

A man needed a loan to purchase a business. The man submitted to a lender a loan application that included a then-accurate statement of his financial condition. The lender reviewed the application and concluded that the man was creditworthy without verifying any of his information. A week after the man submitted his application, however, his financial condition changed significantly for the worse. The man did not report this change to the lender. Two days later, the lender approved the loan, and the man and the lender signed a loan agreement. Before disbursing the loan funds, the lender learned of the change in the man's financial condition.

Is the lender entitled to cancel disbursement of the funds and rescind the loan agreement?

- A. No, because the lender failed to independently assess the man's financial condition before signing the loan agreement. (11%)
- B. No, because the man did not affirmatively misrepresent his financial condition at any time. (11%)
- C. Yes, because the man concealed the change in his financial condition. (10%)
- D. Yes, because after his financial situation changed, the man was obligated to disclose facts necessary to prevent his previous statement of his financial condition from being a misrepresentation. (67%)

Correct

67% Answered correctly

39 secs Time Spent

2023 Version

Explanation:

When disclosure is required to avoid misrepresentation

Previous assertion	Disclosure would prevent previous assertion from being a misrepresentation <i>or</i> 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 and rescindable** 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.

A misrepresentation can be conveyed through an affirmative statement, an act of concealment intended to prevent discovery of facts, or **nondisclosure of a known fact**. Nondisclosure is treated as a misrepresentation if, for example, the nondisclosing party knows that disclosure is necessary to **prevent a previous assertion from being a misrepresentation**.

Here, the man accurately disclosed his financial condition in the loan application, but his financial condition then worsened significantly. Although the man did not affirmatively misrepresent his financial condition at any time, he was obligated to disclose facts necessary to prevent his previous statement from being a misrepresentation **(Choice B)**. Since the lender was unaware of the man's changed financial condition, it justifiably agreed to give him a loan. Therefore, the lender is entitled to cancel disbursement of the funds and rescind the loan agreement.

(Choice A) Reliance is generally justified unless the misrepresentation was obviously false or known by the adversely affected party to be false. Here, the man's financial statement was accurate (not obviously false) when he made it and the lender was unaware that his

finances had worsened before approving the loan, so the lender's reliance was justified. As a result, the lender had no duty to independently assess the man's financial condition.

(Choice C) Concealment requires an *affirmative* act—not a mere *failure* to act (as seen here).

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 a misrepresentation.

References

Restatement (Second) of Contracts § 161 (Am. Law Inst. 1981) (defining when nondisclosure is a misrepresentation).

Restatement (Second) of Contracts § 164 (Am. Law Inst. 1981) (explaining when misrepresentation makes a contract voidable).

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