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First PPP fraud prosecution provides preview of government scrutiny for which all CARES Act beneficiaries must prepare

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The Coronavirus Aid, Relief, and Economic Security (CARES) Act is barely a month old, but as predicted, the government has already begun prosecuting pandemic relief applicants for fraud and abuse.

On May 5, 2020, the Department of Justice (DOJ) announced criminal charges against two New England men for seeking hundreds of thousands of dollars in government-backed Payroll Protection Program (PPP) loans under false pretenses. Although the alleged plot was disrupted before any PPP money was disbursed, prosecutors charged the men with conspiring to make false statements and commit bank fraud, among other felony offenses. In support of the criminal complaints, the government filed a 16-page affidavit that details its investigatory techniques and the defendants' alleged misconduct. Along with contemporaneous comments by the head of DOJ's Criminal Division, the case provides a critical first look into what is sure to be a prolonged effort by myriad government agencies to investigate and prosecute alleged CARES Act fraud.

First PPP fraud prosecution

The catalyst for the investigation of PPP applicants David Staveley and David Butzinger appears to have been information provided by a confidential informant. According to the government's affidavit, an unnamed cooperating source advised local authorities that he was privy to emails between Staveley and Butzinger concerning their attempts to obtain PPP funds using fake documents, copies of which the source provided to government agents.

The government alleges that Staveley applied for three PPP loans totaling over $438,500 to support non-existent employees of restaurants that he never owned. Before the pandemic and by the time of the applications, the government contends, the restaurants had ceased to operate. One, the Remington House, has been closed since 2018 and currently sports "large red/orangey notices indicating 'Stop Work'" on its door and windows. A second, Top of the Bay, is owned by an unidentified third party who told government agents that Staveley never had an ownership interest in the restaurant and was not authorized to apply for PPP relief on its behalf. And a third, On the

Trax, was operated by Staveley, owned by his brother, and closed in early March after its liquor license was revoked.

The government has alleged that Butzinger assisted Staveley in his PPP scheme and separately applied for his own $105,381 PPP loan to support his unincorporated business, Dock Wireless. In seeking the money, Butzinger identified seven full-time employees by name, four of whom the government interviewed. All knew Butzinger, but they denied ever being employed by him or Dock Wireless.

The allegations are bolstered by emails that the government obtained from Google through a search warrant, which was supported by information provided by the cooperating source. Those emails include an offer from Butzinger to Staveley to "create a bull shit 2020q1" tax document to submit with the Top of the Bay application, and an inquiry from Staveley to Butzinger about whether they should "dream up 1st quarter" payroll reports to submit with the Top of the Bay and Remington House applications.

In addition to the search warrant and extensive eyewitness interviews, the government built its case against Staveley and Butzinger using an undercover agent who posed as a compliance officer at the bank where the defendants sought PPP funding. On April 24, the agent participated in a recorded telephone call with a man the government contends was Staveley. The caller stated that he owns Top of the Bay, Remington House, and On the Trax and that each has over 20 employees. The government's affidavit goes on to note:

> [I]n an ironic twist, [Staveley] complained about the reports of large businesses being able to obtain [Small Business Administration] loans under the Paycheck Protection Program, saying 'the whole thing has become a little bit of a sham.'

Three days later, the undercover agent participated in a second recorded telephone conversation, this time with Butzinger. During the call, Butzinger made numerous allegedly false statements in furtherance of his attempt to obtain PPP funding.

The investigation neared its conclusion on April 28 with an interview of Staveley's brother, who appears as the signatory on the PPP applications that Staveley submitted. Staveley's brother denied signing the applications or authorizing Staveley to submit them. Although he acknowledged giving Staveley a power of attorney to open On the Trax in his name, he denied knowledge of any restaurants named Top of the Bay and Remington House.

Staveley is charged in the complaint with violating 18 U.S.C. §§ 371 (conspiracy to make false statements to influence the Small Business Administration (SBA)), 1349 (conspiracy to commit bank fraud), and 1028A (aggravated identify theft) and Butzinger is charged with violating 18 U.S.C. §§ 371 (conspiracy to make false statements to influence the SBA), 1349 (conspiracy to commit bank fraud), and 1344(2) (bank fraud).

DOJ comments on future prosecutions

The day the affidavit supporting the criminal complaint against Stavaley and Butzinger was signed, Assistant Attorney General Brian Benczkowski, head of DOJ's Criminal Division, provided additional insight into the government's plans for investigating CARES Act fraud. Benczkowski said that DOJ had begun a preliminary inquiry into PPP lending, which is being run out of the Criminal Fraud Section's Market Integrity Unit. Investigations are likely to be modeled on DOJ's health care fraud strike force, which identifies targets in part by searching for outliers in Medicare payment data.

As in the health care context, loan amounts above a certain threshold may subject PPP beneficiaries to heightened scrutiny, as the secretary of the treasury recently indicated. But small loan amounts, alone, will not exclude beneficiaries from oversight. Loans that are disproportionate to the nature of the business, the number of employees, or the costs of living in the region where the business operates may also be viewed as red flags. Indeed, thus far, DOJ has contacted 15 to 20 of the largest PPP lenders, and, according to Benczkowski, red flags have already emerged, including efforts to overstate payroll expenses and employee counts and misrepresent the nature of the underlying businesses.

Takeaways for CARES Act beneficiaries

All CARES Act beneficiaries should prepare for heightened government scrutiny, and numerous aspects of the first PPP fraud prosecution are instructive.

No PPP funds were ever disbursed.
Together, Staveley and Butzinger applied for four PPP loans. As to each, the government is explicit that the bank "has not funded the loan to date." The prosecution, therefore, serves as a reminder that under certain criminal and civil fraud statutes, as well as the conspiracy statutes, liability may attach to the mere presentation of false information to the government. It is important to remember that a conspiracy may exist when two or more people agree to commit a criminal act. It is not necessary that the objective of the conspiracy (here the receipt of CARES Act funds) ever actually occur; all that matters is the existence of the agreement. Similarly, actual harm to the public fisc is often not an element of liability, and the government may seek hefty fines and penalties, even absent alleged taxpayer harm.

The investigation appears to have been initiated by a private citizen.
Recipients of small amounts of CARES Act relief may feel immune from heightened government scrutiny. But confidential informants may catalyze criminal investigations of even small borrowers (as with Staveley and Butzinger), and private whistleblowers, called "relators," may sue on behalf of the government to recover federal funds, no matter how minimal, obtained through false or fraudulent claims or statements. Procedures to encourage would-be whistleblowers to report concerns internally, and to protect them after they do so, are, therefore, essential.

None of the requested loans exceeded $150,000.
Despite the relatively small amounts of the requested loans, the government spent 21 days and significant resources investigating the case. As DOJ press release noted, that effort was intended in part to "serve as a warning to others." Moreover, even small loan amounts may emerge as outliers. As AAG Benczkowski suggested, small borrowers may be targeted if PPP data indicates that their loans are disproportionate to their historic payroll expenditures, employee counts, business needs, or similarly situated borrowers.

The investigation was conducted by a large, multi-agency team.
The agencies that investigated Staveley and Butzinger include DOJ's Criminal Fraud Section, the U.S. Attorney's Office for the District of Rhode Island, the FBI, the IRS, the SBA's Office of Inspector General, and the FDIC's Office of Inspector General. In addition to these entities, the CARES Act establishes a separate special inspector general for pandemic relief and authorizes

several Congressional committees to conduct oversight, as we have discussed. Good relations throughout the government, and an understanding of individual agency priorities, will be essential for CARES Act beneficiaries.

The government obtained a search warrant for Gmail records.

Proving scienter will be critical but difficult in PPP fraud prosecutions and civil enforcement actions. Most applicants and beneficiaries will have good faith explanations for their submissions, even if portions of them prove to be inaccurate. Emails like the ones collected by the government in the Staveley and Butzinger case, however, are exactly the type of evidence that the government will seek to support allegations of fraudulent intent. It bears repeating: dance like nobody's watching, but email like it will be read in your deposition.

The government used an undercover agent to collect incriminating statements from the defendant.

PPP funds are requested from and disbursed by private banks. Nevertheless, statements made in PPP applications—and oral representations to bank representatives in furtherance of those applications—may expose applicants and beneficiaries to liability for making false statements to, or otherwise defrauding, the government. That is because PPP loans are backed by taxpayer dollars administered by the SBA. There is no shortage of False Claim Act cases involving alleged fraud on similar SBA programs, which take on heightened importance given the SBA's prominent role under the CARES Act. Vet all CARES Act-related communications carefully, no matter the audience.

Like the government in its effort to investigate and prosecute alleged fraud involving the CARES Act, Nixon Peabody has assembled a multi-disciplinary team that includes former special, criminal, and civil fraud prosecutors to assist with all aspects of applying for, receiving, and responsibly administering pandemic relief funds. For more, see our checklist of Best Practices for CARES Act Funding Compliance.

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