

# Goodwin Alerts

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### U.S. Paycheck Protection Program Lenders: Risks of False Claims Act Enforcement Actions

by Patrice E. Hendriksen

Congress has recently updated the Paycheck Protection Program (PPP) to stabilize the economy in response to the troubling economic impact of the COVID-19 pandemic. Lenders should be aware that the federal government's efforts to provide loans to small businesses in the wake of the pandemic may also result in increased litigation risk for lenders.

On March 27, 2020, the [Coronavirus Aid, Relief, and Economic Security Act](#) (CARES Act) established the PPP, making \$350 billion in loan funding available to small businesses impacted by the pandemic through the U.S. Small Business Administration (SBA). That fund was quickly depleted, causing the federal government to authorize an additional \$310 billion in funding under the [Paycheck Protection Program and Health Care Enhancement Act](#) (PPP & HCE Act). The program was further modified on June 5, 2020, through the [Paycheck Protection Program Flexibility Act of 2020](#). As of [June 10, 2020](#), 5,456 lenders have participated in the program, issuing loans totaling \$511.5 billion.

#### PPP FOR LENDERS

The PPP allows small businesses to obtain low-interest loans of up to \$10 million to cover payroll costs, rent, and other overhead expenses for a certain period of time. PPP loans can only be processed and approved by qualified lenders under delegated authority from the SBA. Lenders may issue covered loans without prior review or approval from the SBA, and agree that they will be responsible for determining borrower eligibility, consistent with PPP requirements.

PPP loans are eligible for forgiveness if the business complies with program terms by, among other things, spending at least 60% of the loan on payroll costs. Loan forgiveness is not all or nothing — rather, borrowers are generally eligible for forgiveness *to the extent* they comply with program requirements. Lenders may request that the SBA purchase the *expected* forgiveness amount of a PPP loan or pool of PPP loans before the borrower's spending period is up. For loans where the lender does not seek advance purchase, the CARES Act provides that the SBA must pay the forgiven amount plus interest within 90 days of when the forgiveness is determined. Lenders will collect borrower payments on principal and interest.

#### POTENTIAL FOR FALSE CLAIMS ACT ENFORCEMENT

With millions of businesses applying for and receiving PPP loans, lenders should be aware of the potential regulatory and legal risks of participating in the program. In the past, the federal False Claims Act (FCA) has served as a powerful tool for the federal government to investigate and initiate actions related to federal funding. Under the FCA, it is unlawful to knowingly present or cause to present a false claim for payment or approval or knowingly make, use, or cause to be made or used, a false record or statement material to a false or fraudulent claim. See 31 U.S.C. § 3729. Primary enforcement of the FCA is vested in the U.S. Attorney General, although the statute also authorizes private citizens to bring civil actions on behalf of the government, i.e., a “*qui tam*” lawsuit. See 31 U.S.C. § 3730.

Over the last decade, the Department of Justice (DOJ) used the FCA as a vehicle to go after numerous Federal Housing Administration (FHA) mortgage lenders for allegedly making non-compliant loans. As part of the FHA program, a lender must generally certify to the government that the loans are eligible for FHA

insurance based on the applicable Department of Housing and Urban Development (HUD) guidelines. If the borrower defaults on the mortgage and the home is foreclosed upon, the FHA reimburses the lender.

DOJ pursued investigations and litigation against FHA lenders on the theory that the lenders submitted, or caused to be submitted, false certifications to the government that loans were eligible for FHA insurance — resulting in reimbursement from the government when those loans defaulted. DOJ received billions of dollars from lenders in connection with resolving such claims. In October 2019, in response to [concerns](#) that the “uncertain and unanticipated FCA liability for regulatory defects” caused many lenders to withdraw from FHA lending, HUD and DOJ executed a joint [Memorandum of Understanding](#) clarifying when and how the agencies would pursue FCA claims against FHA lenders. Pursuant to the MOU, FHA requirements will now be enforced primarily through HUD’s administrative proceedings, and DOJ must confer with HUD before bringing any FCA action based on compliance with FHA requirements. Absent a similar agreement between DOJ and SBA, there is little reason to believe that DOJ will abstain from FCA enforcement in the PPP context.

Indeed, PPP enforcement generally has garnered attention from the federal government and in the public press. Already, DOJ has reportedly issued grand jury subpoenas to large banks as part of a larger effort to investigate PPP fraud, and has already [charged](#) two individuals with allegedly filing bank loan applications fraudulently seeking more than a half-million dollars in PPP funds. In addition, Brian Miller was recently confirmed as special inspector general for pandemic recovery, tasked with conducting audits and investigations of (among other things) the “making, purchase, management and sale” of PPP loans, which may lead to federal investigation and prosecution.

DOJ may take a similar enforcement approach here by using the FCA to police PPP lending. The PPP shares several important characteristics with the FHA program. Similar to the FHA program, PPP loans will be made through an SBA-approved lender on behalf of the federal agency. Also like the FHA program, for each loan made, PPP lenders must certify that they have “complied with the applicable lender obligations” for the program, and have “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.” Finally, much like HUD is required to pay out insurance claims on defaulted FHA loans, the SBA will be required purchase back billions of dollars’ worth of PPP loans. DOJ’s use of FCA enforcement in the FHA context, coupled with the similarities between the two programs, shows that there is a potential risk the statute will be used similarly to enforce PPP lending requirements.

Even if DOJ does not rely on the FCA for enforcement, the *qui tam* provisions of the FCA will permit individual whistleblowers to bring suit on a similar theory. In *qui tam* actions, the government has a right to intervene in the case and, if they decline, the relator can continue with the legal proceedings on his or her own. The government can also choose to dismiss the action over the relator’s objection. 31 U.S.C. § 3730(C)(2)(A). In a memo published in 2018 (the “[Granston Memo](#)”), DOJ instructed its prosecutors to seriously consider dismissing meritless whistleblower FCA cases when it is in the government’s best interest to do so. Unless DOJ exercises this authority to dismiss PPP *qui tam* cases, lenders may be forced to go through the process of defending such actions (even when not brought by DOJ directly). Please see Goodwin’s May 15, 2020, Client Alert, “[U.S. Paycheck Protection Program Loan Recipients: Risks of Qui Tam Actions under the False Claims Act](#),” for information concerning risks to PPP borrowers for FCA claims.

There are some noteworthy differences between the programs. For example, the SBA has provided some [assurances](#) that, under certain circumstances, PPP lenders “will be held harmless for borrowers’ failure to comply with program criteria” and can rely on borrower certifications, and that “[t]he Administrator will hold harmless any lender that relies on . . . borrower documentations and [an] attestation from the borrower.” These

assurances, however, do not directly address the certifications made by lenders themselves. Nor do they necessarily preclude an investigation or enforcement action by DOJ, a separate federal agency.

Given the federal government's previous enthusiasm for FCA enforcement in the FHA lending context, PPP lenders should take care to guard against future FCA claims by exercising caution in certifying compliance with PPP requirements (for example, by considering processes for review or verification of borrower-certified information), even in light of the SBA's guidance about limitations on lender liability.

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