

Borrowers and Banks Beware: The New Year Brings the Nation's First False Claims Act Settlement for Paycheck Protection Program Fraud

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On January 12, 2021, the Eastern District of California entered into a civil settlement with a Paycheck Protection Program (“PPP”) borrower and its CEO to resolve allegations of fraud. The settlement stemmed from a \$350,000 PPP loan that SlideBelts Inc., an internet retail company, received even though it was a prohibited borrower as a debtor in bankruptcy. This is the first civil settlement for PPP-related fraud and is a harbinger of what the New Year will bring for some of the five million PPP loan recipients to date.

The Settlement

According to the [settlement agreement](#), SlideBelts submitted three applications for PPP loans to three different lenders on April 3, 8, and 14 of 2020. The application forms ([SBA Form 2483](#)) provide that loans will not be approved for any applicant that provides an affirmative answer to the very first question on the form, which asks:

1. Is the Applicant . . . presently involved in any bankruptcy?

Even though it was a debtor in a Chapter 11 bankruptcy at the time, SlideBelts answered “no” to this question in each of its three applications.

The settlement agreement provides the first lender rejected SlideBelts’ application on April 10, 2020. At that time, the first lender sent an email advising SlideBelts’ CEO, Brigham Taylor, that Question 1 had been answered incorrectly because the lender knew SlideBelts was presently in bankruptcy. Taylor responded that the answer was an “oversight,” but asserted that the question regarding bankruptcy was “an overreach” by the Small Business Administration (“SBA”). On April 14, 2020, Taylor wrote the first lender again and reiterated that the term “bankruptcy” should not be included in Question 1, and that the lender should approve the loan. The lender rejected Taylor’s request and repeated that SlideBelts was not eligible for a PPP loan because it was in bankruptcy. Three hours later, SlideBelts submitted the third application, signed by Taylor, to a different lender.

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Shortly thereafter, the second lender approved SlideBelts' second application. Taylor signed the loan note with the second lender and, according to the settlement agreement, again "stated falsely that SlideBelts was not in bankruptcy to influence [the second lender] to execute the note and disburse the [\$350,000] loan proceeds to SlideBelts." As a result of the note and the false statements by Taylor and SlideBelts, the second lender not only disbursed the loan proceeds to SlideBelts on April 21, 2020, but also submitted a false claim to the SBA for \$17,500 in loan processing fees, which the SBA paid.

One day after the loan was disbursed, Taylor wrote an email to the second lender stating that SlideBelts "just realized that we may not have answered [Question 1] correctly since we filled out the application quickly and wanted to bring it to your attention." Instead of returning the loan, however, SlideBelts sought retroactive approval of the PPP loan from the bankruptcy court. In doing so, SlideBelts did not disclose to the bankruptcy court that it had obtained the loan by making a false statement to the second lender regarding its status as a debtor in bankruptcy. The SBA and the second lender opposed SlideBelts' motion and requested that the bankruptcy court order SlideBelts to return the loan. SlideBelts did not return the money voluntarily but instead asked the bankruptcy court to dismiss the case so that it could refile for bankruptcy later and apply for a PPP loan while the case was dismissed.

On June 30, 2020, the bankruptcy court granted SlideBelts' motion to dismiss the bankruptcy case. After repeated demands from the SBA to return the proceeds, SlideBelts finally returned the \$350,000 to the second lender on July 8, 2020.

Based on these actions, the United States contends in the settlement agreement that SlideBelts and Taylor are liable to the government for damages and penalties totaling \$4,196,992 for violations of the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") and the False Claims Act ("FCA"). Pursuant to the terms of the settlement agreement, SlideBelts and Taylor agree to pay \$100,000 to resolve these claims, with nearly half to be paid within fourteen days and the remaining amount due over the course of five years. Notably, the settlement amount "represents the amount the United States is willing to accept in compromise of its civil claims arising from the [alleged violations] due solely to the [Taylor and SlideBelts'] financial condition." SlideBelts also agreed that if it failed to make its required payment under the settlement agreement, SlideBelts would consent to the entry of judgment against it for \$2,098,496 (representing its half of the \$4,196,992 in total alleged damages and penalties).

The Takeaway

When Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act to quickly authorize up to \$349 billion in forgivable loans to small businesses on March 29, 2020, it was inevitable that fraud would follow. Enforcement followed, too, with federal prosecutors pursuing dozens of criminal prosecutions for various PPP-related fraud throughout 2020. Those criminal charges often represented the most blatant of crimes and the easiest of targets. All the while civil lawsuits were quiet, or at least not yet public.

But not anymore. This first-of-its-kind civil settlement demonstrates that civil enforcement actions are alive and well and that the government is aggressively pursuing recoveries against companies and individuals, and even against insolvent borrowers. (Indeed, even under pandemic circumstances, the DOJ reported recovering more than \$2.2 billion in settlements and judgments from civil cases involving fraud and false claims against the government in fiscal year 2020.)

Moreover, the settlement paves the way for private relators looking to take advantage of the *qui tam* provisions of the FCA to target PPP fraud. In fact, relator-driven *qui tam* cases—many of which are likely currently pending but under seal while under investigation by the government—may in fact dominate the enforcement scene related to PPP fraud in the New Year. Only time will tell, but at the least the SlideBelts settlement marks the beginning of a new chapter related to combatting pandemic-related fraud with civil enforcement actions and the FCA.

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