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No End In Sight For Pandemic Relief Fraud Enforcement

By **Jason Crawford, Tully McLaughlin and Olivia Lynch** (August 11, 2023, 11:12 AM EDT)


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On June 27, the Small Business Administration's Office of Inspector General issued a report estimating that, of the $1.2 trillion disbursed through COVID-19 Economic Injury Disaster Loans, or EIDL, and the Paycheck Protection Program, $200 billion may have been fraudulently obtained.[1]

According to the SBA OIG, approximately $30 billion of that has been seized or returned to date, and the watchdog's report makes clear that the government's efforts to recover fraudulently obtained funds is far from over.

As stated in the report, "investigations will ensue for years to come" in light of Congress's decision to extend the statute of limitations to 10 years for COVID-19 EIDL and PPP fraud.

Even though the COVID-19 public health declaration ended in May, the ongoing investigation of alleged pandemic relief fraud means that enforcement actions brought under the False Claims Act and the Financial Institutions Reform, Recovery and Enforcement Act has only just begun.

This article will discuss enforcement trends, recent qui tam settlements and some common indicators that the government and private whistleblowers have used to identify potential pandemic relief fraud.

The continued enforcement activity means that a wide range of companies, including both borrowers and lenders, could find themselves under investigation or as defendants in an FCA suit, and so this article concludes with practical steps that companies can take to mitigate these risks.

Enforcement Trends

Amid the challenging circumstances of the pandemic's early days, the SBA moved quickly to help small businesses stay afloat by developing pandemic relief programs such as COVID-19 EIDL and the PPP.

According to the SBA OIG report, the government's decision to expedite the granting of relief loans created a pay-and-chase environment, in which the government prioritized getting funds to applicants even if this resulted in loans being made to ineligible entities and individuals that the government would need to chase after the fact.

The early "chase" activity was largely focused on criminal enforcement of the most egregious pandemic relief fraud, such as the prosecution of Mustafa Qadiri, a California man who pled guilty after using PPP funds to purchase luxury vacations and sports cars.[2]

In connection with these early efforts, leadership from the U.S. Department of Justice Criminal Division highlighted that the government would be using data analytics to identify, investigate and prosecute PPP fraud.[3]

The SBA OIG's June 27 report underscores the important role that data analysis has played in identifying targets for investigation, and the report makes note of several indicators that have helped law enforcement agencies identify potential fraud, including borrowers who submitted multiple loan applications from the same IP address or whose bank accounts matched other applications.

According to the SBA OIG, as of May its oversight and investigative work had resulted in over 1,000 indictments and more than 500 convictions related to COVID-19 EIDL and PPP fraud.

If the first wave of pandemic relief fraud enforcement arose under the criminal code, the second appears to rely more on the federal government's tool of choice for civil enforcement — the FCA. Liability can arise under the FCA where an entity knowingly makes a false certification of compliance that is material to payment.

PPP borrowers were required to make various eligibility and other certifications on the initial application and, if they sought forgiveness, on the loan forgiveness application. Accordingly, the DOJ has actively pursued affirmative FCA actions against borrowers where it identified potential fraud, and has intervened in pandemic relief cases filed under the FCA's qui tam provisions.

Affirmative FCA Cases

Similar to the approach taken by the Criminal Division, the leadership of the DOJ's Civil Division has stated that the department would utilize the FCA and leverage all tools at its disposal — including the use of data analytics — to identify individuals and entities that received relief payments to which they were not entitled.

In the three years since relief funds were disbursed, the DOJ has been steadily implementing this strategy. For example, the U.S. Attorney's Office for the Eastern District of Virginia, in coordination with the SBA OIG, used data analysis to proactively identify and file a complaint against Latifa Brooks, who settled allegations that she had fraudulently obtained and received forgiveness for two PPP loans by listing false gross income amounts and submitting fake tax returns.[4]

Like many other affirmative cases that have been filed, the complaint contained causes of action under the FCA as well as FIRREA. FIERREA allows the government to impose civil penalties for violations of enumerated federal criminal statutes, including those that affect federally insured financial institutions.

Affirmative cases against borrowers have cropped up across the country, but no district has been more active than the USAO for the Northern District of Mississippi. As of June, the Mississippi office had obtained more than 150 FCA judgments, resulting in more than $20 million in cases involving PPP loans, and it shows no signs of stopping this type of enforcement anytime soon.[5]

This early wave of affirmative FCA enforcement was defined by both the high volume of cases and the comparatively small size of the recoveries because many of the actions involved loans made to sole proprietors or independent contractors subject to the $20,833 loan cap.

But cases involving larger dollar amounts have begun to surface. Last month, a trustee moved a Texas bankruptcy court to approve a $13 million settlement of In re: Fresh Acquisitions LLC, in which the DOJ brought claims against two restaurant companies that had received PPP loans which were forgiven before the companies filed for bankruptcy.[6]

As the judgments associated with these affirmative cases continued to pile up, qui tam cases involving pandemic fraud have come out from under seal with a growing number resulting in DOJ intervention and settlement.

Qui Tam Settlements

A defining feature of qui tam enforcement of COVID-19 relief fraud has been the role played by serial relators. Early on in the pandemic, the U.S. Department of the Treasury and the SBA announced that they would disclose the names of PPP loan recipients who had received loans over $150,000.

Over time, more information — such as whether loans were forgiven — has been made available to the public. Based on our review of unsealed qui tam complaints, it appears that the disclosure of loan recipient information has been a virtual treasure trove for serial relators who have combed through the publicly available information in search of potentially ineligible loan recipients.

Although the majority of these qui tam actions resulted in declinations, serial relators have been able to gain traction in select cases. For instance, J. Bryan Quesenberry, a serial relator who has filed dozens of pandemic fraud cases, brought a qui tam action alleging that companies received and retained duplicate PPP loans in spite of requirements that required them to certify that they would not receive more than one loan.

The government intervened, and in February three companies named in the suit paid a total of $530,000 to settle the allegations.[7]

Another serial relator, GNGH2 Inc, has had success bringing actions alleging violations of the loan requirements associated with the second round of PPP funding. When applying for second-draw PPP loans, applicants were required to certify their eligibility for the loan, including that they were not required to register under the Foreign Agents Registration Act, and that they were not "primarily engaged in political or lobbying activities."

Based on a review of second-draw PPP loan applicants, GNGH2 filed qui tam suits against public relations agencies that sought and received forgiveness for second-draw loans. By scouring publicly available information, the relator learned that these PR firms had served as agencies of record for foreign tourism offices, which allegedly triggered an obligation to register under FARA. Two of these qui tam actions resulted in settlements over $2 million.[8]

The same relator filed a qui tam action against a think tank, which ultimately paid over $500,000 in a settlement with the USAO for the District of Massachusetts to resolve allegations that it was ineligible for a second-draw loan because its status as a think tank meant that it was an entity that was primarily engaged in political or lobbying activities.[9]

Not all serial relators have found success in searching out PPP loan recipients to name as defendants in qui tam actions. In U.S. ex rel. Donnellan v. The Sayer Law Group, the U.S. District Court for the District of Alaska summarily dismissed 47 separate pro se actions filed by the same relator over the course of three days in August 2022 for lack of jurisdiction.[10] That said, the sheer scale of PPP loans has clearly motivated relators to seek out potential defendants.

Actions filed by serial relators have driven up the number of cases filed against borrowers, but there have also been qui tam actions filed by more traditional company insiders. These cases have resulted in recoveries where loan recipients were alleged to have inflated employee headcounts on PPP loan applications,[11] and where a business seeking loan forgiveness for PPP loans listed as its own employees multiple individuals that were actually employed and paid by a separate business.[12]

The Long Road Ahead, a Growing Pool of Defendants, and Risk Mitigation

The FCA's statute of limitations has a long reach — and in some circumstances can reach back 10 years from the time of the violation.[13]

But determining whether an FCA cause of action is barred by the statute of limitations is often dependent, in part, on when the relevant government official had knowledge of the alleged fraud, and some FCA complaints are untimely if brought more than six years after the alleged violation.[14]

By extending the statute of limitations to 10 years for COVID-19 EIDL and PPP fraud, Congress has eliminated any uncertainty about whether a suit is timely filed, and this will allow the DOJ to work on pandemic relief fraud investigations through 2031.

The additional time gives the government a longer runway to work on complex investigations and to decide whether to bring more cases against the lenders that processed relief loans. To date, almost all the publicly announced enforcement activity has involved borrowers, and there has only been one DOJ settlement with a lender.[15]

Even so, that settlement may presage an increased focus on lenders going forward, particularly the fintech companies that processed a high volume of loan applications.

Indeed, a December 2022 report from the House Select Subcommittee on the Coronavirus Crisis alleges that a small number of fintech companies facilitated a disproportionately high rate of ineligible PPP loans. The report recommended that the DOJ investigate these fintech companies for potential FCA violations.

The extended statute of limitations also means that serial relators and traditional insiders will likely continue to file qui tam actions, which the DOJ will investigate and pursue where it deems appropriate.

As a result, companies who received PPP loans, or were involved in the lending process or approvals should prepare for the possibility that they could receive either a subpoena from the SBA OIG or a civil investigative demand from the DOJ in the years ahead.

Companies should consider the following steps to mitigate against potential risks.

- In light of the extended statute of limitations, borrowers should maintain records that will allow them to reconstruct events years after the initial application, use of loans and requests for forgiveness. Many PPP borrowers received advice from accountants, consultants or lawyers on the initial application or loan forgiveness application. Such companies should keep in mind that these third-party entities have their own retention policies, which may not be aligned with this extended statute of limitations, and so they should not rely on the retention of relevant records by such entities.

- Loan forgiveness does not equate to a determination that the borrower was eligible for the PPP loan. Even after a loan is forgiven, the SBA Office of Capital Access can open a post-forgiveness review and has begun to do so. PPP borrowers should continue to maintain records establishing initial eligibility and demonstrating that they used the PPP funds for forgivable expenses.

- If a company discovers — after the fact — that it was not eligible for the initial loan or loan forgiveness, the company should consider potential corrective actions such as proactively returning funds in order to avoid the FCA's potential for treble damages or steep FIRREA penalties.

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[6] In re Fresh Acquisitions LLC, et al., 21-30721, ECF 1035 (Bankr. N.D. Tex.).

[7] Three California Companies Settle False Claims Act Allegations Relating to Improper Paycheck

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[11] California Agricultural Companies and Their Owner Agree to Pay $600,000 to Settle False Claims Act Allegations Relating to Improperly Inflated Paycheck Protection Program Loans, January 9, 2023 press release. https://www.justice.gov/opa/pr/california-agricultural-companies-and-their-owner-agree-pay-600000-settle-false-claims-act-0.

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[14] 31 U.S.C. § 3731(b).

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