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Citibank Unable to Recover $500 Million in Accidental Payments

Legal Update
06.01.2021

The playground adage “finders keepers, losers weepers” appears to have been taken to new heights in a recent court decision authored by U.S. District Judge Jesse Furman, costing Citibank around $500 million. The ruling came after Citibank committed what the Court described as one of the “biggest blunders in banking history” when it accidentally wired almost $900 million of its own money to lenders while serving as Administrative Agent under a seven-year, $1.8 billion syndicated loan facility taken out by Revlon, Inc. in 2016.

Last August, Revlon attempted to pay off accrued interest in connection with a “roll-up” transaction. Because of limitations in Citibank’s software, the easiest method to effectuate this transaction was to pay interim interest accrued to all lenders—whether or not they were participating in the roll-up.

Revlon obliged and wired Citibank $7.8 million to facilitate the interest payments to all lenders. Similar technical limitations in Citibank’s software “forced” them to enter payment information into the system as if it were paying off the loan in its entirety, although the principal portions of the payments were to be routed to an internal “wash account” that never left the bank. However, because two boxes were not checked on the software, the entire principal and interest payment went out Citibank’s doors to each of the unsuspecting creditors. Realizing the mistake, Citibank requested a return of the funds the next day. Only upon this communication did the lenders realize the mistake. When certain creditors representing about $500 million of the erroneously paid-out money refused to return the funds (Defendants), Citibank instituted this action to recover.

Judge Furman ruled that the Defendants should keep the money under the discharge-for-value defense – cutting off an otherwise valid claim by Citibank. Relying on precedent, the Court explained that this defense is available when a creditor has received funds in discharge of a currently owed debt even though the payment was given by mistake, if the transferee did not induce the payment through misrepresentation and did not have actual or constructive notice of the mistake at the moment of transfer.

In Citibank's case, it was undisputed that on the payment date, the Defendants were each owed the exact amount of money that they received and none of these creditors made any misrepresentations to induce the mistaken wire transfers. Thus, the Court's application of the discharge-for-value defense turned primarily on whether, at the time of the payments, each Defendant had constructive notice of Citibank's mistake, or in other words, if each Defendant reasonably should have known of the mistake. This Court determined that no such notice existed here.

First, the Court cited numerous employee communications of the Defendants demonstrating that they genuinely believed this was an intentional full paydown. For example, when asked if they suspected the payments resulted from error, one employee-witness quipped, "not in my wildest imagination." The fact that the amounts received exactly matched the amount of principal and interest owed only bolstered their belief that this was intentional and not a more common "fat finger" mistake (e.g., misplaced decimal points). The Defendants also did not expect a mistake of this magnitude from such a sophisticated financial institution with effective internal controls.

Further, and somewhat surprisingly, the Court found Citibank's counterarguments relating to prepayment calculation statements ineffective, despite the fact that lenders received calculation statements prior to receiving payment that clearly indicated lenders would receive "interest payments," with no mention of principal payments. However, lack of uniformity and industry standards around calculation statements led the Court to find these arguments unpersuasive. The Court noted that most banks treat these prepayment statements fairly casually, and mistakes and late-arriving notices are not uncommon. The variability in content, timing, and lack of vigorous controls over these statements prevented the Court from concluding that these particular calculation statements provided sufficient notice to the Defendants.

Lastly, the Court was unmoved by Citibank's equity and policy driven arguments, including arguments that basic common fairness called for a return of the funds and that allowing this defense "would not facilitate wire transfers; it would chill and cripple them." Nevertheless, in the Court's view, Citibank was in the best position to avoid the error that occurred, and the discharge-for-value defense furthers the policy goal of finality in electronic funds transfers.

If this bright-line approach stands on appeal, industry changes could be expected. This may be apparent in changes to cost structures, insurance requirements, or through novel contract terms. Judge Furman also opined that banks or industry associations like the LSTA could create clear standards governing the content and timing of payment notices. For example, if pre-payment notices "always *unambiguously* and explicitly described the size and nature of the payment, the recipient of a payment that deviated from the notice would plainly be on notice of the mistake." After this decision, financial institutions should be prepared for potential changes in the industry.