PPP AGENT FEE AND APPLICANT LITIGATION: AN UPDATE

The rushed roll out of the PPP and the size of the program have led to litigation across the country, mainly in two categories: agents seeking fees for assisting businesses that applied for PPP loans and unsuccessful applicants for loans. The authors review this litigation, describing the claims made by plaintiffs and the negative district court responses in the two cases that have been decided so far.

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In response to the quickly deteriorating economic conditions caused by the COVID-19 pandemic, Congress expanded the Small Business Administration's 7(a) Loan Program by creating the Paycheck Protection Program ("PPP") and authorized the SBA to guarantee 100 percent of the PPP loans made by approved lenders to qualifying businesses. Authorized pursuant to the March 27 Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), loans under the PPP program became available just a week after the CARES Act became law. The SBA released four pages of general guidance on March 31 and an Interim Final Rule ("IFR") governing the program on April 2, the night before applications opened.

Businesses scrambled to apply for the $349 billion in initial funding, which ran out in just 13 days. Problems with the program's roll out were well publicized: the CARES Act did not provide for any exceptions to the Patriot Act's Know Your Customer ("KYC") requirements, which led many lenders to restrict applications to existing customers; the SBA's application approval system was quickly overwhelmed by the crush of applications; and potential applicants were confused by the program's rules on loan forgiveness and repayment. The speed with which the program was rolled out meant that the interim rules and other regulatory guidance from the SBA left many questions unanswered.

The Interim Final Rule ("IFR"), first released on April 2, was published in the Federal Register on an expedited basis on April 15, 2020.[1] On April 24, 2020, Congress made an additional $310 billion in funding available, and over the next few months the SBA issued additional and revised rules and guidance for the program.[2] When the program closed on August 8, 2020, $525 billion in loans had been approved and roughly $124 billion in funding remained untapped.

However, not unsurprisingly, the rushed roll out of the program and scramble for funds together with the sheer size of the program has led to litigation filed across the country. The cases fall primarily into two categories: claims filed by agents claiming entitlement to fees for assisting businesses that applied for PPP loans[3] and claims filed by unsuccessful applicants. The lawsuits

[1] Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 20,811 (Apr. 15, 2020).

[2] The SBA's PPP rules and guidance can be accessed at its website. https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program#section-header-9.

[3] A partial listing of these cases: *In re: Paycheck Protection Program Agent Fees Litigation*, MDL No. 2950; *Sport & Wheat v. Servisfirst Bank Inc. et al.*, No. 20-05425 (N.D. Fla); *Tax Divas LLC, et al, v. JPMorgan Chase Bank*, case number 1:20-cv-05311 (S.D.N.Y.); *Bookmyer v. PNC Bank N.A. et al.*, No. 2:20-cv-02284 (S.D. Ohio); *David S. Lowry, CPA, Ltd., v. U.S. Bancorp., et al.*, 1:20-cv-00348-MWM (S.D. Ohio); *American Video Duplicating Inc. et al, v. Citibank N.A.*, et al, case number 2:20-cv-03815 (C.D. Cal); *M&M Consulting Group LLC v. JPMorgan Chase Bank NA et al.*, case number 8:20-cv-01318 (C.D. Cal.); *Ratliff CPA Firm, PC v. First-Citizens Bank & Trust Co.*, No. 20-cv-02041 (D.S.C. May 29, 2020);*Compu-Tax & Accounting, LLC v. Bank of America, N.A.*, No. 20-cv-01554 (D. Ariz. Aug. 5, 2020); *Profitwise Accounting Inc. v. Bank of America, N.A.*, No. 20-cv-01395 (S.D. Cal. July 22, 2020); *Fisher, P.A. v. Bank of America*, N.A., No. 20-cv-00405 (W.D.N.C. July 21, 2020). Please note that between the time this article was finalized for publication and the date of publication, there have been material developments in a number of the aforementioned cases. For example, dispositive briefing has been filed in *American Video Duplicating*, and *Bookmyer* has been voluntarily dismissed.

filed by would-be borrowers in turn relate primarily to allegations that lenders impermissibly added eligibility conditions or were obligated to lend on a first-come, first-served basis but did not.

Now that we have the benefit of the first decisions addressing the viability of these cases, this article provides an update on the first wave of PPP litigation.

AGENT-FEE CASES

By early August, at least 60 agent-fee cases had been filed in 26 districts.[4] Plaintiffs in these cases attempted unsuccessfully to consolidate them in a Multidistrict Litigation ("MDL"). As described by the Judicial Panel on Multidistrict Litigation's decision declining to create any MDLs, the cases all allege that "lenders across the banking industry failed to pay legally mandated "agent fees" owed to agents."[5] However, the panel declined to create either an industry-wide or lender-specific MDL because there is no predominant defendant across all of the actions (indeed the panel noted that defendants ranged from large national banks to community and regional lenders) and the actions lack sufficient common fact questions because each lender has its own practices and policies for paying agent fees.

As a result, these cases remain pending across the country. The first two courts to have addressed contested motions to dismiss, the Northern District of Florida and the Southern District of New York, have dismissed the actions before them.

Background on the Program and Agent Fees

As mentioned, the PPP was created through an amendment to the SBA's Section 7(a) lending program. As a result, the existing Section 7(a) statutory and regulatory framework apply to PPP loans, except where the CARES Act or SBA regulations have modified program rules. The already-existing regulations governing Section 7(a) loans allow, but do not require, applicants to use an agent to assist in the application process.[6] Although many of the plaintiffs in these cases are accountants, an agent can be any authorized representative of an applicant.[7] If an agent is involved, the statute and SBA regulations require that the applicant, lender, and agent provide the SBA with a copy of a compensation agreement.[8] The form required by the SBA is called the Form 159 Fee Disclosure and Compensation Agreement ("Form 159"). The pre-existing regulations limited how much an agent can be paid prior to the creation of the PPP program, with limits based on the amount of loan and a requirement that compensation be reasonable.[9]

With respect to agent fees, the CARES Act provides that an agent assisting a PPP applicant "may not collect a fee in excess of the limits established by the [SBA] Administrator."[10] The IFR (which temporarily supersedes any existing conflicting program requirement)[11] provides in part:

> Agent fees will be paid by the lender out of the fees the lender receives from SBA.[12] Agents may not collect fees from the borrower or be paid out of the PPP loan proceeds. The total amount that an agent may collect from the lender for assistance in preparing an application for a PPP loan (including referral to the lender) may not exceed . . . a percentage of the loan amount ranging from one percent for loans of $350,000 or less to .25 percent for loans of $2 million or more.[13] The rule goes on to state that the SBA Administrator in consultation with the Treasury Secretary "determined that the agent fee limits set forth above are reasonable based upon the application requirements and the fees that lenders receive for making PPP loans."[14]

Plaintiffs' Claims

Plaintiffs in the agent-fee cases argue that this IFR language mandates the payment of an agent fee regardless of whether there is an agreement between the

[4] *In re Paycheck Protection Program (PPP) Agent Fees Litigation*, MDL No. 2950 (J.P.M.L. Aug. 5, 2020).

[5] *Id.*

[6] 13 C.F.R. § 103.2.2.

[7] *Id.* § 103.1.

[8] 15 U.S.C. § 642 (requiring applicant to certify the identity of and fees to be paid to any agent); 13 C.F.R. § 103.5(a).

[9] *Id.*§ 103(5)(b).

[10] 15 U.S.C. § 636(a)(36)(P)(ii).

[11] SBA Interim Final Rule, 85 Fed. Reg. 20811, 20812 (Apr. 15, 2020).

[12] Lenders under the PPP program receive fees ranging from five percent for loans of $350,000 or less to one percent for loans of $2 million or more. 15 U.S.C. § 636(a) (36)(P)(i).

[13] SBA Interim Final Rule, 85 Fed. Reg. 20811, 20816 (Apr. 15, 2020).

[14] *Id.*

lender and the agent for payment. They further argue that nothing in the CARES Act requires an agreement between an agent, customer, and lender in order for an agent to be entitled to payment of a portion of the fees paid on a funded loan. Although the facts vary, many complaints do not allege an express agreement with lender to be paid a fee. Some complaints allege that agents demanded payment unsuccessfully while others make no mention of a demand or even identify the borrower assisted by the plaintiff agent. Plaintiffs have asserted a variety of causes of action (declaratory judgment, unfair and deceptive trade claims, unjust enrichment, tortious interference, breach of implied contract, conversion), most of which are brought under state law. They seek payment of agent fees, and in some instances, injunctive relief to require the lender to pay fees going forward even in the absence of an agreement.

Decisions to Date

The Northern District of Florida and the Southern District of New York are the only two courts to have addressed these arguments thus far,[15] and both dismissed the claims before them, holding that the CARES Act does not entitle agents to be paid fees in the absence of an agreement.[16] Both courts analyzed the PPP-specific statutory and regulatory requirements in the context of the pre-existing and more detailed Section 7(a) program requirements because they ruled that those provisions continue to apply in the absence of a conflict with the PPP. Both courts looked to the plain language of the CARES Act and concluded that the statute does not require the payment of fees in the absence of an agreement. The courts found no conflict between the CARES Act or the IFR and the pre-existing requirement that an agent enter into a compensation agreement with the lender in order to be paid. The courts reasoned that the CARES Act imposes a limit on what an agent can be paid, but does not mandate payment in the absence of an agreement. The CARES Act's mandate that lenders "shall" be paid a fee out of the loan proceeds contrasts with its language limiting what agents "may" collect and further evidences that Congress did not intend to mandate payment to agents. Further, the IFR also does not impose a requirement to pay; it only provides that if there is an agent fee, it must be paid out of the lender fee. Plaintiffs pointed to various aspects of Form 159 (blanks to be completed or signatures required) as "conflicting" with the CARES Act to argue that the form is not required for PPP loans. Both courts rejected these arguments, essentially recognizing that just because Form 159 was not customized to the PPP program does not mean that it conflicts with the CARES Act or that an agreement is not required.

The Southern District of New York also rejected arguments that because PPP was an emergency program where speed in applying was critical, requiring that an agreement on agent fees be reached with a lender before applying was inconsistent with the program's purpose. Also unsuccessful were arguments that absent a payment requirement, lenders will never agree to pay agents or borrowers will be effectively barred from using agents – thereby making it more difficult for small businesses to obtain PPP loans.

Equitable theories asserted by the plaintiff in the Northern District of Florida fared no better. Specifically, an unjust enrichment claim under Florida law failed because agents could not allege the required direct conferral of a benefit on the defendant. The court concluded that the agent's work may have directly benefitted the borrowers, but the defendants received merely an "incidental benefit" of the agent's work. The Southern District of New York also rejected state law claims, but primarily on the grounds that the claims were premised on an entitlement by the agents to fees under the PPP.[17]

Defendants in both cases also argued that the CARES Act does not support a private right of action. The Northern District of Florida did not find it necessary to reach the implied right of action question because of its ruling on the merits. The Southern District of New York held that even if plaintiffs' reading of the statute and regulatory guidance was correct on the merits, there is

[15] *Sport & Wheat, CPA, PA v. Servisfirst Bank, Inc.*, No. 20-05425, 2020 WL 4882416 (N.D. Fla. Aug, 17, 2020); *Johnson v. JP Morgan Chase Bank, N.A.*, No. 20-cv-4100, 2020 WL 5608683 (S.D.N.Y. Sept. 21, 2020) (The Southern District of New York consolidated six agent-fee actions pending before it for pretrial purposes and issued a single opinion addressing all of the cases).

[16] As an initial matter, the Southern District of New York dismissed some plaintiffs' claims for lack of subject matter jurisdiction because they did not plead that they ever demanded payment from the defendant lenders. The court concluded that where a plaintiff could not establish the futility of a payment demand, the plaintiff lacked standing and therefore dismissal under 12(b)(1) was proper. However, where a defendant had an established policy not to pay agent-fees (at least absent an agreement to do so), the court concluded that futility of making a payment demand was established and jurisdiction was proper.

[17] *Johnson*, No. 20-cv-4100, 2020 WL 5608683, *9-12 (rejecting third-party beneficiary contract, unjust enrichment, and conversion claims among others). The court also dismissed state unfair trade practice claims. *Id*.

no private right of action to enforce the PPP provisions of the CARES Act.

Many agent fee cases remain pending and are on the cusp of, or in the midst of, briefing on motions to dismiss. However, on December 27, 2020, President Trump signed into law H.R. 133, which states that PPP lenders are only required to pay agent fees for those "which the lender directly contracts with the agent."[18] Backdated to March 27, this provision does not bode well for existing plaintiffs and likely marks an end to the onslaught of agent fee lawsuits.

UNSUCCESSFUL APPLICANT ACTIONS

Background

One issue with the PPP Program is that the Treasury Department required that lenders comply with the Patriot Act's KYC requirements. The KYC requirements exist so banks can ensure that customers do not engage in money laundering activities under the guise of seemingly legitimate banking. To comply with KYC requirements, banks must conduct extensive due diligence on customers before they can open accounts with the institution.[19] The KYC requirements go beyond a "check the box" exercise, and can be burdensome and time-consuming for banks.

The incongruity between Treasury's directive and Congress' silence on KYC requirements put both banks and would-be borrowers in a difficult position. Banks were required to choose between speed (granting PPP loans promptly) and thoroughness (making sure that KYC requirements are met for each borrower). Applicants, on the other hand, struggled to qualify for loans from institutions where the customer had not already satisfied KYC protocol.

Banks' reactions to this predicament varied and changed over time. Initially, in an effort to manage their resources and harmonize the tension between needing to process PPP loan applications while also adhering to KYC protocols, many banks elected only to approve loans for existing customers, *i.e.*, customers who have already satisfied the bank's KYC requirements. Some banks, however, reversed course once customers complained. For example, one large bank changed its policy and began approving loan applications from borrowers who hadn't already banked with that institution. Another major bank, however, only approved loans from new customers who operate nonprofits or had fewer than 50 employees.

Rejected Applicants Seek Relief from Courts

Bearing the brunt of these constraints are would-be borrowers who applied for a PPP loan only to be rejected on the grounds that the lender could only accept applications from existing customers. Those applicants who were denied loan applications, or not even permitted to apply, because they did not already bank with a lender, have sought relief and/or clarification from the courts.

Only one major illustrative decision, *Profiles, Inc. v. Bank of Am. Corp.*, has been handed down on this issue.[20] In *Profiles*, the District of Maryland denied a request for a temporary restraining order enjoining a bank from denying loan applications on the basis that the customer did not have a pre-existing account with the institution.

The court in *Profiles* noted that the CARES Act did not support a private right of action under which plaintiffs could sue lenders for not complying with the Act's provisions. The court also held that lenders were free to create their own eligibility requirements separate from what is specified by the Act. Having lost its bid for a temporary restraining order and an attempt to appeal that decision, the plaintiff in *Profiles* dismissed the case. This decision provides some flexibility and relief for lenders, but did not make PPP loans more accessible to customers.

In a similar lawsuit, the plaintiffs in two lawsuits filed in the Southern District of Texas alleged that a bank improperly restricted access to PPP loans to customers with a pre-existing checking account at that bank.[21] Among the plaintiffs' theories is that denying loans to non-previous customers is profitable for the institutions

[18] *More information available at* https://www.loc.gov/law/foreign-news/article/united-states-president-signs-law-to-provide-new-economic-stimulus-to-address-pandemic-hardships/.

[19] *Available at*: https://home.treasury.gov/system/files/246/staterule.pdf.

[20] *Profiles, Inc. v. Bank of Am. Corp., et al*., No. 1:20-cv-00894-SA (D. Md.).

[21] *Scherer v. Wells Fargo Bank, N.A.*, No. 4:20-cv-01295 (S.D. Tex.) and *Scherer v. Frost Bank*, No. 4:20-cv-01297 (S.D. Tex.).

because they can make more substantial origination fees from larger loan amounts for existing clients.[22]

Numerous other plaintiffs filed suit asserting claims that lenders failed to process PPP loan applications on a "first-come, first-served basis" as anticipated by the SBA.[23] These suits arise from the SBA's rules, which state that the PPP program is a "first-come, first-serve" program.[24] However, the rules do not require *lenders* to process applications on a first-come, first-serve basis.

The alleged harm for plaintiffs bringing a claim under the "first-come, first-serve" argument is that they missed the opportunity to promptly apply for loans from lenders that actually were processing loan applications on a first-come, first-served basis. The SBA's guidance on the topic does not include a requirement that applications be processed on a first-come, first-served basis. Other claims asserted in these complaints include negligence, unfair competition, promissory estoppel, and breach of fiduciary duty. The plaintiffs generally argue that the lenders have a duty to review all applications equally and promptly, and that by prioritizing certain applicants over others, lenders have breached those duties. The plaintiffs also argue that they detrimentally relied on the assumption that their applications would be timely reviewed, and in doing so missed out on the opportunity to apply for loans elsewhere.

Among those lawsuits, one complaint goes so far to allege that large bank PPP lenders conspired with each other only to provide PPP loans to their existing clients in order to protect their market share.[25] Plaintiffs brought this action under the Sherman Act and Clayton Act, and the complaint does not include any facts supporting the alleged conspiracy.

While the outcome of the applicant lawsuits that remain pending is uncertain, *Profiles* sets the groundwork for courts to decline to find liability because lenders applied their own means to achieve KYC requirements or process loan applications efficiently. The approach of the Northern District of Florida and the Southern District of New York further point to the importance of the plain language of the CARES Act and IFR in applying the PPP rules to these disputes. Now that the PPP has closed (absent further legislation), the next set of questions to be answered will likely deal with the complicated rules for loan forgiveness. The SBA recently issued a simpler loan forgiveness application for loans of $50,000 or less, and these loans account for the majority of loans made.[26] However, businesses that borrowed more than this amount will need to navigate fairly complex rules, and of course, if loan forgiveness applications are denied, then litigation may well follow.[27] ■

[22] It should be noted that some banks pledged to donate any profits from the program. *See* https://www.americanbanker.com/news/heres-where-wells-fargo-is-donating-its-400m-in-ppp-fees.

[23] *Outlet Tile Center v. JPMorgan Chase & Co.*, No. 2:20-cv-03603 (C.D. Cal)(voluntarily dismissed); *Ryan M. Kull Licensed Clinical Social Work LLC v. Chase Bank USA, N.A.*, No. 1:20-cv-03138 (S.D.N.Y.)(voluntarily dismissed); *Law Office of Sabrina Damast, Inc., et al. v. Bank of Am. Corp.*, No. 2:20-cv-03591 (C.D. Cal.)(voluntarily dismissed); *Legendary Transport, LLC v. JPMorgan Chase & Co.*, et al., No. 2:20-cv-03636 (C.D. Cal.); *Hyde-Edwards Salon & Spa v. JPMorgan Chase & Co.*, No. 3:20-cv-00762-DMS-MDD (S.D. Cal.); *Starwalk of Dallas, LLC v. JPMorgan Chase & Co.*, No. DC-20-05797 (Dallas Cty. Dist. Ct.); and *Sha-Poppin Gourmet Popcorn LLC v. JPMorgan Chase Bank, N.A.*, No. 1:20-cv-02523 (N.D. Ill.).

[24] SBA Interim Final Rule, 85 Fed. Reg. 20811, 20816 (Apr. 15, 2020); s*ee* https://www.proskauer.com/alert/first-come-first-serve-paycheck-protection-program-launched-today.

[25] *Legendary Transport, LLC v. JPMorgan Chase & Co., et al*., No. 2:20-cv-03636 (C.D. Cal.).

[26] *Available at*: https://home.treasury.gov/news/press-releases/sm1148.

[27] *Available at*: https://www.sba.gov/document/support-frequently-asked-questions-ppp-loan-forgiveness.

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