REDEPLOYING EB-5 INVESTMENTS: Navigating Securities Laws After 2020 USCIS Clarifications

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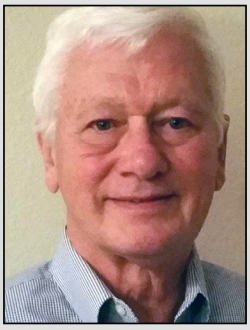

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Redeployment of EB-5 investments continues to be a focus for EB-5 stakeholders as EB-5 investors face visa backlogs while EB-5 immigration requirements, such as "at risk" and "sustainment," remain. The EB-5 Program's own success is partially to blame for the redeployment necessity and the situation had been concerning from an immigration law standpoint because of a lack of clear redeployment guidance. In a "Policy Alert" released in July 2020, the USCIS issued updates to its Policy Manual clarifying certain redeployment requirements. In summary, the update provided that EB-5 capital may be redeployed through the original new commercial enterprise ("NCE"), within the territory of the original regional center ("RC"), provided that it be redeployed "in commerce," and consistent with the NCE's ongoing purpose of conducting lawful business activity. Redeployment does not have to be within a targeted employment area ("TEA") if the required number of jobs have been created, even if the original investment was within in a TEA. Additionally, the guidance provides that the USCIS considers twelve months to be a reasonable time to redeploy capital. While this guidance is helpful for future redeployments, it leaves open the issue of whether these requirements are to be applied retroactively to redeployments that have already occurred. Regardless, redeployment must be approached in light of the existing securities laws and compliance obligations that are the focus of this article.

Before analyzing the current redeployment situation, a quick review of EB-5 basics and common deal terms prior to the emergence of the current visa backlog is merited. In the typical RC investment scenario, the EB-5 investor-applicant subscribed to a RC-sponsored NCE and contributed her capital investment. That transaction involved the sale of securities and triggered U.S. securities law compliance. The NCE then aggregated the capital of all its EB-5 applicants and made a single loan or equity investment into a single job creating entity ("JCE" or "Project") typically for a five-year term. Assuming the JCE was successful and that the investment was timely repaid to the NCE at the end of the five-year term, the long-held assumption was that the EB-5 applicants should have, by that time, completed all immigration processing steps and should be eligible for exit from the NCE. And in fact, that paradigm served the EB-5 industry well from 1990 until about 2014. Generally, EB-5 applicants were able to achieve conditional resident status and file their I-829 petitions within a five-year timeframe. But in 2014, with a deluge of applicants from countries like China, India, and Vietnam overwhelming the limited supply of EB-5 visas available, visa backlogs started to significantly delay immigration processing for many years. Among many EB-5 eligibility requirements are two of relevance to duration -- that the investment must be "at risk" and "sustained" throughout the process of initial petition and two years of conditional permanent residence. But, if the EB-5 investor must wait for six or more years just to start conditional permanent residence, due to petition processing and visa backlogs, then the historical assumptions about a five-year term investment are wildly out of sync with the realities of the EB-5 visa application process.

The timeline for each EB-5 investor's immigration process is dependent upon a host of variables including visa backlogs, processing times at the USCIS, and in many cases the National Visa Center and various Consular posts, therefore, it is difficult to accurately predict how long an EB-5 investor might be required to sustain his or her EB-5 investment,

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or for how long the associated NCE might be required to continue to redeploy the EB-5 capital. In addition to such significant wait-times, note that the sustainment period runs throughout the full two years of the initial grant of conditional permanent residence. Therefore, two more years should be added to the above wait-time estimates and potential investment exit dates. As visa wait times have increased, so too have the "sustainment" requirement and mandatory timeframe during which the EB-5 investment funds must be "at risk." In an effort to comply with these USCIS requirements some NCEs have elected not to repay EB-5 investors when EB-5 loans are repaid by the JCE, but instead, to redeploy EB-5 investment funds when permitted by their organizational documents to do so.

Securities Law Issues Affecting Redeployment

EB-5 financings have usually involved an offering of limited partnership interests or limited liability company (LLC) membership interests to investors, with organizational documents contemplating the use of EB-5 investment funds to provide financial support (typically in the form of a loan or preferred equity investment) for one identified project owned or controlled by an identified JCE. EB-5 investment documentation generally provides that upon repayment of the loan, the proceeds may be distributed to the NCE's investors, assuming cash is available and certain immigration milestones are achieved. The initial project and the terms of repayment to the investors are disclosed in the offering materials given to investors and are relied upon by prospective EB-5 investors to make their investment decisions. Unless a redeployment is contemplated by investors where their initial investment is made, a redeployment involving a second financing similar in scope to the initial deployment described above involves a decision by each investor to take her portion of the loan repayment, or to reinvest such funds in a new project, which may also involve a new JCE or an unrelated project entity.[1]

In order to amend the organizational documents to provide for a redeployment, a vote or consent of investors may be required. Inasmuch as this would constitute a new investment decision, such consent would likely constitute a sale or offering of securities, and, if so, would require the inclusion of information and disclosures normally included in an offering document. A decision to consent to redeployment generally is viewed by the Securities and Exchange Commission (the "SEC") and the courts as a sale and new investment decision with respect to the NCE's securities and, therefore, a new offering and sale of the NCE's securities that must either be registered under the Securities Act of 1933, as amended (the "Securities Act"), or be eligible for an exemption from registration. If EB-5 investors are individually advised with respect to a redeployment, and depending upon the nature of the advice given, concerns are often raised under the Investment Advisers Act of 1940, as amended (the "Advisers Act"),[2] and relevant state securities laws. In addition, the redeployment may raise investment company issues with respect to the NCE, requiring that it find an exemption under the Investment Company Act of 1940, as amended (the "1940 Act").[3]

1 In some instances, certain EB-5 investors may not consent to the changes to the financing because they prefer to have their investments returned, or because they no longer seek an immigration benefit. As a result, NCEs may have less funds to redeploy than were originally deployed.

Securities Act Considerations

2 15 USC §80b-1 et seq.
3 15 USC §80a-1 et seq.

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If EB-5 investors are asked to make a new investment decision, as described above, a new offering and sale of securities is deemed to have occurred, and the NCE is required to comply with the Securities Act with respect to the redeployment.[4] The SEC has not provided specific Securities Act guidance in an EB-5 context with respect to a redeployment; however, the SEC and the courts have provided ample guidance in analogous situations.

The most relevant guidance provided by the SEC relates to the manner in which calls for additional investments or assessments made to investors are treated. The request to investors in a proposed redeployment to use their cash again or to exercise their right to receive cash[5] they would otherwise receive to fund an investment in a new project, is similar to asking investors for voluntary assessments, which often occur in real estate and oil and gas offerings.[6]

The SEC takes the position that if an issuer's offering materials initially describe the circumstances under which a call for additional funds may be made, the maximum amount of funds that may be called, and the use of any such additional funds, then any such call is not deemed to be a new investment decision by an investor because these matters were previously disclosed and contemplated when the initial investment was made.[7] Conversely, if such matters were not contemplated when the initial investment was made, any such call would involve a new investment decision, and thus, a new offering of securities.[8]

Although not directly on point, but representative of the SEC's position in similar situations is guidance from the SEC regarding the manner in which rescission offers are treated. Because the investor must decide whether to accept the rescission offer and sell the securities back to the issuer or whether to retain the securities, such offers are deemed by the SEC to be an offer or sale of securities that must be registered or exempt from registration.[9]

Additionally, court decisions have invoked the "investment decision doctrine" in determining when a sale of securities has occurred for purposes of a statute of limitations determination. These cases generally involve an anti-fraud action where the defendants allege a statute of limitations defense because the initial sale of securities occurred earlier than allowed by such statute. In turn, the plaintiffs respond that the court should not look at the date of the initial sale, but that it should look at the later date when additional funds were called and paid. Thus, the courts have to determine whether the later payment of funds constituted a "sale" of securities for purposes of the securities laws.[10]

As a result of the three strands of guidance referred to above, if a repayment of the initial investment is received by an NCE and EB-5 investors are asked to decide between (a) receiving their portion of the repayment proceeds and (b) making a new investment with those funds into a newly identified JCE, then an analysis of the Securities Act is required. This analysis involves a determination of whether a sale is being made and whether securities law exemptions provided by Regulation S, Regulation D, or any other available offering exemptions under the Securities Act are available. EB-5 professionals are reminded that just because a registration exemption may have been originally available, because of the passage of time and the occurrence of certain events, those same exemptions may not be available when redeployment occurs. For example, investors who originally may have been accredited investors or not U.S. residents, at a later sale date when a redeployment occurs may not continue to be so accredited or so domiciled.

Investment Adviser Issues

An NCE's general partner or managing member, as the case may be, is often deemed a "private fund adviser" to the NCE under the Advisers Act.[11] Private fund advisers can only advise private funds and have certain reduced reporting obligations under the Advisers Act that differ from those advisers who are not private fund advisers.

The primary issue in the context of an NCE in an EB-5 financing is whether the general partner or managing member of the NCE is advising the limited partnership or the limited liability company, as the case may be, or whether the general partner or managing member is advising the individual limited partners or LLC members.[12] Under Rule 203(b)(3)-1[13] of the Advisers Act[14], the SEC takes the position that an NCE will be deemed a single client if that entity obtains investment advice based on its stated investment objectives, as opposed to the individual objectives of its investors.[15] The closest SEC staff guidance on this issue involves a general partner soliciting consents from limited partners whether to take distributions in cash or in kind.[16] In that case, the SEC provided assurances it would take no-action, but cautioned that the general partner could make no recommendation to any limited partner as to whether the limited partner should consent to one alternative or the other. Depending on the nature of any individual advice, the general partner or managing member may no longer be deemed a private fund adviser under the Advisers Act because it would not be advising only private funds and, therefore, would be subject to additional SEC regulation.

Any Advisers Act analysis should also include a consideration of relevant state adviser laws.

4 The Securities Act is designed to regulate the offer and sale of securities. Compliance with the Securities Act requires that the new sale of securities be registered under the Securities Act or that an exemption from registration be available.
5 The definition of a "sale" includes a disposition of value (such as a rescission right) in addition to the disposition of cash. See: Thomas Lee Hazen, The Law of Securities Regulation §5 (7th ed. 2016) ("Hazen").
6 A call for additional funds is sometimes also called an assessment. A call or assessment can be either mandatory as contemplated by the initial investment decision or voluntary if not so contemplated.
7 Tejon Agricultural Partners, SEC No-Action Letter (pub. avail. Apr. 12, 1974); For a further general discussion of what constitutes a "sale" for purposes of Section 2(a)(3) of the Securities Act, see Hazen.
8 American Real Estate Trust, SEC No-Action Letter (pub. avail. July 30, 1976). The SEC has provided additional guidance on the issue of what constitutes a "sale" for Securities Act purposes in the form of Rule 136 (17 CFR §230.136) thereunder. An assessment is related to an additional call for funds in the context of a redeployment and Rule 136 provides that assessable securities are deemed to be an offering and sale of securities. (See, Ingentino v. Bermec Corp., 376 F. Supp. 1154 (S.D.N.Y. 1974)).
9 See, generally, Michelle Rowe, Rescission Offers Under Federal and State Securities Laws, 12 J. Corp. Law 383 (1987).
10 See: Goodman v. Epstein, 582 F.2d 388 (7th Cir. 1978); Hill v. Equitable Bank, N.A., 599 F. Supp. 1062 (D. Del. 1984); Stephenson v. Calpine Conifere II, Ltd., 652 F.2d, 808 (9th Cir. 1981); Issen v. GSC Enterprises, Inc., 508 F. Supp. 1298 (N.D. Ill 1981); and Ingentino v. Bermec Corp., 376 F. Supp. 1154 (S.D.N.Y. 1974) ("Ingentino").
11 Private Funds are pooled investment vehicles that are excluded from the definition of investment company pursuant to, among other sections, Section 3(c)(1) of the 1940 Act.
12 Murray Johnston Ltd., SEC No-Action Letter (pub. avail. Apr. 17, 1987).
13 17 CFR §275.203(b)(3)-1.
14 Rule 203(b)(3)-1 is a nonexclusive safe harbor for determining the circumstances in which a person may count the partnership rather than each individual limited partner as a "client" for purposes of Section 203(b)(3) of the Advisers Act.
15 Six Pack, SEC No-Action Letter (pub. avail. Nov. 13, 1998), see also: WR Investment Partners Diversified Strategies Fund, LP, SEC No-Action Letter (pub. avail. Apr. 15, 1992) (regarding different investor investment amounts); and Burr, Egan, Deleage & Co., Inc., SEC No-Action Letter, 1987 WL 107965 (pub. avail. Apr. 27, 1987) (regarding providing tax advice).
16 Latham & Watkins, SEC No-Action Letter, 1998 WL 527079 (Aug. 24, 1998).

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1940 Act Issues

Most NCEs are considered to be investment companies because, for transactions involving an underlying loan as the deployment to the JCE, the NCE holds a promissory note as a majority of its assets. As a result, these NCEs rely on a 1940 Act exemption from registration provided either by Section 3(c)(1)[17] or Section 3(c)(5)(C)[18] of the 1940 Act.[19] Any redeployment will then also require an analysis of whether such initial exemption remains applicable or whether a new 1940 Act exemption is required.

For example, if the NCE relied initially on the Section 3(c)(1) exemption provided by the 1940 Act, then it must determine whether after the redeployment the number of investors remains at 100 or less. However, if the initial 1940 Act exemption replied upon was Section 3(c)(5)(C), then the NCE must determine whether after the redeployment the provisions of the exemption would continue to exist, or whether another 1940 Act exemption would then be available.

Policy Alert Impact on Securities Law Issues

The Policy Alert allows, with certain restrictions, the NCE to redeploy capital into any commercial activity that is consistent with the purpose of the NCE. In addition, the Policy Alert requires for a redeployment the use of the same NCE and RC, but does not require the use of the same or any JCE, the same commercial activity, or the location of the new project in the same TEA. These provisions and requirements, however, do not change to any significant extent the securities law analysis described above.

Conclusion

Because of long wait times and visa backlogs, NCEs have or are now considering the redeployment of EB-5 funds returned from the initial deployment into new projects and JCEs that may not have been originally contemplated by their respective EB-5 investors. Issuers preparing for new EB-5 offerings should carefully consider structuring offerings to help ensure that redeployment is not deemed to constitute a new investment decision when investors are asked to forgo distribution of repaid investment proceeds and invest such proceeds in a new project. EB-5 professionals structuring initial EB-5 financings should include such contingencies in offering and organizational documents, and provide that the general partner or managing member have authority to make such determinations. While the SEC has not specifically provided guidance regarding securities law issues arising as a result of redeployment of EB-5 funds, significant guidance has been provided in similar situations that EB-5 professionals should strongly consider. In addition, even if the original organizational documents and offering documents provide authorization for a redeployment, any such redeployment will require an extensive 1940 Act analysis, if applicable, to ensure a continuing 1940 Act exemption. Likewise, if a vote is being taken with respect to a redeployment, Advisers Act issues should also be addressed.

EB-5 professionals should be mindful that redeployments are contemplated by the USCIS Policy Manual and appear to be required for many EB-5 transactions, therefore, securities law issues must be thoughtfully addressed for ongoing compliance in redeployments.

17 Section 3(c)(1) provides that an issuer shall not be deemed to be an investment company if it has no more than 100 investors and does not make or propose to make a public offering of its securities (15 CFR §80a-3(c)(1)).
18 Section 3(c)(5)(C) provides a 1940 Act exemption if the issuer's promissory note is secured by qualifying real estate assets (15 CFR §80a-3(c)(5)(C)).
19 The 40 Act is designed to regulate the creation and conduct of investment companies.