

BORROWER BEWARE: FALSE CLAIMS ACT LIABILITY IN CONNECTION WITH THE PPP IS A TRAP FOR THE UNWARY AND THE ARROGANT

Hodgson Russ COVID-19 Litigation & Employment Action Team Alert
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On January 12, 2021, the Eastern District of California settled the first False Claims Act (“FCA”) case based on Paycheck Protection Program (“PPP”)-related fraud. SlideBelts Inc. – a debtor in bankruptcy – and its president and CEO agreed to pay \$100,000 in damages and penalties and to repay PPP funds to resolve claims under the FCA and the Financial Institutions Reform, Recovery, and Enforcement Act. In connection with the settlement, SlideBelts and its president admitted that they falsely stated that SlideBelts was *not* in bankruptcy in order to obtain PPP funds in the amount of \$350,000. Because SlideBelts is currently in bankruptcy, the settlement must be approved by the bankruptcy court.

At first glance, this is not a particularly interesting FCA settlement. After all, settlements under the FCA sometimes amount to many millions of dollars, while this settlement is only a fraction of that. But a closer examination is warranted, as the facts underlying this settlement illustrate how the government views PPP applications and its likely enforcement priorities and targets.

SlideBelts had filed for bankruptcy in August 2019. Notwithstanding the disqualification of bankrupt entities from PPP eligibility, SlideBelts submitted an initial application for a PPP loan on April 3, 2020 to one financial institution, and then another application to a second financial institution five days later on April 8, 2020. In response to Question 1 on the PPP application asking whether SlideBelts was “presently involved in any bankruptcy,” SlideBelts answered “no.” After getting rejected from the first institution because it had knowledge of SlideBelt’s bankruptcy (and pushing back on that institution, claiming that the question on bankruptcy was an “overreach”), SlideBelts submitted a third PPP application to yet another institution, making the same false statement. While that third application was pending, SlideBelts obtained a PPP loan based on its second application.

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Then, on April 22, 2020 – after receiving the PPP funds – the president of SlideBelts emailed the second institution, noting that it may have answered Question 1 (regarding bankruptcy) incorrectly (allegedly because of how “quickly” he had filled out the application). On April 30, 2020, SlideBelts filed a motion in bankruptcy court seeking retroactive court approval of the PPP loan. On June 16, 2020, the SBA and lender opposed the motion, while SlideBelts asked to dismiss the bankruptcy case so that it could apply for PPP funds. Eventually, SlideBelts agreed to repay the funds.

This settlement illustrates a number of key points about the government’s civil and criminal enforcement priorities with the PPP:

- The government is not going to ignore small PPP loans. Notably, the PPP loan amount at issue here was considerably below the \$2M threshold at which the SBA will conduct mandatory loan reviews. Nonetheless, the government invested resources in investigating this loan and in its recovery.
- After-the-fact attempts to correct PPP applications will not work. In this case, SlideBelts’ president attempted to cover his tracks by retroactively correcting the misstatement to the financial institution and went so far as to try to get the bankruptcy court to approve receipt of PPP funds obtained in clear violation of program rules. Those steps were insufficient to preclude government enforcement action.
- PPP applicants must assume that every question on the application or loan forgiveness form is significant and material to the government. The president of SlideBelts in this case arrogantly took the position that the question on bankruptcy was irrelevant and immaterial to whether SlideBelts was an appropriate recipient of PPP funds. While the legal determinations of what questions and statements are material under the FCA will be litigated in the years ahead, borrowers looking to stay out of the government’s cross-hairs should assume that they are all subject to scrutiny and answer them accordingly.
- Borrowers whose applications may contradict easily-verifiable information should be prepared to explain those contradictions. In this case, the president of SlideBelts made a motion in a bankruptcy court regarding its PPP loan. Its status as a bankruptcy debtor was, thus, easily confirmable. There may be legitimate explanations for discrepancies in information submitted in PPP applications versus tax returns or other government filings. But it is crucial to be prepared to explain and address them because they will likely be flagged.



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- Individual liability is a real possibility. The president of SlideBelts in this case is on the hook personally for at least part of this settlement. The government can and will look behind the corporate form when individual wrongdoing is at issue.

The PPP has lent itself to fraud and abuse, with the SBA Office of Inspector General recently noting that \$3.6 billion in PPP funds were made to potentially ineligible recipients (read about the OIG report [here](#).) But it is also a trap for the unwary and the arrogant. For example, in the SBA's recently issued guidance on Second Draw PPP loans (read it [here](#)), in response to a question about documentation needed to support a 25% reduction in gross receipts, the SBA suggests that applicants sign and date financial statements (if not audited) to attest to their accuracy or annotate bank statements showing deposits from the relevant quarters. These types of attestations – along with the more formal certifications in the borrower and forgiveness applications – can all predicate FCA investigations and potential liability. It is important that good-faith borrowers make these statements and attestations carefully and with back-up documentation demonstrating their diligence. Do not assume that any information requested or documentation supplied is irrelevant or unimportant.

If you have questions about the PPP or how you can implement strategies to better protect your business from SBA review or other government scrutiny, please contact Reetuparna Dutta (716.848.1626) or Jason Markel (716.848.1395).

Please check our [Coronavirus Resource Center](#) and our [CARES Act](#) page to access information related to both of these rapidly evolving topics.

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