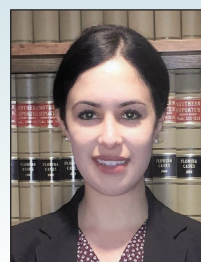
Materiality in Securities and Immigration Contexts



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Federal securities laws are based on the notion that investment and voting decisions should be predicated based on full disclosure of the information necessary "to bring into full glare of publicity those elements of real and unreal values which lie behind a security." Specifically, these laws focus on mandating the disclosure of material information. For example, Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act") prohibits disclosing any untrue statement of material fact or the omission of a material fact that is necessary to prevent statements already made from becoming misleading, in connection with the purchase or sale of securities. Moreover, Rule 14a-9, promulgated under Section 14(a) of the Exchange Act, provides that no proxy solicitation shall be made "which . . . is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading." Accordingly, the standard for materiality has played a central role in the jurisprudence of federal securities laws. Although this article does not thoroughly analyze what constitutes a material change in the context of the Employment Based Fifth Preference Program ("EB-5 Program"), it is enough to conclude for now that the securities laws generally would cast a wider net in terms of "materiality" than would the United States Citizenship and Immigration Services ("USCIS") in the adjudication of individual EB-5 investor petitions.

In the context of federal securities laws, the standard for materiality is whether there is a substantial likelihood that a reasonable investor would consider the misstatement or omission important in deciding whether to purchase or sell a security. Accordingly, this "reasonable investor" standard is an objective determination and courts have generally held that vague statements expressing optimism, belief or puffery may be "such obvious hyperbole that no reasonable investor would rely upon them."

The determination of materiality is a mixed question of law and fact, and the Securities and Exchange Commission ("SEC") has made clear that there is no bright-line quantitative test for materiality. The Supreme Court has likewise noted that having absolute certainty in the application of materiality is an "illusory" and "unrealistic" goal. Despite not articulating a bright-line rule, the Supreme Court has held that a misstated or omitted fact is material if a reasonable investor would have viewed it as significantly altering the "total mix of information made available." The Supreme Court reaffirmed this "total mix" standard in 2011 in Matrixx Initiatives, Inc. v. Siracusano. In Siracusano, the Supreme Court rejected the defendant pharmaceutical company's policy that adverse event reports relating to its products are immaterial unless they pose a statistically significant risk that the product was the cause of the consumer's injuries. Instead, the Supreme Court reiterated that the undisclosed adverse event report in question, although not deemed statistically significant, was material as judged by the "total mix" standard. The Supreme Court further noted that this standard does not impose an affirmative duty to disclose material information, but only requires disclosure when it is necessary "to make . . . statements made, in the light of the circumstances under which they were made, not misleading."

Although five percent has generally been used as the materiality threshold for financial statements "based on the percentage of which an investment represents the company's total assets under management," courts look at both quantitative and qualitative factors in assessing materiality. This practice of deeming information immaterial if it is below a certain percentage threshold, however, has been more closely scrutinized by the SEC. Specifically, the SEC released a staff accounting bulletin that provides that a financial statement's materiality is determined in light of all relevant circumstances such that "there are numerous circumstances in which misstatements below 5% could well be material."

The following chart details cases highlighting the nuances of the issue of materiality in the context of federal securities laws as interpreted by certain circuit courts:

CASE	MATERIALITY DECISION
In re Merck & Co. Securities Litigation., 432 F.3d 261 (3d Cir. 2005)	The Third Circuit held that the defendant's misrepresentation of its revenue was immaterial as a matter of law based on the movement in the price of the company's stock "in the period immediately following disclosure" because when the defendant finally disclosed that there was an improper accounting for revenue, the defendant's stock price did not drop.

CASE	MATERIALITY DECISION
Greenhouse v. MCG Capital Corp., 392 F.3d 650 (4th Cir. 2004)	The Fourth Circuit held that the defendant's CEO's statement that he had graduated college although he had only completed three years was immaterial despite a drop in the company's stock after the misstatement was revealed. The court reasoned that the CEO's failure to finish college did not "alter the total mix of information [available] to a reasonable investor."
City of Monroe Employees Retirement System v. Bridgestone Corp., 399 F.3d 651 (6th Cir. 2005)	The Sixth Circuit held that the defendant company committed a material omission based on its failure to cite any evidence supporting its statement that there was objective data supporting the safety of its tires. According to the court, once the company "elected to make statements such as the statement regarding the 'objective data,' it was required to qualify that representation with known information undermining (or seemingly undermining) the claim." The court reasoned that an affirmative duty to disclose information may arise when an incomplete or misleading disclosure has been made.
FindWhat Investor Group v. FindWhat.com, 658 F.3d 1282 (11th Cir. 2011)	A company offering internet "pay-per-click" advertising services was sued after its stock price dropped following its revelation that part of its revenue was based on "click fraud." The Eleventh Circuit held that the CEO of the company did not commit a material omission by not revealing that part of the company's revenue was coming from illegal click fraud when he announced an increase in the company's revenue because "[n]o reasonable investor would believe that a conclusory, but apparently accurate, report of company-wide revenue growth naturally implied that all was well within every component of the company that could possibly affect revenue in the future."

Even though there is no bright-line rule for materiality, issuers that strictly comply with certain safe harbors may shield themselves from liability. One such safe harbor is the judicially-created "bespeaks caution" doctrine, under which forward-looking information will generally not be deemed material if it also has sufficient cautionary language. For cautionary language to meet the requirements of this doctrine, such language "must be substantive and tailored to the specific future projections, estimates or opinions" at issue. Likewise, the Private Securities Litigation Reform Act contains a safe harbor for forward-looking statements provided that (i) such forward-looking statements are accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those" in the forward-looking statements or (ii) the forward-looking statement was not made with actual knowledge that such statement was misleading or false. Moreover, the Securities Act of 1933 contains its own safe harbor provision—SEC Rule 405—which provides that information is material only if "there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."

In the context of the EB-5 Program, the SEC has filed enforcement actions against securities issuers and principals for violating the materiality provisions of the federal securities laws. Most of these SEC enforcement actions involve allegations of diversion of capital invested by EB-5 investors for personal use. Because capital was used for purposes not described in the offering documents, and that fact (i) if known, would be important to the decision of whether to invest and (ii) was not disclosed to investors, the SEC alleged securities laws violations grounded in materiality. One recent SEC action, filed against the principal of the issuer, involved raising funds through the EB-5 Program for the construction and operation of frozen yogurt and smoothie franchises. The business model articulated in the offering materials was to construct and operate these franchises as conventional stores located in strip malls. However, the principal changed the business model to developing smaller kiosk stores in sports arenas and university campuses, resulting in a substantial downsizing of each enterprise with much smaller investment returns and the creation of fewer jobs. In its complaint, the SEC emphasized that the change in business model was material, because if the fact had been known it would be important to the decision of whether to invest, considering the expectations of financial returns and eligibility for the EB-5 immigrant visa classification. While also alleging that the principal misappropriated over $1 million of EB-5 investor funds for his personal use, the SEC thus charged the principal with violating Section 10(b) of the Exchange Act and Rule 10b-5, among other federal securities laws. The misappropriation of funds was "material to investors because, among other reasons, it has been so extensive that [the principal] and [the commercial enterprise] have not had sufficient funds to complete construction of the stores contemplated in the offering materials." These allegations point to the possible benefits of supplementing offering materials when there has been substantial change in the business model that was described in the original offering documents.

Securities laws thus consider materiality in the light of the statutory mandate to disclose any facts with real potential to influence the decision of whether to invest. Relatively considered, the net is cast wide and issuers are well advised to disclose new facts via supplemental offering documents when in doubt. On the other hand, USCIS has articulated a doctrine of "material change" that penalizes EB-5 investors, mandating the re-filing of I-526 petitions where the changed facts render unapprovable a petition that otherwise would be approved. This conception of materiality, consequently, is directly tied to concluding that new facts make the EB-5 investor ineligible for the immigrant visa. Compared to securities law, it is a narrower conception of materiality; it concerns actual ineligibility for the EB-5 visa, not merely a potential ineligibility. This is clear from the U.S. Supreme Court case relied upon by USCIS, where the Court held the misrepresentation of date and place of birth was not material because the true date and place of birth would not make the applicant ineligible for naturalization. This distinction explains why, for example, a relatively minor adjustment to an earlier job creation estimate should not add up to material change for purposes of immigration law but a major adjustment that results in an estimate of job creation below the minimum 10 jobs per EB-5 investor threshold would be deemed a material change. Although securities counsel may urge disclosure consistent with the purpose of securities laws, this does not have to be at the cost of sacrificing the EB-5 investor's pending petition because there may be instances where supplemental disclosures on account of updated facts should not trigger a finding of material change by USCIS. ■