

# The Return of Normalcy – Second Circuit Reverses Lower Court Decision Regarding Erroneous Payments in Revlon Case

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On September 8, 2022, the United States Court of Appeals For The Second Circuit (the “*Second Circuit*”) reversed a lower court ruling in *In re Citibank* (known colloquially as, “*The Revlon Case*”), regarding the return of erroneous payments made by an administrative agent to members of a lending syndicate. The court’s holding, that, in effect, the recipients of these erroneous payments were not entitled to retain such payments and therefore must return them to the agent, effectively reverts back to standard practices in the syndicated loan market that were in effect for many years prior to the lower court’s ruling (which was criticized by many market participants) in 2020. The 2020 ruling gave rise to the promulgation of “erroneous payment provisions” that have since become standard in syndicated loan agreements so as to provide protections in contract to agents and other parties making such erroneous payments.

It is standard in syndicated loan agreements for many types of payments to and from the borrowers and the syndicated lenders to be managed through an administrative agent. From time to time, payments have been sent to the various parties by the agent in error. Traditionally, the syndicated lending industry followed a common-sense approach in handling such mistakenly received payments. The party receiving the payments would promptly return them to the payor, which was consistent with the “traditional rule” under New York law which, with some exceptions, disallowed retention of funds to which the party was not entitled at the time they were paid.

Everything changed, however, regarding the return of erroneous payments in late 2020 when the lower court in *The Revlon Case* ruled that lender defendants could keep funds mistakenly advanced by Citibank as administrative agent under the so-called “discharge for value” exception to the traditional rule requiring their return advanced by the New York Court of Appeals in the prior case *Banque Worms v. BankAmerica International*. Under the facts of *The Revlon Case*, Citibank, as agent under a \$1.8 billion syndicated loan to Revlon, had intended to transfer payment of accrued interest on the loan, but in error instead “caused the unwitting transfer by wire of Citibank’s funds in the full amount of Revlon’s outstanding principal balance, three years before Revlon’s loan repayment was due...” and at a time when Revlon’s debt was selling at a deep discount to par because of Revlon’s deteriorating financial position. While some recipients of the erroneous payments of almost \$1 billion in aggregate returned them in accordance with industry custom at the time, others did not, and Citibank sued to regain the funds it had disbursed in error.

The lower court holding in *The Revlon Case*, which based its decision on the discharge for value exception, stated “[w]hen a beneficiary receives money to which it is entitled and has no knowledge that the money was erroneously wired, the beneficiary should not have to wonder whether it may retain the funds...” Accordingly, to the surprise of many, the court held that the parties receiving the funds could keep them. This holding created a seismic rift in the syndicated lending market, reversing decades of prior practice and requiring the preparation of erroneous payment provisions in syndicated credit agreements to protect agents under similar future circumstances.

The Second Circuit's recent ruling on appeal in *The Revlon Case*, however, rejected the discharge for value exception stating that it would not be applicable where the payee had constructive notice that the payment was made in error and the portion of the funds attributable to principal were not then due and payable. The court held that based on certain facts available to the payees on the transfer date, including the absence of prior notice of prepayment from Citibank, the deteriorating financial position of Revlon and Revlon's prior attempts to negotiate with its lenders to avoid an acceleration of the loan, the payees would have had, upon receiving the funds in excess of the amount expected, a duty to inquire as to whether the payments were proper before being able to rely on the discharge for value exception. As the opinion stated, "[t]he facts were sufficiently troublesome that a reasonably prudent investor would have made reasonable inquiry, and reasonable inquiry would have revealed the payment was made in error." As a result, the court determined that Citibank is entitled to a return of its funds.

It is unclear whether the payees will further appeal the decision of The Second Circuit, but at present the holding in *The Revlon Case* brings the practice of dealing with erroneous payments under New York law full circle to pre-2000 norms. Whether the erroneous payment provisions will continue as mainstays in syndicated credit agreements remains to be seen, but in the aftermath of this decision syndicated loan agents may rest easier that their liability for erroneous payments has been significantly narrowed. If the recipient of an erroneous payment knew or should have known that the payment was made in error, it will likely need to be returned.