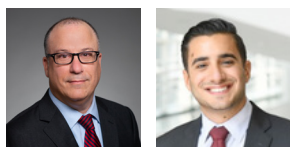


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## Internal Investigations & White Collar Defense Alert

# PPP Fraud Prosecutions Coming as Federal Prosecutors Ramp up Investigations



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Through the Paycheck Protection Program (PPP), first enacted in April 2020 as part of the omnibus Coronavirus Aid, Relief and Economic Securities (CARES) Act, Congress authorized more than \$800 billion in forgivable loans to small businesses. The aim was to keep businesses afloat and to help them retain their employees during the Covid-19 pandemic. In order to qualify for forgiveness, businesses needed to show that 60% of their loan was used for payroll costs and the remaining amount used on other qualifying business expenses. Now, two and a half years later, the vast majority of these loans **have been forgiven**.

The PPP program by itself is one of the largest government spending programs in history, and has unsurprisingly led to individuals improperly or fraudulently seeking funds and loan forgiveness. Notable instances of PPP fraud publicized by the Department of Justice in South Florida include **a Florida man** who fraudulently obtained almost \$4 million in PPP loans and used some of those funds to purchase a Lamborghini, and **a Miami nurse** who received more than \$420,000 and spent the money on personal expenses, transfer-

ring \$239,000 into a personal bank account. Both cases involved false claims about company payroll expenses.

Recognizing the level and scale of PPP Fraud, the federal government has not only communicated an intention to crack

### *Key points:*

**The Paycheck Protection Program and other federal Covid-19 relief programs disbursed hundreds of billions of dollars in loans to small businesses.**

**Federal authorities have ramped up prosecution of loans fraudulently obtained under these programs.**

**Businesses worried about federal scrutiny of their loan or loan forgiveness applications can take proactive steps to resolve any accounting or claim errors.**



down on such fraud, but also **passed bills into law** that establish a ten-year statute of limitations for prosecutions related to PPP and similar programs.

These types of cases have drawn particular attention because covid relief funds were limited, so every dollar fraudulently procured was taken from a potential business or employee in need during the pandemic. With this in mind, the federal government has been aggressively investigating and charging businesses that appear to be taking advantage.

Below, following a brief overview of the CARES Act and the PPP, we outline how businesses large and small can be investigated and charged with fraudulently procuring and/or misusing PPP funds; which criminal statutes apply to these and other related programs; and what you can do make sure your business is protected.

## Overview of the CARES Act and the Paycheck Protection Program

The CARES Act, signed into law on March 27, 2020, created the Paycheck Protection Program in the early days of the pandemic to allow small employers to keep employees working or at least continue to pay them despite Covid closures. The CARES Act authorized more than \$2 trillion to battle COVID-19 and its economic effects, including cash relief for citizens, loan programs for small businesses, support for hospitals and other medical providers, and various types of economic relief for impacted businesses and industries.

The PPP originally provided \$349 billion for relief during the covered period from February 15, 2020, to June 30, 2020. It was later amended, extended and additionally funded to a total of over \$800 billion. The program stopped granting new loans May 31, 2021. Loan recipients can still **apply for loan forgiveness**, however, at any time up to the maturity date of the loan. Loans granted after June 5, 2020 have a maturity of five years.

The PPP allowed recipients to qualify for loan forgiveness if the proceeds were spent on qualifying expenditures. Implemented by the Small Business Administration with support from the Department of the Treasury, the program did not require any collateral or personal guarantees and did not charge any fees.

A PPP loan could be forgiven and essentially turned into a non-taxable grant if the small business could demonstrate that the loan proceeds were used primarily for payroll (capped at \$100,000 per employee). Other permissible uses included rent or mortgage interest (as long as the lease/mortgage was signed before February 15, 2020), utilities, operations expenditures, property damage costs, supplier costs, and worker protection expenditures. Initially, the PPP offered participating businesses forgiveness for up to 8 weeks of payroll (later raised to 24 weeks), based on employee retention and salary levels.

The PPP required businesses to have spent **60% of the loan on payroll** in order to qualify for forgiveness of the entire loan, so record keeping is essential for forgiveness. When the covered period is up, a small business can apply for forgiveness through its lender, and once the lender has received an application, it must decide within 60 days.

## Prosecution of PPP Fraud

The PPP worked to provide relief as quickly as possible by limiting lenders' due diligence requirements and allowing lenders to rely on borrowers' certifications as true in determining program eligibility, loan amounts, and loan forgiveness eligibility. Because the SBA allowed lenders to determine whether or not to provide and forgive loans based on borrowers' application materials alone—without vetting the information—some borrowers submitted false or inaccurate information to their lenders to qualify for larger loans and to have those loans forgiven.

Borrowers can be prosecuted for fraudulently procuring and/or seeking forgiveness for PPP loans under a variety of criminal statutes including:

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**Bank Fraud; Wire Fraud;** Mail Fraud; False Statements; False Statements to the SBA; and, False Statements to a Federally Insured Bank. See 18 U.S.C § 1344; 18 U.S.C. § 1343; 18 U.S.C. §1341; 18 U.S.C. §1001; 18 U.S.C. § 1014; and, 15 U.S.C. § 645. Many borrowers have been prosecuted under some variety of the above listed criminal statutes, which may result in fines up to \$1,000,000 and/or imprisonment of up to thirty years.

Banks should be prepared to begin receiving subpoenas and information requests from federal authorities, as the federal government has **asserted** that it will be cracking down on PPP fraud. This can only be aptly described as a target-rich environment for federal authorities, and the Attorney General has announced dedicated Assistant United States Attorneys to focus on PPP fraud, as well as regional strike forces to more efficiently investigate and prosecute these crimes.

While investigations regarding PPP Fraud have mostly been related to borrowers, the federal government has recently investigated **at least one lender**, resulting in an \$18,673.50 settlement to resolve allegations that the lender improperly processed a PPP loan in violation of the False Claims Act. Banks that were authorized by the SBA to process PPP loans received a fee ranging from 1%-5%, creating an incentive to process as many loan applications as possible, irrespective of the accuracy of those loan applications. In the case referenced above, the bank employees knew the borrower, and knew he was facing charges related to prescribing opioids. However, the bank employees disregarded a statement on his loan application indicating that he was not subject to an indictment. Knowing that the application was

false, the bank processed the loan and received its 5% processing fee. The bank ultimately agreed to pay \$18,673.50 to resolve the allegations.

This likely will not be the last investigation and prosecution of a lender. While the SBA did not require banks to vet applications, the Texas settlement is an indication that banks are not completely absolved from liability and may be the target of an investigation where they knew or should have known an application was inaccurate, false or fraudulent.

Trouble may also be brewing for a cluster of specialized “fintechs” – financial service companies that banks hired as middlemen to streamline and process loan applications. A **report** released on December 1 by the House Select Committee on the Coronavirus Crisis alleges rampant abuse by some fintechs, which had strong incentives to file as many loans – and as many high-value loans – as possible. As reported in the **Washington Post**, the Committee alleges that certain fintechs “seemed to miss obvious flags for fraud” and “dismiss the warning signs.” The report also alleges that the fintechs in some cases outsourced fraud reviews to ill-qualified firms.

### **Prosecution of Fraud in Other Types of Federal Covid-19 Relief Loan Programs**

The Paycheck Protection Program is not the only program that has been the target of fraudulent activity. Other programs in the CARES Act such as the Economic Injury Disaster Loan program (“EIDL”) and the Employee Retention Tax Credit (“ERTC”) have been the subject of fraud investigations or have been the subject of **warnings** by the IRS. Similar to the PPP, the EIDL program provided grants and low-interest loans to

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small businesses affected by Covid-19. Businesses and individuals have been **found guilty** of wire fraud, conspiracy to defraud the EIDL program, theft of government property, and preparing a false tax return. Unlike PPP and EIDL, the ERTC is a tax credit that is available to employers who retained their employees during the Covid-19 pandemic. The credit is worth up to 50% of the wages paid to each employee up to a maximum of \$5,000 per employee. Businesses that improperly apply for the ERTC could face investigations related to tax evasion or false subscription under IRC § 7206. Punishments range from up to \$100,000 and up to five years in prison.

### **Conduct Likely to be Investigated and How to Protect Yourself**

When investigating PPP Fraud, prosecutors will be looking to the information submitted in the procuring of PPP loans, and in the submission of information related to the forgiveness of said loans. False statements may be unintentional, may reflect a business's desire to procure larger loans, or may be related to businesses using funds in violation of the PPP. Many PPP fraud schemes have involved "consultants" who **procure fraudulent loans** in exchange for a percentage "cut." Others may be discovered through financial institutions **reporting** "suspicious activity."

Under the False Claims Act, PPP Fraud has also been uncovered via whistleblowers. Qui tam actions, or whistleblower cases, have already resulted in **at least one investigation** where a company repaid the full amount of its loan back to the federal government after having a qui tam action filed against it.

If you have procured a PPP loan or an EIDL, or have applied for ERTC and are worried about potential criminal li-

ability, there are a few things you can do to protect yourself. First, review all materials submitted to lenders related to the acquisition of PPP, EIDL or ERTC funds to ensure their accuracy. Second, use a funds tracing analysis to determine where the funds secured through these programs were spent. Third, consult with an attorney or an accountant—ideally both—to understand your potential exposure and protect your rights. While there is no "accountant-client privilege," the conversations you have with your attorney for the purpose of soliciting legal advice are privileged, and courts have ruled that the use of an accountant in the representation of a client by an attorney does not break the attorney client privilege (see *U.S. v. Kovel*, 2d Cir. 1961). Fourth, determine the difference between your eligibility for funds and forgiveness and your actual loan disbursement and/or amount of forgiveness, and pay back any additional amounts. Finally, be sure to save all documentation which supports the business's expenditures and salaries. In some circumstances, the SBA may allow the return of funds that were procured in error. This path may be a way to relieve liability, but businesses should retain counsel first to ensure their rights are being protected. ▲

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