LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
TUESDAY, AUGUST 11, 2020

PERSPECTIVE

PPP and FCA claims: Defenses may vary among circuits

By Shawn Collins
and Lisa Northup

The U.S. Department of Treasury and the Small Business Administration recently disclosed the names of businesses to whom they have lent more than $150,000 as part of the Paycheck Protection Program. There were some large, well-known companies on the list that have amplified the controversy over whether the $520 billion in funds allocated to the program are being distributed to businesses that are truly in need of the relief. A key requirement of the PPP is that a PPP loan applicant must certify in "good faith" that "[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant." The "necessity" of PPP funds for these large, well-known companies has been called into question, given the stated objective of the PPP program is helping smaller businesses stay afloat and maintain their payroll while COVID-19 slows down the U.S. economy. Unfortunately, governmental guidance explaining what constitutes "necessary" has been far from forthcoming, and the little guidance that has been provided has come mostly in the form of frequently asked questions released by the SBA.

Question 31 of the SBA's FAQs, which addresses whether businesses owned by large companies with adequate sources of liquidity to support the business' ongoing operations will qualify for a PPP loan, has been particularly confusing because it states that businesses owned by large companies must take the following into account when making their "good faith" certification: (1) the company's current business activity; and (2) the company's ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business." While the question purports to provide clarity for PPP loan applicants that are owned by large companies, the use of equally vague terms like "other sources of liquidity" and "significantly detrimental to the business" to provide clarity to "necessary" has proven futile and only exacerbated the confusion surrounding the PPP program. In short, the limited and unclear guidance provided by the government thus far has left PPP loan applicants, and now recipients, understandably distressed.

The U.S. Supreme Court has not yet weighed in on this issue and circuit courts are split on what constitutes a 'good faith interpretation.' PPP recipients will want to be aware of the varying approaches amongst the circuits because their defense against a potential FCA charge or claim will vary by jurisdiction.

One cause of this distress is that PPP loan recipients face potential liability under the False Claims Act. Specifically, when a certification is a prerequisite to obtaining a government benefit, as is the case with the PPP program, false certifications of compliance give rise to potential criminal and civil liability under the FCA. To be liable under the FCA, an individual or an entity must have knowingly made the false certification. "Knowingly" is defined by statute to require that a person has actual knowledge, acted in deliberate ignorance, or acted in reckless disregard. 31 U.S.C. Section 3729(b)(1)(A). No proof of specific intent is required. *Id.* Section 3729(b)(1)(B).

As one court has explained: "Strict enforcement of the FCA's knowledge requirement helps to ensure that innocent mistakes made in the absence of binding interpretive guidance are not converted into FCA liability." *United States ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 287 (D.C. Cir. 2015). Importantly, the U.S. Supreme Court has not yet weighed in on this issue and circuit courts are split on what constitutes a "good faith interpretation." PPP recipients will want to be aware of the varying approaches amongst the circuits because their defense against a potential FCA charge or claim will vary by jurisdiction.

For example, in *United States v. United Healthcare Ins. Co.*, 848 F.3d 1161, 1178 (9th Cir. 2016), the 9th U.S. Circuit Court of Appeals rejected defendants' argument their certifications could not have been knowingly false because their conduct represented an objectively reasonable interpretation of their legal obligations. The 9th Circuit explained that statements in the preamble of the regulation resolved any potential ambiguity. Specifically, the court pointed to the language in the preamble that stated, "organizations have an obligation to undertake 'due diligence' to ensure the accuracy, completeness, and truthfulness of … data submitted … and will be held responsible for making good faith efforts to certify the accuracy, completeness, and truthfulness of … data submitted."

The D.C. Circuit has taken a slightly different approach. In *Purcell*, the court held that "the FCA does not reach an innocent, goodfaith mistake about the meaning of an applicable rule or regulation" or "claims made based on reasonable but erroneous interpretations of a

defendant's legal obligations." The court, however, added an important caveat that the scienter requirement may still be met if "there is interpretive guidance 'that might have warned [the defendant] away from the view it took." This caveat raises the bar for defendants because it creates the potential for defendants who acted in good faith based on reasonable legal interpretation of the relevant regulations to nonetheless be held liable if interpretative guidance existed that could have (even if it did not in fact) nudge the defendant away from its reasonable interpretation.

More recently, the 11th Circuit set the standard even higher when it affirmed a district court's granting of summary judgment in favor of defendants, and held the correct standard is "whether the defendant actually knew or should have known that its conduct violated a regulation in light of any ambiguity at the time of the alleged violation." *United States ex rel. Phalp v. Lincare Holdings, Inc.*, 857 F.3d 1148, 1155 (11th Cir. 2017). The critical inclusion of "should have known" greatly increases the range of potential circumstances under which defendants may be found liable.

This high-level look at how courts have previously treated defendants facing potential FCA liability in relation to arguably ambiguous regulations shows that, on the one hand, recipients who acted in good faith and yet have the misfortune of facing an FCA investigation or lawsuit may be able to mount a successful defense of their good faith certification based on a reasonable interpretation of what "necessity" means in light of the available governmental guidance at the time of the certification. On the other hand, how a court will view such a defense will vary by jurisdiction and caution should be exercised about assuming such a defense will automatically prevail given the novelty of judicial interpretation of legal guidance related to PPP loans.

Accordingly, recipients of PPP loans are advised to carefully retain all documentation supporting the initial and any subsequent certifications to the government as well as compliance with any loan terms. Communications within and on behalf of the company should be consistent with these certifications. In addition, internal compliance procedures should be up to date so that all employees know how to report suspected issues and feel comfortable reporting suspected issues, and companies should thoroughly investigate these issues once reported and inform the whistleblower of the outcome of the investigation, keeping in mind confidentiality issues. This will reduce the risk of an internal whistleblower raising a complaint with the government or filing a civil FCA lawsuit. These recommended precautions apply to all recipients, including those who received loans under $2 million. While the SBA has announced that loans under $2 million will not be audited, that does not insulate such recipients from the risk of an FCA claim raised by an internal whistleblower, among other possible avenues. ■

Shawn Collins *is a shareholder and* **Lisa Northup** *is an associate at Stradling Yocca Carlson & Rauth.*

Reprinted with permission from the *Daily Journal*. ©2020 Daily Journal Corporation. All rights reserved. Reprinted by ReprintPros 949-702-5390.