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Revlon Reversal: Common Sense Prevails (Finally)

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It is generally the law that mistakenly-received funds must be returned to the sender. Last summer, we covered in detail the now-familiar *Revlon* case in which that understanding was tested and, surprisingly, not followed.* On Thursday of last week, the United States Court of Appeals for the Second Circuit (the "Second Circuit") delivered a much-anticipated reversal of a lower court ruling – issuing a decision that feels like a return to the law as well as common sense.

In August of 2020, Citibank (acting as the administrative agent for a large syndicate of banks and hedge funds) mistakenly sent out payments of over $900 million in full satisfaction of a loan, instead of the intended $7.8 million interest-only payments. It is worth noting that the vast majority of the funds sent to lenders was not money received from Revlon, but was in fact Citibank's own funds − $894 million to be more precise. Of the $894 million of Citibank's funds, approximately $400 million was voluntarily returned by lenders after Citibank alerted them to the mistake the following day. Citibank filed suit to recover the other approximately $500 million of erroneous payments from lenders who refused to comply after multiple requests.

Much to the surprise of many market participants, in February 2021, a federal district court held that such lenders did not have to return the mistakenly-wired funds.

The general rule governing such situations is that "a party who pays money under a mistake of fact, to one who is not entitled thereto, must in equity and good conscience be permitted to get it back. That is a well-recognized principle of law." (*Ball v. Shepard*, 95 N.E. 719, 721 (N.Y. 1911)). But the lower court relied on the "discharge-for-value" exception which excuses a recipient of mistakenly-received funds from returning such funds if the erroneous payment discharges a debt and two requirements are satisfied: (1) the participant had no knowledge that the funds were sent in error and (2) the recipient was actually entitled to the payment. In particular, the court was heavily influenced by the fact the payments received were exactly the amount that would have been owed if Revlon opted to repay this credit facility on the date the wires went out. They also found that the lenders had no actual knowledge of the error because they only called other lenders to confirm if they had also received payment in full, as opposed to reaching out to the agent who actually initiated the wires.

Citibank appealed the decision while, simultaneously, the drafters of syndicated loan agreements scrambled to include language to specifically contract around the ruling – now commonly referred to as “Revlon” or “Erroneous Payments” provisions. This language contains “clawback” language in the agency provisions that require lenders to return erroneous payments and gives the agent recourse against any lender that refuses to do so.

Last week, the Second Circuit reversed the earlier ruling, giving the syndicated loan market the result many market participants had expected all along.** The court held that neither of the two requirements of the “discharge-for-value” exception were satisfied. Addressing the first requirement, the court held that the recipients of the funds had constructive knowledge that the payments were made in error because: (1) no prior prepayment notice was sent, as required by the terms of the credit agreement; (2) the lenders were well aware of Revlon’s financial distress and could not reasonably expect the company to make an unanticipated repayment totaling almost $1 billion; (3) given the debt was currently trading at 20%-30% of its face value, the lenders were aware Revlon could have settled the debt for far less than such face value; and (4) the lenders were aware (and likely angry about) the fact that Revlon had just four days prior taken elaborate steps to prevent acceleration of the loan in question, something Revlon would not have done if they intended to voluntarily accelerate repayment later in the week. As to the second requirement of the “discharge-for-value” exception, the court found that the lenders were not entitled to repayment at that time because the debt was not scheduled to mature until 2023.

It is telling to us that the Erroneous Payment language, which is now universally included in syndicated loan paper, is rarely, *if ever*, objected to; with a few exceptions, most parties treat such language as boilerplate. And that makes sense given that a potential participant in a syndicate would be hard pressed to justify objecting to language confirming they will return a wire sent by mistake.

In an interesting concurring opinion, Judge Michael Park lodged a complaint about the length of time the decision took to produce and release – noting the potential damage done in the meantime. Essentially, Judge Park argues that the result should have been obvious and should have been handed down much sooner. He writes: “In my view, this is a straightforward case that many smart people have grossly overcomplicated and that we should have decided many months ago.… Put simply, you don’t get to keep money sent to you by mistake unless you’re entitled to it anyway.” While impossible to gauge the extent the impact this delay had on Revlon, it is worth pointing out that the company filed for Chapter 11 bankruptcy on June 15, 2022 – a full 16 months after the original ruling and nine months after the case was argued on appeals. This case may not (probably is not) the cause of Revlon’s ultimate bankruptcy, but it certainly has not helped in the company’s efforts to right the ship.

Notwithstanding the delay in arriving at what many view as the correct outcome, the Second Circuit’s recent reversal should be seen as a common-sense return to business-as-expected in the world of syndicated finance, effectively further solidifying an important financial principle: *If it isn’t yours (or isn’t yours yet), give it back*.

*More detailed facts and coverage of the lower court decision are covered in prior *FFF* articles, which can be found **here**, **here** and **here**.

The full opinion of the Second Circuit can be read **here.