonable "in the light of his own intelligence *and information*" and whether the alleged misrepresentations "are shown by facts *within his observation* to be so patently and obviously false that he must have closed his eyes to avoid discovery of the truth." *Seeger*, 115 P.2d at 981 (emphasis added). When clear and conspicuous contract terms directly contradict alleged misrepresentations, facts within the plaintiff's own "information" and own "observation" do show that the misrepresentations are "patently and obviously false." The plaintiff only needs to read the contract to spot the falsity, something plaintiff already has an obligation to do. Courts should not let plaintiffs close their eyes to contract terms "to avoid discovery of the truth."

Consequently, when fraud-in-the-inducement claims are at issue, the proper focus is not whether the plaintiff had *a reasonable opportunity to read* the contract (which is the proper focus for fraud-in-the-execution claims), but rather whether the plaintiff *acted justifiably or reasonably in failing to read* the contract. A rule that a plaintiff's negligent failure to read a contract can *never* defeat a fraud-in-the-inducement claim would encourage parties to refuse to read contracts and open the floodgates to fictitious fraud claims. Public policy mandates a balanced approach. The justifiable-reliance element allows that balancing.

There are many instances where a plaintiff's failure to read a contract, while neglectful, may be considered reasonable and excusable given the overall circumstances. As *Cohn* put it, "[t]he failure to read an instrument prior to its execution is an act *to be explained* and where the testimony *sufficiently explains* such failure, it is removed from the case just as other acts of failure might be removed." 7 P.2d. at 300 (emphasis added). A plaintiff, thus, needs a reasonable explanation for not reading the contract.

So what's a reasonable explanation? *Fleury* speaks in terms of the plaintiff's failure to read the contract being "induced by fraud of the other party." 67 P.2d at 340. *Cohn* similarly speaks in terms of the plaintiff's failure to read the contract being "induced . . . by the false representations and fraud of the other party to the contract that its provisions are different from those set out . . . ." 7 P.2d at 300.

Taken together, these statements logically stand for the proposition that if the defendant *specifically said or did something* that *reasonably induced the plaintiff not to read the contract*, the failure to read will not defeat the fraud claim. In other words, it's not just that fraud induced the plaintiff to enter into a contract, it's that fraud induced the plaintiff not to read the contract. For example, if parties agree to execute a written contract containing all agreed-upon terms and the defendant induced the signing of a contract with different terms by misrepresenting that the document contains "the agreed terms and *that it is not necessary for him to read it*," those statements may (depending on

the parties' relationship and the overall circumstances) support a fraud-in-the inducement claim even if plaintiff never read the contract. Restatement (Second) of Contracts § 172 cmt. a, illus. 1 (emphasis added) (noting in that circumstance, the recipient's "reliance is justified since his fault does not amount to a failure to act in good faith and in accordance with reasonable standards of fair dealing").

Even if the defendant does not expressly say "don't bother reading the contract," a triable justifiable-reliance issue may exist if the defendant's representations and conduct implicitly convey the same message — for example, the defendant misrepresents at the time of execution that the document contains terms different from its actual content, and the parties' relationship makes the plaintiff reasonably believe there is no need to review the contract. *See, e.g.*, *Security-First National Bank*, 122 P.2d at 902 (parties had a ten-year relationship of trust, and defendant fraudulently told the plaintiff that the document being signed was merely a renewal of a prior mortgage); *Fleury*, 67 P.2d at 339 (parties were intimate friends and business associates, and defendant misrepresented that the document being signed was merely a renewal note that would not permit a deficiency judgment). Notably, not only did *Security-First National Bank* and *Fleury* involve contexts where the parties had a longstanding relationship (which provided a reasonable basis for the parties to trust each other), the parties also had a prior *contractual* relationship regarding the same subject matter (which provided a reasonable basis for believing the new document was merely a renewal of a prior agreement).

In contrast, the result should be different where the defendant never specifically said or did anything at the time of signing to induce the plaintiff not to read the contract, and/or where the parties lacked any sort of trust relationship that might excuse the plaintiff's failure to read the contract. In *Hadland v. NN Investors Life Ins. Co.*, 30 Cal. Rptr. 2d 88, for example, plaintiff claimed that an insurance agent misrepresented at a sales meeting that a new policy would be "as good if not better" than the plaintiff's prior policy, but the insurer later sent the plaintiff a certificate clearly stating the coverage benefits and asked the insured to read the coverage and notify the insurer within ten days if it did not meet the insured's needs. *Id.* at 89. Although plaintiff thought the policy would cover claims that the policy clearly showed were not covered, he never read the policy despite a reasonable opportunity to do so. *Id.* at 89-90, 93. The Court of Appeal held that plaintiff, as a matter of law, could not show reasonable reliance because the alleged misrepresentation was directly at odds with the policy's clear and conspicuous terms, and courts must generally hold an insured "'bound by clear and conspicuous provisions in the policy even if evidence suggests that the insured did not read or understand them.'" *Id.* at 95 (quoting *Sarchett v. Blue Shield of California*, 729 P.2d 267, 276 (Cal. 1987)).

*Hadland* comports with the principle that if the defendant did not do anything specifically to induce the plaintiff not to read the contract, the plaintiff cannot avoid its failure to read simply by claiming an intentional tort. *See also Hackethal v. Nat'l Cas. Co.*, 234 Cal. Rptr. at 855, 858 (insured could not claim justifiable reliance where he failed to read policy directly contradicting alleged pre-contract comments, and insurance agent

never specifically said the policy covered administrative hearings as the insured assumed); *Slivinsky v. Watkins-Johnson Co.*, 270 Cal. Rptr. at 589 (no reasonable reliance on false promises of continuing employment where plaintiff never claimed anyone misrepresented the terms of integrated at-will employment agreement).

Given the need for a reasonable excuse for failing to read a contract, plaintiffs who claim they never read the contract will face particular difficulty showing justifiable reliance where: (a) the contract terms were negotiated, and the alleged misrepresentations occurred early in the process, rather than at the time of signing; (b) the plaintiff had an attorney, who owed a fiduciary duty to review and understand the contract even if the client never read it; and (c) the parties had no prior contractual or business relationship, and were equally sophisticated. Many *Pendergrass*-type fraud claims fall within these categories, as they rest on allegations that the defendant made oral "promises" that ended up contrary to the signed contract.

That such "promises" were allegedly made is not the same thing as a defendant specifically telling the plaintiff there is no need to read the document or a defendant engaging in other conduct designed to keep plaintiff from reading the contract. If the defendant did not do anything to induce plaintiff's failure to read, courts should not let plaintiffs avoid clear and conspicuous contract terms simply by claiming they never read the contract and "fraud" occurred. Again, the *Pendergrass* rule may be gone, but its policy predicates should not be forgotten.

**2. Balancing the continuum factors.**

The justifiable-reliance factors discussed above fall on a continuum — with the inability to show justifiable reliance on one end and the ability to show it, or present triable issues, at the other.

A plaintiff will have difficulty showing justifiable reliance, and face dismissal for lack of justifiable reliance, in circumstances where:

- the plaintiff alleges inconsistent pre-contract "promises," not misrepresentations of fact;
- plaintiff's testimony is the only evidence of the pre-contract promises;
- the parties are both sophisticated and have roughly equal bargaining power;
- the contract terms were negotiated;
- the parties were represented by counsel in the negotiations;
- the transaction was of high value;
- the alleged oral promises directly and irreconcilably conflict with the terms of the written contract;
- the inconsistent written terms are clearly and conspicuously displayed in the contract;

- the plaintiff either (a) read the contract, and does not claim that the defendant provided a reasonable explanation for the discrepancy between the alleged oral promises and the written terms; *or* (b) failed to read the contract despite a reasonable opportunity to do so, and there is no evidence the defendant said or did anything to reasonably induce the plaintiff not to read the contract.

On the other hand, plaintiffs will have an easier time showing justifiable reliance, or establishing triable issues, where:

- the alleged misrepresentation reasonably can be couched as factual, not a "promise";
- documents and/or testimony from other witnesses support plaintiff's claim that the misrepresentations occurred;
- the plaintiff is unsophisticated compared to defendant, and defendant has stronger bargaining power or knowledge;
- the contract terms were not negotiated and were given on a "take it or leave it" basis;
- plaintiff was not represented by counsel;
- the transaction was of low value;
- the conflict between the alleged oral promises and written contract terms is not clear and obvious;
- the inconsistent written terms were buried in a lengthy contract or amidst boilerplate, or were otherwise hidden, unclear or inconspicuous;
- plaintiff either (a) read the contract, but the defendant provided a reasonable explanation for the discrepancy between the oral promises and written terms, *or* (b) did not read the contract, but was reasonably induced to not read by defendant's conduct and their longstanding relationship of trust.

The balancing of factors depends on each case's particular facts. In many instances, different factors will point in different directions — for example, the plaintiff is sophisticated but the discrepancy between the alleged misrepresentations and the contract terms is unclear. But the public-policy predicates underlying the *Pendergrass* rule mandate that courts not simply default to sending every case to trial just because multiple factual factors must be balanced. If the court believes that a plaintiff cannot show justifiable reliance by a preponderance of the evidence, it should pull the plug on the fraud claim. The goal of protecting plaintiffs from fraud must be balanced against the goals of preventing fictitious fraud claims and allowing plaintiffs to use a fraud claim to unravel contracts that turn out to be a bad deal.

Professor Korobkin has suggested that courts confronting fraud claims based upon alleged misrepresentations that contradict written terms can: (a) protect nondrafting parties by requiring the drafting party to provide reasonable notice of the contradictory contract terms; and (b) protect drafting parties by applying a heightened "clear and convincing" standard of proof that would require plaintiffs to proffer more than just their

own self-serving testimony. *See* Russell Korobkin, *supra*, *The Borat Problem*, 101 Cal. L. Rev. at 92-96, 100-02. Under Korobkin's suggested heightened standard, plaintiffs could "avoid summary judgment only when they can (1) produce recorded evidence of the alleged misrepresentations, (2) provide third-party testimony that the defendant made representations or promises contradictory to terms embodied in the final written document, or (3) provide evidence that the defendant engaged in a pattern of similar conduct in other transactions." *Id.* at 102.

Korobkin's suggested approach may work in jurisdictions outside California that apply a "clear and convincing" burden of proof to fraud claims. But the California Supreme Court repeatedly has rejected attempts to impose a proof standard for fraud higher than "preponderance of evidence."[22] California courts are not likely to change course just for *Pendergrass*-type promissory fraud claims. The California Legislature theoretically could enact a special rule, as it did for punitive damages. *See* Cal. Civ. Code § 3294(a) (allowing punitive damages "[i]n an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice . . . ."). But such legislation is unlikely.

Most likely, the preponderance of evidence rule will continue to govern *Pendergrass*-type fraud claims in California. Consequently, the best way for courts to balance the competing public-policy considerations — and the only way absent a fundamental change in California law — is to analyze strictly whether plaintiff's evidence creates a triable issue under the preponderance standard for each fraud element, particularly justifiable reliance. Courts also, as discussed in sections IV.B. (7) & (8) below, can balance the public-policy considerations by limiting the remedies for *Pendergrass*-type claims.

### 3. The battle-fronts: Pleading, summary judgment and trial.

*Riverisland*'s elimination of the threshold admissibility-of-evidence question shifts the battle over *Pendergrass*-type fraud claims to three separate stages. Proof issues can potentially be raised at each stage, depending on the circumstances.

***Stage One: Pleading***. Unlike contract claims, plaintiffs must plead fraud claims with particularity. *Small v. Fritz Companies, Inc.*, 65 P.3d 1255, 1264 (Cal. 2003); *Lazar*

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[22] *See, e.g, Rosenthal*, 926 P.2d at 1072 ("Defendants urge us to hold a party opposing arbitration must show fraud not only by a preponderance of evidence, but by clear and convincing evidence. We are not persuaded such a rule does or should exist. Except as the law otherwise provides, the burden of proof is by a preponderance of the evidence. (Evid. Code, § 115.) . . . We have, moreover, previously rejected the suggestion that allegations of fraud, in a civil action, must be proven by clear and convincing evidence."); *Liodas v. Sahadi*, 562 P.2d 316, 320-24 (Cal. 1977) (analyzing prior precedent; concluding preponderance of evidence is burden of proof in civil actions for fraud); *see also Grubb Co. v. Dep't of Real Estate*, 134 Cal. Rptr. 3d 894, 900-01 (Cal. Ct. App. 2011) ("It is now clearly established that a verdict finding liability for fraud or misrepresentation – even knowing misrepresentation – need not be based on clear and convincing evidence, but only on a preponderance of the evidence").

*v. Superior Court*, 909 P.2d at 989. So even at the pleading stage, defendants can force plaintiffs to flesh out the factual allegations supporting their *Pendergrass*-type promissory fraud claims. If the plaintiff cannot allege sufficient facts, the claims can be dismissed at a lawsuit's early stages for failure to plead adequately a misrepresentation or conduct showing justifiable reliance.[23]

***Stage Two: Summary Judgment***. Every element of a fraud claim is a basis for disposing of a case by summary judgment. Defendants facing *Pendergrass*-type claims can argue that the facts compel dismissal as a matter of law.

Justifiable reliance is a key potential avenue for dismissal. Although justifiable reliance is typically a question of fact, "'whether a party's reliance was justified may be decided as a matter of law if reasonable minds can come to only one conclusion based on the facts.'" *Alliance Mortgage Co. v. Rothwell*, 900 P.2d at 609 (quoting *Guido v. Koopman*, 2 Cal. Rptr. 2d at 440); *accord*, *Hadland v. NN Investors Life Ins. Co.*, 30 Cal. Rptr. 2d at 88, 93 ("although the issue of justifiable reliance ordinarily presents a question of fact, there are cases in which it may be decided as a matter of law") (citations omitted).[24] "[I]n such instances where the absence of justifiable reliance is one of law, summary judgment or summary adjudication is an appropriate vehicle." *Hoffman v. 162 North Wolfe LLC*, 175 Cal. Rptr. 3d 820, 834 (Cal. Ct. App. 2014) (listing cases). Summary judgment for the defendant is appropriate where the alleged fraudulent misrepresentations conflict with the written contract and the court concludes reliance was, as a matter of law, not justifiable.[25]

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[23] *See, e.g.*, *Shapiro v. Wells Fargo Realty Advisors*, 199 Cal. Rptr. at 622 (sustaining demurrer to employee's claim for breach of implied-in-fact contract because the employee could not have reasonably relied on conduct that contradicted the written agreement he signed); *Baymiller v. Guarantee Mutual Life Co.*, No. SA CV 99-1566, 2000 WL 1026565 *4 (C.D. Cal. May 3, 2000) (granting dismissal under Federal Rule of Civil Procedure section 12(b)(6), because "[p]laintiff must not only plead the allegations of fraud with enough specificity so that a defendant knows what is false or misleading about a statement and why it is false, but must also establish justifiable reliance on such misrepresentations").

[24] It is easy at the summary-judgment stage to establish a triable issue as to *actual* reliance, in contrast to *justifiable* reliance. Supreme Court precedent allows a trier of fact to infer actual reliance from evidence that the misrepresentation was *material* unless there is direct evidence to the contrary. *See, e.g.*, *Vasquez v. Superior Court*, 484 P.2d 964, 972-73 (Cal. 1971); *Engalla v. Permanente Medical Group, Inc.*, 938 P.2d 903, 919 (Cal. 1997) (holding the plaintiffs "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").

[25] *E.g.*, *Hinesley v. Oakshade Town Ctr.*, 37 Cal. Rptr. 3d at 369-74 (summary judgment for defendant because plaintiff, as a matter of law, could not justifiably rely on landlord-defendant's alleged misrepresentations that three chain businesses would occupy a shopping center where (a) plaintiff was represented by counsel, and (b) plaintiff admitted reading a lease provision stating that the landlord had made no representations regarding any identities of specific tenants and that the tenant was not relying on any such representations); *Slivinsky v. Watkins-Johnson Co.*, 270 Cal. Rptr. at 589 (summary judgment for employer on fraud claim where alleged promises of continuing employment contradicted integrated agreement specifying at-will employment); *Camp v. Jeffer, Mangels, Butler & Marmaro*, 41 Cal. Rptr. 2d at 341 (summary judgment for employer where false representation of job security contradicted signed forms acknowledging at-will employment); *see also Malmstrom v. Kaiser Aluminum & Chemical Corp.*, 231 Cal. Rptr. at 830 (summary judgment for employer on implied-contract claims because "reliance on representations that contradict a written agreement is not reasonable").

Fraud claims also can be dismissed on summary judgment based upon the plaintiff's inability, as a matter of law, to show *detrimental* reliance,[26] or prove the proper type of *damages*.[27]

***Stage Three: Trial.*** If the case survives summary judgment, counsel should provide guidance to the trier of fact as to what factors to consider (including the justifiable-reliance factors discussed above) and how to evaluate them. Rudderless standards, such as simply telling a jury to determine whether reliance was "reasonable," will not balance the competing public-policy interests. Counsel should be as specific as possible, both in arguments to the trier of fact and proffered jury instructions.

If the trial evidence indicates a fraud element is lacking as a matter of law, the defendant should move for a directed verdict or nonsuit. *See, e.g.*, *Hackethal v. Nat'l Cas. Co.*, 234 Cal. Rptr. at 858 (upholding directed verdict on fraud claim; plaintiff's reliance on alleged misrepresentations contrary to contract language unjustifiable as a matter of law); *Hadland v. NN Investors Life Ins. Co.*, 30 Cal. Rptr. 2d at 95 (upholding nonsuit grant on fraud claim where alleged fraudulent misrepresentations were "patently at odds" with insurance policy's express terms).

## IV. HOW TO ENSURE THE GRASS IS GREENER ON THE OTHER SIDE OF THE *PENDERGRASS* RULE.

### A. Tips For Negotiating Contracts In A Post-*Riverisland* World.

*Riverisland* does not leave contracting parties powerless against someone using a promissory fraud claim to end-run negotiated written contract terms. But it does change the playing field. It is not enough simply to show that the alleged false promises contradict an integrated contract's express terms. Contracting parties can, and should, take steps during negotiations to undermine the viability of future promissory fraud claims, including reducing a party's ability to claim justifiable reliance. Here are recommendations to help navigate the post-*Pendergrass* waters.[28]

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[26] *E.g.*, *Hunter v. Up-Right, Inc.*, 864 P.2d 88, 93 (Cal. 1993) (as matter of law, plaintiff could not claim detrimental reliance where he relied on employer's fraudulent representations in resigning, because employer had right to fire him anyway); *see also Leegin Creative Leather Products, Inc. v. Diaz*, 33 Cal. Rptr. 3d 139, 143-43 (Cal. Ct. App. 2005) (affirming anti-SLAPP motion grant: as matter of law, employer could not claim it detrimentally relied on employee's fraudulent misrepresentations of injury by forwarding claim to insurer because the law required employer to submit the claim).

[27] *E.g.*, *Saunders v. Taylor*, 50 Cal. Rptr. 2d 395, 398 (Cal. Ct. App. 1996) (judgment for defendant required as matter of law where plaintiffs who allegedly purchased house in reliance on fraudulent misrepresentations only offered evidence of benefit-of-the-bargain damages and "offered no evidence of what the market value of the house would have been had the true facts been known"); *Ward v. Taggart*, 336 P.2d 534, 537 (Cal. 1959) (where "there was no proof that plaintiffs suffered 'out-of-pocket' loss, there can be no recovery in tort for fraud").

[28] These tips are an amalgamation of the author's own ideas, conversations with lawyers at his firm, and an (continued...)

### 1. *Create a document trail regarding rejected proposals*.

When the *Pendergrass* rule was alive and well, parties did not need to document every aspect of negotiations. Parties knew that clear and conspicuous contract terms could not be circumvented by a promissory fraud claim. But in the post-*Riverisland* world, evidence that a party demanded or offered a term, orally or in writing, could be wielded later as evidence of a promise made without an intent to perform.

To avoid potential "he said/she said" disputes down the road, a party who rejects a proposed term should create a paper trail. Do not reject proposed terms simply by presenting an alternative draft containing contrary terms. Do not reject proposals orally. Send an e-mail or other document that specifically and clearly rejects proposed terms, explicitly spelling out the rejected terms.

### 2. *Tell the other side to read the agreement.*

Tell the other side to "read the agreement." It sounds so simple. Yet often these words are never said. Say it orally. Say it in writing. Evidence that a defendant specifically told the plaintiff to read the agreement will impede the plaintiff's ability to claim the defendant induced the plaintiff not to read the contract.

### 3. *Have the parties initial language that they read the entire agreement and initial key paragraphs*.

Any information indicating that the contract signatories read the contract, or were told to read the contract, can help counter a fraud claim. Initialing will not ensure an absolute bar, as plaintiffs can always claim they simply initialed where told and never read a thing. But initialing will at least hinder a plaintiff's ability to deny reading the contract or to claim the defendant induced the plaintiff not to read it.

### 4. *Where parties are represented by counsel, have counsel sign that they approve the terms and that they and their clients have read the agreement*.

Even before *Riverisland*, many sophisticated drafters included a signature line at the end of the contract for counsel representing each party to confirm that they "approved the agreement as to form." Provisions stating that each party retained their own counsel and that counsel and their clients have reviewed the agreement are also common. After the demise of the *Pendergrass* rule, these types of provisions have heightened importance.

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[28](...continued)
expansion of certain tips presented in an excellent article, Ryan J. Barncastle & Kenneth E. Moore, *The Fraud Exception To The Parol Evidence Rule After Riverisland*, Los Angeles Lawyer 10, 12 (Nov. 2013).

The active participation of counsel severely undermines a *Pendergrass*-type promissory fraud claim.

**5.** ***In high-value transactions, insist that the other side retain independent counsel.***

In a low-value transaction, telling someone to retain counsel is impractical and disingenuous. Fees alone could eat up the transaction's value. But the same is not true for a high-value transaction, such as a large business deal. If the other side in a high-value transaction has not retained counsel, recommend in writing that it do so. If it chooses not to do so, then document — either in the contract itself or by separate e-mail or other correspondence — that the party was advised to retain counsel.

**6.** ***Make sure the signatories have ample time to read and review the agreement, such as by providing copies in advance.***

Denying the other side a reasonable time to read and review the contract facilitates a claim that you induced a failure to read the contract or precluded plaintiff from spotting the inconsistencies between the contract and alleged misrepresentations. Not only can evidence of a rushed transaction support a fraudulent-inducement claim, it can potentially support fraud in the execution. Avoid rushing document execution, and, if possible, cut off any such claim by providing copies of the contract well in advance of the signing.

**7.** ***Where realistic, have multiple individuals from your side present during negotiations or at the signing of the contract.***

Again, there is no admissibility bar after *Riverisland*. It comes down to the strength of evidence. The goal is to avoid a "he said/she said" battle in which the fraud claim comes down to a court or jury deciding which side is telling the truth. The more witnesses to support your version of events, the better.

**8.** ***If your contract executions often involve prior communications with agents, include contract language that denotes the limited authority/responsibility of those agents.***

The use of employees or other agents in negotiating contracts, such as sales personnel using form contracts, can be a fertile basis for promissory fraud claims because the agents may make, or certainly can be accused of making, oral representations when discussing the potential contract. Businesses using agents to negotiate contracts should include agency disclaimers in the contracts. Such disclaimers can take many different forms. For example, they can state that the parties agree that (a) their relationship with the agent is at arm's length and is not a confidential or fiduciary relationship; (b) the agent has not made any representations or warranties regarding specific matters, and no one is relying on any such representations or warranties; or (c) each party has relied on their own

independent investigation and analysis of the matter, not the investigation or analysis of an agent.

The mere existence of such disclaimers will not preclude a fraud claim. If fraud occurred, courts will not treat disclaimers as enforceable exculpatory clauses: "'A party to a contract who has been guilty of fraud in its inducement cannot absolve himself or herself from the effects of his or her 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.'" *McClain v. Octagon Plaza, LLC*, 71 Cal. Rptr. 3d at 893; *accord*, *Danzig v. Jack Grynberg & Associates*, 208 Cal. Rptr. 336, 342 (Cal. Ct. App. 1984). But such provisions, particularly where factually specific, can be valuable evidentiary pieces regarding whether a misrepresentation occurred, whether reliance was justifiable, or whether an agent had the actual or ostensible authority required to hold the defendant liable.[29]

### 9. *If multiple agents negotiate your contracts, establish clear lines of authorization and create and document established protocols for contract negotiation and execution.*

Companies that frequently negotiate contracts through employees or agents, especially on a repeat basis, can help limit promissory fraud claims by establishing clear lines of authorization and clear company protocols.

First, the company should define who in the company has authority to negotiate contracts or to solicit signatures in form agreements. This can help reduce instances of employees or agents exceeding their authorization.

Second, the company should establish clear protocols for authorized employees and agents to follow in negotiating contracts or soliciting signatures on form agreements. The protocols should be tailored to the type of contract at issue, but there are basic protocols applicable to all contexts. For example, companies should establish protocols that instruct agents to (a) ask the other party to read the agreement; (b) provide the other side ample time to review the agreement; (c) avoid making statements that might be considered "promises"; (d) avoid high-pressure sales tactics, such as saying the terms are non-negotiable or the deal is only good if signed immediately; (e) recommend, where practical, that the other party seek independent counsel or other independent advice; (f) have other

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[29] *See, e.g.*, Kathryn Albergotti & Sascha Yim, *supra*, *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*, 40 Wm. Mitchell L. Rev. at pp. 157-158 (noting "[s]ome 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 representatives have not made any promises or representations concerning sales volume, occupancy, exclusives, tax estimates, estimates of common area maintenance costs (where they are not fixed) and similar matters not addressed in the lease" and concluding that such statements "may be helpful to the trier of fact in determining the veracity of a 'he said she said' claim made by a tenant").

witnesses present, where practical, when contracts are being negotiated or signed; and (g) follow specific procedures for handling questions regarding what terms are in the agreement or the meaning of specific terms.

Such provisions and protocols will never preclude a fraud claim. But they can be powerful evidence in a fraud case that the plaintiff's version of events is false, as it is contrary to the company's settled practices established by clear company protocols.

### 10. *Include clear, comprehensive integration and no-representation clauses.*

The mere existence of an integration clause, or a clause stating the signatories are not relying on any representations other than what the agreement contains, will not preclude a successful fraud claim. *McClain v. Octagon Plaza, LLC*, 71 Cal. Rptr. 3d at 893-96 (listing cases); *Hinesley v. Oakshade Town Ctr.*, 37 Cal. Rptr. 3d at 372 (listing cases). Parties often will not even discuss boilerplate provisions during drafting. Still, a clause clearly explaining that the agreement is intended to comprise all deal terms and supersede all prior discussions/understandings can help counter a plaintiff's claim that prior false promises meant there was no meeting of the minds.

Such clauses can also help defeat the justifiable-reliance element if they are specifically tailored to the type of transaction at issue — for example, a clause that specifically states that the agreement supersedes a prior letter of intent or another specific document exchanged during the negotiation process. Similarly, provisions that the signatory is not relying on *specific types* of representations outside the agreement carry more weight than generic clauses. *See, e.g.*, *Hinesley v. Oakshade Town Ctr.*, 37 Cal. Rptr. 3d at 373 (concluding that a lease clause stating the lessee was not relying on representations about tenant identities was "not merely a generic integration/no oral representations clause" and, although the clause did not preclude a fraud claim, it was "certainly a factor" to be considered in determining whether the lessee justifiably relied on alleged misrepresentations about tenant identities).

So, while merger/integration clauses and disclaimer provisions will not bar a fraud claim standing alone, they can be helpful defense pieces to the evidentiary puzzle: "[T]he rule that this kind of contract provision does not, as a matter of law, preclude a finding of fraud does not mean the contract provision is in every case irrelevant." *Hinesley v. Oakshade Town Ctr.*, 37 Cal. Rptr. 3d at 373-74 (specific clause regarding no representation about tenant identities, *coupled with other evidence*, sufficed to defeat claim of reasonable reliance, entitling defendant to summary judgment).

The more specific the integration and no-representation clauses, the better.

### B. Potential Arguments For Defending Against Promissory Fraud Claims In A Post-*Riverisland* World.

So you've followed these negotiation tips but you still end up with a lawsuit. What then? If you represent the plaintiff your goal is simple: Rely on *Riverisland* to ensure introduction of your evidence, and then seek to convince the trial court that whether fraud occurred involves disputed fact questions that a trier of fact must resolve. That's the only litigation tip you need.

But there are many litigation tips for parties *defending* against *Pendergrass*-type promissory fraud claims. There are multiple avenues to pursue a defense judgment or to limit your client's exposure to substantial damages. Although the elements for proving fraud are fact issues, defendants are entitled to summary judgment or a directed verdict where the evidence is insufficient as a matter of law to prove a fraud claim. Listed below are the key potential arguments for seeking to dismiss a *Pendergrass*-type fraud claim as a matter of law (obviously, these arguments can be tweaked into arguments to a trier of fact, but the focus below is on matter-of-law arguments).

#### 1. *As a matter of law, there was no justifiable reliance.*

As discussed above, this is the key line of attack in the post-*Riverisland* world. Defendants should ensure the trial court understands that the issue regards *justifiable* reliance, not actual reliance, and that the policy predicates supporting the *Pendergrass* rule should not be forgotten. Courts must serve as gatekeepers against fictitious fraud claims or claims that flout California public policy.

#### 2. *The alleged pre-contract representations were made by someone who lacked actual or ostensible authority to bind the defendant.*

If the alleged misrepresentation was made by an employee or agent of the defendant, the circumstances might permit an argument that the defendant-principal is not liable because the agent exceeded its actual or ostensible authority: "'[P]ersons dealing with an assumed agent are bound at their peril to ascertain the extent of the agent's authority.' A principal cannot be held [liable] when an actual agent acts beyond the scope of his actual or ostensible authority." *Van't Rood v. County of Santa Clara*, 6 Cal. Rptr. 3d 746, 765 (Cal. Ct. App. 2003) (citations omitted). "An agent has such authority as the principal, actually or ostensibly, confers upon him." Cal. Civ. Code § 2315.[30]

[30] "An agency is ostensible when the principal intentionally, or by want of ordinary care, causes a third person to believe another to be his agent who is not really employed by him." Cal. Civ. Code § 2300. "Ostensible authority is such as a principal, intentionally or by want of ordinary care, causes or allows a third person to believe the agent to possess." Cal. Civ. Code § 2317.

The contract language may help on this issue, if it expressly defines who has authority to negotiate contract terms and omits the employee/agent who purportedly made the misrepresentations. But, admittedly, this defense is often a tough sell.

### 3. *The alleged pre-contract representations were merely non-actionable opinions or predictions about the future*.

Even when claimed to be fraudulent, "predictions as to future events are ordinarily regarded as nonactionable expressions of opinion." *Zeh v. Alameda Community Hotel Corp.*, 10 P.2d 190, 191 (Cal. Ct. App. 1932). "'[T]he law does not interdict prophesying the expression of sanguine business hopes and beliefs in events to come.'" *Id.*; *accord*, *Borba v. Thomas*, 138 Cal. Rptr. 565, 570 (Cal. Ct. App. 1977) ("[p]redictions as to future events . . . are deemed opinions, and are not actionable fraud").

"Fraudulent representations, to constitute ground for relief, must be as *to existing and material facts*; predictions of future events are ordinarily considered non-actionable expressions of opinion." *Richard P. v. Vista Del Mar Child Care Service*, 165 Cal. Rptr. 370, 372 (Cal. Ct. App. 1980) (emphasis added); *accord*, *San Francisco Design Ctr. Associates v. Portman Companies*, 50 Cal. Rptr. 2d 716, 724 (Cal. Ct. App. 1995) ("It is hornbook law that an actionable misrepresentation must be made about past or existing facts; statements regarding future events are merely deemed opinions").

Thus, a plaintiff *"may not justifiably rely upon mere statements of opinion*, including legal conclusions drawn from a true state of facts, unless the person expressing the opinion purports to have expert knowledge concerning the matter or occupies a position of confidence and trust." *Seeger*, 115 P.2d at 980 (emphasis added) (citations omitted).[31]

### 4. *The representations or so-called promises are too vague or indefinite to be actionable*.

"Promises too vague to be enforced will not support a fraud claim any more than they will one in contract." *Rochlis v. Walt Disney Co.*, 23 Cal. Rptr. 2d 793, 801 (Cal. Ct. App. 1993) (promises that plaintiff would receive salary increases or bonuses "appropriate" to the plaintiff's responsibilities and performance and would have "active

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[31] For example, false predictions about expected future profits or commissions are not actionable fraud unless they falsely represent past or existing material facts. 5 B.E. Witkin, Summary of Cal. Law, Torts, § 774, pp. 1123-24 (10th ed. 2005) ("speculative statements about possible profits" or "predictions about *future events* or statements about future actions by some third party" are generally "deemed opinions, and not actionable fraud") (emphasis in original); *Zeh v. Alemeda Community Hotel Corp.*, 10 P.2d at 191 (representations about "future earnings, expected profits or dividends, or the successful conduct of [defendant's] business" are non-actionable "matters of opinion" even if "false when made" or "made with no expectation of their ever being realized"); *Nibbi Brothers, Inc. v. Home Federal Sav. & Loan Ass'n*, 253 Cal. Rptr. 289, 294 (Cal. Ct. App. 1988) (characterizing lender's assurances that developer would continue financing a project as "optimistically assess[ing] the developer's capacity to sustain continued financing" and amounting to nothing more than "a nonactionable expression of opinion"); *Neu-Visions Sports, Inc. v. Soren/McAdam/Bartells*, 103 Cal. Rptr. 2d 159, 163 (Cal. Ct. App. 2000) ("Value is quintessentially a matter of opinion, not a statement of fact").

and meaningful" participation in creative decisions were too vague and indefinite to be actionable), *overruled on another ground*, *Turner v. Anheuser-Busch, Inc.*, 876 P.2d 1022, 1029 (Cal. 1994); *see also Barton v. Elexsys Int'l., Inc.*, 73 Cal. Rptr. 2d 212, 218 (Cal. Ct. App. 1998) (promise that key executives "had to be taken care of" too vague and uncertain to support a claim that it modified stock option agreement); *Saunders v. Superior Court*, 33 Cal. Rptr. 2d 438, 443 (Cal. Ct. App. 1994) (misrepresentation regarding experience and ability of certain court reporters too vague and uncertain to be actionable).

### 5. *There is insufficient evidence that the defendant did not intend to perform the purported "promises."*

A defendant can also defeat a *Pendergrass*-type fraud claim by showing there is insufficient evidence of an intent not to perform the alleged oral promises. "[P]romissory fraud is not easily established." *Riverisland*, 291 P.3d at 1183. "Proof of intent not to perform is required," and "the intent element of promissory fraud entails more than proof of an unkept promise or mere failure of performance." *Id.* If the plaintiff "'adduces no further evidence of fraudulent intent than proof of nonperformance of an oral promise, he will never reach a jury.'" *Id.* (quoting *Tenzer v. Superscope, Inc.*, 709 P.2d at 219); *accord*, *Magpali v. Farmers Group, Inc.*, 55 Cal. Rptr. 2d 225, 231 (Cal. Ct. App. 1996) ("something more than nonperformance is required to prove the defendant's intent not to perform his promise") (internal quotation marks omitted).

Unreasonableness, standing alone, does not provide a basis to infer an intent not to perform: "'[M]aking a promise with an honest *but unreasonable* intent to perform is wholly different from making one with *no* intent to perform. . . .'" *Magpali v. Farmers Group, Inc.*, 55 Cal. Rptr. 2d at 232 (emphasis added). "[A]n erroneous belief, no matter how misguided, does not justify a finding of fraud." *Id.* Thus, evidence that the defendant's promise was "overly optimistic," "erroneous" or "misguided" will not support an inference that the defendant never intended to perform. *Id.* (affirming nonsuit for defendant).

### 6. *As a matter of law, there was no detrimental reliance*.

Detrimental reliance is a necessary element of promissory fraud. *Lazar v. Superior Court*, 909 P.2d at 987-88. If a plaintiff cannot show detrimental reliance on an alleged pre-contract false promise, the fraud claim fails as a matter of law. *Rochlis v. Walt Disney Co.*, 23 Cal. Rptr. 2d at 800 (insufficient evidence of detrimental reliance); *Conrad v. Bank of America*, 53 Cal. Rptr. 2d 336, 352 (Cal. Ct. App. 1996) (same).

For example, in the context of claims that a plaintiff was fraudulently induced to change employment, *detrimental* reliance means that the employee must be "left in worse circumstances than those in which he would have found himself had he not been lied to." *Magpali v. Farmers Group, Inc.*, 55 Cal. Rptr. 2d at 231. That the employee changed employment because of fraudulent representations is insufficient alone: If the

compensation at the new job equaled or exceeded what the employee would have received at the old one, there is no detrimental reliance — and hence no actionable fraud — as a matter of law. *See, e.g.*, *Hunter v. Up-Right, Inc.*, 864 P.2d at 93 (as a matter of law, plaintiff could not claim detrimental reliance where he relied on employer's fraudulent representations in resigning, because employer had right to fire him anyway: the employer "simply employed a falsehood to do what it otherwise could have accomplished directly"); *Rochlis v. Walt Disney Co.*, 23 Cal. Rptr. 2d at 801, 803 (as a matter of law, plaintiff claiming he switched jobs because of fraudulent misrepresentations could not show detrimental reliance, because (a) he earned more at the new job, so he was "enriched not damaged," and (b) he "gave up nothing" by switching jobs, as he admitted that he had already intended to leave his first employer when his commitment ended and the move did not alter his "rights and obligations" under that employment agreement).

### 7. *There is no substantial evidence of damages*.

A defendant can defeat a promissory fraud claim by showing the plaintiff incurred no damages: "Deception without resulting loss is not actionable fraud." *Service by Medallion, Inc. v. Clorox Co.*, 52 Cal. Rptr. 2d 650, 656 (Cal. Ct. App. 1996). "Misrepresentation, even maliciously committed, does not support a cause of action unless the plaintiff suffered consequential damages. And the damages suffered must be referable to, and caused by, the fraud." *Conrad v. Bank of America*, 53 Cal. Rptr. 2d at 353 (citations omitted).

A defendant sued for promissory fraud should first analyze what the plaintiff asserts as damages. Because promissory fraud claims involve alleged "promises," promissory-fraud plaintiffs often seek damages based upon a benefit-of-the-bargain standard of what they would have received had the allegedly false promise been fulfilled. But that is usually the wrong standard. Unless the parties had a fiduciary relationship, a promissory-fraud plaintiff is limited to *out-of-pocket loss*. Benefit-of-the-bargain damages are the standard for calculating loss for breach of contract, not fraud loss. *Runyan v. Pacific Air Industries, Inc.*, 466 P.2d 682, 690 n.15 (Cal. 1970).

"In California, a defrauded party is ordinarily limited to recovering his 'out-of-pocket' loss." *Alliance Mortgage Co. v. Rothwell*, 900 P.2d at 609; *accord*, *Gagne v. Bertran*, 275 P.2d 15, 22 (Cal. 1954) (damages "for deceit" are "measured by the actual losses suffered because of the misrepresentation"); *Fladeboe v. American Isuzu Motors Inc.*, 58 Cal. Rptr. 3d 225, 243 (Cal. Ct. App. 2007) ("[u]nder California law, a defrauded party is ordinarily limited to recovering out-of-pocket damages"); *Dean W. Knight & Sons, Inc. v. First Western Bank & Trust Co.*, 148 Cal. Rptr. 767, 772 (Cal. Ct. App. 1978) (fraud recovery limited to damages that would compensate for detriment actually suffered).

Out-of-pocket loss fundamentally differs from benefit-of-the-bargain damages: The out-of-pocket measure "'is directed to restoring the plaintiff to the financial position

enjoyed by him prior to the fraudulent transaction.'" *Alliance Mortgage Co. v. Rothwell*, 900 P.2d at 609. The out-of-pocket measure thus limits the plaintiff "to recovering what he lost through reliance on the false promise," as opposed to "the profit he could have reaped had [defendant's] representation . . . been true." *Kenly v. Ukegawa*, 19 Cal. Rptr. 2d 771, 773 (Cal. Ct. App. 1993).

California courts have limited benefit-of-the-bargain recovery in fraud cases to fraud *by fiduciaries*. *Ward v. Taggart*, 336 P.2d 537 (Cal. 1959) ("[i]n the absence of a fiduciary relationship, recovery in a tort action for fraud is limited to the actual damages suffered by the plaintiff"); *Auble v. Pacific Gas & Electric Co.*, 55 F. Supp. 2d 1019, 1022 (N.D. Cal. 1999) ("[i]n California, in the absence of a fiduciary relationship, recovery for the tort of fraud is limited to the actual, out-of-pocket damages suffered by the plaintiff").[32]

So, absent a fiduciary relationship or a special statute, promissory fraud victims can only recover out-of-pocket loss, not benefit-of-the-bargain damages. *See, e.g.*, *Simon v. San Paolo U.S. Holding Co.*, 113 P.3d 63, 72-75 & n.4 (Cal. 2005) (victim of promise without intent to perform entitled to $5,000 out-of-pocket loss only); *Auerbach v. Great Western Bank*, 88 Cal. Rptr. 2d 718, 730-31 (Cal. Ct. App. 1999) (plaintiff could only recover out-of-pocket loss for fraudulent promise, not payments made under preexisting contractual obligations).

If the plaintiff cannot show it lost something by being fraudulently induced to enter the subject contract, its fraud claim fails as a matter of law. *See, e.g.*, *Rochlis v. Walt Disney Co.*, 23 Cal. Rptr. 2d at 800-01 (employee who changed jobs because of alleged fraudulent promises had no damages as he earned more at new job); *Conrad v. Bank of America*, 53 Cal. Rptr. 2d at 354 (plaintiff could not show damages from alleged false promise to make a loan because "the record does not establish that plaintiffs were in any different, or worse, position as a result of [a bank manager's] promise to make a loan than they would have been had [the bank manager] adamantly refused to approve a loan when [plaintiff] spoke to him during the week of September 17th"); *see also Lazar v. Superior Court*, 909 P.2d at 992 (employee who changed jobs across the country based on fraud "may properly seek damages for the costs of uprooting his family, expenses incurred in relocation, and the loss of security and income associated with his former employment in New York," but must rely on his contract claim to recover any lost income for wrongful termination).

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[32] Most California fraud claims fall within the parameters of Civil Code section 3333. *See* Cal. Civ. Code § 3333 ("[f]or the breach of an obligation not arising from contract, the measure of damages, except where otherwise expressly provided by this code, is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not"); *Lazar v. Superior Court*, 909 P.2d at 992. Civil Code section 3333 "does *not* enunciate a benefit of the bargain rule"; it "simply sets out the measure of damages long recognized in torts, namely, to compensate a plaintiff for a loss sustained rather than give him the benefit of any contract bargain." *Overgaard v. Johnson*, 137 Cal. Rptr. 412, 413-14 (Cal. Ct. App. 1977). Outside the fiduciary context, California courts have construed section 3333 as endorsing an out-of-pocket standard. *Salahutdin v. Valley of California, Inc.*, 29 Cal. Rptr. 2d 463, 468-70 (Cal. Ct. App. 1994).

And, even the exception for fiduciaries seems suspect and potentially inapplicable when a *Pendergrass*-type fraud claim is at issue, as those claims involve false promises that squarely contradict written contract terms. If the parol evidence rule would preclude a plaintiff from enforcing the alleged promise in contract, it seems counter-intuitive to permit *any* plaintiff — even one in a fiduciary relationship — to effectively transform an allegedly fraudulent promise into a contractual promise by letting the plaintiff pursue benefit-of-the-bargain damages. As further discussed below, cogent arguments exist that California courts should always limit compensatory damages for *Pendergrass*-type promissory fraud claims to out-of-pocket loss. Allowing benefit-of-the-bargain damages arguably would undermine the parol evidence rule and foster fraud claims designed to effectively re-write integrated contracts.

These sorts of remedy issues were non-issues when the *Pendergrass* rule was in effect. But *Riverisland* killed the rule without addressing what remedies might be appropriate now that *Pendergrass*-type claims can see the light of day. The remedy issue is another ripe area for defendants to try to limit exposure, as the next section further demonstrates.

### 8. *Plaintiff's remedy is limited to rescission or remedies that invalidate, not affirm, the existing contract.*

California tort law generally affords fraud plaintiffs the option of either seeking rescission/reformation of the contract *or* standing on the contract and recovering fraud damages. *Lazar v. Superior Court*, 909 P.2d at 990 ("it has long been the rule that where a contract is secured by fraudulent representations, the injured party may elect to affirm the contract and sue for fraud"); *McClain v. Octagon Plaza, LLC*, 71 Cal. Rptr. 2d at 892 n.1 ("[u]nder California law, a defrauded party to a contract may elect to rescind the contract and seek restitution, or stand on the contract and recover damages arising from the fraud").

But this principle seems inappropriate and inapplicable when *Pendergrass*-type promissory fraud claims are at issue. If the purported pre-contract promises squarely contradict written contract terms, then the plaintiff cannot logically stand on the contract and recover fraud damages, because the contract terms and the parol evidence rule would defeat the pre-contract promises. In other words, the plaintiff cannot affirm the contract and sue in tort because the plaintiff would be bound by contract terms that preclude the tort theory. The plaintiff's remedy, rather, should be to sue in fraud to *invalidate* the contract — that is, to claim the contract is either void for fraud in the execution or voidable for fraud in the inducement (and therefore subject to rescission or reformation).

Although *Lazar v. Superior Court*, 909 P.2d at 990, is commonly cited for the principle that fraud victims "may elect to affirm the contract and sue for fraud," that case did not involve *Pendergrass*-type promissory fraud claims. Although the *Lazar* plaintiff claimed it was induced by false promises to relocate from New York to California, there was no written contract and thus no *Pendergrass*-type claim of oral promises contradicting

a written contract. *Id.* at 983. When *Pendergrass*-type promissory fraud claims are at issue, the "affirm and sue" principle seems inapposite.

The California Supreme Court has recognized that the "general contract rule that a party to a contract may elect to affirm the contract and sue for fraud damages" does not always apply and sometimes plaintiffs cannot "'have it both ways.'" *Village Northridge Homeowners Ass'n v. State Farm Fire and Casualty Co.*, 237 P.3d 598, 599, 601 (Cal. 2010). In *Village Northridge*, for example, the plaintiff settled earthquake-related claims with its first-party insurer for $1.5 million and later claimed that the insurer fraudulently induced the plaintiff to sign the settlement by misrepresenting the policy limits. *Id.* at 599-601. Even though the settlement agreement released all known and unknown claims (which included the coverage claims at issue), the plaintiff argued it could elect to affirm the settlement agreement and sue for fraud damages. *Id.* The Supreme Court disagreed, holding that the settlement release "itself bars that option" and the plaintiff therefore must seek rescission first (and restore the settlement consideration) before suing the insurer for damages. *Id.* at 599. Although *Village Northridge* is not directly on all fours, it supports the notion that plaintiffs pursuing *Pendergrass*-type promissory fraud claims must first sue for rescission/reformation and cannot elect to stand on the contract and sue for fraud damages, because the contract terms would bar the fraud claim.

Although *Riverisland* never reached the remedy issue, its language reads consistently with the principle that plaintiffs asserting *Pendergrass*-type promissory fraud claims *cannot* stand on the contract and sue for damages, but instead must invalidate the contract. In rejecting the *Pendergrass* rule, the Supreme Court emphasized repeatedly that the parol evidence rule did not bar evidence of the fraudulent promises because the plaintiff (who sought rescission and reformation of the contract) proffered the evidence to show *the contract was invalid*:

> Section 1856, subdivision (f) establishes a broad exception to the operation of the parol evidence rule: "Where the validity of the agreement is the fact in dispute, this section does not exclude evidence relevant to that issue." 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. "Evidence to prove that the instrument is void or voidable for mistake, fraud, duress, undue influence, illegality, alteration, lack of consideration, or another invalidating cause is admissible. This evidence does not contradict the terms of an effective integration, because it shows that the purported instrument has no legal effect." (2 Witkin, Cal. Evidence (5th ed. 2012) Documentary Evidence, § 97, p. 242.)

*Riverisland*, 291 P.3d at 319 (emphasis in original); *see also id.* at 319 (section 1856 "broadly permits evidence relevant to the validity of an agreement"); *id.* at 320 ("[t]he primary ground of attack on *Pendergrass* has been that it is inconsistent with the principle,

reflected in the terms of section 1856, that a contract may be invalidated by a showing of fraud"); *id.* at 324 ("*Pendergrass* failed to account for the fundamental principle that fraud undermines the essential validity of the parties' agreement. When fraud is proven, it cannot be maintained that the parties freely entered into an agreement reflecting a meeting of the minds.").

A cause of action for rescission or reformation, thus, does not flout the parol evidence rule because the plaintiff is proffering the evidence of inconsistent misrepresentations to show the contract *is invalid*, as opposed to offering the evidence to contradict, alter, vary or supplement the contract's terms. *See* Cal. Civ. Code § 1689(b)(1) (a party to a contract may rescind "[i]f the consent of the party rescinding, or of any party jointly contracting with him, was given by mistake, or obtained through duress, menace, fraud, or undue influence . . . ."). As one pre-*Riverisland* court put it: Evidence of fraud in the inducement "is admissible in an action for rescission because it does not go to contradict the terms of the parties' integrated agreement, but to show instead that the purported instrument *has no legal effect*." *Edwards v. Centex Rel Estate Corp.*, 61 Cal. Rptr. 2d at 535 (emphasis added). Under this rationale as to why the parol evidence rule does not bar a *Pendergrass*-type fraud claim, the principle of standing on the contract and suing for fraud damages does not seem viable.

No post-*Riverisland* California appellate court has addressed this remedy-limitation issue. But two federal courts have. Both concluded that *Riverisland* only allows a plaintiff to introduce evidence of inconsistent fraudulent promises to invalidate the contract, not to obtain compensatory fraud damages without invalidation. *See Clear Connection Corp. v. Comcast Cable Communications Management, LLC*, No. 2:12-CV-02910-TLN-DAD, 2013 WL 6275313, *6 (E.D. Cal. Dec. 4, 2013); *Groth-Hill Land Co. LLC. v. General Motors LLC*, No. C13-1362 TEH, 2013 WL 3853160, *15 (N.D. Cal. July 23, 2013).

In *Groth-Hill,* the District Court for the Northern District of California held that the parol evidence rule barred the plaintiffs' promissory fraud claims because the false promises contradicted the terms of the governing contracts. The Court recognized, citing *Riverisland*, that "a fraud exception to the parol evidence rule permits the use of extrinsic evidence to attack the validity of an integrated written agreement." 2013 WL 3853160 at *15. But it held the fraud exception was inapplicable because plaintiffs' promissory fraud claim does "not attack the validity" of the seven contracts at issue but rather seeks damages based on oral promises over the phone that "run counter to the terms of the written contracts." *Id.* It held that "[t]he fraud exception to the parol evidence rule does not apply in these circumstances; the parol evidence rule does." *Id.*

In *Clear Connection Corp.*, the District Court for the Eastern District of California followed *Groth-Hill*, concluding that "[t]he holding in *Riverisland* . . . is distinguishable from the instant case in that it was limited to the use of extrinsic fraud evidence 'challenging the validity of the agreement itself.'" 2013 WL 6275313 at * 6. *Clear*

*Connection Corp.* held that the parol evidence rule barred the plaintiff's fraud claims as a matter of law because the plaintiff "does not seek to invalidate the contract" but rather "seeks, via compensatory damages, to enforce the alleged oral promises" even though they directly contradict the terms of the parties' integrated contracts. *Id.*

It remains to be seen whether California appellate courts will follow suit. But the distinctions drawn in *Groth Hill* and *Clear Connection Corp.* make abundant sense. The distinction comports with *Riverisland*'s express analysis and with the purpose of both the parol evidence rule and the fraud exception. Since the parol evidence rule protects the sanctity of *valid* written contract terms, it makes sense that a plaintiff could proffer inconsistent false promises to prove the contract was invalid but would contravene the parol evidence rule by choosing to affirm the contract and seek fraud damages. If the contract is valid, the parol evidence rule applies. If the plaintiff sues to invalidate the contract, there is no parol evidence issue.

The outlook in California will remain murky until the Supreme Court weighs in. As is true with most *Pendergrass* and *Riverisland* issues, there is room for disagreement. For example, Professor Sweet, in his critique of the *Pendergrass* rule, noted that "[t]here is a certain logical attractiveness" to limiting promissory fraud claims to the remedies of rescission and restoration of the status quo:

> [This limitation] fits neatly with the analysis that admits the evidence because it shows a defect of formation affecting the existence of the contract. It avoids the seemingly unfair result of allowing the innocent party to circumvent the parol evidence rule by proving the nonexistence of a contract, and then permitting him to use the contract in some manner. And it also seems to effect a reasonable compromise of the conflict between the policy protecting written agreements and the policy discouraging deception.

Justin Sweet, *supra*, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. at 897. But Professor Sweet ultimately concluded that "[d]espite the logical attractiveness of such a limitation, proof of promissory fraud should not be restricted to situations where the remedy sought is rescission and restoration of the *status quo*. Such a restriction clearly would hamper the effectiveness of efforts to minimize fraudulent dealings." *Id.* at 900 (emphasis added).

Professor Sweet's concern about hampering efforts to minimize fraud seems overstated, at least under California law. His primary concern appears to be that a rescission and restitution remedy "may not be capable of adequately policing deceptive conduct," because "[i]f the only penalty is restoration of the *status quo*, much may be gained by the deceiver with little risk." *Id.* at 899-900. But, in California, that would not be the only penalty. A California plaintiff seeking rescission or reformation of a contract

based on fraudulent inducement is entitled to punitive damages — a huge deterrent.[33] Moreover, restitution damages are a broad remedy: Their purpose is to restore the plaintiff to the pre-contract status quo — the position the plaintiff would have been in had the fraud never occurred — which can include the plaintiff receiving consequential damages for out-of-pocket loss.[34] The remedy of rescission/reformation, coupled with restoration damages restoring the status quo and punitive damages, would seem a very substantial deterrent against fraud.

The desire to prevent defendants from committing fraud should not always trump the desire to prevent plaintiffs from asserting fictitious fraud claims and transforming contract disputes into tort claims. Public policy mandates a balanced approach. Again, the *Pendergrass* rule may be gone but its policy predicates should not be forgotten. Requiring plaintiffs alleging *Pendergrass*-type claims to sue to invalidate the contract balances the competing public-policy interests: It prevents wrongdoers from using the parol evidence rule to shield themselves from fraud, without opening the floodgates to fictitious fraud claims by letting plaintiffs affirm contract terms but seek compensatory damages for alleged fraudulent promises that contradict those terms.

In any event, if California courts are going to permit *Pendergrass* plaintiffs to affirm the contract and sue for damages, instead of requiring them to invalidate the contract through rescission or reformation, they must — at the very least — avoid damage remedies that squarely contradict the terms of the contract being affirmed. Professor Sweet asserts that "[i]f it could be said that an action for damages does not amount to enforcement of the false promise, limiting the remedies to rescission *or* damages would fit neatly into the defect of formation rationale" and "might be realistic where damages for fraud are based on out-of-pocket loss," not benefit-of-the-bargain damages. Justin Sweet, *supra*, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. L. Rev. at 900 (emphasis added). Even if benefit-of-the-bargain damages might be proper in certain promissory fraud contexts involving fiduciaries, they directly flout the parol evidence rule where the alleged pre-contract promises directly contradict written contract terms. If California courts do not require plaintiffs pursuing *Pendergrass*-type claims to first invalidate the

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[33] *See Douglas v. Ostermeier*, 2 Cal. Rptr. 2d 594, 606 n.3 (Cal. Ct. App. 1991) (collecting cases awarding punitive damages in actions for rescission and reformation); *Horn v. Guaranty Chevrolet Motors*, 75 Cal. Rptr. 871, 875-76 (Cal. Ct. App. 1969) (defendants who elect to rescind transaction, rather than affirm and sue for damages, can recover punitive damages: "Fraud alone is an adequate ground for awarding punitive damages and it is immaterial that plaintiff's recovery is in the form of specific restitution, rather than monetary damages.") (citations omitted); *Mahon v. Berg*, 73 Cal. Rptr. 356, 357 (Cal. Ct. App. 1968) (plaintiff induced by fraud to enter into contract entitled to punitive damages in action for rescission).

[34] *See, e.g.*, *Runyan v. Pacific Air Industries, Inc*., 466 P.2d at 691 (Cal. 1970) (collecting/summarizing cases: "'concurrent with the award of rescission, the trial court may award money damages or order such other relief as justice may require'"); *Lobdell v. Miller*, 250 P.2d 357, 367 (Cal. Ct. App. 1952) ("In the rescission action a plaintiff is entitled to recover the consideration he gave on restoration or offer of restoration of that which he received. He is also entitled to recover compensation for whatever consequential damages he may have suffered by reason of having entered into the contract. In the latter case, a plaintiff is entitled to recover the difference between the actual value of that with which the defrauded person parted and the actual value of that which he received together with additional damage arising from the particular transaction.").

agreement, they should — in *all* contexts — strictly limit recoverable damages to out-of-pocket loss (plus punitive damages) and disallow benefit-of-the-bargain damages.

## CONCLUSION

The Supreme Court had valid reasons for abrogating the *Pendergrass* rule. But that does not mean the rule's public-policy predicates should be ignored. Courts should apply an exacting burden of proof to *Pendergrass*-type promissory fraud claims in the case-by-case evidentiary analysis that governs under *Riverisland*. They must ensure that plaintiffs proffer reasonable, legitimate excuses for signing contracts that contain terms contrary to alleged false promises. They also should balance the competing policy interests by limiting the remedies for such claims to avoid the tortification of contract disputes.

This article only provides a framework for evaluating the justifiable-reliance element when *Pendergrass*-type claims are at issue, and provides negotiation and litigation tips for navigating this post-*Pendergrass*-rule world. Until the Supreme Court speaks on the myriad proof and remedy issues that *Riverisland* left unresolved, uncertainty will remain. Only time will tell if the *Pendergrass* rule is truly greener on the other side.

*Ted Xanders*