

# False Claims Act Developments in PPP Civil Investigations

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With the second round of Paycheck Protection Program (“PPP”) loans resuming in January 2021, a new wave of investigations into potential fraud and abuse in the use of PPP proceeds has commenced. This new wave comes on the heels of the U.S. Department of Justice (“DOJ”) entering into its first civil fraud settlement to date related to PPP loans. On January 12, 2021, the DOJ entered into a settlement agreement with California-based online retail company, SlideBelts Inc., which, without admitting to liability, accepted responsibility for having misrepresented its bankruptcy status when applying for PPP loans. This first civil settlement is a harbinger for more PPP related False Claims Act (“FCA”) investigations under the Biden administration.

## PPP and Civil Liability Pursuant to the FCA

The FCA allows the U.S. government to recover damages and penalties for false claims made in relation to payments made to the U.S. government. In the context of the PPP, the FCA raises implications for both potential borrowers as well as lenders, as liability may arise in a number of ways. For borrowers, liability can stem from false or misleading statements made regarding a borrower’s: (i) eligibility to receive loan forgiveness, (ii) status in bankruptcy proceedings, (iii) criminal or debarment history, (iv) existence or number of employees on payroll, (v) history of default or delinquency on federally guaranteed loans, or a number of other eligibility factors. To be liable under the FCA, the borrower must have knowingly made false claims to fraudulently obtain PPP proceeds.

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FCA liability may also be of concern to lenders. Lenders can be liable under the FCA for knowingly certifying ineligible borrowers for PPP loans, including by failing to employ sufficient anti-money laundering protocols<sup>1</sup> to verify the borrower's payroll criteria, which are required for eligibility. As such, lenders may face increased FCA liability for, in essence, insufficient compliance mechanisms.

With the second round of PPP loans having resumed at the beginning of the year, it will likely be a matter of time before the DOJ brings an influx of FCA lawsuits. According to a September 1, 2020 memorandum released by the House of Representatives' Select Subcommittee on the Coronavirus Crisis ("Subcommittee"), over \$1 billion in PPP loans were made to companies that received multiple loans, and more than 600 loans totaling over \$96 million went to companies debarred or suspended<sup>2</sup> from doing business with the federal government.<sup>3</sup> Additionally, the federal government's System for Award Management database red flagged more than \$2.98 billion in PPP loans to 11,000 borrowers.<sup>4</sup>

### SlideBelts: First PPP Civil Settlement

Despite the Subcommittee's findings, the DOJ has, to date, resolved only one civil case involving PPP fraud. On January 12, 2021, the DOJ entered into its first civil settlement to resolve PPP fraud allegations brought against SlideBelts Inc. ("SlideBelts" or the "Company"), an internet retail company.<sup>5</sup> The DOJ alleged that SlideBelts and its President and CEO, Brigham Taylor, violated the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA"), as well as the False Claims Act, by improperly applying for and receiving \$350,000 in PPP funds.

<sup>1</sup> Fed. Reg., *Business Loan Program Temporary Changes; Paycheck Protection Program* (April 15, 2020), <https://www.federalregister.gov/documents/2020/04/15/2020-07672/business-loan-program-temporary-changes-paycheck-protection-program>.

<sup>2</sup> A company can be debarred or suspended from doing business with the federal government for many reasons, including because the company had been convicted of or found civilly liable for fraud, violated material terms of their contract with the government, or presented "any other cause of so serious or compelling a nature that it affects the present responsibility of the contract." See Fed. Acquisition

Specifically under the FCA, the DOJ alleged that SlideBelts and Taylor knowingly and falsely represented that SlideBelts was not undergoing bankruptcy at the time of its PPP application. As a consequence, SlideBelts and Taylor were forced to repay the \$350,000 in PPP funds received, and without admitting to liability, agreed to pay a combined \$100,000 in damages and penalties.

In August 2019, SlideBelts applied for Chapter 11 bankruptcy in the Eastern District of California. On April 3, 2020, despite the pending bankruptcy proceedings, SlideBelts submitted an application for a PPP loan for approximately \$300,000 to a financial institution in Sacramento, California ("FI-1"). On April 8, 2020, SlideBelts submitted a second application for a PPP loan to a financial institution in Fort Lee, New Jersey ("FI-2"). On April 14, 2020, FI-1 rejected SlideBelts' application, noting SlideBelts was presently in bankruptcy, contrary to the Company's response to Question 1 of its PPP loan application. Taylor answered and acknowledged the loan rejection, writing "that does make sense. All good!"<sup>6</sup> On that same day, SlideBelts submitted a third PPP loan application to a financial institution in Minneapolis, Minnesota ("FI-3"), again representing that SlideBelts was not presently involved in any bankruptcy. FI-2 granted SlideBelts' loan of \$350,000 and distributed the funds to the Company on April 21, 2020.

On April 22, 2020, after having received the funds disbursed from FI-2, Taylor disclosed SlideBelts' bankruptcy status to FI-2, explaining that SlideBelts "just realized that we may not have answered [Question 1] correctly since we filled out the

Reg. 9.406-2(c) (2019), <https://www.acquisition.gov/sites/default/files/current/far/pdf/FAR.pdf>.

<sup>3</sup> Select Subcomm. on the Coronavirus Crisis, *Select Subcommittee Releases Preliminary Analysis of Paycheck Protection Program Data* (Sept. 1, 2020), <https://coronavirus.house.gov/sites/democrats.coronavirus.house.gov/files/2020-09-01.PPP%20Interim%20Report.pdf>.

<sup>4</sup> *Id.*

<sup>5</sup> Dep't. of Justice, *Final Settlement Agreement* (Jan. 12, 2021), <https://www.justice.gov/usao-edca/press-release/file/1352931/>.

<sup>6</sup> *Id.*

application quickly and wanted to bring it to your attention.”<sup>7</sup> On April 30, 2020, SlideBelts filed a motion in bankruptcy court seeking retroactive approval of the PPP loan, excluding any disclosure of its false statement to FI-2 regarding its status in bankruptcy. On June 16, 2020, the Small Business Administration (“SBA”) opposed SlideBelts’ motion and requested that the Court order SlideBelts to return the loan to FI-2. On January 8, 2021, SlideBelts returned the \$350,000 loan to FI-2. A settlement agreement with the DOJ was reached a few days later on January 12, 2021.

Despite the fact that the DOJ has pursued dozens of criminal cases in connection with PPP fraud, SlideBelts is unique in that it is the first civil settlement that has been reached to date. While the DOJ investigates both civil and criminal allegations related to PPP fraud, it has seemed to be prioritizing cases that have a criminal element. For example, as recently as February 10, 2021, the DOJ prosecuted a Florida man for obtaining \$3.9 million in PPP loans and using those funds, in part, to purchase a \$318,000 Lamborghini sports car for himself.<sup>8</sup> As of February 23, 2021, the DOJ has prosecuted more than 100 defendants in over seventy criminal cases related to the PPP.<sup>9</sup>

### Future of Civil PPP Claims

Recipients or lenders of PPP funds should consider a few points as the DOJ moves into its next phase of prosecutions under the Biden administration. First, there have been numerous and frequent changes regarding the guidance surrounding PPP eligibility and requirements. To date, the PPP loan application form

has been amended seven times and the SBA has issued twenty-nine interim final rules related to the PPP since April 2020.<sup>10</sup> For example, on May 22, 2020, the SBA released an interim final rule<sup>11</sup> clarifying for the first time how to calculate full-time equivalent employees, which in turn had implications for the total loan forgiveness amount borrowers could be eligible for. With this evolving guidance, the government may face increased challenges to establishing the falsity or scienter elements against the borrower under the FCA.

Second, it will be noteworthy to see how misrepresentations regarding eligibility certification will be treated from misrepresentations regarding the use of funds for eligible purposes. So far, the DOJ has pursued cases that involve misrepresentations of both eligibility certification and use of proceeds as criminal prosecutions. However, it is possible that where a case involves only misrepresentations regarding eligibility certification, as was the case in SlideBelts, the DOJ may choose to pursue these cases under civil liability theories.

Third, while the DOJ has prioritized the prosecution of fraud by borrowers, there may also be risk for lenders over time. SBA guidance requires lenders to certify certain facts prior to granting PPP loans, including certifying the fact that sufficient anti-money laundering protocols are in place to verify the borrower’s payroll criteria.<sup>12</sup> To the extent there are falsehoods or fraud related to these certifications, lenders may face risk as well.

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<sup>7</sup> *Id.*

<sup>8</sup> Dep’t. of Justice, *Man Purchased Lamborghini After Receiving \$3.9 Million in PPP Loans* (Feb. 10, 2021), <https://www.justice.gov/opa/pr/man-purchased-lamborghini-after-receiving-39-million-ppp-loans>.

<sup>9</sup> Dep’t. of Justice, *Man Pleads Guilty to Directing COVID-Relief Fraud Scheme* (Feb. 23, 2021), <https://www.justice.gov/opa/pr/man-pleads-guilty-directing-covid-relief-fraud-scheme>.

<sup>10</sup> Small Bus. Admin., *Interim Final Rules*, <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program/ppp-lender-information> (last visited March 10, 2021).

<sup>11</sup> Fed. Reg., *Business Loan Program Temporary Changes; Paycheck Protection Program* (June 1, 2020), <https://www.federalregister.gov/documents/2020/06/01/2020-11536/business-loan-program-temporary-changes-paycheck-protection-program-requirements-loan-forgiveness>.

<sup>12</sup> Fed. Reg., *Business Loan Program Temporary Changes; Paycheck Protection Program* (April 15, 2020), <https://www.federalregister.gov/documents/2020/04/15/2020-07672/business-loan-program-temporary-changes-paycheck-protection-program>.