CARLTON FIELDS

Concurrent EB-5 Offerings in the United States and Abroad

October 01, 2013

Until recently, U.S. offerors and others had to make offerings of EB-5 project investments solely offshore in order to benefit from Regulation S, an exclusion from registration requirements. The offerors had to exclude foreign nationals who were resident in the United States from participation in the project because, under Regulation S, no directed selling efforts could occur in the United States. The separate exemptions that permitted offers to be made in the United States were extremely restrictive, only permitting the issuer, absent costly SEC registration, to make offers to investors that had a pre-existing relationship with the issuer or its placement agent. New Rule 506(c) permits issuers to make general solicitations in the United States, subject to a number of requirements summarized below. Rule 506(c) states that an offering made pursuant thereto should not be subject to integration with a concurrent offering made pursuant to Regulation S. This means that while the limited partnership interests or other securities offered in the EB-5 transaction are being marketed offshore, those securities may be offered in the United States simultaneously in accordance with Rule 506(c) to those persons who wish to obtain permanent residency under the EB-5 program. As a result, at the same time the offshore solicitations are conducted in accordance with the requirements of Regulation S, a separate offering of the same securities may be made in the United States to prospective EB-5 investors in an offering meeting the requirements of Rule 506(c). In general, Rule 506(c) permits an offering under Regulation D (a non-registered offering) to be made by means of advertising or general solicitation, including:

- traditional forms of advertising (such as newspaper, TV, and radio ads);
- web advertising (such as Google Adwords, banner ads, blogs);
- email blasts (that must, under separate laws, comply with anti-spam restrictions);
- seminars open to the applicable public; and
- other forms of networking.

There are a number of requirements applicable to the Rule 506(c) offering that are not requirements of a compliant Regulation S offering. Appendix A provides a high level summary of the requirements

of a Rule 506(c), three of which are newly promulgated:

- Issuers must take reasonable steps to verify that all investors whose subscriptions are accepted are accredited investors;
- Issuers must take reasonable steps to verify that their "Covered Persons" do not have a "Bad Act Event" after September 22, 2013 and to disclose in the offering materials any "Bad Act Event" that occurred prior to September 23, 2013;
- According to proposals that are still subject to public comment and that are not yet in effect, issuers would be required to file a Form D with the SEC 15 days prior to first use of general solicitation, submitting copies of general solicitation materials.

ACCREDITED INVESTORS

The investors in an EB-5 offering will generally be natural persons who are not citizens or permanent residents of the United States. A natural person is an accredited investor if either:

- the person had individual income of $200,000 in each of the two most recent years, or $300,000 of joint income with that person's spouse in each of the two most recent years, and a reasonable expectation of reaching that same income level in the most recent year (the "Income Test"); or
- the person has individual net worth, or joint net worth together with the person's spouse in excess of $1 million, not including the investor's primary residence or mortgage indebtedness on the residence up to the value of the residence ("Net Worth Test").

In addition to the requirement that all investors whose subscriptions are accepted in the Rule 506(c) offering must be accredited investors, the issuer is also required to be able to document that it took "reasonable care under the circumstances" to verify that each investor in the Rule 506(c) offering whose subscription is accepted is an accredited investor. The SEC has stated that the reasonableness of the steps taken to verify that a prospective investor is an accredited investor is affected by:

- the type of accredited investor the investor claims to be [for example, whether the individual purports to qualify under the Income Test or the Net Worth Test];
- the amount and type of information that the issuer has about the investor [this information would extend beyond the investment funds tracing information required in connection with the investor's immigration petition to such things as a reliable documentation of income (in the case of the Income Test) or substantiation of his balance sheet (in the case of the Net Worth Test)]; and

- the manner in which the investor was solicited and the minimum investment amount [typically an EB-5 investment of $500,000 that was not a gift to the investor would tend to support the conclusion that the investor was an accredited investor, even though that alone would not be dispositive].

The SEC has provided certain non-exclusive, safe harbors to satisfy the requirement of reasonable steps to verify the accredited investor status of a natural person seeking to invest in a Rule 506(c) offering:

- For the Income Test, review of the IRS forms that report income, including a W-2, Form 1099, Schedule K-1 and Form 1040 for the two most recent years, along with a written representation from the individual that he has a reasonable expectation of reaching the qualifying income level during the current year;

- For the Net Worth Test, review of one or more of the following types of documentation, dated within the prior three months, and the person's written representation that all liabilities necessary to calculate his net worth have been disclosed to the issuer:
  - For assets: bank statements, brokerage statements and other statements of securities holdings and certificates of deposits, and tax assessments and appraisal reports by qualified independent third parties for real property.
  - For liabilities: a credit report from at least one of the three national consumer reporting agencies.

- For the Income Test or the Net Worth Test: Written confirmation from one of the below persons that the person has taken reasonable steps to verify that the investor was an accredited investor on a date within the preceding three months:
  - a registered broker-dealer;
  - an SEC-registered investment advisor;
  - a duly licensed attorney; or
  - a certified public accountant.

Generally, for EB-5 investors, U.S. tax returns will not be available, nor will U.S. consumer reporting agencies have information concerning the individual's liabilities. Therefore, either the investor will have to supply third party verification of the type mentioned, or the verification process will have to occur outside any safe harbor. We anticipate that third party service providers will develop best practices to gather information concerning investors that are citizens of countries other than the United States to satisfy the "reasonable care under the circumstances" requirement. When making an EB-5 offering that has a Rule 506(c) component, it may be useful to retain a professional services firm to conduct the review process, prepare a report to the issuer setting forth the procedures used, to verify whether the prospective investors are all accredited investors, and to set forth the data

obtained from each investor that is a verified accredited investor. Privacy laws apply to such data, and the issuer and service provider will need to have in effect, and comply with, an appropriate privacy policy. **BAD ACTORS**

The Dodd Frank Act mandated disqualification of offers from reliance on Rule 506 (including Rule 506(b) and Rule 506(c)) if any Covered Person had a Bad Act Event. The final rules provide that a Bad Act Event of a Covered Person prior to September 23, 2013 must be disclosed but otherwise is not a show-stopper, while the existence of a Bad Act Event of a Covered Person after September 22, 2013 makes Rule 506(c) inapplicable to the offering. The burden is on the issuer to take "reasonable care under the circumstances" to determine who are its Covered Persons and whether any of the Covered Persons have a Bad Act Event, and when it occurred. Again, we anticipate that issuers may utilize a knowledgeable external service professional on the team to handle this issue, conduct interviews, collect questionnaires, perform record searches in the appropriate jurisdictions, and prepare a report to the issuer to satisfy the requirement. *Covered Persons include:*

- the issuer;
- each affiliated issuer (for example, a corporate guarantor);
- each predecessor to the issuer;
- each remunerated solicitor (including brokers and anyone directly or indirectly paid to source investors);
- all executive officers of the issuer, the general partners of the issuer and their executive officers and directors;
- each holder of 20 percent or more of the voting equity of the issuer; and
- all promoters of the issuer (such as the regional center and its executive officers and directors).

Bad Act Events include certain:

- criminal convictions;
- injunctions;
- restraining orders or cease and desist orders;
- final, disciplinary, stop, suspension, or false representation orders;
- misrepresentations to the U.S. Postal Service; and
- suspensions, expulsions, or bars from various securities self-regulatory organizations.

PROPOSED EXPANDED FORM D FILING

Nothing is required to be filed with the SEC in connection with the concurrent Regulation S offering, but the SEC has proposed expanded requirements for filing in connection with a 506(c) offering. According to the proposal, 15 days prior to the first use of any general solicitation, the issuer must file with the SEC a Form D that furnishes the SEC with copies of the general solicitation materials. The issuer must update the Form D filing at various times through the conclusion of the offering. You should confer with counsel to ensure all required filings are made as there are penalties for failure to comply. **OFFERING CIRCULAR**

In the case of both Rule 506(c) offerings, which by their terms are made to accredited investors only, and Regulation S, no particular form of prospectus is mandated, but the anti-fraud provisions of the U.S. securities laws apply to all U.S. issuers. Accordingly, the disclosure to both offshore investors and the accredited investors responding to directed selling efforts in the United States pursuant to Rule 506(c) should:

- convey accurately sufficient information about the opportunity and the inherent risks to enable prospective investors to make informed decisions about whether to invest; and
- avoid making material misstatements or failing to provide information, the absence of which makes the statements of the issuer of securities materially misleading.

This guidance must be followed not only in preparing your offering circular, but also in your general solicitation materials and electronic media, including websites and social media.

Issuers of securities should provide investors with a written offering circular that states fairly the nature of the project that the issuer plans to develop, the risks of execution, and information concerning the securities offered. An offering circular should contain the major items found in a prospectus, provided that there are no requirements that properly presented financial statements be audited. Note the requirement to include disclosure of any Bad Act Events prior to September 23, 2013 by any Covered Persons. Especially in connection with Regulation S offerings, where offshore selling agents and referral sources will assist in the distribution, it is important to state prominently in your offering circular that it is the only authorized disclosure document and that investors should not rely upon anything you did not provide directly. Also, the investor's subscription agreement should contain provisions confirming that investors have not relied on any statements not contained in the offering circular you provided to them.

Appendix A **SUMMARY OF REQUIREMENTS FOR RULE 506(c) OFFERING** ACCREDITED

INVESTORS ONLY. All of the investors must be Accredited Investors.

- Natural persons who are Accredited Investors are:
  - Persons that had individual income of $200,000 in each of the two most recent years, or $300,000 of joint income with that person's spouse in each of the two most recent years, and a reasonable expectation of reaching that same income level in the most recent year (the "Income Test"); or
  - Persons with individual net worth, or joint net worth together with the person's spouse, in excess of $1 million, not including the investor's primary residence or mortgage indebtedness on the residence up to the value of the residence ("Net Worth Test");
  - Certain entities delineated in Regulation D.

REASONABLE STEPS TO VERIFY. You must not only achieve the result that all of the accepted subscribers in your Rule 506(c) offering are Accredited Investors, but also document how you took reasonable steps to determine all investors were Accredited Investors and retain the documentation following the offering. What steps are considered reasonable will depend on the facts and circumstances. In consultation with your counsel, you will need to decide what steps to take in your case. In cases where entities wish to invest, verification will vary based on the nature of the entity. Issuers are responsible for complying with privacy laws in holding and maintaining this information. If you want to use a third party to verify any information, you will need to take steps to make sure they are set up to handle confidential and private information and enter into an appropriate agreement before you supply them the private information. NO INTEGRATION WITH OFFERINGS THAT HAVE NON-ACCREDITED INVESTORS. Generally, offerings completed more than six months prior to the first sale in the Rule 506(c) offering or more than six months after the last sale in the Rule 506(c) offering that included one or more non-accredited investors, will not taint the 506(c) offering. Also, sales to offshore investors in compliance with Regulation S will not taint the Rule 506(c) offering even if those offshore investors are not Accredited Investors. INFORMATION REQUIREMENTS. You must not violate the anti-fraud rules by making misstatements or omissions. You will generally want to address the major items that would be included in a prospectus with the exception that your company financial statements need not be audited. You need to keep your website, social media, and other communications free of material misstatements or omissions. Consider limiting your spokespersons or administrators on all of these other outlets to persons who are also completely familiar with your offering materials and who understand disclosure requirements. LIMITATIONS ON RESALE. The certificates for the securities issued in the offering must be legended and the communications to investors and subscription documents must state that the securities purchased in the Rule 506(c) offering may not be resold without compliance with some applicable exemption. NOTICE FILING WITH SEC. Currently, the normal post-commencement Form D filing regime is in effect. Under the SEC proposed rule, Form D with information about the offering, and submission of general solicitations materials used in the offering, must be filed with the SEC 15 days prior to the

first general solicitation and then at specified intervals thereafter. Under the SEC proposed rule, failure to comply carries a penalty prohibiting further 506(c) offering activity for 12 months. STATE FILINGS. Various states have a requirement that a notice be filed and a fee paid prior to making offers to residents of that state. So either the offering will by its terms exclude residents of certain states, or the filings and payment of the fees will need to be timely made in those states. You should get a survey of the state requirements as to cost and timing of these filings before making your first general solicitation. REGISTRATION AS A BROKER-DEALER. If any of your team, or a third party in the United States, is paid commission or compensation for the sale of securities (check and comply with offshore jurisdictions rules, as applicable), they must be registered as a Broker-Dealer. State laws vary on what activities require "issuer dealer" registration and must also be surveyed and considered with your counsel. NO BAD ACTORS. If any of your officers, directors, 20 percent or more shareholders, promoters, placement agents, or brokers for the offering or certain others associated with your offerings have certain criminal convictions, injunctive orders, disciplinary orders, cease and desist orders, suspensions, bar orders, or stop orders, as set forth in the Rules, that occurred after September 23, 2013, you are not eligible to do a Rule 506(c) offering. You must make disclosures of any such Bad Act Events of Covered Persons that occurred prior to September 23, 2013. You must take reasonable steps (and document them) to make sure there are no "bad actors" associated with your company or the offering. STRICT COMPLIANCE. Persons relying on Regulation D exemptions other than Rule 506(c) may have fallback exemptions under Section 4(2) or otherwise that will not be available with respect to an offering involving general solicitation. Therefore, it is very important that you ensure strict adherence and compliance with the satisfaction of every requirement.
Appendix B **SUMMARY OF REQUIREMENTS FOR A REGULATION S OFFERING** Regulation S provides an exclusion from U.S. securities laws, of among other things, offerings made to a non-U.S. person in an offshore transaction. OFFSHORE TRANSACTION

- The offer must not be made to a person in the United States; and either:
  - at the time the investment is subscribed for, the investor is outside the United States, or the issuer reasonably believes the investor is outside the United States; or
  - the transaction is made on a trading floor of a foreign securities exchange.

NON-U.S. PERSONS
A U.S. person cannot be a purchaser in a Regulation S offering. U.S. persons include: **(i)** any natural person resident in the United States of America, its territories and possessions ("U.S."); **(ii)** any partnership or corporation organized or incorporated under the laws of the United States; **(iii)** any estate of which any executor or administrator is a U.S. person; **(iv)** trust of which any trustee is a U.S. person; **(v)** agency or branch of a foreign entity located in the United States; **(vi)** non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person; **(vii)** any discretionary account or similar account (other than an estate or trust) held by a dealer or

other fiduciary organized, incorporated, or (if an individual) resident of the United States; and **(viii)** any partnership or corporation if (i) organized or incorporated under the laws of any foreign jurisdiction and (ii) formed by a U.S. person principally for the purpose of investing in securities not registered under the Securities Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in Rule 501(a) of Regulation D promulgated under the Securities Act) who are not natural persons, estates or trusts. OFFSHORE TRANSACTIONS

Offers should be made outside the United States. No directed selling efforts can be made in the United States as part of the Regulation S offering. (Visits to inspect the project or meet the management team and professionals by an investor solicited through selling efforts offshore are permitted). Directed sales inside the United States would instead be made under the auspices of the concurrent Rule 506(c) offering and comply with the requirements of that Rule. RESALE RESTRICTIONS

Generally, in the category of an EB-5 offering, investors understand that they must hold the investment for a long period of time. The Regulation S provides that the resale of securities issued by a domestic non-public issuer must be restricted from resale to U.S. persons for at least one year.

Related Practices

Immigration Planning and Compliance