BEFORE THE DEPARTMENT OF CORPORATIONS

OF THE STATE OF CALIFORNIA

In the Matter of THE CALIFORNIA CORPORATIONS COMMISSIONER, Complainant vs. HEALTHWEST, INC. Respondent	Agency Case No.: 993-5066 OAH No. L2005020353 DECISION

The Proposed Decision of the Administrative Law Judge, issued March 25, 2005, is attached hereto and incorporated by reference as part of the decision of the Commissioner, including its factual findings. However, the Commissioner supplements the Proposed Decision with the following additional clerical corrections and additional Legal Conclusions:

Clerical Corrections to Proposed Decision

Page 2, Paragraph 10: "December 2, 1994 should be December 2, 2004."

Page 3, Paragraph 11: "September 8, 1994 should be "September 8, 2004."

Page 6, Legal Conclusion Paragraph 5: "section 312000" should be "section 31200."

Legal Conclusion Paragraph 7

Further cause exists to deny the effectiveness of the franchise registration under Corporations Code §31115(b) for the following reasons: Respondent failed to disclose that the *Martin* action (Factual Finding #11a), to which respondent defaulted, alleged unfair business practices, false advertising, and fraud; the *Dhawan* action (Factual Finding #11a) also contained similar allegations, to which respondent likewise defaulted, including factual allegations substantially more serious than disclosed in the circular. The undisclosed *Mecum* action (Factual Finding #11c), to which respondent also defaulted, likewise contains allegations of fraud regarding

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respondent's return of deposits. The undisclosed *Object Factory* action (Factual Finding #11d), to which respondent also defaulted, likewise contains allegations of fraud regarding respondent's return of deposits, i.e. claiming that respondent had promised to return deposits, but failed to do so. The Commissioner finds that these misrepresentations by omission indicate a pattern of uncontested claims by franchisees of fraudulent inducement, contractual breaches, non-payment, or fraud, which reflects adversely on respondent's business practices and on his relationships with prospective franchisees, and would therefore be material to a prospective franchisee.

ORDER

Consistent with the Proposed Decision of the Administrative Law Judge, Respondent's appeal is denied and the Order Denying the Effectiveness of Franchise Registration Application issued by the Commissioner on February 7, 2005 is upheld.

Dated: July 7, 2005

ANTHONY LEWIS
Acting Chief Deputy Commissioner
Department of Corporations

/S/_____

NOTICE TO RESPONDENT

State of California - Department of Corporations

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Order Denying Effectiveness of Franchise Registration Application of:	Case No. 933-5066
HEALTHWEST, INC.,	OAH No. L2005020353
Respondent.	

PROPOSED DECISION

This matter regularly came before Samuel D. Reyes, Administrative Law Judge, Office of Administrative Hearings, in Los Angeles, California, on February 25, 2005.

Edward Kelly Shinnick, Corporations Counsel, appeared on behalf of William P. Wood, Corporations Commissioner (Commissioner), Department of Corporations (Department).

4. Manmohan (Mo) Singh Biring, M.D. (Biring) is respondent's founder, chairman, and majority shareholder. Dr. Biring represented respondent at the hearing.

This matter involves respondent's challenge to an order issued by the Commissioner, an Order Denying Effectiveness of Franchise Registration Application (Order), issued pursuant to Corporations Code[1] section 31115. The Order was issued on the basis of the Commissioner's determination that respondent had offered franchises for sale without prior registration or exemption and that respondent failed to make required disclosures in the application for registration. Respondent denies it has sold any franchises and denies it has failed to make required disclosures.

Oral and documentary evidence was received at the hearing and the matter was submitted for decision.

FACTUAL FINDINGS

1. The Commissioner issued the Order solely in his official capacity.

[1] Unless otherwise stated, all further statutory references are to the Corporations Code.

2. Respondent is a California corporation formed on October 15, 2002. Its principal place of business is 1999 Avenue of the Stars, Suite 1000, Century City, California.

3. Respondent is engaged in the business of offering members of the public the right to operate retail medical spas, or "medspas," which provide non-surgical dermatological procedures that include laser hair removal, Intense Pulse Light treatments, Botox treatments and microdermabrasion. It provides these services outside of California pursuant to franchise agreements.

4. Dr. Biring is licensed as a physician in the State of California.

5. On August 13, 2003, respondent filed an application pursuant to section 31111 for registration of an offer to sell franchises for Inaara MedSpa units for an initial franchise fee of $75,000 and a royalty, payable monthly, of 5% of gross sales. The name of the franchise "Inaara Medspas" is respondent's trademark.

6. On July 7, 2004, the Commissioner issued an Order Denying Effectiveness of Registration Application (First Order). In the First Order, the Commissioner concluded: the offer and sale of franchises for the operation of medspas that includes laser hair removal, Intense Pulse Light treatments, Botox treatments, and microdermabrasions constitutes the provision of medical services and the owner must have a certificate to practice medicine; respondent offered and sold franchises, or purported "licenses," to California residents without having registered the franchise offer; and respondent violated contractual obligations to its franchisees or purported licensees.

7. On July 14, 2004, the Medical Board of California provided an opinion to the Department that operation of Inaara MedSpas, as proposed by respondent in its application for franchise registration, would constitute the unauthorized practice of medicine.

8. On July 20, 2004, the Commissioner issued a Desist and Refrain Order prohibiting further sale of medspa franchises without registration. In issuing the order, the Commissioner concluded that respondent had made untrue statements of material fact and omitted material facts from its registration application.

9. Respondent did not contest the First Order or the July 20, 2004 Desist and Refrain Order.

10. On December 2, 1994, respondent filed a second application (application) pursuant to section 31111 for registration of an offer to sell franchises for Inaara MedSpas offering the same non-surgical dermatological services. This application, unlike the first one, stated the franchise offers in the State of California would be limited to licensed physicians. Initial investments were expected to range from $332,600 to $600,000.

11. a. In Item 3 of the franchise offering circular (circular) filed as part of the application, respondent disclosed two civil actions: *David Martin v. Healthwest, Inc.* (Superior Court of the State of California, County of Los Angeles, case 04C01494), filed September 8, 1994, and *Yogesh Dhawan v. Healthwest, Inc.* (Superior Court of the State of California, County of Los Angeles, Case BC322278), filed September 29, 2004. With respect to both civil actions, the circular noted that the plaintiffs alleged that franchises had been offered without prior registration with the Department; with respect to the latter civil action, the document stated the plaintiff also alleged fraudulent inducement to contract. The document contained the following statement of respondent's position in each case: "Healthwest, Inc. contends that [Martin/Dhawan] was not sold a franchise as there was no use of a trademark." It also contains the following: "Furthermore, Healthwest Inc., bought back David Martin's facility in January 2004 for $129,000 to be paid over a 3 year period" and "Furthermore, Yogesh Dhawan continues to successfully operate the facility."

b. Respondent failed to disclose in the application that he did not contest the *David Martin v. Healthwest, Inc.* matter and that a default judgment had been entered on November 15, 2004.

c. Respondent failed to disclose in the circular that a civil action, styled *Douglas D. Mecum vs. Healthwest, Inc.*, Case number 04 CV 2896, had been filed in the Eighteenth Judicial District Court, Sedgwick County, State of Kansas, on July 9, 2004, or that a default judgment awarding the sum of $28,180.42 to plaintiff had been entered in the matter on August 11, 2004.

d. Respondent failed to disclose in the circular that a civil action, styled *Object Factory, LLC, and Joseph Cash vs. Healthwest, Inc.*, Case number 4220704, had been filed in the County Court, Collin County, State of Texas, on September 27, 2004, or that a default judgment awarding the sum of $25,000, plus costs and interest, to plaintiffs had been entered in the matter on November 17, 2004.

e. Respondent also failed to disclose in the circular the claim made by Candace Hard (Hart) and the $20,000 owed to Hart, which claim and obligation are discussed in factual finding number 16.

12. The facts set forth in factual finding numbers 11b, 11c, 11d, and 11e are material facts required to be disclosed in an application for registration in that the litigation and obligations could potentially adversely affect respondent's value and finances.

13. The Commissioner issued the Order on February 7, 2005, denying the application. Respondent thereafter timely requested a hearing.

14. The parties entered into the following stipulation: respondent sold a franchise/license to Yogesh Dhawan (Dhawan) in late 2003 or early 2004; respondent provided assistance to Dhawan in establishing a medspa, which assistance included help in writing a business plan and a marketing plan; respondent accepted a franchise/license fee; respondent allowed Dhawan to use the Inaara MedSpa name; Dhawan hired Dr. Biring as medical director of the spa; and Dhawan operated an Inaara MedSpa in Torrance, California, until a dispute arose about Dhawan's territorial rights to the Inaara name.

15. The Department presented evidence regarding another two individuals who had dealings with respondent regarding the medspas: Hart and Philip Rowe (Rowe).

16. a. In January or February 2004, Hart, who is not a physician, attended a medspa presentation by respondent in Los Angeles. The presenters described the spa services to be provided under the "Inaara MedSpa" name and stated that a physician would be required on staff, although not necessarily on site. These representatives of respondent informed those in attendance that respondent was "one week away" from receiving a license to sell the franchises.

b. Hart agreed to sign up and received the following confirmation on February 17, 2004:

> "By way of this letter HealthWest, Inc (HWI) agrees to grant Candace Hart a HealthWest, Inc. MedSpa Franchise/License in the San Jose, California area. HWI will receive[sic] $25,000 from Candace Hart towards the franchise/license fee of $75,000. Candace Hart will execute within 20 days, the standard HWI **Franchise/License Agreement**. This partial payment of $25,000 is refundable in the event that Candace Hart is unable to obtain a SBA loan."

On April 15, 2004, Hart paid $25,000 to respondent and respondent provided assistance in preparing a business plan and applying for a Small Business Administration loan.

c. Dr. Biring agreed to act as Hart's medspa physician and planned to use the trademark "Inaara MedSpa" in connection with Hart's business.

d. The loan was denied and Hart requested a refund. Respondent has accepted its obligation to refund the money and in September 2004 paid $5,000 of the amount owed.

17. On February 24, 2004, Rowe, who is not a physician, paid respondent $75,000 for a "license" to operate an "Inaara Medspa" in the Walnut Creek area, which "license" would purportedly be converted to a "franchise" upon approval of an application pending before the

Department. He signed a "Licensing Services Agreement" wherein respondent agreed to "assist" Rowe in establishing one or more MedSpa, in exchange for a "services fee." The agreement stated respondent was to assist the client in the following areas: site selection; MedSpa design/layout; employee hiring/training; MedSpa policies and procedures manual; licensing/permits; budgeting; patient base development; record keeping; equipment; insurance; MedSpa site assistance; compliance; regulatory/earning potential; legal; record keeping; and MedSpa equipment. On August 1, 2004, Dr. Biring agreed to serve as the medical director of Rowe's spa, which opened on that date as "Inaara MedSpa." Rowe terminated the agreement on November 21, 2004 and operates his business under the name "Encore MedSpa."

18. Dr. Biring denied entering into franchise agreements. Rather, he testified, he merely entered into licensing services agreements, such as that signed by Rowe and Dhawan, so that he could assist clients, at times referred to as "licensees," establish medical spas. Clients could choose to enter into a "Facilities and Management Services Agreement" if they wished to receive ongoing support. Respondent testified he did not create franchise arrangements in California because no trademark was required in connection with the operation of the spas. He only used the "Inaara MedSpa" trademark, he stated, if the client requested his medical services, in which case his business name, Inaara, was used to indicate his involvement in providing medical services at the spa. In his view, "Inaara MedSpa" does not refer to a franchised medspa, but to his medical practice within a medspa. The client, he testified, provided the physical facilities, equipment, and non-medical personnel.

19. Except as set forth in this Decision, all other allegations in the Order and accompanying Statement in Support of Order Denying Effectiveness of Franchise Registration Application, and all contentions by the parties at the hearing, lack merit or constitute surplusage.

LEGAL CONCLUSIONS

1. Section 31005, subdivision (a), in pertinent part, defines "franchise" to mean:

> "[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 a 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."

Respondent in fact offered a franchise to Hart and entered into franchise agreements with Dhawan and Rowe, by reason of factual finding numbers 14, 16, and 17. In each case, respondent offered goods and services, namely, the medical spas, under marketing plans and systems created and controlled by respondent. The operation of the clients' businesses, in fact the very name of the business, was associated with the trademark used by respondent, Inaara MedSpa. As it became clear that a physician would be required for the franchises to be registered, respondent bundled his services as medical director, with the trademark, into the medspa product. Lastly, all three franchisees/licensees were required to pay a fee for respondent's services. The facts that respondent at times referred to the clients at "licensees" or that the fee paid was called something other than "franchise fee" does not alter the nature of the activities –a concept grasped by respondent in designating the clients as "franchisees/licensees" and in contemplating a change in name without a change in contractual arrangement once the franchise registration became effective.

2. Respondent offered and sold franchises without having first registered the franchises as required by section 31110, by reason of factual finding numbers 14, 16, and 17 and legal conclusion number 1.

3. Section 31114 requires that the application for registration "shall be accompanied by a proposed offering circular, which shall contain the material information set forth in the application for registration, as specified by rule of the commissioner, and such additional disclosures as the commissioner may require...." California Code of Regulations, title 10, sections 310.111 and 310.114.1 require disclosure of civil litigation and court judgments. As set forth in factual finding numbers 11b, 11c, 11d, 11e and 12, respondent failed to disclose material information pertaining to pending civil litigation and monetary judgments, thereby violating these provisions.

4. Section 31115, subdivision (a) authorizes the Commissioner to issue stop orders denying the effectiveness of a franchise registration if there has been a failure to comply with any provision of the Corporations Code. Cause exists to deny the effectiveness of the franchise registration in that respondent violated section 31110 by offering to sell, and by selling, franchises without first having registered the franchises, by reason of factual finding numbers 14, 16, and 17 and legal conclusion numbers 1 and 2. Further cause exists to deny the effectiveness of the franchise registration in that respondent violated section 31114 and California Code of Regulations, title 10, sections 310.111 and 310.114.1 by failing to disclose material facts in the application for registration, by reason of factual finding numbers 11b, 11c, 11d, 11e and 12 and legal conclusion number 3.

5. Respondent willfully omitted material facts from the application in violation of section 312000, by reason of factual finding numbers 11b, 11c, 11d, 11e and 12.

6. Section 31115, subdivision (b) authorizes the Commissioner to issue stop orders denying the effectiveness of a franchise registration if the offer would constitute misrepresentation, fraud or deceit. Cause exists to deny the effectiveness of the franchise registration in that respondent misrepresented the franchise by failing to disclose pending litigation that adversely affected respondent's value and finances, by reason of factual finding numbers 11b, 11c, 11d, 11e and 12 and legal conclusion number 3.

ORDER

Respondent's appeal is denied and the Order Denying Effectiveness of Franchise Registration Application issued by the Commissioner on February 7, 2005, is upheld.

DATED: 3/25/05

SAMUEL D. REYES
Administrative Law Judge
Office of Administrative Hearings