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Revlon: It's Worth a Double Take (Part I: Syndicate Lender Considerations)

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Summary of Case

On August 11, 2020, the administrative agent in a loan to Revlon intended to make an interest payment to the lender syndicate and instead mistakenly wired almost $900 million of its own money to the lenders. According to the administrative agent, it had intended to make an interest payment in the amount of approximately $7.8 million, but an error with the system used to process payments on the loans resulted in the overpayment. The amount wired represented the full amount of interest and principal outstanding on the loan, which was set to mature in 2023.

The very next day, and less than 24 hours after the payment was made, the administrative agent notified the lenders that the payments were a mistake and requested that the lenders return nearly all the funds it had paid to them. Over the next few days, lenders holding more than $300 million complied with the request and returned the principal payments. In fact, ultimately $400 million was returned to the agent. However, a group of 100 lenders, which were represented by 10 investment managers holding over a half a billion dollars of the loans, refused to comply with the administrative agent's demand.

Beginning on August 17, 2020, the agent filed a series of lawsuits in the Southern District of New York seeking return of more than $500 million. The cases were consolidated into a matter known as *In re Citibank August 11, 2020 Wire Transfers*. The Court put the case on an expedited trial preparation schedule where all discovery, briefing, and argument was completed in just over three months and culminated in a week-long bench trial in December of 2020, which was conducted entirely remotely due to the ongoing pandemic.

In February 2021, the district court issued a 101-page decision holding that the lenders did not need to return any portion of the erroneous payment. The Court noted in its decision that the general rule under New York law is that the recipient of a mistaken payment is not entitled to keep money that was mistakenly wired to them. However, the lenders invoked an exception to this rule known as the "discharge-for-value" doctrine which allows a recipient of a mistaken payment to keep funds if (i) the funds discharge a valid debt, (ii) the recipient did not make a misrepresentation to induce payment, and (iii) the recipient did not have notice of the mistake. The Court determined that the defense applied in what amounted to a huge victory for the syndicate lenders that refused to return the funds.

The administrative agent quickly filed a notice of appeal to the U.S. Court of Appeals for the Second Circuit. The crux of its argument is that the discharge-for-value defense is quite narrow and should not apply to this particular case. It continues to take the position that the funds it mistakenly paid to the lenders should be returned and that such return would be consistent with New York law's overriding legal principle that requires restitution of mistaken payments. That case remains pending.

Reaction from Agents and LSTA

Responsive to the district court ruling in favor of the lenders, the Loan Syndications and Trading Association (the "LSTA") published a market advisory dated March 19, 2021 (the "Market Advisory") with model language intended to be included in loan agreements in order to protect an administrative agent in a syndicated lending transaction where such agent makes an erroneous payment (*i.e.*, an unintended payment) to one or more lenders in the syndicate. In the Market Advisory, the LSTA indicated that it was planning to continue to monitor the market to see what language contracting parties were using before settling on a version of the language to be included in its form Credit Agreements. The LSTA also invited its members to share feedback on the language.

On June 16, 2021, the LSTA issued revised draft erroneous payment provisions with a blackline showing how the language has evolved from the original suggested language. A few salient features of the revisions include that the survival rule, which is discussed below, depending on syndication, operational, or other administrative considerations, apply to successors and assigns of assigning, transferring, or replaced lenders. The new provisions also include an express contractual subrogation of the administrative agent to the lender that receives an erroneous payment. The idea is that, as a result of the administrative agent having made a payment to the lender in question, the administrative agent steps into the shoes of the lender and in that position has all the rights of the lender against the borrower, including those in respect of the collateral and the lender's rights to receive payments under the credit agreement.

Since news of the case hit the market along with the Market Advisory, administrative agents were quick to draft and include protective language in their form credit agreements intended to protect against this risk, many of which have used the exact text published by the LSTA. As one may expect, we have seen syndicate lenders request a number of changes to these proposed provisions, stating that the text goes too far in its protections for the agent in the event it determines it has made an unintentional payment. We have also seen a variety of comments from the borrower side. This week we will take a look at some of the comments we have

received from syndicate lenders, and next week we will turn our attention to the borrower comments.

Lender Concerns

- *Notification Obligations*. The LSTA provisions impose increased notification obligations on lenders, which many have argued will require greater coordination with their back offices. Under the text, in the event a lender receives a payment from the agent that is different than or on a date that is different than the date specified in a payment or prepayment notice, the lender is required to promptly and in any event within one (1) business day notify the administrative agent of such incurrence. Additionally, to the extent a lender receives a payment that is not accompanied by a payment or prepayment notice, the lender is obligated to promptly and in any event not later than one (1) business day inform the administrative agent of the same. Lenders have taken issue with the increased notification obligation generally but have been particularly focused on the required timing, as the individuals at the bank processing payments are often different than the individuals communicating with agents on their syndicated lending transactions. Lenders are concerned that (i) a prepayment notice posted to Intralinks may not get shared with the back office right away and could leave very little time for the back office to confirm the payment received matches the amount specified in the notice; and (ii) even when the prepayment notice is timely passed along by the banker to the back office, the communication coming from the back office may not make its way up to the banker communicating with the agent within one business day for any number of reasons, in either case causing the lender to breach its obligations under the credit or loan agreement. As a result of these concerns, lenders have been bolstering training to ensure that bank personnel responsible for monitoring and processing payments understand the bank's notification obligations under these new provisions.
- *Lack of Sunset*. The Market Advisory suggested that parties may consider a claw-back cut-off date in their erroneous payment provision. Inclusion of such a claw-back cut-off date would mean that the agent could not make a demand to claw back an erroneous payment unless such demand was made within a certain period of time from when the lender received such erroneous payment. The requests we have seen for a sunset is generally in the range of 30-90 days. The concept of a sunset period is not atypical in the lending context, often appearing in the increased costs sections and impairing a lender's ability to bring claims against a borrower past a certain point in time. It is not market practice to have these sunsets built into these concepts to give borrowers certainty that at some point they will not be on the hook for these payments. Lenders are making the same argument – that is, they would like certainty as to when they can close out their books with respect to the payment received. Lenders have acknowledged that agents should receive some period of time to determine whether the agent transmitted an erroneous payment but that agents should be able to make such determination within 30-90 days.
- *Survival*. The LSTA provisions also include a survival provision which provides that the agreements of the lenders survive termination of the lender commitments and/or the repayment, satisfaction or discharge of all obligations (or any portion thereof) under any loan document. The effect of this provision is that an Agent could claw back payments made even after the lender commitments have been terminated. Here, too, lenders have argued

that they will need certainty on the final payout they receive so that they may close out their books on the relevant loan transaction.

Looking Ahead

We will come back next week to highlight some of the borrower comments we have received to the LSTA provisions. We will continue to follow all developments in the *Revlon* case and keep you all updated on the appeal pending before the Second Circuit.