Lender Liability and Obligations Under the CARES Act

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act" or the "Act")—which provides for the distribution of over $2 trillion in forgivable and low-interest loans to qualifying individuals, small businesses, non-profits and larger corporations—includes several consumer protection provisions applicable to lenders. Although the CARES Act was adopted only twelve weeks ago, numerous court decisions have already provided guidance about what lenders may (and may not) do under the Act. Lenders are advised to monitor the rapidly-evolving legal and regulatory framework concerning the CARES Act due to the absence of explicit regulatory guidance regarding many of the Act's terms and provisions. This memorandum reviews some recent noteworthy judicial decisions and government actions regarding administration of funds under the CARES Act.

I. Background

The CARES Act contains several consumer protection provisions. Of particular importance to lenders are the following:

- A foreclosure moratorium and right to forbearance for "federally-backed loans," including loans for properties purchased, securitized, owned, or guaranteed by Fannie Mae or Freddie Mac, or owned, insured, or guaranteed by the Federal Housing Administration ("FHA"), Department of Veterans Affairs ("VA"), or U.S. Department of Agriculture ("USDA").[1]
    - The foreclosure moratorium was extended across all agencies to June 30, 2020,[2] and Federal Housing Finance Agency ("FHFA") and FHA have further extended the June 30 moratorium expiration for Fannie Mae and Freddie Mac mortgages until August 31, 2020.[3]
    - Under the CARES Act, borrowers can extend the moratorium for up to 180 days more if the borrower requests an extension during the covered period (the "covered period" being the end of the emergency or December 31, 2020, whichever is earlier).[4]
    - The moratorium is not limited to borrowers facing a COVID-19 related hardship.[5] The forbearance right requires only a borrower's attestation of financial hardship caused by the COVID-19 emergency. Lenders must ensure that they are forbearing loan

[1] CARES Act § 4022; § 4022(a)(2).

[2] *See*, *e.g.*, "Extended Foreclosure Moratorium for Borrowers Affected by COVID-19" Veterans Benefit Administration (May 14, 2020), https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_20_18.pdf; "Foreclosure Moratorium Extension and Additional Guidance for Servicing Loans Impacted by COVID-19" USDA Rural Development Bulletin (May 14, 2020), https://content.govdelivery.com/accounts/USDARD/bulletins/28bb26e.

[3] *See* "FHA Extends Foreclosure and Eviction Moratorium for Single Family Homeowners for Additional Two Months." HUD No. 20-081 (Jun. 17, 2020), https://www.hud.gov/press/press_releases_media_advisories/HUD_No_20_081; "FHFA Extends Mortgage Foreclosure and Eviction Moratorium" FHFA News Release (Jun. 17, 2020), https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Extends-Foreclosure-and-Eviction-Moratorium-6172020.aspx?utm_medium=email&utm_source=govdelivery.

[4] CARES Act § 4022(c)(1).

[5] *Id.* at § 4022(c)(2).

payments and any fees, penalties, or interest for borrowers with qualifying mortgages who have submitted such a request and attestation.

- Relief from student loans directly provided by the U.S. Department of Education, as well as Federal Family Education Loans ("FFEL") currently owned by the Department of Education.[6] This provision does not apply to private loans, borrowers with Perkins Loans, or borrowers whose FFEL loans are still held by banks or guaranty agencies.

- If a creditor has made an accommodation —such as a forbearance or workout — during the period from January 31, 2020 to 120 days after the end of the national state of emergency, the creditor is required to report that account as having the same status as prior to the accommodation to a credit reporting agency (i.e., an account that was current shall continue to be reported as current). [7]

Lenders also must remain cognizant of the possibility of government enforcement action concerning the CARES Act and in particular the Paycheck Protection Program ("PPP"). The PPP was established to provide forgivable loans to businesses that would be used to keep employees on the payroll during the COVID-19 pandemic. Since passage of the PPP Flexibility Act last month, recipients are now required to use at least 60% of PPP loan amounts to fund payroll costs for a covered period of either eight weeks or 24 weeks in order to obtain full forgiveness.[8] While we are not aware of any enforcement actions having been filed to date, the CARES Act creates an Office of the Special Inspector General for Pandemic Recovery ("SIGPR") within the Treasury Department to enforce the Act. The SIGPR's duties are delineated in Section 4018(c) of the Act, and include the conducting, supervision and coordination of "audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary of the Treasury under any program established by the Secretary under this Act."[9] The SIGPR also collects and summarizes five categories of information regarding each "loan, loan guarantee, and other investment" made pursuant to the Act and provides to Congress quarterly "a detailed statement of all loans, loan guarantees, other transactions, obligations, expenditures, and revenues associated with any program established by the Secretary under section 4003, as well as the information collected under subsection (c)(1)."[10] Lastly, the SIGPR is bestowed with all powers and authorities provided by Section 6 of the Inspector General Act of 1978, including the ability to initiate investigations, obtain access to records, and issue subpoenas.[11]

II. Litigation

Litigants already have seized upon these and other provisions of the CARES Act to commence lawsuits against lenders in federal court alleging unlawful preferential treatment of existing customers in approving PPP loans, violations of Small Business Administration ("SBA") and Treasury Department guidance, or violations of the CARES Act under alternative theories of liability. These cases remain at the incipient stage, but a few notable

[6] *Id*. at § 3513.

[7] *Id*. at § 4021.

[8] *See* our memorandum "Congress Passes Paycheck Protection Program Flexibility Act of 2020," found here. For further guidance on the Paycheck Protection Program, please consult our other memoranda addressing the CARES Act and other COVID-19 insights, all found here.

[9] CARES Act § 4018(c).

[10] *Id.*

[11] 5a U.S.C. § 6.

decisions have called into question whether a private right of action exists under the Act. The decisions to date generally also have permitted lenders to implement eligibility criteria beyond what is expressly provided for in the Act.

At least two federal courts already have suggested that (1) the text of the CARES Act does not create a private right of action and (2) lenders may consider information other than eligibility under the program—for example, whether or not applicants have a pre-existing relationship with the lender—in determining which PPP applications they review and accept, and in what order.

On April 13, 2020, in *Profiles, Inc.* v. *Bank of America*, a Maryland federal district judge declined to issue a temporary restraining order and preliminary injunction blocking Bank of America from imposing certain restrictions on its lending under the PPP.[12] The plaintiffs, a group of small businesses that are depository clients of the bank, sued to force the bank to suspend its policy of accepting PPP loan applications exclusively from small business checking customers that either (i) were already borrowers at the bank or (ii) were not borrowers at any other bank.

In its order, the court held that the CARES Act does not create a right of action for private plaintiffs and that the Act's language "does not constrain banks such that they are prohibited from considering other information when deciding from whom to accept applications, or in what order to process applications it accepts." The court was not persuaded that the bank's gatekeeping policy prevented plaintiffs from obtaining PPP funding elsewhere.

Similarly, on April 29, 2020, in *Scherer* v. *Wells Fargo*, a Texas federal district court rejected a request by two small business owners for a temporary restraining order to prevent Wells Fargo from requiring that businesses seeking funds under the PPP program have a pre-existing checking account at the bank.[13] Echoing the ruling described above, the court found plaintiffs failed to show how they "would suffer irreparable injury if not given access to a loan specifically from Wells Fargo," and that they had "failed to explain why they could not obtain loans under PPP through another lender," noting that over 4,000 other unique lenders are participating in the program.

Both cases remain pending, and the respective courts' initial decisions to deny temporary relief did not dismiss either case.

Several suits also have been filed alleging various alternate theories of liability, including under federal and state competition laws and state advertising laws, as well as alleging fraud and negligence under common law. These cases likewise remain pending.

III. Government Action

The federal government also has taken recent action to implement and clarify the terms and spirit of the Act.

Reacting to news that several CARES Act borrowers were larger private and publicly-traded companies that might not need federal support, the Treasury Department and SBA recently undertook efforts to claw back some PPP loan funds. The SBA reminded applicants that they should carefully review the required certification that "current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant" and went on to note that "it is unlikely that a public company with substantial market value and

[12] 1:20-cv-00894, Apr. 13, 2020, ECF No. 18 (D. Md.).

[13] 4:20-cv-01295, Apr. 29, 2020, ECF No. 20 (S.D. Tex.).

access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification". The SBA has agreed not to challenge whether an applicant's determination was made in good faith so long as it returns its PPP loan funds by May 18th. Although the deadline to return these funds has since passed, no action has yet been brought against any publicly-traded or large private company. Further, the Treasury Department and SBA have said that any PPP loan over $2 million will be subject to review "for compliance with program requirements set forth in the PPP Interim Final Rules and in the Borrower Application Form" before the funds can be forgiven.

The above-mentioned Treasury Department and SBA restrictions on CARES Act lending already have prompted litigation in in federal court. On May 4, 2020, three privately-held technology companies filed suit in California federal court to block Treasury and SBA's regulatory guidance discouraging large companies from seeking PPP funds.[14] The companies argue that recent guidance seeks to "re-impose" the requirement that PPP applicants cannot obtain funding elsewhere, contrary to statutory language that expressly states that this requirement is waived. Plaintiffs also argue that, because several companies in receipt of PPP funds have already disbursed that money to their employees, these companies may have to go into debt to repay their loans, ultimately damaging the financial position of those companies as they struggle to weather the pandemic. This litigation is also in its early stages, with the timing and outcome uncertain, and so should not serve as a basis for lenders to disregard any recent Treasury or SBA guidance. Lenders considering loans to publicly-traded companies and other large companies should monitor this lawsuit and the corresponding regulatory developments and factor them into their PPP approval processes.[15]

IV. Implications and Further Considerations

The SIGPR created by the CARES Act is analogous to the special inspector general for the Troubled Asset Relief Program and has a broad mandate to "conduct, supervise, and coordinate audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary of the Treasury" under the CARES Act. After an investigation, the SIGPR can refer matters to the Justice Department and other agencies for prosecution. On May 5, 2020, the Senate Banking Committee confirmed Brian D. Miller to serve as the SIGPR. It remains to be seen how either Mr. Miller, the Pandemic Response Accountability Committee, or the congressionally-appointed CARES Act oversight committee will approach their respective roles in monitoring CARES Act spending.

Lenders also should be mindful of potential liability under the False Claims Act (the "FCA"). While the SBA has taken steps to reduce potential lender liability for the false claims of borrowers by adopting an interim final rule that a lender "does not need to conduct any verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified the payments for eligible costs,"[16] lenders

[14] *Zumasys Inc. et al.* v. *US Small Business Administration et al.*, 8:20-cv-00851 (C.D. Cal. filed May 4, 2020).

[15] Lenders should also keep apprised of actions being taken by state governments in the states where they do business. State governments have placed additional limitations on foreclosures and evictions, collection lawsuits and other post-judgment remedies, and certain bank fees and limitations, all to varying degrees. *See, e.g.* California Executive Orders N-28-20 and N-37-20; New York Executive Order 202.8. For a comprehensive list of state-specific regulations that operate in concert with the CARES Act's consumer protection provisions, *see* "Major Consumer Protections Announced in Response to COVID-19," National Consumer Law Center (May 6, 2020), https://library.nclc.org/major-consumer-protections-announced-response-covid-19.

[16] Small Bus. Admin., Business Loan Program Temporary Changes; Payroll Protection Program (2020), https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.

should continually re-evaluate and if necessary revise the terms of their lending programs to ensure that no false statements are submitted to the federal government in connection with CARES Act funding.

Although no theory of liability has yet resulted in a judgment against a lender for their conduct in administering CARES Act funds, many theories of liability remain untested given the recent adoption of the Act. These include state and federal "unfair, deceptive, or abusive acts or practices" ("UDAP", or "UDAAP"); false advertising; breach of contract (including impossibility of performance); fraudulent concealment; and fair lending violations. While there can be no certainty regarding whether any of these theories will ultimately succeed, the practical take-away for lenders is the same: constant vigilance is required to ensure that their lending programs comply with federal and state laws, rules and regulations.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Peter J. Linken at 212.701.3715 or plinken@cahill.com; or email publications@cahill.com.