

A venture capitalist read through a publicly held corporation's most recent financial statement, which was available on the corporation's website. The corporation's financial statement disclosed that the book value of the corporation's stock was \$10 per share, but its actual value is \$50 per share. The venture capitalist also noticed that the corporation had invested heavily to develop a new social media platform over the previous year. After doing more research, she became convinced that this platform would become extremely popular and would, in turn, drive up the price of the corporation's stock.

The venture capitalist approached one of the corporation's shareholders whom she had never met. She offered to buy his 500 shares at \$15 a share. The shareholder said that he thought that the shares were worth more. The venture capitalist did not respond. Eventually, the shareholder agreed to the venture capitalist's price for the 500 shares. Two months after this sale, the shareholder learned about the actual value of the stock and the corporation's investment in the new social media platform.

The shareholder asserted a misrepresentation claim against the venture capitalist.

Will the shareholder likely prevail on his claim?

- A. No, because the shareholder had access to the corporation's most recent financial statement at the time of the sale.
- B. No, because the venture capitalist had no duty to disclose the shares' actual value.
- C. Yes, because the venture capitalist had a duty to disclose the shares' actual value when she made the offer.
- D. Yes, because the venture capitalist had a duty to disclose the shares' actual value when the shareholder commented about their actual worth.

Explanation:

Liability for **misrepresentation** generally arises when a defendant actively misrepresents a material fact. However, nondisclosure of a **material fact** will also subject a defendant to liability if the defendant had a **duty to disclose** it. This duty arises when the defendant is engaged in a **business transaction** with a plaintiff who is:

in a **fiduciary relationship** with the defendant

likely to be misled by the defendant's prior statements *or*

mistaken about a basic fact of the transaction that the defendant is aware of and can **reasonably be expected to disclose**.

Here, the venture capitalist knew that her offer to buy the shareholder's shares of the corporation's stock was less than their actual value (material fact) but did not disclose that information to the shareholder. However, she had *no duty* to disclose it because:

the parties had just met (no fiduciary relationship)

she only offered to purchase his shares and made no misleading statement before or after his comment about their actual worth **(Choice D)** *and*

she could not reasonably be expected to reveal that her offer was low because people routinely try to buy stocks for as little as possible to increase the value of the purchase in the long run **(Choice C)**.

Therefore, the shareholder likely will not prevail on his misrepresentation claim.

(Choice A) The fact that the shareholder had access to the corporation's financial statement would not have defeated his misrepresentation claim had the venture capitalist owed him a duty to disclose that information—eg, had the venture capitalist been his financial advisor (fiduciary relationship).

Educational objective:

A defendant must disclose material facts during a business transaction with a plaintiff who is (1) in a fiduciary relationship with the defendant, (2) likely to be misled by the defendant's prior statements, or (3) mistaken about a basic fact of the transaction that the defendant is aware of and can reasonably be expected to disclose.

References

Restatement (Second) of Torts § 551 (Am. Law Inst. 1977) (liability for nondisclosure).

Duty to disclose material facts

Fiduciary relationship
(attorney-client)



Misled by prior statements
(car for sale "in mint condition"
later sustains damage)



Mistaken about basic facts
(seller must disclose that
house has termites)

