ALABAMA BANKERS ASSOCIATION
BOARD**BRIEFS**

A NEWSLETTER FOR ALABAMA'S BANK DIRECTORS

MAY 2020 • VOLUME 5 • NUMBER 2

IN THIS ISSUE

Federal Court: PPP Loan Applicants Can't Sue the Bank over PPP Rules
by Brian Malcom, *Waller*

Impacts of the CARES Act on Creditors' Rights and Bankruptcy
By James Bailey and Chris Hawkins, *Bradley*

What Alabama Banks Should Know About The California Consumer Privacy Act
by Dhruv Sharma, *McGlinchey Stafford*

COVID 19 Impact on Community Bank M&A
by Michael S. Murphey, *Porter White & Company*

Federal Court: PPP Loan Applicants Can't Sue the Bank over PPP Rules

by Brian Malcom

With the promise of low-interest or no-interest loans, and even the possibility of loan forgiveness, small businesses rocked by COVID-19 have recently turned to banks to apply for federally guaranteed funds. These funds are vital to many small businesses in order to help them stabilize their financial health during the widespread economic fallout from the pandemic. They are seeking these funds under the recently enacted CARES Act.

On March 27, the president signed into law the CARES Act, H.R. 748, P.L. 116-136, "to provide emergency assistance and health care response for individuals, families, and businesses affected by the coronavirus pandemic." The purpose of the CARES Act is to provide "immediate assistance to individuals, families, and businesses affected by the COVID-19 emergency."

Section 1102 of the CARES Act, entitled "Paycheck Protection Program," also known as the PPP, authorizes participating lenders to make general business loans available to eligible recipients in order to cover payroll and other expenses. CARES Act § 1102(a)(2), (b)(1). The PPP loans are federally guaranteed up to a maximum amount of $10 million and might be forgiven if the businesses meet certain conditions centered around encouraging businesses to maintain jobs and salaries for employees.

Congress allocated $349 billion for the PPP, but businesses quickly exhausted this pot of money during the first round. The small business PPP loan applicants that did not receive PPP funds were left frustrated and looking for someone to blame. If lawsuits are any indication, some businesses are blaming their bank.

One federal court recently considered an issue that will likely impact many lawsuits in the near future: whether Congress intended to provide a private right of action to allow for businesses to sue lenders under the CARES Act.

Profiles, Inc. filed a putative class action complaint against Bank of America Corp. alleging that BofA wrongfully imposed additional restrictions on borrowing under the PPP beyond those restrictions expressly mentioned in the CARES Act . The federal district judge denied the plaintiff-applicant's motion for a TRO and held that "the CARES Act does not expressly provide a private right of action."

The court also considered whether Congress intended for the statute to have an implied private right of action. In doing so, the court examined whether Congress intended to create both a private right for an applicant and a private remedy. The plaintiffs failed to convince the federal court that Congress intended to create a private right of action for applicants under the CARES Act.

In her memorandum opinion, the federal judge noted that the portion of the CARES Act containing the PPP amended the Small Business Act. The court acknowledged that the issue of whether the CARES Act contained a private right of action was a matter of first impression, but she noted that courts have previously held that the Small Business Act does not contain an implied private right of action.

The court's holding on the issue of whether applicants under the PPP have a private right of action signaled a strong defense for banks against PPP lawsuits in federal court, but it also warned all parties to stay tuned while acknowledging its own limitations under the Constitution.

The opinion reads:

"The plain language of the statute does not suggest an intent to confer the particular right alleged, nor a private remedy against participating [Small Business Act] lenders. To the extent Congress intends to create such a private right of action, it will be able to make its intent clear, if it ultimately amends the CARES Act, as is widely anticipated. Creation of that remedy, however, is not within the purview of this Court."

For now, banks should seek dismissal of claims alleging violations of the PPP in federal court. Banks should also prepare for battle in state courts, as plaintiffs will likely seek to file claims in those courts to frustrate dismissal efforts. Wells Fargo is now facing a putative class action from business owners in a federal court in Texas. The plaintiffs allege that Wells Fargo's policy of allowing only its preexisting customers to apply for a PPP loan from the bank violates the CARES Act, and the plaintiffs seek injunctive relief. Wells Fargo, along with JP Morgan Chase, US Bank, and PNC Financial Services Group Inc., all face lawsuits alleging violation of the PPP rules in various courts throughout the nation. In these suits, plaintiffs are seeking monetary damages and to enjoin the conduct by the banks.

Brian Malcom is a partner at Waller Lansden Dortch & Davis LLP in Birmingham. Representing banks, lenders, financial institutions, and healthcare firms in litigation matters, Brian constantly seeks to insulate clients from liability, while minimizing the impact on their operations. Clients depend on Brian's analytic abilities to resolve commercial disputes related to financial products liability, contractual agreements, and other business issues.

Impacts of the CARES Act on Creditors' Rights and Bankruptcy

By James Bailey and Chris Hawkins

On March 27, the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") became law. The new law contains several temporary amendments to the Bankruptcy Code, some of which apply in the business bankruptcy context and some of which apply in the consumer bankruptcy context. All of the changes are effective only for one year from March 27. In addition, the CARES Act requires creditors to grant forbearances on federally-backed mortgage loans and imposes a 60-day moratorium on foreclosures related to such loans. These key provisions of the CARES Act impact lenders and are discussed herein.

Increased Access to New Small Business Bankruptcy Provisions

Small businesses often struggle to reorganize in bankruptcy. To address this issue, Congress passed the Small Business Reorganization Act of 2019. The act took effect in February 2020 and makes small business bankruptcies faster and less expensive. At the time of enactment, the act only applied to business debtors with secured and unsecured debts less than $2,725,625.

The CARES Act expanded small business eligibility to take advantage of the recent amendments to the Bankruptcy Code. Now small businesses with up to $7.5 million in debt (with some qualifications) may seek relief under these new provisions.

Notable provisions of the Bankruptcy Code available to more small businesses include:

- **Appointment of a Trustee** - The new small business subchapter provides for the appointment of a trustee who will help facilitate reorganization and may monitor payments to creditors under the debtor's confirmed plan.
- **Streamlining Reorganization** - Only the small business in bankruptcy can propose a plan of reorganization, which must be submitted within 90 days of the bankruptcy filing. The court does not have to approve a separate disclosure statement, reducing the time and expense necessary to confirm the debtor's plan. Absent an order from the court, the new small business bankruptcies will not have committees of unsecured creditors. This will further reduce costs of bankruptcy for small businesses.
- **Elimination of the Absolute Priority Rule** - In a typical reorganization, the small business must pay unsecured creditors in full if the owners wish to retain their equity interests. This requirement is no longer applicable to eligible small businesses. Rather than paying all creditors in full, owners can keep their interests by confirming a plan that does not discriminate unfairly among creditors, is fair and equitable, and provides that the small business will contribute its projected disposable income to the plan.
- **Modification of Certain Residential Mortgages** - An individual who operates as an eligible small business may modify a mortgage secured by a residence if the underlying loan was for commercial purposes. This is a change from prior law that generally prohibited modification of mortgages secured by a principal residence.
- **Delayed Payment of Administrative Expense Claims** - The new subchapter for small businesses does not require payment in full of priority claims – including for goods and services provided to the small business during bankruptcy – on the effective date of the plan. A small business debtor may now stretch payment of these claims out over the term of the plan, which will last three to five years.
- **Discharge Limitations** - The scope of the discharge of debts for the small business will depend upon the terms of the plan and the consent of creditors. If creditors contest the plan, exceptions to a discharge, such as fraud and breach of fiduciary duty, will apply to the

small business debtor. This is a departure from a typical business reorganization that has very limited exceptions to discharge.

There is little doubt that the economic turmoil stemming from the outbreak of COVID-19 will increase small business bankruptcy filings. There is a one-year deadline for small businesses with debts up to $7.5 million to file cases under the new subchapter of the Bankruptcy Code. Lenders must be prepared for these new and unique bankruptcy cases.

Current Monthly Income in Consumer Bankruptcy Cases

One notable change under the CARES Act is the amendment to the definition of "current monthly income" in the Bankruptcy Code. The CARES Act exempts from "current monthly income" any "payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act with respect to the coronavirus disease 2019 (COVID-19)." The phrase "current monthly income" is used at various places in the Bankruptcy Code, including in the "means test" used to determine whether a debtor is eligible to quickly liquidate and obtain a discharge under Chapter 7 or instead must seek relief under another chapter of the Bankruptcy Code requiring a commitment of future income toward the repayment of creditors. A debtor's "current monthly income" also impacts, among other things, the amounts to be paid to creditors during a case and the length of time a debtor must make payments to creditors under a plan, also known as the "applicable commitment period."

The intent of this provision of the CARES Act is three-fold. First, it prevents debtors from being ineligible for relief under chapter 7 solely due to increased income from federal stimulus checks in connection with COVID-19. Second, it prevents the stimulus check from being intercepted by a bankruptcy trustee to pay creditors in the bankruptcy case. Finally, the CARES Act prevents the stimulus check from causing an enlargement of time a debtor must commit income toward the repayment of creditors. In essence, the CARES Act ensures that the debtor in bankruptcy is able to use the stimulus check in his or her discretion. This provision may prevent a slightly higher recovery on unsecured debts, but it likely will not have a significant impact on secured debts, where the lender's collateral drives its recovery.

Extension of Time to Complete Confirmed Bankruptcy Plans

A potentially more impactful change to the Bankruptcy Code under the CARES Act is an amendment allowing the debtor to modify a confirmed Chapter 13 plan. The court may approve a chapter 13 plan amendment "if the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic." It also allows a Chapter 13 plan to be extended up to seven years (compared to an existing maximum plan period of five years) from the date of the first payment under the plan, subject to court approval. This amendment will allow Chapter 13 debtors to suspend plan payments for a period of time or reduce their monthly payments to the trustee and still receive a discharge under the protection of the Bankruptcy Code.

From the lender's perspective, this provision of the CARES Act could have an impact on recoveries. With respect to unsecured debts, a modification to the plan could reduce the amount of money paid in by the debtor, meaning creditor recoveries could be reduced. Even if the payments are not reduced, the plan extension could lead to a delayed recovery. For lenders with secured claims, there likely will be no reduction in recoveries. However, there may be a delay in recovery. For example, a mortgage default that was being cured over 60 months now may be cured over 84 months, delaying the timeframe for the lender's recovery.

Forbearance and Foreclosure Provisions

The CARES Act allows consumers who have been financially affected by the COVID-19 pandemic and who have a federally-backed mortgage to seek a forbearance of their mortgage payments for up to six months, with a possible extension of up to an additional six months. If the consumer seeks such a forbearance and attests to a hardship, the lender or servicer is required to allow for this forbearance. During the forbearance time period, extra interest and fees will not accrue, and the suspension of payments under the forbearance will not impact the borrower's credit rating. At the end of the forbearance, the payments will come due, provided the consumer and servicer do not reach another arrangement regarding those payments.

For consumers in bankruptcy, all interested parties must receive notice of the payments that are required during the bankruptcy case. While the consumer and servicer may be aware of the forbearance terms under the CARES Act, they must provide such notice to the court and the Chapter 13 trustee as well. Unfortunately, this forbearance does not fit into the generally neat boxes defined by the Federal Rules of Bankruptcy Procedure or the electronic process for filing bankruptcy pleadings and notices. As courts continue to develop their own preferred processes for handling CARES Act forbearances, lenders and servicers may provide notice on the general bankruptcy docket or may provide notice on the court's claims register.

The CARES Act prohibits a servicer of a federally-backed mortgage loan from initiating the filing or advancement of foreclosure proceedings or the execution of foreclosure-related evictions or sales for a period of 60 days beginning on March 18, 2020. For the purpose of the foreclosure moratorium and forbearance requests, federally backed mortgage loans include those purchased by Fannie Mae, Freddie Mac, insured by HUD, VA or USDA or directly made by USDA. This would include any loans in which the lender or servicer obtained relief from stay in the bankruptcy case and was moving forward. Finally, while the CARES Act does not specifically prohibit a lender from filing a motion for relief from the bankruptcy stay during the foreclosure moratorium, it may be worthwhile for lenders to refrain from filing motions for relief during this period. Some courts might consider the filing of a motion for relief from stay as an advancement of a foreclosure that is prohibited under the CARES Act.

James Bailey and Chris Hawkins are partners at Bradley law firm. James has experience with both debtor and creditor representation in bankruptcy, out-of-court workouts and restructurings, and bankruptcy-related litigation. He also regularly represents commercial lenders and mortgage servicers in federal court commercial litigation.

Chris represents clients in a wide variety of bankruptcy and insolvency-related matters across the country. He represents debtors and creditors in out-of-court business restructurings and Chapter 11 bankruptcy cases. Chris represents creditors and financial institutions in bankruptcy-related litigation. In recent years, he has devoted the majority of his practice to advising large financial institutions on bankruptcy compliance and bankruptcy-related regulatory matters.

What Alabama Banks Should Know About The California Consumer Privacy Act

by Dhruv Sharma

On Jan. 1, California's Consumer Privacy Act ("CCPA") went into effect, activating the most onerous privacy regime in the nation. Broadly speaking, CCPA grants consumers the right to know what personal information is being collected from them; know how that information is being used, shared or sold; and request that such information be deleted or to opt-out of its sale. Consumers also gained the right not to be discriminated against for exercising those rights. Particularly concerning, CCPA authorizes the California Attorney General to bring enforcement actions for non-compliance, and consumers to sue for data breaches. CCPA has generated praise from consumers and confusion and concern among businesses. But do Alabama banks need to worry about what happens in the Golden State, or can they simply watch from the sidelines? Thanks to broad statutory language, the answer lies somewhere in between.

While CCPA only applies to for-profit entities that collect or sell personal information of California residents, the term "resident" is less restrictive or obvious than it seems. For example, a consumer domiciled in Alabama may be considered a California resident if they spend more than 6 months a year in California. Conversely, a consumer remains a California resident even if he or she happens to be temporarily outside California at the time that a business collects his or her personal information. Similarly, consumers that originally resided in Alabama at the time of data collection may have moved to California, bringing them within the purview of CCPA. Given our increasingly connected world where California is much closer than geography implies, whether an Alabama bank serves California residents for CCPA purposes may require greater analysis.

Similarly, CCPA's application to entities that "do business in California," is not limited to California-organized banks, or even banks that have a physical presence in California. Banks with an Internet presence that require or even allow California residents to input personal information may be within the scope of CCPA. Notably, CCPA also applies to entities that share common branding, further extending the web of potentially affected businesses.

This said, CCPA does have limiting criteria, only applying to banks that either generate annual gross revenue in excess of $25 million; derive at least half their annual revenue from selling personal information; or that buy, receive, sell or share personal information of more than 50,000 California residents, households or devices annually. This criteria is somewhat deceptive, though, as "personal information" extends to information beyond what is generally considered sensitive, including, for example, identifiers such as names, postal or e-mail addresses, IP addresses, account names, browsing and search histories, or any inferences drawn from such information to create a profile about a consumer's preferences. In light of this definition, it only takes approximately 135 California residents, households or devices to access a website per day (assuming the site actively or passively collects personal information) to meet the 50,000 resident threshold.

Notably for banks, though, CCPA exempts certain categories of information from its scope, including personal information collected, processed, sold, or disclosed pursuant to the federal Gramm-Leach-Bliley Act ("GLBA"). Importantly, this exemption is imperfect as CCPA has a much more expansive definition of "personal information" than what is covered by GLBA. For example, non-customer data gathered from a bank's website or through marketing efforts is not "nonpublic personal information" subject to GLBA, but is "personal information" subject to CCPA. To the extent banks collect this data, they are not exempt from CCPA coverage.

In short, CCPA represents a potential minefield of trip wires that may unexpectedly impact Alabama banks. Banks who fail to appreciate its scope and impact may do so at their own peril.

Dhruv Sharma is a partner in McGlinchey Stafford's Commercial Litigation practice group. Based in the firm's Irvine office, Dhruv primarily represents banking and other financial institutions in consumer financial services litigation. He can be reached at dsharma@mcglinchey.com.

COVID-19 Impact on Community Bank M&A

by Michael S. Murphey

Introduction

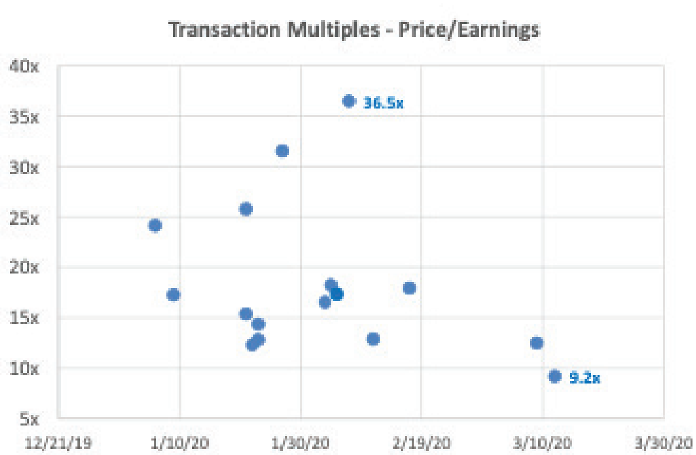
COVID 19 has made an indelible mark on our country, and bank M&A is no exception. In this article, we summarize COVID's current impact on Alabama community bank M&A and provide strategy suggestions to approach M&A activity when the "new normal" economy appears.

Current Impact

Year to date southeastern community and regional stock prices have fallen 14% and 37%, respectively, causing market cap/tangible book value to fall from 1.24x at FYE 2019 to 0.88x currently for community banks and from 1.79x to 1.14x for regional players.

Deal volume and pricing has similar trends. Forty-one (41) deals have been announced YTD 2020, vs 72 last year. No material deal announcement has occurred since March 11. Relevant transaction ratios with YTD 2020 statistics follow:

- **Deal Value/Tangible Book:** Median, High, and Low were 1.44x, 2.02x and 1.05x, respectively. Average multiple of the last three announced transactions was 1.29x, placing them in bottom quartile of YTD announcements.
- **Deal Value/Earnings:** Median, High, and Low were 16.9x, 36.5x and 9.2x, respectively. Average multiple of the last two announced transactions was 10.9x, which were also in the bottom quartile of announcements.



Source: S&P Global Market Intelligence
Note: Assets of target bank <$10B in assets, Transaction announcement date: YTD 2020, Geography: USA

Community Bank Acquisitions in the Age of COVID

Under current market conditions, M&A is difficult at best, and management's time might better be spent focusing on credit quality and employee/customer health. (Uncertainties around credit quality of assets led to significant drop off in M&A during the last recession.) However, assuming no recurrence of a COVID outbreak, most economists believe we have reached the financial nadir of the pandemic and should begin to experience GDP growth in Q3 or Q4 of 2020. Smaller banks will feel increased pressure on their business models in a post COVID economy and strategic M&A opportunities should be pursued once the economy has settled, regardless of the state of the capital markets. Topics relevant to developing an appropriate M&A strategy include:

- **Use stock as your primary acquisition currency:** Acquiring banks can bolster their capital in today's uncertain economy, while selling shareholders can realize enhanced return when the market rebounds. Additionally, a properly structured stock deal can minimize tax liability to the selling shareholders, further enhancing return.
- **Recognize the performance gap in banks with a presence in economically productive counties versus banks located in less attractive markets.** Alabama has 67 counties; each quartile represents 17 counties. We ranked each county by its percent contribution to overall state GDP, then grouped bank performance by quadrant based on bank headquarter location. The following chart provides a snapshot of economic drivers and return metrics by quadrant:

	Quartile One	Quartile Two	Quartiles Three & Four
% states GDP	78%	14%	8%
Bank assets ($mm)	$12,017	$8,321	$5,333
ROE	10.3%	8.6%	8.0%
Dividend yield	6.2%	7.0%	4.7%
Avg Bank size ($mm)	$316	$260	$157
Headquartered Banks	38	32	34

This table above indicates that it might be advantageous for shareholders in Quartiles Two to Four to invest in Quartile One. Frequently, banks in Quartiles Two to Four have stable deposits that might make them a good fit for Quartile One banks.

- **Recognize the liquidity gap between banks which have a presence in economically productive counties versus banks that do not.** The following chart provides a snapshot of loan growth and related funding by quartile:

•

	Quartile One	Quartile Two	Quartile Three & Four
Bank loans ($mm)	$18,248	$6,610	$3,092
Loan growth	8.1%	11.1%	3.0%
Loan/Deposit	85.1%	69.6%	66.1%

The table above indicates that it might be advantageous for banks in Quartile One to merger with banks in Quartiles Two to Four to fund ongoing loan growth.

- **COVID potential impact on Alabama community banking:** Economists and social scientists believe the following traits will accelerate post COVID:
  - migration from mega cities to mid-size cities like Birmingham, Huntsville, Montgomery & Mobile,
  - increased US domestic manufacturing presence in states like Alabama with a strong manufacturing base as current supply chains are revisited, and
  - increased use of technology to meet customer expectations.

  The first two traits will accelerate growth in quartile one (quartile one includes counties which include the major state metros and manufacturing hubs). The technology trait will also benefit the larger more profitable banks in quartile one as they have more cashflow to invest in technology versus other banks in the state. As a consequence, it behooves banks in quartile Two to Four to consider merging with banks in quadrant one.

- **COVID induced economic pressures:** Net Interest Margin, and likely credit quality, will suffer from COVID. Productivity may suffer from social distancing issues within the workplace. Larger banks in more economically viable markets have a better chance to attract reasonably priced capital to support growth and strengthen reserves. This ability to attract capital may support merger activity with banks in other quadrants who seek additional capital to potentially bolster downside capital needs.

In sum, stock based mergers between banks in large GDP markets with deposit rich banks in smaller markets will enhance overall shareholder return, bolster bank balance sheets to support near term COVID related issues, and provide a solid funding base to support the longer term loan growth that may arise in the post COVID economy.

Michael S. Murphey is a financial analyst who supports Porter White's Community Banking practice. He has spent forty years in the southeastern US banking industry in various capacities related to commercial lending, including relationship management, underwriting, credit, and portfolio management.

BOARD BRIEFS

is published six times a year by the Alabama Bankers Association.

QUESTIONS? Call us at (334) 244-9456. Visit ABA online at www.alabamabankers.com.

ALABAMA BANKERS ASSOCIATION

445 Dexter Ave., Suite 10025 Montgomery, AL 36104 | Phone (334) 244-9456