California Lenders Beware - Oral Statements may Trump Written Agreements

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Bankruptcy and Restructuring

The California Supreme Court recently held that a borrower may rely upon oral promises to support a fraud claim against its lender even when such oral promises contradict the written agreement.

In ***Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association***, 55 Cal. 4th 1169 (2013), borrowers, after falling behind on their loan payments, restructured their debt. In the fully integrated written agreement, the borrowers agreed to a modified payment schedule and pledged eight properties as additional collateral. In exchange, the lender agreed to delay enforcement action for three months.

The borrowers later sued their lender, alleging that the lender's agent, prior to signing, orally represented that the borrowers need provide just two additional properties as collateral and the lender would delay enforcement action for two years. Borrowers sought to rescind the agreement on the grounds that it was fraudulently induced.

The trial court granted summary judgment for the lender, relying on *Bank of America v. Pendergrass*, 4 Cal. 2d 258, 263 (1935) ("Pendergrass") to exclude evidence of the oral representations. The Court of Appeal reversed, finding an exception to the Pendergrass rule.

The California Supreme Court affirmed, but rather than fitting the case within an exception to the *Pendergrass* rule, overruled Pendergrass all-together and reaffirmed the statutory exception to the parol evidence rule allowing oral evidence "to establish… fraud." Cal. Civil Code § 1625.

The parol evidence rule generally excludes evidence of prior and contemporaneous oral statements that contradict the clear and unambiguous terms of an integrated written agreement. Such oral statements are thus inadmissible to support an interpretation of a contract that differs with its plain meaning. Nonetheless, the Court held that the parol evidence rule does not preclude evidence of oral statements used to establish a fraudulent inducement claim.

As a consequence, the risk analysis for lenders has changed – cases will be more difficult to win on demurrer or at summary judgment. A borrower alleging that a contract is unenforceable as a result of fraud may now present oral statements that contradict the plain terms of the contract.

Although the implications of Riverisland remain to be seen, there are several practices that may mitigate its impact upon lenders:

Obtain a Pre-Negotiation Agreement. At the outset of workout discussions, all parties should execute a pre-negotiation agreement that sets forth the ground rules for negotiations, including: (i) no rights are waived or obligations incurred until a written agreement is executed and delivered by all parties, (ii) all negotiations and communications (whether written or verbal) are privileged and constitute settlement negotiations for evidentiary purposes, and (iii) only written agreements shall bind the parties.

Give Ample Time to Review Documents. Parties should be given ample time to review all amended loan documents.

Highlight the Integration Clause and Have Signatories Initial Their Understanding of the Provision. Lenders can highlight the integration clause by drafting the integration clause in ALL CAPS or in larger font. Further emphasis can be placed on the integration clause by requiring all signatories to initial their understanding directly under the integration language.

These practices may mitigate the risk that the borrower will be able to avoid its obligations under a written loan agreement by claiming that the lender made false representations that differ from the terms of the written agreement.

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