

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Desist and Refrain Order
Issued To:

JAMES ALBERT SWEENEY II,
BIGCO-OP, INC.

Respondents.

DC Case No. 7188

OAH No.: L2007070313

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated November 2, 2007, is hereby adopted by the Department of Corporations as its Decision in the above-entitled matter.

This Decision shall become effective on FEBRUARY 7, 2008.

IT IS SO ORDERED this 6TH day of FEBRUARY 2008.

CALIFORNIA CORPORATIONS COMMISSIONER

Preston DuFauchard

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PROPOSED DECISION

This matter was heard by Eric Sawyer, Administrative Law Judge, Office of Administrative Hearings, State of California, on October 2, 2007, in Los Angeles.

Kirk E. Wallace, Corporations Counsel, represented the California Corporations Commissioner (Petitioner). Josh Lawler, Esq., Zuber & Taillieu L.L.P., represented James Albert Sweeney II and BigCo-op, Inc. (Respondents).

At the commencement of the hearing, the parties submitted a written stipulation of facts not in dispute and four exhibits which were admitted into evidence. The parties thereafter made closing arguments. The record was closed and the matter was submitted for decision at the conclusion of the hearing on October 2, 2007.

FACTUAL FINDINGS

Parties and Jurisdiction

1. On May 2, 2007, Lead Corporations Counsel Alan S. Weinger, on behalf of Preston DuFauchard, California Corporations Commissioner (Petitioner), issued a Desist and Refrain Order (D&R Order) to a number of subjects, including Respondents, pursuant to California Corporations Code section 25532.¹ The D&R Order was issued by Petitioner based on his opinion that the sale of "licenses" by Respondents amounted to a sale of securities in violation of section 25110, and that such sales were by means including untrue and/or misleading written or oral communications in violation of section 25401.

2. BigCo-op, Inc. and James Sweeney II (Respondents) are the only two subjects of the D&R Order who requested a hearing to challenge the order.

¹ All further statutory references are to the Corporations Code unless otherwise noted.

3. Respondent BigCo-op, Inc. (BigCo-op) is a Delaware Corporation, incorporated on April 17, 2000, and it has a registered business address of 3666 University Avenue, 3d Floor, Riverside, California 92501. BigCo-op has a website located at www.bigco-op.com.

4. Respondent James Albert Sweeney II (Sweeney) is the current CEO and Chairman of BigCo-op and was represented to be the president of BigCo-op on certain of BigCo-op's stock certificates.

5. BigCo-op also did business under the name Ez2Win.Biz, which also had a business address at 3666 University Avenue, 3rd Floor, Riverside, California 92501. Ez2Win.Biz had a website located at www.ez2win.biz. The website claims that Ez2Win.Biz has the exclusive marketing rights to its parent company, BigCo-op, but Ez2Win.Biz was never incorporated and had no separate legal identity from BigCo-op. (BigCo-op and Ez2Win.Biz are therefore collectively referred to herein as BigCo-op.)

6. Petitioner had previously issued a Desist and Refrain Order on October 23, 2006, against BigCo-op, Sweeney, and others, with regard to the sale of stock in BigCo-op he found to be in violation of sections 25110 (sale of unregistered non-exempt securities) and 25401 (sale of securities by mean of misstatement or omission of material fact). That prior order was not contested and has become final.

The BigCo-op, Inc. Business Generally

7. BigCo-op operated both an internet shopping business and a multi-level marketing program. The multi-level marketing program is the basis of the D&R Order, not the internet shopping business. Persons who wanted to participate in the multi-level marketing program were required to purchase a BigCo-op "license" which allowed them to earn commissions when they sold BigCo-op products to others, including licenses, and when those to whom they had sold a license in turn sold licenses to others, and so on, down the multi-level marketing chain.

8. BigCo-op licensees could also earn commissions on purchase transactions on the internet through the BigCo-op internet shopping business network involving a buying member of BigCo-op, who had been signed up by that licensee as a buying member (which was a free process). Licensees also could earn commissions on the purchases of goods and services bought on the BigCo-op website by themselves.

9. BigCo-op licensees could also make money by selling BigCo-op products, which included computer services such as "value suites." Value suites were web templates, which could be sold to merchants to help them set up their own web sites. A certain number of value suites were given to licensees with the purchase of their licenses for re-sale to merchants for a profit.

10. BigCo-op licensees could also sell "merchant memberships" to the BigCo-op marketplace. The merchant membership authorized a small business to plug into the BigCo-op marketplace in order to sell its own products or services (so long as the small business agreed to provide a sufficient rebate to the buyer). Merchant memberships in BigCo-op were offered free to the public. The merchant member did not receive a BigCo-op license and did not participate in the multi-level marketing program. Petitioner only contends that the licenses sold by BigCo-op amounted to securities, not the merchant memberships.

11. BigCo-op represented that licensees could make money and win prizes, including Mercedes Benz automobiles and Rolex wristwatches, by earning commissions selling licenses to others and thereby developing a larger downstream in the multi-level marketing program.

Specific Details About the BigCo-op, Inc. Licenses

12. Beginning in or about the year 2000, BigCo-op and Sweeney offered and sold to the public the BigCo-op licenses.²

13. The various types of licenses sold by BigCo-op were offered through advertising on the website, at sales meetings held in northern and southern California, and by word of mouth. The various types of licenses offered and sold by BigCo-op were referred to as E-commerce Market Brokers (EMBs), E-commerce Entrepreneurs (ECEs), Independent Travel Agents (ITAs) and "EMB Founders Positions". EMB Founders Positions were also sometimes referred to as "Founders Memberships." In order to participate in the multi-level marketing program, purchasers of a license had to pay \$195 as the initial license fee for a basic EMB, ITA or ECE, and \$2,500 for an EMB Founders Position. Various administrative fees and monthly "autoship" charges were also charged to the purchasers of licenses, ranging from \$49 to \$129 a month, depending on the type of license purchased.

14. Those who purchased BigCo-op licenses were encouraged and trained by BigCo-op, and by more senior licensees, to sell licenses for EMB, ITA, ECE and EMB Founders Positions to others, in which they received a commission on each license they sold. The commissions usually aggregated to roughly \$140 for the sale of a basic license, and \$1,000 for the sale of an EMB Founders Position. The prices of licenses and commissions varied at times.

15. BigCo-op claimed the commissions that could be earned by each licensee on the sale of licenses to others were limited to eight levels downstream of the initial licensee.

² The licenses were also referred to at times as "memberships" by some salesmen, although BigCo-op's official policy was that "licenses" were distinct from "memberships."

16. BigCo-op represented that earning commissions on the sales of goods purchased from third party merchants through the BigCo-op website was the "core business" of BigCo-op. BigCo-op and Sweeney also represented that they have invested over five years in developing the technology required to establish the basis for the BigCo-op core business. However, except for the sale of stock, almost all of the income generated by BigCo-op in recent years came from selling licenses and from the monthly autoship fees. In fact, according to BigCo-op financial reports for the fiscal years 2002-2005, which are the most recent ones available (said financial reports were not prepared according to Generally Accepted Accounting Principals), less than 1% of BigCo-op's income came from commissions earned on its core business of commissions paid on the purchase of goods through the BigCo-op shopping network. BigCo-op and Sweeney also represented that it was their expectation that, as the sale of licenses increased as a result of the success of its multi-level marketing efforts, the income that its core business would generate would also increase and eventually exceed the income generated from the multi-level marketing efforts.

17. It was also represented that purchasers of the EMB Founders Position licenses were entitled to a share of 2.5% of the fees received by BigCo-op from the sales of all EMB Founders Positions by BigCo-op, and that EMB Founders would receive a portion of the monthly autoship charges paid by other licensees. EMB Founders Position licenses were reportedly limited to 1000 total. Initially, purchasers of EMB Founders Positions were also provided 500 "free" shares of stock in Big Co-op. During a sales meeting held in October of 2006, which was attended by an undercover investigator from the Department of Corporations, representations were made by independent BigCo-op salesmen that prospective purchasers of the EMB Founders Positions would profit from the shares in BigCo-op, because the company was about to have its initial public offering of stock. It was also represented that BigCo-op was scheduled to go public in December of 2006 and that it had hired Thomas Weisel Partners to do so, who had previously taken Google public.³ The practice of offering "free stock" with the purchase of an EMB Founders Position license was reportedly terminated by BigCo-op after Petitioner issued the initial Desist and Refrain order which prohibited the sale of stock in BigCo-op.

18. BigCo-op did not request Thomas Wiesel Partners or any other third party to make any preparations for or make any application to any governmental or regulator agency to allow BigCo-op to make an initial public offering of stock in 2006, or at any other time thereafter.

³ Respondents did not stipulate that the description of the meeting made by the Department of Corporations investigator is necessarily true or that any of the representations reportedly made at the meeting were condoned or authorized by BigCo-op or Sweeney personally. However, the investigator's report (exhibit 4) established that those representations were made at the meeting by persons who represented themselves as independent representatives of BigCo-op.

19. BigCo-op did not disclose to purchasers of licenses that BigCo-op and Ez2Win.Biz had operated at a loss in each year of its existence and had a continuing loss of over 4 million dollars by the end of 2006. They failed to disclose that almost all the income for the company was generated by the sale of licenses and fees charged to participants in the multi-level marketing program, and that income from the BigCo-op "core business" of making commissions from the sale of goods by third party merchants through the BigCo-op internet shopping network amounted to less than 1% of the company's income. They also failed to disclose to purchasers that the certified public accountant who prepared the financial statements for BigCo-op for years 2003-2006 (excluding 2005, for which there are no financial statements) had included a notice with the statements for each of those years that BigCo-op had not been able to market its products at amounts sufficient to recover its service and administrative costs and had suffered consecutive losses for 5 years. The certified public accountant's notice concluded "because of uncertainties surrounding the ability of the Company to continue its operations and to satisfy its creditors on a timely basis, there is doubt about the company's ability to continue as a going concern."

20. BigCo-op licensees could not earn income without spending their own time and efforts to sell BigCo-op products (including licenses) in order to generate commissions and to sign up purchasing members for the BigCo-op internet market. Each licensee controlled the day-to-day operations of their individual businesses. They each could conduct business at the hours and in the places they choose, they could (but need not) set up meetings, and they were not required to follow a script or follow any set presentation specified by BigCo-op during such meetings. Purchasers of the ITA (Travel) licenses also could earn money from the sale of travel products (as duly licensed travel agents), as well as on-line computer services such as the merchant memberships and "value suites."

21. BigCo-op placed no limits or minimum requirements on how many BigCo-op products (such as value suites or merchant memberships) could be purchased by licensees or had to be sold by licensees in order to maintain their license or be able to earn commissions by selling licenses to others. There were no requirements that any shopping be done through the BigCo-op network by the licensees or those downstream of them in the multi-level marketing chain in order for the licensees to earn commissions from selling licenses to others. There were also no requirements that licensees sell any licenses, although they would only receive commissions if they did. All licensees were required to pay the monthly autoshop fees, however, to maintain their license and to be able to receive commissions on sales of licenses to others.

22. Licensees had no control, involvement or influence in the operations or management of the BigCo-op corporate enterprise. Although the licensees did have control over their own ability to make money by selling BigCo-op memberships and products, they did not have any substantial power or influence to affect the success or failure of BigCo-op.

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LEGAL CONCLUSIONS

1. Respondents engaged in the offer and sale of securities in the state of California, in the form of investment contracts for E-commerce Market Brokers, E-commerce Entrepreneurs, Independent Travel Agents and EMB Founders Positions licenses. Those securities have not been qualified under the Corporate Securities Law of 1968, which is a violation of section 25110. (Factual Findings 3-22.)

Discussion: The parties agree that the BigCo-op licenses should be considered a security subject to regulation if the three-prong test is met from the United States Supreme Court case of *SEC v. W.J. Howey Co.* (1946) 328 U.S. 293. "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." (*Id.*, at 301.)

The parties also agree that the first two prongs of this test are met in this case. The dispute, therefore, is whether the third prong applies, i.e. whether the profits enjoyed by BigCo-op licensees "come solely from the efforts of others." Courts have held that 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. (See, e.g., *SEC v. Glenn W. Turner Enterprises, Inc.* (9th Cir. 1973) 474 F.2d 476, 482.) Thus, it has been held that the more realistic test for the meaning of "solely" is 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. (*Id.*) This flexible approach is consistent with the Supreme Court's *Howey* decision, in which the Court stated that the definition of securities "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. W.J. Howey Co.*, *supra*, 328 U.S. at 299.)

Because the federal standard for determining whether something is a security is similar to California's, federal cases are deemed to be influential authority on that issue. For example, both parties cited to the *Turner* decision, as well as to another federal case, *SEC v. Koscot Interplanetary, Inc.* (5th Circ. 1974) 497 F.2d 473. The *Turner* and *Koscot* cases are instructive because both involved multi-level marketing programs. In both cases, the courts found that selling "memberships" in a multi-level marketing program amounted to a security because the success or failure of the common enterprise was controlled by the promoters who made the significant managerial decisions. This was true, even though the investors were required to bring in new members in order to realize profits from the enterprise. The following discussion from *Turner* is significant:

For purposes of the present case, the sticking point in the *Howey* definition is the word "solely," a qualification which of course exactly fitted the circumstances in *Howey*. All the other elements of the *Howey* test have been met here. There is an investment of money, a common enterprise, and the expectation of profits to come from the efforts of others. Here, however, the

investor, or purchaser, must himself exert some efforts if he is to realize a return on his initial cash outlay. He must find prospects and persuade them to attend Dare Adventure Meetings, and at least some of them must then purchase a plan if he is to realize that return. Thus it can be said that the returns or profits are not coming "solely" from the efforts of others.

The *Turner* court concluded:

It would be easy to evade [the sole effort prong] by adding a requirement that the buyer contribute a modicum of effort. Thus the fact that the investors here were required to exert some efforts if a return were to be achieved should not automatically preclude a finding that the Plan or Adventure is an investment contract. To do so would not serve the purpose of the legislation

In this case, Dare's source of income is from selling the Adventures and the Plan. The purchaser is sold the idea that he will get a fixed part of the proceeds of the sales. In essence, to get that share, he invests three things: his money, his efforts to find prospects and bring them to the meetings, and whatever it costs him to create an illusion of his own affluence. He invests them in Dare's get-rich-quick scheme. What he buys is a share in the proceeds of the selling efforts of Dare. Those efforts are the *sine qua non* of the scheme; those efforts are what keeps it going; those efforts are what produces the money which is to make him rich. In essence, it is the right to share in the proceeds of those efforts that he buys. In our view, the scheme is no less an investment contract merely because he contributes some effort as well as money to get into it.

SEC v. Glenn W. Turner Enterprises, Inc., *supra*, 474 F.2d at 481-483.

In this case, the BigCo-op licenses are similar to the memberships involved in the *Turner* and *Koscot* cases, and should therefore be considered securities subject to regulation. For example, the licensee investors have no control over the BigCo-op business enterprise, although it is the BigCo-op business enterprise that they are selling to prospective new licensee investors, not their own individual talents or services. Put another way, the thing of value that the licensee investors sell to others is the ability to participate in the profits realized from the BigCo-op business, over which the licensee investors have no control. Moreover, after their initial efforts to bring others into the BigCo-op enterprise, the licensee investors have no control over how their profits are realized. It is the activity of the new licensee investors down the multi-level marketing chain that will generate new commissions and therefore profits for the licensee investors further up stream, and so on.

In a sense, the licensee investors make their money from the efforts of those operating the BigCo-op enterprise and those new investors they are able to persuade to join the common enterprise. The licensee investors have no control over either group. As the *Turner* court explained, the licensee investors' initial activity to get others to join the enterprise does not mean they are exercising sufficient control over how they realize their profits. The end result of the BigCo-op multi-level marketing program is that Respondents obtain large infusions of capital for the promise of profits to those investing in the enterprise. As contemplated by the *Howey* decision, a flexible approach should be applied to the BigCo-op licensing program, which is essentially a variable scheme "devised for those who seek the use of the money of others on the promise of profits."

2. Respondents offered and sold securities in the State of California, in the form of investment contracts for E-commerce Market Brokers, E-commerce Entrepreneurs, Independent Travel Agents and EMB Founders Positions licenses, by means of written and/or oral communications, which included untrue statements of material facts and omissions of material facts necessary in order to make the statements true, in violation of section 25401. (Factual Findings 3-22.)

Discussion: For purposes of contesting the D&R Order only, the parties stipulated that in the event the sale of the BigCo-op licenses are determined to involve a sale of securities, Respondents would not contest that portion of the D&R Order finding that those securities were sold by means of misstatement or omission of material fact in violation of section 25401. Since it is the conclusion herein that the BigCo-op licenses involve the sale of securities, it is therefore concluded, based on the parties' stipulation, that those securities were sold by means of misstatement or omission of material fact.

3. Cause exists pursuant to section 25532 for the Corporations Commissioner to have issued orders to Respondents to desist and refrain from such conduct in the future. Therefore, cause exists to affirm the D&R Order. (Factual Findings 1-22.)

ORDER

The Desist and Refrain Order dated May 2, 2007, issued to Respondents BigCo-op, Inc., and James Albert Sweeney II, by the California Corporations Commissioner, is affirmed.

DATED: November 2, 2007

ERIC SAWYER
Administrative Law Judge
Office of Administrative Hearings