

**EB-5 PROGRAM – SECURITIES LAW ISSUES, INCLUDING  
BROKER-DEALER/FINDER FEES**

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**I. REGULATION D.**

**A. GENERAL.**

The Securities Act of 1933, as amended the (“1933 Act”) and the rules adopted thereunder, provide several transaction exemptions for “private placements.” The principal exemptions are contained in Sections 4(2) and 4(6) of the 1933 Act and Regulation D adopted thereunder (“Regulation D”). Regulation D, which is the most commonly used basis for a private placement, contains three separate exemptions (rules 504, 505 and 506), which are based on the amount of funds sought to be raised from the offering. This memorandum shall focus on the rule 506 exemption. Regulation D is a “safe harbor” exemption from the securities registration requirements under the 1933 Act that was adopted by the Securities Exchange Commission (“SEC”) for the purpose of providing Issuers a more objective way of conducting an exempt private placement. Regulation D sets forth specific things that the Issuer must do and specific things that the Issuer must not do in order to qualify for the Regulation D exemption. The Issuer has the responsibility and burden to prove (if challenged) that it has satisfied the conditions and requirements of Regulation D in order to claim the exemption. Regulation D sets forth two categories of compliance obligations that the Issuer must satisfy as follows:

- (1) the requirement to disclose material information to prospective investors; and
- (2) the requirement to comply with the manner in which the offering is conducted.

The Regulation D exemption is available only to the Issuer of the securities and therefore is not available for the re-sale of securities by a person who holds or owns the security.

Also, it is important to mention that Regulation D does not establish an exemption from the antifraud, civil liability or other provisions of the federal securities laws. Regulation D states that Issuers have an obligation to provide such further material information, if any, as may be necessary to make the information required under Regulation D, in light of the circumstances under which it is furnished, not misleading.

Rule 506 (i) has no limitation as to the amount to be raised in the offering, (ii) limits the number of purchasers to no more than 35 (non-accredited investors) but an unlimited number of “accredited investors,” (iii) requires that each purchaser who is not an “accredited investor” either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, and (iv) requires that the Issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description.

**B. LIMITATIONS ON THE MANNER OF OFFERING THE SECURITIES.**

Regulation D specifically prohibits the offer or sale of securities by any form of general solicitation or general advertising, including, but not limited to, the following:

- (1) Any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and
- (2) Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

**C. CONSEQUENCES OF A NON-EXEMPT OFFER AND SALE OF SECURITIES.**

The consequences of failing to qualify for an exemption from the securities registration requirements are significant and grave. If the Issuer fails to comply with all of the requirements of the particular claimed exemption, the Issuer will not have perfected its claim to the exemption for the offering. Unless the Issuer has perfected a claim for another available self-executing exemption, the offering will have been made in violation of the Federal and the applicable State securities laws. Also under most state securities laws, such non-compliance will give the investor a right to rescind his/her purchase of the securities purchased. In such event the Issuer, its directors and executive officers, **personally, will become the insurers of the deal and guaranteeing that no matter what happens, the investors will be able to rescind their investment and get back their investment from the Issuer personally.** In addition, the Issuer may become the subject of a State or SEC investigation.

**D. COMPLIANCE WITH STATE BLUE SKY LAWS.**

Generally, each State securities law has a substantially similar exemption to either Section 4(2) and/or Regulation D for non-public (private placement) offers and sales of securities, as well as sales to accredited investors. However, many states have their own unique approach to qualifying or perfecting an exemption from that State’s securities registration requirements and most state’s securities laws give the purchaser a rescission remedy for non-compliance with the particular exemption and provide for an award of attorneys fees to a successful suing investor.

## **E. FINDERS.**

Often the Issuer will want to use a “finder” to assist in the offer and sale of the securities. Generally a “finder” is someone who is not a licensed broker-dealer. The SEC and FINRA frown upon the use of finders and the payment of fees to finders. In certain states, the use of a non-licensed broker-dealer finder could result in a violation of that State’s Blue Sky laws and loss of the securities registration exemption and may give rise to rescission rights for the purchaser. Accordingly, before engaging a finder to assist the Issuer in the offering, the Issuer should consult with its legal counsel.

## **II. REGULATION S OFFERINGS.**

### **A. INTRODUCTION.**

The SEC adopted Regulation S to provide a “safe harbor” exemption from registration under the 1933 Act for offerings and sales of securities occurring outside the U.S. Regulation S was intended to help U.S. and foreign companies raise capital overseas quickly and inexpensively without having to comply with the expensive and lengthy registration process required under Section 5 of the 1933 Act. By adopting Regulation S as a “safe harbor” exemption, the SEC is affirming that someone who complies with its requirements will definitely have the benefit of the Regulation S exemption. However, Regulation S is not the exclusive means that must be employed to fall within an exemption for the offering. Also, it is important to mention that Regulation S does not establish an exemption from the antifraud, civil liability or the broker-dealer registration requirements of the Securities Exchange Act of 1934, as amended (“1934 Act”), or other provisions of the federal securities laws.

Each safe harbor is subject to two general conditions as follows:

- (1) **General Condition 1 - Rule 903(a)(1):** The offer or sale must occur in an “offshore transaction” (Rule 902(h)). This means that (i) the offer is not made to a person in the U.S. and (ii) the buyer is (or is reasonably believed by the seller to be) outside the U.S. at the time of the sale, or the sale is made through an established foreign securities exchange, or through the facilities of a designated foreign securities market, and the transaction is not pre-arranged with a U.S. buyer.
- (2) **General Condition 2 - Rule 903(a)(2):** No “directed selling efforts” (Rule 902(c)) may be made in the United States by the Issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing in connection with the transaction.

“Directed selling efforts” means any activity undertaken for the purpose of, or that could be reasonably expected to result in, conditioning the U.S. market for the relevant securities (for example, advertising the offering in a widely circulated publication in the U.S.). Regulation S excludes certain types of advertisements and other activities from the definition of “directed selling efforts.”

**B. OFFERINGS OF SECURITIES MADE VIA THE INTERNET TO NON-U.S. INVESTORS.**

In March 1988, the SEC issued an interpretative release relating to, among other things, whether an offering of securities made via the Internet to non-U.S. investors could be deemed to constitute “directed selling efforts” and an “offer” within the U.S. under Regulation S, thereby rendering the Regulation S exemption unavailable. The release indicates that an Issuer that chooses to effect an offering in such a manner could remain eligible for the Regulation S exemption by, among other things, including prominent statements on the applicable web pages indicating that the offer is directed only outside the U.S., and by implementing meaningful precautionary procedures that are reasonably designed to guard against sales to U.S. persons.

**C. INTERACTION WITH REGULATION D.**

The Note to rule 502(a) of Regulation D states that transactions meeting the requirements of a Regulation D exemption generally will not be integrated with simultaneous offerings being made outside the united states in compliance with Regulation S (i.e., in a manner that the securities come to rest abroad).

**III. PAYMENT OF COMMISSIONS.**

There are various alternatives related to the raising of capital related to an EB-5 program.

- (1) Sales by offshore agents located outside the U.S. to foreigners. This should present no problem even if the overall marketing process is administered in the U.S.
- (2) The next level is the U.S. agent identifying marketing agents out of the country, who then market units to individual investors. The U.S. agent does not participate in direct sales to investors but merely provides contacts for marketing abroad. Again, the sales are all done abroad by foreign agents. Paying the foreign agents is not an issue. The domestic finder also receives a finder’s fee. The legality of this payment is in part dependent on whether the finder participates in the sales activity abroad since the finder could then be deemed a broker/dealer, and if not licensed, the issuer and finder would therefore be subject to sanctions and a potential rescission action by the investor.
- (3) U.S. finder is involved in actually identifying the investor. However, the sale is completed abroad by a foreign agent. Again, the issue here revolves around

whether the finder participated in any manner in the sales activity and whether the finder is engaged in the regular business of selling a security or whether this is an isolated transaction. This is very much a factual matter that needs to be looked at on the case by case basis. See Schedule 1 attached hereto for the precautionary measures that need to be taken.

- (4) Finder is engaged by issuer to render services and paid for overall performance of the program and not for any individual sales (no transactional percent or fixed fee paid). This fact pattern would generally be acceptable. Of course, one needs to navigate whether the Reg. S Offering exemption is satisfied since sales activities must be done entirely offshore. However, assuming the sales are partially undertaken in the U.S., then the issuer could otherwise be exempt pursuant to a Reg. D exemption since there is no prohibition against simultaneously undertaking a Reg. S Offering and a Reg. D Offering. In order to comply with Reg. D, a Form D would be filed electronically with the Securities and Exchange Commission. Even if a Form D is not filed and there is not a technical compliance with Reg. D, there is still an exemption under Section 4(2) of 1933 Securities Act.
- (5) The next level of conduct would be sales made to foreigners in the United States. This would clearly not comply with Reg. S and therefore undertaken under Reg. D., of Section 4(2). As noted above, given the fact that the sales were done in the United States, then the same issues would apply as to broker/dealer registration. A finder cannot be involved in any of the selling activity if the finder is paid a transaction based fee or commission. It is unclear under the current state of law whether the finder can receive a transaction based fee as a percentage of the sales proceeds raised, assuming that the other key factors to avoid broker/dealer registration are satisfied.
- (6) With respect to sales abroad, we believe it is an important factor that the foreign sales agent is registered in the applicable jurisdiction since that would provide protection that the ultimate sales agent is licensed in the applicable jurisdiction. We believe the SEC would consider this as an important factor in determining whether or not the finder in the United States acted as a broker/dealer and was paid an improper finder's fee or commission since there would be reliance on the activities of a licensed offshore agent.
- (7) As a totally separate matter, it seems as though it is a common practice in the United States for issuers to pay immigration lawyers fees for referring customers to an EB-5 program. Please note that the fact the referral came from a lawyer does not mean that the transaction is exempt. Again, one will have to look to the nature of the services and the activities of the lawyer in the process. If the lawyer is rendering legal services as an immigration attorney that are being reimbursed by the issuer on behalf of the client, would support the position that no commission was paid. However, if the fee is really a commission paid for a

referral, then again, the standard sets forth above would need to be reviewed and in particular, those standards sets forth as outlined in Schedule I attached hereto.

#### **IV. BROKER-DEALER EXEMPTION.**

A Florida court in *SEC v. Kramer*, No. 8:09-cv-455-T-23TBM (M.D. Fla. Apr. 1, 2011) has rejected the Securities and Exchange Commission's single-factor transaction-based compensation test for broker activity, perhaps signaling a more favorable view toward "finders" in the future. The court held that an array of non-exclusive factors should be evaluated to determine whether a finder engaged in broker activity. These factors include - in addition to receipt of transaction-based compensation - participation in securities transactions at key points, negotiation of the terms or details of a transaction, offering of advice or valuation information, and the aggressive pursuit of investors, for example.

The *Kramer* court analyzed legal precedent concluding that "the distinction between a finder and a broker. . .remains largely unexplored." The court took issue with the Commission's reliance on No-action letters describing a No-action letter as an informal process to seek compliance advice from the Commission and repeatedly stating that they have no binding legal authority. The decision may undermine the ability of the Commission to rely on its own informal opinions in enforcement actions. The court noted: "[a]s this order exhaustively explains, an array of factors determine the presence of broker activity. In the absence of a statutory definition enunciating otherwise, the test for broker activity must remain cogent, multifaceted, and controlled by the Exchange Act."

#### **V. WHO IS A BROKER-DEALER?**

The SEC, Financial Industry Regulatory Authority ("FINRA") and the state securities commissions each require registration, and regulate the activities, of broker-dealers. Under the Exchange Act, a "broker" is broadly defined as "any person engaged in the business of effecting transactions in securities for the account of others", and a dealer as "any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise." Section 15 of the Exchange Act, and the rules promulgated thereunder, require that, prior "to effect[ing] any transactions in, or [inducing] or attempt[ing] to induce the purchase or sale of, any security . . .", a broker-dealer must register with the SEC and become a member of FINRA and the Securities Investor Protection Corporation ("SIPC"). Broker-dealers must also comply with the registration requirements of the laws of each state in which they propose to conduct business.

However, neither the Exchange Act nor the rules promulgated thereunder define what it means to be "engaged in the business of effecting transactions in securities", and the courts and the SEC, by means of enforcement proceedings and through administrative decisions in the form of no-action letters, have come to broadly interpret the constituent parts of this phrase.

## **VI. WHERE DO FINDERS FIT IN?**

The term “finder” is also not defined in the Exchange Act or the rules promulgated thereunder, and the finder exemption from broker-dealer registration has been carved out largely in response to a series of SEC no-action letters. It is generally recognized that an individual or entity will come within the finder exemption if they do nothing more than provide the contact information of a potential investor to an issuer, however, because the finder exemption is not codified and its application often unclear, any activities beyond this can raise issues associated with acting as an unregistered broker-dealer. Moreover, because the finder exception is merely a product of the interpretation of a number of no-action letters, the SEC is free to narrow the scope of permitted finder activities at any time.

In its Guide to Broker-Dealer Registration, the SEC states that a finder may be required to register as a broker-dealer if any of the following hallmarks of broker-dealer activity are present:

- (1) Participation of the finder in important parts of a securities transaction, including soliciting, negotiating or executing the transaction.
- (2) Compensation of the finder that depends upon, or is related to, the outcome or size of the transaction.
- (3) A history of the finder effecting or facilitating securities transactions.
- (4) The finder handling the securities or funds of others in connection with securities transactions.

## SCHEDULE 1

### **WHAT PRECAUTIONARY MEASURES CAN BE TAKEN?**

Businesses contemplating retaining the services of a finder should always conduct appropriate diligence on and obtain representations as to a finder's previous involvement in or engagement with respect to securities transactions, including, without limitation, the number of transactions in which the individual or entity has acted as a finder, the type of services rendered or activities undertaken and the form and type of compensation received for those services.

Any engagement agreement entered into with a finder should:

- explicitly describe actions permitted to be taken by the finder, including, restrictions on the number and type of potential investors that may be contacted;
- prohibit the finder from structuring the investment, negotiating terms or presenting information regarding the issuer or offering to potential investors;
- prohibit the finder from advising potential investors with regard to the investment;
- include no compensation other than non-contingent fees and flat rates to cover expenses and administrative costs; and
- include appropriate representations, warranties and covenants and indemnification against losses arising out of any violations of applicable federal and state securities laws or the breach of any of the representations, warranties or covenants.

While no single factor is dispositive in determining whether a finder is considered a broker-dealer, the SEC has made clear in its No-Action Letters that it considers the manner in which a finder is compensated to be a critical factor in the analysis.