

The Transactional Lawyer

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Riverisland Redux

Scott J. Burnham

An article in a previous issue discussed the case of *Riverisland Cold Storage, Inc. v Fresno-Madera Production Credit Ass’n*,¹ in which the California Supreme Court reversed the long-standing rule of *Bank of America v. Pendergrass*,² that evidence of fraud would not be admissible under the parol evidence rule when the subject matter of the fraud was directly addressed in the contract.³ The case has continued to spawn litigation in the California courts.

In *8451 Melrose Property, LLC v. Akhtarzad*,⁴ the trial court had excluded parol evidence because the subject matter of the fraud was directly addressed in the contract, but *Riverisland* was decided before the Court of Appeal had heard the appeal. Therefore, the Court of Appeal had to determine whether the *Riverisland* decision had retroactive effect. In general, changes in the law are given retroactive effect unless doing so would be unfair. Here, the court held that retroactive effect would not be unfair because courts had so often challenged the *Pendergrass* rule and found ways to circumvent it that a party would be on notice that the outcome could go either way. Furthermore, a party could not be heard to argue that it had committed fraud in reliance on the court not permitting evidence of the fraud to be heard. Rather, defendant’s position was that it had not committed fraud – a position unchanged by retroactivity, for it would still have an opportunity to prove its case.

In *Julius Castle Restaurant Inc. v. Payne*,⁵ the trial court had admitted parol evidence over the defendant’s objection and the jury had found fraud. During the

appeal, *Riverisland* was decided. The court assumed retroactivity without any discussion and affirmed that admission of the evidence was proper. The defendant tried to distinguish *Riverisland* on the ground that it applied only to unsophisticated parties, but the court found no such distinction.

Finally, on remand of *Riverisland*, defendant again moved for summary judgment, claiming that plaintiffs could not prove the reliance element of fraud.⁶ The trial court granted the motion and the plaintiffs appealed. The plaintiffs had alleged that the parties had agreed that defendant would not foreclose on the subject properties for two years if plaintiffs pledged two ranches as additional security. They claimed that defendant represented to them that the written agreement contained those terms, but in fact “it actually provided for only a three month forbearance period and added eight properties as additional security.”⁷

Defendant’s principal argument was that if the plaintiffs had simply read the contract, they would have discovered the actual terms; therefore, they should not have reasonably relied on any representation by defendant. In analyzing plaintiffs’ claim for equitable relief, the Court of Appeal first noted the distinction between fraud in the execution (sometimes called *fraud in the factum*) and fraud in the inducement. In the former, the party claiming fraud does not even know he entered into a contract, and the agreement is void. But with fraud in the inducement, the party knew he was signing an agreement but was induced to sign it by fraud; in that case, the agreement is voidable. California courts have generally ruled that fraud in the execution is unlikely if a party had a reasonable opportunity to read the agreement and discover its terms. However, because this was a case of fraud in the inducement, that rule did not apply.

The court noted that the Supreme Court in *Riverisland* had “declined to ‘explore the degree to which failure to read the contract affects the viability of a claim of fraud in the inducement.’”⁸ On the one hand, it seems incredible that a debtor would not check the written agreement to see what property was listed as collateral. On the other hand, many courts have found that “a party to an instrument who by fraud leads the other party to sign without reading it is in no position to urge the latter’s negligence in bar of reformation.”⁹ In sum, the court in *Riverisland* stated:

Contents	
<i>Riverisland Redux</i>	1
<i>Contracting with Multiple Parties</i>	2
Recent Cases.....	4

The more lenient rule, which permits the allegedly defrauded party that seeks equitable remedies to pursue a claim or defense of fraud despite the party's failure to read the contract and discover its true terms, permits the court to balance the equities between the parties. It can balance the alleged neglect of the party that failed to read the contract, which may amount to negligence or mere carelessness, against the fraud of the other party, which may consist of intentional or merely negligent misrepresentation.¹⁰

The court, however, was spared having to perform this balancing test because the plaintiffs had paid off the loan. Therefore, it was not possible for the court to award the equitable relief sought by the plaintiffs for fraudulent inducement – the court could not avoid the contract and return the parties to the status quo, or reform the contract and enforce it as reformed. Furthermore, if the plaintiffs elected to affirm the contract and sue in tort for fraud, the more lenient rule would not apply and failure to read the written agreement would negate reliance. The court therefore affirmed the grant of summary judgment.

What does all this mean for the transactional attorney? Obviously it is a good idea to give the other party ample opportunity to read the written agreement. Do not characterize what the agreement says – let it speak for itself. While including in the agreement a declaration that each party has read it or having each party initial every page does not necessarily mean each party has read the agreement, selective use of these techniques might be effective. For example, if the plaintiffs in *Riverisland* had initialed the listing of collateral, they would undoubtedly have had a harder time claiming that they were misled as to what was included.

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Notes

1. [291 P.3d 316](#) (Cal. 2013).
2. [4 Cal. 2d 258](#) (1935).
3. See Chris Hogue, *A Look at the Fraud Exception to the Parol Evidence Rule*, [3 THE TRANSACTIONAL LAWYER 2](#) (April 2013).
4. [2013 WL 3947144](#) (Cal. Ct. App. 2013).
5. [157 Cal. Rptr. 3d 839](#) (Cal. Ct. App. 2013).
6. [2015 WL 2213195](#) (Cal. Ct. App. 2015).
7. *Id.* at *4.
8. *Id.* at *7 (citing *Riverisland*, 291 P.3d at 325 n.11).
9. See *Calif. Trust Co. v. Cohn*, [214 Cal. 619](#), 637 (1932).
10. *Riverisland*, [2015 WL 2213195](#) at *10.



Contracting with Multiple Parties

Stephen L. Sepinuck

When one individual or entity wishes to contract simultaneously with multiple individuals or entities, questions immediately arise – or at least should arise – about the nature of the liability of the multiple parties. Is each of them responsible for every promise they collectively make? Should they be? Transactional lawyers sometimes address this issue by including in the agreement a simple statement that the multiple parties are entering into the transaction “jointly and severally.” Unfortunately, this simple statement might resolve the first question while suggesting that the lawyer failed to consider the second. Not every promise should be treated the same way.

Before going any further, it is necessary to understand the relevant terminology. In traditional parlance, there were three types of liability: (i) joint; (ii) several; and (iii) joint and several.¹ The differences can be explained as follows:

Joint – There is a single promise and each promisor is liable for the whole promise. Example: “A and B jointly promise to pay X \$100.” There is a single debt of \$100 owed by both A and B. One problem with this type of liability, at least historically, was that each promisor was an indispensable party to an action against any of the others.

Several – There are multiple promises, with each promisor making a separate promise. Example: X loans A and B \$100 and the agreement among them provides that “A and B

each severally promises to pay X \$50.” There are two separate promises, each for \$50. The problems with this type of liability are that (i) a breach by one of them does not constitute a breach by the other; and (ii) the promisor is not entitled to full recourse against either of them.²

Joint and Several -- There is a single promise and each promisor is separately liable for the whole promise. Example: “A and B jointly and severally promise to pay X \$100.” This is the type of liability most beneficial to the promisee because it permits the promisee to recover the whole promise from any single promisor and does not make any promisor an indispensable party to an action against any of the others.

Notice, however, that “several” has two very different meanings in the terms “several” and “joint and several.” In the former, it concerns whether two or more promisors are making the same promise or separate promises. In other words, when multiple promisors make promises “severally”, they make multiple promises. In the latter context (*i.e.*, in the phrase “joint and several”), the word “several” is about the remedial rights of the promisee: whether each co-promisor is an indispensable party to an action against any one of them.³

By statute and judicial decision in most jurisdictions, the distinction between “joint” and “joint and several” has largely been abolished.⁴ Thus, in most cases when co-promisors make the same promise, neither is an indispensable party to an action against one of the others. As a result, there are really only two types of liability for most types of contractual obligations – “several” and “joint and several” – and the distinction between them is whether the co-promisors are promising the same performance or separate (*i.e.* multiple) performances. That is a contract interpretation issue but the presumption is in favor of the same performance,⁵ and the fact that the interests of the promisors are different or that one receives all or most of the consideration does not necessarily rebut that presumption.⁶ Thus, if in return for a loan from X, A and B promise to pay X \$100, they are presumptively making the same promise and are jointly and severally liable.⁷ Evidence that the amount loaned was \$200 might, however, be sufficient to rebut the presumption.

The upshot of this is that the default rule appears to be that co-promisors make the same, not multiple, promises and are jointly and severally liable. However, this is not always the appropriate result.

In loan agreements to related entities, it is extremely common for all the obligors to be jointly and severally

liable for the total debt, unless there is some tax or other reason for structuring the transaction differently.⁸ Moreover, the representations, warranties, and financial covenants are also usually drafted as joint and several obligations of all the obligors. This helps ensure that the creditor can pursue any of them when any representation, warranty, or covenant is breached.

In other types of deals, transactional attorneys should carefully consider which obligations should be joint and several and which should be merely several. In other words, they should consider which representations, warranties, and covenants should be made by all the promisors – so that each promisor is fully responsible regardless of who caused the breach – and which should be made by only one or some of the promisors.

For example, publishers frequently enter into agreements with multiple co-authors of a single book. Those agreements frequently give the publisher a right of first refusal for any sequel or related subsequent work. That right is often drafted as a covenant by the authors to offer the sequel or subsequent work to the publisher before offering it to anyone else. The following is an amalgam of two similar examples:

Author shall provide Publisher with the first option to publish any materials in the same general subject area as the Work. Author shall submit a proposal and table of contents of the proposed work to Publisher before submitting it to any other publisher. Publisher shall have 60 days after receipt to review the submission and determine whether to exercise its option.

Many such publication agreements also include a clause such as the following:

Multiple Authors. If the term “Author” refers to more than one person, their obligations under this Agreement are joint and several. Publisher may exercise any of its rights or the remedies against any or all of such persons.

While many terms in the publication agreement should be drafted to obligate the co-authors jointly and severally, the covenant to provide the publisher with a right of first refusal should perhaps be drafted differently. As someone who has co-authored several books, I would be quite distressed to learn that I was liable for the publisher’s lost profits because my co-author – without my knowledge or involvement – wrote some new work to which the right of first refusal applies but then failed to offer that new work to our publisher.

Similarly, consider a situation in which the two owners of a corporation or limited liability company that

operates a small business contract to sell their shares or membership rights. In the purchase and sale agreement, which both owners and the buyer sign, it would be entirely appropriate for both of the owners to make the representations and warranties relating to the financial condition of the business and the property owned by the corporation or LLC. It might even be appropriate for them to jointly and severally covenant to sell their rights, even though their ownership interests are held separately. This would help ensure that if one of them failed or refused to close, the buyer would have a claim of breach against them both and would be excused from purchasing the other's interest. On the other hand, if both owners will, as part of the transaction, covenant not to compete with the buyer, it might not be appropriate for each of those covenants to be made jointly and severally. It is not clear why one co-seller should be liable for the breach of that covenant – perhaps several months or years later – by the other co-seller.

A transactional lawyer who has carefully determined which representations, warranties, and covenants should be made jointly and severally, and which should be made only severally, might wish to consider using the following clause in the agreement (and conforming the other terms in the agreement to the distinction this clause draws):

Nature and Extent of Obligation. References herein to [Authors] [Sellers] mean each of them jointly and severally. References herein to “each [Author] [Seller]” mean each of them individually and obligate each of them severally, not jointly.

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Notes

1. See [RESTATEMENT \(FIRST\) OF CONTRACTS § 111\(1\)](#) (1932) (expressing the distinctions more clearly than does the second Restatement).
2. See [RESTATEMENT \(SECOND\) OF CONTRACTS § 288](#) cmts. a–d. See also 9 CORBIN ON CONTRACTS § 52.1.
3. Although not accurate etymologically, it might be helpful to think of “several” alone as “multiple” and “several” in “joint and several” as relating to “sever.”
4. See [RESTATEMENT \(SECOND\) OF CONTRACTS §§ 289\(3\), 290](#).
5. See [id. § 288](#).

6. *Id. cmt. c.* For a case where the presumption was rebutted, see *International Marine, LLC v. Delta Towing, LLC*, [2013 WL 5890551](#) (E.D. La. 2013).

7. See [RESTATEMENT \(SECOND\) OF CONTRACTS § 289](#), *ills.* 6, 7.

8. See *Overseas Shipholding Group, Inc., v. Proskauer Rose, LLP*, [2015 WL 4002291](#) (N.Y. Sup. Ct. 2015).



Recent Cases

SECURED TRANSACTIONS

In re Modern Plastics Corp.,

[2015 WL 4498023](#) (Bankr. W.D. Mich. 2015)

Although a security agreement purported to grant a security interest in “commercial tort claims,” that language covered claims *by* the debtor, not *against* the debtor, and in any event the description by collateral type was inadequate and the security interest could not extend to after-acquired commercial tort claims.

Peterson v. Katten Muchin Rosenman LLP,

[2015 WL 4092323](#) (7th Cir. 2015)

The bankruptcy trustee for some investor funds that made loans secured by nonexistent collateral stated a cause of for malpractice against the law firm that failed to advise them that, by not confirming with the account debtor the existence of the accounts and structuring the transaction so that the funds putatively coming from the account debtor flowed through another entity owned and controlled by the borrower, there was a risk that the borrower was engaged in a massive Ponzi scheme.

BANKRUPTCY

In re Botson,

[531 B.R. 719](#) (Bankr. N.D. Ohio 2015)

Chapter 7 debtors had no claim against their secured party for violation of the discharge injunction by filing a continuation statement or for refusing to file a termination statement even though the filed financing statement covered after-acquired property and the security interest in such collateral had been cut off by § 552(a). While a creditor might violate the discharge injunction by refusing to terminate a filing if there was no remaining property subject to the lien or all remaining collateral were valueless, no such facts were alleged in this case.

In re Hart Oil & Gas, Inc.,

[2015 WL 4055555](#) (Bankr. D.N.M. 2015)

To preserve a claim by the estate, a confirmed plan must identify the claim with some specificity. The confirmed plan in this case, by expressly preserving “avoidance actions,” did preserve the debtor’s strong-arm powers claim under § 544 but not the debtor’s claims for equitable subordination, surcharge of collateral, or lender liability, none of which is an avoidance action. The debtor’s claim for marshaling was also preserved because it was specifically mentioned in the disclosure statement.

GUARANTIES & RELATED MATTERS

JMT Capital Holdings, LLC v. Johnson,

[2015 WL 3832674](#) (N.D. Cal. 2015)

Guarantors had no defense based on the usurious nature of the loan because under Texas law a usury defense is personal to the debtor and cannot be asserted by a guarantor unless the guaranty agreement also contains the usurious provision. However, the guarantors might be entitled to a defense based on the lender’s repudiation of the loan agreement and refusal to continue funding the loan, causing the debtor to be unable to repay the advances that were made. Although the guaranty agreement provided that each guarantors “waives and relinquishes all rights and remedies accorded by applicable law to guarantors and agrees not to assert or take advantage of any such rights or remedies,” because the language covers rights that guarantors may assert directly, not rights of debtors that guarantors may assert indirectly, the defense was not waived.

Berry v. Encore Bank,

[2015 WL 3485970](#) (Tex. Ct. App. 2015)

Guarantors who signed an absolute and unconditional guaranty in which they expressly waived any right “to require or control application of any . . . collateral” had no defense merely because the lender’s preferred ship mortgage was primed by a maritime lien that predated the mortgage. There was no mutual mistake of fact giving rise to a defense because all the parties were aware that repairs to the vessel had begun before loan and guaranty were executed and the guarantors had assumed the risk by expressly agreeing that the lender was not required to realize upon or take any actions with respect to the collateral. The guarantors had no claim for negligent misrepresentation because the guaranty agreement stated that the guarantors were not relying on any representation by the lender regarding the collateral. Finally, the guarantors had no claim for negligence against the lender because the lender owed them no duty with respect to the collateral and, in any event, such a claim would be barred by the economic loss doctrine.

Larasco, Inc. v. Del Norte, LLC,

[2015 WL 2329040](#) (Wash. Ct. App. 2015)

The guarantor of a promissory note that made the borrower responsible for the lender’s attorney’s fees was not liable for the attorney’s fees incurred in collecting because the guaranty agreement covered only the “principal and interest” on the note.

LENDING & CONTRACTING

Canon Inc. v. Tesseron Ltd.,

[2015 WL 3884220](#) (S.D.N.Y. 2015)

The term in a non-exclusive patent license permitting the licensor to terminate the license if the licensee of an entity under its control contests the validity of any of the patents was unenforceable.

Marwell Corp. v. Marwell Corp.,

[2015 WL 4393289](#) (D. Utah 2015)

Because the parties’ security agreement included a clause making a California Superior Court the only forum for any action to enforce its terms or conditions, the secured party’s action in federal court in Utah on the simultaneously executed promissory note and asset purchase agreement would be dismissed, even though the claims did not directly involve the collateral. A breach of the note or purchase agreement necessarily implicates the security agreement and although the secured party has the option to pursue remedies not delineated in the security agreement, the secured party had not disclaimed the remedies provided for by the security agreement.

Clark v. Missouri Lottery Commission,

[2015 WL 3856359](#) (Mo. Ct. App. 2015)

A loan agreement that obligated the borrower to pay the fees of an attorney that the lender hired to collect did not cover the attorney’s fees that the lender incurred in successfully defending against the borrower’s claim that the security agreement was ineffective.

Masters Group International, Inc. v. Comerica Bank,

[2015 WL 4076816](#) (Mont. 2015)

The clause of a forbearance agreement between a lender and a borrower which stated that the agreement “shall be governed and controlled in all respects by the laws of the State of Michigan” covered not only claims for breach of contract and breach of the covenant of good faith, but also tort claims for fraud arising out of a contract.

FirstMerit Bank v. Myrter,

[2015 WL 3916673](#) (W.D. Pa. 2015)

The bank that released one spouse from her guaranty was no longer able to foreclose on real property that the couple held as tenants by the entireties.

In re Modern Plastics Corp.,

[2015 WL 4498023](#) (Bankr. W.D. Mich. 2015)

A lender's assignment of all of its "right, title and interest . . . in, to and under the Loan Documents" was broad enough to cover contract claims against the debtor but not tort claims arising before the assignment. The assignment did cover claims against an individual for breach of fiduciary duty arising after the assignment and resulting in damage to or loss of collateral.

In re MPM Silicones, LLC,

[2015 WL 2330761](#) (S.D.N.Y. 2015)

An intercreditor agreement that excepted from its debt subordination clause "any Indebtedness . . . that by its terms is subordinate or junior in any respect to any other Indebtedness" did not except senior notes with a springing lien subject to lien subordination because subordination of the lien did not subordinate the debt and the exception dealt with debt subordination.

Unison Co., Ltd. v. Juhl Energy Development, Inc.,

[2015 WL 3378285](#) (8th Cir. 2015)

The arbitration clause in a supply agreement covered a dispute arising under a contemporaneously executed financing agreement because the clause covered any dispute in connection with "any legal relationship associated with or contemplated by this Agreement," and the two agreements expressly referenced the financing agreement and created interdependent obligations.

River Community Bank v. Bank of North Carolina,

[2015 WL 3822385](#) (W.D. Va. 2015)

A claim for breach of a loan participation agreement by the buyer due to a forged guaranty was barred by the statute of limitations because the warranty claim started running on the date the transaction closed, not when the forgery was or should have been discovered; although the seller also promised to "take whatever additional actions may be necessary and proper to . . . maintain a Security Interest in the Collateral securing the Loan," that promise too was breached at the closing.

ACE Securities Corp. v. DB Structured Products, Inc.,

[2015 WL 3616244](#) (N.Y. 2015)

A cause of action against the sponsor of a securitization of mortgage loans for its failure to repurchase loans that did not conform to representations and warranties started to run when the warranties were made – at the closing date – because the warranties concerned characteristics of the loans at that time, not when the sponsor later failed to repurchase. While a seller can contractually agree to an obligation separate from a warranty, the breach of which does not arise until some future date, the repurchase obligation in this case was not such an obligation because the promise did not relate to the future performance of the property sold. Accordingly, the claim was barred by the six-year statute of limitations.

Walker v. Builddirect.Com Technologies Inc.,

[349 P.3d 549](#) (Okla. 2015)

To incorporate the terms in a separate document, a written agreement "must make clear reference to the extrinsic document to be incorporated, describe it in such terms that its identity and location may be ascertained beyond doubt, and the parties to the agreement had knowledge of and assented to the incorporated provisions"; under this standard, a written agreement for the sale of goods to a consumer did not incorporate a separate document entitled "Terms of Sale" available on the seller's website because the written agreement merely stated that it was "subject to" the seller's "Terms of Sale" but did not specifically reference the website.



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