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Shapiro Sher was founded in 1972 with the mission of providing outstanding legal counsel for businesses of all sizes. Based in Baltimore, the Firm is nationally recognized for its practices in business law, litigation, bankruptcy, banking, and creditors' rights.

Shapiro Sher's banking lawyers provide experienced counsel in connection with all aspects of commercial loans. Chaired by **Scott Foley**, the firm's **Banking & Financial Services Group** regularly represents regional and community banks, credit unions, finance companies, and other financial institutions in the Mid-Atlantic and in transactions throughout the country.

The banking group includes partner **Pat Gill**, who represents financial institutions in connection with re-documenting troubled loans and structuring, negotiating, documenting, and closing commercial finance transactions. Attorneys in the group also advise financial institutions regarding under-performing and distressed loans. The group routinely handles loan modifications, workouts, restructurings, short and long-term forbearance agreements, and bankruptcy litigation. Because the group has extensive experience in the origination of loans and in workout situations, it is prepared to provide efficient representation at every stage in the lending process.

With decades of experience in the banking industry, Mr. Foley and the firm's other seasoned banking attorneys appreciate the potential hazards facing clients in the commercial loan process, and strive to protect lenders' interests throughout the lifecycle of the loan.

THE PAYCHECK PROTECTION PROGRAM: LOAN FORGIVENESS

By Pat Gill

Now that the initial funding under the Small Business Administration's (SBA) Paycheck Protection Program (PPP) has been committed and a second round of funding for PPP loans is reported to be near exhaustion, lenders should be preparing for the forthcoming wave of requests for PPP loan forgiveness – which is certainly the most enticing feature of the program for borrowers. PPP lenders and borrowers alike have been anxiously awaiting further guidance on the loan forgiveness process. That wait is now over.

On May 16, the SBA published Form 3508, *Paycheck Protection Program Loan Forgiveness Application*, and the accompanying detailed instructions. The application has four components: (1) the PPP Loan Forgiveness Calculation Form (the "Calculation Form"); (2) PPP Schedule A ("Schedule A"); (3) the PPP Schedule A Worksheet (the "Worksheet"); and (4) the optional PPP Borrower Demographic Information Form (the "Demographic Information Form") (collectively and together with the corresponding instructions, the "Forgiveness Application").¹

On May 22, the SBA issued two sets of Interim Final Rules: Docket Number SBA-2020-0032, *Requirements – Loan Forgiveness*² ("Interim Final Rule No. 0032"); and Docket Number SBA-2020-0033, *SBA Loan Review Procedures and Related Borrower and Lender Responsibilities*³ ("Interim Final Rule No. 0033" and together with Interim Final Rule No. 0032, the "Forgiveness Interim Final Rules").

The purpose of this writing is to highlight a few of the issues raised and addressed by the SBA in the Forgiveness Application and the Forgiveness Interim Final Rules, particularly with respect to issues of significance for PPP lenders.

I. PPP Loan Forgiveness Process for Lenders.

- (a) Documentation to be Reviewed. The forgiveness process is commenced upon the borrower's delivery of the Forgiveness Application to the Lender. In connection with each Forgiveness Application received from a PPP borrower, the lender must

¹ <https://www.sba.gov/document/sba-form--paycheck-protection-program-loan-forgiveness-application>

² <https://home.treasury.gov/system/files/136/PPP-IFR-Loan-Forgiveness.pdf>

³ <https://home.treasury.gov/system/files/136/PPP-IFR-SBA-Loan-Review-Procedures-and-Related-Borrower-and-Lender-Responsibilities.pdf>



(i) confirm that the borrower made all requisite certifications in the Forgiveness Application, (ii) confirm receipt of all documentation used to verify payroll and non-payroll costs (as such documentation is listed in the Forgiveness Application), and (iii) confirm the borrower's calculations in the Forgiveness Application. Although it is the borrower's obligation to provide accurate calculations of the forgiveness amount, lenders are "expected to perform a good-faith review, in a reasonable time, of the borrower's calculations and supporting documents concerning amounts eligible for loan forgiveness."⁴ Section 2(a) of Interim Final Rule No. 0033 further provides, by way of example, that "minimal review of calculations based on a payroll report by a recognized thirty-party payroll processor would be reasonable. By contrast, if payroll costs are not documented with such recognized sources, more extensive review of calculations and data would be appropriate." If the lender's "good-faith review" reveals calculation errors or material lack of substantiation in the borrower's supporting documents, the lender should work with the borrower to correct such issues⁵—*provided, however*, that the lender "does not need to independently verify the borrower's reported information if the borrower submits documentation supporting its request for loan forgiveness and attests that it accurately verified the payments for eligible cost." See Section 2(a) of Interim Final Rule No. 0033.

(b) Decision Concerning Forgiveness. Within sixty days after its receipt of a completed Forgiveness Application, the lender must issue to the SBA one of the following decisions regarding forgiveness: approval (in whole or in part); denial; or (if directed by the SBA) a denial without prejudice due to a pending SBA review of the subject PPP loan. When the lender issues its decision to the SBA, it must include (1) the Calculation Form, (2) Schedule A, (3) the Demographic Information Form (if submitted to the lender), and (4) if applicable, a request for payment in the amount that the lender has determined to be forgivable. The SBA then has ninety days to remit the appropriate forgiveness amount to the lender, plus interest accrued through the date of payment (subject to the SBA's right to review the underlying PPP loan and Forgiveness Application to make its own determination regarding forgiveness and eligibility of the borrower).⁶ The lender is responsible for notifying the borrower of the amount forgiven, and any amount that is not forgiven must be repaid by the borrower on or before the two-year maturity of the PPP loan. If the lender denies

⁴ The "good-faith review, in a reasonable time" standard should be familiar to PPP lenders as it mirrors the standard imposed upon lenders in connection with its review of each PPP loan application.

⁵ When assisting the borrower with correcting any such errors or deficiencies, lenders should be careful not to give their borrowers the false impression that the lender is acting in any sort of advisory capacity.

⁶ If the amount remitted by the SBA to the lender exceeds the remaining principal balance of the PPP loan (because the borrower made scheduled payments after the six-month deferment period), the lender must remit the excess amount plus accrued interest to the borrower.



the Forgiveness Application, it must notify the borrower of same in writing. It is likely that certain borrowers will attempt to contest the forgiveness decisions rendered by PPP lenders (whether through the SBA, litigation, or other available means) and, as a result, lenders should implement sound procedures to adequately document their analysis of each Forgiveness Application and be prepared to substantiate such determination in the event a borrower seeks to challenge the same.

II. SBA's Right to Review.

Notwithstanding the general procedure outlined in the preceding section, the SBA may review any PPP loan at any time for the purpose of determining whether (a) the borrower was eligible to obtain the PPP loan, (b) the PPP loan and forgiveness amounts were properly calculated, and (c) the PPP loan proceeds were used for permitted purposes. If the SBA undertakes such a review, it will provide written notice thereof to the lender. The lender shall then have five business days within which to (i) notify the borrower in writing of the pending review, and (ii) transmit electronic copies of the following to the SBA: (1) the borrower's PPP loan application form (SBA Form 2483 or lender's equivalent), (2) the Forgiveness Application and all documentation submitted by the borrower in connection therewith (if the lender has received same; otherwise, the lender shall remit same within five business days after its receipt thereof), (3) a copy of the completed Worksheet (which the lender may not previously have collected, and thus the lender will need to request same from the borrower and forward to the SBA within five business days after the lender's receipt thereof), (4) a signed and certified transcript of account, (5) a copy of the executed promissory note evidencing the PPP loan, and (6) any other related documents that are requested by the SBA. Moreover, once the SBA notifies the lender that it has commenced a PPP loan review, the lender shall not approve any Forgiveness Application. PPP lenders should consider expressly advising their borrowers that the SBA requires that all PPP documentation (including the Worksheet, which isn't otherwise delivered to the lender) be retained by PPP borrowers for six years after the date that the PPP loan is forgiven or repaid in full. Lenders are also obligated to retain certain records in accordance with general SBA retention requirements (which, for federally regulated lenders, means compliance with the requirements of their federal financial institution regulator).

III. Clawback of Loan Processing Fees.

- (a) Ineligible Borrower. Per Section 3(a) of Interim Final Rule No. 0033, if the SBA conducts a loan review and makes the determination that a borrower was ineligible for its PPP loan, the lender shall not be eligible for a loan processing fee. If such



determination was made within one year after the subject loan was disbursed, the lender will be required to remit to the SBA any loan processing fee that it collected from the ineligible borrower⁷—*provided, however*, that the SBA's determination that a borrower was ineligible for a PPP loan will have no effect on the SBA's guaranty of the loan, so long as the lender has complied with (i) its obligations under section III.3.b of the SBA's first PPP interim final rule (85 FR 20811) posted on April 2, 2020 (the "First Interim Final Rule")⁸, and (ii) the document collection and retention requirements described in the lender application form (SBA Form 2484) (the "Lender Application").⁹

- (b) Lender Non-Compliance.** Per Section 3(c) of Interim Final Rule No. 0033, the SBA is also permitted to seek recovery of any loan processing fees received by any lender that failed to comply with (i) its obligations under section III.3.b of the First Interim Final Rule, or (ii) the document collection and retention requirements described in the Lender Application. Unlike the preceding subsection, the SBA's right to clawback loan processing fees as a result of lender noncompliance does not appear to expire after one year, and the SBA may seek to void the guaranty as a result of such noncompliance.

IV. Issues Pertaining to Forgiveness Calculations.

- (a) General.** While the forgiveness calculations may seem a bit daunting at first glance, the Forgiveness Application provides user-friendly worksheets and includes step-by-step instructions to assist the borrower with performing the requisite calculations (e.g. calculating adjustments for Full-Time Equivalency (FTE); salary/hourly wage reductions; etc.).¹⁰
- (b) Alternative Payroll Covered Period.** In the Forgiveness Interim Final Rules and the Forgiveness Application, the SBA has unveiled for the first time some significant flexibility as it relates to the eight-week (56-day) period used by the borrower for

⁷ Note that Interim Final Rule No. 0033 states that the lender is ineligible to receive any loan processing fee in connection with a PPP loan that was made to an ineligible borrower; but the SBA's clawback right appears to terminate after the one-year anniversary of the disbursement date, presumably to provide some finality to lenders with respect to such fee revenue.

⁸ Section III.3.b of the First Interim Final Rule generally requires that the lender (a) confirm receipt of borrower certifications contained in the PPP loan application form, (b) confirm receipt of information demonstrating that borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020, (c) confirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing payroll documentation submitted with the borrower's PPP loan application, and (d) following applicable Bank Secrecy Act (BSA) requirements.

⁹ The Lender Application generally requires the lender to retain the PPP loan application and the various documents demonstrating the qualifying payroll amounts.

¹⁰ The Forgiveness Interim Final Rules indicate that if a borrower offers to rehire an employee or restore his/her hours there shall be no reduction to the forgiveness amount if the employee declined such offer (subject to various conditions that are more fully set forth therein). Furthermore, the Forgiveness Interim Final Rules indicate that if an employee of the borrower is fired for cause, voluntarily resigns, or voluntarily requests a reduced scheduled, the borrower may count such employee at the same full-time equivalency level when calculating the forgiveness reduction amount.



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calculating qualified payroll costs. In general, the “Covered Period” is the eight-week (56-day) period that begins on the day the PPP loan was disbursed. However, a PPP borrower with a biweekly (or more frequent) pay period is now permitted to select an “Alternative Payroll Covered Period” which begins on the first day of the borrower’s first pay period that occurs after the disbursement date of the PPP loan, the effect of which is the borrower’s pay periods will coincide with the Alternative Payroll Covered Period. It should be noted the Covered Period is still utilized for various non-payroll calculations in the Forgiveness Application, and thus the preparer will need to be careful in the event it uses different eight-week periods in completing the Forgiveness Application.

- (c) “Costs Incurred and Payments Made”. The CARES Act states that forgivable expenses include “costs incurred and payments made during the covered period...” Lenders and borrowers alike have been anxiously awaiting clarification as to whether a subject expense is forgivable if it is *either* incurred or paid during the Covered Period (or Alternative Payroll Covered Period); or, in the alternative, is only forgivable if it is *both* incurred *and* paid during the Covered Period (or Alternative Payroll Covered Period). The Forgiveness Interim Final Rules and the Forgiveness Application indicate that: (i) payroll costs incurred but not paid during the borrower’s last pay period of the Covered Period (or Alternative Payroll Covered Period) are eligible for forgiveness if paid on or before the next regular payroll date, and (ii) an eligible non-payroll cost must be paid during the Covered Period or incurred during the Covered Period and paid on or before the next regular billing date, even if such billing date is after the Covered Period.

Conclusion

Many industry experts speculate that the forgiveness portion of the PPP may be the most onerous aspect thereof on lenders, borrowers, and the SBA alike. Accordingly, lenders should begin familiarizing themselves now with the form and content of the Forgiveness Application and the Forgiveness Interim Final Rules and begin to develop sound procedures for the PPP loan forgiveness process. Moreover, lenders must be prepared to monitor and address complaints from frustrated borrowers that do not receive loan forgiveness through no fault of the lender.

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