SEC Brings Another Enforcement Action Against Unregistered Broker Dealer in California EB-5 Offering

SCOT O'BRIEN
PARTNER, AKERMAN LLP

MARK Y. LIU
PARTNER, AKERMAN LLP

The recent U.S. Securities and Exchange Commission ("SEC") enforcement action against Allen Chi of California illustrates the SEC's continued crackdown on unregistered broker-dealers and finders compensated for facilitating introductions between foreign investors and sponsors or promoters of EB-5 projects.

On August 21, 2017, the SEC instituted cease-and-desist proceedings against Allen Chi, a resident of Arcadia, California, pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), alleging that Mr. Chi violated Section 15(a)(1) of the Exchange Act. The SEC order alleges that Mr. Chi, through his company, Mason Investments, LLC, helped introduce Chinese investors, who hoped to qualify for U.S. residency under the EB-5 program, to Suncor Companies, a provider of nursing care facilities. In return for such introductions and related work (detailed below), Mr. Chi allegedly received transaction-based compensation from Suncor Companies in the form of commissions based on a percentage of the amount invested. (Such activities and compensation are hallmarks of broker activities under the Exchange Act.)

The SEC order also noted that the principals of Suncor Companies had previously been determined to have misused and misappropriated investors' funds, although Mr. Chi was not charged with any misappropriation. Although it is unclear, it is possible that the SEC's civil injunctive action against the Suncor Companies led to the SEC order involving Mr. Chi.

Section 15(a)(1) of the Exchange Act makes it unlawful for any broker or dealer "to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless such broker or dealer is registered with the SEC in accordance with Section 15(b) of the Exchange Act. At no time during the fund-raising efforts (September 2012 through February 2014) was either Mr. Chi or Mason Investments a registered broker-dealer under Section 15(b) or associated with a registered broker-dealer. Chi's subsequent association with a registered broker-dealer came after the date of his activities in the Suncor Companies matter.

As a result of the SEC's order, Mr. Chi must pay approximately $2.4 million in disgorgement of compensation received and $246,000 in prejudgment interest to investors injured in the Suncor Companies investment.

Avoiding Section 15(a)(1) Liability

Section 15(a)(1) of the Exchange Act requires that any "broker" that makes use of the U.S. mail or an instrumentality of interstate commerce to effect transactions in securities must register with the SEC. A "broker" is defined by Section 3(a)(4)(A) of the Exchange Act as "any person engaged in the business of effecting transactions in securities for the account of others." Determining whether a person is a broker requires a two-prong analysis: whether the person is (1) "engaged in the business" and (2) "effecting transactions."

Meeting this test requires an analysis of the facts and circumstances surrounding the case. Generally, the receipt by a person of "transaction-based compensation" — compensation that is contingent upon or varies in amount based upon the amount of securities sold —has traditionally been a bright-line test for whether the person has engaged in broker-dealer activities. However, even activities such as solicitation or negotiation may meet this test.

The SEC has adopted Rule 3a4-1 as a safe harbor to broker-dealer registration concerns by providing a broker-dealer registration exemption (colloquially, the "issuer exemption") for persons associated with an issuer, including any officers, employees, or company affiliated with the issuer. Under this rule, such person will not be deemed a broker if he or she (1) is not compensated by payment of commission or other remuneration based on securities transactions, (2) is not associated with a broker-dealer, and (3) limits his or her activities to working on one offering per 12 month period or performs substantial duties other than those in connection with transactions in securities, such as soliciting only

certain financial institutions, and performing only passive or clerical duties involving solicitation of investors.

In applying the broker facts and circumstances test in Mr. Chi's case, as set forth in the SEC's order he performed due diligence, advised the Suncor Companies on the investment structure, and helped with preparing the solicitation materials. In addition, he also allegedly facilitated the execution of investment agreements and the transfer of funds. In short, his activities were far more than passive or clerical duties or merely making an introduction, and additionally, for his work, he was compensated on a "success fee" basis, based entirely on the number of investors he was able to bring in and the amount he helped Suncor Companies raise (that is, "transaction-based compensation"). Unsurprisingly, Mr. Chi was not able to avail himself of the Rule 3a4-1 safe harbor.

EB-5 PROJECTS AND CHINESE INVESTORS

With the number of I-526 petitions steadily increasing and demand seemingly outpacing supply, there is growing concern that the incidence of EB-5 projects using unregistered broker-dealers and "finders" to help find investors – often with the promise of a lucrative commission or success fee –is continuing to rise. As noted in the IIUSA Regional Center Business Journal June 2017 article "Advent of the Broker Dealer," between February 2013 and December 2016, the SEC filed 19 cases against respondents that involved EB-5 programs, with 11 of the 19 cases involving the use of unregistered broker-dealers.

Cases like the one involving Mr. Chi are not new. In March 2016, the SEC ordered a Boca Raton, Florida company called Ireeco LLC and its Hong Kong affiliate Ireeco Ltd. to pay approximately $3.18 million in disgorgement. Ireeco reportedly used its website to solicit Chinese investors, including some of whom were already in the U.S. on a temporary visa, and matched the investors up with a select group of EB-5 regional centers. Each of the regional centers paid transaction-based commissions to Ireeco of approximately $35,000 per investor.

As with the Chi case, the SEC alleged that the transactions facilitated by Ireeco violated Section 15(a)(1) of the Exchange Act because Ireeco engaged in the business of "inducing or attempting to induce the purchase or sale of securities for the accounts of others without registering as a broker-dealer" (emphasis added).

Again, Mr. Chi resident in a Los Angeles, California suburb whose population includes many recent immigrants from China and evidently saw an opportunity to earn compensation by introducing Chinese investors to Suncor Companies and allegedly influencing them to make EB-5 investments. He allegedly facilitated the purchase of Suncor Companies limited liability company membership interests by Chinese investors seeking to obtain United States visas through the EB-5 Program. According to the SEC order, directly and through Mason Investments, Mr. Chi's activities included "performing due diligence on the Suncor Companies, advising the Suncor Companies on the structure of the EB-5 investments, helping to prepare solicitation materials, recommending and advising on the purported merits of the Suncor [Companies'] securities to potential investors, [and] acting as a liaison between the Suncor Companies and the investors…." Mr. Chi also facilitated the execution of investment agreements and the transfer of investment funds. In exchange for his sizable role in facilitating investor purchases of Suncor Companies securities, Mr. Chi received transaction-based compensation.

LAW FIRMS CANNOT ACT AS UNREGISTERED BROKERS-DEALERS

Law firms and lawyers, when helping their immigration or securities clients with their visa applications or choices of investment project, must also be careful not to go too far lest they be determined to have served as brokers without the SEC registration required for that role.

A few months after the Ireeco case, in 2016, the SEC charged Hui Feng, a lawyer in the Law Offices of Feng & Associates based in New York City. According to the SEC order, Mr. Feng opened four offices in China that were each staffed with an employee who was instructed to promote the Feng & Associates website. The website included specifics of various EB-5 projects and made investment recommendations to their investor clients and potential investor clients, nearly all of whom were based in China. Mr. Feng allegedly received over $1.1 million in commissions in connection with these sales, and was contractually entitled to at least an additional $3.1 million in commissions. Pursuant to the SEC order, Mr. Feng was ordered to pay over $1.7 million in disgorgement and interest plus a combined $960,000 civil penalty.

Similarly, in March 2016, the SEC also reached settlement with Linda Yoo, an immigration attorney based in Bellevue, Washington, who received commissions and transaction-based payments for helping her clients invest in EB-5 projects. According to the SEC order, Ms. Yoo was ordered to disgorge $205,000 and pay $50,000 in civil penalties and $23,169 in interest.

Needless to say, neither of these attorneys were registered brokers, thus neither of them were lawfully entitled to broker compensation. This is entirely similar to the raft of enforcement actions brought by the SEC against other immigration attorneys active in the EB-5 industry.

CONCLUSION

There have been recent proposals from the Department of Homeland Security and proposed legislation from the U.S. Congress regarding the EB-5 program, but the passage and impact of these proposed changes on the program is unknown. What is certain is that sponsors and promotors for EB-5 projects will continue to use broker-dealers and finders to help them source investors and investment capital, and those brokers who have an established network of green card-seeking investors from China and other overseas source markets will be in particularly high demand.

As the Chi/Suncor Companies case illustrates, it behooves these sponsors and promoters to choose their broker-dealers very carefully, and ensure that the persons acting as broker-dealers are duly licensed and registered under the Exchange Act (where appropriate) prior to agreeing to provide such broker-dealers a "success fee" or other transaction-based compensation. At the same time, persons or firms acting as brokers, including immigration lawyers, need to either register with the SEC as a broker or structure their fees and scope of services to fall under the Rule 3a4-1 safe harbor (if possible) so as to avoid liability under Section 15(a)(1). Otherwise, they and the companies that hire them risk running afoul of SEC rules and being subject to significant disgorgement and other penalties.