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CRISIS PRACTICE

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False Claims Act Considerations Related to the CARES Act's Small Business Administration Loan Program

An Analysis of Lender and Borrower Risks

On March 27, 2020, Congress passed the Coronavirus Aid, Relief and Economic Security (CARES) Act, which authorized $2.2 trillion to, among other things, help companies and individuals mitigate the financial repercussions caused by COVID-19. Included among those efforts is a lending program through the Small Business Administration (SBA) aimed at helping eligible companies avoid layoffs and furloughs. Companies considering participating in the CARES Act's SBA program[1] – either as lenders or borrowers – should consider potential exposure under the federal civil False Claims Act (FCA).[2]

A review of the guidance surrounding the SBA program makes clear that the Executive Branch has commendably attempted to reduce risks for lenders in order to encourage lenders to participate in the program and to get funds out to borrowers in need quickly. Lenders thus are explicitly allowed to rely on information provided by borrowers and are not required to conduct their own verification. At the same time, lenders are required to certify that they have reviewed the borrower's documentation, so lenders could face FCA civil exposure if they approve loans despite clear red flags in the information provided by the borrower.

For borrowers, the FCA risks are more severe. Borrowers applying for loans in this program must complete a variety of certifications that, if their accuracy is later called into question, could trigger FCA exposure. Those certifications range from the specific – addressing the number of employees and other eligibility criteria – to the extremely broad – for example, that the borrower "is not engaged in any activity that is illegal under federal, state or local law." Companies considering applying for loans in this program should pay careful heed to the certifications they are required to make.

To assist companies in reviewing the potential FCA risks involved in participating in the SBA program, this Client Alert will provide an overview of:

1. The CARES Act's SBA program;
2. The basic rules around the application of the FCA;
3. The application of the FCA to federal investment and loan programs;
4. The SBA program requirements relevant to lenders' and borrowers' FCA exposure.

OVERVIEW OF THE CARES ACT'S SBA PROGRAM

The CARES Act's relief package can be broken down into five general categories:

1. $377 billion in small business loans through the Small Business Administration (SBA);
2. $560 billion for individuals in certain income brackets;
3. $153 billion for public and health services;
4. $500 billion to distressed industries; and,
5. $340 billion for state and local governments.[3]

With respect to item 4, the Act authorizes $454 billion for the Treasury to make loans or invest in programs or facilities established by the Federal Reserve.[4]

For small businesses, the CARES Act provides additional funds to the SBA's 7(a) loan program and Economic Injury Disaster Loan (EIDL) program. The Paycheck Protection Program (PPP) expands the SBA's existing 7(a) loan program and will provide $349 billion in loan guarantees through June 30, 2020.[5] Loans are offered through existing SBA-approved private lenders at the local level, but other private lenders can apply for approval from the SBA and Treasury.[6] To ensure funds are disbursed quickly, the Act streamlines the requirements of the regular 7(a) loan program and allows lenders to rely on the borrower's supporting documentation and attestation rather than independently verifying the documentation.[7] To induce lenders to participate in this program, the SBA guarantees 100% of the loans, placed a one-percent interest rate on loans, and offers substantial fees for processing loans – five percent for loans of $350,000 or less, three percent for loans more than $350,000 but less than $2,000,000, and one percent for loans of $2,000,000 or more.[8]

Businesses seeking a loan through this program must submit an application and certify in good faith:

1. That economic conditions make the loan necessary to support ongoing business operations;
2. That the funds will be used to retain workers and maintain payroll, pay healthcare costs, and make mortgage, lease payments or utility payments; and,
3. That the business has not received or applied for funds from the CARES Act's SBA PPP for the same amount and purpose.[9]

Upon approval, the borrower must track and document expenses for review by the lender for eight weeks after receiving the loan in order to obtain loan forgiveness. The loans are generally forgivable, meaning the borrower is not responsible for any loan payments if it uses all of the proceeds for the intended purpose. That said, certain actions by the borrower will reduce the forgivable amount and require the borrower to repay that amount.[10]

Although the CARES Act authorizes borrowers to use PPP funds for non-payroll costs, such as rent and utilities, the SBA's interim final rule indicates that at least 75% of the forgivable loan amount must be used for payroll costs, which includes salaries, employee benefits, and taxes on compensation.[11] The SBA believes limiting non-payroll costs to 25% of the loan proceeds will ensure these appropriations are primarily used for payroll protection.[12] Similarly, the Act requires the forgivable amount to be reduced for borrowers who reduce their full-time employee headcount or decrease salaries and wages by more than 25% for any employee making less than $100,000 annualized in 2019.[13] But the borrower has until June 30 to restore its employment and salary levels for any changes made between February 15 and April 26, 2020.[14]

FALSE CLAIMS ACT BASICS

The FCA is codified at 31 U.S.C. §§ 3729–33. At its core, the FCA prohibits knowingly presenting or causing to be presented a false claim for payment of government funds, or knowingly making or causing to be made a false statement material to a false claim. There are three primary elements of an FCA violation:

1. *Falsity*. The submission of a false claim, making a false statement material to a false claim, or causing either of the two;
2. *Scienter*. Knowledge that the claim or statement was false – which includes reckless disregard of a claim or statement's falsity; and,
3. *Materiality*. That the falsity in the claim or statement was material to the government's decision to pay the claim.[15]

In terms of what constitutes a "false" claim, the FCA reaches beyond what would typically be considered "fraud" on the government, i.e., falsely padding bills and/or not providing the goods or services billed for. The FCA has also been interpreted to create liability where a company failed to comply with underlying contractual, regulatory, and/or statutory requirements that might be only indirectly related to the quality or price of the goods or services at issue but that the government considered "material" to its decision to accept a claim. This includes instances where a defendant falsely "certifies," either expressly or implicitly, compliance with a contractual, regulatory, and/or statutory requirement.

For falsity (whether explicit or implicit) of a claim to be "material," it need only be reasonably capable of influencing the payment decision of the recipient of the claim. Importantly, a claim may be covered by the FCA even if it is not submitted to the government – courts have held that the FCA's prohibitions reach false claims to intermediaries or other private entities that either implement government programs or use and apply government funds, such as lenders implementing federally funded or guaranteed loan programs.[16]

An unusual feature of the FCA that helps explain the high and increasing prevalence of FCA litigation is that the statute allows private citizen "whistleblowers" (known as relators) to file a "*qui tam*" complaint on behalf of the United States. Such *qui tam* complaints are filed under seal while DOJ investigates the allegations and determines whether to intervene in the relator's case to take over the litigation; allow the relator to proceed in the name of the U.S.; or dismiss the case outright over the relator's objection. Relators are strongly incentivized to bring suit by the statutory right to receive 15-30% of the recovery in a successful lawsuit, plus attorneys' fees and costs. Furthermore, FCA remedies are draconian, with violations punishable by treble damages (with the damages calculated as the loss to the government or the amount improperly obtained), ***plus*** statutory civil penalties of over $11,000 – $22,000 per false claim.[17]

THE FCA'S APPLICABILITY TO LOAN AND INVESTMENT PROGRAMS

As noted above, liability under the FCA is not limited to situations in which there is a direct transaction with the government, but rather also applies to false claims that are presented to a contractor, grantee, or other recipient of

federal funds if those funds are "to be spent or used on the Government's behalf or to advance a Government program or interest."[18] Accordingly, the FCA has been applied in the context of various federal stimulus or bailout investment programs, even when those programs use entities that are not part of the government to administer and facilitate the distribution of federal funds.[19] With regard to federally funded or insured loans, borrowers can be held liable for providing false information on an application.[20]

Lenders can also face potential liability under the FCA based on their underwriting practices in connection with federally funded or insured loans.[21] For example, some FCA cases[22] have focused on loans originated as part of the Direct Endorsement Lender Program in which participating banks are authorized to evaluate the credit risk of potential borrowers, underwrite mortgage loans, and certify the loans for FHA mortgage insurance without prior HUD review or approval.

FCA RISKS IN THE CARES ACT'S SBA PROGRAM

As noted above, the SBA program will involve participation by private companies as both lenders and borrowers.

1. Potential FCA Risks for Lenders

The current guidance surrounding the SBA program makes clear that the Executive Branch has attempted to reduce the FCA exposure that lenders could have faced by participating in the SBA program. The government should be commended for recognizing that for this program to work as intended by Congress, lenders must be willing to participate and to process applications quickly to get needed funds into the hands of the companies that Congress was trying to help. If lenders feared that they would be held liable for inaccuracies in information submitted by borrowers, lenders might have to do their own independent diligence to verify borrower eligibility. That would take valuable time and undermine Congress's goal of getting money quickly to borrowers who need it urgently. The government therefore specified that lenders are entitled to rely on information provided by borrowers and scaled back the certifications required of lenders. The Interim Final Rule provides:

> The intent of the Act is that SBA provide relief to America's small businesses expeditiously, which is expressed in the Act by giving all lenders delegated authority and streamlining the requirements of the regular 7(a) loan program. For example, for loans made under the PPP, SBA will not require the lenders to comply with section 120.150 "What are SBA's lending criteria?." SBA 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. Lenders must comply with the applicable lender obligations set forth in this interim final rule, but will be held harmless for borrowers' failure to comply with program criteria; remedies for borrower violations or fraud are separately addressed in this interim final rule. The program requirements of the PPP identified in this rule temporarily supersede any conflicting Loan Program Requirement (as defined in 13 CFR 120.10). [23]

And the Interim Final Rule goes on to reaffirm this key point:

> **c. Can lenders rely on borrower documentation for loan forgiveness?**
>
> Yes. *The lender does not need to conduct any verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified the payments for eligible costs.* The Administrator will hold harmless any lender that relies on such borrower documents and attestation from a borrower.

> The Administrator, in consultation with the Secretary, has determined that lender reliance on a borrower's required documents and attestation is necessary and appropriate in light of section 1106(h) of the Act, which prohibits the Administrator from taking an enforcement action or imposing penalties if the lender has received a borrower attestation.[24]

Further, while the Lender Application Form has a variety of conditions that the applicant (i.e., the borrower) must certify to the lender, the lender's certifications to the government are much narrower:

> **Lender Certification**
>
> On behalf of the Lender, I certify that:
>
> - The Lender has complied with the applicable lender obligations set forth in paragraphs 3.b(i)-(iii) of the Paycheck Protection Program Rule.
> - The Lender has obtained and reviewed the required application (including documents demonstrating qualifying payroll amounts) of the Applicant and will retain copies of such documents in the Applicant's loan file.
>
> I certify that:
>
> - Neither the undersigned Authorized Lender Official, nor such individual's spouse or children, has a financial interest in the Applicant.[25]

Paragraphs 3.b(i)-(iii) of the Rule, as referenced above, are similarly narrow:

> **b. What do lenders have to do in terms of loan underwriting?**
>
> Each lender shall:
>
> i. Confirm receipt of borrower certifications contained in Paycheck Protection Program Application form issued by the Administration;
>
> ii. Confirm receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020;
>
> iii. Confirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application;[26]

Taken together, these provisions will greatly reduce lenders' risk under the FCA – and potentially other statutes – for processing loans under the SBA program. With that said, the protections are obviously not complete and any lender involved in the SBA program should be vigilant for red flags in applications that could be used post hoc – by regulators or qui tam relators – to allege that the lender was being willfully blind to abuses of the SBA program by borrowers.

2. Potential FCA Risks for Borrowers

Borrowers are in a much different position. Unlike lenders, borrowers are required to make a series of "certifications" that could trigger FCA liability. These certifications include, among other things, that:

- I have read the statements included in this form, including the Statements Required by Law and Executive Orders, and I understand them.

- The Applicant is eligible to receive a loan under the rules in effect at the time this application is submitted that have been issued by the Small Business Administration (SBA) implementing the Paycheck Protection Program under Division A, Title I of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (the Paycheck Protection Program Rule).
- The Applicant (1) is an independent contractor, eligible self-employed individual, or sole proprietor or (2) employs no more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the SBA in 13 C.F.R. 121.201 for the Applicant's industry.
- I will comply, whenever applicable, with the civil rights and other limitations in this form.
- All SBA loan proceeds will be used only for business-related purposes as specified in the loan application and consistent with the Paycheck Protection Program Rule.
- To the extent feasible, I will purchase only American-made equipment and products.
- The Applicant is not engaged in any activity that is illegal under federal, state or local law.
- Any loan received by the Applicant under Section 7(b)(2) of the Small Business Act between January 31, 2020 and April 3, 2020 was for a purpose other than paying payroll costs and other allowable uses loans under the Paycheck Protection Program Rule.[27]

These certifications, in particular those that cross-reference SBA regulations and the new Interim Final Rule for the program, should be closely reviewed by any borrower and could prove a trap for the unwary and unprepared. If a borrower has a question concerning the interpretation of an eligibility criterion, it should attempt to engage with the Treasury, the SBA, and/or its lender to seek clarification. If a borrower submits a certification in good faith that reflects a reasonable interpretation of the relevant requirements, the government should not accuse the borrower of violating the FCA even if the government adopts a different interpretation of the requirement at issue – especially if the borrower was open with the government about the basis on which it was proceeding.[28] Even then, however, the borrower could face litigation risk and expense, heightened by the ability of private citizens to file *qui tam* actions that the government itself might not file.[29]

[1] While the focus of this Client Alert is the SBA component of the CARES Act – which is already in the execution phase – many of the same concerns and principles discussed throughout will apply to many of other components of that Act once those loans, guarantees, and investment programs begin to move forward.

[2] In addition to civil liability under the False Claims Act, the government can pursue criminal remedies for fraud and false statements in connection with CARES Act programs. In the wake of the 2008 financial crisis, the Office of the Special Inspector General for the Troubled Asset Relief Program (or "SIGTARP") recovered over $11,000,000,000 in civil penalties but also referred criminal charges against over 430 individuals, many of which resulted in prosecution and jail.

[3] *What's Inside the Senate's 2 Trillion Coronavirus Aid Package*, NPR, (Mar. 26, 2020), https://www.npr.org/2020/03/26/821457551/whats-inside-the-senate-s-2-trillion-coronavirus-aid-package.

[4] CARES Act, § 4003(b)(4).

[5] CARES Act, § 1102(b).

[6] Before making PPP loans, approved lenders not subject to the requirements of the Bank Secrecy Act must establish an anti-money laundering compliance program equivalent to that of a comparable federally regulated institution.

[7] SMALL BUS. ADMIN., BUSINESS LOAN PROGRAM TEMPORARY CHANGES; PAYROLL PROTECTION PROGRAM (2020), https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf

[8] *Id.*

[9] U.S. TREASURY, PAYCHECK PROTECTION PROGRAM (PPP) INFORMATION SHEET: BORROWERS (2020), https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf. For a copy of the borrower's application form, see https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Application-3-30-2020-v3.pdf

[10] SMALL BUS. ADMIN., BUSINESS LOAN PROGRAM TEMPORARY CHANGES; PAYROLL PROTECTION PROGRAM (2020), https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.

[11] *Id.*

[12] *Id.*

[13] U.S. TREASURY, PAYCHECK PROTECTION PROGRAM (PPP) INFORMATION SHEET: BORROWERS (2020), https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf.

[14] *Id.*

[15] 31 U.S.C. § 3729(a)(1).

[16] *See U.S. ex rel. Garbe v. Kmart Co.*, 824 F.3d 632 (7th Cir. 2016).

[17] 31 U.S.C. § 3729(a)(1).

[18] 31 U.S.C. §3729(b)(2)(A)(2).

[19] *See United States ex rel. Kraus v. Wells Fargo & Co.*, 943 F.3d 588 (2d Cir. 2019) (holding the FCA applied to allegedly false claims submitted by a financial institution to the Federal Reserve Bank of New York to obtain emergency lending facilities); *United States ex rel. Grubea v. Rosicki, Rosicki & Associates, P.C.,* 318 F. Supp. 3d 680 (S.D.N.Y. 2018) (holding that claims submitted to Fannie Mae and Freddie Mac, which received substantial government bailout funds, constituted "claims" within the meaning of the FCA); *United States v. Estate of Layton P. Stuart et al*, No. 1:15-cv-01044-RDM (D.D.C. 2016) (One Financial Bank settled with the United States for over $47 million regarding allegations that its former president and CEO diverted millions of TARP funds for his personal use, thereby violating the FCA).

[20] *See United States v. Davis,* 809 F.2d 1509 (11th Cir. 1987) (alleging that defendant provided false and incomplete information to the Small Business Administration in connection with a disaster loan application).

[21] *See United States v. Quicken Loans Inc.,* 239 F. Supp. 3d 1014 (E.D. Mich. 2017) (FCA case against lender for falsely certifying compliance with FHA underwriting requirements).

[22] *See United States v. Wells Fargo Bank, N.A.*, 972 F. Supp. 2d 593 (S.D.N.Y 2013).

[23] SMALL BUS. ADMIN., BUSINESS LOAN PROGRAM TEMPORARY CHANGES; PAYROLL PROTECTION PROGRAM (2020), https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.

[24] *Id*. (emphasis added).

[25] SMALL BUS. ADMIN., LENDER APPLICATION FORM – PAYCHECK PROTECTION PROGRAM LOAN GUARANTY (2020), https://home.treasury.gov/system/files/136/PPP-Lender-Application-Form-Fillable.pdf.

[26] SMALL BUS. ADMIN., BUSINESS LOAN PROGRAM TEMPORARY CHANGES; PAYROLL PROTECTION PROGRAM (2020), https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.

[27] SMALL BUS. ADMIN., PAYCHECK PROTECTION PROGRAM: BORROWER APPLICATION FORM (2020), https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Application-3-30-2020-v3.pdf.

[28] This is because it ***may*** be possible to defeat the FCA's knowledge (or scienter) and/or materiality elements if a defendant can prove the government was actually aware of the alleged false claims or statements at the time it chose to pay the defendant's claim. *See Spay v. CVS Caremark Corp.*, 875 F.3d 746 (3d Cir. 2017).

[29] Companies should also be aware of some controversy around the above referenced "government knowledge" defense in Congress and elsewhere, with certain prominent members such as Senator Charles Grassley strongly recommending that its scope be curtailed to avoid claims that the knowledge of some government employee "somewhere in the bowels of the bureaucracy" means a defendant would be "automatically off the hook." Press Release, Senator Charles Grassley, Interpreting the False Claims Act (Feb. 13, 2018), https://www.grassley.senate.gov/news/news-releases/interpreting-false-claims-act.