

Business Better (Episode 2): CARES Act Compliance and Enforcement

Speakers: John Wright, John Devine, and Terry Grugan

John Wright:

Welcome to Business Better, a podcast designed to help businesses navigate the new normal. I'm your host, John Wright.

John Wright:

For nearly 15 years, I was senior vice president and general counsel at Triumph Group, Inc., a global aerospace component supplier. I'm now a member of the Securities and M&A groups at Ballard Spahr, a national law firm with clients across industries and across the country.

John Wright:

On today's episode, we'll be discussing the CARES Act, enacted earlier this year to provide several forms of relief in response to the COVID-19 pandemic. We'll discuss what's generally required to comply with the act to take advantage of its benefits, how the government is likely to proceed to enforce those requirements, and the steps that can be taken to ensure compliance and mitigate the risk of enforcement actions and their consequences.

John Wright:

To cover these topics, I'm delighted to be joined by my colleagues, John Devine and Terry Grugan, both of whom are partners in the Philadelphia office of Ballard Spahr.

John Wright:

John Devine is one of the co-leaders of the firm's health care group, and advises clients within the healthcare industry on strategic transactions. He also provides advice on federal and state healthcare laws and regulations, including the CARES Act and the Affordable Care Act.

John Wright:

Terry Grugan is a white collar defense attorney with extensive experience in cases involving public corruption, securities enforcement, and anti-money laundering compliance. He represents individuals and entities in all forms of government investigations and proceedings, and counsels clients on compliance matters under the Federal Securities laws and anti-money laundering statutes and regulations. John and Terry, welcome to the podcast.

John Wright:

John, can you start by giving a brief overview of the CARES Act and the stimulus programs that were included?

John Devine:

Sure, John. Thanks so much for having us today. So, the Coronavirus Aid, Relief, and Economic Security Act was passed by Congress on March 27th of this year. It allowed for over \$2 trillion of economic relief to be provided to organizations of all types.

John Devine:

Now there are a number of different categories, but the few that I think are worthwhile mentioning is, there was \$659 billion attributed to small businesses, that's to be administered through the Small Business Administration. There's \$500 billion for organizations that do not qualify for small business relief, including \$35 billion for the airlines, which also included \$4 billion for cargo carriers and \$17 billion for businesses related to national security.

John Devine:

There was \$175 billion allocated for relief funding for health care providers, which is important for the ongoing pandemic and the recovery anticipated thereafter. And then \$150 billion in funding for tribal and local governments.

John Devine:

That's just to suggest a few, but in large part I think a lot of our clients have been focusing on the 659 billion plus, that's more money that's likely to be coming out administered through the SBA Administration.

John Wright:

That's a lot of money.

John Devine:

It is.

John Wright:

Very impressive set of programs. You say that the programs that you're seeing the most action on are those developed for administration through the SBA. Can you tell us a little more about that program?

John Devine:

Sure. It's not to diminish the importance of the others, for sure. But what a lot of our clients have been focused on has been the PPP program, the Payment Protection Program, that's been focused on getting money to small businesses to help with things like payroll, taxes, utilities, and the like, really to try to keep businesses running, and to bridge to the other side of the pandemic.

John Devine:

As you can understand, too, there's ongoing relief that may be needed, and we're expecting that more money from the government's going to be oncoming. But for the purpose of today's discussion, the Payment Protection Program, to qualify for funds under it, participants need to meet certain size requirements.

John Devine:

Any small business concerns that meets the SBA size standards, either the industry-based size standard or alternative size standard, is one requirement. It also gave relief to sole proprietors, independent contractors, and self-employed persons.

John Devine:

Just a little bit of a note on that, too. What was interesting at the beginning of the deployment of funds was, there was a lot of confusion about whether self-employed persons, so owners of partnerships, limited liability companies and the like, whether they could qualify.

John Devine:

Ultimately, guidance came out that allowed for active owners of businesses, those that are actively engaged in their business, to include sort of guaranteed payments into the loan applications. But that was really a point of confusion at the early stages and something that's important for ongoing loan applications, to the extent that more money becomes available. And also, an important note that we'll talk throughout the podcast about, is just paying attention to ongoing guidance.

John Devine:

But getting back to the requirements, any business with a NAICS code that begins with 72, so it deals with accommodation for food services, so a lot of restaurants and food purveyors, were entitled to relief funds. Any business, 501-C3 non-profit organization, veterans organization or travel business with greater than 500 employees or that meet the SBA industry standard, if more than 500.

John Devine:

So, what's important about today's discussion too. And we're focusing on compliance in enforcement activity is in order to qualify for SBA funds or funds available under the PPP program, participants were required to make good face certifications for the need for more and that the funds would be used for their intended purpose, that to be utilized, to retain workers and payroll, pay for lease and utility payments and that recipients using them for the same uses of some other SDA programs.

John Devine:

So, there's everybody that's paying for the application was required to make certain certifications once the funds were received. What's going to be important, Terry's going to talk about this later on, is what's the government going to look for from an enforcement perspective? Were those certifications accurate? Is the accuracy of those statements correct, moving forward? And they're important for purposes of seeking loan forgiveness, because if the funds are used the way they're intended to be used, they should be forgivable by the government.

John Wright:

Thanks, John. And I understand that there are a variety of mechanisms to enforce the act. Terry, can you tell us a little bit about what some of those enforcement mechanisms are and perhaps a little bit about how the government's likely to deploy them?

Terry Grugan:

Sure, John. So, the CARES Act itself sets forth various we'll say layers of oversight enforcement. Congress has authorized to evaluate these programs and disbursements under them. And we've had congressmen make statements that they are going to convene hearings immediately to evaluate the legality of disbursements under these programs, beyond that you have the agencies themselves that are empowered to audit programs. The SBA has announced various levels of audits. That's going to conduct over loan recipients, beyond that you have the various other agencies who conduct enforcement in these areas. DOJ, Department of Justice, will be evaluating all of the, as they always do, any kind of recipients of government funding to make sure that there's no fraud involved in those. The SEC has a big part to play in this. Public companies are accepting grants or loan funding from the government. Then the SEC will be evaluating whether or not, not only if they have been truthful in applying for those loans, but they have another level of ensuring that they're making all proper disclosures to shareholders.

Terry Grugan:

The FTC has been involved in it's own investigations. The Department of Treasury and its inspector general have been evaluating. So, any time these loans are all being dispersed through federally chartered, federally funded bank, federally insured banks. So, the Department of Treasury is evaluating not only the borrower's compliance, but also the bank's compliance with their obligations. So, you have all these various levels of enforcement. Now the CARES Act also has appointed a special inspector general for pandemic recovery. And while that office has not gone up and running just yet, it will eventually form sort of a hub of a spoke of enforcement. So, all CARES Act enforcement will kind of filter through the inspector general and then the inspector general will be coordinated with the various agencies to bring actions. And this is something very similar to what we saw in following the great recession with the TARP Program.

John Wright:

So, it sounds as though there's a fair battery of agencies that are available to participate in enforcement actions, arising under the CARES Act, all across the government enforcement spectrum. Is that a fair statement?

Terry Grugan:

It is completely fair. This is, as I mentioned, as I think we'll discuss later, the historical analog for what we've seen here with the pandemic relief has been the various government stimulus packages in 2008. What makes this different? Is that just how far reaching this is. The pandemic has hit literally every segment of society, every part of our economy. So, therefore we've had stimulus that has been directed towards every part of our society, every part of our economy. And so, every government agency that has any kind of oversight, over basically everything has some, has some part of its hand in this.

John Wright:

So, it's TARP enforcement on steroids. So, John, maybe you could give us a little bit of an outline of what the experience was under TARP and how that informs us about what we might come to expect for an enforcement activity under the CARES Act.

John Devine:

Absolute. I liked Terry's mentioning that this is the TARPS driven analog, but that the CARES Act, we're anticipating that it's going to be so much more far reaching. Certainly the pandemic continues. So, I think giving a little data and a little statistics as it relates to TARP enforcement activity can just help us understand the scope of anticipated activity moving forward. So, as Terry mentioned, the TARP program was a response to the 2008 financial crisis. It allocated \$700 billion in relief funding. So, just take a note on that, right, 700 billion versus close to over 2.2 trillion that's been distributed under the CARES Act. So, the government clearly has some interest in an enforcement activity. Is similar to the CARES Act, the TARP legislation created a enforcement mechanisms, SIGTARP. SIGTARP, just to give an idea the enforcement activity under SIGTARP continues today.

John Devine:

So, the legislation and relief funding was deployed in 2008. In 2019 alone, the SIGTARP recovered nearly \$900 million. SIGTARP enforcement activity has resulted in close to 380 criminal convictions and civil fines, including 300 defendants, which included 76 bankers in 92 bank borrowers. The enforcement body in total has recovered close to \$11 billion since it began activities. So, you can kind of get an understanding, right? If you do some ratio analysis that \$11 billion recovered since 2008, \$900 million recovered in 2019 alone, we can anticipate significant government enforcement activity and the activity and enforcement mechanisms that the government utilize or we expect to be comparable, but really just think about it fundamentally it's fraud. It's what the government's looking for, its fraud in applying for the loans, it's fraud in the use of the loans, it's fraud as it relates to covering up the illegal activity in the like.

John Devine:

And it's things some of the low hanging fruit, Terry can maybe talk about is, it's the people that have applied for loans that don't have any employees, right? So, making certifications under the PPP program that says, I have a hundred employees and I'm entitled to funds. And then the government finds out that they actually don't have any employees or individuals buying a luxury condominiums or driving around in new shiny cars, right? Those are some of the red herrings that the government's going to be looking for, but as they get more deep into an investigation of how people applied for these loans, the certifications they made, how these loans were used, we expect enforcement activity to be comparable to TARP, but as you mentioned, sort of TARP on steroids.

John Wright:

So, are there any examples in particular of enforcement actions under TARP that sort of stand out as an indication of what we might expect under CARES Act, particular instances?

John Devine:

Sure. I'll give you just a few. And again, they're going back to some of the things I mentioned just generally before, but the TARP enforcement activity brought some actions against the CEO of a particular bank in charge, the CEO that he engaged in fraud, conceal that fraudulent activity while applying for and receiving a \$8.6 million in TARP funds.

John Devine:

The jury convicted that CEO of conspiring to defraud the US, charges included bank fraud, making false bank statements, embezzlement, making false statements to the FDIC, wire fraud and engaging in monetary transactions and property derived from unlawful activity. So, it's sort of the kitchen sink, as you can imagine, that CEO is convicted to eight years and four months in prison. So, it's not insignificant jail time. Scaling down from that a little bit, another chairman and CFO of a another bank was charged with orchestrating a scheme by which TARP funds were used to purchase a luxury condo in Florida. He pleaded guilty to all charges and was sentenced to one year of home confinement, two years of probation, a \$10,000 fine, and almost a \$100,000 in restitution. Enforcement activities sort of continued on from that and that's just a general flavor job, but you get the idea.

John Wright:

It sounds as though some of the activity that we've seen is bigger than has hit the newspapers for the most part. And yet some of the punishments exacted are pretty significant. And I guess we can expect the same under CARES Act. Is that a fair statement?

John Devine:

I think that's a fair statement. And I think what our team has done and Terry has led the charge on this is sort of develop an enforcement tracker to identify some of the enforcement activity that's ongoing. So, Terry will be able to give a little bit more a specific as to what is actually happening now, but I think it's safe to say in what our perspective and advising clients from a compliance perspective is, is let's use the past as a dish of the future. And be aware that the government's going to these vigorously pursuing enforcement activities.

John Wright:

Makes a lot of sense.

John Devine:

Like I said, I think, Terry can be a little bit more specific on those issues.

John Wright:

That makes a lot of sense. Terry, tell us a little bit about what we're seeing already under the CARES act and what we can expect.

Terry Grugan:

So, right now, one kind of threshold consideration that I think we need to keep in mind is that we're, unlike 2008 or unlike anything we've ever really seen, we're still in the midst of the situation that has caused all this trouble. We're still in the pandemic. There are still restrictions. So, government investigative activity is curtailed just as much as private activity and the government is still dealing with trying to get out of this mess. So, what we've seen so far, but nevertheless, we've still seeing a significant amount of enforcement activity. We just haven't seen it as consolidated as we expect to. And as we did under TARP, the DOJ has been very active in bringing fraud prosecutions against people who have sought and received funding through these programs fraudulently as early as March, April, DOJ was bringing cases against people who were applying for loans when they didn't deserve them.

Terry Grugan:

At this point, to this point, it's been fairly low hanging fruit that the government's been going after. For instance, action was brought against a gentleman in Texas who applied for several million dollars in PPP loans to cover payroll for something. I believe the number was 134 employees who did not exist of his company that did not exist. That's an easy case for the government to bring. John actually mentioned luxury automobiles earlier, in the past seven days, not one, but two prosecutions have been brought against different people. One, a Texas fella and another Florida guy who applied for and received several million dollars in loans through the PPP and bought Lamborghinis, among other luxury items, watches, jewelry, houses. So, these are flagrant violations and the government is getting them, is getting to them and prosecuting them pretty immediately. And one comment you made that I thought was interesting.

Terry Grugan:

These fraudsters are taking something, multimillion dollars from the government yet it's not reaching the newspaper. It's not front page news, even though in typical circumstances \$8 million fraud against the government would be a big story that goes to the, I think not only the scope of these programs, the amount of fraud we're going to see, but the amount of tension that the public and the government are putting on these, the enforcement aspect of these programs. And I think what that means is when the dust settles, we're going to see a lot more people looking back at this, and we're going to see a lot more activity, a lot more focus on enforcement. A \$3 trillion check has got to come due and people are going to say, "Was all this money spent well?", So even though we're seeing a ton of activity, now we're going to see a lot more later.

Terry Grugan:

And I think we're actually starting to see a move, enough time's passed that we're starting to see a bit of a move from the low hanging fruit to the slightly more sophisticated cases. Just yesterday there was a press release from Main Justice that six people were charged with conspiracy to obtain about \$24 million in PPP loans. That case involved one person, again, Florida, receiving a little under a million dollars in fraudulent loans, they got the money, it was a success. They recruited other people to help them out. So, then they had other co-conspirators who inflated their PPP applications received fraudulent funding. Then they kind of hired themselves out to others. Ultimately they ran submitting about 90 applications for PPP loans for about \$24 million. 42 of those applications were approved and they ultimately received about \$18 million in PPP funding. And these folks that is the sort of hub of the conspiracy, were getting about 25% kickback from all these entities. There you have an example of a more sophisticated crime, a less obvious one that the government is now having the time and the energy to pursue.

John Wright:

So, I see on the Ballard website that we've got an enforcement tracker that, as you mentioned, that has tracking each of the cases that we're finding launched to enforce provisions of the CARES Act. And just a quick scan of it shows, frankly rather impressive number of cases already brought. And I imagine what you're saying is the infrequency is only going to increase over time. How has the government making choices about what is going to go after and what do you see in that vein? So, that we have some sense of how they're going to choose to deploy limited resources to chase some of these bad actors.

Terry Grugan:

That is a very important question. And that's one reason why we have the tracker to try to figure out where the government's going. And as noted that the obvious fraud cases are easy ones. If someone lies about their employees, that's an easy call. What we need to see and what we don't have answers on just yet is how far the government is going to go in holding applicants to their access stations. I think there's a tendency, appropriately, for consumers to view these loans as a commercial transaction, you fill out, you make statements, you've entered into a promissory note with the bank, and you either meet your obligations or not. The government is not looking at it as a commercial transaction. They are saying, if you lie here, you're committing a crime. So, the question is going to become, down the line, were people honest when they made their necessity certifications, for instance, how is the government going to view that?

Terry Grugan:

What do they mean by, what does the government view necessity to mean? How will they establish bad faith? If they determine someone did not someone potentially conceivably could have had another source of funding, those are the questions we don't quite have yet, or the answers we don't quite have yet. The questions that I think all of us are waiting on. And I don't know if the government knows where it's, where it's going to go with this. I don't know if they have settled on how vigorous those attestations will be regulated from a criminal standpoint, but that's worth following.

John Wright:

And I take it that the government has at its disposal, a couple of tools, like the False Claims act that are pretty severe and that a lot of the people receiving PPP loans may not otherwise have had any reason to understand or appreciate.

Terry Grugan:

That's right. That's right. You could have civil enforcement through False Claims act actions, and that could go to the borrower or the lender as well. There's tons and tons of history of lenders facing False Claims act cases related to government spending programs because banks themselves have to make certain certifications that they have sufficiently evaluated an applicant to the best of their ability. So, that's one tool. The SEC, as I mentioned before, can look at public companies and it can bring enforcement actions against public companies. If they find that they made inaccurate disclosures centered on or involving their PPP funds.

John Wright:

So, given all of that, let's focus on what an organization who's decided to participate in this program might be able to do to protect itself. John, what does an organization do in order to be sort of better prepared to both show that it's complying with the provisions of the act and avoid the bad consequences of enforcement actions?

John Devine:

Right. So, simply putting in place or updating and managing your existing compliance program or putting in place a compliance program that will address some of the requirements related to the receipt of funds. So, we've talked up to date about some more of the egregious type of actions that we expect the government to pursue, but as Terry acutely identified, we're not quite sure where the enforcement action is going to go. We have an idea and certainly TARP is a historical analog, but there are good faith companies, good face certifications, good faith activities that the government may pursue, because the guidance is ever-shifting. So, it's important now to ensure that you have a compliance infrastructure, some sort of policy and program in place to track your certifications and your adherence to the CARES Act requirements. We have a lot of clients that we've had discussions with that are saying, "John, I can't focus on a compliance program right now."

John Devine:

"I have employees that need to get back to work. I'm trying to get supply chains in place. I'm triaging here. I'll focus on that later." And as we know everything putting off until tomorrow, what you could do today is never necessarily a good action to take. And while I appreciate the need to maintain business continuity, what we would offer is that implementing or updating your compliance program might not be a heavy lift right now. It's just important to ensure that you are following the existing government guidance, that your certifications are consistent with what that guidance might be. That you're keeping accurate records as to the funds that have been received and how they've been utilized. That you're accurately filling out your loan forgiveness program for any loans that may be forgiven under the Payment Protection Program. It's important to designate someone internally, to that is overseeing all of this.

John Devine:

Now what we're seeing is that a lot of organizations, the compliance officers, or somebody that might have fit that role may have lost their job or been furloughed, it doesn't necessarily need to be someone that's a compliance officer or has that designation. It can be simply someone that is familiar with the company and all of the individuals, and that is able to take the

government guidance, understand it, work with outside counsel to interpret it, and then communicate that to the key stakeholders within the organization, the board of directors, the executive suite, and what we talk a lot about is creating that regulatory narrative so that you can have the conversation with the government. And if at some point they come knocking on your door to say, "We've made a good faith effort to comply. Here's our documentation, here's the steps we took." And so on and so forth.

John Devine:

And not having that doesn't mean that you're not going to be able to present a case to the government, but it certainly helps if you are prepared to have that dialogue. And one thing I'll just add there, John is just that no compliance program is one size fits all, right. If you're a smaller organization, you don't need to implement a robust program that would be fit for a large public company. And in fact, it's important to tailor your compliance program to the size of your organization, because if you can't adhere to it, it's not useful.

John Wright:

You were just where I was going to go when I almost interrupted you. Terry, Is there anything you'd like, add from your perspective on compliance matters?

Terry Grugan:

Yeah. Just one point that this presents the CARES Act and making sure that companies and borrowers are in full compliance with its obligations presents not only a good, but probably an appropriate opportunity for businesses to ensure that their entire compliance house is in order what everyone needs to keep in mind here is these, while these may be isolated transactions, a single loan application, a single loan your companies and borrowers and banks are opening themselves up to full scrutiny from the government.

Terry Grugan:

So, someone may acquire, may apply for and receive a PPP loan and everything about that PPP loan may be accurate, honest, but the SBA, or maybe the IRS or DOJ or someone else evaluating these records may see that past records don't match up with what they're seeing now. So, and that could open them up to a case. Investigators, auditors, are not limited to auditing or investigating this single transaction. So, it's a good, and it's a correct time for companies to make sure that whether it's their tax issues, whether it's their reporting issues, whether or not it's a public company, making their disclosures that their past compliance is in order. And if not to clean things up now.

John Wright:

Thanks Terry. Well, John and Terry, I think our time for this podcast is just about up, and so perhaps we'll wrap it up here. Thanks very much for shedding some light on the PPP program, the CARES Act and enforcement opportunities for the government and how we can avoid being on the butt end of those opportunities.

John Wright:

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