EB-5 AND U.S. SECURITIES LAW

Covering Regulation D, General Solicitation, State Enforcement, and Immigration Lawyers

About the author: Douglas Slain graduated from Stanford Law School 40 years ago and currently teaches in a grade school in Vientiane, Laos. He received a MA from the University of Chicago studying with Saul Bellow and later founded a number of legal titles now published by Thomson-Reuters.

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*T*he employment-creation immigrant visa category (EB-5) has become the flavor of the month for U.S. immigration for wealthy foreign nationals.

Many laud the EB-5 regional center pilot program, in particular, as a clean and simple means to both invest in the US and to obtain a green card. However, prospective EB-5 investors should pay close attention to the demands of Federal and state securities laws. When a regional center forms a limited partnership or limited liability company the regional center is offering a security and, accordingly, regional centers must comply with Federal and state laws.

The EB-5 visa requires no anchor relative in the United States to petition on the immigrant's behalf. It requires no claim of extraordinary or exceptional ability. It also does not require a showing of fear of persecution in the homeland.

This visa 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 and $1 million anywhere else) in a regional center approved by the U.S. Citizenship and Immigration Services (USCIS).

The investor is provided a private placement memorandum and is asked to sign a subscription agreement. He will then be asked to deposit money into an escrow account.

Foreign investors often have no idea that state and Federal securities laws exist to protect them by providing accurate information and to punish persons or entities that violate these laws. For instance, EB-5 investors must be told that not every investment is safe and not every investment in a regional center will result in green card status, let alone produce a profit.

The Securities Act of 1933, as amended (the "Securities Act"), defines "security" as any note, stock, bond, "investment contract" or any interest or instrument commonly known as a "security." The U.S. Securities and Exchange Commission ("SEC") has determined that interests in a limited partnership are an investment contract, and therefore, a security.

The SEC has also ruled that limited liability company interests are securities. In fact, if a limited liability company offers unregistered interests to a large number of investors, it should expect a visit from Federal and state regulators.

The Securities Act requires that all securities sold must be registered with the SEC, unless exempt.

Rule 506 of Regulation D promulgated under the Securities Act sets forth the exemptions to the registration rules that regional centers must use to avoid registration.

To meet the exemption provided by Regulation D, a regional center must comply with conditions set forth in Rule 502 of Regulation D, including Information requirements. If all of the investors are "accredited investors," there are no informational requirements (though issuers of course are still subject to anti-fraud requirements).

An accredited investor is a person whose 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; whose 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 whose 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.

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

Other potential exemption from registration is provided by Regulation S. Unlike Regulation D, however, **Regulation S does not provide an exemption from state securities registration.**

Under Section 2(a) (4) of the Securities Act, an issuer is a person or entity who issues or proposes to issue any security. The enhanced informational requirements are an onerous and costly requirement that the issuer can avoid by only selling to accredited investors.

Rule 502(c) prohibits a general solicitation or advertising in the offer or sale of securities.

Rule 502(d) prohibits the resale of securities sold under Regulation D unless the securities are registered or another exemption applies to the resale. An exemption available for the resale of restricted securities is in Rule 144 promulgated under the Securities Act. 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.

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 with the SEC for each new offering of securities no later than 15 calendar days after the first sale of securities. 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 factors that 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 limitation on the manner of offering is one that most distinguishes a private placement offering from a public distribution. 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.

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 sold under Regulation D will be voided. The regional center must 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. Sending mass e-mails, newsletters or other mailings is considered general solicitation.

Activities by third party intermediaries such as immigration brokers or finders are included in the determination of whether a regional center has complied with Rule 502(c). If an immigration attorney, for example, accepts fees from someone other than his or her own EB-5 investor client the immigration attorney is acting as a third party intermediary and his activities will be evaluated within the context of Rule 502(c).

Both the EB-5 investor and the regional center should tread lightly with solicitation and marketing activities because the consequences of violating Rule 502(c) will be costly; to wit, any transaction in violation of Rule 502(c) will be voidable and the Regulation D exemption will no longer be available.

Neither an investor nor a regional center wants to be involved in an investment that will require registration; registration means extra time and extra money. Registration by a regional center will enhance the need for disclosures; in fact, such registration would require an initial public offering ("IPO"). 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. 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.

Bottom line, EB-5 investors cannot afford to make investments in a regional center that relies on third party intermediaries who engage in general solicitation or advertising activities.

It is the regional center's obligation to comply with the conditions under Regulation D. However, a potential investor will be well served 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 preexisting 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, solicitation of the investor will not be considered general; in this case, references to specific investment opportunities can be made by the regional center.

SEC no-action letters and releases posit that a pre-existing relationship can be 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.

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 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.

The SEC has determined that a 30-day waiting period should exist between the determination of accredited investor status and the date an offering is made. This 30-day “safe harbor” provides regional centers and potential investors with a guideline.

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.

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.

Violation of the broker-dealer registration requirements may impose liability not only on the agent but also the regional center. The investment opportunity, if found tainted, may also affect the EB-5 investor.

States generally prohibit issuers from paying anyone in consummating a securities transaction unless the recipient is a registered broker dealer or agent.

All states require that broker-dealers and agents register in the states in which they operate. Performing due diligence, negotiating terms, soliciting investors and handling the funds of the investors are activities that states and the SEC has 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 transactions that are expressly listed as “covered securities.”

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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 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. As a result, a regional center should take the prohibition on payments to unregistered broker-dealers seriously.

Generally, a broker-dealer is defined as any person who attempts to effectuate a securities transaction, and an agent is a person whose attempts to consummate a securities transaction on behalf of an issuer or broker-dealer.

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

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