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PERSPECTIVE

## Should law firms worry about liability for PPP loans?

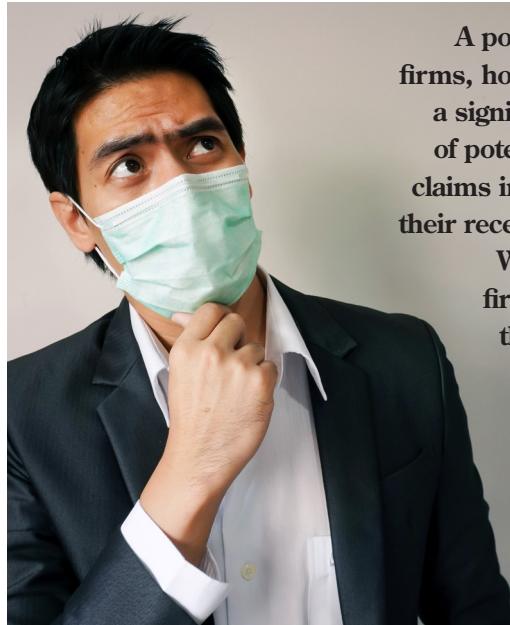
By Byron J. McLain and  
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Over 14,000 law firms, like other small businesses, applied for and received pandemic-related financial assistance pursuant to the SBA's Paycheck Protection Program. A portion of these law firms, however, could face a significant, unfair risk of potential civil liability claims in connection with their receipt of PPP loans. Why? Because law firms are viewed by the Department of Justice and other enforcement agencies as gatekeepers subject to a higher standard of care. Simply put, they are easy targets. As a result, firms should consider supplementing their initial due diligence of the PPP funding process with an internal review or a privileged internal investigation to identify and address any potential vulnerabilities that could subject the law firm to further government examination and/or liability. (For a list of law firms that received PPP loans, visit the Gerben Law Firm's website here: <https://www.gerbenlaw.com/blog/law-firms-that-received-ppp-loans/>.)

Some scenarios that could specifically expose law firms to a particularized and detailed examination by law enforcement agencies include the following:

1. Optimistic year-end law firm economic projections made in early 2020
2. Normal law firm associate attrition misconstrued as layoffs
3. Disgruntled partners serving as whistleblowers

There are a few simple steps any PPP loan recipient can take to mitigate government scrutiny. However, despite all the advance precautions and careful analysis, law firms in particular likely will endure significant review for civil



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liability by law enforcement agencies. Law firms should take immediate, specific precautions to limit their exposure to possible civil claims arising from the Financial Institutions, Reforms, Recovery, and Enforcement Act and False Claims Act statutes.

### SCENARIO 1:

#### **Optimistic Year-End Economic Projections and Results Subject to Discovery.**

Spring 2020 was a disaster. COVID-19 spread quickly with no end in sight. Stay-at-home orders were prevalent. Courthouses shut down, trials were delayed indefinitely, and litigation was at a virtual standstill. Business transactions were scarce, and corporate departments were slow. Law firm's accounts receivable quickly increased, as legal bills were not timely paid. As the world found itself in an unprecedented and indefinite pandemic, the fiscal year looked uncertain at best.

Nevertheless, in early 2020 law firms wanted to maintain optimism and employee morale. As an example, in March 2020 a fictitious regional law firm ("Regions Firm") sent an email describing a recent victory in a pending appeal, and how this win would help its litigation group obtain more clients. A few weeks later, Regions Firm sent another email highlighting optimism in the bankruptcy practice group, as new legal matters arrived (failing to mention that legal fees would likely remain unpaid until 2021). Regions Firm even sent out a cryptically worded email stating the firm was doing "better than expected" and no layoffs were "projected at this time." But behind closed doors, Regions Firm's management was deeply concerned.

Congress then passed the CARES Act in April 2020, authorizing \$649 billion in forgivable loans. Law firms like Regions Firm with 500 or fewer employees appeared eligible for these funds. According to the SBA's website,

the PPP "provide[d] loans to help business keep their workforce employed during the COVID-19 crisis." And after significant due diligence, Regions Firm determined that it could certify in good faith in its PPP Borrower Loan Application that "the current economic uncertainty makes [its] loan request necessary to support the ongoing operations of the Applicant." Despite the public pronouncements to manage employee morale, the Regions Firm needed the PPP funds to avoid layoffs. It submitted a PPP loan application identifying the hundreds of jobs saved.

A few weeks later, Regions Firm received the PPP funds, but it turned out the firm fared far better than was expected, especially given normal expenses were dramatically reduced. The law firm decided to inform its employees, law firm competitors, and clients in a news article that its financial outlook was positive. Despite the best of intentions, all this evidence — the optimistic internal emails, the news article, and Regions Firm's actual performance — is subject to discovery (e.g. civil investigative demands or Rule 16 discovery). This information could be used by civil plaintiffs and the federal government as evidence that at the time Regions Firm certified and applied for the PPP loan, the law firm may not have truly needed or qualified for the loan, especially given its initial positive forecasts and subsequent year-end profits.

#### *Recommendations to General Counsel and Managing Partners at Law Firms Similar to Regions Firm:*

- Create internally or hire outside counsel to conduct a privileged investigation to identify any potential vulnerabilities of the law firm to government scrutiny concerning the receipt of

the PPP funds (e.g., any internal or external positive financial reporting at the time of the PPP loan application).

- Prepare and/or supplement the law firm's "reliance" file for the loan application. This "reliance" file may include excel spreadsheets, articles, FAQs, internet searches, PDF guidance, advice, notes, emails, drafts and other materials relied on to prepare the loan application. It also could include internal correspondence from decision makers, identifying significant financial concerns then present at the law firm.

- Create a timeline of this information to identify the dire state of the law firm predating the PPP loan application submission and supporting its good-faith certifications in the loan application.

- If the firm received a PPP loan for more than \$2 million, consider the pros and cons of presenting this counter-narrative to the government prospectively; after all, the SBA and the Treasury Department already have indicated that all PPP loans over \$2 million will be subject to an audit. By self-reporting a potential borrower error, a PPP loan recipient may receive leniency or completely avoid any penalty. Of course, the borrower should always consult independent legal counsel before proactively approaching the government.

## SCENARIO 2:

### Normal Law Firm Associate Attrition Misconstrued as Impermissible Layoffs.

Fall 2020 was better. Regions Firm was approved for a \$5 million PPP loan a few months earlier and used the proceeds for payroll costs, mortgage interest, rent, and utilities. The loan amount was minuscule compared to the \$900 million in PPP loans received by Texas law firms, the \$1.2 billion received by New York law firms, the over \$1.5 billion received by California law firms, and the \$12 billion received by law firms nationwide. Nevertheless, the PPP loan prevented immediate layoffs and salary reductions at Regions Firm.

Despite the PPP loan, the natural annual attrition of Regions Firm's associates and other employees occurred as they exited near year's end. Some of the

lawyers left due to low billable hours, poor performance, and/or other job opportunities. Others planned their exits immediately after receiving bonus payments. A few salary cuts occurred because the PPP loan — though helpful — did not assist Regions Firm enough. Yet, the law firm had to deal with the negative public relations perception that millions in pandemic aid did not stop the firm from cutting jobs or pay. The federal government unfortunately could misconstrue normal attrition as an explicit rejection of the required certifications in the Loan Forgiveness Application Form 3508 and the overall purpose of the PPP to prevent job losses.

### Recommendations to General Counsel and Managing Partners at Law Firms Similar to Regions Firm:

- As part of the above suggested internal review or privileged investigation, identify all employees exiting the law firm in 2020, and document the specific nature and reasons for their departure. The law firm's loan forgiveness eligibility amount will not be impacted if an employee (a) was fired for just cause, (b) voluntarily resigned, or (c) voluntarily requested and received a reduction in his or her hours.

- Compare the law firm's employee attrition in 2020 to previous years. If the results indicate consistent attrition or lower attrition in 2020, this data may rebut any allegations of fraudulent intent in relation to the PPP loan application.

- Carefully consider the pros and cons to submitting a Loan Forgiveness Application Form 3508. Simply paying the one percent interest without forgiveness on the PPP loan when it matures will not prevent critics from saying that some law firms banked the money received from PPP loans as unintended liquidity, but the government likely will de-prioritize these PPP loan applications for further scrutiny where the law firm already repaid the funds.

## SCENARIO 3:

### Disgruntled Law Firm Partners Serving as Whistleblowers.

A new year has begun.

Regions Firm's financial revenues for 2020 are in. It was a tough 2020 overall, but the law firm saved employee jobs by accepting PPP loans despite certain economic reports indicating otherwise. Some partners brought in new business, stayed busy, and increased the firm's revenue. Other partners, unfortunately, did not. The revenue-generating partners saw a slight increase in their 2020 partner distributions for keeping the firm afloat. Less successful partners saw a sharp decline in their compensation. While some of these underperforming partners at Regions Firm understand the business of law and gracefully accept their salary reduction, others do not.

The disgruntled partners at Regions Firm are prime sources as whistleblowers in civil enforcement actions under the FCA, 31 U.S.C. Section 3729 et. seq., and the Financial Institutions, Reforms, Recovery, and Enforcement Act's civil penalty statute, 12 U.S.C. Section 1833a. These civil penalties could include \$11,665 to \$23,331 for each alleged false PPP loan application, in addition to treble damages (i.e., Regions Firm's \$5 million PPP loan could lead to \$15 million in damages, plus penalties). As equity owners in the law firm, the disgruntled partners at Regions Firm have access to highly confidential partner compensation numbers. They could selectively identify the largest revenue-generating partners and claim that the law firm accepted PPP loans de-

spite making huge profits. Civil plaintiff attorneys may see these whistleblowers as inside witnesses and as an opportunity to obtain a quick settlement from Regions Firm.

### Recommendations to General Counsel and Managing Partners at Law Firms Similar to Regions Firm:

- As part of the above suggested internal review or privileged investigation, perform due diligence to identify any indicia of a partner being a "disgruntled" employee or to identify the partner's knowledge of the law firm's initial dire financial expectations for 2020.

- If the law firm "counsels out" any partners in the upcoming months, ensure the severance package includes specific language to protect the law firm as much as possible from future lawsuits filed by the partner. Although a whistleblower employee typically cannot release fraud claims against an employer brought on behalf of the United States under the FCA, courts have demonstrated a willingness to enforce properly executed waivers of retaliation claims under the FCA. However, the analysis is very case-specific, so always consult independent legal counsel beforehand. ■

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