

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Commissioner of)
Corporations of the State of California)
)
Complainant,)
) OAH No. N 1998110288
)
vs.)
)
FAIRSHARE, KARL M. SJOGREN and)
JOHN G. WILSON)
)
Respondents.)
_____)

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 January 26, 1999.

IT IS SO ORDERED.

DATE: January 26, 1999

William Kenefick

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Commissioner of Corporations of the State of California)	
)	
Complainant,)	
)	OAH No. N 1998110288
vs.)	
)	
FAIRSHARE, KARL M. SJOGREN and JOHN G. WILSON,)	
)	
Respondents.)	
_____)	

PROPOSED DECISION

Jonathan Lew, Administrative Law Judge, State of California, Office of Administrative Hearings, heard this matter on December 4, 1998, in Oakland, California.

Daniel P. O'Donnell, Corporations Counsel, represented complainant.

William D. Evers, Esq, Evers & Hendrickson, LLP, 155 Montgomery Street, 12th Floor, San Francisco, California 94104, represented respondents.

Submission of the matter was deferred pending filing of closing arguments. Complainant's and respondent's briefs were received on December 17, 1998, and marked for identification respectively as Exhibit 7 and Exhibit C. The matter was submitted on December 17, 1998.

FACTUAL FINDINGS

1. On November 3, 1998, the Commissioner of Corporations issued a DESIST AND REFRAIN ORDER pursuant to section 25532 of the California Corporations Code against respondents FairShare, Inc., aka FairShare Capital Markets, Karl M. Sjogren

and John G. Wilson.¹ The Order was based on the opinion of the Commissioner that respondents' offer or sale in the State of California of memberships in FairShare constituted the sale of unqualified investment contracts. The Order was served on respondents FairShare, Inc. and Karl Sjogren on November 13, 1998; and on respondent John G. Wilson on December 1, 1998.

2. By letter dated November 15, 1998, a request for a hearing was made on behalf of respondents.

3. As of October 1, 1998, a diligent search of the records of the Department of Corporations did not disclose a permit or other form of qualification issued to FAIRSHARE, INC., authorizing the offer and sale of securities, nor the filing of a Notice of Issuance pursuant to section 25102(h) of the California Corporations Code, nor the filing of a Notice of Transaction pursuant to section 25102(f) of the Code. It is undisputed that respondents have not sought to qualify FairShare memberships as investment contracts. They contend that they are not selling securities; but rather membership service contracts that are outside the scope of the securities laws.

4. FairShare was formed as a Delaware corporation on July 13, 1993. It has as its mission to create a system to help start-up and emerging companies raise venture capital through a large number of small investors. Karl M. Sjogren is Chairman and Chief Executive Officer of FairShare. John G. Wilson is a trustee of the FairShare CyberTrust, which is FairShare's principal shareholder, and he is a consultant to the company.

5. Concept. Respondents seek to bridge the gap between small and emerging companies and the investing public. They note a study indicating that only 4.2% of the capital needs of small business are met by venture capitalists, and the further difficulty small businesses encounter trying to obtain bank loans or financing through investment bankers (brokers-dealers). Respondents define small businesses as those requiring capital investments in the \$500,000 to \$5 million range. On the investor side, respondents note that middle class investors have no institutional avenue to invest in venture-capital type investments. Individual investors would typically need to be accredited to have access to comparable investment opportunities. This means that they would have to have a net worth of \$1 million and \$200,000 annual income for individuals, or \$300,000 for a family, just to qualify as angel investors. In its Executive Summary respondents describe the concept as follows:

¹ Corporations Code 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 offeror of such security to desist and refrain from further offer or sale of such security unless and until qualification has been made under this law.

The concept is to create a system, based upon the “FairShare Model”, for public venture capital investing by small investors. The system will increase the amount of venture capital available to start-up and emerging companies and provide large numbers of small investors the opportunity to participate in the excitement, satisfaction and potential high returns enjoyed by venture capital investors. The FairShare Model rests upon:

- organizing a large membership of financial angel investors who individually and collectively evaluate the purchase of publicly tradable stock issued by companies seeking to raise rounds of venture capital in small public offerings ranging from \$1 to \$7 million in total size;
- expanding the meaning of “angel investor” to include small investors who, individually or through investment clubs, invest in early-stage companies (the term describes wealthy individuals who make such investments);
- developing deal structure criteria for companies seeking access to the membership that meet or exceed the investor protections demanded by venture capital funds; and
- a business model based on low annual fees to a large number of Members who want education about capital formation issues, as well as venture capital investment opportunities.

The FairShare business model is radically different from the conventional models, in part, because it does not charge commissions; either to companies using the system or to Members who purchase stock in them. The ability to make commission-free investments in promising, yet risky, companies that meet the FairShare’s requirements will be a benefit of membership, just as education and member-to-member networking will be.

6. FairShare is an Internet based operation. In March 1998, it launched a charter membership drive to build a large group of individual investors and investment clubs. It hopes that once a “critical mass” of 5,000 members is reached they will be in a position to fully subscribe or “take down” a \$2 to \$5 million initial public offering (IPO). At that time FairShare expects to file for its own IPO and provide its members an opportunity to invest in FairShare along with other qualified companies given an opportunity to market their stock to its membership. All offerings to members would first be registered and cleared by security regulators in each state where the securities are offered to FairShare members.

The overriding FairShare principle is that members get a better deal on venture capital investments than they can get elsewhere, both in terms of price and allocation. FairShare promises to screen candidates for offerings to its members, and then to negotiate terms of offerings with candidate companies including “investor rights and privileges, valuation, share allocation rights for Members and a performance based

equity structure for management and employees.”² Essentially, FairShare seeks to offer its members investment terms equivalent to what a venture capital fund would require from an investment. If members decide to invest in a company, they do so directly with that company, not through FairShare. Monies to be expended by members to purchase securities are not pooled into a common fund by FairShare. FairShare receives no commission, fee, percentage or money from these individual transactions. No membership fees are used to purchase any securities from issuer companies.

7. Membership. Individuals may participate in FairShare as Charter, Regular or Associate members. A charter membership costs \$99. These are limited to 10,000 members. Charter members are entitled to a waiver of the \$12.50 monthly service fee over a two year period as well as a waiver over five years of the annual fee. In addition to accessing online information, charter members can invest in new company stock offerings and have first shot at twenty percent of these offerings, and up to fifty percent of FairShare’s stock offering. Regular members pay a \$50 membership fee and a \$12.50 monthly service fee after certain conditions have been satisfied by FairShare. Associate membership is free. These members can access most information on the website, but are locked out of certain members-only sections and cannot receive special investment reports and new issue alerts. Importantly, they cannot invest in new company stock offerings, including FairShare’s.

To encourage members to solicit others to become members, all members receive a percentage of new membership fees for each new member recruited. A member becomes eligible to receive 20% of the new member’s membership fee. If that new member sponsors other members, the original member receives 30% of these new members’ membership fees. Therefore, as new referrals are made, up to half of their membership fees will be paid out to existing members. Associate members also receive a referral fee, but at a 10% level. Members are not required to make referrals as a condition of membership.

8. FairShare provides specified services to members as detailed on its website. Much of it is informational and educational. FairShare promises to provide courses, seminars, videotapes and a periodical that provide education on the capital formation process, corporate governance and entrepreneurial matters. It also promises to provide resources that provide education in the selection criteria professional venture capitalists use when considering an investment. Next, FairShare promises to match high net worth members with companies matching their interests, and to notify qualified members if a company enters the system looking for services (i.e. attorney, accountant or consultant) they can provide.

² From Exhibit B, FairShare website section “H. Services.”

A key element of FairShare services is the screening and selection of investment opportunities. They promise to undertake a “due diligence” review of all candidate companies, and then to negotiate terms of the offering on behalf of members at a lower cost per share than would normally be available to an individual investor. FairShare describes this service as follows on its website:

On staff and/or contract to FairShare are lawyers, accountants, engineers, scientists, marketers, management, human resources, systems analysts and finance professionals all working for the membership to determine the chances of success of a young enterprise prior to its selection by FairShare and the membership as a qualified investment candidate. This process is known as “due diligence”. ...

FairShare will negotiate an exclusive contract with the proposed funding candidate on behalf of its members that provides them with a major equity interest in the company. Once a company has proven it can be successful, the entrepreneurs can earn out a larger percentage based on the company’s actual performance (income and earnings) in the future.

FairShare invites members to participate in the screening and review process. It offers an Internet and non-Internet (i.e., fax burst, special mailing, phone hot-line) platform for members to share due diligence questions and commentary on a company, as well as a means for the issuer company to respond.

9. Terms and conditions for membership are set forth in a three-page agreement. There are a number of caveats. FairShare makes no assurance that a critical mass of members will be formed, or that it will be able to provide all services described. It also notes that there is a risk that revenue from the sale of memberships will not be sufficient to cover the cost of membership materials or the delivery of all planned services. FairShare specifies in the agreement that there are no refunds on memberships. In paragraph 4 of the agreement FairShare states that it “is not licensed as a securities broker, investment fund or investment advisor, nor does it intend, at this time, to operate in way that require it to become a licensed or regulated entity.”³

10. Individuals are induced to become members of FairShare as a means of realizing high returns on their venture capital investments. It boasts that it is making the exciting arena of the venture capital world available “for the first time in history, to the average investor.” One of its website headings reads “EARNING 1,000% PROFIT.” Examples are provided over several web pages. Drawing on the success stories of profitable new companies, and making the assumption that FairShare members had

³ Interestingly, there is language in this same paragraph that services may be reduced, delayed or eliminated, or their cost to members may increase “if securities regulators require the company to operate as a regulated entity.”

invested \$100 in each of four rounds of financing for these same companies, spreadsheet grids are displayed over several web pages to show what total returns on investment they would have realized. Total investment returns are shown to be 9034% for EBAY, 614% for Earthweb, 4851% for Geocities and 3707% for The Globe. The clear suggestion is that FairShare members will have this same potential to realize large returns on relatively small investments in emerging companies. FairShare's home page makes a rather direct pitch to ordinary investors to take part in its lucrative investment program. Catchy language in bold type announces "Now YOU can 'Play Like The Big Guys' & Get In On The Most Extraordinary Opportunity Ever Made Available To Ordinary Investors."

FairShare's home page includes other language announcing:

It is ingenious and it works. It is powerful and profitable. It is going to make those who participate in it a great deal of money. ... This is the exclusive arena where the smartest investors put their money. This is the high-profit but seldom seen world of Venture Capital. This is where the *real* money is made.

LEGAL CONCLUSIONS

1. The sole issue is whether a "membership" interest in FairShare qualifies as an investment contract as defined in section 2(a)(1) of the Federal Securities Act of 1933, or section 25019 of the California Corporations Code. In the event it does, it would be considered a security and subject to regulatory control, and specifically to qualification under section 25110.

2. Federal and California securities laws have as their objective the protection of the public against the imposition of insubstantial, unlawful and fraudulent stock and investment schemes. They promote and provide for the full disclosure of all information necessary to make informed and intelligent investment decisions. *People v. Park* (1978) 87 Cal.App.3d 550, 565. The securities law protects the public against spurious schemes, however ingeniously devised, to attract risk capital. *Moreland v. Dept. of Corporations* (1987) 194 Cal.App.3d 506, 512. The substance of the transaction, rather than its form, governs whether an investment is a security. *Ibid.*

Recognizing the limitless ingenuity in the area of investments, especially in the creation of investment schemes, the United States Supreme Court has held that "security" should be interpreted broadly. *Reeves v. Ernst & Young* (1990) 494 U.S. 56, 60-61. It recognized that "blue sky" laws, being remedial in purpose, had historically been broadly construed by state courts so as to afford the investing public with a full

measure of protection. *S.E.C. v. Howey* (1946) 328 U.S. 293, 298. As such, form was disregarded for substance and emphasis was placed upon economic reality. *Ibid.* It is against this backdrop that any analysis of membership interests in FairShare must begin.

3. Two tests have historically been applied in defining investment contracts. The first test derives from the Supreme Court in *S.E.C. v. Howey*, *supra*, 328 U.S. 293 (the “Howey” test), while the second test stems from the California Supreme Court decision in *Silver Hills Country Club v. Sobieski* (1961) 55 Cal.2d 811 (the “risk capital” test). California courts have applied both tests, either separately or together, in determining whether a particular transaction is an investment contract under section 25019. *People v. Figueroa* (1986) 41 Cal.3d 714, 733-34.

The parties urge application of both tests in this case. Accordingly, the following discussion analyzes memberships in FairShare within the context of each test.

4. Howey Test. In *Howey*, the Supreme Court defined an investment contract to be “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” *S.E.C. v. Howey*, *supra*, 328 U.S. 293, 298-99. The four parts of this test are typically analyzed separately. Thus, inquiry is into whether FairShare memberships constituted (1) an investment of money; (2) into a common enterprise; (3) with an expectation of profit; (4) to come solely from the efforts of others.

a. Investment. Respondents urge application of the definition of “investment” set forth in *S.E.C. v Wickam* (D.C. Minn, 1935) 12 F.Supp. 245, 247, namely (1) an expenditure to acquire property or other assets in order to produce revenue; or (2) the placing of capital or laying out of money in a way intended to secure income or profit from its employment. Respondents argue that because FairShare memberships are service contracts, they convey no interest in real property or any other asset. Respondent also points out that members acquire no interest in FairShare through payment of membership fees.

The membership fees cannot be viewed in isolation from the larger scheme in which FairShare members become eligible to participate. The membership fees were paid as consideration for the right to take part in FairShare, a scheme that looked ahead and was tied to the expectation of subsequent venture capital investments in new and emerging companies, including FairShare. Memberships were essentially the price of admission for the opportunity to purchase securities and new offerings on terms favorable to small investors. Only FairShare members would be eligible to invest in these new offerings. By becoming members they were securing the right to purchase securities at prices and allotments made available only to FairShare members.

Whether membership fees are actually used to invest in securities is not critical to finding an investment contract. Courts have examined a number of cases involving the coupling of sale of different kinds underlying property with some type of management packages.⁴ For example, *Howey* arose from a transaction involving the sale of citrus orchard property by one Florida company, marketed in conjunction with a cultivation, harvesting and distribution service offered by another company. *S.E.C. v. Howey, supra*, 328 U.S. 293. The nature of management contracts has varied, and has extended beyond simply managing the property sought. It has also taken the form of an agreement to exercise expert knowledge and judgment in the selection of property to be purchased. *S.E.C. v. Brigadoon Scotch Distrib., Ltd.*, 388 F.Supp. 1288 (S.D.N.Y. 1975). It is the bundling of a sale and management contract that is evaluated as a whole in determining whether an investment contract is present.

Moreover, consideration need not pass necessarily to a promoter or to one closely affiliated with the promoter. *Crowley v. Montgomery Ward & Co.*, 570 F.2d 877 (10th Cir. 1978). FairShare has argued that because all consideration for securities is paid directly by the member to the offering company, without any commission or fees paid to FairShare, no investment contract should arise by virtue of membership in FairShare. *Crowley* is instructive. The court found an investment contract notwithstanding the fact that it involved payment to a third party with absolutely no affiliation with the promoter. The investor in *Crowley* entered into an agreement with Montgomery Ward to operate an “associated store” to sell Ward’s goods. Ward did not require the investor to pay a franchise fee, nor did it require the investor to purchase necessary equipment or fixtures from Ward or one of its approved suppliers. Ward did require the franchisee to provide a fully equipped store acceptable to Ward, and the investor ended up expending substantial sums to secure fixtures and equipment from third parties. The court held that such payment to third parties was an investment in a common enterprise. While the payment did not go directly to Ward, it inured to Ward’s benefit.

The situation presented by FairShare is similar. FairShare agrees to provide its members expertise in the screening, due diligence review and negotiations with promising new businesses with good investment potential. This service is coupled with the exclusive offering of new securities on terms most favorable to its membership, and no one else. That individual members purchase securities directly from the offering company does not make it any less an investment contract if such transaction can be said to inure to FairShare’s benefit.

It does so here. The very success of FairShare depends upon its ability to attract emerging companies into this new scheme to raise venture capital through its membership. It is somewhat cyclical. Companies will use FairShare only if their need for

⁴ A particularly good review of these cases is found in Joseph C. Long, *Blue Sky Law*, Securities Law Series, Vol. 12, Clark & Boardman, § 2.04[2][a].

venture capital can reasonably be met through this scheme. As more companies utilize FairShare, particularly those companies that turn out to be highly profitable investments, FairShare will be better able to expand both its membership base and the number of quality securities offered to members. And as membership increases beyond critical mass, more companies will have an interest in tapping this large investor pool for venture capital. In sum, transactions between individual members and offering companies inure to FairShare's benefit.

When membership fees are properly considered in context of the larger scheme of linking investors with emerging companies in need of venture capital, such fees are clearly paid in consideration for the investor's right to take part in the scheme. They are not merely service contracts, outside the scope of the securities laws. By reason of all the above, the first requirement of the *Howey* test that there be an investment of money is satisfied in this case.

b. Common Enterprise. This element is also satisfied. Although members enter into individual transactions to purchase securities from start up companies, it is the pooling of investors that makes possible the offering on terms favorable to each member. Companies are enticed to seek venture capital through FairShare only because of this large pool or "critical mass" of small investors. FairShare makes the following statement on its website respecting the importance placed on this collective approach:

By joining FairShare, you become part of a very large group of smart investors who collectively have the money to provide the capital that new and expanding companies need and want. ... We are using the age-old principle that there is strength in numbers, that a group of people can do things collectively that they cannot do as individuals.

The horizontal concept of common enterprise is satisfied when two or more investors join a promoter in seeking a goal common to all. This is satisfied in this case.

The common enterprise element is also satisfied under vertical commonality where "the fortunes of the investors are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." *Moreland v. Dept. of Corporations, supra*, 194 Cal.App.3d 506, 514. Members depend upon FairShare to seek out new companies, and then to screen and negotiate fair terms for the sale of their securities to members. FairShare members also share the risk of loss with FairShare. A common enterprise exists where an investor's avoidance of loss depends on the promoter's sound management and continued solvency. *S.E.C. v. Eurobond Exchange Ltd.* (1994) 13 F.3d 1334, 1340. Again, members depend upon FairShare to make wise selections of companies offering securities to members, to provide efficient management and to effectively promote FairShare as a viable forum to both investors and new companies. The common enterprise element is satisfied in this case.

c. Expectation of Profit. This element is satisfied by reason of the matters set forth in Factual Finding 10. FairShare creates an expectation of profit from investments of venture capital into start-up companies, an opportunity made available exclusively to its members. It matters not that membership fees are not directly invested in these companies for reasons already discussed above in subsection a. Membership fees are a necessary part of and coupled to one's ability to participate in the larger scheme of making capital investments in new business ventures.

For those members who actively promote FairShare to others, there is the added expectation of profit through the Sponsors and Benefits Program. (See Factual Finding 7.) Because of the importance of expanding the membership base, FairShare actively promotes the economic rewards available to participants in the member referral program, and suggests that such may indeed be very substantial.⁵

d. Efforts of Others. The "solely from the efforts of others" language in *Howey* has been modified in subsequent cases and has now become an inquiry as to "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *S.E.C. v. Glenn W. Turner Ent., Inc.* 474 F.2d 476, 482 (9th Cir., 1973).

Members rely upon FairShare to locate new and expanding companies that need investment capital, to evaluate these companies for suitability for investment, to negotiate a favorable price per share and then to offer these securities exclusively to members at this original price. Charter members are guaranteed first shot at 20 percent of new company offerings. FairShare holds itself as being able to provide professional staff to participate in the screening of investment opportunities. It promises that "due diligence" review will be undertaken by its own lawyers, accountants, engineers, scientists, marketers, management, human resources, systems analysts and finance professionals "all working for the membership to determine the chances of success of a young enterprise prior to its selection by FairShare and the membership as a qualified investment candidate." (See Factual Finding 8.)

⁵ Under a web page entitled Sharing the Wealth FairShare explains how profitable this can be: "So what does this mean overall? It means that, for every person you enroll as a Member, you could receive ultimately (over the first 5 years of their membership) the sum of \$125. For each new Member that they in turn sponsor, you as Senior Sponsor will receive a total of \$210. In the example shown above – where you talk to only four people and so do they – the total would come to \$700 for your four Direct members and \$3,360 more from all those Indirect members that your Direct members in turn enrolled. ... So you would end up not only being able to participate for free, but you would have an additional \$3,000 to put in your pocket. And that doesn't even begin to count what you could make from the investments you made during that time, which is the real reason you joined FairShare. Pretty simple, isn't it? The only way we could make it any easier would be to back a truck full of money up to your door and dump it on your porch. We're working on that."

FairShare members do not participate in a significant way in the above process, other than being given an opportunity to ask questions and offer comments on companies during the due diligence process. Such participation does not rise to the level of expertise or active professional review promised to be undertaken by FairShare. There is no indication that members are given the opportunity to make crucial company selection or other management decisions, and they are not involved in the important negotiations leading to pricing of securities to be offered members. Respondents counter that FairShare's role is to provide a forum within which the members may pursue their own investment strategy, and essentially conduct their own due diligence review of companies after applying principles/concepts learned from educational materials provided by FairShare. They cannot have it both ways. A major promotional point FairShare makes to its members is that FairShare will undertake its own due diligence and professional review of these companies, select the best investment prospects and then negotiate share prices on terms most favorable to its members.

For all these reasons it is determined that the essential managerial efforts that affect the failure or success of the enterprise are undertaken by FairShare and its principles, not its membership. Such efforts are undeniably the significant ones for FairShare and this portion of the *Howey* test is therefore satisfied.

5. Risk Capital Test. In *Silver Hills Country Club v. Sobieski*, *supra*, 55 Cal.2d 811, the California Supreme Court set forth four factors in what has come to be known as the "risk capital" test: (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 investor's money is substantially at risk because it is inadequately secured. The factors are taken together in the conjunctive.

Silver Hills involved a country club that contracted to purchase a ranch, made the down payment with its own funds, and was subsequently able to improve the land through revenues raised by the sale of country club memberships. In determining whether such were investment contracts, the California Supreme Court distinguished membership contracts that convey a beneficial interest in property from those membership contracts that provide only for the sale of services. The first element of the risk capital test is comparable to the investment test in *Howey* (as discussed in section 4a. above) and is therefore satisfied.

6. Respondents urge a more restrictive view of the FairShare membership agreements along the lines of that seen in *People v. Syde* (1951) 37 Cal.2d 765, 769. *Syde* involved agreements to train adolescents in the performing arts in anticipation of casting them in paid performances. Parents paid for the lessons in advance. Students were given the opportunity to apply their training in paid performances, and this was

determined not to create a property interest in the performance instruction studios. Respondents argue that members in FairShare are given a similar opportunity to apply their learning in an investment forum where the members are introduced to various issuers seeking investors.

Syde is distinguishable. The parties in that case entered into service agreements for the rendition of compensated services. The defendant was contractually obligated to train students for a fee, and the students were contractually bound to participate in the defendant's films or other dramatic productions in return for a share in possible profits in that work. *Ibid.* FairShare members are encouraged to invest in new securities offered through its website, but are under no contractual obligation to do so. The situation is more akin to *Silver Hills*. There, a minimum number of new memberships were needed to raise sums to purchase the ranch property. Club members were entitled to use the club's facilities, but were under no obligation to do so. They received a beneficial interest in club property, not ownership of that property. *Silver Hills Country Club v. Sobieski, supra*, 55 Cal.2d 811. Likewise, FairShare seeks a minimum of 5,000 members to reach a critical mass of investors with which, and so as to be able to attract new business starts. FairShare even places a limit on charter membership at 10,000, perhaps so it can honor its promise to provide charter members first shot at twenty percent of new company stock offerings presented by FairShare. For these several reasons, *Syde* does not govern these facts.

7. Respondents further cite to *Moreland v. Department of Corporations, supra*, 194 Cal.App.3d 506 as authority for their assertion that no investment is present. *Moreland* involved a mining concern's sale of gold ore to the public, where the proceeds of the sale were to go to the mining concern's construction of refining facilities. These facilities were, in turn, to be made available to the ore purchasers for hire in refining their ore. The court held that the agreement did not constitute a contribution of capital to the business because the purchaser stood to gain, if at all, from the resale of gold to someone other than the mining company at a price exceeding what they paid. It was important to the court's reasoning that the mining concern did not retain exclusive control or any control whatsoever over the marketing of gold so as to make investor profits dependent upon its managerial skills or efforts. *Id.* at p. 516.

Here FairShare promises to provide a number of services so as to make investor profits dependent upon its managerial skills or efforts. These include promotion and other efforts to expand membership base, solicitation of and screening of new business ventures, due diligence review of startup companies, negotiation of pricing and share allotments, and marketing of new securities to its membership on exclusive and favorable terms. Membership in, and attendant purchase of securities through FairShare is a comprehensive scheme that must be viewed as a whole. It is not comparable to the simple transaction for sale of a marketable commodity, and the separate refining contract found in *Moreland*.

8. The second and third elements of the risk capital test are easily satisfied. FairShare memberships are offered indiscriminately over the Internet to the public at large. Investors are substantially powerless to effect the success of the enterprise. As discussed under the *Howey* analysis, members do not participate in any meaningful or substantial way in the major decisions and management of FairShare. Though they are offered the opportunity to play some role in the success of the enterprise, they are essentially passive investors. (See above section 4d.)

9. The fourth and final element is also satisfied. Investors' money is substantially at risk because it is inadequately secured. Membership fees are nonrefundable. There is no evidence that collateral or securities are pledged for membership fees or for membership investments in new companies, including FairShare. As to membership fees, up to half may be paid to sponsors who recruit new members. If the enterprise fails to enroll sufficient membership, FairShare acknowledges that it may not be able to deliver all planned services. This is because FairShare depends upon a critical mass of members to cover its own business operation costs, and also to have a large enough pool of investors, and thus venture capital, with which to attract new companies to FairShare.

10. In sum, both the *Howey* and risk capital tests have been satisfied.⁶ FairShare memberships are tantamount to investment contracts and are therefore securities that should be qualified prior to offer for sale in the State of California. In reaching this conclusion, the comprehensive FairShare scheme was evaluated as a whole. Though a seemingly mechanical application of the two tests was undertaken, at every turn an attempt was made to evaluate the substance of the transactions involved, and not the technical form. Cases have adhered to the principle that substance governs over form and that the critical question the courts have sought to resolve is "whether a transaction falls within the regulatory purpose of the law regardless of whether it involves an instrument which comes within the literal language of the definition." *People v. Figueroa, supra*, 41 Cal.3d 714, 735.

Viewed in this context, and by reason of Legal Conclusions 4 through 9, cause exists for issuance of the Desist and Refrain Order under authority of Corporations Code section 25532.

ORDER

1. The appeal of FairShare, Karl M. Sjogren and John G. Wilson is denied.

⁶ This is not to say that both tests needed to be satisfied. The courts have taken the view that a transaction is properly classified as a "security" if it satisfies either test. *Moreland v. Department of Corporations* (1987) 194 Cal.App.3d, 506, 513.

2. The Desist and Refrain Order issued by the Commissioner of Corporations against FairShare, Inc.; aka FairShare Capital Markets, Karl M. Sjogren and John G. Wilson is affirmed.

DATED: _____

JONATHAN LEW
Administrative Law Judge
Office of Administrative Hearings