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# The Paycheck Protection Program Bites Back: Recent Developments in Government Enforcement of PPP Requirements

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# Today's Topics

- COVID-19 and the PPP Program
- Loan Forgiveness, Denials, and Mortgage Companies
- PPP Forgiveness Appeal Process
- COVID-19 Fraud Enforcement

# COVID-19 and the PPP Program

- PPP was established under Title I of the CARES Act, Sec. 1102, H.R. 748, Pub. L. 116-136 (Mar. 27, 2020), which amends the Small Business Act (15 U.S.C. § 636(a)).
- Congress passed the CARES Act to provide relief from the unprecedented threat of economic harm to companies and their employees resulting from the COVID-19 pandemic.
- Congress initially appropriated \$349 billion in PPP funds to pay up to eight weeks of payroll costs and benefits for eligible recipients, plus certain company overhead such as interest on mortgages, rent, and utilities.

# COVID-19 and the PPP Program

- In the section titled “Increased eligibility for certain small businesses,” Congress expanded eligibility to include “any business concern,” that, relevant here, does not employ more than 500 employees. 15 U.S.C. § 636(a)(36)(D)(i).
- Additionally, the small business had to have been in operation on February 15, 2020. 15 U.S.C. § 636(a)(36)(T).

# COVID-19 and the PPP Program

- Eligible borrowers were also required to make a good-faith certification, among other things, of the following:
- (I) that the uncertainty of economic conditions makes the loan necessary to support the ongoing operations of the eligible recipient;
- (II) acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- (III) that the eligible recipient did not have a duplicate application pending; and
- (IV) the eligible recipient had not already received PPP funds.  
15 U.S.C. § 636(a)(36)(D)(i).

# PPP Loan Forgiveness

- As of January 3, 2022, SBA has forgiven at least 820 loans for similarly situated mortgage originators (NAICS codes 522292 and 522310), notwithstanding SOP 50-10-5(K)'s 14-day rule.
- SBA's publicly available PPP data includes information for every applicant and borrower under the PPP loan program. *See* "PPP FOIA," *available at* <https://data.sba.gov/dataset/ppp-foia>.
- NAICS code 522292 covers "lending funds with real estate as collateral," and includes "mortgage banking (i.e., nondepository mortgage lending)."
- NAICS code 522310 covers "arranging loans for others on a commission or fee basis," including mortgages.

# PPP Loan Forgiveness

- What we have been seeing in the industry:
  - Up until later summer/early fall 2021, many mortgage companies received PPP forgiveness.
  - Then the SBA began issuing a significant number of denials.
  - It appears that the SBA may be using third party contractors to conduct the initial reviews and make denial recommendations.

# PPP Loan Forgiveness

- What we have been seeing in the industry:
  - While many mortgage companies have received denials, some have recently received forgiveness.
  - We have assisted a number of clients through the forgiveness application process.
  - And in responding to the SBA's follow-up questions.
  - It is important to understand the rules the SBA is applying to forgiveness applications.



# Mortgage Company Forgiveness/Denial

- SBA denial and forgiveness decisions for mortgage companies have been generally based on restrictions that applied to SBA loan programs prior to PPP.
- These restrictions were incorporated into PPP requirements by an Interim Rule that went into effect April 15, 2020, for PPP applications submitted through June 30, 2020.
- *See Interim Final Rule, 85 Fed. Reg. 20811, § III-2 (Apr. 15, 2020), Docket No. SBA-2020-0015.*

# Mortgage Company Forgiveness/Denial

- The SBA's first Interim Final Rule states, without any explanation, that
  - “[b]usinesses that are not eligible for PPP loans are identified in 13 CFR § 120.110 and described further in SBA’s Standard Operating Procedure (SOP) 50 10, Subpart B, Chapter 2, except that nonprofit organizations...are eligible.”
  - 13 C.F.R. § 120.110(b) provides: “financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances)” are ineligible for SBA loans.

# Mortgage Company Forgiveness/Denial

- SOP 50-10-5(k) states:
  - “SBA cannot guarantee a loan that provides funds to businesses primarily engaged in lending or investment, or to an otherwise eligible business for the purpose of financing investment not related or essential to the business.”
- The SOP states this prohibits loans to:
  - (a) Banks; (b) Life Insurance Companies (but not independent agents); (c) Finance Companies; (d) Factors; (e) Investment Companies; (f) Bail Bond Companies; and (g) Other businesses whose stock in trade is money and which are engaged in financing.

# Mortgage Company Forgiveness/Denial

- There are important exceptions to the exclusions
- SOP 50-10-5(k) states
  - “[Mortgage servicing company that disburses loans and sells them within 14 calendar days of loan closing is eligible.
  - Mortgage companies are eligible when they are primarily engaged in the business of servicing loans.
  - Mortgage companies that make loans and hold them in their portfolio are not eligible.”

# Mortgage Company Forgiveness/Denial

- The 14-day rule
- Interest Income
- Loans held for investment
- Determination of lending based upon website reviews
- No specific reason given

# The Appeal Process – 13 CFR 134

- Receipt of the denial decision
  - 30 calendar days to respond
- The appeal petition
  - “A full and specific statement as to why the final SBA loan review decision is alleged to be erroneous, together with all factual information and legal arguments supporting the allegations.”
- The administrative record
  - “The administrative record shall include non-privileged, relevant documents that SBA considered in making its final loan review decision or that were before SBA at the time of the final loan review decision.”

# The Appeal Process Cont'd

- Objections to the administrative record
  - “The appellant may object to the absence of any document from the administrative record that the appellant believes should have been included in the administrative record.”
- The SBA’s response
  - “SBA may respond to an appeal as determined in its discretion, but SBA is not required to respond.”
  - “[It] must be filed within 45 calendar days after issuance of the Notice and Order.”
- The administrative judge’s decision
  - “The Judge will issue his or her decision within 45 calendar days after the close of record, as practicable.”
- Motion for reconsideration
- Appeal to federal district court

# The Appeal Process – Arguments

- Important to raise all possible arguments in the appeal petition
- Factual Argument Examples
  - Loan data analysis
  - Financial analysis concerning interest income and loans held for investment
- Legal Argument Examples
  - Applicability of the SOP and 14-day rule
  - Retroactivity
  - Arbitrary and capricious application



# The Appeal Process – What We’re Seeing

- Four-to-six weeks for assignment of an administrative judge
- The administrative record contains significant material and analysis by the SBA
- The SBA has been making requests in certain appeals for additional information after appeals have been filed
- The SBA is requesting loan data for the 2019 calendar year, including the funding date, sale commitment date, and the average number of days between these two data points

# PPP Loan Repayment

- Applying for forgiveness within 10 months after the end of your loan forgiveness covered period defers repayment of a PPP loan. The Small Business Act, as amended by the Paycheck Protection Program Flexibility Act of 2020, requires lenders “to provide complete payment deferment relief for impacted borrowers with covered loans, including payment of principal, interest, and fees, until the date on which the amount of forgiveness determined under section 7A [15 U.S.C. § 636m] is remitted to the lender.” 15 U.S.C. § 636m(ii).
- A timely appeal also defers repayment of the loan while the appeal is pending. 13 C.F.R. § 34.1202.
- As a general matter, once deferment ends, the loan must be paid in accordance with the note.
- The borrower may be able to seek a modification of the maturity terms of its loan, but it is unclear whether or not a lender is required to grant such a request. Paycheck Protection Program Flexibility Act of 2020. Pub. L. 116-142 (June 5, 2020).

# COVID-19 Fraud Enforcement

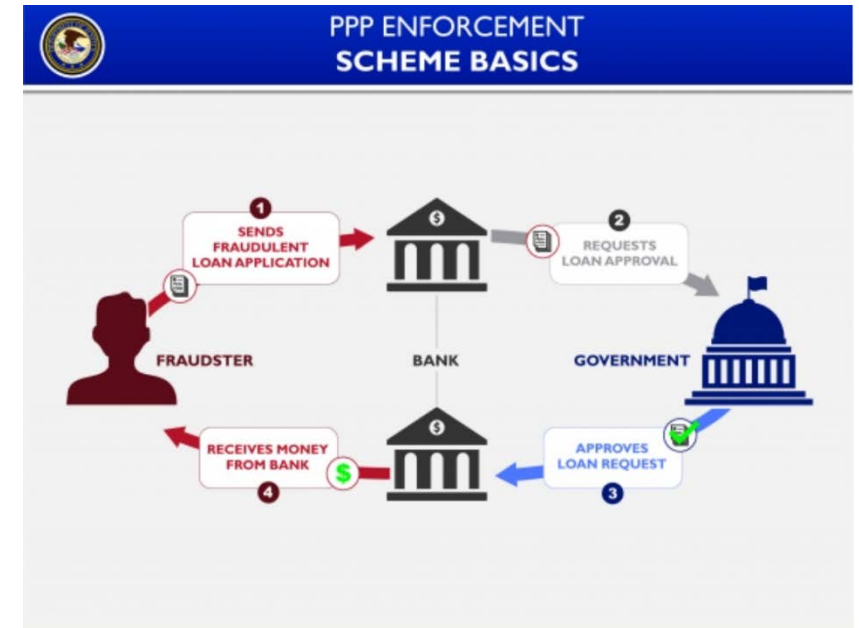
- Prosecuting COVID-19 relief fraud, including PPP loan program fraud, is a “whole-of-government” enforcement effort.
- “The Department of Justice will use every available federal tool-including criminal, civil, and administrative actions-to combat and prevent COVID-19 related fraud.” - Attorney General Merrick Garland (May 17, 2021).
- Over 1,000 active federal investigations and/or cases related to COVID-19 fraud, with cases in every state
- Secret Service estimates program frauds exceeding \$100 billion (December 2021).
- Expect to see continued aggressive criminal and civil enforcement throughout 2022.

## Federal Agencies investigating PPP Fraud

- Through the CARES Act, Congress established the Pandemic Response Accountability Committee (PRAC), comprised of 17 agency inspector generals, including DOJ-OIG, SBA-OIG, HUD-OIG, among others.
- “There is no higher priority for our office than providing oversight of SBA and the taxpayer’s funds at stake through the CARES Act.” – Congressional Testimony of SBA Inspector General Hannibal “Mike” Ware (March 25, 2021).
- In May 2021, DOJ established the COVID-19 Fraud Enforcement Task Force, led by DOJ’s criminal Fraud Section.
  - Fraud section has prosecuted over 150 defendants and seized over \$75 million in cash proceeds derived from fraudulently obtained PPP funds, as well as numerous real estate properties and luxury items.
  - Joint investigations have included the FBI, United States’ Attorney offices, and inspector general offices (SBA-OIG, FHFA-OIG, FDIC-OIG and IRS).
- Joint state-federal task forces

# PPP Fraud – Criminal Cases

- Typical charges include bank fraud, mail fraud, wire fraud, money laundering, identity theft, and conspiracy.
- Fraudulent applications – misrepresentations concerning the existence of the company, the number of employees, payroll size, or other PPP eligibility criteria.
- Misuse of disbursed funds - numerous cases have involved the use of PPP loan proceeds for personal gain, including to purchase real estate, yachts, and exotic cars such as Ferraris, Bentleys and Lamborghinis.



Source: <https://www.justice.gov/criminal-fraud/cares-act-fraud> (visited Jan. 7, 2022).

## Civil PPP Enforcement – False Claims Act

- Pandemic related fraud, including PPP loan fraud, is currently one of the six main False Claims Act enforcement priorities of DOJ’s Civil Division.
- “These schemes will likely include false representations regarding eligibility, misuse of program funds, and false certifications pertaining to loan forgiveness.” Acting Assistant Attorney General Brian M. Boynton, Federal Bar Association Qui Tam Conference (Feb. 17, 2021).
- Example FCA cases:
  - January 12, 2021, the first FCA settlement was entered into with an internet retailer for alleged false statements to financial institutions in its PPP application concerning its pending bankruptcy. \$100,000 settlement included \$17,500 in restitution to SBA for processing fees.
  - October 28, 2021, a Florida duct-cleaning company settled FCA allegations for \$30,000 after obtaining two PPP loans. Although the company returned the proceeds of the second loan (\$169,811) shortly after receiving a civil investigative demand, the settlement agreement identified \$8,490 as restitution for processing fees that SBA had paid to the lender in connection with disbursing the second PPP loan.

# Notable Opinions

- *Camelot Banquet Rooms, Inc. v. United States SBA*, 458 F. Supp. 3d 1044 (E.D. Wis. 2020), granting preliminary injunction on First Amendment grounds to five Wisconsin adult clubs that the SBA had deemed ineligible for PPP loans based on pre-existing regulation that denied eligibility to businesses that “[p]resent live performances of a prurient sexual nature.” 13 C.F.R. § 120.110(p).
- *Pharaohs GC, Inc. v. United States SBA*, 990 F.3d 217 (2d Cir. 2021), finding the text of the CARES Act “strongly suggests that Congress deliberately chose not to change the Administrator's statutory discretion to exclude businesses, other than those it expressly identified in the CARES Act.”
- *In re Gateway Radiology Consultants, P.A.*, 983 F.3d 1239, 1256 (11th Cir. 2020), “[T]he PPP was not created as a standalone program but was added into the existing § 7(a) program, which subjects it to existing conditions and regulations, as well as existing SBA authority.”

# Concluding Thoughts

- During the process, it is important to understand the rules the SBA is applying to forgiveness requests.
- If you do not appeal a denial decision, you may waive your right to forgiveness if other mortgage companies are ultimately successful in overturning their denials.
- The appeal process and legal arguments involved should not be dealt with in a cursory fashion and require thoughtful and detailed responses.



# Questions?

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