

SEC Enforcement Investigating Potential Federal Securities Law Violations by PPP Borrowers

May 21, 2020

It's not just the Justice Department that's looking into PPP loans – although there appears to be plenty of that going on – the SEC's Division of Enforcement is also conducting an investigation into certain PPP loan recipients to determine whether there have been violations of the federal securities laws. To that end, SEC's Division of Enforcement is conducting a fact-finding inquiry, requesting that certain PPP loan recipients produce a variety of documents. While the primary focus of DOJ prosecutors appears to be whether representations made in certifications to the SBA to obtain the PPP loans were fraudulent, the SEC is apparently looking at PPP loans and related company disclosures from a different angle.

You might recall that, under the PPP, to be eligible for a loan, a borrower had to certify that “urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” [FAQs](#) from the SBA indicated that borrowers were required to make this certification in good faith, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that was not significantly detrimental to the business. However, the FAQs also made clear that public companies that applied for PPP loans would be under special scrutiny. For example, according to the FAQs, “it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.” The FAQs ultimately provided safe harbors for loans that were repaid in full by May 18, as well as loans under \$2 million. Loans over that amount would be subject to SBA review and evaluated “based on their individual circumstances in light of the language of the certification and SBA guidance.” According to the FAQs, if the SBA determines “that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request. SBA's determination concerning the certification regarding the necessity of the loan request will not affect SBA's loan guarantee.” (See “[SBA Provides “Safe Harbor” for PPP Loans Under \\$2 Million.](#)”)

Sidebar

Early Justice Department actions appear to have focused primarily on potential fraud in obtaining PPP loans. Treasury Secretary Steven Mnuchin has [warned](#) that companies that received PPP loans “could be subject to investigation” if it turns out they could not make their certifications of necessity in good faith, even suggesting, as reported in the [Washington Post](#), that “I want to be very clear it's the borrowers who have criminal liability if they made this certification and it's not true... We will make sure that what was the intent for taxpayers is fulfilled here.” In early May, as reported in the [WSJ](#), the DOJ charged two men with fraudulently attempting to obtain over \$500,000 in PPP loans, after they claimed “to have dozens of employees...when in fact they had no workers,” and a number of their entities were not even open prior to the pandemic. According to the WSJ, the investigation was part of a broad search for fraud in the program, using data analytics to look for “red flags in loan applications and other documents submitted” to governmental agencies. A government affidavit submitted in the case noted that the investigation was aided when a complaining witness brought information about the case to the local police. The DOJ has made enforcement of fraud in connection with the CARES Act a priority. (See “[What You Need to Know About Potential Exposure if You've Gotten a CARES Act Loan.](#)”) And [Reuters](#) is reporting that the DOJ has sent grand jury subpoenas to several banks seeking records as part of a broader investigation into potential abuse of the PPP by borrowers.

SEC's Division of Enforcement, with its mission emphasizing the investigation of potential violations of the federal securities laws, appears to be looking at the representations in the certifications, as well as analyses, projections and other information, for a different purpose – the adequacy of companies' prior disclosures. Its inquiry is seeking information about companies' qualifications for PPP loans, their demonstrations of necessity for PPP loans to support their ongoing operations, the timing and extent of any going-concern assessments and the financial effect of COVID-19 and related remedial measures on the companies' business operations and obligations. The SEC is also interested in

any considerations of return of PPP loans. Presumably, SEC's Division of Enforcement is examining whether, in light of representations made in the PPP certifications and any underlying analyses performed to demonstrate the validity of those representations, companies were timely and complete in their disclosures to the public regarding their financial condition. While the SEC investigation is framed as a voluntary request pursuant to an "informal" inquiry, it's worth keeping in mind that the SEC routinely shares information with the Justice Department when it believes a criminal investigation may be warranted.

Sidebar

A House oversight subcommittee has [announced](#) that it has sent letters to public companies that met certain criteria demanding that they return the PPP funds. (See "[House Select Subcommittee Announces First Public Investigations Involving CARES Act.](#)") In many cases, the letters also highlighted statements in each company's own SEC filings, press releases or other communications touting its leadership position in the industry, implicitly raising the question of whether there might be inconsistencies between the company's public statements and its certification that the PPP loan funds were necessary. (See "[House Subcommittee Insists Certain Public Companies Return PPP Loans.](#)")

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