

BORROWER BEWARE III: THE SBA'S NEW PAYCHECK PROTECTION PROGRAM (PPP) APPEAL PROCESS STACKS THE DECK AGAINST BORROWERS WHO CHALLENGE FORGIVENESS DENIALS

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Over a period of about four months, anxious and worried business owners applied for and took out more than 5.2 million Paycheck Protection Program (PPP) loans—a total of \$525 billion dollars—without knowing the full extent of the terms, conditions and fine print that would ultimately apply to their loans. For many facing COVID-19-pandemic-driven uncertainties, it was a risk they felt compelled to take to protect themselves, their employees, and their businesses. Little did they know the extent to which the PPP rules would continue to be written after the fact, and in some cases, retroactively. Not only did Congress amend the program on June 5, 2020 with the Paycheck Protection Program Flexibility Act, but between April 2 and August 24 the SBA issued 24 Interim Final Rules (IFRs), an eighteen-page FAQ,[1] and a separate eleven-page forgiveness FAQ[2] outlining various clarifications, interpretations, enforcement guidance, and changes to the PPP program. The result is a complicated, mind-spinning assemblage of rules and calculations that may be overwhelming for many borrowers to comprehend and apply. And a borrower's ability to have its loan forgiven remains subject to SBA oversight and hindsight discretionary review for compliance with those PPP eligibility and forgiveness requirements, and perhaps for a much longer period of time than many borrowers realize.

Mandatory Versus Discretionary SBA Reviews/Audits

The SBA's FAQ #39 made clear to borrowers that the SBA intends to review/audit every loan in excess of \$2 million. That's about 30,000 loans, only .6% of the total number of PPP loans, but that group represents 21% of the total PPP dollars loaned.[3] And while the SBA is specifically targeting all the biggest loans for audit, that doesn't mean borrowers who took out smaller loans get a free pass. The SBA has made clear in its rules that that "[f]or a PPP loan of any size, **SBA may undertake a review at any time** in SBA's discretion."^[4] The SBA follows that statement by noting that borrowers are required to retain supporting documentation for six years after a loan is forgiven or repaid in full, and must permit the SBA or Office of the

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Inspector General to access them upon request.[5] So while many borrowers might be assuming that the initial approval of a forgiveness application by the lender, or SBA's issuance of repayment to the lender, closes out the process and forecloses further inquiry, that simply may not be the case. The SBA will soon be facing an avalanche of forgiveness applications with limited resources for conducting a deep dive on all of them in the short term. As a result, the SBA might initially approve repayment of the loan on a cursory review, but come knocking on the door years later. A borrower facing such a situation may find itself in a difficult position defending that loan if it failed to collect and retain documents supportive of its case for eligibility and forgiveness.

Back in May 2020, and as discussed in our June Alert, the SBA issued an IFR stating its reviews will focus on three subjects: (1) borrower eligibility; (2) loan amounts and use of proceeds; and (3) loan forgiveness amounts.[6] Given that loan applications were largely based on borrower certifications with limited underwriting examination on the front end, the SBA's review is tantamount to a post-disbursement underwriting review of loan eligibility long after the borrower has received and spent the money. While errors in calculations or misclassification of expenditures may reduce the amount forgiven, if the SBA determines that the borrower was ineligible for the loan in the first place, the SBA has said that no amount of the loan will be forgiven.[7] And that could have dire consequences for borrowers who have planned and structured their business operations around anticipated forgiveness. Not only will an ineligibility determination necessitate repayment by the borrower, but the non-recourse provision[8] in the statute that shelters shareholders, members, or partners of the borrower from personal liability may no longer afford protection if the borrower defaults on repayment or loan proceeds were used for improper purposes.

The SBA Adopted Appeal Rules After the Loan Application Period Closed

One of the many things the SBA didn't tell borrowers up front is how and to what extent they might appeal adverse decisions on their forgiveness applications. Rather, the SBA simply indicated several times that it intended to issue a separate rule addressing the appeal process at a later time. Just a few days after the loan application period closed on August 8, the SBA issued its twenty-third IFR on August 11, finally releasing the appeal rules.[9] PPP borrowers, of course, did not have the opportunity to evaluate what its appeal rights would be in the face of a forgiveness denial before applying for a PPP loan. And unfortunately for borrowers, the appeal process is structured as an uphill climb. While the published appeal rules may be amended or fine-tuned later, borrowers should take note of the timing, procedural limitations, and burdens of the appeal process and consider whether additional strategizing, planning, or reviewing is warranted before submitting their forgiveness applications.

The Appeal Framework

Upon issuance of a final adverse determination by the SBA, the borrower may file an appeal with the Office of Hearings and Appeals (OHA). The OHA is a pre-existing administrative adjudicatory body that serves as the forum for hearings required by other SBA programs. The SBA, however, has adopted new Rules of Procedure specific to PPP loans, which are to be incorporated into the SBA's regulations at 13 C.F.R. Part 134 as new Subpart L.[10]

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Under those Rules, an Appeal Petition must be filed within 30 days of the earlier of receipt or notification from the lender of the SBA's final decision.[11] The filing of an appeal, however, does not extend the deferral period for repayment of the loan.[12] Repayment must begin and continue during the appeal process. The rules also state that only a borrower has standing to appeal, not the individual owners of the borrower or the lender.[13]

The borrower's Appeal Petition must include required supporting documentation, as itemized in the regulation. Most notably, it must include "A full and specific statement as to why the SBA loan review decision is alleged to be erroneous, together with all supporting factual information and legal arguments." [14] A 30-day period to develop arguments in response to the SBA's reasons, and to collect and supply all supporting documents, will likely prove challenging for borrowers who have not invested time in advance to prepare themselves for a possible fight or vigorously defend the audit.

The Rules of Procedure also provide that the SBA has the right to respond to the borrower's Appeal Petition and raise arguments of its own. Borrowers, however, may not reply to the SBA's response unless a Judge directs otherwise.[15] All appeals will be "decided solely on a review of the written administrative record, the appeal petition, and response(s) filed thereto, any admitted evidence, and an oral hearing, if held." [16] That same Rule provides, however, that "[g]enerally, the Judge may not admit evidence beyond the written administrative record or permit any form of discovery" by the borrower. And there will be no oral hearing unless the Judge deems one necessary to resolve issues of fact.[17] Consequently, it seems likely that most appeals to the OHA will largely be prosecuted on the paper submissions, which places particular importance and significance on the legal and factual arguments set forth in the Appeal Petition as well as the content of the Administrative Record and materials the borrower submitted to the SBA in the review and audit process.

A weak Administrative Record could prove to be a limiting factor to a successful appeal. The Rules of Procedure require the SBA to prepare the Administrative Record, and that record will include only "relevant documents that SBA considered in making its final decision or that were before the SBA at the time of the final decision." [18] The borrower is afforded only limited rights to object to the Administrative Record as prepared by the SBA in situations where the SBA did not include something the borrower believes should have been included from the SBA's loan file, or to voice a privilege concern. And the borrower must make that objection within 10 days following receipt of the Administrative Record.[19] Under the general rules of administrative law applicable to all federal proceedings, it is essential to at least attempt inclusion of all records you may want to rely on in any further appeal. While the borrower could include additional relevant materials with its Appeal Petition, it remains to be seen how much weight or consideration those materials will be given in the appeal process if the borrower did not submit them to the SBA for consideration during the audit. A borrower is likely to face stiff resistance and objections if it tries introducing new materials into the appeal process that the SBA did not have in the Administrative Record. For this reason, if particular information is important to demonstrating eligibility or substantiating forgiveness amounts, borrowers should avail themselves of opportunities to submit such materials at the earliest opportunity, and make their best case to the SBA during the review/audit process.

Winning an appeal, of course, is more than the content of the Administrative Record. The borrower must also satisfy its burden of proof by making sufficiently persuasive arguments that are grounded in the record evidence. Under the PPP rules, the borrower must show "by a preponderance of the evidence" that the SBA's loan review decision "was based on clear error of fact or law." [20] The "clear error" standard ratchets up the burden of proof for a borrower. As a *sui generis* program rushed

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into law, borrowers have neither the benefit of detailed legislative history nor prior decisional precedent as a guide for interpreting provisions of the PPP. So establishing a clear error of law is likely to be challenging in the absence of a blatant violation of the statute, a regulation, or an IFR. And meeting the “clear error” burden on a factual issue could similarly prove to be a particularly high hurdle on a weak Administrative Record or a poorly framed Appeal Petition.

THE TAKEAWAY

Like the PPP loans themselves, the SBA’s appeal process is riddled with uncertainties. Shifting political headwinds could further shape how the process evolves. Two things, however, are clear. First, the appeal process places the burden squarely on the borrower to prove that the SBA made a “clear error” in denying forgiveness. Second, in the event of an SBA review or audit, borrowers should endeavor to make their best case directly to the SBA in the first instance, and recognize that a forgiveness denial may not be easy to overturn on an administrative appeal. During an SBA review, it will be important for borrowers to respond to SBA inquiries by timely furnishing complete and comprehensive information substantiating eligibility and entitlement to forgiveness. These materials would then become part of the Administrative Record upon which the borrower would rely on an administrative appeal, if necessary. Remember, the appeal rules significantly constrain the introduction of new materials by the borrower that the SBA did not have before it. So if some document or other piece of information is critical to the borrower’s arguments, proof of eligibility, or entitlement to forgiveness, the borrower needs to ensure that such materials are provided to the SBA during the review and audit process, *even if the SBA hasn’t asked for it*. In the face of a denial of forgiveness, the potential for success on appeal may depend on having those critical documents in the Administrative Record.

If you have questions about the PPP or how you can implement strategies to better protect your business from SBA review or other government scrutiny, please contact Jason Markel (716.848.1395), Reetuparna Dutta (716.848.1626), or Benjamin Zuffranieri (716.848.1469).

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

If you received this alert from a third party or from visiting our website, and would like to be added to any of our mailing lists, please visit us **HERE**.

[1] <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>

[2] <https://home.treasury.gov/system/files/136/PPP--Loan-Forgiveness-FAQs.pdf>

[3] <https://home.treasury.gov/system/files/136/SBA-Paycheck-Protection-Program-Loan-Report-Round2.pdf>

[4] 85 Fed. Reg. 33014 (emphasis added).

[5] The document retention requirement is also stated on the last page of instructions to the June 16, 2020 forgiveness application form. See, https://home.treasury.gov/system/files/136/PPP-Loan-Forgiveness-Application-Instructions_1_0.pdf

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[6] 85 Fed. Reg. 33012; *see also* 85 Fed. Reg. 33014 (“SBA may begin a review of any PPP loan of any size at any time in SBA’s discretion.”).

[7] 85 Fed. Reg. 33012.

[8] 15 U.S.C. § 636(a)(36)(F)(v).

[9] 85 Fed. Reg. 52883; <https://home.treasury.gov/system/files/136/PPP-IFR-Appeals-of-SBA-Loan-Review-Decisions-Under-the-PPP.pdf>

[10] The complete Subpart L as adopted through the IFR is set forth at 85 Fed. Reg. 52887-52890.

[11] 13 C.F.R. § 134.1204.

[12] 85 Fed. Reg. 52884.

[13] 13 C.F.R. § 134.1203; *see also* 85 Fed. Reg. 52885.

[14] 13 C.F.R. § 134.1202(a)(3).

[15] 13 C.F.R. § 134.1208.

[16] 13 C.F.R. § 134.1209(d).

[17] 13 C.F.R. § 134.1209(a), (c).

[18] 13 C.F.R. § 134.1207(a).

[19] 13 C.F.R. § 134.1207(d).

[20] 13 C.F.R. § 134.1212