

4 Emerging Trends To Watch In COVID-19 Fraud Enforcement

By **Max Jaeger**

Law360 (February 11, 2022, 7:49 PM EST) -- A second wave of COVID-19 fraud enforcement is looming — one that promises a sea change in case scale and complexity as regulators plumb large companies and organizations that took aid and the lenders that issued it, experts from Morrison & Foerster LLP cautioned during a panel discussion.

Fraud and improper payments have siphoned roughly \$100 billion from the federal Paycheck Protection Program, the Economic Injury Disaster Loans program and federal unemployment assistance funds, the Secret Service said in December. Congress has allocated a total of \$4.5 trillion in aid since the pandemic started.

More than 500 people have been charged with relief fraud, but they are largely the obvious defendants accused of making eyebrow-raising loan applications or buying splashy cars and other luxuries with relief money. Recovery has only amounted to about \$600 million, although it is likely more as the latest figures currently available from the U.S. Department of Justice are from March.

Now, the DOJ is likely eyeing larger recoveries from complex matters concerning how big companies and organizations navigated a shifting regulatory landscape, according to Morrison & Foerster white collar partner Brian Kidd, the former chief of the DOJ's Market Integrity and Major Frauds Unit who oversaw the earliest pandemic relief fraud cases before joining the firm in January 2021.

The comments came during a Morrison & Foerster panel Thursday called "Two Years In: An Inside Look at COVID-19 Relief Fraud and What to Expect Next" that also included government contracts and public procurement practice co-chair Tina Reynolds, white collar partner Adam Braverman, corporate finance co-chair Dave Lynn, securities litigation co-chair Haima Marlier and U.S. Food and Drug Administration Regulatory co-chair Bethany Hills.

"COVID relief fraud enforcement is in its infancy and will be with us for many years," Kidd said during Thursday's panel discussion. "As time passes and investigations mature, we can expect cases brought by the department to become more complex and more sophisticated, including shifting focus to fraud committed by companies and organizations."

Casting a Wider Dragnet

The Coronavirus Aid, Relief, and Economic Security, or CARES, Act was the largest aid package in U.S. history and required speedy administration, but "coupled with that quick release of funding was a

confusing regulatory process" that has caused headaches for businesses and is now complicating investigators' work, according to Reynolds.

"Those rules and regulations and applications changed over time, and because of that, made it a little bit more confusing for borrowers to understand exactly what rules applied at any particular time," she said. "But they're also making it more difficult for law enforcement, because the rules that apply to one borrower may not apply to another borrower who took out a loan later in time."

For instance, the share of loans that had to go toward payroll changed throughout the pandemic. U.S. Small Business Administration rules about company affiliations will also continue to be a pain point, Reynolds predicted.

Small U.S. subsidiaries of larger international companies may have improperly obtained loans for companies with fewer than 500 employees because they didn't count international affiliates as required under SBA rules. Venture capital and private equity funds also risk similar issues in cases where they exercised enough control over the company, she said.

"This was an issue of big scrutiny and is an issue where, even now, there is a lot of confusion in retrospect about eligibility when going back to examine whether affiliation was considered or not," Reynolds said.

'Forgiveness' in the Crosshairs

A majority of existing PPP and EIDL loan fraud cases have focused on individuals and groups accused of fraudulently applying for funds. Now, the government is looking at borrowers who got the money, used it improperly and then fraudulently asked for loan forgiveness.

"We expect to see more fraud and fraud enforcement with respect to the loan forgiveness process," Kidd said.

Loans issued in the past year will see the most scrutiny. More than 96% of PPP loans issued in 2020 have been forgiven, while the government has waived just 69% of the PPP loans it issued last year, leaving investigators plenty of stones to turn over. And while a total of 87% of PPP loans are settled, the SBA has up to six years to go back through those applications.

"There remains the threat of future enforcement even with the loans that have already been forgiven," Kidd said. "The SBA and DOJ are continuing to take a very close look at loan forgiveness applications and are scrutinizing them for any possible signs of fraud."

One area the SBA is examining in retrospect is whether borrowers made accurate certifications about just how badly they needed the money, according to Reynolds. For instance, making shareholder distributions around the time of a loan application might now call into question the necessity of the funds, she said.

Fintech Lenders Under the Lens

Fintech lenders offered a critical complement to traditional banks when it came to getting loan money into borrower's hands, but the emerging industry also had hiccups that are drawing additional scrutiny, according to Kidd.

"Many have said that PPP was fintech's moment to shine, and I think by and large that's exactly what they did. However, there were some risks," Kidd said. "Emerging companies have not had the same runway to build infrastructure for controls and compliance, and that's something they will undoubtedly do as they grow and mature."

An August study by the University of Texas at Austin found that fintech lenders were three times more likely to have issued suspicious loans, Kidd said. The House Select Subcommittee on the Coronavirus Crisis opened a probe in May into four firms that handled a combined \$20.5 billion in loans: Kabbage, BlueVine, Cross River Bank and Celtic Bank. In November, it added to two other startups that processed one-third of all PPP loans issued in 2021: Blue Acorn PPP and Womply.

Expect More False Claims Act Recovery

2021 was a gangbuster year for False Claims Act recovery, but pandemic-related cases came in dribs and drabs. Kidd anticipates the DOJ's commitment to rooting out fraud at all levels will come into sharper focus this year as more FCA actions are revealed.

"Additional cases have been slow to unfold, but we expect that to change in the near future," Kidd said. "FCA cases, like many others including criminal investigations, take time to develop. The fact that there have been only a handful of cases to date does not suggest this is not a priority for the department."

The handful of public cases so far have focused on companies that obtained duplicative loans or used money for noncompliant purposes. According to the DOJ, for example, a Florida private jet company paid \$287,000 to settle claims that its owner diverted nearly \$99,000 of a \$1.7 million PPP loan for personal expenses.

Earlier this month, the DOJ announced that it had recovered more than \$5.6 billion in FCA judgments and settlements in fiscal year 2021 — the second-highest amount ever — thanks to billions of dollars in settlements related to the opioid epidemic.

--Editing by Alanna Weissman and Jay Jackson Jr.