

BEFORE THE
DEPARTMENT OF CORPORATIONS
OF THE STATE OF CALIFORNIA

In the Matter of the Desist and Refrain Order) OAH No. L1998060195
)
Against:)
)
INTERNET & WEB SERVICES)
CORPORATION, BRYAN HERTZ)
AND ROBERT HERTZ,)
)
Respondents,)
)
For hearing pursuant to Section 25532 of the)
Corporate Securities Law Of 1968.)
_____)

DECISION

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

This Decision shall become effective on 9-28-98

IT IS SO ORDERED.

Date: 9-28-98

Dale E. Bonner

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PROPOSED DECISION

On July 31 and August 4, 1998, in San Diego, California, Joyce A. Wharton, Administrative Law Judge, Office of Administrative Hearings, State of California, heard this matter.

Marlou de Luna and Natalie Roberts, Corporations Counsel, represented the complainant.

Kennan E. Kaeder, Attorney at Law, represented respondents, who were present.

Evidence was received and the record remained open for submission of closing briefs. On August 11, 1998, respondents filed a Closing Hearing Brief and a Compendium of Case Law which were marked Exhibits H and I for the record. On August 12, 1998, complainant filed a Closing Argument which was marked Exhibit 9 for the record. On August 17, 1998, respondent filed a Reply Brief which was marked Exhibit J, and complainant filed a Reply Brief and a Request for Judicial Notice which were marked collectively Exhibit 10. On August 19, 1998, complainant filed documents relating to the Request for Judicial Notice and these were marked collectively as Exhibit 11.

Prior to commencement of the hearing, complainant filed a Motion to Compel Discovery and respondents filed Opposition to the Motion along with 11 Motions in Limine. All of these motions were heard and ruled on, on the record, prior to commencement of hearing. Complainant's motion was marked Exhibit 12; respondents' in limine motions and opposition brief were marked as Exhibits K and L.

On August 19, 1998, the record was closed and the matter was submitted.

FINDINGS OF FACT

JURISDICTION

1. On July 15, 1998, Dale E. Bonner, acting in his official capacity as Commissioner of Corporations (hereinafter "complainant"), issued a Desist and Refrain Order against Internet & Web Services Corporation (hereinafter "IWSC"), Bryan Hertz and Robert Hertz. The order was issued pursuant to California Corporations Code¹ section 25532.² The order precludes respondents from the "further offer or sale in the State of California of securities, including but not limited to, **investment contracts, in the form of contracts for web-site stores**, unless and until qualification has been made under said law or unless exempt."

On July 16, 1998, respondents made a timely request for a hearing pursuant to section 25532(d).

On July 22, 1998, complainant issued, filed and served a Complaint in Support of Desist and Refrain Order. The Complaint, in pertinent part, alleges:

"Respondents are in the business of creating a web site mall and have engaged in the offer and sale of securities in the form of investment contract³ for web-site stores. Respondents have offered and sold securities since at least July 1997. Sales of these securities have been made to at least 3 individuals.

...

Respondents have not qualified these securities with the Commissioner nor is there an exemption available to Respondents as required by Section 25110."

ISSUES

2. The following are the factual and legal issues to be determined:

A. Does the sale of a web-site mall store as transacted by IWSC constitute a "security" within the meaning of section 25019?

B. If the web-site mall store transaction does constitute a security, did respondents have the sale qualified under section 25113 or is the transaction exempted?

C. Should the Cease and Desist Order be upheld or vacated?

¹ All statutory references are to the California Corporations Code unless otherwise indicated.

² Section 25532 provides: "(a) If, in the opinion of the commissioner, the sale of any security is subject to qualification under this law and it is being or has been offered or sold without first being qualified, the commissioner may order the issuer or offerer of such security to desist and refrain from the further offer or sale of such security unless and until qualification has been made under this law."

³ Section 25019 provides in relevant part: "'Security' means any note; stock;...investment contract;.... All of the foregoing are securities whether or not evidenced by a written document...."

3. Respondent IWSC is a California Corporation doing business in San Diego County. The corporation was formed in 1995 by Robert Hertz and his son, Bryan Hertz.

Robert Hertz has an extensive background in computer science and technology. He is a computer systems scientist and consultant. He developed very successful automating systems for businesses and institutions. Robert Hertz is a shareholder, officer and director of IWSC. He develops sophisticated computer programs and systems for the company. With regard to the web-site mall stores at issue in this proceeding, Robert Hertz oversees the design and deployment of stores.

Bryan Hertz holds a Computer Science Certificate from Coleman College and is the Chief Executive Officer of IWSC. He oversees the operations of the company.

Both Hertzes work at the IWSC offices in San Diego.

4. IWSC was initially capitalized by its founders with their own cash, equipment, furniture, some consulting jobs, and intellectual property developed and owned by Robert. In about 1996, approximately two and one-half million dollars was raised through a private stock offering. This money was used for development and business expenses such as new equipment, employees and marketing.

IWSC develops and promotes state of the art technology in automation and communication. IWSC is an Internet service provider with access to a computer infrastructure that allows numerous complex transactions to be performed on the Internet.⁴ It also develops Internet applications for industrial use. By mid-1997, IWSC had more than eighty employees.

5. In 1997 IWSC developed "1 World Center", an Internet site described as "The Ultimate Internet Shopping Location". It is intended to provide a shopping experience similar to a mall where numerous "stores" are available. Customers access 1 World Center through the Internet. They can "browse" through the stores, see pictures and information about the merchandise and place orders through their computer.

IWSC owns the 1 World Center "site" on the Internet. IWSC sells individual stores to "merchants" who want to participate in the commercial enterprise. 1 World Center was opened for business in about April 1997. By the summer of 1997, at least fifty stores were opened in the "mall".

In 1997 IWSC and/or 1 World Center employed approximately 15 salesmen to contact prospective store purchasers, negotiate the sale and close the contract. No evidence was presented to explain how IWSC selected prospective purchasers.

⁴ A computer "network" is formed whenever two or more computers are connected to share resources. An "internet" is formed when two or more networks are connected. The "Internet" is an international computer network connected through high speed telephone lines. It allows the transfer of information from any computer to any other computer. It facilitates the "world wide web", e-mail, "on-line shopping" and other computer based activities. A person can access the Internet by using a computer connected to an Internet service provider.

PROMOTIONAL MATERIAL AND REPRESENTATIONS

6. Prospective store purchasers were given a nine-page brochure and a three-page agreement. The following statements are made in the brochure:

- "...the opportunity for you to generate considerable income compared to the money and time that's involved..."
- "1 World Center will assist you and help you set up all of the necessary pieces needed to maintain a successful Internet retailing business!"
- "You don't need to be a computer genius or know everything about the Internet in order to profit from it. The important thing to understand is how quick and simple our company can make it for you to develop a substantial income from the Internet."
- Unlike many businesses, where you are left on your own once you become an owner, when you decide to become a Premier Merchant with 1 World Center you have taken the first step in building an ongoing relationship with a highly focused company whose ongoing compensation comes directly from your financial success. We are your Partners in Success."
- Through our strategic industry partnerships with major companies like IBM, Microsoft, ATMNET and NETSCAPE, and advertising partners such as Ziff Davis, Macklermedia, and Venture Communications, we bring a level of expertise to you that is unparalleled.
- Imagine that your store could generate sales every hour of every day, even when you weren't there, because you hired a "partner" to help you run it. ...and your partner was actually a team of electronic marketing, sales and business management experts, focused on your bottom line profits."
- "Imagine a business where you wouldn't lose income when you were ill or on vacation. You could spend as little or as much time on the business as you wanted so you could take time for the things that you enjoy."
- "...The power of the Internet gets you the potential of 24 hour global exposure. **But that's only if you have the ability and the know-how to exploit that potential.** That's where we come in."
- "Assume that you are one of our Premier Merchants. With the international scope of the Internet, millions of people are shopping on it every day and millions more are exploring it for the first time. We focus our extensive marketing and advertising on these users so you have an ever increasing flow of well heeled shoppers...."
- "No computer experience necessary."
- "...even if you don't already have access to an existing product line... . We have arranged and negotiated wholesale contracts with manufacturers of unique, high quality products for our Premier merchants. In many cases, these major manufacturers will provide us with great wholesale prices

and access to all of their marketing materials. ...we have arranged for many of them to drop ship the products...so that you won't have to deal with shipping or inventory. This will give you a solid foundation on which to build and expand your Internet store... ."

- "We...have an ongoing research and development program to continuously provide the shopper with the safest and most service-oriented location on the Internet. We are committed to implementing all of the latest and greatest in interactive technologies, so that our Center and your store, will maintain a level of shopper loyalty... ."
- "You need regular and effective advertising to let your potential customers know how to find you. You benefit from our Company's full page ads in all the leading ...magazines."
- "The actual mechanics of operating your business and processing your customer orders basically comes down to this:
 - Check your fax machine or computer for the customer orders from your Internet Store...
 - Verify the shipping and credit card information...
 - Wrap, box and drop-ship the products to the shopper yourself, or...
 - Fax or e-mail the order to the manufacturer and they box and drop-ship the products to the shopper.
 - Receive order and shipping confirmation.
 - Record figures in your accounting/tracking log.
- "If you don't initially have your own product line, and we help set up that relationship for you, we will handle all of the above transaction processing for your store for the first 3 to 6 months to allow you to become comfortable with the process!"

7. The following statements are contained in the three-page contract to be signed by the store purchaser:

- "I acknowledge that IWSC/1 WorldCenter has arranged for _____ products to be sold in my Internet store.⁵ I understand that I will not have to inventory any of the above brand name products, as IWSC/1 WorldCenter has arranged to have these products drop-shipped by the manufacturer to an assigned manufacturer's representative."
- "I will be given access to a password protected location to verify all orders from my store. After the first 3 to 6 months of order processing, I will have the ability to directly transmit all orders to the manufacturer's authorized drop ship location."
- "I understand that this is a proprietary relationship between IWSC and the manufacturer or manufacturers [sic] representative, and I will not contact the manufacturer directly, except with the

⁵ The contract also provided for a merchant to be able to sell his or her own product line. Neither of the contracts at issue in this proceeding involved such an arrangement.

express written permission of IWSC/1 World Center Management."

- "we provide you an 'electronic template' that allows you full 'remote control' from the comfort and convenience of your home computer, to change and control retail prices in your store, do special sales and promotions within your store, to add products and change product descriptions in your store, etc, so you can grow and promote your Internet store, as much as you like, at your pace.

8. The promotional brochure and the contract made reference to the store owner's ability to choose the product line, change prices, advertise, process orders and do special sales and promotions. However, the emphasis in promotion, sale and operation of a store was on the generation of income with minimal involvement by the store owner and with ongoing activity and support by IWSC.

THE CARTWRIGHT TRANSACTION

9. Diane Cartwright is a well-educated, articulate forty-seven year old woman. She has worked for twenty-five years in radio and television broadcasting, including positions as a news anchor and feature reporter. She knows how to use a computer and to access the Internet. Cartwright does not own a computer.

In about August 1997, Bob Linden, a marketing representative for IWSC, called Cartwright at her home. Linden and Cartwright once worked together but had not been in contact for nine years. Linden told Cartwright he was marketing stores on the Internet. He explained the concept and sent her the brochure described in Finding 6. After reviewing the brochure, Cartwright asked several questions of Linden and Ernie Brusalis, the vice-president of marketing for IWSC/1 World Center. She had little experience in business and was concerned about accounting procedures, sales, profits and losses.

Brusalis and Linden told her that, for her investment, they would find the name brand store that would generate a substantial return of her investment, IWSC would do all the work - accounting, product line, marketing, advertising, and create up to 200 images of the product she chose.

Brusalis advised Cartwright that a minimum of \$10,000 was required to purchase a store, but the more money invested, the higher the store value and the greater the profit. A brand name store like Black and Decker or Bosch tools cost \$50,000. Brusalis said it would be difficult to give her a satisfactory store for anything less than that. Cartwright told Brusalis she knew little about tools. He responded that she did not have to know or understand the product because IWSC handled product description, promotion, marketing, all the sales and all the accounting. If she had a Fax, IWSC would fax her a statement of her profit for each month. When Cartwright expressed her concern about lack of business and accounting experience, Brusalis told her she did not have to understand those procedures because IWSC would handle it all. She was shown an Internet magazine and told that IWSC would include a monthly advertisement for all the mall stores, including hers. When Cartwright commented that she would not know how to control an Internet business without a computer or having had access to the site, Brusalis told her she did not need a computer, only access to a Fax machine so IWSC could send the monthly statements.

Cartwright told Brusalis her current career left little time to manage a store but she might want the opportunity to control it in the future. Brusalis reiterated she did not have to do anything, the store was totally managed and she just had to check on her profits. He said she had the option to run her store but it was not required; she could let the store run itself or she could manage it

Brusalis told Cartwright that within a minimum of six months her total investment of \$50,000 would be recouped and she would generate a profit between \$5,000 and \$10,000 per month.

When Cartwright asked for a list of stores in various price ranges from which she could choose, Brusalis told her it was proprietary information that he could not release. Cartwright agreed to invest \$50,000. The only store available to her at that price was the Black & Decker store. She was given no other choice.

On September 5, 1997, Cartwright entered a written agreement with IWSC for the purchase of a Black & Decker store at 1 World Center. The agreement specified that she would pay \$50,000 for a "Storefront Design and Setup Fee" and 10% of all gross sales generated in her store to cover "all ongoing web hosting and maintenance fees & order processing fees". The contract also contained the statements set forth in Finding 7.

10. Cartwright named the store "Tools 4 You". Cartwright asked how to contact Black & Decker to discuss her pricing concerns. Brusalis told her she could not do that, only 1 World Center could contact the manufacturer for product shipment or prices.

Cartwright's store opened in late November, 1997. She was given no instructions about how to operate it. She asked to have input in pricing the store items. Brusalis told her the system was not yet set up to do that. She was not able to choose the items featured or to set the prices. When she asked Bryan Hertz about changing prices, he told her to trust them, IWSC knew what it was doing and she would be happy with the results.

Cartwright did receive monthly statements showing sales and profits but she got no information about which items were sold. In January, 1988, IWSC gave her a "password" that allowed her to access information about her store's sales.

11. On January 13, 1998, Bryan Hertz wrote a long letter to Cartwright to address her recent complaints about the operation of her store. In response to her complaint that there were not enough items in her store, he states, "We have made significant progress in assuring that an additional 40 or so products are available for you through Black & Decker and we are striving to add as many as possible." He relayed the following message from IWSC's product manager:

"We are currently researching all pricing on the 64 products in the store and will have a report out by Monday with recommended pricing. We are also selecting the appropriate magazine to place a targeted ad [sic] for the store in, and will have an ad designed by Tuesday."

Hertz described recent IWSC technology that would make it easier for shoppers to order products and advised Cartwright that IWSC "will soon have advanced tools that allow you to easily control promotional aspects of your store, add new products with ease and more easily change prices." Hertz

informed Cartwright of the newly created "Do or Die Store Manager Policy":

"This policy implements what we call Store Managers for each 1 World Center store. Your Store Manager has been assigned within the past few days and will soon be contacting you if he/she has not already. The Store Manager is responsible to be your "On Site" representative within IWSC - a person who is the watchdog for your 1 World Center Store. He is the one who you will contact to request help with anything that concerns you. They are responsible for keeping you informed as to the factors internally and externally that affect you and your store. ...

We are joined in this OPPORTUNITY! We have been, and continue to invest our money in your stores WITH you. We must work together to make our Internet and E-Commerce dreams a reality. ..."

THE BATES TRANSACTION

12. Marion Cartwright Bates is a bright, energetic woman of seventy-five. Since 1964 she has owned and operated a wholesale nursery business in Modesto, California. Other than a sign on the property and on the business truck, Bates does no advertising because hers is the only wholesale nursery in the area and she sells to long time customers. Mr. Bates oversees the growing of the plants and trees. Bates manages the business and does the bookkeeping with the help of one office employee. She works at least 40 hours per week at the business. She plans to work in the business at least 10 more years.

Bates does not own or operate a computer in her home or business. She does not know how to use a computer and has never used the Internet.

Diane Cartwright is Bates' daughter. Cartwright referred Brusalis to her mother who had money for investments. In about early September 1997, Brusalis called Bates and offered to sell her a Bosch Tools store on 1 World Center. Bates and Brusalis spoke three to five times by phone. He told her the store was a wonderful investment and she did not have to operate or manage it, that IWSC would handle everything. No one told her she needed a computer to manage the store. Brusalis sent her the brochure and contract by Fax.

On September 12, 1997, Bates entered a written agreement for the purchase of a Bosch Power Tools store. The agreement specified that she would pay \$30,000 for a "Storefront Design and Setup Fee" and 10% of all gross sales generated in her store to cover "all ongoing web hosting and maintenance fees & order processing fees". The contract also contained the statements set forth in Finding VII. On September 17, 1997 Bates issued her check for \$30,000 to IWSC.

No one from IWSC ever contacted her or sent her any documents to tell her how to operate the store. Bates does not know how to use a computer to access the Internet. However, Cartwright has used a library computer to do it for her.

For reasons that are not material to this proceeding, Bates Bosch Tools store site was never designed or opened.

13. Bryan Hertz testified that IWSC uses the purchase money, described in the contracts as "Storefront Design and Setup Fee", to pay for the cost of the web site, arrangements with the drop-shippers, programming, data entry, graphics and "data base issues". No evidence was presented to establish the actual value of either the product or service provided to the merchant in exchange for the purchase price.

The store owner is not able to access the store's activity until IWSC issues a "password". IWSC has total control of the store's operation for the first three to six months that it is open for business. Respondents describe this as a shake-out period necessary to insure the store is working properly and the owner is trained in dealing with the shipping process. IWSC does not want the manufacturers or drop shippers to be bothered by too many calls from the merchants. After six months the owner has the option to take over the process.

IWSC sets the retail price for each store item when it designs and creates the store.

The "electronic template" referenced in the purchase contract is a series of "tools" the merchant purportedly can use through the computer to change the products, pictures and pricing in the store and to access information about the sales. Bryan Hertz testified that IWSC has refined the template but that all functions were available "in various forms" in 1997. The evidence did not establish the degree to which the template was functional in September, 1997. Neither Bates nor Cartwright understood what the electronic template meant and they were not told they were expected to use it in the management of their stores. IWSC provided no training or instruction to Bates or Cartwright on how to use the electronic template tools. IWSC provides a customer service person to help an inquiring owner use the tools and to help shop customers use the web site technology.

The money generated by purchases from 1 World Center is received by IWSC and deposited into an IWSC bank account that had "sub-accounts" for each store owner. IWSC prepares a monthly accounting for each store, reflecting the gross receipts from sales and shipping costs minus the wholesale cost and shipping. IWSC deducts its 10% fee from the gross profits and the remainder is the merchant's profit. Each month IWSC issues the merchant a check drawn on the IWSC account. IWSC issues the merchant a form 1099 at the end of the year.

Neither the brochure nor the contract addresses the store owner's ability to sell, transfer or otherwise dispose of their store. Both Cartwright and Bates testified Brusalis and Linden told them that, if they were not happy with the investment, their money would be refunded. However, when Cartwright demanded a refund of her and Bates' investment it was not forthcoming. Brusalis advised Cartwright the store was an asset that could be disposed of like any other business, stock or bonds.

14. Respondents did not qualify the sale of the web-site mall stores under section 25113. They presented no evidence to establish that the transaction is exempted.

DISCUSSION OF THE LAW

"What constitutes a security is a question of fact to be decided on a case-by-case

basis." (Moreland v. Department of Corporations (1987) 194 Cal.App.3d 506, 512, citing People v. Figueroa (1986) 41 Cal.3d 714.) In Figueroa the Supreme Court noted: "...the corporate securities laws do not contain an 'all-inclusive formula by which to test the facts in every case. And the courts have refrained from attempting to formulate such a test....In arriving at a determination, the courts have been mindful that the general purpose of the law is to protect the public against the imposition of unsubstantial, unlawful and fraudulent stock and investment schemes and the securities based thereon." (Id. at p.736.) The substance of a transaction rather than its form governs whether the transaction is deemed a security. (Moreland, supra, 194 Cal.App.3d at p.512.) "The term 'investment contract' has been interpreted to reach 'novel, uncommon, or irregular devices, whatever they appear to be...' (citation omitted)" (Hocking v. Mayless Dubois (1989) 885 F.2d 1449, 1455.) "It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." (SEC v. Howey Co. (1946) 328 U.S. 293, 299)

California courts acknowledge the "Howey test" and the "risk capital" test, either or both of which may be applied to determine whether an investment is a security in the form of an investment contract. (Moreland, supra, 194 Cal.App.3d at pp. 561-562.)

The test defined in SEC v. Howey Co., supra, 328 U.S. at p. 301 is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others". The term "common enterprise" is defined as "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties". (SEC v. Glenn W. Turner Ent. Inc. (9th Cir. 1973) 474 F.2d 476, 482 and fn.7; Moreland, supra, 194 Cal.App.3d at p. 562.) The Glenn W. Turner court interpreted the phrase "solely from the efforts of others": "...in light of the remedial nature of the legislation, the statutory policy of affording broad protection to the public, and the Supreme Court's admonitions that the definition of securities should be a flexible one, the word "solely" should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities."(Id.) The fact that investors must exert some effort to achieve a return does not preclude finding an investment contract; the test is "whether the efforts made by other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.(Id.)

The court in Moreland described the "risk capital" test as requiring consideration of the following factors: "(1) whether funds are being raised for a business venture or enterprise; (2) whether the transaction is offered indiscriminately to the public at large; (3) whether the investors are substantially powerless to effect the success of the enterprise; and (4) whether the investors's money is substantially at risk because it is inadequately secured. (Citation omitted)" (Moreland, supra, 194 Cal.App.3d at p. 566.)

"In attempting to determine whether a scheme involves a security, the inquiry is not limited to the contract or other written instrument. 'Characterization of the inducement cannot be accomplished without a thorough examination of the representations made by the defendants as the basis of the sale. Promotional materials, merchandising approaches, oral assurances and contractual agreements were considered in testing the nature of the product in virtually every relevant investment contract case.' (Citations omitted.) (Hocking, supra, 885 F.2d at p. 1457.)

DETERMINATION OF ISSUES

1. The 1 World Center web-site stores promoted and sold by respondents to Cartwright and Bates constitute securities within the meaning of Corporations Code section 25019 by reason of Findings 3 through 13, inclusive.

The scheme as presented and sold to Cartwright and Bates is an investment contract for the following reasons:

A. It involves an investment of money. Findings 9 and 12 establish that Cartwright paid \$50,000 and Bates paid \$30,000.

B. It involves a common enterprise. The "enterprise" includes the successful operation of 1 World Center, not just the operation of the investor's store. Findings 5 through 13, inclusive, establish that regardless of the extent to which Cartwright and Bates were willing or able to participate in the creation and ongoing operation of their stores, the success of the investment is inextricably interwoven with and dependent on the efforts and ongoing viability of IWSC and 1 World Center. The stores cannot operate without the continued technological support, infrastructure, proprietary contracts and Internet site provided solely by IWSC. But for IWSC's effective design, marketing and advertising efforts, customers would not find the stores. But for IWSC's sophisticated computer infrastructure and programming expertise, store customers could not transact a product purchase. The merchant is completely dependent on IWSC to keep the computer systems operating and competitive and to maintain the necessary arrangements with the manufacturers and drop-shippers whom the merchants are precluded from contacting. There is no evidence that the merchant can transfer the store to any other web-site or operate it apart from IWSC. IWSC owns and operates 1 World Center presumably for profit. Its fortunes depend on the success of the stores and it generates income based on the stores' gross receipts. That the scheme involves a common enterprise is manifest in the promotional material statements and in Bryan Hertz' letter to Cartwright (Finding 11).

C. Profits come from efforts made by other than the investor. Findings 5 through 13, inclusive, establish that the efforts of IWSC are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise. The investments promoted and sold to Cartwright and Bates emphasized the minimal equipment, knowledge and effort needed to reap a quick return of the investment and substantial profits. IWSC's salesman repeatedly told Bates and Cartwright that all they needed was access to a Fax to check on sales and profit. IWSC handled everything else. The merchant was totally dependent on the efforts of IWSC for at least the first three to six months of the store's operation. After that the merchant's efforts were at her discretion. Regardless of the extent to which a merchant became involved in the store operation, the undeniably significant efforts continued to be made by IWSC in maintaining the supplier and drop-ship contracts, effective marketing and advertising, providing the technical support and infrastructure to allow customers' easy access to the stores and purchasing process, and in performing accurate and timely accounting.

D. The evidence was not sufficient to determine whether the web-site store transactions meet all the factors of the risk capital test. If Cartwright and Bates are typical 1 World Center store owners, the investors are limited in their ability to effect the success of the enterprise. However, neither

party presented sufficient evidence to determine that the investment funds were used by IWSC as capital, that the offering was made indiscriminately to the public at large, or that the investors's money is substantially at risk because it is inadequately secured.

E. The web-site store scheme, on its face and as promoted and sold to Cartwright and Bates, constitutes the type of transaction the Securities Law intends to oversee in order to protect the public against the imposition of unsubstantial or potentially fraudulent investment schemes.⁶ Cartwright and Bates were not looking for investment opportunities or for new businesses to run. They were solicited by IWSC salesmen. Neither Cartwright nor Bates understand the Internet or computer technology. Neither owns the basic tools to oversee an Internet web-site business. They were attracted solely by the prospect and promise of significant financial return on their investment and IWSC required a substantial investment - \$30,000 and \$50,000. IWSC's promotional brochure and sales representations seek to attract investors/purchasers by the promise of easy profits resulting primarily from the efforts, pre-arranged contracts, technological expertise and ongoing involvement of IWSC. There is a real concern that the investment money is substantially at risk. There is no evidence that if IWSC went out of business or discontinued 1 World Center the investor would have any asset of value or the ability to recoup her investment.

2. Respondents did not qualify the sale of the web-site mall stores under Corporations Code section 25113 and did not establish that the transaction exempted, by reason of Finding 14.

3. Respondents challenge the credibility of Cartwright and Bates. Their demeanor and attitude while testifying, showed each is a clearly disgruntled investor with a personal agenda beyond the issues in this proceeding. This was considered in weighing their testimony and the evidence. Nevertheless, the relevant and uncontradicted evidence along with respondents' documents and testimony create a preponderance of the evidence to support the above stated Findings and Determinations.

4. Cause was established to affirm the Desist and Refrain Order, by reason of Findings 3 through 14, inclusive. The Internet presents uncharted waters for the Securities Law. Investors, promoters and regulators must acknowledge this new world of technology and its possibilities, both good and bad. Those who test these waters must do so with extreme caution. There may be a way to organize and sell web-site mall stores such that the scheme does not constitute a security. Respondents' effort to do so, at least as characterized by the Cartwright and Bates transactions, failed for the reasons set forth in the Determinations 1 and 2, above. This Proposed Decision is limited in its application to transactions that are sufficiently similar to the Bates and Cartwright transactions to be deemed a security and is not intended to apply to the creation and/or sale of a web-site store if the transaction in its entirety does not actually bear the characteristics of an investment contract or other security.

⁶ Fraud was not an issue in this proceeding and no inference of fraud should be made from any of the findings or determinations in this Proposed Decision.

5. The Desist and Refrain Order is properly issued to IWSC, Robert Hertz and Bryan Hertz. By reason of Findings 3, 4, 5 and 11, Robert and Bryan Hertz are the individuals who own, control, operate and manage IWSC. Respondents did not establish that it is factually or legally improper to subject them to the Desist and Refrain Order.

ORDER

The Desist and Refrain Order issued July 15, 1998 is upheld.

Dated: September 16, 1998

JOYCE A. WHARTON
Administrative Law Judge
Office of Administrative Hearings