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**BEFORE THE DIVISION OF SECURITIES
OF THE DEPARTMENT OF COMMERCE
OF THE STATE OF UTAH**

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| IN THE MATTER OF |) | POST TRIAL MEMORANDUM OF |
| |) | COMMERCIAL LOAN ADVISORS, INC., |
| |) | JOHN H. MAY, MARK B. MAY AND |
| |) | PRIME ACCEPTANCE CORP. |
| COMMERCIAL LOAN ADVISORS, INC.; |) | Docket No. SD-01-0069 |
| JOHN H. MAY; |) | Docket No. SD-01-0070 |
| MARK B. MAY; and |) | Docket No. SD-01-0071 |
| PRIME ACCEPTANCE CORP.; |) | Docket No. SD-01-0073 |
| |) | |
| Respondents. |) | |

STATEMENT OF FACTS

LOW BOOK SALES & LEASING, INC. AND PRIME ACCEPTANCE CORP.

1. Low Book Sales & Leasing, Inc. ("Low Book") is a used car dealership and is one of the largest independent automobile dealerships in Utah. Low Book generates approximately \$20 million in revenues per year. The majority of Low Book's business involves the sale of automobiles to purchasers with good to acceptable credit ratings. Some of the purchasers pay cash for their automobiles and some arrange their own financing through institutions such as credit unions. However, the majority rely on Low Book to arrange financing on their behalf. Low Book has financing relationships with a large number of conventional financing sources that provide financing for low to moderate risk automobile loans. (Testimony of Charles Felt.)

2. As a relatively small part of its business, Low Book has targeted, as potential automobile purchasers, individuals who have either impaired credit ratings or have not established credit. When a

person with impaired credit or no credit comes to Low Book, a special presentation is made to the individual to educate them as to how prompt and regular payment of automobile financing obligations can establish credit for those who have previously not established a credit rating and can rehabilitate impaired credit ratings. At one time, Low Book would provide the financing and then either sell the sales contracts to a financing institution with an obligation to service the loans and to buy back non-performing loans, or carry the loans on its own books and records. In October 2000, the principals of Low Book incorporated Prime Acceptance Corp. ("Prime") to finance automobiles purchased from Low Book by persons in this specialty financing category. At the present time, Prime provides the financing for approximately 10% of the automobile's purchased from Low Book. (Testimony of Charles Felt.)

3. Low Book and Prime have been extremely conservative in their approach to providing financing for persons in the specialty financing category. In addition to educating the borrower as to how regular and timely car loan payments can build credit or repair credit, Prime performs extensive credit background checks on potential car purchasers. Prime also has the advantage of being able to meet with the potential borrower face-to-face, which in many instances provides more information about the individual than is obtained from the credit background check. (Testimony of Charles Felt.)

4. The process does not stop when the loan is made. Prime has personnel who are responsible for on-going communication with the automobile purchasers. Both telephonic and written communications are made with purchasers on an on-going basis, providing reminders that payments are coming due and providing notification when payments are not received on time. Prime is careful in its analysis of the frequency of and reasons for late payments in order to better anticipate whether or not foreclosure and repossession is necessary. If it is determined that foreclosure and repossession of the automobile is necessary, that is done immediately and the automobile is then either recycled into Low Book's sales inventory or is disposed of in a manner that will maximize the value of the automobile to Prime. Most importantly, Prime has computer programs that generate reports with extensive detail on loan performance. Through these reports, Prime is able to obtain instantaneous information bearing on the performance and collectability of its inventory of sales contracts as well as the sales contracts that have been assigned. (Testimony of Charles Felt, Exhibit H.)

5. Although defaults on loans that are financed by Prime are not uncommon, Prime has learned that its close relationship with automobile purchasers produces a surprising rate of sales contract completions. In particular, Prime has learned that if purchasers can maintain regular and timely payments through the first eight to twelve months of the loan, they will generally continue regular and timely payments to the completion of the loan. Because the loans are generally three year term, this means that collection procedures are more effectively concentrated on newer loans. (Testimony of Charles Felt.)

COMMERCIAL LOAN ADVISORS, INC., JOHN MAY AND MARK MAY

6. John May first learned of the business opportunity involving personal loans secured by automobile titles when he made a personal loan to an entity which is unrelated to this proceeding. In the process of investigating the loan opportunity, John May became informed of all of the facets of this business opportunity. (Testimony of John May.)

7. After learning about the business, John May decided to explore the possibility of engaging in this business opportunity with others. He contacted Low Book and presented the business opportunity to principals of the company. During the course of the discussions, refinements and improvements were made to the original concept and eventually Low Book and John May decided upon a business plan that they were jointly willing to pursue. (Testimony of John May.)

8. John May determined to pursue this business opportunity with his son Mark May and the two of them incorporated Commercial Loan Advisors, Inc. ("Commercial"). Commercial was formed for the sole purpose of acting as the escrow agent in the business plan formulated by John May and the principals of Low Book. (Testimony of John May.)

THE BUSINESS PLAN

9. The objective of the business plan was for Prime to borrow funds from individual lenders and to provide sales contracts with aggregate principal amounts equal to at least 130% of the loaned amount together with an efficient system of maintaining the collateral at 130% for the protection of the borrower. When a lender makes a loan to Prime, Prime issues a promissory note payable at the end of a stated term with interest at the annual rate of 12% to be paid on a monthly basis. Prime secures the promissory note by assigning automobile sales contracts with an aggregate principal equal to at least

130% of the promissory notes together with the related automobile titles to the lender to secure Prime's performance of its obligations on the promissory note. Under the Assignment Agreement, Prime agrees to service the sales contracts (collect payments, make sure that automobile insurance is kept in force, etc.) and to deposit 75% of the payments on the sales contracts into separate reserve accounts established for each individual lender. The Assignment Agreement also provides that the collateral assigned (the total principal owing on the assigned sales contracts) will at the outset total 130% of the loan amount and that Prime will either add new sales contracts to the collateral or make deposits to the reserve account to keep the collateral value at all times equal to 130% of the loan amount. Finally, the Assignment Agreement delegates Prime to assign additional performing sales contracts to the lender to replace previously assigned sales contracts in default. (Assignment Contracts contained in Exhibits E and F.)

10. Commercial acts as the escrow agent for the lender pursuant to an escrow agreement that is entered into between the lender, Commercial and Prime. Under the escrow agreement, the original sales contracts, related automobile titles and any related documents evidencing the lending relationship between the lender and Prime are assigned to the lender and delivered into the possession of Commercial. Under the escrow agreement and the assignment, Prime and Commercial act as joint signators on the cash reserve account established for the individual lender. Commercial receives periodic reports with respect to the balance in the reserve account and the performance on the sales contracts securing the loan. Commercial reports to the lenders on the status of the loans upon request and makes reports to lenders on sales contract defaults if Prime does not substitute performing sales contract on a timely basis. (Assignment Agreements and Escrow Agreements in Exhibits E and F.)

11. Commercial performs the additional function of locating individuals who will act as finders. These finders in turn direct potential lenders to Prime. Prime pays a fee to finders who introduce lenders to Prime. Although two lenders were friends or business associates of the Mays, Commercial did not actively solicit lenders. Prime also pays Commercial escrow fees for its services as escrow agent. (Testimony of Charles Felt, Testimony of John May, Testimony of Mark May, Finders Agreement in Exhibit E.)

12. With respect to any particular loan, when the lender agrees to make the loan to Prime, Commercial prepares the promissory note, assignment agreement and escrow agreement for signature and sends them to Prime. At the same time, Prime prints a document providing details concerning the sales contracts securing the loans. This report, designated as Exhibit A to the assignment agreement, lists the collateral. This document together with the actual sales contracts and car titles relating to those sales contracts are delivered to Commercial before the loan proceeds are accepted by Prime. Therefore, at the outset of each loan, the collateral securing the loan is in the physical possession of Commercial acting as the lender's agent. (Exhibits E and F.)

SCOPE OF BORROWING BY PRIME

13. The first loans under the business plan were made by lenders to Low Book. At that time Prime had not been formed and Low Book was handling the financing for the special financing category of purchasers. The initial loans made by lenders to Low Book all had a term of nine months. Shortly after these loans were made, Low Book re-negotiated the term of all but one of the loans and they were changed from nine months to twelve months. (Exhibit E, Testimony of John May, Testimony of Charles Felt.)

14. All of the notes have a provision that allows for renewal of the note for additional terms. The original notes entered into by Low Book came up for renewal in June 2001 and, with one exception, were all renewed for additional twelve month periods. The one note that was not renewed was paid on its nine month due date. (Exhibit G, Testimony of John May, Testimony of Charles Felt.)

15. As of the present time, there are twenty-eight loans outstanding on which Prime owes \$819,726.22. The largest principal sum on any note is \$62,652.46 and the smallest note is \$5,996.47. The due dates range from December 20, 2001 to October 19, 2002. The cash balances in the individual reserve accounts securing these notes totaled \$276,170.90 as of mid-September 2001 and the total principal on the contracts securing these notes was \$823,933.96 at that time. The total of these two sources of collateral in September 2001 was \$1,100,104.86 or approximately 134.2% of the loan amounts. Prime has made monthly payments of interest on these notes and has not to date missed a single interest payment. (Testimony of Charles Felt, Exhibit G.)

16. As part of its business plan, Prime determined to maintain a sizeable inventory of sales contracts that it owned outright, in order to ensure that it could always substitute performing contracts from this inventory for non-performing contracts assigned to lenders. As of September 2001, the total principal amount owing on sales contracts being serviced by Prime was \$2,073,694.75. The total principal amount owing on sales contracts assigned to lenders was \$823,933.96. Therefore, in September 2001, Prime had an inventory of sales contracts which it owned outright having a value of more than two times the value of assigned sales contracts. (Exhibit G.)

COMPLIANCE EFFORTS OF PRIME AND COMMERCIAL

17. At the outset of the business plan, Prime and Commercial were aware of the possibility that the notes issued by Prime might be considered to be securities. However, John May was made aware of a legal opinion obtained by the business enterprise to which he had made his personal loan to the effect that promissory notes secured by automobile sales contracts were not securities. For that reason, Prime and Commercial did not believe that securities compliance was an issue. (Testimony of John May.)

18. In the summer of 2000, Commercial held a meeting near Caldwell, Idaho for potential lenders and potential loan finders. After that meeting, representatives of the Idaho Securities Division who were in attendance at the meeting met with John May and informed him that despite Mr. May's understanding to the contrary, they considered the secured promissory notes to be securities. Based upon this information, Commercial and Prime ceased all efforts to seek additional lenders. (Testimony of John May.)

19. Commercial then sought the advice of securities counsel, who suggested that an interpretive opinion be obtained from the Division. (Testimony of John May.)

20. In approximately December 2000, after numerous contacts between the Division and counsel for Commercial, the Division issued a draft interpretive opinion to the effect that the secured promissory notes were not securities under the Utah Securities Laws. Based upon the draft interpretive opinion, Commercial and Prime resumed their efforts to find lenders. (Testimony of John May.)

On March 21, 2000, the Division issued a final interpretive opinion. The interpretive opinion applied the reasoning of a United States Supreme Court case, *Reves v. Ernst & Young*, 494 U.S. 56(1990) and reached the conclusion that the secured promissory notes were not securities under Utah law. (Exhibit C.)

THE DIVISION'S INVESTIGATION

22. The next month, April 2001, one Chuck Newton telephoned the Division to complain about a telephone call he had received from Mark May. George Robison of the Division was the person who received Mr. Newton's telephone call. Mr. Robison told Mr. Newton that if Mr. May called again, to refer him to one George Young. George Young is apparently an alias used by George Robison for undercover work. Chuck Newton did not wait for another call from Mr. May but instead phoned Mr. May and referred him to "his friend" George Young. Mark May then telephoned George Young (George Robison) and talked to him about the promissory note opportunity. (Testimony of Chuck Newton, Testimony of Mark May, Exhibit 2.)

23. At the conclusion of the telephone conversation between George Young and Mark May, the parties agreed to a meeting at a restaurant in Salt Lake City. On April 20, 2001, that meeting occurred. The meeting was attended by John May and Mark May representing Commercial and George Robison and Jude Archuletta posing as George Young and June Young. George Robison and Jude Archuletta secretly recorded the meeting with concealed recording equipment. During the course of the meeting, John and Mark May explained the Commercial/Prime business plan with George and June Young in an effort to recruit them as loan finders. (Exhibit 1 and Exhibit 2.)

24. Based upon the information received by the Division from the Chuck Newton phone call, the Mark May April 19, 2001 telephone call and the April 21, 2001 meeting between John May, Mark May, George R. Robison and Jude Archuletta, the Division concluded that Commercial and Prime had departed from the facts provided in connection with the March 21, 2001 interpretive opinion and that those departures caused the secured promissory notes to become securities. Thereafter the Division withdrew the interpretive opinion and instituted this enforcement action. (Testimony of Paula Faerber, Testimony of George Robison.)

ARGUMENT

The principal argument asserted by the respondents in this matter is related to jurisdiction. The Utah Division of Securities (the “Division”) has based its jurisdiction in this matter on the proposition that the secured promissory notes issued by Prime are securities. Respondents maintain they are not.

At the outset, it is necessary to determine what precedent may be relied upon in analyzing and resolving the issue of whether or not a particular promissory note is a security. Section 61-1-27 of the Uniform Securities Act provides, “This chapter may be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this chapter with the related federal regulation.” As noted in *State v. Larsen*, 865 P.2d 1355 (Utah 1993), this section does not mandate that interpretations of similar federal securities provisions be followed. However, in *State v. Shephard*, 989 P.2d 503 (Utah App. 1999) the Utah Court of Appeals noted that this section permits the construction of terms used in the Utah Uniform Securities Act to be coordinated with federal interpretations of related federal regulations when appropriate. In this case, we are dealing with the definition of the term “security” set forth in § 61-1-13(24) of the Utah Uniform Securities Act, which is identical in most respects to the definition of the term “security” under the federal securities laws. (15 U.S.C.77b(1); 15 U.S.C. 78c(a)(10).) In addition, the Division has indicated the propriety of looking to federal regulation for guidance on this matter inasmuch as the March 21, 2001 interpretive opinion issued by the Division (Exhibit C) applies the reasoning of *Reves v. Ernst and Young*, 494 U.S. 56 (1990), which deals with the interpretation of the term “security” under the Securities Exchange Act of 1934, as amended. (15 U.S.C. 78a, *et. seq.*)

THE REVES CASE

In the *Reves* case, the Supreme Court adopted a test for determining whether or not a note is a security which the Court designated the “family resemblance” test. (*Reves*, 494 U.S. at 64-65.) The test begins with the presumption that every note is a security, but recognizes that the presumption is rebuttable. (*Id.* 494 U.S. at 65.) The family resemblance test is used to rebut the presumption.

The family resemblance test is stated as follows: “A note is presumed to be a ‘security,’ and that presumption may be rebutted only by a showing that the note bears a strong resemblance (in terms of the four factors we have identified) to one of the enumerated categories of instrument. If an instrument is not sufficiently similar to an item on the list, the decision whether another category should be added is to be made by examining the same factors.” (*Id.* 494 U.S. at 67.)

The categories of instruments referred to is a list of notes identified by the Second Circuit Court of Appeals which are not properly viewed as securities. This list was adopted by the *Reves* court. (*Id.* 494 at 65.) The list consists of the following: “‘The note delivered in consumer financing, the note secured by a mortgage on a home, the short term note secured by a lien on a small business or some of its assets, the note evidencing a ‘character’ loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or 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)’” (*Id.* 494 U.S. at 65.)

The four part family resemblance test consists of the following: “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.’ If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller’s cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a ‘security.’...Second, we examine the ‘plan of distribution’ of the instrument...to determine whether it is an instrument in which there is ‘common trading for speculation or investment,’ . . . Third, we 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....Finally, we examine 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.* 494 U.S. at 66–67.)

As noted above, the application of the family resemblance test involves two steps. In the first step, one must determine whether the instrument in question, using the four step analysis, bears a family resemblance to an item on the Second Circuit's list. (*Id.* 494 U.S. at 65-66.) The second step comes into play only if the item in question does not bear a family resemblance to any item on the Second Circuit's list. If that is the case, the second step involves applying the four factor test to determine whether or not the item in question should be added to the list. (*Id.* 494 U.S. at 66.)

It is important to note that in applying the family resemblance test, the four factors are considered as a whole. If any one individual factor is not conclusive with respect to whether or not the item in question should be considered a non-security, the analysis does not stop there. In *Resolution Trust Corp. v. Stone*, 998 F.2d, 1534 (10th Cir. 1993) the Tenth Circuit Court of Appeals when applying the third factor (the public's reasonable perceptions) arrived at the conclusion that "thus, at best, this test leads us to no clear conclusions." (*Id.* 998 F.2d at 1539.) However, after applying all four of the factors, the Court in *Resolution Trust Corp.*, *supra.* stated "On balance, applying the tests specified in *Reves I*, we hold that PAC's EARs do not qualify as notes that are securities." (*Id.* 998 F.2d at 1539.)

APPLICATION OF THE REVES TEST

In the instant case, the promissory note issued by Prime to the individual lender has a stated term of either twelve or eighteen months with interest at the rate of 12% per annum payable monthly. The promissory notes are secured by an assignment of automobile sales contracts which in turn are secured by liens on specific automobiles. The sales contracts are assets of Prime. In addition, these assets fall into a category of assets called accounts receivable. The Second Circuit's list includes (1) the short term note secured by a lien on a small business or some of its assets, and (2) short term notes secured by an assignment of accounts receivable. Because Prime's notes are both short term notes (12 to 18 months) secured by some of Prime's assets and notes secured by an assignment of Prime's accounts receivable, we need only apply the first step of the family resemblance test.

The first factor of the family resemblance test states, in relevant part, "[i]f the note is exchanged to correct for the sellers cash-flow difficulties, or to advance some other commercial or consumer purpose, . . . the note is less sensibly described as a 'security'." (*Reves*, 494 U.S. at 66.) In this regard, this

case is factually analogous to the *Resolution Trust Corp., supra.* case. In *Resolution Trust Corp.*, the alleged security consisted of consumer car loans that had been purchased from car dealers, packaged with enhancements including insurance and servicing of the car loans, and resold at a premium. In the instant case, Prime borrows funds from a lender and secures the borrowing with an assignment of car loans having a principal balance of 130% in excess of the loan amounts. Prime continues to service those assigned car loans and in fact provides a form of enhanced collateral assurance by agreeing to substitute performing car loans from its own inventory for non-performing loans that are assigned as collateral. This plan is in essence the same as selling the accounts receivable with an agreement to service the account receivable and to buy back any non-performing account receivable.

Prime's objective is to correct an inherent cash flow difficulty in its line of business. When Prime purchases a car loan from Low Book, it makes an immediate outlay of funds for the car loan. In terms of cash-flow, its immediate outflow of funds is in excess of its inflow of funds due to the fact that Prime must recapture the purchase price over the three year term of the car loan. By in effect selling car loans from its inventory to correct a negative cash flow, Prime, like the defendant in *Resolution Trust Corp.* "was not selling the [sales contracts] to raise money for general investments in [Prime]; rather, it was selling its stock in trade." (*Resolution Trust Corp.*, 998 F.2d at 1539.)

The second factor of the *Reves* test is an examination of the plan of distribution to determine whether it is an instrument in which there is common trading for speculation or investment. (*Reves*, 494 U.S. at 66.) The Division offered little, if any, proof at the hearing of this case concerning lenders to Prime. The only evidence relating to the loans at issue in this case has been introduced by the respondents. In that regard, it is critical to note that there are only of twenty-nine lenders that have at any time loaned funds to Prime and twenty-eight lenders who have outstanding loans to Prime. The evidence also shows that there has been no trading in the notes. The list of lenders has remained constant with the exception of a single lender whose note was paid at maturity.

In *Resolution Trust Corp.*, the Court when examining the plan of distribution factor, noted that the sales in that case were to a very specialized and sophisticated secondary market that consisted of certain financial institutions and insurance companies and that the purchases were not for potential

speculative or trading value. (*Resolution Trust Corp.*, 998 F.2d at 1539.) There is no evidence in the record in this case concerning the sophistication or lack of sophistication of any of the lenders, but the record is clear that there have only been twenty-nine lenders to Prime during the entire history of this business opportunity. In addition, there were only three finders engaged in the process of finding lenders and there is no evidence that the finders approached anyone other than the twenty-nine lenders. This clearly shows a limited distribution of the promissory notes.

If there is a limited distribution, then the possibility of trading the promissory notes for speculation or investment is non-existent or at least unlikely.

In *Reves*, the finding that the note was a security was based in part on the fact that the issuer of the notes offered the notes over an extended period of time to its 23,000 members as well as non-members. More than 16,000 people held notes when the issuer filed for bankruptcy. Although there is no evidence as to the lender's motivations for making the loans, the record does not show that the lenders were making the loans for potential speculative or trading value. On the contrary, the loans carried a fixed rate of interest which did not vary with the profitability of Prime. There was no feature of the promissory notes that would have motivated speculative trading of the notes. There is no evidence that any lender ever sold any note to any other investor. There is simply no basis for speculative trading of secured promissory notes bearing a simple 12% annual interest rate.

The third element of the *Reves* test is to examine the reasonable expectations of the investing public. In the instant case, this analysis is simple. Although the term "investment" may have been used from time to time with respect to the promissory notes issued by Prime, that term was used in a generic sense and not as a term of art. The issuance of funds in exchange for the promissory note was not an investment on the part of lenders in the business of Prime. The lenders were simply renting money to Prime. The 12% interest rate paid on the notes was not geared to whether or not Prime was profitable. Prime agreed to pay that 12% interest whether or not it was profitable. An investment in the securities context involves putting one's money at the risk of an enterprise in exchange for a share of the profits generated by that enterprise. The collateralized promissory notes issued by Prime were designed to separate the lender from the risks of the business. That is why they were separately collateralized with

collateral equal to 130% of the loan, coupled with an agreement on the part of Prime to maintain the collateral to loan ratio at 130% at all times during the course of the loan. It is clear that any member of the public looking at the lending opportunity offered by Prime could only view it as an opportunity to make a business loan to Prime for a specific purpose and not as an opportunity to make an investment in Prime. (*Reves*, 494 U.S. at 68-69; *Resolution Trust Corp.*, 998 F.2d at 1539.)

The fourth element of the *Reves* test is to examine whether some factor significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary. (*Reves*, 494 U.S. at 67.) There can be no doubt that the collateral arrangement which was part of the business plan of Commercial and Prime significantly reduced the risk to the lenders. The Division has attacked the adequacy of the collateralization proven by Prime and Commercial in this case only on a “what if” basis. Questions were raised by the Division such as, what if the automobile that collateralizes a particular sales contract is demolished, there is no insurance, and the purchaser of the automobile is judgment proof? The “what if” scenarios utilized by the Division in questioning the value of the collateral in this case were not only sheer speculation, but were unrealistic as well.

Under the business plan developed by Prime and Commercial, the possibility of deterioration of the collateral value is eliminated by the requirement that Prime substitute performing sales contracts for sales contracts that are in default. The monies in the individual reserve accounts together with the balances due on the sales contracts are constantly monitored to make sure that they equal 130% of the loan amount. In the event of Prime’s default, the individual lender preserves rights in his or her collateral.

In the event of default and delivery of the collateral to the lender, the value of the collateral would be realized as follows. In the first instance, the value of the cash balance in his reserve account cannot be challenged. Next, after proper notification, the lender can require the purchasers on the sales contracts to send their monthly payments directly to the lender. Every automobile purchaser that pays his or her sales contract to maturity will not only pay the principal amount owing on the sales contract, but will pay interest at the rate of approximately 29% per annum as well. If a purchaser defaults on his payments on the sales contract, the lender can immediately foreclose on that purchase contract and repossess the automobile. Once the lender has the automobile, he or she can sell that automobile or in some other

fashion realize its value. Finally, if a lender forecloses on a sales contract, he can apply to the Utah Tax Commission for a pro-rata refund of sales tax with respect to the unpaid balance.

All in all, the collateralization of the Prime promissory notes is commercially sound. In this regard, the State's only answer is another "what if". The State asks, "What if Prime does not make sure that the lender is an individual who is unable to realize the value of the collateral". The answer is easy. Realization of value on the collateral is a simple process, and it is therefore unrealistic to believe that persons of normal intelligence, particularly those with sufficient funds to make the loans, would not have the ability either personally or through a representative to effectively realize the value of the collateral.

THE INVESTMENT CONTRACT TEST

The Division has not raised the argument that the business plan of Prime and Commercial constituted a security in the form of an investment contract. This is probably due to the fact that the *Reves* court rejected the investment contract analysis with respect to cases involving notes. The Court stated "We reject the approaches of those courts that have applied the *Howey* test to notes; *Howey* provides a mechanism for determining whether an instrument an 'investment contract.' The demand notes here may well not be 'investment contracts' but that does not mean they are not 'notes.' 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,' [citation omitted] and would be inconsistent with Congress' intent to regulate the entire body of instruments sold as investments [citation omitted]". (*Reves*, 494 U.S. at 64.) However, if one were to apply an investment contract analysis, the discussion of the investment contract test in *Resolution Trust Corp.* is instructive.

"We similarly conclude that the EARs were not a 'security' under the Supreme Court's test for investment contracts. To determine whether a financial product is an investment contract, and therefore a security, the Supreme Court applies a test different from that which it applies to notes:

an investment contract...means a...scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or third party....

SEC v. W.J. Howey Co., 328 U.S. 293, 299, 66 S. Ct. 1100, 1103, 90 L. Ed. 1244 (1946). The critical inquiry here is whether the plaintiff expected to receive 'profits' from its investment in the EARs.

The Supreme Court refined the ‘profits’ element of the *Howey* test in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975). There, the Court defined ‘profits’ as ‘either capital appreciation resulting from the development of the initial investment...or a participation in earnings resulting from the use of investors’ funds....’ *Id.*, at 852, 95 S. Ct. at 2060. We have interpreted *Forman* to mean that the receipt of specified interest payments is not the apportionment of profits under *Forman*. [citation omitted.]”

This analysis makes it clear that if the return on funds provided to business enterprises is in the form of annual interest, the “expectation of profits” element of the investment contract test is missing.

THE PUBLIC INTEREST

As set forth above, respondents do not believe that this case can survive the jurisdiction issue. It is abundantly clear that the promissory notes issued by Prime in this matter are not securities and the case should therefore be dismissed for lack of subject matter jurisdiction. However, assuming for the sake of argument only that the Court were to find subject matter jurisdiction in this case, respondents further argue that it would not be in the public interest to impose any of the sanctions sought by the Division.

The facts which were brought out at the hearing on this matter concerning the nature of the Division’s investigation and the basis for the Division’s institution of this action and the facts concerning the respondents’ compliance efforts are in stark contrast with one another. The respondents in this case took substantial steps to determine that their actions were in compliance with the law and in particular the Utah Securities laws. When notified by personnel of the Idaho Securities Division that the business plan formulated by Commercial and Prime might involve the offer and sale of a security, they halted the business plan and Commercial hired counsel to seek an interpretive opinion. Many weeks were spent in communications between the Division and counsel for Commercial in formulating the relevant facts which served as the basis for the interpretive opinion. Yet when the business plan was questioned by Chuck Newton, the Division did not contact either Commercial or Prime to resolve the questions. Instead, the Division arranged for two of its employees to pose as potential finders and secretly record a meeting at which the business plan was discussed superficially. Based only on the superficial information

learned at the meeting, the complaint by Chuck Newton and the phone call from Mark May, the Division first pulled the rug out from under Prime and Commercial by withdrawing the interpretive opinion and then brought the current enforcement action.

In its re-analysis of the business plan, the Division placed most of its emphasis on the fact that lenders did not appear as the lien holders of record on the automobile titles. In this regard, the Division appears to have reached the erroneous conclusion that if the lenders name did not appear as a lien holder on the title to the automobile, that the lender did not have a first lien position. This is simply not true. A fundamental concept of liens is stated as follows: "A lien created by express contract, including an equitable lien so created, is assignable, and passes by an assignment of the debt or obligation which it secures, although the lien is not mentioned in the instrument of assignment; and, furthermore, the lien is so far an incident of the debt which it secures that it cannot be assigned without at the same time transferring the debt or at least some part of it. [footnotes omitted]". (*CJS Volume 53, Liens, § 15 at 477-478.*) In addition, the case of *Skid Evans v. Patton*, 1 P.2d 959 (Utah 1931) stands for the proposition that a party that has acquired a lien on a vehicle through an assignment but whose name does not appear as the lien holder on the title to the vehicle is in the same position and has all the rights of the record lien holder who made the assignment. Therefore it is clear that the absence of the lender's name as lien holder on the titles held as collateral did not put those lenders in any different position than if their names had been recorded as lien holders on the titles. The assignment itself was an effective legal substitution of lien holders.

Respondents had adequately demonstrated their ability and willingness to comply with the law by halting their business plan when it was first called into question and then pursuing the interpretive opinion. In such circumstances a dialog to resolve issues is called for, not an enforcement proceeding. In addition, a dialog would have corrected the Division's misunderstanding with respect to the first lien position issue. With the first lien position issue resolved, the departure from the business plan perceived by the Division that bore on whether or not the secured loans were securities would have been resolved.

The Division could always, if unsure of the original opinion, have withdrawn it. However, enforcement action to remedy conduct sanctions by the Division through its interpretive opinion is simply improper.

Finally, a second consideration on the public interest issue is the fact that most of the lenders who have provided loans to Prime do not reside in the state of Utah. Only three of the twenty-nine lenders, including the lender paid at maturity, have been Utah residents. Two of those Utah residents are personal friends or business associates of the Mays. The remaining twenty-six are all residents of the state of Idaho. As this Court is aware, the state of Idaho attended the hearing in this matter, thus demonstrating that it is fully capable of acting on behalf of Idaho investors.

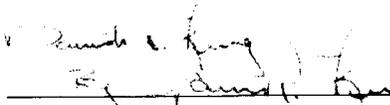
CONCLUSION

It is clear that this case is governed by the family resemblance test set forth in *Reves, supra*. It is also clear that when the family resemblance test is applied, the promissory notes issued by Prime fall into a category of notes that simply cannot be deemed to be securities. This case should therefore be dismissed for lack of subject matter jurisdiction. Assuming however, solely for the sake of argument, that the Court did have subject matter jurisdiction in this case, it is not in the public interest to impose the sanctions requested by the Division. Respondents' history of efforts to comply with the law show that they do not need to be compelled by a Cease and Desist Order or any other sanction for them to be compliant with the securities laws and regulations of this state. Also, in light of the fact that the respondents' business plan was not in practice different in any material respect than what had been represented to the Division, it would be inappropriate to impose sanctions for conduct with respect to which the Division had given prior approval.

Respectfully submitted,

DATED this 29th day of October, 2001.

KRUSE, LANDA & MAYCOCK, L.L.C.

By 
DAVID R. KING
Attorneys for Respondents

CERTIFICATE OF SERVICE

I hereby certify that I caused true and correct copies of the foregoing **POST TRIAL MEMORANDUM OF COMMERCIAL LOAN ADVISORS, INC., JOHN H. MAY, MARK B. MAY AND PRIME ACCEPTANCE CORP.** to be sent via facsimile transmission and mailed, postage prepaid, to each of the following, this 27th day of October, 2001:

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