THE RELEVANCE OF U.S. SECURITIES LAWS TO IMMIGRANT INVESTORS, EB-5 REGIONAL CENTERS AND THEIR ADVISORS

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The EB-5 employment-creation immigrant visa category,[1] especially its more popular regional center pilot program,[2] is on the rise as a favored form of U.S. immigration for wealthy foreign nationals. The EB-5

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The authors are not providing legal advice in this article. Please consult your own securities counsel to discuss your specific facts and the applicability of securities law.

[1] INA § 203(b)(5), 8 U.S.C. § 1153(b)(5).

[2] Authorized under the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act of 1993, Pub. L. No. 102-395, § 610, 106 Stat. 1828; S. Rep. No. 102-918 (1992).

regional center program[3] requires no labor market test to prove the unavailability of U.S. workers; no anchor relative in the United States to petition on the immigrant's behalf; no claim of extraordinary or exceptional ability; no fear of persecution in the homeland; no business to manage directly on a day-to-day basis; or job to perform for a sponsor. The category instead allows conditional and permanent resident status by investing lawfully acquired funds (at least $500,000 within a rural area or one of high unemployment, or $1 million anywhere else) in a regional center approved by U.S. Citizenship and Immigration Services (USCIS). To qualify, each investor must directly or indirectly through the regional center create ten full-time jobs in the United States.

From the investor's point of view, he or she is provided with offering materials from the regional center, such as a private placement memorandum and subscription agreement, and asked to sign the subscription agreement and deposit his money usually into an escrow account or an account controlled by the regional center. An investor, his or her immigration counsel, and/or perhaps even some principals within a regional center may not fully understand the function of those offering documents. The purpose of this article is to provide insight regarding the securities law requirements governing regional center offerings.

When a regional center forms a limited partnership or limited liability company in which the EB-5 investor would become a limited partner (or member, in the case of a limited liability company), the regional center is offering an EB-5 investor a security.[4] Therefore, a regional center must comply with federal and state laws in conducting the offering of securities. Given that the main focus of an EB-5 investment for the investor is obtaining permanent residency in the United States, investors may not recognize or consider that a regional center is offering a security. More importantly, EB-5 investors most likely will have no idea what the implications are if a regional center tells them they are being offered or sold a security. Some regional centers may themselves not be fully aware of these implications.

Moreover, foreign investors, given their likely unfamiliarity with U.S. law, may not understand that state and federal securities laws are designed to protect investors, provide accurate information about potential investments, and punish unscrupulous persons or entities that violate these laws and ultimately injure owners of securities and harm financial markets. These investor concerns and protections may seem unimportant at the outset when the primary focus is on obtaining permanent resident status. Still, investors should recognize that not every investment is safe; not every investment in a regional center will ultimately result in green card status and produce a profit; and not every professional who offers to help investors through the process has the necessary expertise. One major form of investor protection is to

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[3] A list of currently active EB-5 regional centers, effective as of May 2009 (courtesy of Miller Mayer LLP), can be accessed at: http://www.millermayer.com/LinkClick.aspx?fileticket=dE%2fgrYpeBOM%3d&tabid=126&mid=863.

[4] We assume in this article that the regional center is the issuer of the securities. However, if a separate entity other than the regional center is offering the securities to the EB-5 investors, the securities laws we discuss would apply to that entity.

sue for a return of the investment, but this recourse does not help the EB-5 investor achieve permanent resident status.

What then is a security? The Securities Act of 1933, as amended (the "Securities Act") defines "security" quite broadly. It includes any note, stock, bond, "investment contract" or, in general, any interest or instrument commonly known as a "security." An "investment contract" is made when a person (i) invests money, (ii) in a common enterprise, (iii) with an expectation of profit, (iv) to be earned solely from the effort of others. The U.S. Securities and Exchange Commission ("SEC") has determined that interests in a limited partnership are an investment contract, and therefore, a security. Though there have been disputes over whether a membership interest in a limited liability company is also a security, the SEC has considered limited liability company interests to be securities. In fact, if a limited liability company offers unregistered interests in a limited liability company to a large number of investors, it can expect that the SEC will initiate an action against it asserting that the membership interests are securities.

The Securities Act requires that all securities sold must be registered with the SEC, unless exempted by its rules. Rule 506 of Regulation D promulgated under the Securities Act provides the exemptions to the registration rules that regional centers typically use to avoid the burdensome and expensive process of registering the securities to be offered and sold to EB-5 investors.[5] To meet the exemption provided by Regulation D, a regional center must comply with certain conditions set forth in Rule 502 of Regulation D, including:

1. *Information requirements*. If all of the investors are "accredited investors" then there are no informational requirements under Regulation D, though issuers[6] are still subject to anti-fraud requirements under securities laws. An accredited investor is a person whose:

   (i) individual net worth, or joint net worth including that person's spouse, at the time of the purchase of the securities exceeds $1,000,000;

   (ii) individual income exceeded $200,000 in each of the two most recent years and who expects to reach that income level in the current year; or

   (iii) joint income including that person's spouse exceeded $300,000 in each of the two most recent years and who expects to reach that income level in the current year.

   If securities are sold to non-accredited investors, then Rule 502(b) requires that the issuer provide each non-accredited investor with the information specified in that rule (similar to a prospectus

[5] This article does not address the other potential exemption from registration, which is provided by Regulation S. Unlike Regulation D, Regulation S does not provide an exemption from state securities registration.

[6] Under Section 2(a)(4) of the Securities Act, an issuer is a person or entity who issues or proposes to issue any security.

required in a registration of securities). The enhanced informational requirements are an onerous and costly task that the issuer can avoid by only selling to accredited investors.

2. *Limitation on manner of offering*. Rule 502(c) prohibits a general solicitation (discussed below) or advertising in the offer or sale of securities.

3. *Limitations on resale*. Rule 502(d) prohibits the resale of securities sold under Regulation D, unless the securities are registered or another exemption applies to the resale. One potential exemption available for the resale of restricted securities is in Rule 144 promulgated under the Securities Act. Under certain circumstances, Rule 144 states that securities held for at least six months are no longer restricted and may be resold without registration. It is the responsibility of the issuer to ensure that the purchasers of the securities do not violate the resale restrictions.

4. *Integration.* Rule 502(a) also states that offers and sales made within the six months before and after the completion of a Regulation D offering might be considered as a part of that Regulation D offering or "integrated" into that offering. The SEC will generally look at the facts and circumstances of all the offerings within this one-year integration window to determine whether separate sales are actually part of the same offering. The factors that the SEC looks at are whether: (i) the sales are part of a single plan of financing; (ii) the sales involve issuance of the same class of securities; (iii) the sales have been made at or about the same time; (iv) the same type of consideration is being received; and (v) the sales are made for the same general purpose.

Rule 503 requires an issuer offering securities in reliance on Regulation D to file a notice of sales on Form D[7] with the SEC for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering. To determine whether a separate Form D must be filed for a subsequent offering of the same type of securities, the issuer should evaluate the same factors the SEC uses to determine whether there is integration under Rule 502(a), such as whether the offering is part of a single plan of financing or made for the same general purpose. The notice must contain the information required by Form D.

Of the foregoing conditions, the limitation on the manner of offering is one that most distinguishes a private placement offering from a public distribution that requires registration of the securities. To maintain the exemption under Regulation D as a private placement offering, issuers must pay careful attention not to engage in general solicitation or advertising.

General Solicitation or Advertising

If a regional center violates the prohibition on general solicitation and advertising under Rule 502(c), the Regulation D exemptions are no longer available and any securities attempted to be sold under

[7] A copy of the Form D can be found on the SEC's website at http://www.sec.gov/about/forms/formd.pdf.

Regulation D could be voided. The regional center would be required to register the securities or find another available exemption.

General solicitation includes any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio and any seminar or meeting whose attendees have been invited by the foregoing methods. This applies whether conducted in the United States or abroad. In addition, sending mass e-mails, newsletters or other mailings is considered general solicitation.

Activities by any third party intermediary assisting the regional center, such as immigration brokers or finders, are included in the evaluation of whether a regional center has complied with Rule 502(c). If an immigration attorney assists a regional center and accepts fees from someone other than his or her own EB-5 investor client for services rendered to that client, then the immigration attorney would be acting as a third party intermediary and his or her activities should also be evaluated within the context of Rule 502(c).

Both the EB-5 investor and the regional center should vigilantly monitor solicitation and marketing activities because the consequences of violating Rule 502(c) will be costly. As mentioned above, a transaction in violation of Rule 502(c) will be voidable and the Regulation D exemption will no longer be available.[8] If the transaction is voided, this could reverse any financial benefit conferred to the regional center's project. Since there is no precedent in the EB-5 investment context, it is unknown what effect a voided investment transaction could have on any immigration benefit conferred to the EB-5 investor. Nevertheless, an investor does not (and neither does the regional center) want to be involved in an investment that will require registration of the securities; registration means extra time, extra disclosures and extra money. Furthermore, registration by a non-public company such as a regional center will involve even more time and enhanced disclosures, since the registration would be the initial public offering ("IPO") for the regional center.

From a time perspective, the investor cannot afford to wait for the process of a registration statement to be prepared and filed with the SEC, and then for the SEC to declare the registration effective. To complete an IPO, the regional center would need at least three years of audited financials, or if it qualifies as a "smaller reporting company," two years of comparative audited balance sheet data in annual financial statements. The regional center cannot offer or sell securities until the registration statement is effective. What this means in the EB-5 context is that an investor cannot sign a subscription agreement until effectiveness of the registration statement, thereby delaying the filing of the I-526 application with the USCIS. Added to the period of time it takes to get an effective registration statement, it could be four to six years before the EB-5 investor's conditions on residence are removed and lawful permanent resident status is granted unconditionally.

[8] In addition, if the Regulation D exemption is no longer available, issuers will then have to find a separate exemption under each applicable state's securities laws in order to avoid registration of the securities.

Therefore, the EB-5 investor cannot afford to make an investment in a regional center that engages or uses a third party intermediary that engages in general solicitation or advertising activities. As the issuer, it is the regional center's obligation to comply with the conditions under Regulation D. Because of the potential negative impact on the EB-5 investor, however, a potential investor will want to do his or her own due diligence to ensure the regional center is complying with all applicable securities laws.

The initial dissemination of information to potential investors with whom a regional center has no pre-existing relationship may only be made in general terms and may not identify a specific investment opportunity. If there is a pre-existing relationship between the regional center and the potential investor, then a solicitation of such investor would not be considered general and references to specific investment opportunities could be made by the regional center. While there are no specific guidelines on how issuers can form a pre-existing relationship with a potential investor, SEC no-action letters and releases provide that a pre-existing relationship can be properly formed through the use of a questionnaire to determine whether a potential investor is an accredited investor. The SEC has referred to the use of accredited investor questionnaires as essential to establishing a substantive pre-existing relationship.[9]

State Securities Laws, Broker-dealers, Agents, and Finders

One of the benefits of the Rule 506 exemption under Regulation D is that securities transactions pursuant to this regulation are exempt from any state securities registration requirements. In 1996, Congress passed The National Securities Markets Improvement Act ("NSMIA") preempting state securities laws when a transaction involves "covered securities." Securities exempt from registration under Rule 506 of Regulation D are among the transactions that are expressly listed as "covered securities." Under the NSMIA, however, states are still allowed to require notification of the exempt transaction and payment of a fee for such notification from the issuer. All states generally require that an issuer file a copy with it of the Form D[10] filed with the SEC, along with a fee. In addition, the NSMIA does not preclude the states from requiring conditions other than registration of the securities, such as prohibiting issuers from paying remuneration to anyone who is not a registered broker-dealer or agent.[11]

Most regional centers have agents abroad to connect potential EB-5 investors to their offerings. Most regional centers also provide for referral offered to domestic individuals, including often immigration

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[9] In a no-action letter, the SEC found that a 30-day waiting period should exist between the determination of accredited investor status and the date an offering is made (that is, offering materials are provided to the accredited investor). Lamp Technologies, Inc., SEC No-Action Letter, 1997 WL 282988 (May 29, 1997). This 30-day "safe harbor" provides regional centers and potential investors with a concrete guideline to follow.

[10] Under Rule 503, an issuer selling securities in reliance on the exemptions provided for in Regulation D must file a Form D with the SEC.

[11] Federal rules also require broker-dealers to be registered. These rules are not discussed in this article since Regulation D does not have a specific condition prohibiting issuers from paying remuneration to unregistered broker-dealers.

lawyers, for referring potential investors to their regional center. As discussed below, a violation of the broker-dealer registration requirements may impose liability not only on the putative agent but also the regional center. The investment opportunity, if found tainted, may also affect the EB-5 investor.

Though each state's securities statute must be examined for specificity, generally, states prohibit issuers from paying anyone in effectuating a securities transaction unless the recipient is a registered broker-dealer or agent.[12] All states require that broker-dealers and agents register in the states in which they operate (there are a few limited exceptions). States will interpret the activities that qualify as "effectuating a securities transaction" broadly, as will the SEC. Performing due diligence, negotiating terms of the offering, soliciting the investors, and handling the funds of the investors are activities that states and the SEC have found to qualify as broker-dealer activities. In addition, a third party who receives any transaction-based compensation in connection with a securities transaction will almost always be deemed a broker-dealer. On the other hand, if a third party does nothing more than provide the name and contact information of a potential investor to the issuer, the third party would be considered a "finder" rather than a broker-dealer.

Nevertheless, the exception for finders is still unclear in many instances because the concept of a finder is principally a construction of regulatory interpretations from various SEC no-action letters. Moreover, most state securities laws do not explicitly reference finders with respect to their broker-dealer registration requirements. Alabama is one state that does explicitly address finders. In the policy statement regarding Rule 506 exemptions set forth by the Alabama Securities Commission, the commission prohibits any remuneration, including finders' fees, to be paid to unregistered broker-dealers or agents.[13] If the third party intermediary conducts any activities that would be considered broker-dealer activities and is not a registered broker-dealer or agent, then it cannot receive any payments for its services relating to the securities transaction. The determination of whether the activities rise to the level of broker-dealer activities will be made on a case by case basis by the state securities regulatory body or the SEC.

A potential EB-5 investor dealing with a third party intermediary may be unaware of the rules and regulations that apply to an intermediary's activities relating to a Regulation D offering. Recent informal advisories by some regulators to issuers warn that the use of unregistered broker-dealers will render the issuer liable as aiders and abettors of securities law violations under Section 20(e) of the Securities Exchange Act of 1934. Some states also impose civil and criminal penalties for issuers that compensate unregistered broker-dealers. As a result, a regional center should take the prohibition on payments to unregistered broker-dealers very seriously. Potential EB-5 investors should also be concerned, since a

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[12] Generally, a broker-dealer is defined as any person who effectuates or attempts to effectuate a securities transaction, and an agent is a person who effectuates or attempts to effectuate a securities transaction on behalf of an issuer or broker-dealer. Federal securities laws have a similar definition. Section 15 of the Securities Exchange Act of 1934, as amended, defines a "broker" as any person engaged in the business of effecting transactions in securities.

[13] For a copy of the policy statement, see http://asc.state.al.us/statutes.htm.

violation of this prohibition could affect the validity of their investment as a whole in some cases and therefore could potentially impact their ability to receive an EB-5 green card.

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Many hail the EB-5 regional center program as a clean and easy way to invest and thus obtain a green card. Prospective EB-5 investors, regional centers, and the lawyers who counsel them should recognize, however, that the brass ring is attained not merely by qualifying for immigration benefits and maintaining compliance with the Immigration and Nationality Act. All parties involved should also pay close attention to the demands of federal and state securities laws if the goals of permanent residence and return on investment are ultimately to be realized.