

REDEPLOYMENT LESSONS LEARNED: HOW TO PROTECT EB-5 INVESTORS AND REDUCE LITIGATION RISKS TO EB-5 SPONSORS

By Catherine DeBono Holmes, Esq. and Ronald Fieldstone, Esq.

Almost two years after USCIS adopted Policy Manual changes on June 14, 2017 requiring redeployment of capital contributions of EB-5 investors until the end of their two year period of conditional permanent residency, a number of EB-5 investment funds have redeployed investment capital into new investments, and many more will do so in the future as the original job creating projects are sold or refinanced. USCIS has offered no further clarification of the ambiguous statements made in the Policy Manual 2017 regarding redeployment, and there are still unanswered questions from an immigration perspective regarding the standards that will be applied by USCIS in determining whether a reinvestment is “within the scope of the business” of the EB-5 investment fund. But experience gained over the last two years of redeployments by some EB-5 funds offers insights into the issues most important to EB-5 investors and the ways in which all EB-5 fund sponsors can mitigate the risks of litigation by disgruntled investors arising from redeployment of capital into new investments. This article addresses the concerns expressed by EB-5 investors in connection with redeployment, which in some cases has resulted in litigation or threats of litigation against EB-5 fund sponsors, and the means by which sponsors should seek to address these concerns and thereby reduce their risks of litigation.

EB-5 Investors Are Concerned Because They Do Not Have the Right to Select Their Own Reinvestment. EB-5 investors made their original decision to invest in a specific EB-5 project based upon their own review of detailed offering documents describing the project, the developer, and other relevant facts. When their capital is redeployed, however, EB-5 investors have little, if any, choice in how their funds will be invested in one or more new investments. Even if an EB-5 sponsor offers more than one option for reinvestment and allows each EB-5 investor to select among those options, the EB-5 investor does not have the ability to select a reinvestment outside of those pre-selected options. EB-5 investors are understandably concerned that the reinvestment being made or recommended has been selected for the benefit of the EB-5 fund sponsor, or the original project developer, and not with the best interests of the EB-5 investors in mind. In some cases, EB-5 investors have filed or threatened legal actions against the sponsors of their EB-5 funds, claiming that the sponsors have selected reinvestments that have a higher level of risk than the original investment, and that the sponsors have made the selection for their own economic benefit

EB-5 Investors Are Concerned Because of the Unexpectedly Long Waiting Time for a Visa and the Newly Imposed Requirement that Their Capital Remain “At Risk.” The U.S. Visa Control Office first imposed the “retrogression” policy on EB-5 investors from mainland China in 2015, but it was not until 2018 that it was estimated the delay caused by this policy could be as long as 10 to 15 years for these investors. As a result of these extremely long potential delays, the children of some EB-5 investors will “age out” (meaning they will no longer be eligible for a visa based on their parents’ EB-5 application) before these EB-5 investors obtain their visas. Some EB-5 investors have filed or threatened litigation against EB-5 fund sponsors, seeking a return of their capital, on the grounds that they were never informed that they would have to wait so long to obtain an EB-5 visa. The difficulty is that while some EB-5 investors

have decide that they wish to abandon their visa petitions and receive a return of their capital, other EB-5 investors in the same EB-5 fund may wish to proceed with their visa petitions, and their capital must remain “at risk” according to USCIS policy, until they have completed their two year sustainment period.

EB-5 Investors Are Concerned That They Have to Wait for Return of Their Capital Until the Last Investor in Their EB-5 Fund is Eligible for Repayment. It is possible, and even likely, that some investors in an EB-5 fund will be eligible to receive a return of their capital in 5 years, and others over a time period stretching out over 10 or more years. Most EB-5 funds were originally designed to have the ability to make distributions of capital to all EB-5 investors at once, when the original investment was repaid, but those EB-5 investors who are eligible to receive a return of their capital do not want to wait to be repaid until the last EB-5 investor in their fund is eligible for repayment. If an EB-5 fund does not provide for staggered distributions to EB-5 investors as they become eligible for repayment, the EB-5 sponsor is not authorized to make distributions in that manner, and could be subject to litigation if some EB-5 investors suffer losses while other EB-5 investors in the same fund do not because they were repaid earlier.

How to Address EB-5 Investor Concerns and Thereby Reduce EB-5 Fund Sponsor Risks of Litigation. The concerns of EB-5 investors regarding reinvestment are reasonable, and EB-5 fund sponsors must address these concerns if they wish to avoid litigation and all of its attendant expense and reputational harm. We believe that EB-5 fund sponsors should adopt the redeployment practices described below for the benefit of their EB-5 investors.

A. **Use an Independent Review Process and an Independent Investment Adviser to Select the Reinvestment.** An independent review of the proposed reinvestment is an essential element to establish the fairness of the selection process. This is most important in cases where there is any affiliation between the EB-5 fund manager and the parties with economic interests in the project being funded with the reinvestment. If the party making the selection of the reinvestment will receive an economic benefit from the reinvestment in the project chosen, the EB-5 investors would have ample reason to question whether the choice of that project is fair to the investors. For this reason, the EB-5 sponsor should engage an independent third party to re review the proposed reinvestment. The independent review should include due diligence on the project, the track record of the owner or developer of the project, the terms of the reinvestment and any other financing used for the project. We recommend that the EB-5 fund manager use an independent registered investment adviser as part of this process, because it establishes not only the independence of the process but the qualifications of the reviewer to act as an independent party in the reinvestment process.

B. **If a Project by the Same Developer as the Original Project is Available, Consider the Benefits of that Investment to the EB-5 Investors.** Many EB-5 investors selected their EB-5 investment on the basis of their confidence in the developer of the project in which their capital was originally invested. These EB-5 investors may therefore prefer that their capital be reinvested in a project with the same developer, because of their familiarity with the developer, the fact that their original investment was successfully repaid, and the ease of transition from the original investment to a new investment, perhaps with the same forms of investment documents as the original investment. In addition, the fact that the reinvestment is with the same developer

may provide some immigration benefits by demonstrating that the reinvestment is “within the scope” of the EB-5 fund’s business.

C. **Consider and Compare Other Reinvestment Opportunities.** EB-5 fund managers should consider whether there are other reinvestment opportunities that are reasonably available that would better protect the interests of the EB-5 investors. There are several redeployment programs and funds that have been created by experienced third parties, that offer multiple reinvestment options and are open to any EB-5 fund seeking to reinvest capital. Some of these programs offer independent review, ongoing due diligence and administration as part of their program, as well as a selection of potential reinvestment options. There are also experienced regional center operators who have established their own redeployment funds in which EB-5 proceeds from multiple EB-5 funds are pooled and reinvested into multiple projects, which offers the benefit of diversification of investments and some cases more liquidity than investing in a single loan or equity investment.

D. **Review the EB-5 Fund’s Governing Documents and Follow the Procedures Required by those Documents for Reinvestment.** If the partnership or operating agreement of the EB-5 fund does not authorize the general partner or manager to select a reinvestment at all, or only allows reinvestment with the consent of the EB-5 investors, then the consent of the EB-5 investors must be obtained. Rather than asking for approval of a specific reinvestment option, it may be preferable to request approval of an amendment to the partnership or operating agreement to allow the general partner or manager to select all reinvestments for the EB-5 fund, subject to defined standards that apply to selection of the reinvestment. These standards should include the independent review process described in this article. The benefit of this approach is that it covers not only the first reinvestment, but all future reinvestments that may be necessary for as long as the EB-5 fund has EB-5 investors who are not eligible for repayment.

E. **Provide Written Disclosure to EB-5 Investors Prior to Reinvestment of the Material Terms of the Reinvestment.** Whether or not an amendment is required to approve reinvestment, an EB-5 fund manager should provide written notice to EB-5 investors prior to every reinvestment, informing them of the repayment of the original investment and the details of the proposed reinvestment. The notice should include a disclosure of the project in which the reinvestment will be made, the experience of the owner or developer of the project, the terms of the reinvestment, process used by the EB-5 fund manager to select the reinvestment, including any independent advice and reports obtained as part of the process, and the reasons why the EB-5 fund manager selected or recommends the particular reinvestment chosen for the fund.

F. **Offer EB-5 Investors an Opportunity to Withdraw Prior to Redeployment.** As previously described, some EB-5 investors, particularly those from mainland China who are now subject to substantial delays in obtaining their visas under the EB-5 program, would choose to abandon their visa petitions and receive a return of their investment. EB-5 fund sponsors should offer those EB-5 investors an opportunity to be repaid from their share of the repayment proceeds at such time as they are received by the EB-5 fund, rather than having their capital reinvested. It is important to note that this is not a guaranty of repayment, because repayment would only be made to EB-5 investors if and when the EB-5 fund receives repayment of its investment, and only to the extent of each EB-5 investors’ pro rata share of the repayment. Therefore, allowing EB-5 investors to elect to receive repayment rather than reinvesting

proceeds should not be considered an impermissible guaranty of repayment by USCIS. In addition, it is prudent to require that each EB-5 investor requesting repayment provide proof that they have withdrawn their visa petition. Providing EB-5 investors an opportunity to withdraw and receive repayment prior to reinvestment is one of the most important ways for EB-5 sponsors to avoid potential litigation with EB-5 investors.

G. **Review the EB-5 Fund Distribution Provisions and Modify if Necessary to Allow for Staggered Payments to EB-5 Investors.** Because of the long waiting periods that may be experienced by some EB-5 investors, it has become necessary to restructure EB-5 funds to allow for distributions of capital to be made to individual EB-5 investors at different times, rather than to all EB-5 investors at once. However, if the EB-5 fund partnership or operating agreement does not allow for that method of distributions, the EB-5 fund manager could be subject to litigation for making distributions that are not in accordance with the fund's governing agreement. Therefore, as part of the reinvestment process, the EB-5 fund manager should consider whether an amendment should be made in the fund's governing agreement to allow for repayment of capital to each EB-5 investor who is eligible for repayment from the proceeds of repayment of each investment and reinvestment.

Following Best Practices for Redeployment Should Protect EB-5 Investors and Reduce Litigation Risks for EB-5 Sponsors. The EB-5 reinvestment requirement imposed by USCIS has resulted in EB-5 investors having reasonable concerns about the manner in which their capital is being reinvested. EB-5 fund sponsors must appropriately address these concerns to fulfill their duties to the EB-5 investors, and thereby mitigate the potential risks of litigation. We believe the redeployment practices recommended in this article will protect the interests of EB-5 investors and help EB-5 fund sponsors to avoid potential litigation risks associated with reinvestment.

Catherine D. Holmes is a partner in the Los Angeles office of Jeffer Mangels Butler & Mitchell LLP, Chair of JMBM's Investment Capital Law Group, and the author of the Investment Law Blog. She has practiced law at JMBM for over 35 years, focusing on investment capital and business transactions, particularly with respect to hotels, mixed use and other real estate developments. For over 10 years, she has represented both real estate developers who have received EB-5 investments and EB-5 regional centers who have raised EB-5 capital and made investments in hotels, multifamily residential, mixed use and assisted living facilities. She also represents securities broker-dealers and investment advisers in registration and compliance, as well as transactional matters.

Ronald Fieldstone is a partner in the Miami office of Saul Ewing Arnstein & Lehr LLP and has over 40 years of experience in corporate/securities, real estate and taxation law. Since 2009, he has served as corporate/securities counsel for participants in the EB-5 immigrant visa program. He has represented developers, regional centers and marketing agents in more than 300 projects with a combined capital raise of in excess of \$8 billion. Mr. Fieldstone lectures and publishes in this industry for government-sponsored organizations, industry groups and professional associations.