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California Supreme Court Expands Fraud Exception to the Parol Evidence Rule, Eliminating Significant Barrier to Claims of Promissory Fraud Against Insurers

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Last month, the California Supreme Court overruled longstanding precedent and restored to full force the fraud exception to California's parol evidence rule. In *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association*, No. S190581 (Cal. Jan. 14, 2013) (*Riverisland*), the Court held that the parol evidence rule does not exclude evidence of promissory fraud, regardless of whether the fraudulent promise directly contradicts the written terms of the contract at issue. The *Riverisland* decision removes a significant hurdle that insureds had faced to presenting evidence that insurers had misrepresented the terms of a policy.

The Parol Evidence Rule and *Pendergrass*

In a contract dispute, such as an insurance coverage dispute, the parol evidence rule generally bars a litigant from introducing evidence of any prior or contemporaneous oral agreement that contradicts the terms of an integrated written agreement. Cal. Civ. Proc. Code § 1856; Cal. Civ. Code § 1625. Courts often describe the purpose of the parol evidence rule to ensure that bargaining parties are able to express a final, deliberate statement of their agreement in writing, and to eliminate uncertainty surrounding prior negotiations where all terms of the agreement are integrated into a single written contract.

The parol evidence rule is subject to a number of important exceptions, including an exception allowing parol evidence of fraud. Cal. Civ. Proc. Code § 1856(g). This fraud exception, however, was significantly limited by the California Supreme Court in a 1935 decision, *Bank of America v. Pendergrass*, 4 Cal. 2d 258 (1935) (*Pendergrass*).

The *Pendergrass* action was filed by Bank of America to recover on a secured promissory note. While the note required payment on demand, the defendant farmers alleged that the bank had assured them that it would not enforce the note until after the farmers had time to raise and sell their crop. According to the farmers, the bank's recovery action was in violation of this promise. *Pendergrass*, 4 Cal. 2d at 261–62.

The *Pendergrass* Court refused to permit evidence of the bank's assurance, finding such evidence to be parol evidence and not subject to the fraud exception to the parol evidence rule. Evidence of fraud, the *Pendergrass* Court held, could only be admitted to establish some independent fact or representation relating to the written contract, such as fraud in the inducement. It could not be introduced to contradict the written terms of the contract. *Pendergrass*, 4 Cal. 2d at 263–64.

Riverisland Revives the Fraud Exception

Almost eighty years after it issued its opinion in *Pendergrass*, the California Supreme Court reversed course in *Riverisland*. *Riverisland* involved a debt restructuring, in which the borrowers were promised a forbearance period, during which time the lending credit association would not foreclose on the loan. During restructuring discussions, the vice president of the credit association allegedly assured the borrowers that this forbearance period was two years. In truth, the written terms of the loan provided only a three-month forbearance period. *Riverisland*, No. S190581, at pp. 2–3.

The borrowers failed to make their payments, and the credit association initiated foreclosure proceedings one year after the loan had been issued. The borrowers brought a separate action seeking damages for fraud and negligent misrepresentation, based on the enforcement of the loan during the two-year forbearance period. The trial court, relying on *Pendergrass*, granted the credit association's motion for summary judgment. The California Court of Appeals reversed and the California Supreme Court granted a petition for review. *Riverisland*, No. S190581, at pp. 3–4.

The California Supreme Court reconsidered *Pendergrass* and expressly overruled the 1935 decision. The Court determined that *Pendergrass* was inconsistent with the statute it purported to follow, California Code of Civil Procedure section 1856, as well as settled case law. The Court held that, while the *Pendergrass* Court sought to prevent fraud and perjury, the decision actually interfered with the protection against promissory fraud afforded by California law. "It was never intended," the Court held, "that the parol evidence rule should be used as a shield to prevent the proof of fraud." *Riverisland*, No. S190581, at pp. 16–17 (quoting *Ferguson v. Koch*, 204 Cal. 342, 347 (Cal. 1928)).

***Riverisland*'s Potential Impact on Insurance Disputes**

The overruling of *Pendergrass* provides a path for claims of promissory fraud brought by insureds against insurers in certain circumstances, even where the fraudulent misrepresentations are at odds with the policy language. The California Supreme Court's decision removes an argument that the parol evidence rule excludes evidence of fraud based on promises at variance with the terms of a written agreement.

Such a claim may, however, be difficult to prove. As the *Riverisland* Court reiterated, promissory fraud requires a showing of justifiable reliance, and an insured may find it difficult to establish that its reliance on the promises of an insurer was justifiable when those promises contradicted the language of the policy. *See, e.g.*, *Hackethal v. National Casualty Co.*, 189 Cal. App. 3d 1102, 1110–12 (Cal. Ct. App. 1987) (holding reliance on agent's misrepresentation of coverage was unjustifiable as a matter of law where coverage was described in policy).

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