IN THE DISTRICT COURT OF THE FOURTH JUDICIAL DISTRICT OF THE

STATE OF IDAHO IN AND FOR THE COUNTY OF ADA

STATE OF IDAHO, DEPARTMENT OF FINANCE, SECURITIES BUREAU,

Plaintiff,

vs.

GLOBAL AUTO SALES LLC, CHAD LONGSON, and BRANDON BARRINGTON,

Defendants.

Case No. CV01-21-19595

DECISION AND ORDER ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AGAINST DEFENDANT BRANDON BARRINGTON

INTRODUCTION

On December 22, 2021, Plaintiff Idaho Department of Finance ("the Department") filed a Complaint against Defendants Global Auto Sales, LLC ("Global Auto"), Chad Longson ("Mr. Longson"), and Brandon Barrington ("Mr. Barrington" and collectively, "Defendants") alleging Defendants violated Idaho's securities laws by soliciting Idaho investors to purchase securities in the form of promissory notes to finance Defendants' used car business. Promissory notes are defined as securities in Idaho Code § 30-14-102(28).

The Department alleged these securities were unregistered and were marketed by an unregistered agent of the issuer, also in violation of Idaho securities laws. Defendants allegedly made material misrepresentations about the collateral for the investments and failed to disclose material facts regarding a prior regulatory enforcement action brought by the Department against Mr. Longson based on similar facts and securities law violations.

In response to the Complaint, Mr. Barrington filed an Answer on January 27, 2022. On March 16, 2022, the parties filed a Stipulation for Entry of Judgment as to Defendant Chad Longson; the Judgment against Mr. Longson was entered on March 21, 2022. Mr. Barrington was deposed on May 10, 2022. and thereafter on June 6, 2022, filed Motion for Summary Judgment. The Department followed with their own Motion for Summary Judgment against Mr. Barrington on August 10, 2022. The Court will address the Motions in the order they were received.

STANDARD OF REVIEW

"Summary judgment is appropriate if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Bailey v. Peritus I Assets Mgmt., LLC*, 162 Idaho 458, 398 P.3d 191, 194 (2017) (internal quotations omitted). "Upon a motion for summary judgment, all controverted facts are liberally construed in favor of the non-moving party." *G & M Farms v. Funk Irr. Co.*, 119 Idaho 514, 516–17, 808 P.2d 851, 853–54 (1991). "Likewise, all reasonable inferences which can be made from the record shall be made in favor of the party resisting the motion." *Id*. "The burden at all times is upon the moving party to prove the absence of a genuine issue of material fact." *Id*.

ARGUMENT OF THE PARTIES

Mr. Barrington argues that summary judgment should be granted because the State's claim is not supported by evidence required under the *Howey-Foreman* test. The issue before the Court centers upon the definition of a security. Whether a particular instrument's attributes make it a security is ultimately a question of law. *State Dept. of Fin. v. Resource Serv. Co. Inc*., 130 Idaho 877 (1997).

According to Mr. Barrington, the U.S. Supreme Court uses the *Howey-Forman* test to identify the existence of an investment contract, or security, *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975). The Idaho Supreme Court has also adopted the *Howey-Forman* test to characterize transactions under the Idaho Securities Act. *State v. Gertsch*, 137 Idaho 387, 49 P.3d 392 (2002) (citing *State Dept. of Fin. v. Resource Serv. Co. Inc*., 130 Idaho 877, 950 P.2d 249 (1997). Under the *Howey-Forman* test, there are three elements that show the existence of an investment contract: 1) an investment of money; 2) a common enterprise; and 3) a reasonable expectation of profits to be derived from the entrepreneurial or management efforts of others. *Howey*, 328 U.S. at 298-99; *Forman*, 421 U.S. at

852. According to Mr. Barrington, the evidence in this case does not support a finding that the third element of this test has been met. Plaintiff's failure of proof this essential element of their case renders all other facts immaterial. *Barkley*, 121 Idaho 771, 774, 828 P.2d 334 (Ct. App. 1992).

In support of the application of the *Howey-Forman* test Mr. Barrington cites to *In re: Gables Mgmt., LLC*, 473 B.R. 352 (2012). In *Gables*, a creditor gave a debtor two amounts totaling $50,000 as investments into an assisted living facility owned by the debtor. *Gables* 473 B.R. at 354. The parties signed promissory notes, and the creditors were given an unrecorded Deed of Trust to the facility's property, in which they were named as beneficiaries. *Id*. at 356. On an initial investment of $25,000, the creditor was to receive their principal investment at the end of three years, with interest payments of 16 % per annum. *Id*. at 356. A subsequent $25,000 investment contract included the same terms but included monthly interest payments of $333.33. *Id*. at 357. The court pointed out that there was nothing in the documents signed by the parties that suggested the creditors were to acquire any ownership interest in the assisted living facility. *Id*. at 358. The court found that the transactions were loans rather than investment contracts, which do not fall under the definition of securities. *Id*. at 361. The decision rested on the third prong of the *Howey-Forman* test, which was whether the creditors had a reasonable expectation of profits to be derived from the entrepreneurial efforts of the debtor. *Id*.

Here, Mr. Barrington argues that through Global Auto, he sold a security to an investor in the form of promissory notes. Like in *Gables*, there is no evidence that the investor was promised anything more than the return of his full investment after two years of fixed interest payments. As in *Gables*, here, the investor's principal investment would not grow under the agreement. nor was there any provision in the documents signed by the parties that suggests the investor would acquire any ownership interest in Global Auto. Also, as in *Gables*, the parties signed promissory notes in which investors were to receive fixed interest payments, secured by unrecorded titles to vehicles on the car lot.

Finally, as in *Gables,* the investor was promised 10 % interest with a 2-year maturity date. The promissory notes demonstrate the investor only expected interest and a return of his principal, regardless of whether Global Auto turned a profit selling cars.

The *Gables* court was a bankruptcy court that set out to answer whether the transactions between the parties were loans or investments to determine priority. *Gables* at 358. However, in categorizing the transactions, the *Gables* court applied the *Howey-Forman* test to transactions

virtually identical to Mr. Barrington's and determined that the transactions were not securities.

In response, the Department argues summary judgment is appropriate on its claims because Mr. Barrington unlawfully sold promissory notes *that qualify* as securities, therefore violating Idaho's Uniform Securities Act ("IUSA").

The Department contends the promissory notes at issue are securities under the IUSA. The IUSA, like the federal Securities Act of 1933 and the 49 other state securities acts, requires all securities sold in Idaho to be registered (or exempted) and holds all those who "offer or sell" unregistered securities strictly liable. Registration is required so that investors have full disclosure about any potential investments. *See Idaho Code* § 30-14-301; *Zarinegar*, 167 Idaho at 630–32, 474 P.3d at 702–04 (noting that the "maxim of caveat emptor is inapplicable in these [IUSA] cases") *quoting Basic, Inc. v. Levinson*, 485 U.S. 224, 234 (1988). Here, the Department contends Mr. Barrington incorrectly argues that the investments through promissory notes are not securities and therefore not subject to the requirements of the IUSA.

The Department argues that in 1990, the U.S. Supreme Court discussed the distinction between a promissory note, that is commercial or consumer (not security) versus a promissory note that is an investment (security):

> While common stock is the quintessence of a security . . . and investors therefore justifiably assume that a sale of stock is covered by the Securities Acts, the same simply cannot be said of notes, which are used in a variety of settings, not all of which involve investments. Thus, the phrase "any note" should not be interpreted to mean literally "any note," but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts. . . .A majority of the Courts of Appeals that have considered the issue have adopted, in varying forms, "investment versus commercial" approaches that distinguish, on the basis of all of the circumstances surrounding the transactions, notes issued in an investment context (which are "securities") from notes issued in a commercial or consumer context (which are not).

Reves v. Ernst & Young, 494 U.S. 56, 62–63 (1990); *see also S.E.C. v. R.G. Reynolds Enterprises, Inc*., 952 F.2d 1125, 1131–33 (9th Cir. 1991) (addressing an issue left unresolved by *Reves* and holding there is a presumption that every non-"commercial paper" promissory note is a security, no matter the maturity length). According to the Department, the test set forth in *Reves* applies, not *Howey*.

In *Reves*, the Court applied a presumption that a promissory note is presumed to be a security and the issuer can rebut that presumption by showing that the note "'bear[s] a strong family resemblance' to an item on the judicially crafted list of exceptions. . . or convinces the court to add a new instrument to the list." *Reves v. Ernst & Young*, 494 U.S. 56, 64, 110 S. Ct. 945, 950, 108 L. Ed. 2d 47 (1990).

Here, the Department argues the promissory notes do not fit any of the seven (7) categories of non-security promissory notes listed in *Reves*: (1) the note delivered in consumer financing; (2) the note secured by a mortgage on a home; (3) the short-term note secured by a lien on a small business or some of its assets; (4) the note evidencing a "character" loan to a bank customer; (5) short-term notes secured by an assignment of accounts receivable; (6) a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized); or (7) notes evidencing loans by commercial banks for current operations. 494 U.S. at 65. *Reves* examined the following four other factors, addressed in order, to determine if any basis exists to deviate from the presumption of a security. Those factors, particularly factor one, confirm that the promissory notes in this case are securities.

First, the Department argues that motivation of the seller of the promissory notes was to raise funds for a used car business that desired to grow, fill a large lot, buy, and sell cars, grow a seller-financing business, and generate much larger revenues and income for the owners. The funds were put into the general bank accounts for each business and used for the general needs of the business. The promissory notes indicated that the funds would be used to buy vehicles for Global Auto and fund seller-financing loans by Xtreme Finance. Once they were used, those funds remained in the business and continued to flow through both sides of the business as the business flipped its inventory. In addition, the motivation of the investors was profit in receiving a high fixed return of 10-15% annually.

Regarding factor two, the Department continues that regarding any plan of distribution, the evidence indicates these investors were unsophisticated. For example, the investor in question, Brian Tanner admitted that he did not receive any information about the business prior to investing. There is no evidence that the investors recognized the significant flaws in the language of the various promissory notes regarding priority to collateral; nor is there evidence that any of the investors followed up to ensure their collateral was being tracked or protected. There is also no

indication that the issuers limited who could invest. For example, Brian Tanner admitted he was not an accredited investor and was not pre-qualified to invest, nor was he asked whether he was an accredited investor.

Regarding the third factor, the "reasonable expectations of the investing public" would be that these were investments in a used car business that were earning an annual return of 10-15%. *See McNabb*, 298 F.3d 1126 at 1132 (9th Cir. 2002) ("The court must look to a reasonable investor, not the specific individuals in question."). In fact, at least two investors (Brian and Lisa Tanner) and Mr. Longson specifically referred to this as an investment.

Finally, with respect to the fourth factor, there is no other regulatory scheme to protect investors. *Reves*, 494 U.S. at 67. Even Idaho's lien and foreclosure laws are inconsequential because the promissory notes at issue here did not address priority among the various investors, the business did not keep any of its promises regarding tracking or maintaining collateral, and Longson had to personally pay back more than $1,000,000 in principle. *See, e.g., Gertsch*, 137 Idaho at 392, 49 P.3d at 397 ("Consequently, it is the true nature of the scheme, as opposed to Gretsch's characterizations or representations, that is the benchmark for the analysis.").

According to the Department, the four factors of the *Reves* test unanimously and overwhelmingly support the presumption that these notes are securities under Idaho law.

Next, the Department argues that Mr. Barrington sold multiple securities issued by his companies to Idaho investors. Mr. Barrington appears to believe that he can avoid liability for selling the securities because Mr. Longson was the "money guy." However, Mr. Barrington misunderstands well-established securities law that holds individuals responsible for the sale, not just the issuing entity. The Department continues that Mr. Barrington sold the securities in five ways: (1) as a 50-50 owner of the entities, he controlled both entities and thus was responsible for the actions of both entities in issuing securities; (2) he authorized Mr. Longson's actions to solicit investors and raise private capital for the businesses that they both owned, with significant financial benefit to Mr. Barrington; (3) he executed various promissory notes and related documents that authorized the sale of various securities; (4) he was personally the Issuer (I.C. § 30-14-102(17)) of several of the securities since he signed personally as a maker, borrower, or guarantor of the repayment of those investments, and (5) he ratified the sale of the securities by utilizing all of the funds in his businesses for several years, reaping the rewards in terms of greater sales and greater income.

The Department closes their argument by pointing out that Mr. Barrington admitted during his deposition that: (1) he created one issuer--Global Auto; (2) he jointly created the second issuer-- Xtreme Finance; (3) he was a 50-50 owner of both companies; (4) he had control over both companies; (5) he wanted to raise capital for both; (6) he went into a 50-50 partnership with Mr. Longson specifically so Mr. Longson could raise capital for both companies; (7) he knew Mr. Longson was raising capital for the companies over an extended period of time; (8) he admits to knowing of at least five of the ten individual investors; (9) he signed various documents he knew needed to be signed so that Mr. Longson could raise money for the businesses from various individuals; (10) he signed eight promissory notes on behalf of the companies and/or made himself personally liable; (11) he admits nothing stopped him from looking at the financials to know the details about all investors; (12) he and the businesses used investor funds continuously from 2013 through approximately 2018; and (13) the more than $2 million in capital raised during those five years made it possible for his businesses to dramatically increase sales, revenue, and his income from the businesses.

The Department respectfully requests the Court enter summary judgment for the Department on all issues in this case, finding violations of Idaho Code § 30-14-301 (sale of unregistered securities), and impose (1) restitution as a sanction plus pre-judgment interest; (2) a permanent injunction; and (3) a civil penalty of $50,000.

ANALYSIS

The facts in this case are not in dispute. The issue before the Court is to determine if the money fronted to Global Auto and Xtreme Finance qualifies as a security. The Court finds the facts in *Gables* and the *Howey-Forman* test are not applicable to the facts of this case.

Howey provides a mechanism for determining whether an instrument is an "investment contract." *Reves v. Ernst & Young*, 494 U.S. 56, 64, 110 S. Ct. 945, 951, 108 L. Ed. 2d 47 (1990). The demand notes here may well not be "investment contracts," but that does not mean they are not "notes." *Id*. To hold that a "note" is not a "security" unless it meets a test designed for an entirely different variety of instrument "would make the Acts' enumeration of many types of instruments superfluous," *Landreth Timber Co. v. Landreth,* 471 U.S. 681, 692, 105 S. Ct. 2297, 2305, 85 L. Ed. 2d 692 (1985), and would be inconsistent with Congress' intent to regulate the entire body of instruments sold as investments., see *supra,* at 949–950. *Reves v. Ernst & Young*,

494 U.S. 56, 64, 110 S. Ct. 945, 951, 108 L. Ed. 2d 47 (1990). For this reason, the Court applies the more applicable *Reves* test.

In determining whether an instrument denominated a "note" is a "security," within the meaning of the Securities Exchange Act, courts should apply the "family resemblance" test. *Reves v. Ernst & Young*, 494 U.S. 56, 64, 110 S. Ct. 945, 950, 108 L. Ed. 2d 47 (1990). Under that test, a note is presumed to be a "security," and presumption may be rebutted only by showing that the note bears a strong resemblance, determined by examining the four factors in *Reves. Id*.

First, the transactions in question are examined to assess the motivations that would prompt a reasonable seller and buyer to enter. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." *Id*. at 66.

In the matter before the Court, the motivation of the seller of the promissory notes was to raise funds for a used car business. The fundamental purpose of the Securities Act is to eliminate abuse in unregulated securities markets. *Id*. at 60. It is necessary to define "security" as sufficiently broad to encompass virtually any instrument that might be sold as an investment. *Id.* at 61. The purpose of this business was to grow, buy vehicles to fill the property, sell cars, and generate revenue and income for the owners. The funds were put into the general bank accounts for each business and used for the general needs of the businesses. The promissory notes indicated that the funds would be used to buy vehicles for Global Auto and to fund seller-financing loans by Xtreme Finance. In addition, the motivation of the buyer in this matter appears to be that of profit, receiving a fixed return of roughly 10% annually. Based on the record before the Court, there is no genuine dispute of the material fact that the motivation for the creation of these promissory notes was to raise money for the general use of the business, and the buyer's primary interest was creating profit and income.

Second, the Court must examine the "plan of distribution" of the instrument, *SEC v. C.M. Joiner Leasing Corp*., 320 U.S. 344, 353 (1943), to determine whether it is an instrument in which there is "common trading for speculation or investment," *Reves v. Ernst & Young*, 494 U.S. 56, 66, 110 S. Ct. 945, 952, 108 L. Ed. 2d 47 (1990). There is no evidence that the investors obtained any disclosures prior to investing. Investor Brian Tanner admitted that he did not receive any information about the business prior to investing. Tanner Decl. ¶ 4 & 8. In addition, there is no indication that the issuers limited who could invest. For example, Brian Tanner admitted he was

not an accredited investor, and was not asked whether he was an accredited investor. Tanner Decl. ¶ 3. There is no evidence that any investor was sophisticated, as additionally evidenced by the fact that the used car business was a new company with no track record of managing investor capital.

Third, the Court must examine the reasonable expectations of the investing public. The Court will consider instruments to be "securities" on the basis of such public expectations, even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not "securities" as used in that transaction. *Reves* at 66, S. Ct. at 951, 108 L. Ed. 2d 47. In this matter, the promissory notes were monthly interest-only payments. The notes were structured to keep capital in the business. To withdraw capital from the business, investors were mostly dependent on the businesses finding new money. There is no evidence in the record that the business had a cash flow sufficient to cash out large investments upon their maturity. Additionally, and importantly, Brian Tanner and one additional investor specifically referred to the transactions as "investments" on their investment checks. The reasonable expectation in this matter was for investors to receive their money back, along with monthly interest payments. A fixed return in the form of interest payments can be categorized as an investment under the *Reves* test. It is reasonable to this Court and the investing public to view these transactions as investments, not a loan.

Finally, the Court examines whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary. *Id*. at 67. Here, the promissory notes did not address priority among the various investors, the business did not keep any of its promises regarding tracking or maintaining collateral, and Mr. Longson had to personally pay back more than $1,000,000 in principle. If the promissory notes were not to be characterized as a security, there would be no mechanism in place to protect the investors involved.

CONCLUSION

For the reasons stated above, Defendant Mr. Barrington's Motion for Summary Judgment is DENIED. Plaintiff's Motion for Summary Judgment Against Defendant Brandon Barrington is GRANTED.

IT IS SO ORDERED.

10/31/2022 3:56:45 PM

Dated this _____ day of _____, 2022.

MICHAEL REARDON
District Judge

CERTIFICATE OF MAILING

I hereby certify that on this 11/1/2022 day of _____, 2022, I served a true and correct copy of the:

DECISION AND ORDER ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND PLAINTIFFS MOTION FOR SUMMARY JUDGMENT AGAINST DEFENDANT BRANDON BARRINGTON

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By _____
Deputy Clerk 11/1/2022 10:27:27 AM