BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
STATE OF CALIFORNIA

In the Matter of: THE COMMISSIONER OF BUSINESS OVERSIGHT, Complainant, v. LEJUN JAMES SHAO, aka JAMES SHAO, aka JAMES SHAW, WHITEPINE INVESTMENT CORPORATION, and WWW.MYIRAS.NET, Respondents.	Case No. 18-07 OAH No. 2018100026

DECISION

The attached Proposed Decision of the Administrative Law Judge, dated November 15, 2018, is hereby adopted by the Department of Business Oversight as its Decision in the above-entitled matter.

This Decision shall become effective on March 14, 2019.

IT IS SO ORDERED this 12th day of February.

JAN LYNN OWEN
Commissioner of Business Oversight

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In the Matter of: THE COMMISSIONER OF BUSINESS OVERSIGHT, Complainant, v. LEJUN JAMES SHAO, aka JAMES SHAO, aka JAMES SHAW, WHITEPINE INVESTMENT CORPORATION, and WWW.MYIRAS.NET, Respondents.	OAH No. 2018100026

PROPOSED DECISION

This matter was heard by Eric Sawyer, Administrative Law Judge, Office of Administrative Hearings, State of California, on October 16, 2018, in Los Angeles. The record was closed and the matter submitted for decision at the conclusion of the hearing.

Marlou de Luna, Senior Counsel, represented Jan Lynn Owen, the Commissioner of Business Oversight (complainant).

Lejun James Shao was present and represented himself and the other respondents. Mr. Shao was assisted by a Mandarin interpreter provided by complainant.

SUMMARY

Complainant issued a Desist and Refrain Order against respondents for allegedly violating the Corporations Code by offering and selling unqualified securities, making untrue statements of material fact, and engaging in unlicensed investment adviser activity. Respondents only specifically deny engaging in unlicensed investment adviser activity. Because complainant established by a preponderance of the evidence all of the alleged violations, the Desist and Refrain Order will be affirmed.

FACTUAL FINDINGS

Parties and Jurisdiction

1. On August 29, 2018, the Desist and Refrain Order (Order) was issued on behalf of complainant in her official capacity as the Commissioner of Business Oversight (Commissioner). On September 20, 2018, the Order was served on respondents.

2. Respondents timely submitted a request for a hearing to challenge the Order. The hearing in this matter was timely scheduled and completed pursuant to applicable law.

Background Information

3. Lejun James Shao (respondent Shao), also known as James Shao and James Shaw, is a resident of California. Respondent Shao is the sole shareholder of WhitePine Investment Corporation (respondent WhitePine) and the founder of www.myIRAs.net (respondent myIRAs).

4. Respondent WhitePine is a California corporation owned and operated by respondent Shao; its last principal place of business was in San Gabriel, California. Respondent WhitePine is the holding company for respondent myIRAs.

5. Respondent myIRAs is an online service founded in and operated by respondent Shao since August 2006. (Ex. 17, p. 186.)

Respondents' Activities Subject to the Order

6. Respondent myIRAs' business purpose is to help subscribers achieve above-average investment returns. According to respondent myIRAs' website, "If you are do-it-yourself US stock market investors, specially self-directing IRA investors, but are not satisfied with your own investment result or are not satisfied with your current investment advisors, we are here to help you." (Ex. 16, p. 65.) The website also advised, "The money you spent on our service is nothing if considering how much the investment return you will have using our service." (*Ibid.*)

7. Respondent myIRAs offered two types of services: (1) "Portfolio Plus," for which respondents charged $385 per year; or (2) "Short Term Play," for which respondents charged clients $149 per month. Subscribers of either service would have access to respondent Shao's investment advice, which included short and medium term buy and sell recommendations, including daily updates and stock picks. The website described the purpose of Portfolio Plus as "being aimed at small investors, who have only few thousands dollars [*sic*] to invest but want to accumulate enough money in the long run for their retirement." (Ex. 16, p. 70.) The website stated Short Term Play "is for active investors, who have time to trade during market hours, have at least $25,000 to invest and want to achieve much higher return." (*Ibid.*)

8. Respondent Shao testified he had several subscribers to myIRAs over the years, but his capacity was no more than 20 subscribers at one time. During the hearing, customer JZ,[1] a California resident, testified that he paid the yearly $385 subscriber fee for Portfolio Plus from 2012 through 2016. Another client, MR, who resides in Nevada, similarly testified that he paid the yearly subscriber fee for Portfolio Plus in 2013 and 2014. Both MR and JZ testified that they subscribed to myIRAs to obtain respondent Shao's stock pick recommendations for purposes of their own investment decisions.

9. The myIRAs website had a prominently featured disclaimer, which advised that respondents were not "registered investment advisors, broker/dealers, or research analysts/organizations." (Ex. A, p. 1.) There was also a disclaimer that the "information provided in this Service is for educational purposes only and that myIRAs.net is not, and does not represent itself to be offering or recommending any securities to be bought or sold." (*Ibid.*) The website similarly advised readers to verify all claims, do their own due diligence on the securities mentioned, as well as that equity investment comes with higher degree of risk subject to loss and that past performance is not an indicator of future results. (*Ibid.*) Respondent Shao testified the disclaimers were placed on the website upon the advice of his attorney, who advised him the service would not be violating the law so long as he did not provide advice to any particular client.

10. A. Beginning in at least December of 2014, respondents began offering what they referred to as the "Shaw Short Term Play Fund" (Fund). The Fund called for a minimum investment of $10,000 and a maximum investment of $50,000. The Fund was open only to current and previous members of myIRAs.

B. In promoting the Fund, respondents advised that a trial run would last six months, unless either the Fund gained 125 percent value or lost 20 percent value, in which case the run would stop early. Respondents advised that they would only take 20 percent of any profit as their fee.

C. As for "Risk," respondents advised there "will be no risk for the investors. If there is any loss on the Fund, either due to our 20% stop-loss rule or any loss after six months run, we will use our own money to make up the loss. There will be no loss on the principals for our investors." (Ex. 9, p. 33.)

D. As for "Reward," respondents advised, "The maximum reward is 100% return during the run. That is, when the Fund made 125% gain and we deduct 20% expenses from the profit. The net profit for investors will [be] 100%." (Ex. 9, p. 33.)

11. Based on promotional materials from respondents, both JZ and MR invested in the Fund. JZ invested $30,000. (Exs. 10 & 11.) MR invested $10,000. (Exs. 13 & 14.) In addition, YY, a college classmate of respondent Shao and currently a resident of New Jersey, invested $40,000 in the Fund. (Ex. 21.)

[1] Initials are used to protect the privacy of the involved clients.

12. According to respondent Shao, in "January 2015, 11 investors (all from my current and previous service subscribers) agreed to let me to invest their money into US stock market and the run will last 8 months." (Ex. 17, p. 187.) The trial run ended in August 2015 and had lost two percent of its value. (*Ibid.*)

13. A. As a result, respondent Shao proposed to do a second run lasting four months. According to him, five investors decided to withdraw their "investment," which he honored; six other "investors" elected to continue. (Ex. 17, at p. 188.) JZ and MR elected to remain for the second run of the Fund.

B. Respondent Shao testified the parameters of the second run only required respondents to cover 20 percent of any losses suffered by the Fund on the second run. In an update he sent to the six investors dated November 7, 2016, respondent Shao wrote, "As we will be responsible 20% [sic] of the loss. . . ." (Ex. 12, p. 46.) However, JZ and MR testified they still believed respondents would cover their entire loss, if any, on the second run. Moreover, e-mails respondent Shao sent to JZ and MR after the second run's completion did not contain any statement that respondents would only cover 20 percent of client losses, even though JZ and MR clearly requested return of their entire principal investments.

14. Respondent Shao has consistently maintained that during the second run, the Fund suffered catastrophic losses due to option trading. He began investing more of his own money into the Fund with hopes of a recovery, but those investments were also lost. By an unspecified date in 2016, the Fund had only a few thousand dollars in it. Respondent Shao testified he has been unable to pay back the six investors who remained for the second run. After demanding withdrawal of their money, but not receiving any, clients JZ and MR complained to the Commissioner.

15. No evidence presented indicates respondents disclosed to Fund investors the associated risks. In fact, respondents stated there would be no risk. Moreover, respondents' promise to investors that they would receive back their principal investments was reckless, given the unpredictability of markets.

16. The Department of Business Oversight (Department) has not issued a permit or other form of qualification authorizing any person to offer or sell the Fund in this state. Moreover, the Department has no record of having received an application from, or having granted an investment adviser certificate to, any of the respondents.

Respondents' Contentions

17. A. During the hearing, respondent Shao admitted the Fund was an unlicensed investment adviser activity. He did not deny that the Fund was a security for purposes of the Corporations Code.

B. Respondent Shao did not address whether the representations about the Fund were false, misleading, or omitted material information.

C. In his testimony, respondent Shao denied that the information provided to subscribers of myIRAs constituted investment adviser activity requiring certification by the Commissioner, because of the disclaimer on the myIRAs' website and the fact that he did not manage any client's money or give advice to any particular client. He testified he simply provided information for a fee.

18. Respondents also presented mitigating evidence. Respondent Shao did not intend to misrepresent to clients that they would suffer no loss; he earnestly believed his system would either result in profits or the stop-loss would prevent losses greater than what respondents could cover. Respondent Shao invested most of his personal assets in the Fund, which he also lost. No evidence indicates respondent Shao absconded with money from the Fund; all was apparently lost to the market. Respondent Shao earnestly and remorsefully testified during the hearing that he is desperate to start another venture so he can earn enough money to repay the six investors who lost their money from the Fund's second run.

LEGAL CONCLUSIONS

1. In this administrative matter not involving discipline of a professional license, the burden is on complainant to establish cause to support a desist and refrain order by a preponderance of the evidence. (*Owen v. Sands* (2009) 176 Cal.App.4th 985, 992.)

2. Corporations Code section 25532[2] provides the Commissioner with the authority to issue a desist and refrain order for violations of the various provisions of the Corporations Code alleged against respondents in this case. The recipient of such an order may request a hearing to challenge it, which occurred in this case.

The Fund was a Security

3. Pursuant to section 25110, it is unlawful for any person to offer or sell in this state any security, unless such sale has been qualified under sections 25111, 25112 or 25113, or unless such security or transaction is exempted or not subject to qualification under section 25100 et seq. An "investment contract" is defined as a security under section 25019. In determining whether a transaction is an investment contract, California courts have relied on two distinct tests: the federal test described in *S.E.C. v. W.J. Howey Co.* (1946) 328 U.S. 293, 298-299 (*Howey*), and the "risk capital" test described in *Silver Hills Country Club v. Sobieski* (1961) 55 Cal.2d 811, 815. A transaction is a security if it satisfies either test. (*Reiswig v. Department of Corporations* (2006) 144 Cal.App.4th. 327, 334 [*Reiswig*].)

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[2] Further undesignated statutory references are to the Corporations Code.

4. Under the *Howey* test, a transaction is an investment contract when a person (1) invests money; (2) in a "common enterprise"; (3) with an expectation of profits; (4) to come solely or primarily from the efforts of others. (*Howey*, *supra*, 328 U.S. at pp. 298-299.) In determining whether the test is met, "form should be disregarded for substance and the emphasis should be on economic reality." (*Howey*, *supra*, 328 U.S. at p. 298.)

5. A. In this case, the Fund, as analyzed by the *Howey* test, was clearly a security. First, the investors made an investment of money in the Fund, varying from $10,000 to $40,000. "Investment" has been "defined broadly to require only that a person entrusted money or other capital to another." (*Reiswig*, *supra*, 144 Cal.App.4th at p. 336, fn. 4 [internal quotations omitted].)

B. Next, the investment was made in a "common enterprise," which "may be established by showing that the fortunes of the investors are linked with those of the promoters." (*S.E.C. v. R.G. Reynolds Enterprises, Inc.* (9th Cir. 1991) 952 F.2d 1125, 1130 [internal quotations omitted].) Here, the investors and respondents shared the risk of loss of the investment capital, in that they all invested money in the Fund. Also, respondents' management was directly linked to the failure or success of the investment, as the investors purchased an interest in the Fund that was managed and controlled by respondents, who also stood to earn 20 percent of the profit generated by the Fund.

C. Also, there was an expectation of profits, which refers to income from or return on an investment, including "dividends, other periodic payments, or the increased value of the investment." (*S.E.C. v. Edwards* (2004) 540 U.S. 389, 394). Here, respondents represented that "the net profit for investors will [be] 100%."

D. Finally, investors relied upon the managerial efforts of respondents, mainly respondent Shao. Although the Supreme Court held in *Howey* that profits must come "solely" from the efforts of others (328 U.S. at p. 299), the Court omitted the term in a later formulation of the test, describing profits as deriving "from the entrepreneurial or managerial efforts of others[.]" (*United Housing Foundation, Inc. v. Forman* (1975) 421 U.S. 837, 852 [*Forman*].) The Ninth Circuit has adopted this more flexible definition and held that the element is met when "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." (*Hocking v. Dubois* (9th Cir. 1989) 885 F.2d 1449, 1455 (en banc); *Forman*, *supra*, 421 U.S. at p. 852, fn. 16 [acknowledging but declining to address the Ninth Circuit's construction].) The element is satisfied here even under the strict interpretation of this element. The investors in the Fund did not have any control over their investment and did not contribute any managerial efforts. Rather, respondents exercised complete control over the investment and use of funds. Thus, any profits from the investments in the Fund came solely from the managerial efforts of respondents.

6. Based on the above, it was established by a preponderance of the evidence that the Fund was a security subject to qualification under the Corporations Code and was offered or sold without first being qualified, in violation of section 25110. (Factual Findings 1-18.)

Material Misrepresentations or Omissions

7. Section 25401 provides:

> It is unlawful for any person to offer or sell a security in this state . . . by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which the statements were made, not misleading.

8. To show a violation of section 25401, the Commissioner need only prove that a misrepresentation or omission occurred and that it was a "material fact." A fact is material "if there is a substantial likelihood that, under all the circumstances, a reasonable investor would consider it important in reaching an investment decision." (*People v. Butler* (2012) 212 Cal.App.4th 404, 422.) Further, no showing of reliance or causation is required; the materiality standard is an objective one. (*Lynch v. Cook* (1983) 148 Cal.App.3d 1072, 1087-1088.)

9. Misrepresentations concerning a security's safety and expected rate of return are considered material. (*S.E.C. v. Marker* (M.D.N.C. 2006) 427 F.Supp.2d 583, 589; *S.E.C. v. Better Life Club of America, Inc.* (D.D.C. 1998) 995 F.Supp. 167, 177.) In considering whether or not to invest, the safety of an investment or a projection of an enormous rate of return would be material to any reasonable investor.

10. An enforcement action by the Commissioner to enjoin future sales by means of false or misleading statements is designed to protect the public. (*People v. Pacific Land Research Co.* (1977) 20 Cal.3d 10, 17.) For that reason, it is irrelevant that a respondent "knows that the statements or omissions are false or misleading. In light of the language of section 25401, it is reasonable to conclude that the Legislature did not intend to permit members of the public to be harmed by such sales simply because the offeror was unaware that his or her sales pitch was misleading. The relatively small civil penalty authorized implies that administrative enforcement of section 25401 was permissible regardless of whether a violation or threatened violation of that section was a knowing violation." (*People v. Simon* (1995) 9 Cal.4th 493, 515–516.)

11. A. Here, respondents made untrue statements in offering the Fund that were material to reasonable investors making informed decisions. First, respondents omitted any information concerning the risks associated with investing in the Fund. While they did so concerning the information on the myIRAs website, they failed to do so concerning the Fund. In fact, respondents claimed there was no risk, which was a reckless statement because there is *always* risk in *any* investment.

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B. Respondents also promised investors that their principal investment would be returned, regardless of profit or loss. Six investors received no return of any part of their principal investments, including JZ, MR, and YY. There is a factual dispute whether respondents only promised to return 20 percent of investors' principal after the second run of the Fund. Nonetheless, resolution of that dispute is unnecessary because respondents did not even return 20 percent of their investors' principal. While respondent Shao in good faith believed he would be able to return his investors' principal investments, even if losses were sustained, such assurances were reckless given the volatility and uncertainty of the markets. According to *People v. Simon*, it need not be proven in this case that respondent Shao knew such statements were false; it need be proven only that he did not carry out his promises.

12. Based on the above, it was established by a preponderance of the evidence that the Fund was a security respondents offered and sold in this state by means of written or oral communications which included untrue statements of material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, in violation of section 25401. (Factual Findings 1-18.)

Investment Adviser Activity

13. A. Section 25009 defines an investment adviser as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as a part of a regular business, publishes analyses or reports concerning securities. . . ." There are a number of exemptions provided in section 25009, none of which apply to respondents. Section 25013 defines a person as "[a]n individual, a corporation, a partnership, a limited liability company, a joint venture, an association, a joint stock company, a trust, an unincorporated organization, a government, or a political subdivision of a government." Thus all of the respondents may be considered an investment adviser if they otherwise fall within the definition of section 25009.

B. Section 25230 requires the Commissioner to certify an investment adviser unless he or she is exempt or excluded from the definition of an investment adviser. A person may be exempt if he "is registered under Section 203 of the Investment Advisers Act of 1940" (§ 25230.1, subd. (a)); a broker-dealer registered under the Securities Exchange Act of 1934 (§ 25200); does not have a place of business in this state and during the preceding 12-month period has had fewer than six clients who are residents of this state (§ 25202); or falls within one of several other similar provisions. It was not established that any of the exemptions apply to respondents.

14. Section 25009 and the other investment adviser provisions of the Corporations Code are closely patterned after the federal statutory language; therefore, federal securities law is persuasive in construing the Investment Advisers Act of 1940. (*In re M.S.* (1995) 10 Cal.4th 698, 713.)

15. A. In this case, respondents engaged in investment adviser activity, with regard to both the Fund and the myIRAs subscriptions, as defined by section 25009. First, respondents provided advice concerning securities. They promoted and advised several clients to invest substantial amounts in the Fund, which was a security as discussed above. In addition, myIRAs is an online investment service. Subscribers paid respondents for the privilege of gaining access to respondent Shao's investment advice, including short and medium term buy and sell recommendations, as well as daily updates and stock picks. Several subscribers, including one in California and one in Nevada, paid respondents annually for such advice.

B. Second, through both the Fund and the myIRAs service, respondents were in the business of providing investment advice. Whether persons will be considered to be "in the business" of providing investment advice depends on all relevant facts and circumstances and will be found if they received compensation for providing advice about securities and they provided investment advice on more than rare isolated occasions. (*U.S. v. Elliott* (11th Cir. 1995) 62 F.3d 1304, 1313, amended (11th Cir. 1996) 82 F.3d 989.) In this case, respondents advised their clients to invest in the Fund. Through myIRAs, respondents also advised clients on the desirability of investing in certain stocks. Respondents were compensated for their services in connection with the Fund and myIRAs. Respondents provided investment advice on more than rare or isolated occasions.

C. Third, respondents were compensated for providing investment advice to others. Compensation is interpreted broadly, and includes any economic benefit received, whether in the form of an advisory fee or some other fee relating to the total services rendered, commissions, or some combination of the three. (*Elliott, supra,* 62 F.3d at p. 1311.) Here, respondents clearly were compensated by their myIRAs clients; they would have been compensated for their services on the Fund if they had realized a profit.

D. Respondents' argument during the hearing that myIRAs did not involve investment adviser activity was not persuasive. The fact that there is a disclaimer on the myIRAs website does not vitiate respondents' actual investment adviser activity. Put another way, the disclaimer statement that respondents were not providing investment advice was simply not true, nor was it the reason investors subscribed to the service. Respondents clearly were compensated by myIRAs' subscribers to provide advice as to the value of securities and the advisability of investing in or purchasing or selling securities. The two subscribers who testified during the hearing clearly used the information purchased from respondents for that end. The fact that respondent Shao did not directly advise any particular client does not exempt him from section 25009. As the statute itself provides, an investment adviser includes activity "either directly or through publications or writings," as well as someone who "publishes analyses or reports concerning securities." That is exactly what respondents did and continue to do with myIRAs.

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16. The Commissioner has not issued a certificate to conduct business as an investment adviser to respondents, who are neither excluded from the definition of investment adviser nor are their investment adviser activities exempt from the certificate requirement of section 25230.

17. Based on the above, it was established by a preponderance of the evidence that respondents have conducted business as investment advisers in this state for compensation by advising others to invest in the Fund and advising myIRAS subscribers of short and medium term buy and sell recommendations, without first having applied for and secured from the Commissioner a certificate authorizing them to act in that capacity, in violation of section 25230. (Factual Findings 1-18.)

Overall Conclusion

18. Based on the above, it was established by a preponderance of the evidence that cause exists pursuant to section 25532 for the Commissioner to have issued to respondents the Desist and Refrain Order dated August 29, 2018. Therefore, cause exists to affirm that order. (Factual Findings 1-18; Legal Conclusions 1-17.)

ORDER

The Commissioner of Business Oversight's Desist and Refrain Order dated August 29, 2018 is affirmed.

DATED: November 15, 2018

DocuSigned by:

ERIC SAWYER
Administrative Law Judge
Office of Administrative Hearings