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CARES Act Creates New Resources for Fraud Enforcement—and Risks for Businesses

Businesses that receive government funding under the nearly \$2 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES Act) should be mindful of the heightened risks of government investigations of fraud, waste, and abuse, for several reasons.

- With the increased spending comes oversight. The CARES Act creates a new special inspector general for pandemic recovery within the U.S. Department of the Treasury to investigate misconduct, and provides resources towards identifying fraudulent activity related to the CARES Act programs.
- Businesses are under pressure to apply for funds under the CARES Act, including government-backed loans under the \$350 billion Paycheck Protection Program (PPP).
- Borrowers applying for PPP loans are required to certify their eligibility for loans and make other representations that, if not properly substantiated, can expose them to allegations of fraud and potentially lead to damages and penalties.
- Some businesses applying for PPP loans may not have previously dealt with the Small Business Administration (SBA) and may be unfamiliar with SBA's affiliation rules, which are complicated and may make some entities backed by venture capital or private equity funds [ineligible](#).

This update provides an overview of these enforcement risks and discusses the importance of diligence and documentation to mitigate these risks.

The CARES Act Creates a New Inspector General for Pandemic Recovery

In addition to providing relief spending, the CARES Act—the largest economic stimulus bill in U.S. history—provides new funding and resources for government oversight and investigations.

The new special inspector general will, among other things, conduct, supervise, and coordinate audits and investigations related to CARES Act loans. On April 3, 2020, President Trump announced his intention to nominate Brian Miller, a former inspector general of the General Services Administration (GSA), to fill the position.

The CARES Act also creates a Pandemic Response Accountability Committee (PRAC), with \$80 million in funding, to promote transparency and support oversight of funds expended under the CARES Act and prior emergency spending bills in response to COVID-19. Consisting of inspectors general from numerous agencies, the PRAC's role is to "prevent and detect fraud, waste, abuse, and mismanagement" in connection with COVID-19 relief efforts and "mitigate major risks that cut across program and agency boundaries."

Government investigators (and the U.S. Congress) will no doubt scrutinize use of government funding and administration of loan programs under the CARES Act. In addition, last month, the U.S. Department of Justice (DOJ) [announced](#) that it will prioritize investigations and prosecutions into wrongdoing related to COVID-19, including fraudulent schemes.

These developments are reminiscent of responses to prior bailouts and emergencies. The 2008 financial crisis resulted in the creation of a special inspector general for the Troubled Asset Relief Program and investigations and litigation under the False Claims Act (FCA) and the Financial Institutions Reform, Recovery and Enforcement Act related to mortgage lending.

FCA Risks Arising From False Certifications

The FCA is among the risk areas facing loan applicants seeking PPP and Economic Injury Disaster Loans (EIDLs) under the CARES Act, which are limited to small businesses.

The FCA provides for treble damages and penalties for knowingly presenting, or causing to be presented, a false or fraudulent claim for payment to the United States and for knowingly making or using false records or statements material to false or fraudulent claims. FCA liability can be grounded on allegedly false certifications of eligibility related to government contracts and loans.

Under the FCA, actual knowledge is not required to prove liability. "Knowledge" can be shown if a person acts in reckless disregard or in deliberate ignorance of the truth or falsity of the information provided to the government. FCA actions can be initiated by *qui tam* whistleblowers (relators) or by the government. DOJ obtained [more than \\$3 billion](#) in FCA cases in FY 2019.

To obtain a PPP loan, borrowers must fill out an application that requires them to certify, among other things, that:

- They are "eligible to receive a loan under the rules in effect at the time this application is submitted that have been issued by" the SBA implementing the PPP.
- For businesses, they employ "no more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the SBA" in their regulations for the business's industry.
- The funds "will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under" the program rules.
- The applicant "understand[s] that if the funds are knowingly used for unauthorized purposes, the federal government may hold me legally liable, such as for charges of fraud."

Borrowers must also certify that information in the application and all supporting documents and forms "is true and accurate in all material respects" and that they understand "that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law" including but not limited to 18 U.S.C. § 1001 (false statements) and 15 U.S.C. § 645 (false statements and other offenses related to small business aid).

Under the FCA, a certification that an applicant knows to be false or misleading (or that the applicant recklessly fails to substantiate) can trigger liability. Thus, a company's certifications as to their eligibility under SBA's rules could generate FCA risks without proper diligence.

The FCA has long been used in similar contexts. For example, DOJ and *qui tam* relators have pursued FCA allegations that companies fraudulently induced the government into entering into small business set-aside contracts by misrepresenting their eligibility status.

Fraud allegations can also arise from unauthorized use of PPP loans, which must be used for payroll and other defined expenses. The SBA's interim final rule warns borrowers that if they "knowingly use the funds for unauthorized purposes," they "will be subject to additional liability such as charges for fraud." The interim final rule also states SBA will have recourse against shareholders, members, or partners that misuse loans.

The risks are particularly acute given the urgency surrounding the submission of applications for PPP loans and other CARES Act funding. This may result in applications being filed without sufficient diligence.

Final Thoughts

Businesses must be prepared to act quickly, but not lose sight of the risks. Companies in need of financial assistance have strong incentives to apply soon for PPP loans, but they should proceed carefully to ensure that certifications and supporting documentation are truthful and accurate. Among other things, they should carefully analyze the application and impact of the SBA's affiliation rules on their size status. Submitting a loan application based on incomplete or inadequate diligence can lead to problems down the road.

Perkins Coie's team of attorneys is available to help clients navigate the CARES Act and other issues related to COVID-19. The firm's COVID-19 [resources](#) page also has numerous resources specific to the CARES Act and loan eligibility issues.

This update was also posted on the [Coronavirus \(COVID-19\): Guidance for Businesses](#) blog.

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