

# THE FRAUD EXCEPTION TO THE PAROL EVIDENCE RULE: NECESSARY PROTECTION FOR FRAUD VICTIMS OR LOOPHOLE FOR CLEVER PARTIES?

ALICIA W. MACKLIN\*

## I. INTRODUCTION

Consider the following hypothetical:

Two businesses—X, a software company, and Y, a retailer—reach a typical agreement regarding a software license. After extended negotiations, a written, integrated agreement finalizes the deal; it states that X will license software to Y and provide related hosting and technical support services. It does not include, nor did the two parties ever discuss, implementation of the software. Some time after the agreement was made, Y attempts to compel X to implement the software. Y later argues in court that X made fraudulent oral promises that induced Y to sign the written agreement. Y claims that X additionally agreed to provide both a total cost of ownership guarantee, including implementation, and the assistance of its consulting and development personnel to implement the software.

Y's lawyers correctly realize that, in California, the courts have allowed extrinsic evidence of fraudulent promises when those promises are consistent with or independent of the written agreement, notwithstanding the Parol Evidence Rule ("PER"). Thus, while X can present its best argument that the promise to implement the software would directly contradict or vary the terms of the limited licensing contract, the outcome

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\* Class of 2009, University of Southern California Gould School of Law; B.A. 2006, Cornell University. I would like to thank both the staff and the editors of the *Southern California Law Review*, Professor Ariela Gross, Adam Brezine, and finally my sister, Meryl Macklin, for her suggestion of this topic and her guidance in the note-writing process and law school in general.

in court is still unpredictable. Unsuspecting X is in danger of being forced to bear a substantial burden for which it never intended to contract.

X should not find itself in this precarious position. Both X and Y are sophisticated parties, were assisted by lawyers in drafting their agreement, and engaged in lengthy negotiations before settling on the particular language used in the contract. It is doubtful that any substantial agreement would be made outside of the document in this situation. The current fraud exception in California, however, creates an opportunity for any unsatisfied party to modify another party's obligations after the fact. This Note explores the current shortcomings of California's fraud exception and proposes solutions to ensure that sophisticated parties like X *can* rely on written agreements with confidence.

The PER is a substantive rule of law that protects the continued existence of a contract in the United States. It generally bars all extrinsic evidence offered "to vary or add to the terms of an integrated written instrument."<sup>1</sup> The following beliefs support the rule: (1) written evidence is more accurate than human memory; (2) there is a desire to avoid fraud and unintentional invention after an agreement has been reached; and (3) there is a desire not to mislead the finder of fact with emotional evidence.<sup>2</sup> However, the most important policy consideration underlying the PER is the need for predictability in written agreements.

The bright-line PER does, however, contain exceptions,<sup>3</sup> including the fraud exception, which permits the admission of evidence "to establish illegality or fraud."<sup>4</sup> The fraud exception, which this Note specifically addresses, typically arises in cases in which one party makes misrepresentations to another to induce that party to sign an agreement. This exception is underlined by the real concern that a strict PER barring all extrinsic evidence would permit contracting parties to engage in fraud or illegality without fear of consequence. A party engaging in fraud cannot claim any need for predictability in the aftermath of fraudulent actions; and if claims of fraud only arose when actual fraud or illegality had occurred, there would be no issue. Unfortunately, claims of fraud also arise where

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1. 2 B.E. WITKIN, CALIFORNIA EVIDENCE ch. VIII, § 59, at 179 (4th ed. 2000) (emphasis omitted).

2. Masterson v. Sine, 436 P.2d 561, 564 (Cal. 1968).

3. Extrinsic evidence regarding course of dealing, usage of trade, course of performance, mistake, imperfection, and of the validity of an agreement is admissible. CAL. CIV. PROC. CODE § 1856(c)–(f) (West 2007).

4. "This section does not exclude other evidence . . . to establish illegality or fraud." *Id.* § 1856(g).

there has been purposeful or unintentional invention of evidence; one of the PER's goals—to avoid admission of such evidence—remains important within the PER's fraud exception. The PER loses meaning and utility for parties if they are burdened with lawsuits supported by evidence admitted through the fraud exception. Sophisticated parties<sup>5</sup> are hardly the beneficiaries contemplated by the exception's noble goal of protecting from punishment those who have been victims of fraud or illegality. Currently, a party to such an agreement can claim fraud after the fact where none may have been present, and because of the current interpretation of the fraud exception, the outcome in court is unpredictable.

California's current interpretation of the fraud exception comes from the California Supreme Court's decision in *Bank of America National Trust & Savings Ass'n v. Pendergrass*, which defines the distinction between admissible and inadmissible evidence of fraud.<sup>6</sup> On the one hand, evidence of promissory fraud—a promise without intention to perform—that varies or contradicts the terms of the written promise is inadmissible.<sup>7</sup> On the other hand, evidence of promissory fraud that is consistent with or independent of the written agreement<sup>8</sup> and evidence of misrepresentations of fact are admissible.<sup>9</sup> While *Pendergrass* creates an ostensibly defensible rule, there are two main difficulties with the court's interpretation of the fraud exception: 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

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5. Sophisticated parties, as referenced in this Note, refer to parties that are experienced in contracting, are represented by lawyers, and possess a basic understanding of the legal element and nature of contracts. The term used in this Note is in contrast to parties involved in simple sale-of-goods transactions or other consumer contracts. See Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 550–56 (1998) (classifying different types of parties and transactions).

6. *Bank of Am. Nat'l Trust & Sav. Ass'n v. Pendergrass*, 48 P.2d 659 (Cal. 1935).

7. See *id.* at 661–62.

8. *Simmons v. Cal. Inst. of Tech.*, 209 P.2d 581, 587 (Cal. 1949) (“The determinative question upon this issue is ‘whether the writing was intended to cover a certain subject of negotiation; for if it was not, then the writing does not embody the transaction on that subject; and one of the circumstances of decision will be whether the one subject is so associated with the others that they are in effect “parts” of the same transaction, and therefore, if reduced to writing at all, they must be governed by the same writing.’” (quoting 9 JOHN HENRY WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW § 2430, at 97 (3d ed. 1940) (emphasis omitted))).

9. *Pendergrass*, 48 P.2d at 661.

from the PER standard of “vary or *add to* the terms of [the] . . . written agreement.”

Courts’ unclear distinctions lead to unpredictable litigation outcomes, as well as the employment of clever strategies by parties claiming fraud. For example, in many cases it is possible to recast promises as misrepresentations of some existing fact or to claim that they are consistent with or independent of the written agreement.<sup>10</sup> The threat of admissible evidence of a promise independent of a written agreement makes it appear necessary for a company to contract for every possible occurrence—an option that is realistically impossible. Thus, companies are unduly exposed to attack through allegations of fraud.

*Pendergrass* is hardly without criticism from all angles by courts, legal scholars, and practitioners. The major complaint is that the case sets forth an inconsistent, unclear rule. Critics overwhelmingly call for a more liberal fraud exception in California, one that does away with the arbitrary distinction between allegations of attempted fraud. Typically, the alternative suggested is an interpretation that allows courts to review the credibility of the parties in determining whether evidence is admissible.<sup>11</sup> This option, however, cannot adequately serve the essential need for predictability and the capacity of sophisticated parties to rely on written agreements without fear of needless litigation.<sup>12</sup>

Part II of this Note discusses the PER and the clear policy considerations that underlie the rule. Part III explores the fraud exception to the PER and the progression of case law from *Pendergrass* to the present. This part also considers how current application of the fraud exception is unpredictable and leads to confusion in California courts. Finally, Part IV contains a recommendation—contrary to most of the literature and to

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10. See *infra* text accompanying notes 131–34.

11. See *Coast Bank v. Holmes*, 97 Cal. Rptr. 30, 36 (Ct. App. 1971).

12. A review based on credibility is not necessarily helpful in the context of sophisticated parties. A court may determine that sophisticated parties are overwhelmingly credible sources of evidence, and thus a court may assume that such parties are less likely to introduce fabricated evidence against another similarly situated party. However, that idea may be counterintuitive because sophisticated parties still have incentive to use the fraud exception to introduce favorable, perhaps fabricated, evidence. Additionally, such a fact-intensive inquiry (as a credibility review would require) is exactly what this Note suggests sophisticated parties should be spared from when they have a completely integrated written agreement. *But see* Lawrence A. Cunningham, *Toward a Prudential and Credibility-Centered Parol Evidence Rule*, 68 U. CIN. L. REV. 269, 321 (2000) (discussing a link between the PER and credibility and how such a rule would assist judges in making evidence admissibility determinations).

critics of *Pendergrass's* strict rule—to narrow the fraud exception in California for sophisticated contracting parties.

## II. THE PER: BACKGROUND AND UNDERLYING POLICY

To understand the policy considerations underlying the fraud exception to the PER, it is necessary to start with the PER itself and the clear and emphatic policy that led to its inception. The PER is codified at section 1856 of the California Civil Procedure Code<sup>13</sup> and section 1625 of the California Civil Code,<sup>14</sup> similar to the provision found in the Uniform Commercial Code.<sup>15</sup> These statutory provisions, while seemingly very strict, were loosened by the California Supreme Court starting in the late 1960s<sup>16</sup> and eventually were modified to conform to the court's more liberal interpretation of the code in 1978. Generally, this rule of substantive law prohibits the use of "extrinsic evidence (oral or written) to vary or add to the terms of an integrated written instrument,"<sup>17</sup> because such evidence is legally irrelevant.<sup>18</sup>

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13. The statute provides:

- (a) Terms set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement.
- (b) The terms set forth in a writing described in subdivision (a) may be explained or supplemented by evidence of consistent additional terms unless the writing is intended also as a complete and exclusive statement of the terms of the agreement.
- (c) The terms set forth in a writing described in subdivision (a) may be explained or supplemented by course of dealing or usage of trade or by course of performance.
- (d) The court shall determine whether the writing is intended by the parties as a final expression of their agreement with respect to such terms as are included therein and whether the writing is intended also as a complete and exclusive statement of the terms of the agreement.
- (e) Where a mistake or imperfection of the writing is put in issue by the pleadings, this section does not exclude evidence relevant to that issue.
- (f) Where the validity of the agreement is the fact in dispute, this section does not exclude evidence relevant to that issue.
- (g) This section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in Section 1860, or to explain an extrinsic ambiguity or otherwise interpret the terms of the agreement, or to establish illegality or fraud.
- (h) As used in this section, the term agreement includes deeds and wills, as well as contracts between parties.

CAL. CIV. PROC. CODE § 1856 (West 2007).

14. "The execution of a contract in writing, whether the law requires it to be written or not, supersedes all the negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument." CAL. CIV. CODE § 1625 (West 1985).

15. See U.C.C. § 2-202 (2004).

16. See *Masterson v. Sine*, 436 P.2d 561, 563–64 (Cal. 1968). See also *e.g.*, *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641, 643–45 (Cal. 1968).

17. 2 WITKIN, *supra* note 1, ch. VIII, § 59, at 179 (emphasis omitted).

18. *Banco do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. 870, 885 (Ct. App. 1991).

To determine the applicability of the rule to any offered extrinsic evidence, the court must engage in the following analysis: First, the court must determine whether the writing was intended to be an integration<sup>19</sup>—“a complete and final expression of the parties’ agreement, precluding any evidence of collateral agreements.”<sup>20</sup> The existence of an integration clause within the written agreement is proof that the parties intended the agreement to be their final expression; however, the courts have rejected a test looking only to the four corners of the document in favor of an approach that focuses more closely on the parties’ intentions.<sup>21</sup> Second, the court will limit any examination of outside material to collateral agreements that do not contradict express terms of the agreement.<sup>22</sup> Third, extrinsic evidence, to be admissible, must be that which might naturally have been made as a separate contract.<sup>23</sup> Finally, the evidence must not be likely to mislead the trier of fact.<sup>24</sup>

The courts’ limitations on outside material stem directly from the policy considerations<sup>25</sup> underlying the PER and how those courts have interpreted the rule over the years.<sup>26</sup> The first limitation—exclusion of directly contradictory evidence—addresses the belief that written evidence is more accurate than human memory.<sup>27</sup> Additionally, it addresses the concern of fraud or unintentional invention by parties through two avenues: first, *before* an agreement has been reached,<sup>28</sup> such as by a party fraudulently misrepresenting facts to induce the other party to sign the

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19. This Note, however, focuses on issues arising with fully integrated documents, and therefore the issue of whether a document is integrated is relevant only for a general background discussion of the PER.

20. *Banco do Brasil*, 285 Cal. Rptr. at 886.

21. See *Masterson*, 436 P.2d at 563 (allowing examination of collateral agreements to determine whether the outside agreement was intended to be part of the written agreement).

22. *Banco do Brasil*, 285 Cal. Rptr. at 886–87.

23. *Id.*

24. *Id.*

25. See *supra* text accompanying notes 1–5.

26. These considerations, in addition to others, also underlie the fraud exception and factor into the later discussion of the exception.

27. Arthur Corbin and Justice Traynor, however, hold the contradictory belief that “the written word [is] inherently ambiguous, devoid of objective meaning—an empty vessel to be filled by each reader’s unique predilections and perspectives.” Olivia W. Karlin & Louis W. Karlin, *The California Parol Evidence Rule*, 21 SW. U. L. REV. 1361, 1361 (1992). This belief supports the competing interest that it is better to focus on the intent of the parties, rather than on the four corners of any written agreement. *Id.*

28. See *infra* notes 131–42 for a discussion of the balance between the PER and the fraud exception with regard to preventing fraud or unintentional invention at all stages of the contracting process.

agreement, and second, *after* an agreement has been reached,<sup>29</sup> such as by a party fabricating evidence that would be admissible under the fraud exception.

Courts are also concerned with limiting extrinsic evidence that may mislead the finder of fact or the jury.<sup>30</sup> Typically, the party offering evidence outside the written agreement is the economic underdog; the jury may place more weight than is reasonable on evidence supporting a more sympathetic litigant. But is the PER only in place to safeguard the stronger drafting party? The fraud exception appears to be the compromise for the weaker party in admitting evidence to show illegality or fraud.

Finally, one of the most important policy concerns for California's businesses is the need for predictability in written agreements. While proponents of the PER and the court claim that barring extrinsic evidence leads to predictability, litigation concerning the admissibility of PER evidence is still prominent in contract disputes. Additionally, as this Note will demonstrate, there are many instances of litigation over evidence allegedly showing fraud.

Within the discussion of the PER and its exceptions, two sets of parties are relevant: sophisticated, lawyer-represented companies conducting negotiated deals and the economic underdogs who may be less savvy about contractual provisions. Courts attempt to reach a middle ground between the two groups in finding justification for the PER and, later, for the fraud exception. This Note will focus on the issues mainly affecting the former group and California businesses in general. The characteristics of these parties support strong arguments for a very strict PER and a narrower fraud exception<sup>31</sup> because the contracting parties are sophisticated and represented by counsel.

### III. THE FRAUD EXCEPTION TO THE PER

While the PER prohibits extrinsic evidence from varying or contradicting integrated written agreements in order to be admissible, several exceptions are found in the statutory codification of the rule.<sup>32</sup> This

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29. See *Masterson v. Sine*, 436 P.2d 561, 564 (Cal. 1968).

30. *Id.*

31. This Note argues for a narrower fraud exception—at least where sophisticated parties are concerned. Courts may take into consideration the requisite standings of parties when making determinations about admissibility and the relative fairness of certain written agreements.

32. Extrinsic evidence concerning course of dealing, usage of trade, course of performance, mistake, imperfection, and of the validity of an agreement is admissible. See *supra* note 3 and

Note focuses on the fraud exception,<sup>33</sup> which states that “[t]his section does not exclude other evidence . . . to establish illegality or fraud.”<sup>34</sup> Such an exception is a recognized necessity so as not to create a situation where a party can induce another party into a contract fraudulently with the knowledge that evidence of such fraud is inadmissible where there is an integrated written agreement.

The controlling California case is *Bank of America National Trust & Savings Ass’n v. Pendergrass*, which established a distinction between two types of fraud that evidence is offered to prove: promissory fraud, or a promise without intention to perform; and misrepresentation of fact, regarding either the physical content of the written agreement or an existing fact.<sup>35</sup> The former is not admissible when it varies or contradicts the terms of the written promise; however, it is admissible if it is consistent with or independent of the written promise.<sup>36</sup> The latter is always admissible.<sup>37</sup>

In subsequent cases and scholarship, the court is often criticized for sharply departing from the code and case law preceding *Pendergrass*.<sup>38</sup> Within section 1856, there is no qualifying language for what proof of fraud is admissible; additionally, sections of the Civil Code merely include “promise[s] made without any intention of performing” them in their definition of fraud.<sup>39</sup> The distinction for which types of evidence of fraud should be admissible is not found in the code and the *Pendergrass* court found its support elsewhere for the holding. Similarly, case law prior to *Pendergrass* never explicitly required fraud evidence to be consistent with the written agreement to be admissible.<sup>40</sup>

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accompanying text.

33. Some view the term “exception” to be misleading. If a contract is not validly formed due to fraud or illegality, then “there is no contract to be protected by the exclusion of extrinsic evidence.” Justin Sweet, *Promissory Fraud and the Parol Evidence Rule*, 49 CAL. L. REV. 877, 877 (1961).

34. CAL. CIV. PROC. CODE § 1856(g) (West 2007).

35. *Bank of Am. Nat’l Trust & Sav. Ass’n v. Pendergrass*, 48 P.2d 659 (Cal. 1935).

36. *Simmons v. Cal. Inst. of Tech.*, 209 P.2d 581, 587 (Cal. 1949).

37. *See infra* Part III.B.

38. *See Coast Bank v. Holmes*, 97 Cal. Rptr. 30, 35–36 (Ct. App. 1971); Sweet, *supra* note 33, at 880–85.

39. CAL. CIV. CODE §§ 1572, 1710 (West 2007).

40. *See Sweet, supra* note 33, at 881–83. *See also Langley v. Rodriguez*, 55 P. 406, 407 (Cal. 1898) (“The [PER] . . . cannot be avoided by showing that the promise outside the writing has been broken. Such breach in itself does not constitute fraud. But a promise made without any intention of performing it is one of the forms of actual fraud; and cases are not infrequent where relief against a contract reduced to writing has been granted on the ground that its execution was procured by means of oral promises fraudulent in the particular mentioned, *however variant from the terms of the written engagement* into which they were the means of inveigling the complainant.” (emphasis added))



The cases following *Pendergrass* reveal considerable confusion as to how its qualifications to the fraud exception should be applied. The policy consideration of predictability—one of the most important underlying the PER—is not best served by this current, confusing distinction. One difficulty courts encounter is the fact-intensive inquiry that is necessary when confronted with a fraud claim; for sophisticated parties, the threat of a fraud claim after a negotiated deal has taken place should ideally be dispensed with in a more efficient manner. The following three sections set forth the *Pendergrass* decision and describe the way in which California courts have classified cases into instances of misrepresentation of fact or promissory fraud.

#### A. THE *PENDERGRASS* DECISION

In *Pendergrass*, the plaintiff, Bank of America, brought suit to recover payment on a promissory note, and the defendants contended that the note was procured by fraud.<sup>41</sup> The note was a demand note for \$4750 and represented a portion of a previously unsecured debt by Pendergrass and his son to the bank for a purchased ranch.<sup>42</sup> At trial, the defendants attempted to introduce oral evidence showing an alleged fraudulent promise that “if [Pendergrass and son] executed the note and mortgage . . . they would not be required ‘to make any payments on their indebtedness . . . until this money came in from the 1932 crop . . . and that the bank would permit them to go ahead and operate and produce this 1932 crop.’”<sup>43</sup> While this language came from the defendants’ opening statement, their actual pleading stated that the bank allegedly promised to extend or postpone all payments for one year.<sup>44</sup> The appellate court held that an instance of promissory fraud, such as above, could be used as a defense.<sup>45</sup>

Following the lower court’s decision, the case was eventually reversed on other grounds. However, the California Supreme Court was concerned with the lower court’s promissory fraud findings and granted a hearing to revisit the issue of whether “such a promise [is] the subject of parol proof

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(citations omitted); *Blackwell v. Thomasson*, 258 P. 724, 724–25 (Cal. Ct. App. 1927) (admitting an alleged oral promise even though an integration clause made the promise inconsistent).

41. *Bank of Am. Nat’l Trust & Sav. Ass’n v. Pendergrass*, 48 P.2d 659, 660–62 (Cal. 1935).

42. *Id.* at 660.

43. *Id.* at 661.

44. *Id.*

45. *Id.*

for the purpose of establishing fraud as a defense to the action.”<sup>46</sup> The court answered this question in the negative:

Our conception of the rule which permits parol evidence of fraud to establish the invalidity of the instrument is that it 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.<sup>47</sup>

To clarify this distinction between types of alleged fraud, the court specified that statements contradicting the terms of the writing should not be admissible “when the statements relate to rights depending upon contracts yet to be made, to which the person complaining is a party, as under such circumstances he has it in his power to guard in advance against any and all consequences.”<sup>48</sup>

The court found support for its holding from a Virginia case, *Towner v. Lucas’ Executor*, and departed from earlier California cases and the plain language of the Civil Code regarding fraud and false promises.<sup>49</sup> Although the court used *Towner* to support its holding that in cases of promissory fraud the alleged oral promise cannot be inconsistent with the written agreement, it actually relied on Wigmore’s interpretation of this case.<sup>50</sup> In deciding to curtail the admission of parol evidence in cases of alleged fraud, the court elected to compromise the policies of tort law rather than the policies behind the PER.<sup>51</sup>

The court did not use the terms “misrepresentation of fact” and “promissory fraud” that subsequent cases use to distinguish between admissible and inadmissible parol evidence to establish fraud. In the cases following *Pendergrass*, application of the holding has been confusing to

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46. *Id.*

47. *Id.*

48. *Id.* at 662 (quoting *Lindemann v. Coryell*, 212 P. 47, 48–49 (Cal. 1922)).

49. *Towner v. Lucas’ Ex’r*, 54 Va. (13 Gratt.) 705, 716 (1857) (“It is reasoning in a circle, to argue that a fraud is made out, when it is shown by oral testimony that the obligee contemporaneously with the execution of a bond, promised not to enforce it. Such a principle would nullify the rule: for conceding that such an agreement is proved, or any other contradicting the written instrument, the party seeking to enforce the written agreement according to its terms, would always be guilty of fraud.”).

50. See Sweet, *supra* note 33, at 884, for an argument that the court may have erred in citing to Wigmore as supporting the holding of *Towner* because Wigmore “quoted the case to discredit a former Pennsylvania rule that it was fraud to insist on a writing when there had been an earlier oral agreement to the contrary, a rule that is almost universally rejected,” and not to support the proposition that evidence of factual fraud is the only parol evidence admissible under the exception.

51. See *supra* notes 13–19.

say the least: courts have ignored the rule,<sup>52</sup> stretched promises to find that they are consistent with the contract,<sup>53</sup> recast promises as statements of fact so as to avoid the promissory fraud issue,<sup>54</sup> and taken issue with its application in general. Even though a great number of cases<sup>55</sup> have attempted to follow the *Pendergrass* holding, California cases involving written agreements are fraught with confusion and a lack of predictability.

## B. MISREPRESENTATION OF FACT

Courts have conceded that “there can occasionally be a fine line between a *promise* that induces an agreement and a misrepresented *fact* concerning the physical content of an agreement at the time of signing.”<sup>56</sup> After *Pendergrass*, however, parol evidence of fraud “must tend to establish some independent fact or representation” to be admissible to establish the invalidity of an integrated written instrument.<sup>57</sup> The following two sections illustrate the ways in which a court may find the existence of misrepresentations of fact—either as a misrepresentation of the physical content of a written agreement or of an existing fact. These distinctions are best understood through case illustrations because of the fact-intensive inquiry involved.

### 1. Misrepresentation of the Physical Content of a Written Agreement

In *Pacific State Bank v. Greene*, the defendant attempted to introduce evidence of the bank’s alleged misrepresentations that the guaranty she signed related only to a single loan, even though the fine print contained in the agreement stated that the “‘indebtedness’ that was to be guaranteed . . . include[d] ‘all of Borrower’s liabilities,’ which covered four loans.”<sup>58</sup> Her defense was asserted because the bank sought to recover on all of the guaranteed loans she had made through them.<sup>59</sup>

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52. See, e.g., *Chastain v. Belmont*, 271 P.2d 498 (Cal. 1954).

53. See, e.g., *Simmons v. Cal. Inst. of Tech.*, 209 P.2d 581, 587 (Cal. 1949).

54. See, e.g., *Morris v. Harbor Boat Bldg. Co.*, 247 P.2d 589, 592–93 (Cal. Ct. App. 1952).

55. See, e.g., *Bank of Am. Nat’l Trust & Sav. Ass’n v. Lamb Fin. Co.*, 3 Cal. Rptr. 877 (Ct. App. 1960); *Newmark v. H&H Prods. Mfg. Co.*, 274 P.2d 702 (Cal. Ct. App. 1954).

56. *Pac. State Bank v. Greene*, 1 Cal. Rptr. 3d 739, 753 (Ct. App. 2003). See also *Sweet*, *supra* note 33, at 895–96 (“[T]he differentiation between representations of facts . . . and promises can be very troublesome.” For example, there are “cases that classify a promise made without intent to perform as a representation of fact about the state of mind of the promisor. . . . It does not take much manipulation to classify a promise as either a warranty or a fact.”).

57. *Bank of Am. Nat’l Trust & Sav. Ass’n v. Pendergrass*, 48 P.2d 659, 661 (Cal. 1935).

58. *Pac. State Bank*, 1 Cal. Rptr. 3d at 742.

59. *Id.*

The misrepresentations in *Pacific State Bank* concerned the actual physical content of the written agreement and could only be alleged by a party that could reasonably claim naiveté as to the agreement.<sup>60</sup> The court recognized that while *Pendergrass* limited the scope of the fraud exception to exclude promises at variance with the promise in writing, it was not necessary to safeguard the PER by extending the exclusion of evidence to misrepresentations of fact—to do so would eviscerate the fraud exception.<sup>61</sup> The fears that the court had in *Pendergrass*—that the fraud exception would overwhelm the PER and lead to abuse—are not present with misrepresentations of fact, because<sup>62</sup> (1) the timing and circumstances of factual misrepresentations are much narrower than allegations of promissory fraud; (2) allegations of factual misrepresentations do not go “to the heart of that which the parol evidence rule is intended to protect against”<sup>63</sup>; (3) the ability to use such allegations is not easily abused because of the requirement of reasonable reliance; and finally, (4) to exclude evidence of factual misrepresentations would trespass on legislative ground by placing qualifiers on unqualified statutory language.<sup>64</sup>

## 2. Misrepresentation of an Existing Fact: Strained Distinctions

*Continental Airlines, Inc. v. McDonnell Douglas Corp.* involved both misrepresentations of fact and promissory fraud.<sup>65</sup> Ultimately, the factual misrepresentations that the airline manufacturer, Douglas, made to Continental Airlines in a sales brochure were deemed admissible to establish fraud.<sup>66</sup> During negotiations for purchasing the aircraft, Douglas supplied Continental Airlines with brochures and a “Detail Type Specification,” which contained detailed technical information for the aircraft and formed the basis for Continental Airlines’ aircraft purchase. The Detail Type Specification was incorporated by reference into the final

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60. The court draws support for admissibility of these representations from an 1898 California Supreme Court case, *Maxson v. Llewelyn*, 54 P. 732 (Cal. 1898). See also *infra* text accompanying notes 103–12 (discussing how the court misapplied the *Pendergrass* rule in *Bank of America National Trust & Savings Ass’n v. Lamb Finance Co.*, 3 Cal. Rptr. 877 (Ct. App. 1960), and why the bank’s reliance on that holding is flawed).

61. *Pac. State Bank*, 1 Cal. Rptr. 3d at 742.

62. *Id.* at 752–53.

63. *Id.* Conversely, in cases of promissory fraud, “an earlier or contemporaneous promise is proffered in variance with the promises in the agreement.” *Id.*

64. *Id.* But this appears to be exactly what the court in *Pendergrass* did when it introduced the additional requirement for the fraud exception that the promise cannot be in variance with the writing.

65. *Cont’l Airlines, Inc. v. McDonnell Douglas Corp.*, 264 Cal. Rptr. 779 (Ct. App. 1989). See *infra* text accompanying notes 113–20 for a discussion of promissory fraud in *Continental Airlines*.

66. See *Cont’l Airlines*, 264 Cal. Rptr. at 797–98.

Purchase Agreement, and the representations made in all of these documents became the focus of the lawsuit.<sup>67</sup>

While Douglas made various promises or guarantees within the brochures, it also made factual representations. These included (1) “[t]he landing gear, flaps, and *wing engines/pylons are designed for wipe-off without rupturing the wing fuel tank or fuselage shell structure*” and (2) the wings “*are designed to provide strength greater than that of the gear itself in order to prevent rupture of the fuel tank,*” among similar additional representations.<sup>68</sup> The court found that these factual representations were admissible to establish fraud by Douglas because the representations asserted that Douglas “had already accomplished its safety-orientated design for that particular feature of the aircraft,”<sup>69</sup> when in fact it had not.

Similarly, in *Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Development Corp.*, the court found that the alleged promise of the presence of offers for a piece of real estate (among other representations) was a factual misrepresentation, and thus evidence of it was admissible.<sup>70</sup> Ron Greenspan and Ford Motor Company had reached an agreement regarding operation of a Lincoln-Mercury dealership at Greenspan’s Howard Street property.<sup>71</sup> In order to fund the venture, the two discussed an exchange of real properties held by Greenspan (Howard Street) and Ford (Van Ness); the Howard Street property would then be rented back to Greenspan while the Van Ness property would be sold and the profits used to fund the venture. Over the next year, Greenspan claimed to have been induced by Ford’s representations to submit higher counteroffers in response to offers for the property and to enter into a written agreement with Koll to purchase the property.<sup>72</sup> The Purchase Agreement provided for the property exchange and purchase, conditioned on Koll obtaining a financial partner; it also stated that “[t]his Agreement constitutes the sole agreement among the parties, and supersedes any and all prior oral or

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67. *Id.* at 783–84. Continental Airlines sued Douglas when the aircraft that it had purchased subsequently crashed due to two bursting tires. Continental Airlines based its claim on representations that Douglas made concerning the reliability of the airplane tires and the risk of bursting. *Id.*

68. *Id.* at 798. Additionally, Douglas made factual misrepresentations that “the main landing gear *is designed to break away from the wing structure without rupturing fuel lines*” and that “[t]he [wing] support structure *is designed to a higher strength than the gear to prevent fuel tank rupture* due to an accidental landing gear overload.” *Id.*

69. *Id.*

70. *Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Dev. Corp.*, 38 Cal. Rptr. 2d 783 (Ct. App. 1995).

71. *Id.* at 784–85.

72. *Id.* at 784.

written agreements or understandings among them.”<sup>73</sup> After Koll failed to find a partner, the deal was terminated.

Greenspan alleged that Ford made misrepresentations regarding the appraisal value and the actual value of the property, the existence of purchasers and offers for the property, and Koll’s procurement of a financial partner.<sup>74</sup> The court here, oddly, did not use *Pendergrass* or its holding to find that evidence of fraud was admissible notwithstanding the statement that all conditions and representations were embodied within the Purchase Agreement. It simply asserted that there is a “well-settled rule that parol evidence is admissible to prove fraud in the inducement ‘even though the contract recites that all conditions and representations are embodied therein.’”<sup>75</sup> However, from the court’s treatment of the representations made by Ford to Greenspan, it appears that the court viewed them as factual misrepresentations of existing facts concerning the written agreement, and therefore as admissible parol evidence.<sup>76</sup>

In *Edwards v. Centex Real Estate Corp.*, the court allowed subdivision residents to introduce factual misrepresentations made by Centex to illustrate that they had been fraudulently induced into signing release forms.<sup>77</sup> The case arose because Centex had built a subdivision on land that it knew required a certain type of foundational design to be secure and had knowingly failed to implement such a design.<sup>78</sup> Residents eventually began to complain of cracking in their homes’ foundations. Centex responded by hiring inspectors and—even though Centex knew that the foundations were improperly designed—suggesting further repairs. At this point, the residents of the subdivision alleged that Centex made fraudulent promises: all responses made to the residents’ reports of cracks in their home foundations, as well as promises to repair, were fraudulent because Centex knew of the foundation design flaw.<sup>79</sup>

In its defense, Centex cited a release that the residents had signed in which they “acknowledge[d] the possibility of unknown or future foundation damage and expressly waiv[ed] any claims based on such

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73. *Id.* at 785.

74. *Id.*

75. *Id.* at 789 (quoting *Ferguson v. Koch*, 268 P. 342, 345 (Cal. 1928)).

76. Note the continuing confusion as to the exact manner of application of *Pendergrass* when cases clearly applying its rule fail to cite the case or acknowledge its rule.

77. *Edwards v. Centex Real Estate Corp.*, 61 Cal. Rptr. 2d 518, 535 (Ct. App. 1997).

78. *Id.* at 522.

79. *See id.* at 522–23.

damage.”<sup>80</sup> The alleged promises by Centex would contradict these express terms; however, the court characterized the promises made by Centex not as “independent false promises . . . contradicting the terms of the release,” but as “fraud in the inducement or procurement through alleged misrepresentations of fact.”<sup>81</sup> The court supported its conclusion with the assertion that the evidence presented was not offered for the purpose of “contradict[ing] the . . . parties’ integrated agreement, but to show instead that the purported instrument has no legal effect.”<sup>82</sup>

Finally, the court, in the more recent case *Manderville v. PCG & S Group, Inc.*, also found a promise prior to a written agreement to be a misrepresentation of fact and admissible as evidence of fraud.<sup>83</sup> Here, the main issue, similar to that in *Ron Greenspan*, was whether a broad exculpatory clause can absolve a party of liability for fraud with respect to an existing fact.<sup>84</sup> This action began with the purchase of land by two families that intended to split the land into subdivisions and build two homes. In looking for a suitable plot of land, the families were concerned about having the ability to split the property and tailored their search to properties that could be subdivided. During discussions between the families’ brokers and the sellers of the property, it was represented that the property could be divided. The families bought the property based on this assertion and only later discovered that zoning laws prohibited splitting the property.<sup>85</sup>

The court held that the buyers of the property were not barred by the written agreement—which contained an exculpatory clause—from showing that they “justifiably relied on [the] Brokers’ alleged intentional misrepresentations.”<sup>86</sup> The evidence of a factual misrepresentation admitted in defense of an action on a written agreement further exemplifies the confusion surrounding the court’s application of *Pendergrass*’s rule, especially given the noteworthy absence of any mention of the fraud exception in the court’s opinion.

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80. *Id.* at 535.

81. *Id.*

82. *Id.*

83. *Manderville v. PCG & S Group, Inc.*, 55 Cal. Rptr. 3d 59 (Ct. App. 2007).

84. *Id.* at 68–72.

85. *Id.* at 61–65.

86. *Id.* at 71.

### C. PROMISSORY FRAUD

As courts move from discussions of misrepresentations of fact into the realm of promises, the distinctions become even murkier. Certainly, clear instances of promissory fraud—promises without intention to perform that directly contradict the written agreement—do exist. Much more common, however, are those difficult cases featuring the presence of the following two imprecise distinctions: distinctions between promissory fraud and misrepresentation of fact, and distinctions between independent/consistent promises and contradictory/varying promises. The following cases highlight the problems courts encounter when presented with the task of distinguishing between very similar types of promises.

#### 1. Clear Cases of Alleged Promissory Fraud

When fraud claims present clear instances of promissory fraud, common sense can lead to the same outcomes that courts reach through legal analysis of those claims. In *Price v. Wells Fargo Bank*, the alleged fraudulent promise regarding a loan interest rate preceded the contract at issue, which contained completely different terms.<sup>87</sup> The court found the alleged promise contradicted the written agreement and held it to be inadmissible.<sup>88</sup> The suit surrounded a complicated series of loans extended by the Wells Fargo Bank to the Prices.<sup>89</sup> For one of the loans, a \$15,000 mobile home loan, the Prices contended that they were offered a 13 percent interest rate from Bank of America. Wells Fargo then countered, promising a better rate for the Prices. Subsequently, at the actual signing of the loan, Wells Fargo could only offer an interest rate 3 percent higher than prime (higher than the original Bank of America 13 percent rate). This prior oral promise by Wells Fargo was a clear case of promissory fraud because it contradicted the terms of the written loan agreement. This falls squarely within *Pendergrass's* promissory fraud distinction, and thus the parol evidence was found to be inadmissible.<sup>90</sup>

Similarly, in *Brinderson-Newberg Joint Venture v. Pacific Erectors, Inc.*, the inadmissible alleged promise was a promise not to enforce the specific terms of the contract between two parties who both had full knowledge of the actual terms of the agreement.<sup>91</sup> Here, the agreement

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87. *Price v. Wells Fargo Bank*, 261 Cal. Rptr. 735 (Ct. App. 1989).

88. *Id.* at 746–47.

89. *Id.* at 737–38.

90. *Id.* at 746–47.

91. *Brinderson-Newberg Joint Venture v. Pac. Erectors, Inc.*, 971 F.2d 272 (9th Cir. 1992).



between a contractor, Brinderson, and subcontractor, Pacific, laid out the specifics for certain erection work to be undertaken. The actual written agreement “required Pacific to ‘erect complete’ the FGS equipment.”<sup>92</sup> Pacific claimed that it was only required to “pick and set” the FGS components and not erect them completely; it alleged that Brinderson assured it that the language only required picking and setting and that it was too time-consuming to change the specific language in the written agreement prior to closing the deal. The *Brinderson* court approached the analysis of promissory fraud slightly differently by extending the usual PER analysis: the court questioned whether the integrated contract was reasonably susceptible to Pacific’s interpretation.<sup>93</sup> In finding, both under the PER and the fraud analysis, that the contract was not susceptible to such an interpretation, the court held that the alleged false promise contradicted the written agreement, and was therefore inadmissible.<sup>94</sup>

Finally, in *Banco do Brasil, S.A. v. Latian, Inc.*, the acquiring company, Latian, unsuccessfully attempted to introduce evidence that it was allegedly promised a credit line by Banco do Brasil as an additional condition to a written agreement, which specified that it was unconditional and that the credit line would not be extended to Latian.<sup>95</sup> The negotiations were based on Latian acquiring the “Kudsy companies” and also involved the assumption of Kudsy’s obligations to Banco do Brasil. Throughout negotiations, Latian requested assumption of Kudsy’s line of credit (two million dollars) from Banco do Brasil, and Banco do Brasil representatives allegedly made representations that the credit line could be assumed. The written Guaranty Agreement, however, stated that the line of credit was distinct to Kudsy, and not available to Latian, or any new debtors.<sup>96</sup> Latian claimed that the credit line was an indispensable condition of the agreement. Even though the topic was discussed numerous times throughout the lengthy negotiation process, the alleged promise directly contradicted the integrated written agreement.<sup>97</sup> Therefore, the court held that the evidence of an extended credit line was inadmissible under the PER.<sup>98</sup>

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92. *Id.* at 275.

93. *Id.* at 277, 281.

94. *Id.* at 281–82.

95. *Banco do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. 870 (Ct. App. 1991).

96. Additionally, the Security Agreement confirmed that no separate credit line was ever recognized or agreed to by Latian. *Id.* at 878, 889–90 n.46.

97. *See id.* at 892.

98. *Id.* at 891–92.

## 2. Strained Distinctions

*Agosta v. Astor* illustrates an instance in which the court made a strained distinction between an inadmissible promise regarding length of employment and an admissible misrepresentation of compensation when the written agreement specified the employment was “at-will” and included certain compensation terms.<sup>99</sup> *Agosta* was induced to change employment through misrepresentations concerning the length of employment and the compensation terms. The written terms of the compensation plan provided to *Agosta* included an “at-will” provision which expressly allowed the employer or employee to end the relationship with or without cause. The court held that the plan “address[ed] the length of employment by including the at-will provision” and that to introduce allegations of false promises about length of employment would vary or contradict the express terms of the plan.<sup>100</sup> However, somewhat perplexingly, the court found that evidence showing that the employer “promised [*Agosta*] the compensation package he sought to lure him into changing employment . . . [and] never intended to live up to the agreement,” was a misrepresentation of fact, and thus admissible.<sup>101</sup> The court stated, not very convincingly, that while one could not rely on any promise about length of employment because of an at-will express term in the plan, one *could* rely on extracontractual promises regarding compensation.<sup>102</sup>

Another demonstration of the blurred line between misrepresentation of fact and promissory fraud occurs in *Bank of America National Trust & Savings Ass’n v. Lamb Finance Co.*<sup>103</sup> Here, the court exhibited no hesitation in finding that the alleged fraudulent promises contradicting a written promissory note were instances of promissory fraud. However, another California appellate court later found that the *Lamb Finance* court erred and that the evidence should have been admitted as proof of a misrepresentation of fact.<sup>104</sup> The sole shareholder of the *Lamb Finance Co.* executed a guarantee with *Bank of America* for a promissory note. The shareholder contended that she was assured that by signing the guarantee she was not guaranteeing the note with any of her personal property.<sup>105</sup> In

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99. *Agosta v. Astor*, 15 Cal. Rptr. 3d 565, 570–72 (Ct. App. 2004).

100. *Id.* at 571.

101. *Id.* at 572.

102. *Id.*

103. *Bank of Am. Nat’l Trust & Sav. Ass’n v. Lamb Fin. Co.*, 3 Cal. Rptr. 877 (Ct. App. 1960).

104. *Pac. State Bank v. Greene*, 1 Cal. Rptr. 3d 739, 753 (Ct. App. 2003) (“[*Lamb Finance*] correctly articulated the *Pendergrass* limitation, but then misapplied it to the facts of that case.”).

105. This seems strikingly familiar to the situation in *Pacific State Bank*.

fact, the written agreement stated the opposite and allowed the holder of the note to proceed against her directly in the event of a failure to pay.<sup>106</sup> The court cursorily stated that it seemed “obvious . . . that the . . . testimony directly contradict[ed] the written guarantee signed by her; and that such testimony . . . is clearly inadmissible to vary the terms of the instrument.”<sup>107</sup>

The court found support for its finding from two cases: *Newmark v. H&H Products Manufacturing Co.*<sup>108</sup> and *Shyvers v. Mitchell*.<sup>109</sup> In *Newmark*, the court found that alleged representations about the “quality, condition and quantity of the personal property” that was the subject of a purchase agreement were promises that contradicted the terms of an integrated written contract.<sup>110</sup> *Newmark*’s precedent, however, is of questionable value for purposes of the *Lamb Finance* court’s reliance because representations about the actual quality, condition, and quantity of property are clearly addressing existing facts; therefore, it was strained for the court to characterize the alleged promises as promissory fraud, as opposed to misrepresentations of fact. Similarly, *Shyvers* should not have been relied upon because it involves a clear case of promissory fraud—a promise not to enforce the terms of a written agreement—rather than a misrepresentation of the terms contained within the agreement.<sup>111</sup> Neither of the cases relied on by the *Lamb Finance* court was analogous to the situation in this case; in fact, the situation appears almost identical to the issue in *Pacific State Bank*, in which, recall, the court concluded that the alleged misrepresentation was of a fact—the contents of the written agreement—and not promissory fraud.<sup>112</sup>

*Continental Airlines, Inc. v. McDonnell Douglas Corp.*, a case which also involved alleged promissory fraud, illustrates the courts’ tendency to confuse the distinction between promissory fraud and misrepresentation, as well as the distinction between promises contradictory to written terms and those consistent with a written promise.<sup>113</sup> There, *Continental Airlines* was

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106. *Lamb Finance*, 3 Cal. Rptr. at 879.

107. *Id.* at 880.

108. *Newmark v. H&H Prods. Mfg. Co.*, 274 P.2d 702 (Cal. Ct. App. 1954).

109. *Shyvers v. Mitchell*, 284 P.2d 826 (Cal. Ct. App. 1955).

110. *Newmark*, 274 P.2d at 704.

111. *Shyvers*, 284 P.2d at 828. *Shyvers* involved the bank’s alleged misrepresentations “that respondent would never be held liable thereunder, that his bank held ample security for the note, and that respondent’s guaranty was needed solely for the purpose of satisfying the rules of bank examiners.” *Id.*

112. *Pac. State Bank v. Greene*, 1 Cal. Rptr. 3d 739, 754–55 (Ct. App. 2003).

113. See *supra* text accompanying notes 65–69 for a discussion of *Continental Airlines* and the

barred from admitting evidence of a promise that contradicted the Detail Type Specification. It wished to introduce a single sentence from one of the brochures which promised: “The fuel tank *will not rupture* under crash load conditions.”<sup>114</sup> The Detail Type Specification, on the other hand, stated that “[t]he main landing gear system shall be designed so that if it fails due to overloads during takeoff and landing . . . the failure mode *is not likely* to rupture.”<sup>115</sup> Because the promise that the fuel tank “will not rupture” directly contradicted the Detail Type Specification, the court found that the lower court had erred in admitting the evidence.<sup>116</sup> Conversely, a promise that “[t]he main landing gear will be tested . . . to demonstrate the fail-safe integrity of the landing gear” was found to be consistent with the Purchase Agreement because it constituted a test included within the bargained-for flight tests.<sup>117</sup> Additionally, a representation discussing the “successful DC-8 and DC-9 design experience[s]” was found to be an independent representation, and thus admissible.<sup>118</sup>

The *Continental Airlines* court relied on *Pendergrass*, stating that evidence of promissory fraud is only admissible when there is an alleged false promise that is either independent of or consistent with the written instrument.<sup>119</sup> It distinguished admissible factual representations from these promises by claiming that there was a distinction between the promises regarding the fuel tanks (a promise that directly contradicted the incorporated Detail Type Specification) and the factual misrepresentations (representations that Douglas had completed a safety-orientated design in the brochures that contradicted facts<sup>120</sup>). The differences are hard to see, underscoring the risk that a “promise” can be recast as a misstatement of fact, and vice versa.

Similarly, the next two cases highlight the challenge courts face in drawing the distinction between promises that are contradictory to a written agreement and those that are deemed to be consistent with, or independent of, the written agreement, and thus admissible. First, in *Coast Bank v. Holmes*, Coast brought an action against Holmes to recover on a

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misrepresentation of fact claim.

114. *Cont'l Airlines, Inc. v. McDonnell Douglas Corp.*, 264 Cal. Rptr. 779, 795 (Ct. App. 1989).

115. *Id.* at 794.

116. *Id.* at 794–95.

117. *Id.* at 797.

118. *Id.*

119. *Id.* at 795–96.

120. *But see id.* at 798 (Later, the incorporated Detail Type Specification document provided that “[t]he main landing gear *shall be designed* so that if it fails . . . the failure mode is not likely to rupture the integral fuel tank or fuel lines.”).

promissory note.<sup>121</sup> In defense, Holmes presented evidence alleging that Coast promised not to demand payment on the note for a certain period of time, that it would protect Holmes's trust deed by preventing foreclosure, and finally, that it would cancel the note if foreclosure could not be prevented.<sup>122</sup> After criticizing the *Pendergrass* decision, the *Coast Bank* court held that the promise to protect Holmes's security interest was independent of and consistent with the terms of the promissory note and admissible; the other promises, however, were deemed contradictory and inadmissible.<sup>123</sup> Another California appellate court, presented with an analogous set of facts, came to a different conclusion. In *Bank of Beverly Hills v. Catain*, another case involving a promissory note, the plaintiff alleged that the bank had promised "that upon maturity a quarterly or monthly repayment schedule would be adopted and the terms of the note renegotiated."<sup>124</sup> While the court did not discuss *Pendergrass*, it distinguished—perhaps by manufacture—the present case from *Coast Bank* by claiming that an alleged promise regarding the *manner* of payment of the note did not contradict "the face of the note as did the contentions in . . . *Coast Bank* that no payment at all was to be made."<sup>125</sup>

A superficial review of the cases in Part III, without the highlighted perplexing distinctions, creates the impression that the *Pendergrass* rule is adeptly followed by California courts. However, closer inspection reveals that the courts' distinctions between promises and misrepresentations are, even in factually analogous situations, strained and seemingly inconsistent. Part IV.A illuminates the inconsistent application of the fraud exception and further undermines the belief that the *Pendergrass* rule is clear, defensible, and viable as a continued method of applying the fraud exception.

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121. *Coast Bank v. Holmes*, 97 Cal. Rptr. 30 (Ct. App. 1971).

122. *Id.* at 33.

123. *Id.* at 35–36. The court actually provided no reasoning for why it found only one of Coast's promises to be admissible under the fraud exception; the court merely stated, "the promise to protect Holmes'[s] security interest was *clearly* independent of and consistent with the terms of the note and proof thereof was properly received." *Id.* at 36 (emphasis added).

124. *Bank of Beverly Hills v. Catain*, 180 Cal. Rptr. 67, 69 (Ct. App. 1982).

125. *Id.* at 72. The court "conveniently omitt[ed] any discussion of the meaning of an 'on demand' term in the law of negotiable instruments. . . . [and] [i]nstead . . . focused on the credibility of the evidence . . . to establish that the alleged oral agreement might naturally have been made as a separate agreement between the parties." Susan J. Martin-Davidson, *Yes, Judge Kozinski, There Is a Parol Evidence Rule in California—The Lessons of a Pyrrhic Victory*, 25 SW. U. L. REV. 1, 65–66 (1995) (footnote omitted).

## IV. DISSECTING THE EXCEPTION

## A. CALIFORNIA'S FRAUD EXCEPTION AS APPLIED IS INCOMPREHENSIBLE

The fraud exception in California is inconsistently applied and is in need of adjustment to correct the current unpredictability it introduces into litigation. Evidence of this inconsistency is clear upon an examination of the courts' erratic treatment of fraud cases: courts have followed the rule while openly criticizing its application,<sup>126</sup> attacked its underlying policy considerations as irrelevant,<sup>127</sup> avoided it in creative ways,<sup>128</sup> and finally, sometimes have even ignored it altogether.<sup>129</sup> Notwithstanding the overwhelming amount of criticism and inconsistency, the *Pendergrass* rule remains controlling law and binds all California courts. Contrary to what a majority of critics propose, this Note suggests that adopting a narrower interpretation of the fraud exception for sophisticated parties would yield greater consistency and predictability.<sup>130</sup>

The main difficulty in applying the fraud exception stems from the two distinctions courts are currently required to make. The first is the distinction between a misrepresentation of fact and promissory fraud—a difficult one for courts to make consistently.<sup>131</sup> It is clear that evidence

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126. See *Coast Bank*, 97 Cal. Rptr. at 35 (“[I]n California a tenuous distinction has been drawn between an oral promise which is consistent with the written agreement and one which is at variance with a matter covered by the writing.”).

127. See *Tenzer v. Superscope, Inc.*, 702 P.2d 212, 218–19 (Cal. 1985). In *Tenzer*, the court overturned a line of cases holding that an “action for fraud cannot be maintained where the allegedly fraudulent promise is unenforceable as a contract due to the statute of frauds” because it did not share the concern that recognition of such a claim would have a devastating outcome for prevention of fraud and perjury. *Id.*

128. See *Mktg. W., Inc. v. Sanyo Fisher (USA) Corp.*, 7 Cal. Rptr. 2d 859, 863–65 (Ct. App. 1992) (allowing evidence of an alleged fraudulent promise under a theory of fraudulent concealment as opposed to breach of contract or promissory fraud claims, both of which were barred by the PER).

129. See *Lingsch v. Savage*, 29 Cal. Rptr. 201, 209 (Ct. App. 1963) (holding that “as is” language does not bar evidence of misrepresentations without discussion of the PER by finding that “as is” means that “the buyer takes the property in the condition visible to or observable by him”).

130. In his article on the “hard” and “soft” forms of the PER rule, Eric Posner suggests a number of categories of contracts and the respective form of the PER that should be applied to each. The proposed categories for a hard rule are: high-value consumer contracts, unusual-but-simple contracts, complex business contracts, terms central to a contract, collective bargaining contracts, and represented contracts. And similarly, for a soft rule: ordinary consumer contracts, notes and instruments, and forms. Posner, *supra* note 5, at 554–61.

131. It seems strange that courts use the PER to bar promissory fraud versus misrepresentations of fact. Since evidence of promissory fraud is seemingly the exact type of extrinsic evidence the rule excludes there should be no need for the court to mention it and make a distinction between it and a misrepresentation of fact.

should be admitted when the physical document has been misrepresented<sup>132</sup> or when material existing facts extraneous to the document have been misrepresented.<sup>133</sup> However, when creative lawyers and opportunistic parties attempt to recast barred promises as misrepresentations—something easily done—the argument to admit evidence becomes more strained. As one California court recognized, there is only a slight difference between a claim of “promissory fraud (a promise to ‘rip up the contract’ if financing cannot be found) and misrepresentation of fact (a representation that the contract states that the parties will ‘rip up the contract’ if financing cannot be found).”<sup>134</sup> Cases such as *Lamb Finance* and *Pacific State Bank* illustrate the particular difficulty courts face with this distinction, even with facts that ostensibly lend themselves to simple analysis. In both cases, the “injured” party claimed that the physical content of the written agreement was promised to be something other than what it turned out to be—in *Lamb Finance* it was a promise not to guarantee a note with personal property; in *Pacific State Bank* it was a promise that only one loan was being guaranteed with the note. Even with analogous facts, the court in *Lamb Finance* held that the promise was a case of promissory fraud, while the court in *Pacific State Bank* held that the promise was a misrepresentation of fact. Similarly, the court in *Continental Airlines* characterized differently two extraordinarily comparable promises: “the landing gear, flaps, and wing engines/pylons are designed for wipe-off without rupturing the wing fuel tank or fuselage shell structure”<sup>135</sup> (misrepresentation of fact) versus “the fuel tank will not rupture” (promissory fraud).<sup>136</sup>

Second, the distinction between promises without intention to perform that vary or contradict the written agreement and promises that *are* consistent with or independent of the written agreement presents another perplexing issue. The standard for admissible promises here (consistent or independent) will admit evidence that is different from evidence admitted under the PER standard (varies or adds to terms of written agreement) in

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132. And the party can justifiably claim to be naïve as to the true contents of the document.

133. For cases displaying such clear instances see *Manderville v. PCG & S Group, Inc.*, 55 Cal. Rptr. 3d 59 (Ct. App. 2007) (misrepresentation of a central fact about the ability to split a plot of land); *Pacific State Bank v. Greene*, 1 Cal. Rptr. 3d 739 (Ct. App. 2003) (misrepresentation of a physical document); and *Edwards v. Centex Real Estate Corp.*, 61 Cal. Rptr. 2d 518 (Ct. App. 1997) (misrepresentation of a central fact about improperly designed foundations).

134. *Oracle Corp. v. Warranty Corp. of Am.*, No. C 03-3146 PJH, 2005 WL 226163, at \*2 (N.D. Cal. Jan. 28, 2005) (acknowledging Oracle’s policy concerns).

135. *Cont’l Airlines, Inc. v. McDonnell Douglas Corp.*, 264 Cal. Rptr. 779, 798 (Ct. App. 1989) (emphasis omitted).

136. *Id.* at 795 (emphasis omitted).

cases of completely integrated agreements.<sup>137</sup> A party dissatisfied with the outcome of a particular deal can significantly add to the other party's burden under the written agreement if evidence of consistent or independent promises is admitted.<sup>138</sup> With sophisticated parties, though, 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. We also cannot require, or assume, that parties will contract for all contingencies to ensure that there can be no accusations of an independent promise. While the "consistent" promise requirement is more defensible, and more easily applied (though even there, a creative lawyer can shoehorn almost anything into a "consistent promise"),<sup>139</sup> the requirement for an "independent" promise leads to unpredictable and undesirable results.<sup>140</sup>

The two difficulties present in the current application of the fraud exception discussed above result in a circumvention of the PER and its policy concerns. While critics of the *Pendergrass* rule complain that it will result in further injury to victimized parties, this should not be a concern for the types of parties—sophisticated businesses—discussed in this Note. Application of the current rule with a narrower interpretation of the fraud exception for sophisticated parties would not open the door to deceitful practices,<sup>141</sup> but would instead block parties unsatisfied with the results of an integrated contract from unfairly attempting to alter their obligations—and thus burden another party—after a written agreement has been reached. Additionally, the argument espoused by critics of the *Pendergrass* rule

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137. The PER bars such evidence when an agreement is fully integrated. With partial integrations, evidence is admissible to add to the terms of the agreement, but not to vary or contradict the terms. As noted in this Note's hypothetical and argument, however, in the context of the fraud exception and alleged wrongdoing (perhaps on either side of the agreement), adding to the terms of an agreement after the fact can be tantamount to contradicting or varying the parties' original intent.

138. This situation was illustrated with the hypothetical *supra* Part I.

139. In *Continental Airlines*, a promise that "[t]he main landing gear will be tested . . . to demonstrate the fail-safe integrity of the landing gear" was found to be consistent with terms in the written contract that detailed flight tests to be undertaken. *Cont'l Airlines*, 264 Cal. Rptr. at 797.

140. Compare *Coast Bank v. Holmes*, 97 Cal. Rptr. 30, 36 (Ct. App. 1971) (finding a promise not to demand payment on a promissory note until a certain condition passed to be contradictory to the unconditional written promissory note), with *Bank of Beverly Hills v. Catain*, 180 Cal. Rptr. 67, 69 (Ct. App. 1982) (finding a promise "that upon maturity a quarterly or monthly repayment schedule would be adopted and the terms of the note renegotiated" not to contradict the written promissory note and thus admissible as evidence of the alleged promise).

141. Critics of the *Pendergrass* rule fear this possibility. See James P. Anderson, Notes and Recent Decisions, *Parol Evidence: Admissibility to Show that a Promise Was Made Without Intention to Perform It*, 38 CAL. L. REV. 535, 536 (1950).



does not hold as much force when alternative methods for introducing evidence of fraud, such as tort remedies, are considered.<sup>142</sup>

B. CALIFORNIA COURTS SHOULD NARROW THE FRAUD EXCEPTION AS IT APPLIES TO SOPHISTICATED PARTIES

The only way to ensure complete predictability for California businesses is to establish a blanket rule, such as one that strictly prohibits the invocation of the fraud exception by a particular group of sophisticated parties or for a certain class of contracts. No one would really suggest such a strict rule;<sup>143</sup> instead, a compromise must be reached between the competing interests of insuring predictability and preventing true fraud in contractual agreements. In forging such a compromise, the move should be toward a stricter rule that stops short of a blanket rule prohibiting all evidence of alleged fraud.

As discussed above, the *Pendergrass* decision has been attacked because of the strict rule it created in applying the fraud exception.<sup>144</sup> Prior to *Pendergrass*, there was little or no support (either in the code or case law) for the distinction between promissory fraud and misrepresentation of fact.<sup>145</sup> In fact, this distinction is incongruous: on the one hand, proof of fraud through misrepresentation of fact can negate the entire writing; on the other hand, proof of fraud through promissory fraud contradicting the written agreement is barred.<sup>146</sup>

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142. A detailed discussion of such methods is beyond the scope of this Note; however, these other avenues to introduce evidence of fraud suggest that a broad fraud exception to the PER is not necessary.

143. *But see* Megan R. Comport, Comment, *Enforcing Contractual Waivers of a Claim for Fraud in the Inducement*, 37 SANTA CLARA L. REV. 1031, 1032 (1997) (advocating the enforceability of contractual waivers for claims of fraud for sophisticated parties only). Comport also notes the twofold benefits of enforcing contractual waivers: "First, as courts and litigation consume valuable resources, the resulting decrease in claims for fraud in the inducement will be judicially economical. Second, legal certainty will be injected into business related contractual issues." *Id.* (footnotes omitted).

144. Some critics question the force the rule still has today and will have in the near future. In a treatise on evidence, 2 B.E. WITKIN, CALIFORNIA. EVIDENCE ch. VIII, § 1000, at 947 (3d ed. 1986), the rule's continued vitality when a party seeks fraud damages is questioned due to the court's reversal of an analogous rule—"a tort action for damages could not be based on a false promise where the promise itself was unenforceable under the statute of frauds." *Cont'l Airlines, Inc. v. McDonnell Douglas Corp.*, 264 Cal. Rptr. 779, 797 (Ct. App. 1989) (citing *Tenzer v. Superscope, Inc.*, 702 P.2d 212, 218 (Cal. 1985)). Additionally, some critics feel that cases liberalizing the PER signal a similar change to occur with the fraud exception rule.

145. *See Sweet, supra* note 33, at 882-83 ("[T]he law prior to the *Pendergrass* case, despite occasional waverings, did not require that the alleged oral promise be consistent with the writing when fraud was alleged.").

146. *See Anderson, supra* note 141, at 538 (recognizing that with misrepresentation of fact, California finds "that innocent parties are not barred from recovery for fraud because they were gullible

Critics of the promissory fraud distinction often suggest a credibility-based test instead of a rule that hurts the chances for fraud victims to be heard.<sup>147</sup> Such a test would depend on the facts and circumstances of each particular case to determine whether parol evidence of fraud should be admissible, as opposed to the distinction now based solely on admissibility.<sup>148</sup> Proponents of such a test, and vehement critics of *Pendergrass*, cite the importance of placing the focus on “the right to relief from fraud and the policies that support that right, rather than on fraud as a minor aspect of the parol evidence rule.”<sup>149</sup>

Such a recommendation, however, is not well suited to address the needs of sophisticated parties in California.<sup>150</sup> These parties are not likely to be unknowing victims, and thus there is less risk of fraud in the situations discussed in this Note. More often, the situation is one in which an unsatisfied party attempts to alter the agreement after the fact by using the fraud exception as a loophole to introduce fabricated evidence or to try to obtain, through the courts, contractual provisions it was unable to obtain through negotiation. Thus, *Pendergrass* critics misplace their concern for the naïve contracting party in determining that the rule is too strict and bars too much evidence.<sup>151</sup> Instead, because sophisticated parties are in equal bargaining positions during negotiations with regard to one another, a stricter rule is more appropriate.

Furthermore, even with overwhelming criticism of a strict fraud exception, support is present in the case law for *Pendergrass*'s distinction, including arguments for a stricter fraud rule.<sup>152</sup> First, there have been cases

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and ignorant,” and with promissory fraud, “that the parol evidence rule prevents recovery because the innocent parties neglected to protect themselves from the fraud”).

147. See *Coast Bank v. Holmes*, 97 Cal. Rptr. 30, 36 (Ct. App. 1971). Additionally, in his short Notes and Decisions piece, James Anderson suggests a more concrete factor test:

[T]he court should consider the relative bargaining power of the parties, their relationship at the time of execution of the writing, the previous negotiations on the point where the writing conflicts with the alleged oral promise, and their subsequent behavior so far as it shows reliance on the oral promise at the time of execution of the writing and whether the promise was made with no intention of performance.

Anderson, *supra* note 141, at 538–39.

148. *Coast Bank*, 97 Cal. Rptr. at 36.

149. Sweet, *supra* note 33, at 907. But, as this Note suggests, the fear of fraud is diminished for sophisticated parties, and focusing on such a right may not be the ultimate goal.

150. See *supra* note 12 (discussing how a credibility test could hurt sophisticated parties).

151. Critics fail to focus on the types of parties with which this Note is concerned: sophisticated, lawyer-represented businesses. Such parties do not require additional protection, and such protection can actually be detrimental to this type of contracting when it increases transaction costs through litigation.

152. Supporters of *Pendergrass* typically respond to criticism with the argument that “a broad application of the concept of promissory fraud would undermine the policies of the parol evidence rule

following *Pendergrass* that applaud the underlying policy decisions<sup>153</sup> and choose to extend the rule.<sup>154</sup> For example, the court in *Banco do Brasil* found that “[a] broad doctrine of promissory fraud may allow parties to litigate disputes over the meaning of contract terms armed with an arsenal of tort remedies inappropriate to the resolution of commercial disputes.”<sup>155</sup> Additionally, the court in *Price v. Wells Fargo Bank* discussed how the PER and promissory fraud are conceptually consistent with one another.<sup>156</sup> It also recognized that, if construed more broadly, the concept of promissory fraud would “encourage attempts to convert contractual disputes into litigation over alleged fraud.”<sup>157</sup> Moreover, many supporters of *Pendergrass*’s underlying policy concerns question whether the contract remedy for a fraud-based claim is appropriate.<sup>158</sup> The fact that other avenues exist<sup>159</sup> to present actual evidence of fraud illustrates the lack of a need for a more lenient fraud exception.

The following recommendations address the concerns this Note has explored with regard to sophisticated parties and how the fraud exception can be tailored to better meet their needs in successfully negotiating written agreements. Additionally, these recommendations, in a practical sense, may have already been followed by some courts.<sup>160</sup> Finally, they are also

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and encourage attempts to convert contractual disputes into fraud litigation.” *Banco do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. 870, 892 (Ct. App. 1991).

153. These cases favor considerations underlying the PER over those supporting a fraud cause of action.

154. See, e.g., *Banco do Brasil*, 285 Cal. Rptr. 870; *Slivinsky v. Watkins-Johnson Co.*, 270 Cal. Rptr. 585 (Ct. App. 1990); *Price v. Wells Fargo Bank*, 261 Cal. Rptr. 735 (Ct. App. 1989).

155. *Banco do Brasil*, 285 Cal. Rptr. at 892 (quoting *Price*, 261 Cal. Rptr. at 746). But note that “[i]f fraud allegations can be proved, there is no principled reason to prefer contract litigation to tort litigation. If they cannot be proved, a court can bring a halt to meritless suits” through an appropriate remedy. *Martin-Davidson*, *supra* note 125, at 62.

156. While promissory fraud requires “a showing of tortious intent and reliance in addition to proof of an oral promise,” the PER “is concerned only with proof of an oral promise.” *Price*, 261 Cal. Rptr. at 746.

157. *Id.* (“A broad doctrine of promissory fraud may allow parties to litigate disputes over the meaning of contract terms armed with an arsenal of tort remedies inappropriate to the resolution of commercial disputes.”).

158. This concern can be seen in cases that have refused to admit evidence in following the *Pendergrass* rule. In *Marketing West, Inc. v. Sanyo Fisher (USA) Corp.*, 7 Cal. Rptr. 2d 859, 860 (Ct. App. 1992), the breach of contract and promissory fraud claims were barred by the PER and the restrictive fraud exception. The case was tried instead on the theory of fraudulent concealment, and the defendant was found to be liable under that theory. *Id.* at 864–65. Instead of following the trend of other courts of bending the rule or the evidence to admit, the court instead realized that an alternate theory was better suited to allow introduction of the evidence.

159. A thorough discussion of these other avenues is beyond the scope of this Note, although they include tort remedies and the use of the theory of promissory estoppel to introduce evidence of fraud.

160. For example, note the court’s disbelief in *Banco do Brasil* that sophisticated parties are in

manifested in other areas of contract litigation and may ultimately influence a court's decision on admissibility. For example, to assert that the PER applies, a party must first demonstrate that the document is fully integrated. One way to do so is to prove the enforceability of an integration clause; such a showing requires a party to argue that there is an absence of coercive behavior or adhesive terms. In making this argument, a party is presented with the opportunity to make a sophisticated parties argument,<sup>161</sup> and in practice this can make a significant difference. It is important, however, to move beyond the basic tendencies that we see in courts handling cases involving sophisticated parties and to propose ground rules that lead to equality across the board.

### 1. Narrowing the Misrepresentation of Fact Requirements

First, courts attempting to draw the threshold distinction between misrepresentation of fact and promissory fraud should focus on defining more precisely what constitutes an existing fact. Allowing a party to introduce evidence of a misrepresentation of fact, as opposed to promissory fraud, can be manipulated by shrewd parties as discussed previously.<sup>162</sup> An interpretation of the rule should require that either the misrepresentation is part of the physical content of the document itself,<sup>163</sup> or a misrepresentation of a material fact or a fact that is the direct subject of the contract. In conducting the analysis, the court should test the misrepresentation to be sure it cannot easily be recast as a promise. Note the distinction, for example, between "this property has a value of X" and "we will not enforce

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need of increased protection from fraud:

We do not share the concern expressed in some circles that parties to a contract in California are not capable of drafting a written instrument which will fully and completely define a particular legal relationship. As we view it, it 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. Parties to a business or commercial transaction, such as those in this case, 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. The courts simply cannot permit clear and unambiguous integrated agreements, such as the one before us, 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*, 285 Cal. Rptr. at 893.

161. When dealing with sophisticated parties, a basic assumption is that there is little risk of coercive behavior or adhesion contracts due to the likelihood of equal bargaining power and attorney representation.

162. See *supra* Part IV.A.

163. This should be required in cases in which a party can claim reliance on the promise and naiveté as to the contents of the document. This would not be at issue with sophisticated parties that cannot reasonably state that they did not know the contents of the written agreement.

the terms of this note.” Recasting the former as “I promise you this property has a value of X” does not convert the misrepresentation into a promise, but recasting the latter into a misrepresentation about the terms of the note (“the note is not enforceable”) does violence to the entire meaning of the note itself.

## 2. Narrowing the Promissory Fraud Standard

In a more controversial recommendation, this Note also suggests that the promissory fraud doctrine should be narrowed. Instead of admitting evidence of alleged promissory fraud that is consistent with or independent of the written agreement, courts should either follow the more strict PER standard for complete integrations—barring evidence that varies from or adds to the written agreement—or follow a “substantial variance” test. While critics of the already narrow *Pendergrass* rule assert that the focus needs to be on the “right to relief from fraud,”<sup>164</sup> fraud is a lesser concern for sophisticated parties, who are in a position to protect themselves in a contract negotiation. The two tests suggested by this Note would better protect sophisticated parties from attempts to modify an agreement by a party unhappy with the deal it had made. These two tests would also protect against the risk a party may be burdened with “consistent” or “independent” agreements that significantly add its obligations.

Additionally, a suggestion proposed by Eric Posner,<sup>165</sup> and others,<sup>166</sup> for how to interpret the PER may be useful to apply to the fraud exception. Posner’s theory advances a tailored approach to PER application that depends on the characteristics of the contract and the parties involved;<sup>167</sup> the two ends of the spectrum are the “hard-PER,”<sup>168</sup> or exclusion of extrinsic evidence and complete reliance on the writing, and the “soft-PER,” or affording equal weight to the writing and extrinsic evidence interpretations.<sup>169</sup> For sophisticated parties and high-value contracts,

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164. See Sweet, *supra* note 33, at 907.

165. See Posner, *supra* note 5.

166. See, e.g., Tony Cole, *The Parol Evidence Rule: A Comparative Analysis and Proposal*, 26 U. N.S.W. L.J. 680, 697–701 (2003).

167. Posner suggests that “[t]he classes could be based on the kind of transaction, such as sales of goods, real estate transactions, and bills and notes; or on the kind of parties, such as sophisticated parties, consumers, and lawyer-assisted parties.” Posner, *supra* note 5, at 550.

168. In analyses of contract interpretation and the PER following Posner, the terms “objective” and “subjective” are used to describe similar approaches to interpreting particular types of contracts or situations. See Cole, *supra* note 166, at 699–700 (making a distinction between personal and legal agreements and what form of PER to interpret each agreement with).

169. Posner, *supra* note 5, at 534.

Posner maintains that a hard-PER approach is superior “because the greater amounts at stake justify higher transaction costs.”<sup>170</sup> He recognizes a similar problem with PER interpretation that this Note also introduced with the fraud exception in the context of contracts between sophisticated parties:

Imagine that two sophisticated parties, following negotiations, reduce their deal to a writing. The writing contains a merger clause, but under soft-PER, courts might admit statements . . . to supplement or vary the terms of the writing. As a result, 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 . . . will erroneously enforce those terms should a dispute arise.

This kind of opportunism not only gives each party an incentive to state self-serving terms during the negotiations, but also gives each an incentive to insist on a more ambiguous writing, as well as an incentive to take costly self-protective measures, such as carefully monitoring and recording the course of the negotiations. *The parties would prefer ex ante a regime in which they could commit themselves to relying only on the writing.*<sup>171</sup>

Posner’s hypothetical here is similar to the hypothetical offered in the Introduction of this Note. The difference lies in the alleged presence of wrongdoing when the fraud exception is introduced; in Posner’s hypothetical he illustrates how parties may act in a self-serving manner. But the vice this Note’s hypothetical introduces is that a party’s self-serving behavior may go beyond trying to add to the contract to an attempt to convert a contract claim into one for fraud, thus considerably upping the ante in litigation.<sup>172</sup> In both cases, however, it is clear that sophisticated parties would certainly prefer, at least before a dispute has arisen, to rely only on their thoroughly negotiated agreements to cut down on litigation or transaction costs after the fact.

A similar approach to Posner’s PER suggestion could also be followed with respect to the fraud exception: with certain types of parties, or contracts, a narrower fraud exception would apply.<sup>173</sup> Such an approach

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170. *Id.* at 554.

171. *Id.* at 564–65 (emphasis added) (footnotes omitted).

172. It can be either the party who misrepresented facts or promises engaging in wrongdoing, or the party alleging fraud for deceitful purposes.

173. For example, a narrower fraud exception might involve barring all evidence of fraud except for misrepresentations of the physical content of the agreement or material facts and promissory fraud

would satisfy current critics of the *Pendergrass* fraud exception rule,<sup>174</sup> as well as those concerned that the fraud exception produces unpredictability in litigation for sophisticated parties. A tailored approach is not without its own problems, however. Introducing a sliding scale, no matter what the criteria, can lead to more litigation over the very point on which this Note was trying to avoid additional litigation. Also, any of the recommendations mentioned here may be unworkable with cases at the margin where it is difficult to determine if both parties are truly sophisticated and competent contracting parties. However, as problems arise with any version of a rule, the benefits of a narrow fraud exception for sophisticated parties may vastly outweigh the costs.

Finally, critics of a stricter rule claim that a combination of a liberal admission standard along with a heavy burden of proof will best protect parties.<sup>175</sup> This is not the case, however, with sophisticated parties engaging in high cost transactions; even with a high burden of proof, these parties should not be encumbered with litigation costs to fight fabricated or misrepresented evidence of fraud. A rule that grasps the true nature of sophisticated, lawyer-represented party transactions will be most beneficial to these parties.

## V. CONCLUSION

The fraud exception as applied in California after *Pendergrass* is ill suited to address the needs of sophisticated contracting parties; its application subjects these parties to unpredictable results in court. As demonstrated above, courts encounter extreme difficulty in distinguishing both between promissory fraud and misrepresentation of fact, and between promises that are independent of or consistent with the written agreement and those that vary or contradict the written agreement. To protect the interests of sophisticated contracting parties, a stricter fraud exception is necessary. Such an exception can be created by narrowing the definition of an existing fact for misrepresentations of fact and altering the test for promissory fraud. This Note presents several options for altering the promissory fraud test, including using the PER standard of varying or adding to the terms of the written agreement, employing a substantial

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that does not add to or vary the terms of the written agreement.

174. Critics find this rule to be *too* narrow. Even though other devices and avenues exist to avoid the impact of a narrower fraud exception, "it is capable of preventing . . . victim[s] of fraud from obtaining relief." Sweet, *supra* note 33, at 906-07.

175. *See id.*

variance test, and implementing Posner's sliding scale test. While these tests are not without their own problems, each would promote predictability and the ability of sophisticated parties to rely on their contracts without fear of unfounded litigation. Above all, "[t]he 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."<sup>176</sup>

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176. *Banco do Brasil, S.A. v. Latian, Inc.*, 285 Cal. Rptr. 870, 893 (Ct. App. 1991).