



# *The Triple Trustee Transfer:* A Potential Solution to Prevent the Illegal Diversion of EB-5 Investments

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In traditional private corporate securities offerings, investors typically drive many of the demands that are placed on issuers in return for the ability of the issuers to access the investors' capital for a presumed financial rate of return. As such, third-party trustees acting on behalf of investors are entirely commonplace in, for example, a corporate or municipal debt offering under a debt indenture structure. However, in the evolving EB-5 transactional market, the use of independent third-party trustees has not yet been implemented wholesale, and instead, the potential for fraud and illegal diversion of EB-5 investments threatens the industry in the wake of a few instances of such allegations.

Although some EB-5 market participants have voluntarily adopted certain best practices along these lines, the impetus has most recently been on lawmakers to determine, on behalf of potential EB-5 investors, the level and mechanisms of security that investors may otherwise demand in a more traditional securities offering when they are focused more squarely on financial incentives. Indeed, recent legislative proposals seem to echo the notion that a third party should be involved in EB-5 fund flows in order to help prevent fraud with account transparency and independent authorized signatories. For example, Section (P) of H.R. 5992, a bill introduced in early October 2016 in the House of Representatives, proposes that each new commercial enterprise (NCE) create a separate account to hold EB-5 investments at third-party banks or other financial institutions; independent authorized signatories located at such banks or other financial institutions would then be asked to provide written consent prior to the transfer of EB-5 investments to an EB-5 investor to another separate account (presumably the NCE's operating account) or to a job creating entity (JCE) prior to otherwise using the EB-5 investment for the job-creating project associated with the EB-5 investment opportunity (see Section 203(b)(5) of H.R. 5992).

Upon evaluation of the current legislative proposal contained in H.R. 5992 and market realities, a "triple trustee transfer" mechanism embedded within the typical EB-5 deal fund flow for an EB-5 project relying upon indirect job creation may be worth considering as a best practice solution to provide investors with comfort in light of the recent concerns in the EB-5 market. Assuming the typical flow of an EB-5 investor's investment to an EB-5 project utilizing a regional center is: (1) from EB-5 investor to an escrow account, (2) from the escrow account to the NCE, and (3) finally, from the NCE to the JCE in order to fund the job-creating EB-5 project, then there are at least three levels at which use of independent banks or financial institutions would be prudent. The following paragraphs set forth a brief

description of the proposed new and evolved roles for independent third-party trustees.

Independent third-party trustees could be used as follows to help mitigate investor risk at each level of EB-5 funding flow described in the preceding paragraph:

At the first level described above, a third-party trustee, acting as an escrow agent (for purposes of this article, the "Escrow Trustee"), could continue to be used to hold EB-5 investments on behalf of EB-5 investors in an escrow account after an EB-5 investor subscribes to an EB-5 offering.

Although the Escrow Trustee would take direction from the NCE as to the timing and amount of money to be released to the NCE Trustee (as defined and described below), the understanding would be that the Escrow Trustee would act from the standpoint of what is expected by the EB-5 investors and not allow, for example, any EB-5 investments to be sent directly to the NCE. The EB-5 industry already typically uses such escrow agents to hold EB-5 investments, which is a positive first step to ensuring the security of EB-5 investments.

At the second level described above, a new and different third-party trustee (for purposes of this article, the "NCE Trustee") could be engaged to act on behalf of the NCE to direct the flow of EB-5 investment from escrow to the NCE Trustee upon the escrow release triggers set forth in the escrow agreement. The NCE would send a written direction to the Escrow Trustee with a carbon-copy to the NCE Trustee, directing the Escrow Trustee to release the eligible EB-5 investments to the NCE Trustee in accordance with the procedure agreed upon among the parties. The idea is for the NCE Trustee to hold EB-5 investments released from escrow by the Escrow Trustee to comfort investors that the NCE could not then misdirect or divert funds to a use other than the job-creating activity described in the offering documents. The NCE Trustee could perform the function of what is commonly known as a subscriber representative in many escrowed EB-5 transactions, but the NCE Trustee would be an independent third party.

At the third level described above, an entirely different and, based on current practice, relatively new third-party trustee (for purposes of this article, the "Deployment Trustee") could be used to transfer EB-5 investments released by the NCE Trustee at the direction of the NCE to the Deployment Trustee. Prior to a potential draw date or investment date, as agreed upon under deployment documentation (loan agreement or investment documentation) entered into by the NCE, the JCE, and the Deployment Trustee, the NCE would send a notice to the JCE and the Deployment Trustee as to the amount of EB-5 investments held by the NCE Trustee and available to be applied to the EB-5 project on a potential deployment date. The JCE would then, subject to certain other requirements set forth in the deployment documentation, submit a request for the available amount of EB-5 investments and attach the details to the request as to the various invoices or sources of bridge financing with respect to the EB-5 project that need to be repaid from the EB-5 investments. Assuming satisfaction of conditions set forth in the deployment documentation, the NCE would approve the draw request and direct the NCE Trustee to transfer

the EB-5 investments to the Deployment Trustee. The Deployment Trustee could then pay parties owed by the JCE directly for any such amounts owed in connection with the EB-5 project or otherwise direct the application of funds in accordance with the approved use.

At each level of the EB-5 fund flow described above, there is the potential for a different independent bank or financial institution to act as a trustee (whether Escrow Trustee, NCE Trustee, or Deployment Trustee) as the EB-5 investments are shepherded through the various phases of the EB-5 deal to the ultimate application for the EB-5 project. If such a model were used, all transfers of EB-5 investments within an EB-5 transaction would be from one independent trustee to another independent trustee, and investments for different EB-5 projects controlled by the same principals could not easily be commingled.

Furthermore, the use of such third-party trustees could also potentially be a boon to those NCEs who do not have or who do not wish to invest in and build out in-house staff necessary to accomplish these ends who, regardless, may not pass muster with regard to independence. NCEs who engage third-party trustees could typically be expected to pay an upfront fee plus an annual fee for so long as the EB-5 investments are deployed; usually, the annual ongoing fee is based on the amount of the funds under management by the trustee.

The “triple trustee transfer” mechanism described in this article provides a potential starting point for analysis of one of the mechanisms that could help keep EB-5 investments from being diverted for illegal purposes. It is our hope that this simple description of how the proposal set forth in Section (P) of H.R. 5992 could be brought to life will further the discussion among industry participants to help ensure a long and rich history of successful EB-5 transactions.

## About the Authors

Mariza McKee is a trusted counselor to regional centers, new commercial enterprises, job creating entities, and other stakeholders that raise and deploy EB-5 capital. A securities and transactional partner in Kutak Rock LLP’s Chicago office, Mariza leads the firm’s national EB-5 finance practice – an interdisciplinary team of securities, tax, corporate, debt, and real estate lawyers. Mariza also represents clients in a variety of other securities, commercial, and merger and acquisition matters. She approaches EB-5 transactions from a risk manager’s vantage point and constructs legal strategy to help clients achieve business objectives while navigating securities laws and evolving EB-5 program requirements. A frequent speaker and writer on EB-5 and securities law considerations, Mariza is an active member of the EB-5 community dedicated to elevating EB-5 industry practices and standards.

Kamille Curylo, a partner in Kutak Rock LLP’s Chicago office, has represented clients nationally in over \$20 billion in aggregate principal amount of various bond and structured debt financings. With a background in economics, past experience working as a debt trader for a prominent international bank, and nearly a decade of experience counseling clients through billions of dollars of complicated debt transactions, Kamille brings a versatile skill set to the negotiation table. She focuses her practice on student loan securitization transactions throughout the country, EB-5 loan financings, health care and senior living transactions in Illinois and Colorado, and renewable energy transactions throughout the country.

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