

FEDERAL CIVIL ENFORCEMENT

Expert Analysis

For Civil Enforcement, The Pandemic Is Just Beginning

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Early in the COVID-19 pandemic, many businesses worried about how to avoid running afoul of government scrutiny, especially as regulators warned businesses that they would look carefully at economic misdeeds. There have been many criminal prosecutions of COVID-related fraud—on March 26, 2021, the DOJ announced that the Fraud Section has criminally charged at least 120 defendants to date in fraud cases involving the Paycheck Protection Program (PPP) of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (among hundreds of other criminal cases)—but those often alleged egregious misconduct, such as obtaining loans for nonexistent businesses and spending loan proceeds on luxury goods.

Two new end-of-year settlements go beyond such incidents of egregious

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wrongdoing, however, and shed greater light on how the government might pursue civil enforcement for companies whose behavior was grey, sloppy, or pushed boundaries.

CARES Act Funds-Related Enforcement

On Jan. 12, 2021, the DOJ entered into the first civil settlement involving alleged PPP loan fraud. The DOJ alleged that SlideBelts, and its president and CEO Brigham Taylor, made multiple loan applications and ultimately received a \$350,000 PPP loan, but failed to disclose that the

company had declared bankruptcy—a required disclosure in the loan applications and a bar to receiving a PPP loan—until after receiving the loan distribution. The DOJ contended that the company's misrepresentations about its involvement in bankruptcy proceedings constituted knowing false statements and caused false claims for payment to be made to the SBA, in violation of the False Claims Act (FCA) and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). In response to government demands, SlideBelts ultimately returned the

loan to the lender several months after receiving it. Nonetheless, the company and its CEO agreed to pay \$100,000 to settle the claims.

The fact that DOJ pursued this matter, and how it pursued it, is noteworthy. First, the loan that SlideBelts received was a relatively small amount of \$350,000. This put it well below, for example, a \$2,000,000 safe harbor that the Treasury Department had established for the economic necessity certification under the PPP program. It shows that DOJ will not be deterred by smaller dollar amounts in pursuing cases.

Second, the DOJ pursued this case even though SlideBelts had repaid the loan rather than seek loan forgiveness under the PPP program. This answers one question many asked about the program: Would the government prioritize its enforcement actions by ignoring loans that were repaid, rather than forgiven. This suit gives a clear negative answer. Indeed, while some have speculated that a claim under the FCA cannot lie until the SBA forgives an applicant's PPP loan—turning a bank loan into a government grant—the DOJ took the position in the SlideBelts settlement that the fact that the SBA had guaranteed the loan and paid \$17,500 in loan processing fees was enough to violate the FCA.

Third, the DOJ apparently concluded that the false statements about the company's bankruptcy were enough to justify a suit, even though the settlement did not allege that the company

had misused the loan funds. The company's multiple loan applications and repeated misrepresentations on this point—including in the face of one financial institution rejecting SlideBelts' application on the grounds that it was ineligible because of the bankruptcy—likely contributed to the DOJ focus in this case.

Finally, the DOJ decision to charge violations under both the FCA and FIRREA underscores the potential financial costs associated with such an action. For SlideBelts, the DOJ imposed a \$100,000 fine after concluding that the company did not have

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the ability to pay more. But it noted that actual damages and penalties in the case would have been \$4.2 million, despite the relatively small loan amounts that SlideBelts requested and received. The FCA imposes treble damages and a \$23,331 maximum penalty per false claim. FIRREA imposes different, capped damages that could prove more substantial in PPP loan cases: \$2,048,915 per violation, per day, up to \$10,244,577 per violation.

Disclosure and Securities Fraud Cases

Beyond recipients of federal funds, companies also faced challenges

around how they disclosed their financial position in the quickly changing economic landscape at the start of the pandemic. An enforcement action by the SEC at the end of 2020 demonstrates that those decisions will be carefully scrutinized.

On Dec. 4, 2020, the SEC announced that it settled charges with The Cheesecake Factory for making misleading disclosures about the impact of the COVID-19 pandemic on its business operations and financial condition. The action—which marked the SEC's first charge against a public company for misleading investors about the financial effects of the pandemic—alleged that The Cheesecake Factory had materially misrepresented the condition of its operations in the face of the pandemic. Specifically, the company had stated on Forms 8-K filed with the SEC on March 23 and April 3, 2020 that its restaurants were “operating sustainably” during the COVID-19 pandemic, despite contemporaneous internal corporate documents that showed the company was losing approximately \$6 million in cash per week and that it projected that it had only 16 weeks of cash remaining. Notably, while The Cheesecake Factory did not disclose that internal information in the filings and accompanying press releases, the company did share it with potential private equity investors or lenders in an effort to seek additional liquidity from them. The company also failed to disclose that it had already informed its landlords

that it would not pay rent in April due to the impacts that COVID-19 inflicted on its business. The Cheesecake Factory agreed to pay a \$125,000 penalty and to cease-and-desist from further violations. The settlement, which the SEC announced eight months after The Cheesecake Factory made the alleged materially false and misleading statements, demonstrates the SEC's careful attention to inconsistencies between external and internal communications.

The SEC has also brought several enforcement actions against companies and individuals for violations of the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder for false and misleading statements related to COVID-19 issues. On Feb. 11, 2021, for example, the SEC charged Arrayit Corporation with making false and misleading statements to investors about the status of the company's development of a COVID-19 test in the early months of the pandemic, among other allegations. The SEC had also previously filed charges against Mark Schena, Arrayit's President and Chief Science Officer, for related conduct. While the complaints do not allege that the company or Schena made the alleged misrepresentations in public disclosures, the SEC alleges that investors posted these statements on the public internet forum InvestorsHub.com, and that the misstatements led to surges in the price and trading volume of Arrayit's stock.

Expect More Cases Like These

Public statements by government officials indicate that the cases against SlideBelts, The Cheesecake Factory and Arrayit are representative of future enforcement actions, not outliers.

At the Federal Bar Association Qui Tam Conference on Feb. 17, 2021, in his first public address as Acting Assistant Attorney General, Brian Boynton vowed that pandemic-related fraud will continue to be a DOJ Civil Division enforcement priority, and that "the False Claims Act will play a significant role in the coming years as the government grapples with the consequences of this pandemic." Boynton specifically highlighted the FCA as a tool that enables whistleblowers to address fraud schemes arising out of the CARES Act, including false representations regarding eligibility, misuse of program funds, and false certifications pertaining to loan forgiveness. Boynton noted that the Civil Division "is working closely with various Inspector Generals and other agency stakeholders to identify, monitor, and investigate the misuse of critical pandemic relief monies, and we expect this collaborative effort to translate into significant cases and recoveries."

While FCA cases often take years to investigate, recent activity from the DOJ signals that COVID-related investigations are not only underway, but may also move more quickly than usual. Indeed, in a March 26, 2021 press release about its policing of

COVID-19 fraud, the DOJ noted the "unprecedented pace and tempo" of its enforcement efforts as well as the uptick in whistleblower complaints relating to the pandemic and government stimulus programs.

Similar observations can be made about the SEC. In a May 2020 speech, Steven Peiken, then Co-Director of the Division of Enforcement, described several priority areas for the Division's recently-enacted Coronavirus Committee, including a focus on identifying disclosures that appear to be significantly out of step with others in the same industry, as well as potential insider trading and market manipulation surrounding announcements by issuers in industries particularly impacted by the pandemic. And like the DOJ, the SEC's activities over the past year underscore its focus on pandemic-related misconduct: in a Nov. 2, 2020 Annual Report for Fiscal Year 2020, the SEC Division of Enforcement reported that it had already opened more than 150 COVID-related inquiries and investigations and recommended several COVID-related fraud actions, many of which are ongoing.