

May 27, 2020

COVID-19

# Lessons From the First DOJ PPP Fraud Prosecutions

By [Brian Hayes](#), [Holland & Knight](#)

---

The U.S. federal government enacted the CARES Act, a \$2-trillion stimulus package, on March 27, 2020, to aid people reeling from the effects of the COVID-19 pandemic. Implementation of one of the CARES Act's relief initiatives, the Paycheck Protection Program (PPP), has been in the spotlight due to concerns about borrowers' eligibility and the risk of fraud. The DOJ has already begun to file charges against PPP fraudsters.

This article highlights lessons learned thus far from the government's prosecutions.

See "[COVID-19 Economic Relief Packages Bring Fraud Risks](#)" (Apr. 1, 2020).

## The Paycheck Protection Program

Administered by the Small Business Administration (SBA), the PPP was intended to enable the government to quickly put funds into the hands of small businesses through forgivable loans, which employers could use to keep workers on the payroll during the economic downturn.

Eligible small businesses that certified in the loan application that the current economic uncertainty made its PPP loan request

"necessary to support [its] ongoing operation" could quickly obtain an SBA-guaranteed loan. Borrowers could use PPP funds to retain workers and maintain payroll, and to make mortgage interest, lease and utility payments. The amount of the loan was calculated using a formula tied to the size of the borrower's payroll. Companies that used the funds in the manner required by PPP and kept all of their employees on payroll for eight weeks could have the loan forgiven by the SBA.

Sadly, government relief efforts attract fraud, and the CARES Act has been no exception. As of the week of April 27, 2020, according to Brian Benczkowski, supervisor of the Criminal Division at the Department of Justice, the National Center for Disaster Fraud had received more than 12,000 calls and emails reporting COVID-19-related fraud, with 4,200 of those deemed worthy of criminal investigation. After DOJ analyzed data obtained from PPP lenders, Benczkowski observed that applicants were "overstating their payroll costs, overstating the number of employees they've had, [and] overstating the nature of their business." In addition, Treasury Secretary Steven Mnuchin pledged that all PPP loans in excess of \$2 million would be reviewed.

See "[Supply Chain Disruptions Spur Public, Private Mitigation Efforts](#)" (May 13, 2020).

## Charged Cases

Although lenders only recently began distributing funds obtained through the PPP to borrowers, the government's efforts to police PPP fraud are already resulting in criminal cases. Since May 4, 2020, six individuals have been charged by DOJ in five cases for participating in alleged schemes to defraud involving PPP loans.

### **Staveley and Butziger**

In a complaint filed in Rhode Island on May 4, 2020, *United States v. Staveley and Butziger*, the defendants were charged with conspiring to obtain PPP loans on behalf of 4 different companies totaling more than \$500,000. The complaint cited evidence from various sources indicating that the businesses were non-existent or not in operation. It also noted that one of the defendants, in a conversation with an undercover agent posing as a banker, identified certain individuals as employees of his business. In later interviews with law enforcement, several of those individuals denied employment as described by the defendant. The complaint also described emails obtained by the government between the defendants in which they allegedly discussed creating false documents in support of loan applications.

### **Fayne**

In a complaint filed on May 12, 2020, *United States v. Maurice Fayne*, the defendant, a reality TV show personality, was charged with bank fraud for obtaining a PPP loan in excess of \$2 million from a Georgia bank on behalf of a business known as Flame Trucking, Inc.. In the complaint, the government presented evidence that bank statements submitted in support of

the loan application to the lender bank were not genuine, and that the defendant spent the loan proceeds on personal items, rather than payroll and other business expenses.

### **Rai**

In another complaint also filed on May 12, 2020, in Beaumont, Texas, *United States v. Shashank Shekhar Rai*, the defendant was charged with fraudulently seeking PPP loans from two banks. In one loan application, Rai sought a \$10-million loan by claiming his business employed 250 individuals with an average monthly payroll of \$4 million. In the second, Rai sought a loan of \$3 million by claiming he paid 264 employees monthly payroll totaling approximately \$1.2 million. In fact, according to DOJ, no employees worked for Rai or his purported business, Rai Family LLC, at the relevant times.

### **Yates**

In a complaint filed on May 18, 2020, in Texarkana, Texas, *United States v. Samuel Yates*, the defendant was charged with fraudulently seeking PPP loans from two different lenders. Yates allegedly sought loans in the amount of \$5 million and \$500,000, claiming to have 400 and 100 employees, respectively. According to the government, Yates used a random name generator that is publicly available on the internet to create lists of purported employees and submitted forged tax documents with each application.

### **Ma**

In a complaint filed on May 20, 2020, in New York, New York, *United States v. Muge Ma*, the defendant was charged with various fraud and false statement offenses in connection with

applications for multiple PPP loans, as well as two SBA Economic Injury Disaster Loans, totaling more than \$20 million. According to the complaint, Ma sought the PPP loans on behalf of two LLCs – Hurley Human Resources and New York International Capital – both purportedly located in Manhattan.

The complaint states that Ma submitted five PPP loan applications in total for Hurley and NYIC, asserting that each employed hundreds of employees with monthly average payroll ranging from about \$1.6 million to \$2.4 million. Although Ma submitted various tax, bank, and payroll records in support of his loan requests, the complaint describes evidence which the government asserts establish that the records were fabricated and that Ma is the only employee of his companies. According to the complaint, at the time that Ma was attempting to obtain the PPP loans, he was also negotiating to purchase large quantities of COVID-19 test kits and personal protective equipment from foreign manufacturers, falsely asserting that NYIC represented New York state, including during a conversation recorded by an undercover law enforcement agent.

## Lessons Learned

### 1) Prosecutors Are Not Currently Focusing on the “Necessity” Certification

PPP loan applicants are required to certify that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” Although much debate about implementation of the program centered on how SBA intended to interpret and audit borrowers’ certifications regarding the necessity of the loan to continued business

operation, law enforcement thus far has relied on more readily provable lies in PPP loan applications as the basis for criminal charges.

For example, in the Georgia prosecution, authorities focused on the defendant’s use of the loan proceeds in a manner not permitted by the PPP. After alleging that the defendant certified in his application that the \$2 million in loan proceeds would be used to “retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments,” law enforcement described evidence showing he instead used the funds to pay \$40,000 in child support, repay personal loans and purchase jewelry valued at over \$84,000. The criminal complaint also noted that when executing a search warrant at the defendant’s residence to seize the jewelry, law enforcement discovered a 2019 Roll Royce in defendant’s garage with a retail value of over \$380,000 – still bearing temporary dealer tags.

Similarly, in the New York, Rhode Island and Texas cases, the complaints focused on defendants’ false statements to lenders about the number of individuals employed by the defendants purported companies and their payroll costs. Although the defendants sought to obtain forgivable SBA loans by claiming that they had dozens or hundreds of employees on payroll, according to the charges, there were few or no employees working at any of the identified entities.

In terms of criminal prosecutions, this trend seems likely to continue, as the SBA itself recently adjusted its evaluation of the “necessity” certification when reviewing PPP loans. On May 13, 2020, SBA announced that those who sought PPP loans in amounts less than \$2 million would be deemed to have

made the necessity certification in good faith. Additionally, even those who obtained PPP loans over \$2 million whom SBA determines did not make the necessity certification in good faith can avoid further adverse SBA action by repaying the loans. Although the SBA's position would not be binding on other authorities, prosecutors, who must prove the defendant's fraudulent intent beyond a reasonable doubt, will be unlikely in most cases to premise a fraud charge solely on the subjective "necessity" certification under these circumstances.

## 2) Criminal Investigation of PPP Fraud Is a Multi-Agency Team Effort

DOJ's Benczkowski and Treasury Secretary Mnuchin have been the primary government spokespersons on pursuit of PPP loan fraud, and criminal cases filed thus far demonstrate that DOJ and the Treasury is drawing upon a wide range of investigative resources. Beyond the expected involvement of agents from the FBI and the SBA Office of Inspector General, announcements made in connection with the PPP criminal charges described above credit participation from the U.S. Postal Inspection Service, Homeland Security Investigations, the IRS's Criminal Investigation Division, Treasury's Inspector General for Tax Administration, the FDIC Office of Inspector General, as well as the Office of the Inspector General at the Federal Housing Finance Agency.

See "[The Fiendishly Difficult Problem of Managing Parallel Resolutions](#)" (Sep. 4, 2019).

## 3) Full Toolkit Will Be Used

Further, although DOJ has used data analytics to identify cases for investigation, once those

are underway, charging documents make clear that investigators are employing the full panoply of traditional investigative tools to gather evidence in support of charges. In addition to reviewing bank records, investigators executed search warrants on email accounts in the Rhode Island and Beaumont, Texas, fraud cases. Undercover agents recorded conversations with the defendants in the Rhode Island and New York prosecutions, and agents consensually recorded a conversation between Rai and a lender employee in the Beaumont, Texas, case.

In the Georgia case, law enforcement used seizure and search warrants to recover more than \$500,000 from several bank accounts, jewelry that the defendant admitted he had purchased with PPP loan proceeds and nearly \$80,000 in currency from the defendant's residence.

Data mining will be an important component of the government's effort to cull through millions of loan applications to identify potential targets, but, in the end, agents and prosecutors will rely upon traditional "gumshoe" techniques to get cases charged.

See "[Case Against Former Goldman Sachs Executive Highlights Value of Robust Compliance and the Willingness to Make Tough Judgments](#)" (Apr. 29, 2020).

## Suspicious Activity Reporting Obligations Cannot Be Overlooked

The PPP was intended to put money into the hands of business owners quickly and, as a result, was implemented by the government in

a manner that directed lenders to relax some due diligence and underwriting standards that they might otherwise apply to commercial loans. Unfortunately, the government's fear that rampant abuse by borrowers of coronavirus stimulus programs could occur appears to have come true, and the filing of charges so quickly by DOJ suggests that criminal prosecutions of PPP borrowers for fraud will continue for some time.

Processing the crush of PPP applications presented a substantial challenge to financial services providers (to date, lenders have approved millions of PPP loans), but their diligence with regard to otherwise applicable BSA/AML reporting obligations cannot be allowed to slip. In fulfilling their duty to report suspicious activity, regulators expect financial institutions to employ dynamic risk assessment programs that evolve with the risk landscape. Financial institutions should be prepared to demonstrate to regulators during upcoming examinations that their BSA/AML compliance teams have assessed the risk of increased suspicious activity in connection with PPP loans, and explain how they have accounted for it. Adjustments to transaction monitoring protocols, and alerts or training for employees on the signs of illicit financial activity by borrowers in connection with PPP loans should be considered. Monitoring charged criminal cases could be useful in identifying red flags in this regard. For example, the complaint in the Georgia prosecution recounted how the borrower wire transferred \$430,000 in round-dollar increments to 3 individuals almost immediately after receiving his PPP loan proceeds.

The government, using a variety of law enforcement agencies and techniques, has

just begun to reveal what is likely to be a long string of prosecutions of borrowers for PPP loan fraud. Although processing PPP loans strained the resources of financial services providers, fraud connected to the PPP will continue to demand the attention of BSA/AML compliance professionals for the foreseeable future.

*Brian Hayes is a partner in Holland & Knight's Chicago office and is the leader of the firm's Midwest white collar defense and investigations practice. Prior to joining Holland & Knight, Hayes served in the U.S. Attorney's Office for the Northern District of Illinois and was Chief of the Criminal Division.*