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Alert | EB-5 Securities and Immigration Compliance

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U.S. District Court for District of Columbia Issues Important Decision in Favor of EB-5 Investors

Introduction

In the matter of *Huashan Zhang, et al. v. United States Citizenship and Immigration Service, et al.* (Case No. 15-cv-995, United States District Court for the District of Columbia, Nov. 30, 2018) (the Opinion), plaintiffs challenged the decisions of the United States Citizenship and Immigration Service (USCIS) to deny their EB-5 immigrant investor visa petitions based upon USCIS' erroneous interpretation of its own regulation. Plaintiffs also challenged USCIS' denials of their petitions as violative of the Administrative Procedure Act (APA) and Immigration and Nationality Act (INA). Furthermore, plaintiffs moved for certification of a class.

Although it is too early to know if USCIS will appeal the decision or if other district courts will follow the ruling of the District of Columbia, as it stands, this is a significant decision favorable to EB-5 investors. The court found that USCIS' interpretation of the term "capital" is "plainly erroneous, and its denials based on that interpretation are arbitrary and capricious." (*See* Opinion at page 43). The court further found that USCIS violated the APA's notice and comment requirement, as its interpretation was a legislative rule rather than an interpretative rule or statement of policy. In addition, plaintiffs' motion for certification of a class was granted with certain modifications to the class definition; the modifications affect those petitioners whose petitions were denied solely based upon USCIS' flawed interpretation as described in the USCIS Immigrant Investor Program Office's released remarks on April 22, 2015 (the 2015 IPO Remarks).

Background

Congress established the EB-5 Visa Program (the Program) in order to stimulate the economy and create American jobs through foreign investment in the United States. The Program provides that alien investors (the EB-5 Investors or EB-5 Investor) may become eligible to immigrate to the United States if they "invest" the prescribed amount of "capital" into a "commercial enterprise" that benefits the U.S. economy by creating not less than 10 full-time jobs for U.S. citizens or lawfully admitted aliens (8 U.S.C. § 1153(b)(5)(A)). Pursuant to the Program, an EB-5 Investor must first submit an I-526 immigrant investor petition (the Petition), which must be "accompanied by evidence that the alien has invested or is actively in the process of investing lawfully obtained capital in a new commercial enterprise in the United States, which will create full-time positions for not fewer than ten (10) qualifying employees." (8 C.F.R. § 204.6(j)).

How the Court Ruled

The issue in *Zhang* was whether loan proceeds invested as cash in a new commercial enterprise under the Program were to be considered "cash" or "indebtedness" which is required to be collateralized, within the meaning of the term "capital."

The term "capital" is defined in the regulation as "cash, equipment, inventory, other tangible property, cash equivalents, and indebtedness secured by assets owned by the alien entrepreneur, provided that the alien entrepreneur is personally and primarily liable and that the assets of the new commercial enterprise upon which the petition is based are not used to secure any of the indebtedness." (8 C.F.R. § 204.6(e)). The "capital" must be lawfully attained, as "[a]ssets acquired, directly or indirectly, by unlawful means (such as criminal activities) shall not be considered capital" for purposes of the Program. (*Id.*)

According to the 2015 IPO Remarks, if an EB-5 Investor uses loan proceeds as EB-5 capital, then such EB-5 Investor must demonstrate that they are personally and primarily liable for the indebtedness, and that the indebtedness is secured by assets petitioner owes sufficient to secure the amount of the debt. Thus, USCIS treated cash capital obtained from loan proceeds contributed to the new commercial enterprise as a contribution of "indebtedness" that must be personally collateralized, rather than an actual cash contribution.

The individually named plaintiffs were two EB-5 Investors whose petitions were denied because their EB-5 investment amounts were sourced from uncollateralized loans. Plaintiff Zhang obtained the requisite $500,000 via a loan from a company of which he was 99 percent owner; the loan was secured by his undistributed profits. USCIS denied Plaintiff Zhang's petition because the loan was not secured by his own personal assets, so his investment did not qualify as capital. Likewise, Plaintiff Hagiwara obtained the requisite $500,000 from a personal loan from a corporation of which he was majority shareholder. Mr. Hagiwara's petition was also denied because he had invested "indebtedness" and not "cash," as investing loan proceeds is equivalent to investment indebtedness, which must be secured by personal assets.

The court held USCIS' interpretation – that loan proceeds invested as cash should be characterized as indebtedness – to be plainly erroneous and inconsistent with the plain meaning of the regulation. Among other reasons, the court found that the EB-5 Investor who utilizes loan proceeds is not contributing debt to the commercial enterprise through the use of loan proceeds, but cash. (*See* Opinion at pages 17, 23, and 29).

The court also ruled in favor of the plaintiffs on the issue of the APA violation. The APA requires federal agencies to publish a general notice of proposed rulemaking in the Federal Register; however, federal agencies may promulgate interpretative rules, statements of policy, rules of agency organization, procedures and practices, without publication. (5 U.S.C. § 553(b)). The court held that by "requiring investors to personally collateralize loan proceeds invested as cash, USCIS added an additional requirement to the regulatory definition of "capital" not found within the text. In so doing, USCIS impermissibly created "*de facto* another regulation." (*See* Opinion at page 48, quoting *Christensen*, 529 U.S. at 588). The creation of an additional requirement that is not found in the regulation is a substantive rule that is invalid unless there is notice and comment under the APA. (*Id*. at page 48). As a result, USCIS' interpretation concerning collateralizing loan proceeds as capital added an extra requirement, which effectively amends the regulation. As USCIS did not submit such interpretation for notice and comment, USCIS violated the APA.

Conclusion

The court remanded plaintiffs' and class members' petition denials to USCIS for reconsideration in connection with the Opinion. It is unclear what the long-term repercussions of the Opinion will be on USCIS and the EB-5 Program, especially given the current state of uncertainty relating to and the strong push for legislative change of the EB-5 Program. It is also unclear whether USCIS will attempt any formal rulemaking as to limitations on acceptable forms of capital under the EB-5 Program, or some other means to narrow the scope of eligibility.

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