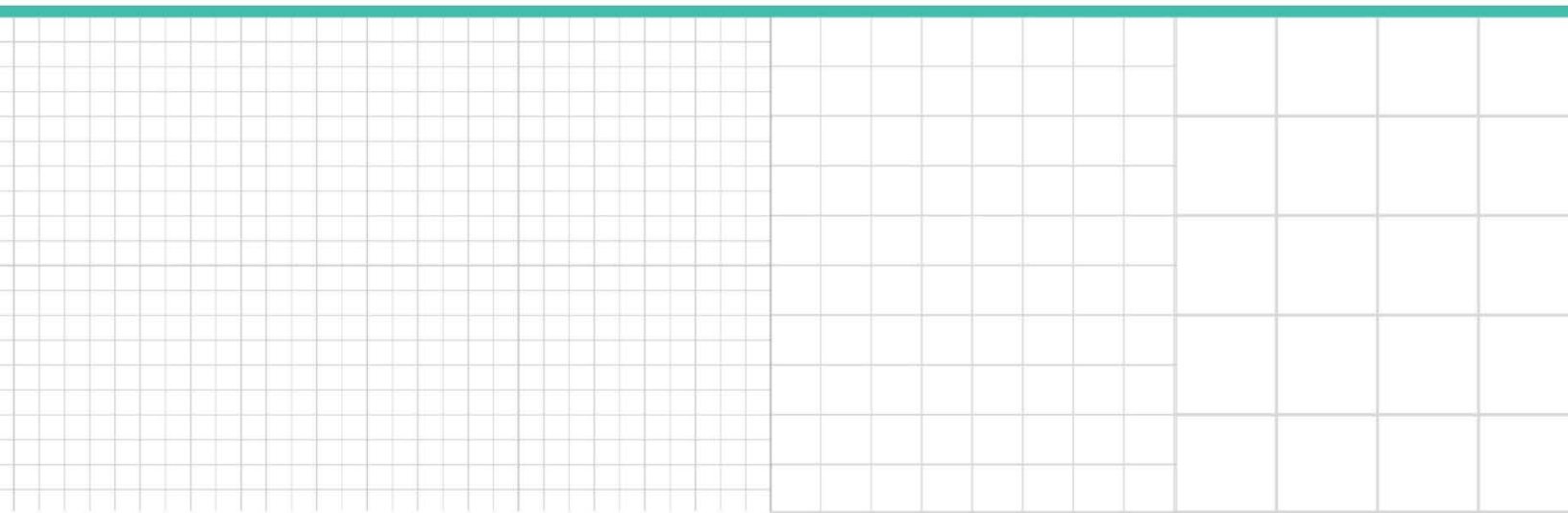


Professional Perspective

CARES Act Increases Oversight and Criminal Investigations

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CARES Act Increases Oversight and Criminal Investigations

Contributed by [Daniel R. Alonso](#), Buckley LLP

The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, signed into law by President Donald Trump on March 27, 2020, is expected to provide badly needed relief for those most affected financially by the coronavirus. This includes small and mid-sized businesses that would not otherwise be able to make payroll or meet expenses, and potentially be forced into bankruptcy.

The infusion of \$2 trillion into the U.S. economy—the largest such action in history—includes more than \$450 billion for government loans to struggling companies, as well as \$350 billion under the Paycheck Protection Program for loans to small businesses that promise to keep their payrolls going through the crisis. The act also provides unemployment benefits for some who would not be traditionally eligible for state unemployment insurance benefits.

If history is any guide, wherever there is a big pot of money, some people will look to steal it. Some desperate individuals might misrepresent their eligibility for unemployment benefits. Others will try to defraud government agencies like the Small Business Administration, banks, and non-bank lenders through various misrepresentations about eligibility for relief. Still others, realizing that they or their companies have cut corners, will make false certifications to the Department of the Treasury, the SBA, or other government agencies.

In the corporate world, this will affect eligible small, medium, and large companies and their executives, who will have to balance the difficult task of keeping their businesses afloat while striving to ensure that their employees stay clear of activity that might lead to a criminal investigation. It will also affect the influx of additional lenders who will for the first time be allowed to make federally-guaranteed loans under section 7(a) of the Small Business Act. Act, §1102(a)(2), 1109(b).

Many businesses and lenders will not be accustomed to dealing with federal agencies and their innumerable forms in the way that, for example, government contractors regularly do. They might be in for a shock when they see the detailed—and unwaivable—representations and certifications that the government will require under the act and its soon-to-come implementing regulations. Without compliance programs that are designed or modified to ensure scrupulous accuracy and deter fraud and false statements, businesses and lenders could find themselves in the crosshairs of the cadre of government agencies that are now on high alert, at a particularly difficult time.

Criminal Investigations

The government, in the form of the prosecutors in the Department of Justice and the agency inspectors general, is well aware of the numerous ways the act's appropriations can be targeted, and will be ready to investigate any and all potential crimes. Even before the act's passage, various coronavirus fraud task forces had begun to pop up, like the one in [Virginia](#), whose mission is “to identify, investigate, and prosecute fraud related to the ongoing coronavirus pandemic in Virginia.”

Indeed, the DOJ announced its [first enforcement action](#) to combat fraud related to the coronavirus pandemic five days before the president signed the act into law. Although it was a civil enforcement action rather than a criminal prosecution, it alleged a violation of the wire fraud statute (18 U.S.C. §1343)—a crime—in order to invoke the DOJ's authority to seek civil injunctive relief under 18 U.S.C. §1345. Notably, the assistant attorney general for the DOJ Civil Division [said](#) at the time that the Department “will not tolerate criminal exploitation of this national emergency for personal gain.” DOJ now has a dedicated Coronavirus Fraud News page on its website.

No doubt much of the Department's efforts in the early phase of this crisis will focus on the kinds of [scams](#) outlined by Attorney General William P. Barr in seeking the public's assistance—fake cures, phishing schemes, malicious websites, fraudulent charitable donations, and the like. But the real story is the extraordinary amount of oversight over the relief money itself contained within the Act. Section 4018 establishes, within the Department of the Treasury, the Office of the Special Inspector General for Pandemic Recovery, with a SIGPaR to be appointed by the president with the advice and consent of the Senate. Act, §§ 4018(a); 4018(b)(1). Congress was clearly worried about the vulnerability of taxpayer funds to waste, fraud, and abuse, and worked to ensure as much scrutiny as possible.

Congress gave the SIGPaR the duty to conduct audits and investigations of “the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary of the Treasury under any program” established under the Act. Act, § 4018(c)(1). The act also grants the special IG the same duties and powers that other agency IGs have

under the Inspector General Act of 1978, including subpoena power under Section 6 of that act, as well as the general obligation to root out fraud, waste, and abuse. Act, §§ 4018(c)(1)(3); 4018(d)(1).

Because IG subpoena power, and investigative authority generally, extends to third parties in a position to impact federal programs, the SIGPaR can be expected to scrutinize any entity or individual involved in the “sale of loans, loan guarantees, and other investments made” under the programs established by the act. Notably, the new SIGPaR is in addition to the existing IGs for various agencies, most relevantly the SBA and the Department of Labor, so we can expect both overlapping and collaborative efforts among different agencies.

Just as significantly, the act also establishes a Pandemic Response Accountability Committee and allocates \$80 million to its mission of oversight. Constituted separately from the SIGPaR, the committee will have its own staff and its own authority to conduct investigations and reviews, including subpoena power. And in a novel configuration, the committee will consist solely of existing federal IGs (at least 10), nominally established within the existing Council of Inspectors General on Integrity and Efficiency, created by the IG Act. Act, § 15010(b), (c).

It is tasked with the duty to “conduct and coordinate oversight of covered funds and the Coronavirus response and support Inspectors General in the oversight of covered funds and the Coronavirus response in order to detect and prevent fraud, waste, abuse, and mismanagement; and identify major risks that cut across programs and agency boundaries.” Act, § 15010(d)(1)(A).

What will all this mean for criminal enforcement? For more than four decades, the IGs have been the backbone of the DOJ's battle against fraud and corruption relating to government programs and government agencies. That a new oversight committee with its own subpoena power is made up exclusively of IGs is extraordinary and should produce the kind of collective focus on prevention, detection, and investigation that will hopefully minimize waste in this huge injection of federal dollars.

This new committee will have substantial audit, investigative, and reporting authority, which in turn can be expected to lead to enhanced investigative efforts as the IGs continue to work with U.S. attorneys and other partners in law enforcement. Although IGs have many other responsibilities besides criminal enforcement, experience shows that when they see potential criminality, they can be dogged in its pursuit.

At the same time, from the perspective of companies seeking loans and lenders extending government-backed loans, criminal investigations can be a blunt instrument, and even companies and individuals who are ultimately absolved of criminal liability typically go through a very painful and disruptive investigative experience. It is therefore crucial for companies to do everything in their power to avoid scrutiny. That begins with understanding the framework under which criminal authorities operate.

Legal and Policy Framework

In navigating how best to comply with the act, companies of all sizes should bear in mind the basics of corporate criminal liability in the U.S. On the federal level, organizations can be charged criminally for the acts and omissions of their employees and agents, as long as the individuals were acting within the scope of their employment and acted at least in part for the benefit of the organization. *New York Central & Hudson River Railroad Co. v. United States*, 212 U.S. 481, 494-95 (1909). This is a very liberal respondeat superior standard, and the DOJ has used it even in the case of relatively low-level employees committing isolated crimes within larger organizations.

In part to mitigate the potentially harsh effects and collateral consequences of hinging the criminal liability of an entire organization on what could be the acts of just one person, DOJ has promulgated the Principles of Federal Prosecution of Business Organizations, now memorialized in section 9-28.00 of the Justice Manual. To oversimplify, that policy offers the carrot of lenient treatment, including avoidance of a criminal conviction, if the company meets [certain criteria](#), such as cooperating with the government's investigation, self-reporting wrongdoing, remediating the harm caused, and demonstrating that it had maintained an adequate compliance program.

The types of crimes that could implicate companies either seeking or providing loans under the act fall into two broad categories: fraud and false statements. It is notable that the act contains no new substantive criminal provisions. Observers have [complained for years](#) that federal law vastly overcriminalizes behavior, so much so that [no one even knows how many crimes](#) are enumerated in the U.S. Code. Those critics will presumably be relieved that Congress did not use the

opportunity of this crisis to create additional crimes. This is not surprising, as fraud, corruption, and false statements and certifications are well covered by existing federal law.

As discussed below, the general federal false statements statute, 18 U.S.C. § 1001, is often a fallback that prosecutors use when false representations have been made to a government agency, but they are unable to prove the other elements of criminal fraud—which typically include an intent to obtain money or property from the victim through the false statements. Thus, section 1001 can often be the most powerful tool in the government's criminal arsenal.

Fraud Crimes

With respect to fraud, Section 1109(i) of the act makes clear that the PPP loans are subject to the existing criminal provisions of 15 U.S.C. § 645, the Small Business Act's specific anti-fraud statute, which contains four key crimes. Section 645(a) prohibits knowing false statements or the willful overvaluation of loan security in order to obtain a loan or other thing of value under the SBA loan program. Section 645(b) criminalizes embezzlement by those “connected in any capacity” with the SBA.

Section 645(c) prohibits concealing or diverting mortgaged property, while section 645(d) criminalizes misrepresentation as a small business when seeking contracts that are meant as set-asides for actual small businesses. All of the criminal sections of the Small Business Act are punishable by different prison terms, with the highest being 10 years.

Notably, notwithstanding the existence of a specific SBA anti-fraud statute, perusal of the SBA IG's [reports](#) of criminal [investigations](#) it has handled in recent years reveals that in SBA IG cases, prosecutors are much more likely to use the basic anti-fraud statutes in the federal criminal code—wire fraud (18 U.S.C. § 1343) and mail fraud (18 U.S.C. § 1341)—than the specific statutes tailor-made for the SBA. This is not surprising, as specific statutes tend to have more onerous jurisdictional elements or required mental states than the tried-and-true mail and wire fraud statutes.

Plus, the theoretical penalties for mail and wire fraud, a maximum of 20 years per count (30 if the scheme affects a financial institution), are twice the penalty for the most serious SBA fraud charge. Because of its flexibility, Judge Jed Rakoff of the Southern District of New York, when he was a prosecutor, called mail fraud “our Stradivarius, our Colt 45, our Louisville Slugger...and our true love.”

To prove a violation, prosecutors must show a scheme to defraud a victim or victims out of money or property, intent to defraud or harm the victim of the scheme, material misrepresentations, and either an interstate or international wire communication, or a mailing, in furtherance of the scheme. The scheme does not have to be successful, and no one need lose money for there to be a violation. And in loan fraud cases, criminal liability can attach even if the loans are used for purposes that are legitimate on their face, such as to keep payroll going or to obtain other disaster relief. Moreover, assuming the elements of the fraud crime are met, criminal prosecutions are not defeated simply because a loan has been repaid.

Other fraud crimes are specifically geared towards fraud within and against financial institutions. Bank fraud, 18 U.S.C. § 1344, is a powerful federal anti-fraud law, carrying a maximum 30-year penalty and a 10-year statute of limitations. Although essentially as broad as mail or wire fraud, bank fraud requires that the intended victim be a “financial institution,” as defined in the federal criminal code. That definition is limited to certain types of financial institutions—notably federally-insured depository institutions and credit unions, federal reserve banks, and some others—and thus would exclude certain smaller SBA lenders from its purview.

Nonetheless, it is likely that covered institutions will be providing the vast majority of loans under the act, which would invoke both bank fraud and related provisions. See, e.g., 18 U.S.C. § 1005 (false entries in records of depository bank with intent to injure the bank “or any other company” or individual).

Thus, schemes that the SIGPaR, prosecutors, and the committee will be on the lookout for include:

- Misrepresentations of the eligibility of existing companies for coverage under the PPP
- Nominee or straw owners used to mask ineligibility; outright creation of false companies
- Unscrupulous lenders demanding up-front payments from borrowers who might or might not be eligible

- Incorporating identity theft schemes into loan fraud schemes
- Corrupt activity by employees of lenders or the SBA, including collusion between borrowers and lenders
- A pattern of loans at certain lenders that do not meet the requirements of the Act or the regulations to come

Doubtless many other types of schemes will come under investigation in light of “the reality of fraud, a crime of extraordinary variety, limited only by human imagination” (e.g. *United States v. Rybicki*, 354 F.3d 124, 155 (2d Cir. 2003) (*en banc*) (Raggi, J., concurring)).

Ultimately, of course, all of this involves federal money, which brings into play criminal laws (as distinguished from the powerful but civil False Claims Act) against defrauding or otherwise unlawfully diverting U.S. government funds. See:

- 18 U.S.C. §641 (theft of government property, including theft by false pretenses)
- 18 U.S.C. §666 (theft and bribery in federally-funded programs)
- 18 U.S.C. §371 (conspiracy to defraud the U.S., requiring agreement between two or more people and an overt act)
- 18 U.S.C. § 1002 (possession of a false document for the purpose of enabling someone to obtain money from the U.S.)
- 18 U.S.C. § 1031 (major fraud against the U.S., added in the wake of the 2008 financial crisis, and specifically targets large fraud schemes involving “economic stimulus, recovery or rescue plan provided by the Government”)

Major fraud against the U.S., added in the wake of the 2008 financial crisis, notably allows the U.S. attorney general to pay up to \$250,000 to those who provide information about violations of the law. 18 U.S.C. § 1031(g)(1).

The above is by no means an exhaustive list of federal fraud statutes, and for companies trying to avoid investigations, the specifics of particular laws are not as important as the general concept that the government will be laser-focused on misrepresentations to obtain either direct loans from the SBA or federally-guaranteed loans from lenders. It is also useful to bear in mind that the government is also always on the lookout for corruption—in the form of company employees or government agents who collude with unscrupulous actors for personal gain—and companies should bear that possibility in mind as well.

False Statements and Certifications

Although we can expect the government to focus on the fraud laws in the U.S. Code, they will focus just as hard on “mere” false statements to the government—without the additional elements present in anti-fraud laws—and in particular on false certifications to the SBA or the Treasury Department. The act contains many requirements that borrowers and lenders file certifications, and we can expect that the regulations to be promulgated will contain additional such provisions.

The basic federal false statements statute, 18 U.S.C. § 1001, generally prohibits unsworn statements to the government that are materially false. More specifically, and as relevant to the CARES Act, the actor must knowingly and willfully either falsify, conceal, or cover up “by any trick, scheme, or device a material fact,” or make or use “any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry.” 18 U.S.C. §1001(a)(1) and (3).

Each false statement is punishable by up to five years in prison. Section 1001(a)(3), regarding false writings and documents, will be most applicable to the paper-heavy loan process. But expect the government to rely also on section 1001(a)(1), which punishes concealment of a material fact rather than an affirmative misrepresentation. Because that section requires that the actor have been under a duty to disclose a particular material fact and knowingly and willfully fail to do so (*United States v. Safavian*, 528 F.3d 957, 964 (D.C. Cir. 2008)), so it will be important to see how the Treasury regulations and the required forms are phrased.

Sharp-eyed readers of the act will notice that Congress actually mentioned section 1001 within the text, but only in the section covering emergency unemployment benefits. That section spells out that knowing false statements are not only grounds for ineligibility for further benefits, but they also “shall be subject to prosecution” under section 1001. Section 2104(f)(1)(B).

It is difficult to tell whether Congress believed that the mandatory language would require prosecutors to file charges—which is beyond Congress's authority to do—or whether it was merely underscoring the seriousness of unemployment insurance fraud by pointing to an existing criminal statute. In any event, the absence of a similar mention of section 1001 in the sections that apply to businesses and lenders is irrelevant to whether the statute actually applies. It does, and is available for use by federal prosecutors for any false statements in connection with the programs created by the act.

Following is a non-exhaustive list of certifications required under the act where the SIGPaR, the Committee, and the DOJ will likely focus:

- The PPP requires all recipients applying to make a good faith certification attesting to necessity, to their intention to use the funds to maintain payroll or certain payments, and that the requested loan is not duplicative of others for the same purpose. (Adding language to create 15 U.S.C. § 636(a)(36)(G)(i))
- The act requires mid-sized businesses, when applying for direct loans and loan guarantees under section 4003(c)(3)(D)(i) of the act to make many certifications, including necessity, that the funds will be used to retain at least 90 percent of the work force, that the company will not pay dividends on common stock or repurchase publicly-traded stock for a period of time, and that the company will not outsource any of its jobs outside the U.S.
- The principal executive and financial officer of all companies, when seeking loans under section 4003 of the act, must certify that their companies are not barred under section 4019(c) of the act, which prohibits entities that are controlled by executive branch leaders and members of Congress or certain relatives from obtaining loans.
- To be eligible for the loan forgiveness provisions of the act, a borrower must submit documentation attesting to the requirements of the loan forgiveness program (including the retention of a certain number of employees), and a representative must certify that the documentation is true and correct and for what purpose the amount for which forgiveness is sought was used. Act, § 1106(e).
- With respect to emergency disaster loans, (termed Emergency EIDL Grants), which are required to be paid out urgently (within three days), the act requires the SBA to accept a self-certification. Notably, unlike the other certifications listed, this one is required to be filed under penalty of perjury, opening up an additional avenue of criminal investigation, namely, the federal perjury statute, 18 U.S.C. § 1621. Act § 1110(e)(2).
- Under the section that opens up SBA-guaranteed lending to “additional lenders,” the act requires borrowers to certify that they do not have another SBA loan application pending and did not receive one from Feb. 15 through the end of this year. Act § 1109(f).
- Under section 4114 of the act, air carriers and contractors must also file certain certifications regarding employees, maintaining payroll, paying dividends, and making capital contributions.
- Even local governments must certify to the Treasury Secretary, through their chief executives, that the funds are consistent with the uses spelled out in the section of the Act providing coronavirus-related relief to such governments. Act, § 5001.

As is evident, the government does not like to part with \$2 trillion without requiring lots of people to attest to information on lots of forms. This will be the weak point for many borrowers.

Pitfalls for Lenders

As mentioned, borrowers are not the only actors that can expose themselves to criminal investigation under the act. Lenders will also have to make certain certifications to the Treasury Department under the impending regulations, and for that reason must make all efforts to ensure that their internal records are thoroughly accurate. Specifically, it is important that neither borrowers nor unscrupulous or careless employees be allowed to tarnish the records of the institution through false statements or fraud schemes.

Although in many, if not most, cases the lender will be a victim (along with the government) of such fraudulent activity, once investigators uncover false certifications, they will set out to determine whether anyone at the lending institution knew of the falsity, thereby triggering a potential criminal investigation. (For purposes of SBA administrative penalties only, the act holds harmless PPP lenders who rely on representations from borrowers, Act §1106(h).)

It is worth noting that at the outset of an investigation, IGs do not know whether a case is likely to be civil or criminal, as the government has the power to act on fraud through either civil enforcement or criminal prosecution. In fact, in the wake of the savings and loan scandals of the 1980s, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989, which in part authorizes civil enforcement of certain criminal statutes, including mail, wire, and bank fraud, as well as false statements, if the acts affected federally-insured financial institutions. 12 U.S.C. § 1833a.

Additionally, lenders who make SBA-guaranteed loans face an additional pitfall if they intend to [securitize their loan portfolios](#) and sell the securities on the secondary market. Just as false certifications to the Treasury Department based on misrepresentations in a loan portfolio can form the basis of a false statements case, so, too, can false certifications to the purchasers of securities trigger a securities fraud investigation.

Again, unless an employee of the lending institution was aware of the falsity and presented the information anyway, the lender will not be criminally liable. But securities fraud investigators, either from the DOJ or the Securities and Exchange Commission, when faced with false representations in the sale of securities, will seek to find out who knew what, thus triggering a complicated and costly investigation.

Preparation Is Key

For any company or lender seeking to get involved in any way with the relief money provided by the CARES Act, now is the time to review policies and procedures to minimize the chance that an unscrupulous, or even careless, employee, might trigger an unwanted investigation. For businesses seeking loans and filing certifications with the government, it might not be considered enough to reinforce existing Code of Conduct provisions against fraud.

It will be crucial to have specific procedures surrounding any and all representations and certifications made to the government or to any lending institution. These should include, at a minimum, a second (or third) level of review by someone wholly separate from the person preparing the form and signing it. In larger companies, this should be a compliance officer or in-house lawyer, who will be expected to test every representation made, including by reviewing the documents on which the representations are based. Other aspects of a robust compliance program, like training, might have to wait a bit in light of the breakneck speed at which companies need relief, but strong procedures to ensure accuracy of all representations are key.

Lenders, who will want to protect the integrity of their loan portfolios and rein in unscrupulous or careless employees, will want to take a similar look at their loan procedures. It might be useful, for example, to build in basic external due diligence to ensure that the borrowers at least are who they say they are and seek to make sure that they are comfortable with the representations that have been made regarding ownership and eligibility for loans.

To that end, the Treasury Department issued a [PPP information sheet](#) that purports to require lenders to verify that the borrower was in operation on Feb. 15, 2020, that the borrower had actual employees for whom it paid salaries and payroll taxes, and the dollar amount of average monthly payroll costs.

Additionally, when securitizing loan portfolios for sale on the secondary market, lenders will want to focus on testing the representations made to the underwriters and purchasers in much the same way as the borrowers should be testing their own representations. Already, vendors are hawking new fintech mechanisms to originate small business loans under these SBA programs, and while these solutions may speed up and simplify the process, they also raise new concerns regarding how the lender will properly diligence the loans it originates and the certifications it must make.

Conclusion

The federal government is already in high gear in terms of setting up the process for issuing loans and disbursing funds. Law enforcement authorities, and in particular the SIGPaR and the other IGs, will not be far behind. Although the economic imperatives are front and center for borrowers and lenders alike, focusing on the process by which these loans are made will pay dividends in terms of keeping government investigators away, to say nothing of helping executives sleep soundly at night.