UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE:	Chapter 11
KABBAGE, INC. d/b/a KSERVICING, *et al.*,	Case No. 22-10951 (CTG)
	(Jointly Administered)
Debtors.	Courtroom No. 7 824 North King Street Wilmington, Delaware 19801
	Wednesday, March 22, 2023 2:00 p.m.

TRANSCRIPT OF BENCH RULING HEARING
BEFORE THE HONORABLE CRAIG T. GOLDBLATT
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

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(Proceedings commenced at 2:00 p.m.)

THE COURT: Good afternoon. This is Judge Goldblatt. We're on the record in *In Re Kabbage, Inc.*, which is Case No. 22-10951.

We are here for the purpose of my announcing a decision in the matter that was heard in the evidentiary hearing on Monday. So, thanks to all for gathering. Here it goes:

We are here on the debtors' motion to enforce a settlement agreement reached at the early stages of this bankruptcy case with Customers Bank and approved by this Court. The debtor contends that Customers Bank's settlement payments, which totaled approximately $20.5 million, was $1,555,656 less then Customers Bank was required to pay under the terms of the settlement agreement.

The Court conducted an evidentiary hearing on this motion on March 20th, 2023. The Court heard the testimony of three witnesses: Tameka Williams and Donna Evans from the debtor KServicing, and Alyssa White from Customers Bank. The Court also admitted into evidence a number of exhibits which the Court has reviewed.

At the outset, I want to say that I fully understand why this is a dispute that the parties needed to bring to the Court for a judicial resolution. I found all of the witnesses to be entirely credible. This is a circumstance in which both sides have genuine reason to believe in their positions. I view this as a close case.

To start with the punchline, my review of the evidence leads me to conclude that the debtor has carried its burden of showing, by a preponderance of the evidence, that it is entitled to the additional $1.56 million that it seeks. While there is certainly some evidence pointing in the other directions, for the reasons I will explain, my factual finding is that the debtor has carried its burden even if only narrowly.

A few procedural niceties. This dispute is within the Court's subject matter jurisdiction under 28 U.S.C. Section 1334(b) as a dispute over a post-petition agreement that had been agreed by the Court. It is a core matter under Section 157(b) such that this Court may enter final judgment.

As a technical matter this action seeks money damages so case can be made that such a money judgment may only be issued in connection with an adversary proceeding under Bankruptcy Rule 7001, but even if that is the case those procedural protections are certainly waivable and it is common practice to seek to enforce a settlement agreement that is approved by the Court through motions practice.

Here, no party has taken issue with proceeding by way of motion and the Court is entirely comfortable resolving the dispute in the posture in which it has been presented by the parties. Accordingly, pursuant to Bankruptcy Rule 7052 and 9014, I am now setting forth my findings of fact and conclusions of law.

The settlement agreement, itself, was admitted into evidence. That agreement, of course, is attached to the Court's order authorizing the debtor to enter into the agreement which is docketed at D.I. 232. By way of context, the debtor, KServicing, was a servicer of loans issued under the payment protection program. Customers Bank owned some number of those PPP loans. Under prepetition agreements KServicing was entitled to a fee for servicing those loans and was, otherwise, required to remit to Customers Bank the amount it collected on those loans.

Disputes arose between the parties which led KServicing to stop remitting payments to Customers Bank and to file a lawsuit in the District Court for the Northern District of Georgia. Those disputes were settled in connection with the settlement agreement at issue here.

Paragraph 8 of the agreement provides that within three business days of the effective date Customers Bank shall pay to KServicing an amount equal to the settlement payment. The effective date is defined as the date on which the Court enters the order approving the agreement which was November 9th, 2022.

The settlement payment is defined as the settlement amount which is separately defined as $58 million less the amount of the disputed KServicing holdbacks as of the petition date. Disputed KServicing holdbacks is also a defined term and means collectively the disputed KServicing fee holdback and the disputed KServicing remittance holdback.

Both of those items were originally contested between the parties, but over the course of the litigation the dispute narrowed so that by the time we reached the evidentiary hearing the only area of disagreement was the amount of the KServicing remittance holdback. That term is, of course, also defined in the agreement. As relevant here, it means the amount collected from borrowers that KServicing is required to remit to Customers Bank under the terms of the parties prepetition agreements.

Now the settlement agreement also set out a mechanism by which the parties would endeavor to reconcile how much needed to be paid. Paragraph 3 of the agreement provided that the parties would work together in good faith between the execution date and the effective date which was the date on which the Court entered the order approving the settlement to determine what the amount of the holdback would be.

Before getting into the specifics of how the parties endeavor to reconcile the amount of the KServicing remittance holdback it bears mention that the record made clear that throughout the parties relationship there were regular and recurring issues with respect to the accuracy and the integrity of the data. Over the nearly 100,000 PPP loans that KServicing serviced for Customers Bank, the record suggests that many thousands of these loans were subject to discrepancies in the accounting data and that in the ordinary course of business the parties met regularly in an effort to reconcile those discrepancies.

For the purpose of this dispute, the point of that finding is not to criticize either party. It is simply a recognition of the fact that both parties and now this Court were left to do the best they could do with information that everyone appreciated was imperfect.

I will also add that, perhaps related to the prior point, the parties had a variety of other disputes that cropped along the way including disputes about canceled loans and the payment of interest. During the evidentiary hearing the parties spent a fair amount of time pointing out the issues on which it turned out that one side was right and the other was wrong perhaps with the intent of persuading this Court that the fact that a party made a mistake about some different issue meant either that they were a bad actor or that it was likely that they also made a mistake about this issue.

To be clear, I am drawing no such inference. I am satisfied that both parties were acting in good faith. Yes, there were mistakes. That is a function of the fact that capable, but imperfect humans were working with even more imperfect data. There is nothing at all surprising or remarkable that various other mistakes were made and it is to the parties credit that when they realized there was mistake they corrected it and/or dropped the issue.

I am not, otherwise, addressing the facts relating to those "other" since resolved disputes which I consider irrelevant to the remaining dispute that is now before me.

The evidence shows that on November 4th, 2022 KServicing sent Customers Bank a spreadsheet, referred to as the Synovus repayment file, which was a listing of transactions relating to individual PPP loans identifying amounts paid to KServicing that KServicing was required to remit to Customers Bank. It appears that this file was derived from information related to KServicing's account at Synovus Bank. That account was opened in November 2020 after the sale of the debtors' principal assets to American Express at close.

The evidence further shows that Customers Bank used this information in determining the amount of the disputed KServicing remittance holdback and made its settlement payment based on that information. Just to be clear about this, the inclusion of an amount within the

KServicing remittance holdback operated to reduce the amount that Customers Bank paid to KServicing. That makes sense because these were amounts that KServicing owed to Customers Bank, but in substance including an amount within this remittance holdback and reducing the settlement payment by that amount was a mechanism by which Customers Bank, effectively, paid itself amounts that were due to it from KServicing.

It bears note that the evidence also shows that Customers Bank was comfortable that this amount was correct because the amount it generated turned out to be within about $1,500 of the amount in its trial loan balance analysis which was Customers Bank's own accounting of the amounts outstanding on the various loans.

Thereafter, however, KServicing determined that five of the loans included in the remittance file as loans for which KServicing had collected funds from borrowers, but had not yet remitted to Customers were improperly included in the file. The reason that their inclusion was incorrect was that KServicing demonstrated that in 2020 it had, in fact, made payments to customers in the amount of the disputed $1.56 million on account of those loans.

Those payments were made not out of the Synovus Bank account, which the debtor opened after the closing of the American Express transaction, but out of a prior account at Wells Fargo Bank that presumably was transferred to American Express as part of the transaction. The evidence that these loans were included in the disputed KServicing remittance holdback and that the same loans had been paid in 2020 is clear and specific.

The circumstances were articulated with fair precision in Paragraphs 9 to 18 of Ms. Williams declaration, that is at D.I. 671, which was admitted into evidence and was not materially disputed. The net result of that is that in substance KServicing has paid that $1.56 million to Customers Bank twice; first in October 2020 when those amounts were paid, and again in November 2022 when those amounts were deducted from the settlement payment.

Customers Bank makes, essentially, three responses to this showing; one is legal, the second is factual, and the third is one that I will describe as equitable. I will describe each of these three responses.

While I find that the legal argument fails as a matter of ordinary contract principals, the factual and equitable arguments have some real force. But at the end of the day neither can quite overcome the clear and simple factual showing that the debtor has made.

The legal argument that Customers Bank makes is that Paragraph 3 of the settlement agreement says that the parties had worked together in good faith from the time the agreement was executed until it became effective when approved by this Court to reconcile the amount of the holdbacks and to determine the amount of the settlement payment which was due three days thereafter. Customers position is that it was entitled to and did, in fact, rely on the information that KServicing provided to it and that Paragraph 3 operates to estop KServicing from coming in after the effective date with new data showing that the amount paid was incorrect.

I do not think that that is correct as a matter of contractual construction. That is not to say a contract cannot be written to operate that way. Parties will sometimes do that, but when that is what a party intends one would expect it to be reflected in clear contractual language that so specifies. But a provision that says that the parties will work hard to share information and try to get it right by date X should not be read to mean that if it turns out that there was just a mistake the party is barred from recovering the amount to which it is, in fact, entitled under the terms of the agreement.

Paragraph 20 of the settlement agreement provides that it is governed by Pennsylvania law, and Pennsylvania case law strongly supports this reading of the contract. Acme Markets v. Federal Armored Express, Inc., 648 A.2d 1218, Superior Court of Pennsylvania (1994), is a good example.

The case notes that Pennsylvania law generally enforces contracts according to their language. It adds, however, that: "Pennsylvania law abhors forfeitures and penalties, and enforces them with the greatest reluctance;" *Id.* at 1221.

The point is that while it is possible to construct an enforceable contract that sets up a procedural rule that if a party fails to comply will bar the party from recovering an amount to which they are, in fact, entitled such an outcome is a disfavored one. If the parties want to establish such a mechanism they certainly need to be express about it. And there is nothing in Paragraph 3 of this settlement agreement to suggest it should be so construed.

The second argument that Customers Bank makes is a factual argument. It contends that it was comfortable with the settlement amount it paid because it turned out to be within $1,500 or so of its trial balance analysis that it kept across the entire portfolio for PPP loans that were serviced by KServicing.

Alyssa White testified about the trial balance analysis in some detail. She explained that this analysis was the basis for Customers own financial reporting and that she believed that it accurately stated the amounts due on the portfolio PPP loans. In view of the flaws with KServicing data over the course of the relationship, if there was $1.56 million for which KServicing was paid twice it necessarily followed, Customers Bank argued, that there was some offsetting error somewhere else in the oceans of data.

Much of the cross-examination of Ms. White was dedicated to litigating a discovery dispute. KServicing contends that it asked for the information that underlies the trial balance analysis over the course of discovery and did not receive it. Customers Bank's response was that most of the underlying information was exchanged between the parties in the ordinary course of their relationship such that KServicing had access to it without the need for it to be produced in the litigation.

In any event Customers Bank says that if it failed to produce information requested by KServicing in discovery it was incumbent upon KServicing to file a motion to compel. KServicing now askes that the information be excluded from evidence because it was not provided in discovery or, at least, the basis for testing the information was not provided in discovery.

I will admit into evidence the material that Customers Bank has proffered. In the end, my conclusion is that even considering that evidence and appreciating the points that Customers Bank has made about the trial loan balance analysis I nevertheless conclude that the preponderance of the entire body of evidence is that KServicing is entitled to the disputed $1.56 million.

That said, I am satisfied that the evidence that Customers Bank has proffered about the trial loan balance analysis should properly be included in the record for the purpose of permitting a reviewing court to assess whether that factual finding is clearly erroneous.

My finding, however, is that the evidence that I do have about the trial loan balance analysis, while entitled to some weight, is insufficient to overcome the specific showing that the debtors have made. I am by no means rejecting Ms. White's testimony about the trial loan balance analysis. The problem is that there is something that is necessarily conclusory about it.

According to the evidence that was presented the trial loan balance analysis is a function of countless individual debits and credits. And it is only as good as each of the underlying inputs. To accept Customers Bank's argument would require the Court to accept largely, on faith, the proposition that there must be some countervailing error somewhere in the course of the relationship to balance out the specific showing about the $1.56 million that the debtors have made.

It is by no means impossible that Customers Bank is right about this, but in a world of imperfect information my task is to do my best to make findings of fact based on the evidence that the parties put in front of me. My finding is that the specificity of the evidence that the debtor has provided outweighs the more general and somewhat conclusory evidence that Customers Bank has presented based on the trial loan balance analysis.

As I have said, this is a close call. Maybe its 55/45, but may finding of fact is that the preponderance of the evidence supports the conclusion that the debtors are entitled to the disputed $1.56 million.

The final point that Customers Bank makes is what I call an equitable argument. It argues that KServicing bears the responsibility for the poor quality of the data. Customers Bank contends that in a world in which errors are abundant, this ruling, essentially, permits KServicing to cherry-pick one error from a vast field of problematic data when that is convenient for KServicing, and that it is fundamentally unjust to permit KServicing to benefit in this manner from a problem that was of its own making.

I do understand that point and, as I have said, it is not entirely without force. That said, notwithstanding what is often said about bankruptcy courts being courts of equity, this is a contract dispute which is a legal rather then an equitable matter. And my task is, therefore, to do my best to weigh the evidence of objectively and reach the judgment that is dictated by the law and the facts.

My conclusion, based on that review of the evidence presented, is that the debtors have a legal entitlement to recover the disputed $1.56 million from Customers Bank. I do not believe that any principal of equity, even accepting the points that Customers Bank is making, would permit this Court to reach a different outcome in light of those findings and conclusions.

So, that is my ruling. The parties are directed to settle an order consistent therewith.

Is there any other matter that the parties believe the Court should address why we are here?

(No verbal response)

THE COURT: All right. Seeing none, I thank the parties for the superb manner in which this complex dispute was presented.

With that we are adjourned. Thank you.

(Proceedings concluded at 2:21 p.m.)

CERTIFICATION

I certify that the foregoing is a correct transcript from the electronic sound recording of the proceedings in the above-entitled matter to the best of my knowledge and ability.

/s/ Mary Zajaczkowski March 22, 2023

Mary Zajaczkowski, CET-531

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