

"[T]elling the truth  
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## Tell the Truth!

by  
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Telling the truth is always good. It seems, though, that telling the truth about the present may be more important than telling the truth about one's intentions for the future. Courts – and some people – will grant you a little more leeway to puff about your plans for the future than to strain the truth about a current, verifiable state of affairs. This principle of human nature – and legal practice – is well illustrated by a recent case decided by the federal trial court for the Northern District of Illinois, *Bors v. Duberstein*, 2004 WL 1588271, 33 EBC 1893 (N.D. Ill. 2004).

In *Bors*, an executive complained that she had been lied to by certain shareholders and officers of her employer. The executive said those shareholders and officers had mislead her in an attempt to convince her to trade her phantom stock shares, for which she was currently entitled to cash, for restricted stock. More particularly, the executive claimed the directors and officers painted a very rosy picture about the company's future fortunes, which they predicted would culminate in a lucrative initial public offering. The executive, after trading her phantom shares for restricted stock, was sorely disappointed when instead of hitting a big payday, her restricted stock became worthless when the company a few years later found itself in bankruptcy.

The executive argued that by failing to disclose to her important facts about the poor financial prospects of the company, various shareholders and officers committed "fraud by omission." The court dismissed the executive's complaint because it concluded that the shareholders and officers owed the executive no duty to speak. The court noted that in Illinois the requirements for fraud by omission are (1) concealment of a material fact, (2) with the intent to deceive, (3) where the plaintiff was unaware of the concealed fact and would have acted differently if she had known of it. Additionally, however – and this was the critical point of the analysis – the party omitting or concealing the material fact must have had the opportunity and *duty* to speak.

One circumstance in which a duty to speak will arise under Illinois law is where a "defendant's acts contribute to the plaintiff's misapprehension of a material fact and the defendant intentionally fails to correct [the] plaintiff's misapprehension." The court in *Bors* concluded that the defendants' statements and alleged omissions did not create a duty to speak under this standard for two reasons. First, the defendants' statements referred to future events, and statements that

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relate to contingent events, expectations or probabilities, rather than to present facts, will not support a claim of fraud under Illinois law.

Second – and this is an important planning point for employers – the statements and omissions the executive complained of did not create a duty to speak because the restricted stock agreement specifically disclaimed any such duty. In particular, in her restricted stock agreement the executive acknowledged and agreed that neither the company nor its directors and officers had “any duty or obligation to disclose to [the executive] any material information regarding the business of [the company] or affecting the value of the stock,” including any plans to make a public offering of its stock. The executive, the court said, was therefore not justified in relying on oral statements made prior to her signing the restricted stock agreement and, as a consequence, even if the statements created misapprehension, the defendants had no duty to speak and therefore could not have committed fraud.

In contrast, in a 2003 decision from the same court, a plaintiff was able to bring a cognizable fraud claim because the plaintiff alleged a scheme to fraudulently misstate and conceal the net worth of his company. *Byczek v. Boelter Companies, Inc.*, 264 F.Supp.2d 720 (N.D. Ill. 2003). This was a cognizable claim because it involved misrepresentations and omissions of *current financial conditions*, not predictions of future performance.

The court also noted that in federal securities law cases, there is a duty to speak so as to render statements already made not misleading. Notably, in a decision from 2001, a federal trial court held that the former chairman of the board of a corporation stated a claim for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 where he alleged that the employer falsely denied the existence of an imminent merger when negotiating a severance agreement that provided for the sale of the chairman’s stock to the corporation. *Rizzo v. The MacManus Group, Inc.*, 158 F.Supp.2d 297 (S.D. N.Y. 2001).

### Lessons Learned

There are at least two lessons to be learned from *Bors*. First, tell the truth. That will not only make your mother proud, but also minimize the number of reasons you might get sued. Although under Illinois state fraud standards, misrepresentations about future events may not create the same legal risk as misstatements of current facts, the risk of a federal securities fraud claim based on a misrepresentation about a company’s future plans or prospects would remain.

Second, and perhaps more practically, employers may wish to add to their equity compensation agreements the type of language which proved helpful in *Bors*. Recall that the directors and officers in *Bors* were not required to refute the executive’s claims that they failed to tell the whole truth because the restricted stock agreement expressly disclaimed any obligation to disclose to the executive material information. This type of provision was effective not only in *Bors*, but also in a decision by the Seventh Circuit Court of Appeals, which hears appeals from federal trial courts in the states of Illinois, Indiana, and Wisconsin. *Carr v. CIGNA Securities, Inc.*, 95 F.3d 544 (7th Cir. 1996). In *Carr*, the Seventh Circuit stated that a fraud claim based on oral statements is barred when the claimant is also provided with a written statement contradicting the oral statements. Employers may therefore wish to include language in future equity compensation agreements disclaiming any duty or obligation to disclose to an executive any material information regarding the business of the company or affecting the value of the company’s stock.

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