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Manufacturing Success: Paycheck Protection Program Fraud Investigation Trends

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- Frequently called upon to conduct internal corporate investigations involving financial misappropriations



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Agenda

- CARES Act/PPP Background
- PPP enforcement trends to date
 - Early criminal cases
 - Federal agencies involved in investigations
 - The role of financial institutions
 - Anticipated civil enforcement
 - Preparing for a PPP audit
- Investigative techniques for PPP enforcement
 - Subpoenas
 - Search warrants
 - Civil audits
 - Best practices for responding



CARES ACT/PAYCHECK PROTECTION PROGRAM BACKGROUND



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CARES Act/PPP

- CARES Act signed into law on March 29, 2020
- Created Paycheck Protection Program, which authorized up to \$349 billion in forgivable loans to small businesses for job retention and related expenses
- In April 2020, Congress authorized more than \$300 billion in additional PPP funding
- PPP lending program closed on August 8, 2020
- \$134 billion of PPP funding remains available



Summary of PPP Approved Lending

Loan Count	Net Dollars	Lender Count
5,212,128	\$525,012,201,124	5,460

Lender Size	Lender Count	Loan Count	Net Dollars	% of Amount
>\$50 B in Assets	34	1,696,961	\$190,260,579,519	36%
\$10 B to \$50 B in Assets	88	769,963	\$100,975,416,018	19%
<\$10 B in Assets	5,338	2,745,204	\$233,776,205,586	45%

The Paycheck Protection Program (PPP) closed to new loan applications at 11:59pm on August 8, 2020.

Source: SBA Paycheck Protection Program (PPP) Report
(Approvals through 08/08/2020)



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Loan Size

Loan Size	Loan Count	Net Dollars	% of Count	% of Amount
\$50K and Under	3,574,110	\$62,742,565,653	68.6%	12.0%
>\$50K - \$100K	683,785	\$48,676,961,052	13.1%	9.3%
>\$100K - \$150K	294,557	\$36,058,010,813	5.7%	6.9%
>\$150K - \$350K	377,797	\$84,782,932,509	7.2%	16.1%
>\$350K - \$1M	199,679	\$113,558,427,234	3.8%	21.6%
>\$1M - \$2M	53,218	\$73,887,171,387	1.0%	14.1%
>\$2M - \$5M	24,248	\$72,184,996,045	0.5%	13.7%
>\$5M	4,734	\$33,121,136,431	0.1%	6.3%

*** Overall average loan size is: \$101K.**

Source: SBA Paycheck Protection Program (PPP) Report
(Approvals through 08/08/2020)



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A Different Kind of Stimulus

- Despite a more than 100-year history of federal efforts to stimulate the economy during times of crisis in order to prevent economic calamity, aspects of CARES Act/PPP differ significantly from past efforts:
 - Federal assistance is flowing more directly to smaller individual players in the U.S. economy (compare to TARP in 2008)
 - So-called “main street” stimulus efforts subject a different kind of target company to government scrutiny



Bank Involvement & Potential Liability

- Every PPP loan application was processed either by a bank or through a financial lending institution
- As the primary records custodian for processing PPP loan applications, banks should be prepared to receive subpoenas and other information requests from federal law enforcement agents
 - SBA guidance states that lenders may rely upon borrower representations made on PPP application forms
 - However, investigators may want to examine whether the lender knew or should have known that certain information on the application was inaccurate or false but nevertheless processed the loan
- Banks and financial lending institutions had a motive to process large numbers of loan applications
 - They were compensated on each loan they processed, and such compensation sustained smaller lending institutions, which were particularly vulnerable in the early days of the pandemic



A Target-Rich Environment

- By design, with banks administering the stimulus program, various law enforcement and regulatory enforcement options are on the table for the government:
 - Available criminal enforcement statutes, inter alia:
 - 18 U.S.C. § 1344, federal bank fraud statute
 - 18 U.S.C. § 1343, federal wire fraud statute
 - 18 U.S.C. § 1341, federal mail fraud statute
 - 18 U.S.C. § 1001, making false statements
 - 15 U.S.C. § 645, false statements to SBA
 - 18 U.S.C. § 1014, false statements to federally insured bank
 - Civil & regulatory enforcement
- On March 19, 2020, the Department of Justice ordered every U.S. Attorney's Office to appoint a Coronavirus Fraud Coordinator





**Paycheck Protection Program
Borrower Application Form**

By Signing Below, You Make the Following Representations, Authorizations, and Certifications

CERTIFICATIONS AND AUTHORIZATIONS

I certify that:

- I have read the statements included in this form, including the Statements Required by Law and Executive Orders, and I understand them.
- The Applicant is eligible to receive a loan under the rules in effect at the time this application is submitted that have been issued by the Small Business Administration (SBA) implementing the Paycheck Protection Program under Division A, Title I of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (the Paycheck Protection Program Rule).
- The Applicant (1) is an independent contractor, eligible self-employed individual, or sole proprietor or (2) employs no more than the greater of 500 or employees or, if applicable, the size standard in number of employees established by the SBA in 13 C.F.R. 121.201 for the Applicant's industry.
- I will comply, whenever applicable, with the civil rights and other limitations in this form.
- All SBA loan proceeds will be used only for business-related purposes as specified in the loan application and consistent with the Paycheck Protection Program Rule.
- To the extent feasible, I will purchase only American-made equipment and products.
- The Applicant is not engaged in any activity that is illegal under federal, state or local law.
- Any loan received by the Applicant under Section 7(b)(2) of the Small Business Act between January 31, 2020 and April 3, 2020 was for a purpose other than paying payroll costs and other allowable uses loans under the Paycheck Protection Program Rule.

For Applicants who are individuals: I authorize the SBA to request criminal record information about me from criminal justice agencies for the purpose of determining my eligibility for programs authorized by the Small Business Act, as amended.

CERTIFICATIONS

The authorized representative of the Applicant must certify in good faith to all of the below by **initialing** next to each one:

- _____ The Applicant was in operation on February 15, 2020 and had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on Form(s) 1099-MISC.
- _____ Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.
- _____ 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 Paycheck Protection Program Rule; I understand that if the funds are knowingly used for unauthorized purposes, the federal government may hold me legally liable, such as for charges of fraud.
- _____ The Applicant will provide to the Lender documentation verifying the number of full-time equivalent employees on the Applicant's payroll as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities for the eight-week period following this loan.
- _____ I understand that loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, and not more than 25% of the forgiven amount may be for non-payroll costs.
- _____ During the period beginning on February 15, 2020 and ending on December 31, 2020, the Applicant has not and will not receive another loan under the Paycheck Protection Program.
- _____ I further certify that the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects. I understand that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than \$5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000.
- _____ I acknowledge that the lender will confirm the eligible loan amount using required documents submitted. I understand, acknowledge and agree that the Lender can share any tax information that I have provided with SBA's authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of compliance with SBA Loan Program Requirements and all SBA reviews.

Signature of Authorized Representative of Applicant

Date

Print Name

Title

PPP Certifications

(SBA Form 2483 p. 2, 04/20 ed.)



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PPP ENFORCEMENT TRENDS TO DATE



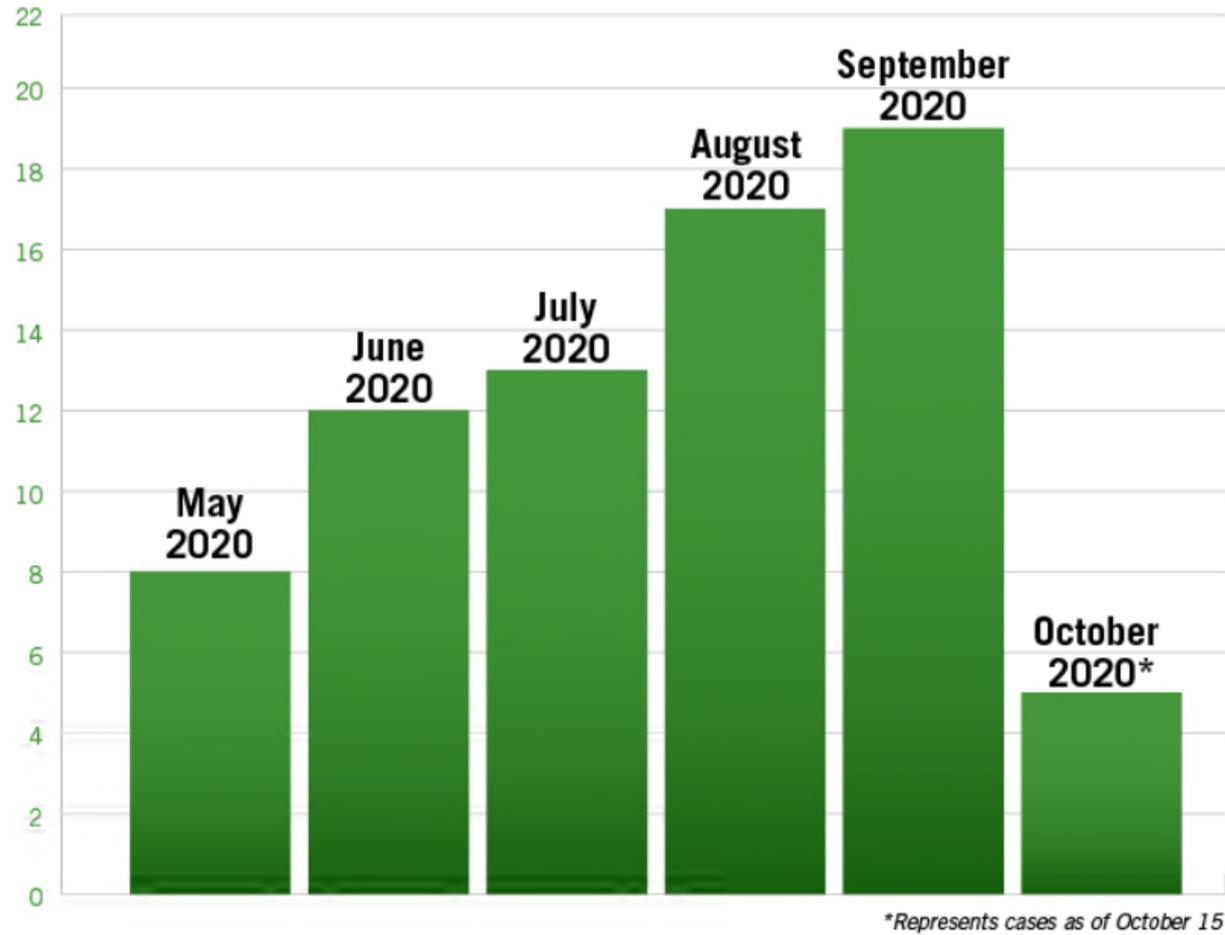
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An Avalanche of Criminal Cases

- 65 borrowers criminally charged throughout the United States since May 2020
 - Total attempted fraud: \$227 million
 - Southern District of Florida has the most cases so far
- Most common charges:
 - Bank fraud; wire fraud; false statements to financial institution/SBA; conspiracy; money laundering
- Eight borrowers have pleaded guilty so far



Cases per Month



Source: Fox Rothschild's PPP Fraud Prosecution Tracker



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PPP Fraud Prosecution Tracker

Fox Rothschild's White-Collar Criminal Defense & Regulatory Compliance Practice Group is tracking, in real time, all federal criminal cases alleging PPP loan violations.

To access our [PPP Fraud Prosecution Tracker](#), contact us by email or phone using the information at the end of this presentation.



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A Multitude of Federal Agencies

- SBA
- FBI
- IRS
- FDIC
- TIGTA
- USPIS
- FHFA
- Federal Reserve
- Secret Service
- And state and local law enforcement



Two Primary Themes of Early Criminal Cases

(1) Individuals or small groups who lied on loan applications about having legitimate businesses, or who claimed they needed PPP funding to pay their employees, but instead used the money to purchase luxury cars and jewelry for themselves, finance home renovations and even gamble in Las Vegas.

(2) Organized criminal rings. For example, the Justice Department recently filed charges in Ohio and Florida against 11 individuals, including a professional athlete and his manager, who collectively applied for \$24 million in PPP funding.



Additional Anticipated Criminal Trends

- The PPP loan application requires that the applicant disclose the identity of each 20% or more equity owner of the company.
 - The SBA maintains an enumerated list of entities that are presumptively excluded from applying for a loan under 13 C.F.R. §120.110, including those businesses located in a foreign country.
- In addition to properly identifying the company owners, applicants must answer questions regarding the owners' past and current involvement with the criminal justice system.
 - If certain criminal history is present, the applicant is not eligible for a PPP loan.



Additional Anticipated Criminal Trends (Cont'd)

- Size qualifications for applicants:
 - Applicants must certify that they are: (1) an independent contractor, eligible self-employed individual or sole proprietor, or (2) employ no more than the greater of 500 or more employees or, if applicable, the size standard in number of employees established by the SBA for the applicant's industry.
 - The SBA has clarified that a “small business concern” is not solely restricted to those enterprises with 500 or fewer employees but that PPP applicants must qualify as eligible under §3 of the Small Business Act, 15 U.S.C. §632.
 - Affiliation rules require applicants to count employees of all affiliates when determining the size of a business.
 - Total employee calculation is average number of people employed for each pay period over the last year
 - The calculation is to be made without regard to number of hours worked or temporary employee status



What is Economic Necessity Anyway?

- Economic necessity certification:

CERTIFICATIONS

The authorized representative of the Applicant must certify in good faith to all of the below by **initialing** next to each one:

_____ Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant. **

– FAQ #31

- Good faith consideration of the borrower’s financial needs based on “current business activity” and the borrower’s “ability to access other sources of liquidity sufficient to support their on[-]going operations...[.]”

– FAQ #46

- “Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith.”
- Caution: Safe harbors are such as this are extremely narrow in their application



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Congressional Pressure

- Senate Select Subcommittee on the Coronavirus Crisis investigation
- Preliminary analysis released on September 1, 2020:
 - More than \$1 billion in PPP funding (10,856 loans) to companies that received multiple loans
 - More than 600 loans (\$96 million) to excluded companies
 - More than 350 loans (\$195 million) to government contractors with significant performance and integrity issues
 - More than 11,000 loans (\$2.98 billion) where federal databases raised red flags about the borrower
 - Hundreds of PPP loans approved with key information missing from application



Congressional Pressure (Cont'd)

- Senate Subcommittee recommendations:
 - SBA and Treasury must improve internal controls for loan forgiveness
 - SBA and Treasury must improve its audit plan for borrowers
 - Stated plan to audit only those PPP loans in excess of \$2 million is “plainly insufficient”
 - SBA should implement a risk-based audit plan and utilize random sampling
 - Public outreach to warn borrowers of criminal penalties
 - Encourage whistleblowers
 - SBA and Treasury must improve their cooperation with Congress and the Pandemic Accountability Committee



Anticipated Civil Enforcement

- SBA audits
 - SBA FAQ 46 (updated October 7, 2020): “SBA has previously stated that all PPP loans in excess of \$2 million, **and other PPP loans as appropriate**, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form.”
- Other federal agencies to assist?
 - Department of Labor, Wage and Hour Division



Preparing for a PPP Audit

- Gather pertinent documents
 - PPP loan application and supporting documentation
 - 2019 tax returns and financial statements
 - Corporate organization and ownership structure
 - Records of employees
 - PPP loan documentation executed
 - PPP Loan Forgiveness Application and supporting documentation
 - Copies of all emails or other correspondence with lender or SBA
- Contact counsel before responding



INVESTIGATIVE TECHNIQUES FOR PPP ENFORCEMENT



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Investigative Techniques

- Subpoenas
- Search warrants
- Civil audits/inquiries
- Qui Tam?



The Necessity of *Kovel*

Does an Accountant-Client Privilege Exist?

“No confidential accountant-client privilege exists under federal law, and no state-created privilege has been recognized in federal cases nor is there justification for such privilege...[.]”

Couch v. U.S., 409 U.S. 322, 335 (1973)

See also United States v. Hickok, 481 F.2d 377, 379 (9th Cir. 1973); KRL v. Moore, No. 2:99-cv-02437-JAM-DAD, 2006 WL 548520, at *4 (E.D. Cal. Mar. 3, 2006) (“It is well established that a person has no expectation of privacy in business and tax records turned over to an accountant.”), *aff’d in part, rev’d in part on other grounds, and remanded sub nom.* KRL v. Estate of Moore, 512 F.3d 1184 (9th Cir. 2013); United States v. McLaughlin, 910 F. Supp. 1054, 1059 (E.D. Pa. 1995) (“Moreover, the defendants’ voluntary provision of the records to [his accountant] knowing that they would be used to prepare and be incorporated into tax returns which would be viewed by others, establishes that the defendants had no legitimate expectation of privacy in them.”).



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Kovel in a Nutshell

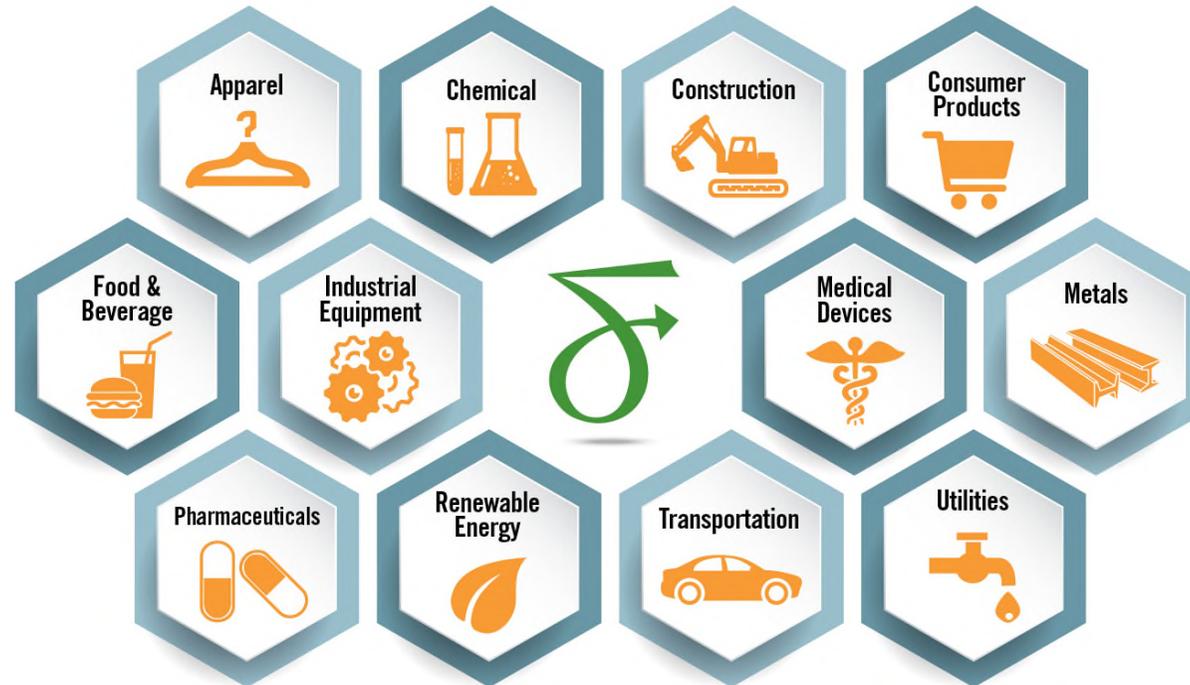
Learning from the Cases Distinguishing *Kovel*

- A communication between an attorney and a third party does not become shielded by the privilege solely because the communication proves important to the attorney's ability to represent the client.
- *Kovel* recognized that the inclusion of a third party in attorney-client communications does not destroy the privilege **if, and only if**, the purpose of the third party's participation is to **improve the comprehension of the communications between attorney and client.**
- If what is sought is not legal advice but only accounting service, or if the advice sought is the accountant's rather than the lawyer's, no privilege exists.



The Fox Rothschild Manufacturing Team

Our Manufacturing Team combines deep experience and industry knowledge spanning a wide range of legal disciplines to provide clients with the strategic advice they need to succeed.



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Questions?



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