GIBSON DUNN

Private Equity Firms and PPP Fraud Liability Under the False Claims Act

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The U.S. Department of Justice's increased focus on the private equity sector in recent years has coincided with that sector's growing investment in the highly regulated healthcare and life sciences industries. That increased focus has been further fueled by the CARES Act and its Paycheck Protection Program, which was in operation from April 2020 through May 31, 2021. In March 2021, the DOJ announced new enforcement priorities focusing on CARES Act fraud. Chief among the potential targets are private equity-backed companies. While private equity firms were ineligible for PPP loans, their portfolio companies may have been eligible, and it is likely that prosecutors and private plaintiffs will seek to hold private equity firms liable under the False Claims Act for a portfolio company's actions with respect to PPP.

The Small Business Administration released data on the companies that received PPP loans and analysis of this data revealed that over 8,100 privately backed companies were approved for PPP loans of $150,000 or more. Of these, 2,528 were private equity-backed companies. Under the CARES Act, businesses were eligible to receive PPP loans issued by private lenders and credit unions but backed by the SBA. PPP loans were to be used for select purposes including: funding payroll and benefits paying mortgage interest, rent, or utilities; and other worker protection costs related to COVID-19. In April 2020, due to confusion about private equity firms' eligibility for the loans, the SBA issued an interim final rule stating that private equity firms were ineligible for PPP loans.

Portfolio companies, however, would continue to qualify for the loans if they met special size requirements under the SBA's affiliation rules. The affiliation analysis under the SBA's rules involves six different bases for affiliation, including ownership, stock options, control, management, identity of interest, and the existence of franchise and license agreements. While this is a fact-specific analysis, for the purposes of the PPP, a private equity firm was likely to be considered an "affiliate" of a portfolio company, and portfolio companies controlled by the same private equity firm were likely to be "affiliates" of each other. Under the rules, if the aggregate number of employees at the borrower and its affiliates exceeded a certain size, the borrower was ineligible for PPP loans. In addition, upon application, borrowers were required to certify in good faith that the loan was necessary, that they satisfied the affiliation rules for size and eligibility, and that they agreed to use the funds appropriately. If these certification requirements are determined to have not been met, the SBA will seek immediate repayment of the loan.

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's False Claims Act or Private Equity groups, or the authors in San Francisco:

Winston Y. Chan (+1 415-393-8362, wchan@gibsondunn.com)

Related People

Winston Y. Chan

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Trisha Parikh (+1 415-393-8314, tparikh@gibsondunn.com)

Please also feel free to contact the following practice leaders and members:

Private Equity Group:
Richard J. Birns – New York (+1 212-351-4032, rbirns@gibsondunn.com)
Scott Jalowayski – Hong Kong (+852 2214 3727, sjalowayski@gibsondunn.com)
Ari Lanin – Los Angeles (+1 310-552-8581, alanin@gibsondunn.com)

False Claims Act/Qui Tam Defense Group:

San Francisco
Winston Y. Chan – Co-Chair (+1 415-393-8362, wchan@gibsondunn.com)
Charles J. Stevens (+1 415-393-8391, cstevens@gibsondunn.com)

Washington, D.C.
Jonathan M. Phillips – Co-Chair (+1 202-887-3546, jphillips@gibsondunn.com),
F. Joseph Warin (+1 202-887-3609, fwarin@gibsondunn.com)
Joseph D. West (+1 202-955-8658, jwest@gibsondunn.com)
Robert K. Hur (+1 202-887-3674, rhur@gibsondunn.com)
Geoffrey M. Sigler (+1 202-887-3752, gsigler@gibsondunn.com)

New York
Reed Brodsky (+1 212-351-5334, rbrodsky@gibsondunn.com)
Mylan Denerstein (+1 212-351-3850, mdenerstein@gibsondunn.com)
Alexander H. Southwell (+1 212-351-3981, asouthwell@gibsondunn.com)
Casey Kyung-Se Lee (+1 212-351-2419, clee@gibsondunn.com)

Denver
Robert C. Blume (+1 303-298-5758, rblume@gibsondunn.com)
Monica K. Loseman (+1 303-298-5784, mloseman@gibsondunn.com)
John D.W. Partridge (+1 303-298-5931, jpartridge@gibsondunn.com)
Ryan T. Bergsieker (+1 303-298-5774, rbergsieker@gibsondunn.com)

Dallas
Robert C. Walters (+1 214-698-3114, rwalters@gibsondunn.com)
Andrew LeGrand (+1 214-698-3405, alegrand@gibsondunn.com)

Los Angeles
Nicola T. Hanna (+1 213-229-7269, nhanna@gibsondunn.com)
Timothy J. Hatch (+1 213-229-7368, thatch@gibsondunn.com)
Deborah L. Stein (+1 213-229-7164, dstein@gibsondunn.com)
James L. Zelenay Jr. (+1 213-229-7449, jzelenay@gibsondunn.com)

Palo Alto
Benjamin Wagner (+1 650-849-5395, bwagner@gibsondunn.com)

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