UNPUBLISHED OPINION

309

See #340

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

In re: BROOKE GRANT, Debtor.	Bankruptcy Number 88B-04704 [Chapter 7]
MARY YVONNE ("BONNIE") S. HAYMOND; CLARENCE R. SILVER; LARRY R. SILVER; ROY R. SILVER; MARJORIE S. SMITH; RICHARDS G. SMITH; C. LEWIS BUTEHORN; and MAMIE R. SILVER, MARJORIE S. SMITH, and CLARENCE R. SILVER as Co-Trustees of Testamentary Trusts created by the Estate of C. W. Silver. Plaintiffs, vs. BROOKE GRANT, Defendant.	Adversary Proceeding Number 88PB-0972

MEMORANDUM DECISION AND ORDER

Richard W. Giauque, Esq. and Stephen T. Hard, Esq. of Giauque, Williams, Wilcox & Bendinger, Salt Lake City, Utah, attorneys for plaintiffs.

Richard A. Rappaport, Esq. of Cohne, Rappaport & Segal, Salt Lake City, Utah, and John B. Mason, Esq. of counsel, attorneys for defendant.

The complaint in this adversary proceeding seeks a nondischargeable judgment against the defendant in an amount exceeding $1,200,000. The plaintiffs allege the debt arose from the defendant's use of materially false written statements upon which they reasonably relied. The statements were published as part of a financial closing in which stock in a family business was sold to a corporation controlled by the defendant. The defendant personally guaranteed the corporation's payment of the purchase price. The corporation eventually defaulted on the purchase contract and the defendant could not satisfy the guarantee.

The matter was taken under advisement after sixteen days of trial spread over ten weeks. The court has reviewed the evidence, including hundreds of exhibits, judged the credibility of the witnesses, and made an independent review of applicable case law. The court has jurisdiction over this case by virtue of 28 U.S.C. §§ 157 and 1334. This is a core matter within the meaning of 28 U.S.C. §§ 157(b)(1) and 157(b)(2)(I). This court has authority to enter a final order. Now, being fully informed, the court enters its memorandum decision as provided by Bankruptcy Rule 7052.

The Shareholders and C.W. Silver Co., Inc.

The plaintiffs in this action are the former shareholders (collectively Shareholders) of C.W. Silver Co., Inc. (CWS). CWS was established in 1917 and became a major electrical contractor. The Shareholders, except for C. Lewis Butehorn (Butehorn), are the wife, sons, daughters or son-in-law of C.W. Silver, the founder of the company. Clarence R. Silver (Bud Silver), Larry Silver, and Butehorn, were shareholders, officers, and directors of CWS, had been employed by the company for years, and played a pivotal role in the transaction at issue.[1]

CWS had been a profitable company from 1976 through 1982 showing yearly profits from $130,000 to $200,000. In 1983 the company suffered a significant loss of $342,205. By 1984 the losses had been reduced to $30,291, but CWS was in a highly leveraged position and in need of a significant capital infusion.

---

1 Bud Silver was employed by or associated with CWS for over 23 years. He had been a director of CWS since 1962. He is an experienced businessman knowledgeable in finance and in making credit decisions. As the eldest of the Silver children, he exercised significant control over not only the business affairs of CWS, but over his younger brothers and sisters as well. At the time of trial he was 72 years old. During the period relevant to this action, he was approaching retirement and actively seeking a method of converting his shareholder equity in CWS into cash for his retirement. Bud Silver and his mother, Mamie R. Silver, had decided it was time for him to retire and turn the business over to his younger brother, Larry Silver.

Larry Silver worked for CWS for over twenty years. At the time of trial he was 53 years old. He graduated from the University of Utah in letters and science and was responsible for the financial operations of CWS. He was Chairman of the Board of directors of CWS, but functioned under the actual supervision of Bud Silver.

Butehorn, the only non-family Shareholder, had been president and general manager of CWS for over eleven years. He originally became affiliated with CWS in 1975 when he purchased stock in the business from the estate of Lynn Silver. Butehorn was 62 years old at the time of trial.

Some of the Shareholders initially considered selling their interests to Richard L. Smith, the grandson of C.W. Silver, and son of Richards G. and Marjorie Silver Smith.[2] Smith however said he would not retain Larry Silver as Chairman of the Board if his buyout was successful. Not all of the Shareholders were anxious to sell, but those nearing retirement or not actively involved in the business were.[3] In December of 1984, Bob Jensen, CWS's accountant discussed the potential acquisition of CWS with another of his clients, Brooke Grant (Grant), the defendant in this action.

Grant and the Hanover Companies

Grant was an entrepreneur engaged in the acquisition and turnaround of troubled companies. He is well educated, having received a B.A. in economics and a J.D. from Stanford University. He is a CPA and worked as a tax accountant with Touche, Ross & Company. He was the former Chairman of the Board and President of Tracy Collins Bancorp, the holding company for Tracy Collins Bank & Trust. He had also been Chairman of the Board and President of Talcot Corporation, a factoring company listed on the New York Stock Exchange.

---

2 Richards G. Smith was a shareholder and had been employed by CWS for more than 20 years. His wife, Marjorie S. Smith, a daughter of C.W. Silver, is also a shareholder in CWS.

3 Butehorn on the other hand wanted to keep his shares, or even purchase more because he believed the company had turned around in 1984. Butehorn received an offer to purchase his stock from Larry Silver. Apparently, the offer was initiated as a result of Smith's challenge to Larry Silver's position if Smith acquired the stock. Larry Silver also brought the competing offer of the Hanover Companies to Butehorn's attention. A great deal of activity relating to liquidation of the company or its shareholders' interests occurred in late 1984. Bud Silver nevertheless continued his efforts toward converting his equity into cash by doing such things as gathering information on leveraged buyouts.

In 1984 and 1985, Grant was a majority shareholder and Chairman of the Board of a group of related entities collectively referred to as the Hanover Companies. Among the Hanover Companies were Hanover Western, Hanover Energy, Inc., Hanover Energy Partnership, Hanover Lantrust, and Hanover Financial, Inc. The Hanover Companies were engaged in a wide variety of enterprises, including asset acquisition and land and energy development.[4]

Grant ran the Hanover Companies with the aid of David Jerman (Jerman). Jerman was Grant's protege and Grant intended that Jerman would eventually run the Hanover Companies. In return for Jerman's assistance, Grant conveyed to him a 49% ownership interest in the Hanover Companies. At the times relevant to this case, Grant and Jerman were the sole shareholders or general partners of the Hanover Companies.[5] A falling out eventually occurred between Grant and Jerman.[6] As a result, Jerman left Grant and the Hanover Companies to return to graduate school in April of 1985, shortly after the CWS transaction.

---

4 Hanover Western was a holding company for industrial sales and distribution companies that manufactured or supplied such items as electric motors, steel, and wood products. Hanover Energy, Inc. and Hanover Energy Partnership were engaged in developing drilling programs in the oil and gas industry. Hanover Lantrust, Inc. invested in and developed real estate ventures including projects in Park City, Utah. Hanover Financial, Inc. engaged in investment and mortgage banking, and in fund raising.

5 Although the Shareholders argued otherwise, the court finds that Grant's wife, Sally, lacked any direct ownership interest in the Hanover Companies.

6 Grant indicated Jerman was a great weakness in the Hanover Companies and had no grasp of financing. Jerman indicated Grant attempted to totally control his business and personal affairs. The precise cause of the rift is unimportant except to the extent it was based primarily on personal conflicts and not as a direct result of this transaction. The estrangement does have a bearing upon the credibility of both Grant's and Jerman's testimony.

Hanover Western had previously acquired EMSCO, an electrical company similar to CWS. Grant believed that as a result of Hanover Western's managerial expertise, EMSCO was made profitable. In late 1984, EMSCO had completed several consecutive months of profitable operation. Grant envisioned that through his expertise he could turn CWS around and return it to profitability, with CWS complementing EMSCO in the Hanover Companies' general scheme.

Hanover Energy, Inc. had extensive oil and gas reserves which were independently evaluated by S & W Petroleum Consultants, Inc. (S & W). The value of the proven and probable reserves as reflected in the records of Hanover Energy, Inc. was updated periodically according to S & W's engineering reports.[7] In late 1984 and early 1985, S & W forwarded to Grant appraisals of Hanover Energy, Inc.'s interest in the net remaining reserves based upon a starting price of between $30 and $26 per barrel. Grant used these figures as a basis for the valuation of his interest in Hanover Energy.

In late 1984, Hanover Energy acquired the Sand Creek oil field. The potential for development of this field was significant. In February of 1985, S & W valued the discounted cumulative cash flow of the Sand Creek field at $24,604,300 based upon a price of $24 per barrel. Costs to develop the new field were estimated to be $2,586,000. These values were not reflected in Grant's or Jerman's personal financial statements. Grant relied upon S & W's valuations and believed that taking into consideration its large

---

[7] Grant and Jerman further discounted the figures received from S & W's appraisals in order to reflect conservative values in their financial statements. Jerman testified some of S & W's figures were discounted as much as 50%.

proven and probable reserves in both the Sand Creek field and others, Hanover Energy showed a substantial positive net worth.

However, in order for the oil and gas reserves to provide a positive cash flow, it was necessary to infuse large amounts of capital to develop the wells and place them into production. Hanover Energy Partnership and Hanover Energy Inc.'s internal financial statements showed significant sums, listed as expenses, which were in fact capital infusions invested in order to realize upon the reserves. Partnership entities were to absorb the losses (or expenses) and pass them through to investors. Even if those expenditures were capitalized instead of expensed, the entities were not producing a significant positive cash flow on a regular basis. Instead, they were using any available cash produced, as well as borrowed funds, for asset acquisition and development.

Hanover Lantrust had various real estate interests throughout Utah. Some of these holdings were income producing and showed a positive cash flow. Developments in the Park City, Utah area included an inventory of units for sale as well as uncompleted units. Hanover Lantrust anticipated further profitable developments in the area. Once again however, realization of a profit from the real estate developments required large capital infusions and substantial debt service.

Grant funded a portion of the companies' capital needs from his personal resources. He utilized $5,000,000 in funds generated from the sale of his interest in Tracy

Collins Bank. Grant also received $4,500,000[8] from the settlement of litigation against Ian Cummings in favor of Grant and his wife Sally. In addition, the Hanover Companies had a substantial line of credit available and actively sought to raise capital from outside investors. The efforts at fund raising were not as successful as hoped, and even though these projects required large amounts of capital, at the time of the CWS transaction Grant believed the overall value of the Hanover Companies' assets exceeded any outstanding indebtedness. The enterprises were however, highly leveraged with a modest, if any, positive cash flow.

Economics of the Time

Notwithstanding Grant's efforts, the Hanover Companies still ran a risk founded in the speculative nature of the investments made. The Hanover Companies' continued success depended on a continuing strong economy to support their ongoing activities. However such was not to be the case. The oil and gas industry suffered a significant downturn in early 1985 at approximately the same time as the closing of the CWS transaction. The price per barrel of crude oil dropped from $30 in 1984 to $26, and held at or about that price into 1985. The price then dropped further to $24 per barrel. The decline in the price per barrel made the extraction of oil and gas reserves unprofitable.

---

8 Grant testified he received the money on August 31, 1984, and used the funds to pay off his Zions Bank personal line of credit and all business lines of credit. $1.5 million was also placed in bank repos.

A similar economic decline occurred in the real estate market in 1985. This decline was pronounced in the Park City, Utah area where condominium development for the ski industry was especially hard hit. Grant attributed part of this decline to the 1986 Tax Reduction Act.

The crash of the oil and gas industry and the real estate market coincided to devalue the assets of the Hanover Companies and inhibit further growth. The highly leveraged position of the Hanover Companies ultimately created severe cash flow problems resulting in an inability to debt service its obligations. Eventually, all the Hanover Companies became insolvent.

The Transaction

Bud Silver wanted to sell his stock in CWS and negotiated with Richard L. Smith for the purchase of the company during the latter part of 1984. The attorney for CWS, Craig Carman (Carman)[9], participated in these negotiations. Smith's offer of $2.08 per share was less than the Shareholders had hoped for.[10] CWS's accountant thereafter approached Grant to inquire whether the Hanover Companies were interested in acquiring CWS.

On December 11, 1984, Bud and Larry Silver, Grant, and Jerman met to discuss the sale of CWS to the Hanover Companies. Bud Silver outlined terms and

---

9 Carmen was a CPA as well as an attorney.

10 The Smith offer was not actually rejected until well into January of 1985.

conditions similar to the sale contemplated with Richard L. Smith, except that the sales price was increased to $3.00 per share. The terms of the sale included a signing bonus of $3,000 for each Shareholder if the sale was consummated. The sale was also conditioned upon the approval of Onan Corporation (Onan), a major supplier to CWS. The initial meeting was generally successful and the parties informally agreed in principle to many of the terms and conditions of the sale.

Notice was then given to the balance of the Shareholders that the Hanover Companies were to make an offer for the purchase of the shares of CWS. A meeting was held at the Hanover Companies' offices on December 14, 1984, between the Shareholders, Grant, and Jerman. At that meeting the parties introduced themselves and generally told of their personal and business backgrounds. A promotional brochure regarding the Hanover Companies was given to the Shareholders. It contained broad introductory comments regarding the business of the Hanover Companies but contained no specific information regarding their financial condition other than the general statement that the companies were profitable. Grant made a lengthy presentation to the Shareholders regarding himself and his companies. The content of the presentation was discussed extensively at trial. Suffice it to say that Grant sold himself and his companies to a willing audience by reciting his business prowess and family connections. He described his net worth to be in excess of $22 million and Jerman's net worth to be in excess of $8 million.

A Letter Agreement, drafted by the Hanover Companies' legal staff but patterned after the Richard L. Smith offer, was presented to and signed by the

Shareholders at the December 14, 1984, meeting. The document was not reviewed by Carmen until after it was signed by the Shareholders. Once Grant had baited the hook, he set it by delivering a signing bonus of $3,000 to each Shareholder. The Shareholders left the December 14th meeting with checks in hand.

The Letter Agreement was contingent upon the approval of Onan and a due diligence inquiry by Hanover Western, the acquiring company. Several additional conditions of sale were not resolved by the Letter Agreement but were viewed by the Shareholders as being part of the consideration for the sale of their stock. These conditions included employment and consulting contracts for some of the Shareholders, insurance benefits, covenants not to compete, lease arrangements, and options to purchase the premises. Grant and Jerman, who were to personally guarantee the purchase, had not yet signed the guarantee. The Letter Agreement did not reflect all of the major terms of the contract.

In light of the contingent nature of the agreement, a series of transactions aimed at consummation of the actual sale took place between mid December of 1984 and the closing in mid February of 1985. The Shareholders delivered the Letter Agreement to Carmen for his review and the Hanover Companies turned drafting of the final contract over to their counsel. Hanover Western also began its due diligence inquiry by reviewing the operations and financial condition of CWS.

An extension to delay the closing date until 10 days after Onan's approval, but no later than March 31, 1985, was executed by the parties on December 26, 1984.

In order to gain Onan's approval, Hanover Western developed a presentation for Onan describing Hanover Western's qualifications and business plan for CWS. Grant, along with Bud and Larry Silver, presented the information to Onan seeking approval of the sale in early January of 1985.

When the principals returned from the January, 1985 Onan presentation, a meeting occurred between the management and staff of CWS and Grant. Grant introduced himself and his management team, described his anticipated program for CWS, and assured the staff he was people oriented and interested in their welfare. On January 16, 1985, a resolution of the Shareholders placed Grant and Jerman on the CWS Board of Directors. Grant also replaced Larry Silver as Chairman of the Board.

Grant immediately proceeded to change the management of CWS. On January 16, 1985, Jerman fired Butehorn as president of CWS with the consent of all the Shareholders except Bonnie Haymond. Hanover Western replaced Butehorn with Dick Coon. Coon, who had been approved by Onan, was paid by Hanover Western to come to Salt Lake City and manage CWS. Hanover Western also fired Stuart Christensen and Richard Tonge, other key management personnel. These changes were accomplished with the consent of Bud and Larry Silver, who maintained control of three of the five members of the Board of Directors.[11] Hanover Western proceeded to infuse new capital into CWS

---

[11] Bud Silver indicated at trial he thought such aggressive actions on the part of Hanover Western were a little out of step, but he didn't object because he didn't want to throw a monkey wrench into the sale.

through a line of credit at Zions First National Bank (Zions Bank). Hanover Western eventually invested over $200,000 in cash in CWS.

Though Hanover Western had assumed management of CWS, the final documents concerning the sale were not yet drafted and Carmen proceeded with the task during January and February of 1985. Carmen, together with Butehorn and Bud and Larry Silver, began to explore methods to provide more security for the payment for the shares of CWS by Hanover Western. Grant encouraged the Shareholders to contact Zions Bank for financial information regarding the Hanover Companies and gave permission to Zions Bank to release such information. Butehorn received negative information from Grant Misback, an officer at Zions Bank, that the Hanover Companies were highly leveraged and may be incapable of making substantial capital infusions into CWS. Conflicting reports were received from Thomas C. Swegle, also of Zions Bank, indicating that the Hanover Companies were adequately capitalized and profitable. The Shareholders were unable to obtain a current Dun and Bradstreet report on the Hanover Companies.[12]

After discussing several alternatives with Carmen on January 28, 1985, the Shareholders decided that in addition to the personal guarantees previously agreed upon, they would require signed personal financial statements from both Grant and Jerman. The financial statements would have to be certified by the signor as true and correct.

---

12 They did eventually obtain one report which indicated a slow payment history.

This request, as well as other suggestions for securing payment of the purchase,[13] was flatly rejected by Grant at a meeting on January 28, 1985. Grant indicated the Letter Agreement did not call for additional forms of security, that he did not want investigation into his personal affairs, and that his personal guarantee should be sufficient. Grant simply did not feel his personal financial statement was any of the Shareholders' business. At the meeting on January 28, 1985, Grant did however, read to the Shareholders certain data from his personal financial statement dated September, 1984. He described the value of certain assets and discussed some of his contingent liabilities. Grant indicated the Hanover Companies had access to a substantial line of credit which had been drawn against.

Grant recited this information to the Shareholders in support of his allegations of net worth. Grant did not indicate to the Shareholders the extent to which the Hanover Companies experienced cash drains in order to fund their expansion. It appears that none of the Shareholders made any specific inquiry regarding the financial condition of the Hanover Companies, nor did they request any written financial information regarding the same.

Since Grant adamantly refused to deliver his or Jerman's personal financial statement to the Shareholders, negotiations stalled. Hanover Western was operating CWS. Onan was *still* considering approval of the takeover. The president of CWS had been

[13] The Shareholders suggested a corporate bond, holding the stock in escrow, pledging other assets as collateral, a bank guarantee, a letter of credit, the guarantee of Sally Grant, or a life insurance on Grant.

fired and replaced by an outsider, and no agreement by Grant to the Shareholders' demands for a personal financial statement appeared forthcoming.

The parties finally reached a compromise in which Grant and Jerman would allow the Shareholders to review copies of their financial statements prior to the closing. The signed originals were then to be delivered to the Shareholders at closing by giving the statements to Carmen. They were to be held solely by Carmen and not photocopied or reproduced. On February 11, 1985, Wayne Watkins, a Hanover Company employee, delivered copies of Grant's and Jerman's financial statements dated January 31, 1985, to a meeting of the Shareholders. Carmen and some of the Shareholders reviewed the financials. The Shareholders passed the financial statements from one to another with little comment or discussion. Those who reviewed the financial statements were primarily interested in the bottom line.[14] Bonnie Haymond did not attend the meeting, though her husband George Haymond did.

Onan eventually gave its approval for Hanover Western's purchase of the Shareholders' stock in CWS. An agreement regarding employment and consulting contracts, insurance benefits, lease arrangements, and covenants not to compete was reached. The closing took place in Carman's office on February 15, 1985, though last

---

[14] The January 31, 1985, financial statement of Grant differed from the information recited by Grant in the January 28, 1985, meeting. It indicated a decrease in case from $1,400,000 to $135,000 and an increase in receivables from $3,322,000 to $6,172,000. If any of the Shareholders had questions regarding the content of the financials, those questions were not communicated to Grant, Jerman, or anyone able to answer them at the Hanover Companies. No one asked for additional financial information regarding the Hanover Companies, to see financial or operating statements, or to review real estate or engineering appraisals regarding oil and gas reserves.

minute wrangling occurred over insurance benefits. Grant was not present at the closing but was represented by Jerman. The agreement, including a personal guarantee previously signed by Grant and Jerman, and the originals of Grant's and Jerman's financial statements were delivered to Carmen.

The sale complete, Hanover Western now owned and operated CWS and proceeded to attempt to make CWS profitable. To assist in the turnaround, Hanover Western obtained a $2,500,000 line of credit from Zions Bank guaranteed by Grant.

<u>The Financial Statements</u>

Grant's financial statement dated January 31, 1985, (Financial Statement) was captioned as the statement of Brooke and Sally Grant, though it was signed only by Brooke Grant. It was a two page unaudited balance sheet that contained no footnotes or explanatory cover letter. It listed a total net worth of $21,516,038. Assets not related to the Hanover Companies totaled $4,902,000. Notes receivables owed to Grant from the Hanover Companies totaled $4,350,000. Investments in Hanover corporations and partnerships totaled $11,186,163 and investments in Hanover real estate were valued at $1,963,875. Total liabilities consisted of accrued estimated income taxes of $350,000 and various mortgages debited at $536,000.

Included under the heading related to investments in corporations and partnerships was an entry for Hanover Energy Corporation. It listed proven reserves at

80% of value totaling $3,986,163 and probable reserves valued at $7,200,000. The Financial Statement did not include the Sand Creek field.

No line items or footnotes specifically referred to any corporate obligations on which Grant was a guarantor. The Financial Statement had "netted out" the value of certain of Grant's interests in the Hanover Companies by first determining the value of the corporate asset, deducting any encumbrances, and listing only the balance on the personal statement.[15] In fact, Grant had personally guaranteed various obligations not only of the Hanover Companies, but others as well.[16] The total amount of those guarantees was between $6,000,000 and $10,000,000.

Jerman also delivered his personal financial statement to the Shareholders at closing. It showed a positive net worth of $8,461,916. The bulk of the assets, or $8,330,366, was comprised of Jerman's interest in the Hanover Companies. He listed liabilities of $500. Jerman paid no cash for his interest in the Hanover Companies, but was given the interest by Grant in return for his efforts in management of the Hanover Companies. When Jerman left the Hanover Companies in April of 1985, Grant cashed

[15] Grant kept his personal financial statements on computer within the Hanover Companies. They were updated periodically and numerous financial statements dated from January of 1984, forward were received into evidence. None of the financials were audited and all were "netted out". The values placed on the assets were updated according to current real estate appraisals and S & W's valuations of the oil and gas reserves. It was the custom of Grant and his companies to produce voluminous financial data on a regular basis and to net out all personal financial statements.

[16] Grant had guaranteed obligations owed to Mountain West Savings & Loan, First Interstate Bank, Commercial Security Bank, Prudential, Valley National Bank, Zions Bank and Chase Manhattan. In addition, Grant guaranteed debts for Lake Power Machinery, Barry Hansen and CLL Partnership.

out Jerman's interest in the Hanover Companies for $45,993.05. Jerman was willing to accept that sum in return for release of his obligation to work for Grant and the Hanover Companies, and for the execution of a release, indemnification and settlement agreement. The value of assets of the Hanover Companies at the time Grant's and Jerman's Financial Statements were issued were sufficient to satisfy the indebtedness against them, including those obligations on which Grant was personally obligated.

In 1985 and 1986 the price of oil dropped and the value of the oil and gas reserves, both proven and probable, diminished considerably as a result of the lower profit margin relative to the cost of extraction. In addition, the value of the Park City and other real estate developments decreased to the point that the loans which Grant had personally guaranteed had insufficient collateral to support them. In 1985 Grant listed contingent liabilities on his financial statements because the assets securing the indebtedness were insufficient to satisfy the obligations.

<u>The Default</u>

Upon closing the sale of the Shareholders' stock in CWS on February 15, 1985, Hanover Western paid 20% of the sales price, or $225,000, to the Shareholders. The balance of the payments were to be made in 7 equal yearly increments. On February 21, 1986, Hanover Western paid to the Shareholders $183,673.72. However, when the 1987 payment came due, Hanover Western requested that the Shareholders accept an interest only payment.

In response, the Shareholders demanded Grant's current financial statement. Grant supplied a financial statement dated January 31, 1987. It disclosed total assets of $9,540,189, liabilities of $4,854,558, and a net worth of $4,685,631. Grant now disclosed contingent liabilities of $19,880,000. The Shareholders thereupon accelerated the remaining amounts due under the promissory notes.

Grant eventually filed a voluntary petition under chapter 7 on August 12, 1988. The Shareholders' expert witness testified the amount due on the defaulted promissory notes for the purchase of their stock, including accrued interest at the default rate, was $1,312,828.00.

Issue Presented

The issue presented is whether the facts adduced at trial demonstrate that Grant obtained money, property, credit, or services by the use of a materially false written statement respecting Grant's or an insider's financial condition. The statement must have been made by Grant with the intent to deceive and must have been reasonably relied upon by the Shareholders in agreeing to sell their stock in CWS. After due consideration it is the opinion of this court that: (1) all the Shareholders, with the exception of Butehorn and Bonnie Haymond, have established by clear and convincing evidence a prima facie case for nondischargeability; (2) Grant has asserted credible defenses; (3) Grant did not, within the purview of 11 U.S.C. § 523(a)(2)(B), obtain money or property from the

Shareholders by the intentional use of a materially false written statement; and, (4) Grant's debt to the Shareholders is discharged in bankruptcy.

Discussion

11 U.S.C. § 523(a)(2)(B)[17] provides that a discharge does not affect any debt incurred in obtaining money or property by use of a statement in writing

> (i) that is materially false;
>
> (ii) representing the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive....

The burden of proof is on the Shareholders and each Shareholder must prove his or her case by clear and convincing evidence.[18] *John Deere Co. v. Gerlach (In re Gerlach)*, 897 F.2d 1048, 1052 (10th Cir. 1990); *and Driggs v. Black (In re Black)*, 787

---

[17] The Shareholders originally plead 11 U.S.C. § 523(a)(2)(A) as well as 11 U.S.C. § 523(a)(2)(B). They asserted that statements made by Grant regarding his financial condition, as well as the management and expertise of the Hanover Companies, were relied upon by them and were intentionally and materially false. Since the majority of the statements related to the financial condition of Grant or an insider of Grant, the court dismissed the Shareholders' claims for relief. 11 U.S.C. § 523(a)(2)(A) specifically excludes statements made regarding financial condition. The remaining portion of this claim for relief relating to the management or other expertise of the Hanover Companies was abandoned by the Shareholders.

[18] This is not a class action suit, but a case with multiple plaintiffs. Each plaintiff must present evidence sufficient to sustain his or her claim for relief, though certain evidentiary matters such as falsity and materiality may be common to each case.

F.2d 503, 505 (10th Cir. 1986). Objections to dischargeability are narrowly construed. *Black*, 787 F.2d at 505.

To establish a prima facie case the Shareholders must show that Grant obtained money, property, credit, or services by the use of a materially false writing concerning his or an insider's financial condition upon which the Shareholders reasonably relied. The element of intent to deceive will be presumed once the Shareholders have carried the burden of persuasion on all other elements of their prima facie case. *North Park Credit v. Harmer (In re Harmer)*, 61 B.R. 1 (Bankr. D. Utah 1984). The burden then shifts to Grant to present evidence which "by the mere introduction of evidence that rebuts the presumed fact of intent will cause that presumption to disappear." *Harmer*, 61 B.R. at 4.

The Shareholders assert the operative written statements regarding Grant's or an insider's financial condition consist of Brooke and Sally Grant's Financial Statement dated January 31, 1985, Jerman's financial statement, and a promotional brochure describing the Hanover Companies. It is uncontested that Grant gave his and Jerman's financial statement to the Shareholders at the closing to support his personal guarantee and to obtain the Shareholders' stock in CWS for Hanover Western. By so doing, credit was extended to Hanover Western and Grant from the Shareholders by agreeing to accept payment for their stock over a seven-year period and by accepting promissory notes from

Hanover Western which were personally guaranteed by Grant.[19] The Financial Statements constitute a writing regarding Grant's and Jerman's financial condition within the meaning of 11 U.S.C. § 523(a)(2)(B).[20] The Shareholders, at times, have also alleged the promotional brochure was a writing within the meaning of 11 U.S.C. § 523(a)(2)(B).

Material Falsity

Much evidence was presented at trial to support the Shareholders's contention that Grant's Financial Statement was false and that the falsity was material. The Shareholders complain of three major omissions, concealments, and understatements in the Financial Statement: (1) the omission of major contingent liabilities; (2) the "net equity" basis of computing the Financial Statement; and, (3) the omission of negative information affecting interpretation of the Financial Statement or the valuation of assets. It is well settled "that the omission, concealment, or understatement of any of the debtor's liabilities constitutes a 'materially false' statement." *Harmer*, 61 B.R. at 5.

In order for the Financial Statement to be materially false it must be "one which paints a substantially untruthful picture of the debtor's financial condition by misrepresenting information of the type which would normally affect the decision to grant credit." *John Deere Co. v. Iverson (In re Iverson)*, 66 B.R. 219, 224 (Bankr. D. Utah 1986). At the time the Financial Statement was published, Grant was personally liable on

[19] *See, Gerlach*, 897 F.2d at 1050 n.1.

[20] Jerman is an insider as defined in 11 U.S.C. § 101(30)(A)(iii) if he is a general partner of Grant.

numerous obligations of the Hanover Companies, as well as the obligations of others. Though the exact figures were contested, it is apparent that Grant was contingently liable for amounts between $6,000,000 and $10,000,000.

Each side presented an expert witness in the field of accounting to assist the court in determining whether and to what degree these contingent liabilities should have been listed in either the body of the Financial Statement, footnoted, or not listed at all. According to the expert testimony, it is apparent that no specific guidelines are provided by the accounting profession for an unaudited personal financial statement such as that at issue except that the statement should not be misleading.

However, some general guidance can be distilled from the expert testimony. An unaudited statement may contain any information as long as it does not mislead the reader. It is acceptable when listing a personal ownership interest in a corporation or partnership to list the value of the interest held by the individual. This figure may be calculated by valuing the assets and then deducting the liabilities. Once "netted out", the individual's interest is then listed on the personal financial statement. It is inappropriate to list the assets or liabilities of an entity in the body of a personal financial statement if the proceeds of a loan were given to the entity.

If the individual has personally guaranteed corporate or partnership debt, it is not necessary to list the debt in the body of the personal financial statement or to footnote such guarantees if the corporate or partnership assets are sufficient to service the debt. However, if failing to list the contingent corporate or partnership liabilities in the body of the financial statement or failing to footnote their existence would mislead the reader, such an omission is improper. If the debt is primarily owed by a close corporation it is more essential to fully disclose contingent liability.

The court must consider the financial condition of Grant, Jerman, and the Hanover Companies at the time the transaction took place in February, 1985. This inquiry involves both a conclusion regarding the apparent net equity of the entities, as well as their cash needs and availability.

The Hanover Companies had substantial assets. The appraised value of those assets was sufficient to cover the indebtedness for which they served as collateral. Hanover Lantrust was developing large tracts of real estate in the Park City, Utah area, though time and money were required before those projects would produce significant cash flow. Hanover Energy had independent appraisals of substantial proven and probable oil and gas reserves which were conservatively valued and which Grant discounted further. It had recently acquired the Sand Creek field which showed great promise, though time and money were needed to develop the reserves before they would produce significant cash flow. EMSCO had begun to show a profit. The Hanover Companies also had lines of credit available to finance short term needs. Therefore, the valuation of assets placed on both Grant's and Jerman's financial statements were not false as they related to the value of the ownership interest which each held in the Hanover Companies at the time the financial statements were issued.

While the assets had significant value and potential, a large cash infusion was necessary to realize that potential. The Hanover Companies' projects were draining cash, both from Grant personally and from independent financing sources. Efforts at fund raising were not as successful as expected. Although some of the projects were starting to show self-sufficiency, in the main they were highly leveraged and not producing a consistent positive cash flow. The amount of cash needed to meet the ongoing fixed obligations of the Hanover Companies as well as develop the various projects was substantial.

The financial condition of the Hanover Companies must be viewed as a whole instead of on a project by project basis. The Hanover Companies asset base in undeveloped or uncompleted projects, their leveraged cash position, and rapid expansion all indicated a potential inability to fund the various projects if there was an economic downturn. At the time Grant's Financial Statement was published, there existed a reasonable likelihood there would be insufficient cash available to the primary obligor to service one or more of the obligations personally guaranteed by Grant. If that occurred, the highly leveraged position of the Hanover Companies would in turn likely produce a default on obligations guaranteed by Grant.

Providing a "netted out" financial statement with no footnotes or other indication of the extent of Grant's contingent liability was misleading in light of the potential for default, the cash drain, the closely held nature of the entities, and the undeveloped nature of the assets of the Hanover Companies. The extent of the contingent liability would have influenced an informed investor, and failure to disclose the information produced a financial statement that did not portray Grant's actual financial condition.

The potential for default of the primary obligors required that Grant indicate on his personal Financial Statement the extent of his personal contingent exposure in order to avoid misleading the Shareholders. The amount of the personal guarantees in relation to the net assets set forth in the Financial Statement is significant and material, both in dollar amount and in proportion. Though the omission of any one guaranteed loan by itself may not have made the Financial Statement false, "[v]iewing the misrepresentations contained in the financial statement as a whole, rather than separately, the financial statement is materially false." *Fentress County Bank v. Lambert (In re Lambert)*, 64 B.R. 170, 176 (Bankr. E.D. Tenn. 1986).

The Shareholders also assert Grant's ownership interest in the assets listed on the Financial Statement was materially false. The Financial Statement indicated that the assets and liabilities of both Brooke and Sally Grant were contained therein, though the document was signed only by Brooke Grant. Grant testified that he and his wife held assets as tenants in common, having originally established their ownership interests according to the community property laws of the state of California. The Shareholders argue this admission indicates that Grant only owned half of the assets represented on the Financial Statement, thus slashing his net worth to only $11,000,000 and rendering the Financial Statement materially false. *Lambert*, 64 B.R. at 175. No evidence other than

Grant's testimony, later recanted, was received to indicate that Sally Grant actually owned one-half of Grant's interest in the Hanover Companies.[21] No evidence was presented to contradict Grant's later assertion that by mutual consent between he and his wife all of the Hanover assets listed on the joint Financial Statement were available to support the personal guarantee.

The Shareholders assert several additional facts prove the Financial Statement's material falsity. They argue that information regarding the negative cash flow of certain of the Hanover Companies should have been included. They also argue that the method of valuing proven and probable reserves should have been disclosed. Expert testimony at trial did not indicate that the writing complained of should have included such information. Information of this nature may have been appropriate for the corporate or partnership financial statements, but inclusion on an unaudited personal financial statement is not required.

Grant's failure however, to list his contingent liabilities arising from his personal guarantees constitutes a material omission from the Financial Statement. This omission renders the Financial Statement materially false within the meaning of 11 U.S.C. § 523(a)(2)(B). Jerman's financial statement was not materially false, reflecting as it did

---

21 Grant testified that all assets except Sally Grant's inherited property were held 50/50 between he and his wife. He later indicated he meant that division for tax purposes, and because generally he considered Sally an equal partner in his ventures. No deeds, titles or other indication of Sally Grant's ownership of the Hanover assets listed on the joint Financial Statement were received into evidence. Some of the Shareholders indicated they had assumed Sally Grant's interest was only in household or personal property.

a reasonable value of his interest in the Hanover Companies. Jerman had no contingent liability at the time of closing which should have been included in his financial statement. The promotional brochure, disclosing in general terms the activities of the Hanover Companies, is too broad and vague to be considered by this court to be materially false or to directly relate to the financial condition of the entities. Therefore, the court need not analyze these two documents further.[22]

Reasonable Reliance

Grant urges that the Shareholders could not have reasonably relied upon his Financial Statement because the Letter Agreement executed by the parties on December 14, 1984, was a final binding contract. Grant likens the Letter Agreement to an earnest money receipt and offer to purchase, binding upon the parties under Utah law. *Reed v. Alvey*, 610 P.2d 1374 (Utah 1980); *and, Bunnell v. Bills*, 368 P.2d 597 (Utah 1962). Grant's theory is that if the Letter Agreement was binding as of December 14, 1984, and the Financial Statement was not produced until February of 1985, the Shareholders could not have relied upon it in making their decision to sell their shares to Hanover Western. The Shareholders' decision to sell was ostensibly made at the time they signed the Letter Agreement.

---

22 Nor was there any reliance by the majority of the Shareholders upon information contained in the brochure. The information was so general and promotional that reliance, if there had been any, was not reasonable.

Based upon the extraneous evidence produced at trial, the court rejects this argument. *Reed*, 610 P.2d at 1377. Such an interpretation is contingent upon an agreement having been reached between Grant and the Shareholders setting forth with clarity the parties, the subject matter, and the consideration. *Nixon & Nixon, Inc. v. John New & Assoc.*, 641 P.2d 144, 146 (Utah 1982). Such was not the case. Employment and consulting agreements, insurance benefits, and covenants not to compete remained to be negotiated. These were not terms of contracts to be entered into in the future, but were integral parts of the total consideration given by the Shareholders at the time of sale. *Bunnell*, 368 P.2d at 600.

It is not necessary that all terms of the agreement be set forth in writing to create a binding contract, but they must be agreed upon or otherwise generally ascertainable. The items which had not been fully negotiated between the Shareholders and Grant were not "matters which the law makes certain or complete by presumption, rule or custom and usage". *Reed*, 610 P.2d at 1378. The Letter Agreement was not a final binding contract.

The court must next analyze whether the Shareholders relied upon Grant's materially false Financial Statement and whether that reliance was reasonable. All Shareholders, as if in chorus, testified they would not have closed the transaction if Grant had not provided his Financial Statement. Two Shareholders, however, did not rely upon the Financial Statement.

Bonnie Haymond was not at the February 11, 1985, meeting and did not review Grant's Financial Statement prior to executing the sales agreement. Instead, she relied upon the information conveyed to her by her husband who purportedly reviewed the Financial Statement. Theories of agency aside, the court is not clearly convinced the evidence supports the argument that the reliance placed by Bonnie Haymond was directly tied to Grant's Financial Statement and not merely a reliance on the interpretation placed upon it by her husband. Further, the court finds the testimony of George Haymond not particularly credible.

Butehorn did review Grant's Financial Statement at the February 11, 1985, meeting. In fact, he was probably more concerned about Grant's Financial Statement and the conditions for the sale of the stock than the other Shareholders. His decision to execute the sales agreement however, was not based upon Grant's Financial Statement, but upon his potential financial isolation should he not have completed the sale. Butehorn was summarily terminated by Grant with the knowledge and consent of the majority of the Shareholders. He was out of work and negotiating the sale of his stock with the entity which had fired him. He was unable to look for support to the other shareholders who had approved his termination. If Butehorn had not agreed to sell his shares, he would have been the sole remaining minority shareholder in CWS after it was acquired by Hanover Western. Understandably, Butehorn was not in a position to challenge the transaction. His reliance was upon the actions and decision of the other Shareholders, not upon Grant's Financial Statement.

The balance of the Shareholders reviewed Grant's Financial Statement and relied upon it, as well as other factors, in deciding to sell their shares. It is not necessary that the Shareholders rely exclusively on the false Financial Statement. It is sufficient that it is an important factor in their decision. *Central Nat'l Bank and Trust Co. v. Liming (In re Liming)*, 797 F.2d 895, 897-98 (10th Cir. 1986).

Grant asserts the Shareholders reliance was not reasonable. For their reliance to be reasonable the Shareholders must meet four tests. First, they must not have known at the outset Grant's Financial Statement was inaccurate. Second, there must have been sufficient information to present an accurate picture of Grant's financial condition. Third, the Shareholders own investigation must have revealed the likelihood that Grant's Financial Statement was correct. Fourth, they must have attempted to independently verify the information. *Iverson*, 66 B.R. at 225-26.

The remaining Shareholders knew that Grant Misback of Zions Bank had indicated the Hanover Companies were highly leveraged and unlikely to contribute capital to CWS. They also had conflicting correspondence from Thomas C. Swegle at Zions Bank indicating the Hanover Companies had the financial ability to perform. The Shareholders thereafter made no further inquiry with the Hanover Companies bank concerning Grant's or the Hanover Companies financial condition. They knew a current Dun and Bradstreet report on the Hanover Companies was unavailable. They knew Grant resisted attempts to secure his guarantee by bond, collateral or insurance. They knew he adamantly refused to publish his Financial Statement. They made little inquiry into the financial condition or assets of the Hanover Companies and did not ask to see appraisals of listed assets. They failed to discuss the alleged turnaround effectuated by the management of the Hanover Companies with the prior owners at EMSCO with whom they were familiar. Bud Silver was told that he should contact EMSCO's lawyer to obtain details about Grant, but he never did. Bud Silver drove by and observed Grant's home and the Park City projects and made a limited inquiry of his son, a geologist, regarding the oil reserves. The Shareholders also considered Grant's religious and civic affiliations.

Though the Shareholders' investigation was cursory and may be viewed in hindsight as less than prudent, that investigation must be examined in the context of the transaction.

> We note that in some cases, the courts have held that reliance upon representations of the debtor is not unreasonable simply because the creditor failed to take steps to verify the information. *See, e.g., Carini*, 592 F.2d at 381; *Matter of Garman*, 643 F.2d 1252, 1259-60 (7th Cir. 1980), *cert. denied*, 450 U.S. 910, 101 S.Ct. 1347, 67 L.Ed. 2d 333 (1981). However, those cases are distinguishable in that they involved ongoing relationships between the debtor and creditor *(Carini and Garman)*, the statements contained no information indicating that further investigation was required *(Garman)*, there was no indication that further investigation would have uncovered the falsity of the representations *(Garman)*, or the asserted failure to verify occurred *after* the loan had been made *(Carini)*. . . In *Garman*, the court noted that the bankruptcy and district courts focused on whether the decision to loan the debtor the money was reasonable, rather than whether the reliance on the debtor's statements was reasonable. [Emphasis in original.]

First Bank of Colorado Springs v. Mullet (In re Mullet), 817 F.2d 677, 681 (10th Cir. 1987). This court cannot substitute its seasoned business judgment for that of the Shareholders simply because their conduct is perceived as being "less than prudent." *McMillan v. Firestone (In re Firestone)*, 26 B.R. 706, 718 (Bankr. S.D. Fla. 1982).

The issue is whether the Shareholders had reason for further inquiry and the court determines they did not. There was no ongoing business relationship between the parties. The Shareholders are not commercial lenders as is usually found in nondischargeability actions under this section of the Bankruptcy Code. Therefore, there are no industry or company standards with which the Shareholders must comply. There is nothing on the face of the Financial Statement which would have indicated it was false. The fact that the Financial Statement was titled in both Brooke and Sally Grant's names, but did not contain Sally's signature, is not compelling. Though the Financial Statement is cursory, generally rounded to the nearest thousand, and lacks the detail a prudent investor may have desired, there is nothing on the face of the document which makes it sufficiently inconsistent so as to require further inquiry. *Capital City Bank & Trust v. Kroh (In re Kroh)*, 88 B.R. 987, 995 (Bankr. W.D. Mo. 1988).

Neither is there any indication on the face of the document to indicate that Grant was contingently liable on a substantial portion of the Hanover Companies debts, as well as the debts of others, so as to prompt further inquiry. The brief mention of contingent debt or lines of credit at the January 28, 1985, meeting was insufficient to contradict the face of Grant's Financial Statement.

Furthermore, had the Shareholders effectuated a more exhaustive inquiry into the financial affairs of the Hanover Companies, it is unlikely that inquiry would have revealed the sort of negative information adduced at trial. It simply is not customary for privately held corporations to disseminate information in the form of internal operating statements or unaudited financial statements to potential business contacts. The Hanover Companies were controlled by Grant and were unlikely to provide internal financial information to the Shareholders. The Hanover Companies financial statements which were available for dissemination, such as those given Zions Bank, were unaudited and would have required extensive accounting expertise to unravel. Grant, in fact, indicated that one of the reasons he did not wish to give his Financial Statement to the Shareholders in the first place was that they did not have the business sophistication to understand it.

The timing of the Shareholders receipt of the Financial Statement is also important. They were first allowed to review the Financial Statement on February 11, 1985, and the closing occurred on February 15, 1985. The Shareholders cannot be expected to have conducted much investigation into the specifics of the Financial Statement in such a short period. Viewing the situation in its totality, the court finds the Shareholders had no reason to believe the Financial Statement was not reasonably complete and accurate, and that their own cursory investigation had revealed the likelihood that the Financial Statement was correct. The reliance placed upon Grant's Financial Statement by the Shareholders, other than Bonnie Haymond and Butehorn, was reasonable.

Intent to Deceive

"The fundamental purpose of the intent to deceive element is to assure that only the debtor who dishonestly obtains money, property, credit, or services be punished with denial of discharge, and that the honest, though mistaken, debtor be protected." *Iverson*, 66 B.R. at 224-25. The majority of the Shareholders have established the existence of a prima facie case relating to Grant's Financial Statement sufficient to establish the presumption of intent. The court now turns to the evidence presented by Grant rebutting that element.

Grant's mere assertion without corroboration that he did not intend to deceive the Shareholders by the use of the Financial Statement is insufficient to overcome the presumption of intent to deceive established by the Shareholders' evidence. "A finding of an 'intent to deceive' is a finding of fact relating to a subjective state of mind wherein the debtor's credibility is an important factor. Proof of fraudulent intent may be inferred from the surrounding circumstances." *Harmer*, 61 B.R. at 9. Because intent to deceive is virtually incapable of direct proof it must be inferred from all circumstances surrounding the transaction. *Management Jets Int'l., Inc. v. Mutschler (In re Mutschler)*, 45 B.R. 482, 491 (Bankr. D. N.D. 1984).

The court is cognizant that Grant is both a lawyer and an accountant and is properly charged with the knowledge and insight that may be ascribed to those professions. "Where the debtor is an individual of intelligence and experience in financial matters, courts have been more inclined to hold him responsible for uttering a false financial statement." *Mutschler*, 45 B.R. at 491. Grant is also an entrepreneur having, at the time in question, an optimistic view of his ability to effectuate remarkable financial transactions. He previously had significant success with Tracy Collins, Talcot, and with his litigation against Ian Cummings. He also apparently believed that "[i]t is always the Adventurous who accomplish great things."[23] The issue is whether this state of mind can be equated to an intent to deceive in the circumstances of this case.

The Shareholders interpret Grant's conduct as a sophisticated scheme to conceal negative information from them. Even had Grant dishonestly drafted the financial statement, without more that would have been insufficient to deny his discharge. "While we certainly do not wish to encourage the type of behavior attributed to Mullet by the bank, we must reiterate that a showing of the debtor's dishonesty is simply not sufficient to prevent discharge under § 523(a)(2)." *Mullet*, 817 F.2d at 682.

The Shareholders have failed to prove that Grant was intentionally deceptive and dishonest and that he knew at the time of the transaction he had no likelihood of repaying the debt. To the contrary, the evidence indicates Grant believed, based upon his reliance on independent evaluations, that his companies could repay the obligation. Moreover, Grant had recently paid off all his business as well as his personal lines of credit.

---

23 A quote from Montesquieu appearing on the promotional brochure of the Hanover Western Companies given to the Shareholders.

This case is distinguishable from *Clancy v. First Nat'l Bank of Colorado Springs*, 408 F.2d 899 (10th Cir. 1969). *Clancy* held that if a debtor is fully aware of loans that were not disclosed on a financial statement (which Grant was) and further paints a "rather sunny" picture of his financial condition (which Grant did) when in fact he is hopelessly insolvent (which Grant was not), there is intentional deception. In this case, Grant was not hopelessly insolvent at the time of the transaction. In fact, Grant had reason to believe that the newly discovered oil reserves in the Sand Creek field would provide great profit. The fact his companies were highly leveraged and he was investing heavily in oil and gas capitalization does not indicate he believed those investments would fail, or that Hanover Western would be unable to meet its commitments. Optimism cannot be equated with intentional deceit.

The reverses which occurred which made it impossible for the Hanover Companies to meet their obligations were, to a certain extent, created by the oil and gas industry and by the real estate market, all conditions beyond Grant's control. While Grant may not have been an innocent victim of market forces, neither was he intentionally deceptive. To be intentionally deceptive Grant must have known or had reason to know at the time of the negotiations that there was a reasonable likelihood Hanover Western could not satisfy the obligation. He must further have taken action to prevent the Shareholders from receiving any negative information. To the contrary, he encouraged them to contact Zions Bank for information prior to publishing his Financial Statement.

No evidence indicates Grant refused to provide requested information to the Shareholders regarding his companies, only that he was reluctant to disclose his personal finances.

It is also important in determining Grant's intent to consider the nature of the transaction between Grant and the Shareholders. This transaction is not the type typically described in the case law concerning nondischargeability litigation between a borrower and a commercial lender. This was an arm's length purchase and sale transaction negotiated over two months time between parties of equal bargaining power with tough stands assumed by each side. It is reasonable that each side would attempt to negotiate the most favorable transaction possible.

Neither does the theory of reckless indifference or disregard of the facts apply to this case. "[A] statement need only be made with reckless disregard for the truth to make the underlying debt nondischargeable under § 523(a)(2)(B)." *Liming*, 797 F.2d at 897. Reckless conduct can provide intent. "[T]he requisite intent may be inferred from a sufficiently reckless disregard of the accuracy of the facts." *Black*, 787 F.2d at 506. Grant however did not recklessly omit the contingent liability from his Financial Statement,[24] he consciously did so on this, as well as other occasions, believing that this method of accounting was proper. Neither is his optimistic view of his projects and abilities sufficient to represent reckless conduct. He relied not only on his own evaluation, but upon the professional valuation of assets by others. Grant maintained throughout trial

---

[24] "Of course, proof that a false statement was made with actual knowledge of its incorrectness suffices." *Lambert*, 64 B.R. at 177.

that the method of "net equity" accounting and the omission of contingent liability on his Financial Statement is appropriate and that the Financial Statement is not false. On a loan by loan basis Grant's position is verified by the expert witnesses. It is only when the obligations are totalled and the magnitude of his personal exposure is evident that the omission creates a false statement. It is Grant's knowledge and intent at the time that is dispositive, not the court's after the fact conclusion.

Timing is also an important element in determining Grant's intent. For each negative financial result which occurred after the transaction at issue, there were plausible explanations at the time of the transaction. Grant was not recklessly indifferent of negative facts which should have been disclosed to the Shareholders. He simply did not perceive those facts as being negative in the context of the relative market conditions[25].

---

[25] Many cases finding intent to deceive include facts which indicate the debtor knew of the insolvency or other negative information at the time the false writing was published. In *Clancy*, the debtor knew he was hopelessly insolvent at the time of the loan and knew he had incurred other significant indebtedness only three days prior. *Clancy*, 408 F.2d at 905. In *Kroh*, the debtor and his brother incurred a number of loans within a relatively short period of time knowing their company had severe cash flow problems before an involuntary petition was filed six months later. *Kroh*, 88 B.R. at 996. In *Harmer*, the debtor knew at the time he published his financial statement that outstanding judgments of $115,000 existed. *Harmer*, 61 B.R. at 5. In *Lambert*, the debtor knew at the time of the written statement that his bank was under investigation and that no sales of its stock justified the value he placed on its shares. *Lambert*, 64 B.R. at 175. In *Avco Fin. Serv. v Lesher (In re Lesher)*, 80 B.R. 121, 124 (Bankr. E.D. Ark. 1987), the debtor failed to list existing liquidated student loans on the loan application. In *Regency Nat'l Bank v. Blatz (In re Blatz)*, 37 B.R. 401, 403 (Bankr. E.D. Wis. 1984), the debtor's financial statement changed from a positive net worth of $1,448,750 to a negative $2,469,706 within three months.

> '[T]he debtor's unsupported assertions of an honest intent will not overcome the natural inferences from admitted facts.' [Citations omitted]. Liming, within three months of obtaining a loan based on a financial statement showing a net worth of $183,000 and debts of $88,000, admitted to a net worth of only $33,000 and debts of $264,000. He cited no intervening events and offered no other adequate explanation for this remarkable shift in his financial status.

Liming, 797 F.2d at 897.

It was not until two years after the closing that Grant defaulted on the obligation to the Shareholders and an additional year before Grant filed this petition. He paid substantial amounts to the Shareholders against the purchase price. He obtained and personally guaranteed a line of credit for CWS with Zions Bank. He caused Coon's salary and other expenses to be paid by Hanover Western and infused an additional $200,000 into CWS.

Perhaps if Grant's testimony was the only evidence of the interpretation of the Hanover Companies financial circumstances at that time, the retrospective view of the Shareholders would have more credence and the court would find Grant's testimony less credible. However Jerman testified that he left the Hanover Companies in April of 1985 at what he perceived to be the most potentially profitable point in their history. He indicated he could not conceive of any greater success in the oil and gas industry than that achieved by the Hanover Companies. Regardless of Grant's assertion that Jerman was the weak link in the Hanover Companies, Jerman played a significant role in the operations. He was a 49% owner and had been Grant's representative at the closing.[26] Jerman was fully conversant with the economic structure of the Hanover Companies and with their overall goals. His interpretation corroborates Grant's view and negates the presumption

[26] The circumstances surrounding Grant and Jerman's relationship were side-stepped at trial, but it was apparent that the entire subject was painful for both of them. Although not fully developed at trial, it is obvious from the testimony that the personal and professional commitment to the individual success of each other runs deep and strong between the two. Regardless of the undercurrents, Jerman's independent third party testimony supports Grant's claims regarding the financial condition of the Hanover Companies at the time of the closing and the issuance of the Financial Statement. Jerman also testified that he would receive an economic benefit if Grant loses this litigation, thus Jerman's testimony was against his interests.

of intent to deceive.[27] The court finds Jerman's testimony to be credible. Given the unusual relationship between Grant and Jerman, and the depth of emotion evidenced by Jerman, his testimony rebuts the Shareholder's interpretation of the evidence. The Shareholders have failed to carry their burden of proving Grant's intent to deceive by clear and convincing evidence.

Conclusion

The heavy burden placed upon the Shareholders to prove all elements of their claim for relief by clear and convincing evidence has not been met. Subsequent events are insufficient to retroactively imply an intent to defraud upon Grant. Without this element the claim for relief fails. Therefore, it is hereby

ORDERED, that the debt owed by Grant to the Shareholders is discharged.

DATED this 14 day of ~~September~~, 1990.

JUDITH A. BOULDEN
United States Bankruptcy Judge

[27] Jerman testified that, contrary to the Shareholders' assertion that Grant knew his Financial Statement was false because he was worth less, Grant believed the Financial Statement was understated and that he was worth much more.