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PPP Loan Fraud Enforcement 2.0: Preparing for the Next Round of Scrutiny

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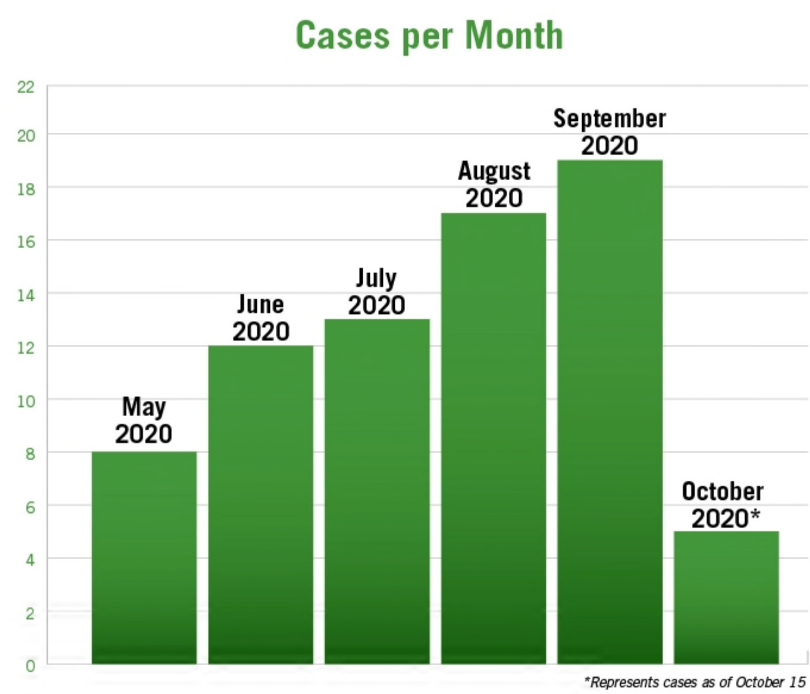
While the $525 billion Paycheck Protection Program (PPP), enacted as part of the CARES Act, has undoubtedly helped millions of deserving businesses survive the COVID-19 pandemic, it has also provided a unique opportunity for fraudsters to take advantage of the government's unprecedented largesse. The Justice Department has already filed charges against dozens of borrowers alleging PPP loan fraud, but federal authorities are preparing to cast a wider net that will dramatically expand the number of loans that face scrutiny.

As we have written previously, the Justice Department and other federal law enforcement agencies have acted swiftly to identify and prosecute PPP loan fraud — in many cases while loans were still being made by the Small Business Administration (SBA). Since the CARES Act passed barely seven months ago, the Justice Department has filed criminal charges against 65 borrowers who it alleges collectively tried to fraudulently obtain $227 million in PPP loan funding, in loan amounts ranging from $30,000 to $24 million. These early criminal cases represent the most brazen examples of PPP fraud, such as borrowers claiming phantom employees and using PPP funds for personal items. But these early cases are just the beginning, as government investigators move beyond the most egregious examples of fraud to focus on more nuanced issues of potential fraud, such as eligibility for PPP loans, expenditure of PPP loan proceeds and loan forgiveness. At the same time, the Small Business Administration has vowed to audit all PPP loans in excess of $2 million and Congress has intensified its oversight (and criticism) of the PPP program. In this highly charged environment, we can expect to see more significant scrutiny of borrowers across the PPP loan spectrum, and not just for the most glaring instances of fraud.



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Criminal Prosecutions Continue Apace

In an October 7, 2020 speech, Deputy Attorney General Jeffrey A. Rosen announced that the Justice Department has criminally charged 65 individuals with PPP loan fraud in connection with $227 million in relief funds. Eight of those defendants have already pleaded guilty and more convictions are expected.

The PPP loan fraud cases filed by the Justice Department largely fall into two categories. The first category is made up of individuals or small groups who lied on loan applications about having legitimate businesses, or who claimed they needed PPP funding to pay their employees, but instead used the money to purchase luxury cars and jewelry for themselves, finance home renovations and even gamble in Las Vegas. The second category of cases involves organized criminal rings. For example, the Justice Department recently filed charges in Ohio and Florida against 11 individuals, including a professional athlete and his manager, who applied for $24 million in PPP funding.

More criminal cases involving PPP fraud are undoubtedly on the horizon. In a recent speech, Acting Assistant Attorney General Brian Rabbitt emphasized that the Justice Department is not slowing its efforts in this area. To would-be fraudsters, he delivered a stern warning: "You will be identified. You will be held accountable. You will face the severest of consequences for trying to exploit your fellow Americans' suffering for your own personal gain."

Intensifying Congressional Oversight

Over the summer, the Senate Select Subcommittee on the Coronavirus Crisis opened an investigation of the PPP following allegations that it favored larger companies over small businesses. The subcommittee reviewed data on all 5.2 million PPP loans approved by the Small Business Administration, and issued its preliminary analysis on September 1, 2020, concluding that "tens of thousands of loans issued by the administration could be subject to fraud, waste, or abuse." The Select Subcommittee also concluded that the administration "appears to lack the appropriate oversight mechanisms to identify and root out these problems," noting that the SBA has stated it will only audit PPP loans in excess of $2 million, leaving the remaining 99.4 percent of funded PPP loans with no scrutiny whatsoever.

The Select Subcommittee identified a series of issues with the PPP that suggest a high risk for fraud, waste and abuse, described below:

- The SBA's PPP rules provided that businesses were not permitted to apply for more than one loan. The Select Subcommittee determined that over $1 billion in loan proceeds went to companies that received more than one PPP loan. The Select Subcommittee identified 10,856 loans in this category, and noted that only 65 of these loans were in excess of $2 million and therefore subject to SBA audit.
- Many PPP loans went to companies that have been debarred or suspended from contracting with the federal government. Pursuant to the SBA's PPP eligibility criteria however, such companies were ineligible for PPP loans. The Select Subcommittee identified 613 loans totaling $96.3 million in this category.
- Government contractors with known performance and integrity issues received PPP loans. The federal government's Federal Awardee Performance and Integrity Information System (FAPIIS) database tracks contractor misconduct. The Senate Subcommittee found that the SBA approved 353 loans worth $195 million to companies identified in FAPIIS.
- By comparing data contained in the federal government's System for Award Management (SAM) with PPP loan applications, the Senate Subcommittee identified numerous red flags involving more than 11,000 borrowers and nearly $3 billion in PPP funding. The discrepancies identified by the Senate Subcommittee include:
  - Key information in PPP loan applications that does not match data in SAM
  - Inconsistent business addresses
  - Companies that were created after February 15, 2020, and were therefore not eligible for PPP loans.
- Many PPP loan applications omitted key information about the borrower and were nonetheless approved. For example, hundreds of loan applications failed to identify the name of the borrower in the "borrower name" field, and several hundred additional applications did not have complete business addresses for the borrower.

The Senate Subcommittee's report concluded with a series of recommendations to improve oversight of PPP.

- First, the subcommittee recommended that SBA and Treasury should **improve internal controls for loan forgiveness**, including making use of existing federal and commercial databases to verify information provided by borrowers.
- Second, the subcommittee recommended that the administration should **improve its audit**

plan for PPP borrowers. As noted, the SBA's stated plan is to audit only those PPP loans in excess of $2 million and "other PPP loans as appropriate." Finding this plan to be "plainly insufficient," the Senate Subcommittee recommended that the SBA implement a risk-based audit program and utilize random sampling techniques. The subcommittee further recommended that SBA audits should be accompanied by public outreach to warn borrowers about criminal penalties and to encourage whistleblowers to come forward to the SBA's Office of Inspector General.

- Third, the Senate Subcommittee stated that Treasury and the SBA must **improve their cooperation with oversight bodies** such as Congress and the Pandemic Response Accountability Committee.

Enforcement 2.0: What's Next

The Justice Department's unrelenting torrent of criminal charges against PPP borrowers shows no sign of easing, so we expect to see more announcements of new criminal cases and additional guilty pleas in the months to come. But as we noted, identifying and prosecuting the most brazen examples of PPP loan fraud — the "low-hanging fruit" — was the easy part.

Now comes the hard part: auditing some reasonable sample of the more than 5.2 million PPP loans that were funded. To this end, we anticipate that a variety of government agencies will engage in a new wave of enforcement activity. To start, we expect the SBA to follow through on its promise to scrutinize larger PPP loans. While the SBA previously announced that it would focus its limited audit resources on loans in excess of $2 million — which comprise only .6 percent of all PPP borrowers — it was careful to qualify that statement by stating that it would also audit "other PPP loans as appropriate." This means borrowers with loans under $2 million are not immune from scrutiny and should be prepared for inquiries from government investigators.

Congressional oversight of the entire PPP framework can be expected to drive additional regulatory scrutiny of borrowers. The Senate Subcommittee report from September 2020 was highly critical of the administration's approach to PPP implementation, and identified five categories of loans in which fraud and abuse were most likely to be prevalent, and recommended that SBA adopt a risk-based approach to audit selection.

Finally, we anticipate that other regulatory agencies may assist the SBA in its herculean task of auditing PPP borrowers. The Department of Labor has already begun auditing PPP loan recipients under the guise of routine wage and hour inquiries. Other federal agencies may support the SBA in this effort in the coming months.

Any business owner concerned about PPP loan compliance should immediately consult counsel and not wait to be contacted by law enforcement. Any business owner who has already received a subpoena or inquiry from any law enforcement agency regarding a PPP application or loan should immediately consult with counsel who can assess the full potential for civil and criminal exposure before responding to any such subpoena or inquiry.

For additional information on the topic of this alert, contact Matthew D. Lee at mlee@foxrothschild.com or 215.299.2765; Marissa Koblitz Kingman at mkingman@foxrothschild.com or 973.548.3316; or any member of the firm's national White-Collar Defense & Regulatory Compliance Practice.

PPP Fraud Prosecution Tracker

Fox Rothschild's White-Collar Criminal Defense & Regulatory Compliance Practice Group is tracking in real time all federal criminal cases alleging PPP loan violations.

To access our PPP Fraud Prosecution Tracker, contact White-Collar Criminal Defense & Regulatory Compliance Practice Group Co-Chairs Matthew S. Adams at madams@foxrothschild.com or 973.994.7573 and Matthew D. Lee at mlee@foxrothschild.com or 215.299.2765.