IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: KSERVICING WIND DOWN CORP., *et al.*,[1] Post-Confirmation Debtors.	Chapter 11 Case No. 22-10951 (CTG) (Jointly Administered)
KSERVICING WIND DOWN CORP. (f/k/a Kabbage, Inc.), Plaintiff, v. ROBERT FROHWEIN, *et al.*, Defendants.	Adv. Pro. No. 25-52372 (CTG)

D&O AND SHAREHOLDER DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS

[1] The post-confirmation Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, as applicable are: KServicing Wind Down Corp. (f/k/a Kabbage, Inc. d/b/a KServicing) (3937); KServicing Wind Down Canada Holdings LLC (f/k/a Kabbage Canada Holdings, LLC) (N/A); KServicing Wind Down Asset Securitization LLC (f/k/a Kabbage Asset Securitization LLC) (N/A); KServicing Wind Down Asset Funding 2017-A LLC (f/k/a Kabbage Asset Funding 2017-A LLC) (4803); KServicing Wind Down Asset Funding 2019-A LLC (f/k/a Kabbage Asset Funding 2019-A LLC) (8973); and KServicing Wind Down Diameter LLC (f/k/a Kabbage Diameter, LLC) (N/A). The Debtors' mailing and service address is KServicing Wind Down Corp. c/o Resolute Commercial Services, 6750 E. Camelback Road, Suite 103, Scottsdale, AZ 85251.

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Defendants Donald Butler, Jonathan Ebinger, Robert Frohwein, Bryan Stolle (together, the "Directors"), Kathryn Petralia (together with Frohwein, the "Officers" and together with the Directors, the "D&O Defendants"), Bennu Holdings Limited Co. ("Bennu"), BlueRun Ventures IV, L.P. ("BlueRun"), BRV Opportunities Fund, L.P. ("BRV"), Curieux Limited Co. ("Curieux"), The Frohwein Family 2015 Trust ("FFT"), MDV IX, L.P. ("MDV"), Raymond James & Associates, Inc. CSDN FBO Robert Frohwein RIRA U/A/D 5/27/16 A/C 2867A298 ("RJ RIRA"), Thomvest Ventures Ltd. ("Thomvest") (together with Frohwein and Petralia, the "Shareholder Defendants" and together with Butler, Ebinger, and Stolle, the "D&O and Shareholder Defendants") respectfully submit this *Memorandum of Law in Support of D&O and Shareholder Defendants' Motion to Dismiss*.[2]

NATURE AND STAGE OF PROCEEDING

Kabbage, Inc. (d/b/a KServicing) ("Kabbage" or "Plaintiff" or "Debtor") filed for bankruptcy on October 3, 2022. Voluntary Pet. for Non-Individuals Filing for Bankruptcy, D.I. 1. On March 15, 2023, this Court entered an order confirming Kabbage's Amended Joint Chapter 11 Plan of Liquidation ("Plan"). D.I. 680. On October 16, 2025, Kabbage, through its Wind Down Officer, filed a complaint, Adv. D.I. 1 (the "Complaint"), alleging claims for breach of fiduciary duty, recovery of a fraudulent transfer, and disallowance and equitable subordination of certain proofs

[2] Citations to "Adv. D.I." refer to the docket for this Adversary Proceeding, Adv. Pro. No. 25-52372, and citations to "D.I." refer to the docket for the jointly administered KServicing Chapter 11 Cases, Case No. 22-10951 (CTG).

of claim.[3] For the reasons stated herein, the Complaint should be dismissed with prejudice under Rule 12(b)(6).[4]

SUMMARY OF ARGUMENT

The Complaint should be dismissed with prejudice because it fails to state a plausible claim for relief. Plaintiff's fiduciary duty claims rest on the flawed premise that Kabbage's Directors and Officers turned a blind eye to compliance failures—yet the Complaint's own allegations and the documents it incorporates by reference demonstrate the opposite. Kabbage maintained written compliance policies subject to mandatory board-level reporting, a dedicated audit committee charged with compliance oversight, and independent third-party auditors who repeatedly confirmed the adequacy of Kabbage's controls. Nor did the Directors and Officers consciously disregard any red flags of illegality. The Complaint's fraudulent transfer claim fares no better, as it seeks to recover from minority shareholders who concededly never received the challenged transfer and who cannot be held liable as "beneficiaries" under any recognized theory. And the Complaint's disallowance and subordination claims are derivative of its failed substantive claims and must fall with them. In short, the Complaint is an exercise in hindsight, attempting to recast reasonable business judgments made during an unprecedented national crisis as actionable breaches of fiduciary duty and fraudulent transfer. The law does not permit it.

As the COVID-19 pandemic rapidly evolved into an economic crisis, Congress and the Small Business Administration ("SBA") launched an unprecedented public-private partnership:

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[3] On or before July 20, 2023, Kabbage changed its corporate name to KServicing Wind Down Corp., the named Plaintiff in this action. Mot. of the Post-Confirmation Debtors for Entry of an Order Amending Case Caption ¶ 9, D.I. 910.

[4] The D&O and Shareholder Defendants consent to entry of final orders or judgments by the Court if it is determined that the Court, absent consent of the parties, cannot enter final orders or judgments consistent with Article III of the Constitution.

the Paycheck Protection Program ("PPP"). The U.S. government committed an initial $349 billion in emergency capital for distribution as forgivable loans, and tasked lenders with deploying that capital rapidly to avert the mass layoffs, defaults, and business closures that could cascade the U.S. economy into depression. With traditional banks prioritizing existing, well-capitalized clients, the government relied on "fintech" innovators like Kabbage to make funds accessible to the nation's smallest and most vulnerable businesses. Answering the government's call, Kabbage became one of the nation's largest PPP lenders, fulfilling over $7 billion in PPP loans for 278,000 small businesses and sole proprietors, helping the government save hundreds of thousands of jobs.

The regulatory framework for PPP lending was created at breakneck speed—the SBA released regulatory guidance for PPP lenders on the evening of April 2, and lending began the next day. The lynchpin of PPP lending was that if borrowers applied for the loans in good faith, those loans would be forgiven, and if lenders relied on borrower documents and attestations, they would be held harmless for borrowers' inaccuracies. To ensure that lending occurred quickly enough to restabilize the American economy, lenders were not required to conduct verifications of borrower documentation. Lawmakers contemporaneously acknowledged that the program's comparably lax requirements would attract fraudulent borrowers but concluded that was a cost worth the benefit—and so the CARES Act was passed by a unanimous Senate and signed into law.

But as the immediacy of the crisis passed, lawmakers reversed course, given media coverage of borrower fraud, and attempted to cast hindsight blame on lenders and their management who served borrowers throughout the emergency. Various government entities announced multiple

expensive and long-running investigations, including into Kabbage.[5] Eventually, these investigative costs forced Kabbage into bankruptcy.

Kabbage maintained—including in filings before this Court—that the government's claims and investigations were baseless, and that Kabbage acted honorably in exceedingly difficult circumstances. Inexplicably, however, the Wind Down Officer appointed to administer the post-confirmation estate, entered into hundreds of millions of dollars of settlements in connection with the government's unproven allegations.[6] Those questionable settlements now represent almost all of the estate's major remaining unpaid claims—and are the sole justification for Plaintiff's sprawling litigation.

The revisionist campaign against Kabbage and its management inappropriately attempts to punish those who answered the government's call during a crisis. But Plaintiff's fiduciary duty and fraudulent transfer claims against the D&O and Shareholder Defendants are not only factually spurious but also legally flawed. Addressing the Complaint's claims in the order they are addressed in this brief: Count III alleges that Kabbage's Directors Butler, Ebinger, and Stolle (as well as co-defendant directors)[7] breached both of their *Caremark* fiduciary duties: (1) failing to implement adequate "information systems," and (2) ignoring "red flags" of unlawful conduct.

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[5] In December 2024, the DOJ intervened in a civil proceeding against three Kabbage officers, including Frohwein and Petralia (the "Texas Case"). Notably, last month, the District Court for the Eastern District of Texas stayed discovery in the Texas Case on the ground that the officers' motions to dismiss "provide substantial arguments for dismissal of many, if not all, of Plaintiff's claims." J.A. Ex. 50 at A00721 (Order Granting Stay).

[6] In addition to entering into settlements with the DOJ and SBA, the Wind Down Officer also entered into a settlement with Cross River Bank, a Kabbage partner bank.

[7] Frohwein is not named as a defendant in Count III, but the Complaint nevertheless appears to allege that Frohwein is liable under *Caremark* in his capacities as both a director and an officer. *See* Compl. ¶ 305.

Count II asserts those same *Caremark* theories ("information systems" and "red flags") against Kabbage Officers Frohwein and Petralia (as well as co-defendant officers). Count I alleges Frohwein and Petralia (as well as co-defendant officers) breached their duty of care in their capacities as officers. Count IV seeks to recover an alleged fraudulent transfer from certain Kabbage shareholders, including the Shareholder Defendants (as well as co-defendant shareholders). And Counts V through VII seek to disallow or equitably subordinate certain defendants' claims. As set forth below, each of Plaintiff's claims fails for multiple reasons.

Counts II and III: "Information Systems" Theory against D&O Defendants. The claim that the D&O Defendants breached their fiduciary duties because Kabbage failed to maintain proper oversight systems is contradicted by the Complaint's own allegations. To plead an "information systems" theory under Delaware's *Caremark* standard, the Complaint must allege the D&O Defendants "utterly failed" to implement any reporting or information system or controls in a manner that constitutes bad faith. As the Complaint concedes, Kabbage had written protocols governing board-level risk reporting, a designated committee to oversee risks, and third-party advisors who audited and approved its policies. The existence of these processes, systems, and policies routinely defeats "information systems" claims at the pleading stage. *See* § I.A, below.

Counts II and III: "Red Flags" Theory against D&O Defendants. The Complaint's theory that the D&O Defendants breached their fiduciary duties by ignoring "red flags" likewise fails. To plead this *Caremark* theory, a Complaint must allege that defendants observed but consciously and in bad faith ignored the warnings ("red flags") of unlawful conduct. But the Complaint does not plead that any D&O Defendant was aware of a red flag of unlawful conduct—let alone ignored one in bad faith—because the D&O Defendants had no reason to suspect Kabbage was engaging in unlawful conduct by violating SBA guidance. *See* § I.B.1, below. Considering

the specific allegations against the Directors, the Complaint fails to plead "red flags" of illegality, rather than "yellow flag" indications of business risk. Nor does the Complaint allege that any such purported warnings were ignored—rather, the Complaint affirmatively alleges that Kabbage modified internal policies in response to independent audits and responded to employee concerns. *See* § I.B.2, below. Finally, the Complaint's remaining non-duplicative allegations against the Officers neither allege "red flags" under Delaware law nor are plausible when considered alongside the documents that the Complaint incorporates by reference. *See* § I.B.3, below.

Count I: Duty of Care Claims against Officers. The Complaint attempts to salvage its *Caremark* claim against the Officers by labeling those same allegations as duty of care claims. But Delaware courts routinely dismiss plaintiffs' attempts to do exactly that. It is well settled that *Caremark* "oversight" falls squarely within the duty of loyalty, and that courts dismiss plaintiffs' attempts to evade the difficult *Caremark* standard by labeling "oversight" claims as failures of the duty of care. *See* § II.A, below. To the extent the Complaint attempts to allege anything in support of its duty of care claim that is not duplicative of the *Caremark* claim, it fails because the Complaint does not plead any non-conclusory facts that either Officer acted with the gross negligence that is required to state a duty of care claim. *See* § II.B, below.

Count IV: Fraudulent Transfer Claims against Shareholder Defendants. The Complaint's attempt to recover an alleged fraudulent transfer from the Shareholder Defendants fails. The Complaint seeks to avoid one step of the arm's length merger transaction between American Express and Kabbage: the October 13 Transfer (defined below), in which Kabbage transferred its intellectual property assets to its parent. This theory suffers from multiple flaws that each require dismissal. The Shareholder Defendants did not receive that transfer either as initial or subsequent transferees—as the Complaint concedes. A plaintiff cannot recover an alleged fraudulent transfer

from shareholders—let alone minority shareholders—who did not actually receive that transfer absent veil piercing, which the Complaint does not allege. *See* §§ III.A.1–2, below. To the extent Plaintiff argues the Shareholder Defendants "benefited" from the October 13 Transfer, such that Plaintiff could nevertheless recover the transfer from them, that also fails, because Plaintiff cannot show an actual direct, quantifiable, and accessible benefit. *See* § III.A.3, below. And, in any event, the Complaint fails to plead a constructive or actual fraudulent transfer. The Complaint does not state a constructive fraudulent transfer claim because the October 13 Transfer was made for reasonably equivalent value—*i.e.*, in satisfaction of Kabbage's valid contractual obligation under the Merger Agreement; and it does not state a claim for actual fraudulent transfer because the Complaint's allegations demonstrate that—rather than being made with intent to hinder, delay, or defraud creditors—the October 13 Transfer was made in order to satisfy an obligation *to* its arm's length, third-party creditor American Express. *See* § III.B, below.

Finally, the Complaint's remaining claims, asserting disallowance and equitable subordination (**Counts V–VII**), fail. The Complaint cannot plead claims for disallowance under Section 502(d) (**Count VI**) without pleading a fraudulent transfer (which it does not), *see* § IV.A, below; it does not (and cannot) plead the elements of disallowance under Section 502(e) because it does not allege the D&O Defendants are co-liable with the Debtor on a separate creditor's claim (**Count V**), *see* § IV.B, below; and it fails to allege conduct that would warrant equitably subordinating the D&O Defendants' proofs of claim under Section 510(c) (**Count VII**), *see* § IV.C, below.

STATEMENT OF FACTS

In 2009, Frohwein and Petralia founded Kabbage to provide automated lending services to small, underserved businesses. Compl. ¶¶ 59, 61. Ebinger, Stolle, and Butler joined the Kabbage Board of Directors (the "Board") in 2011 and 2012, and each served on the Board until late 2020.

Compl. ¶¶ 39, 40, 42. The Shareholder Defendants were all shareholders of Kabbage. Compl. ¶¶ 34, 35, 45, 46, 48, 50–53, 335.

A. Congress Responds To The COVID-19 Pandemic With The Emergency Paycheck Protection Program

The COVID-19 pandemic transformed the American economy overnight. On March 27, 2020, the CARES Act was signed into law, providing a $2.2 trillion stimulus package—roughly ten percent of the total U.S. GDP—to prevent a frozen economy from spiraling into depression. Compl. ¶ 69. A centerpiece of the CARES Act was the PPP, a $349 billion initiative to provide small businesses with the liquidity they needed to survive the pandemic without mass layoffs or salary reductions.[8]

As the SBA and lawmakers emphasized, speed was the overriding priority of PPP lending.[9] After the PPP was unveiled on April 2, 2020, the SBA directed lenders to begin processing loan applications almost immediately "using their own systems."[10] Lending under the PPP launched the next day, on April 3, 2020.[11] Within just two weeks, all $349 billion in authorized funding was committed.[12] Recognizing that even this unprecedented fiscal stimulus was insufficient to curb

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[8] Coronavirus, Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 1102(a)–(b), 134 Stat. 281, 286–94 (2020) (codified as amended at 15 U.S.C. § 636(a)).

[9] *See* J.A. Ex. 10 at A00149 (SBA and Treasury joint press release) (emphasizing "[s]peed is the operative word"). Three days after passage of the CARES Act, Senators Rubio, Collins, Cardin, and Shaheen stated that "[i]t is critical that this relief is disbursed to small businesses as quickly as possible to help ensure that no small businesses are forced to choose between solvency and retaining their employees during this uncertain time." J.A. Ex. 7 at A00140 (Letter from Senators to Steven Mnuchin & Jovita Carranza).

[10] J.A. Ex. 10 at A00149.

[11] J.A. Ex. 13 at A00157 (SBA press release).

[12] J.A Ex. 22 at A00238 (Congressional Research Service report); *see* Compl. ¶¶ 105–06 (describing the onslaught of applications in the initial weeks of PPP).

the economic shock of the pandemic, Congress quickly authorized an additional $310 billion to continue PPP lending.[13] Once again, administration officials urged lenders to "process loan applications previously submitted by eligible borrowers and disburse funds expeditiously."[14] From April 27 to August 8, 2020, lenders disbursed these additional funds.[15]

The regulatory framework governing the PPP was assembled in real time, at a breakneck pace. The SBA and the Department of Treasury published guidance in the form of interim final rules ("IFRs") and an expanding list of frequently asked questions ("FAQs"). This guidance changed as frequently as daily.[16] Those agencies issued the first IFR guidance the evening of April 2, 2020—the day before PPP lending began.[17] By August 11, 2020, shortly after the first round of PPP lending, the SBA and the Department of Treasury had published 23 IFRs and 51 FAQs.[18]

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[13] Paycheck Protection Program and Health Care Enhancement Act, Pub. L. No. 116-139, § 101(a)(1), 134 Stat. 620, 620 (2020) (amending CARES Act § 1102(b)(1), 134 Stat. at 293).

[14] J.A. Ex. 23 at A00244 (Treasury and SBA joint statement).

[15] *Id.*; Act of July 4, 2020, Pub. L. No. 116-147, § 1, 134 Stat. 660, 660 (extending the commitment period for PPP loans until August 8, 2020).

[16] U.S. Dep't of Treasury, Paycheck Protection Program ("Treasury Homepage"), https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses/paycheck-protection-program [https://perma.cc/S2SH-WP96] (last visited Apr. 9, 2026) (collecting guidance).

[17] *See* Treasury Homepage (showing "Interim Final Rule 1" as "originally posted April 2, 2020"). The first IFR became effective two weeks after it was made available, on April 15. *See Business Loan Program Temporary Changes; Paycheck Protection Program* ("First IFR"), 85 Fed. Reg. 20811, 20811 (Apr. 15, 2020).

[18] *See* J.A. Ex. 40 at A00411 (PPP FAQs as of Aug. 11, 2020) (containing 51 FAQs); Treasury Homepage (showing 23 IFRs "originally posted" on or before Aug. 11, 2020).

To ensure rapid approval and disbursement of funds, the PPP guidelines explicitly included processes for expedited borrower applications and lender review.[19] For borrowers, the SBA required only a two-page application containing basic information, a good-faith certification that the requested loan would not be used for an improper purpose, and documentation of payroll costs, which determined the eligible loan amount.[20] PPP loans would be forgiven "up to the full principal amount of the loan and any accrued interest" provided that the borrowers maintained or rehired employees at their existing salary levels and used the loan proceeds for approved purposes.[21]

For lenders, underwriting obligations were similarly streamlined, requiring them only to: (i) "[c]onfirm receipt of borrower certifications" in PPP applications; (ii) "[c]onfirm receipt of information demonstrating" that the borrower had salaried employees on or around February 15, 2020; (iii) "[c]onfirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application;" and (iv) follow "applicable" Bank Secrecy Act ("BSA") requirements by "establish[ing] an anti-money-laundering (AML) compliance program equivalent to that of a comparable federally

[19] First IFR § III.1, 85 Fed. Reg. at 20812. Government officials contemporaneously acknowledged that these expedited processes would inevitably lead to borrower fraud. *See* 166 Cong. Rec. H1907, H1911 (daily ed. Apr. 23, 2020) (statement of Rep. McGovern, including an article for the record where former special inspector general of the Troubled Asset Relief Program stated that "[e]verybody's acceptance of some or a lot of fraud is going to have to be high, because it's going to happen").

[20] J.A. Ex. 29 at A00286–87 (SBA Form 2483); *see also* J.A. Ex. 8 at A00143 (SBA Borrower Fact Sheet)

[21] First IFR § III.2(o), 85 Fed. Reg. at 20813–14; *see also* J.A. Ex. 8 at A00143–44 (Borrower Fact Sheet).

regulated institution" (the "Underwriting Provisions").[22] Lenders' underwriting obligations were expressly "limited to the items above and reviewing [PPP applications]."[23]

In other words, lenders were explicitly permitted to rely on the documentation submitted by borrowers, and "[did] not need to conduct any verification," so long as the borrower attested he or she accurately verified information and included supporting documents.[24] Notably, the SBA promised to "hold harmless any lender that relie[d] on such borrower documents and attestation," explaining that such "lender reliance … is necessary and appropriate in light of section 1106(h) of the [CARES] Act, which prohibits the [SBA] Administrator from taking an enforcement action or imposing penalties if the lender has received a borrower attestation" (the "Hold Harmless Provision").[25] The first FAQ issued by the SBA, published on April 3, 2020, reinforced this framework: lenders were "expected to perform a good faith review, in a reasonable time, of the borrower's calculations and supporting documents," but "[p]roviding an accurate calculation of payroll costs [was] the responsibility of the borrower."[26]

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[22] First IFR § III.3(b), 85 Fed. Reg. at 20815. The First IFR states that a qualifying AML program "***may include*** a customer identification program (CIP), which includes identifying and verifying their PPP borrowers' identities … . [Lenders] should also understand the nature and purpose of their PPP customer relationships to develop customer risk profiles. Such entities will also generally have to identify and report certain suspicious activity to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN)." *Id.* (emphasis added). As set forth below, *see* Statement of Facts § I.C.1, Kabbage's AML Policy included such programs.

[23] First IFR § III.3(b), 85 Fed. Reg. at 20815; *see also* Compl. ¶ 2. In addition, lenders were informed that the SBA guaranteed 100% of outstanding PPP loans, backed by the full faith and credit of the United States. *See* J.A. Ex. 9 at A00146 (PPP Information Sheet: Lenders).

[24] First IFR § III.3(c), 85 Fed. Reg. at 20815.

[25] *Id.* at 20815–16.

[26] J.A. Ex. 26 at A00252 & n.2, FAQ No. 1 (PPP FAQs as of Apr. 29, 2020). Notably, this first FAQ did not define "good faith review."

Although the FAQs and IFRs multiplied, none of the evolving guidance modified the First IFR's Hold Harmless Provision or Underwriting Provisions. The SBA also pledged that "[t]he U.S. government w[ould] not challenge lender PPP actions that conform" to the FAQs and IFRs.[27]

B. Kabbage Delivers Urgently Needed Funds To Struggling Small Businesses

Kabbage was well positioned to assist in the PPP because of its existing proprietary automated lending technology and an established customer base of small businesses. *See* Compl. ¶¶ 59, 61, 65. Prior to the pandemic, Kabbage's business model involved partnering with banks to originate loans while it handled marketing, servicing, and collections. *Id.* ¶ 60.[28]

The SBA urged non-bank lenders, like Kabbage, to apply to become PPP lenders to "increase the scope of PPP lending options and the speed with which PPP loans can be disbursed to help small businesses across America."[29] Kabbage answered the government's call—it applied to become a non-banking PPP lender on April 9, 2020, and was approved to lend on April 13, 2020. Compl. ¶ 101. In a matter of months, Kabbage quickly became one of the nation's largest providers of PPP loans. *Id.* ¶ 1.

C. Kabbage's BSA/AML Compliance Program

1. Kabbage Had An Established Pre-Existing BSA/AML Compliance Infrastructure

Long before the pandemic, Kabbage established an Enterprise BSA/AML and Office of Foreign Asset Control ("OFAC") Policy for "complying with the BSA and all other relevant statutes relating to money laundering and sanctions" (the "BSA/AML Policy"). J.A. Ex. 4 at A00061

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[27] *Id.* at A00252.

[28] *See also* J.A. Ex. 5 at A00081, A00083 (2019 Treliant Report).

[29] J.A. Ex. 26 at A00258, FAQ No. 22 (FAQs as of April 29).

(2019 Policy) (effective July 24, 2019);[30] *see* Compl. ¶ 82. Although Kabbage was not itself a "financial institution" subject to the BSA, it "made a commitment to maintain an effective BSA/AML program" pursuant to its bank partnerships, since at least 2017. J.A. Ex. 4 at A00061 (2019 Policy); J.A. Ex. 5 at A00081 (2019 Treliant Report); *see* Compl. ¶¶ 60, 82.

Pursuant to the Policy's terms, the Board was responsible for overseeing Kabbage's BSA/AML program. Compl. ¶ 83. Specifically, the Board was required to: (1) review BSA/AML reporting, as appropriate; (2) review the annual independent testing of the BSA/AML program and any corrective action plans; (3) address any BSA/AML issues escalated to the Board; and (4) review feedback from bank partners on the BSA/AML program and receive reports on any remedial action. *Id.* While compliance reporting was "provided directly to the full Board," a separate audit committee (the "Audit Committee") was delegated the risk and compliance oversight functions. J.A. Ex. 5 at A00083 (2019 Treliant Report). The Board also designated a dedicated BSA/AML Officer—Azba Habib, initially—who was responsible for day-to-day oversight of BSA/AML compliance. *Id.* at A00083, A00103; *see* Compl. ¶ 97. As BSA/AML Officer, she was required to: "promptly alert[] the Board to any material issues of BSA/AML non-compliance," "monitor the effectiveness of BSA/AML compliance … and tak[e] corrective action,," "ensur[e] Kabbage personnel receive BSA/AML training," and "conduct[] an annual risk assessment" to report to the

[30] This document, as well as other documents in the *Joint Declaration on Behalf of All Defendants*, J.A. Ex. 1, are incorporated into the Complaint by reference. *See In re Burlington Coat Factory Secs. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997) ("[A] document integral to or explicitly relied upon in the complaint may be considered without converting [a] motion to dismiss into one for summary judgment." (cleaned up)); *Lepore v. SelectQuote Ins. Servs., Inc.*, 2023 WL 8469761, at *2 (3d Cir. Dec. 7, 2023) (a document is incorporated by reference "if the claims asserted in the complaint depend on its contents"). Further, Plaintiff "is presumably on notice of" Kabbage's documents "by virtue of [its control over] the Debtors' estates," making incorporation especially appropriate. *Stanziale v. CopperCom, Inc.* (*In re Conex Holdings, LLC*), 518 B.R. 792, 804 n.66 (Bankr. D. Del. 2014).

Board. J.A. Ex. 4 at A00065 (2019 Policy); *see also* Compl. ¶ 85. These annual risk assessments were performed pursuant to a methodology developed by another "independent, third party provider" commissioned by Kabbage. J.A. Ex. 5 at A00082 (2019 Treliant Report).

The Chief Compliance Officer ("CCO") was responsible for, among other things, "promoting and implementing a strong culture of BSA/AML compliance," "holding personnel accountable for resolution of BSA/AML corrective actions," and "overseeing annual, or more frequent as necessary, compliance quality assurance, independent control testing, and review of [the BSA/AML] Policy and reporting results to the Board." Compl. ¶ 84. In addition to the BSA/AML Officer and the CCO, all Kabbage employees were "require[d] … to report unusual or potentially suspicious activity to the BSA/AML Officer or designee." J.A. Ex. 4 at A00072 (2019 Policy); *id.* at A00066–67 (imposing even further reporting requirements on Kabbage employees with "responsibilities impacting the BSA/AML Program"). Kabbage's BSA/AML Policy further provided that: (1) all Kabbage employees had a duty to inform the CCO and BSA/AML Officer of any compliance-related issues; (2) could report violations anonymously to the BSA/AML Officer; and (3) could not be retaliated against for reporting violations. *Id.* at A00066–67, A00074 (2019 Policy); J.A. Ex. 35 at A00354–55, A00362 (2020 Policy). The CCO was responsible for reviewing the BSA/AML Officer's work. *Id.* at A00354.

Kabbage also employed numerous Know Your Customer ("KYC") and Know Your Business ("KYB") processes, including: (i) a customer identification program, to verify the identity of all customers at the time of onboarding, and periodically thereafter, J.A. Ex. 4 at A00061, A00068–69 (2019 Policy); (ii) a manual and automated third-party screening tool, which screened all applicants, customers, employees, and vendors on a regular basis, *id.* at A00071–72; (iii) transaction monitoring processes through which Kabbage reviewed loan repayments above $5,000 for

detection of possible money laundering, *id.* at A00073–74; (iv) ongoing review of "questionable activity reports" by a third party, for any issues that were escalated for further investigation, *id.* at A00073; and (v) annual BSA/AML and OFAC training for all board members and company employees, *id.* at A00075.

2. Kabbage's Compliance Policies Were Routinely Audited

Kabbage's BSA/AML compliance was routinely audited by the independent third-party consulting and compliance firm Treliant LLC ("Treliant"). Compl. ¶¶ 87, 88. In 2018, Treliant assessed the "design and effectiveness" of Kabbage's BSA/AML Policy. J.A. Ex. 3 at A00039 (2018 Treliant Report); *see* Compl. ¶ 87. Treliant concluded that "[t]he Company's Board of Directors maintains sufficient oversight of the BSA/AML Program through the Audit Committee of the Board, including regular reporting on key [c]ompliance items and receiving escalation of material issues." J.A. Ex. 3 at A00047. Treliant also assigned the BSA/AML Policy elements a grade reflecting the level of "assurance" that Kabbage's controls could effectively mitigate an identified risk. *Id.* No elements of Kabbage's BSA/AML Policy were deemed inadequate. Most elements received the highest "Reasonable Assurance" score, while some received the next-highest "Limited Assurance." No element received an "Insufficient Assurance" score. *Id.* at A00047–48.

In 2019, Treliant conducted another annual audit of Kabbage's BSA/AML Policy. Compl. ¶ 88. The 2019 Report found that Kabbage's BSA/AML Policy was "robust," "thoughtfully constructed," and "adequately cover[ed] the BSA/AML and OFAC standards that would be expected" of a similar company. J.A. Ex. 5 at A00081, A00083 (2019 Treliant Report). To assess the Board's performance, Treliant reviewed BSA/AML reporting to the Board, Board and committee meeting minutes, the amended charter for the Audit Committee, approval documentation of key BSA/AML documents, and the formal approval of and professional qualifications of the BSA/AML Officer. *Id.* at A00083. Treliant also observed that "Kabbage requires that all Kabbage personnel receive

BSA/AML training appropriate to their roles and responsibilities at least annually." *Id.* at A00075. Treliant "did not find any material concerns or issues," *id.*, and, once again, Treliant did not assign any "Insufficient Assurance" ratings, *id.* at A00086–88.[31] The Board reviewed this audit report in November 2019. Compl. ¶ 89.

3. Kabbage's Protocols Met And Were Tailored To PPP Requirements

Kabbage's established reporting and monitoring systems were effective in advance of, and appropriate for, PPP lending.

The Board held "multiple formal and informal meetings between April 2020 (the start of the PPP) and August 2020," Compl. ¶ 202, including one where it approved an updated annual BSA/AML Policy with PPP-specific amendments, *id.* ¶ 82. That updated Policy was drafted at the start of PPP lending, as evidenced by a Kabbage partner bank approving it just weeks after PPP lending began, on April 27, 2020. *See* J.A. Ex. 35 at A00364 (2020 Policy). The updated policy made two changes to meet new PPP requirements: (1) now that Kabbage was, for the first time, a direct lender, it would report suspicious activity directly to FinCEN (in addition to its existing policy of reporting suspicious activity to its partner banks), *id.* at A00361; *see* First IFR § 3(b)(iv)(II), 85 Fed. Reg. at 20815, and (2) Kabbage decreased its ownership requirement thresholds for its customer identification program, thus enhancing the program by taking a more conservative approach, *see* J.A. Ex. 35 at A00358 & nn.5–6 (2020 Policy); *see* J.A. Ex. 26 at A00259–60, FAQ No. 25 (PPP FAQ as of April 29).

During Kabbage's PPP lending, Frohwein and Petralia also addressed compliance and staffing issues as they arose. When fraud personnel requested the return of several furloughed

[31] Treliant identified areas for improvement but noted that Kabbage "had a number of enhancements underway" that "were not fully implemented during the period of review." J.A. Ex. 5 at A00086 (2019 Treliant Report).

employees, Petralia approved an additional hire to assess fraud risk. Compl. ¶ 106. And when Kabbage's BSA/AML Officer, Habib, requested on May 15, 2020, that Frohwein approve engaging an outside consulting firm for BSA/AML support, Frohwein responded: "go for it." *Id.* ¶ 170. Alvarez & Marsal ("A&M") was engaged three days later to conduct a third-party risk assessment of Kabbage's BSA/AML program, specifically focused on PPP lending. *Id.* ¶ 131.

A&M prepared a draft report (the "A&M Report"), which concluded that Kabbage maintained "a PPP compliance program that generally appears to be consistent with the SBA's PPP Interim Final Rules guidance and applicable BSA/AML and OFAC requirements and our understanding of regulatory expectations." J.A. Ex. 30 at A00292 (A&M Report). A&M observed that Kabbage was "currently in the midst of enhancing its controls and making key operational changes to comply with evolving SBA PPP guidance changes." *Id.* A&M also found that Kabbage was "staffed to handle the volume of applications and risk tickets that are being generated." *Id.* at A00302.

Kabbage's compliance personnel actively identified and addressed issues that arose in connection with PPP lending. From the beginning of April until June 2020, Kabbage's BSA/AML Officer, Habib, acting consistently with the BSA/AML Policy, flagged risks and recommended improvements to the Policy as novel PPP-related issues arose. Compl. ¶¶ 97, 126, 133–36. When Habib left the company in June 2020, her direct superior assumed the BSA/AML Officer role on an interim basis. *Id.* ¶¶ 36, 85, 194.[32]

Moreover, Kabbage used automated fraud screening tools to detect fraud without the need for human review. Compl. ¶ 111. Emailage, Sentilink, and Threatmetrix each generated a risk

[32] J.A. Ex. 4 at A00064 (2019 Policy) ("The BSA/AML Officer reports directly to the CCO, who is also appointed by the Board.").

score for each applicant. J.A. Ex. 30 at A00306 (A&M Report). Applications that triggered elevated scores received an "SBA Failed Manual Verification" flag, and loan funds could not be disbursed until the flag was cleared by Kabbage's Fraud Review team. *Id.* In addition to these automated tools, Kabbage maintained detailed manual review procedures for specific customer types, including general partnerships, seasonal businesses, and professional employer organizations. *Id.* at A00304. Approximately 75% of all PPP application reviews were automated; the remaining 25% were subject to manual review. *Id.* Before any loan could be funded, the borrower was required to answer knowledge-based authentication questions correctly; borrowers who failed the authentication were routed to an escalated review process that could result in the application being flagged and the borrower not getting the funds. *Id.* at A00306.

Kabbage also maintained automated knock-out rules that declined applicants who failed to meet PPP eligibility requirements, including applicants who: (1) were non-U.S. citizens; (2) were in an ineligible industry; (3) had more than 500 employees; (4) started operations after February 15, 2020; or (5) had an associate or owner who was incarcerated, on probation, or had been indicted for a felony or crime of moral turpitude. *Id.* at A00303. Kabbage ran queries comparing new borrower application information to existing customer information, flagging any applications with duplicate information. *Id.*

4. Kabbage's PPP Loan Distribution System Met The Dire Needs Of The Pandemic

The demand for PPP loans was unprecedented. Kabbage's existing customer base—made up of small businesses and sole proprietors, Compl. ¶ 59—needed PPP loans the most because they were generally unable to seek funding through traditional financial institutions, *id*. ¶ 61. With over 12,000 pre-registrations before lending even began, Frohwein observed that Kabbage's start to PPP lending was "the absolute craziest thing that [he'd] ever been involved in or could have

imagined." *Id.* ¶ 75. At one point, Kabbage faced a backlog of as many as 35,000 applications pending review, but it continued tirelessly servicing loans. *Id.* ¶ 109. In all, Kabbage fulfilled over $7 billion in PPP loans on behalf of more than 278,000 small businesses and sole proprietors, helping the government save hundreds of thousands of jobs in the process. Amend. Disclosure Statement for the Amend. Joint Ch. 11 Plan of Liquidation of Kabbage, Inc. (d/b/a KServicing) & Its Affiliated Debtors 4, D.I. 467 ("Disclosure Statement").

D. American Express Executes A Transaction To Purchase Kabbage's IP Assets

On August 13, 2020, Kabbage and American Express Travel Related Services Company ("Amex") entered into a merger agreement (the "Merger Agreement") setting out a multi-step merger transaction (the "Merger"). Compl. ¶ 250. The Merger was structured via a series of tax-efficient steps. *Id.* ¶ 251. On October 13, 2020, pursuant to its obligations under the Merger Agreement, Kabbage transferred (the "October 13 Transfer") technology and intellectual property to a wholly owned subsidiary, Alpha Kabbage Inc. ("Alpha Kabbage"). *Id.* (The Complaint does not allege that the Shareholder Defendants received proceeds from the October 13 Transfer.) Amex was not interested in acquiring Kabbage's lending portfolio, which remained at legacy Kabbage and included PPP lending and non-PPP small- and medium-sized business lending. *See id*. Then, a newly formed Amex subsidiary merged into Alpha Kabbage, which would be renamed American Express Kabbage, Inc. ("Amex Kabbage"), and which survived the Merger as a wholly owned subsidiary of Amex. *Id*. ¶¶ 251, 273. In exchange for the cancellation of their existing shares of Amex Kabbage, all shareholders of Amex Kabbage received a per-share payment of the merger proceeds. *Id*.

Duff & Phelps issued a solvency opinion in connection with entry into the Merger Agreement. *Id.* ¶ 246. As a condition to closing the Merger in October 2020, Duff & Phelps issued a "bring down" solvency opinion—on which the Board was specifically permitted to rely, *see* 8 Del.

Code § 141(e)—opining that post-Merger Kabbage (which, as set forth below, would be renamed KServicing) would have sufficient cash to fund its remaining loan servicing operations. *Id.* ¶ 271.

The Complaint does not allege that any of the D&O Defendants were aware of threatened or pending investigations or litigation before the parties entered into the Merger Agreement.

E. Following Changes To PPP, Kabbage's Successor KServicing Files For Bankruptcy

After the Merger, Kabbage continued servicing PPP loans under the new name KServicing. *Id.* ¶¶ 270, 278. In the months that followed, a new administration departed from earlier guidance, and the government began investigating PPP lenders on account of misrepresentations made by borrowers. *Id.* ¶¶ 278, 280. Faced with the crippling expense of unanticipated government investigations and lawsuits, KServicing filed for bankruptcy on October 3, 2022. *Id.* ¶ 281.

F. KServicing Repeatedly Affirms That Kabbage Complied With All Applicable PPP Requirements

KServicing's new management replaced the D&O Defendants in 2020, at the time of the Merger. From the start of the bankruptcy case through confirmation, management maintained that, "[u]nder the most difficult of circumstances, [Kabbage] processed loan applications in good faith, in accordance with [applicable law]." Decl. of Deborah Reiger-Paganis in Supp. of the Ch. 11 Pets. & First-Day Pleadings ¶ 42, D.I. 13 ("First Day Decl."); Disclosure Statement 30.

Specifically, KServicing's First Day Declaration and its amended Disclosure Statement explained that PPP regulations were being issued contemporaneously with, or lagging, actual lending, generating confusion. First Day Decl. ¶ 42 ("New rules and guidance were issued on a near daily basis during the first few months of the PPP Loan Program."); Disclosure Statement 4, 30 ("[T]he now-concluded PPP faces scrutiny due to lender confusion with deciphering unclear and frequently-evolving SBA guidance, or lack thereof," and "a distinct lack of clarity and guidance from the SBA during the PPP's initial rollout."). It acknowledged that "[s]peed was the watchword

of the PPP," and that lenders faced pressure to approve applications as quickly as possible. First Day Decl. ¶ 41; *see id.* ¶ 42 ("[G]overnment officials ... ask[ed] lenders to process loans to eligible PPP Borrowers on the same day that they applied."). KServicing further made clear that "[t]he Debtors believe[d] they adhered to the PPP Loan rules and regulations in good faith," Disclosure Statement 34, and "[a]t all times, [Kabbage] complied with PPP lending requirements," *id.* 31; *see* First Day Decl. ¶ 17. KServicing likewise observed that a hallmark of the PPP program was minimal review of PPP borrower applications. Disclosure Statement 30–31 (explaining that pursuant to the SBA, lenders "were permitted to rely on PPP Borrower representations," and that requiring additional review of borrower loan calculations "would … impose more than 'minimal review' requirements on lenders, and transfer risk to them that the PPP rules did not contemplate"). KServicing described the government investigations as "hindsight investigations and misdirected scrutiny," *id.* at 4, and affirmed that "the DOJ's allegations are wholly without merit," *id.* at 31.

ARGUMENT

To survive a motion to dismiss, Plaintiff must allege facts giving rise to a plausible claim for relief—one that "allows the Court to draw the reasonable inference that defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). "If the allegations of the complaint are contradicted by documents made a part thereof, the document controls and the Court need not accept as true the allegations of the complaint." *Walker v. Sonafi Pasteur* (*In re Aphton Corp.*), 423 B.R. 76, 87 n.30 (Bankr. D. Del. 2010) (cleaned up) (quoting *Sierra Invs., LLC v. SHC, Inc.* (*In re SHC, Inc.*), 329 B.R. 438, 442 (Bankr. D. Del. 2005)).

Section I of this brief addresses Plaintiff's *Caremark* claim against the Directors (Count III) and Officers (Count II), first addressing the "information systems" theory against the Directors and then the Officers; and then addressing the "red flags" theory against the Directors and then the Officers. Section II addresses the claim for breach of the duty of care against the Officers

(Count I); Section III addresses the constructive and intentional fraudulent transfer claim arising out of the October 13 Transfer against the Shareholder Defendants (Count IV); and Section IV addresses the claims for disallowance and equitable subordination of certain defendants' proofs of claim filed in KServicing's bankruptcy (Counts V–VII). Each of these claims fails to state a plausible claim for relief.[33]

I. PLAINTIFF'S *CAREMARK* CLAIMS FAIL (COUNTS II AND III)

The Complaint fails to plead what is "possibly the most difficult theory in corporation law"—that the D&O Defendants are liable for failing to oversee Kabbage under Delaware's *Caremark* doctrine. *In re Caremark Int'l Inc. Deriv. Litig*., 698 A.2d 959, 967 (Del. Ch. 1996). For a *Caremark* claim to survive dismissal, the plaintiff must allege one of two theories—either that the defendant (1) "utterly failed to implement any reporting or information system or controls" (the "information systems" theory) or, (2) "having implemented such a system or controls, consciously failed to monitor or oversee its operations" (the "red flags" theory). *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006). Corporate directors must monitor the whole corporation, but officers need only oversee operations (and implement reporting systems) that cover their respective "area[s] of authority." *In re McDonald's Corp. S'holder Deriv. Litig.* (*McDonald's I*), 289 A.3d 343, 369 (Del. Ch. 2023).

A complaint must plead bad faith to state a *Caremark* claim. *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019); *JLL Consultants, Inc. v. Gothner* (*In re AgFeed USA, LLC*), 558 B.R. 116, 126 (Bankr. D. Del. 2016). Because "[b]ad faith is a state of mind," *IBEW Loc. Union 481*

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[33] The Directors join and incorporate by reference the arguments set forth in the *Memorandum of Law in Support of Motion to Dismiss of Non-Management Director Defendants Ioannis Pipilis and Alex Chulack*, and the Shareholder Defendants join and incorporate by reference the arguments set forth in the *Memorandum of Law in Support of Certain Defendants' Motion to Dismiss Counts IV, VI, and VII*.

Defined Contribution Plan & Tr. v. Winborne, 301 A.3d 596, 619 (Del. Ch. 2023), under either *Caremark* theory, a complaint must plead a failure to act that is "sufficiently sustained, systemic, or striking" to support "an inference that the fiduciary *consciously* failed to take action." *McDonald's I*, 289 A.3d at 376 (emphasis added) (as to red flags); *see also id.* at 375 ("The officer must consciously fail to make a good faith effort to establish information systems.").

Notably, "a bad outcome, without more, does not equate to bad faith." *Bricklayers Pension Fund of W. Pa. v. Brinkley*, 2024 WL 3384823, at *13 (Del. Ch. July 24, 2024) (quoting *Rich v. Yu Kwai Chong*, 66 A.3d 963, 980 (Del. Ch. 2013)). Concluding otherwise "would impose liability by hindsight." *Winborne*, 301 A.3d at 621. *Caremark* only requires that a fiduciary make "a good faith effort"—*i.e.*, to "try" to put in place a reasonable system of monitoring and reporting and to oversee the company's operations. *Marchand*, 212 A.3d at 821; *see In re ProAssurance Corp. S'holder Deriv. Litig.*, 2023 WL 6426294, at *1 (Del. Ch. Oct. 2, 2023) ("Oversight claims should be reserved for extreme events. The point is to maintain a baseline expectation that fiduciaries try, in good faith, to monitor key corporate risks and ensure that the entity operates lawfully.").

A. The Complaint Fails To State An "Information Systems" Claim Against The Director & Officer Defendants

To state a *Caremark* claim against either directors or officers under an "information systems" theory, the Complaint must plead facts sufficient to support a reasonable inference that Kabbage's monitoring system was so deficient that "the directors [or officers] knew that they were not discharging their fiduciary obligations" to perform oversight. *Stone*, 911 A.2d at 370, 372; *see also Marchand*, 212 A.3d at 823 ("In decisions dismissing *Caremark* claims, the plaintiffs usually lose because they must concede the existence of board-level systems of monitoring and oversight[.]"). Here, Plaintiff cannot satisfy the high burden to plead an "information systems" claim against any of the D&O Defendants because—even viewing all of the Complaint's allegations and

the documents incorporated by reference in the light most favorable to Plaintiff—the Complaint concedes the existence of a board-level monitoring system, committee, and reporting protocol that was subject to third-party audit and review.

1. The Complaint Fails To State An "Information Systems" Claim Against Directors Butler, Ebinger, Frohwein, and Stolle (Count III)

a. The Complaint Concedes The Existence Of Information Systems And Controls

The Delaware Supreme Court has described systems and controls that, if present, typically defeat a *Caremark* information systems claim, including "a regular protocol requiring board-level reports about the relevant risks," "a relevant committee," and/or "third-party monitors, auditors, or consultants." *Marchand*, 212 A.3d at 823; *see also Stone*, 911 A.2d at 370–72 (noting that incorporated-by-reference audit report demonstrated that the board designated a BSA/AML officer, delegated compliance oversight responsibilities to departments and committees, adopted and periodically updated written BSA/AML policies, required annual compliance reporting to the board, and directed employees to report suspicious activity—all of which "refut[ed] the assertion that the directors 'never took necessary steps … to ensure that a reasonable BSA compliance and reporting system existed'"); *City of Detroit Police & Fire Ret. Sys. v. Hamrock*, 2022 WL 2387653, at *15–16 (Del. Ch. June 30, 2022) (dismissing *Caremark* claim where the complaint conceded existence of oversight committee that received reports and oversaw relevant policies, "demonstrat[ing] the existence of a system rather than its absence"). Here, the Complaint alleges, and the documents it incorporates show, that ***all*** of these systems and controls were present, negating any claim that Kabbage "utterly failed to implement any reporting or information system or controls." *Stone*, 911 A.2d at 370.

Mandatory Reporting Protocols. Boards can establish oversight systems by "enact[ing] written policies and procedures designed to ensure compliance with [] BSA and AML regulations."

Stone, 911 A.2d at 372. When those reporting protocols "requir[e] board-level reports about the relevant risks," they defeat an information systems claim. *Marchand*, 212 A.3d at 832; *Hamrock*, 2022 WL 2387653, at *15 (dismissing information systems claim where "Plaintiff does not allege that board-level reporting on mission critical risks was discretionary"); *Bricklayers*, 2024 WL 3384823, at *4 (dismissing information systems claim where company had a compliance committee that was required to "report regularly to the Board"); *Firemen's Ret. Sys. of St. Louis v. Sorenson*, 2021 WL 4593777, at *13 (Del. Ch. Oct. 5, 2021) (dismissing information systems claim where board received annual risk assessment reports); *Rojas v. Ellison*, 2019 WL 3408812, at *9 (Del. Ch. July 29, 2019) (dismissing information systems claim where audit committee's charter required it to discuss material compliance issues with management).

Here, the Complaint plainly concedes (and the documents incorporated by reference confirm) the existence of board-level mandatory reporting protocols. *See* Compl. ¶¶ 83–85. Before Kabbage became a PPP lender, the Board established a written BSA/AML Policy. Compl. ¶ 82; J.A. Ex. 4 at A00061 (2019 Policy); *see also* Statement of Facts § I.C.1. The Policy specifically delegated BSA/AML compliance to a BSA/AML Officer—who oversaw Kabbage's compliance program, and a Board-appointed CCO—to whom the BSA/AML Officer reported. *See* Compl. ¶¶ 84, 85; J.A. Ex. 4 at A00065–66 (2019 Policy). The Policy also required the BSA/AML Officer to provide mandatory reports to the Board regarding BSA/AML compliance. Compl. ¶ 85; J.A. Ex. 4 at A00065–66 (2019 Policy) ("The BSA/AML Officer owns this Policy and is responsible for … [p]romptly ***alerting the Board*** to any material issues of BSA/AML non-compliance, and instituting and monitoring corrective action."); *id*. at A00068 (requiring BSA/AML Officer to run an "annual risk assessment" and "report[] the results … ***to the Board***") (emphases added); J.A. Ex. 35 at A000353 (2020 Policy) (similar). All Kabbage employees were likewise required under

the Policy to report BSA/AML compliance issues to the BSA/AML Officer and the CCO. J.A. Ex. 4 at A00066–67 (2019 Policy) (requiring Kabbage employees "[r]eport[] unusual activity to the CCO, BSA/AML Officer, or designee"). And the Complaint alleges that, at all relevant times, Kabbage had an active BSA/AML Officer, Compl. ¶¶ 85, 140—and a fraud department with dedicated employees, *id.* at ¶¶ 37, 178. In addition, employees were able to report anonymously and were protected from retaliation. *See* J.A. Ex. 4 at A00074 (2019 Policy); J.A. Ex. 35 at A00362 (2020 Policy); *see also* Statement of Facts § C.1.

Board Committee. Courts also routinely dismiss information systems claims where a board establishes an oversight committee that operates in good faith. *See, e.g.*, *In re LendingClub Corp. Deriv. Litig.*, 2019 WL 5678578, at *10 (Del. Ch. Oct. 31, 2019) (dismissing information systems claim because company had an audit committee that met regularly); *In re Gen. Motors Co. Deriv. Litig.*, 2015 WL 3958724, at *15 (Del. Ch. June 26, 2015) (dismissing information systems claim where audit committee met and received reports); *Brewer v. Turner*, 2025 WL 2769895, at *10 (Del. Ch. Sep. 29, 2025) (dismissing information systems claim where complaint demonstrated that company had board committees tasked with monitoring risk); *South v. Baker*, 62 A.3d 1, 18 (Del. Ch. 2012) (dismissing information systems claim where mining company had a safety committee overseeing health and environmental compliance); *Stone*, 911 A.2d at 372 (dismissing information systems claim where outside report found that an audit committee "oversaw [the company's] BSA/AML compliance program on a quarterly basis"). If an oversight committee exists, a plaintiff can state an information systems claim only in extreme cases—for instance, if an "[a]udit [c]ommittee [] failed to complete its audits." *Rich*, 66 A.3d at 972.

The Complaint fails to plead that Kabbage lacked a functioning compliance committee. To the contrary, the Complaint relies extensively on Treliant risk assessments, *see* Compl. ¶¶ 87–93,

126, which affirmatively state that Kabbage did have a "delegated committee"—the Audit Committee—for Kabbage's "risk and compliance oversight function." J.A. Ex. 5 at A00082–83 (2019 Treliant Report) ("While compliance reporting is provided directly to the full Board, the charter for the Board's Audit Committee delegates the risk and compliance oversight function to the Audit Committee."). Moreover, Treliant reviewed a sample of the Audit Committee's minutes and charter, and it "did not find any material concerns or issues." *Id.* The presence of a functioning committee warrants dismissal of Plaintiff's "information systems" claim.

Third-Party Audits. Courts have also found that a board's "use of third-party monitors, auditors, or consultants" to stay apprised of compliance risks, coupled with mandatory board-level reporting from management, precludes an information systems claim. *Marchand*, 212 A.3d at 823; *see, e.g.*, *ProAssurance*, 2023 WL 6426294, at *13 (information systems claim dismissed where complaint detailed "engagement of auditors," "oversight of management," and "Board-level updates"); *City of Birmingham Ret. & Relief Sys. v. Good*, 177 A.3d 47, 59 (Del. 2017) (information systems claim dismissed where board received presentations from management on status of environmental problems); *Stone*, 911 A.2d at 372–73 (information systems claim dismissed where board relied on annual presentations from a BSA officer and periodic compliance audits).

The Complaint concedes that Kabbage had third-party auditors independently assess Kabbage's BSA/AML Policy in 2018 and 2019. *See* Compl. ¶¶ 87–88; *see also* Statement of Facts § I.C.2. Neither report found that any audited elements were insufficient to mitigate identified risks. J.A. Ex. 3 at A00047–48 (2018 Treliant Report); J.A. Ex. 5 at A00086–88 (2019 Treliant Report). Together with its "regular protocol requiring board-level reports" and Audit Committee,

Kabbage's oversight by "third-party … auditors" more than defeats a *Caremark* "information systems" claim. *See Marchand*, 212 A.3d at 823 & n.112.[34]

b. Having Conceded The Existence Of Information Systems, The Complaint's Remaining Allegations Fail To State An Information Systems Claim

Count III also includes a patchwork of other conclusory and post-hoc allegations, *see* Compl. ¶¶ 317–19, which fail to salvage the Complaint's "information systems" theory against the Directors.

First, the Complaint's conclusory assertion that "a Board acting in good faith would not have permitted Kabbage to become a PPP lender," Compl. ¶ 319, simply is not plausible. Considering the existence of every "board-level system[] of monitoring and oversight" identified by the Delaware Supreme Court[35]—including mandatory reporting protocols, functioning Audit Committee, and routine and ongoing third-party audits of existing BSA/AML Policies, which satisfied all applicable PPP regulations—there is no basis to suggest that "permitting Kabbage to become a PPP lender" somehow constitutes *prima facie* evidence of bad faith. *See* Compl. ¶¶ 82–85, 87–89; J.A. Ex. 35 at A00351, A00353 (2020 Policy); *see also* Statement of Facts § I.C.3.

Second, the Complaint's allegation that the Board acted in bad faith by "utterly fail[ing]" to implement reporting systems that provided the Board with timely and accurate information relating to PPP lending, *see* Compl. ¶ 317, is implausible and inconsistent with other allegations and documents incorporated into the Complaint. This allegation again cannot be squared with

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[34] At most, the Complaint's allegations amount to criticism of these systems as imperfect, which falls far short of alleging the Directors' "utter failure" to establish them in the first place. *See, e.g.*, *Gen. Motors*, 2015 WL 3958724, at *14 (allegation that defendants "did not receive specific types of information" insufficient to establish that they utterly failed to inform themselves); *Stone*, 911 A.2d at 372 ("written policies and procedures designed to ensure compliance" are sufficient).

[35] *See Marchand*, 212 A.3d at 823.

Kabbage's robust reporting regime,[36] Kabbage's continued improvements to its already-adequate policies (which improvements began immediately after the start of PPP lending),[37] and Kabbage's overall compliance with the government's evolving SBA requirements.[38]

Third, the Complaint's assertion that the Board "did not ask whether there had been an independent assessment of Kabbage's PPP compliance program" between March and October 2020, Compl. ¶ 318, is legally insufficient. *Caremark* does not obligate directors to ask specific compliance questions—it only requires that they have monitoring systems in place. *Marchand*, 212 A.3d at 821.[39] A failure to discuss a specific risk "is not enough for the Court to conclude a

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[36] Kabbage's directors approved an updated and audited Policy in 2019. Compl. ¶ 82. Treliant concluded that this updated policy was one "that would be expected for an organization of the type and complexity of [Kabbage]." J.A. Ex. 5 at A00083 (2019 Treliant Report); J.A. Ex. 4 at A00061 (2019 Policy) (BSA/AML Policy established for "complying with the BSA and all other relevant statutes related to money laundering and sanctions" as part of Kabbage's "contractual obligations" to its partner banks "to comply with regulations"). *See also* Statement of Facts § I.C.1.

[37] Compl. ¶ 82. Although *Caremark* does not require bespoke information systems when adequate monitoring systems already exist, *see* n.38, below—Kabbage began drafting a further updated Policy at the start of PPP lending, which was approved by a partner bank on April 27, 2020, just weeks after lending began, and which was approved by Kabbage's Board thereafter. J.A. Ex. 35 at A00364 (2020 Policy); *see also* Statement of Facts § I.C.1.

[38] *See* First IFR, 85 Fed. Reg. at 20815. To the extent the Complaint attempts to argue that the Board acted in bad faith by not instituting a PPP-specific policy, *see* Compl. ¶ 317, that is implausible because PPP lending began less than one day after the regulations were released. *See* Statement of Facts § I.A. But even absent the exigencies of the pandemic, *Caremark* would not have mandated a new set of PPP-specific BSA/AML policies. *See Rojas*, 2019 WL 3408812, at *9 (dismissing information systems claim arising out of alleged violation of state consumer protection law where company had a committee "charged with legal and regulatory compliance" generally but no monitoring of state consumer protection laws specifically); *Bricklayers*, 2024 WL 3384823, at *4 (dismissing information systems claim predicated on Medicaid violations where company had a compliance committee responsible for "oversight of all compliance activities of [the company] with respect to all lines of business," not just Medicaid).

[39] Although the Delaware Supreme Court held that the plaintiffs in *Marchand* stated a *Caremark* claim, here the facts are different in every material respect. In *Marchand*, the Delaware Supreme Court found bad faith plausible because a corporate board did not discuss food safety compliance *and* the company lacked both a "board committee that addressed food safety" and "regular process[es] or protocols that required management to keep the board apprised of … compliance

board of directors acted in bad faith." *Bricklayers*, 2024 WL 3384823, at *15 (no discussion of Medicaid compliance risk by the board of a Medicaid plan administrator between January 2020 and April 2021). Delaware courts have repeatedly held that even multi-year gaps in discussion of a risk do not support an inference that a reporting system was absent. *See, e.g.*, *Horman v. Abney*, 2017 WL 242571, at *10 (Del. Ch. Jan. 19, 2017) (a shipping company's failure to discuss compliance with laws governing shipping cigarettes for four years "is not sufficient to allege that [a] system was not in place or that the Board was simply going through the motions"); *Constr. Indus. Laborers Pension Fund v. Bingle*, 2022 WL 4102492, at *13 (Del. Ch. Sep. 6, 2022) (a software company's failure to discuss cybersecurity risks for 26 months insufficient to sustain information systems claim).[40]

Finally, the Complaint's assertion that "if the Board had acted in good faith, it would have instituted policies to ensure it received [particular] [r]eport[s]," Compl. ¶ 320, is exactly the sort of hindsight-driven "could have, should have" speculation Delaware courts reject, *see Gen. Motors*, 2015 WL 3958724, at *15. As the Court of Chancery made clear, "[c]ontentions that the Board did not receive specific types of information do not establish that the Board utterly failed" to implement reporting systems. *Id.* at *14. Complaints about the quality, quantity, or frequency of reports at most suggest the Board could have refined its system, not that it lacked one. *Id.* at *15.

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practices, risk, or reports." 212 A.3d at 822. In contrast, as set forth above, Kabbage had a functioning Audit Committee and a regularly audited BSA/AML Policy that required board-level reporting. Compl. ¶¶ 83–85, 87–89; J.A. Ex. 3 at A00042, A00047 (2018 Treliant Report); *see also Bricklayers*, 2024 WL 3384823, at *15 (distinguishing *Marchand* because company had compliance committees and board received reports).

[40] Notably, during the eight-month window in which the Complaint alleges that Kabbage did not ask specifically about Kabbage's "PPP compliance program," the Board approved an updated BSA/AML Policy, which was updated within weeks of the start of PPP lending. *See* n.37, above.

2. The Complaint Fails To State An "Information Systems" Claim Against Officers Frohwein and Petralia (Count II)

The Complaint's "information systems" theory against the Officers (Frohwein and Petralia) is based on the same allegations as those against the Directors. *See* Compl. ¶¶ 303–13. The only conceivable addition appears to be the Complaint's allegation that the Officers did not have information systems to mandate reporting directly from employees to "themselves." *Id.* ¶ 305. To the extent this allegation is made against Frohwein and Petralia,[41] Delaware law does not require reporting directly to a president or a CEO "themselves," as opposed to delegated officials with particularized compliance roles, as was the case at Kabbage. *See id.* ¶¶ 84–85; *see also* Statement of Facts § I.C.1.[42] The Complaint thus fails to state an information systems claim against the Officers for the same reasons that the Complaint fails to state an information systems claim against the Directors. *See* § I.A.1, above.

B. The Complaint Fails To State A "Red Flags" Claim Against The D&O Defendants

To succeed on a *Caremark* red flags theory, a plaintiff must allege that defendants were alerted to evidence of illegality—the proverbial "red flag"—and then acted in bad faith by consciously failing to address it. *Marchand*, 212 A.3d at 820; *AgFeed USA*, 558 B.R. at 127 (red flags must be "consciously disregarded" (quoting *Gen. Motors*, 2015 WL 3958724, at *16)). A plaintiff

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[41] This allegation is group-pled against all officers. *See* Compl. ¶ 305.

[42] Delaware law does not require every officer to monitor compliance risks in every department. *See Segway Inc. v. Cai*, 349 A.3d 628, 635 (Del. Ch. 2023) ("At a minimum, a plaintiff … would need to demonstrate that the officer failed to make a good faith effort to monitor central compliance risks within her remit that pose potential harm to the company or others."). That is consistent with the principle that a plaintiff cannot state a claim against directors for delegating compliance responsibilities to certain officers in the first place. *See Stone*, 911 A.2d at 373 (dismissing *Caremark* claims against directors where they "delegated to certain employees and departments … the responsibility of monitoring compliance"); J.A. Ex. 5 at A00083 (2019 Treliant Report) (Board delegated "day-to-day management" of compliance to BSA/AML Officer and CCO).

must show that the red flag put defendants on notice of unlawful conduct and that the defendants' conscious disregard of the red flag proximately caused "corporate trauma." *In re Plug Power Inc. S'holder Deriv. Litig.*, 2025 WL 1277166, at *13 (Del. Ch. May 2, 2025) ("For a red-flag theory to work, the red flag must be sufficiently connected to the corporate trauma at issue to elevate the board's inaction in the face of the red flag to the level of bad faith."); *see also In re TransUnion Deriv. S'holder Litig.*, 324 A.3d 869, 887 (Del. Ch. 2024) ("[T]he risks identified and ignored … must be ***legal violations so obvious and material that disregarding them amounts to bad faith***." (emphasis added)). "Corporate trauma" typically refers to legal liabilities flowing from illegality—*i.e.*, that the company is "violat[ing] statutory requirements or … [is] engag[ing] in fraudulent or criminal conduct." *Reiter v. Fairbank*, 2016 WL 6081823, at *13 (Del. Ch. Oct. 18, 2016).

The red flag must be "waved in one's face or displayed so that [it is] visible to the careful observer." *Wood v. Baum*, 953 A.2d 136, 143 (Del. 2008) (quoting *In re Citigroup Inc. S'holders Litig.*, 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003)). Moreover, "liability requires a showing that the directors ***knew*** that they were not discharging their fiduciary obligations"—negligence or gross negligence is insufficient. *Stone*, 911 A.2d at 370 (emphasis added); *see Giuliano v. Grenfell-Gardner*, 2025 WL 2502176, at *12 (Del. Ch. Sep. 2, 2025) (same as to officers).

None of the Complaint's sparse allegations meet the exacting standard necessary to trigger *Caremark* liability under Delaware law. As set forth below, the Court does not even need to parse the Complaint's many implausible allegations of red flags because the entire theory fails for a threshold reason: The Complaint does not plead that any D&O Defendant had reason to believe that Kabbage was failing to comply with the SBA's evolving guidance—and because no D&O Defendant had reason to infer legal liability that would cause corporate trauma, there was no red flag that could be ignored in bad faith. That alone is sufficient to dismiss this claim. *See* § I.B.1,

below. But even if one considers the specific purported red flags pled, both as to the Directors, *see* § I.B.2, below, and the Officers, *see* § I.B.3, below, the Complaint fails to state a claim.

1. The D&O Defendants Had No Reason To Believe Kabbage's Conduct Was Unlawful

The Complaint's red flags theory fails at the outset because the D&O Defendants had no reason to believe that Kabbage's conduct was unlawful—let alone in a manner that could expose the company to corporate trauma. There are no allegations in the Complaint asserting that the D&O Defendants had "notice of [] ongoing violations of the law." *Rojas*, 2019 WL 3408812, at *10 (emphasis omitted); *see also Melbourne Mun. Firefighters' Pension Tr. Fund v. Jacobs*, 2016 WL 4076369, at *12 (Del. Ch. Aug. 1, 2016) (dismissing red flags claim against directors where the "Board consistently expressed … its view that its business practices were not violative of international antitrust laws"); *TransUnion*, 324 A.3d at 889 (dismissing red flags claim where company's board acted under the advice of qualified counsel because "it cannot fairly be inferred that the [b]oard relied on counsel in bad faith"); *Bricklayers*, 2024 WL 3384823, at *19 (dismissing red flags claim where "the [b]oard accepted management's statements that both the compliance issues and the regulatory risks were being handled").

Here, the Complaint does not allege the D&O Defendants ever received notice that Kabbage failed to comply with the law. The Complaint incorporates by reference numerous documents that explicitly confirm the opposite—the D&O Defendants' good faith belief that Kabbage ***complied*** with the law. *See, e.g.*, Compl. ¶ 199 (quoting J.A. Ex. 33 at A00337–41 (texts between Kabbage executives about A&M Report)); J.A. Ex. 33 at A00341 (informing Frohwein that "everything we're doing on PPP we've run through our outside coun[se]l focused on SBA…. I have no problem defending all of it with reference to specific SBA IFR guidance."); Compl. ¶ 115 (quoting J.A. Ex. 21 at A00215 (texts between Kabbage executives about Kabbage's PPP participation));

J.A. Ex. 21 at A00216 (in response to email saying that Kabbage's calculations were incorrect, informing Frohwein and Petralia: "fine to listen to him but we've gone through this with coun[se]l"). Where, as here, the Complaint fails to allege that the D&O Defendants had any reason to believe that Kabbage was violating the law, there is no *Caremark* red flags liability.

2. The Complaint Further Fails To State A "Red Flags" Claim Against Directors Butler, Ebinger, Frohwein, and Stolle (Count III)

It is not clear that the Complaint even attempts to plead a cognizable red flags theory against the Directors. *See* Compl. ¶¶ 314–25; *see also id.* ¶ 18 (alleging "Kabbage's Directors (except for Frohwein)" were unaware of Kabbage's purported failures). The Complaint only alleges a few threadbare flags that were purportedly "visible" to the Directors: (1) "Kabbage had just furloughed numerous employees"; (2) the Board "needed to take remedial measures to get its BSA/AML compliance control 'equivalent to that of a comparable federally regulated institution' before making loans"; and (3) a one million dollar reserve for contingent liabilities was insufficient. Compl. ¶¶ 319, 322. None of these allegations constitutes a *Caremark* red flag.

Employee Furloughs (Alleged Red Flag #1). The Complaint alleges that, in early 2020, "[w]ith the entire country quarantined in their homes, commerce" and, therefore, small business lending, "flatlined." *See* Compl. ¶ 65. "As a result, Kabbage had to essentially shutter all but its most basic operations" and "furloughed a significant number of employees." *Id.* ¶ 66. But the Complaint also specifically alleges that the Directors did not know that these furloughs caused Kabbage to be "understaffed to conduct reasonable reviews of PPP loan applications." *Id.* ¶ 206 (alleging that loan review understaffing was not disclosed to the Board).

This allegation—that the Board knew generally of ***company-wide*** employee furloughs—is not a red flag. Delaware courts consistently hold that generalized, company-wide issues like staffing shortages are too broad to provide the specific notice required to trigger *Caremark* red flag

liability. *See, e.g.*, *Hamrock*, 2022 WL 2387653, at *25–26 (pipeline company directors' knowledge of "general recordkeeping deficiencies" and subsidiary's safety violations were general risks that could not constitute red flags that would have put board on notice of specific corporate trauma resulting from gas explosion at pipeline run by different subsidiary); *Clem v. Skinner*, 2024 WL 668523, at *9 (Del. Ch. Feb. 19, 2024) (warnings of general compliance program weaknesses were not red flags of specific corporate trauma arising out of illegal insulin billing practices). Because Kabbage's furloughs spanned multiple departments, Compl. ¶ 66, and were part of a broader cost-saving initiative across the organization, they could not constitute a red flag that is reasonably tied to the Complaint's theory of corporate trauma of exposing Kabbage to liability for PPP violations (and certainly cannot support an inference of bad faith).

Litigation Risk (Alleged Red Flag #2). The Complaint alleges that Frohwein told the Board about a "risk of law suit[s] around PPP" and acknowledged the existence of "litigation risk." Compl. ¶¶ 213, 228. But litigation is one of the most common risks that American businesses face, and such statements are insufficient to provide notice that Kabbage "was headed for corporate trauma." *Bricklayers*, 2024 WL 3384823, at *17 (observing that "reports of increasing regulatory scrutiny, state investigations, and threatened litigation" do not, without more, "constitute red flags");[43] *see also Fisher v. Sanborn*, 2021 WL 1197577, at *14 n.137, *16 (Del. Ch. Mar. 30, 2021) (noting that presentations that warned of increasing "'Level 3' complaints," a category of customer complaint that included threats of litigation, did not constitute a red flag because they did not "indicate that the Company had violated consumer protection laws").

[43] Here, the alleged references to litigation risk were even more superficial than the red flags alleged in *Bricklayers*, where the Court of Chancery held that repeated warnings characterizing pharmaceutical reimbursement practices as a "regulatory and reputational risk with the possibility for adverse legal action" were too "devoid of details" to put directors on notice of the fact that certain officers were illegally inflating reported costs. 2024 WL 3384823, at *18.

2019 Treliant Report (Alleged Red Flag #3). Plaintiff pleads that Treliant's 2019 Report was provided to the Board, and that the Board did not "address the issues identified" in it. Compl. ¶¶ 89–93. But the 2019 Treliant Report found that Kabbage's BSA/AML program was "robust," "thoughtfully constructed," and "adequately cover[ed] the BSA/AML and OFAC standards that would be expected for an organization of [its] type and complexity."[44] It rated no element of Kabbage's BSA/AML program as insufficient. J.A. Ex. 5 at A00086–88 (2019 Treliant Report). Delaware case law confirms the 2019 Treliant Report thus did not provide any red flag warning that the Directors could have disregarded in bad faith. For example, in *Reiter*, a report indicated that a company's AML compliance risk had escalated from "low" to "high" over two years, but that court found that the report was not a red flag because the report did not conclude that the company was violating the law; instead, the report was a non-actionable "yellow flag[] of caution."[45] 2016 WL 6081823, at *13. The same reasoning should follow here.

Even if the Treliant Report was a red flag (which it was not), the Complaint concedes that the Directors did not disregard it and instead remedied any purported issues. The Complaint is clear that the Directors reviewed the report on November 13, 2019, Compl. ¶ 89, and approved an updated BSA/AML Policy in July 2020, J.A. Ex. 35 at A000346 (2020 Policy). That updated Policy both (1) improved items that received the middle "Limited Assurance" grade in the 2019

[44] J.A. Ex. 5 at A00081, A00083 (2019 Treliant Report).

[45] Moreover, even if the Court viewed the Complaint's cherry-picked statements in the 2019 Treliant Report in a vacuum, they still would not constitute a red flag. *See, e.g.*, *Sorenson*, 2021 WL 4593777, at *15–16 ("[U]pdates to the [b]oard about aspects of [company's] cybersecurity measures that needed improvement" were not "'red flags' … of illegality" absent allegations "that [company's] standards ran afoul of regulatory or legal requirements"). Again, the lowest rating Treliant gave Kabbage was "Limited Assurance"—meaning there was some assurance that the control addressed the identified risk—which it marked yellow (a literal yellow flag). J.A. Ex. 5 at A00086–88 (2019 Treliant Report).

Report,[46] and (2) included PPP-specific changes, *see, e.g.*, J.A. Ex. 35 at A00358 nn.5–6 (2020 Policy). Thus, it is no surprise that Kabbage's Head of Policy believed the Policy was "being remediated/updated" between November 2019 and July 2020. Compl. ¶ 194. These allegations preclude a finding that the Board acted in bad faith. *See, e.g.*, *Clem*, 2024 WL 668523, at *11 (no conscious disregard of red flags where "in due course, remediation efforts were made" by the board). Attacks on the Board's chosen response[47] are precluded by the business judgment rule.[48]

3. The Complaint Fails To State A "Red Flags" Claim Against Officers Frohwein And Petralia (Count II)

The Complaint's red flag theories against Frohwein and Petralia as Officers appear to be that they allegedly ignored: (1) statements from subordinate employees about staffing shortages; (2) references made to PPP-related litigation risk during the Merger diligence process; (3) flaws in Kabbage's controls found by the 2019 Treliant Report; (4) supposed PPP violations identified in the A&M Report; (5) a news article about borrower fraud on Kabbage's platform; (6) an employee

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[46] For example, after the Report found that Kabbage's KYC protocols did not identify prohibited customer types as well as they could, J.A. Ex. 5 at A00087 (2019 Treliant Report), the July 2020 policy modified those protocols to include new categories of prohibited customers. J.A. Ex. 35 at A00358–59 (2020 Policy).

[47] Notably, as explained above, the Complaint also establishes that the Board's chosen response was, in fact, diligent. As documents incorporated by reference show, by April 2020, Kabbage had already sent the updated 2020 BSA/AML Policy to a partner bank, demonstrating that—contrary to the Complaint's allegations, *see* Compl. ¶ 194—Kabbage set upon updating its BSA/AML Policy as soon as PPP lending began. *See* Statement of Facts § I.C.3 (citing J.A. Ex. 35 at A00364 (2020 Policy)).

[48] *See Melbourne Firefighters*, 2016 WL 4076369, at *9 ("Simply alleging that a [fiduciary] incorrectly exercised its business judgment and made a 'wrong' decision in response to red flags … is insufficient to plead bad faith."); *Transunion*, 324 A.3d at 889 ("[A]n inadequate, delayed, or misguided response to red flags cannot support a claim for breach of the duty of loyalty—no matter how it is categorized."); *In re Qualcomm Inc. FCPA S'holder Deriv. Litig.*, 2017 WL 2608723, at *4 (Del. Ch. June 16, 2017) ("[S]econd-guess[ing] the timing and manner of the board's response to [] red flags … fails to state a *Caremark* claim.").

email about a calculation error in Kabbage's online loan applications involving employee payroll costs; and (7) Wells Fargo's termination of its relationship with Kabbage. *See* Compl. ¶¶ 93, 117–18, 206, 227, 258–65, 306.[49] These allegations do not state a claim for *Caremark* liability because: (1) they are not red flags that actually warned Frohwein or Petralia of alleged corporate trauma; and (2) the Complaint fails to allege that either Frohwein or Petralia ignored those alleged red flags in bad faith.

Staffing Shortages (Alleged Red Flag #1). The Complaint alleges that Frohwein and Petralia received warnings from subordinates about inadequate staffing—specifically, that Frohwein was told by Habib that Kabbage had "very limited resources in compliance," Compl. ¶ 130 (emphasis removed), and that Nicole Hill asked Petralia for "the return of six employees to help with assessing fraud risk,[50] *id.* ¶¶ 106, 206. Neither message was a red flag because neither provided notice of any unlawful conduct.

In addition, Habib and Hill received timely responses. After Habib sent Frohwein an email noting that hiring A&M could benefit compliance, Kabbage engaged A&M just three days later. *Id.* ¶¶ 130–31. Likewise, when Hill asked Petralia to hire furloughed compliance employees back, Petralia approved an additional hire. *Id.* ¶ 106. These remediation responses foreclose a red flag claim. *See* n.48, above.

Litigation Risk (Alleged Red Flag #2). Plaintiff argues that Frohwein and Petralia ignored Amex's concerns about PPP-related litigation risk. Compl. ¶ 227. But abstract concerns about

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[49] To the extent that the Complaint alleges that Frohwein and Petralia also ignored the same red flags as other Directors, those claims fail for the reasons set forth above. *See* § I.B.2, above. The Complaint does not allege that Frohwein or Petralia knew of the other "red flags" referenced in the Complaint.

[50] The Complaint does not allege that either Frohwein or Petralia were aware of Hill's other alleged criticisms of Kabbage's fraud controls. *See* Compl. ¶¶ 94–95.

"the possibility for adverse legal action," especially in the context of transactional due diligence, are not red flags, *see Bricklayers*, 2024 WL 3384823, at *18, and do not constitute notice of "obvious and material" illegality, *see TransUnion*, 324 A.3d at 887. *See also* § I.B.2, above.

2019 Treliant Report (Alleged Red Flag #3). Plaintiff broadly alleges that "Defendants" did not address the issues identified in the 2019 Treliant Report. Compl. ¶ 93. But for reasons stated above, the 2019 Treliant Report was not a red flag, and even if it was, Kabbage responded to it. *See* § I.B.2, above.

A&M Report (Alleged Red Flag #4). Plaintiff alleges that the A&M Report was a red flag and cites Frohwein's incredulous reaction to the A&M Report and its potential impact on the Amex deal.[51] Compl. ¶¶ 25, 193, 199. But the A&M Report, like the 2019 Treliant Report, could not plausibly constitute a red flag because the report itself concluded that Kabbage's PPP compliance program "generally appear[ed] to be consistent with the SBA's PPP Interim Final Rules guidance and applicable BSA/AML and OFAC requirements." J.A. Ex. 30 at A00292 (A&M Report).[52] For all its emphasis on Frohwein's use of an expletive when responding to the A&M Report, the Complaint does not even attempt to explain how the report's *positive* conclusion that Kabbage *complied with applicable rules and regulations*, could plausibly constitute a *red flag of non-compliance*.[53]

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[51] The Complaint does not allege that Petralia ever saw the A&M Report.

[52] Plaintiff points to the A&M Report's references to certain areas "need[ing] improvement," Compl. ¶¶ 176–77, J.A. Ex. 30 at A00306 (A&M Report), but the actual warnings are only of increasing compliance risk, which does not constitute a red flag. *See Reiter*, 2016 WL 6081823, at *13 (no red flags liability because, absent any finding of illegality, the compliance report defendants received was a "yellow flag[] of caution concerning … escalating … compliance risk").

[53] Because, for the reasons identified in the text, the Complaint's red flag allegation based on the A&M report, Compl. ¶¶ 25, 193, 199, is not plausible, the Court may end its inquiry there. Nevertheless, because the Complaint appears fixated on Frohwein's message about the A&M Report, and because both the message and the A&M Report are incorporated by reference into the Complaint, *see id.*, the Court may consider the following: Frohwein's message expressed

News Article About Borrower Fraud (Alleged Red Flag #5). The Complaint pleads that, on September 10, 2020, Frohwein and Petralia saw a news article about high rates of fraud on Kabbage's lending platform. Compl. ¶¶ 260–61. The Complaint fails to allege that the article (or the request for comment that preceded it, Compl. ¶¶ 258–59) was a red flag because, again, the article did not suggest that *Kabbage* was breaking the law. Reporting about fraudulent borrowers' use of Kabbage's platform merely demonstrated that: (1) Kabbage, like every lender (PPP and non-PPP alike) had a nonzero rate of fraud; and (2) as lawmakers predicted before PPP lending began, the program would inevitably attract higher fraud than traditional lending by virtue of its design. *See* Statement of Facts § I.A n.19.[54] Reports of *borrower* fraud that parties all treated as inevitable do not constitute red flags that *a lender* was violating PPP regulations. *See IMG Holding LLC v. Dimon*, 2024 WL 1634878, at *4 (Del. Ch. Apr. 16, 2024) (articles detailing Zelle fraud by *customers* were not red flags because they did not "describe any failures by [company] to investigate or reimburse customers properly"); *Fisher*, 2021 WL 1197577, at *14 & n.137, *16 (presentations that warned of increasing customer complaints and threats of litigation, but did not "indicate that

frustration with a table in the introduction to the draft A&M Report, which contained a misleading color scheme that gave the reader the (entirely false) impression that A&M opined that Kabbage was noncompliant when in fact the report concluded that Kabbage was compliant. *See* Compl. ¶ 199 (alleging Frohwein stated "if you read the report, you'll see the problems. They're all in red—literally."). A&M's color-coding emphasized the compliance categories that A&M believed were most important in bright red coloring, even if Kabbage received the highest "quality" grade for its performance in that category. *See, e.g.*, J.A. Ex. 30 at A00297–301 (A&M Report) (denoting "High" importance of identifying regulatory updates in red, while assigning Kabbage a "Quality of Risk Management" rating of "Strong," meaning that "Kabbage's risk management systems fully identif[ied] and appropriately control[led] all risks posed by the product or process"); *id.* at A00302 (same for Know Your Customer / Customer Due Diligence risk). Frohwein's response reflected frustration with that misleading color scheme because of the misinterpretations that it would inevitably cause.

[54] Notably, given the Hold Harmless Provision, which insulated lenders from liability for relying on borrower attestations, First IFR § III.3(c), 85 Fed. Reg. at 20815–16, the mere existence of some degree of fraud was not expected to result in any liability for Kabbage.

the Company had violated consumer protection laws … did not constitute a 'red flag'"); *Cai*, 349 A.3d at 628 (dismissing red flags claim because plaintiff failed to allege defendant knew of "material legal violations").

Messages Regarding Online Loan Application Calculation Errors (Alleged Red Flag #6). The Complaint highlights an email from a Kabbage employee to Petralia (and other officers, but not Frohwein) raising an issue that Kabbage employees had purportedly identified with its online loan application. The Complaint alleges that borrowers' loan eligibility was supposed to be calculated based on a business's "eligible payroll costs," which excluded annual salaries in excess of $100,000. Compl. ¶ 117. It further suggests that Kabbage employees proactively identified that certain borrowers appeared to be incorrectly certifying that they were entitled to higher loan amounts by including salaries that were in excess of $100,000, and suggested that Kabbage place a cap in their automated system. *Id.* Far from pleading that Petralia and the other officers ignored this message in bad faith, documents incorporated by reference into the Complaint show that they took steps to resolve the issue within hours of the purported communication. J.A. Ex. 24 at A00246 (Email chain concerning $100K caps) ("The cap is back in now – getting a full list of impacted accounts." (emphasis omitted)); *see Bricklayers*, 2024 WL 3384823, at *19 (no bad faith where a board "accepted management's statements that … [issues] were being handled"). Likewise, the Complaint alleges—on the basis of a group text message chain—that Frohwein and Petralia were aware of a "glaring error" in loan calculations, *see* Compl. ¶ 115, even though that same text chain establishes that Frohwein approved of further investigation of the alleged error despite having already discussed it with counsel. *See* J.A. Ex. 21 at A00215–16.

Communications With Wells Fargo (Alleged Red Flag #7). The Complaint asserts that on or around June 5, 2020, Wells Fargo terminated its relationship as Kabbage's corporate bank for

two reasons: (1) "lingering concerns about defaults in Kabbage's legacy [i.e., non-PPP] loan portfolio;" and (2) "[i]n part because of its growing concerns about Kabbage's PPP program." Compl. ¶ 167. Further, the Complaint alleges that Wells Fargo's relationship manager "explained the reasoning for its decision with Frohwein personally," but nevertheless allowed Kabbage to keep its accounts with Wells Fargo for several additional months. *Id.* ¶¶ 167–68. Neither Wells Fargo's decision, nor the Complaint's vague allegations about what Wells Fargo's relationship manager told Frohwein, can constitute red flag warnings of illegality that Frohwein ignored in bad faith. *First*, the Complaint does not even attempt to plead that Wells Fargo provided any type of red flag warning that Kabbage was engaged in illegal conduct. Nor would such an allegation be plausible, given that the Complaint concedes that Wells Fargo continued doing business with Kabbage for "several months." *Id.* ¶ 168. *Second*, the Complaint does not allege that Wells Fargo advised Kabbage of compliance risk—which, even if it had, would not have constituted a red flag under Delaware law, *see* n.39, above.

In sum, Plaintiff fails to allege a single red flag that Frohwein or Petralia disregarded in bad faith. As such, the Complaint fails to state a *Caremark* red flag claim against the Officers.

II. PLAINTIFF'S DUTY OF CARE CLAIM AGAINST FROHWEIN AND PETRALIA FAILS (COUNT I)

Plaintiff's duty of care claim against the Officers fails for two reasons. *First*, the Complaint largely attempts to repackage its *Caremark* allegations as breaches of the duty of care, which is not permitted under Delaware law. *Second*, the Complaint fails to plead any viable duty of care

theory, against either Frohwein or Petralia, that is not duplicative of the Complaint's *Caremark* allegations.

A. Plaintiff Cannot Plead A Duty Of Care Claim By Recycling Its *Caremark* Allegations

Under Delaware law, the fiduciary duty of oversight "only derives from the duty of loyalty, with no room for the duty of care." *Ont. Provincial Council of Carpenters' Pension Tr. Fund v. Walton*, 294 A.3d 65, 89 (Del. Ch. 2023). Courts routinely recharacterize duty of care allegations about "purported failures to oversee and actively monitor" as *Caremark* claims and then reject them under *Caremark*'s demanding standard. *Gottlieb v. Liebowitz* (*In re KSL Media, Inc.*), 732 F. App'x 535, 536 (9th Cir. 2018) (rejecting an argument that "fail[ing] to oversee [a company's] operations" could state "a claim for breach of the duty of care"); *see, e.g.*, *Grenfell-Gardner*, 2025 WL 2502176, at *6, *12 (dismissing duty of care claim that was "in essence" an oversight violation because "oversight claims require a showing of bad faith"); *Kravitz v. Tavlarios*, 2020 WL 3871340, at *8 (S.D.N.Y. July 8, 2020) (allegations that "implicate only an alleged failure to monitor the Company … [constitute] a *Caremark* claim, which implicates only a breach of the duty of loyalty … [and] fail[] to state a claim for breach of the duty of care"); *cf. In re GoPro, Inc. S'holder Deriv. Litig.*, 2020 WL 2036602, at *10 (Del. Ch. Apr. 28, 2020) (evaluating a failure-to-disclose claim under *Caremark* because "if directors have actual knowledge of wrongdoing and fail to take corrective action, that *is* a *Caremark* claim") (cleaned up). In short, courts hold that failures of oversight must be evaluated under the stringent *Caremark* standard, even if pled as breaches of the duty of care.

Most of Count I's allegations are repackaged oversight allegations, which as set forth above, *see* §§ I.A, I.B, do not survive *Caremark*. Count II alleges that Officers "were responsible … to assure themselves that information and reporting systems existed in the organization,"

Compl. ¶ 291; "fail[ed] to ensure Kabbage's compliance with relevant BSA/AML laws and regulations," *id.* ¶ 293; "failed to take appropriate action … to prevent Kabbage from violating the law," *id.* ¶ 295; "ignored major compliance issues," *id.* ¶ 296; "failed to ensure that Kabbage had [adequate] information and reporting systems," *id.* ¶ 297; and failed to address certain issues that were the "product of … the lack of reasonable reporting systems," *id.* ¶ 298. "Although framed as a duty of care claim," these claims "are in essence oversight violations." *See Grenfell-Gardner*, 2025 WL 2502176, at *12. Because "oversight claims require a showing of bad faith"—and, for the reasons stated in § I, the Complaint fails to do so—this claim must be dismissed.

B. Plaintiff Fails To State Any Non-*Caremark* Duty Of Care Claim

Once the Complaint's oversight allegations are excised from the duty of care claim in Count II, two allegations remain—that the Officers acted with gross negligence by (1) improperly certifying Kabbage's compliance with PPP regulations, Compl. ¶ 294, and (2) retaining insufficient assets to cover Kabbage's legal liabilities, *id.* ¶ 299. These allegations are insufficient to save the duty of care claim. "A claim for breach of the duty of care requires a showing of gross negligence which generally 'requires directors and officers to fail to inform themselves fully and in a deliberate manner." *Burtch v. Opus, LLC* (*In re Opus E., LLC*), 528 B.R. 30, 66 (Bankr. D. Del. 2015) (quoting *Official Comm. of Unsecured Creditors of Fedders N. Am., Inc. v. Goldman Sachs Credit Partners L.P.* (*In re Fedders N. Am., Inc.*), 405 B.R. 527, 539 (Bankr. D. Del. 2009)); *see also McPadden v. Sidhu*, 964 A.2d 1262, 1274 (Del. Ch. 2008) (officer's duty of care is breached by gross negligence—"conduct that constitutes reckless indifference or actions that are without the bounds of reason"); *Metro Storage Int'l LLC v. Harron*, 275 A.3d 810, 845–46 (Del. Ch. 2022) (same). Because courts focus on process, not results, they do not second-guess officers' business judgments or operational choices. *See Hurwitz v. Mahoney* (*In re Space Case*), 2024 WL 1628440, at *8 (Bankr. D. Del. Apr. 15, 2024) (duty of care claim failed because "the facts alleged merely

describe[d] business decisions, some imperfect in hindsight," and were "not sufficient to rebut … the business judgment presumption"). The Complaint does not come close to stating a duty of care claim based on the two remaining allegations.

First, Plaintiff alleges that Frohwein, Petralia, Askins, Robinson, and Taussig "decided to certify that Kabbage was in compliance with required PPP regulations" even though they knew that Kabbage "lacked a BSA/AML 'compliance program equivalent to that of a comparable federally regulated institution.'" Compl. ¶ 294. This claim fails against Frohwein and Petralia for multiple reasons. Frohwein and Petralia did not sign the certification[55] and the Complaint does not plead a single non-conclusory fact suggesting Frohwein or Petralia played any role in preparing or disseminating the certification.[56] Thus, the Complaint does not actually allege that either of them "decided to certify" Kabbage's compliance. Compl. ¶ 294; *see Stanziale v. Heico Holdings, Inc.* (*In re Conex Holdings, LLC*), 514 B.R. 405, 414 (Bankr. D. Del. 2014) (dismissing fiduciary duty claims that "lump[ed] all [individual defendants] together").[57] Moreover, even if the Complaint alleged that Frohwein or Petralia had certified Kabbage's compliance (and it does not), the

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[55] Compl. ¶ 100; *see also* J.A. Ex. 17 at A00178, A00183 (SBA Form 3507).

[56] *See* Compl. ¶¶ 289–302. Delaware courts routinely reject conclusory assertions that officers must have been responsible for a misrepresentation because of their general oversight role. *See, e.g.*, *In re Baker Hughes Inc. Merger Litig.*, 2020 WL 6281427, at *16 (Del. Ch. Oct. 27, 2020) (rejecting as insufficient the "unsubstantiated assertion" that a CFO would have reviewed or authorized the allegedly false statement "because she was CFO"); *see also id.* (dismissing duty of care claims under more lenient state law "conceivability" pleading standard).

[57] *See also Joseph v. Frank* (*In re Troll Commc'ns, LLC*), 385 B.R. 110, 120 (Bankr. D. Del. 2008) (dismissing fiduciary duty claims that "lack[ed] sufficient detail about which officers, if any, knowingly participated" in a challenged act); *Bank of Am., N.A. v. Knight*, 725 F.3d 815, 818–19 (7th Cir. 2013) (Easterbrook, C.J.) (affirming dismissal where complaint pled what "defendants collectively did, without imputing concrete acts to specific litigants" because "[l]iability is personal").

Complaint and documents it incorporates by reference render it implausible that the SBA certification was false in the first place.[58]

Second, Plaintiff asserts that "Frohwein, Petralia, Askins, Robinson, and Taussig acted with gross negligence in failing to ensure that Kabbage retained sufficient assets to cover its legal liabilities" and should have "preserved *all* Kabbage's cash to cover these liabilities." Compl. ¶¶ 299–300. But other allegations throughout the Complaint demonstrate that matters relating to the post-Merger capitalization of Kabbage, including obtaining a solvency opinion, were spearheaded by Kabbage's CFO, who is not a defendant in this action. *See* Compl. ¶¶ 246, 248, 250; *see also* n.56. Here, too, the Complaint's group-pleading—replete with generalized assertions about what "Kabbage instructed" or "Kabbage insisted," *see* Compl. ¶¶ 230–44—fails to state a claim against Officers Frohwein and Petralia. *See Conex Holdings*, 514 B.R. at 414 (to satisfy *Twombly* and *Iqbal* pleading standard, plaintiff must "supply[] specific facts as to each defendant's wrongdoing"); *see also* n.57.[59] As such, the duty of care claim must be dismissed.

III. PLAINTIFF'S FRAUDULENT TRANSFER CLAIM AGAINST THE SHAREHOLDER DEFENDANTS FAILS (COUNT IV)

The Complaint alleges (Compl. ¶¶ 327–32) that the October 13 Transfer constitutes a constructive and actual fraudulent transfer, which can be recovered from the Shareholder Defendants in their capacities as "entit[ies] for whose benefit such transfer was made" under Bankruptcy Code Section 550(a)(1). Accepting the Complaint's allegations as true, this theory fails for at least two

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[58] *See, e.g.*, J.A. Ex. 5 at A00083 (2019 Treliant Report); *see also* Statement of Facts §§ I.C.1, I.C.3 (explaining that Kabbage's BSA/AML systems complied with applicable PPP regulations).

[59] To the extent the Complaint alleges any facts against Frohwein that are not group-pled, they demonstrate the opposite of the type of "devil-may-care attitude or indifference to duty amounting to recklessness" required to plead gross negligence. *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *4 (Del. Ch. Aug. 26, 2005); *see* Compl. ¶ 244 (Frohwein consulted outside counsel regarding contingent liabilities); *id.* ¶ 248 (Frohwein discussed litigation risks with Board).

reasons. *First*, the Complaint fails to state a claim under Section 550 against the Shareholder Defendants (which the Complaint concedes were neither initial nor subsequent transferees of the October 13 Transfer) because it neither alleges veil piercing nor other elements of "transfer beneficiary" liability. *See* § III.A, below. *Second*, recovering from the non-transferee Shareholder Defendants as "beneficiaries" requires the existence of an avoidable transfer—which the October 13 Transfer was not, because it was made pursuant to an enforceable antecedent contractual obligation (the Merger Agreement) executed months earlier. *See* § III.B, below.

A. The Shareholder Defendants Cannot Be Held Liable As Fraudulent Transfer "Beneficiaries" Under Bankruptcy Code Section 550(a)(1)

Even if the Complaint did state a plausible *prima facie* fraudulent transfer claim (which, as set forth in § III.B, below, it does not), Plaintiff could not recover from the Shareholder Defendants. The Complaint concedes the Shareholder Defendants were neither initial nor subsequent transferees of the October 13 Transfer, and the Complaint's novel and expansive "beneficiary" theory cannot succeed unless it alleges: (1) facts sufficient to support piercing the corporate veil between Alpha Kabbage (the initial transferee) on one hand, and the Shareholder Defendants (shareholders of the initial transferee), on the other hand; and/or (2) an actual, direct benefit that is quantifiable and accessible.

1. Bankruptcy Code Section 550 Permits Recovery Only Against Transferees And A Limited Set Of "Transfer Beneficiaries"

Section 550(a) of the Code allows a trustee to recover from (i) the initial transferee or "the entity for whose benefit such transfer was made" or (ii) "any immediate or mediate transferee." 11 U.S.C. § 550(a). The Complaint is explicit that the Shareholder Defendants are *not* initial, mediate, or immediate transferees. *See, e.g.*, Compl. ¶¶ 32, 251–54, 333–37. As such, the Complaint fails to state a fraudulent transfer claim against the Shareholder Defendants unless it

establishes that they are "entit[ies] for whose benefit" the October 13 Transfer was made under Section 550(a)(1), which it does not.

An entity for whose benefit a transfer is made under Section 550(a)(1) "is typically the guarantor of a debt that was extinguished by the transfer." *Janvey v. Libyan Inv. Auth.*, 840 F.3d 248, 265 (5th Cir. 2016); *see also Reily v. Kapila* (*In re Int'l Mgmt. Assoc.*), 399 F.3d 1288, 1292 (11th Cir. 2005) (benefit to guarantor is "paradigm case"); *Dunn v. HPS Inv. Partners, LLC* (*In re Alta Mesa Res., Inc.*), 2024 WL 4379801, at *4 (Bankr. S.D. Tex. Oct. 1, 2024) (same). Plaintiff does not suggest the Shareholder Defendants are guarantors.

In the rare instances where courts have held a non-guarantor shareholder of a transferee liable for a fraudulent transfer, plaintiffs have pierced the corporate veil between the shareholder (parent) and the transferee (subsidiary). *See, e.g.*, *BYJU's Alpha, Inc. v. Camshaft Cap. Fund, LP* (*In re BYJU's Alpha*), 2025 WL 665294, at *15 (Bankr. D. Del. Feb. 27, 2025) (parent of wholly owned subsidiary that received fraudulent transfer liable as "beneficiary" under Section 550(a)(1) where veil was pierced as a matter of law).[60] Plaintiff does not even attempt to pierce the corporate veil to the Shareholder Defendants.

Plaintiff is left to argue that the Shareholder Defendants are liable as beneficiaries because they received an actual, direct benefit that is quantifiable and accessible under the Illinois *McCook Metals* test. *See, e.g.*, *Baldi v. Lynch* (*In re McCook Metals, L.L.C.*), 319 B.R. 570 (Bankr. N.D. Ill. 2005); *see also Halperin v. Moreno* (*In re Green Field Energy Servs., Inc.*), 594 B.R. 239, 287–

[60] *See also Alta Mesa*, 2024 WL 4379801, at *6 ("[S]hareholders are not liable for transfers to the corporation unless (i) they actually received distributions of the transferred property; or (ii) there is reason to pierce the corporate veil."); *Schechter v. 5841 Bldg. Corp.* (*In re Hansen*), 341 B.R. 638, 645–46 (Bankr. N.D. Ill. 2006) (similar); *Kravitz v. Samson Energy Co.* (*In re Samson Res. Corp.*), 2022 WL 3135288, at *7–8 (Bankr. D. Del. Aug. 4, 2022) (denying summary judgment because triable issue of fact existed as to whether controlling shareholder and affiliated entities were alter egos of transferees).

88 (Bankr. D. Del. 2018); *Alta Mesa*, 2024 WL 4379801, at *7. But *McCook Metals* does not apply to shareholders in the absence of veil piercing. The Delaware Court of Chancery observed that extending liability to a transferee's majority shareholders absent veil piercing would "be inconsistent with Delaware's policy of safeguarding corporate separateness" because it would "render[] every majority shareholder of a closely-held corporation … liable for transfers to the corporation, although the corporation is entirely legitimate and all corporate formalities have been carefully observed." *Cleveland-Cliffs Burns Harbor LLC v. Boomerang Tube, LLC*, 2023 WL 5688392, at *14 (Del. Ch. Sep. 5, 2023) (citation omitted) (holding shareholders, directors, and officers of Delaware corporation liable for fraudulent transfer received by corporation would "ignore the fundamental nature of corporations" as legal entities separate from their shareholders, officers, and directors (citation omitted)).

Here, the Court does not need to decide whether *McCook Metals* could extend beneficiary liability to a shareholder of a transferee in the absence of veil piercing. Because the Complaint does not allege *either* (1) facts sufficient to support veil piercing *or* (2) that the Shareholder Defendants received an actual, direct benefit that is both quantifiable and accessible, the constructive and actual fraudulent transfer claim must be dismissed.

2. The Complaint Does Not Plead Facts To Support Veil Piercing

The Complaint does not even attempt to allege the elements of veil piercing against the Shareholder Defendants. "Persuading a Delaware court to disregard the corporate entity is a difficult task" because it requires a plaintiff to state facts that demonstrate "complete domination and control" to the point that the entity "no longer ha[s] legal or independent significance of [its] own." *Wallace v. Wood*, 752 A.2d 1175, 1183–84 (Del. Ch. 1999) (citations omitted) ("Effectively, the corporation must be a sham and exist for no other purpose than as a vehicle for fraud."). Plaintiff

does not and could not plausibly allege that any of the 16 minority shareholders named in the Complaint—let alone all of them—were alter egos of Alpha Kabbage.

3. The Shareholder Defendants Did Not Receive Any Actual, Direct Benefit From The October 13 Transfer That Is Quantifiable And Accessible

Struggling to meet the *McCook Metals* test, the Complaint attempts to plead two separate theories of "benefit"—that the Shareholder Defendants benefitted because the October 13 Transfer increased the value of the overall "Kabbage enterprise," Compl. ¶ 253, and because the October 13 Transfer was one of a series of steps that ultimately facilitated their receipt of merger consideration, *id.* ¶ 333. Neither of these allegations, taken as true, meets the *McCook Metals* test.

Appreciation of "Kabbage Enterprise" (Transfer "Beneficiary" Theory #1). The Complaint alleges that the October 13 Transfer benefitted the Shareholder Defendants by increasing the value of their shares in the overall "Kabbage enterprise" by transferring assets from an indirect subsidiary to a direct subsidiary. Compl. ¶¶ 251–54. Accepting this theory as true, it fails for two reasons. *First*, an increase in the value of an enterprise is not an "accessible" benefit to its shareholders.[61] *Second*, this alleged benefit is not "quantifiable" because there is no way to determine the amount by which share values (in a privately-held company, no less) increased by virtue of an intercompany transfer between subsidiaries.[62] In short, the conclusory allegation that the October 13 Transfer increased the value of the Shareholder Defendants' equity interests in Kabbage is precisely the

[61] *See Green Field Energy*, 594 B.R. at 288–89 (defendant with 50% ownership interest in two special purpose entities that received cash transfers from debtor did not have "actual access" to benefit because he did not actually receive transferred cash; any appreciation of equity interest insufficient to constitute "accessible" benefit).

[62] *See Alta Mesa*, 2024 WL 4379801, at *5 (private equity firm defendants, which dually owned both transferor and transferee, not liable as "transfer beneficiaries" even if transfers increased equity value of entity they owned because such amount was not "quantifiable").

type of inaccessible and unquantifiable allegation of benefit that courts have deemed insufficient to trigger liability under Section 550(a)(1).

Receipt of Merger Consideration (Transfer "Beneficiary" Theory #2). Alternatively, the Complaint alleges that the Shareholder Defendants benefitted from the October 13 Transfer because that transfer was a precondition to them receiving eventual merger consideration from Amex. Compl. ¶ 333; *see also id.* ¶¶ 251, 273 (alleging October 13 Transfer was made from Kabbage to Alpha Kabbage, so that Alpha Kabbage could enter into a transaction pursuant to which it merged with and into a separate subsidiary, so that Amex could purchase the transferred assets, so that Amex could then pay the Shareholder Defendants). This is an indirect benefit at best, and indirect benefits "do not transmogrify shareholders into transfer beneficiaries." *Alta Mesa*, 2024 WL 4379801, at *5; *see also Bonded Fin. Servs., Inc. v. Eur. Am. Bank*, 838 F.2d 890, 896 (7th Cir. 1988) ("Someone who receives the money later on is not an entity for whose benefit such transfer was made; only a person who receives a benefit from the initial transfer is within [§ 550(a)(1)].") (cleaned up); *Weiss v. Arabella Expl. Inc.* (*In re Arabella Petroleum Co.*), 647 B.R. 851, 872 (Bankr. W.D. Tex. 2022) (noting that plaintiff could not prove defendant was a transfer beneficiary because he received indirect benefits as a shareholder); *Bodenstein v. Univ. of N. Iowa* (*In re Peregrine Fin. Grp., Inc.*), 589 B.R. 360, 380 (Bankr. N.D. Ill. 2018) (defendant must benefit "as soon as the transfer is made").

B. The October 13 Transfer Is Not Avoidable Because It Was Made Pursuant To A Valid Contractual Obligation

Even if Plaintiff were able to recover against non-transferee minority shareholders under the theory that they were "beneficiaries" under Section 550(a)(1), and it cannot, Plaintiff's fraudulent transfer claims are foreclosed by the fact that there was no avoidable transfer in the first place. The Complaint alleges that Kabbage effectuated the October 13 Transfer as a ***required***

condition of the Merger Agreement entered into on August 16, 2020. Compl. ¶¶ 250–51, 254–55. To state a claim for constructive fraudulent transfer, the Complaint must allege that Kabbage received less than reasonably equivalent value in exchange for the transfer. *See* 11 U.S.C. § 548(a)(1)(B)(i). And to state a claim for intentional fraudulent transfer, the Complaint must allege—either through direct evidence or badges of fraud—that the Debtor made the transfer with an actual intent to hinder, delay, or defraud creditors. *See* 11 U.S.C. § 548(a)(1)(A). As set forth below, the Merger Agreement precludes avoidance of the October 13 Transfer under either theory.

Here, there is no question that the Merger Agreement was an enforceable obligation. Compl. ¶ 251. Plaintiff does not seek to avoid the Merger Agreement's obligation to effectuate the October 13 Transfer.[63] Moreover, the Merger Agreement did not afford Kabbage any voluntary termination rights; after it was executed on August 16, Kabbage was obligated to close the Merger pursuant to the Agreement's terms.[64] Had Kabbage declined to effectuate the October 13 Transfer—or to take any other step required to effectuate the multi-step Merger, *see* Compl. ¶ 251—Amex had the right to sue Kabbage for specific performance, *see* J.A. Ex. 42 at A00532 (Merger Agreement § 9.10), and damages, *id.* at A00513 (§ 7.2), arising out of Kabbage's breach.

Thus, by completing the Merger and its attendant steps, Kabbage satisfied an antecedent contractual obligation, which constitutes reasonably equivalent value and obviates Plaintiff's constructive fraudulent transfer claim. *See, e.g.*, 11 U.S.C. § 548(d)(2)(A) (defining "value" to include

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[63] By contrast, in its litigation with Amex, Plaintiff does seek to avoid other obligations that Kabbage incurred in connection with the Merger Agreement. *See* Original Compl. ¶¶ 265–69, 277–83, *KServicing Wind Down Corp. v. Am. Express Kabbage Inc.* (*In re KServicing Wind Down Corp.*), Adv. Pro. No. 25-52371 (Bankr. D. Del. Oct. 16, 2025), D.I. 1 (seeking to avoid Kabbage's indemnification obligations in Merger Agreement as fraudulent).

[64] The Agreement provided for a limited set of conditions constituting cause not to close, J.A. Ex. 42 at A00512 (Merger Agmt. § 7.1), none of which the Complaint alleges occurred.

"satisfaction … of a present or antecedent debt of the debtor"); *Gellert v. Coltec Indus., Inc.* (*In re Crucible Materials Corp.*), 2012 WL 5360945, at *8 (Bankr. D. Del. Oct. 31, 2012) (no constructive fraudulent transfer claim where it was "clear that the payments were made in exchange for reasonably equivalent value because they were made to pay an obligation assumed" under a purchase agreement); *Pardo v. Gonzaba* (*In re APF Co.*), 308 B.R. 183, 187 (Bankr. D. Del. 2004) (no constructive fraudulent transfer where transfers made pursuant to promissory note because payments pursuant to enforceable note obligation satisfied antecedent debt);[65] *Barber v. Golden Seed Co.*, 129 F.3d 382, 388–89 (7th Cir. 1997) (affirming ruling that satisfaction of obligations performed pursuant to contract constitutes reasonably equivalent value); *Sender v. Dutton* (*In re Clark*), 619 B.R. 1, 5–6 (Bankr. D. Colo. 2020) (where contract "created a legally enforceable obligation on the Debtor's part to transfer his entire interest in the Property to the Defendant" and "the Debtor satisfied this pre-existing obligation," cancellation of the obligation constituted "'reasonably equivalent value' in exchange for the transfer under § 548(d)(2)"); *Goodman v. H.I.G. Cap., LLC* (*In re Gulf Fleet Holdings, Inc.*), 491 B.R. 747, 766 (Bankr. W.D. La. 2013) (dismissing trustee's fraudulent transfer claims because "[b]y definition, [debtor] received reasonably equivalent value from the satisfaction of its contractual obligations"); *Kaye v. Nath* (*In re Duke & King Acquisition Corp.*), 508 B.R. 107, 148 (Bankr. D. Minn. 2014) (satisfaction of contractual obligations conferred reasonably equivalent value where contract imposed a duty that "created a debt in the sense of the Bankruptcy Code, 11 U.S.C. §§ 101(5)(A) and (12)" because payments made to satisfy that debt "abated the contractual liability dollar-for-dollar").

[65] In *APF*, the parties argued that satisfaction of an antecedent debt for reasonably equivalent value necessitated dismissal only of the constructive fraudulent transfer claim and, as such, the court held that the intentional fraudulent transfer claim survived. 308 B.R. at 187.

Nor is the October 13 Transfer an intentional fraudulent transfer. Instead of being made with an intent to "hinder, delay, or defraud creditors," the October 13 Transfer had a legitimate business purpose: to fulfill binding contractual obligations that it owed ***to*** a third party—Amex.[66] *See Maxus Liquidating Tr. v. YPF S.A.* (*In re Maxus Energy Corp.*), 641 B.R. 467, 527 (Bankr. D. Del. 2022) (noting evidence of a legitimate business purpose for a transaction—*i.e.*, a purpose other than an intent to hinder, delay, or defraud—can rebut the implication of fraudulent intent). Satisfaction of an antecedent obligation may sometimes constitute a preference, but fulfilling an obligation set forth in a valid arm's length contract cannot give rise to a claim for actual fraudulent transfer. *See Fedders*, 405 B.R. at 545–46 (dismissing debtor's actual fraudulent transfer claim seeking to avoid security interest and fees transferred to lenders pursuant to arm's length credit agreements); *B.E.L.T., Inc. v. Wachovia Corp.*, 403 F.3d 474, 477 (7th Cir. 2005) (Easterbrook, J.) ("a preference among creditors," absent insider dealing, is not a fraudulent conveyance); *cf. Sharp Int'l Corp. v. State St. Bank & Tr. Co.* (*In re Sharp Int'l. Corp.*), 403 F.3d 43, 56 (2d Cir. 2005) (under New York fraudulent conveyance law, a "payment was at most a preference between creditors and did not 'hinder, delay, or defraud either present or future creditors'"); *id.* at 54 ("A conveyance which satisfies an antecedent debt made while the debtor is insolvent is neither fraudulent nor otherwise improper, even if its effect is to prefer one creditor over another."); *see also Gulf Fleet Holdings*, 491 B.R. at 767 (dismissing actual fraudulent transfer claims where transfers "satisfied an antecedent debt" even where trustee pled facts showing transfers were made to an insider and debtor was insolvent); *Leslie v. Hancock Cap. Partners II, L.P.* (*In re Fitness Holdings Int'l, Inc.*), 660 F. App'x 546, 548 (9th Cir. 2016) (dismissing "actual fraudulent conveyance" claim

[66] *See* 11 U.S.C. § 101(10)(A) (defining "creditor" as any party with "claim" against debtor); *id.* § 101(5) (defining "claim" as any right to payment or right to an equitable remedy for breach of performance, regardless of whether those rights are contingent, unmatured, or disputed).

"because the [t]rustee failed to demonstrate that the [t]ransfer was not applied to a valid, antecedent debt").[67] Kabbage entered into a Merger Agreement in August 2020 with Amex, an arm's length third party. Compl. ¶¶ 73, 255. When Kabbage closed on the Merger in October, it did so with the intent to comply with its binding contractual obligations—not to hinder, delay, or defraud its creditors.

Count IV must be dismissed.

IV. PLAINTIFF'S CLAIMS TO DISALLOW OR SUBORDINATE THE D&O DEFENDANTS' INDEMNIFICATION CLAIMS SHOULD BE DISMISSED (COUNTS V–VII)

Finally, the Complaint seeks to disallow the claims of "all Defendants" under Section 502(d) of the Bankruptcy Code, *see* Compl. ¶¶ 350–60, and the D&O Defendants under Section 502(e), *id.* ¶¶ 338–49, and further seeks to equitably subordinate "all Defendants'" claims under Section 510(c), *id.* ¶¶ 361–65. These claims should be dismissed along with the rest of the Complaint.

A. The Complaint's Section 502(d) Disallowance Claims Fail (Count VI)

Section 502(d) provides that courts "shall disallow any claim of any entity from which property is recoverable" on account of a fraudulent transfer, unless the entity has returned such property to the estate. To survive a motion to dismiss, Plaintiff must allege facts establishing (1) an avoidable transfer occurred, and (2) the defendant from whom property is recoverable has not satisfied its liability. *See* 11 U.S.C. § 502(d).

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[67] *See also* Emil A. Kleinhaus & Alexander B. Lees, *Debt Repayments as Fraudulent Transfers*, 88 Am. Bankr. L.J. 307, 310 (2014) ("[A] principle that emerges from a long line of decisions is that a debtor's intent to 'prefer' one creditor over another is fundamentally different from the intent to 'hinder, delay, or defraud' that is required by the fraudulent transfer statutes.").

Plaintiff's Section 502(d) disallowance claims (asserted in Count VI against "all Defendants," Compl. ¶¶ 350–60) must be dismissed for three reasons: (1) the Complaint fails to plead that an avoidable transfer occurred, § III.B, above;[68] (2) even if the Complaint did state a fraudulent transfer claim, which it does not, the Complaint fails to state a claim to recover that transfer from the Shareholder Defendants as "beneficiaries," § III.A, above;[69] and (3) even if the Complaint stated a fraudulent transfer claim against the Shareholder Defendants, which it does not, Count VI must be dismissed against all remaining defendants who either (a) are not alleged to be beneficiaries of a fraudulent transfer (*i.e.*, Butler, Ebinger, and Stolle), and thus from whom the property cannot be recovered, or (b) did not file proofs of claim against the Debtor (*i.e.*, Bennu, BlueRun, BRV, Curieux, FFT, MDV, RJ RIRA, and Thomvest).

B. The Complaint's Section 502(e) Disallowance Claims Fail (Count V)

The preamble to Section 502(e)(1) provides that "the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor." In other words, the two threshold requirements for disallowance under Section 502(e)(1) are that: (1) the claim must be for reimbursement or contribution, and (2) the entity filing the claim (here, the D&O Defendants) must be co-liable with the debtor on a separate creditor's claim (or must have secured that separate creditor's claim).[70] These requirements fulfill the basic

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[68] *See Swift v. Halimi* (*In re CL H Winddown LLC*), 2023 WL 5740195, at *4 (Bankr. D. Del. Sep. 5, 2023) (dismissing Section 502(d) claims where fraudulent transfer and preference claims dismissed).

[69] *See also* 11 U.S.C. § 502(d) (disallowing only claims of "entity from which property is recoverable").

[70] *See In re Touch Am. Holdings, Inc.*, 409 B.R. 712, 715–16 (Bankr. D. Del. 2009) ("To achieve disallowance of a claim under Bankruptcy Code § 502(e)(1)(B), [plaintiff] must prove three elements: (i) the claim must be contingent, (ii) the claim must be for reimbursement or contribution, and (iii) the debtor and the claimant must be co-liable on the claim."). Although the

purpose of Section 502(e)(1) by disallowing the "double payment by the estate"[71] that would occur if the Bankruptcy Code permitted Creditor A to have a valid claim against the debtor, while also allowing Creditor B (who was co-liable with the debtor on Creditor A's claim) to file *another* claim against the debtor to obtain reimbursement or indemnification in connection with Creditor B's payments to Creditor A.

Those are not the facts alleged here, and as such, the Complaint does not even attempt to allege the co-liability or security relationship that is the foundation of Section 502(e) disallowance. Count V's only allegations are that creditors (including the D&O Defendants) filed proofs of claim and that the Plan rejected certain Debtor obligations to its former directors and officers. *See* Compl. ¶¶ 339–47.[72] Absent allegations that the D&O Defendants are co-liable with the debtor on another creditor's claim, or that they have secured a third party's claim, Count V must be dismissed.[73]

Complaint does not plead sufficient facts to put the D&O Defendants on notice of which subsection of Section 502(e) it seeks to rely, it appears that Plaintiff may be attempting to state a claim under Section 502(e)(1)(B). *See* Compl. ¶ 348.

[71] *Touch America*, 409 B.R. at 719; *see also* H.R. Rep. No. 95-595, at 354 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6310 (Section 502(e)(1) "prevent[s] competition between a creditor and his guarantor for the limited proceeds in the estate").

[72] The only other assertion in Count V simply parrots the language of section 502(e)(1)(B). *See* Compl. ¶ 348 (alleging claims "are disallowed to the extent that they are 'contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution'").

[73] Nor could the Complaint plead these facts. With the bankruptcy case closed, Plaintiff could not argue now for the first time that the D&O Defendants somehow "secured the claim of a creditor." 11 U.S.C. § 502(e)(1). Likewise, the Debtor and the D&O Defendants could not be co-liable on the D&O Defendants' claims or defense costs. *See, e.g.*, *In re Wedtech Corp.*, 85 B.R. 285, 290 (Bankr. S.D.N.Y. 1988) (debtor "obviously cannot be co-liable with [defendants] on the causes of action asserted in adversarial proceedings brought by [itself]").

C. The Complaint's Section 510(c) Equitable Subordination Claims Fail (Count VII)

To prevail on an equitable subordination claim under Bankruptcy Code Section 510(c), Plaintiff must establish: (1) the claimant engaged in inequitable conduct; (2) that misconduct caused injury to the debtors' creditors; and (3) subordination is consistent with the Bankruptcy Code. *United States v. State St. Bank & Tr. Co.*, 520 B.R. 29, 80 (Bankr. D. Del. 2014).

The Complaint's allegations—which merely allege that "Defendants' claims should be equitably subordinated" because they are liable for breach of fiduciary duty and/or fraudulent transfer, *see* Compl. ¶¶ 362, 365—are insufficient to invoke this "drastic and unusual remedy." *Tilton v. MBIA Inc.* (*In re Zohar III, Corp.*), 639 B.R. 73, 90 (Bankr. D. Del. 2022), *aff'd*, 620 F. Supp. 3d 147 (D. Del. 2022) (citation modified). *First*, the equitable subordination claims must be dismissed because the Complaint fails to state fiduciary duty claims against the D&O Defendants, §§ I & II, above, or fraudulent transfer claims against the Shareholder Defendants, § III, above. *See Gowan v. Wachovia Bank, N.A.* (*In re Dreier LLP*), 453 B.R. 499, 517 (Bankr. S.D.N.Y. 2011) (holding that where "Trustee has withdrawn or the Court has dismissed all of the substantive claims … it follows that the allegations do not support equitable subordination"). *Second*, the equitable subordination claims must be dismissed against the Shareholder Defendants because, even if the Complaint's allegations were true, (1) receiving a fraudulent transfer (or an indirect "benefit" from a fraudulent transfer) is insufficient to warrant equitable subordination, and (2) the Complaint does not allege the Shareholder Defendants (who were all minority shareholders) were "insiders." *See Duke & King*, 508 B.R. at 154 (receipt of fraudulent transfer does not evince "pervasively-tainted conduct" necessary to warrant equitable subordination); *Picard v. Merkin* (*In re Bernard L. Madoff Inv. Sec. LLC*), 515 B.R. 117, 158 (Bankr. S.D.N.Y. 2014) (pleading equitable subordination against non-insider requires "'gross and egregious' conduct 'tantamount to fraud,

misrepresentation, overreaching or spoliation'" (citation omitted)). *Third*, the equitable subordination claims against Bennu, Curieux, BlueRun, BRV, FFT, MDV, RJ RIRA, and Thomvest must be dismissed because the Complaint does not allege that any of these entities filed claims that could be subordinated.[74]

CONCLUSION

For the foregoing reasons, the D&O and Shareholder Defendants respectfully request that the Court dismiss Plaintiff's Complaint with prejudice.

Respectfully submitted,

COZEN O'CONNOR

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[74] To the extent any disallowance claims are not dismissed, then the equitable subordination claims must be dismissed as duplicative of surviving disallowance claims. *See Dreier*, 453 B.R. at 517 (dismissing claim for equitable subordination under section 510(c) where proving fraudulent transfer would lead to disallowance under section 502(d), because disallowance "provides broader relief").

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