Overview

Join us for our Lender Beware webinar on May 6. Click here for more information and to register.

The first $349 billion is already exhausted. The speed with which that money was depleted shows how quickly borrowers lined up and lenders jumped in to participate in the Paycheck Protection Program (PPP) under the CARES Act. But the urgency prompting this reaction also is fertile ground for future civil liability.

Lenders face at least two potential adversaries who will scrutinize their choices and their conduct in processing and servicing loans under the PPP: dissatisfied loan applicants and the government. Civil litigants have already begun mining the new regulations provided in the (immediately effective) Interim Final Rule to find alleged fault with how lenders have processed loan applications. It can be anticipated that the federal and state governments will also investigate and bring enforcement actions against lenders in the months and years to come for flawed underwriting and lending practices in connection with PPP loans.

To defend against civil liability, lenders must unpack what the PPP regulations actually require—and that includes understanding where they remain silent.

Recent Civil Litigation

Recently filed lawsuits have accused lenders of numerous allegedly wrongful practices in how they have processed loan applications under the PPP. The lenders are an easy target—while small businesses are suffering and unable to receive funding, some lenders have been accused of profiting off the taxpayer funded loan program. And banks receiving public money in response to a financial crisis harkens back to strongly negative headlines from 2008.

Over the last two weeks, multiple putative class action lawsuits have been filed against major lending institutions across the United States. Plaintiffs sharply criticize lenders for the following types of alleged misconduct:

- Failing to approve loans on a “first-come, first-served” basis
- Prioritizing existing customers over new applicants
- Prioritizing larger loans so as to earn larger fees
- Failing to disclose—and, in some cases, affirmatively misrepresenting—to the public how they were processing the applications

While these allegations may have bumper-sticker appeal to a frustrated public, the relative strength of the actual claims is fact-specific and may not bear the weight of legal scrutiny.

As a threshold matter, the PPP rules and overall structure do not necessarily align with how lawsuits are characterizing them.
• First, the CARES Act does not provide for an express private cause of action, and it appears unlikely that courts will interpret it as providing an implied one. A federal court in Maryland has already held that it does not. See Profiles, Inc. v. Bank of America Corp., No. SAG-20-0894, 2020 WL 1849710, *7 (D. Md. Apr. 13, 2020) (denying temporary and preliminary injunctive relief against a lender for its restrictions on borrowing under the PPP) (currently on interlocutory appeal to the Fourth Circuit). As a result, civil actions brought exclusively under the CARES Act may not survive a motion to dismiss.

• Second, there is a disconnect between public perception of what lenders are required to do in processing the loan applications and what the PPP rules in fact provide. Even if lenders are considered Small Business Administration (SBA) “delegates” when processing and servicing loans (see, e.g., the Lender Application Form), the lender obligations under the PPP program rules are relatively few. For example, the section of the Interim Final Rules titled, “What do lenders need to know and do,” principally addresses borrower eligibility, reduced lender underwriting requirements, and lender fees—as opposed to providing detailed rules that lenders must follow when processing loan applications.

Indeed, although the Interim Final Rule generally describes the PPP as “first-come, first-served,” nothing in the regulations covering lenders requires them to process individual applications on a first-come, first-served basis, or prescribes the criteria on which they must base approval decisions. “The statutory language does not constrain banks such that they are prohibited from considering other information when deciding from whom to accept applications, or in what order to process applications it accepts.” Profiles, Inc., 2020 WL 1849710 at *7.

• Third, the undeniable financial incentive for the banks to issue larger loans—they earn a larger fee—is transparent. If Congress had intended to incentivize lenders’ participation without regard to loan size, it could have structured fees accordingly (for example, by providing for a flat fee). It did not do so.

In light of the above framework, the source of a lender’s potential civil liability from private suit appears less likely to arise from failing to meet the requirements of the CARES Act itself, than it is to arise from lender representations to borrowers about how it intends to process loan applications. To that end, some recent lawsuits have alleged that lenders affirmatively misrepresented how they would process applications, and that plaintiffs relied on those misrepresentations to their detriment—by standing in line with the wrong financial institution and missing out on receiving any federal funds as a result. Other lawsuits do not identify actual misrepresentations but instead allege that lenders had an affirmative duty to disclose their processes and wrongfully concealed them. Broadly speaking, plaintiffs allege concrete financial harm arising out of the failure to receive PPP funds.

In supporting these allegations, some plaintiffs have pointed to advertisements on bank websites that applications would be processed on a “first-come, first-served” basis, while others have identified email communications from lenders that confirmed their applications were timely received, only to be told later that the lenders never submitted them to the SBA. Many plaintiffs have cited the fact that they were permitted to apply to only one lender for a PPP loan to avoid triggering a fraud alert, which allegedly strengthened their reliance on lender representations about how their loan application would be processed.

Multiple putative class action lawsuits against large lenders arising out of their participation in the PPP are now pending across the country, alleging statutory and common law-based claims and seeking a variety of monetary and injunctive remedies. Claims include, inter alia, breach of fiduciary duty, negligence, promissory estoppel, fraudulent concealment, unjust enrichment and a variety of statutory-based consumer fraud, false advertising, and unfair and deceptive business practices claims. Other actions have focused on the alleged impact the failure to receive funding had on the would-be borrower, including claims for intentional interference with contractual relations and tortious interference with prospective economic advantage.

Litigation of these claims will require courts to determine several issues, but a threshold question will be the legal relationship between the particular lender and potential borrower, so as to identify the scope of any alleged duties owed between them. Resolution of that question may be highly fact-specific and undermine class certification.

Other fact-specific questions will focus on what exactly was represented, whether the potential borrower was in fact misled, and whether the cause of its injury was the alleged deception (versus, more generally, the pandemic or the applicant’s ineligibility for the loan). Finally, for the reasons identified above, to the extent certain claims require allegations that a government regulation was actually violated, that element may be lacking.

Potential Government Scrutiny of PPP Lenders

In addition to private causes of action, PPP lenders face potential future civil scrutiny from the Department of Justice (DOJ) and other law enforcement if they fail to comply with the PPP lender obligations. (There also may be criminal investigations, which will be covered in the next Lenders Beware alert). Though the CARES Act has relaxed many traditional underwriting requirements, it has not eliminated them altogether. The future interpretation and enforcement of those requirements remain open questions.
Several provisions within the PPP appear to soften underwriting requirements and offer protection to lenders who voluntarily participate in the PPP. For example, in a section titled, "What do lenders have to do in terms of loan underwriting," the Interim Final Rule generally allows lenders to confirm "receipt" of certain documentation (and shifts the burden to the borrowers to certify the accuracy of what they provide). See Interim Final Rule at 3.b.i-iii. And, in a section titled, "Can lenders rely on borrower documentation for loan forgiveness," the rule offers the following answer:

Yes. The lender does not need to conduct any verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified the payments for eligible costs. The Administrator will hold harmless any lender that relies on such borrower documents and attestation from a borrower. Id. at 3.c. The rule further explains that this "hold harmless" provision is in accord with Section 1106(h) of the CARES Act, which forbids the administrator from bringing any enforcement action against a lender that relies on this documentation in the context of loan forgiveness.

But these more forgiving provisions do not present the full picture of potential liability for a lender. For example, the FAQs issued in conjunction with the Interim Final Rule appear to go beyond asking a lender to confirm "receipt" of borrower documentation. Instead, they indicate that, in regards to borrower payroll costs, "[l]enders are expected to perform a good faith review, in a reasonable time, of the borrower's calculations and supporting documents concerning average monthly payroll cost." Additionally, the CARES Act does not exempt lenders from all anti-money-laundering and fraud monitoring roles. Lenders must still follow BSA requirements, although they are not always required to re-verify BSA information where they have an existing relationship with a borrower. See Interim Final Rule at 3.b.iv. BSA violations can subject entities and individuals to stiff civil and criminal penalties.

To that end, lenders should be wary of relying on any relaxed element of the underwriting rules, as there is virtually no guidance thus far as to how the DOJ or other relevant regulators, investigators and prosecutors will interpret the intersection of CARES Act obligations with other, generally applicable (and more stringent) lending standards, like Know Your Customer requirements. This concern is elevated in potential situations where lenders have actual knowledge about borrowers (from other lending activities), and that knowledge conflicts with the information provided by those same borrowers when applying for PPP loans.

Moreover, every "verification" provided by a lender to the SBA is, if not accurate, a potential source of False Claims Act (FCA) liability, and there is precedent for such an enforcement regime. In the aftermath of the last financial crisis, the DOJ ramped up its FCA enforcement of certifications made with regard to government-backed mortgages (e.g., FHA loans). In the FHA context, lenders argued that the DOJ was attempting to penalize relatively minor or inadvertent ministerial errors, and yet the DOJ nonetheless secured billions of dollars from mortgage lenders, both big and small. While the current administration has significantly curtailed the use of the FCA to pursue mortgage lenders, there is no reason that a future administration could not use similar tactics to investigate PPP lenders.

Finally, even the "hold harmless" language in the Interim Final Rule is less than a model of clarity. First, it arguably applies only to actions taken in connection with PPP loan forgiveness, not the loan application or servicing. See Interim Final Rule at 3.c. Second, while the provision may shield lenders from certain SBA enforcement actions, it does not appear to extend to other government agencies. A future DOJ administration could interpret the CARES Act regulations less permissively than the present one.

For all of these reasons, the landscape of potential liability for lenders participating in the PPP is anything but certain. Lenders should pay particular attention to how they are representing their processes and procedures to potential borrowers, who may rely on those representations in deciding how to proceed in these very uncertain times. Lenders should also proceed cautiously if any proposed course of action appears to deviate from sound compliance processes to which they typically adhere. Given how quickly the ground is shifting, lenders should document their understanding of and reliance on the current rules, as well as their good faith compliance with them, as added potential defenses for later scrutiny. Finally, lenders should be on the lookout for any guidance offered by the SBA and other government agencies over the coming weeks and months as further clarification of the rules is provided.
News & Publications

CLIENT ALERTS
Lender Beware Series - Part I: Mitigating Risks in Lending Stimulus Funds to Small Businesses
April 27, 2020
By: Ashwin J. Ram, Leah M. Quadrino, Stacie R. Hartman, Matthew B. Kulkin, Michael Campion Miller, Jeremy B. Glen, Anna M. Stressenger, Caitlin Conroy, Jason Meade, Josh Oppenheimer

CLIENT ALERTS
Lender Beware Series - Part III: Criminal Exposure for Banks Participating in the CARES Act
May 5, 2020
By: Michael Campion Miller, Stacie R. Hartman, Matthew B. Kulkin, Leah M. Quadrino, Ashwin J. Ram, Jeremy B. Glen, Jason Meade, Caitlin Conroy, Anna M. Stressenger

Events
ON DEMAND
Lender Beware: Mitigating Risks in Lending Stimulus Funds to Small Businesses
May 6, 2020
Speakers: Michael Campion Miller, Stacie R. Hartman, Matthew B. Kulkin, Leah M. Quadrino, Ashwin J. Ram, Jeremy B. Glen

Practices
Financial Services
Commercial Litigation

© 2021 STEPTOE & JOHNSON LLP. ALL RIGHTS RESERVED. ATTORNEY ADVERTISING.