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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
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OCT 23 2009
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COMMISSIONERS

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BOB STUMP

In the matter of:

SIR MORTGAGE & FINANCE OF ARIZONA, INC., an Arizona corporation,

GREGORY M. SIR (a/k/a "GREG SIR"), and ERIN M. SIR, husband and wife,

Respondents.

Docket No. S-20703A-09-0461

ANSWER AND MOTION TO VACATE TEMPORARY ORDER TO CEASE AND DESIST

Sir Mortgage & Finance of Arizona, Inc ("Sir Mortgage"), Gregory M. Sir ("Mr. Sir," and together with Sir Mortgage, "Respondents") and Erin M. Sir respond to the Temporary Order to Cease and Desist ("TCD") and Notice of Opportunity ("Notice") filed by the Securities Division ("Division") by admitting, denying and alleging as set forth below.

I. Overview.

Respondents deny that they violated the Arizona Securities Act ("the Act"). For twelve years, Mr. Sir and Sir Mortgage have operated as a licensed mortgage banker in Arizona, subject to the extensive regulation of the Arizona Department of Financial Institutions ("ADFI," formerly known as the State Banking Department). Over those twelve years, Sir Mortgage has become a respected and successful business in Arizona. Sir Mortgage and Mr. Sir stand by their track record over these twelve years. Of course, like any mortgage-related business, Sir Mortgage has been impacted by current market conditions. Respondent Erin M. Sir had no involvement in any of the actions alleged by the Division.

For the last twelve years, the Division never took an interest in Sir Mortgage; instead, regulation of Sir Mortgage and other mortgage banks was appropriately left to the ADFI. The Division's abrupt change of direction is unfounded both as a matter of Arizona law, and as a matter of policy. As explained in the July 15, 2009 letter from Sir Mortgage's counsel to the Division (attached as Exhibit A), the loan assignments used by Sir Mortgage are not securities under Arizona

law. Notably, the Division did not respond to this letter and has never offered a legal analysis of why the Staff believes the Act applies. There are only the misguided allegations in the Notice. And as a matter of policy, Sir Mortgage is subject to ADFI oversight, and the Commission should respect the existing regulatory structure established by ADFI. The ADFI has vigorously acted to protect Arizona by shutting down or placing into receivership mortgage bankers, mortgage brokers and other institutions who have violated Arizona law, or who have become insolvent. In short, the ADFI is not "asleep at the switch." In a time of limited state government resources, and significant other enforcement priorities, Respondents are baffled as to why the Division has – after twelve years – have now chosen to launch this proceeding against Respondents. And after twelve years why it believes a TCD is appropriate. Sir Mortgage's regulator, ADFI, obviously does not share the Division's view that immediate action against Sir Mortgage is appropriate.

Although Respondents deny that the Commission has jurisdiction, they have cooperated with the Division's investigation. They have provided 2,354 pages of documents to the Division in response to subpoenas, emails, correspondence and verbal requests. They have repeatedly offered to allow the Division's personnel access to all of their files.

The TCD was inappropriately issued without notice or a hearing, and Sir Mortgage faces the destruction of its long-standing business if the TCD remains in place without relief – all based on a novel and untested policy of the Division towards mortgage bankers that has yet to be adopted by the Commission.

To Respondents' knowledge, the Division's investigation began at least in March of this year. At the time the Division issued the TCD, Respondents had provided potential dates for Mr. Sir's examination under oath in response to a Division request, produced voluminous documents, met and spoke with the Division's counsel on multiple occasions, responded to several written questions posed by the Division and provided a sound and lengthy legal analysis in July. The Division has ignored the requirement under A.C.C. R14-4-307(A) that the extraordinary and onerous TCD should only issue when the public welfare requires immediate action. The authority

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

the Commission delegated to the Division has been misapplied. As a result, the TCD should be vacated.

II. Response to Specific Allegations by Erin M. Sir.

Erin M. Sir denies that the Commission has jurisdiction (Notice Paragraph 1), denies that that she should be joined in this case (Notice Paragraphs 5 and 6), denies that the marital community is subject to this case (Notice Paragraph 6), and denies that any relief should be entered against her. Erin M. Sir is not mentioned in any of the remaining paragraphs (Notice Paragraphs 2-4 and 7-58), and she denies that those paragraphs have any relevance to her whatsoever. Further, Erin M. Sir lacks information sufficient to form a belief as to the remaining paragraphs (Notice Paragraphs 2-4 and 7-58) and, accordingly, denies same.

III. Response to Specific Allegations by Respondents.

1. Respondents deny the allegations of Paragraph 1 of the Notice. Respondents state that the Commission lacks jurisdiction for the reasons set forth in the July 15, 2009 letter attached as Exhibit A. In addition, Respondents deny that the Commission's constitutional authority under Article XV of the Arizona Constitution applies in any way.

2. Respondents admit the allegations of Paragraph 2, but deny that Respondents were required to be registered as a securities dealer or salesman.

3. Respondents admit the allegations of Paragraph 3, but deny that Respondents were required to be registered as a securities dealer or salesman.

4. Paragraph 4 does not require a response.

5. Respondents admit that Erin M. Sir is the spouse of Mr. Sir. Respondents deny the remaining allegations of Paragraph 5.

6. Respondents deny this matter has any relevance to or bearing on the marital community. Respondents lack sufficient information to form a belief as to the truth of the allegations contained in Paragraph 6 and, therefore, deny same.

7. Respondents deny the allegations of Paragraph 7.

8. Respondents deny the allegations in Paragraph 8.

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
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9. In response to Paragraph 9, Respondents state the referenced website speaks for itself. To the extent there are any remaining allegations in Paragraph 9, Respondents deny them.

10. In response to Paragraph 10, Respondents state that the Articles of Incorporation speak for themselves.

11. In response to Paragraph 11, Respondents state that any documents referred to in this paragraph speak for themselves and, accordingly, deny the descriptions of same in Paragraph 11. Respondents state that the website speaks for itself.

12. In response to Paragraph 12 of the Notice, Respondents are uncertain what "principal loan amounts" the Division is referring to and, therefore, deny that allegation. Respondents repeat that the website speaks for itself. Respondents deny any remaining allegations in Paragraph 12. Respondents note that the allegations in Paragraphs 12 and 14 are inconsistent.

13. In response to Paragraph 13 of the Notice, Respondents state that the loan documents speak for themselves. Respondents deny any remaining allegations in Paragraph 13.

14. In response to Paragraph 14 of the Notice, Respondents note that allegations that begin with "at all relevant times" and "less often" are inconsistent and confusing. Respondents are without sufficient information to form a belief as to the truth of the remaining allegations contained in Paragraph 16 and, therefore, deny same.

15. Respondents note the allegations in Paragraph 15 are confusing and unintelligible and, on that basis, deny same.

16. In response to Paragraph 16, Respondents note that the term "most often" is confusing and unintelligible. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 16 and, therefore, deny same.

17. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 17 and, therefore, deny same.

18. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 18 and, therefore, deny same.

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
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19. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 19 and, therefore, deny same.

20. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 20 and, therefore, deny same.

21. Responding to Paragraph 21, Respondents state that whatever the Division believes is "discussed further below" in the Notice speaks for itself. Respondents state the referenced document speaks for itself. Respondents are without sufficient information to form a belief as to the truth of any remaining allegations contained in Paragraph 21 and, therefore, deny same.

22. Responding to the allegations in Paragraph 22, Respondents state the documents referenced therein speak for themselves. Respondents deny any remaining allegations contained in Paragraph 22.

23. Respondents deny the allegations of Paragraph 23.

24. Respondents allege that lenders have full authority and responsibility to review, evaluate, and manage all loans that they voluntarily choose to enter into; and, accordingly, Respondents deny the allegations of Paragraph 24. Respondents further state that whatever the Division believes is "discussed further below" speaks for itself.

25. Regarding the allegations of Paragraph 25 of the Notice, Respondents state the "loan checklist" speaks for itself. Respondents state that each loan file speaks for itself, and that lenders have full authority and responsibility to review, evaluate, and manage all loans that they voluntarily choose to enter into; and, accordingly, Respondents deny any remaining allegations of Paragraph 25.

26. Regarding the Property evaluation, Respondents state the document speaks for itself. Respondents deny that there was a prospectus. Respondents are without sufficient information to form a belief to the remaining allegations of Paragraph 26 and, therefore, deny same.

27. Respondents deny that there was a prospectus. Respondents are without sufficient information to form a belief to the remaining allegations of Paragraph 27 and, therefore, deny same.

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PHOENIX, ARIZONA 85004
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28. Respondents deny that there was a prospectus. Respondents are without sufficient information to form a belief to the remaining allegations of Paragraph 28 and, therefore, deny same.

29. Respondents state that any documents referred to in Paragraph 29 speak for themselves. Respondents are without sufficient information to form a belief as to the truth of any remaining allegations in Paragraph 29 and, therefore, deny same.

30. Respondents state that any documents referred to in Paragraph 30 speak for themselves. Respondents are without sufficient information to form a belief as to the truth of any remaining allegations in Paragraph 29 and, therefore, deny same.

31. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 31 and, therefore, deny same.

32. Respondents deny the allegations of Paragraph 32.

33. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 33 and, therefore, deny same.

34. Respondents state any documents referred to in Paragraph 34 speak for themselves. Respondents are without sufficient information to form a belief as to the truth of the remaining allegations contained in Paragraph 34 and, therefore, deny same.

35. Respondents state any documents referred to in Paragraph 35 speak for themselves. Respondents are without sufficient information to form a belief as to the truth of the remaining allegations contained in Paragraph 35 and, therefore, deny same.

36. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 36 and, therefore, deny same.

37. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 37 and, therefore, deny same.

38. Respondents deny the allegations of Paragraph 38.

39. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 39 and, therefore, deny same.

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40. Respondents state the documents provided to the Division speak for themselves. Respondents deny any remaining allegations in Paragraph 40.

41. Respondents state the documents provided to the Division speak for themselves. Respondents deny any remaining allegations in Paragraph 41.

42. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 42 and, therefore, deny same.

43. Respondents deny that there was a prospectus and further deny the remaining allegations of Paragraph 43.

44. Respondents state that any Court documents speak for themselves. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 44 and, therefore, deny same.

45. Respondents state that any court documents speak for themselves. Respondents are without sufficient information to form a belief as to the truth of the remaining allegations contained in Paragraph 45 and, therefore, deny same.

46. Respondents state that any court documents speak for themselves. Respondents are without sufficient information to form a belief as to the truth of the remaining allegations contained in Paragraph 46 and, therefore, deny same..

47. Respondents state that any court documents speak for themselves. Respondents deny any remaining allegations of Paragraph 47.

48. Respondents deny they issued loans. Respondents are without sufficient information to form a belief as to the truth of any remaining allegations contained in Paragraph 48 and, therefore, deny same.

49. Respondents deny there was a prospectus and the allegations of Paragraph 49.

50. The allegations in Paragraph 50 are unintelligible. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 50 and, therefore, deny same.

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
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51. Respondents are without sufficient information to form a belief as to the truth of the allegations contained in Paragraph 51 and, therefore, deny same.

52. Respondents deny the allegations of Paragraph 52.

53. Respondents deny the allegations of Paragraph 53.

54. Respondents deny the allegations of Paragraph 54.

55. Respondents deny the allegations of Paragraph 55.

56. Respondents deny the allegations of Paragraph 56.

57. Respondents deny the allegations of Paragraph 57.

58. Respondents deny the allegations of Paragraph 58.

59. Respondents deny each and every allegation not expressly admitted herein.

60. Respondents deny that any order should be entered against them and deny that any relief should be granted against them.

IV. Affirmative Defenses.

Respondents and Erin M. Sir allege the following affirmative defenses:

A. The Commission lacks jurisdiction over the subject matter of the Notice.

B. The loan documents are not securities.

C. The Division's claims are barred by estoppel.

D. The Divisions' claims are barred by laches.

E. The Division's claims are barred by acquiescence.

F. The Division's claims are barred by waiver.

G. The Notice fails to state a claim upon which relief can be granted.

H. The Division's claims are barred by the applicable statute of limitations.

I. There has been no offer or sale of securities.

J. The Notice fails to allege securities fraud with reasonable particularity as required by Rule 9(b) of the Arizona Rules of Civil Procedure.

K. Respondents did not know, and in the exercise of reasonable care could not have known, of any of the alleged untrue statements or material omissions alleged in the Notice.

L. The Notice fails to demonstrate scienter.

M. The claims set forth in the Notice are barred, in whole or in part, by contributory negligence.

N. The claims set forth in the Notice are barred, in whole or in part, by the doctrine of unclean hands.

O. Each lender had the right, duty and obligation to conduct their own due diligence.

P. The Notice fails to demonstrate Respondents' proximity caused any damage to any person.

Q. The Division's claims are barred because the alleged "investors" failed to mitigate their damages.

R. The Division's claims are barred because the damages alleged in the Notice, if any, were caused by the intervening or superseding acts of others over whom the Respondents and Erin M. Sir have no control, and for whose acts Respondents and Erin M. Sir are not legally responsible.

S. The Division's claims are barred, in whole or in part, because of mutual mistake.

T. The Division's claims are barred, in whole or part, due to a failure to satisfy a condition precedent.

U. The Division's claims are barred, in whole or part, because of payment, accord and satisfaction.

V. The Division's claims are barred, in whole or part, because of ratification.

W. The Division's claims are barred, in whole or part, because the Division failed to join an indispensible party or parties.

X. Respondents' liability, if any, must be reduced in proportion to the fault of all other persons who caused or contributed to the alleged damages, if any, regardless of whether they are parties to this action or could have been named in this action.

Y. Any alleged misstatements or omissions were not material.

Z. The claims set forth in the Notice invade the exclusive jurisdiction of the ADFI.

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

AA. The claims set for the in the Notice are contrary to public policy for the reasons specified in Section I hereof.

BB. The Division (and the Commission, to the extent it grants the relief requested by the Division) failed to provide adequate notice of their change in policy regarding regulation of mortgage bankers regulated by ADFI, thus, depriving Respondents and Erin M. Sir of due process United States and Arizona Constitutions.

CC. The Temporary Cease and Desist Order set forth in the Notice was not issued by an impartial magistrate or officer, but rather by an employee of the Division, thus, depriving Respondents and Erin M. Sir of due process under United States and Arizona constitutions.

DD. The Temporary Cease and Desist Order set forth in the Notice was issued by an officer not authorized to issue such orders by rule or statute, and the Notice is accordingly void.

EE. The delegation of authority to the Division or its Director to issue Temporary Cease and Desist Order is contrary to the United States and Arizona constitutions.

FF. The Notice fails to provide constitutionally adequate notice to Respondents and Erin M. Sir because it fails to adequately describe the penalties or relief requested (such as the amounts of the penalties and restitution).

GG. The relief requested in the Notice violates the excessive fines clause of the United States Constitution.

HH. The Temporary Cease and Desist Order has halted Respondents' business and livelihood, without a hearing, thus, depriving Respondents of due process under the United States and Arizona constitutions.

II. The Division has failed to exhaust its administrative remedies before ADFI.

JJ. The relief requested in the Notice is so great as to constitute the constitutional equivalent of a criminal sanction, and these proceedings violate due process by failing to accord Respondents and Erin M. Sir the rights and procedures available in criminal actions.

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

KK. The Notice proposes to punish Erin M. Sir even though she played no part in the actions alleged in the Notice, thus, violating her rights to due process under the United States and Arizona constitutions.

LL. These proceedings violate A.R.S. § 41-1001.A.11 because this docket has not been assigned to an "independent administrative law judge" outside of the Commission.

MM. Any losses experienced by lenders were caused by the decline in real estate values, not by Respondents.

NN. Respondents and Erin M. Sir reserve the right to raise any other affirmative defenses or claims which may become apparent during the course of discovery, and Respondents and Erin M. Sir reserve the right to amend their Answer accordingly.

V. Hearing.

Respondents have requested a hearing.

VI. Relief.

Respondents and Erin M. Sir request that the Commission:

(1) Dismiss the Notice in its entirety, and with prejudice;

(2) Quash or revoke the Temporary Cease and Desist Order set forth in the Notice;

(3) Award Respondents and Erin M. Sir their reasonable attorneys fees under A.R.S. § 41-1007.

(4) Award Respondents compensation for the taking of their property effected by the Temporary Cease and Desist order set forth in the Notice.

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ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

RESPECTFULLY SUBMITTED this 24th day of October, 2009.

ROSHKA DeWULF & PATTEN, PLC

By _____

Paul J. Roshka, Jr., Esq.
Timothy J. Sabo, Esq.
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
602-256-6100 (telephone)
602-256-6800 (facsimile)
Attorneys for Respondents

ORIGINAL and thirteen copies of the foregoing filed this 24th day of October, 2009 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered this 24th day of October, 2009 to:

Marc E. Stern, Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mark Dinell
Assistant Director of Securities
Securities Division
Arizona Corporation Commission
1300 West Washington Street, 3rd Floor
Phoenix, Arizona 85007

Michael Dailey, Esq.
Staff Attorney
Securities Division
Arizona Corporation Commission
1300 West Washington Street, 3rd Floor
Phoenix, Arizona 85007

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

Ruth B. Autrey

Sir.ACC/pld/Answer.doc

ROSHKA DEWULF & PATTEN, PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET - SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

Exhibit A

ROSHKA DEWULF & PATTEN

ROSHKA DEWULF & PATTEN, PLC
ATTORNEYS AT LAW
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET
SUITE 800
PHOENIX, ARIZONA 85004
TELEPHONE NO 602-256-6100
FACSIMILE 602-256-6800

July 15, 2009

VIA HAND DELIVERY

Michael Dailey, Esq.
Securities Division
Arizona Corporation Commission
1300 W. Washington Street, 3rd Floor
Phoenix, AZ 85007

Re: Sir Mortgage & Finance of Arizona, Inc., File No. 9699

Dear Mr. Dailey:

This letter provides our analysis of why the loan assignments made by our client, Sir Mortgage & Finance of Arizona, Inc ("Sir Mortgage") do not constitute a security under the Arizona Securities Act, A.R.S. § 44-1801 et seq. ("Act"). Our analysis includes: (1) a review of the facts; (2) an extensive analysis of the definition of "security" under the Act; (3) a review of the "bank" exclusion under A.R.S. § 44-1843.A.2 and the "mortgage" exemption under A.R.S. § 44-1843.A.10. We conclude that the loan assignments do not fall within Arizona's definition of security and, in the alternative, we conclude that the bank and mortgage exemptions should apply. We, therefore, believe that the Securities Division ("Division") of the Arizona Corporation Commission should take no action in this matter.

I. Facts.

Sir Mortgage has successfully operated as a mortgage banker in Arizona for twelve years (six years prior to incorporation, and six years after incorporation.) Sir Mortgage is respected in its industry, and it helped form the industry association for similar businesses in Arizona. Sir Mortgage focuses on maintaining high loan quality, and it often has more funds available from lenders than loans it considers worthy. Another key strategy of Sir Mortgage is maintaining a good relationship with its regulator, the Arizona Department of Financial Institutions ("ADFI") (formerly known as the Banking Department). As of June 30, 2009, Sir Mortgage had $62,385,839.71 in loans outstanding and being serviced (not including loans that have been foreclosed).

We have provided the Division with the complete loan file pertaining to borrower William W. Calvin, III (Bates Nos. SIR00177 – SIR00558). We have also provided the Division with loan files for the nine loans that have closed to date in 2009 (SIR00559 –

SIR00797). We have also offered to let the Division inspect all of Sir Mortgage's loan files at its office.

As you can see from the loan files, the loans all have similar structures. First, Sir Mortgage enters into a Note and Deed of Trust, Secured Loan Agreement or similar document evidencing a secured loan from Sir Mortgage to a Borrower. The loans are always secured by an interest in real property. After the loan is concluded, Sir Mortgage may assign an interest in the loan to one or more lenders in exchange for a payment equal to the principal amount of the loan. The assignment may be for the entire loan, or for an undivided interest in the loan. Loan assignments are recorded with the County Recorder's office, and the assignment includes all rights under the loan agreement, including rights to collateral. A small portion of the interest payments are assigned by written agreement to GEL Investments, Inc., an affiliate of Sir Mortgage. Loan payments are received by an independent loan servicing company.

If 100% of the loan is assigned, Sir Mortgage has minimal involvement with the loan, and retains no economic interest in the loan (other than interest assignment to GEL). If the loan is not fully assigned, Sir Mortgage also maintains an undivided interest in the loans, the same as the other lenders.

The lenders are a select group of sophisticated lenders. We are providing you under separate cover an annotated lender list that provides brief comments regarding each lender (Bates Nos. SIR00798 – SIR815). As shown on this annotated list, many of the lenders are experienced real estate investors. Others include CPAs, lawyers, and wealthy individuals. In addition, a number of the investors are pension plans, profit sharing plans or similar entities. Sir has a strict policy of only assigning loans to sophisticated lenders. Mr. Sir informs us that he as turned away potential lenders on a number of occasions because they were not sophisticated lenders.

Before any assignment, Sir Mortgage reviews the loan with each potential lender. The lender has access to all loan documents, including due diligence information. In addition, each lender receives a standard package of loan documents to review, and to sign if they agree. (See the loan files we have provided for examples of cover letters detailing the documents provided).

At its inception, Sir Mortgage had a required minimum assignment (lender requirement) amount of $100,000. More recently (approximately 2004), the minimum amount has increased to $250,000. These high minimums help ensure sophisticated lenders of means.

Sir Mortgage does not advertise for lenders. (Sir Mortgage's advertisements are solely for new borrowers). Typically, Sir Mortgage does not have enough loans to satisfy demand from existing lenders.

Sir Mortgage is a licensed Arizona mortgage banker (#0905357) under the jurisdiction of the ADFI pursuant to A.R.S. § 6-941 et seq. Sir Mortgage is subject to ADFI's full "examination and supervision" powers. A.R.S. § 6-121. In addition, it must post a bond or equivalent (A.R.S. § 6-943.H), follow strict accounting standards (A.R.S. § 6-946) and is banned from numerous "prohibited acts" (A.R.S. § 6-947). Sir Mortgage is subject to random audits by the ADFI, and has in fact been audited twice.

II. The loan assignments are not "securities" under the Act.

The Act's definition of "security" includes "investment contract" and "real property investment contract." A.R.S. § 44-1801.26. We first consider the overall need for regulation, and then we consider the specific terms "real property investment contract" and "investment contract."

A. There is no need for the Commission to regulate assignments of mortgage banker loans.

1. *Sir Mortgage is subject to ADFI's extensive oversight.*

The definition of "security" in the Act closely follows the federal securities laws, and federal interpretations are often used. *See e.g. Eastern Vanguard Forex, Ltd., v. Arizona Corp. Comm'n*, 206 Ariz. 399, 410 ¶36, 79 P.3d 86, 97 (App. 2003); *see also* Laws 1996, ch. 198, § 11(C) (statement of legislative intent that courts may use interpretations by the SEC and federal courts in interpreting the Act). The federal definition contains a "if the context otherwise requires" clause, as does the Act. In commenting on this provision, the Supreme Court has noted that where regulation is not needed, this language should be used to narrow the definition of security to avoid needless regulation. *See Marine Bank v. Weaver*, 455 U.S. 551, 558-59 (1982). The court thus found that bank CDs are not securities because banks are subject to "a comprehensive set of regulations governing the banking industry." *Id.* Here, Sir Mortgage is subject to extensive regulation by ADFI, including ADFI's full powers of "examination and supervision" just like other banks. This extensive regulatory supervision obviates the need for additional, parallel supervision by the Division.

Arizona law likewise recognizes that the need for regulation must be considered. In *Butler v. American Asphalt & Contracting Co.*, 25 Ariz. App. 26, 540 P.2d 757 (1975), the court explained that the purpose of the Act is to "safeguard the investing public from

fraudulent devices and tricks" and that in some cases "no such protections are needed." *Id.* Here, the Act's protections are not needed due to ADFI's extensive regulation of Sir Mortgage. Moreover, in *Butler* the court emphasized the experience of the investors, explaining that the Act "was not intended as a protection for those able to fend for themselves." *Id.* As explained above, Sir Mortgage's lenders are all sophisticated lenders who are "able to fend for themselves."

2. *Extensive authority weighs against regulation.*

In addition, the overwhelming weight of authority under the federal securities laws has been that loan participations offered by banks or similar financial institutions are not securities. For example, in *In re Epic Mortgage Insurance Litigation,* 701 F.Supp. 1192, 1248-49 (E.D. Va. 1988) *aff'ed in part and rev'd in part on other grounds sub nom. Foremost Guarantee Corp. v. Meritor Savings Bank,* 910 F.2d 118 (4th Cir. 1990), the court stated that "courts uniformly hold that the purchase and sale of whole loans and loan participations in analogous transactions do not constitute securities." *Id.* To the same effect is *Banco Espanol de Credito v. Security Pac. Nat'l Bank,* 763 F.Supp. 36, 42-43 (S.D.N.Y. 1991). The court noted that "recent cases hold that participations in commercial loans are not "securities"... [e]very circuit court that has ever considered the question has concluded that loan participations are not securities." *Id.* The court explained that because the buyer "purchased participation in a specific, identifiable" loan, the "loan participation did not have an identity separate from the underlying loan" and was therefore not a security. *Id.* The 2nd Circuit affirmed. *Banco Espanol de Credito v. Security Pac. Nat'l Bank,* 973 F.2d 51, 54-55 (2nd Cir. 1992).

The 9th Circuit likewise has found that loan participations are not securities. *See First Citizens Federal Savings and Loan Assoc. v. Worthen Bank and Trust Co.*, 919 F.2d 510, 515-16 (9th Cir. 1990). The case was brought under both Arizona and federal securities laws. In that case, Worthen was the lead lender, but sold participations to twenty other institutions. The court found that neither the underlying note nor the participation agreement were securities under federal law or Arizona's Act. *Id.*

The 5th, 6th, 7th, 8th, and 10th Circuits likewise agree that such participations in loans from financial institutions are not securities. *See United American Bank of Nashville v. Gunter*, 620 F.2d 1108, 1115-1119 (5th Cir. 1980) ("participation was part of a routine commercial transaction beyond the purview of the federal securities laws"); *Union Planters National Bank of Memphis v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1182 (6th Cir. 1981) (noting that the "existence of collateral is strongly suggestive of a commercial loan" not a security); *American Fletcher Mortgage Co., Inc. v. U.S. Steel Credit Corp.*, 635 F.2d 1247, 1253-54 (7th Cir. 1980)(noting that "[t]o be sure, the loan was risky, but the risk taken was the ordinary commercial risk taken by any

secured lender, not an investment risk")(quotation marks and citation omitted); *Union Bank of Little Rock v. Farmers Bank*, 786 F.2d 881 (8th Cir. 1986); *McVay v. Western Plains Service Co.*, 823 F.2d 1395, 1398-1400 (10th Cir. 1987)(noting that "loan participations are a common and wholesome credit device").

Here, the loan assignments are: (1) made by a regulated financial entity, Sir Mortgage; (2) are for "specific, identifiable" loans (*Banco Espanol*), (3) are fully collateralized (*Union Planters*), and (4) the risks are the ordinary risks of a lender (e.g. the borrower may not repay, the collateral may not yield as much as originally thought)(*American Fletcher*). Thus, the loan assignments should not be considered securities.

3. *Arizona regulatory history weighs against regulation.*

The mortgage banking industry in Arizona is long-standing. Sir Mortgage has operated for twelve years. Numerous other mortgage bankers operate in a similar manner. We are not aware of the Commission ever taking action against a regulated mortgage banker, although the Commission has repeatedly taken action against those who are not regulated mortgage bankers who sell unsecured real estate notes. *See e.g. Gerald Edwin Patchen II*, Decision No. 71163 (June 16, 2009) (unsecured notes); *Guillermo Ricardo De La Vara*, Decision No. 70547 (October 8, 2008) (sale of second or third position liens); *Donald Anthony Tomasian*, Decision No. 70389 (June 20, 2008) (falsely implied that he was a mortgage banker). The Commission discussed mortgage banker status in *Creative Financing Funding, LLC*, Decision No. 64653 (March 25, 2002). In that case, the Respondent was a mortgage broker who falsely held himself out as a mortgage banker. The Commission emphasized the difference, explaining that "A mortgage broker is prohibited from handling third party funding. The mortgage broker license is not interchangeable with a mortgage banking license." *Id.* at Finding of Fact No. 14. Thus, the Commission has emphasized the importance of mortgage banker status, and has consistently pursued those who are not regulated mortgage bankers while not taking any action against the numerous Arizona mortgage bankers who make use of loan assignments, loan participations, or similar processes. This longstanding inaction, coupled with the extensive regulatory oversight of Sir Mortgage and the overwhelming authority against regulation of commercial loan participation agreements demonstrates that the Sir Mortgage loan assignments are not securities.

B. Real Property Investment Contract.

The Act closely follows the definitions in the Securities Act of 1933 and the Securities Exchange Act of 1934. There is one notable difference – the Arizona Legislature added a specific definition of "real property investment contract." Because

"investment contract" is the most ambiguous element of the definition of "security," the Legislature's inclusion of a much more specific definition of "real property investment contract" shows the Legislature's intent to remove any ambiguity regarding real property notes. As we will explain, the loan assignments do not qualify as "real property investment contracts;" for this reason alone they should not be considered securities. In other words, an agreement concerning a real property note cannot be a security unless it is a "real property investment contract." Any other reading renders Legislature's decision to add a definition of "real property investment contract" mere surplussage. *See State ex rel. Department of Economic Security v. Hayden,* 210 Ariz. 522, 523 ¶ 7, 115 P.3d 116, 117 (2005) ("[w]e interpret statutory language to give effect to each word of the statute, such that no clause, sentence or word is rendered superfluous, void, contradictory or insignificant.") (internal quotation omitted).

The Act defines "Real Property Investment Contract" as:

> a contract for the sale or purchase of a promissory note secured directly or collaterally by a mortgage, deed of trust or other lien on real property, including a contract as defined by section 33-741, or any **agreement, arrangement or understanding in connection with such note**, lien or contract in which a person agrees, implies to do or does **any of the following**, whether or not the investor is aware that any of the following actions are contemplated or taken:
>
> (a) Guarantee the note, lien or contract against loss at any time.
>
> (b) Promise to provide a market for the sale of the note, lien or contract, in connection with a sale or purchase.
>
> (c) Offer to accept or accept funds for investment in notes or contracts secured directly or indirectly by a lien on real property, where the real property is unspecified at the time of investment.
>
> (d) Pay any interest or premium for a period before actual purchase and delivery of the note or contract.
>
> (e) Pay any money to an investor if the note or contract is in arrears.
>
> (f) Guarantee that principal or interest will be paid in conformity with the terms of the note or contract.

(g) Accept, from time to time, partial payment toward the purchase of the note or contract.

(h) Promise to repurchase the note or contract, in connection with sale or purchase.

A.R.S. § 44-1801.18 (emphasis added). The loan assignments are likely an "arrangement... in connection with a note." However, they do not satisfy any of the enumerated points, and thus they do not constitute a "real property investment contract." A specific response to each enumerated point follows.

(a) Guarantee the note, lien or contract against loss at any time.

Sir Mortgage does not guarantee the loan assignments against loss.

(b) Promise to provide a market for the sale of the note, lien or contract, in connection with a sale or purchase.

Sir Mortgage does not promise to provide a market for the sale of the loan assignment.

(c) Offer to accept or accept funds for investment in notes or contracts secured directly or indirectly by a lien on real property, where the real property is unspecified at the time of investment.

The real property is always specified by the time the lender makes a loan. The loan documents provided to the lender prior to execution of the loan assignment include the legal description of the parcel.

(d) Pay any interest or premium for a period before actual purchase and delivery of the note or contract.

Sir Mortgage does not pay any interest or premium prior to delivery of the loan assignments.

(e) Pay any money to an investor if the note or contract is in arrears.

Sir Mortgage does not pay any money to the lenders if the loan is in arrears.

(f) Guarantee that principal or interest will be paid in conformity with the terms of the note or contract.

Sir Mortgage makes no such guarantee.

(g) Accept, from time to time, partial payment toward the purchase of the note or contract.

Sir Mortgages does not accept partial payments.

(h) Promise to repurchase the note or contract, in connection with sale or purchase.

Sir Mortgage does not promise to repurchase the loans.

A review of the loan files we have provided should verify that the assignments to lenders do not have any of these enumerated features.

Generally, these enumerated points go towards a determination of whether the arrangement constitutes a simple interest in a secured real estate note, or whether it has additional features, such as guarantees or profits in addition to interest, that would point towards the arrangement constituting a security. Here, the lenders receive a recorded assignment of an undivided interest (or complete interest if 100% assignment) in the loan. No additional features are included. Thus, the loan assignments are not "real property investment contracts", and thus are not securities.

C. Investment contract.

As explained above, because the loan assignments are not "real property investment contract," they should categorically not be considered a "security." However, if the Division believes that a separate analysis of "investment contract" is needed, Arizona authority fully supports the loan assignments not being investment contracts. Arizona follows the three part *Howey* test for determining whether an agreement is an "investment contract." *See e.g. Rose v. Dobras,* 128 Ariz. 209, 211, 624 P.2d 887, 889 (App. 1981); *Dagget v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 565, 733 P.2d 1142, 1148 (App. 1986). The three parts are (1) the investment of money; (2) "in a common enterprise;" (3) with the expectation that they will earn a profit solely through the efforts of others." *Rose, supra.* The lenders have certainly parted with money. In Arizona, a "common enterprise" may be shown through either "vertical commonality" or "horizontal commonality." *Dagget, supra.* Horizontal commonality "requires that a pooling of funds collectively managed by a promoter or third party take place" *Vairo v. Clayden*, 153

Ariz. 13, 17, 734 P.2d 110, 114 (App. 1987). Here, funds are not pooled and invested into mortgage loans – instead each lender obtains an undivided interest in a single, discrete loan. Vertical correlation requires "a positive correlation between the success of the investor and the success of the promoter without a pooling of funds." *Id.* Here, the lender's success is dependent on the repayment of the loans. In *Vairo* the court contrasted full recourse, typical notes with non-recourse notes from a previous case *(Dagget)* where payment was due only upon the promoter's success. The loan assignments here are much more like the full recourse notes in *Vairo* than the non-recourse notes in *Daggett.* Thus, vertical commonality does not exist.

The third prong of the *Howey* test concerns the expectation of profits through the efforts of others. In Arizona, these are the "essential managerial efforts which affect the failure or success of the enterprise." *Foy v. Thorp*, 186 Ariz. 151, 158, 920 P.2d 31, 38 (App. 1996) (citation omitted). In *Foy*, the court found that the efforts of a property manager were not such "managerial efforts." In contrast, the court did find "managerial efforts" in the case of a lease of an apple orchard where the lessor maintained full management of the orchard and was responsible for all aspects of production. *Rose, supra.* Here, Sir Mortgage's actions are like the property manager in *Foy*. After the assignment, Sir Mortgage's role is essentially ministerial. Again, the lender's success is dependent on whether the borrower repays the loan, not on the efforts of Sir Mortgage. Thus, the third prong of *Howey* is not satisfied.

Moreover, many cases hold that interest earned on a note is not "profit" or "efforts of others" within the meaning of the third prong of *Howey*. *See First Citizens*, 919 F.2d at 516 (holding that a loan participation agreement was not an "investment contract" under Arizona law); *United American Bank of Nashville*, 620 F.2d at 1117 (interest income not "derived from managerial efforts" of lead lender in loan participation); *Union National Bank of Little Rock*, 786 F.2d at 885 (fixed interest not considered profit within meaning of *Howey* test; no "managerial efforts" involved because return was based upon borrower's ability to repay rather than administrative efforts of seller of note).

Here, the assignment of undivided interests in specific secured loans does not satisfy the "common enterprise," "profit" or "effort of others" aspects of the *Howey* test. Thus, the assignments are not "investment contracts."

III. <u>Bank exemption</u>.

Under A.R.S. § 44-1843.A.2, securities issued by "a national bank.... or issued by a state bank or savings institution the business of which is supervised and regulated by an agency of this state or of the United States" are exempt from registration. The terms

"state bank" and "savings institution" are not defined in Title 44 or in Title 6. However, as previously noted, Sir Mortgage is a "mortgage banker" under A.R.S. § 6-941 et seq. The terms "supervised and regulated" are similar to "examination and supervision" under A.R.S. § 6-121. Thus, A.R.S. § 44-1843.A.2 should be read in harmony with A.R.S. Title 6, and those entities that are regulated as "banks" or "bankers" and are subject to ADFI "examination and supervision" should be included within the exclusion under A.R.S. § 44-1843.A.2.

IV. Mortgage Exemption.

Under A.R.S. § 44-1843.A.10, there is an exemption from registration for "notes or bonds secured by a mortgage or deed of trust on real estate or chattels... if the entire mortgage, contract or agreement together with all notes or bonds secured thereby is sold or offered for sale as a unit, except for real property investment contracts." The "sale as a unit" requirement could be interpreted in two ways: (1) the exception applies as long as the loan and the security for the loan are not separated; or (2) the exception applies only if the entire mortgage is sold to one purchaser.

Arizona precedent supports the first interpretation. For example, one case found that that the sale of two promissory notes secured by a UCC financing statement qualified for this exemption. *James M. Blute III, M.D., P.C. Profit Sharing Plan v. Terrazas*, 166 Ariz. 111, 112-13, 800 P.2d 977, 978-79 (App. 1990). The court held that the "unit" requirement was satisfied because the notes were secured by "an undivided interest in inventory." *Id.* Here, the lenders are assigned an "undivided interest" in the loan and its collateral. Moreover, the second possible definition (entire mortgage) is disproved by the fact that *Blute* involved two separate notes. In addition, the Arizona Supreme Court has referred to this exemption broadly as applying to "notes secured by mortgages or deeds of trust on real estate or chattels." *State v. Tober,* 173 Ariz. 211, 213, 841 P.2d 206, 208 (Ariz. 1992). And in *MacCollum v. Perkinson*, 185 Ariz. 179, 185-86, 913 P.2d 1097, 1103-04 (App. 1996), the Court of Appeals discussed this exemption and focused on whether the note in question was secured at the time it is issued. Here, the notes are secured from the onset.

V. Conclusion

Sir Mortgage is a well-established, respected mortgage banker. It has nothing to hide, and has operated openly its entire existence. Its operations are closely regulated by the ADFI. It has a strict policy of assigning loans only to experienced, sophisticated lenders. Its lenders must lend a minimum of $250,000. In short, there are no "mom & pop" lenders to protect here.

As the Arizona Court of Appeals recognized in *Butler v. American Asphalt & Contracting Co, supra,* the Act does not apply to sophisticated investors who can "fend for themselves." And as the U.S. Supreme Court recognized in *Marine Bank, supra,* the definition of "security" does not include instruments offered by entities subject to another extensive regulatory scheme. Because Sir Mortgage only assigns loans to sophisticated investors, and because is subject to ADFI's regulatory scheme, the Act does not apply.

This conclusion is reinforced by the Commission's regulatory history – the Commission has not asserted jurisdiction over regulated mortgage bankers in the past, even as it has actively pursued numerous cases against others offering real estate-related promissory notes. And this conclusion is supported by the many cases that hold that participations in secured loans offered by regulated financial entities are not securities.

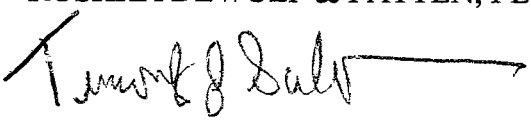
Moreover, the Sir loan assignments do not have any of the enumerated characteristics of a "real property investment contract" as specified in A.R.S. § 44-1801.18. And both Arizona and federal authority supports the conclusion that assignments of secured mortgage notes are not "investment contracts" under the *Howey* test.

Lastly, even if the loan assignments are securities, they are likely exempt from registration under both the "bank" exemption (A.R.S. § 44-1843.A.2) and the "mortgage" exemption (A.R.S. § 44-1843.A.10).

We are hopeful that this letter has satisfied any questions or concerns of the Division. If you have any questions, please feel free to call us at 602.256.6100. In addition, we are willing to meet with you and Mr. Sir to discuss these matters if you feel that would be helpful.

Very truly yours,

ROSHKA DEWULF & PATTEN, PLC



Paul J. Roshka, Jr.
Timothy J. Sabo
Attorneys for Sir Mortgage

cc: Sir Mortgage & Finance of Arizona, Inc.
Ronald Baran, Special Investigator

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