

EB-5 Capital Markets

Legal perspectives on EB-5 project finance

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SEC to Return Escrowed EB-5 Investment Funds to Immigrant Investors of Intercontinental Regional Center Trust of Chicago

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Posted in EB-5 Law & Policy, Regional Center, Securities Law

On April 9, 2013, U.S. District Court Judge Amy St. Eve directed the return of more than \$147 million funds held in escrow to investors in the Intercontinental Regional Center Trust of Chicago (Intercontinental). As reported in our previous Alert, the Securities and Exchange Commission (SEC) initiated a civil action against Intercontinental and its principal on February 8, 2013, alleging that Intercontinental fraudulently sold more than \$145 million in securities to over 250 investors. Intercontinental is accused of, among other things, lying to investors regarding the approval of permits and zoning (the proposed project was a hotel near Chicago's O'Hare airport) and submitting fraudulent documents to U.S. Citizenship and Immigration Services (USCIS) in an attempt to secure preliminary approval of the project.

In a press release, the SEC announced that all investors' principal investment in the fraudulent securities offering will be returned. According to press reports, lawyers for the defendants did not attempt to argue against the return of escrowed funds.

The escrow feature of the Intercontinental offering proved particularly important in this case. Because the deal terms required an escrow, the escrow agent, rather than Intercontinental, had control over these funds. The SEC alleged in its complaint that the defendants misappropriated portions of the \$41,500 each investor had paid in administrative fees that were not placed in escrow, including diversion of such funds into foreign accounts controlled by Intercontinental's principal. Such administrative fees generally cover professional services, marketing and other operational fees paid by the project and/or regional center. But for the escrow arrangement, the \$500,000 job-creating investment funds might have suffered the same fate as the administrative fees.

While the immigration regulations are silent on the use of escrows in the EB-5 program, market standards have often required that principal investment funds be held in an escrow account until the satisfaction of release conditions related to conditional I-526 petitions for the investors. We have seen a recent trend for less stringent release conditions and in some cases, elimination of the escrow entirely. We will be discussing this trend in an upcoming blog article.

Potential EB-5 investors should consider this case as a reminder of the importance of adequate due diligence

before investing money in an EB-5 project. The USCIS consistently reminds investors that regional center designation does not mean that the regional center's capital investment projects are backed or guaranteed by the government in any way. It is up to each individual investor to carefully review the investment, in part by relying on experienced and properly incentivized professionals. Marketing consultants and agents who present projects to individuals are usually paid a commission out of one or both of the administrative fee or the project sponsor's payments on the invested capital. Some law firms representing individual investors also participate in these commissions. Neither the recipients of these commissions nor the amounts of these commissions are typically disclosed in offering materials. The amounts are often much larger than investors think. Investors should consider the conflicts of interest these commissions create before relying on marketing consultants or agents to perform due diligence or advise on the attractiveness of a project.

While the U.S. securities laws may create a remedy to investors who are defrauded in a project, investors cannot always count on the ability of regulators to protect their interests. In many projects, both the administrative fees and the job creating funds will have been spent before disclosure problems are discovered. In such cases, there may be no funds available to redress investor losses.