THEY KNOW WHAT YOU DID LAST SUMMER: DOJ ANNOUNCES FIRST CIVIL SETTLEMENT INVOLVING PPP BORROWER

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U.S. Investigations, Enforcement, and White Collar Alert

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The long-anticipated wave of civil enforcement actions involving participants in the Paycheck Protection Program (PPP) has begun.

On 12 January 2021, the U.S. Department of Justice (DOJ) announced the first civil settlement resolving fraud allegations against SlideBelts, Inc. (SlideBelts), a California e-retailer and manufacturer of fashion accessories, and its President and CEO, Brigham Taylor.[1] As we have discussed in prior alerts,[2] aggressive criminal and civil enforcement activity targeting PPP borrowers was a foregone conclusion given the minimal safeguards initially imposed by the U.S. Small Business Administration (SBA), the speed with which lenders disbursed loan proceeds, and reports indicating that more than US$4 billion in PPP funds are likely attributable to fraud.[3] The SlideBelts settlement agreement[4] (Settlement Agreement) demonstrates that DOJ is following through on its promises to make PPP enforcement against companies and individuals a top priority[5] and that the government will use all criminal and civil tools available—including the False Claims Act[6] (FCA) and the Financial Institutions Reform, Recovery and Enforcement Act[7] (FIRREA)—to pursue potential PPP fraud. We expect SlideBelts to be a harbinger of the type of enforcement actions U.S. Attorney's Offices and DOJ's Civil Division will bring and the positions they will take in coming months.

THE SLIDEBELTS SETTLEMENT

SlideBelts and Taylor agreed to pay US$100,000 in monetary penalties and return the US$350,000 PPP loan the company received to resolve allegations that they made false statements to federally insured banks in violation of the FCA and FIRREA. According to the Settlement Agreement, on 3 April 2020, SlideBelts submitted the first of three PPP loan applications to three different lenders, each containing the false representation that the company was not presently involved in a bankruptcy proceeding. Five days later, on 8 April, SlideBelts submitted a second PPP application to a different lender, again misrepresenting its bankruptcy status.

On 10 April, the first lender, which was also a creditor in the company's ongoing Chapter 11 case, informed Taylor that SlideBelts had incorrectly answered the bankruptcy question on its PPP application. Taylor responded that the answer was an “[o]versight” but also told the lender that he thought the bankruptcy question was “an overreach” by SBA. On 14 April, Taylor contacted the lender again to indicate that he believed the question was inappropriate and requested approval of the application. When the lender refused and reiterated that the company was ineligible for a PPP loan due to its bankruptcy status, Taylor replied “that does make sense. All good!” Three

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hours later, he submitted a third loan application to a different lender, again falsely representing the company's bankruptcy status.

Ultimately, the second lender approved the company's PPP application and Taylor signed the US$350,000 note. DOJ alleges that based on his prior communications with the lender on the first application, Taylor knew that the lender considered the company's bankruptcy status to be material to its decision to execute a note and that Taylor knew the company would automatically default on the PPP loan because the loan agreement provided for default in the event of the borrower's bankruptcy.

On 22 April—the day after SlideBelts received the loan proceeds—Taylor informed the lender that the company may have inadvertently provided an incorrect answer to the PPP application's bankruptcy question. But instead of returning the loan proceeds, on 30 April, SlideBelts asked the bankruptcy court to retroactively approve the PPP loan while again failing to disclose the company's misrepresentation. On 16 June, SBA and the lender opposed the company's motion. In response, SlideBelts petitioned the bankruptcy court to dismiss its case so that the company could "apply for [PPP] funds while the case is dismissed."[8] During a hearing on the company's motion, which the bankruptcy court granted, SBA reiterated its position that SlideBelts was obligated to immediately return the loan. Eventually, on 8 July—more than two and a half months after receiving its PPP loan—SlideBelts returned the US$350,000 in loan proceeds to the lender.

TOP TAKEAWAYS FROM THE SLIDEBELTS SETTLEMENT

DOJ has Signaled its Intention to use FIRREA in Conjunction With the FCA for PPP Enforcement

Although the FCA will be the main enforcement tool the government uses to pursue civil liability against PPP borrowers, the SlideBelts Settlement Agreement is significant in that it demonstrates DOJ's intention to use FIRREA in conjunction with the FCA, as may be appropriate in some PPP enforcement actions. Passed in response to the Savings and Loan Crisis, FIRREA empowers DOJ to impose civil penalties for violations of fourteen enumerated federal criminal statutes that involve or affect federally insured financial institutions.[9] Examples of covered criminal conduct include wire fraud, mail fraud, false claims made on a federal agency, and false representations made to federal officials. FIRREA is an especially handy enforcement tool because it enables DOJ to obtain civil penalties for conduct punishable under its enumerated predicate criminal statutes and reduces the government's burden of proof from the high reasonable-doubt standard required in criminal cases to the much less demanding preponderance-of-the-evidence standard applied in civil cases.

Despite its usefulness to federal prosecutors, DOJ only sparingly used FIRREA until the enforcement actions arising out of the 2008 Troubled Asset Relief Program (TARP). Rarely referenced or invoked since then, FIRREA appears poised for an encore performance in connection with PPP fraud enforcement. As we discussed previously, past is prologue, and borrowers may glean valuable lessons from the enforcement strategies the government adopted during TARP.[10]

The Necessity Certification Still Looms Large

Although SlideBelts made overtly false representations regarding its status as a debtor in bankruptcy, substantial FCA risk exists for PPP borrowers even in the absence of outright falsehoods. SBA audits already underway and ensuing DOJ enforcement actions will focus on borrower certifications that economic uncertainty at the time of application made the loan request necessary to support the borrower's ongoing operations. While the contours of

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what constitutes necessity for PPP purposes are still mostly undefined, SBA has signaled that its necessity analysis for borrowers with loans of US$2 million or greater will be expansive, examining events that occurred after the time of application and taking into account other criteria not mentioned in the text of the CARES Act or the SBA's PPP regulations, like annualized executive compensation in excess of US$250,000.[11]

Individuals are Squarely in the Government's Crosshairs

Often overlooked given the prominence of cases featuring corporate defendants, the FCA also imposes liability on individuals who knowingly make false statements or present false claims to the government on behalf of a business, or who cause such statements or claims to be made. The SlideBelts settlement underscores the real risk of individual liability for officers, directors, and board members in the context of PPP fraud enforcement, especially given the likelihood that the incoming Biden administration's DOJ leadership will reinstate stricter Obama-era policies with respect to individual accountability for corporate wrongdoing in coming months.

The Risk of Substantial Fines and Monetary Penalties is Real

The relatively modest US$100,000 settlement amount imposed against SlideBelts is not necessarily representative of the scope and scale of liability that companies and individuals may face when confronted with PPP fraud allegations. The SlideBelts settlement must be understood in context—the company received a US$350,000 loan and there is usually some precedential value to the government for a company willing to be the "first in line" to settle in what is expected to be a wave of additional cases. Irrespective of the settlement amount, it's also significant to note the government's claim in the Settlement Agreement that SlideBelts was potentially liable for "damages and penalties totaling $4,196,992 under FIRREA and the FCA."[12]

K&L Gates' Investigation, Enforcement, and White Collar practitioners continue to monitor government investigation and enforcement activities in connection with PPP fraud and abuse allegations. Contact the authors of this alert if you have questions or need assistance.

FOOTNOTES

[1] *See* Press Release, U.S. DEP'T OF JUST., EASTERN DISTRICT OF CALIFORNIA OBTAINS NATION'S FIRST CIVIL SETTLEMENT FOR FRAUD ON CARES ACT PAYCHECK PROTECTION PROGRAM (Jan. 12, 2021).

[2] *See*, *e.g.*, Christopher L. Nasson, et al.,*2021: A New Year, the Same Fear – Why Companies Should Expect a Wave of PPP Investigations*, K&L GATES HUB (Dec. 21, 2020) ; Neil T. Smith, et al.,*COVID-19: Federal Stimulus Today, Federal Investigation Tomorrow: What TARP Can Tell Us About the Coming Wave of CARES Act Enforcement*, K&L GATES HUB (Apr. 28, 2020); Mark A. Rush, et al., *COVID-19: Looming False Claims Act Liability for Paycheck Protection Program Loans*, K&L GATES HUB (Apr. 9, 2020); David C. Rybicki, et al., *COVID-19: Multiple Investigations of Coronavirus Fund Recipients Underway*, K&L GATES HUB (June 3, 2020).

[3] Press Release, U.S. HOUSE OF REPRESENTATIVES, SELECT SUBCOMM. ON THE CORONAVIRUS CRISIS, PRELIMINARY ANALYSIS OF PAYCHECK PROTECTION PROGRAM DATA (Sept. 1, 2020).

[4] *See* U.S. DEP'T OF JUST., U.S. ATTORNEY'S OFFICE, EASTERN DISTRICT OF CALIFORNIA, SETTLEMENT AGREEMENT (Jan. 12, 2021), [hereinafter *Settlement Agreement*].

[5] *See*, *e.g.,* U.S. DEP'T OF JUST., PRINCIPAL DEPUTY ASSISTANT ATTORNEY GENERAL ETHAN P. DAVIS

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DELIVERS REMARKS ON THE FALSE CLAIMS ACT AT THE U.S. CHAMBER OF COMMERCE'S INSTITUTE FOR LEGAL REFORM (June 26, 2020).

[6] 31 U.S.C. § 3729–33.

[7] 12 U.S.C. § 1833a.

[8] *See* Settlement Agreement, *supra* note 4, at 5.

[9] 18 U.S.C. § 20.

[10] *See* Neil T. Smith, *supra* note 2.

[11] *See* U.S. SMALL BUS. ADMIN., SBA FORM 3509, PAYCHECK PROTECTION PROGRAM LOAN NECESSITY QUESTIONNAIRE (Oct. 2020).

[12] *See* Settlement Agreement, *supra* note 4, at 3.

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