Déjà-vu All Over Again: Government Enforcement in Response to Economic Crises

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With the dust from enforcement actions stemming from the post-2008 recession beginning to settle, COVID-19 ("Coronavirus") has thrust the world into an uncertain economic future. Companies must confront the obvious public health implications of COVID-19, as well as pandemic-induced shocks to supply chains, demand conditions, and business operations. Many will debate the similarities and differences between 2008 and 2020, but one similarity is apparent and inescapable: a crisis requiring trillions of dollars of government stimulus invites significant regulatory oversight and enforcement scrutiny. This oversight and scrutiny will look not only for the causes of the crisis, but also reactions thereto, by both public and private actors. Company actions, including those viewed as necessary to respond to the crisis, will be evaluated by government investigators in hindsight with a rearview mirror after the crisis has subsided and in the light of subsequent events and perceived consequences not known at the time of the crisis. If the past is prologue, the following areas will draw the most governmental interest and may require extra diligence.

1. False Claims Act Investigations

The False Claims Act ("FCA"), 31 U.S.C. §§ 3729-3733, prohibits false statements or misrepresentations to the government in connection with billing, contracting, or procurement. It provides for civil penalties and treble damages when the party submitting the claim knew, or should have known, the statement was false or misleading. It also applies to "any person" who "causes" a false claim, including companies, funds, or individuals who exercise control over the funds or are involved with submitting the false statement. Attorney General William Barr recently stated that the "Department of Justice [will] remain vigilant in detecting, investigating, and prosecuting wrongdoing related to the crisis," including vigorous investigation and prosecution of FCA claims.

FCA violations can take a variety of forms, but largely fall into three broad categories as a result of COVID-19. The first group includes applicants for relief under the Coronavirus Aid, Relief, and Economic Security ("CARES") Act. Applicants are required to make several representations and certifications during the application process, including about eligibility for funds, necessity and use of proceeds, presence or absence of conflicts, compliance with conditions or use of funds, and other representations and covenants. Any person responsible for the funds or involved with the submission of false statements is subject to investigation and possible lawsuit for penalties and damages. The second group comprises banks or other lenders distributing the CARES Act relief. Although the Act provides certain protections, including allowing lenders to rely on certifications by borrowers, lenders likely will face questions about whether their reliance was reasonable and whether they knew or
should have known that certain borrowers did not meet the qualifications for relief. Lenders also may face questions about whether they favored existing clients with outstanding loans over other clients or new applicants, raising questions about conflicts of interest. A third group includes firms enlisted by the government to provide services for combatting the virus or assistance with the economic recovery, including, for example, urgent needs for pharmaceutical therapies or medical supplies. These companies also can anticipate questions and audits as the urgency of the response fades from collective memory. False claims relating to government services typically include billing for services not rendered or goods not delivered, overcharges billed to a federal government agency, or other misstatements about the character and performance of the goods and services provided.

The FCA is not only a civil statute, authorizing the DOJ to pursue civil money penalties and treble damages, but it is also a criminal statute that imposes potentially significant prison terms and criminal fines. Criminal penalties can include significant fines and suspension from government contracting or even debarment. Additionally, federal contractors face disclosure obligations if they become aware of credible evidence of a violation. In the 2019 fiscal year, the federal government recovered over $3 billion in settlements and judgments related to FCA violations, about $2.6 billion of which related to health care. Moreover, Inspectors General (“IGs”) at various agencies, including the Small Business Administration and the banking regulators, for example, will be reviewing the CARES Act and other programs for compliance; many IGs routinely involve local U.S. Attorney’s offices in their investigations. Several congressional committees in both the House and the Senate will exercise their oversight responsibilities to investigate and hold hearings on the COVID-19 response and recovery.

2. Antitrust Investigations

In times of crisis, we often band together and seek cooperative approaches to problem-solving, many of which may be pro-competitive. Despite the pandemic emergency, U.S. antitrust law continues to apply, and authorities are monitoring industries to detect indications of collusive behavior. The DOJ recently warned the business community of its intent to focus on public health products during the Coronavirus emergency. “Individuals or companies that fix prices or rig bids for personal health protection equipment such as sterile gloves and face masks could face criminal prosecution,” while “[c]ompetitors who agree to allocate among themselves consumers of public health products could also be prosecuted.”

**Legitimate competitor collaboration may raise questions of anticompetitive conduct.** While there is much work that competitors can do together that is lawful—research and development toward a vaccine or therapy, for example—cooperation among competitors is subject to antitrust scrutiny and may be viewed differently after-the-fact. In a Joint Federal Trade Commission (“FTC”)–DOJ Statement, the federal antitrust regulators made clear that “there are many ways firms, including competitors, can engage in procompetitive collaboration that does not violate the antitrust laws,” but emphasized their commitment to be vigilant and scrutinize such activity to ensure compliance with those laws. Joint ventures or other collaborations thus are best undertaken with proper legal structures and prior assistance of counsel to avoid perceptions of legitimate efforts as problematic or misinterpreted. Public statements about those efforts will be the subject of particular review and may require additional due diligence prior to issuance.
Reactions to volatile demand may raise questions about price fixing or bid rigging. As demand conditions experience significant volatility, sales employees facing pressure to meet targets have greater incentives to participate in price fixing or bid rigging. Moreover, even where there may not be explicit wrongdoing, parallel actions may be viewed with suspicion and result in antitrust investigations. One illustrative example involved the air cargo industry’s response to the Iraq War and resulting spikes in fuel prices. In reaction to this sudden volatility, the air cargo companies adopted fuel and war surcharges to cover increased costs associated with avoiding the combat theatre. Parallel pricing and similar announcements led to costly criminal antitrust investigations of industry coordination of those surcharges, which lasted several years. Late last year, a former executive at a large European air cargo company was extradited and arraigned in Georgia almost ten years after the investigation began and well after her employer settled its liability. Another area of focus is procurement by government agencies at the federal, state, and local levels. Training and detection efforts undertaken by the Procurement Collusion Strike Force, the interagency partnership that includes staff from the DOJ Antitrust Division, U.S. Attorneys’ offices, and others, have raised awareness among procurement officials at all levels of government about indicia of bid rigging, fraud, and related crimes. Signaling also has been an area of focus. Companies may draw scrutiny for public announcements they make about competitive information, such as output or capacity. The DOJ and FTC have treated certain types of signaling as invitations to collude, punishable under Section 1 of the Sherman Act, 15 U.S.C. § 1, and Section 5 of the FTC Act, 15 U.S.C. § 45.

Companies with a strong position may face heightened scrutiny. Companies with a strong market position in their sector can anticipate increased scrutiny from their critics, including competitors. Already, politicians and others are expressing substantial concern about whether large companies will increase their positions during the COVID-19 crisis, resulting in permanent harm to the economy. While it remains lawful in the United States for a company to acquire monopoly power through superior skill or expertise, a company can face investigation, liability, and treble damages for conduct thereafter that tends to exclude (or may be perceived as excluding) competition. Such conduct can include, but is not limited to, business tactics that foreclose rivals from access to customers or industrial sabotage of rivals. Recently, the DOJ has focused in particular on improper use of “no poach” contracts as a means to tie up expertise and limit competition. Although federal enforcement of monopolization has been less frequent, state enforcers and private parties may bring actions as well. In particular, private companies forced into bankruptcy in the aftermath of COVID-19 may have a heightened incentive to bring claims of monopolization against their larger rivals.

Supply shocks will give rise to questions about price. As families hurried to prepare for self-quarantining and shelter-in-place orders, bulk purchasing depleted store shelves and quickly exhausted supplies readily available online. In a now-widely reported story, two Tennessee brothers purchased 17,000 bottles of hand sanitizer for later sale online. The online marketplace detected postings for sale of bottles between $8 and $70 and pulled them down. After news outlets reported the plan and criticism followed, the men donated the supply. It then was reported that the Tennessee Attorney General had opened an investigation of the incident. Reports indicate that the DOJ has opened similar criminal investigations into third-party sellers on online marketplaces. Repeated incidents also may raise questions about similar suppliers on similar marketplaces and the monitoring of those suppliers. Conduct may be analyzed under fraud statutes and many state laws that can reach such conduct. Additionally, the Department of Health and Human Services (“HHS”) designated certain medical supplies as subject to the anti-hoarding restrictions within the Defense Production Act of 1950. Those supplies were designated to "prevent[] accumulation in excess of reasonable demands of business, personal, or home consumption, or for the purpose of resale at prices in excess
of prevailing market prices.” Willful violation of the Defense Production Act is punishable by up to one year in prison and a $10,000 fine. Beyond penalties or settlements, companies facing price gouging investigations incur costs and scrutiny that can harm their reputation.

3. Securities and Commodities Law Investigations

Times of crisis and volatility also tend to engender closer scrutiny of securities and commodities markets and their participants, as the Securities and Exchange Commission (“SEC”) and Commodity Futures Trading Commission (“CFTC”) seek to ferret out fraudulent or manipulative activity, or activity that could be perceived as such.

Fraud and manipulation. In the midst of the 2008 financial crisis, a number of London Interbank Offered Rate (“LIBOR”) contributor panel banks allegedly made inaccurate rate submissions in attempts to make themselves look better and more financially sound, to counter concerns about credit, and in some instances to benefit their traders’ positions. International investigations by regulators across the globe ensued, resulting in numerous prosecutions, massive fines, and a slew of private litigation. In the midst of the Coronavirus pandemic, actions by traders in an illiquid or constrained market may be questioned in hindsight, particularly if they exacerbate the constraints or are perceived as benefiting disproportionately from illiquidity by, for example, engaging in aggressive pricing behavior, driving a hard bargain and requiring counterparties to pay higher prices, or engaging in conduct viewed by regulators as inconsistent with legitimate price formation. More than a few SEC and CFTC investigations have been initiated by counterparties who feel abused in such situations.

Likewise, the asset-backed securities (“ABS”) market, and likely the home and auto loan markets as well, may face close scrutiny, as large numbers of borrowers find themselves unable to pay in the midst of job losses and furloughs—just as the residential mortgage markets, and in particular, the subprime and alternative loan markets, underwent lengthy investigations, enforcement actions, and private lawsuits in the wake of the 2008 financial crisis, following a period of allegedly “poor underwriting, irrationally exuberant investing, and weak regulatory controls.” The extensive use of securitizations in these sectors is sure to draw the attention of the SEC.

In periods of volatility and market unrest, even legitimate activity may lead to questions from regulators. Legitimate trading behavior, such as an aggressive trading strategy or approach to the market, runs the risk of misinterpretation in times of crisis, leading to expensive investigations, even if no enforcement actions subsequently occur. Withholding a product from the market in an attempt to get a better price also may lead to questions from regulators about intent and market disruptions, and potential future investigations. As in the case of antitrust investigations, behavior often is viewed in hindsight, and as such, market participants should ensure that they have sufficient compliance and oversight in place—particularly in the midst of largely, if not entirely, remote working environments—to ensure accurate disclosures and legitimate, market-based approaches to illiquid or constrained markets.

Material Nonpublic Information (“MNPI”) and Insider Trading. Insider trading also poses significant risks. As we previously reported, the SEC has highlighted concerns about increasing incentives to trade on MNPI, as larger numbers of people may have access to MNPI in the current environment, which may be even more valuable than under normal circumstances. However, in some instances, companies and their employees may receive—and legitimately may be entitled to receive—MNPI from affiliates or competitors, often through affiliates or contractual relationships, such as supply contracts. How this MNPI is handled and utilized is key. Just because a company or employee may
legitimately possess MNPI does not grant that company or employee carte blanche to utilize that information. Rather, the use of the MNPI generally will be limited by contract (that is, its use generally will be limited to furthering the purposes of the contract) or circumstances surrounding the relationship, such that the company and its employees may not be able to utilize that information for other purposes. Improper use of MNPI also has been a particular focus of the CFTC. To that end, it is imperative that SEC and CFTC registrants and other participants in the securities and commodities markets understand the extent of appropriate uses of MNPI, ensure the integrity of their compliance systems, and take steps to maintain the confidentiality and limit dissemination of MNPI.

**Disclosures.** As we have previously reported, the SEC in particular will likely scrutinize disclosures made during the Coronavirus pandemic, to ensure that they timely and accurately disclose material risks and impacts of the Coronavirus on business operations. In fact, investor lawsuits stemming from the Coronavirus already have commenced, with cruise lines in particular facing allegations that they lied about the impact of the Coronavirus. Regulatory investigations are likely to follow. Accordingly, public companies should ensure that their disclosures are accurate, substantiated, timely, and realistically address COVID-19 impacts, and that sufficient oversight exists to curtail any perception, in hindsight, that the disclosures were too favorable and misleadingly painted the outlook for a company.

In sum, in the midst of such an uncertain environment, participants in the securities and commodities markets should take steps to ensure that they have appropriate systems in place to monitor trading and other activity remotely. Although the SEC and CFTC have relaxed certain regulatory requirements in light of the Coronavirus, market participants nonetheless are expected to continue to abide by their respective antifraud and anti-manipulation regulations to ensure maintenance of market integrity. If the 2008 financial crisis is any indication, these and other regulators will be on the lookout for and aggressively pursue what they perceive as misbehavior, even if the conduct is at bottom legitimate.

4. **Whistleblowers**

Many investigations arise from whistleblowers. Accordingly, how a company treats its employees during a crisis may reduce or greatly increase the risk of whistleblowing. Both the SEC and CFTC have granted whistleblower awards for millions—and in some instances tens of millions—of dollars, to incentivize individuals to come forward and provide the agencies with information. The FCA, too, has a robust whistleblower provision. Accordingly, if individual employees witness or participate in questionable conduct, do not believe they are being treated fairly, or believe that their complaints or concerns are falling on deaf ears, they may be incentivized to turn to regulators for assistance. To that end, notwithstanding the largely remote working environments most companies are utilizing today, companies should take care to remain connected to their employees, keep lines of communication open, and maintain robust lines of supervision and reporting.

**Conclusion**

The COVID-19 pandemic creates significant uncertainty to companies and their employees. In the face of such uncertainty, companies can avoid larger risks by redoubling their compliance efforts and reminding employees to remain vigilant in their compliance with laws and regulations.
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1 Special thanks to Paul Hastings Associate Kathryn Harris for her assistance.
7 Id.
14 For further details regarding the government’s enforcement against hoarding and price gouging in the midst of the Coronavirus crisis, please see our earlier writing on this subject, available here.
15 Jonathan C. Lipson, Securitization and Social Distance, 37 REV. BANKING & FIN. L. 827, 828 (2018). For further guidance regarding mitigation of fraud risks for lenders during the Coronavirus crisis, please see our earlier writing on this subject, available here.
16 For further details on the SEC’s guidance on disclosures in the wake of the Coronavirus and related relief measures the SEC has undertaken, please see our earlier writings, available here, here, here, and here.
17 For our earlier analyses of certain significant SEC and CFTC whistleblower initiatives, please see our earlier writings, available here and here.

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