

BORROWER BEWARE: PREPARE NOW TO DEFEND YOUR COMPANY'S PAYCHECK PROTECTION PROGRAM (PPP) LOAN FROM SBA REVIEW OR A POSSIBLE FALSE CLAIMS ACT OR CRIMINAL INVESTIGATION

Hodgson Russ COVID-19 Litigation & Employment Action Team Alert
June 15, 2020

When the Coronavirus Aid, Relief, and Economic Security Act (CARES) was adopted on March 27, 2020, businesses welcomed the prospect of receiving COVID-19 financial relief through the Paycheck Protection Program (PPP). The PPP was layered atop the SBA's existing Section 7(a) loan program, through which the federal government guarantees loans issued by qualified lenders to eligible business borrowers. The PPP program temporarily relaxed several criteria for obtaining an SBA loan, greatly expanding the availability of the lending program to a wider range of businesses. While clearly broader, the criteria for eligibility and the implications of the "necessity" certification weren't quite so clearly defined, and left open many unanswered questions. But the prospect of "free money" by way of loan "forgiveness" induced countless businesses to submit loan applications at the earliest opportunity, beginning in early April 2020, despite the uncertainties.

Uncertain Eligibility and the SBA's Changing Criteria and Guidance

It wasn't long before the SBA began issuing interpretive guidance by way of publishing interim rules and Frequently Asked Questions (FAQ). Changes were made to eligibility requirements, the good faith and necessity certifications were tightened, and the consequences made more apparent to borrowers if they are later found to have been ineligible for the loan or the certification found to have been made in bad faith. Among other things, the SBA began receiving criticism for flip-flopping on its guidance, vacillating on the interpretation of eligibility requirements (e.g., inclusion or exclusion of foreign employees in the 500-employee limit; common control and corporate affiliation tests; the availability of short-term liquidity to businesses; etc.), and changing the rules after applications were submitted or even funded. Moreover, while the possibility of loan forgiveness (*i.e.* "free money") was the PPP's most appealing quality, some of the "fine print" terms applicable to eligibility and forgiveness are obtuse and guidance is still being drafted after the fact.

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PPP Loan Forgiveness is Subject to SBA Review and Scrutiny

As an initial matter, to obtain forgiveness of the loan, the borrower must file a forgiveness application with its lender (see our alert on this form here) and establish that it met both the eligibility criteria for the loan and the requirements and conditions for forgiveness, including use of the proceeds for allowable purposes and within the applicable covered period. But what seems like a simple process to obtain forgiveness is subject to a multi-tiered review, with a number of federal agencies having jurisdiction and the political will to scrutinize borrowers' statements, certifications, and use of the PPP funds.

The SBA issued an Interim Final Rule (13 C.F.R. Part 120) on May 22, 2020 to address the process for reviewing and auditing the loans and loan forgiveness applications. Lenders collect and perform an initial review of the forgiveness application and may approve it, deny it, or deny it without prejudice pending referral to the SBA for review. The SBA also has independent discretion to review all PPP loans, not just those in excess of \$2 million, whether referred by the lender or not. And in the course of such a review, the SBA is empowered under 15 U.S.C. § 634(b)(11) to "administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, and documents which are relevant to the inquiry." In effect, the SBA may conduct a litigation-style hearing and adjudicate the borrower's entitlement to forgiveness. Per the May 22 Interim Final Rule, the SBA will review borrower representations and statements in three main areas: (1) borrower eligibility; (2) loan amounts and use of proceeds; and (3) loan forgiveness amount. Importantly, the SBA's May 22 Interim Final Rule states that it may undertake such a review "at any time," that the borrower must retain PPP documentation for six years after the loan is forgiven or paid in full, and that the borrower must allow access to information bearing on the loan upon request. This implies that an SBA review may be conducted years after a loan is applied for, forgiven, or even paid in full, when COVID-19 is hopefully a distant, unpleasant memory.

False Borrower Certifications Can Lead to False Claims Act Penalties and Criminal Liability

Some borrowers may take comfort in the SBA's FAQ #46 (released on May 13), which provides that if the SBA determines that the borrower did not have an adequate basis for the necessity certification, and the borrower then repays the loan, the SBA will not pursue administrative enforcement or referrals to other agencies (like the Department of Justice or DOJ) based on its determination on the necessity certification. But the DOJ – and private whistleblowers who are incentivized to find instances of fraud – are not bound by the SBA's determination and either can bring a False Claims Act action against a borrower for the making of false statements or certifications in connection with the PPP. The False Claims Act, 31 U.S.C. § 3729 *et seq.*, is a civil fraud statute that allows the government to collect *three times the amount of damages sustained* and a per claim penalty for each false claim presented to the government for payment or approval. Notably, the False Claims Act does not require an "intent to defraud" on the part of the borrower for liability; acting in "reckless disregard" of the truth or falsity of the information is sufficient. And a private individual (*i.e.*, a whistleblower) may pursue an action on behalf of the government under the False Claims Act and obtain a portion of the recovery.

There are also a number of criminal statutes that can apply to the making of false statements to the government; 18 U.S.C. § 1001 is commonly used by prosecutors, targeting those who (among other things) knowingly and willfully falsify or conceal a material fact within the jurisdiction of the executive branch of the government. Penalties include imprisonment

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of up to 5 years.

It is clear that the DOJ is actively investigating. According to a Bloomberg interview with Assistant Attorney General Brian Benczkowski, the DOJ is in the process of contacting some of the largest loan processors, as well as the SBA, and has identified “red flags” in *both approved and rejected applications*. Charges have already been brought in certain egregious cases, including against an individual accused of filing bank loan applications fraudulently seeking more than \$5 million in forgivable loans under the CARES Act by claiming that he had over 400 employees when he had none.

Moreover, the CARES Act also created a number of oversight bodies, including the Special Inspector General for Pandemic Recovery (SIGPR). SIGPR is empowered to audit and investigate the financial assistance programs included in the CARES Act and has the authority to issue subpoenas for documents, effect arrests, and execute warrants for the search and seizure of property. SIGPR must also report to the Attorney General when it reasonably believes there has been a violation of federal criminal law. It is too soon to know how broadly or vigorously SIGPR will exercise its authority. But, the similarly-empowered Special Inspector General for the TARP (SIGTARP) was instrumental in working with the DOJ to pursue False Claims Act investigations against financial institutions and individuals relating to Troubled Assets Relief Program (TARP) funds—even for *relatively small damage amounts*—following the Great Recession.

Borrowers Should Take Steps Today to Prepare to Defend their PPP Loan

With all these agencies scrutinizing PPP loans, borrowers should expect vigorous review and audits and, in certain cases, enforcement actions. So what's a borrower to do? Whether in the context of responding to an audit, a grand jury subpoena, or a False Claims Act whistleblower complaint, a borrower's ability to successfully navigate scrutiny may depend heavily on at least three things: (1) having an understanding of the criteria that were applicable at the time the borrower applied for and took the loan, as well as any SBA interim rules, guidance, and amendments to the CARES Act that are deemed retroactively applicable to the loan; (2) the quality of the contemporaneous documentation and evidence available and being generated today to prove that those criteria were satisfied and the funds were used properly; and (3) the retention of that information and ability to explain it in the future during an investigation or hearing.

Contemporaneous analysis and thorough documentation is particularly important in light of the vaguely-defined requirements for eligibility. Take the SBA's FAQ #31 for example, which explains that when borrowers make their good faith necessity certification, they should be “taking into account their current business activity and their ability to access other sources of liquidity to support their ongoing operations in a manner that is not significantly detrimental to the business.” An after-the-fact weighing of these factors may turn out differently from the initial, height-of-the-pandemic response. Borrowers must think critically and strategically *now* about what those factors mean relative to their businesses, and what documents or other evidence they would use to prove up these criteria in the context of an investigation or audit. Borrowers would be wise to invest the time and effort in the present to understand and protect their interests and plan for circumstances that could put their ability to obtain forgiveness of their PPP loan in jeopardy. The more groundwork a borrower lays today, the better prepared it will be to defend itself in a review, audit, or investigation.

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If you have any questions or concerns regarding the terms of your company's PPP loan and what you should do to prepare for any inquiries, please contact Jason Markel (716.848.1395), Ben Zuffranieri (716.848.1469), Reena Dutta (716.848.1626) or any member of our COVID-19 Litigation & Employment Action Team.

Please check our Coronavirus Resource Center and our CARES Act page to access information related to both of these rapidly evolving topics.

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