ARIZONA CORPORATION COMMISSION

SECURITIES DIVISION
(602) 542-4242
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March 3, 1992

Sheldon Sternberg, Esq.
Sternberg & Cohn, P.C.
80 East Columbus Avenue
Phoenix, Arizona 85012

RE: Clearwater Development, Inc.
A.R.S. §§ 44-1843(A)(10), 44-1801(22)

Dear Mr. Sternberg:

On the basis of the facts set forth in your letter of January 24, 1992, and in reliance upon your opinion as counsel, the Securities Division will not recommend enforcement action for violation of Section 44-1843(A)(10) of the Securities Act of Arizona subject specifically to your oral representation that the following terms, described in your letter dated November 27, 1991, will be removed from the proposal: (1) repayment of the note in the event of a financial or medical emergency of the buyer or his dependents and (2) repayment of the note in the event that the collateral note receivable is in arrears more than 90 days.

The Division strongly disagrees with your opinion expressed in your letters dated January 7 and 24, 1992 regarding the applicability of Section 44-1801(22) to the note described in your letter.

As this position is premised upon the facts set forth in your letters as modified, it should not be relied on for any other set of facts or by any other person. Please also note that this position applies only to the registration requirements of the Act; the anti-fraud provisions of the Act continue to be applicable.

We have attached photocopies of your letters. By doing this we are able to avoid having to recite or summarize the facts set forth therein.

Very truly yours,

DEE RIDDELL HARRIS
Director of Securities

DRH:LRB:wjw
Attachments

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January 24, 1992

VIA FAX AND FIRST CLASS MAIL

Mr. Dee R. Harris, Director
Arizona Corporation Commission
Securities Division
1200 West Washington, Suite 201
Phoenix, Arizona 85007

RE: Clearwater Development, Inc. - Request for No-Action Letter

Dear Mr. Harris:

I received your letter indicating that Clearwater's request for a No-Action Letter has been denied because you concluded that the issuance of the Notes under the facts outlined in my letters dated November 26, 1991 and January 7, 1992 are deemed to be the issuance of securities which are real property investment contracts.

Clearwater will eliminate the substitution of collateral and escrow deposit portion of the previous proposal so that the transactions will consist of simple, individual, separate collateralized short term loans.

Specifically, now being proposed is the following:

1. Clearwater borrow by issuing notes to no more than ten lenders over a period of no more than ninety days.

2. The total amount borrowed be no more than $250,000.00.

3. The term of each loan be for ten months, renewable at the option of the holder.

4. Each loan will be evidenced by a note collateralized by security agreement and collateral assignment of beneficial interest of purchase money note, the related deed of trust and the borrower's beneficial interest in a subdivision trust insofar as it relates to the collateral note, deed of trust and the lot encumbered by the deed of trust.

5. As a condition of the loan, the collateral note obligation will be current and the collateral deed of trust will be the sole lien on the property.

6. The amount borrowed would be the lesser of (a) 62.5% of the purchase price of each lot, or (b) 70% of the balance of the amount receivable from the sale of each lot.

7. The lender will receive interest monthly and in addition, a proportionate share of the principal payments received by Clearwater from the collection of the collateral note.

8. The loan transaction would be transacted through First American Title Insurance Company who would provide title insurance that the collateral assignment of beneficial interest in the deed of trust would be owned by lender free and clear of all liens and encumbrances, and that the real property which is the subject of the deed of trust being held as collateral is a first deed of trust free and clear of liens and encumbrances. In addition to the UCC filing, the title company will hold the collateral note as agent for the lender in perfection of the security interest and will be irrevocably instructed to allocate funds to the lender from collections from the collateral note in accordance with the requirements of the loan documents.

9. The proceeds of each loan will be utilized as designated in the loan agreement for one or more of the following purposes:

(a) to pay obligations due or coming due on borrower's purchase money obligation;

(b) to pay the release purchase price for each lot so that collateral deeds of trust be a first deed of trust; and

(c) to pay property taxes and accounts payable.

Clearwater will provide each lender, prior to closing, with the same information that it provides to its lending bank, to include those items set forth in page 3 of my letter dated November 27, 1991.

Each lender will be required to disclose a net worth establishing that the suitability requirements as enunciated by the regulations of the Commission are complied with. Moreover, lenders who do not demonstrate by background an ability to analyze and judge the nature of the loan and risks attendant thereto will be required to consult with an attorney, CPA, or financial advisor, to review the loan.

Subject to modification to conform to the contents of this letter, the documentation submitted to you will be utilized.

For the reasons set forth in my letters dated November 27, 1991 and January 7, 1992, and based upon the revised proposal set forth therein, I believe: (1) that the proposed notes are not securities under Reves v. Ernst & Young, 110 S.Ct. 945 (1990); (2) the notes would be loans and not "real property investment contracts" within the definition of A.R.S. Paragraph 1801(15); and (3) the transactions would fall within the exemptions under A.R.S. §44-1843(A)(10).

Please indicate whether, under the circumstances described herein, you can confirm that opinion.

Very truly yours,

Sheldon H. Sternberg

SHS:ap

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SHELDON STERNBERG
BETH S. COHN

January 7, 1992

VIA FAX

Mr. Mike Burton
Arizona Corporation Commission
Securities Division
1200 West Washington, Suite 201
Phoenix, Arizona 85007

RE: Clearwater Development, Inc. -
Request for No-Action Letter

Dear Mike:

Pursuant to our conversation yesterday and my previous conversation with Sara Ziskin while you were on vacation, I am submitting herewith the following additional information:

1. Exemption Under A.R.S. §44-1843(A)(10). A.R.S. §44-1843(A)(10) was adopted from the Uniform Securities Act paragraph 402(b)(5). See 69 AmJur2.d paragraph 86 which is enclosed. Such subparagraph clearly encompasses the creation of the deed of trust note ("DTN") and the sale thereof. The granting of a security interest in the DTN and the collateral assignment of the related deed of trust would be encompassed in the definition of sale under 44-1801 paragraph 18, which includes the "other disposition of the security or interest in a security for value". Is Clearwater's proposed issuance of notes secured by an assignment of the beneficiary's interest in a deed of trust on real estate covered by the exemption? A 1985 amendment to the Uniform Securities Act which exempts "a transaction in a bond or other evidence of indebtedness secured by a real estate mortgage, deed of trust, PERSONAL PROPERTY SECURITY AGREEMENT, ... if the entire ... agreement together with all bonds and other evidences of indebtedness secured thereby, is offered and sold as a unit". The Clearwater documents provided, clearly establish that the secured personal property security agreement exemption established by the Uniform Securities Act as amended is applicable. See Am Jur Supp paragraph 84 enclosed.

2. Promissory Note Not a Security. Clearwater would modify the proposed loan terms to qualify the notes as "a non-security". If the no-action letter cannot be issued on the basis of the above exemption, Clearwater would propose to modify the "proposed note transactions" to fit squarely within the non-security conditions provided in the U.S. Supreme Court case of Reves v. Ernst & Young, infra., as follows:

Clearwater would issue renewable nine month to one year notes to no more than ten lenders borrowing no more than $250,000.00 within 90 days. Additionally, Clearwater would agree

to limit the use of the proceeds of each loan to (1) bring current its obligations on its purchase money obligation, (2) pay the release price for the subject lot so that first deeds of trust serve as collateral, and (3) pay property taxes and accounts payable. The funds will be utilized to correct cash flow deficiencies under the "Reves" test. Since its inception in 1985, Clearwater's operations have been funded primarily by shareholder contributions and loans, seller financing on the purchase of real estate, commercial bank loans, and short-term secured loans from stockholders and business associates. Clearwater has approximately $3,000,000.00 in assets and equity and stockholder loans of $1,200,000.00. The proposed transaction results from changes in bank policies and unacceptable lending proposals from Greyhound Financial Corporation and not from lack of credit worthiness.

3. The "any note" portion of the definition of "security" under the federal securities laws from which A.R.S. §44-1801.22 is derived, has been defined to exclude various types of loan transactions by the various federal Courts of Appeal. The differing approaches to the issue was resolved by the U.S. Supreme Court case in Reves v. Ernst & Young, 110 S.Ct. 945 (1990). In the Reves case, the Supreme Court stated that there is a presumption that every note is a security, but the presumption is rebuttable. The Supreme Court adopted the Second Circuit's "family resemblance" test, creating a "judicially crafted" list of instruments commonly denominated as "notes" which are not within the "security" category, to which Courts may add.

The Court reaffirmed in principal that the distinction of "security" in Section 3(A)(10) of the Exchange Act is virtually identical to the Securities Act definition. The Court stated that Congress was concerned with the regulating the investment market, not with creating a general federal cause of action for fraud. The types of notes designated as not securities included: (1) the note delivered for consumer financing, (2) the note secured by a mortgage on a home, (3) the short-term note secured by a lien on a small business or some of its assets, (4) the note evidencing a "character loan" to a bank customer, (5) short-term notes secured by an assignment of accounts receivable, (6) a note which simply formalizes an open account debt incurred in the ordinary course of business, and (7) notes evidencing loans by commercial banks for current operations. The proposed transaction clearly fits within (3) and (5).

In explaining the "family resemblance" test, the Court looked at (1) the motivations of the seller and buyer to enter into the transaction. A note is "less sensibly described as a security if it 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"; (2) the plan of distribution of the instrument. It is necessary to determine whether the instrument is one in which there is a common trading for speculation or

investment; (3) the reasonable expectations of the investing public. Instruments were considered to be securities if the public expects that to be the case; and (4) the existence of another risk reducing factor such as a regulatory scheme or collateral. Reves was cited in the case of Singer v. Livoti, 741 F.Supp. 1040, 1049 (S.D.N.Y. 1990). The Court stated "it is hard to see why an exception for a conventional real estate mortgage should be different simply because it covered "a home" rather than, for example, a store-front, an office building, a series of homes, or VACANT LAND." In a note evidencing a loan of approximately $350,000.00 by one person, the Court stated: "surely there was no public expectation that a short-term note of this sort would be traded or speculated in as a security, for the most that any purchaser could derive would be the collection of interest at 10% for less than a year .....". The Court went on to state "we note the existence of "some factors such as the existence of another regulatory scheme which reduces the risk of the instrument". "Such instruments are ordinarily generated, as this one was, through the help of a licensed professional, such as an attorney, real estate broker, or mortgage broker. .... Furthermore, all states provide for public recordation of mortgages, an opportunity for mortgage lenders to search out prior liens and defects in title in the public record before investing, and give statutory protection by the recordation against subsequent encumbrances of the collateral."

The Clearwater documentation provided shows extensive security protection utilizing the title company, title insurance, the recordation of the security agreement, the holding of physical possession of the note for collateral, and the title company controlling the application of proceeds from collections of the DTN.

"Short-term promissory notes" as referred to in Reves has not been defined. However, it appears that a period longer than nine months would still be considered short-term.

I am enclosing the CCH Federal Securities Law Reports explanation of the Reves case and the case of Singer v. Livoti. Two Law Review articles explaining Reves are found in 21 Amem.St.U.L.Rev. 387 and 26 Wake Forrest L.Rev. 503.

Please call.

Very truly yours,

Sheldon H. Sternberg

SHS:ap
Enclosures

DUPLICATE

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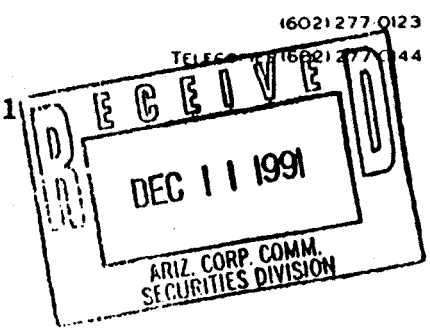
November 27, 1991



Mr. Dee R. Harris, Director
Arizona Corporation Commission
Securities Division
1200 West Washington, Suite 201
Phoenix, Arizona 85007

RE: Issuance of a Series of Notes Collateralized by Collateral Assignments of Beneficial Interest in Deeds of Trust

Dear Mr. Harris:

I am general counsel and president of Clearwater Development, Inc., an Arizona corporation ("Clearwater"). Clearwater proposes to borrow from numerous offerees in separate transactions between $22,000.00 and $26,000.00. In such transactions the Lender will receive a recourse Promissory Note of Clearwater collateralized by a Security Agreement and Collateral Assignment of a money purchase Note and Deed of Trust and Beneficial Interest in a Subdivision Trust, as such beneficial interest in the Subdivision relates to the purchase money Note and Deed of Trust being provided as collateral.

Based upon the facts and reasons discussed in this letter, I believe that the lending transactions are exempt from registration pursuant to Section 44-1843(A)(10) of the Securities Act of Arizona, and we wish to obtain your confirmation of that opinion.

BACKGROUND

Clearwater purchased 320 acres of property, located between Glendale Avenue and Bethany Home Road and Perryville Road and 183rd Avenue, in Maricopa County, pursuant to a two beneficiary Subdivision Trust, Trust No. 7221, First American Title Insurance Company of Arizona. The property was purchased from Romola Farms, an Arizona partnership, who holds a first beneficial position in the Subdivision Trust, while Clearwater is the second beneficiary. In 1988, Clearwater commenced subdivision and sales of lots having water, electricity, telephone, irrigation, and graded roads, primarily two acres in size. Two acre lots were sold for as little as $39,000.00 and presently $41,500.00. A minimum down payment of 10% is required and interest is at 11% per annum. The payment terms vary, but mostly a 15-year amortization with the entire balance due in 6 years was established. Title was conveyed to the purchaser and purchase money Notes secured by Deeds of Trust were received. Pursuant to a financing arrangement with Great Western Bank, 60 acres was

released from Trust No. 7221 and transferred to Trust No. 7666, Arizona Title, subdivided and improved. Clearwater Joint Venture No. 1, 99.9% owned by Clearwater, was the sole beneficiary of Trust No. 7666. Presently, the Great Western obligation is discharged, the Joint Venture is dissolved, and Clearwater succeeded to all Clearwater Joint Venture No. 1's assets and liabilities.

The enclosed combined financial statement as of June 30, 1991, and footnotes thereto, describe the assets, liabilities, and net equity of Clearwater. As of June 30, 1991, the combined equity and stockholder loans total $1,196,900.00. Subsequently, in excess of $80,000.00 was loaned and the improvements described in footnote 9 of the financial statement is near completion and substantially paid for.

PROPOSED TRANSACTIONS

Clearwater proposes to borrow from numerous offerees in separate transactions the lesser of (a) 62.5% of the purchase price of each lot, or (b) 75% of the balance of the amount receivable from the sale of each lot, typically between $22,000.00 and $26,000.00. The Lender will receive a recourse Promissory Note collateralized by a Security Agreement and Collateral Assignment of Beneficial Interest of the purchase money Note, the Deed of Trust, and the beneficial interest in the applicable Subdivision Trust insofar as it relates to the Note, Deed of Trust and the lot sold. As a condition of the loan, a Deed of Trust being used as collateral will be the sole lien on the property. To the extent appropriate, the Lender's position will be title insured.

Initially, it is intended that the loan will bear interest at the rate of 11% per annum and shall be payable monthly with the principal balance due, as negotiated, from three to five years. So that loan receivable balance ratios remain unimpaired, the Lender will also receive a proportionate share (usually 75%) of the principal payments received by Clearwater from the collection of the collateral Note.

Clearwater will agree to substitute collateral or repay the loan should the collateral Note receivable be in arrears more than 90 days. Additionally, Clearwater will agree to prepay the loan should the Lender, Lender's spouse, or dependents suffer an unforeseen medical or financial emergency which requires the use of the funds loaned. To assure its performance, Clearwater proposes to deposit 10% of the net proceeds borrowed from all lenders in a separate segregated bank account, money market account, governmental securities fund, or other similar liquid account.

The lenders must be individuals, family units, and bona fide entities. No direct or indirect splitting of loan positions will be permitted. The entire collateral Note and Deed of Trust will

be assigned in each transaction. Lender suitability statements will be required.

Paragraph 10 of the Security Agreement and Collateral Assignment of Beneficial Interest provides in detail for all of the beneficiary's rights to enforce the Deed of Trust to be transferred to the Lender should there be a default under the collateral Note and Deed of Trust.

DISCLOSURE

Clearwater will provide each Lender, prior to closing, the following:

A. A most recent financial statement.

B. Loan Agreement describing the transaction and what Clearwater perceives to be the risks.

C. Copies of the specific lot sale documents, including (1) Real Estate Purchase Agreement; (2) Deed of Trust Note; (3) Deed of Trust; (4) Legal Description; (5) Declaration of Conditions, Covenants and Restrictions; (6) Title Reports and easement documents; (7) Subdivision Plat; and (8) Department of Real Estate Subdivision Public Report.

D. The Collection Agent's written verification of the balance of the collateral Note.

E. A Clearwater lot sales history.

F. Clearwater lot forfeiture history including the disposition of repossessed lots and replacement collateral history.

G. Loan closing documentation, including (1) The Promissory Note; (2) The Security Agreement and Collateral Assignment of Beneficial Interest; (3) Collection Instructions; (4) Notice of Assignment of Direction to Pay; and (5) UCC-1.

H. Commitment for Title Insurance.

Enclosed are (1) the form of items B and G(1-5), (2) items A, C(5 &7), F and G, (3) typical items C(1-4, 6&8), D and H, and (4) Lender Suitability Certification.

EXEMPTION

We believe that a no-action letter is appropriate because the exemption from A.R.S. §44-1841 and §44-1842 is applicable under A.R.S. 44-1843(A)(10), which states:

"44-1843 Exempt Securities; Fee Filing;
A. The provisions of paragraphs 44-1841 and 44-1842 do not apply to any of the following classes of securities; .....

10. Notes or bonds secured by a mortgage or deed of trust on real estate or chattels, or a contract or agreement for sale of 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."

A beneficial interest in a deed of trust constitutes interest in real property. A collateral assignment of beneficial interest constitutes a mortgage. The collateral assignment of a beneficial interest in a deed of trust, therefore, fits within the technical definition of the exemption. Moreover, the transaction is within the spirit of the exemption which permits the issuance of notes secured by the seller's interest in a contract or an agreement of sale.

The offering of the collateral is not "a real property investment contract" under A.R.S. §44-1801.15 because (1) no guaranty is being provided, (2) the bank account deposits and substitution agreements are merely additional collateral arrangements between the borrower and lender, (3) the payments required under the promissory note are borrower's obligation and independent of the payment under the collateral note, and (4) the remaining portions of 44-1801.15 are inapplicable.

Very truly yours,

Sheldon H. Sternberg

SHS:ap