Navigating the Uncertainties of COVID-19:

A Guide for EB-5 Issuers on Securities Laws Disclosure in the Midst of the Pandemic

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The novel coronavirus known as COVID-19 ("COVID-19"), together with related governmental and regulatory responses, have affected economic and financial market conditions as well as the operations, results and prospects of companies across many industries. Although the true extent of the economic and financial disruptions remains unclear, the global economy has experienced and continues to experience significant changes in business and economic conditions generally as the COVID-19 crisis continues.

Unfortunately, projects utilizing EB-5 financing ("EB-5 Projects") are not immune from the pandemic and its adverse effects on the U.S. and global economies, including market volatility, market and business uncertainty and closures, supply chain and travel interruptions, the need for employees to work at external locations and extensive medical absences among the workforce.

As the pandemic economy continues to impact new commercial enterprises ("NCEs") and job-creating-entities ("JCEs") alike, this article will discuss (i) appropriate disclosures to EB-5 investors regarding COVID-19 and its impact on both their investment and their EB-5 Project and (ii) the timing of such disclosures and when obtaining consent from EB-5 investors is appropriate. We will discuss these issues in the context of three common EB-5 offering scenarios: new offerings, existing/on-going offerings and offerings that are either closed or experiencing distress.

New Offerings

In addition to COVID-19's clear impact on the business and operations of EB-5 Projects within a myriad of industries, it has also seemingly had a stifling effect on the number of NCEs conducting new EB-5 offerings ("EB-5 Offerings").

Of course, there has been a gradual reduction in the number of EB-5 Offerings in recent years that cannot be attributed to COVID-19 alone. To be sure, the lack of definitive policy determinations by USCIS, changes to TEA determinations and methodologies, increased minimum investment amounts and the increasing visa backlog for investors from Mainland China are contributing factors. The United States' uncertain political climate – particularly in an election year – is also likely a factor.

Nevertheless, the financial and market disruptions caused by COVID-19 have led some EB-5 operators to adopt a "wait and see" approach with respect to new EB-5 Offerings. Though certain EB-5 operators with exceptional projects and/or meaningful migration agent relationships have been able to conduct successful EB-5 Offerings during this tumultuous time, prospective EB-5 Offerings must deal directly with the uncertainties faced caused by COVID-19, the constraints it continues to impose, and the potential impact, financial and otherwise, that COVID-19 may have on prospective EB-5 investors.

Those considering a new EB-5 Offering should ensure that appropriate disclosures are made in the offering materials. Afterall, the laws, rules and regulations promulgated by the Securities and Exchange Commission ("SEC") are designed to protect investors by attempting to ensure that offering documents contain full and fair disclosure, and at their core focus on the disclosure of material information.

The obligations to provide full and fair disclosures are codified in numerous federal statues, including Rule 10b-5 of the Securities Exchange Act of 1934 (the "Exchange Act") (which prohibits disclosing any untrue statement of material fact or omitting a material fact that is necessary to prevent statements already made from becoming misleading), Rule 14a-9, promulgated under Section 14(a) of the Exchange Act (which 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

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in order to make the statements therein not false or misleading"), and the Securities Act of 1933 (the "Securities Act").

Although the SEC has made clear there is no bright-line quantitative test for materiality, the standard for materiality in the context of federal securities laws remains 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.

In the context of a new EB-5 Offering, offering documents should contain cautionary language and forward-looking statements that avail NCEs of safe-harbors enacted under the Private Securities Litigation Reform Act of 1995 (PSLRA) and Securities Act. Accordingly, NCEs should (1) tailor these forward-looking statements specifically for COVID-19 and the various risks and uncertainties related thereto and (2) emphasize that the accuracy of such statements depends on future events and assumptions, and that COVID-19 may cause actual results to differ materially.

In addition to cautionary language and risks factors that might traditionally be associated with a particular EB-5 Project, an NCE's offering documents should also include robust disclosures regarding COVID-19 and how the pandemic may present additional risks or exacerbate existing project-specific risks. With this in mind, NCEs should clearly disclose how COVID-19 may cause construction delays, impact operations and demand for the project or delay the ability to obtain financing (or the ability to obtain financing on commercially reasonable terms, if at all). As an example, a hospitality project may provide disclosures regarding COVID-19's potential impacts on the tourism industry, including how demand may be impacted by travel restrictions and how operations may change as the hospitality industry continues to recover and evolve.

NCEs conducting new offerings should also engage immigration counsel to review offering documents for immigration disclosures related to COVID-19, including the potential impact to job creation and allocation and how operational changes at USCIS may lead to increased processing times for investor petitions.

Existing Offerings

For NCEs currently conducting an EB-5 Offering, it is possible that its offering documents were prepared prior to COVID-19 pandemic. Though an NCE's offering documents may contemplate general risks, including those related to public health crises and pandemics, they are unlikely to address the current nature of the pandemic or the severity of its impact on the global economy.

Since securities laws consider materiality in light of the statutory mandate to disclose any facts with real potential to influence the decision of whether to invest, the net is cast wide and issuers are well advised to disclose new facts via supplemental offering documents when in doubt. In this way, issuers can potentially avoid securities liability by providing investors with material disclosures on an on-going basis.

As an example, imagine an EB-5 Offering where offering documents were prepared more than one year ago and contain a capital structure and development timeline that predated COVID-19. Now for illustrative purposes, imagine that COVID-19 caused supply chain disruptions, employee furloughs and reduced operations that delayed construction and significantly increased project costs. If the NCE delivers its dated offering materials to prospective EB-5 investors without also providing supplemental disclosures that update and/or correct the dated information (such as the extent of the delays or how the project will account for the capital shortfall), the NCE may be deemed to have violated federal securities laws by failing to disclose material facts and/or making statements that might now be misleading as a result of the changed circumstances presented by COVID-19.

Since it is generally known that securities laws cast a wider net in terms of "materiality" than would USCIS in the adjudication of individual EB-5 investor petitions,[1] securities attorneys typically urge disclosure consistent with the purpose of securities laws (i.e., full and fair disclosure). However, such disclosure does not necessarily have to be at the cost of sacrificing the EB-5 investor's pending petition since there may be instances where supplemental disclosures on account of updated facts should not trigger a finding of material change by USCIS.[2]

1 O Torres & W Cornelius, Determining Materiality in Securities and EB-5 Immigration Contexts, Immigration Options for Investors & Entrepreneurs (AILA 4th ed 2019).

2 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. USCIS Policy Manual, Ch.4, Immigrant Petition by Alien Entrepreneur, at https://www.uscis.gov/policymanual/HTML/PolicyManual-Volume6-PartG-Chapter4.html.

As NCEs gather the information necessary to update their offering materials in response to COVID-19, they should be mindful of providing as much up-to-date information as possible, including the current financial and operating status of the EB-5 Project, job creation, updated capital structures, development timelines and financial projections. In addition to providing current updates, NCEs should consider providing any plans to update future operations or financial plans in response to COVID-19 along with risks factors and cautionary language describing how COVID-19 may impact projections and estimated timelines.

Once prepared, NCEs should distribute their supplemental offering materials to existing investors in order to keep them apprised of recent developments. Additionally, the supplemental offering materials should be provided to all prospective investors alongside the original offering documents. By providing both current and prospective investors with updated disclosures regarding COVID-19 and meaningful updates on the EB-5 Project, EB-5 issuers can help avoid liability for securities laws violations based upon the failure to disclose new material information. Moreover, providing existing investors with an update of any potentially material changes effectively starts the "clock" with respect to any statutory period of time by which investors may bring a claim against the issuer for securities laws violations related to such updates.

Distressed Projects

Although hospitality, condominium, multifamily rental and mixed-use real estate development projects have certainly experienced significant impact from COVID-19, they are far from the only businesses affected by these conditions. However, the impact of COVID-19 cannot be understated, as businesses across various industries are now experiencing severe financial distress.

For example, there has been reluctance in financial markets that has delayed bond issuances and other government-backed forms of financing in the context of education and charter school projects. Many EB-5

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Projects, particularly those in recreational and entertainment industries, have struggled to meet the financial projections contained in their offering materials.

Of course, hospitality, multifamily and other commercial real estate projects remain particularly affected by COVID-19, and such industries may be particularly subject to distress based on significant reductions in the work force, restricted operations and supply chain disruptions brought on by the pandemic. As a result, EB-5 Projects within these industries may be forced to delay or forego construction activities or operations, in some cases leaving JCEs unable to service their EB-5 financing obligations.

Additionally, financial markets are trending conservatively and historically low interest rates have made it difficult to sell EB-5 Projects subject to the EB-5 financing, which was once common underwriting and industry practice.

Depending on the severity of the distress, NCEs must analyze the impact of distress and determine whether it is advisable to continue the EB-5 Offering. Of course, such determination must be predicated on the potential remedies and outcomes and the fiduciary duty to preserve visa eligibility and financial investment of EB-5 investors.

For on-going EB-5 Projects that have managed to sustain operations during COVID-19, or projects that have become distressed due to the pandemic, NCEs must ensure that they comply with best-practices regarding securities laws disclosures while also balancing how project-level changes may be construed by USCIS and whether such changes would be deemed material in the immigration context and that could affect the approvability of the I-526 petition.

The NCE would be well advised to err on the side of providing EB-5 investors with as much information as is practicable as it weighs its options. Should the NCE elect to terminate its EB-5 Offering, the NCE should consult with both securities counsel to craft the appropriate disclosures and immigration counsel to determine the potential impact on existing immigration petitions. If the NCE is seeking to take action on account of a distressed project, such as accepting a reduced payoff amount for EB-5 financing, consenting to material modifications to the capitalization or altering the fundamental nature of the underlying EB-5 Project, the NCE should endeavor to provide all material information to ensure that NCEs fulfill their disclosure obligations and demonstrate their adherence to fiduciary duties.

When is Investor Consent Required?

For on-going EB-5 Projects, NCEs should be urged to strongly consider providing EB-5 investors all material updates and information. Although the most conservative approach would entail always seeking investor consent to material changes and/or proposed actions, some issuers may, depending on the context of materiality and the nature and extent of the proposed changes, opt for a simple acknowledgement of receipt of the disclosure.

Alternatively, some issuers may elect to provide a standalone, informational notice that contains meaningful updates but requires no further action on the part of the EB-5 investor. Such practice may be more practicable where the EB-5 Offering is no longer active (and as such there is no affirmative duty to update the offering materials).

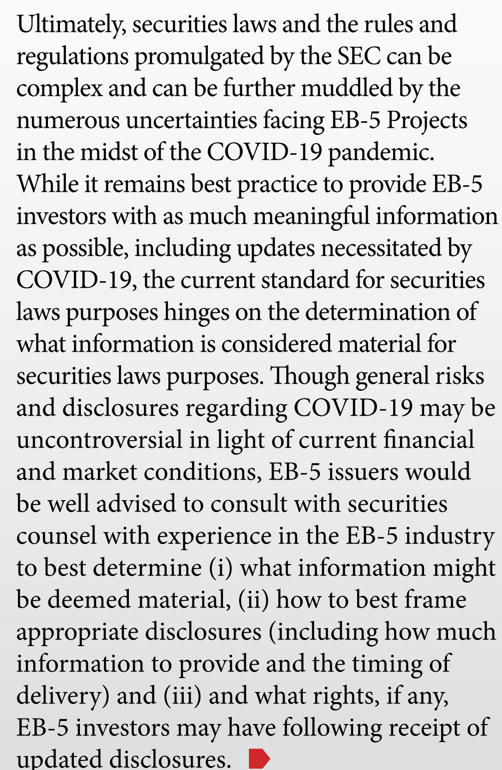
In determining a desired course of action, NCEs should first review their operating agreement or limited partnership to understand what rights are held by EB-5 investors. If, for example, EB-5 investors were granted approval rights in certain circumstances – such as changes in structure or EB-5 financing terms – then the provisions of the operating agreement or limited partnership agreement must control. If consent or approval is required, NCEs should provide all information necessary for EB-5 investors to exercise their rights. Even if consent is not expressly required, NCEs should still be mindful of their fiduciary duties to investors (which would obligate the NCEs and their managers or general partners to act in good faith and in the best interests of investors) and proceed with caution when consenting to and/or taking certain actions that could potentially impact investors. In those circumstances, prudence would dictate that EB-5 issuers err on the side of providing more information rather than less, and at least seek written acknowledgement from investors that such information was received.

Ultimately, EB-5 issuers should consult with securities counsel on the nature and extent of its disclosures and should weigh the potential risks of not seeking investor consent. Of course, it would always be advisable to have affirmative consent since it likely provides the best defense against claims of securities laws violations relative to disclosure obligations.

As EB-5 issuers weigh disclosure, it is critical to determine how significantly the changes described differ from the original offering materials. For example, if the notice details that construction has been delayed or an additional source of financing is available, perhaps a simple notice of the change is sufficient. If, on the other hand, the NCE is forced to take a particular action that may have a direct or indirect impact on EB-5 investors – such as accepting a reduced payoff amount on its EB-5 financing – the conservative approach would dictate that the NCE seek the affirmative consent of investors. In doing so, the NCE effectively insulates itself from liability because investors would face an uphill battle in trying to prove securities laws violations based on not having received appropriate updates.

Additionally, if COVID-19 has forced a dramatic departure from the project's business plan, EB-5 issuers should consider seeking investor consent, particularly because such changes could be deemed material from an immigration perspective. In such event, the best defense available to the EB-5 issuer is the consent provided by the EB-5 investor.

Conclusion



Ultimately, securities laws and the rules and regulations promulgated by the SEC can be complex and can be further muddled by the numerous uncertainties facing EB-5 Projects in the midst of the COVID-19 pandemic. While it remains best practice to provide EB-5 investors with as much meaningful information as possible, including updates necessitated by COVID-19, the current standard for securities laws purposes hinges on the determination of what information is considered material for securities laws purposes. Though general risks and disclosures regarding COVID-19 may be uncontroversial in light of current financial and market conditions, EB-5 issuers would be well advised to consult with securities counsel with experience in the EB-5 industry to best determine (i) what information might be deemed material, (ii) how to best frame appropriate disclosures (including how much information to provide and the timing of delivery) and (iii) and what rights, if any, EB-5 investors may have following receipt of updated disclosures.