

In Practice: Before Drafting Another Contract, Consider These 2013 Cases

As we reflect on 2013, two California decisions stand out as especially noteworthy. While both cases involved real estate contracts, their impact will be felt on nearly all contracts in California. In *Riverisland Cold Storage v. Fresno-Madera Production Credit Ass'n*, the California Supreme Court overturned a 78-year-old rule that prohibited evidence of oral promises that contradict a written contract. In *Maynard v. BTI Group*, a standard attorney's fee provision in a contract between the parties was interpreted very broadly by an appeals court to cover tort claims as well as contract claims.

The California Supreme Court Restricts the Parol Evidence Rule

In *Riverisland Cold Storage v. Fresno-Madera Production Credit Ass'n*, 55 Cal. 4th 1169 (2013), plaintiffs fell behind on loan payments and defendant initiated a foreclosure action. The parties agreed in writing that the defendant credit association would take no enforcement action for three months if the plaintiffs made certain payments and pledged eight parcels as additional collateral. Plaintiffs missed the payments but eventually repaid the loan and the defendant dismissed its foreclosure action. The plaintiffs then brought a fraud claim, alleging that the defendant's

vice president told them before they signed the agreement that he would extend the loan for two years in exchange for collateral of two ranches. The plaintiffs claimed that they never read the agreement despite signing it and initialing next to descriptions of the parcels.

The trial court granted summary judgment for the defendant, finding that the evidence of oral promises contradicted the written agreement and so was barred under *Bank of America v. Pendergrass*, 4 Cal. 2d 258 (1935). *Pendergrass* involved borrowers who missed payments and alleged that the lender orally promised not to enforce the loan to induce the borrowers to pledge additional collateral. The parol evidence rule, which gives preference to contracts over oral promises, provides that when parties enter an integrated written agreement, extrinsic evidence may not be relied on to alter or add to its terms. An exception allows evidence where the validity of the contract itself is in dispute, and Civil Code Section 1856 (g) allows evidence used to establish fraud. *Pendergrass* severely limited the fraud exception by holding that evidence of fraud "must tend to establish some independent fact or representation, some fraud in the procurement of the instrument or some breach of evidence concerning its use, and not a promise directly at variance with the



Will Rosenthal

promise of the writing."

Despite the factual similarity, the appeals court in *Riverisland* reversed the grant of summary judgment and held that the false statements were allowed as factual misrepresentations, deciding that *Pendergrass* was limited to promissory fraud cases. The California Supreme Court affirmed but expressly overruled *Pendergrass* and its progeny for several reasons. First, the court cited California cases that criticized *Pendergrass* or resisted applying it by various means, leading to legal uncertainty. Second, it noted a concern that the rule may further fraudulent practices, since oral promises made without the intention of performance can be an effective way to deceive if evidence of those promises is not admissible. Finally, the court relied on the principle that a case's weight as precedent

is diminished if it departs from an established rule without discussing contrary authority, as in *Pendergrass*. Thus, the Supreme Court reaffirmed the maxim that the parol evidence rule should not be used to prevent proof of fraud and remanded the case to address reliance.

Riverisland will make it harder for defendants to succeed on summary judgment motions and some may worry that it makes fraud allegations too hard to respond to, although the decision is in line with a majority of other jurisdictions. Further, proving fraud remains difficult and plaintiffs face a number of significant hurdles, including proving reliance and justifying their failure to read the signed agreement. To protect against potential claims of oral promises, contract drafters should take steps such as making the terms of contracts as clear as possible, requiring parties to initial next to important terms, and including an integration clause that specifically states that the parties intend for the written contract to supersede prior discussions.

BE CAREFUL WITH Language in Attorney's Fee Provisions

Maynard v. BTI Group, 216 Cal. App. 4th 984 (2013), serves as a cautionary tale for those drafting contracts with attorney's fee provisions. The plaintiff Catherine Maynard sued her broker, BTI, for negligence and breach of contract after her business was sold but the buyer filed for bankruptcy and part of the purchase price went unpaid. Since the broker failed to obtain security from the buyer as Maynard had requested, she sued for the balance of the purchase price. In a bench trial, BTI prevailed on the contract claim but Maynard was awarded \$24,000 for negligence.

Both parties sought attorney fees: BTI as the prevailing party on the contract claim and Maynard as the

prevailing party in the action. The listing agreement the parties had entered into provided: "All parties to this agreement agree to mediate, in good faith, any dispute prior to initiating arbitration or litigation. The prevailing party in the event of arbitration or litigation shall be entitled to costs and reasonable attorney fees..." The trial court awarded Maynard attorney fees as the prevailing party and denied BTI's request. The Court of Appeal affirmed the fee award since it read the attorney's fee provision broadly to entitle the party who prevailed in the overall dispute to recover its fees.

BTI argued that the operative provision was Civil Code Section 1717, which awards attorney's fees to the "party prevailing on the contract" when the contract provides for them. Yet before Section 1717 comes into play, the scope of the parties' attorney's fee agreement must be considered under a more general provision that allows parties to agree to award attorney's fees to the prevailing party. Courts take a pragmatic view of the prevailing party as the party whose net recovery is greater in the sense of most accomplishing its litigation objectives.

Analyzing the specific language used in the parties' contract, the Court likened the phrase "any dispute" to attorney's fees clauses that used broad language covering all claims "arising out of," "in connection with" or "related to" a contract. These phrases have all been interpreted in California cases as applying to tort claims with some nexus to a contract claim. Thus, Maynard was the prevailing party in the "ordinary or popular sense" of the term, since she recovered the purchase price balance. BTI's claim was rejected because there may be no more than one prevailing party with respect to the resolution of a single dispute.

The key takeaway seems to be

that not only can contract language broaden the scope of the dispute eligible for a fee award, but that the fee provision might be deemed to be unlimited in the absence of contractual language limiting the fee provision to contract claims. Civil Code Section 1717 deems all contractual attorney's fee provisions to be reciprocal, even if not so drafted. Parties drafting attorney's fee provisions should consider drafting a provision that expressly restricts the scope to contract claims and excludes other claims in order to manage exposure to attorney's fee claims and curb some of the incentives for non-contract-based cross-claims that might otherwise arise.

Will Rosenthal is an associate in the Los Angeles office of Sidley Austin. He can be reached at 213.896.6154 or via email at wrosenthal@sidley.com. Amy Lally is a partner in the Los Angeles office of Sidley Austin. She can be reached at 213.896.6642 or via email at alally@sidley.com.

In Practice articles inform readers on developments in substantive law, practice issues or law firm management. Contact Greg Mitchell with submissions or questions at gmitchell@alm.com.