

**BEFORE THE  
DEPARTMENT OF CORPORATIONS  
STATE OF CALIFORNIA**

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| In the Matter of the Desist and Refrain Order Issued by:              | ) | OAH No. L-9611021 |
|   | ) |                   |
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| THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA           | ) |                   |
|   | ) |                   |
| Complainant.  | ) |                   |
|   | ) |                   |
| NATIONAL SCHOOL REPORTING SERVICES, INC., a New York Corporation; and | ) |                   |
| NEIL ROSEN, an Individual   | ) |                   |
|   | ) |                   |
| Respondents.  | ) |                   |
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PROPOSED DECISION

On March 28, 1997, in San Diego, California, Alan S. Meth, Administrative Law Judge, Office of Administrative Hearings, State of California, heard this matter.

Raymond F. Burg, Senior Corporations Counsel, represented complainant.

Michael G. King, Attorney At Law, represented respondent.

Evidence was received, the record was closed, and the matter was submitted.

FINDINGS OF FACT

I

On September 22, 1995, Alan S. Weinger, Supervising Corporations Counsel, issued a Desist and Refrain Order pursuant to Corporations Code section 31402, the California Franchise Investment Law, to respondents National School Reporting Services, Inc., and Neil Rosen. The order directed respondents to desist and refrain from the further offer and sale in the State of California of a franchise unless and until the offer was registered under the Franchise Investment Law or unless exempt. In the opinion of the Commissioner of

Corporations of the State of California, the offer or sale of the franchise was subject to registration under the Franchise Investment Law and such franchise was offered for sale without the offer first being registered. In the further opinion of the Commissioner, this order was necessary and appropriate in the public interest for the protection of franchisees consistent with the purposes of the Franchise Investment Law.

The order was posted on the bulletin board in the office of the Commissioner of Corporations in San Diego, California, on September 28, 1995, and it was served on respondents.

By letter dated September 19, 1996, respondents requested a hearing and waived their right to have the matter heard within 15 days.

On November 22, 1996, Mr. Burg on behalf of Keith Paul Bishop, Commissioner of Corporations, filed an Accusation in his official capacity. The matter was continued two times until finally heard on March 28, 1997. The desist and refrain order remains in effect pending the final decision in this matter.

## II

Respondent National School Reporting Services, Inc. (hereafter, "NSRS") is a New York corporation and is located in Stamford, Connecticut. Respondent Neil Rosen is the president of NSRS. The company is in the business of gathering information about schools and school districts, such as district size, extra-curricular activities, special education programs, and so forth. It then compiles that information into school reports which it sells to real estate agents and brokers, who in turn furnish the reports to prospective home buyers. In 1994, NSRS marketed its reports in three states: New York, New Jersey, and Connecticut. It charged real estate agents and brokers a flat annual fee for an unlimited number of reports.

National Schools of California, Ltd., (hereafter, "NSC") is a limited partnership organized under the laws of California, with offices in San Diego, California. Gregory Lawlor and Jan Anton formed the partnership. Both are experienced in the real estate industry. In late 1993, Lawlor learned about NSRS and its business and contacted Rosen by telephone. They discussed the business and Rosen's plans to expand. At that time, Rosen was looking for capital and they discussed the possibility of Lawlor purchasing stock in NSRS. After speaking to Rosen several times, Lawlor told Anton about NSRS and they both expressed an interest in NSRS.

During their discussions, Lawlor and Anton learned

how NSRS marketed its products. They had different ideas about how the school reports should be marketed, with which Rosen disagreed, and as a result of that disagreement, the parties abandoned the idea of Lawlor and Anton purchasing stock in NSRS. Nevertheless, Lawlor and Anton were still interested in the business, and Rosen was still interested in expanding his business into California. Eventually, they entered into agreement called "Exclusive Rights and License Agreement" (hereafter, "the agreement"). It became effective on March 15, 1994.

NSRS markets its products through direct sales by an independent sales force. Salespersons call on real estate offices and make presentations to try to sign up the office broker or owner. Lawlor and Anton thought they might penetrate the market in California more quickly by offering their products to title and mortgage companies. They felt these companies had account representatives who called on real estate companies who could be used to market the school reports to real estate agents and brokers. They were not wedded solely to their plan, and considered NSRS's method of marketing the products as a potential method as well. Lawlor and Anton also wanted to charge their customers differently for the products. Instead of the flat annual fee charged by NSRS, they wanted to charge on a per report basis.

Lawlor's and Anton's ideas were incorporated into the agreement. It took a long series of negotiations to prepare the agreement. At first, the negotiations were heated because Rosen did not want it done any way but his, but eventually the agreement was reached. Attached to the agreement is "Schedule 2" which was the marketing plan written by Lawlor and Anton.

The agreement between NSRS and NSC gave NSC exclusive rights in certain California counties to market the school reports, to use NSRS's software system to produce the reports, and to use NSRS's trademark and service marks. In exchange, NSC was to pay a fee of \$300,000.00 to NSRS. In connection with the marketing of the products, the agreement in paragraph 8(b) provided as follows:

"Notwithstanding anything to the contrary above, [NSC] shall be entitled to Market the Licensed Products only (i) to real estate agencies and brokers in the same manner as by [NSRS], its franchisees, licensees and agents for other parts of the country, (ii) to title companies, developers, property management companies, and mortgage brokers in accordance with the marketing plan attached as Schedule "2" hereto or (iii) as otherwise approved

in advance in writing by [NSRS] (such written approval or the refusal to grant the same shall be made by [NSRS] within thirty (30) days of its written receipt of a request from [NSC]."

The agreement further provided:

"(c) In no event shall [NSC] charge, or permit any real estate agency or broker, title company, mortgage broker or any other person to charge, any fee of any kind to the public for the Licensed Products."

Paragraph 8(b)(iii) was inserted into the agreement because the parties recognized the licensed product could be marketed in other ways and they felt there should be flexibility. The parties understood they would be reasonable and any other form of marketing had to be done in such a way as to maintain the reputation and standards of NSRS to ensure the company would not be hurt. Nevertheless, Anton understood the methods for marketing the school report were agreed upon jointly and NSRS had to approve how NSC was going to market it. He knew NSC could not do what it wanted independently and had to make its intentions part of the agreement.

After NSC began operation, it marketed the school report in accordance with paragraph 8(b)(ii). In addition, it also marketed the school report to multiple listing services and Boards of Realtors. NSC used a brochure in its marketing efforts which was written by Lawlor but which was taken from copy containing points describing the benefits of the school report supplied by NSRS. NSRS also supplied something akin to a booklet containing an independent distributor's agreement, answers to frequently asked questions, marketing information, and sales pitches. NSRS suggested NSC use it. Some of it was helpful and may have been used by NSC in the beginning.

NSC was not as successful as the parties hoped. It defaulted on its payments, the parties entered into a Forbearance Agreement which granted NSC additional time to meet its payment obligations, and eventually NSC filed suit against NSRS in California state court. That action was removed to federal court.

### III

Respondents did not register the agreement with the Department of Corporations.

## DETERMINATION OF ISSUES

### I

At the hearing, respondents offered the deposition transcripts of Lawlor and Anton into evidence under Evidence Code section 1292. In support of the offer, respondents submitted the declaration of Mr. King as to his efforts to locate Lawlor and Anton, and the declarations of a process server describing his efforts to serve them with subpoenas. Respondents established Anton and Lawlor were unavailable. People v. Saucedo (1995) 33 Cal.App.3rd 1230, 1236-39. They also established the former testimony was offered in a civil action and otherwise satisfies the requirements of section 1292. The deposition transcripts of Lawlor and Anton are admitted.

Respondents requested the court take official/judicial notice of the "Order Denying Motion For Summary Judgment And Granting Motion For Leave To File Third Amended Complaint" issued by United States District Judge Barry Ted Moskowitz on November 12, 1996. The request was granted during a telephonic conference call with counsel prior to the hearing. The motion was based upon the transcripts of Anton and Lawlor. The court's discussion of the background of the dispute was taken from those transcripts and the agreement. Both the transcripts and the district court order were considered by the administrative law judge in this proceeding.

### II

The Commissioner of Corporations established the agreement between NSRS and NSC was a franchise within the meaning of Corporations Code section 31005. Respondents did not establish an exemption or exception to the requirement of registration. The agreement was not registered as required under section 31110. The Desist and Refrain Order was properly issued and is therefore affirmed.

Corporations Code section 31005 defines "franchise" as:

- "a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:
- (1) A franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor: and
  - (2) The operation of the franchisee's business

pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate; and

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

Of the four elements needed to establish a franchise, three are not in dispute in this proceeding. The only issue is whether the agreement creates a marketing plan prescribed in substantial part by NSRS. Respondents contend it does not. The Department contends it does, and offers in support of that conclusion Release No. 3-F, Revised, entitled "When Does An Agreement Constitute A `Franchise,'" issued by the Commissioner of Corporations on June 22, 1994.

The first step in determining if the agreement in this matter is a franchise is to ascertain the Legislative intent so as to effectuate its purpose. People v. Kline (1980) 110 Cal.App.3d 587, 593. The Legislative intent in enacting the Franchise Investment Law is contained in section 31001 which indicates the intent is to provide prospective franchisees with information necessary to make an intelligent decision about the franchise offered, to prohibit the sale of franchises if it would lead to fraud or a likelihood the franchisor's promises would not be fulfilled, and to protect the franchisor by ensuring the parties better understood the relationship between them. Generally, statutes like the Franchise Investment Law, which are remedial and protective, are liberally construed to effect their object, and with respect to each element of the statutory definition of "franchise," the court in Kim v. Servosnax, Inc. (1992) 10 Cal.App.4th 1346, 1356 indicated "...each element should be construed liberally to broaden the group of investors protected by the law and to carry out the legislative intent."

Release 3-F is an expression of the Commissioner's interpretation of the relevant statutes and as such, is entitled to great weight. People v. Kline, supra. At pages 2 through 7 of the release, the Commissioner analyzes the marketing plan or system element, and at page 4, analyzes the phrase "prescribed in substantial part" as it relates to a marketing plan. The Commissioner noted there are close questions of interpretation where an agreement grants to a person the right to engage in a business subject to some restrictions but with a measure of freedom. Such is the case here. Whether the directions are "substantial" is a question which must be determined after an evaluation of all the provisions of the agreement "... and the effect which these provisions have as a whole on the ability of the person

engaged in the business to make decisions substantially without being subject to restrictions or having to obtain the consent or approval of other persons."

Focusing on the sole question of whether there is a marketing plan or system substantially prescribed by NSRS in the agreement, the answer clearly is there is. NSRS operated its business in the East by distributing its school report directly to real estate agents and brokers, and that is how Rosen wanted the reports marketed in California. Lawlor and Anton persuaded him another method of marketing might work in California, and both parties recognized other methods might also work. But respondents did not relinquish their control over their product and allow Anton and Lawlor the freedom to do whatever they wanted. Rather, they set forth two specific plans in paragraph 8(b) of the agreement which allowed NSC to market the school reports in only one way or the other. Or, if another method was later created, NSC could use it if NSRS gave its approval. Whichever method NSC chose, it was still one contained in the agreement and therefore one which required the consent and approval of NSRS.

Respondents emphasize the plan to market the school report to title companies, developers, property management companies, and mortgage brokers came from Lawlor and Anton. Respondents believe that if the franchisor did not create the marketing plan or system before they entered into the agreement, or used another plan or system in its own business operations, then there is no franchise. However, the definition of "franchise" in section 31005 does not look to the source of the marketing plan or system; it looks to the contract or agreement between the parties. The agreement here is entirely restrictive regarding the method by which the school report may be marketed, and the only way NSC could use another method is with respondents' approval.

The restrictions placed on the ability of NSC to market the school report as it saw fit are not solely contained in paragraph 8(b). For example, paragraph 8(c) prohibits NSC from charging or permitting a real estate agency or broker, etc. to charge any fee to the public for the school report. Thus, even though the ultimate consumer of the school report is a potential home buyer under either paragraph 8(b)i or 8(b)ii, respondents provided that no one, including NSC, could sell a school report to such consumers. Another example is paragraph 8(d) which requires NSC in its sale of NSRS's products to maintain the high standards and reputation of NSRS and its products.

Respondents point to a number of considerations set forth in Release 3-F (paragraph B 2 (c)) which the

Commissioner in the past used to find a franchise, and demonstrated they were not part of this agreement and consequently argued this agreement cannot be a franchise. That argument is not persuasive. Consideration of other factors contained in paragraph B 2 (g) of the Release points to the opposite conclusion, such as an exclusive territory awarded to NSC, permitting NSC to purchase advertising copy and promotional materials from NSRS and requiring approval by NSRS of materials not purchased from NSRS (paragraph 12), limiting the sale of competitive products (paragraph 22), providing training (paragraph 12), providing trade secrets (paragraph 5(a)), and so forth.

In light of the direction to liberally construe each element of the definition of "franchise" to broaden the group of investors protected by the law, and to carry out the legislative intent of the law, it must be concluded the agreement in this case contains a marketing plan or system prescribed in substantial part by respondents. Since it is conceded all the other elements of a franchise are present, the agreement is a franchise and required registration under the Franchise Investment Law.

#### ORDER

The Desist and Refrain Order issued by the Commissioner of Corporations on September 22, 1995 against respondents is affirmed.

Dated: April 15, 1997

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ALAN S. METH  
Administrative Law Judge  
Office of Administrative

Hearings