Western Independent Bankers
# Directors Digest
**A Community Bank Directors Advisor** **Issue #74 - August 2013**

## When "Getting it in Writing" Isn't Enough

*By Kenneth E. Moore and Ryan J. Barncastle, STUART|MOORE*

Walt Disney dryly reaffirmed the power of the pen and an executed written agreement when he said, "People still think of me as a cartoonist, but the only thing I lift a pen or pencil for these days is to sign a contract." All extensions of credit by community banks are memorialized in a written contract and the relationship between bank and borrower is defined by the terms of the written agreements that are signed in ink. Since the 1930s, a banker has been able to rely on a signed written contract as a defense to a borrower saying, "You tricked me!" A recent California Supreme Court case stands this reliance on its head.

Earlier this year, the Supreme Court of California overruled a long-standing principle of law that will not only increase future challenges to written contracts, but will also reshape the procedures surrounding entering into valid and enforceable written agreements. In *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association,* by overruling the *Bank of America v. Pendergrass* decision, the Supreme Court of California opened the door for challenging written contracts with evidence of oral statements that conflict with documented agreements. This ruling was a large departure from well-established law that has implications that impact most every commercial contract, specifically including a financial institution's loan agreements.

The parol evidence rule protects the integrity of written contracts by making their terms the exclusive evidence of the parties' agreement. "It is founded on the principle that when the parties put all the terms of their agreement in writing, the writing becomes the agreement, and the written terms supersede statements made during negotiations." This is codified by California Code of Civil Procedure Section 1856. However, California Code of Civil Procedure has exceptions to the parol evidence rule, including Section 1856(f), which states that "where the validity of the agreement is the fact in dispute, this section does not exclude evidence relevant to that issue." Additionally, an established exception to the rule allows a party to present extrinsic evidence to show that the agreement was tainted by fraud. In such instances, extrinsic evidence may be admitted.

In 1935, the court in *Bank of America v. Pendergrass* restricted the applicability of the fraud exception as a means to introduce extrinsic evidence by holding that "evidence offered to prove fraud 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." Thus, evidence of oral agreements that conflicted with the terms of the signed agreement could not be used to prove a borrower's claim of fraud.

In *Riverisland Cold Storage, Inc.,* the plaintiffs defaulted under the terms of a loan from Fresno-Madera Production Credit Association (FMPCA). Plaintiffs and FMPCA agreed to a forbearance agreement whereby FMPCA agreed that it would refrain from taking enforcement action stemming from the plaintiffs' default for a short period of time. In exchange, the plaintiffs agreed to make payments and as collateral, pledged eight separate parcels of real property. The plaintiffs initialed their names on pages bearing the legal description of each piece of property. The plaintiffs did not read the agreement, but simply signed it at the locations tabbed for signature, later claiming they did not know that what they signed differed from oral discussions with FMPCA's executives.

The plaintiffs alleged that an FMPCA vice president met with them two weeks prior to the execution of the agreement and told them that FMPCA would extend the loan for two years and that two pieces of property were all that was needed for collateral. Plaintiffs alleged that these assurances were repeated at the execution of the forbearance agreement. Though the plaintiffs defaulted under the terms of the forbearance agreement, causing FMPCA to initiate foreclosure proceedings, the plaintiffs ultimately repaid the loan and FMPCA dismissed the foreclosure action. Despite this resolution, plaintiffs brought an action for fraud and negligent misrepresentation against FMPCA.

In response to the lawsuit, FMPCA moved for summary judgment, arguing that any evidence contrary to the terms of the written agreement was to be excluded pursuant to the parol evidence rule. The trial court agreed and granted summary judgment in favor of FMPCA, citing *Pendergrass*, ruling that the fraud exception to the parol evidence rule does not allow parol evidence of promises at odds with the terms of the written agreement. The Court of Appeals reversed the trial court's decision and the Supreme Court of California affirmed, referring to Pendergrass as an "aberration."

In overturning the *Pendergrass* decision, the *Riverisland Cold Storage, Inc.* court asserted that *Pendergrass* "failed to account for the fundamental principle that fraud undermines the essential validity of the parties' agreement." The court continued, "the parol evidence rule should not be used as a shield to prevent the proof of fraud." This case means that in California when a borrower claims they were tricked, they can attempt to prove that claim by introducing extrinsic evidence of oral discussions that differ from the terms of a signed written agreement. This will increase the difficulty of enforcing loan agreements and will have a lasting impact on the enforceability of written agreements in California.

As a result of the holding in *Riverisland Cold Storage, Inc.,* banks should rethink their loan documentation and signing process. Efforts to mitigate risk may include: (1) developing a systematic process with respect to preparing loan documents to accurately reflect agreements and discussed deal terms; (2) limiting the number of bank representatives who are responsible for explaining and/or discussing agreements with borrowers, (3) providing all parties with ample time between receipt of loan documents and signing of those loan documents, (4) including acknowledgments initialed by a borrower that confirm she was provided sufficient time to review the agreement before signing, (5) avoiding "take it or leave it" sales pressure tactics, (6) and requiring that key loan provisions be initialed. These precautionary measures, if properly implemented, should provide your institution with added reassurance that it can rely on the terms of its written loan agreements despite the decision in *Riverisland Cold Storage, Inc.*

---

*Kenneth E. Moore and Ryan J. Barncastle are partners of STUART | MOORE (www.stuartmoorelaw.com), a California-based law firm that specializes in the representation of financial institutions. They can be reached at 805-545-8590.*