A woman prepared an accurate statement of her financial condition and submitted it with a loan application to a local bank with which she had done business for many years. Shortly thereafter, the woman's financial condition worsened significantly, but she failed to disclose this fact to the bank. Unaware of the woman's changed financial condition, the bank then agreed to lend money to the woman.

The bank later learned of the woman's true financial condition. The bank refused to honor its promise to lend money to the woman, contending that the parties' contract was voidable at the bank's option because of the woman's misrepresentation.

If the woman sues the bank for breach of contract, will the bank's misrepresentation defense likely succeed?

A. No, because the woman did not make any subsequent affirmative misrepresentations about her financial condition.

B. No, because the woman's representations were accurate at the time she submitted the loan application to the bank.

C. Yes, because the woman had an obligation to correct her previous representations about her financial condition in order to prevent them from being fraudulent.

D. Yes, because the woman had an obligation to tell the bank about her changed financial condition due to the longstanding relationship of trust and confidence between them.

Explanation:

When disclosure is required to avoid misrepresentation

Previous assertion	• Disclosure would prevent previous assertion from being a misrepresentation *or* fraudulent or material
Mistake about basic assumption	• Disclosure would correct other party's mistake about basic assumption of contract AND • Failure to disclose would constitute lack of good faith & fair dealing
Fiduciary relationship	• Other party is entitled to know fact because of confidential/fiduciary relationship
Mistake about writing	• Disclosure would correct other party's mistake about contents or effect of writing that embodies agreement

A **misrepresentation** is an **untrue assertion of fact** that makes a contract voidable by the adversely affected party when:

- the misrepresentation is fraudulent (ie, made knowingly or recklessly with intent to induce the other party's assent to the contract) OR material (ie, likely to induce a reasonable person's assent)
- the misrepresentation induced assent to the contract *and*
- the adversely affected party justifiably relied on the misrepresentation.

Nondisclosure of a known fact is tantamount to an assertion that it does not exist if, among other things, the party not disclosing the fact knows that disclosure is necessary to **prevent** a previous **assertion from being fraudulent**.

Here, the woman's representations were accurate when she submitted the loan application to the bank. However, she had an obligation to correct her previous representations to prevent them from being fraudulent **(Choice B)**. The woman failed to do so, and because the bank was unaware of her financial condition, it justifiably agreed to lend money to the woman. Therefore, the bank's misrepresentation defense will likely succeed.

(Choice A) The fact that the woman made no subsequent affirmative statements about her financial condition is irrelevant. Disclosure of her actual financial condition was still necessary to prevent her previous representations from being fraudulent.

(Choice D) The relationship between the woman and the bank is *not* a confidential or fiduciary relationship (eg, attorney-client relationship) that would obligate her to disclose this information to the bank.

Educational objective:

Nondisclosure is equivalent to an assertion that a fact does not exist if the party not disclosing the fact knows that disclosure is necessary to prevent a previous assertion from being fraudulent.

References

- Restatement (Second) of Contracts § 161 (Am. Law Inst. 1981) (when nondisclosure is a misrepresentation).
- Restatement (Second) of Contracts § 164 (Am. Law Inst. 1981) (when misrepresentation makes a contract voidable).