Think Before You Click:
A $500 Million Mistake!

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A major objective of this blog is to keep lenders apprised of significant judicial decisions that impact their business lives so they can learn from them, correct bad habits and improve their best practices. WurstCaseScenario seeks to help lenders avoid making mistakes. Today, we focus on a critical decision from the Southern District of New York ("SDNY") concerning a costly mistake that could and should have been avoided.

Readers of these pages should remember the debacle that resulted from another bank inadvertently terminating the Uniform Commercial Code (UCC) financing statements perfecting the security interests of the syndicate of lenders in the General Motors case.

As an aside, we may want to keep in mind that the facts underlying this decision all occurred during the COVID-19 pandemic.

In 2016, Revlon took out a seven-year, $1.8 billion syndicated loan with Citibank as agent. Amongst its duties, the bank was to receive payments from Revlon and pass them on to the 2016 term loan lenders.

In the spring of 2020, Revlon, through a series of transactions, obtained over $800 million in "new financing" in part by adding an amendment to the 2016 loan agreement. This included sharing collateral that had previously secured the 2016 term loan as collateral for new loans from other lenders. Some of the 2016 term loan lenders, including most of the defendants in this action, opposed the amendment claiming that it would "siphon away collateral that was providing essential security for payment of the 2016 Term Loans."

On Aug. 11, 2020, the bank intended to wire approximately $7.8 million in interest-only payments to the term loan lenders. Instead, it mistakenly wired some $894 million, which effectively paid off the term loan lenders. When it realized its error, it requested the term loan lenders return the wires, and some actually did, to the extent of $393 million. The bank brought actions against those 2016 term loan lenders that did not return some $501 million in wires made in error, claiming they were unjustly enriched.

You must be wondering, "How could this error have been made?" Those 2016 term loan lenders who joined the syndicate for the 2020 financing had the right to roll up the balances on their 2016 term loans into their 2020 transaction. It appears that the bank, in *rolling up* these loans, intended to effect ledger payments from one loan to the other but, instead, sent those funds to the 2016 term loan lenders along with the $7.8 million of interest payments that they did intend to wire out. (I know, you are still scratching your heads – so am I). As a result, in addition to Revlon's $7.8 million in interest payments, almost *$900 million* of the bank's money was sent as well. The payments equaled — to the penny — the amount of principal and interest that Revlon owed on the 2016 term loan.

The bank has a "six-eye" approval procedure (three people): (a) the "maker" inputs the payment information; (b) the "checker" reviews and verifies the transaction; and (c) the "approver" does a final review of the transaction. However, none picked up the error.

In December 2020, the Court held a six-day remote bench trial to decide whether the bank could recoup the money. The defendants in this case — 10 investment advisory firms' managing entities that collectively received more than $500 million of the mistaken wire transfers — contended that this exception to the general rule, known as the "discharge-for-value defense," applied here and that the bank was not entitled to the return of its money.

In its analysis, the Court noted that as a general matter, the law treats a failure to return money that is wired by mistake as unjust enrichment or conversion and requires that the recipient return such money to its sender.

Federal courts, in ruling on state law issues, look to the rulings from that state. You may remember that in the General Motors case, the Second Circuit Court of Appeals certified the critical issue to the Delaware Supreme Court, who ruled that despite the bank's error in that case, it intended to file the termination statements leaving it unsecured.

In the instant case, the SDNY considered a 1991 decision, where the New York Court of Appeals explained the New York exception to unjust enrichment, stating:

> *When 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; rather, such a beneficiary should be able to consider the transfer of funds as a final and complete transaction, not subject to revocation.*

The SDNY explained the New York exception to the general rule:

> *The recipient is allowed to keep the funds if they discharge a valid debt, the recipient made no misrepresentations to induce the payment, and the recipient did not have notice of the mistake.*

The Court determined that once the bank sent the wire transfer, the mistake was irreversible. The internal checks completely failed. Instead of treating the wire transfers as interest-only payments, the bank's agents failed to check the boxes which resulted in the system defaulting to principal payments. The transaction was supposed to go to an internal account for verification, but instead, it went straight to the 2016 term loan lenders. An entire day passed before the bank realized its mistake and it was too late. Essentially, the court held that since all elements of the "discharge-for-value" defense had been met, the bank could not recover its funds.

Takeaway: Wire transfers are irrevocable and final. Perhaps the six eyes required to verify the transfers were impacted by the pandemic and working at home; perhaps with distractions of young children and pets (as we are now accustomed as we Zoom with our colleagues and clients on a daily basis). However, one must be certain before sending a wire, or run the risk of having a costly lesson; or, another costly lesson.

In re Citibank August 11, 2020 Wire Transfer, 20-cv-6539 (SDNY, February 16, 2021)