

## Questions Remain After First FCA Settlement With PPP Lender

By **Olivia Lynch, Stephen Byers and Tully McLaughlin**

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On Sept. 13, the U.S. Department of Justice reached its first-ever settlement with a Paycheck Protection Program lender under the False Claims Act. The lender agreed to pay \$18,673.50 to resolve allegations it improperly processed a PPP loan on behalf of an ineligible applicant.

While small in amount, this settlement is significant for what it could signal about future FCA enforcement actions against other PPP lenders.

In spring 2020, while many aspects of the PPP remained undefined until days — or even weeks — after lenders began accepting PPP applications, one aspect of the program seemed clear: PPP loan applicants were responsible for ensuring their eligibility for a PPP loan, and PPP lenders were not responsible for the same sort of gatekeeping that applies in other contexts.

Rather, as the U.S. Small Business Administration's first PPP interim final rule and early iterations of the SBA's FAQ document stated, while lenders were "expected to perform a good faith review, in a reasonable time, of the borrower's calculations and supporting documents concerning average monthly payroll cost," they were otherwise permitted to rely on borrower representations and certifications.

Some of the relevant guidance included the following:

- In early April 2020, the SBA's interim final rule stated that it "will allow lenders to rely on certifications of the borrower in order to determine eligibility of the borrower and use of loan proceeds and to rely on specified documents provided by the borrower to determine qualifying loan amount and eligibility for loan forgiveness."<sup>[1]</sup>
- On April 3, 2020, the SBA's PPP FAQ document reinforced the PPP interim final rule, stating that "lenders may rely on borrower representations, including with respect to amounts required to be excluded from payroll costs."<sup>[2]</sup>



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- On April 6, 2020, the SBA updated its PPP FAQ document to explain that borrowers were obligated to determine their eligibility as a small business, not lenders: "It is the responsibility of the borrower to determine which entities (if any) are its affiliates and determine the employee headcount of the borrower and its affiliates. Lenders are permitted to rely on borrowers' certifications."<sup>[3]</sup>
- On April 23, 2020, as focus shifted to the economic necessity certification, the SBA added to the PPP FAQ document that "[l]enders may rely on a borrower's certification regarding the necessity of the loan request."<sup>[4]</sup>

And in 2021, when Congress appropriated more money for the PPP and second-draw PPP loans became available, there was no indication of a change in this policy. Indeed, the SBA's updated FAQ document reiterated that "as the PPP Interim Final Rules indicate, lenders may rely on borrower representations."<sup>[5]</sup>

Reinforcing the notion that PPP lender responsibility was limited to a good faith review of the borrower's average monthly payroll cost calculations, the SBA published a procedural notice on Jan. 15, 2021, addressing PPP excess loan amount errors.<sup>[6]</sup>

The SBA specified that "[i]f an excess loan amount error is due in whole or in part to the lender's failure to satisfy its obligations under PPP rules (as further explained in FAQ 1) ... the SBA guarantee will not apply to the excess loan amount."

It was against this backdrop that the recent FCA settlement with Prosperity Bank<sup>[7]</sup> was announced, raising questions regarding how much protection the SBA policies really afford PPP lenders. The facts of the Prosperity Bank case, as set forth in DOJ's press release, provide only limited insight.

In May 2020, Prosperity Bank, a regional bank with branches throughout Texas and Oklahoma, processed and approved a \$213,400 PPP loan for Woodlands Pain Institute PLLC.

As of the date of submission of Woodlands Pain's PPP application, the company's sole owner, Emad Bishai, was facing criminal charges stemming from his practice of prescribing opioid medicines.

In order to be eligible for a PPP loan, applicants were required to answer "no" to the question of whether the applicant, or any individual owning more than 20% equity, was subject to an indictment, criminal information, arraignment or other means by which formal criminal charges are brought in any jurisdiction.

When completing the PPP application, Bishai checked the box marked "no" and, as required by the form, wrote his initials beneath the question.

Eighteen months later, in November 2021, the DOJ announced a \$523,331 civil FCA settlement with Bishai, which in part stemmed from the fact that this misrepresentation on Woodlands Pain's PPP application had resulted in receipt of a loan to which it was not entitled.<sup>[8]</sup>

But the DOJ did not stop with Bishai. The DOJ also took action against the lender, Prosperity Bank, on the basis that, at the time Prosperity Bank processed Woodlands Pain's application, it knew that Woodlands Pain's sole owner was facing criminal charges.

The DOJ press release did not specify the basis for this knowledge — for example, it didn't say exactly who at the bank knew of the criminal charges, and how.

Despite the alleged knowledge of Bishai's criminal charges, and therefore Woodlands Pain's ineligibility for a PPP loan, Prosperity Bank approved Woodlands Pain's application for a \$213,400 PPP loan and received a 5% loan processing fee in the amount of \$10,670 from the SBA.

Prosperity Bank and the DOJ agreed on a settlement amount of \$18,673.50, which — based on the fee that Prosperity Bank received — is close to the roughly double-damages amount for which the DOJ often settles FCA cases.

Though small in dollar value, the DOJ's settlement with Prosperity Bank is likely a harbinger of more substantial FCA enforcement actions against PPP lenders. And it brings to the forefront many questions, including the following.

### **Where is the line between negligence and recklessness?**

FCA liability attaches only to a knowing violation, but specific intent to defraud is not required. Rather, knowledge is defined by the FCA as either actual knowledge, deliberate ignorance or reckless disregard of the truth or falsity of the information.

And the line between mere negligence, which is not actionable under the FCA, and recklessness is often murky and subject to differing opinions, particularly with the benefit of 20/20 hindsight.

Collective corporate knowledge has been held insufficient to prove scienter under the FCA. But in the Prosperity Bank case, did anyone have actual knowledge of the criminal charges, and if not, what was the basis for the DOJ pressing this as an FCA action? Did the bank have information available to it regarding the criminal charges that it ignored?

The DOJ press releases regarding the Woodlands Pain matter only states that Prosperity Bank knew that Woodlands Pain's sole owner was facing criminal charges. The press release does not specify who knew what within the bank.

As the media reported extensively in the spring of 2020, many of the initial PPP loans were made by lenders to their already existing customers.[9] It is of course common for a lender to have a good deal of information on an entity with which it has done business in the past, particularly where credit has been extended.

This raises further questions. What if that information indicated a lack of eligibility for a PPP loan, but was unknown to the lender personnel within the bank who were processing PPP loans in the utter chaos of the early days of the program?

And, given the SBA guidance and the breakneck pace at which PPP loans were issued — in accordance with congressional intent — what obligation did lenders have to thoroughly vet representations and certifications being made in PPP loan applications against their already existing customer information?

The Prosperity Bank settlement also raises the question of whether the DOJ may take issue with PPP lenders who processed loan applications that, on their face, contained information that would have been sufficient to demonstrate initial ineligibility.

Given that the SBA's guidance neither instructed lenders to review the application for eligibility nor that lenders must ensure that they assess what information they knew about the PPP loan applicant, it is not clear how the DOJ will approach lender culpability in such instances.

### **What damages will the government try to assess against PPP lenders?**

At first blush, this seems a relatively straightforward question in light of the fact that PPP lenders benefited from making PPP loans in the form of fees.

Pursuant to the Coronavirus Aid, Relief and Economic Security, or CARES, Act, lenders who originated PPP loans were entitled to receive a fixed fee from the SBA ranging from 1% to 5% of the loan amount: 5% for loans of not more than \$350,000; 3% for loans of more than \$350,000 and less than \$2 million; and 1% for loans of at least \$2 million.

For Prosperity Bank, the settlement amount was close to double the 5% loan processing fee, which, according to the DOJ press release, reflected "Prosperity Bank's efforts to cooperate with the government's investigation and provide relevant facts along with its implementation of additional compliance measures."

For the largest PPP loan of \$10 million, lenders could have received up to \$100,000 in processing fees. Under the FCA, that amount could be trebled if litigated, and civil penalties exceeding \$25,000 per false claim could also be applied.

But there is also the question of what happens when recovery of the PPP loan amount is not possible and the government would otherwise have to bear the loss.

In the Prosperity Bank case, the DOJ was able to recover double the loan amount from the sole owner of the ineligible entity. But there remains the possibility that in other circumstances the DOJ may seek to recover double or treble the amount of the entire loan from the lender, in addition to the lender's fees, if FCA liability can be established.

### **Does timing matter?**

Specifically, will the DOJ treat a PPP lender's actions in April 2020 differently than the same or similar actions in 2021?

As the initial tranche of PPP applications were being submitted in April 2020, lenders were inundated with PPP applications<sup>[10]</sup> and under tremendous pressure to process loan applications for SBA approval.

For example, on March 31, 2020, SBA administrator Jovita Carranza said: "Speed is the operative word; applications for the emergency capital can begin as early as this week, with lenders using their own systems and processes to make these loans."<sup>[11]</sup>

And, U.S. Department of the Treasury Secretary Steven Mnuchin "pledged to get checks cut at 'lightning speed.'"<sup>[12]</sup>

Lenders were in a very different situation in spring 2020 than they were just six months later, when Congress passed legislation in December 2020 funding a second round of PPP loans.

Such timing considerations do not appear to have helped Prosperity Bank. Per [federalpay.org](http://federalpay.org), Woodlands Pain's PPP loan was approved on April 30, 2020, meaning it was processed by Prosperity Bank during the first month of the PPP's existence.

DOJ prosecutors, with the benefit of hindsight, might disregard or downplay the pandemonium of the early days of PPP program.

## **Conclusion**

It is difficult to know how much to read into the Prosperity Bank case because the only publicly available facts appear in terse DOJ press releases.

But it is certainly an indication that PPP lenders should not presume that they will have an ironclad safe harbor from FCA enforcement actions where the DOJ may, with the clarity of hindsight, deem lenders' conduct to have recklessly caused the government to fund loans made to ineligible borrowers.

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[1] See, e.g., SBA, First Interim Rule, Business Loan Program Temporary Changes; Paycheck Protection Program, 85 FR 20811, April 15, 2020, available at <https://www.federalregister.gov/documents/2020/04/15/2020-07672/business-loan-program-temporary-changes-paycheck-protection-program>.

[2] See SBA PPP FAQ (Version 1) as of June 25, 2020, available at <https://www.sba.gov/sites/default/files/2020-06/Paycheck-Protection-Program-Frequently-Asked-Questions%20062520-508.pdf>.

[3] See SBA PPP FAQ (Version 1) as of June 25, 2020, available at <https://www.sba.gov/sites/default/files/2020-06/Paycheck-Protection-Program-Frequently-Asked-Questions%20062520-508.pdf>.

[4] See SBA PPP FAQ (Version 1) as of June 25, 2020, available at <https://www.sba.gov/sites/default/files/2020-06/Paycheck-Protection-Program-Frequently-Asked-Questions%20062520-508.pdf>.

[5] See SBA PPP FAQ (Version 5) as of January 29, 2021, available

at <https://www.sba.gov/sites/default/files/2021-01/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

[6] See SBA Procedural Notice, Paycheck Protection Program Excess Loan Amount Errors, Control No. 5000-20078, January 15, 2021, available at <https://www.sba.gov/sites/default/files/2021-01/5000-20078-508.pdf>.

[7] DOJ, U.S. Attorney's Office, Southern District of Texas, First-ever False Claims Act settlement received from Paycheck Protection Program lender, September 13, 2022, available at <https://www.justice.gov/usao-sdtx/pr/first-ever-false-claims-act-settlement-received-paycheck-protection-program-lender>.

[8] DOJ, U.S. Attorney's Office, Southern District of Texas, Woodlands pain doctor pays half million dollars for fraudulent PPP and billing allegations, November 15, 2021, available at <https://www.justice.gov/usao-sdtx/pr/woodlands-pain-doctor-pays-half-million-dollars-fraudulent-ppp-and-billing-allegations>.

[9] See, e.g., Ruth Simon and Peter Rudegeair, Big Banks Favor Certain Customers in \$350 Billion Small-Business Loan Program, Wall Street Journal, April 6, 2020 available at <https://www.wsj.com/articles/big-banks-favor-certain-customers-in-350-billion-small-business-loan-program-11586174401>; see also Amara Omeokwe and Ryan Tracy, Treasury Department Encouraged Banks to Prioritize Existing Customers for PPP Loans, House Panel Says, Wall Street Journal, October 16, 2020 available at <https://www.wsj.com/articles/treasury-department-encouraged-banks-to-prioritize-existing-customers-for-ppp-loans-democratic-report-says-11602861336>.

[10] Thomas Franck, Bank of America sees booming rescue loan demand, with applications for nearly 10% of program, CNBC, April 6 2020, available at <https://www.cnbc.com/2020/04/06/bank-of-america-sees-booming-rescue-loan-demand-with-applications-for-nearly-10percent-of-allotment.html>.

[11] Treasury, Press Release, With \$349 Billion in Emergency Small Business Capital Cleared, Treasury and SBA Begin Unprecedented Public-Private Mobilization Effort to Distribute Funds, March 31, 2020, available at <https://home.treasury.gov/news/press-releases/sm961>.

[12] Lauren Fox, Small business loans could become target of fraud and a government watchdog is already trying to stop it, CNN, March 31, 2020, available at <https://www.cnn.com/2020/03/31/politics/sba-loans-fraud-ig/index.html>.