Case No. 17-56522

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HUI FENG and LAW OFFICES OF FENG & ASSOCIATES P.C.,
Defendants-Appellants,

v.

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

Appeal from the United States District Court
For the Central District of California
Case No. 2:15:cv-09420
The Honorable Consuelo B. Marshall

DEFENDANTS-APPELLANTS HUI FENG AND LAW OFFICES OF FENG & ASSOCIATES P.C.'S REPLY BRIEF

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I. INTRODUCTION

Despite more than enough ink having been spilled over this case, the principal question for this Court is whether immigration attorneys in the United States have the right to provide EB-5 immigration program related legal services without registering as a stock broker. The answer to this question will determine whether thousands of overseas clients could resume receiving unrestricted EB-5 legal services from immigration attorneys in this country. A fundamental threshold question to be answered is whether the SEC's novel and narrow interpretation of "profit", which elevates form over substance, withstands scrutiny. Moreover, this case will also test the policy implications of whether the registration exemption in the Investment Advisors Act are meaningless for millions of attorneys, accountants, teachers and engineers in the practice of their profession.

The predicament Appellants face in this case is not a singular event. The EB-5 program was authorized by Congress in the early 1990s, and until the sudden and unwarned enforcement actions by the SEC starting in 2013, no one (including immigration attorneys, accountants, immigration and business consultants or regional centers) thought the EB-5 program constituted securities offerings, let alone that anyone facilitating this program without registering as a stock broker could be accused of violating § 15(a). Indeed, there was no reason to believe otherwise, as the very name of the "EB-5 program" comes from the fact that it is

name of the employment-based fifth preference visa that participants receive. The EB-5 industry participants in general, and Appellants in particular, genuinely believe the EB-5 program is an immigration program designed to obtain a green card, and not a for profit securities program. And immigration attorneys like Appellants do not think they need to register as a stock broker before offering their clients EB-5 related immigration guidance or advice. In practice, the contingent legal fees, based on immigration application approval, could easily be structured as higher legal fees for the immigration attorneys for their successful immigration advisory services if the industry participants knew that the SEC would mistake them for "commissions".

II. ARGUMENT

By reading Appellee Securities and Exchange Commission ("SEC")'s Brief, one would have the impression that there are no material facts in dispute. In fact, Appellants dispute significant material facts, and take issue with the very choice of words used by the SEC, as those words misleadingly contain mistaken categorizations of the "material" facts.

Appellants are bona fide immigration legal service providers who provide their clients many means of immigrating to the United States, and – since it became popular after 2009 - the EB-5 program is just one of those means. The EB-

5 program is an immigration program, not a securities investment program. And as the evidence in this case made abundantly clear, generally speaking, there could be no net profit for any of the immigrant investors at issue here. It is the possibility of obtaining a green card, not profit, which causes these Chinese investors to participate in such a program.

The fees the SEC repeatedly refers to and calls "commissions" are simply contingent fees payable upon the immigration application approval – so they are only paid when the client gets what they actually wanted: immigration approval. Indeed, the SEC does not dispute that the contingent fees were only paid once the immigration application was approved, which could be several years after the EB-5 client invested.

Appellants used their professional training and business experience to conduct legal due diligence review and screening over many EB-5 program offerings for their clients so that they would not be trapped by the many fraudulent EB-5 program offerings the SEC has belatedly discovered. Pointedly, the SEC has not made a single claim that Appellants failed to obtain green cards for their clients through the EB-5 program. Instead, the SEC accuses Appellants of providing clearly useful, effective, and successful immigration services without first registering as a stock broker.

In reality – if there is a security at issue here – Appellants acted as Investment Advisors, not brokers. The SEC didn't sue Appellants as unregistered investment advisors likely because Appellants would be exempt from that registration. Under that Act, attorneys (among others) needn't register so long as their "performance of such services [are] solely incidental to the practice of [their] profession." Advisers Act § 202(a)(11)(B), codified at 15 U.S.C. § 80b-2(a)(11)(B). Rather than deal with this issue, the SEC only repeats the obvious, stating there is no such exemption to the broker registration requirements in the Exchange Act. But without a clear distinction between a broker and an investment advisor, the SEC may accuse those qualifying for investment advisor registration exemption of violating the broker registration requirement instead. This seems inherently inequitable.

A. Selected Problems with the SEC's Arguments

The SEC's Brief sidesteps many of the key facts and arguments. What follows is not meant as an exhaustive review of why they are wrong because there are just too many to list them all, but is instead intended as only a selection of the many problems Appellants have with the SEC's case, recitation of "facts", and argument.

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1. **There are no Securities Here**

Importantly, the SEC doesn't even try to refute the mathematical impossibility of any net profit for any EB-5 participant.[1] And that's really the

[1] Save one, as noted in the Opening Brief. Moreover, in EB-5 program investment documents, there is a standard clause that gives the immigrant clients the right to demand refund of their investment of $500,000 plus any administrative fees from the regional centers if their immigration application were not approved. See, e.g., SER078 (second sentence of last full paragraph). If the immigrant clients are truly attracted by "profit", why wouldn't they stay in the program for a profit even if the immigration application were denied?

Of note, on February 6, 2018, the Hon Darrin P. Gates of the United States District Court for the Southern District of Florida issued an order in *S.E.C. v. Quiros, et.al,* Case. No. 16-vc-21301 (S.D. Fla.) (the "Jay Peak" EB-5 case) authorizing Michael I. Goldberg, the Court-appointed Receiver in that matter, to "redeploy" immigrant clients' funds into the One Wall Street Project. Dkt.448 (Order), in *S.E.C. v. Quiros, et.al,* Case. No. 16-vc-21301 (S.D. Fla.).This was based on a motion wherein the Receiver states "the Receiver believes [the One Wall Street EB-5 project] has already created sufficient jobs for the CPR (conditional permanent resident) investors who elect to redeploy their funds and will continue to create jobs pursuant to the guidelines of the EB-5 program…". See Dkt. 445 (Motion, p.3), in *S.E.C. v. Quiros, et.al,* Case. No. 16-vc-21301 (S.D. Fla.). Tellingly, the point of the motion is about getting client immigration applications approved, and there is no mention that the CPR investors are investing in the One Wall Street Project for profit.

Only five days ago, on July 25, 2018, a group of Chinese immigrant investors filed class action law suit against the State Department and the United States for their interpretation and administration of EB-5 program quota. *Wang, et al. v. Pompeo, et al.*, Case No. 18-cv-1732 (D.D.C. 2018). The Chinese plaintiffs accuse the defendants of harming their interest in obtaining American green cards – not their desire for "profit". In fact, if you consider that the Chinese people are traditionally oppressed and persecuted by their own government in China, the importance of obtaining green card for their family members would have to be so great so that they are willing to risk immediate or future retribution by the government for joining in such a law suit.

point. The SEC wants everyone to put on blinders, to exclude all other mandatory fees necessary to participate in the EB-5 program, and to focus *only* on the $500,000 that might generate a return. When they do that, they have now created a mythical situation where, by excluding the other required fees and costs, the SEC constructs a straw man to argue against so they can be sure to win an argument Appellants didn't make.

"The Supreme Court has long instructed that securities law places emphasis on economic reality and disregards form for substance." *SEC v. M&A West, Inc.*, 538 F.3d 1043, 1053 (9th Cir. 2008), citing *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-300 (1946); *Danner v. Himmelfarb*, 858 F.2d 515, 518 (9th Cir. 1988); *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 481-82 (9th Cir. 1973); accord *S.E.C. v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1086 (9th Cir. 2010); *SEC v. Luna*, 2014 U.S.Dist.LEXIS 24263, at *25 (D.Nev. 2014). The SEC seems intent to ignore the economic reality of the EB-5 program – especially as it pertains to the facts in this case.

To shed light on the logical inconsistency of the SEC's position, a comparison with a typical "use of funds" disclosure in a PPM might be helpful. In a typical investment through a PPM, the PPM discloses how much of the investment will go toward, among other things, marketing fees and/or

administrative costs. The only difference here is that instead of these costs being identified as a portion of the total "at risk" investment, they are separately listed.

There is no practical difference, and the SEC is effectively engaging in a "form over substance" argument. For example, in the CMB PPM:

> The Partnership hereby offers for sale (hereinafter, the "Offering") … limited partnership interests (hereinafter, individually, a "Unit" and collectively, the "Units") at a Subscription Price of $1,045,000 per Unit (hereinafter, the Subscription Price"), with a minimum subscription for all Investors of one (1) Unit ($1,045,000). The Subscription Price is the sum of (a) the price per Unit of $1,000,000 (the "Unit Price"'), which amount shall constitute a Capital Contribution to the Partnership, and (b) a "Syndication Fee" of $45.000 per Unit (the "Syndication Fee").

SER099; See, also CMB PPM at SER088 (table at bottom of page showing the total Subscription Price inclusive of fees); PPM for SLS Lender (SER077) showing required fees of $545,000 ("In addition to the Capital Contribution, each investor will be required to pay the Administrative Fee"); PPM for EB5 Capital (SER170) showing total required to invest is $545,000.

In reality, the total required investment, together with the total possible return should be used to evaluate whether there is an expectation of a profit. And when you do that analysis on our facts, there can be no expectation of profit. And the SEC knows it. But if the total investment is considered, there is no expectation of profit and therefore no security, and that is why the SEC is so desperately trying to exclude those administrative fees from the discussion.

The fact that the USCIS has a separate rule to measure "return" differently in the unique context of the EB-5 program is of no importance – it is a separate statutory scheme with its own peculiar requirements and purpose. Those separate statutes shouldn't be artificially conflated with the securities laws in a way that rewards clever wording in a PPM to somehow exempt a portion of a required investment.

2. **"Over the Counter Markets"**

In its brief, the SEC argues that transactions that take place directly between a subscriber and an offer or (through a PPM for a particular EB-5 project) are somehow part of the secondary "over the counter market". But where is the market here? This is a private transaction not offered pursuant to any kind of organized or even informal marketplace. Indeed, over the counter (or "OTC") markets typically involve market makers, which are third parties (usually brokers) who sell securities under their control.[2] OTC markets are *always* secondary markets, meaning that the transactions are between holder of securities (not the issuers) and downstream purchasers. Here, there are no secondary market trading transactions. The SEC is accusing Appellants of facilitating primary (not secondary market) EB-5 offerings

[2] For example, 17 CFR § 240.15c2-11 (issued pursuant to the Securities Exchange Act of 1934) sets forth procedures for the submission and publication of quotations by broker-dealers for OTC securities. This relates solely to secondary market transactions.

by regional centers. As argued in Appellants' Opening Brief, that is not the type of activity that requires registration under Section 15(a) of the Exchange Act.

3. **Scienter**

In Part III, Section D of the SEC's Brief, the SEC over-simplifies the application of "scienter". Just because Appellants knowingly did not disclose the contingent fees they would receive on immigration application approval does not mean they did so with scienter.

> "Scienter . . . is a subjective inquiry. It turns on the defendant's actual state of mind." [*Gebhart v. SEC*, 595 F.3d 1034 (9th Cir. 2010)] at 1042. Thus, "although we may consider the objective unreasonableness of the defendant's conduct to raise an inference of scienter, the ultimate question is whether the defendant knew his or her statements were false, or was consciously reckless as to their truth or falsity." *Id*.

SEC v. Platforms Wireless Int'l Corp., 617 F.3d 1072, 1093 (9th Cir. 2010).

Appellants explained, and the SEC did not refute, that the reason for Appellants' nondisclosure was to avoid having to negotiate with clients about voluntarily rebating portions of the contingent fees. In a portion of his testimony not highlighted by the SEC, Mr. Feng stated:

> In my point of view, my clients come to me to get a green card. As long as I serve that interest well, then the fee is a small portion, which I feel like I -- I'm not jeopardizing the client's interest just by not disclosing that small portion of the fee.

SER325 (lines 10-14). As such, there is no real conflict of interest from Appellants' point of view (despite the out-of-context quote a page earlier in the

testimony the SEC cites to). Keep it in mind, such fees are only payable to Appellants if a client's immigration application is successful. Appellants are therefore incentivized to use their best judgment in guiding their clients to an EB-5 program that will actually succeed in the client's goal: obtaining approval of the client's immigration application. The regional center executives have stated that this is an industry standard fee payable to all immigration agencies, consultants or attorneys, including Appellants.[3] Why such an arrangement creates any actual conflict of interest is never explained by the SEC.

Moreover, since the provision of a rebate to a client was voluntary on Appellants' part, why would such a solely discretionary act be a required disclosure? As we have questioned in our opening brief, if a store owner decides to discount an item for one patron, is he forced to tell every other patron that someone else received a discount? The SEC clearly avoided addressing this question in its responding brief.

4. **ABCL**

The SEC incorrectly argues "Feng also created ABCL, a foreign entity with no purpose other than to act as a depository for commission payments." Appellants

[3] For example, Kraig A. Schwigen, Senior Vice President, World Wide Operations, CMB Regional Centers stated "Virtually everybody in this industry knows that all Regional Centers pay referral fees." SER064. He went on to say "the referral fee is a cost of business for us. Nearly every client has a referral fee cost attached to them." SER062.

have repeatedly explained (and the SEC has not challenged) that Appellants set up three offices and hired up to five employees in China since March 2013 (before the SEC started its investigation against Appellants in October 2014) in order to compete with Chinese immigration agencies in China which overwhelmingly dominate the EB-5 advisory business to Chinese clients. See, e.g., SER363 (lines 4-24), ER000459-462 (paragraphs 25, 27, and 34), and ER000471-473 (paragraphs 26, 28, and 31). Appellants later set up ABCL in April 2014 to formalize the business structure. The SEC cites no legal authority and there is none that prohibits American citizens from using a foreign relative as a legal representative for overseas businesses. Further, Appellants have no legal obligation to inform the regional centers in an arms-length business cooperation that a representative of ABCL is related to Appellants and the regional centers rightly did not make any inquiry about that fact either – likely because they knew it doesn't matter. And – importantly – aside from a loan, Appellants have not received any of the money paid to ABCL. See ER000460 (paragraph 28), and ER000473 (paragraph 32).

5. ***Hansen***

The SEC's reliance on the analysis of *Hansen* factors[4] is also misleading from two perspectives. First, Appellants are helping clients with immigration

[4] These are taken from *S.E.C. v. Hansen*, U.S. Dist. LEXIS 17835, 1984 WL 2413 (S.D.N.Y. 1984).

transactions, not securities transactions. Everything Appellants have done in the EB-5 context that appears to be covered by the *Hansen* factors is actually incidental to Appellants providing EB-5 immigration services to their clients. Appellants' clients often cannot write or speak English, so Appellants use their bilingual skills to act as a translator between the regional centers and clients so that they can communicate each other's request and concerns. Are interpretation services the hallmark of a broker? Second, if only stock brokers can do anything mentioned in the *Hansen* factors, then what is left to do by immigration attorneys in the EB-5 program? What about other corporate attorneys who routinely advise their clients in all kinds of transactions including securities transactions? This precise point was raised in the Northern District by Judge Vaughn Walker in *SEC v. M&A West, Inc.*, 2005 U.S.Dist.LEXIS 22452 (N.D.Cal. 2005), where Judge Walker recognized that lawyers, who commonly "draft documents and orchestrate transactions" are not commonly regarded as brokers. *Id.*,*26-27.

If the SEC gets its way in this case, virtually all corporate attorneys advising securities transactions could be required by the *Hansen* factors to register as stock brokers. This sort of extreme departure from the realities of the legal and business world was rejected by Judge Walker over 10 years ago, and should be rejected again now.

6. The SEC Misrepresents That Appellants Failed to Raise An Argument with The Appellate Court

For some reason, in Section IV of its brief, the SEC claims that Appellants argue "that he should not have been required to disgorge amounts paid to overseas entities […]. Feng never raised this point to the district court." SEC Br. 53. This is patently false. This precise issue was briefed and raised before the district court. *See* Dkt. 81 at 12:17-13:24. Moreover, as previously stated, aside from a loan, Appellants have not received any money paid to ABCL. See ER000460 (paragraph 28), and ER000473 (paragraph 32).

III. CONCLUSION

If an offering with no reasonable expectation of any actual profit can be a security, then the reach of the SEC has just grown by immense and unprecedented proportions. The SEC would be free to parse transactions and re-interpret them in order to show that some portion of them (when isolated from the rest of the transaction) could possibly show a "profit."

Moreover, if immigration attorneys advising EB-5 clients need to register as brokers because EB-5 program investments are securities offerings, what about other corporate attorneys advising securities transactions? By reasonable extension of the SEC's allegations, all corporate attorneys may need to register as brokers if they want to advise securities transactions and be paid for their services.

Cases against immigration attorneys and the EB-5 program are a relatively new venture by the SEC, who apparently announced a series of cases in 2015 in order to put the world on notice that the SEC was occupying the EB-5 space. Importantly, it had not done so previously. Indeed, while the SEC has announced a number of settled actions (available through the SEC's website), the SEC chose the central district of California to test their arguments by filing the only truly contested unregistered broker case against an immigration attorney Appellant is aware of.[5] It is highly unreasonable to believe that suddenly hundreds of immigration attorneys all over the country either purposefully or negligently want to violate the broker registration requirement in their normal professional practice. Attorneys are conservative people by their professional training. They would not take the unnecessary risk if the law is clear.

The law is unclear, or we wouldn't be here. This Court now has the opportunity to clarify under what circumstances EB-5 offerings are securities, and if they are securities, what actions are allowed for immigration attorneys without

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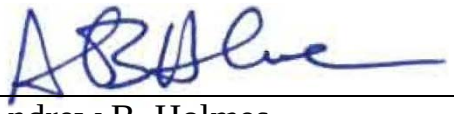
[5] Another case, *S.E.C. v Steve Qi, et al.*, 17-cv-08856, was filed in the Central District on December 8, 2017, and counsel for Appellants is handling a case for an accountant accused of violating § 15(a) under similar circumstances, *S.E.C. v. Luca International Group, LLC, et al.*, 15-cv-03101 (N.D. Cal.), filed July 6, 2015.

triggering a broker registration requirement. This may clarify the rules for the entire EB-5 industry to follow going forward.

Dated: July 30, 2018

HOLMES, TAYLOR, SCOTT & JONES LLP

By: 

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CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(A)(7)

I hereby certify that this brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because it contains proportionately spaced typeface of 14-point Times New Roman prepared using Microsoft Word and contains 3902 words.

Dated: July 30, 2018

HOLMES, TAYLOR, SCOTT & JONES LLP

By: 

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CERTIFICATE OF SERVICE

I hereby certify that on this 30th day of July, 2018, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

To the best of my knowledge, all participants in this case are registered CM/ECF users who are being automatically served through the Appellate ECF system.

I declare under penalty of perjury that the foregoing is true and correct. Dated this 30th day of July 2018, at Los Angeles, California.

Andrew B. Holmes