One Year of COVID-19: The Government's Efforts To Address CARES Act Fraud

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Over the course of a year beginning in March 2020, starting with the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), the U.S. government has approved trillions of dollars in relief funds in efforts to keep the U.S. economy afloat. Part of these relief efforts has included government-backed loans to private enterprises, including the Payment Protection Program (PPP) and the Economic Injury Disaster Loan program (EIDL). Promptly after the launch of the programs, the government began bringing criminal fraud cases against individuals for furnishing false information in loan applications. Then, in January 2021, the government announced the first civil settlement with a corporate entity related to CARES Act fraud. While it is unclear yet if this development indicates that more civil enforcement actions are to come, the government's use in that settlement of the often overlooked Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) is noteworthy and could expand the government's efforts to extract significant fines for corporate PPP fraud. Companies and other organizations that have applied for funds through the PPP or the EIDL should pay close attention to these developments.

The CARES Act

In March 2020, in response to the COVID-19 pandemic, Congress passed the $2.2 trillion CARES Act which, coupled with additional legislation in the following months, established programs to revive the American economy. One such effort was the PPP, a now $953 billion small business loan program, implemented by the Small Business Administration (SBA), permitting eligible businesses to apply for an SBA-guaranteed loan through a private lender, with the SBA compensating the lender for all processing costs. As part of this process, borrowers had to certify that their application materials were true and that the funds were used in accordance with the requirements of the PPP,[1] namely that the funds were used "to maintain ... payroll, hire back employees who may have been laid off, and cover applicable overhead."[2] The CARES Act also established the EIDL, which was intended to help businesses "meet financial obligations and operating expenses that could have been met had the disaster not occurred."[3] In contrast to the PPP's use of private lenders, EIDL applications are submitted directly to the SBA.

Criminal Enforcement of CARES Act Violations

Shortly after the CARES Act took effect, the U.S. government brought its first criminal action for fraudulently seeking a loan. On May 5, 2020, two individuals were charged in the District of Rhode Island for conspiring together to obtain PPP and EIDL loans to "pay employees of businesses that were not operating prior to the start of the ... pandemic and had no salaried employees, or, as in one instance, to pay employees at a business the loan applicant did not own."[4] The charges were conspiracy to make false statements to influence the SBA (18 U.S.C. §371), conspiracy to commit bank fraud (18 U.S.C. §1349), and aggravated identify theft (18 U.S.C. §1028A).[5] In the ensuing year, the government has filed a wave of criminal actions against individuals across the country, with allegations and charges mirroring those brought in May 2020, such as

[1] Treasury Dept., PPP Information Sheet for Borrowers.

[2] Treasury Dept., Assistance for Small Businesses instructions.

[3] U.S. Small Business Administration, COVID-19 Economic Injury Disaster Loan instructions.

[4] Dept. of Justice Office of Public Affairs, "Two Charged in Rhode Island With Stimulus Fraud" (May 5, 2020).

[5] *United States v. Staveley*, Case No. 1:20MJ34LDA (D.R.I. filed May 4, 2020) (Dkt. 3).

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wire and bank fraud,[6] making false statements to a bank,[7] and money laundering.[8] As of late March 2021, the government has publicly charged 474 people for defrauding various COVID relief programs, including charging over 120 defendants with defrauding the PPP.[9]

The SlideBelts, Inc. Civil Settlement

On January 12, 2021, after nearly a year of the government's pursuit of solely criminal charges against individuals, the U.S. Attorney's Office for the Eastern District of California announced the nation's first civil settlement for CARES Act fraud against a corporate entity.[10] The settlement involved SlideBelts, Inc., a fashion accessory company incorporated in Delaware with its principal office in the greater Sacramento, California, area. Under the SBA rules for administering the PPP, any applicant that is "the debtor in a bankruptcy proceeding, either at the time it submits the application or at any time before the loan is disbursed," is ineligible for the PPP program.[11] Despite entering bankruptcy proceedings in 2019, SlideBelts allegedly falsely indicated in its PPP application that it was not in bankruptcy proceedings. SlideBelts ultimately received a $350,000 loan, with the SBA reimbursing $17,500 in loan processing fees to the lender that provided the loan.

After the loan was disbursed, SlideBelts alerted the lender that it "may not have answered" the questions on the loan application correctly because the company had "filled out the application quickly." Rather than return the loan, SlideBelts petitioned the bankruptcy court for retroactive approval of the PPP loan, which both the SBA and the lender opposed. SlideBelts then asked the court to dismiss its bankruptcy case so that it could reapply for PPP funds while the case was dismissed and then later refile for bankruptcy. The court granted the dismissal, and SlideBelts later returned the $350,000 loan.

In mid-January 2021, the U.S. Attorney's Office in Sacramento announced that it had reached a civil settlement with SlideBelts related to the false statements the company made in connection with obtaining a PPP loan. The government contended that SlideBelts violated both FIRREA[12] and the False Claims Act (FCA),[13] with potential penalties exceeding $4 million. The settlement agreement included a payment of $100,000 from SlideBelts, $17,500 of which constituted restitution for the loan processing fees.

The FCA and FIRREA

The government has long favored aggressive enforcement of the FCA, securing an average of approximately $3.7 billion per year in settlements and judgements over 2011-2020.[14] The FCA penalizes, among other things, the "knowing" presentation or making of a "false or fraudulent claim for payment or approval."[15] The FCA permits civil penalties of no less than $5,000 and no more than $10,000 per false claim (adjustable by the Federal Civil Penalties Inflation Adjustment Act, 28 U.S.C. §2461), plus treble damages for the amount of loss suffered by the government (or double damages provided the defendant cooperates with government investigators).[16] Under FCA case law, a false application made to obtain a government-guaranteed loan from a private lender (such as a PPP loan) creates an inchoate violation of the FCA that does not ripen into an actionable claim "until a later event of legal consequence between the lender and the government" occurs, such as a default on the loan, which would trigger the government's obligation to disburse funds.[17] The statute of limitations for an FCA action is six years after the violation occurred or three years after the government knew or should have known of the violation (but in no event more than 10 years after the violation occurred), whichever occurs last.[18]

In contrast, FIRREA, which emerged out of the 1980s savings and loan crisis, was seldom used by the government until the aftermath of the 2008 financial crisis. The statute authorizes civil penalties for the violation of any one of 14 enumerated criminal offenses, such as bank or wire fraud.[19] However, unlike a criminal prosecution under those statutes, under FIRREA, the government must prove violation of the relevant statutes by only a preponderance of the evidence in order to recover a civil penalty.[20] In addition, because violation of a predicate offense equates to violation of FIRREA, the government does not need to prove a loss or damage and can impose civil penalties regardless of

[6] U.S. Attorney's Office, Central District of California, "Three Additional Members of Alleged Fraud Ring Based in San Fernando Valley Arrested on Charges of Exploiting COVID-Relief Programs" (March 12, 2021).

[7] Dept. of Justice Office of Public Affairs, "Man Charged With $1.9 Million COVID-Relief Fraud" (Jan. 28, 2021).

[8] Dept. of Justice Office of Public Affairs, "California Man Charged With Conspiring To Launder Proceeds of Fraud Schemes Targeting New Jersey Law Firm and SBA Loans" (March 18, 2021).

[9] *Law360*, "DOJ Says Hundreds Charged With COVID-19 Fraud So Far" (March 26, 2021); *see also* Dept. of Justice Press Release, "Fraud Section Enforcement Related to the CARES Act" (March 26, 2021).

[10] U.S. Attorney's Office, Eastern District of California, "Eastern District of California Obtains Nation's First Civil Settlement for Fraud on Cares Act Paycheck Protection Program" (January 12, 2021).

[11] 85 Fed. Reg. at 23451.

[12] 12 U.S.C. §1833a.

[13] 31 U.S.C. §3729-33.

[14] Dept. of Justice, Fraud Statistics Overview, 1986-2020.

[15] 31 U.S.C. §3729(a)(1).

[16] *Id.* §3729(a)(1)(G); (a)(2).

[17] *U.S. ex rel. Bibby v. Wells Fargo Bank, N.A.*, 906 F. Supp. 2d 1288, 1295-97 (N.D. Ga. 2012).

[18] *Id.* §3731(b).

[19] 12 U.S.C. §1833a(c).

[20] Id. §1833a(f).

whether a loss occurred.[21] Under FIRREA, the maximum civil penalty is either $1.1 million per violation, $1.1 million per day or $5.5 million per violation for a continuing violation, or the amount of pecuniary gain or loss if it exceeds those thresholds.[22] FIRREA has a ten year statute of limitations.[23]

Looking Forward

While the government initially focused its efforts on combatting alleged PPP fraud on criminal prosecutions of individuals, the SlideBelts settlement suggests that its focus may shift to civil enforcement actions against corporate entities. Tracking compliance with PPP rules and the scope of FIRREA regulations is particularly important for companies navigating COVID relief funds.

The PPP's structure — providing government-guaranteed loans through private lenders with the SBA reimbursing processing fees — may lead some to believe that, absent a default, the government's loss is limited in nature and would make any penalties under the FCA relatively minimal (*i.e.*, up to a $10,000 fine per false claim plus either double or triple the loan processing fees). However, FIRREA provides the government with significantly wider enforcement capabilities than does the FCA and changes that calculation. As the government does not need to show any loss to invoke FIRREA violations, a falsely obtained PPP loan, which a company pays back in full with interest, could still trigger a civil penalty in excess of $1 million. And, with FIRREA's lengthy statute of limitations, the government could pursue such penalties anytime through the early 2030s.

To limit potential exposure to liability, companies or other organizations that have applied for COVID relief funds, such as PPP loans, should review the eligibility requirements, ensure that no inadvertent misstatements were made, and provide training to any employees responsible for loan applications on the requirements for PPP, as well as any updated rules issued by the SBA.

[21] *See*, *e.g.*, 18 U.S.C. §1344 (not requiring any loss or damage for a conviction under federal bank fraud statute).

[22] *See id.* §1833a(b)(1)-(3); 28 C.F.R. §85.3(a)(6)-(7).

[23] 12 U.S.C. §1833a(h).