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Borrower Beware:
Defending PPP Loans From After-the-Fact
Government Scrutiny

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Paycheck Protection Program (PPP)

- Incorporated into existing SBA § 7(a) small business loan program (see 15 U.S.C. § 636).
 - SBA loan statute provides that “No financial assistance shall be extended pursuant to this subsection if the applicant can obtain credit elsewhere.” 15 U.S.C. § 636(a)(1)(a)(i).
 - “Credit elsewhere” is “the availability of credit on reasonable terms and conditions to the individual loan applicant from non-Federal, non-State, or non-local government sources, considering factors associated with conventional lending practices....” 15 U.S.C. § 632(h).
 - PPP temporarily suspends the “credit elsewhere” requirement with the possibility of 100% loan forgiveness to the borrower. 15 U.S.C. § 636(I).
- Loan proceeds must be used by an eligible borrower for designated purposes in a permissible allocation ratio within a specified “covered period” to be forgivable. See *generally* 15 U.S.C. § 9005.

PPP “Rules” Continue to Be Written After the Fact

- PPP hurriedly enacted on March 27, 2020, leaving many unanswered questions and uncertainties about eligibility, forgiveness, permitted uses, and both short- and long-term implications to borrowers.
- SBA/Treasury have issued, and continue to issue, numerous guidance documents, interim final rules, forms and instructions, certification requirements, and responses to Frequently Asked Questions (FAQ).
- Congress amended the program on June 5, 2020 with the Paycheck Protection Program Flexibility Act (PPPFA)—extends loan terms, forgiveness periods, employee restoration period, compensation caps.
- The “rules” and “requirements” continue to be written after the fact. Some changes are retroactive, some are not.
- PPP compliance has been fraught from the outset with complexities, subtle nuances, ambiguities and inconsistent guidance – ***The goal posts keep moving!***

Forgiveness Applications and Loan Review

- Borrower submits forgiveness application to the lender
- Applicant executes a full page of borrower certifications
- Application must include supporting documentation that the borrower is required to maintain and make available (see 15 U.S.C. § 9005(e)):
 - FTE headcounts
 - Payroll and pay rate information
 - Payroll tax filings reported to IRS
 - State income, payroll and unemployment filings
 - Canceled checks, transcriptions, receipts, and other documents demonstrating payment of forgivable expenses
 - ***Any other documentation the Administrator/SBA deems necessary***

Deceptive simplicity??

When/How to Submit Forgiveness Application

- Technical Rules (85 FR 38306):
 - Submit any time before maturity of the loan if the borrower has spent the loan proceeds.
 - Must apply within 10 months after “covered period” ends, or repayment of principal, interest, and fees must begin at that time.
 - What “covered period” is the borrower using for its application? (8 week, 24 week, week ending 12/31?)
 - Repayment remains in deferral upon submission of application, pending SBA determination
- **When is the best time for a borrower to submit the forgiveness application?**

“I understand that the time to use PPP loans has been extended, and there’s no current urgency to apply for forgiveness. However, we’ve spent all the money, so we’re ready to fill out the application now.

Any reason why we shouldn’t?”
- *No single answer to this question is applicable to all clients. Before submitting forgiveness applications, borrowers should re-examine their initial analyses, strategies, and legal requirements. Did the subsequent rules or options applicable to your loan change? Do they affect how much, if any, can be forgiven? Is there an alternative strategy now available to maximize forgiveness? Is the borrower likely to be targeted for an audit? Has the borrower prepared and laid the groundwork to defend an SBA audit? What documentation is the borrower planning to submit with the forgiveness application?*
- Be mindful of Freedom of Information Law (FOIA) implications with submissions containing sensitive information, and the mounting political and media pressure for more disclosure about borrowers
 - Take calculated and affirmative steps to protect the information by marking documents confidential and invoking FOIA disclosure exemptions

Lender Review Process

- Lender conducts initial review of forgiveness applications
 - Lender conducts “good faith review” of calculations and supporting documents concerning amounts eligible for forgiveness
 - If identify calculation or paperwork errors, should attempt to work with borrower to correct, but burden always remains on borrower
- Accuracy of documents are responsibility of borrower
 - Lender entitled to rely upon what the borrower submits and attests/certifies
 - Lender not subject to any enforcement action or penalties from SBA as long as reasonably relying on such material
 - Lender must confirm borrower completed required certifications/attestations
- Lender issues determination within 60 days:
 - Approve (in whole or in part) and request SBA to issue payment
 - Deny and specify reasons
 - Deny without prejudice due to pending SBA review
 - Borrower can request SBA to review lender’s adverse decision within 30 days
- If lender approves, requests SBA pay forgiveness amount to lender within 90 days
 - But “subject to any SBA review of the loan or loan application” 85 FR 38310
 - “SBA will use the 90-day period to help ensure that applicable legal requirements have been satisfied.” 85 FR 38311
 - 90 days + SBA payment of forgiveness amount to lender = false sense of security for borrower

SBA Review/Audit Process

- Reviews/Audits will focus on 3 broad areas (85 FR 33012):
 1. Borrower eligibility
 2. Loan amounts and use of proceeds
 3. Loan forgiveness amount
- If later determined to be an ineligible borrower, ***no portion of the loan will be forgiven***
- Forgiveness amounts will be reduced or eliminated for improper use of proceeds, ineligible expenses, or incorrect calculations of forgiveness amounts
- Borrowers—*particularly those with loans over \$2M or at high risk for an audit*—should lay the groundwork today to defend their loans from review/audit and substantiate and document their eligibility and entitlement to forgiveness

SBA Review/Audit Process

■ What loans will be reviewed/audited?

- All loans over \$2 million will be reviewed and audited (FAQ #39)
- “SBA may review any PPP loan, as the Administrator deems appropriate” in its discretion. 85 FR 33012
- Potential high risk audit targets:
 - Businesses deemed automatically ineligible by statute or regulation
 - Publicly-traded companies and those subject to affiliation rules
 - Corporate groups
 - Hedge funds and private equity firms
 - Private-equity-backed portfolio companies
 - Large private business “chains” and franchises
 - Businesses with highly compensated owners or officers
 - Businesses that stood to profit from COVID-19
 - Businesses whose loan application failed to state the number of jobs that would be preserved with the loan money
 - Borrowers whose paperwork reflects inconsistencies

■ When will SBA conduct its review?

- Nothing limits SBA to conducting reviews in the 90-day period after lender’s forgiveness approval
- “SBA may begin a review of any PPP loan of any size at any time in SBA’s discretion.” 85 FR 33014
 - Underwriting; time considerations; political pressures???
- Document retention requirements for borrower’s PPP documentation suggest a review or audit could occur as long as 6 years after forgiveness or repayment...maybe more?????

SBA Review/Audit Process

- What might a review or audit look like?
 - Review loan application and forgiveness applications, including certifications and representations
 - Evaluate borrower eligibility against all relevant PPP statutory requirements, SBA/Treasury requirements, interim final rules, and FAQs
 - Evaluate propriety and eligibility for requested loan amount
 - Evaluate applicability of any safe harbors relied upon by the borrower
 - Evaluate use of loan proceeds and forgiveness eligibility
 - Verify calculations of forgiveness amounts
 - Evaluate adequacy and content of supporting documentation
 - **Assess submitted materials for reliability and consistency**
 - **Conduct supplemental investigation as deemed necessary or appropriate in SBA's discretion**
 - Failure to respond to requests for supplemental information may result in a determination of ineligibility or denial of forgiveness
 - Timeline for responding to any such inquiries is unclear; but, borrowers should expect and be prepared to respond and produce materials to SBA on short deadlines
 - SBA may consider possible agency referrals if appropriate (e.g., false claims and criminal liability)
- SBA review/audit is not necessarily limited to the borrowers' applications and submissions
 - SBA has pre-existing powers under 15 U.S.C. § 634(b)(11) to investigate potential violations of the statute, regulations, or rules, and has the power to compel production of witnesses and documents anywhere in the U.S.
 - Remember statutory forgiveness application requirement—borrower must submit “any other documentation the Administrator/SBA deems necessary”
 - “Documentation each borrower may **voluntarily submit** with its loan forgiveness application.” (85 FR 33009). **Does the borrower need/want something in the record that it is not required to submit, but is important?**

Eligibility Issues

- Loan Eligibility—*many potential sub-issues*, some data-driven, some not.
 - Many types of businesses automatically ineligible for Section 7(a) loans under statute and SBA regulations
 - Business Size/Headcount eligibility issues: Qualify as traditional “small business”; or have no more than 500 employee headcount (watch U.S./foreign headcount issues); or meet SBA’s “Alternate Size Standard”:
 - Maximum tangible net worth of business not more than \$15M
 - Average net income after Fed taxes (excluding carry-over losses) for two fiscal years prior to application is not more than \$5M (FAQ #2).
 - Calculations of maximum eligible loan amount: the lesser of (a) 2.5 times the borrower’s average total monthly “payroll costs” over the previous 12 months or (b) \$10 million
 - Payroll cost issues—including versus excludable items in calculations; FTE vs. PTE
 - Treatment of employees earning >\$100K
 - U.S. versus foreign employee headcounts
 - Corporate group eligibility--\$20M aggregate limit under 4/30 Interim Final Rule for single corporate group “majority owned, directly or indirectly, by a common parent”
 - Complicated corporate affiliation rules and waiver and headcount exception issues—13 C.F.R. §§ 121.103, 121.301(f), interim rules, and FAQ #5 and #6 (released 4/6), #23 and #24 (released 4/13) and #44 (released 5/5).
 - Special “rules” and guidance for seasonal businesses
 - Special statutory rules for NAICS 72 businesses (Accommodation and Food Services)
 - Criminal history of an owner having 20%+ equity interest
 - Only certain types of non-profits are eligible
 - **Necessity Certification and Good Faith**
 - Many more....

Consequence of Ineligibility

- Eligibility is a critical issue and subject to hindsight review by SBA
 - Evaluated based on the provisions of the CARES Act, and the rules and guidance available at the time of the borrower's PPP loan application. 85 FR 33012
 - But subsequent changes, events, and circumstances may also bear on the forgiveness issue and forgiveness application
- Eligibility fight will likely arise at SBA review level, not lender review
 - Lender is subject to loss and SBA clawback of lender processing fees if borrower is deemed ineligible
- Loan cannot be forgiven if borrower is deemed ineligible, and SBA may pursue repayment and other remedies.
- Who repays if borrower defaults? Could be personal liability.

Non-recourse provision protecting shareholders, members, or partners of borrower only applies if the borrower is an eligible recipient and proceeds are used for approved purposes. 15 U.S.C. § 636(a)(36)(F)(v).

Permissible vs. Forgivable Use of Proceeds

- SBA § 7(a) outlines many permissible allowable uses of typical SBA small business loan proceeds (e.g., plant acquisition, construction, conversion, expansion, acquisition of land, material, supplies, equipment, and working capital), but none of these are recognized as forgivable uses under PPP.
- PPP and Interim Rules (15 U.S.C. § 636(a)(36)(F); 85 FR 20814, 36311) identify **permissible use** categories:
 - Payroll costs (as defined by PPP)
 - Interest on mortgages (mortgage in effect prior to 2/15/20)
 - Rent (lease in effect prior to 2/15/20)
 - Utilities (in service prior to 2/15/20)
 - Interest on other debt obligations incurred prior to 2/15/20
 - Costs related to continuation of health care benefits during periods of sick, medical, family leave and insurance premiums
 - Refinancing an SBA Economic Injury Disaster Loan (EIDL) made between 1/31/20-4/3/20, but rules differ if EIDL was used to pay payroll vs. non-payroll
- PPP requires borrowers to acknowledge on their loan applications “that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments.”
- To be a **forgivable use**, PPP proceeds must be used for payroll costs, interest on mortgages, rent, utilities, and (per Forgiveness FAQ 8/4/20) interest on business loans “secured” by real or personal property
 - Initially required minimum 75% be spent on payroll. PPPFA changed to 60% minimum.
 - Lots of rules, subtleties and nuances on what constitutes “payroll costs” and how you calculate them
- Spend the proceeds on forgivable expenses during the “covered period”
 - Initially 8 weeks after disbursement; PPPFA changed to earlier of 24 weeks or 12/31/20, but can still elect to use 8 weeks if the loan was disbursed prior to June 5. 85 FR 36310
 - Alternative covered period election for payroll costs for certain employers (e.g., seasonal businesses), but election does not apply to non-payroll portion.

Forgiveness Amounts

- Preliminary Forgiveness Amount = (Payroll costs + forgivable non-payroll costs – Salary/Wage Reductions) x (FTE Reduction Quotient)
 - *FTE Reduction Quotient* = Average FTE headcount during covered period divided by average FTE headcount during prior historical period selected by borrower
 - Historical period options: 2/15/19-6/30/19 or 1/1/20-2/29/20.
 - *Salary/Wage Reduction* = The reduction in salary in excess of 25% of an employee's total salary or wages compared to the most recent full quarter during which the employee was employed before the covered period
 - Applies to the portion of the decline in salary and wages that is not attributable to the FTE Reduction Quotient
 - Part-time employees must be adjusted to full-time employee equivalency in one of two ways: (1) divide average hours worked by each PTE by 40; or (2) count each PTE working less than 50 hours per week as .5 FTE
- Owner compensation replacement limitations for individuals with self-employment income (revised effective 6/24 per 85 FR 38307):
 - 8 weeks of 2019 profit up to \$15,385 for an 8-week covered period or 2.5 months of 2019 profit up to \$20,833 for a 24-week covered period
 - Not just a cash consideration; must consider certain other things depending on type of business (e.g., health insurance, retirement contributions, IRS section 179 deductions, unreimbursed expenses, etc.)

Forgiveness “Cures” and Safe Harbors

- FTE Restoration Safe Harbor

- If FTE Reduction Quotient < 1.0 such that it reduces forgiveness, the reduction in forgiveness can be avoided if:
 - 1) The borrower reduced FTE headcount between 2/15/20 and 4/26/20; and
 - 2) The borrower restored FTE headcount not later than [6/30/20 originally, now 12/31/20 under PPPFA] to the headcount that existed during the pay period that included 2/15/20 Wage Reduction Safe Harbor

- Salary/Wage Restoration

- If borrower made a wage cut between 2/15/20 and 4/26/20, it can avoid the forgiveness reduction by restoring wages by [6/30/2020 originally, now 12/31/20] to levels existing on 2/15/20

- Employer Inability to Restore FTE for one of two reasons (85 FR 36310, 38308):

- **Documented** inability to rehire prior employees or find qualified replacements by 12/31/20
- **Documented** inability to meet compliance requirements of HHS, CDC, or OSHA between March 1 and December 31, 2020, and “related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID–19.”

- *De minimis* exceptions—terminations for cause, voluntary resignation, and voluntary schedule reductions requests, but **must have records** to demonstrate

Appeals of SBA Determinations

- SBA finally issued Interim Final Rule for appeals of adverse SBA determinations on August 11
 - Appeals from SBA determinations will be channeled through pre-existing Office of Hearings and Appeals (OHA) (see 15 U.S.C. § 634(i)) where an administrative Judge is assigned.
 - SBA promulgated specific Rules of Practice for PPP loans—will eventually be found at 13 C.F.R. Part 134.
 - Out for public comment; could be some amendments
- Appeals could be a long, difficult road for borrowers
 - ***Appeal of SBA decision does not extend deferral period for repayment of loan.*** If denied forgiveness, repayment must begin and continue through appeal process
 - Regulation sets up multi-step appeal process for challenging adverse determinations:
 1. SBA issues final adverse determination to borrower
 2. Appeal SBA determination to OHA
 3. Request reconsideration (this step optional) of initial OHA decision within 30 days, or becomes final OHA decision
 4. Request review by Administrator of OHA's reconsidered or final decision
 5. Request seek judicial review of Administrator's final decision in federal court
- Borrower bears burden of proof on OHA appeal to show, “by a preponderance of the evidence,” that the SBA’s loan review decision “was based on ***clear error of fact or law.***”
- Administrative Record is narrow, and will be prepared by SBA
 - Record includes only “***relevant documents that SBA considered in making its final decision or that were before the SBA at the time of the final decision.***” Remember required vs. voluntary submission?
 - Borrower may object to absence of missing documents, or make privilege objections, within 10 days
- Absent Protective Order, decisions will be public record and may contain confidential or personally identifiable info if “decisionally-significant or otherwise necessary for a comprehensible decision.”

OHA Appeal Process

- Appeal Petition
 - Only the borrower has standing to appeal. Individual owners of the borrower do not have standing.
 - Implications to individuals who lose non-recourse protection where borrower was deemed ineligible or proceeds used for improper purposes
 - Borrower must file its “Appeal Petition” **within 30 days** of the earlier of: (i) receipt of the final SBA loan review decision; or (ii) notification by the lender of the final SBA loan review decision
 - Appeal Petition must include the following, or could be dismissed by the Judge:
 1. The basis for OHA’s jurisdiction and proof that the appeal is timely;
 2. A copy of the SBA loan decision being appealed;
 3. ***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;***
 4. The relief being sought;
 5. Signed copies of payroll tax filings reported to the IRS and State quarterly business and individual wage reporting and unemployment insurance tax filings actually reported to the relevant state, for the relevant periods of time, if not provided with the PPP Loan Forgiveness Application, or an explanation as to why they are not relevant or not available;
 6. Signed copies of applicable federal tax returns actually filed with the IRS with appropriate schedules documenting income for self-employed individuals or partners in a partnership, if not provided with the PPP Borrower Application Form, or an explanation as to why they are not relevant or not available;
 7. Name, address, telephone number, email address and signature of the appellant or its attorney.
 - Only SBA may respond to an appeal, and its response to the Appeal Petition should set forth relevant facts and legal arguments to the issues presented
- All appeals “decided solely” on review of the written Administrative Record, Appeal Petition, SBA response to Appeal Petition, admitted evidence, and oral hearing, if one is held.
 - ***“The Judge may not admit evidence beyond the written administrative record or permit any form of discovery.”***
 - Judge has discretion to allow SBA to conduct limited discovery from borrower for good cause shown
 - No oral hearing or testimony unless granted on motion, at Judge’s own initiative, where Judge deems necessary to resolve disputes over material facts

Preparing for PPP Litigation

- Because PPP is a sui generis program, layered with complexity and ambiguity, the potential for litigation arising from denials of loan forgiveness is high.
- Litigation is most likely over eligibility and forgiveness standards
 - An adverse ruling on eligibility may have dire consequences for borrowers who have already expended funds and structured their affairs anticipating forgiveness
 - The necessity certification and SBA guidance incorporate broad eligibility standards and subjective concepts, including “good faith”

Necessity Certification and Guidance

- Borrowers should be prepared to demonstrate facts and circumstances proving “that the ***uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations***” of the business.
- SBA FAQ #31: “Borrowers must 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 is ***not significantly detrimental to their business***. For example, 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...the basis for its certification.”
- SBA FAQ #37 indicates that FAQ #31 applies to private companies

“Uncertainty” Exists, Disputes May Follow

- What degree of “uncertainty” needs to exist to demonstrate “good faith” and to qualify for loan eligibility?
- Will eligibility and/or loan forgiveness determinations entail an examination of actual financial impacts?
- Will such determinations be analyzed solely at the time of application, or also encompass some later period?
- When does accessing potential sources of liquidity become “sufficiently detrimental” that they need not be accessed?
- What levels of available liquidity are disqualifying?
- FAQ #31 appears to contradict, in an imprecise way, the CARES Act waiver of the “credit elsewhere” requirement.

Facts and Circumstances Test

- Necessity Certification clear – testing is a ***fact-specific inquiry***
 - “Borrowers [must] demonstrate facts and circumstances”
- What objective evidence supported the borrower’s subjective, good faith beliefs of eligibility and need?
 - The preservation of evidence regarding business activity, cash flows, sources and extent of potential liquidity, operational needs, and industry impacts is essential
 - Borrowers have only 30 days to submit petitions challenging loan review decisions

Facts and Circumstances Are Not Always Clear

- Uncertainty, impacts and available liquidity are not always clear and vary from business to business and industry to industry
- Manufacturing Company X –
 - The successful pivot – from substantial potential losses to financial stability and success
- Construction Company Y -
 - Apparent, but not actual, liquidity
Bonding company and other debt covenant obligations
- The cover of the book can be misleading

Collect and Preserve Essential Evidence

Gather records and data that document key impacts

- Prepare memo collecting information and data behind loan certification
- Measure inefficiencies and impacts of required mitigation measures
- Lost and delayed business
- Loss and aging of receivables
- Price concessions demanded by customers
- Financial sacrifices made by ownership, management and employees
- Perform loan covenant testing
- Analyze cross default provisions in lending agreements

Submit documentation at earliest opportunity

- SBA rules are unclear on when borrowers can demonstrate facts supporting eligibility and loan forgiveness

Documenting Impacts – Evidence

Communications Demonstrating Uncertainty and Liquidity Constraints - 3/21/20

- “We have received your email *** [but] right now there is a 30-day hold on non-supply type invoices. I was actually going to call [] and see what outstanding invoices there were, and ask you for a hold. We are furloughing part of our staff including accounting, and they are trying to prioritize. [You] know we will be good for payment. Regards,”

Documenting Impacts – Evidence

Forbearance Communications and Agreements – 4/3/20

- “Per the below emails [the parties] agree to a six month extension of time to pay [Smith] the \$493,000 currently due ... under the ... Agreement *** This is a one-time accommodation requested by [Jones] as a result of the unprecedented disruptions caused by Covid-19 problems and all other terms of the Agreement, including timing of the previously negotiated future year payments, remain unaltered.”

Documenting Impacts – Collect Industry Information

Coronavirus: How Law Firms Are Handling The Downturn – Law 360, June 25, 2020

“The spreading coronavirus pandemic has upended the legal industry, forcing firms to cut salaries, lay off attorneys and make changes...”

- Collect best industry information at both height of pandemic and closest to date of loan certification

Prepare to Make Your Best Case

- Prepare now to meet audit examination and challenge denials
- Lay the groundwork for successful demonstration of eligibility and loan forgiveness
 - Carefully identify pandemic impacts and burdens
 - Analyze the borrower's specific market and industry data
 - Collect key evidence today, before it is lost
 - Remember, only 30 days to prepare petition challenging loan review determinations
- The burden of demonstrating eligibility is on the borrower
- Hope for the best, but prepare for the worst.
- What's coming next is "uncertain"!

The Political Landscape

- *Potbelly, which returned a \$10 million PPP loan in April, just got another one. This time it's for keeps, Chicago Tribune, 8/18/20*
- *Small Business Loans Helped the Well-Heeled and Connected, Too, WSJ, 7/7/20*
- *Investment Banks Got Aid Intended for U.S. Small Businesses, Reuters, 7/7/20*
- *White Male-Owned Businesses in MA Received Majority of PPP Loans, Patch.com, 7/8/20*
- *Dozens of Expensive Private Schools Received Millions in U.S. Pandemic Loans, Reuters, 7/6/20*
- *Union for Laid-Off Workers Wants to Know if Hotel Took PPP Loans, Bloomberg, 7/15/20*
- *Warren Calls for Investigation of Small Business Loan Program, Saying Banks were 'Playing Favorites,' Boston Globe, 4/24/20*

False Claims Act, 31 U.S.C. § 3729 *et seq.*

- Liability for any person who--
 - (A) knowingly presents, or causes to be presented, a **false or fraudulent claim** for payment or approval;
 - (B) knowingly makes, uses, or causes to be made or used, **a false record** or statement material to a false or fraudulent claim;
 - (C) **conspires** to commit a violation of subparagraph (A), (B), (D), (E), (F), or (G);
 - (G) knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or **knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government.**

- “Claim” is any request or demand for money or property that
 - (i) is presented to an officer, employee, or agent of the United States; or
 - (ii) is made to a contractor, grantee, or other recipient, if the money or property is to be spent or used on the Government’s behalf or to advance a Government program or interest, and if the United States Government--
 - (I) provides or has provided any portion of the money or property requested or demanded; or
 - (II) will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded

False Claims Act

- No specific intent to defraud required; “recklessness” and “deliberate ignorance” suffice
- Treble damages and a per claim penalty
- Whistleblowers can bring an action on behalf of the government and obtain between 15%-30% of any recovery
- Statute of limitations can run up to 10 years after the date on which the violation was committed

False Claims Act: the Most Effective Weapon

- “[W]e will energetically use every enforcement tool available to prevent wrongdoers from exploiting the COVID-19 crisis. In that effort, the False Claims Act is one of the most effective weapons in our arsenal...Going forward, the Civil Division will make it a priority to use the False Claims Act to combat fraud in the Paycheck Protection Program.”
- Enforcement will focus on “knowing” violations that are “material” to the government’s payment decisions and “[c]omplying with thousands of rules, terms and conditions, and complicated guidance can be a dizzying task under normal circumstances; it is significantly more difficult in time like today.”
 - Principal Deputy Assistant Attorney General Ethan P. Davis delivers remarks on the False Claims Act at the U.S. Chamber of Commerce’s Institute for Legal Reform, 6/26/20

Criminal Liability

- Wire fraud (18 U.S.C. § 1343)
- False Statements to the Government (18 U.S.C. § 1001)
- Bank fraud (18 U.S.C. § 1344)
- False Statements to the SBA (18 U.S.C. § 1014)
- Conspiracy (18 U.S.C. § 371)

The Government Is Watching...

- “Whenever there’s a trillion dollars out on the street that quickly, the fraudsters are going to come out of the woodwork in an attempt to get access to that money. There are unfortunately businesses that are sending in loan applications for large amounts of money that are overstating their payroll costs, overstating the number of employees they’ve had, overstating the nature of their business.” Assistant Attorney General Brian Benczkowski to Bloomberg News, 4/30/20.
- Attorney General Barr has urged the public to report fraud and directed all U.S. Attorneys to prioritize the investigation and prosecution of COVID-related fraud schemes.
- Prosecutors have begun contacting lenders and the SBA to look for “red flags” in both approved and rejected applications.

The Government Is Watching...

- 7/13/20 – Owner of a residential construction contracting firm in Washington D.C. was charged with submitting fraudulent documents to obtain more than \$400,000 in PPP loans. According to the government, the IRS Forms 1099 submitted as part of the application included social security numbers that were invalid and the tax return submitted was inconsistent with the one the owner filed with the IRS.
- 7/14/20 – Texas man charged with fraudulently obtaining more than \$1.1 million in PPP loans. He allegedly submitted two fraudulent loan applications, claiming that both companies had numerous employees and hundreds of thousands of dollars in payroll expenses. But, according to the government, neither company had employees or paid the wages identified in the applications. The funds were invested in a cryptocurrency account and the rest was held in a bank account and depleted via ATM withdrawals.
- 7/17/20 – California man charged with fraudulently seeking \$8.5M in PPP loans on behalf of different companies. He is alleged to have submitted fraudulent loan applications that included misleading statements about the companies' business operations and payroll expenses and also submitted fake and altered documents and used the funds to make risky stock-market bets and to gamble at a casino.
- 8/6/20 - Project manager employed by a major retailer plead guilty to bank fraud charges for fraudulently seeking more than \$8 million in PPP loans by claiming non-existent payroll expenses and also making false representations about the date that the LLP for which he applied for funding was established. The case was investigated by the DOJ, US Attorney's Office for the Northern District of Oklahoma, Federal Housing Finance Agency Inspector General, FDIC Inspector General, and the SBA Inspector General.

Borrower Application Certifications

- “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.”
- “The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under the Paycheck Protection Program Rule; I understand that if the funds are knowingly used for unauthorized purposes, the federal government may hold me legally liable, such as for charges of fraud.”
- “I further certify that the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects. I understand that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than \$5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000.”
- “The Applicant is eligible to receive a loan under the rules in effect at the time this application is submitted that have been issued by the Small Business Administration (SBA) implementing the Paycheck Protection Program under Division A, Title I of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (the Paycheck Protection Program Rule).”
- “The Applicant (1) is an independent contractor, eligible self-employed individual, or sole proprietor or (2) employs no more than the greater of 500 or employees or, if applicable, the size standard in number of employees established by the SBA in 13 C.F.R. 121.201 for the Applicant’s industry.”

Forgiveness Application Certifications

- “I understand that if the funds were knowingly used for unauthorized purposes, the federal government may pursue recovery of loan amounts and/or civil or criminal fraud charges.”
- “The Borrower has accurately verified the payments for the eligible payroll and nonpayroll costs for which the Borrower is requesting forgiveness.”
- “The information provided in this application and the information provided in all supporting documents and forms is true and correct in all material respects. I understand that knowingly making a false statement to obtain forgiveness of an SBA-guaranteed loan is punishable under the law, including 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than \$5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000.”
- “The tax documents I have submitted to the Lender are consistent with those the Borrower has submitted/will submit to the IRS and/or state tax or workforce agency. I also understand, acknowledge, and agree that the Lender can share the tax information with SBA’s authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of ensuring compliance with PPP requirements and all SBA reviews.”
- “I understand, acknowledge, and agree that SBA may request additional information for the purposes of evaluating the Borrower’s eligibility for the PPP loan and for loan forgiveness, and that the Borrower’s failure to provide information requested by SBA may result in a determination that the Borrower was ineligible for the PPP loan or a denial of the Borrower’s loan forgiveness application.”

Lessons from the Past: TARP

■ SIGTARP

- Duty to conduct audits and investigations of the purchase, management, and sale of assets under TARP
- Partnered with other criminal and civil law enforcement agencies, including FBI, SEC, and New York AG's office
- Almost 400 convictions
- Recoveries of more than \$11 billion
- Still in existence!

■ SIGPR

- Created by the CARES Act to conduct audits and investigations of the funds disbursed under the Act

Protecting Your Business from Scrutiny

Whether in the context of responding to an SBA review, 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) Understanding the criteria 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 applicable to the loan, including retroactively;
- (2) The quality of the contemporaneous documentation and evidence available at the time of application, and being generated thereafter, to prove that the criteria for eligibility and forgiveness were satisfied;
- (3) The retention of that information and ability to explain it in the future during an SBA review, investigation, or hearing; and
- (4) Appropriate disclosures to the lender and/or SBA, if errors or changed circumstances.

Consult with your financial and legal advisors sooner rather than later to develop strategies to protect your business and to maximize loan forgiveness

Questions?

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