No Quarter for PPP Lenders

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Much ink has been spilled in recent weeks about how some recipients of Paycheck Protection Program ("PPP") relief obtained their loans through mistakes or false pretenses. Now banks are coming under fire for their lending practices in connection with this hastily prepared and implemented program, which left them grappling with how to properly issue loans in the face of procedural and substantive gaps in the law. Many lenders tried to fill these gaps by supplementing the PPP application to address practical concerns not covered in the law. Two recent cases, however, demonstrate that banks may face legal exposure for supplementing the applicant eligibility requirements published by the Small Business Association ("SBA"). Prudent lenders would do well to consider with counsel the best ways to avoid becoming entangled in such matters.

Background on the PPP

As part of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), the SBA was authorized to establish a new loan program to assist small businesses adversely impacted by the COVID-19 emergency. P.L. 116-2. Section 1102 of the CARES Act amended the Small Business Act, 15 U.S.C. § 636, to establish the
Paycheck Protection Program ("PPP"). The PPP authorizes participating lenders to make loans to eligible small businesses. See P.L. No. 11-136, § 1102(a)(2).

Initially, a pool of $349 billion was established to fund the program, but it was quickly depleted and replenished with an additional $310 billion on April 24, 2020. The amount of any one loan is capped at $10 million per applicant. The program is meant to provide funding on a first come, first served basis. 13 C.F.R. Part 120.

The legislation financially incentivizes banks' participation in the PPP by providing participating lenders with processing fees of five percent on loans up to $350,000, three percent on loans in amounts between $350,000 and $2 million, and one percent on loan exceeding $2 million. See PPP Lenders Information Sheet, (last visited May 21, 2020).

**PPP Eligibility Requirements**

PPP borrower eligibility requirements are comparatively less stringent than those of typical business loans. To qualify for a PPP loan, an applicant need only show that it has 500 or fewer employees (or is a small business concern as defined in section 3 of the Small Business Act (15 U.S.C § 632)); was in operation on February 15, 2020 and either had employees for whom salaries and payroll taxes were paid, or independent contractors. Applicants also must certify that “current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant, [and] the funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments...” SBA Form 2484, (last visited May 21, 2020). Finally, at least currently, applicants must also certify that they have not received another PPP loan. *Id.*

**Lenders Add Criteria**

A number of lenders added additional eligibility criteria typical of other commercial loans that they process. For example, in addition to the SBA mandated requirements, some banks have required applicants to have a business checking account in that bank as of a previous date certain. Similarly, other lenders have required applicants to have had as of a previous date certain either a small business checking or credit relationship with the bank, or a small business checking account and no business credit or borrowing relationship with another lender. Criticism of these additional criteria has emerged because of concerns that it gives unfair priority to the banks’ customer over non-customers and thereby, among other things, disproportionally makes loans less available to otherwise qualified minority and women owned businesses.

**Senators Assail Banks’ Augmented Eligibility Requirements**

Sen. Marco Rubio (R. Fla.) chairs the Senate’s Committee on Small Business and Entrepreneurship, which oversees all legislation and issues relating to the SBA. On April 3, 2020, he tweeted the following:

The requirement that a #Small Business not just have a business account but also a loan or credit card is NOT in the law we wrote and passed or in the regulations.
He went on, stating that the condition is bank-added “not a govt one,” and asserted that banks “should drop it” because “[t]his money is 100% guaranteed by the fed govt.” Marco Rubio (@MarcoRubio), Twitter (Apr. 3, 2020), [url here](url here).

Sen. Ben Cardin (D-Md.), the ranking member of the committee also released a statement about the PPP that day:

I am deeply troubled by reports of financial institutions turning away small businesses that desperately need capital through the Paycheck Protection Program. The small business provisions in the CARES Act were written to get funds into the hands of American small business owners as quickly as possible so they can keep employees on payroll and avoid financial ruin while we work to combat COVID-19. Creating artificial barriers that block businesses from much-needed capital is redlining by another name.

See [Cardin Statement](Cardin Statement) on Launch of Paycheck Protection Program (Apr. 3, 2020).

In the same vein, on April 9, 2020, Senators Kaine, King and Coons wrote to the President and CEO of the American Bankers Association, advising:

We have heard from many constituents that because they do not have a preexisting account or because their lender is not accepting applications, that they are unable to apply for relief through this vital program. Unfortunately, many of these same customers that do not have preexisting relationships are those most likely to be already struggling to pay their bills and keep their businesses afloat. We are calling for your member banks with the resources to do so to open up applications for new customers urgently.

See [Letter](Letter) from Senators Kaine, King, and Coons to Rob Nichols (Apr. 9, 2020).

**Banks are Sued By Loan Applicants**

On the heels of these developments, two recent lawsuits challenge banks’ augmenting statutorily-express PPP eligibility requirements, as summarized below.

**Profiles, Inc. v. Bank of America Corp.**

In *Profiles, Inc. v. Bank of America Corp.*, 1:20-cv-00894-SAG (D. Md.), a group of small businesses took Bank of America (“BoA”) to task for allegedly implementing, “a loan process that unlawfully prioritized their existing borrowing clients by barring their depository clients and other small businesses from even applying for funds from the governmental loan programs.” Second Amended Compl., ¶ 4, Apr. 7, 2020, ECF No. 5. Plaintiffs further allege that after their lawsuit was filed, BoA “revised its policy on April 4, 2020, by allowing depository-only clients to apply for PPP loans but imposed an additional illegal requirement – that depository-only clients must have no credit card or loan with any other bank.” *Id.* at ¶ 5.

Plaintiffs’ legal claims are premised on alleged breaches of the CARES Act and the SBA’s 7(a) loan program (meant to help startup and existing small businesses obtain loans when they might not otherwise be able to obtain funding), specifically that BoA illegally created “unlawful requirements to apply for a PPP loan from it...” *Id.* at
¶¶ 101, 111. They also allege unjust enrichment based upon the allegation that by prioritizing BoA clients with BoA debt or no other bank debt, BoA enhanced its credit risk profile.

Shortly after filing their Second Amended Complaint, the Profile plaintiffs moved for a temporary restraining order and preliminary injunction, seeking to enjoin the aforementioned conduct. See Motion for Temporary Restraining Order, 1:20-cv-00894-SAG (D. Md.), Apr. 7, 2020, ECF No. 7. In denying the application, the Court focused primarily on the likelihood of success prong of the TRO analysis, finding that based on its plain language there was no implied private right of action under the CARES Act. See Memorandum Opinion, Apr. 13, 2020, ECF No. 17. The Court further held that even if the Act provided applicants with some statutory right to apply for a PPP loan through a lender of choice, nothing in the Act evidenced Congress’s intent to enable PPP loan applicants to bring civil suits against PPP lenders to enforce those rights. Id. at 13. Moreover, assuming there was an implied private right of action, the court found that the CARES Act does not prohibit banks from considering other information or dictate the order in which a bank must process the applications it accepts. Id.

**Scherer v. Wells Fargo**

A similar lawsuit was filed against Wells Fargo in the U.S. District Court for the Southern District of Texas. In Scherer v. Wells Fargo, 4:20-cv-01295 (S.D. Tex.), a self-employed small business owner and a sole proprietor alleged that the bank was “refusing to accept PPP loan applications unless the small business applicant had an established business checking account with Wells Fargo as of February 15, 2020” and as a consequence was “unlawfully prioritizing these existing customers who had a ‘Wells Fargo business checking account as of February 15, 2020.’, and shutting out other businesses who qualify equally under the PPP and CARES Act.” Second Amended Compl., ¶ 6., May 12, 2020, ECF No. 25.

The Scherer action asserts broader legal claims than those advanced in Profile. In addition, to violations of the CARES Act and the SBA’s 7(a) loan program (15 U.S.C. 636(a)), the Scherer plaintiffs allege negligence, common law fraud, unjust enrichment, and violation of twenty-four states consumer protection statutes.

Like the plaintiffs in the Profile matter, the Scherer plaintiffs moved for a temporary restraining order. See Motion for Temporary Restraining Order, Scherer v. Wells Fargo, 4:20-cv-01295 (S.D. Tex.), Apr. 22, 2020, ECF No. 9. On April 29, 2020, the court denied the motion on the grounds that the TRO was unjustified because plaintiffs had not experienced a substantial threat of irreparable injury since there were 4,975 other lenders to whom they could have applied for a PPP loan. Id. at 3. The court, unlike the judge in the Profile case, did not opine on the legal merits of plaintiffs’ claims.

Neither bank is out of the woods yet, however, as both cases now proceed to discovery.

**New Jersey May Be Fertile Ground For Lawsuits Against Lenders**
New Jersey is home to scores of banks that participate or have participated in the PPP. See Lenders Participating in PPP by State (available here). Further, notwithstanding the Profiles court’s finding that the CARES Act appears to not have an implied private right of action, lenders should not ignore that New Jersey is also home to a very broad and powerful consumer rights statute.

The New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1 et seq. (“CFA”), makes it unlawful for a “person” to use “unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, or the knowing concealment, suppression, or omission of any material fact with the intent” that someone else rely on the foregoing, “in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived or damaged thereby.” N.J.S.A. 56:8-2. The term “advertisement” includes “the attempt...to induce directly or indirectly any person to enter or not enter into any obligation or acquire any title or interest in any merchandise or to increase the consumption thereof or to make any loan.” N.J.S.A. 56:8-1(a)(emphasis added). Among other things, the CFA entitles prevailing plaintiffs to triple damages and attorneys’ fees.

Of importance, the CFA is not limited to righting wrongs against individuals. Under certain circumstances, a business may be considered a “person” under the act and may sue to enforce their rights under this statute. Coastal Group, Inc. v. Dryvit Systems, Inc., 274 N.J. Super. 171, 179-180 (App. Div. 1994). Moreover, lending is one of the activities that falls within the CFA’s broad purview. Gonzalez v. Wilshire Credit Corporation, 207 N.J. 557, 564 (2011); Lemelledo v. Beneficial Management Corp. of America, et al., 150 N.J. 255, 266 (1997).

Consequently, to avoid the risk of liability under the CFA, banks should be sure to carefully word all advertising and loan application documents to assure that they cannot arguably be said to misrepresent or inaccurately represent eligibility requirements of the PPP to applicants and potential applicants. Such measures are important in addition, because as demonstrated by the Scherer lawsuit, CFA claims are often accompanied by state common law claims.

**Takeaways**

Irrespective of the business reasons for banks wishing to require PPP applicants to have a loan/banking relationship to eligible for a PPP loan and the legal arguments that may permit them to do impose such additional requirements, there are enough cross-winds stirring for banks to be concerned and to take steps to reduce the risk of suit and potential exposure.

Similarly, as plaintiffs and politicians argue that the rationale for the PPP is to get needed money into the hands of as many impacted small businesses as possible as quickly as possible, the practice of requiring additional eligibility requirements will be further called into question. Such conduct will be argued to violate some “first come, first served” element of the program, placing it squarely in the cross-hairs of the CFA and other State’s consumer protection statutes. It is clear that there is currently a taste to sue lenders for how they process PPP loans. Until more cases
wind their way through the pipeline and the parameters of liability becomes more defined or Congress immunizes lenders for participating in the PPP, banks certainly will face litigation risk related to these issues, as well as the burden of lost time and expense that goes with it.

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