

# Alerts & Publications



## DOJ Reviewing PPP Loan Applications for Criminal Fraud, Finding “Red Flags”

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The Department of Justice is currently conducting a criminal “review” of loan applications under the [Paycheck Protection Program](#) (PPP), an emergency small business loan program established under the CARES Act, looking for evidence of fraud in borrowers’ applications. The component of DOJ conducting the review, the Fraud Section’s Market Integrity and Major Fraud Unit, has been involved in a series of similar industry-wide reviews in recent history, including following the last financial crisis involving mortgage fraud and mortgage-backed securities, and broad investigations of large financial institutions in connection with LIBOR and foreign exchange trading.

DOJ’s announcement of a sweeping review at this early stage should come as no surprise given the sheer size of the funds made available and the rapid public criticism of several prominent institutions that announced their application for PPP funds. The head of the Criminal Division, Brian Benczkowski, has already stated that DOJ has found “red flags” in its review of both accepted and rejected applications. That the DOJ turned so quickly to criminal prosecutors suggests the seriousness of the government’s intent to scrutinize applicants seeking funds from this unprecedented program. Now that this review has begun, the relevant questions are how DOJ will conduct its investigation, what it will find, and what this means for institutions and individuals that applied for funds or processed applications under the program.

First, if history is a guide, DOJ will use its leverage over institutions that processed the loans to do the government’s initial work of identifying potential irregularities in loan applications. DOJ calls this “cooperation,” although commentators often criticize the government for outsourcing its investigative work to private institutions. Nevertheless, given the extent of the program, the first round of which reportedly involved US\$349 billion disbursed to over one million businesses, it is not surprising DOJ would impose on financial institutions in this way. DOJ will almost certainly expect cooperating institutions to provide investigative leads and will likely pursue those leads primarily through its own resources where it can.

Second, DOJ will scrutinize loan applications for material misrepresentations that can supply the basis of a fraud case. The PPP loan application is a short form that contains a series of required certifications, although lenders are permitted to create their own forms or online portals requesting the same information and certifications. Some of those certifications may be relatively

straightforward for some businesses, but raise complex questions for others. For example, determining whether the applicant meets maximum size or revenue standards for eligibility under the PPP or fails to meet those standards due to the size of its “affiliates” may require substantial fact development and turn on subjective interpretations.

Other questions contain a clear subjective component that could subject good-faith borrowers to DOJ scrutiny. For example, the application requires a certification that the “current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” This certification is fraught with ambiguity with respect to the meaning of most of its undefined terms. “Current economic uncertainty,” for example, might include potential impacts that are not just immediate, but are foreseeable several months down the road. What does “necessary” mean and does it exclude certain categories of investment-backed businesses? And, finally, what is meant by “support ongoing operations”? Is this requirement satisfied if the funds will protect an applicant from the adverse impacts of the crisis or does it require a determination that the business cannot continue without the emergency relief funds? As of today, the Treasury Department and SBA have provided minimal guidance on the meaning of these terms, addressing only one aspect—the impact of other available sources of credit or liquidity—of the necessity question in a single [FAQ](#) (#31/37). This ambiguity will create unacceptable risk for some applicants, while others may rely on the vagueness of these requirements to challenge the propriety of any criminal charges.

The PPP also restricts the permissible uses of PPP loan proceeds by successful applicants for the purpose of ensuring most of the funds are allocated to payroll costs to keep workers employed in the near term. These restrictions apply both to the substantial portion that may be entirely forgiven and to the full amount of the loan subject to a two-year repayment schedule. Such use restrictions provide a basis for DOJ to investigate exactly how recipients used their funds. In numerous prior bank fraud investigations, DOJ has used applicants’ certifications about how loan proceeds were to be used as the hook for a material misrepresentation case. DOJ will examine these certifications and compare them to publicly available information about the applicants, as well as information about the applicants supplied by the institutions that processed the loans, and ultimately information it may gather through other investigative means. DOJ will also review communications between the applicant and the lender that could support an alleged intent to mislead the government.

Third, unlike in past crises, the DOJ will be constrained in its investigative processes by the very crisis that spawned the PPP loan program. COVID-19 limitations around the country mean that grand juries are not meeting, witnesses are generally not available for interviews, and many courts will only hear emergency proceedings. What is available, however, are documents provided by cooperating institutions, and the current crisis likely means that DOJ prosecutors will scrutinize such records even more carefully than usual given the lack of other available investigative options.

Finally, a common theme in investigations that are driven from the top down in response to political pressure—and this review has the earmarks of such an investigation—is that they often take on a life of their own and produce cases that a line prosecutor might otherwise use his or her better judgment to decline. For example, it is unusual for the head of the Criminal Division to announce an investigation before any charges have been brought and rarer still to comment on potential findings at this preliminary stage.

Criminal convictions rightly demand a high, evidentiary standard: proof beyond a reasonable doubt. Applicants should not face criminal penalties for submitting good-faith applications that inadvertently contained an unintentional error or for struggling with whether their efforts to keep their employees on payroll genuinely met the “necessity” standard in the face of minimal guidance from the government. Accordingly, institutions and individuals under investigation, with assistance from counsel, will have to hold DOJ accountable to that fundamental standard of proof even in these extraordinary times.

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