

CONTRACTS II (§ 112 – C)
SUPPLEMENTAL CASE MATERIALS

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***O’Riordan v. Federal Kemper Life Assurance*, 36 Cal.4th 281, 114 P.3d 753, 30 Cal.Rptr.3d 507 (2005).**

Supreme Court of California

**Patrick O’RIORDAN, Plaintiff and Appellant,
v.
FEDERAL KEMPER LIFE ASSURANCE,
Defendant and Appellant.**

No. S115495.

July 7, 2005.

*****508 *283 **754 KENNARD, J.**

After his wife’s death from breast cancer, plaintiff, as beneficiary of his wife’s life insurance policy, sought to collect the policy proceeds. Defendant insurance company, however, rescinded the policy and denied plaintiff’s claim. It asserted that the wife had concealed from the insurer her smoking of cigarettes in the 36-*****509** month period preceding her application, and that had she been truthful it would not have issued a policy at the “preferred nonsmoker rate.” Plaintiff sued. The trial court granted the insurer’s motion for summary judgment. We conclude that whether there was concealment is a disputed material fact, and therefore summary judgment was improper.

***284 I**

****755** In 1996, plaintiff Patrick O’Riordan and his wife Amy consulted Robert Hoyme, an independent insurance agent, for the purpose of replacing their life insurance policies with term life insurance. Hoyme suggested a policy issued by defendant Federal Kemper Life Assurance Company (Kemper). In the course of two meetings with Hoyme, the O’Riordans filled out application forms for Kemper policies at the preferred nonsmoker rate.

The insurance applications had a medical questionnaire, which asked these two questions: (1) “Have you smoked cigarettes in the past 36 months?,” and (2) “Have you used tobacco in any other form in the past 36 months?” According to plaintiff, his wife, Amy, had smoked for many years but quit in 1991, five years before submitting her application. Amy told Hoyme that she had been a smoker and that her previous life insurance policy was a smokers’ policy. She also

mentioned that she “might have had a couple of cigarettes in the last couple of years.” Hoyme replied: “That’s not really what they’re looking for. They’re looking for smokers.” He explained that the O’Riordans would have to undergo blood and urine tests to determine whether their bodies contained any traces of smoking. Someone--the record does not say whether it was Hoyme or Amy--checked the boxes marked “No” next to the two questions at issue. A doctor, approved and paid for by Kemper, examined Amy and took blood and urine samples, which showed no traces of nicotine.

Although Hoyme had been an independent agent for many years, he had not previously sold insurance for Kemper. He submitted a request to be appointed as Kemper’s agent, along with the O’Riordans’ policy application forms, to Cenco Insurance Marketing Corporation, a general agent for Kemper with authority to recruit agents. On May 24, 1996, two days after the ***285** O’Riordans had filled out their applications, Cenco approved Hoyme’s request to be appointed a Kemper agent. On June 28, 1996, Kemper issued a term life insurance policy to Amy at the preferred nonsmoker rate, listing plaintiff as the beneficiary. Kemper paid Hoyme a monthly commission as its agent on the policy.

In November 1997, Amy was diagnosed with metastatic breast cancer. When Amy learned that she had only a short time to live, she began smoking again. She died *****510** on June 26, 1998, two days before the policy’s two-year contestability period expired.

When plaintiff sought to collect on Amy’s life insurance policy, Kemper conducted an investigation and learned that in July 1995, less than a year before Amy applied for the policy, Amy had asked her physician for, and received, a nicotine patch. The physician’s report stated that although Amy had quit smoking several years previously, “recently, due to some stressors, she did start to smoke a little bit again, but is not smoking as much as she smoked previously.” Based primarily on this information, Kemper concluded that Amy had falsely answered the application’s questions pertaining to her smoking. It denied plaintiff’s claim, and it rescinded the policy it had issued to Amy.

Plaintiff then filed this action in superior court against Kemper, Cenco, and Hoyme. As amended, his complaint sought damages for breach of contract, breach of the covenant of good faith and fair dealing, negligence, fraud, negligent misrepresentation, and emotional distress. After plaintiff settled with Hoyme, the court, at plaintiff's request, dismissed the complaint against Cenco, leaving only Kemper as a defendant.

Kemper moved for summary judgment or summary adjudication, claiming the facts were undisputed that Amy falsely answered the application's questions about smoking and tobacco use in the 36 months preceding her application, thus entitling Kemper to rescind Amy's life insurance policy. Kemper added that had Amy told the truth it would not have issued the policy. In his response, ****756** plaintiff admitted that Amy had smoked a couple of cigarettes in 1995 but said that this was the full extent of her smoking in the 36-month period preceding her application, and that she had obtained the nicotine patch as a precautionary measure. Plaintiff asserted that Amy had accurately described her cigarette usage to Hoyme when she applied for the insurance policy. The trial court granted Kemper's motion and entered judgment for Kemper. Plaintiff appealed.

***286** In a two-to-one decision, the Court of Appeal affirmed the judgment. Justice Nicholson's lead opinion concluded that even if Amy had smoked only two cigarettes in the 36 months preceding her application, she concealed the extent of her cigarette usage because she answered "no" to the questions in the application pertaining to her cigarette and tobacco usage in that period. The lead opinion described Kemper's two questions about Amy's use of tobacco as "a term of the [insurance] contract," which unambiguously required Amy to answer "yes" to each question if she had smoked even one cigarette during the 36-month period at issue. Although the lead opinion concluded that insurance salesman Hoyme was Kemper's agent when he assisted Amy in answering those two questions, it reasoned that Hoyme's actual and ostensible authority "did not extend to interpreting an unambiguous term in the insurance."

Justice Blease concurred in the result, but on different grounds. In his view, based on the report of Amy's doctor who had given her the nicotine patch, Amy's smoking "was not confined to a couple of cigarettes but was a continuous

problem...." Thus, he concluded, she "concealed the true extent of her smoking ... which justifies rescission of the policy...."

Justice Hull dissented. He concluded that Kemper was estopped from asserting any concealment by Amy of her cigarette use, because she did tell Hoyme, whom Justice Hull viewed as Kemper's agent, that she had smoked a couple of cigarettes in the two years before her application. *****511** Moreover, Justice Hull said, Hoyme had "the ostensible authority to advise Amy O'Riordan of the information the insurance company needed to decide whether to issue a nonsmoker's policy...."

We granted plaintiff's petition for review.

II

Under California law, every party to an insurance contract must "communicate to the other, in good faith, all facts within his knowledge which are ... material to the contract ... and which the other has not the means of ascertaining." (Ins. Code, § 332.) "Materiality" is determined by "the probable and reasonable influence of the facts upon the party to whom the communication is due...." (§ 334.)

When an insured has engaged in "concealment," which is defined by statute as the "[n]eglect to communicate that which a party knows, and ought to communicate" (§ 330), the insurer may rescind the policy, even if the act ***287** of concealment was unintentional (§ 331). Similarly, a materially false representation at the time of, or before, issuance of a policy may result in rescission of the policy. (§ 359.) Thus, when an applicant for life insurance misrepresents his or her history as a smoker in order to obtain a nonsmoker rate, the insurer may rescind the policy. (*Old Line Life Ins. Co. v. Superior Court* (1991) 229 Cal.App.3d 1600, 1603-1606, 281 Cal.Rptr. 15.)

Kemper asserts that the facts are undisputed that Amy concealed the true extent of her cigarette use during the 36-month period preceding her application for life insurance. But plaintiff argues that Kemper is estopped from asserting any concealment by Amy because Hoyme, whom plaintiff claims was Kemper's agent when he sold Amy the policy, told Amy she could answer "no" to Kemper's two questions inquiring into her smoking during the period at issue. Alternatively, plaintiff argues that Hoyme had ostensible authority to construe the meaning of the questions and that in advising Amy to respond "no" to the questions at issue, he misrepresented their meaning. * * *

Here, we need not decide the merits of plaintiff's claims of estoppel and ostensible authority. As we will explain, regardless of how those questions are resolved, it is a triable issue of fact whether Amy concealed or failed to communicate material information to Kemper regarding her use of cigarettes in the 36 months preceding her application for life insurance at a nonsmoker rate. Therefore, the trial court erred in granting Kemper's summary judgment motion.

Pertinent are Amy's answers to the two questions in Kemper's medical questionnaire inquiring into her cigarette and tobacco usage. The first question asked, "Have you smoked cigarettes in the past 36 months?" That inquiry can reasonably be construed as an attempt to determine *habitual* use, not the smoking of a single cigarette or two during that entire period. Had Kemper intended disclosure of the ***512 latter, it could have inquired into the smoking of "any" cigarette during the relevant period. The second question asked: "Have you used tobacco *in any other form* in the past 36 months?" *288 (Italics added.) Because this question directly followed the question pertaining to *cigarette* use, an applicant could reasonably construe it as inquiring into use of tobacco in any form *other than cigarettes*. Therefore, an applicant who, like Amy, has smoked just a couple of cigarettes but has not used tobacco in any other form during the period at issue could correctly answer "no" to this question.

Thus, if (as plaintiff maintains) Amy smoked only a cigarette or two during the 36 months preceding her application and did not use any other tobacco products, she did not conceal her cigarette usage by answering "no" to the two questions at issue.

Moreover, even if, as Kemper insists, those two questions required disclosure of even a single cigarette smoked during the period at issue, Amy did not conceal that information from Kemper, because she did mention it to Hoyme when she applied for the life insurance. Although Hoyme was not Kemper's agent when he assisted Amy in responding to Kemper's medical questionnaire, he became one when his request to be so appointed--submitted with Amy's application--was granted. (See generally Ins. Code, § 1704.5.) Once he became Kemper's agent, Hoyme had a duty to disclose to Kemper any material information he had pertaining to Amy's life insurance policy, and Kemper is deemed to have knowledge of such facts. (*In re Marriage of Cloney* (2001) 91 Cal.App.4th 429, 439, 110 Cal.Rptr.2d 615 ["As a

general rule, an agent has a duty to disclose material matters to his or her principal, and the actual knowledge of the agent is imputed to the principal."]; Civ.Code, § 2332 ["As against a principal, both principal and agent are deemed to have notice of whatever either has notice of, and ought, in good faith and the exercise of ordinary care and diligence, to communicate to the other."].) Therefore, Hoyme's knowledge of Amy's smoking of one or two cigarettes during the 36 months preceding the application was imputed to Kemper. "The fact that the knowledge acquired by the agent was not actually communicated to the principal ... does not prevent operation of the rule." (*Columbia Pictures Corp. v. DeToth* (1948) 87 Cal.App.2d 620, 630, 197 P.2d 580.)

Nor does it matter that Hoyme acquired the information regarding Amy's cigarette use before he became Kemper's agent. "The principal is charged with knowledge which his agent acquires before the commencement of the relationship when that knowledge can reasonably be said to be present in the mind of the agent while acting for the principal." (*Columbia Pictures Corp. v. DeToth, supra*, 87 Cal.App.2d at p. 631, 197 P.2d 580; see also *Schiffman v. Richfield Oil Co.* (1937) 8 Cal.2d 211, 220-221, 64 P.2d 1081; Rest.2d Agency, § 276.) Here, because Hoyme became Kemper's agent shortly after acquiring information about Amy's **758 smoking, his knowledge of her smoking *289 "can reasonably be said to be present in [his] mind" (*Columbia Pictures Corp., supra*, 87 Cal.App.2d at p. 631, 197 P.2d 580) while he was acting as Kemper's agent.

Kemper contends that Amy did not tell Hoyme that she had smoked any cigarettes during the 36 months preceding the application. [FN2] And Kemper points to the ***513 medical report by Amy's physician who, at Amy's request, prescribed a nicotine patch in the year preceding her application, as evidence that Amy smoked more than just "a couple" of cigarettes in the period at issue. Based on the medical report, Justice Blease concluded in his concurring opinion that Kemper was entitled to summary judgment because Amy's cigarette use "was not confined to a couple of cigarettes but was a continuous problem."

FN2. Although Hoyme testified in his deposition that he did not recall Amy telling him that she had smoked two cigarettes during the 36 months preceding the application, he did remember having "some conversation [with Amy] or a question ...

about, you know, having, you know, a cigarette ... in the past, you know, at a special function or something like that....” He also said that he often told applicants that “if you have one [cigarette] once or twice a year, then it’s probably not a big deal.”

But the question of Amy’s cigarette use is a disputed material fact. In response to Kemper’s motion for summary judgment, plaintiff declared that Amy had quit smoking in 1991 (more than three years before her life insurance application) and, apart from two cigarettes Amy shared with her sister during the three-year period at issue, she did not resume smoking until after she was diagnosed with terminal cancer in 1997, the year after submitting her application. Plaintiff also submitted a corroborating declaration by Amy’s

sister, Pamela Inouye, who said that to her knowledge the only cigarettes Amy smoked from 1991 to 1997 were a couple of cigarettes the two of them shared. When, as here, a dispositive factual issue is disputed, summary judgment is improper. (*Guz v. Bechtel National, Inc.* (2000) 24 Cal.4th 317, 334, 100 Cal.Rptr.2d 352, 8 P.3d 1089.)

***290 CONCLUSION**

We reverse the judgment of the Court of Appeal, and we remand the matter to that court for further proceedings consistent with this opinion.

WE CONCUR: GEORGE, C.J., BAXTER, WERDEGAR, CHIN, and MORENO, JJ.

Rosen v. State Farm Gen. Ins. Co., 30 Cal.4th 1070, 70 P.3d 351, 135 Cal.Rptr.2d 361 (2003).

Supreme Court of California

George ROSEN, Plaintiff and Respondent,
v.
STATE FARM GENERAL INSURANCE
COMPANY, Defendant and Appellant.

No. S108308.

June 12, 2003.

***1072 ***362 **353 BROWN, J.**

The insurance policy in this case defined “collapse” as “actually fallen down or fallen to pieces.” However, sound public policy, the Court of Appeal concluded, requires coverage for imminent, as well as actual, collapse, lest dangerous conditions go uncorrected. By failing to apply the plain, unambiguous language of the policy, the Court of Appeal erred. (Civ.Code, § 1644.) “[W]e do not rewrite any provision of any contract, [including an insurance policy], for any purpose.” (*Certain Underwriters at Lloyd’s of London v. Superior Court* (2001) 24 Cal.4th 945, 968, 103 Cal.Rptr.2d 672, 16 P.3d 94 (*Lloyd’s of London*).)

FACTUAL AND PROCEDURAL BACKGROUND

Plaintiff submitted a claim to defendant, his homeowners insurance carrier, for the cost of repairing two decks attached to his home. Plaintiff repaired the decks upon the recommendation of a contractor who had discovered severe deterioration of the framing members supporting the decks. Plaintiff believed his decks were in a state of *imminent* collapse, entitling him to policy benefits.

Defendant denied plaintiff’s claim on the ground, among others, that there had been no collapse of his decks within the meaning of the policy, in that its coverage was expressly restricted to *actual* collapse.

The “Losses Not Insured” section of plaintiff’s homeowners policy provided that defendant did not insure for any loss to the dwelling caused by “collapse, except as specifically provided in SECTION I – ADDITIONAL COVERAGES,

Collapse.” That provision stated:

“We insure only for direct physical loss to covered property involving the sudden, entire collapse of a ***363 building or any part of a building. [¶] Collapse means *actually fallen down or fallen into pieces*. It does not include settling, cracking, shrinking, bulging, expansion, sagging or bowing.”

***1074** Plaintiff sued defendant for breach of contract and breach of the covenant of good faith and fair dealing. Defendant moved for summary judgment, arguing that plaintiff did not suffer a compensable loss because the decks did not actually collapse. In his opposition to the motion, plaintiff argued there was a material factual issue as to whether his decks were in a state of imminent collapse. Plaintiff also argued that public policy required that the collapse provision of the policy be construed to provide coverage for imminent collapse. The trial court denied defendant’s motion for summary judgment, concluding there were triable issues of material fact. The parties agreed to try the case to the court on the narrow issue of whether defendant owed plaintiff policy benefits due to the *imminent* collapse of his decks.

The trial court found for plaintiff. “The public policy of the State of California is ... that policyholders are entitled to coverage for collapse as long as the collapse is imminent, *irrespective of policy language*.” The trial court declined to honor the policy’s restriction of coverage because it would, in the court’s view, “encourage property owners to place lives in danger in order to allow insurance carriers to delay payment of claims until the structure actually collapses....”

The Court of Appeal affirmed, holding that a homeowner’s policy that expressly defines the term *collapse* as *actually fallen down or fallen into pieces* must, nevertheless, for reasons of public policy, be construed as providing coverage for *imminent* collapse.

We reverse.

DISCUSSION

“[I]nterpretation of an insurance policy is a

question of law.’ (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 18, 44 Cal.Rptr.2d 370, 900 P.2d 619 (*Waller*).) ‘While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply.’ (*Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1264, 10 Cal.Rptr.2d 538, 833 P.2d 545 (*Bank of the West*).) Thus, ‘the mutual intention of the parties at ****354** the time the contract is formed governs interpretation.’ (*AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 821, 274 Cal.Rptr. 820, 799 P.2d 1253 (*AIU Ins.*)).) If possible, we infer this intent solely from the written provisions of the insurance policy. (See *id.* at p. 822, 274 Cal.Rptr. 820, 799 P.2d 1253.) If the policy language ‘is clear and explicit, it governs.’ (*Bank of the ***1075** West, supra*, 2 Cal.4th at p. 1264, 10 Cal.Rptr.2d 538, 833 P.2d 545.)” (*Palmer v. Truck Ins. Exchange* (1999) 21 Cal.4th 1109, 1115, 90 Cal.Rptr.2d 647, 988 P.2d 568.)

As the Court of Appeal acknowledged, the policy language here was clear and explicit. “The plain language of the collapse provision in Rosen’s homeowners policy is unambiguous, in that it is susceptible only of one reasonable interpretation--actual collapse of a building or a portion thereof is a prerequisite to an entitlement to policy benefits. By defining the term ‘collapse’ to mean ‘actually fallen down or fallen into pieces,’ State Farm effectively removed any ambiguity in the *****364** term collapse. Under no stretch of the imagination does actually mean imminently.”

The lack of ambiguity in the collapse provision here distinguishes this case, the Court of Appeal pointed out, from the case upon which the trial court principally relied--*Doheny West Homeowners’ Assn. v. American Guarantee & Liability Ins. Co.* (1997) 60 Cal.App.4th 400, 70 Cal.Rptr.2d 260 (*Doheny West*).

In *Doheny West, supra*, 60 Cal.App.4th at pages 402-403, 70 Cal.Rptr.2d 260, the homeowners association of a large condominium complex sued its property insurer for breach of contract and bad faith, alleging that the parking structure of the complex, as well as the swimming pool and associated facilities built above the parking structure, had been in a state of imminent collapse, and that the insurer had wrongfully denied a claim for the necessary repairs the association had made to the structure.

Unlike the policy in this case, the *Doheny West* policy did not specify that the reach of the term *collapse* was restricted to *actual* collapse.

Instead, the *Doheny West* policy excluded coverage for collapse except “for loss or damage caused by or resulting from risks of direct physical loss involving collapse of a building or any part of a building” resulting from specified causes. (*Doheny West, supra*, 60 Cal.App.4th at p. 402, 70 Cal.Rptr.2d 260.) While the *Doheny West* trial court held that this language embraced imminent as well as actual collapse, the trial court found for the defendant insurer on the ground the plaintiff homeowners association had not met its burden of proving that any part of the building was in a state of imminent collapse. (*Id.* at p. 403, 70 Cal.Rptr.2d 260.)

The Court of Appeal affirmed. Noting that its task was not merely to construe the word *collapse* in isolation, but rather to construe the total coverage clause, the Court of Appeal held that the coverage clause before it “cannot be said to be clear, explicit, and unambiguous, and thus must be interpreted to protect the objectively reasonable expectations of the insured. [Citation.]” (*Doheny West, supra*, 60 Cal.App.4th at p. 405, 70 Cal.Rptr.2d 260.) With these ***1076** principles in mind, the Court of Appeal stated: “It is undisputed that the clause covers ‘collapse of a building,’ that is, that there is coverage if a building falls down or caves in. However, the clause does not limit itself to ‘collapse of a building,’ but covers ‘risk of loss,’ that is, the threat of loss. Further, on its terms it covers not only loss resulting from an actual collapse, but loss ‘involving’ collapse. Thus, with the phrases ‘risk of loss,’ and ‘involving collapse,’ the policy broadens coverage beyond actual collapse.” (*Ibid.*, fn. omitted.)

However, the Court of Appeal rejected the plaintiff’s contention that the policy phrases in question “broaden[ed] coverage to the extent that the clause covers ‘substantial impairment of structural integrity.’” (*Doheny West, supra*, 60 Cal.App.4th at p. 405, 70 Cal.Rptr.2d 260.) The Court of Appeal concluded that the trial court had correctly interpreted the policy language before it “by requiring that [the] collapse be actual or imminent.” (*Id.* at p. 406, 70 Cal.Rptr.2d 260, fn. omitted.) “This construction of the policy,” the Court of Appeal observed, “avoids both the absurdity of requiring an insured to wait for a seriously damaged building to fall and the improper extension of ****355** coverage beyond the terms of the policy, and is consistent with the policy language and the reasonable expectations of the insured.” (*Ibid.*)

We agree with the Court of Appeal that *Doheny West* is distinguishable from *****365** this case. As

the Court of Appeal observed: "It is a well-established rule that an opinion is only authority for those issues actually considered or decided. (*Santisas v. Goodin* (1998) 17 Cal.4th 599, 620, 71 Cal.Rptr.2d 830, 951 P.2d 399; *Wilshire Ins. Co. v. Tuff Boy Holding, Inc.* (2001) 86 Cal.App.4th 627, 639, 103 Cal.Rptr.2d 480.) At no time did the court in *Doheny* [West] hold that an unambiguous collapse provision expressly limiting recovery to actual collapse must nevertheless be construed to provide coverage for imminent collapse. The court also did not purport to discern a public policy establishing a contractual entitlement to coverage for imminent collapse in all cases. It simply construed the ambiguous collapse provision before it, as it was required to do. (*AIU Ins.* [, *supra*,] 51 Cal.3d 807, 822, 274 Cal.Rptr. 820, 799 P.2d 1253.) In so doing, it was required to resolve the ambiguity in favor of the insured and in accordance with the reasonable expectations of the insured. (*Kazi v. State Farm Fire & Casualty Co.* (2001) 24 Cal.4th 871, 879, 103 Cal.Rptr.2d 1, 15 P.3d 223.) [¶] In construing the collapse provision in *Doheny* [West] to provide coverage for both actual and imminent collapse, the court expressly relied on the broad language of that particular policy. Specifically, the court held that the 'phrases "risk of loss," and "involving collapse" ' effectively 'broaden[ed] coverage beyond actual collapse.' The State Farm collapse provision at issue in this case, however, does not contain any comparable language that can be construed to extend coverage beyond actual collapse."

*1077 However, "[n]otwithstanding the lack of ambiguity in State Farm's collapse provision," the Court of Appeal held, "as a matter of public policy, that State Farm must provide insurance benefits for imminent collapse of Rosen's two decks."

The Court of Appeal gave the following explanation for its decision not to enforce this unambiguous coverage provision: "The notion that in the absence of coverage for imminent collapse an insured may wait until the full or partial actual collapse of a building simply to ensure coverage is troubling indeed. The actual collapse of a building or any part of a building tragically can result in serious injury or loss of human life, as well as substantial property damage. A requirement that an insurer provide coverage when collapse is imminent clearly is in the best interests not only of the insured and the insured's visitors but also of the insurer. Rectifying the problem prior to an actual collapse may well save lives and money. Moreover, our holding does not unduly burden the insurer

because its liability is limited for a loss which is imminent, and, thus, soon to occur anyway. Surely, an insurer's exposure to liability will be far greater in the event of an actual collapse. [¶] Any holding to the contrary would encourage property owners to risk serious injury or death or greater property damage simply to ensure that coverage would attach. We cannot and will not sanction such a result. We therefore conclude that notwithstanding the language of the collapse provision, public policy mandates that State Farm afford Rosen coverage for the imminent collapse of his decks."

Applying the same logic, with the same lack of restraint, courts could convert life insurance into health insurance. In rewriting the coverage provision to conform to their notions of sound public policy, the trial court and the Court of Appeal exceeded their authority, disregarding the clear language of the policy and the equally clear holdings of this court. In *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, 77 Cal.Rptr.2d 107, 959 P.2d 265, we held that an insurer's duty to defend its insured in a "suit seeking ***366 damages" was limited to a civil action prosecuted in court, and did not extend to a proceeding conducted before an administrative agency pursuant to an environmental statute. The Court of Appeal in *Fireman's Fund Ins. Co. v. Superior Court* (1997) 65 Cal.App.4th 1205, 78 Cal.Rptr.2d 418, we noted with approval, had rejected the "suggestion ... 'because it is in the nation's best interests to have hazardous waste cleaned up, our courts must construe **356 insurance policies to provide coverage for such remedial work lest the insureds be discouraged from cooperating with the EPA.'" (*Foster-Gardner*, at p. 888, 77 Cal.Rptr.2d 107, 959 P.2d 265.) "[T]he Court of Appeal in *Fireman's Fund* aptly stated, 'While we agree that it is in everyone's best interests to have hazardous wastes cleaned up, we do not *1078 agree that a California court may rewrite an insurance policy for that purpose or for any purpose. This is a contract issue, and imposition of a duty to defend CERCLA proceedings that have not ripened into suits would impose on the insurer an obligation for which it may not be prepared.... Whatever merit there may be to these conflicting social and economic considerations, they have nothing whatsoever to do with our determination whether the policy's disjunctive use of "suit" and "claim" creates an ambiguity.' (*Fireman's Fund*, *supra*, 65 Cal.App.4th at p. 1214, fn. 8, 78 Cal.Rptr.2d 418, see also *AIU [Ins.]*, *supra*, 51 Cal.3d at p. 818, 274 Cal.Rptr. 820, 799 P.2d 1253 [The answer is to be found

solely in the language of the policies, not in public policy considerations’].” (*Ibid.*, fn. omitted.)

In *Lloyd’s of London, supra*, 24 Cal.4th 945, 103 Cal.Rptr.2d 672, 16 P.3d 94, we held that an insurer’s duty to indemnify its insured for “all sums that the insured becomes legally obligated to pay as damages” is limited to money ordered by a court, and does not extend to expenses required by an administrative agency pursuant to an environmental statute. We rejected the argument that we should rewrite the indemnification provision, extending it to cleanup orders issued by an environmental agency, in order “to advance the cleanup of a contaminated site and the abatement of the contamination’s effects by calling in the insurer’s resources in supplement to those of an insured that is prosperous or in place of those of an insured that is not. Our reason is that we do not rewrite any provision of any contract, including the standard policy underlying any individual policy, for any purpose. (See *Aerojet- General Corp. v. Transport Indemnity Co.* [(1997)] 17 Cal.4th [38,] 75-76, 70 Cal.Rptr.2d 118, 948 P.2d 909.) To do so with regard to the standard policy, with which we are here concerned, might have untoward effects generally on individual insurers and individual insureds and also on society itself. Through the standard policy, individual insurers made promises, and individual insureds paid premiums, against the risk of loss. To rewrite the provision imposing the duty to indemnify in order to remove its limitation to money ordered by a court might compel insurers to give more than they promised and might allow insureds to get more than they paid for, thereby denying their ‘general[] free[dom] to contract as they please[]’ of any effect in the matter. (*Id.* at p. 75, 70 Cal.Rptr.2d 118, 948 P.2d 909; accord, *Linnstruth v. Mut. Benefit etc. Assn.* (1943) 22 Cal.2d 216, 218, 137 P.2d 833.) It is conceivable that to rewrite the provision thus might result in providing society itself with benefits that might outweigh any costs that it might impose on individual insurers and individual insureds. It is conceivable. But unknown. Knowledge ‘depend[s] in large part on’ what we are ill suited for, that is, the ‘amassing and analyzing of ***367 complex and extensive empirical data.’ (*Aerojet-General Corp. v. Transport Indemnity Co.*, *supra*, 17 Cal.4th at p. 76, 70 Cal.Rptr.2d 118, 948 P.2d 909.) Without such knowledge we could not proceed.” (*Lloyd’s of London, supra*, 24 Cal.4th at pp. 967-968, 103 Cal.Rptr.2d 672, 16 P.3d 94.)

Plaintiff contends that recent legislation establishing a limited new cause of action for certain specified housing defects (Sen. Bill No.

800 (2001-2002 *1079 Reg. Sess.) chaptered as Stats.2002, ch. 722, § 3 [adding Civ.Code, § 895 et seq., eff. Jan. 1, 2003]), read in light of our decision in *Aas v. Superior Court* (2000) 24 Cal.4th 627, 101 Cal.Rptr.2d 718, 12 P.3d 1125 (*Aas*), provides this court with a statutory basis for refusing to enforce the plain language restricting the coverage of this policy for collapse to actual collapse. The contention lacks merit.

In *Aas, supra*, 24 Cal.4th 627, 101 Cal.Rptr.2d 718, 12 P.3d 1125, we applied the economic loss rule in a negligence action by homeowners against the developer, contractor, and subcontractors who built their dwellings. The plaintiffs alleged that their homes suffered from many construction defects, but they conceded that many of the defects had **357 caused no bodily injury or property damage. The trial court barred them from introducing evidence of the defects that had caused no injury to persons or property. We upheld the trial court’s ruling. We explained that under the economic loss rule, “appreciable, nonspeculative, present injury is an essential element of a tort cause of action.” (*Id.* at p. 646, 101 Cal.Rptr.2d 718, 12 P.3d 1125.) Construction defects that have not ripened into property damage, or at least into involuntary out-of-pocket losses,” we held, “do not comfortably fit the definition of “‘appreciable harm’” – an essential element of a negligence claim.” (*Ibid.*)

In enacting Senate Bill No. 800 (2001-2002 Reg. Sess.), the Legislature sought to respond to, among other things, “concerns expressed by homeowners and their advocates over the effects” of our decision in *Aas, supra*, 24 Cal.4th 627, 101 Cal.Rptr.2d 718, 12 P.3d 1125 “that defects must cause actual damage prior to being actionable in tort.” (Sen. Com. on Judiciary, Analysis of Sen. Bill No. 800 (2001-2002 Reg. Sess.) as amended Aug. 28, 2002, p. 1.) In summary, Senate Bill No. 800 “[p]rovides for detailed and specific liability standards for newly constructed housing. Establishes definitions of construction defects. Creates a new prelitigation process that requires that claimants alleging a defect give builders notice of the claim, following which the builder has an absolute right to repair before the homeowner can sue for a violation of those standards. [¶] If the builder fails to acknowledge the claim within the time specified, elects not to go through the statutory process, fails to request an inspection within the time specified, or declines the offer to repair, or if the repair is inadequate, the homeowner is relieved from any further prelitigation process. Provides third-party inspectors with immunity from liability.”

Senate Bill No. 800 (2001-2002 Reg. Sess.), plaintiff argues, “affords this Court with the statutory basis for rejecting [defendant’s] actual ***1080** collapse definition: requiring [plaintiff] to wait for the decks to actually collapse off the side of his home before coverage would attach is akin to requiring a homeowner to wait for damage to result from a defect before he can sue the homebuilder.” Plaintiff’s analogy fails. Senate Bill No. 800 is applicable “only to *****368** residences originally sold on or after January 1, 2003.” (Civ.Code, § 938.) It is one thing for the Legislature to rewrite the rules for construction defect litigation for homes sold in the future. In *Aas*, we emphasized that “the Legislature may add whatever additional protections it deems appropriate....” (*Aas, supra*, 24 Cal.4th at p. 653, 101 Cal.Rptr.2d 718, 12 P.3d 1125.) However, it would be quite another thing for this court to rewrite the coverage provision of an existing homeowners insurance policy to remove a restriction. Again, by agreeing to this contract of insurance, the insurer made promises, and the insured paid premiums, against the risk of loss. To rewrite the provision imposing the duty to indemnify in order to remove its limitation to actual collapse would compel the insurer to give more than it promised and would allow the insured to get more than it paid for, thereby denying their freedom to contract as they please. (*Lloyd’s of London, supra*, 24 Cal.4th at pp. 967-968, 103 Cal.Rptr.2d 672, 16 P.3d 94.)

DISPOSITION

The judgment of the Court of Appeal is reversed and the matter remanded for further proceedings consistent with this opinion.

WE CONCUR: GEORGE, C.J., and BAXTER, CHIN, JJ.

Concurring Opinion by MORENO, J.

I concur with the result. I also concur in the majority’s conclusion that the coverage provision is unambiguous in this case. But I do not agree with the majority’s conclusion that courts are forbidden from employing public policy when determining how insurance policy clauses are to be interpreted and enforced. * * *

****358** Notwithstanding the categorical statements of the majority and of *Lloyd’s of London*, it is still true that we will not enforce terms of contracts that ***1081** violate public policy. The public policy in question may sometimes be based on statute

(see, e.g., *Wildman v. Government Employees Ins. Co.* (1957) 48 Cal.2d 31, 307 P.2d 359) but does not necessarily have to be--it can be based on other policies perceived to be contrary to the public welfare. (See *Altschul v. Sayble* (1978) 83 Cal.App.3d 153, 162, 147 Cal.Rptr. 716 [court refuses to enforce fee-for-referral agreements among attorneys as contrary to public policy].) We have never held that this principle is inapplicable to insurance contracts. (See *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 821-822, 274 Cal.Rptr. 820, 799 P.2d 1253 [general contract principles are applicable to insurance contracts].)

Indeed, in some instances, courts have modified or supplemented language in insurance policies on essentially public policy *****369** grounds. For example, courts have held that, notwithstanding clauses in insurance policies that require the insured’s cooperation and timely notice of a claim to an insurer, breach of those terms would not serve as a defense to insurance coverage if the insurer has not been prejudiced thereby. (*Northwestern Title Security Co. v. Flack* (1970) 6 Cal.App.3d 134, 140, 85 Cal.Rptr. 693; *Campbell v. Allstate Ins. Co.* (1963) 60 Cal.2d 303, 306, 32 Cal.Rptr. 827, 384 P.2d 155.)

The argument in favor of the Court of Appeal’s and the insured’s position takes the above principles as a point of departure. The Court of Appeal reasoned that there are compelling public policy grounds not to enforce the “actual collapse” limitation at issue here when it would preclude coverage for imminent collapse. As the court stated: “The notion that in the absence of coverage for imminent collapse an insured may wait until the full or partial actual collapse of a building simply to ensure coverage is troubling indeed. The actual collapse of a building or any part of a building can tragically result in serious injury or loss of human life, as well as substantial property damage. A requirement that an insurer provide coverage when collapse is imminent clearly is in the best interests not only of the insured and the insured’s visitors but also of the insurer. Rectifying the problem prior to an actual collapse may well save lives and money. Moreover, our holding does not unduly burden the insurer because its liability is limited for a loss that is imminent, and, thus, soon to occur anyway. Surely, an insurer’s exposure to liability will be far greater in the event of an actual collapse.” * * *

****359 *1082** The Court of Appeal’s reasoning is not without force. An insurance policy that clearly

establishes a financial incentive to maintain a hazardous condition injurious to the public may well be contrary to public policy. This case is therefore distinguishable from those cases cited by the majority in which enforcement of a policy exclusion would not create such a perverse incentive but merely retard the accomplishment of some worthwhile goal, such as cleanup of hazardous wastes. (See, e.g., *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, 77 Cal.Rptr.2d 107, 959 P.2d 265.)

The Court of Appeal's reasoning is, however, ultimately unpersuasive. In determining whether a contract violates public policy, courts essentially engage in a weighing process, balancing the interests of enforcing the contract with those interests against enforcement. (*Bovard v. American Horse Enterprises, Inc.* (1988) 201 Cal.App.3d 832, 840-841, 247 Cal.Rptr. 340, citing Rest.2d Contracts, § 178.) But the cases make clear that the judicial power to declare public policy in the context of contract interpretation and enforcement should be exercised with great caution. ""The power of the courts to declare a contract void for being in contravention of sound public policy is a very delicate and undefined power, and, like the power to declare a statute unconstitutional, should be exercised only in cases free from doubt.' [Citation.] ... 'No court ought to refuse its aid to enforce a contract on doubtful and uncertain grounds. The burden is on the [one challenging the contract] to show that its enforcement would be in violation of the settled public policy of this

state, or injurious to the morals of its people.'""
***370 (*Bovard v. American Horse Enterprises, Inc.*, *supra*, 201 Cal.App.3d at p. 839, 247 Cal.Rptr. 340.)

In this case, there is a strong public policy in favor of allowing insurers to enforce unambiguous policy provisions, thereby encouraging stability in the insurance industry and allowing insurers the benefit of the bargain created by such unambiguous language. On the other hand, the extent of the danger to the public that the Court of Appeal and plaintiff identify is very much in doubt. The argument that literal enforcement of the policy provision at issue will create substantial financial incentives to allow decks to collapse so as to injure the public ignores the existence of various countervailing disincentives. These include the tort duty imposed on property owners not to injure others through their property's hazardous conditions, as well as the strong interest in keeping oneself, one's family, and persons invited onto one's property, free from harm. Nor can we say with confidence that the Court of Appeal's conclusion is correct that its holding would ultimately benefit the insurer--the insurer is in a far better position to make that determination. Given these doubts, and given the strong policy in favor of enforcing *1083 unambiguous terms, I cannot say the insured has carried its burden of demonstrating that public policy compels us to invalidate or reinterpret the "actual collapse" provision of this insurance policy.

WE CONCUR: KENNARD and WERDEGAR, JJ.

Pacific State Bank v. Greene, 110 Cal.App.4th 375, 1 Cal.Rptr.3d 739 (2003).

Court of Appeal, Third District.

**PACIFIC STATE BANK, Plaintiff and
Respondent,
v.
Dawn GREENE et al., Defendants and
Appellants.**

No. C039662.

July 10, 2003.

As Modified on Denial of Rehearing Aug. 7, 2003.

Review Denied Oct. 15, 2003.

****741 *378 KOLKEY, J.**

*****1** This case raises the question whether the parol evidence rule bars a party from offering evidence that her signature on an agreement was procured by a misrepresentation over the content of the physical document to be signed. The aggrieved party claims that she agreed to guarantee a single loan and that a bank employee misrepresented on the day of signing that the guaranty agreements at issue related only to that single loan. But although that single loan's number and amount were specified at the top of the guaranty agreements, the agreements' fine print defined ****742** the "indebtedness" that was to be guaranteed to include "all of Borrower's liabilities," which covered four loans. The bank subsequently brought an action against the aggrieved party to recover on all of the borrower's loans up to the limits of the guarantees. And the trial court sustained the bank's objections to the aggrieved party's offer of the bank employee's misrepresentations pursuant to the parol evidence rule and granted the bank's motion for summary judgment.

We shall reverse. The parol evidence rule "generally prohibits the introduction of any extrinsic evidence, whether oral or written, to vary, alter or add to ***379** the terms of an integrated written instrument" (*Alling v. Universal Manufacturing Corp.* (1992) 5 Cal.App.4th 1412, 1433, 7 Cal.Rptr.2d 718) "because [such evidence] cannot serve to prove what the agreement was, this being determined as a matter of law to be the writing itself." (*Tahoe National Bank v. Phillips* (1971) 4 Cal.3d 11, 23, 92 Cal.Rptr. 704, 480 P.2d 320.)

But at least since the parol evidence rule's codification in this State in 1872, the rule has specified statutory exceptions for mistake, illegality, or fraud. (Code Civ. Proc., § 1856, subs. (e), (f), (g).) Although the California Supreme Court narrowed the scope of the statutory fraud exception nearly 70 years ago so as to exclude "a promise directly at variance with the promise of the writing" (*Bank of America etc. Assn. v. Pendergrass* (1935) 4 Cal.2d 258, 263, 48 P.2d 659 (*Pendergrass*)), we conclude that this judicial limitation should not be further extended to preclude parol evidence of a misrepresentation of *fact* over the content of the physical document at the time of signing. Such an extension would conflict with the Legislature's express and unqualified statutory exception for fraud – a policy judgment that we have no power to overrule--and is unnecessary to safeguard the vitality of the parol evidence rule (which was *Pendergrass's* purpose in narrowing the scope of the fraud exception).

In *Pendergrass*, the California Supreme Court limited the scope of the statutory fraud exception in order to avoid the risk that the fraud exception, by permitting evidence of promises at variance with the writing, would swallow up the rule.

But evidence of a mischaracterization of the agreement to be signed does not create the same risk: Factual misrepresentations over the content of a document at the time of signing are more narrow in time and circumstance than allegations of promissory fraud, which can arise at any time during contract negotiations; factual misrepresentations, unlike prior promises, do not go to the heart of that which the parol evidence rule prohibits; and claims of misrepresentation over the content of a document are not easily abused and will rarely be successful because the defrauded party cannot normally complain of unfamiliarity with the language of the document and must show he or she *reasonably* relied on the misrepresentations. (See *Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal.4th 394, 419-423, 58 Cal.Rptr.2d 875, 926 P.2d 1061.) Most importantly, qualifying the unqualified language of a statute with unexpressed exceptions premised on legislatively unmentioned policy judgments creates a trap for the unwary reader, undermines the predictive value of statutory language so necessary for jurisprudential stability, imposes transaction costs

consisting of lawyer and judicial hours scouring the case law for counterintuitive interpretations, and *380 risks judicial trespass upon the legislature's province by varying the enacted words of the **743 statute. Jurisprudential stability demands predictability, based largely on a judicious respect for the doctrine of stare decisis and reliance on the plain language of our laws (which reliance also serves to restrain the judiciary from overstepping its constitutional role of interpreting, and not rewriting, statutes). Accordingly, we will not interpret the unqualified statutory exception for fraud to exclude factual misrepresentations over the content of a writing at the time of its signing.

FACTUAL AND PROCEDURAL BACKGROUND

I. The Guaranty Agreements

***2 Plaintiff Pacific State Bank (Pacific) made four loans to Dell Merk, Inc., dba Uprite Construction (Uprite). Three of the loans were each in the principal amount of \$150,000. The fourth loan--loan No. 22004673, dated July 6, 1999, which was secured by a trailer owned by Uprite--was for \$32,075.

Defendant Dawn Greene is president of defendant Dawn's Transport. Greene is married to Christopher Dell'Aringa, president of Uprite. Greene agreed with Dell'Aringa to purchase the trailer securing the \$32,075 loan by assuming the loan, which had a balance of \$27,000. Pacific agreed to the arrangement.

To effect the transfer, Greene signed two guaranty agreements in favor of Pacific, one personally and the other on behalf of Dawn's Transport. The form and terms of the two guaranties were identical, other than the capacity in which Greene signed them. The amount of each guaranty was \$27,000--the balance owing on the trailer. And the maximum amount of liability under each guaranty was \$27,000 (plus all costs and expenses of enforcement). Although the boxes headed "Loan Date" and "Loan No." on page 1 of the guaranties were left blank, the notations "07-06-1999" and "Loan No.[.] 22004673" -- the loan date and number of the trailer loan -- appeared in the upper-left-hand corner of pages 2 through 4 of the guaranties.

Each guaranty provided that the guarantor "absolutely and unconditionally guarantees and promises to pay PACIFIC STATE BANK ('Lender') ... the Indebtedness (as that term is defined below) of DELL MERK, INC. DBA UPRITE

CONSTRUCTION ('Borrower')" on the terms and conditions set forth in the Guaranty.

But the "DEFINITIONS" section of each guaranty defined the term "**Indebtedness**" to extend beyond the trailer loan and to include *all* of Uprite's *381 loans: "The word 'Indebtedness' is used in its most comprehensive sense and means and includes any and all of Borrower's liabilities, obligations, debts, and indebtedness to Lender, now existing or hereinafter incurred or created; including, without limitation, all loans, advances, interest, costs, debts, overdraft indebtedness, credit card indebtedness, lease obligations, other obligations, and liabilities of Borrower, or any of them, and any present or future judgments against Borrower, or any of them; and whether any such indebtedness is voluntarily or involuntarily incurred, due or not due, absolute or contingent, liquidated or unliquidated, determined or undetermined; whether Borrower may be liable individually or jointly with others, or primarily or secondarily, or as guarantor or surety; whether recovery on the indebtedness may be or may become barred or unenforceable against Borrower for any reason whatsoever; and whether the Indebtedness arises from transactions which may be voidable on account of infancy, insanity, ultra vires, or otherwise."

Each guaranty also contained an "**Integration**" clause that provided in relevant **744 part: "Guarantor warrants, represents and agrees that this Guaranty, together with any exhibits or schedules incorporated herein, fully incorporates the agreements and understandings of Guarantor with Lender with respect to the subject matter hereof and all prior negotiations, drafts, and other extrinsic communications between Guarantor and Lender shall have no evidentiary effect whatsoever. Guarantor further agrees that Guarantor has read and fully understands the terms of this Guaranty; ... the Guaranty fully reflects Guarantor's intentions and parol evidence is not required to interpret the terms of this Guaranty...."

***3 Similarly, each guaranty contained a provision that the guarantor "represents and warrants to Lender that (a) no representations or agreements of any kind have been made to Guarantor which would limit or qualify in any way the terms of this Guaranty...."

II. The Defaults

After Greene signed the guaranties, Dawn's Transport was added to the certificate of title for

the trailer. Greene claims that she made all the monthly payments on the trailer in a timely fashion. Uprite, however, defaulted on its loans to Pacific, leaving a principal balance due of over \$428,000 on the first three loans and of approximately \$23,000 on the trailer loan.

III. Pacific's Lawsuit

Pacific brought an action against Uprite and amended the complaint to add causes of action for breach of the guaranty agreements against Greene and *382 Dawn's Transport, seeking the full amount of each guaranty for Uprite's indebtedness. In their answer, Greene and Dawn's Transport raised affirmative defenses that their consent to the guaranties was obtained by mistake, innocent misrepresentation, and fraud.

Pacific moved for summary judgment against defendants Greene and Dawn's Transport.

Defendants' opposition was supported by a declaration from Greene stating that "[she] was induced to enter into the guarant[ies] alleged in this action based upon misrepresentations made to [her] by Pacific State Bank." Claiming that the misrepresentations were made during her meeting with Pacific employees Laura Mafae and Connie De Wayne, Greene declared:

"7. Before I signed the documents I asked Ms. Mafae what I specifically was signing for and she stated 'Loan # 22004673,' which was the trailer loan, and she pointed at the loan number at the top of the written guaranty form and verified that at that time, the payoff on the trailer was \$27,000. She told me that was all I was signing for.

"8. At this time I specifically asked about any other debts of [Uprite] and I was advised by Ms. Mafae that I was not signing for anything other than the trailer. I made it very clear to Ms. Mafae and Ms. De Wayne that I would not agree to be liable for anything other than the trailer, and Ms. Mafae reassured me that was all that I was signing for.

"9. At that time, I signed a guaranty for the trailer for Dawn's Transport and another guaranty personally. Ms. Mafae told me that my personal guaranty was required in case anything happened to Dawn's Transport such that it was unable to pay off the trailer. She again pointed **745 out the loan numbers at the top of the guaranty forms to me, and explained that the forms were not two separate loans, but rather that both of these guarant[ies], my own and that of Dawn's

Transport, were for the same loan number, for the trailer loan."

Pacific filed written objections to these paragraphs in Greene's declaration based on the parol evidence rule. The court sustained the parol evidence objection.

As a result, the trial court ruled that . . . defendants unconditionally guaranteed *383 all the indebtedness of Uprite and entered judgment against Greene and Dawn's Transport in the principal amount of \$27,000 *each*--the maximum amount of each guaranty--and well beyond what was owing on the trailer loan. Defendants filed a timely notice of appeal from the judgment.

DISCUSSION

* * *

II. The Admissibility of Evidence Under the Parol Evidence Rule

***4 Defendants assert that the trial court erred in sustaining Pacific's objections to Greene's declaration pursuant to the parol evidence rule.

A. *The Parol Evidence Rule*

The parol evidence rule is codified in section 1856 of the Code of Civil Procedure. Generally speaking, it prohibits the introduction of extrinsic *384 evidence, whether oral or written, to vary the terms of an integrated written agreement or to add terms to an integrated agreement that is also intended as a complete and exclusive statement of the parties' agreement. (§ 1856, subs.(a) & (b).

Section 1856's principal provisions provide as follows:

"(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." (§ 1856, subs.(a) & (b).) [FN3]

FN3. [Because of their integration clauses,]

[t]he guaranty agreements here qualified as a final, complete, and exclusive statement of the terms of the agreement. Thus, their terms could not be contradicted by parol evidence pursuant to section 1856, subdivision (a), or supplemented by evidence of “consistent additional terms” pursuant to section 1856, subdivision (b).

There are a number of statutory exceptions to the parol evidence rule, however. These include . . . fraud.

***5 Section 1856, subdivision (g), provides: “This section does not exclude other evidence of the circumstances under which the agreement was *385 made or to which it relates, as defined in Section 1860, [FN4] or to explain an extrinsic ambiguity or otherwise interpret the terms of the agreement, or to establish illegality or fraud.”

FN4. Section 1860 provides: “For the proper construction of an instrument, the circumstances under which it was made, including the situation of the subject of the instrument, and of the parties to it, may also be shown, so that the judge be placed in the position of those whose language he is to interpret.”

Defendants assert the excluded portions of Greene’s declaration should have been admitted to prove a meaning to which the contract was reasonably susceptible or to prove fraud under those exceptions to the parol evidence rule.

B. Admissibility to Prove the Agreement’s Meaning

[The court first concluded “that the parol evidence was not admissible to interpret the existing language of the guaranties.” The court reasoned that there was no question that the language in the definition of “indebtedness” included all of Uprite’s loans and so extrinsic would not be allowed to demonstrate the meaning of that term.]

*C. * * * Fraud Inducing the Agreement*

Although the evidence in Greene’s declaration is not admissible to interpret the agreements, it is admissible under the statutory fraud exception to the parol evidence rule.

***7 Parol “[e]vidence to prove that the instrument is void or voidable for mistake, fraud, duress, undue influence, illegality, alteration, lack of consideration or other invalidating cause is

admissible. This evidence does not contradict the terms of an effective integration, because it shows that the purported instrument has no legal effect. [Citations.] [¶] Comment c of Rest [atement Second of] Contracts[, section] 214, ... explains: ‘What appears to be a complete and binding integrated agreement may be a forgery, a joke, a sham, or an agreement without consideration, or it may be voidable for fraud, duress, mistake, or the like, or it may be illegal. Such invalidating causes need not and commonly do not appear on the face of the writing. They are not affected even by a “merger” clause.’ “ (2 Witkin, Cal. Evidence, *supra*, Documentary Evidence, § 95, pp. 217-218; Code Civ. Proc., § 1856, subds. (e), (g); *Hershey v. Los Angeles Pacific Co.* (1915) 171 Cal. 353, 355, 153 P. 230; *Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Development Corp.* (1995) 32 Cal.App.4th 985, 995, 38 Cal.Rptr.2d 783.)

[The section on “Mistake,” in which the court concluded parol evidence to show mistake was admissible, has been redacted]

***388 **749 2. Fraud.**

“It is ... settled that parol evidence of fraudulent representations is admissible as an exception to the parol evidence rule to show that a contract was induced by **750 fraud.” (*Richard v. Baker* (1956) 141 Cal.App.2d 857, 863, 297 P.2d 674; accord, § 1856, subds. (f) & (g).)

In this case, Greene’s declaration raises a triable issue of fact as to fraud in the inducement or execution of the guaranty agreements. (See *Rosenthal v. Great Western Fin. Securities Corp.*, *supra*, 14 Cal.4th at p. 415, 58 Cal.Rptr.2d 875, 926 P.2d 1061.) [FN7] Greene claims that Pacific’s employee represented that the agreements only related to the trailer loan, pointed out the trailer loan number on the agreements, and noted that the \$27,000 amount of the guaranty was the payoff for the trailer loan--notwithstanding the fact that the definition of “[i]ndeбtedness” refuted the notion that the guaranties applied to only a single loan. A trier of fact could infer that the bank employee was familiar with the terms of the documents drafted by the bank and that the employee’s representations as to the agreements’ contents were therefore intended to deceive.

FN7. The Supreme Court in *Rosenthal v. Great Western Fin. Securities Corp.*, *supra*,

14 Cal.4th at page 415, 58 Cal.Rptr.2d 875, 926 P.2d 1061, distinguished between fraud in the execution of a contract and fraud in the inducement of a contract: "In brief, in the former case 'the fraud goes to the inception or execution of the agreement, so that 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, mutual assent is lacking, and [the contract] is void. ...' [Citation.] Fraud in the inducement, by contrast, 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' [Citation.]" The parties have not briefed this distinction, and we need not address what type of fraud is involved here in order to reach our decision.

Pacific, however, invokes a well-settled limitation on the fraud exception to the parol evidence rule: "[T]he California Supreme Court has declared the *390 fraud exception does not apply if the evidence is offered to show a promise contradicting the written agreement." (*West v. Henderson* (1991) 227 Cal.App.3d 1578, 1583, 278 Cal.Rptr. 570, citing *Pendergrass, supra*, 4 Cal.2d at p. 263, 48 P.2d 659.)

In *Pendergrass*, our state high court said: "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." (*Pendergrass, supra*, 4 Cal.2d at p. 263, 48 P.2d 659.) The Supreme Court explained that the use of promissory fraud to invalidate an integrated agreement would nullify the parol evidence rule: "Such a principle would nullify the rule: for conceding that such an agreement [that is, an oral promise not to enforce a term in the contract] 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.... For reasons founded in wisdom **751 and to prevent frauds and perjuries, the rule of the common law excludes such oral testimony of the alleged agreement" (*Ibid.*)

***9 In short, the perceived necessity for this promissory fraud limitation lies in the recognition that without it, the fraud exception could swallow

the rule. Any party who claimed a promise contrary to that contained in the contract could claim that the contrary contract constituted proof of promissory fraud--that is, that the earlier or contemporaneous promise was false and made without any intention of performing it, as evidenced by its absence in the subsequent agreement. Although this judicial rule has been criticized as inconsistent with the unqualified language in the statutory exception for fraud (*Coast Bank v. Holmes* (1971) 19 Cal.App.3d 581, 591, 97 Cal.Rptr. 30), we are bound by the California Supreme Court's ruling. (*Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455, 20 Cal.Rptr. 321, 369 P.2d 937.)

But we disagree that the *promissory* fraud limitation precludes admission of a misrepresentation of *fact* over the content of a physical document at the time of execution. "Promissory fraud' is a promise made without any intention of performing it." (*Alling v. Universal Manufacturing Corp., supra*, 5 Cal.App.4th at p. 1436, 7 Cal.Rptr.2d 718.) The Supreme Court's limitation on the fraud exception expressly bars "a promise directly at variance with the promise of *391 the writing" (*Pendergrass, supra*, 4 Cal.2d at p. 263, 48 P.2d 659), not a misrepresentation of fact. (*Edwards v. Centex Real Estate Corp., supra*, 53 Cal.App.4th at p. 42, 61 Cal.Rptr.2d 518; 2 Witkin, Cal. Evidence, *supra*, Documentary Evidence, § 98, p. 219.)

Significantly, *Pendergrass* and most of its progeny have involved promissory fraud, not misrepresentations of fact.

For example, in *Pendergrass, supra*, 4 Cal.2d 258, 48 P.2d 659, the California Supreme Court ruled that parol evidence was not admissible to prove a bank's promise that it would *defer* the defendant ranchers' obligation to pay their indebtedness if they executed a new note and mortgage--in direct contravention of the unconditional promise contained in the note. This was a claim of promissory fraud, not a misrepresentation of a fact.

In *Continental Airlines, Inc. v. McDonnell Douglas Corp., supra*, 216 Cal.App.3d at page 419, 264 Cal.Rptr. 779, "the unequivocal promise in the brochures ... that the wing fuel tank and fuel lines 'will not rupture,' varied and contradicted the qualified language of the Detail Specification," which was part of the parties' contract and which instead provided that failure of the landing gear was "not likely" to rupture the wing fuel tanks or fuel lines. Thus, that case also involved a promise

at variance with the ultimate contract.

In *Banco Do Brasil, S.A. v. Latian, Inc.*, *supra*, 234 Cal.App.3d at pages 996-997, 1003-1004, and 1009-1011, 285 Cal.Rptr. 870, the Court of Appeal concluded that a claimed oral promise of a \$2 million line of credit that was to have been a condition to any obligations under a written guaranty was inconsistent with the integrated guaranty agreement, which provided that its obligations were absolute and unconditional. Again, the fraud was promissory. The court explained that the fraud exception to the parol evidence rule had no application ****752** where “parol evidence is offered to show a fraudulent promise directly at variance with the terms of the written agreement.” (*Id.* at p. 1009, 285 Cal.Rptr. 870, citations omitted.) * * *

*****10** We believe that a distinction between promissory fraud and misrepresentations of fact over the content of an agreement at the time of execution is a valid one and that the latter circumstance should fall within the statutory exception for fraud for the following reasons: (1) The language of the statutory exception is unqualified and does not limit the misrepresentations covered; (2) it is not necessary to extend *Pendergrass* to cover factual misrepresentations over the content of the writing in order to safeguard the vitality of the parol evidence rule; and (3) a further extension of *Pendergrass* would unduly restrict the statutory exception for fraud.

First, a further judicial narrowing of the fraud exception to the parol evidence rule, so as to exclude evidence of factual misrepresentations over the contents of the writing, would fly in the face of the broad language of two statutory exceptions to the parol evidence rule. Section 1856, subdivision (f), provides: “Where the validity of the agreement is the fact in dispute, this section does not exclude evidence relevant to that issue.” And subdivision (g) of the same statute provides in relevant part: “This section does not exclude other evidence ... to explain an extrinsic ambiguity or otherwise interpret the terms of the agreement, or to establish illegality or fraud.” * * *

*****11** Second, while *Pendergrass* may have been justified in judicially restricting the breadth of the statutory exception for fraud in order to protect the vitality of the parol evidence rule, the right to introduce misrepresentations of facts ****753 *393** over the content of the physical document to be signed does not threaten to swallow up the rule.

In the case of promissory fraud, an earlier or contemporaneous promise is proffered in variance with the promises in the agreement; evidence of such a contrary promise goes to the heart of that which the parol evidence rule is intended to protect against. But a claim of a mischaracterization of the content of the physical document to be signed is more narrow in time and circumstance: It can only occur at the time of signing, whereas a claim of promissory fraud can arise from a purported promise made at any time at or before the agreement is signed. And the need to prove the element of reasonable reliance in order to successfully make out a misrepresentation claim also protects against abuse: * * [A] “party’s *unreasonable* reliance on the other’s misrepresentations, resulting in a failure to read a written agreement before signing it, is an insufficient basis, under the doctrine of fraud in the execution ...” for permitting that party to void the agreement. (*Rosenthal v. Great Western Fin. Securities Corp.*, *supra*, 14 Cal.4th at p. 423, 58 Cal.Rptr.2d 875, 926 P.2d 1061.) Thus, the particular circumstances of the contract’s execution, including the prominent and discernible provisions of the contents of the writing in issue, must make it reasonable for the party claiming fraud to have nonetheless relied on the mischaracterization. This is not an easily met burden of proof, which also prevents this type of evidence from swallowing up the parol evidence rule.

But in this case, the guaranty agreements contained a number of provisions (e.g., the guarantee amount and loan number) consistent with defendants’ purported understanding that they only agreed to guarantee the trailer loan. It was the fine print of a definition that undermined this seeming conformity with defendants’ understanding. Further, in an ordinary business transaction to purchase encumbered property, the purchaser of the property would not anticipate assuming any debt obligation unrelated to the property. Thus, defendants met their burden of showing a triable issue of reasonable reliance on the misrepresentations.

***394** To be sure, 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. For instance, had defendants’ evidence in this case been limited to the existence of a prior oral promise that they would only be required to guarantee the trailer loan – a promise that induced defendants’ consent to the guaranties – this would have been a case of

promissory fraud. But instead, this is a case where at the time of the contract's execution, its physical content was mischaracterized – a factual misrepresentation, not a false promise.

*****12** Pacific relies heavily on *Bank of America v. Lamb Finance Co.* (1960) 179 Cal.App.2d 498, 3 Cal.Rptr. 877 (*Lamb Finance*), which refused to admit evidence of a fraudulent misrepresentation. That case correctly articulated the *Pendergrass* limitation, but then misapplied it to the facts of that case. * * * ***395 **755 ***13** We conclude that *Lamb Finance's* analysis--which fails to address the distinction between promissory and factual fraud and relies on promissory fraud cases--goes beyond the *Pendergrass* limitation and cannot be reconciled with the broad language in the statute that makes an unqualified exception for fraud.

* * *

***396 ***14** Finally, we conclude that just as the fraud exception must be construed so as not to swallow up the parol evidence rule, the judicial limitation on the fraud exception, pronounced in *Pendergrass, supra*, 4 Cal.2d 258, 48 P.2d 659, and meant to fortify the rule, must not be expanded so as to undermine the vitality of statutory fraud exception itself. The fraud exception, codified by the Legislature, is itself a policy judgment that we may not overrule or unduly narrow but must instead construe to effect its object and to reconcile with the rule of which it

forms an exception. (See Civ.Code, § 4.) We conclude that the *Pendergrass* limitation on the fraud exception to the parol evidence rule ****756** should not be extended to preclude parol evidence of a mischaracterization – that is, a misrepresentation of *fact* – over the content of an agreement at the time of the signing. Evidence of such fraud to invalidate an agreement is expressly authorized by Code of Civil Procedure section 1856, subdivisions (f) and (g).

***397 D. Conclusion**

We therefore conclude that the trial court erred in excluding evidence of factual misstatements over the content of the guaranty agreements. Such evidence was admissible to show mistake or fraud under section 1856, subdivisions (e), (f), and (g). Once this improperly excluded evidence is considered, it is apparent that a triable issue of mistake and fraud was raised, which would have afforded defendants a defense to enforcement of the guaranty agreements.

DISPOSITION

The judgment is reversed. Defendants shall recover their costs on appeal. (Cal. Rules of Court, rule 27(a)(1).)

We concur: SCOTLAND, P.J., and MORRISON, J.