

BEFORE THE  
DEPARTMENT OF CORPORATIONS  
STATE OF CALIFORNIA

In the Matter of the Request of:

HEE YANG JOUNG, aka JOHN H. JOUNG,  
and JNM GROUP, INC., dba MARU  
COSMETICS USA, a California corporation

Respondents,

vs

THE CALIFORNIA CORPORATIONS  
COMMISSIONER,

Complainant,

for a hearing pursuant to section 31402 of the  
Franchise Investment Law.

OAH No. L2007040148

DECISION

The attached Proposed Decision of the Administrative Law Judge is hereby  
adopted by the Commissioner of Corporations as his Decision in the  
above-entitled matter.

This Decision shall become effective on 2 AUGUST 2007.

IT IS SO ORDERED this 1ST day of AUGUST 2007.

CALIFORNIA CORPORATIONS COMMISSIONER

\_\_\_\_\_  
Preston DuFauchard

BEFORE THE DEPARTMENT OF CORPORATIONS  
OF THE STATE OF CALIFORNIA

In the Matter of the Request of:

HEE YANG JOUNG, aka JOHN H. JOUNG,  
and JNM GROUP, INC., dba MARU  
COSMETICS USA, a California corporation,

Respondents,

vs

THE CALIFORNIA CORPORATIONS  
COMMISSIONER,

Complainant,

for a hearing pursuant to section 31402 of the  
Franchise Investment Law.

OAH No. L2007040148

**PROPOSED DECISION**

Chris Ruiz, Administrative Law Judge, Office of Administrative Hearings,  
heard this matter on May 8, 2007, at Los Angeles, California.

Lindsay B. Herrick, Corporations Counsel, represented Complainant.

Brad Lee, Attorney at Law, represented Hee Yang JounG (Joung) and JNM  
Group, Inc. (JNM) (collectively, Respondents). H. Anthony Kim, a court-certified  
interpreter (Korean language), provided interpretation for Joung and witness  
Hakchoong Kim.

Oral and documentary evidence was received and the matter was argued and  
submitted on May 8, 2007. This decision was due by June 7, 2007.

**FINDINGS OF FACT**

1. On February 27, 2007, Preston DuFauchard (Complainant),  
Commissioner of the Department of Corporations (Commissioner), issued a Desist  
and Refrain Order (D&O) to Respondents. The Commissioner determined that  
Respondents' sale of "franchises," more fully discussed below, constituted the sale of  
franchises in this state and in violation of the Franchise Investment Law. The D&O

ordered Respondents to halt the further offer or sale of said franchises unless and until the same are duly registered.

2. On April 2, 2007, Respondents filed a request for hearing challenging the issuance of the D&O, and this hearing ensued.

3. In order to sell franchises in California, a seller must comply with the Department of Corporations' (Department) application process. This application process allows the Department to examine and determine whether the proposed franchise sale is legitimate. For example, the Department requires three years of past financial statements, a copy of the proposed franchise agreement, consent by the applicant to service of process, authorization by the applicant for the Department to review financial records at any time, and information on all prior litigation in which the applicant has been a party. The application process is required for both a franchisor and a sub-franchisor. Respondents have not registered as a franchise or obtained an exemption.

4. JNM is a California corporation and Joung is its president. In early 2005, JNM was doing business under the fictitious business name of Maru Cosmetics. Maru Cosmetics offered "Beauty Credit" cosmetics, a product line manufactured by a Korean company named Somang Cosmetics (Somang). Maru Cosmetics targeted low to middle income consumers with its affordable line of cosmetics. Joung opened and operated a "Maru Cosmetics" store in the Beverly Center shopping center in Los Angeles, California.

5. Hakchoong Kim (Kim) has known Joung since the early 1990's. In March 2005, Joung told Kim that he (Joung) had the exclusive right to sell Maru Cosmetics. Joung also told Kim that he was "thinking about setting up a franchise," but Joung did not say that he had the right to sell franchises. Joung encouraged Kim to open his (Kim's) own store, also selling Maru Cosmetics. Kim agreed and Joung obtained a location for Kim's store in Long Beach, California. Joung told Kim that there was "a line of investors" waiting to open the Long Beach property if Kim was not interested. Joung signed the lease agreement on behalf of Kim. Joung and Kim did not have any written agreement regarding their business relationship.

6. In establishing Kim's store, Joung told Kim that "everything needed to go through him (Joung)." Kim paid all expenses to Joung. Joung invoiced Kim for the property improvements, security, a computer system, and rent. Joung also coordinated, and billed Kim for, the custom installation of cabinets and shelving as required by Somang. The interior of Kim's business location was required, by Somang, to have a particular appearance. Joung coordinated this required appearance with the contractors. Joung provided five days of training for Kim's business. Joung did not provide a formal business plan.

7. Joung obtained the cosmetic products for Kim's business from Somang. Joung then "marked-up" the price of the product by approximately two percent. The product was shipped directly from Somang to Kim's business location. Kim was required to buy and sell only Somang products and he could only purchase Somang products from Joung.

8. In approximately July 2005, Maru Cosmetics changed its name to Beauty Credit. Both Joung's store and Kim's store changed their respective names to Beauty Credit. At or about this time, Joung told Kim that he (Joung) had "franchise rights." Kim did not ask Joung for written evidence of this claim.

9. The opening day of Kim's business was attended by executives from Somang who made some adjustments in the store's displays and also in the pricing of the cosmetics.

10. In March 2006, Joung sent Kim an invoice for \$30,000 for a "franchise contract fee." Kim never paid this invoice because by that time his business had failed and closed in February 2006. It was not established why Kim's business failed. It was not alleged, or established, that Joung caused Kim's business to fail.

11. In 2005 or 2006, Joung placed a newspaper advertisement which contains the terms "Somang Cosmetics" and "Beauty Credit" and "Franchise Business." The advertisement listed Joung's phone number in the event a reader was interested in obtaining a franchise business.

12. All of the above factual findings are based on the exhibits and testimony of Joanne Ross, a Department attorney who testified regarding the franchise application process, and Kim. Respondent did not testify or offer any witnesses.

## CONCLUSIONS OF LAW

1. Under the California Franchise Investment Law,<sup>1</sup> it is unlawful for any person to offer or to sell any franchise in California unless the offer of the franchise has been registered or exempted from registration by the Department. (Corp. Code, § 31110.) The Legislature's intent in enacting the Franchise Investment Law more than thirty years ago<sup>2</sup> was threefold: (1) to provide franchisees with full and complete information so that they can make an intelligent decision regarding the offered franchise; (2) to prohibit the sale of a franchise if it would lead to fraud or the likelihood that the franchisor's promises would not be fulfilled; and (3) to protect the franchisor by providing a better understanding of the relationship between the

---

<sup>1</sup> Corporations Code section 31000, et seq.

<sup>2</sup> See Stats. 1970, ch.1400, section 3, p. 2645.

franchisor and the franchisee regarding their business relationship. (Corp. Code, § 31001.)

2. Because the Franchise Investment Law is remedial and protective, it is to be liberally construed to effectuate its intent. Thus, when considering each of the four elements of a franchise, "each element should be construed liberally to broaden the group of investors protected by the law and to carry out the legislative intent." (*Kim v. Servosnax, Inc.* (1992) 10 Cal.App.4th 1346, 1356.)

3. Corporations Code section 31005, subdivision (a) defines "franchise" as follows:

(a) "Franchise" means a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

(1) A franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor; and

(2) The operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and

(3) The franchisee is required to pay, directly or indirectly, a franchise fee.

4. Making the determination of whether an agreement, business opportunity or some other arrangement is actually a franchise subject to registration is often difficult. Accordingly, the Commissioner issued Release 3-F, entitled "When Does an Agreement Constitute a Franchise?" (revised June 22, 1994) (Release 3-F), to help make that determination. Release 3-F offers a detailed analysis of how the Commissioner determines whether an agreement is a franchise under the Franchise Investment Law.<sup>3</sup> Release 3-F begins by noting the four elements which must be found in order to determine that an agreement is a franchise, and further notes that the failure to find any one of these four elements means that the agreement is not a franchise. The four elements, all of which are also found in Corporations Code section 31005, subdivision (a), are as follows:

---

<sup>3</sup> The Commissioner's written opinions are entitled to great weight. (*People v. Kline* (1980) 110 Cal.App.3d 587, 593.)

1. A right must be granted to the franchisee to engage in the business of offering, selling or distributing goods or services;
  2. The right must be granted to engage in the business under a marketing plan or system prescribed in substantial part by the franchisor;
  3. The operation of the franchisee's business must be substantially associated with an advertising or other commercial symbol designating the franchisor or an affiliate of the franchisor, such as a trademark, service mark, trade name or logotype; and
  4. The franchisee must be required to pay, directly or indirectly, a fee or charge, known as a "franchise fee," for the right to enter into the business.
5. Analysis of each of the foregoing elements, as applied to the facts of this case, shows that the arrangement between Joung and Kim did constitute a franchise within the meaning of Corporations Code section 31005 and is thus subject to registration under the Franchise Investment Law.

**Right to Engage in a Business:**

Under this portion of the analysis, Release 3-F states, in pertinent part:

For an agreement to be a "franchise," the franchisee must be granted the right to engage in the business of offering, selling, or distributing goods or services; but an agreement which grants the franchisee the right to engage in a business identified with the franchisor's commercial symbol is no less a franchise by reason of the fact that the franchisee previously, on his own and without reference to the franchisor's plan and symbol, had been engaged in the particular line of business. (Comm. Op. No. 72/29F.) Furthermore, the franchisee must be granted the right to offer, sell, or distribute goods or services to others rather than solely to the franchisor. (Comm. Op. Nos. 74/11F, 82/3F.) Also, the grant of the right by the franchisor to franchisees to solicit others to join in the franchise operation, or to solicit sales of other franchises, constitutes the right to engage in business. (PL/22F.)

If the agreement does not grant the franchisee the right to engage in business, it is not a franchise. Thus, an agreement by which a person designated as "franchisee," for a fee which is designated as "franchise fee," is given the right to participate in the profits of a business, but who is given no right to operate or participate in the operation of the business, is not a franchise, but is a profit participation arrangement or investment contract which may be subject to the qualification



requirements of the Corporate Securities Law of 1968. (Comm. Op. No. 72/27C.)

Anyone who otherwise meets state and local criteria may operate a business which sells cosmetics to the public. The documentary evidence did not establish that Joung had the authority to sell Somang franchises. Also, the documentary evidence did not establish that Joung actually granted Kim the right to engage in the business of selling Somang cosmetics. No written agreements between Somang and Joung, or Joung and Kim, were offered into evidence. However, the appearance of Somang executives at the grand opening of Kim's store, which Joung coordinated, where they made modifications in the appearance of Kim's store and in the pricing of the products, is evidence that Somang approved Kim's operation as a franchisee. This evidence, combined with the fact that Kim was only allowed to sell Somang's products, establishes that Kim was granted a right to engage in the selling of Somang cosmetics.

**Marketing Plan or System:**

Under this portion of the analysis, Release 3-F states:

For the agreement to constitute a "franchise," the business in which the franchisee is granted the right to engage in must be operated under a marketing plan or system prescribed in substantial part by the franchisor.

¶ . . . ¶

**(b) Interpretation in Line with Objective of the Law**

In making the determination whether there is a prescribed marketing plan or system, it is necessary to keep in mind the objective of the Law to deal with a multiplicity of business arrangements created by the franchisor and presented to the public as a unit or marketing concept, and for all of which the franchisor ostensibly assumes responsibility by causing these arrangements to be operated with the appearance of some centralized management and uniform standards regarding the quality and price of the goods sold, services rendered, and other material incidents of the operation. The marketing plan or system prescribed by the franchisor is one of the important means by which the appearance of centralized management and uniform standards is achieved. (Comm. Op. No. 73/39F.)

¶ . . . ¶

(g) Some Examples

The Commissioner of Corporations' opinions have considered the presence of a marketing plan in light of the following provisions in an agreement:

Prescribing or limiting resale prices (Comm. Op. Nos. 72/11F, 73/5F, 73/47F; PL/27F);  
Restrictions on use of advertising or mail order business (Comm. Op. No. 73/47F);  
Requiring display racks (Comm. Op. No. 73/9F);  
Giving detailed directions and advice concerning operating techniques (Comm. Op. Nos. 72/11 F, 72/20F, 73/17F);  
Assigning exclusive territory (Comm. Op. Nos. 72/45F, 73/20F, 73/25F, 73/30F);  
Providing for uniformity or distinctiveness of appearance (Comm. Op. Nos. 72/10F, 72/21F, 73/26F, 73/27F, 73/29F);  
Limiting sale of competitive products (Comm. Op. Nos. 72/3F, 72/25F, 73/30F);  
Limiting use of products (Comm. Op. No. 74/6F);  
Requiring approval of advertising and signs (Comm. Op. Nos. 72/4F, 72/45F);  
Prohibiting engaging in other activities (Comm. Op. No. 75/6F);  
Providing training sessions (Comm. Op. Nos. 72/25F, 72/34F, 72/42F);  
Assigning contract (Comm. Op. No. 74/7F);  
Use of manual (Comm. Op. No. 72/42F);  
Providing "trade secrets" (Comm. Op. No. 74/8F).

While any one of the examples of restrictions may not amount to "a marketing plan or system prescribed in substantial part by a franchisor," several such restrictions taken together may be sufficient to amount to such a plan or system.

The appearance of Kim's store was designed with particularity so as to satisfy the particular requirements of Somang. This included specific display racks for the cosmetics. Kim was required to only sell a certain type of cosmetics, namely Somang's. Kim was also required to change the name of his store to Beauty Credit and Joung provided training at Kim's store. All of these factors are evidence that Kim was required to follow Somang's system of selling cosmetics.



### **Substantial Association with Franchisor's Commercial Symbol:**

Under this portion of the analysis, Release 3-F states, in pertinent part:

To constitute a franchise, the operation of the franchisee's business must be substantially associated with the franchisor's commercial symbol, such as a trademark, service mark, trade name, or logotype. An agreement is not a franchise, though it prescribes a detailed marketing plan or system for the operation of the business authorized thereby, if that business is not substantially associated with a commercial symbol of the franchisor or its affiliate.

Again, the objective of the Law is to deal with a multiplicity of business arrangements presented to the public as a unit or marketing concept operated pursuant to a uniform marketing plan and under a common symbol. Therefore, if the franchisee is granted the right to use the franchisor's symbol, that part of the franchise definition is satisfied even if the franchisee is not obligated to display the symbol. (Comm. Op. No. 73120F.)

Moreover, in line with the objective of the Law, for the operation of the franchisee's business to be substantially associated with the symbol, it must be communicated to the customers of the franchisee. A commercial symbol which a supplier of goods or services only uses on its invoices or in its advertising to distributors, but which the supplier does not permit the distributors to show in dealing with their customers, is not in the eyes of the public substantially associated with the operation of the supplier. (Comm. Op. Nos. 71/16F, 73118F.)

However, where the trademark is communicated to the customers of the supplier, the appearance of a unified operation is established and it is immaterial whether the advertising containing the trademark is originated, distributed, or paid for by the supplier or by the distributor. In resolving the question whether there is a substantial association between the licensee's business and the licensor's commercial symbol, it is necessary to consider whether that commercial symbol is brought to the attention of the licensee's customers to such an extent that the customers regard the licensee's establishment as one in a chain identified with the licensor. (Comm. Op. Nos. 73/5F, 7811 F.)

The operation of the franchisee's business must be substantially associated with an advertising or other commercial symbol designating the franchisor or an affiliate of the franchisor, such as a trademark, service mark, trade name or logotype. (Corp. Code, § 31005, subd. (a).) In this matter, there is no question that Kim was

required to sell only products with the Somang name and he was required to name his store "Beauty Credit." A customer entering Kim's store would reasonably assume that it was in the Somang chain.

**Franchise Fee:**

Under this portion of the analysis, Release 3-F states, in pertinent part:

For the agreement to constitute a franchise, the agreement must call for the payment of a franchise fee by the franchisee.

(a) Definition

Section 31011 of the Law contains a broad definition of "franchise fee." That section includes in the definition any fee or charge that a franchisee is required to pay or agrees to pay for the right to enter into a business under a franchise agreement. In accordance with this definition, any fee or charge which the franchisee is required to pay to the franchisor or an affiliate of the franchisor for the right to engage in business is a franchise fee regardless of the designation given to, or the form of, such payment. Whether or not a fee or charge is "required" and whether it is made "for the right to enter into a business," is a mixed question of fact and law.

In this case, Joung sent Kim an invoice for \$30,000 for a "franchise contract fee." While Joung's counsel argued, in his closing statement, that this invoice was a mistake, there was no evidence supporting that argument. Further, the document speaks for itself and established that Joung charged Kim a franchise fee.

6. Because each of the elements of a franchise is present, and Respondents have neither registered as a franchise, nor obtained an exemption, cause exists for the Commissioner to have issued the Desist and Refrain Order. (Factual Findings 1-12, Legal Conclusions 1-5.)

**ORDER**

WHEREFORE, THE FOLLOWING ORDER is hereby made:

Respondents' appeal of the Desist and Refrain Order, issued by the Commissioner of Corporations on February 27, 2007, against Respondents Joung and JNM, is denied.

Date: June 4, 2007,

CHRIS RUIZ  
Administrative Law Judge  
Office of Administrative Hearings