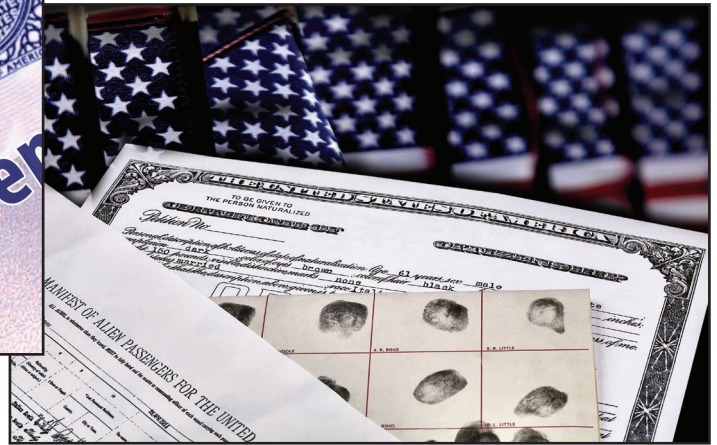


# The Bitter Side of *Ius Pecuniae* in the United States: Risks Facing EB-5 Investors

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Enacted by Congress in 1990,<sup>1</sup> the United States Citizenship and Immigration Services' EB-5 Immigrant Investor Program marks the United States' participation in a popular trend for countries seeking economic stimulus: open arms toward foreigners with deep pockets. Dubbed *ius pecuniae* by international academics,<sup>2</sup> some countries offer an independent and usually more effective residency process for foreigners willing to risk a substantial investment in the host country. The country's goal is economic progress; the foreign investor's goal is legal residency in the host country and, to varying degrees, a return on investment. The United Kingdom, for example, has a tiered system where the amount of money invested in the country dictates the number of years the investor must wait before requesting permanent residency.<sup>3</sup>

The United States' iteration of *ius pecuniae*, the EB-5 program—which, in turn, is named after the employment-based fifth preference visa received by its participants—can be described and understood in simple terms. Under the EB-5 program, hopeful immigrant investors, along with their spouses and unmarried children, can obtain permanent residency in the United States if they invest the requisite amount of funds in a commercial enterprise in the United States and, through that enterprise, create or maintain at least ten full-time jobs in the United States for a minimum of two years.<sup>4</sup> With the immigration nuances handled by immigration

attorneys and others advertised as EB-5 specialists, management of the commercial aspects of the process is often left to domestic businesses charged with ensuring the investor's funds are used in accordance with the program requirements (i.e., to create sustained full-time jobs). Unfortunately, this system sometimes creates the perfect recipe for imperfect information and barriers to intervention by investors. And with large sums of money at stake, the possibility of falling into a mire of misuse or fraud stalks the foreign investors seeking a new home.

## Nature and Structure of EB-5 Investments

To qualify for permanent residency under the EB-5 program, hopeful participants must usually invest at least \$1 million in capital in such a way that creates at least ten full-time jobs for United States workers. If, however, the investment is for principal use in a qualified "targeted employment area" (i.e., a rural area with a high unemployment rate), an investor need only invest \$500,000. There is no rigid rule dictating how EB-5 participants must structure their investments or how the investor businesses must operate. The United States Citizenship and Immigration Services (the U.S. CIS) simply requires that the investment be in a "commercial enterprise," with the bulk of the business-related rules focusing on the program's job creation

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goals.<sup>5</sup> A commercial enterprise can take the form of a corporation, business trust, sole proprietorship, partnership, or other business entity (which may be privately or publicly owned). The commercial enterprise must be formed to generate profit, and must set forth a business plan and provide evidence concerning the required job creation.

For investors less inclined to take an active role in the planning and management of the enterprise—which is often most attractive for foreign investors—the U.S. CIS and related regulations allow for pooled investments. That is, one commercial enterprise can be used by various program participants, along with nonimmigrant investors, provided that each program participant invests the required funds and such funds create the required jobs. While the U.S. CIS indeed requires that a program participant actually engages in the management of the commercial enterprise, this requirement appears more relaxed in practice. Under applicable regulations,<sup>6</sup> the program participant can either be involved in day-to-day direct management or general policy-making activities. The latter leaves great ambiguity and effectively takes the teeth out of the provision. This same regulation also provides that if the enterprise is structured as a limited partnership, all that is necessary is for the investor to have the same rights, powers, and duties provided by the Uniform Limited Partnership Act; whether the investor exercises or even knows about these rights is a separate issue. Accordingly, foreign investors seeking the residency benefits of the EB-5 program, but not the time commitment and stress associated with running a business, often opt for participation in a pooled investment that is managed by a domestic business partner. In theory, such a structure is a “win-win” for all parties: the United States realizes job creation; the foreign investor receives permanent residency and benefits from his or her investment with minimal effort; and the domestic business manager shares in the fruits of a valuable enterprise. Yet, practical barriers inherent in this system leave foreign investors vulnerable to inept business partners and outright scammers.

### Practical Limitations Plaguing Foreign Investors

The pooled, hands-off commercial enterprise is most

attractive for foreign investors and has gained popularity in the United States. Unfortunately, this structure brings with it the potential for misuse, misappropriation, and waste of investor funds. Most EB-5 plan participants do not have the social or professional network enjoyed by domestic investors. Foreign investors likely have few contacts in the United States and do not feel confident questioning or analyzing the domestic business partner managing the enterprise. Rarely will foreign investors be on a level playing field with enterprise managers when it comes to legal and financial know-how in the United States. Nor will most foreign investors have the unbridled ability to oversee or, more importantly, fully understand the intricacies of the operations of the enterprise in which they have invested. While foreign investors usually engage professionals in the EB-5 arena, these professionals often have working relationships with domestic business managers or work for finder’s fees, resulting in different motivations with respect to the projects.

In addition, an investor’s limited understanding of the business structure in which he or she has invested and misconceptions as to the legal, economic, or immigration consequences of asserting investor rights may stall or deter an investor from taking an active role in managing or protecting his or her investment. When faced with red flags, a foreign investor may sit idle for fear of destabilizing the project or jeopardizing chances at permanent residency. Other investors, having heard about the litigious nature of the United States, may fear being sued in the United States for intervening or speaking out against the business manager. Others may fear general retribution—legal or otherwise—from the business manager. Some foreign investors are plainly naïve, thinking that their investment is safe simply because it is in the United States and is related to what they perceive to be official government business (i.e., immigration). Lastly, language and cultural barriers create an implicit obstacle to a full understanding of the nature of the business by foreign investors.

Understanding the foreign investors’ practical shortcomings from the outset, or having learned it after some experience, domestic business partners can exploit the disconnect in a number of ways. They can engage in self-serving transactions with related entities, use funds

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for personal items or services, overcharge management fees, or simply siphon off funds. The lingual, professional, and geographical divides allow domestic managers to hide or disguise troubling aspects of the commercial enterprise. Thus, whether a domestic manager intended to defraud or misuse investor assets from the outset, such a scheme becomes a tempting option once the manager realizes the amount of money being handled and the ease with which it could be mishandled.

### Job Creation, Compliance, and Fiscal Responsibility Can Prove Difficult to Reconcile

At the same time, EB-5 projects present incompatible goals and incentives. The U.S. CIS's job creation requirement compels the hiring of U.S. workers to work for the enterprise, whether or not the labor is actually needed. The business manager must keep the foreign investors content by focusing on job creation for the few years required by the U.S. CIS for permanent residency, but does not focus on long-term sustainability for the enterprise. As a consequence, business managers can deploy funds for goods, services, or even projects that do not make economic sense but create the requisite number of jobs. As an example, a business manager may use investor funds to build facilities that will never yield a return great enough to justify the expenditure. Similarly, compliance with applicable tax and securities regulations may be of lesser priority to the business managers, who must trace direct job creation to specific investor funds while managing the pooled funds. The business manager might value generating evidence of job creation over generating clean accounting entries or a business model that seeks profits over mere job creation.

### When the Chickens Come Home to Roost: The EB-5 Imbroglio

The foregoing is not a theory. These elements have indeed combined to create some nightmares for foreign investors. And when the music stops playing, the EB-5 participants are faced with legal, regulatory, financial, and emotional difficulties of the type not previously experienced by the foreign investors. Sometimes the projects simply run out of money; other times regulators intervene and seize control of the enterprise. In either

instance, the foreign investors must deal with issues on all fronts. They must attempt to recoup what they can of their investment; salvage their hopes of permanent residency; and address the legal and regulatory liabilities of the enterprises of which they are legally a "business partner." Meanwhile, the government intervenes with civil enforcement actions and, sometimes, criminal proceedings against the domestic business managers. The result is a complicated legal and regulatory melee that could include court-appointed fiduciaries, investor class actions, angry trade creditors, suits against third parties, and perhaps most troublingly, uncertainty regarding residency. Examples of this unfortunate result can be found throughout the country: the Jay Peak proceedings (Florida/Vermont);<sup>7</sup> the San Francisco Regional Center proceedings (California);<sup>8</sup> the Chicago Convention Center proceedings (Illinois);<sup>9</sup> and the Aero Space Port International Group proceedings (Washington).<sup>10</sup>

With each case presenting different facts and problems facing the aggrieved investors, there is no guidebook for courts to determine proper relief. Even where a responsible party, such as a receiver or a regulatory agency, steps in to unscramble the mess left behind, the aforementioned competing interests (e.g., job creation versus preservation of the estate) further complicate matters relating to disposition of remaining property and settlement with other parties. The result is a series of legal proceedings that could take years to resolve.

### Advice for Prospective EB-5 Participants

There is no known deterrent for fraudulent or inept business partners. The best advice for an investor is to treat an EB-5 investment like any other business venture. Due diligence is key, and ongoing, active management and oversight by the investor can go a long way in identifying and acting upon red flags and even deterring impropriety. In this regard, investors should seek trusted, independent professionals to help evaluate a potential EB-5 investment and maintain review of the enterprise's operations. EB-5 "specialists" and project managers comprise a relatively small community, with loyalties, possible commissions, and self-interest potentially affecting the partiality of opinions given to foreign investors.

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Second, if something appears wrong, the investor should not hesitate to consult an attorney and exercise appropriate investor rights. The United States legal system provides useful protections, and fear of interference with the enterprise or retribution from others should not discourage action when important questions remain unanswered by those managing the enterprise.

Finally, to the extent possible, investors should seek added investor protections baked into the enterprise structure. This may take the form of ongoing and liberal financial disclosure obligations on the part of the business manager, an executive or a managerial position elected by the investors to represent their interests, or even ongoing oversight by a neutral third party, such as a law firm or an accounting firm.

### Conclusion

Ius pecuniae is a useful and direct immigration policy for countries and investors that know what they want. Nonetheless, countries, including the United States, must ensure that their immigration program does not facilitate failed or fraudulent business endeavors. United States lawmakers are taking aim at the EB-5 program as it currently exists. Some seek to eliminate the program in its entirety<sup>11</sup> while others seek to increase the investment requirement while adding fraud prevention and recovery mechanisms.<sup>12</sup> Given the current political climate and the acknowledged need to curb the opportunity for misuse and fraud, hopeful immigrants can expect changes to the EB-5 program. Whatever those changes may ultimately be, however, should not affect foreign investors' resolve to stay informed and involved in their business endeavor and to take action when necessary to protect their interests.



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### Endnotes

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- 2 Jelena Dzankic, *Citizenship with a Price Tag: The Law and Ethics of Investor Citizenship Programmes*, 64(4) N. IR. LEGAL Q. 387, 388 (2014).
- 3 UK VISAS & IMMIGRATION, TIER 1 (INVESTOR) OF THE POINTS BASED SYSTEM – POLICY GUIDANCE 38 (12/2016 ed.), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/577675/T1\\_I\\_Guidance\\_12\\_2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/577675/T1_I_Guidance_12_2016.pdf).
- 4 8 C.F.R. § 204.6(j)(4) (2017).
- 5 See generally 6 U.S. CITIZENSHIP & IMMIGRATION SERVICES, POLICY MANUAL, pt. 6, Ch. 2 (2017) available at <https://www.uscis.gov/policymanual/HTML/PolicyManual-Volume6-PartG-Chapter2.html#S-A>.
- 6 8 C.F.R. § 204.6(j)(5).
- 7 *SEC v. Quiros et al.*, Case No. 1:16-cv-21301 (S.D. Fla.) and related cases.
- 8 *SEC v. San Francisco Regional Center LLC et al.*, Case No. 3:17-cv-00223 (N.D. Cal.).
- 9 *U.S. v. Sethi*, Case No. 1:14-cr-00485 (N.D. Ill.) and related cases.
- 10 *SEC v. Chen et al.*, Case No. 2:17-cv-00405 (W.D. Wash.).
- 11 Press Release, Senator Chuck Grassley, Feinstein, Grassley Introduce Legislation to Eliminate Troubled EB-5 Investor Visa Program (3 Feb. 2017), available at <https://www.grassley.senate.gov/news/news-releases/feinstein-grassley-introduce-legislation-eliminate-troubled-eb-5-investor-visa>.
- 12 See e.g., Kevin Penton, *House Judiciary Committee Calls for EB-5 Reforms*, LAW360 (8 Mar. 2017), <https://www.law360.com/immigration/articles/899203>; Allissa Wickham, *Examining Goodlatte's EB-5 Bill, As Deadline Looms*, LAW360 (16 Sept. 2016), <https://www.law360.com/articles/840663/examining-goodlatte-s-eb-5-bill-as-deadline-looms>; Kelly Knaub, *GOP Rep. Goodlatte Pushes for EB-5 Reform Bill*, LAW360 (12 Sept. 2016), <https://www.law360.com/articles/838754/gop-rep-goodlatte-pushes-for-eb-5-reform-bill>.