

A doctor was employed at a hospital when she applied for a personal loan from a bank. She accurately disclosed her income in the loan application. Before the bank had reached a decision regarding the loan application, the doctor was fired from the hospital. The doctor decided not to inform the bank of this fact because she feared that the bank would refuse to give her the loan.

A few days later, a bank representative called the doctor and informed her that her loan application was approved. The doctor accepted the terms of the loan and signed the loan agreement. Before disbursing the funds, the bank learned of the doctor's firing and refused to honor the loan agreement.

If the doctor sues the bank for breach of contract, will she be likely to prevail?

- A. No, because the doctor's ability to repay the loan was a condition precedent to the disbursement of the funds.
- B. No, because the doctor's nondisclosure of her firing was a fraudulent misrepresentation.
- C. Yes, because the bank's reliance on the doctor's disclosure of her income in the loan application was unjustifiable.
- D. Yes, because the loan agreement was memorialized in a signed writing.

## Explanation:

### When disclosure is required to avoid misrepresentation

|                                       |                                                                                                                                                               |
|---------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Previous assertion</b>             | <ul style="list-style-type: none"><li>• Disclosure would prevent previous assertion from being a misrepresentation <i>or</i> fraudulent or material</li></ul> |
| <b>Mistake about basic assumption</b> | <ul style="list-style-type: none"><li>• Disclosure would correct other party's mistake about basic assumption of contract</li></ul>                           |
| AND                                   |                                                                                                                                                               |
|                                       | <ul style="list-style-type: none"><li>• Failure to disclose would constitute lack of good faith &amp; fair dealing</li></ul>                                  |
| <b>Fiduciary relationship</b>         | <ul style="list-style-type: none"><li>• Other party is entitled to know fact because of confidential/fiduciary relationship</li></ul>                         |
| <b>Mistake about writing</b>          | <ul style="list-style-type: none"><li>• Disclosure would correct other party's mistake about contents or effect of writing that embodies agreement</li></ul>  |

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

- The misrepresentation was fraudulent (ie, made knowingly or recklessly with the 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.
- The adversely affected party justifiably relied on the misrepresentation.

**Nondisclosure** of a known fact is treated as an untrue assertion if, among other things, the nondisclosing party knows that disclosure is necessary to **prevent** a previous **assertion from being fraudulent**.

Here, the doctor accurately disclosed her income in the loan application but was then fired. She knew that she needed to disclose this fact to the bank to prevent her previous disclosure from being fraudulent but failed to do so. Since the bank was unaware of her firing, it justifiably agreed to give her a loan. Therefore, the contract is voidable by the bank, and the doctor is unlikely to prevail in her breach-of-contract suit.

\*A misrepresentation is also material if the maker knows that it will likely induce this particular party's assent—even if a reasonable person would not be induced.

**(Choice A)** A **condition precedent** is an explicit contract term requiring a future event to occur before a party becomes obligated to perform. But here, there is no indication that the

bank's obligation to disburse the funds was explicitly conditioned on the doctor's ability to repay the loan.

**(Choice C)** Reliance is almost always justified unless the misrepresentation was obviously false or known by the adversely affected party to be false. Here, the doctor's disclosure was accurate (not obviously false) when it was made and the bank was unaware of her firing when it approved the loan, so the bank's reliance was justified.

**(Choice D)** The fact that the loan agreement was memorialized in a signed writing does not prevent it from being voidable on the basis of the doctor's fraudulent misrepresentation.

**Educational objective:**

Nondisclosure of a known fact is treated as an untrue assertion of fact (ie, misrepresentation) if the nondisclosing party 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).