

CLIENT ALERT

The Major Fraud Statute May Apply to Borrowers of Funds Under the CARES Act

JUNE 10, 2020

Congress expanded the Major Fraud Statute, 18 U.S.C. § 1031, to protect federal stimulus funds distributed under the Emergency Economic Stabilization Act of 2008 in response to the last major financial downturn. Now, the Major Fraud Statute is potentially applicable to any business that accepts government assistance distributed under the more recent Coronavirus, Aid, Relief, and Economic Security (CARES) Act of 2020.^[1]

While cases with significant civil penalties may be brought under the more familiar False Claims Act, the Major Fraud Statute equips prosecutors with the ability to seek criminal sanctions, including significant jail time and fines, in addition to civil penalties for fraud in any application for, or receipt of, federal assistance funds of \$1,000,000 or more. Applicants and recipients of CARES Act funds should be attentive to the requirements for obtaining such funds to avoid potential prosecution under the Major Fraud Statute.

BACKGROUND ON THE MAJOR FRAUD STATUTE

The Major Fraud Statute may become a key tool of the federal government in prosecuting fraud related to the application for, or receipt of, funds made available through the recently enacted CARES Act. The statute, as originally enacted in 1988, targeted fraud against the federal government in the procurement of property or services.^[2] It was amended to include a broader range of offenses in the wake of the 2007-2009 economic recession (the “2009 Amendment”).^[3]

The 2009 Amendment was part of the Fraud Enforcement and Recovery Act and was designed to protect other stimulus measures that had already been put in place to strengthen the U.S. economy.^[4] As part of this multi-pronged effort, the government also increased its pursuit of False Claims Act cases.^[5] The 2009 Amendment expanded the Major Fraud Statute to include fraud in connection with, among other things, “[f]ederal assistance, including through the Troubled Asset Relief Program [TARP], [or] an economic stimulus, recovery or rescue plan provided by the Government”^[6]

In its current form, the Major Fraud Statute criminalizes the knowing execution or attempted execution of:

[A]ny scheme ... to defraud the United States; or to obtain money or property by means of false or fraudulent pretenses, representations or promises, in any grant, contract, subcontract, subsidy, loan, guarantee, insurance, or

other form of Federal assistance, including through the Troubled Asset Relief Program, an economic stimulus, recovery or rescue plan provided by the Government, or the Government's purchase of any troubled asset ..., or in any procurement of property or services ... **if the value of such grant, contract, subcontract, subsidy, loan, guarantee, insurance, or other form of Federal assistance, or any constituent part thereof, is \$1,000,000 or more.**^[2]

Those convicted under the Major Fraud Statute face up to 10 years of imprisonment and up to \$1,000,000 in fines for each violation, not to exceed \$10,000,000 for multiple counts.^[3] By comparison, the False Claims Act, "the Government's 'primary litigation tool' for recovering losses resulting from fraud,"^[4] allows the government to recover per claim penalties "plus 3 times the amount of damages which the Government sustains because of the act" of the defendant.^[5] In addition, the Major Fraud Statute authorizes the U.S. Attorney General to compensate any whistleblower who provides information to the government about a potential prosecution under the statute.^[6] In some instances, the Major Fraud Statute may also provide a longer statute of limitations than the False Claims Act.^[7]

ELEMENTS OF THE MAJOR FRAUD STATUTE

To prove an offense under the Major Fraud Statute, the government must show that the defendant acted with specific intent to defraud the government.^[8] "[T]o act with an intent to defraud means to act knowingly and with the purpose to deceive or to cheat."^[9] This element can be satisfied with proof that the defendant made false representations with the specific intent of obtaining funding for which it is not eligible.^[10]

Although materiality is not an explicit element of the statute, at least one court has held that it too must be proven.^[11] "A declaration is material if it has 'a natural tendency to influence, or [is] capable of influencing, the decision making body to which it is addressed.'"^[12] The government does not need to prove the decision making body was actually influenced by the statement, only that the misrepresentations could have influenced the decisionmaker.^[13]

REQUIREMENTS FOR OBTAINING FUNDS UNDER THE CARES ACT

On March 27, 2020, the CARES Act was enacted into law. As relevant here, the wide-ranging legislation includes two provisions that make government funds potentially available to private businesses: (1) the Paycheck Protection Program ("PPP"), and (2) the Coronavirus Economic Stabilization Act of 2020 ("Stabilization Act"). Both provisions offer to specific types of businesses the potential to receive substantial amounts of federal financial funds, but require those businesses to adhere strictly to various PPP or Stabilization Act rules.

I. The Paycheck Protection Program

The PPP provides funds to cover, among other things, payroll costs, including employment benefits, to small businesses with fewer than 500 employees, nonprofits, veterans' organizations, tribal concerns, self-employed individuals, sole proprietorships, and independent contractors.^[14] Along with payroll costs, recipients may also use the PPP funds to pay interest on their mortgages, rent, and utilities.^[15] To obtain a loan, however, borrowers must, among other things, first make a good-faith certification that they have met all the conditions of the loan, including that they intend to use the loan for its specified purposes.^[16] One of those conditions is that the loan be necessary to support the ongoing operations of the small business due to the "uncertainty of current economic conditions."^[17]

II. The Coronavirus Economic Stabilization Act

The Stabilization Act authorizes the Treasury Secretary to make loans, loan guarantees, and other investments, to support eligible businesses within "severely distressed sectors" of the United States economy.^[18] The Stabilization Act provides that the Treasury Secretary "shall endeavor to seek the implementation of a program or facility ... that provides financing to banks and other lenders that make direct loans" to mid-sized businesses and nonprofits with between 500 and 10,000 employees.^[19] An applicant for a loan from such a program or facility must make a good-faith certification that the loan is needed to support ongoing operations of the business due to the current economic conditions.^[20]

The Stabilization Act further supports the Federal Reserve by establishing a Main Street Lending Program (“Lending Program”) to support additional lending to small and mid-sized businesses.^[26] On April 9, 2020, the Federal Reserve established the Lending Program, under which four-year loans may be extended to companies with either 10,000 employees or fewer or revenues below \$2.5 billion.^[27]

Use of loan proceeds or investments received from the programs authorized under the Stabilization Act is not restricted to covering payroll or other designated expenses, unlike the use of loan proceeds received through the PPP. Nor can loans received from programs established by the Stabilization Act be forgiven.^[28]

Because the PPP and Stabilization Act may authorize loans in excess of \$1,000,000, like TARP, the threshold amount for prosecution for fraud related to these programs under the Major Fraud Statute may be established in many instances.^[29]

CONCLUSION

Similar to the government’s increase in False Claims Act actions during and after the 2009 economic recession, the government has already begun ramping up its civil and criminal enforcement actions to protect federal funds during the current coronavirus pandemic.^[30] For example, Treasury Secretary Steven Mnuchin has warned of criminal prosecutions related to loan fraud,^[31] and the U.S. Department of Justice has filed criminal charges—including a charge under the Major Fraud Statute—against individuals who allegedly filed fraudulent loan applications seeking funds under the PPP.^[32]

Compliance with the requirements set forth under the PPP and the Stabilization Act is critical. Applicants for, and borrowers of, federal funds of \$1,000,000 or more who submit a false or misleading statement in their loan applications for the programs authorized under the PPP and Stabilization Act could be subject to criminal prosecution, fines, and/or potential imprisonment under the Major Fraud Statute. Parties are encouraged to contact legal counsel if they have any questions or seek legal advice.

^[1] Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), Pub. L. No. 116-136, 34 Stat. 281 (2020).

^[2] See Sen. Rep. No. 100-503, 1, 1988 U.S.C.C.A.N. 5969, 5969 (Sept. 12, 1988).

^[3] See Sen. Rep. No. 111-10, 1–4, 2009 U.S.C.C.A.N. 430, 430–32 (Mar. 23, 2009), available at <https://www.govinfo.gov/content/pkg/CRPT-111srpt10/pdf/CRPT-111srpt10.pdf>.

^[4] Fraud Enforcement and Recovery Act, Pub. L. 111-21, 123 Stat. 1617 (2009); see Sen. Rep. No. 111-10 at 4.

^[5] See, e.g., Jessica Ortiz and Caleb Hayes-Deats, *False Claims Act Litigation Will Follow Stimulus Package. Here's How To Avoid It*, Nat'l L.J., Apr. 5, 2020, available at <https://www.law.com/nationallawjournal/2020/04/05/false-claims-act-litigation-expected-in-wake-of-stimulus-package-heres-how-to-avoid-it/> (“In the five years after 2009, when Congress passed stimulus bills to respond to the financial crisis, the government and private whistleblowers filed nearly 4,000 [False Claims Act] cases and recovered almost \$23 billion.”); Alexander Canizares and Barak Cohen, *Insight: Coronavirus Puts DOJ on Heightened Alert for Potential Fraud*, Bloomberg Law, Mar. 24, 2020, available at <https://news.bloomberglaw.com/white-collar-and-criminal-law/insight-coronavirus-puts-doj-on-heightened-alert-for-potential-fraud> (noting that President Obama created a Financial Fraud Enforcement Task Force in 2009 that “ushered in a wave of housing and mortgage fraud investigations and *qui tam* cases under the False Claims Act and the Federal Institutions Reform, Recovery, and Enforcement Act that resulted in large settlements and litigation.”).

^[6] 18 U.S.C. § 1031(a)(2).

^[7] 18 U.S.C. § 1031(a) (emphasis added).

^[8] *Id.*

^[9] *United States ex rel. Johnson v. Kaner Med. Grp., P.A.*, 641 F. App'x 391, 394 (5th Cir. 2016) (quoting *United States ex rel. Steury v. Cardinal Health, Inc.*, 625 F.3d 262, 267 (5th Cir. 2010)).

¹⁰⁹ 31 U.S.C. § 3729(a)(1). Damages are reduced if the defendant provided information about the violation to the government and fully cooperated with the government's investigation. *Id.* at § 3729(a)(2).

¹¹⁰ 18 U.S.C. § 1031(g). As of January 21, 2020, though, no whistleblower fund or payment had been authorized. U.S. Dep't of Justice Archives, *Major Fraud Against the U.S.*, Jan. 21, 2020, available at <https://www.justice.gov/archives/jm/criminal-resource-manual-930-major-fraud-against-us>.

¹¹² Compare 18 U.S.C. § 1031(f) (establishing a seven-year statute of limitations, "plus any additional time allowed by law," for prosecuting violations of the Major Fraud Statute) with 31 U.S.C. § 3731(b) (providing that a civil action brought under Section 3730 of the False Claims Act "may not be brought (1) more than 6 years after the date on which the violation of section 3729 violation is committed, or (2) more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the official of the United States charged with responsibility to act in the circumstances, but in no event more than 10 years after the date on which the violation is committed, whichever occurs last").

¹¹³ *United States v. Hartline*, 746 F. App'x 124, 128 (3d Cir. 2018).

¹¹⁴ *Id.* at 128–29 (internal quotation marks and citation omitted).

¹¹⁵ *Id.* at 129.

¹¹⁶ *Id.* at 128; see also *United States v. Litvak*, 808 F.3d 160, 170 (2d Cir. 2015) ("We have not previously addressed the contours of materiality for purposes of 18 U.S.C. § 1031. Because the parties agree that materiality is an element of Section 1031, and that such requirement is coextensive with Section 1001's materiality element, we assume as much and therefore have no occasion to address the issue here."). In *Litvak*, the appellate court reversed the defendant's Major Fraud Statute conviction because, although his misstatements could have influenced the decisions of investors who bought and sold securities, the misstatements could not have influenced the decision of, and so could not be material to, the Treasury, which oversaw the investment program. *Litvak*, 808 F.3d at 172–74. Specifically, "[b]ecause ... the evidence was insufficient to permit a rational jury to find that Litvak's misstatements were material to the Treasury, we reverse his convictions on those charges." *Id.* at 169. The circuit court also vacated Litvak's related securities fraud conviction and remanded the case for a new trial. *Id.* at 190.

At the retrial without the major fraud charge, a jury again found Litvak guilty of securities fraud, see *United States v. Litvak*, 2017 WL 3638079, at *13 (D. Conn. Apr. 17, 2017), but the conviction was vacated on appeal, see *United States v. Litvak*, 889 F.3d 56, 72 (2d Cir. 2018). The government then voluntarily dismissed the securities fraud claim against Litvak. See *SEC Voluntarily Dismisses All Claims Against Jesse Litvak*, Litigation Release No. 24368, Dec. 6, 2018, available at <https://www.sec.gov/litigation/litreleases/2018/lr24368.htm> (describing the U.S. Attorney for the District of Connecticut's motion to dismiss the criminal case against Litvak, and the district court's grant of that motion to dismiss in August 2018).

¹¹⁷ *Hartline*, 746 F. App'x at 128 (quoting *United States v. McBane*, 433 F.3d 344, 350 (3d Cir. 2005)).

¹¹⁸ *Id.*

¹¹⁹ CARES Act, § 1102. Businesses with over 500 employees may also be eligible for PPP funds under certain circumstances. See U.S. Dep't of the Treasury, Paycheck Protection Program Loans Frequently Asked Questions (FAQs) at 1–2, Apr. 26, 2020, available at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>; see 15 U.S.C. § 632.

¹²⁰ CARES Act, § 1102(a).

¹²¹ *Id.*

¹²² *Id.*

¹²³ CARES Act, §§ 4001–4029.

¹²⁴ *Id.* at § 4003(c)(3)(D)(i).

¹²⁵ *Id.* at § 4003(c)(3)(D)(i)(I).

¹²⁶ *Id.* at § 4003(c)(3)(D)(ii).

^[27] Bd. of Governors of the Fed. Reserve System, *Federal Reserve Takes Additional Actions to Provide up to \$2.3 Trillion in Loans to Support the Economy*, Apr. 9, 2020, available at <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm>.

^[28] CARES Act, § 4029(b)(2).

^[29] See 18 U.S.C. § 1031(a)(2).

^[30] See, e.g., Robert J. Wagman, Jr. & Matthew G. Nielsen, *Insight: First Comes Federal Money-Then Comes Enforcement*, Bloomberg Law, Apr. 20, 2020, available at <https://news.bloomberglaw.com/us-law-week/insight-first-comes-federal-money-then-increased-enforcement> (“History teaches that whenever the government spends a lot of money in a short amount of time, increased government criminal and civil enforcement always follows.”).

^[31] See Erica Werner, *Oversight Efforts Stumble as White House Continues Changing Rules on Emergency Spending Measures*, Wash. Post, Apr. 28, 2020, available at <https://www.washingtonpost.com/us-policy/2020/04/28/mnuchin-coronavirus-small-business-ppp/> (describing an appearance by Mnuchin on the news, during which he stated that firms that improperly took PPP loans could be subject to criminal liability).

^[32] See U.S. Dep’t of Justice, *Two Charged in Rhode Island with Stimulus Fraud*, May 5, 2020, available at <https://www.justice.gov/opa/pr/two-charged-rhode-island-stimulus-fraud> (announcing criminal charges of conspiracy to make false statements to influence the Small Business Administration and conspiracy to commit bank fraud); U.S. Dep’t of Justice, *Engineer Charged in Texas with COVID-Relief Fraud: Texas Engineer Fraudulently Sought More Than \$10 Million in CARES Act SBA Paycheck Protection Loans*, May 13, 2020, available at <https://www.justice.gov/opa/pr/engineer-charged-texas-covid-relief-fraud> (announcing criminal charges of wire fraud, bank fraud, making false statements to a financial institution, and making false statements to the Small Business Administration); U.S. Dep’t of Justice, *Chinese National Arrested for \$20 Million Scheme to Fraudulently Obtain Loans Intended to Help Small Businesses During COVID-19 Pandemic*, May 21, 2020, available at <https://www.justice.gov/usao-sdny/pr/chinese-national-arrested-20-million-scheme-fraudulently-obtain-loans-intended-help> (announcing criminal charges of bank fraud, wire fraud, making false statements to a bank, making false statements to the Small Business Administration, and major fraud against the United States under the Major Fraud Statute).

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