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Government Investigations & White Collar Alert

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Whistleblower-initiated FCA investigation highlights risks to PPP borrowers, other pandemic relief beneficiaries

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Whistleblowers represent a significant threat to PPP beneficiaries — we cover what businesses who received pandemic relief funds should anticipate as scrutiny surges.



What's the Impact?

- / Prior to the pandemic, whistleblower-initiated FCA investigations exceeded government-initiated investigations; that trend is likely to be exacerbated by pandemic-related layoffs and the relatively small amount of most PPP loans
- / Whistleblower lawsuits will continue to emerge from under seal, likely spawning more FCA investigations and litigation
- / Pandemic relief beneficiaries facing FCA investigations should consult with experienced counsel to minimize risks

Late last month, the Department of Justice (DOJ) announced a False Claims Act (FCA) settlement that every recipient of coronavirus relief funding should note. Among its unique features, the settlement:

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- / is the first FCA settlement involving the Paycheck Protection Program (PPP) to arise out of a *qui tam*, or whistleblower-initiated, action;
- / portends what is likely to be a flood of similar *qui tam* actions involving PPP loans that are about to come out from under seal; and
- / reflects the government's efforts to protect FCA claims involving PPP debt from avoidance through bankruptcy.

The Bernstein settlement

On August 26, 2021, DOJ announced that Seth Bernstein, the owner of a jet charter company doing business as JetReady, agreed to pay \$287,055 to settle [allegations that he misappropriated PPP loan proceeds](#). The settlement resolved allegations brought by former JetReady employee Victoria Hablitzel in a *qui tam* action.¹

According to Hablitzel's complaint and the government's press release, Bernstein applied for the funds in April 2020 and, within days of receiving a \$1,173,382 PPP loan, diverted \$98,929 to cover, among other items, charitable contributions to support the construction of a drive-in theater in Nantucket, Massachusetts, and sports fields in Winter Park, Florida. JetReady failed to use any of the PPP funds for payroll or to bring back furloughed employees, as contemplated by the program. Consistent with the FCA's treble damages provision, the \$287,055 settlement amount appears to represent just shy of three times the amount that Mr. Bernstein allegedly misappropriated.

Importantly, the whistleblower was a company accountant (assistant controller), and thus was in a unique position to trace the PPP funds. Further, the company account into which the PPP funds were transferred had a negative account balance prior to the transfer, meaning any expenditure made from that account was surely paid for with PPP funds. The government may decline to prosecute cases where it is unable to adequately trace funds, or if the borrower is able to show that it spent the PPP funds on approved expenses and/or would have made the challenged expenditure regardless of receiving the PPP loan.

Implications for PPP beneficiaries

*The government has announced four FCA settlements involving the PPP to date,² but the Bernstein settlement is the first to arise out of a *qui tam* action*

The FCA permits private citizens to sue on behalf of the United States to recover public funds allegedly obtained through fraud. The government investigates the allegations as the complaint remains under seal and, eventually, elects whether to intervene or decline. Even if the government declines, the "relator" may continue to prosecute the case on the government's

¹ *United States ex rel. Hablitzel v. All in Jets, LLC et al.*, No. 20-cv-61420 (S.D. Fla.).

² See DOJ releases: [August 26, 2021](#); [June 2, 2021](#); [April 21, 2021](#); and [January 12, 2021](#).

behalf subject to certain restrictions. In either event, the relator may receive up to 30 percent of any recovery.

That powerful financial incentive—combined with the government’s indication that it will focus the majority of its investigative resources on [PPP loans over \\$2 million](#)—means that most PPP beneficiaries are more vulnerable to scrutiny catalyzed by former employees than by the government itself.

That was the case with the Bernstein settlement. Although Bernstein fell into the \$2 million-or-less “safe harbor,” he faced an extensive DOJ investigation because of a *qui tam* action by JetReady’s former assistant controller, Hablitzel, who was laid off along with numerous other JetReady employees after the initial coronavirus outbreak in March 2020.

The pandemic, of course, caused many similar layoffs, and it is likely that at least some disgruntled former employees became whistleblowers. Furthermore, even in normal times, whistleblower-initiated FCA investigations exceed government-initiated investigations by a factor of approximately 4 to 1. The key take away is that even borrowers who acted in “good faith” or fall within a safe harbor may still face government investigation relating to their PPP loans.

The Bernstein settlement portends what is likely to be a flood of similar qui tam actions involving PPP loans that are about to come out from under seal

The FCA gives the government 60 days to investigate a *qui tam* complaint while it remains under seal. In nearly every case, however, the government receives at least one (and often several) court-ordered extension. Many FCA investigations take several years to complete.

The timeline of the Bernstein settlement provides insight into FCA investigations involving PPP. Mr. Bernstein received a \$1.1 million PPP loan in April 2020. Ms. Hablitzel filed her *qui tam* complaint in July 2020. And the government moved to unseal the complaint “for settlement purposes” in August 2021. In other words, the government investigated for approximately one year.

Extrapolating that timeline, lenders began disbursing PPP loans in spring 2020. Whistleblowers likely began filing *qui tam* actions involving those loans in spring and summer 2020. And if the government takes approximately one year to investigate those cases, a flood of *qui tam* actions should be emerging from under seal in the coming months.

Settlements of those actions, or interventions followed by government complaints in intervention, will provide significant insight into theories of FCA liability involving the PPP. They may also inspire other would-be relators to file additional *qui tam* actions.

The Bernstein settlement reflects the government's efforts to secure FCA claims involving PPP debt in bankruptcy

Finally, the Bernstein settlement is significant because it reflects the methods that the government will use to protect FCA claims involving PPP loans in bankruptcy proceedings.³

In the Bernstein settlement, the government required Bernstein to acknowledge that if his obligations under the agreement were avoided for any reason, including bankruptcy, the United States would rescind the FCA release and file a civil action to recover significantly more than the settlement amount. To protect that ability, the government required Bernstein to agree that "the United States has an undisputed, noncontingent, and liquidated allowed claim against Bernstein," and "[a]ny proceeding that the government initiates to collect the FCA settlement is not subject to an automatic stay" under the Bankruptcy Code.

Though historically (since enactment of the Bankruptcy Code in 1978) virtually all corporate debt has been fully dischargeable in a Chapter 11 reorganization, Congress enacted certain exceptions in 2005. It changed the corporate reorganization discharge statute to exclude from discharge certain fraud-related debt owed to a "domestic governmental unit," or a debt owed to an individual who brought suit under the FCA or similar state statute. *United States ex rel. Minge v. Hawker Beechcraft Corp. (In re Hawker Beechcraft, Inc.)*, 515 B.R. 416, 431 (S.D.N.Y. 2014).

Thus, an FCA claim, if proven through trial or admissions in a settlement agreement, can be excepted from the bankruptcy discharge. See *United States v. Spicer*, 155 B.R. 795 (Bankr. D.D.C. 1993), *aff'd* 57 F.3d 1152 (D.C. Cir. 1995). And typically, DOJ takes the position that FCA liability constitutes a debt that is not dischargeable, and that takes priority over most competing claims.

What's next?

Whistleblowers likely constitute the most significant threat to small PPP beneficiaries, and their allegations have just begun to surface. Any PPP beneficiary that receives an FCA civil investigative demand or similar information request from the government should assume the existence of a *qui tam* action and consult counsel with knowledge of the pandemic relief program at issue, DOJ's and its Civil Fraud Section,⁴ and the nuances of the FCA.

³ In August 2020, JetReady filed a petition for bankruptcy relief under Chapter 11 captioned *In re All in Jets, LLC*, No. 20-bk-11831 (Bankr. E.D.N.Y.).

⁴ Indeed, the Bernstein settlement is also notable because Habitzel filed her *qui tam* complaint in the Southern District of Florida, but the investigation appears to have been coordinated by the Civil Fraud Section in Washington, DC. Typically, "Main Justice" delegates FCA cases worth \$10 million or less to the appropriate United States Attorney's Office. Thus, the Civil Fraud Section's joint handling of a matter worth, at most, three times the PPP loan amount (~\$3.5 million), is significant. It suggests that, consistent with the Civil Fraud Section's approach to FCA investigations involving the 2008 Troubled Asset Relief Program, the office will quarterback the national effort to recover allegedly misappropriated PPP loan proceeds. That effort will also be supported by numerous federal agencies and a new "COVID-19 Fraud Enforcement Task Force" and hotline operated by DOJ's National Center for Disaster Fraud. DOJ highlighted the task force and hotline in the Bernstein settlement press release.

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