The Litigation Risks In Main Street Lending Program

By **Robert Huffman and Caroline Wolverton** (July 1, 2020)

Robert Huffman

Caroline Wolverton

If litigation stemming from the Paycheck Protection Program is a guide, legal action concerning the recently launched Main Street Lending Program will come in three primary forms: investigations and litigation based on the False Claims Act, other government investigations and borrower civil litigation against lenders.

Main Street lenders and borrowers can steer clear of litigation roadblocks by understanding the potential risks in each of these procedural areas and taking proactive measures to comply with program requirements — and to document their compliance.

Relatedly, the U.S. Department of Justice could facilitate the MSLP's objectives by issuing a policy statement that it will not bring False Claims Act actions against Main Street lenders where borrowers act contrary to their certifications of compliance, and will move to dismiss qui tam actions against Main Street borrowers and lenders that lack merit or are contrary to program objectives. This would be consistent with the DOJ's False Claims Act policies and priorities announced on June 26, for COVID-19-related programs.

Paycheck Protection Program and Main Street Lending Program

The historic Coronavirus Aid, Relief and Economic Security, or CARES, Act, signed by President Donald Trump on March 27, created the PPP and the MSLP as loan programs to help small and medium-sized businesses survive the severe economic downturn caused by COVID-19. While both emergency lending programs are administered by federal agencies, private lenders have issued a large number of PPP loans and will issue all MSLP loans.

Paycheck Protection Program and Implementation

The PPP provides a direct incentive for small businesses to keep workers on the payroll. Administered by the Small Business Administration, the program authorizes loans of up to $10 million. So long as a PPP borrower spends its loan on allowable uses — payroll, mortgage or rent payments, and utilities — the loan will be forgiven subject to certain reductions. Small Business Administration regulations incorporate a hold-harmless provision for lenders' reliance on borrower certifications of eligibility and compliance with program requirements.

Main Street Lending Program

The MSLP offers up to $600 billion in loans to small and medium-sized businesses that were in sound financial condition before COVID-19. Main Street loans are intended to serve as a bridge to help these businesses continue operations and payroll through the economic downturn resulting from the pandemic. The loans are capped at substantially larger amounts than PPP loans, between $35 million and $300 million depending on the MSLP loan facility utilized, and unlike PPP loans, Main Street loans are not forgivable.

While private lenders will issue Main Street loans, the Federal Reserve through the Federal

Reserve Bank of Boston will purchase them with funds appropriated under the CARES Act. Unlike in the PPP, lenders will retain 5% of Main Street loans. Main Street lenders must conduct an assessment of a potential borrower's financial condition and apply their own underwriting standards to loan applications. However, the Federal Reserve's FAQs state that a lender may rely on the borrower's certifications of eligibility and compliance with program requirements and is not expected to independently verify the certifications or monitor ongoing compliance.

False Claims Act Investigations and Lawsuits

Since lenders will submit Main Street loans to the Federal Reserve for purchase, the loans are likely subject to the False Claims Act. Businesses can run afoul of the False Claims Act if they submit a claim to the government "knowing" that it is based on false information, which encompasses reckless disregard or deliberate ignorance of whether a claim is false, and the information is material to the government's payment determination.

Violations of the False Claims Act result in treble damages and civil penalties of up to $25,000 per false claim or statement. Both the DOJ and private individuals or organizations, referred to as "qui tam relators," can bring lawsuits in federal district court to recover damages and penalties for violations of the False Claims Act.

Borrowers and lenders participating in the MSLP could become the target of a False Claims Act investigation and/or lawsuit if a borrower fails to adhere to eligibility and other program requirements. One theory would be that the borrower's certification that it would comply with MSLP requirements amounts to a material false statement and violation of the False Claims Act. Because the borrower made the certification in order to get the loan and the lender presumably will have conveyed the certification to the Federal Reserve when selling the loan (the Federal Reserve has not yet made available the procedures for loan sales), both potentially could face liability if the certification is false.

The MSLP restrictions on executive compensation, stock repurchase and dividends in particular could be bases for a False Claims Act investigation or lawsuit. Any false certifications or representations made by the MSLP borrower or lender in applying for the federal funds also could give rise to False Claims Act liability as a "fraudulent inducement" of the federal funds.

To avoid a False Claims Act violation, Main Street lenders and borrowers should carefully adhere to program requirements and guidance from the Federal Reserve, available on its website in the form of FAQs (effective June 20). They also should keep detailed, well-organized documentation of eligibility and satisfaction of all of the MSLP's requirements.

Other Government Investigations

Aware of the potential for fraud in connection with the massive government spending authorized by the CARES Act, the DOJ announced early on that investigating and prosecuting fraud in CARES Act programs would be a top priority. True to its word, the DOJ has been scrutinizing PPP loans closely and has brought criminal charges against multiple PPP borrowers. Main Street borrowers and lenders should anticipate similar scrutiny.

In addition to civil penalties under the False Claims Act, fraud against the government can carry criminal penalties including up to five years in prison. Criminal statutes provide further penalties that include up to 30 years in prison for fraud in seeking a loan and in seeking to influence federally insured financial institutions or federal agencies.

Beyond DOJ enforcement action, investigations could be initiated by the special inspector general for pandemic recovery, which is authorized to audit and investigate U.S. Department of the Treasury programs under the CARES Act, and by the Pandemic Response Accountability Committee, which is afforded general oversight authority concerning stimulus funds. Additional entities such as state banking regulators and even Congress also could initiate investigations concerning Main Street loans.

To minimize the risk of investigation by one or more of these authorities and to be prepared in the event an investigation occurs, Main Street borrowers and lenders should carefully review and comply with eligibility and other program requirements. They should maintain thorough, well-organized documentation of all actions in connection with the MSLP.

Borrower Actions Against Lenders

Funds available for Main Street loans are limited, and how banks decide which loans to approve could become the subject of litigation. Main Street lenders could face claims similar to prospective PPP borrowers' contentions that lenders improperly prioritized loans according to profit for the lender. Those PPP claims, brought under state unfair competition and deceptive trade practices laws and common law, allege that lenders gave preferential treatment to applicants for bigger loans, which carry bigger loan fees, and to existing customers, because supporting existing customers would increase the likelihood that their existing loans would be repaid.

In addition to these arguments, Main Street lenders could see claims that their 5% shared risk in MSLP loans gives them an even greater incentive to prioritize loans to existing customers based on the lenders' subjective perception of lower risk than on loans to borrowers with whom they have no relationship. Lenders also could see claims that they used loan documentation that is not substantially similar to the documentation used for similarly situated non-MSLP borrowers, contrary to the expectation expressed in the Federal Reserve's FAQs.

Here again, it will be important for lenders to maintain detailed and well-organized documentation of their actions on loan applications. Lenders also should ensure that they use loan documentation that is substantially similar to what they use for similarly situated borrowers outside the MSLP.

Lastly, substantive differences between the PPP and MSLP could provide Main Street lenders with defenses not available to PPP lenders. While the PPP established most of the borrower eligibility requirements for that program, the Federal Reserve's FAQs state that the MSLP eligibility criteria should be viewed as minimum requirements and Main Street lenders are expected to conduct their own assessments of potential borrowers' financial conditions. Main Street lenders may be able to defend claims of denied borrowers by pointing to their assessments of the borrower's financial condition.

Proposal for a DOJ Policy Statement About MSLP False Claims Act Actions

The DOJ announced several False Claims Act policies and priorities on June 26 that could have significant impacts on False Claims Act investigations and litigation, including qui tam actions, involving the MSLP.

First, the DOJ announcement stated that it will use the False Claims Act "to hold accountable those who knowingly attempt to skirt [MSLP] requirements." Second, the DOJ acknowledged the need to take care not to discourage businesses from accessing in good faith the important resources that Congress made available in the CARES Act. Accordingly, "if a company is eligible for a loan and submits certifications in good faith, it will have nothing to fear from [DOJ's] Civil Division."

Finally, with respect to qui tam actions alleging violations of CARES Act requirements, the DOJ noted its authority to dismiss qui tams that do not serve the interests of the United States as outlined in the January 2018 Memorandum authored by Deputy Assistant Attorney General Michael Granston, and stated that it would use its dismissal authority "judiciously" to "weed out [qui tam] cases that involve regulatory overreach or are otherwise not in the interests of the United States."

Thus, for example, "we will consider moving to dismiss qui tams that are based on mistakes with paperwork or honest misunderstandings of the rules," or where the qui tams "try to hold companies liable for doing what the government said was okay to do."

To further encourage lending under the MSLP, the DOJ should revise the Justice Manual to state that it will not pursue False Claims Act actions against lenders that are based on borrower misconduct if the lender received the borrower's certifications of compliance with program requirements, and that it will move to dismiss any comparable qui tam suit.

The Federal Reserve FAQs' statement that Main Street lenders may rely on borrowers' certifications gives lenders some assurance that they won't be the target of a False Claims Act action so long as they obtain the necessary certifications. However, a DOJ policy statement as outlined above would give lenders confidence that by issuing Main Street loans in reliance on those certifications they will not be subjecting themselves to liability for borrower misconduct.

A similar DOJ policy statement applicable to False Claims Act actions based on Main Street loans would facilitate lenders' participation in the MSLP and encourage lending through the program. The U.S. Chamber of Commerce has advocated for a similar policy statement from the DOJ with regard to PPP loans.

Borrower businesses working to get back on their feet also could benefit from protection against unmeritorious False Claims Act actions. A DOJ policy statement that it will move to dismiss qui tam suits against borrowers that fail to allege with specificity that the borrower knowingly submitted false information that was material to the loan decision would help businesses concentrate their resources on recovery.

Conclusion

Main Street borrowers and lenders should be aware of the potential for liability under the False Claims Act and as a result of other government enforcement authority, and lenders should recognize the potential for civil actions by prospective borrowers. To minimize their risk, MSLP participants should understand and comply with eligibility and other program requirements. In the event of doubt about what is required, a participant should confer with counsel.

Lastly, borrowers and lenders should maintain thorough, well-organized documentation of all actions under the MSLP. With care and attention to detail, Main Street borrowers and lenders can position themselves to avoid litigation detours on the road to financial recovery.

Robert Huffman is a partner and Caroline Wolverton is senior counsel at Akin Gump Strauss Hauer & Feld LLP.