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For VC-Backed Small Businesses, “Self-Certifying” Eligibility for a PPP Loan Can Come with Legal Risks

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The current U.S. Small Business Administration (SBA) application for a Paycheck Protection Program (PPP) loan requires the small business applicant to self-certify a number of specific items ranging from the necessity of the loan funds to the applicant’s overall eligibility.

While much has been written about the SBA’s guidance on “affiliation” rules to determine eligibility for SBA PPP loans, the question now facing many small businesses (and their respective boards) is: **how should a small business examine the legal risk for self-certifying its eligibility for a PPP loan?** Particularly if, for example, a small business is capitalized to a degree that it may not necessarily require a loan from the government to pay for the business’ expenses in the short-term?

Specifically, one of the PPP Borrower Application Form certifications (which is mandated by the CARES Act) requires the applicant to certify that:

“Current economic uncertainty makes this loan request necessary to support the ongoing operations of the applicant.”

Problematically, the SBA has not issued any guidance on how the government will assess the truthfulness of an applicant’s certification, notwithstanding the fact that arguably, nearly every small business could certify that uncertainty is upending their business at least to some degree. But how does an applicant determine if the uncertainty rises to the level of “necessity”?

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That question—without any further guidance from the SBA—is subjective and open-ended. In all likelihood, the government will evaluate the truthfulness of that specific certification post-hoc and on a case-by-case basis as the PPP continues to come under a more intense microscope politically. There is no doubt that this program – and the businesses that receive PPP funds – will be scrutinized closely. (Already, specific companies and industries have come under intense scrutiny j*ust for receiving federal aid.*)

One can expect that if it is discovered (by a government audit, internal whistleblower, or the general public) that a company which had reasonable capital reserves applied for and obtained funds from a PPP loan, then that company may be the target of intense negative public criticism at a minimum, and potentially subject to civil and criminal liability.

To be sure, if the SBA, Treasury Department, or any other government agency has reason to believe that an applicant has potentially failed to meet the PPP requirements or has misrepresented any of the PPP certifications, there is a high likelihood that there will be an enforcement action against the applicant to recover those funds and/or recommend civil or criminal prosecution.

Having worked at the Justice Department following the financial crisis of 2008, after Congress pumped over $1 trillion into the economy following two major stimulus bills (the Troubled Asset Relief Program (TARP) under the Emergency Economic Stabilization Act and the American Recovery and Reinvestment Act), there is no doubt that there will be several enforcement entities putting a microscope on the distribution of taxpayer funds out of the CARES Act in general (and the PPP in particular) for years to come.

The SBA Office of Inspector General (OIG): One of those entities is the SBA OIG. The PPP application includes a certification to enable sharing applicant information with the "SBA Office of Inspector General, for the purpose of compliance with the SBA Loan Program Requirements and all SBA Reviews."

The office is led by Hannibal Ware and is staffed by analysts, auditors, lawyers, and investigative agents who are highly trained (along with other federal agencies) and perform law enforcement functions similar to FBI agents.

The office was established in 1978 by a federal law that created inspectors general for a number of federal agencies to provide "independent, objective oversight to improve the integrity, accountability, and performance" of federal agencies and its programs.

In a recent SBA OIG report that was issued *before* the COVID-19 pandemic, the office touted its investigations in the second quarter of 2019 that were referred to the Justice Department for civil and criminal prosecution, resulting in 23 indictments,19 convictions, and multimillion-dollar settlements on small business contracting fraud cases brought under the False Claims Act (FCA).

To put this *pre*-COVID-19 investigatory work in perspective, the SBA OIG has now, under the CARES Act, been appropriated an *additional* $25,000,000 to investigate waste, fraud, and abuse, including within the PPP program.

There is, therefore, a clear mandate that the SBA OIG must now attentively scrutinize any concerns about possible misstatements, questions about eligibility, and any programmatic violations by PPP funds recipients.

How do the SBA OIG and other OIGs work with the Justice Department?

In all likelihood, because criminal cases require higher standards of proof, (“beyond a reasonable doubt” vs. “preponderance of the evidence”) as well as proof that the defendant possessed specific intent to commit the crime, it is fair to assume that the SBA OIG will refer more cases to the Justice Department for civil enforcement rather than for criminal enforcement.

The False Claims Act and Recovery of Taxpayer Dollars: The Justice Department’s primary civil enforcement tool when it comes to federal dollars is the FCA, commonly known as “Lincoln’s Law.” It was enacted in 1863 following the Civil War to allow for civil prosecution of defense contractors that defrauded the Union Army.

Significantly, for FCA cases, the standard of proof to bring a case is lower than a criminal case. Moreover, a recipient of federal money can be civilly prosecuted under the FCA even if a person merely has a “reckless disregard” or is “in deliberate ignorance of the truth or falsity” of information submitted to the government (such as a PPP certification).

The FCA is a particularly sharp sword for two reasons. First, the FCA provides for government recovery of up to three times the amount of damages, in addition to penalties ranging from $11,463 to $23,331 for each “false claim.” These numbers can be quite staggering, particularly for small businesses.

Second, the FCA provides that whistleblowers can file cases on the government’s behalf, whereupon the government is legally mandated to investigate the claims. If a whistleblower brings a successful case, he or she stands to receive between fifteen and thirty percent of the total recovery.

In 2019, the Justice Department recovered more than $2.1 billion of its $3 billion in FCA settlements and judgments from whistleblower suits.

Last year, the SBA OIG worked with the Justice Department on several FCA cases regarding fraud on its programs, including:

- In a whistleblower case, the majority owner of a Virginia diving company agreed to pay $20 million to settle civil claims related to a scheme in which he and others caused the firm to falsely represent that it qualified as a small business concern when it did not.
- A New Jersey construction company and its co-owner paid $2.4 million to settle a civil case after the company falsely claimed service-disabled veteran-owned status. The company was a front company for a second firm owned by the co-owner, fraudulently receiving $54 million in set-aside contracts that were performed by the second firm.
- A Florida company paid $500,000 to resolve FCA allegations for failure to comply with work performance requirements in a NASA 8(a) contract.

Criminal Referrals to DOJ: As mentioned above, the SBA OIG and other investigative agencies also make referrals to the Justice Department for criminal prosecution. And the Justice Department has similarly organized a variety of task forces across the nation to respond to COVID-19-related cases—see, for example, DOJ's announcement of its Hoarding and Price Gouging Task Force.

In the past, the SBA OIG has touted its criminal referrals for fraud committed on its programs. Below is a sampling of cases pre-CARES Act:

- A Connecticut man pled guilty to making a false statement for the purpose of obtaining an SBA business disaster loan after falsifying loan documents submitted through the RISE Act following Hurricane Sandy. The man received a loan of more than $1.6 million after claiming the hurricane destroyed his marine business, when in fact it had been demolished before the storm.
- A South Carolina man was sentenced to 51 months' incarceration after pleading guilty for wire fraud. The man and a second person formed a firm and falsely designated the second person as the majority owner to apply to the SBA 8(a) disadvantaged individuals' program; the firm was in fact controlled by the first man and a third person, who were non-disadvantaged individuals.
- A Missouri contractor and the president of a Kansas electric company were indicted for conspiracy, wire fraud, and money laundering related to their roles in a $346 million SBA contract fraud scheme. A third man pled guilty to conspiracy to commit wire fraud. The three men operated companies with straw owners who were socially and economically disadvantaged or service-disabled veterans; the men used the straw owners' identities to fraudulently obtain SBA certifications and approximately $346 million in federal contract payments.

Multiple Investigative Bodies Will Intensify the Microscope: Another risk factor to consider is that although the SBA is the federal agency administering the PPP with the Treasury Department's assistance (and the SBA OIG serving as the principal investigatory body charged with auditing and investigating cases for SBA programs), there are additional other entities that now have the legal charter—and the resources—to focus singularly on COVID-19-related programs like the PPP.

This is unsurprising, considering that there is already a firestorm over the PPP's expedited rollout and "glitches" that have sparked finger-pointing to a variety of folks involved in the program.

Some of these new, additional investigatory bodies with subpoena authority include:

- **Pandemic Response Accountability Committee**: This committee is established within the Council of Inspectors General on Integrity and Efficiency (a council of existing inspectors general that was created by law in 2008) and is composed of the inspectors general of nine federal agencies. The committee has the authority to conduct audits and investigations, issue subpoenas for documents and testimony, and refer matters to other inspectors general for enforcement and to the Attorney General for criminal and civil prosecution.
- **The House Select Committee on the Coronavirus Crisis**: Speaker of the House Nancy Pelosi recently announced the formation of this congressional committee to "examine all aspects of the federal

response to the coronavirus to ensure that taxpayer dollars are being wisely and efficiently spent to save lives, deliver relief and benefit our economy" and to ensure there is "no waste, fraud, abuse, price-gouging or profiteering." The Committee is expected to have professional staff and subpoena authority.

And again, if history is any lesson from the 2008 financial crisis (and the federal stimulus that was a fraction of the COVID-19-related stimulus)—after which oversight activity from IGs and congressional panels led to over 1,600 criminal convictions and more than $11 billion in recoveries and over 3,000 audits—we can expect to see similar scrutiny in 2020 and beyond.

Congressional Oversight and Reputational Risk: Finally, while everything above highlights the legal and regulatory scrutiny that may ensue for government funds recipients under the PPP, reputational risk could be exposed through Congressional oversight.

As mentioned, lawmakers are already asking questions about the PPP rollout, and are poised to adding billions to the program. And with great funding, comes great responsibility. Each of the investigative bodies above, at some point or another, will not only pursue targeted enforcement actions, but will also report to Congress on the work they have done.

For example, the Pandemic Response Accountability Committee is required by law to build a public website detailing the expenditure of CARES Act funds.

If taxpayer dollars are being used to back companies within industries that are politically fraught, members of Congress or the media, for example, will undoubtedly use the opportunity to "name and shame" those entities. This is already occurring.

It is therefore imperative to be know - and evaluate - these risks before applying for federal aid.

Visit our COVID-19 Resource Center