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Paycheck Protection Program 2.0: What Borrowers Need to Know

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Alixandra Smith

Chief, Business and Securities Fraud Section U.S. Attorney's Office, Eastern District of New York

Alixandra Smith is the Chief of the Business and Securities Fraud Section at the U.S. Attorney's Office for the Eastern District of New York. She has investigated and prosecuted a wide variety of criminal matters against both individuals and entities, including fraud involving publicly-traded companies, market manipulation, insider trading, healthcare fraud, tax crimes, money laundering, cyber-enabled crime, and violations of the FCPA. Alix is also an adjunct professor at NYU Law School.

During her time at the EDNY, Alix has worked on significant white collar cases. For example:

- Co-lead prosecutor on *United States v. Martin Shkreli and Evan Greebel*, in which a pharmaceutical executive and his attorney were charged with securities fraud, wire fraud conspiracy, and securities fraud conspiracy in connection with four complex fraud schemes. Both defendants were tried and convicted in separate trials lasting a combined total of 17 weeks in 2017.
- Led the EDNY team that, along with the DOJ's Fraud Section, investigated and prosecuted *United States v. Odebrecht* and *United States v. Braskem*, collectively one of the largest foreign bribery cases in history. In that case, Brazilian-based companies Odebrecht and Braskem pled guilty to conspiracy to violate the FCPA for their roles in a bribery scheme that involved payments of close to a billion dollars over a 15-year period to foreign government officials in Brazil and twelve other countries to obtain and retain business in those countries.
- Lead criminal prosecutor for *United States v. AmerisourceBergen Specialty Group*, in which a subsidiary of a major pharmaceutical company pled guilty to a violation of the Federal Food, Drug and Cosmetics Act for the illegal distribution of misbranded oncology drugs, and paid a total of \$885 million in criminal and civil penalties.

Prior to joining the EDNY, Alix was an associate at two law firms in New York; completed clerkships with the Honorable Julio M. Fuentes, United States Court of Appeals for the Third Circuit, and the Honorable Faith S. Hochberg, United States District Court for the District of New Jersey; and served as an adjunct professor at Fordham Law School. She graduated from Harvard University and Harvard Law School.

Camille C. Bent

Partner

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Camille is a Bankruptcy and Restructuring Partner in BakerHostetler's New York office. She specializes in corporate bankruptcy, restructuring and commercial litigation. She has significant experience in disputes and transactions arising out of corporate insolvencies and sounding in fraud, including asset sale, fraudulent transfer, negligent misrepresentation, and wrongful redemption cases. Camille has represented debtors, creditors, trustees, committees, and other interested parties, and her practice is industry agnostic.

Camille is a member of the Bankruptcy & Restructuring Committee at the New York City Bar Association.

George A. Stamboulidis

*Partner, Co-Leader of White Collar Team
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George Stamboulidis is Managing Partner of BakerHostetler's New York office and co-leader of BakerHostetler's White Collar, Investigations and Securities Enforcement and Litigation practice, which is ranked in Chambers USA: America's Leading Lawyers for Business. He is a seasoned litigator and has tried dozens of complex federal jury trials as a prosecutor and as a defense attorney. Recognized for his experience in the areas of white collar and business defense, George is regularly engaged by corporations, directors, and officers to advise and defend in complex federal grand jury and regulatory investigations, and has been appointed a federal monitor five times by the DOJ.

George counsels and successfully represents Fortune 100 companies on FCPA issues, including conducting reviews to make best practice policy enhancements to corporate compliance policies, revise and optimize corporate training programs, and conduct testing to ensure that the policy enhancements are followed. He is a nationally recognized lecturer on corporate criminal liability and the use of proactive defense tactics, and he regularly presents to members of the financial services, insurance, pharmaceutical, energy, construction, and real estate industries, among others.

Peter F. Grupe

Director
Protiviti



Peter is a Director in the Protiviti Forensic practice at Protiviti, a global risk and business consulting firm. He has over thirty years of experience in risk consulting, law enforcement, crisis management and corporate finance.

He has spent the past nine years providing consulting services to corporations and individuals around the world. Protiviti Forensic is responsible for conducting complex white collar crime investigations of financial crime, bribery and misconduct, FCPA program compliance and investigations, assisting clients with anti-bribery and corruption programs, fraud risk assessments, background investigations, acquisition due diligence, physical security assessments and crisis management.

Peter has also held various executive management roles with the Federal Bureau of Investigation. He retired in 2011 after 24 years of service as the Assistant Special Agent in Charge of the largest White Collar Crime Branch of the FBI (New York Office). In that capacity, Peter had direct supervision over approximately 1500 pending investigations, 200 Special Agents, 40 Forensic Accountants, 15 Intelligence Analysts and 40 Professional Support employees. He was responsible for all investigative, financial and administrative functions associated with every investigative program. These investigative programs included Financial Institution Fraud, Corporate and Securities Fraud, Anti-Money Laundering, Public Corruption, Foreign Corrupt Practice Act, Health Care Fraud and Bankruptcy Fraud. He is credited with successfully managing the largest Ponzi scheme investigation in history and the largest insider trading investigation in history, in addition to sensitive investigations of elected and appointed public officials. He was also a senior member of the New York SWAT Team responsible for all high-risk operations around the world.

Patrick T. Campbell

Partner

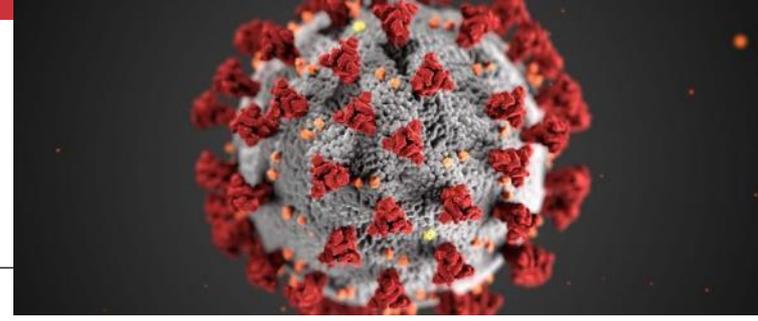
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Patrick Campbell is a member of BakerHostetler's White Collar, Investigations and Securities Enforcement and Litigation team. He focuses his practice on white collar criminal and civil regulatory matters and internal investigations, specifically in the areas of securities, construction, corruption, asset forfeiture, and money laundering. He represents clients in highly-sensitive federal and state investigations conducted by the DOJ, SEC, CFTC, FTC, and NY DFS. Patrick also regularly counsels clients on "best practices" for corporate governance and ethics and compliance matters.

Patrick is the Chair of the New York City Bar Association's Compliance Committee.

Agenda



- New PPP Loan Eligibility and Rules
- New PPP Forgiveness Requirements
- New EIDL Provisions
- Enforcement Developments and Trends
- Risk Mitigation Steps
- Key Takeaways

“The FBI will continue to aggressively pursue those who are using the money from this taxpayer funded economic relief program to pad their own pockets.”

– William F. Sweeney, Jr., Assistant Director-in-Charge, FBI, NY Field Office

Where We Are

- July 11, 2020 – SBA announced conclusion of EIDL advance program, which distributed more than \$20 billion in advance funds
- Aug. 10, 2020 – PPP closed, over \$525 billion in loans distributed
- Public demand for new stimulus package, including additional support for small businesses
- Dec. 27, 2020 – Economic Aid Act enacted into law
 - \$284.5 billion for reopened and expanded PPP
 - \$20 billion for EIDL advance grants
- Jan. 19, 2021 – PPP portal reopened for all borrowers (will close on Mar. 31, 2021)
- SBA – as of Feb. 15, 2021, 1,673,707 loans approved for over \$125.7 billion under reopened PPP

Revived PPP

Highlights

Important Dates

- **January 19, 2021:** PPP portal re-opened for all eligible borrowers; previous borrowers can seek additional loans (“Second Draw PPP Loans”)
- **March 31, 2021:** PPP portal will close

Key Program Highlights

- All PPP loans guaranteed by SBA
- Loans do not require collateral or personal guarantees
- All loans have five-year maturity with 1% interest rate
- Lenders rely on borrower’s certifications regarding loan eligibility and compliance with PPP rules

Revived PPP

First Draw PPP Loans

- Original PPP eligibility requirements and limits apply, including:
 - 500 or fewer employees or meets SBA industry size standard
 - Accommodations and food services companies with more than one physical location and employs less than 500 per location
 - SBA alternative size standards: borrowers with maximum net worth of >\$15M and average net income of \$5M (after federal taxes)
 - Cannot have 20% owner that is:
 - (1) incarcerated; (2) on probation or parole; (3) subject of current indictment or information; (4) has felony conviction in past five years
 - Max loan amount: lesser of 2.5 times borrower's average monthly payroll costs (\$100K annualized cap per employee) and \$10M (\$20M if borrower is part of corporate group)
 - “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant”
- Borrower must be in operation as of Feb. 15, 2020, with either employees or independent contractors on payroll as of that date
- Publicly traded companies and businesses in which President, Vice-President, heads of executive departments, or members of Congress, or their spouses, own, control, or hold at least 20 percent of any class of equity excluded
- Previous PPP borrowers who returned funds or did not accept full amount of initial loan may apply for First Draw PPP Loan

Revived PPP

Second Draw PPP Loans



Additional restrictions include:

- 300 or fewer employees
- Must demonstrate 25% reduction in gross receipts during quarter in 2020, compared with same quarter in 2019
- Must have used or will use “full amount of the initial PPP loan for authorized purposes on or before the expected date of disbursement”
- Max loan amount: 2.5 times borrower’s average monthly payroll costs (\$100K annualized cap per employee) up to \$2M
 - “Accommodation & Food Services” sector may borrow up to 3.5 times borrower’s average monthly payroll costs

Revived PPP

Use Restrictions

- Like before, PPP loans may be used for:
 - Payroll costs (capped at \$100,000 on annualized basis for each employee)
 - Healthcare related costs and insurance premiums
 - Rent, mortgage interest, utilities, interest on certain other debt, and refinancing of certain other SBA loans
 - Other permissible uses under Small Business Act
- Like before, at least 60% of loan proceeds must be used for payroll costs
- New eligible costs:
 - Worker protection costs related to COVID-19
 - Uninsured property damage costs caused by looting or vandalism during 2020
 - Certain supplier costs and expenses for operations
- Codifies ability of lender to rely on certification or documentation submitted by borrower for loan

Revived PPP Loan Forgiveness

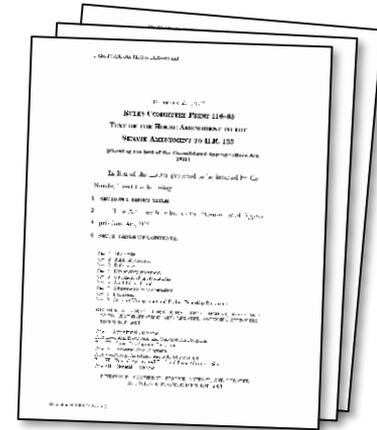
- In Jan. 2021, SBA published updated PPP loan forgiveness guidance and forms
- Form 3508S – PPP loan of \$150,000 or less
 - One page of limited information to include employees at time of application and time of forgiveness application
 - Borrowers are NOT required to submit supporting documentation with application but are mandated to produce records during SBA loan review or audit
- Form 3508 – Revised PPP Loan Forgiveness Calculation Form
- Form 3508EZ – If loan is more than \$150,000 and at least one of the following conditions apply, borrower need not complete PPP Schedule A:
 - Borrower did not reduce annual salary or hourly wages of any employee by more than 25% compared to most recent full quarter before covered period AND borrower did not reduce number of employees or average paid hours of employees between Jan. 1, 2020 and end of covered period
 - Borrower did not reduce annual salary or hourly wages of any employee by more than 25% during covered period compared to most recent full quarter before covered period AND borrower was unable to operate during covered period at same level of business activity as before Feb. 15, 2020
- For Forms 3508 and 3508EZ, Borrowers must submit payroll and non-payroll documentation
- Economic Aid Act requires SBA to develop plan that details policies and procedures for conducting forgiveness reviews and audits of covered loans and metrics to determine which loans will be audited

EIDL Program

Updates in Dec. 2020 Legislation

Dec. 2020 Consolidated Appropriations Act included following changes to existing EIDL program:

- Added \$20 billion in funding for \$10,000 Targeted EIDL Advance grants (see next slide)
- Removed requirement that EIDL Advance and/or Targeted EIDL Advance grants be deducted from PPP loan forgiveness
- Extended EIDL application process for loans related to COVID-19 to Dec. 31, 2021
- Provisions that were proposed and not ultimately adopted:
 - Preventing SBA from setting “unofficial cap” on EIDL loans at \$150,000, and allowing prior loan recipients to seek additional funds above \$150,000
 - Further reducing limitations for borrowers with criminal history



EIDL Program

Targeted Advance Grants

- \$10,000 EIDL Advance grants were available under CARES Act, but program ran out of money by July 2020
- New legislation provides for Targeted EIDL Advance grants of up to \$10,000
- Small businesses that are eligible:
 - Applied for EIDL loan
 - Located in federally designated “low-income community” (defined by 26 U.S.C. § 45D(e))
 - Suffered 30% reduction in revenue during 8-week period after Mar. 2, 2020
 - Fewer than 300 employees
 - Cannot be agricultural enterprise
- First priority will be given to eligible businesses who previously received EIDL Advance of less than \$10,000, or previously applied for EIDL Advance and did not receive it for lack of program funding
- As of Feb. 4, 2021, SBA is reaching out to borrowers who qualify

Enforcement Developments

SIGPR



Special Inspector General for Pandemic Recovery

- SIGPR authorized to “conduct, supervise and coordinate audits and investigations” of funds disbursed under CARES Act; special agents are authorized to carry firearms, make arrests, and execute warrants
- On June 2, 2020, Brian D. Miller confirmed as Special Inspector General by Senate
 - Served as federal prosecutor for 15 years
 - Was Inspector General for General Services Administration from 2005 – 2014
- Unsure of jurisdiction over PPP/EIDL fraud
- Feb. 1, 2021 third quarterly report to Congress:
 - Stated while his office necessarily spent much of its nascent stage navigating challenges of standing up office in midst of pandemic, it is now “operational and formidably aggressive”
 - Continues to enter into MOUs with various U.S. Attorney’s Offices and partnerships with regulators
 - Concerned about “multiple dipping,” which could involve PPP/EIDL borrowers if conduct also involves program over which SIGPR has jurisdiction

Enforcement Developments

Recent Criminal Actions and Trends

- DOJ Fraud Section reports that as of Jan. 2021, in conjunction with other offices, it has prosecuted more than 100 defendants in more than 70 criminal cases for PPP loan fraud, and seized more than \$60 million in assets related to such frauds
- Expect to continue to see criminal prosecution of borrowers who misappropriate funds from PPP and EIDL loan programs, with shift towards more sophisticated schemes, for example:
 - **EDNY, Oct. 2020** – Defendant charged with wire fraud for submitting falsified applications for EIDL loan and EIDL Advance
 - **SDTX/Fraud, Nov. 2020** – Seven defendants charged with wire fraud conspiracy for submitting 80 fraudulent PPP applications for total of \$16 million in loans; certain loan funds were issued to co-conspirators as fake “employee paychecks,” and cashed at business controlled by co-conspirator
 - **EDNY, Dec. 2020** – Defendant charged with wire fraud for obtaining almost \$2 million in PPP funds, in part by submitting falsified IRS documents for fake business; funds were used to purchase luxury vehicles and pay personal expenses
 - **NDGA/Fraud, Jan. 2021** – Six defendants charged with wire fraud conspiracy for submitting PPP loan applications with false information for loans totaling \$3 million; one defendant organized scheme, recruited his co-defendants and coordinated false applications, and then received kickbacks from loan proceeds
- Moving forward, likely shift in focus on fraud in loan forgiveness applications and lenders, including with respect to customer diligence (e.g., filing of SARs) and claims of preferential treatment

Enforcement Developments

DOJ Civil Actions

- First civil action for alleged PPP fraud settled on Jan. 12, 2021
- Settled FCA and FIRREA claims for \$100,000
- Against company and CEO for allegedly falsely claiming that company was not in bankruptcy when applying for PPP loan
- No allegations that company was fake, falsified its employee count or payroll information on its loan applications, or used or intended to use loan proceeds for personal expenses
- Company ultimately repaid loan



Enforcement Developments

Civil Enforcement Trends

“[G]oing forward the False Claims Act will play a central role in the Department’s pursuit of COVID-19 related fraud”

– Deputy Assistant AG Michael D. Granston remarks at ABA Civil FCA and Qui Tam Enforcement Institute (Dec. 2, 2020)”

- More civil fraud cases likely to emerge for wider array of alleged violations, including conduct we have not seen yet:
 - False certification that current economic uncertainty makes loan necessary to support ongoing operations of applicant
 - False statements concerning ability to secure credit from other sources
- Increased whistleblower activity

Enforcement Developments

SEC Actions



- Established Coronavirus Steering Committee that coordinates Division of Enforcement's response to COVID-related issues
- According to its Division of Enforcement 2020 Annual Report, between mid-Mar. 2020 and end of its fiscal year, SEC opened more than 150 COVID-related inquiries or investigations, many of which are ongoing
- SEC reportedly is inquiring into publicly traded companies that received stimulus funds and is scrutinizing whether representations those companies made in loan applications were consistent with their disclosures to investors in securities filings
- SEC under new Chairman Gary Gensler expected to increase focus on accuracy of public disclosures

PPP 2.0 – Challenges, Risks and Mitigation for Borrowers

- 1) PPP 2.0 introduced new documentation to provide for more streamlined and efficient process
- 2) PPP 2.0 also allowed second draws or second loans for qualifying businesses with additional restrictions
- 3) Borrowers must document, segregate and preserve all records related to applications for funding and forgiveness; requests for forgiveness of loans less than \$150,000 do not require documentation, however need to be made available if/when audited
- 4) Loan proceeds and use of funds should be segregated from other accounts and business uses
- 5) Ensure appropriate internal controls over borrowed monies to include segregation of duties and use of loan proceeds in accordance with rules
- 6) Funds must be accounted for and used for their intended short term current needs, i.e. payroll costs, benefits and mortgage interest

Five Key Takeaways

Stay informed of latest developments

Study and comply with rules

Carefully complete loan and loan forgiveness applications

Establish controls over use of loan funds

Maintain documentation

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