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Navigating

Civil Liability under the Paycheck Protection Program

Thursday, May 20, 2021

Overview of Presentation

- **A review of critical aspects of CARES Act relief programs**
- **Civil liability and potential risk factors**
- **Criminal cases under relief programs and predictions for more cases to come**
- **Tips for remaining compliant with CARES Act relief program requirements**

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CARES Act Relief Programs

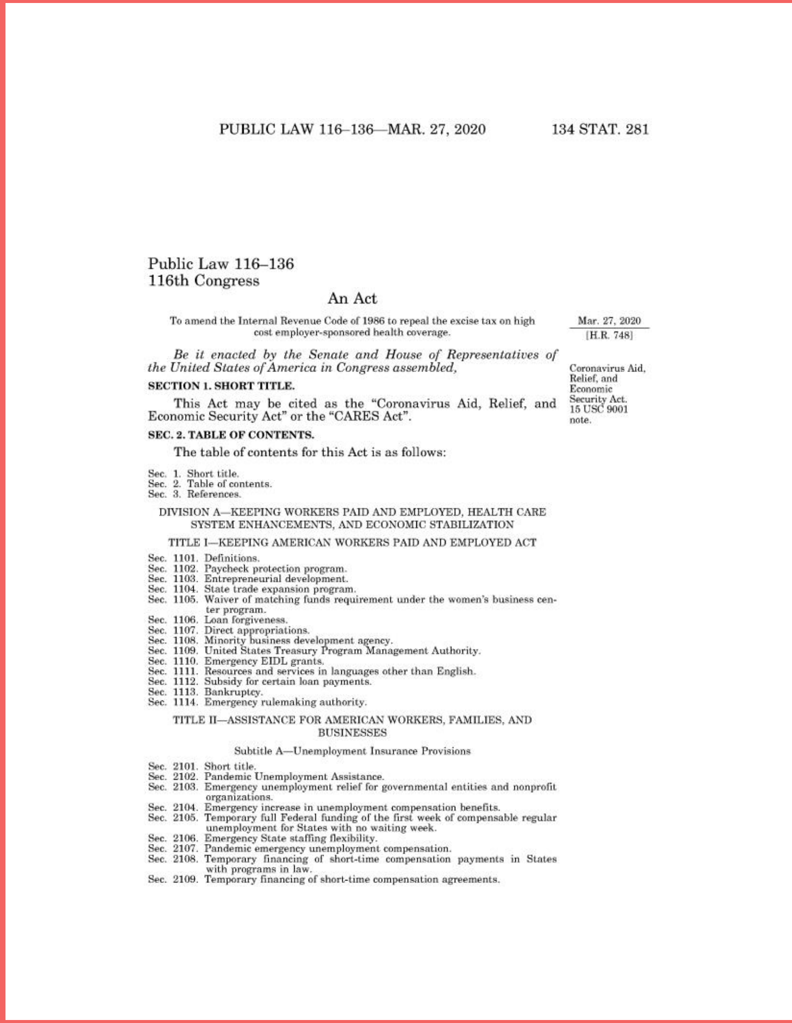
CARES Act Relief Programs

- The CARES Act, which was signed into law in March 2020, created $2.2 trillion in economic stimulus programs to respond to the COVID-19 pandemic.
- The Act provided substantial aid to businesses and individuals, protections for workers, and assistance to states and the healthcare industry.
- The government extended these programs and provided additional pandemic relief through several amendments to the CARES Act, including the Economic Aid Act in December 2020 and the American Rescue Plan Act in March 2021.
- Our focus is on the relief programs that provide federal loans and grants directly to businesses, primarily through the Small Business Administration.

CARES Act Relief Programs

- In the CARES Act, Congress created:
  - Paycheck Protection Program
  - Main Street Lending Program
  - Loans to Aviation Companies
  - Loans to Companies Critical to National Security

- More recently:
  - Shuttered Venue Operator Grants
    - Applications opened April 26, 2021
  - Restaurant Revitalization Fund Grants
    - Applications opened May 3, 2021



PUBLIC LAW 116–136—MAR. 27, 2020 134 STAT. 281

Public Law 116–136
116th Congress

An Act

To amend the Internal Revenue Code of 1986 to repeal the excise tax on high cost employer-sponsored health coverage.

Mar. 27, 2020
[H.R. 748]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Coronavirus Aid, Relief, and Economic Security Act. 15 USC 9001 note.

SECTION 1. SHORT TITLE.

This Act may be cited as the "Coronavirus Aid, Relief, and Economic Security Act" or the "CARES Act".

SEC. 2. TABLE OF CONTENTS.

The table of contents for this Act is as follows:

CARES Act Relief Programs – Focus on Paycheck Protection Program

- The Paycheck Protection Program was the most popular program of direct assistance to businesses.
  - The PPP has provided over $700 billion in loans to small businesses.
  - SBA lenders have made over 8 million PPP loans.
  - The PPP involves over 5000 participating lenders, including many new to SBA lending.
- The deadline to apply for a PPP loan was extended several times. The application deadline is now May 31, 2021, with no current push for extending again.

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Polling Question 1

Did your company receive a Paycheck Protection Program loan?

Civil Liability and Potential Risk Factors

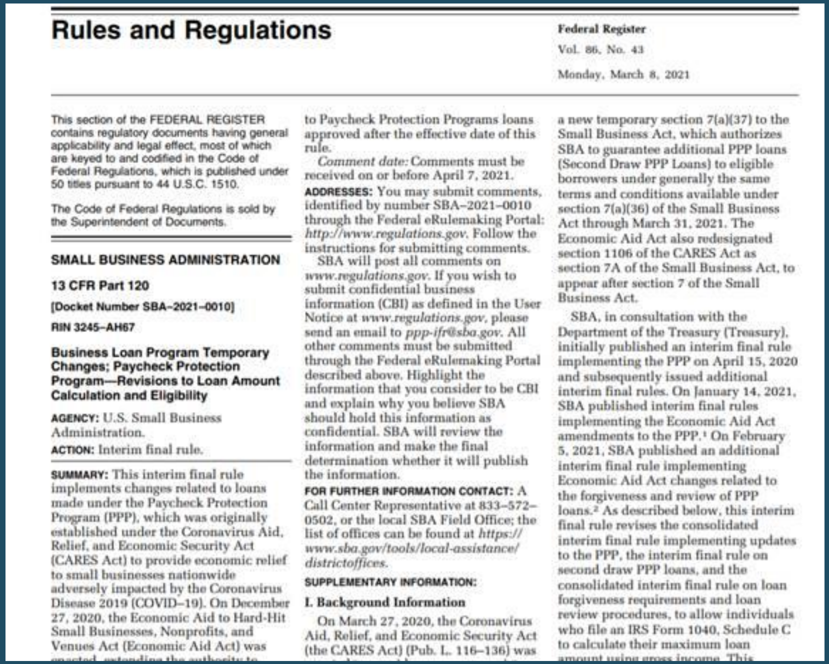
Touchpoints for Potential Liability

- Beginning - Eligibility
  - Certifications
    - Economic necessity
    - Affiliates & number of employees
- Middle - Compliance with Program Requirements
  - Restrictions on borrowers & grantees
    - Main Street Lending Program – restrictions on dividends and executive compensation
    - Escrow requirement for change in ownership transactions involving PPP borrowers
  - Limitations on expenditure of funds
- End – PPP Forgiveness, Reporting & Document Retention
  - PPP Forgiveness application – more certifications
  - Reporting under grant programs
  - Retention of documents under PPP for six years

Liability Risks at the Beginning, Middle & End of Relief Programs

Touchpoints for Potential Liability

- The Small Business Administration's shifting guidance on a variety of issues creates risk for businesses.
  - The SBA and Treasury have published **30** interim final rules in the past year on the PPP alone.
  - SBA has issued **30 pages** of FAQs on the PPP; additional FAQs on forgiveness of PPP loans.
- The frequent changes to the government's guidance has created a moving target problem for businesses.



Rules and Regulations

Federal Register
Vol. 86, No. 43
Monday, March 8, 2021

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

The Code of Federal Regulations is sold by the Superintendent of Documents.

SMALL BUSINESS ADMINISTRATION

13 CFR Part 120

[Docket Number SBA–2021–0010]

RIN 3245–AH67

Business Loan Program Temporary Changes; Paycheck Protection Program—Revisions to Loan Amount Calculation and Eligibility

AGENCY: U.S. Small Business Administration.

ACTION: Interim final rule.

SUMMARY: This interim final rule implements changes related to loans made under the Paycheck Protection Program (PPP), which was originally established under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to provide economic relief to small businesses nationwide adversely impacted by the Coronavirus Disease 2019 (COVID–19). On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Economic Aid Act) was enacted, extending the authority to Paycheck Protection Programs loans approved after the effective date of this rule.

Comment date: Comments must be received on or before April 7, 2021.

ADDRESSES: You may submit comments, identified by number SBA–2021–0010 through the Federal eRulemaking Portal: *http://www.regulations.gov*. Follow the instructions for submitting comments.

SBA will post all comments on *www.regulations.gov*. If you wish to submit confidential business information (CBI) as defined in the User Notice at *www.regulations.gov*, please send an email to *ppp-ifr@sba.gov*. All other comments must be submitted through the Federal eRulemaking Portal described above. Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential. SBA will review the information and make the final determination whether it will publish the information.

FOR FURTHER INFORMATION CONTACT: A Call Center Representative at 833–572–0502, or the local SBA Field Office; the list of offices can be found at *https://www.sba.gov/tools/local-assistance/districtoffices*.

SUPPLEMENTARY INFORMATION:

I. Background Information

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) (Pub. L. 116–136) was ... a new temporary section 7(a)(37) to the Small Business Act, which authorizes SBA to guarantee additional PPP loans (Second Draw PPP Loans) to eligible borrowers under generally the same terms and conditions available under section 7(a)(36) of the Small Business Act through March 31, 2021. The Economic Aid Act also redesignated section 1106 of the CARES Act as section 7A of the Small Business Act, to appear after section 7 of the Small Business Act.

SBA, in consultation with the Department of the Treasury (Treasury), initially published an interim final rule implementing the PPP on April 15, 2020 and subsequently issued additional interim final rules. On January 14, 2021, SBA published interim final rules implementing the Economic Aid Act amendments to the PPP.[1] On February 5, 2021, SBA published an additional interim final rule implementing Economic Aid Act changes related to the forgiveness and review of PPP loans.[2] As described below, this interim final rule revises the consolidated interim final rule implementing updates to the PPP, the interim final rule on second draw PPP loans, and the consolidated interim final rule on loan forgiveness requirements and loan review procedures, to allow individuals who file an IRS Form 1040, Schedule C to calculate their maximum loan

Touchpoints for Potential Liability

"Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant."

- The certification of necessity is a particularly significant liability risk for PPP borrowers.

- The CARES Act did not create a bright-line test for necessity, but did set out the following guardrails:
  - The traditional SBA test – that the borrower was *unable to obtain credit* elsewhere – does not apply.
  - The Act presumes that borrowers have suffered adverse impact by the COVID-19 pandemic.
  - Eligibility is met between these guardrails.

- There is still ambiguity as to what "necessary" really means. The SBA is re-examining many borrowers' certifications as part of the loan forgiveness process.

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Civil Fraud Enforcement – SlideBelts Inc. Settlement

- DOJ reached the first civil fraud settlement related to the PPP in early 2021 with SlideBelts Inc., an internet retailer.
- Prior to applying for a PPP loan, SlideBelts had filed for bankruptcy.
  - Bankruptcy debtors are not eligible for PPP loans.
  - Nonetheless, SlideBelts claimed that it was not involved in any bankruptcy on its loan application materials and in its loan agreement.
- DOJ claimed entitlement to $4.2 million in penalties and damages.
  - Loan was only worth $350,000.
  - Borrower had paid back loan in response to demands by the government.
- The company and its CEO ultimately paid $100,000 in damages and penalties in addition to repaying the loan.

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Civil Fraud Enforcement – DOJ Civil Division's FinTech Investigation

- DOJ's Civil Division is currently investigating whether FinTech company Kabbage Inc. and multiple other FinTech companies miscalculated the amount of loans PPP borrowers were entitled to receive.
- The potential miscalculations targeted by the investigation reportedly stem from confusion about how to account for payroll taxes.
- It is not clear that there was any misconduct or that the investigation will result in any penalties, but the probe demonstrates the heightened risk of investigations that lenders and FinTech companies are exposed to when facilitating pandemic relief programs.

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Touchpoints for Potential Liability

- Several factors increase the risk that companies will find themselves subject to government investigations related to COVID-19 relief, including:
  - An uptick in whistleblower reports and lawsuits under the False Claims Act ("FCA");
  - Audits of all PPP loans of $2 million or more; and
  - Increased coordination among federal law enforcement agencies across the United States, and internationally.

Risk Factors

Risk Factors – Whistleblower Complaints

- Whistleblower complaints are likely to increase in the coming months and trigger government inquiries under the PPP and other COVID-19 relief programs.
- DOJ is actively encouraging whistleblowers to bring claims forward, and certain claims can prove highly lucrative for the whistleblower.
- Growing concerns about layoffs and disconnected, disgruntled employees could lead to an increase in whistleblower complaints.

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Risk Factors – Whistleblower Complaints

- The FCA provides for *qui tam* lawsuits.
  - Brought on behalf of the United States by individuals with knowledge of alleged fraud against the government.
  - Substantial risk for businesses: Cost of a FCA violation can far exceed the amount of the alleged fraud.
    - Civil penalties of up to $23,607 per false claim *plus* treble damages.
    - Relators and DOJ will parse the alleged fraud to maximize the number of distinct false claims for payment, further increasing a company's liability by driving up the amount of civil penalties.
    - Depending on whether DOJ takes over a case, whistleblower could recover as little as 15 percent to as much as 30 percent of the total recovery if successful.

Qui tam whistleblowers are "an essential source" of leads for government enforcement actions.

DOJ, March 26, 2021

Polling Question 2

Has your company applied for forgiveness of its PPP loan?

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Risk Factors – PPP Audits

- The SBA is automatically auditing all PPP loans of $2 million or more as part of the loan forgiveness process.
  - Tens of thousands of loans issued under the program meet or exceed this threshold.
- As part of these audits, borrowers must complete a loan necessity questionnaire, which the SBA uses to conduct a *post hoc* assessment of borrowers' necessity certifications.
  - The questionnaire seeks information to evaluate how well or poorly a company predicted its need for a PPP loan by looking at business activity and liquidity.
  - There is concern that these audits may lead to adverse forgiveness determinations or fraud allegations.
- There is no free pass for smaller loans: SBA is also auditing PPP loans under $2 million "as appropriate" – if forgiveness applications raise concerns.

Risk Factors – Mergers and Acquisitions

- Many companies that took PPP loans are now or will soon be the subject of merger or acquisitions transactions.
- When an event qualifying as a “change in ownership” occurs, the borrower must follow certain procedures set out by the SBA.
- A “change in ownership” includes:
  - The sale of at least 20 percent of the ownership interest of the borrower;
  - The borrower selling or otherwise transferring at least 50 percent of its assets; and
  - The borrower merging with or into another entity.

Risk Factors – Mergers and Acquisitions

- Even after a change of ownership, borrowers remain responsible for
  - Performing all obligations under the PPP loan;
  - The certifications made when applying for the PPP loan, including the certification of necessity; and
  - Compliance with all other applicable PPP requirements.
- Companies and SPACs acquiring or merging with borrowers are therefore poised to inherit the borrowers' PPP compliance obligations, as well as any liability for false certifications made in connection with the loan applications.
- There are reportedly dozens of SPAC transactions involving startups that received forgivable pandemic relief loans within the past year – this trend is likely to continue.

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Risk Factors – Increased Law Enforcement Coordination

- U.S. law enforcement is increasingly coordinating across DOJ components and other government agencies.
- DOJ has also pursued international coordination between its International Computer Hacking and Intellectual Property ("ICHIP") program and foreign counterparts.
  - Given that PPP funds cannot be spent by foreign affiliates, intra-company payments that cross international borders may be an emerging risk area for scrutiny by regulators.
- The result is more investigations and DOJ enforcement activity.

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Criminal Cases

Department of Justice Enforcement Actions

- In March 2021, one year after Congress passed the CARES Act, DOJ announced that it had criminally charged 474 individuals for their alleged fraudulent activities.
- The alleged frauds involved efforts to obtain a collective $569 million through schemes related to the COVID-19 pandemic.
- Among other tools, DOJ is using the fraud injunction statute to pursue and stop fraudulent activities related to the pandemic.
- DOJ's enforcement activity is likely to turn from simpler criminal activities to more complex white-collar schemes.

"Historic level of enforcement action"

US DOJ , March 26, 2021

Early Simple Fraud Cases Shifting to More Complex Conduct

- Most criminal cases to date have dealt with blatant fraud:
  - False loan applications misrepresenting key eligibility requirements. Examples include:
    - Falsely representing the number of a company’s employees.
    - Intentionally misspelling a proprietor's name to conceal that he was under indictment and therefore ineligible.
    - In some cases, applications were supported by falsified documents (bank statements, tax documents, etc.).
    - Misappropriating pandemic relief funds to purchase luxury homes, luxury cars (Lamborghinis seem popular), and in one case, an alpaca farm.

- DOJ is expected to increase scrutiny of corporate entities and pursue cases involving more complex conduct in the coming months, in line with recent civil investigations and enforcement.

“To anyone thinking of using the global pandemic as an opportunity to scam and steal from hardworking Americans, my advice is simple – don’t. . . . No matter where you are or who you are, we will find you and prosecute you to the fullest extent of the law.”

Nicholas L. McQuaid, Acting Assistant Attorney General, Department of Justice, Criminal Division

Polling Question 3

Has SBA approved forgiveness of your PPP loan?

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Compliance Tips

Compliance Tips

- Ensure financial and accounting controls are in place to guarantee that program loans are only used for permitted expenditures.
- Designate one or more individuals to “own” compliance with applicable program requirements and to ensure compliance is well documented.
- When acquiring or merging with a company that benefitted from a pandemic relief program, conduct due diligence targeted specifically at compliance and potential fraud related to those programs.

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Compliance Tips – Paycheck Protection Program

- For the certification of necessity, prepare and maintain a detailed memorandum documenting:
  - The company's view of the economic uncertainty it faced when it applied for the PPP loan;
  - How that uncertainty impacted its operations, the impacts on the company's business attributed to the uncertainty created by the pandemic;
  - The (un)availability of other potential sources of liquidity and the (in)adequacy of such liquidity; and
  - The reasons why a PPP loan was necessary to retain employees.
- Maintain a robust file of supporting documentation for the memorandum.

Compliance Tips – Documentation is Key

- In all federal relief programs, maintaining accurate and clear documentation is key to ensuring – and proving – compliance with program rules.
  - For instance, under PPP, maintaining clear documentation will allow businesses to provide consistent information across initial application, forgiveness application, loan necessity questionnaire, and additional submissions to SBA.

- Ensure the company's document retention protocols do not cause inadvertent and premature destruction of required and other relevant program documentation.
  - Shuttered Venue Operator Grants require grantees to retain employment records for four years after receiving grant.
  - PPP documentation must be retained for six years after forgiveness.

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Presenters

Adrianne L. Goins

Counsel

Washington

+1.202.639.6533

agoins@velaw.com

Adrianne Goins resolves disputes for clients. Her practice focuses on commercial arbitration and government contracts disputes. Adrianne is a trusted advisor on major legislative and policy developments including the Paycheck Protection Program and other measures related to the coronavirus pandemic.

Jessica S. Heim

Partner

San Francisco

+1.415.979.6920

jheim@velaw.com

Jessica helps clients—specifically companies, their Audit Committees or individual executives—respond to issues that arise through whistleblower hotlines or government inquiries of every sort. She works with them to conduct internal investigations and advises and defends them in government investigations and enforcement actions.

G. Zachary Terwilliger

Partner

Washington

+1.202.639.6568

zterwilliger@velaw.com

Zachary ("Zach") Terwilliger has extensive experience in federal trials, appeals and investigations. Those frontline skills combine with his mastery of involved management roles overseeing operational programs, setting policy parameters and managing teams to accomplish strategic objectives.

THANK YOU

Office address

Office phone numbers

Email address

www.velaw.com

@VinsonandElkins

Austin T +1.512.542.8400	**Dallas** T +1.214.220.7700	**Dubai** T +971.4.330.1800	**Houston** T +1.713.758.2222	**London** T +44.20.7065.6000	**New York** T +1.212.237.0000
Richmond T +1.804.327.6300	**Riyadh** T +966.11.250.0800	**San Francisco** T +1.415.979.6900	**Tokyo** T +81.3.3282.0450	**Washington** T +1.202.639.6500	

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