KEY POINTS

- The recent US Court of Appeals decision in the *Citibank v Revlon lenders* case cemented the New York law position that the presence of constructive knowledge is sufficient to invalidate a "discharge for value" defence in an unjust enrichment case. By contrast, actual knowledge is required under English law.
- Although less critical in light of the latest US ruling, the Revlon blocker continues to feature in syndicated facility agreements in the US (and European loan markets).
- The standard Revlon blocker in the European market may evolve to include language that imputes knowledge on the lenders, so as to make up for the stricter knowledge threshold that would be applied by English courts.

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Erroneous payments in syndicated loans: the future of the "Revlon blockers"

Even though the Second Circuit has restored a sense of calm by ordering the lenders to return mistaken payments to Citibank in the infamous *Revlon* case, the Revlon blocker is here to stay. This article will examine its various permutations and will propose suggestions on how parties may wish to fine tune their Revlon blockers in light of the Second Circuit's emphasis on the role of constructive knowledge in dismissing the "discharge for value" defence.

Towards the end of last year, the US Court of Appeals for the Second Circuit reversed the infamous New York Federal District Court ruling in the *Revlon* case. Since the facts of the case and both court decisions have already been widely reported, this article will give just a brief refresher of the case before examining the impact these decisions have had on loan documentation in both the US and European loan markets and its possible future evolution.

BACKGROUND TO THE *REVLON* CASE AND THE RULINGS OF THE DISTRICT COURT AND SECOND CIRCUIT

In 2020, Citibank, the administrative agent under Revlon's $1.8bn syndicated facility agreement, mistakenly transmitted funds to Revlon's lenders, in an amount which matched the total principal and interest outstanding under the facility (the principal not being due for another three years). At the time, Revlon was in distress and so a number of lenders refused to return the funds to Citibank upon request.

The District Court ruled in favour of those lenders on the basis of the US "discharge for value" doctrine, a rule that states that a mistaken payment is not recoverable if, among other things, that payment was actually due to the payee and the payee had no notice of the mistake. The decision has recently been overturned by the Second Circuit, chiefly on the grounds that the Revlon lenders had been on constructive notice of Citibank's mistake and were therefore not entitled to keep the funds. It held that a "reasonably prudent person who faced an avoidable risk of loss" would have questioned the validity of the payment on account that: (i) Revlon was insolvent and the principal of the loan was not due to be paid for another three years; (ii) Revlon had recently made an exchange offer to holders of its 2021 notes in order to avoid acceleration of the loan; (iii) no notice of prepayment had been given by Revlon (as required under the facility agreement); and (iv) participations in the loan were trading at 20% to 30% of the face amount. The Second Circuit held that reasonable inquiry by the lenders would have quickly revealed the funds had been transmitted in error. In addition, the Second Circuit disagreed with the District Court that a "discharge for value" had taken place on the basis that no debt was actually due and payable on the date on which the funds were received.

Since the Second Circuit ruling, the lenders' motion for a rehearing has been denied, thus likely bringing an end to the entire saga.

REVLON BLOCKERS FOLLOWING THE DISTRICT COURT DECISION

When the District Court initially ruled in favour of the lenders in the *Revlon* case, this acted as a wake-up call for the entire market: no financial institution previously expected it could permanently lose billions simply by entering mistaken wire instructions. Shockwaves were not only felt in the New York loan market, but also further afield in Europe and Asia. While the decision in the *Revlon* case had no direct bearing outside of the New York law jurisdiction, the case's impact on both sides of the Atlantic was not surprising given the interconnectedness between the two markets and the similarities between the New York law and English law doctrines of restitution.

In response to the District Court decision and the alarm this evoked among financial institutions, the Loan Syndications and Trading Association (LSTA) promptly published a Market Advisory and draft model form of erroneous payment provision. Their counterpart across the pond, the Loan Market Association (LMA), soon followed with a form of erroneous payment provision that market participants could opt to include in their facility documentation.

Both clauses impose an express contractual obligation on lenders to return erroneous payments upon notice from the administrative or facility agent. They also build in a waiver of any available defence or set-off the lenders might have under relevant law in relation to erroneous payments.

There are however some key differences, which reflect discrepancies in the underlying law. Most notably, under the LSTA language, if a lender receives an amount that is different from the amount notified to it in a payment notice (or if there was no prepayment notice accompanying the amount), then an error is presumed and the lender is required to notify the administrative agent. This language

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bolsters the New York law position that constructive knowledge defeats the claim the "discharge for value" rule (which absolves a payee of their obligation to return an erroneous payment) is applicable. By contrast, the LMA model provision is somewhat simplified and mainly sets out the obligation of the lenders to return to the agent any payments which the agent has notified as having been made in error. This may in part be because, as noted previously,[1] the law of restitution is believed to be generally more favourable to the mistaken payer in England, where (unlike in New York) a "discharge for value" requires that payer to have had the authority to discharge the debt on behalf of the original obligor.

Another notable difference in the current LSTA and LMA language relates to the consequences of a lender's failure to return erroneous payments. Under the LSTA language, any lender that fails to comply with its obligation to return such payments is deemed to have assigned its relevant loans (but, of course, not its lending commitments) to the administrative agent who then has a right to then sell them. This language was later expanded to expressly and contractually subrogate the administrative agent into the claim of any lender that receives an erroneous payment. Under the LMA provision, no such remedy is provided. It can be assumed that the deemed assignment language was not favoured by European loan market participants in part because of the administrative complexities arising from the deemed assignment/subrogation mechanism, including with respect to how unfunded commitments should be treated once decoupled from the loan participations of the defaulting lender.

Adoption of the model forms of erroneous payment provisions has been widespread but by no means universal. The vast majority of US market participants have incorporated some version of the model LSTA provision into their forms, though the language regarding deemed assignments has often been omitted. On the European side, our review of the English law precedents revealed a high degree of adherence to the language of the LMA erroneous payments provision. Many of the facility agreements we reviewed included the LMA provision verbatim, though more often than not dispensing with the time limit (suggested as an option in the form) on the facility agent's ability to claw back mistaken payments. On the other hand, we have not seen examples in the European precedents of parties supplementing the LMA language with an LSTA-style deemed assignments construct. Other minor technical variations we have come across include specifying that the facility agent must act reasonably in declaring that a payment had been made in error and introducing an express time limit by which recipients of erroneous payments must return such funds following the agent's notice.

REVLON BLOCKERS FOLLOWING THE SECOND CIRCUIT DECISION AND BEYOND

The Second Circuit decision clearly set out the limitations to the application of the "discharge for value" defence and outlined an array of circumstances that could potentially put payees on notice of mistaken payments and thereby oblige them to repay those payments. While this decision has given bankers and their lawyers much comfort and renders the Revlon blocker less critical, especially in the NY market where the Second Circuit decision has a direct bearing on the legal regime governing facility agreements, we still see, and expect to continue to see, the Revlon blocker feature in New York law and English law governed facility agreements alike. This is not at all surprising for anyone with experience in contractual drafting. Legal documents have an inexorable tendency towards bloat and, rather than being any kind of exception to this rule, the typical facility agreement could be more accurately characterised as this rule personified, with every provision in the boilerplate traceable back to a market crisis, a legal development or another systemic event.

The Second Circuit's emphasis on the power of constructive knowledge in collapsing a lender's "discharge for value" defence, however, goes to highlight the corresponding shortfall in English law's protection of payors of erroneous funds. The background position under English law is that an erroneous payment will only be recoverable if the recipient has actual knowledge of the mistake. It will be interesting to monitor therefore if market participants are more alive to this shortfall in the English law unjust enrichment regime in light of the Second Circuit decision and if they respond by buttressing erroneous payments provisions in English law facility agreements by borrowing the LSTA language that effectively imputes knowledge on payees where suspicious circumstances present themselves. The LSTA provision specifies the circumstances under which knowledge will be imputed. These are where the receipt of funds is in an amount that does not match the figure promised in the corresponding prepayment notice, or where prepayment funds are received without an accompanying prepayment notice being made. Other red flag circumstances could be included to offer maximum protection to agents. For example, taking inspiration from the facts of the *Revlon* case itself, the financial condition of the borrower could be cited, as well as the price at which the debt was being traded in the secondary market at the time of the transmission of funds.

Given the financial risks at stake, it would not be surprising to see the English law clauses becoming more structured and ultimately converging with those across the Atlantic. ■

1 'Payments by mistake: when will the discharge of an existing debt be a defence to a claim for repayment?' (2021) 7 JIBFL 457.

Further Reading:

- Payments by mistake: when will the discharge of an existing debt be a defence to a claim for repayment? (2021) 7 JIBFL 457.
- The ministerial receipt defence to restitutionary claims (2010) 10 JIBFL 589.
- LexisPSL: Banking & Finance: Article: Agent banks' duties in the era of cov-lite loans and infinite liquidity.