

How The Gov't Is Cracking Down On PPP Fraud

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The U.S. Department of Justice is scrutinizing borrowers who have fraudulently applied for loans through the U.S. Small Business Administration's Paycheck Protection Program, established by the Coronavirus Aid, Relief, and Economic Security Act. In the past six weeks alone, the DOJ filed charges in eight separate cases against defendants accused of fraud in connection with the PPP loans:



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- On May 5, the DOJ announced its first criminal charges related to the PPP. In two cases in the U.S. District Court for the District of Rhode Island, the DOJ alleged that two businessmen filed fraudulent loan applications seeking more than a half-million dollars in forgivable PPP loan funds. In their loan applications, the businessmen allegedly misrepresented the number of employees at various businesses, which had zero employees and were not even operating when the COVID-19 pandemic began.[1]
- On May 13, the DOJ announced two more sets of charges: one in the U.S. District Court for the Northern District of Georgia against a reality TV personality, who allegedly used over \$1.5 million of his PPP loan proceeds to "bankroll lavish purchases of jewelry and other personal items" rather than finance his trucking company, and another in the U.S. District Court for the Eastern District of Texas against an engineer for wire fraud, bank fraud, false statements to a financial institution, and false statements to the SBA for applying for over \$10 million in PPP loans for a business that had zero employees.[2]
- On May 19, another man was charged in the Eastern District of Texas with fraudulently seeking PPP loan money based on falsified employee certifications.[3]
- On May 22, the DOJ brought wire and bank fraud charges against a Washington resident who allegedly submitted false payroll records to obtain over \$1.5 million in loan funds and a Hollywood film producer who allegedly diverted loan funds for personal expenses, rather than legitimate business needs.[4]
- On June 4, the DOJ charged an Arkansas project manager with allegedly filing fraudulent loan applications with multiple banks, seeking \$8 million in PPP loans based on fictitious payroll expenses.[5]

The number of such charges continues to grow, demonstrating the government's strong intent both to claw back any loan proceeds that were obtained based on fraud. Assistant Attorney General Brian A. Benczkowski of the DOJ's Criminal Division emphasized this point when stating that "[t]he department and our law enforcement partners will remain vigilant in our efforts to protect critical CARES Act relief programs from fraud and abuse." [6]

There are a number of ways to come under the DOJ's scrutiny. When applying for a PPP loan, a borrower must make a number of certifications to the SBA. The certifications — all of which must be made in good faith — relate to eligibility and the accuracy of supporting documentation. In certain cases, the representations extend to compliance with civil rights

laws and the purchase of only American-made equipment and products.

A great deal of concern was caused by the SBA's April 23 issuance of FAQ 31, warning borrowers to carefully consider the "need" certification and suggesting that borrowers with alternate sources of liquidity could not make the need certification in good faith. That FAQ provided a safe harbor that allowed borrowers to reevaluate their need certifications and, if appropriate, return the PPP loan proceeds by May 7 without exposure to prosecution based on the that certification.[7]

On May 13, the SBA issued FAQ 46, which provided an additional safe harbor from prosecution for misrepresentations regarding the need certification for all PPP loans of less than \$2 million. Specifically, FAQ 46 deemed all borrowers of such loans as having made their need certification in good faith. Further, the SBA stated that if in its review of PPP loans in excess of \$2 million it concludes that the need certification was made without an adequate basis, then the SBA would seek repayment of a PPP loan and inform the lender that such loan was not eligible for forgiveness.

Notably, as the aforementioned DOJ charges demonstrate, the safe harbors relating to the need certification do not provide protection with respect to any other fraudulent conduct in the PPP loan process, including failure to satisfy the eligibility requirement that the borrower qualify as a small business. Simply stated, the SBA's safe harbors are not absolute; the DOJ is not prohibited from initiating civil or criminal actions against PPP loan borrowers even where the SBA has not made a referral. PPP loan borrowers may face potential criminal and civil exposure for making false statements under a variety of federal statutes.[8]

The risks to PPP loan borrowers also are not limited to governmental prosecution. Qui tam whistleblowers may bring False Claims Act cases against PPP loan borrowers for making inaccurate certifications or otherwise violating the requirements relating to PPP loans. Such exposure can be initiated through a government hotline or a civil complaint in which the government may intervene. Circuit courts have found viable FCA claims in situations where the defendant fraudulently submitted the paperwork necessary to obtain a government assurance and a subsequent default on the loan resulted in the government's expenditure of funds.[9]

PPP loan certifications are likely a focus of future government review. The CARES Act authorizes a special inspector general for pandemic recovery to examine the loans and loan guarantees awarded by the secretary of the Treasury. Separately, the CARES Act establishes additional responsibilities for inspectors general through the creation of a Pandemic Response Accountability Committee, which is charged with overseeing all funds made available to nonfederal entities for coronavirus response.

In addition to making the required certifications in good faith, PPP loan borrowers should contemporaneously document the basis for their PPP loan certifications, including the nature of the uncertainty created by the ongoing pandemic, the corresponding need and the lack of other meaningful sources of liquidity. In particular, companies should:

- Contemporaneously (or as close as possible) articulate facts that support need certification;
- Contemporaneously document employees on payroll during the covered period established in the PPP loan legislation;

- Maintain supporting documentation submitted in support of the loan, including all materials submitted to the PPP lender with a loan application;
- If feasible, closely track expenditure of PPP loan proceeds by authorized category;
- Monitor and investigate whistleblower complaints regarding receipt and use of PPP loan proceeds to company hotlines; and
- Prepare for potential inquiries from the press regarding receipt and use of loan proceeds.

Even if civil or criminal charges are not brought, any governmental inquiry will require PPP loan borrowers to incur cost, effort and potential public relations implications in responding to any governmental inquiry. Taking steps now will help borrowers be prepared to respond.

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[1] <https://www.justice.gov/opa/pr/two-charged-rhode-island-stimulus-fraud>.

[2] <https://www.justice.gov/opa/pr/reality-tv-personality-charged-bank-fraud>; <https://www.justice.gov/opa/pr/engineer-charged-texas-covid-relief-fraud>.

[3] <https://www.justice.gov/opa/pr/texas-man-charged-5-million-covid-relief-fraud>.

[4] <https://www.justice.gov/opa/pr/software-engineer-charged-washington-covid-relief-fraud>; <https://www.justice.gov/opa/pr/hollywood-film-producer-charged-17-million-covid-relief-fraud>.

[5] <https://www.justice.gov/opa/pr/arkansas-project-manager-charged-oklahoma-covid-relief-fraud>.

[6] <https://www.justice.gov/opa/pr/engineer-charged-texas-covid-relief-fraud>.

[7] The safe harbor's return date was subsequently extended to May 18 by SBA's FAQ 47.

[8] As the PPP applications enumerate, borrowers may face potential exposure under 18 U.S.C. § 1001 for making false statements, 18 U.S.C. § 3571 for a sentence of fine, 15 U.S.C. § 645 for making misrepresentations related to aid to small businesses, and 18 U.S.C. § 1014 for making false statements in loan and credit applications. These enumerated regulations alone expose the PPP borrowers to imprisonment and substantial fines, including: imprisonment of not more than five years and/or a fine of up to \$250,000 under 18 USC 1001 and 3571; imprisonment of not more than two years and/or a fine of not more than \$5,000 under 15 USC 645; and, if submitted to a federally insured institution, imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000 under 18 USC 1014. In addition, recent charges brought by the DOJ

demonstrate the Agency's propensity to include wire and bank fraud counts in any set of charges.

[9] See, e.g., [United States v. Van Oosterhout](#), 96 F.3d 1491, 1494 (D.C.Cir.1996) ("It is generally accepted that the false application for a guaranteed loan by the debtor establishes only an 'inchoate' violation of the Act that does not ripen into a claim actionable under the statute until a later event of legal consequence between the lender and the government [A]n actual payment to the lender qualifies as the event that effectuates the 'claim' for the government has 'disbursed funds.' ") (citing [United States v. McNinch](#), 356 U.S. 595, 599 (1958)); [United States v. Rivera](#), 55 F.3d 703, 707 (1st Cir.1995); [United States v. Ekelman & Assocs., Inc.](#), 532 F.2d 545, 550-51 (6th Cir.1976).