

INTRODUCTION

BancBoston Financial Company (BancBoston) filed a complaint objecting to the dischargeability of the debt owed to it by the debtor, Joy R. Dunyon (Dunyon). Dunyon was a personal guarantor of the obligations Ryan Distributing Company (Ryan) owed to BancBoston. BancBoston's complaint pleads three causes of action under 11 U.S.C. § 523(a)(2)(B).

BancBoston alleges that Dunyon intentionally issued two materially false written financial statements respecting his financial condition thereby deceiving BancBoston into lending money to Ryan while Ryan was under Dunyon's control. BancBoston further contends that false weekly loan and collateral aging reports reflecting Ryan's accounts receivable and inventory were submitted by Ryan to BancBoston. BancBoston alleges that it reasonably relied on the summaries and reports in providing financing to Ryan.

A three day trial was held on the matter during which the court heard the testimony of numerous witnesses, considered documentary evidence, and an extensive series of stipulated facts. The court has judged the demeanor of the witnesses and carefully weighed the evidence. After due consideration of the evidence and the briefs of the parties, the court hereby provides its memorandum decision.

FACTUAL BACKGROUND

Ryan was established during 1978 or 1979 and was in the business of wholesaling electronic equipment and appliances to various retailers. In October of 1983, Dunyon invested in Ryan by transferring to the company two parcels of real property. Dunyon became a 50% owner of Ryan and Chairman of the Board of Directors.

In 1983, Ryan sought operational financing from BancBoston. Dunyon was asked to act as personal guarantor on financing arranged through BancBoston. On May 2, 1984, BancBoston entered into a \$3.5 million commitment with Ryan secured by accounts receivable, inventory, and by personal guarantees of the principals including Dunyon. In connection with the loan to Ryan and Dunyon's personal guaranty, BancBoston acquired the first of the allegedly false writings, a document entitled "Joy R. Dunyon and Janis R. Dunyon, Summary of Business Investments December 31, 1983", dated December 31, 1983.

Dunyon was not active in the management of Ryan until the fall of 1984. Ryan's president, Jack Ryan, was primarily responsible for the management and operation of the company. Through various means, weekly loan and collateral aging reports were overvalued. This allowed Ryan to obtain additional financing from BancBoston to which Ryan was not otherwise entitled under BancBoston's lending formula. BancBoston now complains those reports constituted a false writing upon which it relied in advancing funds

to Ryan. As early as the fall of 1984, BancBoston was aware of and expressed concern regarding Ryan's accounting irregularities.

In April of 1985, Dunyon was involved in an ATV accident that hospitalized him for two months. Dunyon was released from the hospital approximately June 15, 1985.

BancBoston performed an audit in June of 1985 that revealed that Ryan was submitting improper requests for funds. As a result of the June audit and the deteriorating financial condition of Ryan, representatives of BancBoston traveled to Salt Lake City to meet with the principals of Ryan, including Dunyon, at his home. At that meeting, Dunyon was asked for an updated financial statement. Dunyon submitted a 1984 Summary similar to the 1983 Summary to BancBoston at that time. The 1984 Summary constitutes the second allegedly false writing submitted to BancBoston.

Because of Ryan's financial problems, BancBoston required a modification of the financing agreement with Ryan where no new extensions of credit were granted against new accounts receivable. Rather, the lending formula was changed from advances on posted receivables to disbursements on collected accounts. Thirty percent of the collected accounts receivable were retained by BancBoston and applied to the loan, with the balance returned to Ryan for operating expenses.

At Dunyon's insistence, Jack Ryan was demoted to the position of sales manager at Ryan in approximately November of 1985. At that time, Dunyon became the controlling principal of Ryan. Ryan closed its doors and ceased operations in April of

1986. At the time Ryan ceased its operations, it had an outstanding indebtedness to BancBoston in excess of \$338,000.

On January 30, 1987, BancBoston obtained a judgment personally against Dunyon for the amount of \$347,947.30 plus costs and interest. On September 18, 1987, Dunyon filed a petition for relief under chapter 7 of the Bankruptcy Code in this court.

ANALYSIS OF THE EVIDENCE

A. RYAN DISTRIBUTING'S BUSINESS PRACTICES

The history of Ryan was best related by the testimony of David Robert Peterson (Peterson), a CPA with Haynie & Company who acted as financial adviser and out-of-house CPA for Ryan. Ryan was thinly capitalized from the beginning. Originally, operating financing for Ryan had been provided by Zions First National Bank in return for a secured position in Ryan's accounts receivable and inventory. The financing was further supported by a personal guarantee of R. Abbott. In approximately October of 1983, Dunyon became involved with Ryan when Dunyon invested in Ryan by transferring to the company two parcels of real property, each valued at \$100,000. He became a 50% owner of Ryan and Chairman of the Board of Directors.

R. Abbott, the personal guarantor on the letter of credit with Zions First National Bank, elected to withdraw his financial support for Ryan in 1983. Ryan was

faced with obtaining a new personal guarantor in order to support its operational financing. Peterson was also the accountant for Dunyon and, aware of Dunyon's financial status, suggested to the parties that Dunyon may wish to increase his involvement with the company and act as personal guarantor. Because Dunyon's assets consisted primarily of real estate as opposed to liquid assets, Peterson determined that Zions First National Bank would not accept Dunyon as personal guarantor and, therefore, financing was arranged through BancBoston.

B. NEED FOR DUNYON'S GUARANTEE

The practices of BancBoston and the terms of the financing agreement with Ryan were explained by the testimony provided by Joseph Johnson (Johnson), a BancBoston examiner, Ron Waterworth (Waterworth), a BancBoston regional loan officer, Scott Bowman (Bowman), Ryan's chief accountant, and Peterson. BancBoston's customary practice was to obtain the personal guarantee of principals of corporations to whom BancBoston loaned money when the assets of the corporation were leveraged more than 4 or 5 to 1. Jack Ryan, the president of Ryan, had an insubstantial financial statement. Dunyon agreed to act as personal guarantor and to allow his 1983 financial statement to be presented to BancBoston. The evidence is unclear how the transmission of the financial data took place. Dunyon does not recall having met with a representative of BancBoston or giving his financial statement to BancBoston but, in any event, a

document entitled "Joy R. and Janis R. Dunyon Summary of Business Investments December 31, 1983" (1983 Summary) found its way to BancBoston. Dunyon executed a personal guarantee to support the \$3.5 million loan commitment. It is apparent that Dunyon intended the 1983 Summary to be used as his financial statement.

Little evidence exists regarding how the 1983 Summary was used or who, if anyone, at BancBoston reviewed it at the time the loan was made. The guaranty was eventually placed in the loan file as evidenced by the testimony of Debra Evers (Evers), a bank auditor. Peterson testified that he was concerned whether or not the non-liquid financial statement of Dunyon would be acceptable to Zions First National Bank, but that it probably would be acceptable to BancBoston. Waterworth testified that company policy would have prohibited consummation of the loan unless the corporation's principals guaranteed the obligation. Evers testified that she reviewed the file after an audit and that, because of the personal guarantee, she modified her audit report to reflect the presence of additional security in the form of the guarantees.

The Loan and Security Agreement dated May 2, 1984, (exhibit 85) makes no reference to the personal guarantee of Dunyon. The personal guarantee executed by Dunyon was not admitted into evidence. The only document admitted that refers to the guarantee is exhibit 88, dated March 24, 1984, which appears to be an interoffice synopsis of the terms of the loan forwarded to members of BancBoston's Asset Based Credit Committee. The document, among various other details, states "Guarantee: unlimited of

principals, John T. Ryan and Joy R. Dunyon." The stipulated facts of the parties indicate only that BancBoston acquired a balance sheet of Dunyon dated December 31, 1983, and that such statement was in the possession of BancBoston at the time of the execution of the loan on May 2, 1984.

There is no direct evidence to indicate that BancBoston reviewed Dunyon's 1983 Summary. No evidence exists that the 1983 Summary was an integral element of Dunyon's personal guarantee. Rather, the evidence suggests that a financial statement would have been a required document to complete the loan file. No one testified that BancBoston even looked at the 1983 Summary prior to the approval of the loan, only that it existed in the files and the fact that an unlimited guarantee was noted in the file. Waterworth, in fact, testified that it would not be standard procedure to investigate the contents of a corporate guarantor's financial statement or to independently verify its accuracy unless assets in the financial statement were to be used as collateral. Waterworth did, however, testify that if the information in the financial statements had been materially false it would have been hard to receive loan approval.

C. ACCURACY OF DUNYON'S FINANCIAL STATEMENTS

Extensive evidence was presented on the accuracy of the two financial statements submitted by Dunyon to BancBoston.¹ The front page of the 1983 Summary

¹ The two documents entitled "Joy R. and Janis J. Dunyon Summary of Business Investments" (continued...)

listed certain assets of Joy R. and Janis Dunyon, including notes receivable, insurance, a residence, furniture and fixtures, jewelry, tools, a motor home, and certain business investments including Joyco, Joy Dunyon & Associates, J. F. Dunyon Company and Ryan Distributing Company (Dunyon companies). The 1983 Summary also listed liabilities and reflected a net equity on December 31, 1983, of \$2,979,303 at cost and \$4,836,278 at fair market value. Attached to the 1983 Summary were compiled balance sheets for the Dunyon companies dated December 31, 1983.

A similar summary of business investments was delivered to BancBoston dated December 31, 1984, (1984 Summary) showing a net equity of \$2,966,121 at cost and \$5,081,093 at fair market value. Also attached to the 1984 Summary were compiled balance sheets for the Dunyon companies dated December 31, 1984.

BancBoston asserts that the 1983 and 1984 Summaries were presented to it as financial statements and that the summaries were materially false. Dunyon maintains

¹(...continued)

have an interesting history as related by Dunyon. Dunyon's parents had extensive real estate holdings that were transferred to a series of related entities. J. F. Dunyon Company was a Utah limited partnership comprised of Dunyon's father's children, his wife and his grandchildren, and was created after Dunyon's father's heart attack in 1978. Dunyon and his mother Eileen were general partners of that entity. J. Dunyon & Associates was a Utah limited partnership consisting of Dunyon, his wife and six children. The purpose of the company was to hold various forms of real estate. Joyco, Inc., was organized in 1976, was a Utah corporation, and was owned by Dunyon and his wife, Janis. The purpose of the corporation was to take advantage of certain tax opportunities in relation to their investments. Dunyon also operated a dba known as Joyco Leasing.

Each of these entities owned extensive interests in real property and contracts receivable, and had corresponding liabilities. Dunyon testified that balance sheets of the different entities were compiled by Peterson, his accountant. He also testified that Valley Bank & Trust operated as a trustee of various trusts established for Dunyon's children. In order to describe to Valley Bank & Trust the relationship of the various holdings of the entities, the 1983 and 1984 Summaries were prepared.

those documents are not false and that they accurately represented his and his wife's family financial interests. Dunyon also testified that the summaries were originally prepared for unrelated financing requests from Valley Bank & Trust.

BancBoston complains that the residence valued at \$620,000, furniture and fixtures valued at \$200,000 (\$236,00 in 1984) and jewelry valued at \$7,000 (\$29,000 in 1984) were the sole property of Janis Dunyon and, therefore, inclusion in the statements provided to BancBoston constituted a material misrepresentation of Dunyon's financial position. The court is not overly concerned with this distinction because other misrepresentations in the Summaries are more significant. Dunyon listed two items as assets, Solitude 300 acres and the Smith Canyon contract receivable, collectively valued at \$732,673 in 1983 and \$819,641 in 1984. They were, in fact, family assets that he assumed would be transferred to J. F. Dunyon Company, but had not been transferred as of the date of the statements. A \$59,125 obligation payable to Zions First National Bank was not on the 1984 Summary because the obligation had been disbursed on the last day of the year for bank convenience. Several personal guarantees or indemnity agreements were not set forth on the summaries; i.e., 1) \$30,000 indemnity agreement dated August 7, 1984, for the West Wind lawsuit; 2) \$32,000 obligation of Joyco Leasing to Valley Bank & Trust dated December 31, 1983; 3) between \$17,000 and \$41,000 owing to Lynn Bennion as of December 31, 1983, and December 31, 1984; and 4) \$800,000 indebtedness to American Savings. These inaccuracies go far beyond inadvertent omissions or

inconsequential inclusions. They substantially altered the total picture of the assets and liabilities of Joy and Janis Dunyon.

D. ACCURACY OF FINANCING REQUESTS MADE BY RYAN

On May 2, 1984, BancBoston entered into a secured inventory and accounts receivable loan agreement with Ryan in which BancBoston made available to Ryan up to \$3.5 million. Advances were based on 50% of the net security value of base inventory and 80% of net outstanding base accounts receivable. The loan procedures, as they related to accounts receivable, provided that Ryan forward to BancBoston a weekly loan and collateral aging report listing eligible accounts receivable for computing the availability of funds from the \$3.5 million loan. BancBoston would return to Ryan 80% of the value of those accounts receivable as its operating capital.

The testimony of Bowman sets forth the methods by which financing requests were made to BancBoston. Over a period of time, Jack Ryan entered into a course of conduct that inflated the amount of those accounts receivable. The net effect was to overstate eligible accounts receivable for the purpose of obtaining additional funds from BancBoston to which Ryan was not entitled under the loan agreement.

The methods used to inflate the accounts receivable were varied. In some instances inventory was transferred to retailers on consignment. The transfers were then posted on the books of Ryan as accounts receivable when, in fact, no obligation existed

on the part of the retailer to pay any amount to Ryan except upon actual sale by the retailer. Another practice also developed in which customers of Ryan would be issued credit memos for returned merchandise but those credit memos were not posted to the ledgers, thereby keeping the level of the accounts receivable artificially high. Ryan also engaged in the practice of rebilling aged accounts so that the accounts appeared to be eligible current accounts receivable. In addition, Ryan had certain employee accounts, or unbooked accounts, that artificially inflated the value of the accounts receivable.

The evidence indicates that Jack Ryan was solely responsible for artificially inflating the value of the accounts receivable. Dunyon's management responsibilities did not include the supervision of the reports to BancBoston. Between March of 1983 and March of 1984, he visited Ryan approximately once a week for two to three hours. Between March of 1984 and April of 1985, Dunyon increased his presence at Ryan to two to three days a week for a period of two, three or four hours. He stated, however, that he was frequently away from Ryan for periods of one to five weeks during the period between March or April of 1984 and April of 1985 when he had his accident.

Dunyon's responsibilities during this period were limited to participation in management meetings and major management decisions. The duties of daily management of the business resided with its president, Jack Ryan. BancBoston does not assert that the scheme of Ryan to inflate eligible receivables originated with Dunyon, but it does assert that he knew, or should have known, of the scheme and its effect on BancBoston.

It was the practice of BancBoston to periodically audit the accounts and financial records of its borrowers. Evers, an in-house auditor for BancBoston, testified regarding certain of those audits. Johnson testified regarding the common practices and procedures for troubled loans and in-house audits in the industry and of BancBoston.² BancBoston conducted several in-house audits of Ryan. The audits occurred during September of 1984, January of 1985, June of 1985, September of 1985, November of 1985 and February of 1986. Johnson indicated that an audit every three to six months is the standard time between bank audits. He also indicated that if there were problems with an account, the audits could be conducted more frequently.

BancBoston's practice was to perform an audit and then have the in-house auditor report to the bank officer in charge of the loan for any necessary action. A series of interoffice memos prepared by the original loan officer, C. D. Channing (Channing) reflecting his views of the account, were entered into evidence. Channing did not appear as a witness, and there was little explanation regarding the contents of his memos, thus the court is left to draw its own conclusions from the memos. The second of Channing's entries (exhibit 75) is dated October 31, 1984, approximately five months after the initial loan. An audit was conducted in September of 1984, at which time BancBoston became aware of numerous bookkeeping errors overstating BancBoston's collateral and resulting

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Although not in charge of the Ryan accounts, Johnson had reviewed the file.

in an over-advance to Ryan of \$500,000. According to the memo, the over-advance was subsequently resolved.

In January of 1985 Evers conducted her first audit of Ryan. She testified extensively regarding BancBoston's method of conducting an audit, the frequency, the procedures for verification of funds, and the methods used to tie to source documents Ryan's general ledger and financial statement. An audited financial report of Ryan was not available so Evers was forced to go directly to the source documents for the audit. She found that certain credit memos had not been appropriately credited, that there were errors in the posting of the accounts, and that payments were not credited to the appropriate accounts. Additionally, a \$100,000 tax refund was improperly carried as an account receivable. The month end figures, sales and accounts payable did not tie in. The accounting errors were substantial and resulted in a significant misrepresentation of the balance of Ryan's accounts receivable.

Evers forwarded her report regarding these conditions to Channing. Channing's February 1, 1985, memo (exhibit 74) referenced a meeting with Jack Ryan and Dunyon, and indicated that Ryan's management and its accountants cited a computer breakdown to account for numerous problems with books and records. The interoffice memo indicated that another examination was to be scheduled for mid-March. However, no audit took place in mid-March.

Channing's memo of April 22, 1985, (exhibit 74) also recognized that Ryan anticipated that its year end audit would show a loss of \$108,000 as of October 31, 1984. Jack Ryan had expressed a desire for a capital infusion to cover the year end loss, preferably from Dunyon.³ Channing indicated that he would continue to monitor the account closely and "make sure the loan remains within availability". A follow-up exam had been requested in order to verify management's contention that its books and records were in order. At this point, the loan was transferred from Channing in the northwest to BancBoston's Los Angeles office. About this time, in April of 1985, Dunyon suffered a disabling accident on an ATV.

Ryan's October 31, 1984, audited financial statement was not made available to BancBoston until May of 1985. BancBoston's interoffice memo dated May 21, 1985, (exhibit 77) reflects a meeting with Waterworth, Jack Ryan, Bowman (Ryan's in-house accountant), Allen Coombs (Ryan's Financial Assistant) and Peterson, at which time the audited financial statement was reviewed. The memo showed a change in the leverage ratio from 5.8 as of October 31, 1983, to 8.4 on October 31, 1984. The 1984 year end financial statements (exhibit 20) showed that Ryan was out of trust with ITT, its other major lender, by \$800,000. It also showed a net loss of \$107,948 and a decrease in working capital of \$187,020. BancBoston's May 21, 1985, memo anticipated a June audit

³ Exhibit 79, however, a status report dated April 17, 1985, by D. J. Parker, indicated Jack Ryan hoped to buy out Dunyon.

by BancBoston. The memo also reflected Jack Ryan's continuing effort to sell Dunyon's share of the business or to sell real estate owned by the company to Dunyon to raise cash.

BancBoston's interoffice memo dated June 19, 1985, (exhibit 78) recites a meeting with Jack Ryan, Bowman, Coombs and Peterson. Jack Ryan was still attempting to raise capital by a sale of assets to Dunyon or by some other cash infusion. The memo reflected concern over the condition of the company and recited an ultimatum given to management that it was given 30 days to finalize a cash infusion from an outside investor, plus a satisfactory audit, or BancBoston would reduce its advance rate or reach out for security on the guarantees of the principals. The memo expressed concern over BancBoston's collateral indicating a "5/14/85 receivable verification effort showed a 71% exception response."

Evers conducted her second audit in June of 1985. In that audit she found numerous barter accounts totaling between \$50,000 to \$100,000, listed on Ryan's accounts receivable. She also discovered C.O.D. and cash accounts that appeared on the accounts receivable aging report. Other funds had been misapplied and the aging report was incorrect. Her testimony further indicated that although Ryan had previously promised to correct its accounting procedures, the June audit indicated they had not been corrected. The bottom line of the audit showed an over advance from BancBoston to Ryan as of August 7, 1985, of \$391,000. BancBoston's memo dated July 9, 1985, (exhibit 81) reflects

a meeting with Jack Ryan, Waterworth and Peterson. It acknowledged that Ryan was out of trust with both ITT and BancBoston. Jack Ryan was still looking for an equity infusion of \$400,000 and was supposedly finalizing negotiations with a prospective investor.

As a result of the June audit and the deteriorating financial condition of Ryan, Waterworth traveled to Salt Lake City to meet with the principals of Ryan. Ryan at this point was leveraged 14 to 1. On July 8, 1985, Waterworth, Parker, Peterson, Ryan and Bowman met with Dunyon in his home for approximately 45 minutes. Dunyon had been released from the hospital for about two weeks. He was heavily medicated for pain and was sleeping up to 22 hours per day. Dunyon testified that at this time he was barely alive. The representatives of Ryan and BancBoston had agreed not to review in detail the numerous problems with the accounting because of Dunyon's deteriorated physical condition.

At that meeting, Waterworth asked Dunyon for an updated financial statement. Dunyon provided to Waterworth the 1984 Summary. Dunyon wrote his name across it and the date, 7-8-85. Waterworth's testimony indicated that he asked Dunyon if the financial information was current and that Dunyon replied that it was by dating it July 8, 1985. Dunyon does not recall the meeting at all, but acknowledges that it must have occurred. He testified that he was on heavy medication during July of 1985. Dunyon's memory is nonexistent on many aspects during the period of his convalescence.

Based on the court's observation of Dunyon's demeanor at the trial, the court deems this to be a credible explanation given Dunyon's physical condition.

Because Ryan was substantially out of trust and because the July 1985 indebtedness of Ryan to BancBoston totaled \$1,664,000 (stipulated fact 22), BancBoston modified its lending agreement with Ryan. By letter dated August 7, 1985, (exhibit 68) BancBoston indicated to Dunyon the extent of the over-advance. In that letter, BancBoston reiterated that the bank held the personal guarantees of Jack Ryan and Dunyon and requested that the guarantees be collateralized by either advancing cash, money market instruments or marketable securities of \$500,000 or real estate valued at \$1,000,000. The letter stated:

We are requesting that this collateral be provided in a form satisfactory to the bank by August 15, 1985. Should this condition not be met, BancBoston shall revise its rate of advance on loans made under the 5-31-85 loan agreement to 70% of daily, approved sales assigned to BancBoston Financial, beginning August 16, 1985.

The bank would assist the company in collecting its accounts receivable and would enter into a factoring agreement whereby Ryan would submit all sales invoices to BancBoston which would, in turn, collect those accounts directly.

Even though the testimony is unclear on the mechanics of the new loan agreement, it is acknowledged by all concerned that a drastic change in relationship between BancBoston and Ryan took place at this time. The deposition of Ron Robinson, the accountant for Ryan, indicated that after this point in time, no further money was

loaned by BancBoston. Of the collected accounts receivable, Ryan would be permitted to keep 70% in order to continue to operate and 30% would be applied against the loan balance. Waterworth indicated that the bank was attempting to exercise prudent lending practices and that, instead of shutting Ryan down, it elected to continue this procedure in an attempt to collect on its over-advanced position. Stipulated fact 23 also indicates that after July, 1985 "no new extensions of credit were granted against new accounts receivable".

By August of 1985, Dunyon had recuperated sufficiently to return to Ryan. Dunyon replaced Bowman by hiring Ron Robinson, the brother-in-law of Peterson, to act as financial officer of Ryan. Robinson reported directly to Dunyon. Dunyon infused approximately \$160,000 into Ryan in August of 1985 to shore up the faltering company. By October of 1985, Dunyon became aware of the out of trust status with ITT and certain problems with the Sony inventory. Dunyon, aware of the overdrafts with ITT and BancBoston, and what appeared to be the course of dealing of Jack Ryan to overinflate the accounts receivable, demoted Ryan to the position of sales manager in November of 1985.

On or about February 12, 1986, Dunyon fired Jack Ryan. When Jack Ryan left, he left behind a stack of unposted credit memos two feet high that would have substantially reduced the balance of the accounts receivable. Dunyon testified that it was not until May 9, 1986, that he became fully aware of the extent of the overinflation of the accounts receivable through a memo (exhibit 19) from Marie Cameron, the bookkeeper.

Dunyon testified that everyone else in the company seemed to know of the events before he did. The financial condition of Ryan continued to deteriorate and, in June of 1986, ITT Financial withdrew its financing and Ryan went out of business.

Dunyon remained on medication until March of 1986. He underwent surgery in July of 1987, and testified that by October of 1987, he could function with a reasonable degree of reliability. He remains confined to a wheelchair.

APPLICATION OF THE LAW

This court has jurisdiction over this adversary proceeding under 28 U.S.C. §§ 157(a) and 1334(b). This proceeding to determine the dischargeability of a debt is a "core proceeding" under 28 U.S.C. § 157(b)(2)(I). BancBoston's three claims for relief are plead under 11 U.S.C. § 523(a)(2)(B). The claims are based on three false writings. These writings are the 1983 and 1984 Summaries and the collateral aging reports given to BancBoston upon which it calculated loan advances.

In cases involving a determination of an exception from a debtor's discharge, the facts are to be construed narrowly with the burden of proving that a debt falls within the statutory exception clearly resting upon the party opposing the debtor's discharge. *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986). Section 523(a)(2)(B) of the Code excepts from the debtor's discharge debts incurred by use of a false written statement respecting the debtor's or an insider's financial condition. BancBoston must show by clear and convincing evidence that the debtor "[1] obtained money, property, credit, or services; [2]

by using materially false written, statements respecting the debtor's or an insider's financial condition; [3] with the intent to deceive; and [4] upon which the creditor reasonably relied to advance the money, property, credit, or services." *In re Iverson*, 66 B.R. 219, 224 (Bankr. D. Utah 1986) (citations omitted).

I. OBTAINING MONEY

Did Dunyon receive money, property, an extension, renewal or refinancing of credit when any one of the false writings was submitted to BancBoston? Dunyon was controlling shareholder and Chairman of the Board of Directors of Ryan and arguably funds received by Ryan would be deemed received by Dunyon. The evidence establishes that Dunyon's guarantee was required by BancBoston before the May 2, 1984, loan was made and the guarantee was apparently supported by the 1983 Summary. The advance of funds on May 2, 1984, constituted Dunyon obtaining money from BancBoston. Likewise, through the submission of the weekly accounts receivable statements, Dunyon "obtained money" from BancBoston that was used by Ryan.

The receipt of money as it relates to the 1984 Summary is more troublesome. Robinson's deposition indicated that BancBoston loaned no new money after July of 1985. No new extensions of credit were granted against new accounts receivable after July 1985 (stipulated fact number 23). BancBoston argues, however, that by not shutting Ryan down in July of 1985, by exercising "prudent lending practices" and by allowing Ryan to use 70% of its collected receivables for operating expenses while it

applied 30% to the outstanding debt, Dunyon continued to receive money within the meaning of the statute. It must be remembered that the accounts receivable belonged to Ryan and were only collateral for BancBoston's loan. Though mention is made of a "factoring" agreement, no document exists to indicate Ryan ever transferred title to its receivables to BancBoston in return for the 70% Ryan was allowed to keep.

This court is familiar with the district court's opinion in *Rothey v. Shah*, No. C86-1059G, slip op. (D. Utah Dec. 13, 1988) wherein the court determined that forbearance to collect on a delinquent note constitutes an extension of credit within the meaning of 11 U.S.C. § 523(a)(2). It is not necessary to apply *Rothey* to the present case, or to determine whether the instant financial arrangement is consistent with the district court's ruling that forbearance is an extension of credit. In this case, insufficient evidence exists to indicate that the 1984 Summary caused BancBoston to continue with the modified financial arrangement, or in any way affected its lending or collection practices.

II. MATERIALLY FALSE STATEMENT IN WRITING

Section 523(a)(2)(B) requires use of a statement in writing. The 1983 and 1984 Summaries certainly qualify. Dunyon argues that no specific accounts receivable ledger was admitted that was proved to be in error. There are, however, representative examples of the weekly loan and collateral aging reports (exhibits 65 and 66) and sufficient testimony by Bowman to indicate how the written reports were submitted to BancBoston to satisfy this element of the statute.

Section 523(a)(2)(B)(i) requires the written statement to be materially false. Dunyon may have prepared his 1983 and 1984 Summaries merely as a guide to Valley Bank & Trust, and the inclusion of joint assets or the omission of liabilities or footnotes relating to contingent liability may have been appropriate under those circumstances. When he published those documents by twice giving them to BancBoston, he knew, or should have known, they were incomplete for the purposes BancBoston intended to use them. The statements or omissions as they related to family assets and contingent liabilities were false. The amounts involved are material not only in dollar amount but in relation to the total assets listed. The court therefore concludes both the 1983 and 1984 Summaries were materially false.

Ryan's weekly collateral reports were, in fact, overstated. The evidence is overwhelming that the business practices of Ryan consistently operated to artificially increase the value of the accounts receivables by failing to post credit memos, rebilling accounts, posting consignment accounts as accounts receivable, as well as other practices designed to induce BancBoston to advance funds to which Ryan was not entitled. BancBoston has met its burden of proving the falsity of the weekly collateral aging reports, in general, by clear and convincing evidence, even though each specific collateral aging report may not have been proven false.

Section 523(a)(2)(B)(ii) requires the materially false written statement to be promulgated respecting the debtor's or an insider's financial condition. The 1983 and 1984 Summaries relate to Dunyon's financial status. The collateral aging reports were of

Ryan, a company in which Dunyon was a 50% shareholder and Chairman of the Board. 11 U.S.C. § 101(30)(A)(iv) provides that an insider of an individual debtor is a corporation of which the debtor is a director, officer, or person in control. BancBoston has met its burden of showing the relationship of the writings to both Dunyon and Ryan.

III. REASONABLE RELIANCE BY BANCOSTON

Section 523(a)(2)(B)(iii) requires that BancBoston must have reasonably relied upon the materially false written statement. Numerous cases have dealt with the standards applicable to reasonable reliance. Both parties cite *In re Iverson*, 66 B.R. 219 (Bankr. D. Utah 1986) in support of their positions. That case sets forth four categories where a creditor's reliance upon a materially false writing is not reasonable:

- 1) Where the creditor knows at the outset the financial statement is not accurate;
- 2) Where the financial statement contains insufficient information to present an accurate portrait of the debtor's financial condition;
- 3) Where the debtor's own investigation reveals the likelihood the financial statement is false or incomplete; or
- 4) Where the creditor fails to independently verify any of the information contained in the statement.

Id. at 225-26 (citations omitted). Furthermore, any failure to show reasonable reliance will not be mitigated by a showing of the debtor's deceit. *In re Mullet*, 817 F.2d 677, 680 (10th Cir. 1987).

A. THE 1983 SUMMARY

The testimony is clear that BancBoston required the personal guarantees of the principals of Ryan and would not have made the loan but for those guarantees. In addition, this practice is consistent with BancBoston's general practices. Whether BancBoston considered the 1983 Summary in support of the guarantee is another matter. Peterson testified that he did not think Zions First National Bank would accept Dunyon's financial statement, thus Ryan had to find a different lender. The clear implication is that BancBoston had a different standard. No evidence exists that anyone at BancBoston reviewed Dunyon's 1983 Summary. Dunyon was not questioned by BancBoston regarding the obviously questionable information on the face of the financial statement.⁴ No evidence exists that even minimal investigation or independent verification was made into the document. To the contrary, Waterworth testified that, as a matter of course, investigation is not routinely made into financial statements of corporate officers.

The clear impression from the evidence is that the 1983 Summary was only technically necessary to complete BancBoston's loan documentation file. BancBoston did not rely on the contents of the financial statement in making the loan. Rather, BancBoston relied only on the physical existence of the document in the loan file. BancBoston may have relied on the guarantee in making the loan. An argument could

⁴ The title of the document was "Summary of Business Investments"; it was not a financial statement. It was a summary for both Joy R. and Janis Dunyon, not just Joy R. Dunyon. No vehicles appear on the document except the motor home, that, from its high value, is clearly not a transportation vehicle. The 1983 Summary lists assets at costs and fair market value, an unusual method of listing assets on a financial statement except, perhaps, for real property or securities.

be made that the guarantee itself was a false written statement, but the guarantee is not in evidence and BancBoston has not presented this argument to the court.

B. THE 1984 SUMMARY

The 1984 Summary given by Dunyon to Waterworth at the July 8, 1985, meeting in Dunyon's home, carries the same facially apparent concerns as the 1983 Summary. In addition, it fails to list either directly, or as a footnote, the guarantee to BancBoston that was then in existence. Johnson and Waterworth both testified that because BancBoston already knew of the guarantee, its omission was not critical. The court cannot help but wonder why such an omission would not have made BancBoston inquire further into the possibility of other such omissions.

The 1984 Summary is further tainted by the assertion that BancBoston reasonably relied upon its accuracy as of July 8, 1985. Waterworth testified that he asked Dunyon if the summary was accurate as of that date and Dunyon said it was, though Dunyon does not remember saying so. How a statement dated December 31, 1984, listing cash assets and long term debt service could be identical six months later is questionable. If it were, the obvious fact established is that in six months Dunyon did not service any of his debt and did not use any of his cash. It is also questionable that Dunyon's financial position was totally unaffected by his accident three months before. For BancBoston to have relied upon such an assumption is not reasonable and is not in keeping with the prudent practices that BancBoston has set as its standard.

Waterworth stated that the inaccuracies in the financial statements probably would have made a difference in the treatment of the loan. He stated that the correct financial statement would have made it hard to get approval from the loan committee and that it would have generated a lot of discussion. He did not testify, however, what standards BancBoston has regarding the percent or dollar amount of personal assets a guarantor must have in relation to a loan. The court is left with the clear conviction that the personal guarantee of the principal of the corporation was used by BancBoston as leverage against the borrower, but not looked to as a primary source of collateral upon which an extension of credit would rise or fall.

The credibility of BancBoston's alleged reliance on the 1984 Summary is also suspect based on the total facts and circumstances under which the summary was given. BancBoston knew of accounting irregularities at Ryan as early as the fall of 1984, though not the full extent of the irregularities. BancBoston knew Ryan was out of trust with ITT from Ryan's 1984 financial statement. BancBoston knew it received the 1984 audited financial statement of Ryan seven months after the end of the fiscal year. BancBoston knew it had over advanced \$391,000 as of August 7, 1985. BancBoston knew Ryan had been trying to find an investor to obtain a cash infusion to shore up the company. BancBoston also had given an ultimatum to Jack Ryan at the June 19, 1985, meeting. In order to continue lending under the terms of the May 4, 1984, agreement, an equity infusion was required to be finalized within thirty days with an audit showing satisfactory results.

By July 8, 1985, the audit had been conducted showing the over advance and that no cash infusion had been received. BancBoston obtained the 1984 Summary from Dunyon at his home during his convalescence while he was heavily medicated. Waterworth later requested, on August 7, 1985, (exhibit 68) that Dunyon secure his guarantee by cash, money market investments, or marketable securities of \$500,000 or \$1,000,000 worth of real estate. Dunyon eventually offered only third trust deeds on some condominiums that Waterworth turned down. Dunyon's inability to satisfactorily pledge the guarantee should have alerted BancBoston to a problem.

Waterworth testified that the practice of BancBoston is to independently verify the value of assets only when the assets are pledged as collateral for a guarantee. BancBoston never took collateral for the guarantee, apparently because its August 7, 1985, demand was not met. No independent investigation of the accuracy of the 1984 Summary was made.

The August 7, 1985, demand was in the alternative, to either collateralize the guarantee by August 15, 1985, or suffer a reduction in the advance rate to 70% and factor the accounts. The evidence is insufficient to show that a factoring agreement was eventually entered into, but the evidence does support that BancBoston immediately changed its finance practices so that it did not advance funds based on posted accounts receivable, but instead on collected accounts receivable. Waterworth's testimony indicated that this was considered a "prudent lending practice" and was a superior course of action to calling the account. Calling the account would have put the company out of business

and severely limited the possibility of BancBoston's collecting the account, Waterworth characterized as the worst account in the west coast office.

The evidence clearly shows that BancBoston modified its lending practices and stopped loaning on new receivables. It considered only money already collected, not billed. It assisted with its personnel in the collections of the accounts so that 30% could be applied to reduce Ryan's indebtedness to BancBoston. From August 1985 to May 1986 the account was paid down from \$1,290,173 to \$337,346 (exhibit 86). During that period, more was paid on the loan than was "advanced" to Ryan.

The court concludes the evidence is clear that BancBoston did not reasonably rely upon Dunyon's 1984 Summary but instead merely exercised its business judgment to make the best of a bad loan by trying to maximize collection on the account. Dunyon's 1984 Summary played little part in BancBoston's treatment of the loan. BancBoston did not continue to attempt to collateralize the guarantee and made no attempt to verify the information on the 1984 Summary despite Dunyon's inability to collateralize the guarantee.

C. COLLATERAL AGING REPORTS

The collateral aging reports forwarded by Ryan to BancBoston during the time between May of 1984 and July of 1985 were part of the general lending documentation of BancBoston and were used to calculate the loan amount available to Ryan. BancBoston knew that there were substantial accounting errors in the collateral

reports in the fall of 1984 but, based on the representations of employees of Ryan, had reason to believe the errors would be corrected. The June 1985 audit finally revealed a portion of the inaccuracies which had not been corrected by Ryan and, after deducting the ineligible accounts receivable, reflected the \$300,000 over advance. It is apparent that prior to July 1985, BancBoston assumed that the collateral aging reports were substantially correct and relied upon them.

Both the audits during September of 1984 and January of 1985 showed substantial errors appearing in the collateral aging reports. After the January 1985 audit, BancBoston's reliance on these reports was probably an error in judgment, but most likely reasonable because of the explanations provided by Ryan employees. After July of 1985, BancBoston knew the accounts were substantially overstated, the errors had not been corrected, and the information received from Ryan was not reliable. This is apparent based on the change of lending procedures from advances on accounts receivable to funding based only on collected, not billed accounts. Under the circumstances, any such reliance upon the collateral aging reports after July of 1985 was not reasonable.

IV. INTENT TO DECEIVE

Section 523(a)(2)(B)(iv) requires that Dunion made or published the materially false writing with the intent to deceive BancBoston. Courts have struggled with how a creditor could prove intent where the debtor denies its existence. Intent may be found from circumstantial evidence if all other elements of section 523(a)(2)(B) have been

met. The court in *Iverson*, 66 B.R. at 225 (citing *In re Black*, 787 F.2d at 507) has recognized that "[t]he requisite intent may be inferred from a sufficiently reckless disregard of the accuracy of the facts." Furthermore, intent may be also inferred when the debtor knew or should have known of the falsity of the statement. *Iverson*, 66 B.R. at 225. Finally, the presumption of intent will not be rebutted by a mere denial of intent to deceive. *Id.* However, this does not mean that in every case this court is required to presume intent when the other elements of a section 523(a)(2)(B) action are proven.

A. 1983 AND 1984 SUMMARIES

Dunyon denies any intent to deceive BancBoston by publishing the 1983 and 1984 Summaries, and, indeed, still maintains the summaries were accurate. Dunyon knew, however, that the 1983 Summary was going to be given to BancBoston in support of the guaranty and loan. The Summary was prepared for Valley Bank's use. Perhaps the summary was sufficient for Valley Bank's purposes, even with material omissions, inclusions and inconsistent representations. However, the omissions and errors were bound to be misconstrued by any lender unless it was familiar with the context of the Summary. Dunyon, nonetheless, published the 1983 Summary. The court determines that Dunyon's actions constituted a sufficient reckless disregard of the accuracy of the facts to infer his intent. The publication was intentionally misleading to BancBoston. *See In re Black*, 787 F.2d at 506; and *In re Harmer*, 61 B.R. 1, 9 (Bankr. D. Utah 1984).

The 1984 Summary contains omissions and errors similar to the 1983 Summary. Dunyon, likewise, gave the 1984 Summary to Waterworth knowing he would use it for the bank's purposes. When Dunyon gave the 1984 Summary to Waterworth, he had been released from the hospital for approximately two weeks. He had suffered significant injuries that still leave him in a wheelchair. He was on heavy medication. Nonetheless, Dunyon attempted to run his business in this condition. He implied that the 1984 Summary was unchanged from December 31, 1984, to July 8, 1985 by placing that date upon the document and signing it. Under all the circumstances, the court determines that publication of the 1984 Summary under these conditions involved a reckless disregard for the truth. Based on Dunyon's reckless publication of the 1984 Summary, the court will also infer his intent to deceive BancBoston with his 1984 Summary.

B. COLLATERAL AGING REPORTS

The court has found that the collateral aging reports forwarded to BancBoston up until July of 1985 were materially false as they related to Ryan's financial condition and were reasonably relied upon by BancBoston. The court must now determine whether Dunyon, as opposed to Ryan, published those collateral reports during this period with an intent to deceive BancBoston.

What was Dunyon's involvement with those reports from 1983 to July of 1985? Bowman, Ryan's chief financial officer during this time, testified that he met with Dunyon to review the accounts receivable and past due accounts. He testified that

Dunyon knew of the consignment accounts and of the barter accounts. Bowman also testified that he believed that the ineligible accounts were "backed out" of the weekly collateral reports forwarded to BancBoston. Bowman testified that he did not know if Dunyon was aware of the accounting problems, but believed he was. Dunyon denies that he was aware of the impact of these accounts on BancBoston. A copy of the collateral reports were forwarded to Jack Ryan and Dunyon, but the actual numbers for the reports were prepared by Ryan staff and given to Bowman to fill out the reports.

Dunyon did not prepare the reports or supply the numbers. Dunyon testified that he knew of irregularities in the accounting procedures, but did not know of their effect upon the advances until after his accident in April of 1985. In the spring of 1985, he requested various reports from Jack Ryan but did not receive the reports. He also testified he was not aware of the January 1985 audit results, though he was aware that auditors were present at the Ryan offices. The evidence is also clear that Jack Ryan was primarily responsible for the inflation of the collateral aging reports.

Although BancBoston has attempted to establish that Dunyon knew, or should have known, about the irregularities in the accounting procedures prior to April 1985, they have failed to show by clear and convincing evidence that Dunyon knew of the accounting irregularities and of their effect on BancBoston's advances sufficiently to form an intent to deceive. Further, BancBoston failed to establish that Dunyon caused the false aging reports to be prepared.

Credible evidence is also insufficient to support a finding that during Dunyon's hospitalization from April 1985 to July 1985, he had any control over Ryan and that he intended and caused the false reports to be forwarded to BancBoston. Though he did communicate with employees of Ryan while hospitalized, insufficient evidence exists that he was familiar enough with the reports that he caused them to be published or that he had sufficient knowledge of their actual content to be able to form an intent to deceive. Based on this evidence, the court is unable to infer the intent of Dunyon to deceive BancBoston.

The court need not determine Dunyon's intent regarding the collateral aging reports after July of 1985 because of the previous finding that any reliance upon the reports by BancBoston was unreasonable in light of their knowledge of the errors in the accounting system. The collateral aging reports were not used after July of 1985 as a basis for advances of funds, rather only the amounts actually collected were used. Further, the agreement to allow Ryan to retain sufficient funds to operate was not based upon the collateral aging reports, but upon BancBoston's own desire to collect the maximum amount on a bad loan.

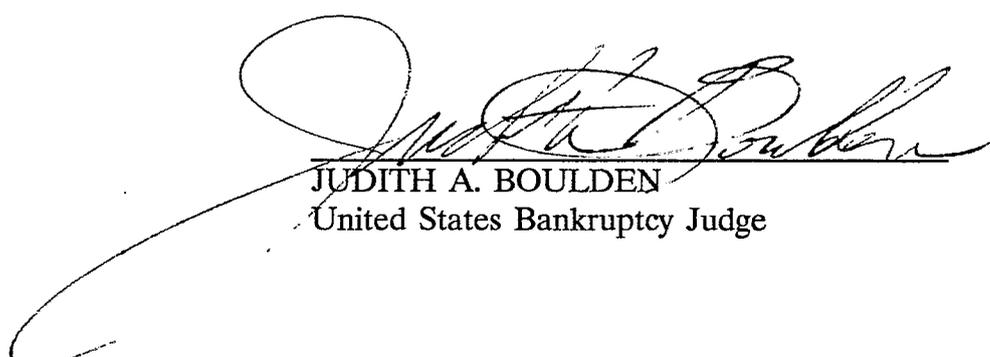
CONCLUSION

BancBoston has shown by circumstantial evidence and stipulated facts that Jack Ryan intended to defraud BancBoston by overinflating accounts receivable and inventory in order to obtain money from it. However, Jack Ryan is not the defendant in

this action. Insufficient evidence exists to establish that BancBoston reasonably relied on the 1983 and 1984 Summaries of Dunyon in advancing money to Ryan. Further, BancBoston has failed to tie Dunyon to the false collateral aging reports with sufficient knowledge of their inaccuracies to form an intent to deceive BancBoston. The financial arrangement after August of 1985 was merely an attempt to collect a bad loan and Dunyon's actions played little part in the managerial decisions of BancBoston.

The court, therefore, concludes that BancBoston has failed to prove by clear and convincing evidence all the necessary elements of its complaint. The relief sought in BancBoston's complaint is denied. Counsel for Dunyon is directed to prepare an order consistent with the court's ruling.

DATED this 18th day of January, 1989.



JUDITH A. BOULDEN
United States Bankruptcy Judge