

In The News

SBA Faces 'Parade' of Lawsuits Over Handling of PPP

06.26.20

Washington Business Journal

The Small Business Administration has become ensnared in a series of lawsuits regarding its rollout of the Paycheck Protection Program — which experts say could have significant consequences for the program and future coronavirus relief efforts.

Since the CARES Act was signed into law March 27, the SBA has become the subject of at least 26 separate nonbankruptcy lawsuits, according to a review of filings available on court document search engine PACER. The lawsuits range from who could apply to the PPP, who could lend under the program and whether the SBA strayed too far from the will of Congress when writing its much-analyzed PPP regulations.

"I think that the parade of lawsuits was to be expected given how quickly this was rolled out," said David Roth, a shareholder at law firm Munsch Hardt Kopf & Harr PC, adding the SBA can be sued in any court. "I think that in their rush to get out guidance and to get out frequently asked questions and forgiveness applications and all that, they leaned too heavily on their past practices and inferences about the statute."

The SBA said it does not comment on ongoing legal proceedings.

Key features of the PPP, including an initial rule that capped nonpayroll expenses at 25%, did not appear in the original CARES Act passed by Congress, nor did certain eligibility rules that limited which businesses could apply for the loans — some of those eligibility rules were taken from the agency's other, existing loan programs for small businesses. One such restriction, for example, prohibited adult-oriented businesses of a "prurient nature," which includes strip clubs, from applying for a PPP loan.

A group of 42 such businesses filed suit May 12 against the SBA and won a preliminary injunction from U.S. District Judge Matthew Leitman in the U.S. District Court for the Eastern District of Michigan. That ruling allowed the plaintiffs to apply to the program.

"Simply, Congress did not pick winners and losers in the PPP," Leitman wrote in his opinion. "Instead, through the PPP, Congress provided temporary paycheck support to ALL Americans employed by ALL small businesses that satisfied the eligibility requirements — even businesses that may have been disfavored during normal times."

That injunction has been held up by the Sixth Circuit Court while the case continues to play out after the SBA appealed Leitman's decision.

The SBA's rule barring companies in bankruptcy proceedings from the PPP has also drawn challenges, including Hidalgo County Emergency Service v. SBA. The bankruptcy court sided with Hidalgo, which said it was in the middle of Chapter 11 bankruptcy proceedings, granting it a preliminary injunction that was ultimately overturned and denied June 22 by the Fifth Circuit Court upon the SBA's appeal.

In Jani-King International Inc. v. United States Small Business Administration — filed April 15 — the plaintiff said the SBA discriminated against small businesses that operated under what the agency classified as a franchise agreement. The SBA has permitted franchises to participate in the PPP in some cases, but the plaintiff said it was denied access to the program. Both parties asked for summary judgment but it was denied, and the case is still pending.

The SBA has also changed its own policies regarding eligibility over the course of the program. On June 12, the agency changed its rule that originally said business owners who had been convicted of a crime within the last five years were ineligible. Now, that's been limited to a conviction within just the past year, except in the cases of financial crimes, including fraud or embezzlement. That original rule was the subject of a recent lawsuit brought by the American Civil Liberties Union, among others.

Roth said he expects the agency to make more proactive rule changes as it works through the various lawsuits. Other recent changes to the forgiveness application, he said, already made it far easier for small loan amounts to be forgiven.

"I expect to continue to see amended guidance," he said. "I think the trend in the guidance we are seeing is to be much more permissive of taxpayers and lower the bar for proving loan qualification and loan forgiveness."

These cases are also important to watch for future programs as Covid-19 continues to wreak economic havoc, especially in regions where cases are rising once again, and Congress readies potential additional relief, said Bonnie Rothell, a partner at law firm Morris, Manning & Martin LLP.

"They are important precedent-setting cases. I don't know if they are going to have a huge impact because money has been allocated, and you can't go back and change it. But I think it's going to be used as a basis for some of the questions that are coming up right now," Rothell said. "There are going to be other funding rounds down the road."

The SBA has also drawn a lawsuit for its lack of transparency with the overall program and its loan data. The Washington Post, Bloomberg, Dow Jones, ProPublica and The New York Times filed a lawsuit May 12 for the agency to hand over data on all the loans it has made under the PPP. American City Business Journals — the parent company of this publication and 43 other Business Journals across the country — and five other news organizations joined the lawsuit on May 29.

The SBA said in a response to that lawsuit filed June 12 that the information was exempt from disclosure under the Freedom of Information Act. Information about other SBA loan products, including the agency's flagship 7(a) program, is publicly available.

But on June 19, the SBA reversed that statement to a degree: It said it will disclose some data, including the business names, addresses, NAICS codes (industry codes used by the federal government), ZIP codes, business type, demographic data, nonprofit information, jobs supported and loan amounts in ranges — instead of the specific loan amounts — but only for loans of more than \$150,000. For loans under \$150,000, the agency will provide totals, aggregated by ZIP code, industry, business type and various demographic categories.

About 4.74 million businesses have been approved for \$517.1 billion in PPP loans through June 25, according to SBA data. The average loan size is \$109,071.

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