S190581

In the Supreme Court

OF THE

State of California

RIVERISLAND COLD STORAGE, INC., LANCE WORKMAN, PAM WORKMAN, LAURENCE A. WORKMAN, CAROLE WORKMAN and WORKMAN FAMILY LIVING TRUST,

Plaintiffs/Appellants

VS.

FRESNO-MADERA PRODUCTION CREDIT ASSOCIATION,

Defendant/Respondent

After Rehearing Denied and After the Published Opinion
In the Court of Appeal, Fifth Appellate District
5th Civil No. F058434

REPLY BRIEF ON THE MERITS

Scott J. Ivy—No. 197681
LANG, RICHERT & PATCH
5200 North Palm Avenue
Fourth Floor
P.O Box 40012
Fresno, California 93755-0012
Telephone: (559) 228-6700
Fax: (559) 228-6727

Nickolas J. Dibiaso—No. 43885
Lynne Thaxter Brown—No. 104958
DOWLING, AARON & KEELER
8080 North Palm Avenue
Third Floor
P.O. Box 28902
Fresno, California 93729-8902
Telephone: (559) 432-4500
Fax: (559) 432-4590

Attorneys for Defendant/Respondent/Petitioner
FRESNO-MADERA PRODUCTION CREDIT ASSOCIATION

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INTRODUCTION

Plaintiffs entered into a written loan forbearance agreement with defendant. They claim defendant made oral representations, before and at the time of signing, regarding certain terms of the agreement which are directly contradicted by the terms of the signed writing. There is no question that plaintiffs had the opportunity to read the agreement before signing and discover that the terms were not the same as which they claim were represented to them orally.

The Court of Appeal held that evidence of defendant's alleged oral representations is admissible under the fraud exception to the parol evidence rule as a "misrepresentation of fact" about the contents of the agreement. The appellate court followed several cases that depart from the seemingly straightforward rule set forth in *Bank of America National Trust and Savings Association v. Pendergrass* (1935) 4 Cal.2d 258. These cases distinguish between pre-execution statements described as "misrepresentations of fact" and those described as "false promises," and hold that *Pendergrass* applies only to "promissory fraud" and does not bar evidence of pre-contract "factual misrepresentations," even if they are at variance with the terms of the signed writing.

Defendant demonstrated in the opening brief that the "false promise" versus "factual misrepresentation" distinction as the test of admissibility is unworkable, leads to inconsistent and confusing results, invites gamesmanship and perjury, and undermines the major goals of the parol evidence rule.

Plaintiffs' answer brief barely responds to this issue, aside from half-heartedly arguing that defendant exaggerates the difficulty courts have in differentiating between admissible "misrepresentations" and inadmissible "promises."

Instead, plaintiffs shift gears entirely and now seize upon the distinction between fraud in the "inducement" of a contract and fraud in the "execution" or "inception," which *Pendergrass* recognized, but some appellate courts have ignored. Apparently conceding that in a case alleging fraud in the inducement, the fraud exception does not permit introduction of parol evidence regarding the terms of the contract which are contrary to the signed writing, plaintiffs abandon the central allegation of their lawsuit and now say their claim reflects fraud in the execution of the loan forbearance agreement. Plaintiffs argue that a "misrepresentation as to the terms contained in a written agreement" amounts to fraud in the execution and therefore, there is no occasion for the Court to apply or reconsider *Pendergrass*, because *Pendergrass* concerns cases involving fraud in the inducement of a contract.

Plaintiffs' abrupt change of position is not only a telling indicator of the weakness of their case, but ignores the fact that they had the ability to protect themselves from defendant's alleged fraud, *whatever* its name, by simply reading the agreement before signing it. It also highlights the deficiencies in the current state of the rule and the problems inherent when application of the fraud exception to the parol evidence rule is based on the characterization of the alleged fraud and

pre-contract statements. If labels are dispositive, parties will simply recast alleged fraud in the "inducement" as fraud in the "execution," and "false promises" as "misrepresentations," as plaintiffs have done here, and the drain on judicial resources and unpredictability in contractual relations will continue. Contracting parties will have no incentive to read documents before signing them, and in fact a powerful incentive not to read before signing, as those wishing to later avoid their contractual obligations will be permitted to do just what the parol evidence rule is designed to prevent – impeach the written agreement with claims of alleged oral statements.

The Court should reiterate the straightforward rule established in *Pendergrass* and reaffirmed in *Casa Herrera, Inc. v. Beydoun* (2004) 32 Cal.4th 336: Evidence of prior or contemporaneous representations as to the terms contained in an agreement which are at variance with the terms of the signed writing are inadmissible – regardless of the type or characterization of the alleged fraud – when a party has a full opportunity to review the contract before signing it.

ARGUMENT

A. Plaintiffs' claims reflect allegations of fraud in the inducement, not fraud in the execution, of the loan forbearance agreement

1. Plaintiffs have never relied on a theory of fraud in the execution

Plaintiffs turn 180° in their answer brief. At every stage of this case, until now, plaintiffs' theory has been that they were "fraudulently induced" into signing the loan forbearance agreement by Mr. Ylarregui's alleged misrepresentations about the length of the forbearance period and the additional

security. This is what plaintiffs alleged in their complaint, and they sought damages and rescission,[1] recognized forms of relief for fraud in the inducement of a contract. (1 CT 1.) They repeated these allegations in their opposition to defendant's motion for summary judgment (1 CT 280-289, 293-300; 2 CT 305-335), and again in their answer to defendant's petition for review in this Court. (Answer to Petition for Review, pp. 1, 2, 6, 7, 9.)

Plaintiffs have never claimed, until now, that their claims amount to fraud in the "execution" or "inception" of the loan forbearance agreement.

2. A "misrepresentation as to the terms contained in a written agreement" does not constitute fraud in the execution

Moreover, plaintiffs' contention that a "misrepresentation as to the terms contained in a written agreement" constitutes fraud in the "execution" of a contract is wrong.

In *Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal.4th 394, 415 and *Village Northridge Homeowners Association v. State Farm Fire & Casualty Co.* (2010) 50 Cal.4th 913, 921, the Court declared that fraud in the "execution" or "inception" of a contract occurs when "the promisor is deceived as to the nature of his act, and actually does not know what he is signing, or does not intend to enter into a contract at all." (See also Black's Law Dictionary (9th ed. 2009) [defining "fraud in the factum," also termed "fraud in the execution" and

[1] In a case of fraud in the execution of a contract, on the other hand, the contract is void and may be disregarded without the necessity of rescission. (*Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal.4th 394, 415.)

"fraud in the making," as "[f]raud occurring when a legal instrument as actually executed differs from the one intended for execution by the person who executes it, or when the instrument may have had no legal existence . . . [e.g.], as when a blind person signs a mortgage when misleadingly told that the paper is just a letter."].)

Plaintiffs erroneously rely on *Pacific State Bank v. Greene* (2003) 110 Cal.App.4th 375 as support for the proposition that misrepresentations about the contents of an agreement constitute fraud in the "execution." (AB 12-15, 29.) Nowhere in *Greene* did the court so hold. In fact, *Greene* expressly did not address what type of fraud was involved in the case. (*Id.* at 389, n. 7.)

Plaintiffs also mischaracterize and exaggerate the importance of the decision in *Fleury v. Ramacciotti* (1937) 8 Cal.2d 660. *Fleury* nowhere holds that a misrepresentation about the content of an agreement constitutes fraud in the "execution" of a contract, nor does it appear that the case has anything to do with the fraud exception to the parol evidence rule to begin with.[2]

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[2] *Fleury* was decided just two years after *Pendergrass*, a landmark decision regarding the fraud exception to the parol evidence rule, yet *Fleury* makes no reference at all to *Pendergrass* or to the fraud exception. Indeed, in the 74 years since *Fleury*, no California court has ever relied on (even cited) the case in the context of the fraud exception to the parol evidence rule or in connection with the *Pendergrass* decision, except the Fifth District Court of Appeal in the instant case. Plaintiffs themselves never relied on or cited *Fleury* in the trial or appellate court, but rather, only belatedly embraced the case after the Court of Appeal's decision.

3. Plaintiffs' claims reflect allegations of fraud in the "inducement"

Plaintiffs do not claim, nor does the record demonstrate, that they were deceived as to the nature of their act, or they did not know what they were signing, or they did not intend to enter into the loan forbearance agreement. To the contrary, there is no dispute that plaintiffs knew they were signing a loan forbearance agreement; they knew the nature and character of such an agreement; and they intended to enter into it as opposed to some other kind of instrument.

Plaintiffs claim instead that defendant made false representations that induced them to sign the loan forbearance agreement. These allegations comport precisely with the Court's definition of fraud in the "inducement" of a contract: "Fraud in the inducement . . . occurs when 'the promisor knows what he is signing but his consent is *induced* by fraud, mutual assent is present and a contract is formed, which, by reason of the fraud, is *voidable*.'" (*Rosenthal v. Great Western Fin. Securities Corp.*, *supra*, 14 Cal.4th at 415 (italics in original); *Village Northridge Homeowners Association v. State Farm Fire & Casualty Co.*, *supra*, 50 Cal.4th at 92; see also Black's Law Dictionary (9th ed. 2009) [defining "fraud in the inducement" as "[f]raud occurring when a misrepresentation leads another to enter into a transaction with a false impression of the risks, duties, or obligations involved"].)

Plaintiffs' eleventh-hour attempt to re-label the fraud alleged reveals not only the weakness in their case, but illustrates the problems inherent in any rule in which application of the fraud exception is governed principally by the

manner in which the parties and courts label the type of fraud alleged. For the same reasons that application of the fraud exception should not depend on the ethereal distinction between a "false promise" and "misrepresentation of fact," the label assigned to the type of fraud alleged should not be dispositive. We discussed those at length in the petition for review and opening brief and will not re-plow the same ground here.

Moreover, when the alleged fraud concerns the terms of the contract (as opposed to matters collateral to the agreement) and the signing party has sufficient opportunity to review the contract prior to execution, he or she has the ability to protect against an alleged fraud – regardless of *how* the fraud is characterized – by simply reading the agreement and refusing to sign it if it contradicts or fails to include representations previously made.

B. The fraud exception to the parol evidence rule should not apply when the alleged fraud – *however* labeled – concerns the terms of the contract and the party has an opportunity to read the contract before signing it

Even if the Court concludes that a "misrepresentation as to the terms contained in a written agreement" constitutes fraud in the "execution" of a contract, or a subspecies or variation thereof, the fraud exception to the parol evidence rule does not apply where, as in this case, the signing party has not been prevented from reading the contract before signing it. If a party has the ability and opportunity to read the contract himself, it is not an adequate excuse for his failure

to read that the other party purported to state the contents. (*Rosenthal v. Great Western Fin. Securities Corp., supra*, 14 Cal.4th at 423.)

California law is clear that "[r]easonable diligence requires the reading of a contract before signing it." (*Brookwood v. Bank of America* (1996) 45 Cal.App.4th 1667, 1674; *Brown v. Wells Fargo Bank, N.A.* (2008) 168 Cal.App.4th 938, 959.) "Generally, it is *not reasonable* to fail to read a contract; this is true even if the plaintiff relied on the defendant's assertion that it was not necessary to read the contract." (*Brown v. Wells Fargo Bank, N.A.*, supra, 168 Cal.App.4th at 959, citing *Rosenthal, supra*, 14 Cal.4th at 423-424 [italics in original].)

It is contrary to these principles and the integrity of written contracts to allow a party to a fully integrated written agreement to avoid his or her contractual obligations (and also allow him or her to turn a contract dispute into a tort dispute) simply by refusing to read the agreement before signing and later claiming he or she was misled into signing it by representations as to its terms. Yet this is precisely the effect of the Court of Appeal's decision in this case.

Such a rule encourages irresponsibility and ignorance by contracting parties. If a party has the ability and opportunity to read the contract, he or she should not be rewarded for failing to do so. The other party has a right to rely on the contract as written and he should not be required to take the risk of a later oral dispute as to what its contents ought to have been. The Court should reject any

rule that puts a premium on ignorance as opposed to vigilance on the part of contracting parties. It does not serve society and will lead to increased litigation.

Very simply, it is not possible for a person who can read and is not prevented from reading what he signs to be "misled" into signing a contract containing terms that are different from those represented to him, when he can discover the truth by merely looking at the contract before he signs it. Parties to business and commercial transactions need to be able to rely on the words embodied in their contracts and must be assured that the contents of their agreements will be upheld in court. In the absence of costly self-protective measures, such as carefully monitoring and recording the course of negotiations, contracts would not worth the paper on which they are written.

The fraud exception to the parol evidence rule should apply only in the following cases.

First, when the alleged fraud involves matters collateral to the written document. In such a case, the innocent party is not able to protect him- or herself by reading the contract before signing it. The example we cited in the opening brief is where the defendant auto mechanic misrepresents the condition of the brakes on plaintiff's car in order to get plaintiff to buy new brakes. Plaintiff can (and is obligated to) carefully read the purchase contract before signing it, but the defendant's fraud (i.e., that the brakes are in good condition and do not need to be replaced) would not be discoverable by reading the contract.

Second, when the alleged fraud concerns matters embraced in the writing, but the defrauding party prevents the innocent party from reading the contract before signing it, or stands in a fiduciary relationship such that the innocent party may be entitled to rely on the oral statements without reading the contract.

We believe this is the rule established by *Pendergrass* and reaffirmed in *Casa Herrera* and we urge the Court to apply it here.

C. Plaintiffs' failure to read the agreement before signing it was not reasonable

There is no dispute that plaintiffs had an opportunity to read the documents but simply signed without reading them.[3] They now try to blame defendant for their failure to read before signing by claiming that Mr. Ylarregui "specifically told them to sign it at the indicated places rather than read it." (AB 17.) Not quite. Mrs. Workman testified that Mr. Ylarregui showed them where they needed to sign on the documents (2 CT 349 [31:2-4]), but there is no evidence that he told them not to read the documents, or otherwise discouraged or prevented them from reading the documents before signing them.

Plaintiffs also attempt to excuse their failure to read the documents before signing by claiming that Mr. Ylarregui was a "trusted friend" and that a

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[3] Plaintiffs' assertion that they did not read "every term" of the loan forbearance agreement before signing it (AB 17) is a gross misstatement of the evidence. There is no evidence that plaintiffs read any term of the agreement (or the other documents either).

"confidential" and "special" relationship existed between the parties. They cite no evidentiary support for this claim. Moreover, the mere placing of trust in another person does not create a fiduciary relationship. (*Zumbrun v. Univ. of So. Cal.* (1972) 25 Cal.App.3d 1, 13.)

Nor did the parties' business relationship give rise to a confidential or fiduciary relationship. Even if a certain "business friendship" may have developed as a result of the parties doing business together, as a general rule, a loan transaction is at arm's length and there is no fiduciary relationship between the borrower and lender. (*Bank of America Corp. v. Superior Court* (2011) 198 Cal.App.4th 862, 870, n.7; *Oaks Mgt. Corp. v. Superior Court* (2006) 145 Cal.App.4th 453, 466; *Nymark v. Heart Federal Savings & Loan Ass'n.* (1991) 231 Cal.App.3d 1089, 1093 ["The relationship between a lending institution and its borrower-client is not fiduciary in nature."].)

Plaintiffs also cite the California Commercial Code and implied covenant of good faith and fair dealing as establishing a special relationship between the parties. (AB 20.) California courts, however, have determined that the relationship of bank and commercial borrower does not constitute a special relationship for the purpose of the covenant of good faith and fair dealing. (*Kim v. Sumitomo Bank* (1993) 17 Cal.App.4th 974, 979; *Careau & Co. v. Security Pacific Business Credit, Inc.* (1990) 222 Cal.App.3d 1371, 1399, fn. 25.)

The cases plaintiffs cite on this point (AB 17-21) are distinguishable. In *Sullivan v. Dunningan* (1959) 171 Cal.App.2d 662, for example, the innocent

party did not know the nature of the document she signed, and had no reasonable opportunity to read it before she signed it, because she was legally blind. Her son and his wife, with whom she owned property and had a relationship of trust and confidence for many years (the son having lived with her all his life in order to help her), told her she was signing a document to take his name off title to the property when it was in fact a deed conveying her interest in the property to his wife and him. (*Id.* at 665-667.) Moreover, the issue was not the parol evidence rule, or application of the fraud exception, but rather, it was the statute of limitations and whether the innocent party should have discovered the fraud sooner.[4]

That is not this case. There is no evidence that plaintiffs' eyesight was impaired or that they did not know what they were signing, and as explained, there was no relationship of trust and confidence between defendant and them.

Plaintiffs also rely on *Gridley v. Tilson* (1927) 202 Cal. 748, but that case predates *Pendergrass* and actually favors defendant. In *Gridley*, the defendant tried to avoid the effect of a certain provision in a contract by testifying he did not have his glasses with him at the time he signed the contract and therefore he did not read it or the specific provision. The Court found this was not a sufficient excuse "in the absence of a showing that he was prevented by the

[4] There is likewise no indication in several of the other cases plaintiffs cite that the parol evidence rule was an issue. (See, *Simmons v. Ratterree Land Co.* (1932) 217 Cal. 201; *Kane v. Mendenhall* (1936) 5 Cal.2d 749; *Security-First Nat. Bank v.* Earp (1942) 19 Cal.2d 774; *Kantlehner v. Bisceglia* (1951) 102 Cal.App.1.)

agent from reading the limiting clause or was otherwise tricked into signing the document without reading it." (*Id.* at 752.) The Court also noted that the defendant had made no request to have the contract read to him. (*Ibid.*)

Likewise, in this case, there is no evidence that Mr. Ylarregui prevented plaintiffs from reading the documents, or tricked them into signing without reading, or that plaintiffs were otherwise unable to ascertain the contents of the documents before signing them.

Further, all of the cases plaintiffs cite predate this Court's *Rosenthal* decision, where the Court unambiguously declared: "California law, like the Restatement, requires that the plaintiff, in failing to acquaint himself or herself with the contents of a written agreement before signing it, not have acted in an objectively unreasonable manner. One party's misrepresentations as to the nature or character of the writing do not negate the other party's apparent manifestation of assent, if the second party had 'reasonable opportunity to know of the character or essential terms of the proposed contract.' [Citation.] If a party, with such reasonable opportunity, fails to learn the nature of the document he or she signs, such 'negligence' precludes a finding that the contract is void for fraud in the execution. [Citation.]." (*Rosenthal v. Great Western Fin. Securities Corp., supra*, 14 Cal.4th at 423; emphasis added.)

D. Plaintiffs' "alternative approaches" to *Pendergrass* should be rejected

We have demonstrated previously that appellate courts' application of the fraud exception to the parol evidence rule in the 75 years since this Court

decided *Pendergrass* has been confusing, inconsistent and unpredictable. The Court itself has recognized this "judicial confusion." (*Casa Herrera*, *supra*, 32 Cal.4th at 348.) Plaintiffs claim we have exaggerated the confusion, but they also acknowledge the "awkward intellectual gymnastics" appellate courts have performed in applying *Pendergrass*. (AB 45.) None of plaintiffs' suggested alternatives, however, solves the problems.

Plaintiffs discuss at some length the general rule that the presence of a merger or integration clause in a contract does not bar parol evidence of fraud. (AB 33-36.) We agree and do not contend that parol evidence is never admissible to prove fraud. As we discussed, if the alleged fraud pertains to the contents of the written contract and the signing party cannot read the contract and discover that the terms are different from what was represented, or the fraud pertains to matters extrinsic to the writing, the evidence is admissible notwithstanding the presence of a merger or integration clause.

Plaintiffs also devote much attention to two law review articles criticizing the *Pendergrass* decision. (AB 40-46.) These articles[5] propose an approach which basically admits all evidence of fraud, but requires a higher standard of proof ("clear and convincing"). Such an approach favors policies of tort law over those underlying the parol evidence rule, provides no incentive for

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[5] Sweet, *Promissory Fraud and the Parol Evidence Rule*, 49 Cal. Law Rev. 877 (1961) and Note, *Parol Evidence: Admissibility to Show that a Promise was Made Without Intention to Perform It*, 38 Cal. Law Rev. (1950)

vigilance on the part of contracting parties, and essentially allows the fraud exception to obliterate the parol evidence rule, with disastrous effects on the stability of contractual relationships in California.

Finally, plaintiffs argue that the Legislature is the correct forum for addressing these issues, not this Court. (AB 46.) However, Civil Code section 1856, subdivision (g)[6] contains no qualifying language for what proof of fraud is admissible, and until the Legislature includes such language, we must look to the courts to give meaning to the statute.

E. Defendant raised the issue regarding the "justifiable reliance" element of plaintiffs' claims below

Plaintiffs contend that that defendant raised the issue regarding the "justifiable reliance" element of plaintiffs' claims "for the very first time" in the opening brief. (AB 21.) Not so. Defendant raised the issue in the trial court in support of its motion for summary judgment. In opposition to the summary judgment motion, plaintiffs asserted the additional "undisputed fact" that they did not read the loan forbearance agreement but instead relied on Mr. Ylarregui's alleged misrepresentations. (2 CT 303, 310, 317, 324, 331, 338.) In response, defendant argued extensively that the *Greene* exception, if it even existed, could not apply because there was no reasonable reliance. (2 CT 472-474.) The trial

[6] Section 1856, subdivision (g) permits parol evidence "of the circumstances under which the agreement was made or to which it relates . . ., or to explain an extrinsic ambiguity or otherwise interpret the terms of the agreement, or to establish illegality or fraud." (Emphasis added.)

court did not rule on the issue of justifiable reliance but granted defendant's motion on other grounds. (2 CT 495-502.)

Defendant again raised the issue in the Court of Appeal in its respondent's brief (RB 23) and in its petition for rehearing.

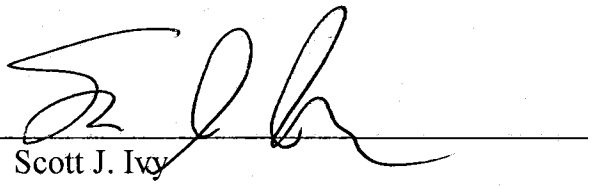
CONCLUSION

For the above reasons and those set forth in the opening brief, PCA respectfully requests the Court to reverse the Court of Appeal's decision.

Dated: September 28, 2011

Respectfully submitted,

LANG, RICHERT & PATCH

By 
Scott J. Ivy

DOWLING, AARON & KEELER
Nickolas J. Dibiaso
Lynne Thaxter Brown

Attorneys for Respondent
FRESNO-MADERA PRODUCTION CREDIT ASSOCIATION

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Dated: September 28, 2011

LANG, RICHERT & PATCH

By _____
Scott J. Ivy

DOWLING, AARON & KEELER
Nickolas J. Dibiaso
Lynne Thaxter Brown

Attorneys for Respondent
FRESNO-MADERA PRODUCTION CREDIT ASSOCIATION

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PROOF OF SERVICE

STATE OF CALIFORNIA)
) SS
COUNTY OF FRESNO)

I am a citizen of the United States and a resident of the County aforesaid; I am over the age of eighteen (18) years and not a party to the within-entitled action. My business address is 8080 North Palm Avenue, Fresno, California 93711. On September 28, 2011, I served the within document(s):

REPLY BRIEF ON THE MERITS

☒ **BY MAIL:** By placing the document(s) listed above in a sealed envelope with postage thereon fully prepaid, in the United States mail at Fresno, California, addressed as set forth below.

Steven E. Paganetti
Wild, Carter & Tipton
246 West Shaw Avenue
Fresno, CA 93704
Attorney for Appellants

Eric A. Amador
LaMontagne & Terhar, LLP
1401 Fulton Street, Suite 804
Fresno, CA 93721
Attorney for Appellants

Court of Appeal
Fifth Appellate District
2424 Ventura Street
Fresno, CA 93721

Hon. Adolfo M. Corona
Fresno County Superior Court
Department 201
1130 "O" Street
Fresno, CA 93721

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_____
George Hewett