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When the Government Comes Knocking: Paycheck Protection Program and Preparing for Government Scrutiny

What do a reality TV star from Georgia, a Texas engineer, and two New England businessmen have in common? In a little over one week, they were the first people in the nation to be arrested and charged with COVID-19 relief fraud. The charges stemmed from alleged false statements made on their respective applications for Small Business Administration (SBA) loans under the Paycheck Protection Program (PPP).

In most of these cases, the defendants falsely claimed on their applications that they had employees and payroll costs that they did not have.^[1] In one case, the defendant spent PPP funds for unauthorized purposes by using them to pay for extravagant personal items like custom made jewelry. ^[2] While these cases likely represent more egregious abuses of the PPP program, a harbinger of government investigations is on the horizon.

Even honest mistakes with PPP loans can result in heightened scrutiny from investigators. If past is prologue, the various agencies empowered with broad enforcement authority for ferreting out PPP fraud will continue to aggressively investigate businesses and individuals for years to come in search of misconduct. This heightened scrutiny may not lead to an indictment or a finding of guilt, but will be costly to investigate and defend.

Given this reality, it is essential that businesses that have received PPP loans understand the program's requirements; the agencies tasked with investigating COVID-19 fraud; the criminal and civil penalties involved; and best practices for addressing government scrutiny.

Note: *Frost Brown Todd recently hosted a webinar on how businesses can prepare for government investigations and*

enforcement actions in the COVID-19 era. [Click here to watch the webinar.](#)

The CARES Act & PPP Overview

The Coronavirus Aid, Relief, and Economic Security (CARES) Act is a federal law enacted on March 29, 2020, in response to the COVID-19 pandemic. The CARES Act created the PPP, which allows small businesses and other qualifying organizations to receive forgivable loans in order to maintain employment of their workers.^[3] PPP loans are backed by the SBA and issued by participating banks on a “first-come, first-served” basis.^[4]

The loan proceeds can only be used by businesses on payroll costs, interest on mortgages, lease payments, rent, and utilities. The interest and principal on the loans are forgiven if businesses spend the proceeds within 24 weeks of receipt and use at least 60 percent of the forgiven amount on payroll, and loan payments under the program are deferred until after the SBA makes a determination on forgiveness. The loans are calculated as a multiple of average monthly payroll costs.

To obtain a PPP loan, a business must make a series of certifications in good faith. Specifically, among other things, a business must certify in good faith that:

- “[t]he Applicant was in operation on February 15, 2020 and had employees for whom it paid salaries and payroll taxes or paid independent contractors . . .;”
- “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant;” and
- “[t]he funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments”

Borrowers certify that using the funds for unauthorized purposes may be prosecuted as fraud. Borrowers also attest that “the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects,” and that knowingly making a false

statement on an application is punishable under federal criminal laws.

Businesses that receive PPP loans in amounts under \$2 million are deemed by the government to have made the “economic uncertainty” certification (also known as the “necessity certification”) in good faith.^[5] Nevertheless, all loan recipients, regardless of the size of the loan, can still be held criminally or civilly responsible if they made other certifications in bad faith or misused PPP funds.

The Government’s COVID-19 Fraud Investigators

Law enforcement and regulators are increasingly looking for ways to respond to the economic devastation caused by the coronavirus crisis. It is, thus, likely that numerous agencies will aggressively probe PPP loan recipients for evidence of misconduct and false certifications. Although these agencies will coordinate on investigations in many cases, they generally have independent investigating authority to probe a business for evidence of PPP fraud.

Department of Justice (DOJ) Prosecutors & Task Forces

Federal prosecutors, wielding significant tools like grand jury subpoena power and cooperation agreements, are likely to be at the forefront of this effort. Attorney General Bill Barr has directed U.S. Attorney’s Offices (USAOs) to prioritize the detection, investigation, and prosecution of criminal conduct related to COVID-19.^[6] To that end, each USAO has designated a prosecutor to be the “Coronavirus Coordinator” for the district.^[7] The USAOs have also organized COVID-19 task forces in their districts, many of which are joint federal-state enterprises that combine the resources of federal and local enforcement agencies to target COVID-19–

DOJ’s Criminal Division, which operates out of Washington, D.C. and has prosecuting authority independent from that of USAOs, will also play a leading role in investigating and prosecuting PPP fraud, as it has in the early criminal cases. The Criminal Division’s Fraud Section

will be a key actor in these efforts because of its mandate to assist in the prosecution of complex white-collar cases for DOJ and Attorney General Barr's request that USAOs consult with the Fraud Section on COVID-19 fraud cases. The Criminal Division's National Center for Disaster Fraud, which is a partnership between DOJ and other agencies that coordinate COVID fraud investigations, will also be active in these investigations.

Other Federal Law Enforcement

Federal law enforcement agencies like the Federal Bureau of Investigation (FBI) and Internal Revenue Service (IRS) are also expected to devote significant resources to probing PPP fraud. The FBI may use a panoply of tools, including search warrants, witness interviews, and even undercover operations (as was the case in the PPP prosecution involving the two New England businessmen), in order to investigate these matters. Recent cases have also shown that other agencies like IRS Criminal Investigation are likely to investigate PPP fraud implicating tax laws or involving tax documents.

Offices of Inspectors General

Federal Offices of Inspectors General (OIG) will play a major role in investigating PPP fraud, such as the SBA OIG, Treasury Inspector General for Tax Administration, or Federal Deposit Insurance Corporation OIG. OIGs are independent and objective entities within federal agencies whose duty is to combat waste, fraud, and abuse in the programs and operations of their agencies. They generally have the power to conduct audits and investigations in service of that responsibility. Based on the early PPP criminal cases, OIGs will actively pursue fraud related to SBA loans.

Moreover, federal law has created unique watchdogs and regulatory entities for the specific purpose of ferreting out COVID-19 relief fraud, including the Special Inspector General for Pandemic Recovery (SIGPR), and the Pandemic Response Accountability Committee. Each of these entities can issue subpoenas, and the SIGPR can seek search warrants independently of DOJ, administer

oaths, and take testimony.

State Authorities

There are also several state actors empowered to investigate PPP fraud. Many state attorneys general and local law enforcement agencies are members of the joint federal–state task forces mentioned above. Additionally, given that state law generally criminalizes fraud and theft, local district attorneys, elected prosecutors, sheriff’s offices, and state police agencies that are analogous to the FBI will have jurisdiction to investigate many underlying actions associated PPP fraud.

Potential Criminal Charges & Civil Claims

At the state and federal level, a potential defendant can be charged under criminal fraud statutes or sued under civil fraud statutes or both simultaneously, making the litigation threats salient. At the federal level, prosecutors are likely to rely on one or more of the following criminal fraud statutes in charging a case involving PPP misconduct:

- Bank fraud (18 U.S.C. § 1344)
- False statements (18 U.S.C. § 1001)
- False statements on loan applications (18 U.S.C. § 1014)
- False statements to the Small Business Administration (15 U.S.C. § 645)
- False, fictitious or fraudulent claims (18 U.S.C. § 287)
- Mail fraud (18 U.S.C. § 1341)
- Wire fraud (18 U.S.C. § 1343)

Conspiracy (18 U.S.C. § 371) and conspiracy to commit fraud (18 U.S.C. § 1349) are some of the other charges that might apply. Each of these crimes comes with a significant threat of imprisonment; for instance, the punishment for committing bank fraud or wire fraud includes a statutory maximum sentence of 30 years’ imprisonment.

[8]

State criminal laws will vary by locality, but a broad array of fraud and theft statutes will exist in every state, providing a hook for local investigators and local prosecutors to investigate and bring prosecutions under state law if desired.

On the civil fraud side, whistleblowers as well as the government may bring lawsuits against businesses for submitting fraudulent claims under the False Claims Act (31 U.S.C. §§ 3729–33). The False Claims Act (FCA) provides that a person is liable under the statute if that person knowingly submits a false claim to the government or causes another to submit a false claim to the government or knowingly makes a false record or statement to cause a false claim to be paid by the government. Violations of the FCA are punishable with civil fines up to \$11,000 per violation and treble damages. Whistleblowers are permitted to bring FCA claims on behalf of the government, and if victorious, are given a share of the government's recovery under the FCA. Accordingly, private suits are encouraged by the law's framework.

Preparing for Government Scrutiny

The stakes are high when the government pursues an investigation. To prepare for scrutiny from government investigators or private litigants, businesses who received PPP loans should do the following in consultation with outside legal counsel:

- Confirm that funding applications are accurate.
- Implement controls to ensure the appropriate expenditure of funds.
- Keep accurate records about the use of funds.
- Develop a plan of action in case the government shows up at your door.

To ensure and support the accuracy of applications, businesses should create a specific file for each PPP loan that includes documents to support accuracy of the certifications and representations made in the applications. The following documents, among others, should be included to support the eligibility and loan amount representations:

- Organization charts
- Entity formation documents
- Evidence that the borrower was in business on February 15, 2020
- Copies of all IRS Form W-2s issued to employees for 2019 and 2020
- Monthly payroll reports for 2019 and 2020
- Business tax returns for 2018 and 2019
- Internal company documents detailing the necessity for the loan and economic uncertainty that existed at the time of application
- Internal company documents detailing overall strategy for use of the PPP funds at the time of application
- Financial records
- Records showing current business activity and sources of liquidity

Additionally, the SBA's loan forgiveness application instructions require borrowers to retain "[a]ll records relating to the Borrower's PPP loan" in their files for six years after the loan is forgiven or fully repaid, including the following: documents submitted with the application, documents supporting the borrower's certifications and its eligibility for the loan, documents necessary to support the forgiveness application, and documents demonstrating material compliance with PPP requirements.

Business should also consider providing a memorandum to file from legal counsel that discusses the good faith certification standard and analyzes whether the business made its certifications, especially the necessity certification, in good faith.

Businesses should consider opening a separate bank account for PPP funds for easy tracking and documenting of expenditures. These spending controls will help to ensure the use of PPP funds for permissible purposes. Businesses should also consider appointing an internal compliance manager to oversee the expenditure of the funds.

To ensure accurate documentation of spending, businesses should include in the PPP file a set of supporting records showing proof of payments charged to the loan. For example, the files should include monthly payroll documents, rent and utility bills, and mortgage interest payments. Businesses should also consider using separate accounting ledgers showing these costs and expenditures.

Finally, in consultation with outside counsel, a PPP recipient should develop a protocol for how it will respond when the government comes knocking. As a threshold matter, businesses should consult with outside counsel immediately upon receiving any contact from the government about the company's PPP loan, whether that outreach comes in the form of a subpoena, civil investigative demand, correspondence, email, phone call, or even a personal visit from an agent. Any response to the government should be coordinated with outside counsel. Businesses should not destroy, alter, or hide records in the event of such government contact.

PPP recipients should also work with counsel to develop a written protocol for what to do if the government executes a search warrant at the business. Such a written protocol might call for the designation of one person to deal with agents executing a search warrant, address the management of employees who are present during the execution of a warrant, set out procedures for advising agents of the existence of privileged material in records to be searched, and set out procedures for monitoring the search or memorializing questions asked by government agents during a search.

Government investigations are serious matters and can be distressing, especially during the fast-changing, ever-evolving environment in which businesses are forced to operate during the coronavirus pandemic. With a proper understanding of the risks involved, and with proper planning, a PPP loan recipient will be prepared for the worst.

For more information, please contact [Gabe Davis](#), [Zenobia Harris Bivens](#), or any attorney in Frost Brown Todd's [Business and Commercial Litigation Practice](#).

*To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a **Coronavirus Response Team**. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.*

[1] On May 5, 2020, the U.S. Department of Justice (DOJ) announced conspiracy and bank fraud charges against two businessmen with ties to Rhode Island. Prosecutors accused them of working together to carry out a deceptive scheme to obtain more than \$500 thousand in PPP loans. Among other things, the two businessmen are alleged to have provided false statements in connection with their PPP applications. They claimed to own restaurants and other businesses that they did not own, falsified the number of workers they employed, lied about their businesses' operating status, and lied about the salary paid to their employees, according to DOJ. They also provided fraudulent tax documents to support their PPP applications. For more information, visit <https://www.justice.gov/opa/pr/two-charged-rhode-island-stimulus-fraud>.

Days later, on May 13, 2020, the Department of Justice announced that a Texas engineer had been arrested for wire fraud, bank fraud, false statements to a financial institution, and false statements to the SBA. Those charges stemmed from two PPP applications seeking more than \$10 million that the engineer submitted to a bank for a purported business that he operated. In each of the applications, the engineer is alleged to have falsely certified that his business had hundreds of employees, when in fact the businesses had zero employees. For more information, visit <https://www.justice.gov/opa/pr/engineer-charged-texas-covid-relief-fraud>.

[2] On May 13, 2020, DOJ also announced bank fraud charges against a reality TV star from a VH1 television show. The charges stemmed from a \$2 million PPP loan he obtained for his trucking company. After certifying on his loan application that he would use the funds to make payroll and pay other qualifying business expenses, the defendant instead spent more than \$1.5 million of those funds to pay personal debts; to buy jewelry, including a

custom made Rolex watch and a custom made 5.73 carat diamond ring; and to pay child support. For more information, visit <https://www.justice.gov/opa/pr/reality-tv-personality-charged-bank-fraud>.

[3] <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program>.

[4] So far, Congress has authorized over \$600 billion for loans under the program. PPP loans have a maturity of two years (potentially five years, depending on when the loan was made) and an interest rate of 1%. Generally speaking, a business must have 500 employees or less to qualify for a PPP loan. Neither collateral nor personal guarantees are required.

[5] See Small Business Administration PPP FAQ No. 46, https://www.sba.gov/sites/default/files/2020-06/Paycheck-Protection-Program-Frequently-Asked-Questions_05%2027%2020-508.pdf.

[6] <https://www.justice.gov/ag/page/file/1258676/download>.

[7] <https://www.justice.gov/file/1268521/download>.

[8] 18 U.S.C. §§ 1343, 1344.

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