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Revlon erroneous payment decision reversed on appeal

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On September 8, 2022, the United States Court of Appeals for the Second Circuit reversed and remanded a ruling by the Southern District of New York that had allowed lenders to reap the benefits of Citibank's $1 billion mistake.

What you need to know

In August 2020, acting as agent under the $2 billion Revlon credit facility, Citibank intended to transfer Revlon's $8 million payment of accrued interest to the Revlon lenders when it accidentally included $900 million of its own money in payment of the outstanding principal amount. Citibank alerted the lenders of the mistake and sued those that refused to return the funds, arguing that equitable principles required the recipients of erroneous payments to return them.

On February 16, 2021, the Southern District ruled against Citibank holding that the "discharge for value" exception to the equitable principle applied. This defense provides that a recipient of an erroneous payment is not required to return it if the recipient is a bona fide creditor with no notice that the payment was a mistake, because in these situations the transferor is better positioned to prevent the mistake than the transferee. The Second Circuit reversed and remanded the decision on the basis that the "discharge for value" exception did not apply and the funds should be returned.

The Southern District had determined that the recipients were bona fide creditors because the amounts paid were actually owed under the credit facility, and while there was a payment schedule that did not provide for payment at that time, Revlon had the right to prepay the loan voluntarily at any time. In reversing the decision, the Second Circuit noted that precedents applying the "discharge for value" defense in lending transactions that included a payment schedule only extended it to payments that were past due. The Second Circuit found that the recipients were not bona fide creditors because the debt that was paid was not yet due and the lenders had no present entitlement to the funds when they were received.

In finding that the recipients had no actual or constructive notice that the payment was a mistake, the Southern District noted that a mistake of that magnitude had never happened before and would have been inconceivable. The Second Circuit noted that the applicable standard is inquiry notice, or whether a reasonable or prudent person in the same position would make an inquiry into the nature of the payment. Because the lenders were aware that Revlon was in financial distress and was unlikely to be able to pay its debt in full at any point, the Second Circuit concluded that the lenders had inquiry notice and, upon inquiry, would have been told that the payment was erroneous.

The Second Circuit also noted that the market had acted quickly to circumvent the Southern District opinion by incorporating erroneous payment provisions drafted by the Loan Syndication and Trading Association and other trade groups. While the decision that gave rise to this language has been reversed, we recommend retaining these provisions in case the requirement to return erroneous payments is ever again called into question.

To discuss these issues, please contact the author(s).

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