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PPP Loan Forgiveness: Appealing Adverse Rulings, Responding to SBA Loan Audits

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Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act

- \$325B to small businesses, including \$284B for PPP expansion
 - Second Draw PPP loans – expires March 31, 2021
 - Must be a prior PPP borrower for Second Draw loans
 - \$80B reserved for minority borrowers, low-income borrowers, employers of 10 or fewer employees and small lenders
 - \$35B reserved for new PPP borrowers:
 - Newly authorized categories of eligible borrowers (e.g., news organizations)
 - Old PPP rules apply to these new borrowers



Second Draw PPP Loans

- Eligibility –
 - 300 or fewer employees, except for hospitality industry
 - Must show 25% reduction in gross receipts in the first, second, third or fourth quarter of 2020 compared to the same quarter in 2019
- Loan amount – 2.5 X average total monthly payroll costs during, at applicant's option, the one year period before the date on which the loan is made or 2019 calendar year
 - \$2M maximum loan
 - Multiplier is increased to 3.5 for hospitality industry
- Covered period – option of 8 week or 24 week period
- Authorized uses expanded



Other PPP Provisions

- PPP authorized expenses are tax deductible
- Loan forgiveness process simplified for smaller loans
- Grants up to \$10M for live venue or performing arts operators/promoters, independent movie theaters and film and theatrical producers and cultural organizations that suffered economic loss as a result of the pandemic



Where we were

- Trump issued national emergency on March 13th.
- CARES Act passed on March 27th creating the Paycheck Protection Program (PPP) using the existing SBA 7a program. Program specifically says borrowers do not need to show that credit is unavailable elsewhere.
- Banks are given a week to digest the terms of the new program, create internal policies to implement the program, and put together loan documents.
- Treasury Secretary Mnuchin on April 1st says he will consider replenishing PPP if funds run out.
- SBA issues its first interim rule the night before the program opens, modifying the application, and confirming that the available funds are first-come, first-serve.





Where we are now

- Covered periods have ended. Borrowers have applied for loan forgiveness or getting ready to apply for loan forgiveness.
- SBA issued necessity questionnaires for loans \$2 million or more. Lenders start requesting completed necessity questionnaires for any borrower who has already filed for loan forgiveness.
- Appropriations Act signed into law by President Trump on December 27th modifying the terms of the PPP and appropriating funds to SBA for the audit process.

Loan Forgiveness



Loan Forgiveness Approval Process



SBA Review and Appeal Rights



Important Deadlines for Reviews and Appeals

Step 1: Borrower Applies for Loan Forgiveness

- Three Existing Loan Forgiveness Applications:
 1. SBA Form 3508 (06/20)
 2. SBA Form 3508EZ (6/20)
 3. SBA Form 3508S (10/20) – For loans of \$50,000 or less

SBA Form 3508EZ versus SBA Form 3508 Form

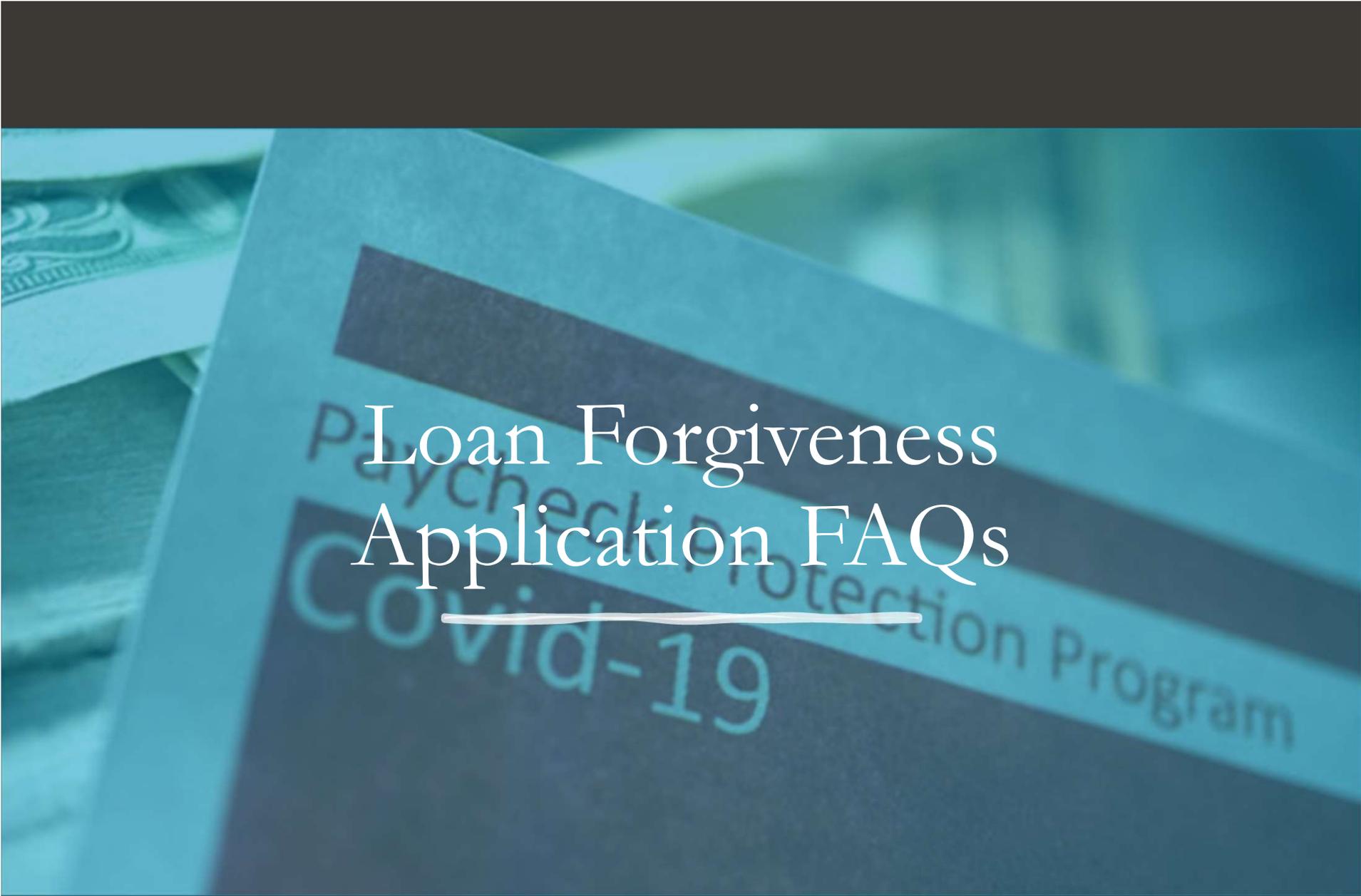
- SBA Form 3508EZ –
 - Sole proprietor with no employees
 - Businesses who can certify:
 - Did not reduce salary or wages more than 25%; and
 - Did not reduce employees or average paid hours.
 - Businesses who can certify:
 - Did not reduce salary or wages more than 25%; and
 - Unable to operate due to requirements from HHS, CDC or OSHA.

\$150,000 Certification

- Loans up to \$150,000 will be forgiven in full if the borrower signs and submits a certification (of not more than one page) that provides minimal information (number of employees retained due to PPP loan, estimated amount of loan spent on payroll expenses, and total loan value) and agrees to retain relevant records for a period of four years (employment records) or three years (all other records).
- Certification form expected later this month.

New Uses Eligible for Loan Forgiveness

- **Covered operations expenditures** - Cloud computing, and other human resources and accounting needs.
- **Covered property damage costs** - Costs related to property damage due to public disturbances that occurred during 2020 that are not covered by insurance.
- **Covered supplier costs** - Expenditures to a supplier pursuant to a contract, purchase order, or order for goods in effect prior to taking out the loan that are essential to the borrower's operations at the time at which the expenditure was made. Supplier costs of perishable goods can be made before or during the life of the loan.
- **Covered worker protection expenditure** - Personal protective equipment and adaptive investments to help borrower comply with federal health and safety guidelines or any equivalent state and local guidance related to COVID-19 during the period between March 1, 2020, and the end of the national emergency declaration.



Loan Forgiveness Application FAQs

Step 2: Lender Reviews Loan Forgiveness Application

- Lender has 60 days from receipt of a complete loan forgiveness application to determine whether the borrower is eligible for loan forgiveness and send the decision to SBA.

What will Lender Review?

- When borrower submits loan forgiveness application, Lender will:
 - ✓ Confirm receipt of the borrower certifications;
 - ✓ Confirm receipt of the documents the borrower must submit to verify payroll and nonpayroll costs;
 - ✓ Confirm the borrower's calculations for payroll and nonpayroll expenses using documents submitted by borrower; and
 - ✓ Confirm that borrower made the calculation correctly with respect to the 60% payroll requirement.

Step 3: Lender will Notify SBA of its Decision on Loan Forgiveness Application

- Lender may:
 - Approve (in whole or in part)
 - Deny
 - Deny without prejudice due to pending SBA review of the loan for which forgiveness is sought

➤ Borrower May Request SBA Review of Lender's Decision

- Lender must notify borrower in writing if the lender denies loan forgiveness application in full.
- Borrower may request that SBA review lender's decision by notifying its lender within 30 days of receipt of the denial notice. The PPP lender must notify SBA of the review request within 5 days of receiving the request.
- If SBA accepts borrower's request SBA will notify the borrower and the lender of the results of the review.

Step 4: SBA Reviews Lender's Decision

- SBA has 90 days to review the lender's decision and remit the loan forgiveness amount to the lender plus any interest accrued through the date of remittance.
- If any information submitted to SBA indicates the borrower may be ineligible for a PPP loan SBA will require the PPP lender to contact the borrower in writing to request additional information. SBA may also contact the borrower directly.

➤ What must a Lender do when SBA Notifies the Lender that SBA is initiating a Loan Review?

- If SBA reviews a PPP loan it will notify the lender via the PPP Forgiveness Platform. Lender has to notify borrower in writing within 5 business days of receipt of notification from SBA.
 - NOTE: This is different from a review by OIG or another agency.

Within 5 business days of receipt of notice of review Lender has to submit via the PPP Forgiveness Platform the following documents:

- 1) Borrower application form and all supporting documentation
- 2) Loan forgiveness application and all supporting documentation.
- 3) A signed and certified transcript of account.
- 4) A copy of the executed note evidencing the PPP loan.
- 5) Any other documents related to the loan requested by SBA.

Step 5: SBA Issues Decision

- If SBA remits loan forgiveness amount the lender will notify the borrower of the payment and the date on which the borrower's first payment is due, if applicable.
 - Lenders have to service PPP loans similarly to 7a loans.
- If SBA determines that borrower is ineligible for a PPP loan or ineligible for the PPP loan amount or loan forgiveness amount SBA may seek repayment of outstanding PPP loan balance or pursue other available remedies.

AUDITS OF PAYCHECK PROTECTION PROGRAM LOANS



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Who Will Be Audited?

- Application certification that “current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant”
- SBA FAQs 39 & 46 –
 - Borrower and its affiliates in the aggregate with loans of \$2M or more
 - “other loans as appropriate”
- Publicized abuses
- SBA FAQ 46 – “Any borrower that, together with its affiliates, received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith”



SBA Audits vs. SBA Reviews

- SBA Reviews – Loan Forgiveness Application
 - Loan forgiveness and eligibility
 - Any red flags
- Standard SBA Audits
 - More in-depth review – assume will conduct standard SBA review plus loan necessity review
 - SBA auditors can be expected to be more aggressive



How Will My Client Know When It Will Be Audited?

- Lender will notify borrower that it will be audited
 - Loan Necessity Questionnaire – SBA Forms 3509 (for-profits) & 3510 (nonprofits)
 - 10 business days to submit
 - Failure to comply – determination of ineligibility, no forgiveness, repayment of the loan, or SBA may “pursue other available remedies”
 - Must submit simultaneously loan forgiveness application if not yet submitted
 - Submit to lender
 - Lender submits through SBA portal
 - Lender must submit within 5 business days



How Will the Audit Process Be Conducted?

- Receipt of Notice of SBA Audit and Loan Necessity Questionnaire from borrower's lender
- Borrower submits Questionnaire and loan forgiveness application (if not already submitted) within 10 business days
- Lender submits borrower response within 5 business days
- If SBA requires additional information, will inform lender, who will submit request to borrower
- Borrower must submit additional information within 10 business days
- Appears that audit will be done on the papers. In-person audit?
- Borrower can appeal adverse decision under SBA appeals process



Special SBA Audits

- SBA suspects fraud or serious violations of SBA laws and regulations
- Referred to Dept. of Justice?
- Need to bring in your white collar defense partner



What Can My Client Do To Prepare for an Audit?

- Have client prepare draft of Loan Necessity Questionnaire
 - Review draft
- Have client prepare supporting documentation
- Send client due diligence questionnaire
 - Financial analysis of borrower at time of application
 - Board resolution approving the loan application
 - Review eligibility qualification
 - Review uses of loan proceeds
 - Closure or curtailment of business as a result of the pandemic
 - Availability of other funding
 - Dividend and capital distributions



What is the Loan Necessity Questionnaire?

- Business Activity Assessment
 - Gross revenue comparison 2020Q2 vs. 2019Q2
 - Seasonal borrowers – Q3 option
 - Governmental shutdown or order significantly requiring changes in operations?
 - Voluntary closure or reduction in operations or other alteration of operations?
 - New non-COVID capital improvement projects 3/13/20 thru Covered Period?



What is the Loan Necessity Questionnaire?

- Liquidity Assessment
 - Cash position prior to applying
 - Dividends and other capital distributions 3/13/20 thru Covered Period
 - Excludes pass-through estimated tax payments
 - Prepayment of debt 3/13/20 thru Covered Period
 - Refinances?
 - Employees with compensation in excess of \$250,000 during Covered Period (including owner employees)
 - 20% ownership by and market cap of public companies
 - Book value of private company borrowers prior to PPP loan application



What is the Loan Necessity Questionnaire?

- Liquidity Assessment (cont.)
 - Majority ownership by parent company
 - If parent company is a foreign company, market cap of parent if publicly listed overseas on date of loan application
 - 20% ownership by private equity firm, VC firm or hedge fund
 - Foreign government or foreign state-owned enterprise ownership
 - Other CARES Act funding



What is the Loan Necessity Questionnaire?

- Supporting documentation:
 - Financial statements showing quarterly gross revenues for 2019 and 2020
 - Balance sheet or bank statements showing cash position as of the last day of the calendar quarter immediately preceding loan application
 - Financial evidence of amounts of dividends and capital distributions
 - Financial evidence of debt prepayments
 - Payroll documentation of total compensation payments in excess of \$250,000, divided into owner-employee compensation and other employee compensation
- Designation for confidential treatment (i.e., not subject to FOI)



What is the Loan Necessity Questionnaire?

- SBA may request additional supporting documentation
 - 10 business days to respond?
- Certifications
 - Information and supporting documentation are true and correct in all material respects
 - Have made reasonable inquiry of people, systems and other information available to Borrower
 - Knowing false statement is a criminal offense



What is the Loan Necessity Questionnaire?

- Nonprofits (Form 3510)
 - Gross receipts from gifts, grants and contributions (supporting documentation)
 - Borrower's expenses for 2020Q2 and 2019Q2 (supporting documentation)
 - Restrictions on borrower's use of net income or cash for payroll and other authorized costs
 - Endowment funds (including donor-restricted endowments) (supporting documentation)
 - Non-cash investments
 - Special items for educational institutions and health care service providers



How Can You Assist Your Client in Completing the Loan Necessity Questionnaire?

- Advocacy needed:
 - Success during Covered Period
 - Distributions made to principals prior to or during the Covered Period
 - “Fat” balance sheet or available capital at time of application
- Optional response items
 - 1,000 character limitation
- Will Lender permit supplemental submissions?



Potential Audit Issues

- Rear view mirror auditor perspective on post-loan profitability
 - Certification should be evaluated at time of loan application
- Sufficiency of funds
 - Waiver of “credit elsewhere” requirement
 - SBA FAQ 31 – borrower’s “ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business”
 - But 13 C.F.R. §120.102
- Request for stakeholder information of less than 20% owners (i.e., criminal, prior SBA history)
 - 13 C.F.R. §120.110
 - SBA FAQ 12



Additional Fox Rothschild LLP Resources

- **Resource Center:** CARES Act, PPP and FFCRA
 - <https://www.foxrothschild.com/coronavirus-resources/cares-act-ppp-and-ffcra/>
- **Article:** *Will You Be Ready for a Paycheck Protection Program Audit?*
 - <https://www.foxrothschild.com/publications/will-you-be-ready-for-a-paycheck-protection-program-audit/>
- **Article:** *Stimulus Package Expands PPP, Simplifies Loan Forgiveness and Adds Disaster Grants*
 - <https://www.foxrothschild.com/coronavirus-resources/publications/stimulus-package-expands-ppp-simplifies-loan-forgiveness-and-adds-disaster-grants/>





Appealing an
SBA Loan
Review
Decision



Which SBA Decisions May be Appealed?

- Borrowers may appeal SBA loan review if SBA determines the borrower:
 - Was ineligible for a PPP loan;
 - Was ineligible for the PPP loan amount received;
 - Used the PPP loan proceeds for unauthorized uses;
 - Is ineligible for loan forgiveness in the amount determined by the PPP lender; in its full or partial approval decision issued to SBA; or
 - Is ineligible for PPP loan forgiveness in any amount when the PPP lender issued a full denial decision to SBA.

*Borrower may also have right to appeal any other PPP matter referred to OHA by SBA.

How does a Borrower file an Appeal?

- Appeals will be heard by SBA Office of Hearings and Appeals (OHA).
- Appeal petition must be filed within 30 calendar days after the earlier of:
 - a) Borrower's receipt of the final SBA loan review decision, or
 - b) Notification by borrower's lender of the final SBA loan review decision, whichever is earlier.
- Borrower must serve a copy of the appeal petition with all attachments on the Associate General Counsel for Litigation at SBA.

What must be included in the Appeal?

1. The basis for OHA's jurisdiction, including, but not limited to, evidence that the appeal is timely filed;
2. A copy of the SBA loan review decision that is being appealed, or a description of that decision if a copy is unavailable;
3. A full and specific statement as to why the SBA loan review decision is alleged to be erroneous, together with all factual information and legal arguments supporting the allegations;
4. The relief being sought;
5. Signed copies of payroll tax filings actually reported to the Internal Revenue Service (IRS), and State quarterly business and individual employee 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 (SBA Form 3508, SBA Form 3508EZ, or lender's equivalent), 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 (e.g., IRS Form 1040 with Schedule C/F) documenting income for self-employed individuals or partners in a partnership, if not provided with the PPP Borrower Application Form (SBA Form 2483 or lender's equivalent), or an explanation as to why they are not relevant or not available; and
7. The name, address, telephone number, email address and signature of the borrower or its attorney.

After the Appeal is Filed

- OHA will assign the matter to an Administrative Law Judge or Administrative Judge.
- Judge will issue a notice and order establishing a deadline for production of the administrative record and specifying a date for the close of record.
 - Typically, the administrative record will be due 20 calendar days after issuance of the notice and order unless additional time is requested and granted, and the record will close 45 calendar days from the date of OHA's receipt of the appeal unless additional time is requested and granted.

What is the Administrative Record?

- Relevant documents that SBA considered in making its final decision or that were before SBA at the time of the final decision. Does not need to contain all documents pertaining to the borrower. SBA may claim privilege as to certain materials.
- SBA is responsible for filing the administrative record and serving it on the borrower.
- Within 10 days of receipt of the record, the borrower may object to SBA's privilege designation or object to documents being absent from the record, and the Judge will issue a ruling.
- SBA may respond to an appeal and serve a copy on the borrower and each persons identified in the certificate of service before the administrative record is closed.

How Will Judge Decide the Appeal?

- Judge will determine whether the SBA loan review decision was based on clear error of fact or law. Borrower has the burden of proof.
- Generally, Judge may not admit evidence beyond the written administrative record or permit any form of discovery.
- All appeals will be decided solely on review of the written administrative record, the appeal petition, SBA's response, any admitted evidence, and any oral hearing, if held.

Judge's Decision and Right to Appeal

- Decision will be issued within 45 calendar days after close of record, as practicable.
- Judge's Decision is the initial decision. The initial decision will become final decision of SBA 30 calendar days after its service unless a request for review or a request for reconsideration is filed.
- If a request for review is filed, the decision of SBA is a final decision appealable to federal district court.

Borrower Considerations

- The parties may submit a joint motion requesting that the Judge permit alternative dispute resolution to assist in resolving the matter.
- Only the borrower can appeal. Owners of the borrower and the lender do not have standing to appeal an SBA loan review decision.
- An appeal does not extend the deferral period of the loan.
- Borrower may not file an appeal with OHA if SBA remits to the lender the loan forgiveness amount set forth in the decision issued by the lender to SBA. Borrower must begin repayment of any remaining balance of its PPP loan.
- Borrower is not entitled to recover attorney's fees incurred in pursuing the appeal if it prevails.

Will information be kept confidential?

- Information listed below that is submitted with the filing will not be available to the public pursuant to the Freedom of Information Act:
 - a) Confidential business and financial information;
 - b) Personally identifiable information;
 - c) Source selection sensitive information;
 - d) Income tax returns;
 - e) Documents and information covered under 13 C.F.R. § 120.1060; or
 - f) Any other exempt information.
- Either party may seek a protective order over any document or information filed or submitted during the appeal.

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