

Fraud and abuse prevention, detection and enforcement under the Paycheck Protection Program

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The Biden Administration recently instituted additional checks and guardrails to address the potential for waste, fraud, and abuse under the CARES Act, and recent actions showcasing some of the more egregious, intentional examples of PPP loan fraud provide an insight into how enforcement efforts are being applied.

On February 10, 2021, David Hines pled guilty to one count of wire fraud in connection with fraudulently obtaining funds from the Paycheck Protection Program (PPP), established as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act in 2020.¹

Hines made several applications for PPP loans on behalf of different companies, using false and misleading statements, receiving approximately \$3.9 million. He used the funds (intended to provide forgivable loans to small businesses, for job retention and other expenses) on personal expenses including a \$318,000 Lamborghini.² For his crime, Hines was sentenced to more than six years in prison.

This outcome is not a surprise — the U.S. Department of Justice (DOJ) Criminal Division's Fraud Section has been ramping up its investigations and prosecutions of individuals that committed fraud in obtaining PPP funds.³ More than 120 defendants in over 70 criminal cases have been prosecuted for such fraud, resulting in recovery of more than \$60 million.⁴

This article discusses trends in DOJ's enforcement actions, how DOJ may investigate potential fraud, and identify best practices for PPP recipients.

PPP and fraud

The CARES Act and the PPP were designed to provide a direct incentive for small businesses to keep their workers employed and on payroll.⁵ Congress expanded these efforts in late 2020 via the passage of the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act.⁶ The House Select Subcommittee on the Coronavirus Crisis noted that the Small Business Administration (SBA) issued more than 8.2 million PPP loans totaling over \$718 billion.⁷

While many deserving businesses benefited from this program, there were bad actors.⁸ To address the potential for waste, fraud, and abuse, in February 2021, the Biden Administration instituted

further checks and guardrails, such as loan guaranty approval being contingent on passing SBA fraud checks and a review of U.S. Department of the Treasury's Do Not Pay database, and public records.⁹

An Office of Inspector General (OIG) was established to "conduct, supervise, and coordinate audits and investigations" in connection with loans made under PPP.¹⁰ The Office is now up and running and will be "formidably aggressive."¹¹

The SBA is conducting manual loan reviews for the largest loans in the PPP portfolio and a random sampling of the remaining loans. A September 2020 analysis conducted by SBA's OIG identified "\$4.6 billion in potentially fraudulent PPP loans, including \$3.6 billion that went to borrowers on the Treasury Department's Do Not Pay list, \$692 million in duplicate PPP loans, and \$402 million to borrowers with Taxpayer Identification Numbers (TINs) created after the program cutoff date."¹²

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Further, SBA's OIG identified another 55,000 loans, which totaled \$7 billion, that was made to "companies that exceeded maximum loan amounts based on the number of employees, exceeded maximum business size standards, or received TINs after the program cutoff date."

In December 2020, SBA's independent financial auditor identified a broader set of more than two million PPP loans worth \$189 billion (more than one third of all PPP loans issued in that period) that "are potentially not in conformance with the CARES Act and related legislation."¹³

In addition to the DOJ and the SBA OIG, the House Select Subcommittee on the Coronavirus Crisis is also looking into issued PPP loans, targeting fintech firms and the banks that partnered with them. The fintech firms would process the loans

and the partner banks would issue the funds. On May 27, 2021, the Subcommittee sent requests for information to those companies seeking documents and information related to their handling of PPP loans, questioning whether they followed the proper screening methods before issuing the loans.¹⁴ This is because of their connection to PPP fraud cases being pursued by the DOJ.¹⁵ A May 28, 2021 Press Release from the Subcommittee stated that, “FinTechs and their bank partners handled 75 percent of the approved PPP loans that have been connected to fraud by DOJ, despite facilitating just 15 percent of PPP loans overall.”¹⁶ This shows that as time goes on, additional scrutiny is going to be placed not only on who received PPP loans, but how they received them.

Two laws that DOJ could rely upon in pursuing PPP fraud are the Financial Institution Reform, Recover, and Enforcement Act (FIRREA) and the False Claims Act (FCA). The FIRREA makes it a crime for an individual or entity to make false statements to obtain a loan from the SBA. An individual or entity found to have violated FIRREA is subject to a civil penalty of up to \$1,000,000 (or \$5,000,000 for a continuing violation).¹⁷

Under the FCA, it is a crime for a person to defraud a federal program by submitting false claims for funds and, if convicted, the government can recover: (1) a civil penalty between \$5,000 and \$10,000 for each false claim, (2) three times the amount of damages actually suffered and (3) the costs of any civil action the government brings to recover a penalty or damages.¹⁸

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Accordingly, the potential for a significant damages award against a defendant guilty of PPP fraud is high and something that should be considered in the event of prosecution. Additional causes of action, depending on the case, could include, but are not limited to, bank fraud, wire fraud, money laundering, and conspiracy.

A few recent actions showcasing some of the more egregious, intentional examples of PPP fraud provide insight into how enforcement efforts are being applied:

- **Bankruptcy debtor sought PPP loan:** Prosecutors in the Eastern District of California brought civil claims under the FCA and FIRREA against online fashion accessories company, SlideBelts, Inc., and its CEO, Brigham Taylor, alleging that they falsely claimed that the company was not in bankruptcy in order to qualify for a PPP loan. In January, the DOJ settled its civil action with SlideBelts, Inc. in connection with its bankruptcy case.¹⁹
- **Group sought millions in PPP funds:** In January 2021, the DOJ charged six individuals with allegedly fraudulently

obtaining approximately \$1.5 million in PPP loans on behalf of five businesses in Georgia and South Carolina. DOJ alleges that the individuals were part of a larger group that obtained approximately \$3 million. The indictment alleges that one defendant recruited five other individuals to apply for PPP loans for their respective businesses and aided the other applicants in submitting the loan applications containing numerous false and misleading statements in exchange for a percentage of the loan proceeds.²⁰

- **One man submitted 118 Fraudulent PPP loan applications:** Leonel Rivero owned a tax-preparation business and submitted approximately 118 applications seeking more than \$2.3 million in PPP loans. The fraudulent applications were submitted on behalf of himself and accomplices and contained false and fraudulent IRS forms containing purported income and expense information, resulting in them receiving more than \$975,000 in PPP loans.²¹
- **Texas man applied for fifteen PPP loans:** In March 2021, Dinesh Sah pled guilty to charges that he fraudulently applied for fifteen different PPP loans, seeking funds from eight different lenders using eleven different companies. The applicant obtained \$17.3 million by inaccurately claiming that the businesses had numerous employees and used the proceeds to purchase homes, jewelry, and luxury vehicles.²²
- **Florida couple filed four applications for PPP loans:** Latoya Stanley and Johnny Philus filed four fraudulent loan applications, seeking more than \$1 million in PPP funds, as well as funds from the Economic Injury Disaster Loans program. Both claimed to employ more than 15 individuals at their companies. Neither company employed anyone.²³

How to assess your own program

While outright fraud in seeking PPP loans is one thing, the way the PPP loans were used is another. DOJ’s pursuit of brazen examples of fraud should not provide comfort for those that did not commit fraud in applying for and receiving PPP loans. Audits of PPP loans are ongoing and if PPP loan proceeds were commingled with the businesses’ other funds, then the potential for the loan proceeds to be used inappropriately for a non-payroll purpose is high.

In consideration of this, if a company received a PPP loan, it should revisit its risk assessment to include government scrutiny relating to PPP loans.

When evaluating the loans and proceeds, companies should consider the following:

- (1) Was the PPP loan application consistent with the company’s prior applications for loans? If the circumstances did change between the applications, be prepared to explain any differences.
- (2) Does the company have a thorough understanding and accounting for the sources and uses of the PPP loan proceeds? Were the funds co-mingled with other funds? Were the funds used properly for payroll and payroll-related expenses? If so, how will the company demonstrate how the funds were used?

- (3) Is everything appropriately documented in accordance with the requirements of the PPP loan lender, particularly with how the funds were utilized? While the SBA has some standard forms, certain lenders may require financial information in a different form.
- (4) Was due diligence conducted prior to applying for the PPP loan, ensuring that the company was eligible to receive loan proceeds? Was there appropriate governance and oversight over the taking and use of the funds (for example, evidence of review and approval from senior levels of management)?
- (5) Has there been a consideration of data analytics to measurably demonstrate and document compliance? For example, can the company show a 25 percent reduction in gross receipts during 2020 compared with the same quarter of 2019 (a requirement for companies seeking PPP loans)?
- (6) Check the company's whistleblower hotline. Were there any allegations or complaints made regarding how the loan money was obtained or used?
- (7) Does the company have any affiliates or joint ventures that also complied with PPP guidelines or sought PPP funds?

Conclusion

While PPP has expired, the governmental oversight in connection with those loans continues. The government appears to be stepping up efforts to investigate and determine whether funds were obtained and used properly.

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A company that received PPP loans should, in advance of any such inquiry, begin to review what statements and disclosures were made in obtaining those loans proceeds, how the funds were held, and how the funds were spent. Getting ahead of any investigation and identifying potential issues, with proper legal counsel and financial advice, will help ensure that you, or your company, is properly positioned should the government come calling.

Notes

¹ Press Release, U.S. Dep't of Just., *Man Purchased Lamborghini After Receiving \$3.9 Million in PPP Loans*, Rel. No. 21-144, (Feb. 10, 2021), <https://bit.ly/3sWVR4D>

² *Id.*

³ As noted by former Acting Assistant Attorney General Brian Rabbitt, in a September 2020 speech, the Criminal Fraud Division of the DOJ began investigations of PPP fraud "almost immediately" and brought cases against alleged fraudsters even while loans were still being made. Brian Rabbitt, Acting Assistant Att'y Gen., *Remarks at the PPP Fraud Criminal Fraud Enforcement Action Press Conference*, (Sept. 10, 2020), <https://bit.ly/3CrChqG>

⁴ In a March 26, 2021 Press Release from the DOJ on COVID-19 fraud, Attorney General Merrick B. Garland stated that DOJ's enforcement initiative regarding such schemes "sends a clear and unmistakable message to those who would exploit a national emergency to steal tax-payer funded resources from vulnerable individuals and small businesses. We are committed to protecting the American people and the integrity of the critical lifelines provided for them by Congress, and we will continue to respond to this challenge." Press Release, U.S. Dep't of Just., *Justice Department Takes Action Against COVID-19 Fraud*, Rel. No. 21-272, (Mar. 26, 2021), <https://bit.ly/3w19WzM>; see Press Release, U.S. Dep't of Just., *Florida Man Sentenced After Fraudulently Obtaining \$3.9 Million in PPP Loans*, Rel. No. 21-431, (May 12, 2021), <https://bit.ly/3MCjQwH>; Ryan Lucas, *DOJ Has Charged Nearly 500 With COVID-Related Fraud in the Past Year* (Mar. 26, 2021, 1:10 PM), <https://n.pr/3vU9X8J>

⁵ Coronavirus Aid, Relief, and Emergency Security Act, Pub. L. No. 116-136, 134 Stat. 281, Section 1102(a)(1)(B) (2020).

⁶ Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act, Pub. L. No. 116-260, 134 Stat. 1182 (2020).

⁷ Congress of the United States, *Lowering the Guardrails: How the Trump Administration Failed to Prevent Billions in Pandemic Small Business Fraud*, (Mar. 25, 2021), <https://bit.ly/3Cwwo5x>

⁸ Press Release, *FACT SHEET: Biden-Harris Administration Increases Lending to Small Businesses in Need, Announces Changes to PPP to Further Promote Equitable Access to Relief*, (Feb. 22, 2021), <https://bit.ly/3sXB1IH>

⁹ *Id.*

¹⁰ Pub. L. 116-136, Section 4018 (2020).

¹¹ Off. of the Inspector Gen. for Pandemic Recovery, *Quarterly Report to the United States Congress*, (Dec. 31, 2020), <https://bit.ly/3sWXShe>

¹² Congress of the United States, *Lowering the Guardrails: How the Trump Administration Failed to Prevent Billions in Pandemic Small Business Fraud*, (Mar. 25, 2021), <https://bit.ly/3Cwwo5x>

¹³ *Id.*

¹⁴ Press Release, U.S. Congress, *Select Subcommittee Launches Investigation into Role of FinTech Industry in PPP Fraud*, (May 28, 2021), <https://bit.ly/3CwCXEJ>

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ The False Claims Act ("FCA") and the Financial Institution Reform, Recovery, and Enforcement Act ("FIRREA") makes it unlawful for an individual or entity to make a false statement for the purpose of obtaining a loan from or for the purpose of influencing the U.S. Small Business Administration (SBA). 12 U.S.C. § 1833a.

¹⁸ The FCA creates civil liability for a person who knowingly (including recklessly or with deliberate ignorance) defrauds a federally funded program by submitting false claims for money. 31 U.S.C. § 3729. When any person knowingly or recklessly "presents, or causes to be presented, a false or fraudulent claim for payment or approval" to the government or knowingly or recklessly "makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim ..." 31 U.S.C. §§ 3729(a)(1)(A), (a)(1)(B). A person is liable also if they knowingly or recklessly "makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money ... to the Government ..." 31 U.S.C. § 3729(a)(1)(C).

¹⁹ Press Release, U.S. Atty's Off. Eastern Dist. of Cal., *Eastern District of California Obtains Nation's First Civil Settlement for Fraud on Cares Act Paycheck Protection Program*, (Jan. 12, 2021), <https://bit.ly/364v8KC>

²⁰ Press Release, U.S. Dep't of Just., *Six Charged in Connection with a \$3 Million Paycheck Protection Program Fraud Scheme*, Rel. No. 21-108, (Jan. 28, 2021), <https://bit.ly/3Cu8XTi>

²¹ Press Release, U.S. Dep't of Just., *Tax Preparer Charged with COVID-19 Loan Fraud*, Rel. No. 21-231, (Mar. 17, 2021), <https://bit.ly/3Ksy4zu>

²² Press Release, U.S. Dep't of Just., *Texas Man Pleads Guilty to \$24 Million COVID-Relief Fraud Scheme*, Rel. No. 21-266, (Mar. 24, 2021), <https://bit.ly/3J620kQ>

²³ Press Release, U.S. Dep't of Just., *Couple Pleads Guilty to \$1.1 Million COVID-Relief Fraud After Falsely Claiming to be Farmers*, Rel. No. 21-211, (Mar. 8, 2021), <https://bit.ly/3CColyw>

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