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**“EB-5 SECURITIES: NEW DEVELOPMENTS  
AND UPDATED NYU STERN DATABASE –  
2018 EDITION”**

**By Scholar-in-Residence Gary Friedland and  
Professor Jeanne Calderon  
NYU Stern School of Business**

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# “EB-5 Securities - New Developments and Updated NYU Stern Database – 2018 Edition”<sup>1</sup>

## I Introduction

In December 2017, we released the first edition of the NYU Stern EB-5 Securities Database providing annual updates on SEC enforcement actions and other important securities law developments in the EB-5 space.<sup>2</sup> In this edition, we update that SEC enforcement action database and discuss other major developments in EB-5 securities.<sup>3</sup>

Below are some of the major developments discussed in this paper, many of which involve the country’s largest and most successful regional centers.

Private actions initiated by EB-5 immigrant investors: For several years, a virtually endless stream of capital supplied by Chinese immigrants seeking a visa fueled the explosive growth of EB-5 capital. This provided an expansive source of funding for U.S. businesses, particularly for large real estate projects in the U.S. However, as retrogression and per-country limits on the EB-5 quota is creating excessively long visa waiting lines (particularly for new EB-5 investors from mainland China),<sup>4</sup> the number of Chinese immigrants who opt to rely on EB-5 as their path to lawful residency has steadily declined.<sup>5</sup>

Consequently, regional centers and developers are now seeking to find EB-5 investors from other countries to fill the void left by the Chinese market. In contrast, a flurry of recent cases demonstrates that there is no shortage of existing EB-5 investors from China prepared to commence lawsuits against regional centers, New Commercial Enterprises (“NCE”), and other bad actors who have allegedly

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<sup>1</sup> Scholar-in-Residence Gary Friedland, Esq. ([gfriedla@stern.nyu.edu](mailto:gfriedla@stern.nyu.edu)) and Professor Jeanne Calderon, Esq. ([jcaldero@stern.nyu.edu](mailto:jcaldero@stern.nyu.edu)) of NYU Stern School of Business. The authors acknowledge the valuable assistance of Stephen Zheng, an undergraduate student at the NYU Stern School of Business, in helping to compile the data in the Database.

<sup>2</sup> [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#)

<sup>3</sup> For a basic discussion of EB-5 securities, see pages 9-12 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#)

<sup>4</sup> The EB-5 visa petitioner’s “country of origin” or “country of chargeability” is generally determined by reference to where the petitioner was born, rather than where he or she is currently a citizen or resident.

<sup>5</sup> <https://iiusa.org/blog/analyzing-form-i-526-statistics-by-investors-country-of-chargeability-for-fiscal-year-2017-what-is-new-and-what-it-tells-us/>

perpetrated fraud (including securities fraud) and subsequent misappropriation of the investors' funds.

Nevertheless, our discussion of private EB-5 lawsuits brought against the CMB Regional Center<sup>6</sup> (one of the largest and most successful regional centers) focuses on a case commenced in 2018 by Chinese investors frustrated with the long visa waiting lines, not premised on the misappropriation of funds by the sponsor. With \$450 Million raised from 900 investors to fund the construction of the Century Plaza Hotel megaproject in Los Angeles, this case involves one of the largest EB-5 capital raises in the Program's history.<sup>7</sup>

Unlike investors who have brought other EB-5 lawsuits, they seek to rescind their investment and exit the EB-5 immigration process abandoning a visa. To support their rescission claim, the investors advance legal theories not pursued in previous EB-5 cases. As we will discuss, if they prevail, this might lead to a surge of Chinese investors who opt to exit the Program by rescission of their investment, rather than by completing the visa process. We highly recommend that all EB-5 stakeholders read the complaint, as much for its entertaining writing style as the novel legal arguments raised. Ultimately, however, we question whether the court will find the legal arguments to be persuasive.

CMB-SEC settlement agreement: Unrelated and subsequent to the investors' filing of the complaint in the Century Plaza Hotel case, the SEC issued a significant Order that reflects a major settlement with CMB and its affiliates relating to alleged violations of the federal securities laws.<sup>8</sup> This represents the first major SEC action to cite violations relating to the offering of EB-5 securities without registering with the Commission or having a valid exemption from registration.<sup>9</sup> It also represents only the second time that the SEC has assessed a penalty against a regional center or NCE for paying transaction-based fees to unregistered broker-dealers. Incidentally, this case might have a bearing on the outcome of the CMB Century Plaza Hotel litigation.

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<sup>6</sup> The lawsuit was filed against CMB Export LLC, the CMB Regional Center and related parties. For simplicity sake, we refer to these entities as the CMB Regional Center. *Zhan v. Hogan*, Case No. 4:18-CV-04126 (C.D. Ill., filed 7/11/2018);

<https://eb5projects.com/system/uploads/document/file/591/CMBcomplaint.pdf>

<sup>7</sup> See page DS-3 of [EB-5 Capital Project Database – Revisited and Expanded \(March 29, 2016\)](#)

<sup>8</sup> [SEC Release - CMB](#); [SEC Order - CMB](#)

<sup>9</sup> A similar issue was previously raised by the SEC in its enforcement action in Luca. See footnote 27 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#)

SEC civil enforcement actions: Although the number of private lawsuits by EB-5 investors alleging fraud continues to increase, the SEC has commenced only one civil enforcement action in 2018<sup>10</sup> alleging securities fraud arising out of an EB-5 offering. That case relates to the Palm House Hotel project in Palm Beach, Florida.

When we featured this case in 2017, it was then an example of a private action brought by the EB-5 investors, distinct from an SEC enforcement action. Since our last publication, the SEC has filed its own action against the key defendants named in the private lawsuit.<sup>11</sup>

The Palm House Hotel SEC enforcement action and the related private litigation are noteworthy for several reasons. Perhaps, most importantly, the case demonstrates that investors in third-party regional center projects could be just as vulnerable to fraud as those in which the regional center, the NCE, and Job Creating Entity (JCE) are under common control. Investors, therefore, should not assume they are insulated from fraud, simply because the JCE developer is not related to, or under common control with, the regional center or NCE.<sup>12</sup> This case ranks among the most egregious securities law violations of any of the SEC enforcement actions to date in the EB-5 space. The fraud - as described by the SEC, Department of Justice (“DOJ”) and the private lawsuit - reflects new acts of greed and self-dealing not present in previous EB-5 enforcement actions.

However, one should not infer that the number of bad actors in the EB-5 space has declined because only one enforcement action has been filed to date this year. We believe the lack of new enforcement actions can be attributed to several factors, including substantial reductions in the SEC budget and its staff; the time consuming, detailed, and confidential nature of the investigation performed by the SEC and the interplay with other agencies before the SEC commences an action (for example, USCIS, FBI, DOJ, IRS and state law enforcement agencies);

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<sup>10</sup> Only one enforcement action had been filed through October 15, 2018. On October 18, 2018 the SEC filed another civil enforcement action - against an immigration attorney, Jean Chen, that is discussed in Section VIII B of this paper, “Unregistered broker-dealer wearing many hats.” [SEC v. Chen](#); [SEC Release – Chen](#).

<sup>11</sup> [SEC Release – PHH](#); [SEC complaint – PHH](#)

<sup>12</sup> Entities owned or controlled by a “lone wolf” or a small group of related persons - as opposed to a major developer – are more likely to expose the immigrant to risk than a major developer with a track record of successful projects and that utilizes independent fund administration. See [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

and the lack of scrutiny of the actual flow of EB-5 funds until the review by USCIS of the I-829 petitions at a very late stage in this multi-year immigration process.

Related Companies as purchaser of Palm House Hotel project: The Related Companies (“Related”), the company that has utilized the greatest amount of EB-5 capital,<sup>13</sup> takes on a different role in the Palm House Hotel project. An affiliate of Related has emerged as the “stalking horse bidder” to purchase the Hotel at auction in connection with the Hotel entity’s recent bankruptcy filing.<sup>14</sup> The auction of the Hotel further complicates and jeopardizes the investors’ potential recovery.<sup>15</sup> We will explain how the EB-5 investors’ ability to recover any of their investment is at risk.

SEC acknowledges impact of Kokesh decision: Our previous paper discussed the 2017 US Supreme Court decision in *Kokesh v. SEC*.<sup>16</sup> We will explain the significance of recent Congressional testimony by the SEC Chairman and one of the SEC Commissioners in which they acknowledge that the decision is already adversely affecting the SEC’s enforcement actions. The Kokesh decision might have the most serious impact on EB-5 securities fraud enforcement actions, due to the vulnerability of EB-5 investors and the failure by Congress to enact EB-5 integrity reform measures to provide the needed protection.

Quiros settlement: In February 2018, the SEC and Ariel Quiros, the alleged mastermind behind the massive EB-5 fraud in Jay Peak, finally reached a settlement wherein he agreed to pay more than \$80 Million. We will discuss how these funds will be collected and distributed by the Jay Peak receiver. Then we will compare this with the method of distribution of the \$150 Million settlement collected in 2017 by the receiver from Raymond James Financial.<sup>17</sup>

USIF sued by investors who have obtained EB-5 visas: USIF, one of the largest regional centers in the country, is defending at least two

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<sup>13</sup> See page 9 of 2017 EB-5 Project Database: [2017 EB-5 Project Database 2017 Supplement with Trends \(August 16, 2017\)](#).

<sup>14</sup> See <https://www.palmbeachdailynews.com/news/20181012/related-cos-enters-minimum-bid-for-auction-of-palm-beach-hotel-property>

<sup>15</sup> Obstacles to the investors’ recovery exist in any event and would occur irrespective of whom ultimately purchases the Hotel.

<sup>16</sup> See page 27 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#)

<sup>17</sup> See the discussion of the Raymond James settlement at page 31 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#)

major lawsuits filed in 2018. The first suit was brought against USIF in its usual capacity - as a third-party regional center, the arrangement by which it typically sponsors EB-5 projects of an unrelated developer. Numerous Chinese investors petitioned the court for breach of fiduciary duty and breach of contract for alleged improper redeployment of the investors' funds.<sup>18</sup> We focus on the more recent lawsuit against USIF where it acted as an in-house regional center, under common control with a USIF affiliate as the NCE and developer.<sup>19</sup> There the investors, all of whom have obtained their visas, sued for fraud based on the alleged acts perpetrated by USIF that were facilitated by its multiple roles and divided loyalties.<sup>20</sup>

Criminal actions: We briefly discuss some of the criminal prosecutions commenced by DOJ in 2018.<sup>21</sup> We also discuss the likelihood of future criminal prosecutions being brought against the bad actors involved with the Jay Peak fraud, especially Ariel Quiros. We assume that even though Joseph Walsh, Sr., the regional center owner-operator in the Palm House Hotel project was not named in the criminal prosecution brought in Connecticut against Robert Matthews, the hotel operator, it is likely that DOJ will initiate a criminal prosecution against Walsh in Florida.

Bank escrows: Few banks are willing to allow escrow accounts to be established to hold EB-5 investors' subscription funds.<sup>22</sup> Their reluctance has been attributed to concerns about potential liability, reputational risk, national security matters, and other factors. The lawsuit recently filed by the EB-5 investors in the Jay Peak projects against People's United Bank might cause those few banks to become less inclined to establish EB-5 escrow accounts.<sup>23</sup>

Updated Database: Exhibit A updates our 2017 database of SEC civil enforcement actions in the EB-5 arena to reflect new developments

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<sup>18</sup> Ang v. USIF, Sup Ct, NY County, filed 7/9/2018); [Ang v. U.S. Immigration Fund](#)

<sup>19</sup> For a discussion of the differences between a third-party regional center and an in-house regional center, see pages 22-23 of [A Roadmap to the Use of EB-5 Capital: An Alternative Financing Tool for Commercial Real Estate Projects](#)

<sup>20</sup> *Fu v. Mastroianni* (Palm Beach County 15<sup>th</sup> Judicial Circuit, filed 10/11/2018); <https://drive.google.com/file/d/1So-cjrmm-3yY3YczPVu4aYxi2rOIZp-J/view?usp=sharing>

<sup>21</sup> It is noted that the prosecution of federal criminal cases in each of the U.S. District Courts is the responsibility of the U.S. Attorney for that District. <https://www.justice.gov/usao/mission>

<sup>22</sup> <https://iiusa.org/blog/eb5-retrospective-approached-successful-eb5-banking/>

<sup>23</sup> *Sutton et al. v. People's United Financial Inc.*, case number 2:18-cv-00146 (D. Vt., September 7, 2018).

in those actions, as well as to provide current information about new enforcement actions.

**Integrity reforms:** Despite the increasing number of cases alleging EB-5 securities fraud and the misappropriation of investors' funds, neither Congress nor USCIS has adopted sorely needed integrity reforms. As discussed, we expect that reform will continue to be a low priority for Congress. However, OMB's publication of its Fall 2018 agenda in October 2018 provides a glimmer of hope for meaningful reform by USCIS.

## II Private Lawsuits by EB-5 Investors

### A. Zhan v. Hogan – CMB and the 1940 Act

In 2018, EB-5 investors continued to file lawsuits similar in type to lawsuits filed by investors in 2017 against regional centers, NCEs and other bad actors who allegedly defrauded them.<sup>24</sup> The investors typically seek to have the misappropriated funds recovered to enable the project to be completed. The recovered misappropriated funds provide the capital to create the required jobs to enable the investors to complete the visa process and ultimately be repaid their capital investment. The increase in private lawsuits might be attributable in part to investor frustration with the slow pace with which the SEC initiates civil enforcement actions against fraudsters.<sup>25</sup>

However, the EB-5 investors who have sued the CMB Regional Center (sometimes "CMB") in the Century Plaza Hotel project case had a different motivation for initiating litigation, thus adopting a different legal approach.<sup>26</sup> They are among those EB-5 investors from China who

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<sup>24</sup> The typical claims in these cases include: investor funds were prematurely released to the NCE; the funds were misappropriated; the loan administration terms were violated; an inadequate amount of capital was obtained from other sources; the funds never reached the property, and/or the project was not completed and thus, the necessary jobs were not created to support approval of the investors' I-829 visa petitions.

<sup>25</sup> See a discussion of the reasons that EB-5 investors typically prefer that the SEC file an enforcement action, rather than the investors bring a private lawsuit, against the regional center and other bad actors at page 40 to 42 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

<sup>26</sup> The defendants named in the lawsuit include CMB Export LLC and the CMB Illinois Regional Center LLC, and Patrick Hogan, the CEO of CMB. The [SEC Order - CMB](#) issued in August 2018 is discussed in Section IIC of this paper; it refers to CMB Export LLC as a regional center. For simplicity sake, we sometimes refer to "CMB" or to the "CMB Regional Center" to include these two entities and other related parties named as defendants. The CMB EB-5 website indicates that CMB Export LLC was CMB's first approved regional center, and that CMB now operates 15 regional centers. <https://www.cmb5visa.com/>

are frustrated by the long visa waiting line delaying the realization of their immigration dream. They do not allege their invested funds have been misappropriated, the project will not be completed, or any of the other abuses cited in many of the investor-initiated lawsuits have occurred. Instead, they are prepared to terminate their EB-5 visa petitions in an effort to rescind and recover their EB-5 investment. This reflects the diametric opposite approach to the one pursued by an investor whose main goal is to obtain the visa, with the subsequent recovery of his or her capital investment as a distant second priority.

The CMB investors rely upon legal theories not previously advanced in the EB-5 context. Their rescission claims are based on several causes of action, including alleged violations of the federal securities laws, which apply equally to EB-5 securities as well as to other securities.<sup>27</sup> The complaint alleges the failure of the issuer (sometimes the “Century Plaza NCE”) to register under the Investment Company Act of 1940 (the “1940 Act”) and the violation of the broker-dealer requirements of the 1934 Securities Exchange Act (the “1934 Act”)<sup>28</sup>.

It is important to note that CMB recently filed a motion to dismiss the investors’ complaint based on the claim that the federal securities laws do not provide the investors with a private cause of action for violations of either of these provisions.<sup>29</sup> Although we believe that CMB might prevail in its motion to dismiss, this case merits discussion because of its obvious significance to the 900 investors in that project as well as to many other EB-5 investors, especially those Chinese investors in large EB-5 projects who are still waiting for the approval of their I-526 petitions or issuance of their temporary green card.

Of these two securities law theories presented by the investors, we believe the court is more likely to allow the case to proceed to trial, and the investors to seek rescission, based on the failure of the NCE to register as an investment company under the 1940 Act. CMB’s motion to dismiss relies on cases decided by federal district courts in the Second

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<sup>27</sup> The complaint also contains a separate count for rescission based on the alleged misrepresentations made by the defendants as to the estimated timeframe for obtaining a visa. We do not discuss this claim because non-securities law issues are generally beyond the scope of this paper.

<sup>28</sup> See a discussion of the broker-dealer provisions set forth in Section 15(a) of the 1934 Act as applied to EB-5 securities at pages 60 to 64 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

<sup>29</sup> Defendants’ Motion to Dismiss and Memorandum of Law, *Zhan v. Hogan*, Case No. 4:18-CV-04126 (C.D. Ill., filed 8/27/2018).

and Ninth Circuit Court of Appeals.<sup>30</sup> The Seventh Circuit, the federal circuit within which the federal trial court is located in this case, has apparently not yet been presented with this issue. Thus, the court might rule that a private right of action does exist. The court might rely upon Section 47 of the 1940 Act which could be interpreted to support a private right of action seeking rescission based on a failure of the issuer-NCE to register.<sup>31</sup> This would be consistent with the views suggested by several leading EB-5 securities lawyers who have previously written on the general subject of the applicability of the 1940 Act to EB-5 projects and the risks of rescission for failure to register.<sup>32</sup> However, any further discussion of the private right of action under the 1940 Act is an extremely technical issue, and beyond the scope of this paper.<sup>33</sup>

Thus, given the importance of this case, the balance of this discussion assumes that the investors have the right to bring the action. However, as explained below, we believe that even if the court allows the case to proceed on the merits, it is likely that the court will rule in CMB's favor that the Century Plaza NCE is excluded from the provisions of the 1940 Act, including its registration requirements.

#### **B. 1940 Act – Background**

Accordingly, we focus on the complaint's reliance upon the 1940 Act, one of the federal securities laws that have not served as the basis for liability in the EB-5 context. The first count in the investors' complaint seeks rescission of their investments based on the failure of the NCE to register as an "investment company" under the 1940 Act. Before we examine the 1940 Act in the context of the CMB case, we provide an overly simplified review of the portions of the Act that are most relevant to the investment of EB-5 capital.

The 1940 Act is the primary source of federal securities regulation for mutual funds. However, its application extends beyond mutual funds.

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<sup>30</sup> See page 9 of Defendants' Motion to Dismiss and Memorandum of Law, *Zhan v. Hogan* Case, No. 4:18-CV-04126 (C.D. Ill., filed 8/27/2018).

<sup>31</sup> See <http://legcounsel.house.gov/Comps/Investment%20Company%20Act%20Of%201940.pdf>

<sup>32</sup> In fact, the investors' response to the defendants' motion to dismiss cites these articles in the response to the motion to dismiss. See pages 7 and 8 of Plaintiff's Response to Motion to Dismiss, *Zhan v. Hogan*, Case No. 4:18-CV-04126 (C.D. Ill., filed 9/9/2018).

<sup>33</sup> Investors are permitted to bring a lawsuit under the federal securities laws only in the specified circumstances in which the law expressly provides for a private cause of action. See, for example, Section 12(a) of the 1933 Act. The courts do not imply that a violation of the federal securities laws provides a private right of action.

It regulates certain issuers of securities that meet the definition of an "investment company."<sup>34</sup>

In addition to any obligation to comply with the registration requirements of the 1933 Act, an issuer that meets the definition of an investment company is subject to registration under the 1940 Act<sup>35</sup> unless the issuer meets an exclusion from such Act.<sup>36</sup> Registration under the 1940 Act is significantly more burdensome and expensive than compliance with an exemption from registration under the 1933 Act.

Although the 1940 Act does not specifically refer to EB-5 securities, technically all NCEs which serve as an intermediary between the EB-5 investors and the project entity meet the investment company definition. The NCE issues equity interests in the entity (i.e., the NCE) to the investors who contribute their EB-5 capital which is then pooled together for deployment by the NCE to the JCE project entity.<sup>37</sup> Thus, the definition would apply to an NCE which makes a loan to the project entity or which makes an equity investment in the project entity.<sup>38</sup> As such, the NCE would be subject to registration as an investment company, unless it qualifies for an exclusion from the definition.

The 1940 Act provides exclusions for certain issuers from the investment company definition.<sup>39</sup> Unlike the exemptions from registration under the 1933 Act, if an investment company fits within an exclusion it is excepted from all the provisions of the 1940 Act.

The two most common exclusions are provided by Section 3(c)(1) and Section 3(c)(5) of the statute, sometimes referred to as the "C1" exclusion" and "C5" exclusion, respectively.

Most NCEs are excluded from the investment company definition and thus, not subject to the 1940 Act provisions, based on the C1 exclusion. That exclusion applies to any issuer whose securities are

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<sup>34</sup> Section 3 of the 1940 Act. The Act should not be confused with the Investment Advisors Act of 1940.

<sup>35</sup> Section 6 of the 1940 Act.

<sup>36</sup> Section 3 of the 1940 Act.

<http://legcounsel.house.gov/Comps/Investment%20Company%20Act%20of%201940.pdf>

<sup>37</sup> See Section 3 of the 1940 Act.

<sup>38</sup> Technically, according to the statute, the Section 305(c)(1) exclusion applies to an issuer "whose outstanding securities...are beneficially owned by not more than one hundred persons." Also note that if the investors invest equity directly in the project entity, in which case the NCE and JCE are the same entity rather than a two-tier structure, the NCE does not meet the definition of an investment company.

<sup>39</sup> These exclusions are sometimes referred to by commentators and practitioners as exemptions.

owned by not more than 100 persons.<sup>40</sup> As a practical matter, virtually all NCEs that in fact raise \$50 Million or less for an EB-5 project are excluded from the 1940 Act requirements.<sup>41</sup> Most EB-5 projects raise less than \$50 Million; hence, 100 or fewer immigrants invest in the NCE.

Even if more than 100 immigrants invest in an NCE, the NCE would not be subject to the provisions of the 1940 Act based on the C5 exclusion. That exclusion excepts an issuer that is “primarily engaged in . . . purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.”<sup>42</sup>

The statutory language does not resolve the issue of whether an NCE that deploys the EB-5 capital as a mezzanine loan to the project would qualify under the C5 exclusion since the loan is not directly secured by a “lien or other “interest in real estate.” The resolution of this issue is significant because the mezzanine loan structure is the most common way for an NCE to deploy EB-5 capital to a project.<sup>43</sup> Pursuant to this structure, a senior lender makes a loan to the JCE project entity secured by a mortgage against property owned by the JCE. The NCE makes a loan to the company that owns 100% of the equity interests in the JCE project entity.<sup>44</sup> The mezzanine loan is secured by a pledge of the borrower’s equity interest in the JCE, rather than secured by a mortgage against the property. The NCE typically has the right to foreclose on the pledged equity interest in the borrower and, through its ownership of the JCE property-owning entity, becomes the owner of the underlying real estate. Nevertheless, the mezzanine loan is not “directly” secured by a “lien or interest in the real estate.”

Although the SEC has not taken a position on this issue in the EB-5 context, guidance can be gleaned from the SEC’s response to a no-action

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<sup>40</sup> Even though certain family members count toward the calculation of the annual EB-5 visa quota, they are excluded from the calculation of the number of investors. Furthermore, the number of investors is based on actual investors, not based on the number of investors who would have invested if the project actually raised the maximum amount of EB-5 capital sought to be raised. Thus, if the maximum capital sought to be raised is \$100 Million, but the amount of capital actually raised is \$49 Million, the NCE would not be subject to the 1940 Act.

<sup>41</sup> Almost all EB-5 project locations qualify as a Targeted Employment Area (“TEA”) with a minimum investment level of \$500,000.  $\$500,000 \times 100 = \$50 \text{ Million}$ .

<sup>42</sup> Section 305(c)(5)(C) of the 1940 Act

<sup>43</sup> If the EB-5 capital is deployed by the NCE to the JCE property-owning entity as a construction loan secured by a mortgage against the property, then the NCE may qualify for the C5 exclusion because the mortgage would constitute a “lien” in real estate.

<sup>44</sup> See Exhibit A of [A Roadmap to the Use of EB-5 Capital: An Alternative Financing Tool for Commercial Real Estate Projects](#).

letter request filed by Capital Trust Inc., a real estate investment trust (a REIT), in 2007. In the Capital Trust No-Action Letter, SEC staff concurred with the applicant's position that even though a mezzanine loan is not directly secured by real estate, the described mezzanine loan was the "functional equivalent of a second mortgage."<sup>45</sup> Thus, the SEC staff determined that an issuer that holds a mezzanine loan can qualify for the C5 exclusion if the loan is the functional equivalent of a second mortgage. The SEC based its conclusion on the existence of 6 conditions that were met in the Capital Trust situation.<sup>46</sup> The letter contains the standard no-action letter caveat: its conclusion was based on the facts and representations contained in the letter and any different facts or representations may require a different conclusion.<sup>47</sup> Thus, the letter does not serve as precedent and may not be binding on the SEC in the case of other similar requests.

In addition, the SEC has not made it a priority to examine the applicability of the 1940 Act to EB-5 capital issuers. The Commission has not announced that it has taken any enforcement action against an NCE that has failed to register as an investment company. Similarly, it has not announced a policy or position on the applicability of the 1940 Act provisions to an NCE that makes a mezzanine loan.

### **C. Application of 1940 Act to CMB's Century Plaza NCE**

*Investors' complaint:* The investors' complaint states that the investors' capital was deployed by the NCE as a mezzanine loan. The complaint also states that 900 immigrants invested EB-5 capital in the NCE. Thus, the NCE meets the definition of an investment company, and the C1 exclusion based on the number of investors is clearly not available.

The determination of whether the NCE is an investment company subject to the 1940 Act pivots on the application of the C5 exclusion.

The complaint claims that the C5 exclusion is not applicable to the Century Plaza NCE.<sup>48</sup> It argues that CMB's mezzanine loan creates a

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<sup>45</sup> <https://www.sec.gov/divisions/investment/noaction/2007/capitaltrust052407-3c5c.pdf> ("Capital Trust No-Action Letter")

<sup>46</sup> See the conditions set forth on page 5 of the Capital Trust No-Action Letter. *Id.*

<sup>47</sup> It is noted that this no-action letter was atypical. Typically, a no-action letter requests that the SEC not take enforcement action against the requester based on the facts and circumstance described in the request. This no-action letter was in the form of an interpretative letter to request clarification of a rule. See <https://www.sec.gov/fast-answers/answersnoactionhtm.html>.

<sup>48</sup> Paragraphs 42 to 44 of the Complaint, *Zhan v. Hogan*, Case No. 4:18-CV-04126 (C.D. Ill., filed 7/11/2018).

pledge (not a mortgage) of an interest in another company. Accordingly, it alleges this “pledge” does not meet the requirements of the C5 exclusion. To support its position, the investors’ complaint simply cites a paragraph from a 2018 no-action letter, Great Ajax LLC Funding (the “Great Ajax No-Action Letter”).<sup>49</sup> That No-Action Letter states, in essence, that the SEC generally has taken the position that an interest does not qualify for the C5 exclusion “if it is an interest in the nature of a security in another issuer engaged in the real estate business.”<sup>50</sup>

*Counter position to investors’ complaint:* It is noted that CMB’s motion to dismiss the complaint appropriately does not address the merits of this argument. The core of its argument is that even if the investors were correct, no private right of action is created by the 1940 Act for failure to register as an investment company.

We are not persuaded by the substantive position advanced in the investors’ complaint. First, the complaint fails to even mention the Capital Trust No-Action Letter that squarely addresses the mezzanine loan structure in the context of the C5 exclusion.

Moreover, the Complaint omits a critically relevant footnote in the Great Ajax No-Action Letter that serves as the basis for the investors’ position. That footnote - footnote 6 - specifically cites the Capital Trust No-Action Letter as an example of the SEC’s position that certain mezzanine loans may qualify as the functional equivalent of a second mortgage, and thus entitle the issuer to be excluded from the provisions of the 1940 Act.<sup>51</sup> Thus, the Great Ajax No-Action letter cited by the investors’ complaint, in fact, reaffirms the SEC position and thus, presumably strengthens CMB’s position.

We note that we have not had the opportunity to review the relevant documents in the CMB case, such as the mezzanine loan agreement and inter-creditor agreement, to determine whether the structure complies with the conditions set forth by the SEC in the Capital Trust No-Action Letter.

Additionally, as explained below, we believe it is likely that the SEC has already determined that the C5 exclusion applies to the Century

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<sup>49</sup> <https://www.sec.gov/divisions/investment/noaction/2018/great-ajax-funding-021218-3c5.htm> (“Great Ajax No-Action Letter”).

<sup>50</sup> See Paragraph 42 of Complaint, *Zhan v. Hogan*, Case No. 4:18-CV-04126 (C.D. Ill., filed 7/11/2018).

<sup>51</sup> See Footnote 6 of the Great Ajax No-Action Letter: <https://www.sec.gov/divisions/investment/noaction/2018/great-ajax-funding-021218-3c5.htm>

Plaza NCE. This would provide strong support for concluding that the NCE is excluded from the provisions of the 1940 Act, including registration. If the 1940 Act does not apply, then the investors' claim for rescission would be moot, without the need to consider whether a private right of action under the 1940 Act exists.

We reach this conclusion based on a recent SEC Order against CMB in an apparently unrelated matter. Coincidentally, the SEC issued the Order against CMB and 37 of its affiliated NCEs (the "CMB Order" or "SEC Order") after the complaint was filed in the Century Plaza case.<sup>52</sup> The Order relates to an SEC investigation alleging that the specified 37 EB-5 securities' offerings between 2011 and 2015 did not comply with the registration requirements of the 1933 Act.<sup>53</sup> Although the Order merely refers to the EB-5 projects by "group number" as assigned by CMB, and does not identify them by project name or project location, we have determined that the Century Plaza NCE was not one of the NCEs alleged by the SEC to have violated the registration requirements.<sup>54</sup>

Furthermore, the Order emphasizes that in agreeing to accept the settlement offers, the SEC took into consideration that "in 2015, [CMB] began an intensive process to develop and implement an effective securities compliance program. The changes were designed to ensure robust compliance with the federal securities laws, including the registration requirements and broker-dealer regulations."<sup>55</sup>

Even though the settlement related to the registration requirements of the 1933 Act and does not mention the 1940 Act, the discussion of the compliance program uses broader language – the "federal securities laws," which by its terms includes the 1940 Act.<sup>56</sup> Undoubtedly, the SEC examined the Century Plaza offering as part of its investigation of the CMB Regional Center that led to the SEC Order.

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<sup>52</sup> [SEC Release - CMB](#); [SEC Order - CMB](#)

<sup>53</sup> See paragraphs 46 and 47 of the [SEC Order - CMB](#) wherein the SEC alleged that the securities were offered without registration with the SEC and lacking a valid exemption from the registration requirements. *Id.* In addition, the Order imposed a penalty of \$515,000 against Patrick Hogan, CEO of CMB, for violation of the broker-dealer provisions of the 1934 Act, as further discussed below in the Broker-Dealer section of this paper.

<sup>54</sup> The NCE defendant named in the Century Plaza case includes the designation "Group 48". CMB assigns a "Group No." to each of its EB-5 projects, based on the chronological order in which a project is offered. According to the Century Plaza Hotel case complaint, CMB has assigned Group No. 48 to the Century Plaza project. Although the SEC Order includes projects 47 and 50, it does not include project 48. Also see CMB EB-5 website: <https://www.cmbeb5visa.com/>

<sup>55</sup> See Paragraph 48 of the [SEC Order - CMB](#).

<sup>56</sup> Compare Paragraph 48 with Paragraphs 46 and 47 of the [SEC Order - CMB](#).

The SEC had ample time to examine the offering, and the SEC Order emphasizes that CMB meaningfully cooperated with the SEC investigation.<sup>57</sup> Notably, the offering represents the largest EB-5 offering by CMB or any of its affiliates,<sup>58</sup> and one of the largest EB-5 capital raises in the history of the EB-5 Program.<sup>59</sup>

Accordingly, it is reasonable to assume that the SEC determined that the Century Plaza NCE met an exclusion from the investment company definition and thus, was not required to register as an investment company. If the SEC believed the largest EB-5 project in the CMB Regional Center's history did not comply with the 1940 Act registration requirements, then why would the SEC Order include a statement lauding the CMB federal securities laws compliance program?<sup>60</sup>

The foregoing analysis might be academic; the court might simply rule that CMB's failure to register as an investment company is not actionable because the 1940 Act does not provide a cause of action for this violation. In that case, the court would not reach the issue of whether the Century Plaza NCE is an investment company subject to registration under the 1940 Act.

#### D. Significance of Century Plaza Hotel case

The outcome of the Century Plaza Hotel case has potentially major consequences for other projects, especially those projects with Chinese investors who seek to recover their EB-5 investment without completing the visa process. If the court determines that the investors have a right of rescission under the 1940 Act (or by virtue of any of the other counts alleged by the investors), this decision might encourage other Chinese investors who are facing long visa waiting lines to consider suing their NCE for rescission based on the same theory. Obviously, we cannot predict with any accuracy, assuming they had a legal basis for rescission,

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<sup>57</sup> The offering commenced in 2015 or 2016 and the Order was not issued or finalized until 2018. See sheet DS3 of [EB-5 Capital Project Database – Revisited and Expanded \(March 29, 2016\)](#). Also see CMB EB-5 website: <https://www.cmbeb5visa.com/>

<sup>58</sup> CMB EB-5 website: <https://www.cmbeb5visa.com/>

<sup>59</sup> See Sheet DS-3 of [EB-5 Capital Project Database – Revisited and Expanded \(March 29, 2016\)](#).

<sup>60</sup> It is noted that while the court would not be bound by the SEC's determination, it is likely that it would defer to the SEC's determination on this technical issue. *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

how many existing investors might seek to terminate the immigration process and rescind their investment.<sup>61</sup>

Despite the issues raised by securities lawyers with an expertise in EB-5 investments, presumably few, if any, NCEs have registered as an investment company. However, only a very limited number of NCEs might realistically face a valid claim that they violated the registration requirements of the 1940 Act. Critically, most NCEs will qualify for the C1 exclusion from the 1940 Act based on the number of investors. Most EB-5 capital offerings have raised \$50 Million or less of EB-5 capital and thus, fall below the threshold number of investors.<sup>62</sup> Furthermore, due to the diminished interest in the EB-5 Program by new Chinese investors, it is anticipated that few new projects will seek to raise more than \$50 Million of EB-5 capital.

Nevertheless, many large-scale EB-5 project offerings in recent years have sought capital raises of more than \$50 Million, thus potentially subjecting themselves to a claim that they failed to register as an investment company. We have released three databases – in 2015, 2016 and 2017 – of 72 large-scale real estate projects that have utilized a substantial amount of EB-5 capital as part of their capital stack.<sup>63</sup> Most of these projects raised or sought to raise more than \$50 Million, and many raised \$100 Million or more.

However, not all of the offerings in our databases were successful at raising all the EB-5 capital sought, or even at raising more than \$50 Million.<sup>64</sup> Furthermore, we believe it is likely that Chinese investors comprise the bulk of the immigrants who have invested in these projects; but, we do not have specific data to support this. Also, we do not know

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<sup>61</sup> For example, even if an investor has the legal right of rescission, many will choose to continue with the immigration process. The length of the visa waiting line for an investor depends on several variables, including the investor's country of origin, and date that the investor filed the visa petition with USCIS (the "priority date").

<sup>62</sup> If the minimum investment level were increased, by legislation or regulation as proposed in recent years, then an issuer, the NCE, could raise more than \$50 Million from 100 investors or less, yet still be excluded from the investment company definition and the 1940 Act provisions. In that case, the amount of capital that could be raised, yet not be subject the NCE to the 1940 Act provisions would depend on the amount of the increased minimum investment levels.

<sup>63</sup> 2017 EB-5 Project Database: [2017 EB-5 Project Database 2017 Supplement with Trends \(August 16, 2017\)](#); 2016 EB-5 Project Database: [EB-5 Capital Project Database – Revisited and Expanded \(March 29, 2016\)](#) ; and 2015 EB-5 Project Database contained in Appendix B of [A Roadmap to the Use of EB-5 Capital: An Alternative Financing Tool for Commercial Real Estate Projects](#).

<sup>64</sup> See, for example, the discussion of the abandoned EB-5 project at the Park Lane Hotel at Page 43 of [What TEA Projects Might Look Like Under EB-5 2.0: Alternatives Illustrated with Maps and Data](#).

the status of the various investors' immigration petitions. Almost certainly, some of the investors have completed the EB-5 immigration visa process. Presumably many of the investors have advanced to a stage in the immigration process where they are not facing the long waiting lines, or they have already obtained their temporary green card.

Thus, many of these investors have achieved, or are sufficiently advanced on the path to achieving, their immigration goal. Presumably, they would opt to complete the immigration process and then seek recovery of their capital investment, rather than seek rescission as the method to recover their capital investment and negatively impact their immigration goals.

However, regional centers and NCEs should recognize that the investor's receipt of I-526 visa approvals does not necessarily insulate them from a lawsuit by frustrated investors seeking rescission. For example, readers might be surprised to learn that the CMB EB-5 website indicates that 869 of the 900 investors in the Century Plaza Hotel NCE have received their I-526 visa approvals; nevertheless, they initiated the lawsuit.<sup>65</sup>

#### **E. Apparent compliance with the 1933 Act**

Presumably the investors' attorney probably first considered, and rejected, a more obvious legal theory that would have more clearly supported a rescission claim. The 1933 Act expressly provides investors with a limited right of rescission against the issuer if the offering of securities does not comply with the registration provisions of the 1933 Act. Sections 12(a)(1) and 13 of the 1933 Act provide for this limited one-year right of rescission. Few, if any, EB-5 offerings are registered; instead, they rely upon the exemption from registration provided by Rule 506 of Regulation D and/or Regulation S.<sup>66</sup>

One might consider the potential rescission claims under the 1933 Act of the EB-5 investors in the 37 CMB EB-5 projects that were the subject of the SEC Order. The SEC presumably had a substantial basis for alleging that the NCEs did not comply with the registration

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<sup>65</sup> This data was obtained from the relevant webpage on 10/3/2018. Presumably, CMB updates this data from time to time. <https://www.cmbeb5visa.com/project/group-48-century-plaza/> A review of the CMB EB-5 website indicates that several of its EB-5 projects have more than 100 investors. However, the capital raise for many of these projects preceded the Century Plaza Hotel. Many of the investors have received I-526 visa approvals and some have received I-829 visa approvals.

<sup>66</sup> 2016 EB-5 Project Database: [EB-5 Capital Project Database – Revisited and Expanded \(March 29, 2016\)](#).

requirements of the 1933 Act.<sup>67</sup> The NCE's requirement to register or comply with an exemption from registration applies to all NCEs, irrespective of the number of investors.

It appears that based primarily on the information available on CMB's EB-5 website, most of the 37 offerings commenced before the Century Plaza offering.<sup>68</sup> Assuming that the immigrants subscribed to their EB-5 capital investments in those projects before October 2017 (one year before the date of the Order), it is likely that the one-year statute of limitations would bar any rescission claims based on the failure to comply with the registration requirements of the 1933 Act.<sup>69</sup>

Finally, it is noted that the complaint in the Century Plaza Hotel case points out that the Private Placement Memorandum states that CMB relied on the exemption from registration under Rule 506 of Regulation D. The complaint, however, alleges that the defendants did not file Form D as required by the Rule.<sup>70</sup> The complaint suggests, but does not directly allege, that the failure to file the Form D might jeopardize the availability of the exemption. Although the complaint is correct that the filing of Form D is a requirement for relying on the Regulation D exemption, the SEC's position is that the filing is not a condition to qualifying for the exemption.<sup>71</sup> The complaint does not allege any other basis for challenging the Regulation D exemption nor seek rescission based on the failure to comply with the 1933 Act registration requirements.

Moreover, we have determined that the EB-5 offering for the Century Plaza Hotel was not one of the offerings that was the subject of the recent SEC Order discussed earlier in this section.<sup>72</sup> Thus, the SEC's statements in the SEC Order about CMB's "robust securities compliance program" would reasonably lead one to conclude that, in connection with its investigation, the SEC determined that this EB-5 offering complied

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<sup>67</sup> However, as part of the settlement agreement, CMB did not admit or deny any of the SEC's findings.

<sup>68</sup> CMB EB-5 website: <https://www.cmbeb5visa.com/>

<sup>69</sup> We have not considered the applicability of state securities laws nor any rescission rights that might be available under those laws.

<sup>70</sup> See Paragraph 48 of the Complaint, *Zhan v. Hogan*, Case No. 4:18-CV-04126 (C.D. Ill., filed 7/11/2018).

<sup>71</sup> See Question 257.07 of <https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>

<sup>72</sup> See the earlier discussion in Paragraph C of this Section II in which we determined that the EB-5 offering for the Century Plaza Hotel was not included as one of the offerings that was the subject of the SEC Order issued on September 21, 2018.

with the registration requirements of the 1933 Act – presumably by reliance on the Regulation D and/or Regulation S exemption.

### **III New SEC Civil Enforcement Actions**

#### **A. Palm House Hotel**

As discussed, the Palm House Hotel project represents the only EB-5 capital raise that has resulted in an SEC civil enforcement action initiated in 2018 - through October 15, 2018.<sup>73</sup> The private lawsuit brought by the investors in 2016 was featured in our 2017 edition as an example of an action initiated by EB-5 investors as distinct from an enforcement action brought by the SEC.<sup>74</sup>

#### **B. Litigation history**

However, multiple legal actions - governmental and private - were commenced in the first 8 months of 2018. We briefly review the history of the various actions.

From 2012 to 2015, Palm House Hotel, LLC, an NCE (“Palm NCE”) raised approximately \$44 Million from at least 88 foreign investors to fund the redevelopment of a hotel project known as the Palm House Hotel (the “Hotel”) in Palm Beach, Florida.

The NCE was formed by a third-party regional center, the South Atlantic Regional Center (“SARC”, “Regional Center” or “RC”). The Regional Center and NCE were owned and controlled by Joseph Walsh, Sr. The Hotel entity was effectively owned and controlled by Robert Matthews. Walsh did not own any interest in the Hotel and Matthews did not own any interest in the Palm NCE or Regional Center.

As discussed below, Walsh and Matthews, as well as related parties, allegedly defrauded the EB-5 investors. Almost all of the EB-5 funds were misappropriated by Walsh, Matthews, and their co-

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<sup>73</sup> The SEC formally commenced another enforcement action in 2018, albeit under seal. On September 8, 2018, the SEC filed charges against Ariel Quiros’ former son-in-law for aiding and abetting Quiros’ misappropriation of EB-5 investor funds to acquire the Jay Peak ski resort. On the same day, Burstein consented to an entry of final judgment. Even though this complaint relates solely to Burstein, we did not treat this as a separate action initiated this year because it arises out of the massive Jay Peak fraud action commenced by the SEC in 2016. SEC Release - Burstein: <https://www.sec.gov/litigation/litreleases/2018/lr24259.htm>. In addition, on October 18, 2018 the SEC filed another civil enforcement action - this time against an immigration attorney, Jean Chen. This case is briefly discussed in Section VIIIB of this paper, “Unregistered broker-dealer wearing many hats.”

<sup>74</sup> See Pages 37 to 40 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

conspirators, with almost none of the funds invested in the Hotel. USCIS denied all of the investors' I-526 petitions because the project failed to demonstrate that the requisite number of jobs would be created.<sup>75</sup>

On November 14, 2016, EB-5 investors filed a 99-page complaint (450 pages with exhibits) in federal court against numerous defendants, including the NCE, the Regional Center, Walsh, and Matthews.<sup>76</sup> The complaint alleges fraud and other abuses by the various bad actors.

On November 6, 2017, Matthews, the developer, filed a personal Chapter 11 bankruptcy petition apparently to halt the foreclosure process on his \$40 Million personal residence in Palm Beach, Florida.<sup>77</sup>

On March 15, 2018, DOJ announced that a federal grand jury had returned a 20-count indictment charging Matthews, the hotel developer and his attorney with various fraud and money-laundering actions arising out of the scheme that defrauded the EB-5 investors.<sup>78</sup> On August 29, 2018, a tax evasion charge relating to the Hotel property against Matthews and his wife was added to the indictment.<sup>79</sup> Matthews faces substantially more than 100 years in prison if he is convicted on all counts.

Despite significant allegations in the investors' complaint of fraud and misappropriation of investor funds, Walsh (the owner-operator of the RC), issued a press release hailing the indictment of Matthews as a vindication of Walsh's claim of innocence.<sup>80</sup>

On August 2, 2018, the Hotel entity filed a voluntary petition for bankruptcy under chapter 11 of the Bankruptcy Code, which is still

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<sup>75</sup> See Paragraph 32 of [SEC complaint – PHH](#). One petition was not formally denied (the investor's attorney was responding to USCIS's Notice of Intent to Deny).

<sup>76</sup> The defendants included family members of Walsh and Matthews, their alleged construction companies, in-house promoters, attorneys, and other companies and their individual members, who unlawfully received the misappropriated EB-5 investment funds. *Lan Li v. Joseph Walsh*, Case No. 9:16-cv-81871 (SD FLA, 11/14/2016),; [https://eb5projects.com/system/uploads/document/file/325/Palm\\_House\\_Complaint\\_with\\_exhibits.pdf](https://eb5projects.com/system/uploads/document/file/325/Palm_House_Complaint_with_exhibits.pdf)

<sup>77</sup> *In re Matthews*, No. 17-23426 (Bankr. S.D. Fla., filed Nov. 6, 2017).

<sup>78</sup> <https://www.justice.gov/usao-ct/pr/indictment-alleges-florida-developer-and-real-estate-attorney-scammed-foreign-investors>; *United States v. Matthews*, No. 3:18-cr-00048-SRU (D. Conn, filed 3/14/2018); <https://www.justice.gov/usao-ct/pr/real-estate-developer-wife-charged-tax-evasion>

<sup>79</sup> <https://www.justice.gov/usao-ct/pr/real-estate-developer-wife-charged-tax-evasion>

<sup>80</sup> Here is a link to the press release: <https://www.marketwatch.com/press-release/a-significant-outcome-has-been-achieved-for-investors-in-the-palm-house-hotel-by-usreda-sarc-and-its-companies-2018-03-19>. The Matthews' indictment focused on transactions that occurred in Connecticut. Walsh did not have any connections there. As explained in this Section III of the paper, the SEC complaint focused on both Walsh and Matthews.

pending.<sup>81</sup> One of the main goals of the bankruptcy is to sell the Hotel at an auction, free and clear of all liens and encumbrances, to provide funds to pay claims of creditors and others.<sup>82</sup> As discussed in section IIIE below, the federal Bankruptcy Court issued an order approving the bid procedure and scheduling an auction of the Hotel.

On August 3, 2018, the SEC filed a civil enforcement action in federal court for violating the antifraud provisions of the federal securities laws. The defendants named in the SEC's complaint include the Regional Center, the NCE, Walsh (the owner-operator who controlled the Regional Center and the NCE) and Matthews (who owned and controlled the Hotel) were individually named in the enforcement action.<sup>83</sup>

Lending credibility to many of the allegations contained in the investors' complaint filed almost two years earlier, the SEC complaint and the US Attorney's indictment repeats almost all of the allegations alleged by the investors.

### C. PPM representations vs. actual events

Based on the SEC complaint, the criminal indictments, and the EB-5 investors' complaint, a chart comparing: (i) the representations made by the NCE, Regional Center and/or developer in the Private Placement Memorandum, other offering materials, and related documents initially presented to the investors and (ii) the alleged actual events or facts is set forth below.

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<sup>81</sup> Technically, the bankruptcy petition was filed by the receiver on behalf of the Hotel. The receiver was appointed prior to the filing of the SEC enforcement action - in an unrelated state court case in connection with the foreclosure of the first mortgage on the Hotel. A discussion of the complex series of transactions relating to the mortgage is beyond the scope of this paper. Relevant to the EB-5 investors, a second mortgage was supposed to be filed by the NCE to secure the EB-5 loan on the Hotel. However, the validity of the mortgage has been contested by the first mortgage holder, as well as the owners of the Hotel entity. *In re: 160 Royal Palm, LLC*, Case No. 18-19441 (Bankr. S.D. Fla., filed 8/2/2018)

<sup>82</sup> See Debtor's Motion for the entry of an order (I) approving bid procedures and bid protections in connection with the sale of substantially all of its assets, (II) approving the form and manner of notice of sale, (III) scheduling an auction and sale hearing and (IV) approving the sale of the assets free and clear of liens, claims and encumbrances. *In re: 160 Royal Palm, LLC*, Case No. 18-19441 (Bankr. S.D. Fla., filed 8/10/2018).

<sup>83</sup> [SEC Release – PHH](#); [SEC complaint – PHH](#).

PPM Representations	Actual Events or Facts
Establish bank escrow at PNC Bank.	No escrow was established.
Deposit investors' contributions to be held in escrow, pending each investor's I-526 petition approval by USCIS	No funds were invested in escrow. Investor funds wired into a business checking account falsely named "escrow account" and immediately transferred to a network of other bank accounts controlled by the NCE and its affiliated entities and individuals.
Funds not to be released from escrow until escrow conditions have been satisfied.	Funds were released immediately to the NCE. Then funds were misappropriated by RC operator Walsh and unrelated Developer Matthews.
Developer invested \$22M of equity in the hotel project. Marketing brochure stated that investment was "very safe" based, in part, on the substantial equity contribution made by the developer.	Developer did not contribute any equity to the hotel project. The Hotel property had not been acquired at the time of the original offering. The Hotel was thereafter acquired with no equity invested by Developer or others. The Hotel paid the entire purchase price by granting a first mortgage to the seller in the amount of \$27.5M. The recording of the deed and the first mortgage was delayed for 7 months under suspicious circumstances. EB-5 investor funds were improperly used to pay down the mortgage. The mortgage has been in foreclosure since 2015.
In addition to the \$22M in equity, the Developer secured a \$29M bridge loan from a bank.	No construction loan was secured. Instead, the \$29 million that was represented as a "construction loan" from a "bank," was the first mortgage taken by the Hotel owner in exchange for the developer acquiring the Hotel without having to contribute any equity. No capital was provided from any source other than EB-5 investors. Virtually no EB-5 funds reached the project. Developer and JCE did not obtain a bank loan.
NCE to loan funds to JCE Hotel project. Loan terms also stated that no funds would be transferred from NCE to JCE without verifying I-526 approval per investor.	Although no I-526 was approved, funds were transferred and misappropriated by Walsh (the RC owner-operator) Matthews (the developer), and their co-conspirators.
NCE guaranteed refund of EB-5 investor's contribution, if an investor's I-526 petition was denied.	All I-526 petitions were denied because project could not demonstrate that jobs would be created. No refunds were made to any of the investors as all funds were misappropriated soon after they were wired.

Audited financial statements to be provided to investor periodically.	No financial statements or reports of any type were provided to the investors.
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One of many examples of the collusion between Walsh (the NCE/RC operator) and Matthews (the developer) relates to Matthews’ personal residences. \$5.5 Million of the investor funds were “loaned” to Matthews to “save” his personal residence. The SEC Complaint documents that Matthews sent an email to Walsh expressing his “gratitude” for “saving his house.”<sup>84</sup> In addition, during 2014, Matthews misappropriated several million dollars of investors’ funds to re-purchase his former home in Connecticut, using a “strawman” to make the purchase. That individual was also indicted and plead guilty to conspiracy to commit bank fraud and engage in illegal monetary transactions in relation to this misappropriation of the EB-5 investor funds.<sup>85</sup>

**D. Lessons learned from the Palm House Hotel case**

This case represents a disturbing recent trend in which EB-5 investor fraud occurs despite the supposed “independence” of the regional center and NCE manager, on the one hand, and an unrelated developer who controls the project entity, on the other hand.<sup>86</sup> The SEC enforcement action and the federal indictment in this case illustrate that this scheme to misappropriate the investor funds by the unrelated regional center and developer can be just as egregious as the numerous cases where one individual owns and controls the regional center, NCE, and developer. It also adds an additional layer of collusion, not present in the prior self-dealing EB-5 fraud cases brought by the SEC.

The Palm House Hotel case also demonstrates that retaining a professional to perform due diligence prior to the immigrant’s investment is important; however, it cannot always adequately protect the investor’s immigration goals and financial investment. The pre-investment due diligence must be coupled with continued monitoring and reporting of the investment, transactions, and project development by an independent administrator.

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<sup>84</sup> Paragraph 27 of [SEC complaint – PHH](#).

<sup>85</sup> <https://www.justice.gov/usao-ct/pr/indictment-alleges-florida-developer-and-real-estate-attorney-scammed-foreign-investors>; *United States v. Matthews*, No. 3:18-cr-00048-SRU (D. Conn, filed 3/14/2018).

<sup>86</sup> See Pages 42 to 45 inclusive of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

These functions include confirmation that: the escrow has been established and the escrow agent's written acknowledgment of the terms and conditions of fund release; escrow conditions have been satisfied and notification to the investor that the funds will be or have been transferred; the funds flowed directly from the escrow to the NCE to the JCE; and the funds have been deployed into the project and confirmation that the funds were only used for their intended purpose. Otherwise, without being watched by a monitor or by providing the promised transparency or notifications, the regional center, NCE or developer could circumvent the best-practice protections built into the offering documents.

In many of the previous SEC enforcement actions, the investors' funds were prematurely released from escrow before the escrow condition was met.<sup>87</sup> In the Palm House project, the escrow abuse was more blatant - chiefly because the represented escrow account was never created. Despite these representations that the funds would be held in escrow until the investors' I-526 petitions were approved and that the money could only be released if the bank was provided with the approved I-526 forms, no escrow was even established. The investment funds went directly to the NCE's business checking account. Thus, the investors' funds were directly obtained and released to the NCE rather than through a bona fide escrow.

#### **E. Sale of Hotel to Related would impact investor recovery**

On October 10, 2018, the US Bankruptcy Court issued an Order relating to the auction and sale of the Hotel, including approval of the bid procedure and the schedule of an auction sale of the property to be held on November 16, 2018.<sup>88</sup> Although the EB-5 investors are listed in the bankruptcy petition as creditors, they face several obstacles to sharing in the potential sale proceeds. Below is a simplified discussion of these obstacles.

Pursuant to an asset purchase agreement approved by the Bankruptcy Court, an affiliate of Related<sup>89</sup> is apparently the "stalking

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<sup>87</sup> See Pages 32 and 33 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

<sup>88</sup> Order Granting Debtor's Motion for the Entry of an Order, *In Re 160 Royal Palm, LLC*, Case No. 18-19441 (Bankr. S.D. Fla., filed 8/10/2018), [Order Granting -Debtor's \(PHH\) Motion 10/10/2018](#).

<sup>89</sup> The stalking horse bidder is RREF II Palm House Hotel, LLC, according to Paragraph 4 of the Order. The asset purchase agreement was signed on behalf of the stalking horse bidder by Justin Metz and Michael Brenner, President and Executive VP, respectively, of Related Fund Management,

horse bidder.” This agreement is subject to an auction sale of the Hotel.<sup>90</sup> The amount of the stalking horse bid is \$32 Million, effectively setting a floor for the purchase price at the auction. Therefore, if a qualified bidder at the auction offers at least \$32.5 Million, the property may be sold to the qualified bidder.<sup>91</sup>

According to the Bankruptcy Petition, the total amount of creditor claims - secured and unsecured - is almost \$115 Million. Approximately \$31 Million is secured (most is due to the holder of the first mortgage that is in foreclosure), and more than \$83 Million is owed to unsecured creditors.<sup>92</sup> The unsecured creditors include the EB-5 investors. Thus, the total debt owed by the Hotel entity, the debtor in bankruptcy, far exceeds the Stalking Horse Bid that was approved by the court.

It must be emphasized that the “Debtor” in the bankruptcy action is wholly owned by a parent company (the “Debtor’s Parent”). The Debtor’s Parent has not filed a bankruptcy petition. Technically, the EB-5 investors contributed their equity capital to an NCE (Palm House LLLP) which was to deploy the pooled capital to the Debtor’s Parent, not to the Debtor that is in bankruptcy. Then, the funds were supposed to be transferred to the Debtor, typically for incorporation into the construction project.

Accordingly, the extent to which, if any, the EB-5 investors will be entitled to a portion of the proceeds from the sale of the Hotel will depend on numerous factors. These factors include the amount of the winning bid at the auction sale; the treatment of the EB-5 investor claims against the Debtor in bankruptcy; the relative priority of the claims of the EB-5 investors versus other creditors;<sup>93</sup> and the potential invalidity of any of

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an affiliate of The Related Companies, LLC.

<https://www.sec.gov/Archives/edgar/data/803649/000119312513075277/d491275dex992.htm>. We note that the RREF acronym is often used as part of the name of the entities the Rialto Real Estate Fund, an affiliate of Lennar (one of the nation’s largest homebuilders), utilizes in connection with some of its acquisitions. <http://rialto.com/en/firm/history.aspx>. However, we assume Rialto is not involved with the bid.

<sup>90</sup> For a general discussion of the bankruptcy auction process pursuant to Section 363 of the Bankruptcy Code and the role of a “stalking horse bid,” see <https://www.jonesday.com/bankruptcy-sales-the-stalking-horse-03-16-2015/>.

<sup>91</sup> Order Granting Debtor’s Motion for the Entry of an Order, *In Re 160 Royal Palm, LLC*, Case No. 18-19441 (Bankr. S.D. Fla., filed 8/10/2018), [Order Granting -Debtor’s \(PHH\) Motion 10/10/2018](https://www.documentcloud.org/documents/4635528-Palm-House-bankruptcy-filing.html).

<sup>92</sup> <https://www.documentcloud.org/documents/4635528-Palm-House-bankruptcy-filing.html>

<sup>93</sup> If the EB-5 investors’ claims are treated as debt owed by the Debtor’s Parent, rather than by the Debtor (the owner of the Hotel), then the investors would have a claim against the net sales proceeds, if any, that remain to be distributed to the Debtor’s Parent (the equity owner of the Hotel entity) after the Debtor’s creditors are paid.

the other creditors' claims (including the first mortgage loan taken back by the seller of the property to the Debtor under questionable circumstances).

If, as we anticipate, the investors' claims are not paid in full from the Hotel sales proceeds, the investors might still recover all or some of their investment from: any disgorgement and related payments recovered by the SEC in its enforcement action; any restitution paid by Matthews and others as restitution in the DOJ criminal prosecution; or any judgments and settlements from their own civil litigation. Related concepts are discussed further in the Criminal Prosecution section of this paper.

Presumably, the Hotel's bankruptcy filing was not made with the aim to discharge debt relating to the EB-5 fraud. Under the Bankruptcy Code, the bankruptcy estate cannot discharge a debt for a violation of the securities laws or debt arising from the debtor's fraud.<sup>94</sup>

#### **F. Palm House Hotel closing thoughts**

The Palm House Hotel case marks several "firsts" in the EB-5 context. This is the first SEC enforcement action in which a private lawsuit brought by the EB-5 investors preceded the SEC action. Additionally, it also represents the only civil enforcement action which was preceded by a criminal prosecution initiated by the US Attorney's Office.<sup>95</sup>

It is one of the only actions, if not the only enforcement action, where one of the principal bad actors filed for personal federal bankruptcy protection and the project developer filed for federal bankruptcy protection close in time to the SEC enforcement action.

In September 2018, a lawsuit was commenced by the EB-5 investors in a similar EB-5 project sponsored by SARC (Walsh's regional center) near the location of the Palm House Hotel. This project offering occurred a few years before the Palm House offering. The developer proposed to use the investors' funds to purchase an office park that purportedly had just signed a lucrative lease to serve as headquarters for an insurance company. Walsh acquired the office park with some of the funds, but the insurance company never signed a lease and the property remained vacant. Walsh allegedly misappropriated the remainder of the

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<sup>94</sup> [11 U.S.C § 523](#)

<sup>95</sup> See [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

funds not used to purchase the property and then overleveraged the property with debt for his own gain. The complaint alleges fraud, including securities fraud.<sup>96</sup>

#### IV SEC Acknowledges Impact of Kokesh Decision

The timing of the SEC's filing of the Palm House Hotel case might have been influenced by the 2017 US Supreme Court decision in *Kokesh v. SEC*. That decision particularly motivates the SEC to promptly file civil enforcement actions in court.<sup>97</sup> There, the Supreme Court held that the statute of limitations for disgorgement of ill-gotten gains, the primary monetary sanction that the SEC seeks in enforcement actions,<sup>98</sup> is limited to 5 years. Thus, it is essential that the SEC act expeditiously to preserve its ability to obtain the maximum disgorgement remedy. Note that some of the recent EB-5 securities enforcement actions allege wrongdoing that occurred more than 5 years from the date of the filing of the action.<sup>99</sup>

On May 16, 2018, Steven Peikin, co-director of the SEC's Enforcement Division, testified before the Financial Services Committee of the U.S. House of Representatives at a hearing entitled "Oversight of the SEC's Division of Enforcement."<sup>100</sup> He advised the Committee members that the Kokesh decision will result in a significant reduction in the size of monetary sanctions that the SEC will be able to collect on behalf of harmed investors. At the time of his testimony, Director Peikin estimated that, based on pending cases in litigation or cases that have since been settled, the SEC has not been able to seek \$800 million in the disgorgement of ill-gotten gains since the Supreme Court's decision in Kokesh. He pointed out that "there will be cases where there is ongoing fraud for years and we don't discover it until some of that money is out of our reach."<sup>101</sup>

The following month, on June 20, 2018, SEC Chairman Jay Clayton testified before the House Committee on Financial Services. He also cited

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<sup>96</sup> *Chen v. Walsh*, case number 1:18-cv-23894 (S.D., Fla, filed 9/20/2018).

<sup>97</sup> *Kokesh v. SEC*, 137 S. Ct. 1635 (2017); [https://www.supremecourt.gov/opinions/16pdf/16-529\\_i426.pdf](https://www.supremecourt.gov/opinions/16pdf/16-529_i426.pdf)

<sup>98</sup> See page 7 of <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>

<sup>99</sup> See page DS-1 of Appendix A of [Understanding EB-5 Securities](#).

<sup>100</sup> <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403383>; [https://financialservices.house.gov/uploadedfiles/051618\\_cm\\_memo.pdf](https://financialservices.house.gov/uploadedfiles/051618_cm_memo.pdf)

<sup>101</sup> <https://www.wsj.com/articles/supreme-court-2017-decision-has-cost-investors-over-800-million-sec-says-1526487555>

the devastating impact that Kokesh has had, and will continue to have, upon the SEC's ability to return funds to the investing public. Chairman Clayton's written testimony stated that he is "troubled by the substantial amount of losses that we may not be able to recover for...investors. Said simply, if the fraud is well-concealed and stretches beyond the five-year limitations period..., it is likely that we will not have the ability to recover funds invested." <sup>102</sup>

In his testimony before the Committee, Chairman Clayton reiterated the concerns expressed by Director Peikin, and requested that Congress give the SEC the authority to seek restitution for investors' losses where the investors were defrauded, but the investigators discovered the abuse too late to compensate the victims. Restitution, rather than disgorgement, could result in greater financial recovery for the SEC and ultimately, the investors, because restitution reflects the losses suffered by the investors which could far exceed the ill-gotten gain of the bad actor.<sup>103</sup> Although some of the House members on the two committees seemed persuaded by Director Peikin's and Chairman Clayton's testimony and expressed a willingness to propose legislation to extend the statute or expand the remedies available to the SEC, grave doubts exist, due to the current political climate in Washington, D.C., as to whether any legislation will be proposed, let alone enacted, in the foreseeable future.<sup>104</sup>

In light of the Kokesh decision, the SEC must commence an enforcement action within 5 years after the fraud occurs to seek disgorgement as a remedy arising out of that fraud. The Kokesh decision might prompt the SEC Enforcement Division to accelerate investigations or otherwise jeopardize its ability to collect monetary sanctions in many cases.

Even if the investigatory process is accelerated, a key element in complying with the 5-year statute of limitation is detecting the fraud. A substantial portion of the 5-year limitation period might be absorbed by the time frame from the occurrence of the fraud until the SEC discovers that a fraud has occurred. Thus, early detection of the occurrence of the

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<sup>102</sup> <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission>

<sup>103</sup> <https://www.c-span.org/video/?447253-1/sec-chair-jay-clayton-testifies-house-oversight-hearing>; <https://www.wsj.com/articles/sec-wants-more-power-to-get-funds-back-for-bilked-investors-1529622404>

<sup>104</sup> See, for example, 29:57 of <https://www.c-span.org/video/?447253-1/sec-chair-jay-clayton-testifies-house-oversight-hearing>

fraud is critical to the SEC's timely filing of a claim within the statute of limitations.

However, securities fraud in the EB-5 context is likely to go undetected for longer periods than in other securities fraud contexts because the flow of EB-5 investor funds is not monitored or reviewed by USCIS, until a relatively late stage in the process. In some cases, this might occur more than 5 years after the fraud occurs.<sup>105</sup>

The Kokesh decision might have the most devastating impact on enforcement claims involving EB-5 investors from mainland China. For example, at an EB-5 trade group conference in April 2018, Charlie Oppenheim, Chief of the Visa Controls Office at the U.S. Department of State, estimated that, due to retrogression, in the case of a new investor, the estimated time frame from filing the initial visa petition to obtain a conditional visa approval is approximately 15 years.<sup>106</sup>

Although the I-829 review is the point at which USCIS is most likely to discover a misappropriation, the securities laws' statute of limitations might have long expired and bar the filing of an action. Due to these extraordinarily long delays, we continue to vigorously support fund administration and account transparency protections of the type that were contained in various reform bills introduced by Senators Grassley and Leahy as well as Representative Goodlatte, aimed to detect EB-5 abuses at an early stage. Unfortunately, no EB-5 reform bills are currently pending, and none appear to be on the horizon.<sup>107</sup>

One would expect that the SEC's staff will more routinely seek to require individuals and entities under investigation to enter into tolling agreements to prevent the expiration of the statute of limitations.<sup>108</sup> Staff might pursue this approach at an earlier stage of the investigation than has been customary in the past.<sup>109</sup> Nevertheless, the Kokesh decision is likely to have a profound impact on SEC enforcement actions because many claims will be barred by the applicable statute of limitations. Furthermore, even if the case is not dismissed, the amount

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<sup>105</sup> [EB-5 2.0: Can Account Transparency Save the Program Save the Program?](#)

<sup>106</sup> <https://blog.lucidtext.com/2018/04/>; Also see pages 4 through 8 of [EB-5 2.0: Can Account Transparency Save the Program Save the Program?](#)

<sup>107</sup> [EB-5 Program: It's Broken, When Will It Be Fixed?](#)

<sup>108</sup> See Section 3.1.2 of the "Enforcement Manual" of the SEC Division of Enforcement concerning the Statute of Limitations and Tolling Agreements.

<https://www.sec.gov/divisions/enforce/enforcementmanual.pdf>

<sup>109</sup> See, for example, paragraph 79 of the complaint filed in the SEC enforcement action in *SEC v. Aero Space Port International Group*, <https://www.sec.gov/litigation/complaints/2017/comp23778.pdf>

of recovery may be limited by the fraud that occurred within the statutory period.<sup>110</sup>

## V Quiros' Jay Peak Settlement and Distribution to EB-5 Investors

### A. Quiros settlement

In February 2018, the SEC finally settled the civil enforcement action against Ariel Quiros, the mastermind of the Jay Peak Ponzi scheme. Quiros agreed to pay almost \$84 Million to the SEC.<sup>111</sup> More than \$81 Million of the award was in disgorgement, representing profits gained by him because of the misconduct alleged by the SEC.<sup>112</sup>

In an effort to satisfy his disgorgement obligations under the settlement, Quiros agreed to transfer 17 parcels of real estate to the Jay Peak receiver to satisfy his disgorgement obligation under the settlement.<sup>113</sup> This includes a luxury condominium unit at a Trump-branded condominium building in New York City purchased with EB-5 investor funds.

On October 19, 2018, the Jay Peak receiver, Michael Goldberg, filed a motion with the Florida federal district court to approve a settlement agreement that includes a waiver of any interest Quiros may have in the disgorged real estate, receivership entities and related properties.<sup>114</sup> On the same day, the court preliminarily approved the settlement agreement. The settlement agreement is intended to facilitate the sale of the various properties and enable the proceeds to be used for the benefit of the EB-5 investors.<sup>115</sup>

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<sup>110</sup> The *Kokesh* decision might have had the effect of accelerating the SEC's filing of the enforcement action in the Palm House Hotel case. There, the capital raise offering began in 2012 and the SEC enforcement action was filed on August 3, 2018. Presumably some of the alleged fraud started, and some of the capital was raised, before August of 2013, more than 5 years before the SEC enforcement action was filed.

<sup>111</sup> SEC Release – Quiros; [https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE\\_450\\_-\\_Final\\_Judgment\\_Quiros\\_2-6-18-1.pdf](https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE_450_-_Final_Judgment_Quiros_2-6-18-1.pdf)

<sup>112</sup> SEC Release – Quiros

<sup>113</sup> See page 2 of [https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE\\_450\\_-\\_Final\\_Judgment\\_Quiros\\_2-6-18-1.pdf](https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE_450_-_Final_Judgment_Quiros_2-6-18-1.pdf). We note that only 16 parcels are listed in the Final Judgment, but the text of documents filed with the court refers to 17 parcels.

<sup>114</sup> <https://jaypeakreceivership.com/wp-content/uploads/2018/10/Receivers-Motion-for-I-Approval-of-Settlement-Between-Receiver-and-Ariel-Quiros-II-Entry-of-a-Bar-Order-and-1.pdf> (the “Receiver’s Motion for Quiros Settlement Approval”).

<sup>115</sup> <https://jaypeakreceivership.com/wp-content/uploads/2018/10/Order-I-Preliminarily-Approving-Settlemtn-Between-Receiver-and-Ariel-Quiros-II-Approving-Form-and-Content-of-Notice-and-Manner-and-Method-of-Service-and-Publication-1.pdf>

It is noted that, based on a tax law change under the Tax Cuts and Jobs Act of 2017, restitution payments made pursuant to a settlement agreement or court order may be tax deductible.<sup>116</sup> However, it appears that the disgorgement and other payments paid by Quiros will not be tax deductible.<sup>117</sup>

#### **B. Enforcement action against Quiros' son-in-law**

On a related note, on September 8, 2018, the SEC issued a Release announcing a settlement with Quiros' former son-in-law, Joel Burstein. Burstein was his financial broker and the branch manager at the Raymond James Financial location in Florida where Quiros' financial activities were centered. Burstein agreed to pay a civil penalty of \$80,000 to the SEC.<sup>118</sup> His settlement with the SEC follows a separate settlement Raymond James Financial reached last year with, the Jay Peak receiver, Michael Goldberg, who continues to oversee the several properties that were the subject of the Jay Peak fraud. As part of that settlement, the receiver and the EB-5 investors generally released Raymond James and its employees, including Burstein, from and against any further claims, lawsuits or liabilities.<sup>119</sup> Obviously, the general release related to civil matters.

#### **C. Distribution of Quiros settlement vs. Raymond James settlement**

In the 2017 edition, we noted that pursuant to a settlement reached with the Jay Peak receiver, Raymond James agreed to pay \$150 Million. Most of these funds were earmarked for payment to the creditors of the Jay Peak entities under receivership and distribution to certain EB-5 investors of Jay Peak.<sup>120</sup>

Unlike the Raymond James settlement, pursuant to a court-ordered "Fair Fund" established at the motion request of the SEC, the entire

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<sup>116</sup> IRC 162(f): <https://www.law.cornell.edu/uscode/text/26/162>

<sup>117</sup> See <https://www.clearyenforcementwatch.com/2018/02/1962/>. Also, the Quiros judgment includes a stipulation that the debt is not dischargeable in bankruptcy. See Paragraph 13 of [https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE\\_450 - Final Judgment Quiros 2-6-18-1.pdf](https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE_450_-_Final_Judgment_Quiros_2-6-18-1.pdf).

<sup>118</sup> [SEC Release – Burstein](#); [SEC Complaint – Burstein](#).

<sup>119</sup> <https://jaypeakreceivership.com/wp-content/uploads/2017/04/SIGNED-Settlement-Agreement-with-Exhibits-12.pdf>

<sup>120</sup> [https://jaypeakreceivership.com/wp-content/uploads/2017/05/41810676\\_1-2.pdf](https://jaypeakreceivership.com/wp-content/uploads/2017/05/41810676_1-2.pdf); <https://jaypeakreceivership.com/wp-content/uploads/2017/04/SIGNED-Settlement-Agreement-with-Exhibits-12.pdf>

settlement funded by Quiros will be distributed to the EB-5 investors.<sup>121</sup> The Federal Account for Investor Restitution (“FAIR”) Funds provision of the Sarbanes Oxley-Act gives the SEC the discretion, with court approval, to have these funds be directed to the injured investors, instead of to the United States Treasury.<sup>122</sup>

In conjunction with the Quiros settlement, the SEC announced that Quiros’ partner, William Stenger, has agreed to pay a \$75,000 civil penalty, which, incidentally, is \$5,000 less than the penalty imposed again Burstein.<sup>123</sup> The SEC did not allege that Stenger personally profited from the scheme; thus, the SEC did not seek disgorgement from him.<sup>124</sup> Presumably, Stenger’s cooperation with the federal investigation influenced the relatively minor amount accepted by the SEC in this settlement.

#### **D. Possible SEC Whistleblower award**

It is likely that tips provided to the SEC by one or more whistleblowers led to the government investigation of Jay Peak and the monetary sanctions paid.<sup>125</sup> Reportedly, in 2012, Douglas Hulme complained to the State of Vermont about various abuses, including the misuse of EB-5 funds.<sup>126</sup> He was a key consultant to Quiros and Stenger. In 2014, Antony Sutton, one of the EB-5 investors, filed documents with the State claiming that Quiros and Stenger had perpetrated a fraud upon the investors.<sup>127</sup> Thus, it would not be surprising if Mr. Hulme or Mr. Sutton, or both of them, also submitted a whistleblower tip to the SEC.<sup>128</sup>

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<sup>121</sup> [https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE\\_447\\_-\\_SECs\\_Unopposed\\_Motion\\_for\\_Judgment\\_Against\\_Defendants\\_Ariel\\_Quiros\\_and\\_William\\_Stenger\\_and\\_for\\_Court\\_to\\_Establish\\_Fair\\_Fund\\_2-2-18-1.pdf](https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE_447_-_SECs_Unopposed_Motion_for_Judgment_Against_Defendants_Ariel_Quiros_and_William_Stenger_and_for_Court_to_Establish_Fair_Fund_2-2-18-1.pdf)

<sup>122</sup> See [Section 308\(a\) of Sarbanes-Oxley Act](#); Also see, [SEC Information for Harmed Investors](#); and [SEC Sox 308 Report to Congress](#). In May 2018, the SEC amended its “Current Rules of Practice and Rules on Fair Fund and Disgorgement Plans”. In particular, see [Rules 1100 et seq.](#)

<sup>123</sup> [https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE\\_451\\_-\\_Final\\_Judgment\\_Stenger\\_2-6-18-1.pdf](https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE_451_-_Final_Judgment_Stenger_2-6-18-1.pdf); <https://www.sec.gov/news/press-release/2018-10>

<sup>124</sup> [https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE\\_447\\_-\\_SECs\\_Unopposed\\_Motion\\_for\\_Judgment\\_Against\\_Defendants\\_Ariel\\_Quiros\\_and\\_William\\_Stenger\\_and\\_for\\_Court\\_to\\_Establish\\_Fair\\_Fund\\_2-2-18-1.pdf](https://jaypeakreceivership.com/wp-content/uploads/2018/02/DE_447_-_SECs_Unopposed_Motion_for_Judgment_Against_Defendants_Ariel_Quiros_and_William_Stenger_and_for_Court_to_Establish_Fair_Fund_2-2-18-1.pdf)

<sup>125</sup> For a more in-depth discussion of the SEC Whistleblower Program as applied to EB-5 fraud, see [SEC Whistleblower Program as a Valuable EB-5 Securities Anti-Fraud Enforcement Tool](#)

<sup>126</sup> <https://vtdigger.org/2016/07/25/documents-suggest-state-ignored-warnings-about-jay-peak-in-2012/>

<sup>127</sup> <http://digital.vpr.net/post/meet-london-car-dealer-who-broke-jay-peak-eb-5-fraud-case#stream/0>

<sup>128</sup> Michael Gibson, the Managing Director of USAdivisors.org, was the first to raise serious questions about the integrity and viability of the Jay Peak EB-5 projects, as detailed in his in-depth article found at: <https://www.linkedin.com/pulse/jay-peak-autopsy-eb-5-visa-fraud-greed-ignorance-michael-gibson/>

The enforcement action was filed on April 12, 2016.<sup>129</sup> The judgment entering the settlement order was filed on February 6, 2018, and the Notice Date posted on the Notice of Covered Action (NOCA) website was March 30, 2018, with June 28, 2018 as the 90-day deadline for filing an application for an award.<sup>130</sup> If one or more whistleblower claims were filed and the SEC determines that awards are appropriate, the minimum and maximum awards, in the aggregate, would range from approximately \$8.4 Million to \$25.2 Million.<sup>131</sup>

## VI USIF

A case filed in October 2018 against the USIF Regional Center, one of the largest regional centers in the country, provides another example of how even Chinese investors who have completed the EB-5 visa process are vulnerable to fraud. In our 2017 paper, we discussed the lawsuit filed against the New York City Regional Center by investors who have completed the EB-5 visa process.<sup>132</sup> The USIF case involves the successfully completed, mixed-use project known as “Harbourside” in Jupiter, Florida.<sup>133</sup>

As mentioned in the introduction, USIF typically sponsors EB-5 projects as a third-party regional center where the project developer is unrelated to USIF.<sup>134</sup> In the Harbourside lawsuit, numerous Chinese investors, each of whom has obtained his unconditional visa and permanent green card, sued the USIF regional center and related parties for fraud, breach of fiduciary duty and an assortment of other causes of action.

The investors’ complaint alleges that pursuant to a preconceived plan and through a series of steps, their investment originally structured as a well-protected senior mortgage loan was relegated to a relatively powerless equity position in an entity controlled by USIF. This allegedly enabled USIF to devalue the investors’ capital.

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<sup>129</sup> [SEC Enforcement Action – Jay Peak](#)

<sup>130</sup> See Notice No. 2018-24 listed in Notice of Covered Actions found at: <https://www.sec.gov/whistleblower/nocas>.

<sup>131</sup> This would represent 10% to 30% of the monetary sanctions imposed against Quiros.

<sup>132</sup> *Chen Dongwu v. New York City Regional Center*, Index No. 652024/2017, (Sup Ct, NY County, May 5, 2017). This can be accessed by visiting: <http://iapps.courts.state.ny.us/iscroll/>

<sup>133</sup> *Fu v. Mastroianni* (Palm Beach County 15<sup>th</sup> Judicial Circuit, filed 10/11/2018); <https://drive.google.com/file/d/1So-cjrm-3yY3YczPVu4aYxi2rOIZp-J/view?usp=sharing>

<sup>134</sup> See Appendices B and C to [A Roadmap to the Use of EB-5 Capital: An Alternative Financing Tool for Commercial Real Estate Projects](#).

We emphasize that USIF has not yet filed its answer or other response to the investors' complaint. Thus, we choose not to discuss the case in further detail until USIF has the opportunity to present its position. However, if the investors' allegations are true, it appears that the conflict of interests created by USIF's common control of the regional center, NCE and developer presented it with an incentive to economically disadvantage the investors, which it appears to have seized upon.

## VII DOJ Criminal Prosecutions

In contrast to the single SEC EB-5 related civil enforcement action initiated thus far in 2018, the DOJ has initiated several criminal prosecutions against bad actors relating to alleged EB-5 fraud.

As mentioned in the discussion of the Palm House Hotel project, DOJ announced a grand jury indictment against Robert Matthews (the Hotel's developer), his attorney, and Matthews' wife.<sup>135</sup> The criminal prosecution was initiated before the civil enforcement action was brought by the SEC. Most of the other EB-5 related prosecutions in 2018 involved relatively small capital raises.<sup>136</sup>

It remains to be determined whether DOJ will initiate a criminal prosecution against Ariel Quiros. Although the SEC enforcement action was settled, this civil settlement does not limit DOJ's authority to criminally prosecute Quiros. Similarly, the pending settlement between Quiros and the Jay Peak receiver (discussed in Section VA above) includes a requirement that the Jay Peak receiver use his best efforts to obtain a bar order from the court enjoining all investors and creditors from prosecuting or pursuing any claims against Quiros. The bar order requirement specifically excludes any prosecution or claims by governmental entities.<sup>137</sup> Based on the criminal actions brought against other bad actors who have defrauded EB-5 investors, it would seem reasonable to expect DOJ to commence an action against Quiros - the

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<sup>135</sup> See Section IIIB of this paper.

<sup>136</sup> See, for example, <https://www.justice.gov/usao-edla/pr/two-maryland-men-charged-eb-5-visa-scheme-defraud-investors>; and <https://www.justice.gov/usao-dc/pr/us-files-complaint-forfeit-500000-eb-5-visa-investment-funds-and-over-140000-sanctioned>

<sup>137</sup> Paragraph 13(d) of the Receiver's Motion for Approval of Quiros Settlement: "Bar Order. The Receiver will use his best efforts to obtain the entry of the Bar Order enjoining all investors and creditors of the Receivership Entities (*excluding governmental entities*) from prosecuting or pursuing any claims against Mr. Quiros arising out of the facts related to the SEC Action." (emphasis added.) <https://jaypeakreceivership.com/wp-content/uploads/2018/10/Receivers-Motion-for-I-Approval-of-Settlement-Between-Receiver-and-Ariel-Quiros-II-Entry-of-a-Bar-Order-and-1.pdf>

mastermind of the most highly publicized fraud action in the history of the EB-5 Program.<sup>138</sup>

Similarly, it would be surprising if DOJ does not seek to criminally prosecute Joseph Walsh, the owner-operator of the regional center and NCE in the associated Palm House Hotel project. Subsequent to the criminal prosecution of the developer Matthews, the SEC brought the civil enforcement action naming as defendants both Walsh and Matthews as well as others. The SEC complaint indicates that Walsh and Matthews were co-participants in the scheme to defraud the investors, and that Walsh's misrepresentations to the investors were even more extensive than Matthews'.<sup>139</sup>

Perhaps Walsh was not prosecuted in the same federal court action as Matthews because Walsh's personal and business contacts were centered in Florida, rather than Connecticut where the Matthews prosecution was brought. Or, perhaps the investigation leading to the subsequent SEC action revealed evidence that was not available to DOJ at the time it commenced the criminal prosecution of Matthews.

In addition, an order of restitution to be paid by the criminal to the victims is typically part of the sentence imposed by the court in a DOJ criminal prosecution for fraud, including for EB-5 securities fraud.<sup>140</sup> Since most of the criminal prosecutions brought by DOJ against EB-5 fraudsters have not yet reached the sentencing phase, restitution orders have been issued in only a few prosecutions thus far.<sup>141</sup>

Moreover, restitution might result in a significantly greater award to the victims of EB-5 securities fraud than paid in disgorgement in the SEC civil action because restitution not limited to the ill-gotten gains obtained by the bad actor. It is noted that an order of restitution is

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<sup>138</sup> It is possible DOJ might also bring a criminal action against William Stenger. However, Stenger's cooperation with the federal investigation, and his relative lack of participation in the fraud compared to Quiros, would tend to mitigate against such an action. See <https://jaypeakreceivership.com/wp-content/uploads/2016/09/DE-215-Judgment-of-Permanent-Injunction-and-Other-Relief-Against-Defendant-William-Stenger-1.pdf>

<sup>139</sup> See, for example, Paragraph 3 of the [SEC complaint – PHH](#).

<sup>140</sup> See Figure 1: Overview of the Federal Restitution Process on page 11 (16 of 56 of pdf) of the GAO Report to Congressional Committees "Federal Criminal Prosecution Most Debt is Outstanding and Oversight of Collections Could Be Improved ( February 2018): <https://www.gao.gov/assets/690/689830.pdf>

<sup>141</sup> See, for example, the sentences imposed against Anshoo Sethi, the central figure in the Chicago Convention Center fraud action, and Lobster Dargey, the bad actor in the two Path America fraud actions. See the Database attached as Appendix A to this paper.

enforceable for 20 years plus any period of imprisonment. A restitution debt operates as a lien against an offender's property for this period.<sup>142</sup>

## VIII Unregistered Broker-Dealers

### A. Payments to unregistered broker-dealers

During 2018, the SEC continued to pursue as unregistered broker-dealers under Section 15(a) of the 1934 Act attorneys as well as others who receive transaction-based fees from regional centers or NCEs in exchange for referring clients to make an EB-5 investment in a particular project.<sup>143</sup> Historically, the SEC has primarily targeted the recipient of the fees rather the regional center or NCE that makes the payment.

On the flip side, the SEC has not typically charged the payer of the transaction-based fee with a violation. The SEC action against American Life and its CEO, Henry Liebman, had been the notable exception prior to 2018 - at least with respect to an enforcement action that had been resolved.<sup>144</sup> However, the SEC Order (referred to in the CMB lawsuit section of this paper) which alleged 1933 Act registration violations, also targeted CMB and its CEO, Patrick Hogan, for allegedly making payments to unregistered broker-dealers, in violation of Section 15(a).<sup>145</sup> Pursuant to the settlement, Hogan agreed to pay \$515,000.

### B. Unregistered broker-dealer wearing many hats

An SEC enforcement action filed on October 18, 2018 describes the different paths which one immigration attorney pursued to take advantage of her clients who were seeking to obtain EB-5 visas.<sup>146</sup> In that case, Jean Chen, an immigration attorney, received over \$12M in transaction-based fees from unrelated regional centers to which she directed her immigration law clients. But as the SEC's complaint states: Chen's "fraud [perpetrated on her clients] did not stop with ... receipt of

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<sup>142</sup> [18 U.S.C. § 3613\(b\)](#)

<sup>143</sup> The SEC's enforcement in this area extends beyond attorneys. See, for example, the Order that charged Edwin Shaw, LLC, as an unregistered broker-dealer: <https://www.sec.gov/news/press-release/2018-30>. See also the enforcement action brought against Jason Lee, an immigration attorney: <https://www.sec.gov/litigation/admin/2018/34-83212.pdf>, to which she directed her immigration law clients.

<sup>144</sup> [SEC Order – American Life and Henry Liebman](#)

<sup>145</sup> On page 64 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#) we suggested that investigations or enforcement actions might be pending against one or more regional centers that made the payments to attorneys named in the administrative proceedings.

<sup>146</sup> [SEC v. Chen](#); [SEC Release – Chen](#)

millions of dollars of undisclosed funds from independent regional centers. To further profit,” she acquired and secretly controlled a regional center to which she steered other of her immigration law clients to make their EB-5 investments, without disclosing her management and control of the regional center.<sup>147</sup> The SEC alleges various violations of the federal securities laws, including securities fraud as well as failure to register as a broker-dealer.

### **C. Hui Feng SEC rehearing per Supreme Court decision**

The investors’ complaint in the CMB Century Plaza Hotel case alleges that some of the EB-5 investors were recruited to invest in the NCE by the immigration attorney Hui Feng and his law firm.<sup>148</sup> Some readers might recall that Hui Feng was the one lawyer who refused to settle with the SEC when on December 7, 2015, it announced 10 settled administrative proceedings against immigration attorneys and law firms for acting as unregistered broker-dealers.<sup>149</sup> There is no indication in the SEC Order regarding CMB as to whether Hui Feng was one of the unregistered broker-dealers allegedly paid by CMB and its CEO in those projects unrelated to the Century Plaza Hotel.

As discussed in the 2017 edition, the SEC brought an enforcement action in federal district alleging, inter alia, that immigration attorney Feng was an unregistered broker-dealer in violation of Section 15(a)(1) of the 1934 Act and committed fraud. The district court granted the SEC’s motion for summary judgment and found that he and his law firm were liable to pay more than \$2 Million to the SEC.<sup>150</sup> In reaching its holding, the court determined that the investors’ equity interest in the relevant NCEs constituted a security for purposes of the 1933 Act and 1934 Act.

Of lesser note at the time, the court imposed an injunction against Feng, and the SEC subsequently brought a separate administrative proceeding to impose a bar on Feng associating with brokers, dealers, and others. The initial decision of the SEC administrative law judge (“ALJ”) issued on March 10, 2018, imposed this bar.<sup>151</sup>

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<sup>147</sup> See Paragraph 85 of the SEC complaint filed in [SEC v. Chen](#).

<sup>148</sup> See Paragraph 20 of the Complaint in the CMB Century Plaza Hotel case - *Zhan v. Hogan*, Case No. 4:18-CV-04126 (C.D. Ill., filed 7/11/2018).

<sup>149</sup> <https://www.sec.gov/news/pressrelease/2015-127.html>

<sup>150</sup> *SEC v. Feng*, No. 2:15-cv-9420 (C.D. Cal. Aug. 10, 2017);

[https://eb5projects.com/system/uploads/document/file/405/96 - Order on MSJ\\_1 .pdf](https://eb5projects.com/system/uploads/document/file/405/96 - Order on MSJ_1 .pdf)

<sup>151</sup> <https://www.sec.gov/alj/aljdec/2018/id1242ce.pdf>

However, in June 2018, the US Supreme Court held in *Lucia v. SEC* that the appointment of ALJs by the SEC does not meet constitutional law requirements.<sup>152</sup> As part of its effort to remedy any constitutional defects, the SEC and many other federal agencies subsequently ratified and reappointed its ALJs. It also offered to rehear pending administrative proceedings, including the bar imposed against Feng by the March 2018 initial decision.<sup>153</sup> We anticipate that if Feng elects to have the matter reheard, the replacement ALJ will reach the same conclusion on this limited issue.

## IX Bank Escrow

The typical EB-5 offering provides that the funds contributed by the EB-5 investor to qualify for the visa will be held in escrow until the escrow conditions are satisfied. However, very few banks are willing to establish these escrow accounts. The banks' reluctance can be attributed to concerns about: compliance with increased federal regulations,<sup>154</sup> complicated escrow terms associated with the unusual nature of EB-5 transactions, exposure to reputational risk and potential liability.

A recent class action filed by the Jay Peak EB-5 investors against People's United Bank (the "Bank") merits attention, particularly by banks that have established and maintained EB-5 escrow accounts or are contemplating the creation of such accounts. The claims against the Bank arose out of the securities fraud perpetrated by Quiros against the Jay Peak EB-5 investors.

In 2016, Jay Peak investors filed a class-action lawsuit in federal district court against Quiros, Stenger and others including the Bank.<sup>155</sup> In May 2018, the court dismissed the Jay Peak investors claims against the Bank for lack of jurisdiction. The Bank did not have operations or minimum contacts in Florida.<sup>156</sup>

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<sup>152</sup> *Lucia v. SEC*, 138 S. Ct. 2044 (2018)

<sup>153</sup> See page 2 of Exhibit A of the SEC Order in re Pending Administrative Proceedings <https://www.sec.gov/litigation/opinions/2018/33-10536.pdf>

<sup>154</sup> The applicable law and regulations include: Bank Secrecy Act; USA Patriot Act; Anti-Money Laundering Program Requirements (AML); Know Your Customer, Office of Foreign Assets Control (OFAC).

<sup>155</sup> *Daccache v. Raymond James Financial, Inc.*, Case No. 16-cv-21575 (S.D. Fla., May 3, 2016)

<sup>156</sup> Order Dismissing Amended Complaint Against People's United Bank et al., Case No. 16-cv-21575 (S.D. Fla. May 15, 2018).

<https://www.leagle.com/decision/infdco20180523861>

Less than four months after the dismissal, the investors filed a class-action lawsuit against the Bank in federal district court in Vermont, the state in which the escrow accounts were established and the investor funds were deposited and maintained. The complaint alleges several causes of action including aiding and abetting common law fraud; aiding and abetting breach of fiduciary duty; and civil conspiracy to commit fraud with Quiros.<sup>157</sup>

The People's United Bank case is likely to cause banks to heighten their sensitivity to opening and maintaining EB-5 escrow accounts. The case may reinforce the concern that the EB-5 escrow accounts may expose the bank to unnecessary and unanticipated risks, especially if the court certifies this as a class action and the investors prevail. Presumably, at a minimum, this case will cause banks to re-evaluate their internal controls to make sure they have installed and continue to implement procedures to monitor the activity of the escrow account, as well as to seek to ensure that the flow of investors' funds and other activities comply with the escrow agreement and other governing documents as well as applicable law.

## **X Updates to SEC Enforcement Action Database**

Our 2017 edition included as Exhibit A our "Database of SEC EB-5 Securities Enforcement Actions."<sup>158</sup> Our database compiles a summary of the actions initiated by the federal government involving EB-5 projects where fraud was alleged, most of which involve the misappropriation of the investors' funds (the "2017 SEC Database").

We have updated the 2017 SEC Database to reflect new developments, including the Palm House Hotel enforcement action, and the Quiros SEC settlement (the "2018 SEC Database"). In addition, it reflects settlements in several other actions. For example, during 2018 the SEC settled the enforcement action against Emilio Francisco of Caffe Primo and against Lily Zhong of EB-5 Asset Manager.<sup>159</sup> We identified

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<sup>157</sup> *Sutton et al. v. People's United Financial Inc.*, case number 2:18-cv-00146 (D. Vt., September 7, 2018).

<sup>158</sup> See the Database starting at page 67 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

<sup>159</sup> See the Database in Exhibit A of this paper. In addition, the court terminated the receiver despite the judgment of approximately \$35 Million rendered in 2017 in the Proton enforcement action. Presumably the court determined that the estimated cost of seeking recovery outweighed the likelihood of recovery.

[http://www.grassmueckgroup.com/cases/beverlyproton/Doc\\_239\\_Final\\_Judgement\\_and\\_Perm\\_Injunc](http://www.grassmueckgroup.com/cases/beverlyproton/Doc_239_Final_Judgement_and_Perm_Injunc)

the changes from the 2017 SEC Database by highlighting the items in bold in the 2018 SEC Database. The categories in the 2017 SEC Database described on pages 18 to 23 of the 2017 edition continue to apply to the 2018 SEC Database.<sup>160</sup>

## **XI EB-5 Reform - Integrity**

The fraudulent scheme perpetrated in the Palm House Hotel case reinforces the need for adoption of EB-5 integrity reform measures without further delay. However, EB-5 legislative reform continues to prove elusive. Obviously, EB-5 reform ranks relatively low on Congress' priority list for immigration reform.

Thus, more than 3 years after Senators Grassley and Leahy introduced a comprehensive EB-5 immigration reform bill and more than 2 years after the SEC commenced its enforcement action in the landmark Jay Peak case, no integrity measures have been enacted. No legislation is even pending.

The most recent legislative effort, a draft bill proposed in March 2018, was quickly tabled. Moreover, the first draft of that bill omitted the most important integrity reforms contained in previous Congressional proposals aimed to address the expanding EB-5 securities fraud abuses. The subsequent March 2018 draft bill proposed a relatively meaningless watered-down fund-administration guideline.<sup>161</sup> The March 2018 proposal suggests that if and when EB-5 reforms are enacted, any integrity measures are likely to be ineffective.

We believe that until and unless independent third-party fund administration and account transparency measures are required by Congress or USCIS, the misappropriation of investor funds by bad actors is likely to increase.<sup>162</sup> Obviously, third-party fund administration will not eliminate fraud. However, the current environment encourages bad actors to thrive. This is in part because they know no one is monitoring

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[tion.pdf](#);

<http://www.grassmueckgroup.com/cases/beverlyproton/Doc 249 Order Directing Receiver to File Motion to Dissolve Receivership within Sixty Day.pdf>

<sup>160</sup> See Pages 18 to 23 of [Understanding EB-5 Securities: NYU Stern Database of SEC EB-5 Securities Enforcement Actions \(2017 edition\)](#).

<sup>161</sup> See pages 8 and 9 of [EB-5 Program: It's Broken. When Will It Be Fixed?](#)

<sup>162</sup> In the interim, presumably some regional centers will retain professionals, such as NES Financial and Exiger, to provide some of these and related services.

or reviewing the flow of funds until USCIS's review at a late stage in the immigration process, long after the misappropriation has occurred.

The extended visa waiting lines compound this problem. Investors' funds are remaining outstanding for longer periods than at any other time in the Program's history, thereby providing bad actors with an even greater opportunity to misappropriate the immigrant investors' funds. It is no wonder that in virtually every SEC civil enforcement action involving EB-5 fraud the NCE did not have an independent fund administrator, escrow conditions were ignored, and periodic reports of the status of investor funds were not furnished to investors.

Fortunately, USCIS finally appears to be ready to step forward and fill the void created by Congress's failure to act. The Fall 2018 OMB Unified Agenda, published on or about October 17, 2018, included a surprise announcement: DHS "plans to publish notice of proposed rulemaking to solicit public input on proposals that would increase monitoring and oversight of the EB-5 Program."<sup>163</sup>

Although we are encouraged, we are also wary that this proposed rule will become trapped in the same regulatory abyss as the proposed regulations that would increase the minimum investment levels.<sup>164</sup> Further cause for concern is provided by the timetable for release of the advanced rulemaking – September 2019. Presumably, that reflects a best-case scenario. In the meantime, the status quo continues to the bad actors' benefit, and unfortunately to the detriment of investors and the EB-5 Program.

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<sup>163</sup> <https://www.reginfo.gov/public/Forward?SearchTarget=Agenda&textfield=1615-AC26>

<sup>164</sup> Proposed regulations were issued on January 13, 2017 and the public comment period expired in 2017. However, DHS estimates for the date of release for final regulations have been missed on two prior occasions, and the regulations have not even arrived at OMB for its required review.

## Appendix A Updated Database of SEC Civil Enforcement Actions

**Data Sheets start on next page.  
See DS-1 through DS-4 inclusive.**

Updates to 2017 Database reflected in bold, italicized fonts

Case Reference		SEC Filing						Project Location and Type		
#	Commonly Referred to Case Name (Regional Center, Location or Key Defendant)	Date of SEC Filing of Complaint with Court	SEC Release Link including Link at bottom of Release to SEC Complaint filed in US District Court	EB-5 Role of Named Defendants	Does Securities Law Wrongdoing include Diversion of Funds (Yes or No)	Years of Alleged Wrongdoing	Time frame from Initial Wrongdoing to SEC Filing	Project Location: City or County and State	Urban or Rural	Type of Project
<b>16</b>	<b><i>Palm House Hotel</i></b>	<b><i>8/3/2018</i></b>	<b><i><a href="https://www.sec.gov/litigation/litreleases/2018/lr24224.htm">https://www.sec.gov/litigation/litreleases/2018/lr24224.htm</a></i></b>	<b><i>RC, NCE, JCE, principals</i></b>	<b><i>Yes</i></b>	<b><i>2012 to 2017</i></b>	<b><i>2012 to 2015</i></b>	<b><i>Palm Beach, FL</i></b>	<b><i>Urban</i></b>	<b><i>Hotel</i></b>
15	Home Paradise Investment Center (Edward Chen)	9/20/2017	<a href="https://www.sec.gov/litigation/litreleases/2017/lr23944.htm">https://www.sec.gov/litigation/litreleases/2017/lr23944.htm</a>	GP, NCE, JCE, RC	Yes	2014 to 2017	2014 to 2017	Ontario & Los Angeles, California	Urban	2 projects: Interior design center; Residential condo. 2 other major hotel/condo projects in downtown LA not included in the SEC action as of 9/30/2017.
14	Green Box	9/19/2017	<a href="https://www.sec.gov/litigation/litreleases/2017/lr23938.htm">https://www.sec.gov/litigation/litreleases/2017/lr23938.htm</a>	GP, NCE, JCE	Yes	2014 to 2015	2012 to 2017	Detroit, Michigan	Urban	No - environmental friendly recycling center
13	Kameli	6/22/2017	<a href="https://www.sec.gov/litigation/litreleases/2017/lr23866.htm">https://www.sec.gov/litigation/litreleases/2017/lr23866.htm</a>	GP, NCE, JCE, RC	Yes	2009 to 2016	2009 to 2017	Various locations in Illinois and Florida	Some urban, some rental	Yes - senior living facilities
12	Muroff	4/28/2017	<a href="https://www.sec.gov/litigation/litreleases/2017/lr23818.htm">https://www.sec.gov/litigation/litreleases/2017/lr23818.htm</a>	GP, NCE, JCE	Yes	2010 to 2013	2010 to 2017	Boise, Idaho	Rural	Luxury real estate; gold mining operations
11	Aero Space International Group (Chen)	3/15/2017	<a href="https://www.sec.gov/litigation/litreleases/2017/lr23778.htm">https://www.sec.gov/litigation/litreleases/2017/lr23778.htm</a>	GP, NCE, JCE, RC	Yes	2011 to 2015	2011 to 2017	Grant County, Washington	Rural	Industrial park development (7 projects)
10	Henderson	1/17/2017	<a href="https://www.sec.gov/litigation/litreleases/2017/lr23721.htm">https://www.sec.gov/litigation/litreleases/2017/lr23721.htm</a>	GP, NCE, JCE, RC	Yes	2010 to 2017	2010 to 2017	San Francisco, California	Urban	Nursing facility and retail center; call centers; and dairy operations. (7 projects)
9	Caffe Primo (Emilio Francisco)	12/27/2016	<a href="https://www.sec.gov/news/pressrelease/2016-281.html">https://www.sec.gov/news/pressrelease/2016-281.html</a>	GP, NCE, JCE	Yes	2013 to 2016	2013 to 2016	Multiple locations in Southern California	Urban	Assisted living facilities; Caffe Primo restaurants. 19 projects.
8	Proton (Liu and Wang)	5/26/2016	<a href="https://www.sec.gov/litigation/litreleases/2016/lr23556.htm">https://www.sec.gov/litigation/litreleases/2016/lr23556.htm</a>	GP, NCE, JCE, RC	Yes	2014 to 2016	2014 to 2016	Laguna Niguel, California	Urban	Cancer treatment center
7	Jay Peak	4/12/2016	<a href="https://www.sec.gov/news/pressrelease/2016-69.html">https://www.sec.gov/news/pressrelease/2016-69.html</a>	GP, NCE, JCE	Yes	2008 to 2016	2008 to 2016	Jay, Vermont	Rural	Ski resort facilities; hotel; and biomedical research facility. 8 phases.
6	Suncor (Yang and Kano)	11/19/2015	<a href="https://www.sec.gov/litigation/litreleases/2015/lr23414.htm">https://www.sec.gov/litigation/litreleases/2015/lr23414.htm</a>	GP, NCE, JCE	Yes	2012 to 2014	2012 to 2015	San Bernadino, California	Urban	Nursing care facilities (3 projects)
5	EB-5 Asset Manager (Zhong)	11/3/2015	<a href="https://www.sec.gov/litigation/litreleases/2015/lr23409.htm">https://www.sec.gov/litigation/litreleases/2015/lr23409.htm</a>	GP, NCE, JCE	Yes	2011 to 2015	2011 to 2015	Port St. Lucie and other locations along east coast of Florida	Urban and rural	Commercial real estate development
4	Path America (Dargey)	8/24/2015	<a href="https://www.sec.gov/litigation/litreleases/2015/lr23326.htm">https://www.sec.gov/litigation/litreleases/2015/lr23326.htm</a>	GP, NCE, JCE, RC	Yes	2012 to 2015	2012 to 2015	Seattle and Everett, Washington	Urban	Yes - Mixed use hotel and residential, and retail and residential. 2 projects.
3	Luca	7/6/2015	<a href="https://www.sec.gov/news/pressrelease/2015-141.html">https://www.sec.gov/news/pressrelease/2015-141.html</a>	GP, NCE, and JCE	Yes	2007 to 2014	2007 to 2015	Drilling: Texas, Louisiana	Rural	Oil and gas drilling projects (8 projects)
2	USA Now (Ramirez)	9/30/2013	<a href="https://www.sec.gov/news/press-release/2013-210">https://www.sec.gov/news/press-release/2013-210</a>	GP, NCE, JCE, RC	Yes	2010 to 2013	2010 to 2013	McAllen, TX	Rural	No - energy and restaurant grill. 2 projects.
1	Chicago Convention Center	2/6/2013	<a href="https://www.sec.gov/litigation/litreleases/2013/lr22615.htm">https://www.sec.gov/litigation/litreleases/2013/lr22615.htm</a>	GP, NCE, JCE, RC	Yes (Admin fee only; investors' capital contributions held in escrow)	2011 to 2013	2011 to 2013	Chicago, Illinois	Urban	Yes - Hotel and conference center
Not an SEC action; Filed by Office of US Attorney	CIIF (Chan)	US Attorney filed 5/24/2017	<a href="https://www.justice.gov/usao-cdca/pr/us-files-9-lawsuits-seeking-forfeiture-properties-worth-over-30-million-allegedly">https://www.justice.gov/usao-cdca/pr/us-files-9-lawsuits-seeking-forfeiture-properties-worth-over-30-million-allegedly</a>	RC, NCE, JCE, principals	Yes	2008 to 2017	2008 to 2017	Southern California	Urban and rural	Real estate development

Updates to 2017 Database reflected in bold, italicized fonts

Case Reference		Regional Center and Relationships					EB-5 Capital		
#	Commonly Referred to Case Name (Regional Center, Location or Key Defendant)	RC Date of USCIS Designation/ If Terminated, Date of Termination	RC Name	Related Party: NCE and JCE (Yes or No)	Related Parties: NCE and RC (Yes or No)	Related Parties: RC and JCE (Yes or No)	Actual EB-5 Capital Raised (excluding Admin Fees)	Alleged Amount of Diversion or Other Misuse of Investor Funds	Max. EB-5 Capital Raise sought
16	<i>Palm House Hotel</i>	<i>Designated 5/27/2010</i>	<i>South Atlantic Regional Center</i>	No	Yes	No	<i>\$44,000,000</i>	<i>\$21,478,000</i>	<i>N/A</i>
15	Home Paradise Investment Center (Edward Chen)	Designated 9/23/2011	Home Paradise Investment Center	Yes (Note that RC and NCE are apparently unrelated to JCE in two EB-5 megaprojects unrelated to this SEC action.)	Yes	Yes	\$22,500,000	\$12,100,000	
14	Green Box	Designated 2010	Green Detroit Regional Center	No	Yes	No	\$4,475,000	\$3,900,000	\$35,000,000
13	Kameli	Designated 3/5/2009	Chicagoland Foreign Investment Group Regional Center	Yes	Yes	Yes	\$88,700,000 (some investors didn't fully fund their investment)	\$10,270,000	NA
12	Muroff	Designated 9/13/2011	Idaho State Regional Center	Yes	Yes	Yes	\$140,500,000	\$31,000,000	NA
11	Aero Space International Group (Chen)	Designated 3/1/1994	Aero Space Port International (ASPI) Group Regional Center	Yes	Yes	Yes	\$14,500,000	\$14,500,000	NA
10	Henderson	Designated 11/1/2011	San Francisco (EB-5) Regional Center	Yes	Yes	Yes	\$107,500,000	\$17,100,000	\$144,000,000
9	Caffe Primo (Emilio Francisco)	Terminated 5/16/2017	Z Global Regional Center (as per SEC Memo of Law)	Yes	Yes	Yes	\$65,500,000	\$9,500,000	Not stated in complaint
8	Proton (Liu and Wang)	Terminated 1/26/2017	Pacific Proton Therapy Regional Center	Yes	Yes	Yes	\$27,000,000	\$20,000,000	\$150,000,000
7	Jay Peak	Designated 6/26/1997; ; Notice of Intent to Terminate issued by USCIS in 2017	State of Vermont Agency of Commerce & Community Development (aka "Vermont EB-5 Regional Center"); Notice of Intent to Terminate issued by USCIS	Yes	No	No	\$418,500,000	\$200,000,000	\$392,000,000
6	Suncor (Yang and Kano)	RC not referenced in complaint	RC not referenced in complaint	Yes	NO RC	NO RC	\$20,000,000	\$10,000,000	\$20,000,000
5	EB-5 Asset Manager (Zhong)	Terminated 5/9/2016	US EB5 Florida Regional Center	Yes	Yes	Yes	\$8,500,000	\$8,000,000	NA
4	Path America (Dargey)	Terminations: (1) Sunoco (11/23/2016); (2) KingCo (3/23/2016). Both terminations pending appeal per restructuring transactions. <i>Sunoco's appeal was approved, Kingco's denied.</i>	Path America Sunoco & Path America KingCo	Yes	Yes	Yes	\$150,000,000	\$17,600,000	\$240,000,000
3	Luca	Terminated - 2/2/2016	Luca Energy Fund Regional Center	Yes	Yes	Yes	\$8,000,000	\$5,400,000 (of entire \$68 million amount, including \$8 million EB-5)	\$37,000,000
2	USA Now (Ramirez)	Terminated 3/28/2014	USA Now	Yes	Yes	Yes	\$5,000,000	\$2,000,000	\$15,000,000
1	Chicago Convention Center	Terminated 11/20/2013	InterContinental Regional Center Trust of Chicago	Yes	Yes	Yes	\$145,000,000	All held in escrow	\$249,500,000
Not an SEC action; Filed by Office of US Attorney	CIIF (Chan)	Designated: 1/7/2010	California Investment Immigration Fund (CIIF)	Yes			\$50,000,000.00	\$30,000,000	NA

Updates to 2017 Database reflected in bold, italicized fonts

Case Reference		Construction and Funds			EB-5 Investment Structure		Information about Immigrant Investors		
#	Commonly Referred to Case Name (Regional Center, Location or Key Defendant)	Project construction status at time of SEC filing	Location of funds immediately prior to the diversion	Escrowed funds - early release (Yes or No)	Loan or Equity Model	Bank or Other Institutional Lender as senior lender (not merely as escrow) Yes or No	# Immigrant (or EB-5) Investors	Investors' Country of Origin	Immigration - Petition Status
<i>16</i>	<i>Palm House Hotel</i>	<i>Virtually no work done</i>	<i>Some at NCE, Some at JCE</i>	<i>Escrow never established</i>	<i>Loan</i>	<i>No</i>	<i>88</i>	<i>China and Iran</i>	<i>I-526 petitions denied</i>
15	Home Paradise Investment Center (Edward Chen)	Virtually no work done	At NCE, after released from escrow	Yes - Full release upon I-526 filing	Loan (interior design project) & equity (condo project)	NA	45	China	NA
14	Green Box	Made only down payment on equipment	At the JCE (unrelated to the NCE)	Apparently, no escrow	Loan	NA	9	China	NA
13	Kameli	Constructed only one of several planned senior living facilities. Construction not commenced on most of the others.	Escrow not referenced in complaint	Apparently, no escrow	Loan	NA	226	China, Iran	Majority of I-526s approved for one of the funds
12	Muroff	Construction in Process	Unclear if funds were ever held in escrow	Apparently, no escrow	NA	NA	281	China	NA
11	Aero Space International Group (Chen)	None	Unclear if funds were ever held in escrow	Apparently, no escrow	Loan	NA	18	China	NA
10	Henderson		Escrow not referenced in complaint	Apparently, no escrow	Some was deployed as loan, some was deployed as equity.	NA	215	China	NA
9	Caffe Primo (Emilio Francisco)	No construction on assisted living facilities project; some Caffe Primo restaurants are operating	Released from Escrow to NCE	Yes - Early release "upon becoming an LP"	Loan	NA	131	China	NA
8	Proton (Liu and Wang)	None	Released from Escrow to NCE	Yes - Probably immediate	Loan	No	54	China	I-526 Stage; 8 were approved
7	Jay Peak	Ponzi scheme; all but last phase completed	Released from Escrow to NCE	Yes	Equity	No	837	74 different countries	364 permanent green cards, 347 permanent green cards, 126 net conditional residents
6	Suncor (Yang and Kano)	Under construction, not completed	Released from Escrow to NCE	Yes - Upon filing I-526	Loan	Construction loan referenced, but no lender named	40	China	NA
5	EB-5 Asset Manager (Zhong)	Mixed use or residential real estate	Released from Escrow to NCE	Yes - until 526 approved, but actually released much earlier	Equity	No	17	China	NA
4	Path America (Dargey)	Farmer's Market substantially completed; Tower at excavation stage	Released from Escrow to NCE	Yes - \$400,000 upon filing. \$100,000 retained until I-526 approval. Dargey directed escrow agent	Loan	Voya Financial; and Binjiang	282	China	I-526 approvals: 69; I-526 denials: 192
3	Luca	Work in process; on verge of bankruptcy	Released from escrow	NA	Loan	No	16	China	NA
2	USA Now (Ramirez)	None	Released from Escrow to NCE	To be released upon USCIS approval of business plan, but never approved. In fact diverted funds for personal use on the same day or a few days after deposit in escrow.	Loan	No	11	Mexico, Egypt, Nigeria	I-526s Denied
1	Chicago Convention Center	No construction activity	Investor contributions held in escrow	No	NA	(State of Illinois bond financing - never obtained)	290	China	I-526s did not reach decision stage
Not an SEC action; Filed by Office of US Attorney	CIIF (Chan)	Virtually none				No	100	China	Some received temporary green cards

Updates to 2017 Database reflected in bold, italicized fonts

Case Reference		Case Status			Related Actions	
#	Commonly Referred to Case Name (Regional Center, Location or Key Defendant)	Relief Sought	Case Status	Case Outcome	Private Cause of Action filed by Immigrant Investors (Yes or No)	Criminal Action filed by US Attorney (DOJ): Yes or No
<b>16</b>	<b><i>Palm House Hotel</i></b>	<b><i>Disgorgement; Penalties; Injunction</i></b>	<b><i>Pending (JCE/Hotel Filed Ch. 11 Bankruptcy)</i></b>	<b><i>TBD</i></b>	<b><i>Yes</i></b>	<b><i>Yes - Indictment - 3/15/18 and 8/31/18</i></b>
15	Home Paradise Investment Center (Edward Chen)	Disgorgement; Penalties; Injunction; Receivership	Pending	TBD	No	No
14	Green Box	Disgorgement; Penalties; Injunction	Pending	TBD	No	Yes - Indictment, 9/20/2017
13	Kameli	Disgorgement; Penalties; Injunction; Receivership	SEC's motion for preliminary injunction and appointment of receiver denied. Disgorgement and other remedies to be determined at trial.	TBD	No	No
12	Muroff	Disgorgement; Penalties; Injunction; Permanent Bar	Settled (same day as complaint "filed")	Disgorgement: \$6.5M; Penalties: \$2.1M	<b>Yes</b>	No
11	Aero Space International Group (Chen)	Disgorgement; Penalties; Injunction	Pending	TBD	No	No
10	Henderson	Disgorgement; Penalties; Injunction; Receivership	Pending	TBD	No	No
9	Caf�e Primo (Emilio Francisco)	Disgorgement; Penalties; Injunction; Receivership	Pending	Disgorgement: \$1.8M; Interest \$117K ; Penalty: \$369K	No	No
8	Proton (Liu and Wang)	Disgorgement; Penalties; Injunction; Receivership	Decided 4/20/2017	<b><i>Disgorgement: \$26.7M; Penalty: \$8.2M. Uncollected - Receiver Terminated</i></b>	No	No
7	Jay Peak	Disgorgement; Penalties; Injunction; Retention of Equity; Receivership	<b><i>Settled with both Stenger and Quiros (2/6/2018)</i></b>	<b><i>Disgorgement: \$81M; Penalty: \$1M, (Total Paid by Quiros ~\$84M); Stenger paid \$75,000</i></b>	Yes	No
6	Suncor (Yang and Kano)	Disgorgement; Penalties; Injunction.	Pending	TBD	No	No
5	EB-5 Asset Manager (Zhong)	Disgorgement; Penalties; Injunction; Receivership; Repatriation	<b><i>Settled Jan. 2018</i></b>	<b><i>Disgorgement: \$10.4M. Penalty: \$650K</i></b>	No	No
4	Path America (Dargey)	Disgorgement; Penalties; Injunction; Receivership; Repatriation	Settled	Disgorgement: \$18.4M	No	Yes- Guilty plea 1/4/2017; 4 year sentence; Restitution: \$24M
3	Luca	Disgorgement; Penalties; Injunction; Receivership	Decided 7/26/2016	Disgorgement: \$68.3M	No	No
2	USA Now (Ramirez)	Disgorgement; Penalties; Injunction; Receivership	Decided (Final judgment 3/31/2017)	Disgorgement: \$12+M; Civil Penalty: \$10M	No	No
1	Chicago Convention Center	Disgorgement; Penalties; Injunction; Repatriation	Settled (consent judgment): 3/7/2014	Disgorgement: \$11.5M; Penalties: \$3.9M; Refund of Escrow: \$147M	No	Yes - Guilty plea 1/3/2014; 3 year sentence; Restitution: \$8.85M
Not an SEC action; Filed by Office of US Attorney	CHIF (Chan)	Seizure of real estate	8 of 9 properties seized		Yes - filed 9/20/2017	Yes - Victoria Chan plead guilty on 11/27/2017. Sentencing scheduled 7/19/2018. 45 yr maximum.