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Heightened Oversight May Lead to Rise in False Claims Act Actions Related to Assistance Programs Under the CARES Act

Just as a rise in federal enforcement actions accompanied the federal stimulus package passed in the wake of the 2008 financial crisis, we expect enhanced federal enforcement to accompany the recent Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). The Department of Justice ("DOJ") may increase its use of the False Claims Act ("FCA") as an enforcement mechanism, particularly against businesses seeking relief under the small business assistance provisions of the CARES Act. Increased pressure and stressors on workers navigating the COVID-19 crisis may also lead to a rise in whistleblower filings under the FCA related to CARES Act programs.

First enacted during the Civil War, the False Claims Act, 31 U.S.C. § 3729, *et seq*., has been used since the mid-1980s to bring a steady volume of claims against government loan or grant recipients. If found liable under the FCA, defendants face treble damages, civil penalties, and the prevailing plaintiffs' expenses and attorneys' fees. The FCA is a popular enforcement mechanism for DOJ and for whistleblowers (called *qui tam* relators), who can sue on the government's behalf and receive a percentage of the recovery.

Under the FCA, an entity or individual can be held liable not only for submitting a false claim to the government for payment, but also for causing the submission of such a claim. 31 U.S.C. § 3729(a)(1)(A). The FCA also prohibits knowingly making, using, or causing to be made or used, a false record or statement in connection with a claim for payment. 31 U.S.C. § 3729(a)(1)(B). Particularly relevant for entities pursuing aid under CARES Act small business programs, the failure to comply with eligibility or regulatory requirements for winning that aid can trigger liability under the FCA.

Several CARES Act provisions are intended to assist businesses affected by the COVID-19 crisis. These provisions provide a range of relief, including small emergency economic injury grants, business assistance under the Exchange Stabilization Fund (up to $500 billion), and loosened affiliation rules for small business loans for hotel, food service, and franchise businesses.

In light of the significant increase in available funds and loosened eligibility criteria, businesses that face financial strains from the COVID-19 crisis that were not previously eligible for assistance from the federal government may now apply for the first time. Without experience navigating federal funding requirements, they could violate important prerequisites and find themselves on the wrong side of an enforcement action. Businesses that have previous experience with the SBA will still have to navigate thoughtfully the newly enacted CARES Act programs and guidelines. These risks may be heightened by the pressure applicants are likely feeling to move quickly to obtain funding, out of concern that available funds will be depleted. However, the desire to act fast should not come at the expense of careful preparation of these submissions to the federal government.

Businesses awarded federal funds under special set aside programs like those enacted or expanded under the CARES Act will continue to be a favorite target for FCA actions by DOJ and the *qui tam* relator's bar alike. The two most common theories that we would expect to see applied to these programs are a false eligibility certification theory or a fraud in the inducement theory. Applicants for funds will have to provide information about their businesses, and make certifications about their eligibility to participate. It is the responsibility of the applicant to ensure that it meets the eligibility

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requirements *before* certifying its compliance to the government. For CARES Act small business programs, this *ex ante* certification requirement presents significant FCA risk given the eligibility changes and the relatively scant guidance currently available to applicants about how the government defines and interprets many of the terms in the applications for funds. Furthermore, if a defendant knowingly misrepresents its eligibility to receive government funds in the application—or makes other material false statements in an application in order to receive funds—the applicant could face allegations that it fraudulently induced the government to award the aid. Under either theory, FCA damages (before trebling and application of civil penalties) may be the value of all payments under the award.

Because a misrepresentation included in an application for small business funding pursuant to the CARES Act may result in FCA liability, applicants should take care to avoid intentionally or recklessly running afoul of the eligibility criteria. The following few examples illustrate scenarios that may, based on currently available guidance, prompt FCA litigation in connection with the CARES Act's small business loan program:

Example 1 – Set-Aside Contracts. The CARES Act sets aside funding for small businesses owned or operated by minorities, veterans, women, and other defined categories of applicants. This is already a fertile area for FCA enforcement, with numerous FCA actions brought to enforce eligibility criteria for loans provided by preexisting programs. Eligibility requirements for loan programs that provide preference for certain categories of applicants vary by program, but they generally center on considerations of *percentage ownership* and *control*. For example, to qualify for a set-aside contract for a service-disabled veteran-owned small business (a "SDVOSB"), a business must be at least 51% owned by one or more service-disabled veterans and one or more disabled veterans must control the business's day-to-day operations, among other requirements. *See*, *e.g.*, *United States v. Strock*, No. 15-CV-0887-FPG, 2018 WL 647471 (W.D.N.Y. Jan. 31, 2018), *reconsideration denied*, No. 15-CV-887-FPG, 2018 WL 4658720 (W.D.N.Y. Sept. 28, 2018). The SBA may look to existing program eligibility requirements in determining eligibility for set-aside contracts under the CARES Act.

Example 2 – Aggregation Requirements. The CARES Act loosens certain Small Business Administration loan eligibility requirements for CARES Act programs, which may also create FCA risk. In particular, for certain businesses, the CARES Act waives the requirement that the business aggregate the employee headcount of their affiliates. This waiver thus increases the number of businesses eligible for funding reserved for small businesses (i.e., with fewer than 500 employees). Because the waiver is applicable only to businesses in the food service and hospitality industries, SBA-approved franchises, and businesses that receive financial assistance from Small Business Investment Company funds, we may see increased scrutiny of whether businesses receiving funding pursuant to such waivers accurately represented their eligibility. Affiliation principles applicable to these CARES Act programs are set forth in 13 C.F.R. 121.301, *et seq*., and 13 C.F.R. 123.300, *et seq*. The most common of these are affiliation based on ownership, management, identity of interest, and negative control. By way of example, a private equity fund would count as a small business's "affiliate" for employee headcount purposes where, *inter alia*, the private equity fund owns 50% or more of the portfolio company's voting equity. Even a minority investor in a company can be considered an affiliate depending upon the facts and circumstances. In short, determination of affiliation is highly fact-dependent, and careful compliance with headcount requirements is therefore critical to minimize FCA exposure.

Example 3 – Large Business Contractors. Large companies working with small businesses must also be aware of possible increased litigation risk related to the CARES Act. For example, a large business acting as a subcontractor for an eligible small business that receives a loan pursuant to the CARES Act will invite scrutiny. This is a traditional area of FCA enforcement, and an uptick in attention to these relationships can be expected. In *United States ex rel. Savage v. Washington Closure Hanford LLC*, for example, a *qui tam* relator alleged FCA violations where a large company used a

smaller company as a façade to procure federal contracts reserved for small businesses; once those contracts were awarded, they were actually performed by the large manufacturer who reaped the financial benefits. No. CV-10-5051-EFS, 2015 WL 5825966 (E.D. Wash. Oct. 6, 2015). Subcontracting arrangements therefore present certain FCA risks that should be carefully evaluated before certifying compliance with federal law.

In addition to risks arising in connection with the CARES Act itself, businesses struggling to deal with the COVID-19 crisis face the possibility that employees under increased stress and pressure from the crisis may choose to raise compliance concerns via litigation rather than internal business processes. This is particularly so where, as here, there are established theories under which whistleblowers may bring FCA cases challenging small business loans or grants.

In sum, while the CARES Act provides important and valuable benefits to small businesses and the economy at large, businesses and their affiliates must pay increased attention to the CARES Act programs' eligibility and certification requirements to avoid potential exposure to FCA liability, particularly in light of the rapidly evolving landscape.

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