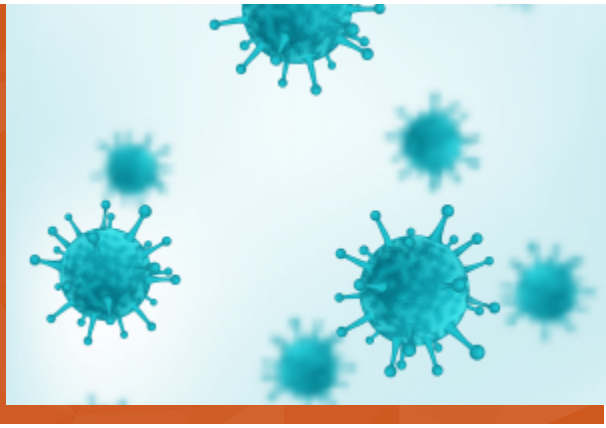
COVID-19 Alert: Question 46 Guidance

Paycheck Protection Program Update: What the Question 46 Guidance Means for Recipients of PPP Loans Under $2 Million



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As we have previously reported, on May 13, 2020, the Treasury Department and the Small Business Administration (the "SBA") released new guidance, embedded in a *Frequently Asked Questions* memorandum, that relates to the "economic necessity" requirement for Paycheck Protection Program ("PPP") loans (the "Question 46 Guidance"). The Question 46 Guidance may be found here.

Of particular note: The Question 46 Guidance provides the following "safe harbor" for recipients of smaller PPP loans:

> "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."

Based on the above language, several commentators have concluded that recipients of smaller PPP loans are not accountable for misstatements on PPP applications that relate to the economic necessity of the loan.

We believe that such interpretations of the Question 46 Guidance are inaccurate.

The Government Has Not Waived its Ability to Audit Recipients of Smaller PPP Loans for Compliance with PPP Standards

Several commentators have suggested that the Question 46 Guidance exempts recipients of smaller PPP loans from SBA audit requirements on the subject of economic necessity. This conclusion is not supported by the language of the Question 46 Guidance.

The Question 46 Guidance contains no language that suggests that recipients of smaller PPP loans are exempt from government audit authority. In fact, the third paragraph of the Question 46 Guidance plainly states (emphasis added):

> "SBA has previously stated that all PPP loans in excess of $2 million, ***and other PPP loans as appropriate***, will be subject to review by SBA for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form."

Rather than an audit exemption, the Question 46 Guidance is more properly understood as an enforcement standard *that is specific to the SBA*. Specifically, the Question 46 Guidance indicates that, in an effort to conserve its limited resources, the SBA will not investigate the intent behind economic necessity certifications made by recipients of PPP loans that are less than $2 million. As such, if the SBA conducts a general audit of a recipient of a smaller loan and determines that the loan was, in fact, not needed, the SBA will not *affirmatively* investigate the intent of the recipient to determine whether the recipient's certification of economic necessity was made in bad faith. Instead, the SBA will presume that any misstatements of economic necessity were unintentional and will impose outcomes that are consistent with unintentional acts – namely, the disgorgement of loan proceeds, without further SBA enforcement action. The relevant language of the Question 46 Guidance that relates to this latter point is here:

> "If SBA determines in the course of its review that a borrower [regardless as to loan size] lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies based on its determination with respect to the certification concerning necessity of the loan request."

To be clear: There is no language in the Question 46 Guidance that overturns the general requirement that a PPP loan recipient must demonstrate economic necessity for the loan. The scope of the Question 46 Guidance simply states that *if* the SBA conducts an audit of a smaller PPP loan recipient and determines that the loan was, in fact, not needed, the SBA will deny forgiveness of the loan, without further inquiry into the intent of the recipient.

RECIPIENTS OF SMALLER PPP LOANS ARE NOT EXEMPT FROM CRIMINAL PENALITIES OR CIVIL FINES FOR MISSTATEMENTS ON PPP LOAN APPLICATIONS

Several commentators have suggested that the Question 46 Guidance effectively exempts recipients of smaller PPP loans from criminal penalties or civil fines arising from misstatements in loan applications related to economic necessity. Such commentators emphasize the use of the term "safe harbor" as a basis of this position. Again, this conclusion is not supported by the plain text of the Question 46 Guidance. Neither the Question 46 Guidance nor any other guideline, regulation, or statute related to the PPP instructs that criminal and civil penalties for false statements on PPP loan applications concerning economic necessity do not apply to recipients of smaller PPP loans. In fact, the statutory and regulatory structure of the PPP indicates otherwise.

According to the CARES Act, the federal law that authorized the PPP, a PPP Loan is "*deemed to be a loan under the Small Business Act (15 U.S.C. 631 et seq.) for purposes of section 16 of such Act (15 U.S.C. 645)*", meaning that penalty regime of the SBA applies to PPP Loans.

Under the SBA penalty regime, an SBA loan applicant that makes a false statement on a loan application is subject to both criminal and civil penalties that escalate based on intent and knowledge. ***These penalties are identified on the PPP loan application itself***:

- **Criminal Penalties** – Potential criminal penalties for false statements or fraud in connection with a PPP loan include **(i)** imprisonment of not more than 5 years and/or a fine of up to $250,000 (18 USC §§ 1001 & 3571); **(ii)** imprisonment of not more than 2 years and/or a fine of not more than $5,000 (15 USC § 645(a)); and **(iii)** imprisonment of not more than 30 years and/or a fine of not $1 million (18 USC § 1014). Beyond the penalties expressly referenced in

the PPP loan application, criminal penalties under other federal fraud statutes or SBA-specific criminal statutes (*e.g.*, regarding embezzlement or concealment) may apply.

- **Civil Penalties** – In addition to criminal penalties, the government can pursue civil fraud remedies under the civil False Claims Act (31 U.S.C. 3729-3733) or the Program Fraud Civil Remedies Act (31 U.S.C. 3801-3812).

The Department of Justice ("DOJ"), the Securities and Exchange Commission ("SEC"), and the SBA all have enforcement authority with respect to fraud claims related to the PPP. In addition, the House and Senate have each established "select committees" to investigate PPP-related fraud. At this time, it is unclear whether the SBA's approach to reviewing PPP loans as articulated by the Question 46 Guidance will be binding on these other regulatory bodies. As described above, the Question 46 Guidance is most properly viewed as an enforcement standard, *that is specific to the SBA*, that describes how the SBA will deploy its limited resources to motivate compliance with PPP requirements. Despite the "safe harbor" language, the Question 46 Guidance is not a "liability shield" for recipients of smaller PPP loans:

- The Question 46 Guidance does not appear to be applicable to any other enforcement agency. As such, there is nothing in the Question 46 Guidance that prevents the DOJ, for example, from initiating a False Claims Act enforcement action against a recipient of a loan in an amount under $2 million for loan application misstatements regarding economic need.

- There is no language in the Question 46 Guidance that indicates that if, in the course of a general audit, the SBA discovers that a recipient of a smaller PPP loan intentionally provided false information related to economic need, that the SBA is waiving its right to assess enhanced penalties.

- The Question 46 Guidance is, at most, a statement of the SBA's present enforcement standard, given its current resource limitations. There is nothing in the language of Question 46 Guidance that indicates that the standards articulated therein are binding, and not subject to change.

As such, unless the CARES Act's penalty provisions are specifically amended, recipients of smaller PPP loan amounts remain subject to criminal penalties and civil fines if loan applications contain misstatements of economic need.

In connection with the issuance of the Question 46 Guidance, the Treasury Department has extended the deadline for PPP loan recipients to consider return of loan proceeds until **May 18, 2020** (from May 14, 2020). We recommend that all PPP loan recipients, irrespective of loan size, consider carefully whether they meet the PPP program requirements, in light of recent guidance, including guidance articulated in Questions 31, 37, 39, 43 and 46 of the Treasury Department's Paycheck Protection Program Frequently Asked Questions. We emphasize that although the Question 46 Guidance provides some assurance to recipients of smaller PPP loans, it must be understood in the larger regulatory context of the PPP program.

Morse continues to review the evolving regulatory landscape related to PPP loans and is focused on assisting our clients through these unprecedented and challenging times. Please contact the Firm should you have questions concerning this subject, or any other COVID-19 response matters.

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