



## **US CARES Act: How to Avoid Liability from COVID-19 Fraud**

**Compliance and Ethics**

**Government**



## Cheat Sheet

- **Record keeping.** Develop and retain meticulous records, and for federal contractors, retain records for at least six years.
- **Supporting docs.** Collect supporting documentation for all certifications.
- **Section 3610 relief.** Ensure indemnification clauses with subcontractors cover claims related to 3610 relief applications and information disclosure.
- **DOD distinctions.** Department of Defense (DOD) contractors should follow specific guidance listed in DOD deviations.

It is necessary for companies and federal contractors, now more than ever, to be diligent in recordkeeping related to applications for and use of relief from federal benefits under the US Coronavirus, Aid, Relief, and Economic Security Act (CARES Act). To date, the US Department of Justice (DOJ) has criminally charged 474 defendants in 56 federal district courts, targeting a total of [US\\$569 million](#) in COVID-19 fraud. These cases send a clear message to businesses, including federal contractors, seeking or using CARES Act relief.

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The unprecedented pace of prosecutions related to business' use of CARES Act relief funding demonstrates the effective partnership between DOJ and approximately 120 federal government agencies, including each of the 93 US Attorney Offices (USAO), all of which have established individual COVID-19 fraud task forces. In light of this scrutiny, it's important to keep the following key points in mind.

## **PPP loans and Section 3610 obligations and requirements**

The [CARES Act](#) became law on March 27, 2020, and it contains relief measures to aid businesses, including federal contractors, during the COVID-19 pandemic. Among its most meaningful provisions for contractors are the Paycheck Protection Program (PPP) and Section 3610 — both of which expire, respectively, on [June 30, 2021](#), and [September 30, 2021](#). PPP loans support companies in keeping their workers on the payroll, while Section 3610 is for paid-leave reimbursement.

Although Section 3610 is important to contractors, they can rely on other avenues of relief available to them under the FAR and in provisions written in contracts themselves (e.g., FAR sections on excusable delays, stop work and suspension orders, and related costs recoveries or equitable adjustments, among other clauses).

### **Acquiring and spending PPP loans**

Any federal contractor, including those servicing the US Department of Defense (DOD), may qualify as small businesses eligible for PPP loans. Depending on the industry, some small contractors may exceed 500 employees.

PPP loans may *only* be expended for “allowable uses,” including:

- Payroll costs;
- Costs concerning group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- Employee salaries, commissions, or similar compensations;
- Interest payments on mortgage obligations;
- Rent;
- Utilities; and
- Interest on any other debt obligations that were incurred before the covered period.

Lastly, a borrower of a PPP loan must certify that (1) the “covered loan” is necessary for its “ongoing operations,” (2) it will be used to retain workers and maintain a payroll, or make mortgage, lease, or utility payments, (3) the borrower has no other applications pending for PPP loans, and (4) no monies to be received are for duplicate purposes.

### **Acquiring and spending Section 3610 relief**

Section 3610 of the CARES Act allows federal agencies to reimburse their contractors for providing paid leave to keep its employees or subcontractors in a “ready state.” The reimbursement is also available when the contractor's employees or subcontractors can neither perform work on a site that has been approved by the federal government nor telework because their job duties cannot be performed remotely.

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DOD has recently issued [two class deviations](#) that permit the recovery of paid leave reimbursement in the context of:

- (1) Keeping employees in a “ready state,” which includes “protect[ing] the life and safety of Government and contractor personnel”; and
- (2) “Protecting the life and safety of Government and contractor personnel against risks” from COVID-19.

Covered costs must be a result of COVID-19 and costs that would not be incurred in the normal course of the contractor’s business. Moreover, contractors must be audit ready. Records for relief must be “segregated and identifiable” within the contractor’s internal records, and reasonably and easily ascertainable to be regulatory and statutory compliant.

Essentially, DOD explains the process for Section 3610 relief applications where the CARES Act has failed to do so for contractors. In fact, DOD devised three checklists advising contractors of the information they should gather:

- (1) Abbreviated Reimbursement Checklist;
- (2) Multipurpose Reimbursement Checklist; and
- (3) Global Reimbursement Checklist.

Not following these checklists can result in ill-preparedness for a DOD audit of expenditures, the denial of reimbursement, or potentially a lawsuit.

For example, within the Abbreviated Reimbursement Checklist, a contractor must supply DOD with (1) a “narrative supporting its request” for reimbursement, including the circumstances requiring the paid leave, (2) when the paid leave was provided, (3) why telework could not be performed by the contractor’s employee, (4) how the paid leave costs are segregated within their internal systems, (5) a description of the contractor’s methodology for developing paid leave rates, and (6) an explanation of any company-specific guidance about reimbursement under Section 3610. Critically, a prime contractor’s signature for itself and its sub-contractors is a certification that the submission is made in “good faith, and the supporting data is accurate and complete to the best of the contractor’s knowledge.”

It is a common industry practice for subcontractors to withhold its detailed cost information from primes and to provide such competition sensitive information directly to the contracting officer under separate cover. These situations underscore the necessity for contractors to explore negotiating an appropriate indemnification clause with subcontractors that can serve as a protection against claims arising from inadequate or fraudulent disclosures that the prime was unable to thoroughly assess.

## Legal exposure

Legal liability, although not exclusively but, particularly under the False Claims Act (FCA), from a contractor’s request for and use of PPP and Section 3610 relief, is expected to increase through qui tam actions brought by relators. The FCA provides for treble damages and statutory penalties ranging from a minimum of US\$11,803 and maximum of US\$23,607 for each claim.

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Some actions that may run afoul of the FCA are as follows:

- Charging the government for more than was provided;
- Fraudulently seeking a government contract or relief;
- Submitting a false application for a government loan;
- Demanding payment for goods or services that do not conform to the contractual or regulatory requirements;
- Submitting a claim that falsely certifies the defendant has complied with a law, contract term, or regulations; and
- Attempting to pay the government less than is owed.

When applying for reimbursement under Section 3610, contractors must ensure that their requests conform with the applicable agency's requirements. The best way to do this is by utilizing the contractor's approved internal system for tracking and reporting costs and scrutinizing the costs to ensure they fall within the scope of Section 3610.

Moreover, contractors must ensure they are seeking reimbursement for costs that are not incurred from their normal business operations to avoid claims of fraud with merit. They should make a written determination for themselves and their subcontractors.

If the facts show the contractor submitted the request for reimbursement with knowledge that the request was false, or with a deliberate ignorance or reckless disregard for the accuracy of the information, the contractor may be suspended, debarred, or held liable under the FCA.

Additionally, contractors should verify the sources supporting its requests for reimbursement and other documents requested by an agency to avoid any claim of false certification.

To date, the DOJ has primarily focused on criminally prosecuting those abusing PPP loans and recently obtained its first civil settlement under the FCA for PPP loan misuse. For instance, if a contractor's PPP loan is not spent for an "acceptable use," liability under the FCA could arise because the PPP loan application was submitted to secure funds for unauthorized reasons.

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Further, if the PPP loan is not used to further a contractor's "ongoing operations," but is used for some other purpose, it is also likely that FCA liability could be imposed from the false or fraudulent assertions contained within the PPP loan application.

Recently, a contractor's CEO was charged, in his professional and personal capacity, with [multiple criminal charges](#) involving nearly US\$13 million in COVID-19 relief funding where, allegedly, the CEO falsely inflated the number of employees within PPP loan applications and falsely certified that the company and its affiliates did not receive a PPP loan when it had. The CEO was personally named because the investigation revealed that US\$2 million of the total amount of money received went to his personal bank account.

Among others, this case underscores that when the government's investigation reveals individual culpability, individuals will likely be named in FCA complaints. Accordingly, it is critical that contractors and subcontractors update their understanding of the legal risks presented by the FCA

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and other fraud statutes.

In another case, a criminal defendant obtained more than US\$1.1 million in PPP loans and was [charged](#) for filing two fraudulent PPP loan applications in support thereof. When submitting his applications, the defendant claimed that his two companies — Texas Barbecue and Houston Landscaping — had numerous employees and expended thousands in payroll expenses. The government alleged that neither business had employees or payroll expenses consistent with the amounts claimed within the PPP loan applications.

Similarly, another defendant attempted to obtain US\$3.1 million in PPP loans, but he provided [“false and misleading”](#) documents about his businesses’ operations and payroll expenses.

In these instances, the defendants face potential liability for fraudulently seeking federal relief and submitting fraudulent loan applications. Such liability can be mitigated or potentially avoided altogether by ensuring requests for loans are factually supported by contemporaneous and well-maintained company records.

In yet another case, a Hollywood film producer obtained US\$1.7 million in PPP loans and was [charged](#) for submitting PPP loans containing false certifications to PPP lenders. Even though the defendant certified that his PPP loans were for payroll expenses and other business-related expenses, he allegedly transferred more than half of the money to his personal account and used it to pay personal debts.

FCA or other potential fraud liability may be warranted here because the PPP loans were not spent on an “allowable use” and there was a false certification about compliance with the CARES Act.

## Conclusion

The infusion of billions of federal dollars into the economy provided much-needed relief, but, like any stimulus program, increased the attendant risk of fraud, waste, and abuse. Companies and government contractors are strongly encouraged to maintain meticulous records (and for at least six years in the case of federal contractors), ensure the existence of supporting documentation behind *all* certifications, and, for prime contractors, ensure indemnification clauses cover, among others, claims related to unsupported information disclosed by subcontractors for 3610 relief. For DOD contractors, it’s most important to follow the guidance in the DOD deviations to ensure they are audit ready and positioned to defend against any fraud claim, with merit.

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