

EB-5 Capital Markets

Legal perspectives on EB-5 project finance

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USCIS EB-5 Engagement with Securities and Exchange Commission

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On April 3, 2013, representatives from the Staff of the Securities and Exchange Commission (SEC) participated with the U.S. Citizenship and Immigration Services (USCIS) in an EB-5 stakeholder conference call opened by Rob Silvers, counsel to the USCIS Director Mayorkas. Present from the Staff were representatives from four Divisions – Corporation Finance, Trading and Markets, Investment Management and Enforcement. The call was intended to provide general information to stakeholders.

In general, the Staff members confirmed the application of various securities laws to EB-5 programs. For many in the EB-5 industry, the views expressed will be unwelcome news, as many have been operating under the assumption that some or all of the securities laws that apply to other investment programs do not apply to EB-5 programs. For experienced securities lawyers working on EB-5 programs, however, the call broke no new ground but did serve as a confirmation of the advice we have been giving our clients.

Some notes about SEC Staff Interpretations

The Staff members on the call provided the standard disclaimer given in every public talk – that the views expressed represented their own and not necessarily those of the Commission as a whole. Despite this disclaimer, Staff members are careful in their public speaking, and generally speak only considered views that have been adopted by the senior leadership of the SEC.

When considering Staff interpretations, it is important to note the structure of United States securities laws. Federal securities laws represent various statutes passed by Congress and amended from time to time.^[1] These laws frequently call upon the SEC to adopt formal implementing regulations. In addition, the SEC Staff routinely provides informal interpretations of the securities laws and the regulations through various means. In addition, all fifty states have their own securities laws, known as blue sky laws, and except in limited instances of federal preemption, these blue sky laws apply in addition to the federal laws. Experienced securities lawyers will advise clients based on all of these sources of law. However, not all of these sources of law have the same legal weight, and in particular, the views of the Staff do not necessarily represent positions that would ultimately prevail in a civil lawsuit brought by the SEC or a private plaintiff, or in a criminal action brought by the Department of Justice. Nonetheless, the Staff's views are often persuasive in court, and at a minimum, one can expect substantial legal expenses and regulatory entanglement from operating in a manner contrary to Staff interpretations.

Various speaker notes

The Division of Corporate Finance representative confirmed that federal securities laws apply to transactions in securities. The SEC noted that the definition of “securities” is very broad, and likely includes most if not all of the investment vehicles used in the EB-5 program. The Securities Act of 1933 provides that all offers and sales of securities must be registered with the SEC unless an exemption from registration applies. EB-5 offerings are frequently conducted in accordance with two exemptions — Regulation D, applicable to private placements of securities, and/or Regulation S, applicable to sales to non-U.S. persons.[2] Each of these exemptions has a number of requirements that must be satisfied. The representative discussed an important condition of Regulation D – the prohibition on general solicitation (for example, advertising, publicly accessible web sites or conducting seminars where the general public is invited). The representative noted that the SEC has proposed regulations under the JOBS Act to lift the ban on general solicitation in certain circumstances, but until such regulations are adopted, general solicitation will disqualify an offering from Regulation D. The representative could not predict when such regulations will be adopted. The representative noted an important caveat that an exemption from registration requirements *does not* mean that the offering is exempt from other provisions of the securities laws. In particular, exempt offerings are subject to the anti-fraud provisions of the securities laws.

The Trading and Market Division representative focused on the laws requiring persons engaged in the business of engaged in the business of effecting transactions in securities for the account of others to register as broker-dealers. The representative expressed a broad view of the types of conduct that trigger the requirement to register as a broker-dealer. The representatives stated that in general, if someone is involved in the sale and offering of EB-5 investments and is compensated based on the success of the offering – a “salesman’s interest” in the program – that person is most likely engaging in brokerage activities which trigger the obligation to register as a broker-dealer under the Securities Exchange Act of 1934 (1934 Act). The representative also provided a very broad view of the jurisdiction of the SEC to enforce broker-dealer requirements for persons soliciting foreign investments. In the view of the SEC Staff, any activities using United States means of commerce, such as telephone calls made from the U.S., are likely sufficient to invoke U.S. jurisdiction for activities that require broker-dealer registration, regardless of whether the investors are foreign persons. In response to questions, the Staff representatives noted that:

- the Staff does not believe that the Supreme Court’s decision in *Morrison v. National Australia Bank, Ltd.* limiting the extra-territorial application of another section of the 1934 Act is an impediment to their enforcement activities, and
- the broker-deal registration laws apply equally to solicitation of issuers (as opposed to investors) from within the United States.

The Trading and Market Division representative also discussed the applicability of broker-dealer registration laws to persons employed by Regional Centers to conduct offerings for the account of the Regional Center, and the availability of Rule 3a4-1 as a non-exclusive exemption from registration requirements for such persons.

The Investment Management Division representative addressed applicability of the Investment Advisers Act of 1940 and the Investment Company Act of 1940 to EB-5 programs. The representative noted that individuals and entities that do not fall into the broker-dealer category will often be required to register under the Investment Advisers Act if they provide investment advice for compensation. The representative noted that anti-fraud provisions apply to investment advisors, and investment advisors have fiduciary duties to their clients, including the duty to disclose all conflicts of interest.

The representative also stated that Regional Centers which pool investments for third parties and that hold

securities likely are investment companies that need to register under the Investment Company Act absent an available exemption. The representative discussed three exemptions that might be available to Regional Centers:

- the 3(c)(1) exemption for an investment company with no more than 100 investors that is not making a public offering;
- the 3(c)(7) exemption for qualified purchases, who must meet a significantly higher net worth standard than accredited investors; and
- the 3(a)(2) exemption for government securities, which may apply if the Regional Center is sponsored by a governmental agency.

The Division of Enforcement representative discussed the February 2013 enforcement action brought against the Chicago Convention Center project. The representative focused on the allegations in that case that the defendants made false representations to USCIS as part of a scheme to defraud investors. He noted that false statements about the ability of a project to create jobs may be fraudulent under the securities laws. He also noted that anti-fraud provisions apply not only to misstatements but also to omissions of material information.

[1] Examples of amendments include the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Jumpstart Our Business Startups (JOBS) Act.

[2] The SEC did not speak about state blue sky laws, as those are outside the SEC's jurisdiction. However, we note that some states do not have any exemption for programs that are excluded from federal registration requirements under Regulation S. This is currently a significant issue for programs that do not comply with Regulation D, such as by employing general solicitation in the offer and sale of the securities.