

# Management Alert



## SEC Charges EB-5 Fund Operators and Finders

By Gregory L. White, Christopher F. Robertson and Mark A. Katzoff

The Securities and Exchange Commission (the “Commission” or “SEC”) has become increasingly active in enforcing alleged violations of U.S. securities laws arising under the EB-5 Immigrant Investor visa program. EB-5 transactions — which are designed to result in the issuance of the much-coveted U.S. “green card” to foreign investors (and certain of their immediate family members) who place at least \$500,000 of capital at risk in a U.S. business which creates 10 or more jobs — typically involve the issuance of securities.

Although immigration legislation creating the EB-5 program was first enacted in 1990, SEC enforcement activities in connection with EB-5 financings only began in earnest during the last few years. These new developments are noteworthy because — in addition to allegations of garden-variety fraud leveled against a small number of participants — the Commission has begun to focus on the full array of securities laws and rules, charging persons with the sale of unregistered securities and with acting as broker-dealers and investment advisors without proper registration.

### The Luca Complaint

On July 6, 2015, the Commission filed a complaint (the “Luca Complaint”) in the United States District Court for the Northern District of California against Luca International Group, LLC (“Luca”) and various affiliates.<sup>1</sup> The Luca Complaint alleges fraud in connection with the offering of securities, some of which were offered to Chinese EB-5 investors. The fraud allegations include misstatement of results, the operation of a Ponzi scheme, and misappropriation of funds for improper purposes such as the payment of a \$200,000 speaking fee to a former US President for marketing projects unrelated to the businesses for which monies were raised and personal uses. The Commission also charged certain Luca affiliates with acting as unregistered broker-dealers and investment advisors and with engaging in unregistered securities offerings. The relief sought by the Commission includes permanent injunctions against some defendants’ future participation in certain securities activities, disgorgement of profits earned by engaging in unregistered activities, and appointment of a receiver over, and freezing the assets of, a number of the parties, including the fund entities that received money from investors (the “Luca Funds”). While Luca has issued a press release stating that it plans to dispute the Commission’s charges, two of Luca’s principals asserted the Fifth Amendment in sworn testimony before the Commission’s staff.

The Commission accused two individuals and a firm owned by one of them (the “Luca Brokers”) of acting as unregistered broker-dealers. One of the individual Luca Brokers conducted seminars in which he recommended investment in Luca Funds. The Luca Complaint described the other individual Luca Broker as Luca’s “principal fundraiser” and “former Vice President of

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<sup>1</sup> The Commission’s announcement of the complaint is available on the Commission’s web site at this link, which also provides access to the complaint and the related settlement order: <http://www.sec.gov/news/pressrelease/2015-141.html>.

Business Development”, who alleged participated actively in seminars organized by the Luca entities. The latter Luca Broker was the only one charged with knowingly engaging in securities fraud (the allegations state that this individual was aware of the fraud of the Luca entities, and in some instances guaranteed returns to investors). The Luca Complaint did not discuss the availability of an “issuer exemption” for this person.<sup>2</sup>

Separately, the Commission reached a settlement with Westeria Global, Inc. (“Westeria”) and its principal Hiroshi Fujigami (“Fujigami”) who reportedly solicited Japanese investors for certain non EB-5 projects of Luca affiliates based on allegations that they acted as unregistered broker-dealers.<sup>3</sup>

Fujigami through Wisteria and a Japanese business partner<sup>4</sup> allegedly solicited over 400 investors through seminars and received commissions for investors who ultimately invested in the Luca Funds. The Commission’s order does not indicate how Fujigami and Wisteria initially established contact with the Japanese investors or whether they actively engaged in soliciting the investors or marketing the offerings beyond making introductions to Luca principals and serving as translators at meetings between investors and Luca principals.

The Luca Complaint also charged Luca (which the SEC described as an umbrella organization for its affiliated funds and the issuer of marketing materials and advertisements), and Luca’s principals with engaging in the offering and sale of unregistered securities from September 2007 through March 2014. The SEC asserted that while some of the Luca funds filed Form Ds with the Commission claiming exemptions under either Rule 505 or Rule 506 of Regulation D, the exemptions were not available because Luca engaged in general solicitation through newspaper, television and radio ads.<sup>5</sup> In addition, the Commission alleged that a number of the investors in the Luca Funds were not accredited and that one or more of Luca’s principals encouraged investors to falsely claim accredited investor status.

The Commission further charged certain Luca entities which allegedly acted as general partner, manager or in a similar capacity to the Luca Funds, as well as the sole owner of these entities (collectively, the “Luca Managers”), with acting as unregistered investment advisers. In support of this charge, the Luca Complaint alleged that the Luca Managers engaged in the business of providing investment advice regarding specific securities for compensation and that they made investment decisions for the Luca Funds in return for compensation. The Luca Complaint also alleged that most of the Luca Managers held themselves out as “identifying oil and gas development prospects” for fees.

One of the Luca Funds allegedly offered equity securities to EB-5 investors and then lent the investors’ capital to another Luca Fund which would use the loan proceeds for oil and gas operations. It is not clear from the Luca Complaint whether the EB-5 Luca Fund engaged in multiple investments beyond extending this loan, although the Luca Complaint noted generally that the stated purposes of the funds were to “acquire, develop and operate oil and natural gas wells in specific places.”

## Earlier SEC Action - The Ireco Settlement

The Luca action is part of a series of cases in which the SEC is targeting illegal private placement practices in EB-5 financings. Less than two weeks prior to the announcement of the filing of the Luca Complaint, the SEC reached a settlement with two

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<sup>2</sup> While a detailed discussion of the so-called “issuer exemption” is beyond the scope of this article, Rule 3a4-1 promulgated under the Securities Exchange Act of 1934, as amended, exempts from the definition of “broker” natural persons who are officers, directors, partners or employees of an issuer or certain affiliates of the issuer that meet the criteria set forth in the rule.

<sup>3</sup> *In Re Westeria Global, Inc. and Hiroshi Fujigami*, 1934 Act Rel. No. 75362 (July 6, 2015) (the “Westeria Matter”).

<sup>4</sup> The Japanese partner was described as a Japanese national living in Macau and was not part of the settlement.

<sup>5</sup> Until recently, general solicitation was prohibited in all Regulation D offerings. Most of Luca’s fundraising predated the amendments to Rule 506 permitting general solicitation in limited circumstances. Moreover, the complaint does not suggest that Luca engaged in the additional steps to verify accredited investor status required for a general solicitation under the current rules. The Luca Complaint does not address the potential availability of Regulation S — the offshore exemption from registration — but some of the investors in the Luca Funds were apparently based in the United States.

companies also involved in EB-5 transaction. Ireeco, LLC (“Ireeco”), and Ireeco’s parent, Ireeco Limited (“Limited”) settled following SEC allegations that they had acted as unregistered broker-dealers in EB-5 deals.<sup>6</sup> Unlike the Luca Complaint, but similar to the related Wisteria Matter, the Commission did not allege fraud in these cases.

Ireeco and Limited maintained a web site offering to help investors find EB-5 investments. If an investor requested information through the site, Ireeco and Limited would then arrange a meeting to discuss the EB-5 program and ultimately suggest potential EB-5 projects of interest to the investors. The companies would then give the investor’s contact information to the EB-5 “regional centers<sup>7</sup>” sponsoring projects in which the investor expressed interest. These regional centers would then directly provide the investors with offering information. The investors also continued to consult Ireeco and Limited if they had questions regarding the investments. For these actions, according to the Commission, Ireeco and Limited received a commission based on a fixed portion of the “administrative fee” paid by each foreign citizen who invested in an EB-5 project and received a conditional green card, ultimately receiving fees for more than 158 investors.

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The SEC’s actions against various participants in EB-5 transactions make it clear that, whether or not an offering involves alleged fraud, offerors of EB-5 project securities and other persons participating in the promotion of such projects must be careful to comply with all aspects of the applicable securities laws, including either registering or securing exemptions for the offering of the securities and complying with the broker-dealer and investment adviser rules.<sup>8</sup>

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<sup>6</sup> *In Re Ireeco, LLC and Ireeco Limited*, 1934 Act Rel. No. 75268 (June 23, 2015) (the “Ireeco Matter”). The Commission’s announcement of the settlement is available on the Commission’s web site at the following link, which also provides access to the settlement order: <http://www.sec.gov/news/pressrelease/2015-127.html>.

<sup>7</sup> Regional centers are designated by the United States Citizenship and Immigration Services (“USCIS”), the agency which administers the EB-5 program, pursuant to Section 610 of the Appropriations Act of 1993 and 8 CFR Section 204.6(e). Regional centers sponsor EB-5 projects and one of the benefits of such sponsorship is that it permits a foreign investor to count indirectly created jobs toward the minimum jobs that must be created by such investor’s investment.

<sup>8</sup> Another relevant securities statute to consider is the Investment Company Act of 1940, [15 U.S.C. §§ 80a-1–80a-64](#), particularly with respect to offerings of funds that exceed 100 investors.

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