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Citibank Loan 'Blunder' Ruling Raises Appellate Issues

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On Feb. 16, Judge Jesse M. Furman of the U.S. District Court for the Southern District of New York held that Citibank NA is not entitled to recover approximately $500 million of its own money accidentally sent to Revlon Inc.'s lenders in "one of the biggest blunders in banking history."[1]

The order has sent shockwaves through the syndicated loan industry. So far, most commentators have focused on the court's detailed factual findings, including explicit witness credibility findings, and concluded that the order is likely to survive appeal because of the significant deference appellate courts give such determinations.

That analysis, however, glosses over important, and potentially outcome-determinative, legal issues that will likely be reviewed by an appellate court without deference to the district court's conclusions.

Background

In 2016, Revlon entered into a $1.8 billion syndicated loan scheduled to mature in September 2023. On Aug. 11, 2020, Revlon directed Citibank, which was then acting as administrative agent for the loan, to execute a roll-up transaction with certain lenders that involved payment of accrued interest to all lenders. Citibank mistakenly issued a full repayment of the $894 million loan principal in addition to the $7.8 million in interest that it intended to issue.[2]

It is undisputed that Citibank made the payment in error, using its own funds. At the time, Revlon debt was trading for between 20 and 30 cents on the dollar. Within 24 hours, Citibank notified the recipients of the mistake and requested the funds' return. Some lenders returned approximately $400 million. Approximately a week after making the mistaken payment, Citibank sued the non-complying lenders to recover the remaining $500 million. Moving quickly, Judge Furman conducted a virtual bench trial in December 2020.[3]

The Court's Holding That Citibank Cannot Recoup its Accidental Payment

In a 101-page decision, Judge Furman held that the defendants did not have to return the funds. The court's holding is based entirely on the "discharge-for-value" affirmative defense. The "classic formulation of the discharge-for-value defense" from American Law Institute treatise "Restatement (First) of Restitution" provides:

> A creditor of another ... who has received from a third person any benefit in discharge of the debt ... is under no duty to make restitution therefor, although the discharge was given by mistake of the transferor ..., if the transferee made no misrepresentation and did not have notice of the transferor's mistake.[4]

All agreed that the New York Court of Appeals 1991 decision in Banque Worms v. Bank America International sets forth "the governing standards for the defense under New York law."[5]

In Banque Worms, a bank mistakenly transferred nearly $2 million dollars to a creditor's agent. Unlike with Revlon, the underlying loan had matured on the date of the payment. Approximately two hours later, the bank notified the recipient that the funds were sent in error.

Based on the discharge-for-value rule, the district court held that the defendant did not have to return the mistakenly transferred funds.[6]

On appeal, the U.S. Court of Appeals for the Second Circuit certified to the New York Court of Appeals the question whether "New York would apply the 'Discharge for Value' rule as set forth at Section 14 of the Restatement of Restitution" or would instead "apply the rule that holds that money paid under a mistake may be recovered, unless the payment has caused such a change in the position of the receiving party that it would be unjust to require the party to refund."[7]

The New York Court of Appeals held that "the 'discharge for value' rule ... should be applied in the circumstances of this case,"[8] after which the Second Circuit ruled that Banque Worms was "entitled to retain the mistakenly transferred funds."[9]

In the present case, the court agreed with the defendants that Banque Worms entitles them to keep Citibank's money.[10]

The Standard of Appellate Review

Although findings of fact may only be overturned on the basis of clear error, the district court's conclusions of law are reviewed de novo on appeal.[11]

Notwithstanding the multiple references to witness credibility and demeanor in the order,[12] mixed questions of fact and law — such as whether a party has constructive knowledge — are similarly reviewed under a de novo standard.[13] And of course, appellate courts can, and sometimes do, reverse factual findings where appropriate.[14]

Potential Legal Issues on Appeal

On appeal, the order will be subject to de novo review regarding several legal questions, including whether the discharge-for-value defense applies to not-yet-matured debt and when knowledge of mistake should be measured.

An appellate court could also reach a different conclusion as to whether the defendants had constructive knowledge that the payment was a mistake, without altering any of the court's factual findings.

Whether a Debt Needs to be Due

If an appellate court finds that, as Citibank argued, the discharge-for-value defense only applies when a debt is due, the defense would not apply here.[15]

In rejecting Citibank's argument,[16] the court held that Banque Worms "appear[s] to focus on the recipient's status as a bona fide creditor that 'entitles' it to the funds at issue, not on when the transfer occurred in relation to the payment schedule."[17]

However, the Banque Worms decisions did not expressly decide this issue — because the debt in Banque Worms was due when the payment was made — and the court here could easily be reversed by an appellate court given the absence of controlling authority.[18]

An appellate court could find that, as a matter of policy, it is reasonable for a recipient who receives a payment when it is due to conclude that the payment cannot have been a mistake, yet not reasonable for a recipient who receives a payment months or years before it is due, as was the case here, to reach the same conclusion.

Indeed, the rule as articulated in the order would seem to allow a creditor to keep any mistaken payment received at any time in any amount so long as it were for an amount no more than the total debt.

Whether the Mistake Need Be Known at the Moment of Receipt

An appellate court could also disagree with the court's legal conclusion that that the discharge-for-value defense applies so long as the recipient did not know the payment was a mistake at the moment the money is received, which could also prove to be outcome determinative.[19]

An appellate court might accept Citibank's argument that the relevant point in time for assessing knowledge is when the debt is discharged, i.e., when "the funds are applied to credit the debtor's account."[20] As the order acknowledged, the discharge-for-value defense is simply a "specific application" of "the bona fide purchaser rule" and without a discharge, no value has been provided.[21]

An appellate court could also set aside the judgment if it held that the moment the evaluation is properly done is when the recipient — or person with relevant authority at the recipient — first knows about the payment.

The appellate court could reason that it would seem impossible, or virtually so, for someone to know that a payment is a mistake before they even know the payment exists. For a corporate entity, this would at least arguably mean that the relevant measuring point is when knowledge of the payment is received by a person with responsibility for the loan.[22]

Under this potential legal framework, there may even be sufficient factual findings in the order for an appellate court to conclude that some defendants knew the payment was a mistake by the time they knew about the payment.

For example, some defendants "first learned of the payments upon receiving [Citibank's] Recall Notice."[23] While the order finds that certain of the defendants' employees may not have immediately recognized the payment as an obvious mistake,[24] an appellate court could reason that these appear to be more junior employees responsible for administering payments who would not necessarily be in a position to appreciate the clearly erroneous nature of the payment.[25]

An appellate court may likewise be concerned about the broader consequences of a rule that seemingly precludes the return of even an obvious "fat finger" accidental payment sent by wire, e.g., sending $1 million when $100,000 is due; even an obvious mistake may only be obvious when compared by a person with relevant knowledge to other information post-receipt, such as the size and timing of the expected payment.[26]

Defendants' Constructive Knowledge

One of the few issues where the court ruled in Citibank's favor is that constructive knowledge can be sufficient to defeat the discharge-for-value defense.[27] Under the restatement treatise, this is an objective standard based on what a reasonable person should have concluded.[28]

Even though the court found constructive knowledge could be sufficient to defeat the application of the discharge-for-value defense, much of the order focuses on the actual subjective knowledge of the defendants after the payment was made, all of which an appellate court could deem irrelevant.[29]

An appellate court evaluates constructive knowledge on a de novo basis and could simply disagree with the court about what a reasonable person should have concluded based on the facts found to be true in the order.[30]

For example, the following facts were all found to be true:

- The money was not due yet and there was no clear reason why Revlon would pay hundreds of millions of dollars that it did not yet owe.[31]
- There was no notice of prepayment, as required by the agreement.[32]
- The calculation statements sent in advance of the payment referred only to an interest payment and did not say anything about a principal payment.[33]
- The amount of the payment was more money than Revlon had. In fact, Revlon's debt was trading at 20 to 30 cents on the dollar. The defendants not only knew that, they had authorized the filing of a lawsuit contending Revlon was insolvent.[34]
- The lenders were sophisticated parties on the eve of commencing a lawsuit seeking to accelerate payment of the loans.[35]

An appellate court would also be within its rights to substitute its judgement as to the significance of potential indicia of mistake.[36] Indeed, the idea that Revlon made a massive and unexpected prepayment on debt not due for years, without any advance notice or consideration, is arguably just as implausible as receiving a payment many multiples of what is owed, which the court acknowledged would constitute constructive notice.[37]

Unlike Banque Worms, where there was no indicia of mistake, an appellate court may conclude that these facts demonstrate constructive knowledge of mistake even though the payment matched the outstanding principal, which the court relied on to distinguish this payment from other constructive knowledge cases.[38]

In the face of these objective facts, one could also ask what difference it should make in the constructive knowledge analysis that a recipient of unexpected funds swears up and down on the witness stand that he couldn't imagine that the erroneous payment was a mistake.

Other findings by Judge Furman that appear potentially vulnerable on appeal are the following:

- The court concluded that it is not uncommon in the industry for payment notices to be split between interest and principal portions, in an effort to explain why the defendants were not on notice of a mistake when they received a notice referring to interest payments only, not of a principal payment.[39] An appellate court could put more weight on the fact that, here, there was no "split" notice, but instead a single notice that referred exclusively to interest.

- Likewise, the court held that the absence of a prepayment notice is not controlling because banks sometimes forget to send them or they come late.[40] But an appellate court might focus on the fact that, because the agreement plainly calls for prepayment notices and there was a prepayment without notice, there necessarily was some mistake. An appellate court could conclude that a reasonable person in these circumstances would at least have asked Citibank whether the mistake was a missing notice or an inadvertent payment.

- The court held that it would be unreasonable to assume the payment was a mistake because some defendants testified that they believed Revlon's sponsor, Ronald Perelman and his holding company MacAndrews & Forbes Inc. may have paid Revlon's debt in full in order to prevent the defendants from filing an imminent lawsuit.[41] An appellate court may instead put more weight on facts pointing away from what would have been, in effect, a settlement payment by Perelman — such as the fact that the full amount claimed was paid, with no notice, no discussion of settlement, no release, and no settlement agreement.

- The court held that it would be unreasonable and irrational to assume the payment was a mistake because a mistaken payment of this magnitude was a black swan event that, while possible, had not previously occurred.[42] However, the order also credits testimony from a defense witness that believed Revlon had pulled a "rabbit out of their hat" in securing alternate financing.[43] An appellate court may simply have a different view as to which "unlikely-but-possible" event is the most credible inference, especially where other lenders appear to have reached a different conclusion and returned $400 million to Citibank.[44]

- The court holding that the lenders' satisfied their duty of inquiry without contacting Citibank[45] could be deemed erroneous as a matter of law. An appellate court could conclude that for someone on constructive notice of a possible mistake to conduct an inquiry in good faith, the most logical step would be to contact the payor to confirm the payment was intended and the fact that the defendants did not do so supports an inference that they did not want to confirm what they suspected: that the payment was made in error.

In sum, there are many critical issues on which an appellate court would not owe the district court's order deference and which, depending on how it resolves those issues, could lead it to direct the lenders to return the erroneous payment to Citibank.

In the meantime, while appellate courts sort through these issues, banks and other administrative agents would be well served to strengthen their controls over disbursements to avoid losing funds in mistaken transfers.[46]

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[1] In re Citibank August 11, 2020 Wire Transfers, No. 20-CV-6539 (JMF), 2021 WL 606167, at 99 (S.D.N.Y. Feb. 16, 2021) (the "Order") at 3-4.

[2] Order at 4-6, 9-10, 12-15.

[3] Id. at 2, 5 n.5, 18-19, 27-28, 76, 89-90; see also Citibank's Proposed Findings of Fact and Conclusions of Law, No. 1:20-cv-06539-JMF, (S.D.N.Y 2020), ECF No. 143 at 47.

[4] Order at 36, 99-100,

[5] Id. at 37 (citing Banque Worms v. BankAmerica Int'l, 77 N.Y.2d 362, 368 (1991)).

[6] Banque Worms v. Bank Am. Int'l, 726 F. Supp. 940, 940-942 (S.D.N.Y. 1989).

[7] Banque Worms v. BankAmerica Int'l, 77 N.Y.2d 362, 366 (1991).

[8] Id.

[9] Banque Worms v. BankAmerica Int'l, 928 F.2d 538, 541 (2d Cir. 1991).

[10] Order at 99.

[11] Rose v. AmSouth Bank of Florida, 391 F.3d 63, 65 (2d Cir. 2004).

[12] See Order at 3, 65-66, 76, 86 n.38, 93.

[13] Diebold Found., Inc. v. Comm'r, 736 F.3d 172, 187 (2d Cir. 2013); White v. White Rose Food, 237 F. 3d 174, 178 (2d Cir. 2001).

[14] DiRienzo v. Philip Servs. Corp., 294 F.3d 21, 31 (2d Cir. 2002) (reversing factual finding as "clearly erroneous" based on factual allegations the trial court order "fail[ed] to acknowledge"); Parker v. Sony Pictures Ent., Inc., 260 F.3d 100, 112 (2d Cir. 2001) (reversing factual findings post-trial).

[15] The court held that "it is undisputed that the 2016 Term Loan was not 'due' on August 11, 2020;

indeed, the loan was not set to mature for another three years." Order at 43.

[16] Citibank relied primarily on language in a 1915 New York Court of Appeals decision Carlisle v. Norris, which was in turn quoted by the New York Court of Appeals in Banque Worms, that "[i]f defendants received the proceeds in good faith and without notice of any wrong and credited them on an indebtedness due them, plaintiff is not entitled to recover them back." Carlisle v. Norris, 109 N.E. 564, 569 (N.Y. 1915) (emphasis added).

[17] Order at 44.

[18] The Order relied primarily on The Restatement (First) of Restitution in rejecting Citibank's argument. Order at 44.

[19] Id. at 47-48.

[20] Id. at 46-47 (internal quotation and punctuation marks omitted).

[21] Id. at 60-61. In many cases, a prepayment can only be made under certain conditions. This reinforces the notion that the relevant time period should be the moment of receipt only when the underlying debt is due as that payment automatically discharges a debt, which is not necessarily true for an early prepayment.

[22] See 14A N.Y. Jur. 2d Business Relationships § 677 ("[A] corporation is bound by the knowledge acquired by, or notice given to, its officers or agents which is within the actual or apparent scope of their authority or employment and which relates to a matter to which their authority or employment extends.").

[23] Order at 23; see also, e.g., id. at 20 ("There are currently no agent notices for this ... could this be a mistake?"); id. at 23 ("don't invest [the money received] by accident").

[24] Id. at 71-72.

[25] An appellate court could also be concerned that the Order seems to punish Citibank for working quickly, holding it against the bank that there was only very limited evidence that recipients knew the payment was a mistake before Citibank's recall notice. Id. at 75. An alternate possible conclusion seemingly consistent with the court's factual findings is that the more senior people in a position to appreciate the erroneous nature of the payment did not even learn of the payment's existence until after Citibank was already seeking to recall the money.

[26] Id. at 66, 87 (discussing how a "fat finger" mistake is "is obvious on its face" and "would have been immediately obvious to any recipient").

[27] Id. at 57.

[28] Restatement (Third) of Restitution and Unjust Enrichment § 69 (2), (3(c)) (2011) ("A person has notice of a fact if the person ... has reason to know it" meaning "other facts known to the person would make it reasonable to infer the existence of the fact, or prudent to conduct further inquiry that would reveal it.").

[29] Order at 54-64.

[30] Diebold Found., Inc. v. Comm'r, 736 F.3d 172, 187 ("[W]e review de novo the ... Court's determination that the Shareholders did not have constructive knowledge, but review for clear error the factual findings that underpin the determination"); Albee Tomato, Inc. v. A.B. Shalom Produce Corp., 155 F.3d 612, 616-17 (2d Cir. 1998) (reversing summary judgment order based on improper weighing of evidence regarding constructive notice).

[31] Order at 5-7.

[32] Id. at 85.

[33] Id. at 82.

[34] Id. at 26, 76, 89-90; see also Citibank's Proposed Findings of Fact and Conclusions of Law, No. 1:20-cv-06539-JMF, (S.D.N.Y 2020), ECF No. 143 at 47.

[35] Order at 89-93.

[36] Monteleone v. Bahama Cruise Line, Inc., 838 F.2d 63, 66 (2d Cir. 1988) (accepting district court's finding of fact as not clearly erroneous but holding the facts did not demonstrate constructive notice).

[37] Order at 87 (A "misplaced decimal point or double payment" would be "immediately obvious to any recipient").

[38] Id. at 89 (distinguishing this case from others where the mistaken payment "'substantially exceeded' the size of the outstanding debt").

[39] Id. at 81.

[40] Id. at 82-84.

[41] Id. at 89-93.

[42] Id. at 69.

[43] Id. at 91.

[44] Id. at 5 n.5. An appellate court may not put much weight on the fact that the size of the mistaken payment was large, id. at 86-87, concluding that that is just a function of large financial institutions transacting in large payments.

[45] Id. at 78 ("[E]ven assuming arguendo that there were sufficient red flags to trigger a duty of inquiry, it does not follow ... that that inquiry would have taken the form of contacting the bank to confirm whether the payments were intentional.").

[46] In the wake of this decision, parties have also been adding contractual provisions to credit agreements whereby lenders agree to waive the discharge-for-valued defense and return any mistaken payments. This is also a prudent step for banks and other administrative agents to take.