

21-487

In re: Citibank August 11, 2020

1 **UNITED STATES COURT OF APPEALS**
2 **FOR THE SECOND CIRCUIT**

3
4 August Term, 2021

5
6 (Argued: September 29, 2021 Decided: September 8, 2022)

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8 Docket No. 21-487

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12 CITIBANK, N.A.,

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14 *Plaintiff-Appellant,*

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17 v.

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19 BRIGADE CAPITAL MANAGEMENT, LP, HPS INVESTMENT PARTNERS, LLC,
20 SYMPHONY ASSET MANAGEMENT LLC, BARDIN HILL LOAN MANAGEMENT
21 LLC, GREYWOLF LOAN MANAGEMENT LP, ZAIS GROUP LLC, ALLSTATE
22 INVESTMENT MANAGEMENT COMPANY, MEDALIST PARTNERS CORPORATE
23 FINANCE LLC, TALL TREE INVESTMENT MANAGEMENT LLC, NEW
24 GENERATION ADVISORS LLC,

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26 *Defendant-Appellees,*

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28 INVESTCORP CREDIT MANAGEMENT US LLC, HIGHLAND CAPITAL
29 MANAGEMENT FUND ADVISORS LP,

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31 *Defendants.*

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34 Before: LEVAL, SACK, and PARK, *Circuit Judges.*

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Plaintiff Citibank, N.A, the Administrative Agent for the lenders on a \$1.8 billion seven-year syndicated loan to Revlon Inc., appeals from the judgment of the United States District Court for the Southern District of New York (Jesse M. Furman, *J.*) in favor of Defendants, the Loan Managers for certain lenders, who received and refused to return Citibank’s accidental, unintended early repayment of the loan. The district court, after a bench trial, relying on *Banque Worms v. BankAmerica International*, 570 N.E.2d 189 (N.Y. 1991), ruled that the rule of discharge-for-value provided a defense against Citibank’s suit for restitution. Held, because the Defendants had notice of the mistake and because the lenders were not entitled to repayment at the time, the rule of *Banque Worms* does not protect the Defendants. The judgment is VACATED and the case is REMANDED to the district court.

Judge Park concurs in a separate opinion.

NEAL KUMAR KATYAL (Sean Marotta, Reedy C. Swanson, Erin Chapman, Nathaniel A.G. Zelinsky, Hogan Lovells US LLP, Washington D.C.; Nicole A. Saharsky, Mayer Brown LLP, Washington D.C.; Matthew D. Ingber, Christopher J. Houpt, Mayer Brown LLP, New York, N.Y., *on the brief*), Hogan Lovells US LLP, Washington, D.C., *for Plaintiff-Appellant*.

KATHLEEN M. SULLIVAN (Adam M. Abensohn, David M. Cooper, Benjamin I. Finestone, Robert S. Loigman, Quinn Emmanuel Urquhart

1 & Sullivan, LLP, New York, N.Y., *on*
2 *the brief*), Quinn Emmanuel Urquhart
3 & Sullivan, LLP, Los Angeles, CA, *for*
4 *Defendant-Appellees*.

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6 LEVAL, *Circuit Judge*:

7 This case raises the question whether, under New York law, the
8 recipients of an accidental, unintended payment of approximately \$500
9 million were required, under the circumstances, to return the payment.
10 Citibank N.A. is the Plaintiff-Appellant. Citibank served as
11 Administrative Agent for the lenders of a \$1.8 billion syndicated seven-
12 year loan to Revlon, Inc. (“the Loan” or “the Debt”), with responsibility
13 to collect interest and principal payments from Revlon and transmit them
14 to the Loan Managers for the lenders. Citibank appeals from the
15 judgment of the United States District Court for the Southern District of
16 New York (Jesse M. Furman, *J.*) in favor of the Defendant-Appellees,¹
17 who were Loan Managers for lenders of the majority of the loan.

¹ Defendant-Appellees are Brigade Capital Management, LP (“Brigade”), HPS Investment Partners, LLC (“HPS”), Symphony Asset Management LLC (“Symphony”), Bardin Hill Loan Management LLC (“Bardin Hill”),

1 In undertaking to transmit accrued interest to the lenders' Loan
2 Managers, Citibank had made a ministerial error in administering a
3 computer program, which caused the unwitting transfer by wire of
4 Citibank's funds in the full amount of Revlon's outstanding principal
5 balance, three years before Revlon's loan repayment was due, and, at a
6 time when, because Revlon was understood to be deeply insolvent, loan
7 participations were trading at 20% to 30% of the face amount. The next
8 day, when Citibank discovered that the accidental transmission had
9 occurred, it demanded the return of the portion representing principal.
10 Upon the Defendants' refusal, Citibank brought this action for restitution.

11 Based on a ruling of the New York Court of Appeals in *Banque*
12 *Worms v. BankAmerica International*, 570 N.E.2d 189 (N.Y. 1991), the district
13 court decided that Defendants were not obligated to return the money. *In*

Greywolf Loan Management LP ("Greywolf"), ZAIS Group LLC ("ZAIS"), Allstate Investment Management Company ("Allstate"), Medalist Partners Corporate Finance LLC ("Medalist"), Tall Tree Investment Management LLC ("Tall Tree"), and New Generation Advisors LLC ("New Generation").

1 *re Citibank August 11, 2020 Wire Transfers*, 520 F. Supp. 3d 390 (S.D.N.Y.
2 2021). In *Banque Worms*, the Court of Appeals had ruled in favor of a
3 lender's right to retain a bank's mistaken repayment of a loan to the
4 bank's client that was due and payable. *Id.* at 190-91. The Court of
5 Appeals had explained that its ruling was based on the American Law
6 Institute's "discharge-for-value" rule, published at Section 14 of the
7 RESTATEMENT (FIRST) OF RESTITUTION (Am. Law Inst. 1937) ("First
8 Restatement"). The rule of Section 14 specified circumstances that excuse
9 the recipient of a payment made in discharge of a debt pursuant to a
10 mistake of the payor as to his rights or duties from the customary
11 obligation to return mistaken payments.

12 We conclude that that this case does not fall within the scope of the
13 New York Court of Appeals's *Banque Worms* ruling. We accordingly
14 VACATE the judgment of the district court and REMAND this case to the
15 district court for further proceedings consistent with this opinion.

1 **BACKGROUND**

2 The great majority of the complex facts are not in dispute. This
3 recitation of the facts is largely taken, nearly verbatim, from Judge
4 Furman’s clear, fastidious, and scholarly exposition.²

5 **A. The 2016 Loan**

6 In 2016, pursuant to a credit agreement, Revlon took out the seven-
7 year, \$1.8 billion syndicated, collateralized Loan. *In re Citibank*, 520 F.
8 Supp. 3d at 397.

9 Citibank serves as the Administrative Agent for the lenders in
10 administering the Loan. Its duties, set forth in the Amended Loan
11 Agreement (“the Agreement”), included receipt of payments of principal
12 and interest from Revlon to be transmitted to the lenders (the
13 “Debt holders” or “Lenders”). Agreement, § 2.8.

14 The Defendants are Loan Managers for those Debt holders that
15 refused to return the mistakenly transmitted funds. The outstanding

² The few changes made are not intended to alter the substance of Judge Furman’s findings.

1 principal and accrued interest on these Debtholders' loans was
2 \$558,558,375.74 on August 11, 2020, the date of Citibank's mistaken
3 payment. *In re Citibank*, 520 F. Supp. 3d at 398.

4 The Loan was not payable for three more years – until September 7,
5 2023 (seven years after the closing date). That maturity date was subject
6 to acceleration if any notes representing an unsecured senior debt (a set
7 of notes due in early 2021 – the “2021 Notes”) remained outstanding on
8 November 16, 2020, in which case the Loan would also mature on
9 November 16, 2020.³ *Id.*

10 Several provisions of the Agreement are pertinent. First, the
11 Agreement provides that it is to be “governed by, and construed and
12 interpreted in accordance with, the laws of the state of New York.”
13 Agreement, § 10.11 (capitalization and emphasis omitted). Second, to the
14 extent relevant here, it defines the “Interest Payment Date” — that is, a
15 date on which an interest payment is due — as either “the last day of”

³ Other preconditions were also necessary before the Accelerated Maturity Date could take effect. Agreement, § 1.1.

1 each “Interest Period” or “the date of any repayment or prepayment.”
2 Agreement, § 1.1. Finally, under Section 2.11(a), entitled “Optional
3 Prepayments,” Revlon was permitted to prepay any part of the Debt
4 “upon irrevocable written notice delivered to [Citibank] . . . three
5 Business Days prior thereto.” Agreement, § 2.11(a). Upon receipt of any
6 such notice Citibank was required to “promptly notify each relevant
7 Lender thereof.” *Id.*⁴ The Agreement does not define the term

⁴The full text of the prepayment provision is as follows:

The Borrower may at any time and from time to time prepay any Tranche of Revolving Loans, the Swingline Loans or any Tranche of Term Loans, in whole or in part, without premium or penalty except as specifically provided in Section 2.11(b), upon irrevocable written notice delivered to the Administrative Agent no later than 12:00 Noon, New York City time, (i) three Business Days prior thereto, in the case of Eurocurrency Loans that are Revolving Loans, Swingline Loans or Term Loans, (ii) one Business Day prior thereto, in the case of ABR Loans that are Term Loans and (iii) on the date of prepayment, in the case of ABR Loans that are Revolving Loans or Swingline Loans, which notice shall specify (x) the date and amount of prepayment, (y) whether the prepayment is of a Tranche of Revolving Loans or Swingline Loans or a Tranche of Term Loans and (z) whether the prepayment is of Eurocurrency Loans or ABR Loans; provided, that if a Eurocurrency Loan is prepaid on any day other than the

1 “promptly.”

2 **B. The May 2020 Transaction and UMB Bank Litigation**

3 In the spring of 2020, Revlon’s “liquidity position” was “extremely

last day of the Interest Period applicable thereto, the Borrower shall also pay any amounts owing pursuant to Section 2.21. Upon receipt of any such notice the Administrative Agent shall promptly notify each relevant Lender thereof. If any such notice is given, the amount specified in such notice shall be due and payable on the date specified therein (provided, that any such notice may state that such notice is conditioned upon the occurrence or non-occurrence of any transaction or the receipt of proceeds to be used for such payment, in each case specified therein (including the effectiveness of other credit facilities), in which case such notice may be revoked by the Borrower (by written notice to the Administrative Agent on or prior to the specified effective date) if such condition is not satisfied), together with (except in the case of Revolving Loans that are ABR Loans) accrued interest to such date on the amount prepaid. Partial prepayments of Term Loans, Revolving Loans or Swingline Loans shall be in an aggregate principal amount of (i) \$1,000,000 or a whole multiple of \$100,000 in excess thereof (in the case of prepayments of ABR Loans) or (ii) the Borrowing Minimum or a whole multiple of the Borrowing Multiple in excess thereof (in the case of prepayments of Eurocurrency Loans), and in each case shall be subject to the provisions of Section 2.18.

Agreement, § 2.11(a).

1 tight,” and the company sought to raise additional capital.⁵ *In re Citibank*,
2 520 F. Supp. 3d at 399. Revlon accomplished this through a series of
3 transactions in May 2020 (together, “the May 2020 Transaction”). Revlon
4 entered into a credit agreement with a subset of the 2016 Lenders (or their
5 affiliates), using collateral that had originally secured the 2016 Loan to
6 secure instead new loans extended by these Lenders.⁶ *In re Citibank*, 520
7 F. Supp. 3d at 399.

8 As part of the May 2020 Transaction, Revlon issued a senior secured
9 term loan facility in an aggregate principal amount of \$815 million, plus
10 the amount of certain fees and accrued interest that had been capitalized.

⁵ According to a complaint (discussed in detail below) which all Defendants except Tall Tree authorized UMB Bank to file against Revlon and Citibank, “Revlon reported an operating loss of \$186.2 million and net loss of \$213.9 million in the first quarter of 2020. Its reported net sales in the first quarter of 2020 declined \$18.1 from the same prior-year period and adjusted EBITDA decreased 26.8%.” J.A. 174 [Comp. ¶ 167, *UMB Bank, N.A. v. Revlon, Inc.*, No. 1:20-cv-06352 (S.D.N.Y. Aug. 12, 2020) (“UMB Bank Complaint”)].

⁶ The UMB Bank Complaint stated that the May 2020 transaction would “siphon away substantially all of the collateral from the 2016 Term Lenders.” UMB Bank Comp. ¶ 11.

1 J.A. 1132. Of that \$815 million, Revlon used (i) \$65 million to repay a
2 revolving credit facility, *id.*, which it had obtained the previous month,
3 J.A. 1135, (ii) approximately \$246 million to pay outstanding principal,
4 interest, and other fees on a Term Loan obtained in 2019 and due in 2023,
5 J.A. 1134, and (iii), \$112.8 million to repurchase and cancel a portion of
6 the 2021 Notes, *id.*

7 The May 2020 Transaction also included an amendment to the
8 Agreement that granted a subset of Lenders that participated in the
9 refinancing (“BrandCo Lenders”) what are called “roll-up” rights – the
10 right to exchange their position in the 2016 Term Loan for a position in
11 new term loans scheduled to mature in 2025. *In re Citibank*, 520 F. Supp.
12 3d at 399. The aggregate principal amount that could be “rolled-up” from
13 the 2016 Term Loan to the new loans was \$953 million. J.A. 1132.

14 The aggregate result is that the May 2020 Transaction enabled
15 Revlon to issue a new \$1.7 billion debt facility, of which over \$800 million
16 was “new financing.” *In re Citibank*, 520 F. Supp. 3d at 399.

17 As part of the May 2020 Transaction, Revlon issued a “solvency

1 certificate” asserting “that the company is solvent and would be able to
2 meet [its] liabilities or service those liabilities as they come due.” *Id.*

3 As previously noted, the May 2020 Transaction included an
4 amendment to the 2016 Loan Agreement making some collateral that had
5 previously secured the 2016 Loan serve instead as collateral for new
6 loans. *Id.* Several of the Debtholders, including Defendants’ clients,
7 objected to the May 2020 Transaction, contending that it violated the
8 terms of the 2016 Loan Agreement, and labeling it an effort to “siphon
9 away collateral that was providing essential security for payment of the
10 2016 Loans.” *Id.* Nonetheless, Revlon executed the transaction in May
11 2020, asserting that it had secured the approval of a sufficient number of
12 the holders of the 2016 Loan to allow that withdrawal of collateral.

13 This dispute gave rise to litigation in which a number of
14 Debtholders — including those associated with all Defendants here
15 except Tall Tree — authorized UMB Bank, the designated successor to
16 Citibank as their Administrative Agent on the 2016 Loan, to file a lawsuit
17 against Revlon and Citibank, asserting a variety of claims stemming from

1 the May 2020 Transaction. *Id.* at 409.

2 Several allegations in the UMB Bank Complaint are pertinent here.
3 First, the UMB Bank Complaint alleged *inter alia* that, in the May 2020
4 Transaction, Revlon improperly siphoned collateral away from the 2016
5 Debtholders, such as the trademarks and other intellectual property
6 associated with Revlon’s most famous brands including Elisabeth Arden,
7 the value of which was “enormous relative to the value of the entire
8 Revlon enterprise.” UMB Comp. ¶ 2. Second, it alleged that Citibank and
9 Revlon had improperly manipulated the voting provisions of the 2016
10 Loan Agreement to gain approval of an amendment that permitted
11 Revlon to strip collateral backing the 2016 Loan. *In re Citibank*, 520 F.
12 Supp. 3d at 446-47. Third, the UMB Bank Complaint alleged that an event
13 of default had already occurred on the 2016 Loan, and sought to
14 accelerate payment of the Debt. *Id.* at 409. Finally, it also alleged that
15 Revlon was insolvent by as much as \$1.71 billion, UMB Comp. ¶ 170, and
16 was “facing a severe liquidity crisis compounded by the global COVID-
17 19 pandemic.” *In re Citibank*, 520 F. Supp. 3d at 409.

1 The UMB Bank Complaint was filed on August 12, 2020, at
2 approximately 2:06 p.m. — roughly twenty hours *after* the August 11 wire
3 transfers. *Id.* The 117-page complaint had, however, been under
4 discussion for some time, and the Defendants bringing the suit had
5 authorized the filing of the Complaint between July 30 and August 10,
6 2020, just before the August 11 wire transfers. *Id.*⁷

7 **C. Revlon Offers to Exchange the 2021 Notes**

8 As noted above, the maturity date on the Loan was subject to
9 acceleration if the 2021 Notes remained outstanding on November 16,
10 2020. On August 7, 2021, four days prior to Citibank’s accidental
11 payment, Revlon offered to exchange the 2021 Notes for new notes due
12 in 2024. J.A. 1359. Revlon’s purpose in making the exchange offer was to
13 avoid the acceleration of the 2016 Loan. J.A. 861 [Tr. 889-90]; J.A.867 [Tr.
14 913]. Needless to say, none of Revlon’s disclosures with regard to the
15 exchange mentioned anything about raising funds to pay off the 2016
16 Term Loan, as Revlon was giving no consideration to making such a

⁷ The *UMB Bank* action was voluntarily dismissed on November 6, 2020.

1 payment. J.A. 867-68 [Tr. 914-917].

2 **D. The Events of August 11, 2020**

3 On August 2, 2020, five of the Debtholders, all managed by Angelo
4 Gordon and Co. (“Angelo Gordon”), were exchanging their positions in
5 the 2016 Loan for positions in the new Revlon credit facility via a “roll-
6 up” transaction. *Id.* at 400. As part of a “roll-up” transaction, the borrower
7 pays the exchanging debtholder interim interest accrued as of the date of
8 the transaction, but does not pay the outstanding principal; instead, the
9 borrower delivers notes for the principal amount of the new loan. *Id.* at
10 399. For reasons of administrative convenience in effectuating the Angelo
11 Gordon roll-up, Revlon decided to pay accrued interest to *all* of the 2016
12 Debtholders, even though no interim interest payment was due to those
13 not participating in the Angelo Gordon roll-up. *Id.* at 400. To that end, on
14 August 11, 2020, Revlon sent Citibank a direction letter instructing
15 Citibank to effectuate the repurchasing of the Angelo Gordon
16 Debtholders’ interests in the 2016 Loan as part of the roll-up transaction,
17 specifying August 11, 2020, as the repurchase date. Citibank did not

1 notify other Debtholders that it would be rolling up the Angelo Gordon
2 debt. The other 2016 Debtholders thus had no awareness that they would
3 receive accrued interest on the date of the Angelo Gordon roll-up.

4 Citibank's Asset-Based Transitional Finance ("ABTF") team, a
5 subgroup of Citibank's Loan Operations group that is focused on
6 processing and servicing asset-based loans, was tasked with executing
7 the roll-up. This would be done on Flexcube, a software application and
8 loan processing program, which Citibank used for initiating and
9 executing wire payments. *Id.* at 400. On Flexcube, the easiest (or perhaps
10 only) way to execute the transaction — to effectuate the roll-up, paying
11 interim interest accrued as of August 11, 2020, and reconstitute the 2016
12 Loan with only the remaining Debtholders — was to enter it in the system
13 as if paying off the loan in its entirety, thereby triggering accrued interest
14 payments to all Debtholders, while directing the principal portion of the
15 payment to a "wash account" — an internal Citibank account used to
16 account for internal cashless fund entries, ensuring that the money does
17 not leave the bank. *Id.* at 400-01. At around 4:00 p.m. on August 11, 2020,

1 the ABTF team was informed that there would be a “Roll-up Repurchase
2 for Revlon TL 2016 scheduled to close either 8/11/2020 or 8/12/2020” and
3 was told to “pay the Principal to the Wash Account when accrued interest
4 is processed effective 8/11/2020.” *Id.* at 401.

5 At 4:54 p.m., Citibank received from Revlon the funds needed to
6 make the interest payments to the Debtholders, and the ABTF team was
7 instructed to proceed. *Id.* Several members of the ABTF team, including
8 some of those involved in processing the August 11 wire transfers, were
9 employees of Wipro Limited (“Wipro”), an entity based in India. These
10 Wipro employees worked exclusively on Citibank matters and
11 maintained Citibank email addresses. *Id.* After receiving the 4:54 p.m.
12 email, Arokia Raj, a Wipro team manager and member of Citibank’s
13 ABTF team, directed Santhosh Kuppusamy Ravi, another Wipro
14 employee, to begin processing the transaction according to the
15 instructions the ABTF team had received. *Id.* The ABTF team understood
16 that it was expected to remit interest payments to the Debtholders and to
17 move an amount equal to the outstanding principal — approximately

1 \$894 million — into Citibank’s internal wash account. The principal was
2 not to be sent to the Debtholders or to leave the bank at all. *Id.* Placing the
3 principal into the wash account would allow the loan to then be rebuilt
4 to reflect a slightly smaller remaining principal balance following the roll-
5 up of the Angelo Gordon Debt.

6 To process a transaction of this type, the ABTF team needed to
7 undertake a number of steps including creating an interest schedule,
8 drafting invoices (“Calculation Statements”) to be sent to Debtholders,
9 and inputting payment instructions in Flexcube. *Id.* The transaction was
10 subject to Citibank’s “six-eye” approval procedure, which requires that
11 three people review and approve a transaction before it is executed.
12 Under this procedure, (1) the “maker” — in this case, Ravi — first inputs
13 the payment information into Flexcube; (2) the “checker” — here, Raj —
14 then reviews and verifies the transaction; and finally (3) the “approver”
15 — here, Vincent Fratta, a Citibank senior manager based in Delaware —
16 serves as a final check on the maker and checker’s work. *Id.*

17 Because the vast majority of wire transactions that Citibank

1 processed using Flexcube involved the payment of funds to third parties,
2 the default option, unless suppressed, causes any payment entered into
3 the system to be transferred as a wire payment. *Id.* Citibank’s internal
4 Fund Sighting Manual provided instructions for suppressing Flexcube’s
5 default. When entering a payment, the employee would be presented
6 with a menu with several boxes that could be checked along with an
7 associated field to input the account number. *Id.* The Fund Sighting
8 Manual explained that, in order to suppress payment of a principal
9 amount, “ALL of the below field[s] must be set to the wash account:
10 FRONT [;] FUND [; and] PRINCIPAL” — meaning that the employees
11 were required to check all three of those boxes and input the wash
12 account number into the relevant fields. *Id.* at 402. Notwithstanding these
13 instructions, Ravi, Raj, and Fratta all believed — incorrectly — that a wire
14 transfer of the principal could be properly suppressed by setting only the
15 “PRINCIPAL” field to the wash account. *Id.* Accordingly, when Ravi built
16 out the transaction between 5:15 and 5:45 p.m., he checked off only the
17 PRINCIPAL field, and did not check the FRONT and FUND fields.

1 At 5:45 p.m., Ravi emailed Raj for approval of the transaction,
2 explaining that “Princip[al] to Wash A[ccount] & Interest to DDA
3 [Demand Deposit Account].” *Id.* After reviewing the transaction, Raj
4 believed — incorrectly — that the principal would be sent to the wash
5 account and only the interest payments would be sent out to the
6 Debtholders. Raj then emailed Fratta, seeking final approval under the
7 six-eye review process, explaining, “**NOTE:** Principal set to Wash and
8 Interest Notice released to Investors.” *Id.* Fratta, also believing incorrectly
9 that the default instructions were being properly overridden, responded
10 to Raj via email, “Looks good, please proceed. Principal is going to wash.”
11 *Id.* at 402-03.

12 Raj then proceeded with the final steps to approve the transfers,
13 which prompted a warning on his computer screen — referred to as a
14 “stop sign” — stating: “Account used is Wire Account and Funds will be
15 sent out of the bank. Do you want to continue?” *Id.* at 403. But the “stop
16 sign” indicated neither the amount that would be “sent out of the bank,”
17 nor whether it constituted the amount of the interest payment (which was

1 intended to be sent out of the bank), the amount of the outstanding
2 principal on the loan, or a total of both. *Id.* Because Raj intended to release
3 the interim interest payment to the Debtholders, he clicked “YES.” *Id.*
4 Shortly after 6:00 p.m., Raj emailed confirmation of the transaction to the
5 team: “Principal set to wash and Interest paid to investors with Invoice.”
6 *Id.* At 6:53 p.m., following standard procedure, Ravi sent Raj the back-up
7 documentary support for the transaction, including the approval emails,
8 a record of receipt of the interest payment from Revlon, and screenshots
9 from Flexcube showing that the payments had been made. Although
10 these screenshots showed both \$7.8 million in interest and \$894 million in
11 principal under the “Amount Paid” field, Ravi did not perceive anything
12 to be amiss because he believed — incorrectly — that the system reflected
13 the principal as having been paid to Citibank’s internal wash account. *Id.*

14 The ABTF team was also responsible for generating and sending to
15 the Debtholders the Calculation Statements, which provided notice of the
16 payment of interest. *Id.* The Calculation Statements, of course, made no
17 mention of a payment of principal. They were sent to the Debtholders

1 through custodians, administrators, or trustees at approximately 5:30
2 p.m. on August 11, 2020 — shortly before the payments themselves. *Id.*
3 Each Calculation Statement stated: “Please be advised that Interim Libor
4 Interest will be paid on the LIBOR outstanding under the above
5 referenced facility,” *i.e.*, the 2016 Loan. *Id.* Each Calculation Statement
6 then explained that “[i]nterim interest is due as per the detailed
7 calculation below.” *Id.* The “Interest Due Period” was listed as “29-MAY-
8 2020 to 11-AUG-2020.” *Id.* After listing the applicable interest rate and
9 number of days, each Calculation Statement included a “Total Due,”
10 followed by a dollar amount — the amount of accrued interest being paid
11 to the particular Debtholder. Next, each Calculation Statement explained,
12 “We will credit your account representing the above Interim Interest
13 based on the following instructions,” listing a “Credit Date” of “11-AUG-
14 2020”; a “Total Due,” followed by the same dollar amount; a deduction
15 for tax withholding; and finally a “Credit Amount” (the amount of
16 interest being paid). *Id.*

1 In total, Citibank paid out \$894 million in principal and \$7.8 million
2 in interim interest. The amount received by the Debtholders matched to
3 the penny the amount of principal and accrued interest outstanding on
4 the 2016 Loan for each Debtholder. *Id.* at 432. The \$894 million principal
5 payment was made with Citibank’s own funds, as Revlon, of course, had
6 no intention of making that payment. At the time, the 2016 Loan was
7 trading between 20-30 cents on the dollar. *See* J.A. 778, 815, 890 [Tr. 559,
8 704, 1004-05].

9 **E. Citibank’s Response to the August 11 Wire Transfers**

10 Around 9:00 a.m. the following day, August 12, 2020, Raj, as part of
11 his normal responsibilities, began reviewing the “cash break manager
12 application” to identify any “cash breaks” — that is, discrepancies
13 between credits and debits from the previous day’s transactions. *In re*
14 *Citibank*, 520 F. Supp. 3d at 404. This type of reconciliation activity is an
15 important back office function at most financial institutions and is
16 undertaken to ensure that anticipated incoming and outgoing payments
17 match the actual banking activity. *Id.* Raj quickly discovered significant

1 discrepancies in surprisingly large amounts and realized that, in addition
2 to the intended interest payments, amounts equal to the outstanding
3 principal balance on the 2016 Loan had gone to the Debtholders, instead
4 of going to the wash account. *Id.* At 9:37 a.m., Raj emailed Fratta that
5 “Principal was set to wash and only Interest was set to DDA. But, it looks
6 like funds ha[ve] gone out Can you please review and advi[s]e if this
7 need[s] to be raised to tech.” *Id.* Fratta expressed surprise and suggested
8 in a chat with Raj that the principal payment could have been the result
9 of a “tech issue.” *Id.*

10 At 9:52 a.m., Fratta broke the news to his supervisor, Vincent
11 Farrell, head of Citibank’s North American Loan Operations, in a Skype
12 chat. “[B]ad news,” he wrote. “[P]rincipal to wash, wires look[] like they
13 went out the door.” *Id.* Fratta followed up a few minutes later: “[Y]up,
14 confirmed. [P]rincipal out the door when it was supposed to be sent to
15 wash for Revlon restructure.” *Id.* At 10:26 a.m., Fratta emailed Citibank’s
16 technology support group:

1 Yesterday we processed a payment with Principal to the
2 wash and Interest to be sent to noteholders. All details in the
3 front end screens yesterday le[d] us to believe that the
4 payment would be handled in that manner Screenshots
5 provided below indicating that the wash account . . . is
6 present and boxes checked appropriately for the principal
7 components.

8 *Id.* Fratta then forwarded the same email to members of his team, with
9 the subject line “Urgent Wash Account Does not Work.” *Id.* He stated:
10 “Flexcube is not working properly, and it will send your payments out
11 the door to noteholders/borrowers. The wash account selection is not
12 working. This led to ~1BN going out the door in error yesterday for an
13 ABTF Deal, Revlon.” *Id.*

14 At 10:46 a.m., Ravi also emailed the technical support team,
15 attaching screenshots of the Flexcube options that had been selected and
16 explaining that “[w]e have processed principal to wash and Interest to
17 DDA[,] however funds ha[ve] gone out along with principal in the . . .
18 transaction.” *Id.* Over the course of the day, Fratta learned that the
19 principal payments were not caused by a system failure, but by human
20 error: the failure to select the FRONT and FUND fields when inputting

1 the default override instructions in Flexcube. *Id.* at 404-05. Around 1:53
2 p.m., Fratta emailed his front office colleagues working on the 2016 Loan
3 and explained:

4 During our processing and internal rebooking of this
5 Agented deal, we had a processing error, which [led] to the
6 full principal amount of the loan outstanding being sent via
7 wire to all of the noteholders in the deal. Each of the 315
8 noteholders received their pro rata share of 893,944,008.52 as
9 of 8/11/20 of the full amount of the loan, which is incorrect.
10 We intended to only remit their share of interest and not the
11 principal. We will be contacting the lenders asking them to
12 return their share of this erroneous payment as soon as
13 possible.

14 *Id.* at 405.

15 At approximately 2:25 p.m., Citibank began sending Recall Notices
16 to the Debtholders explaining that funds had been transmitted
17 erroneously. *Id.* The first set of Recall Notices informed recipients that
18 “we have paid Interest accrual from May 29th to August 11th. Your share
19 of Principal amount was also released erroneously.” *Id.* After listing the
20 recipient’s share of the principal payment, each Recall Notice in the first
21 tranche requested that the recipient “[p]lease return the principal portion

1 of the payment you received ... as soon as possible.” *Id.* At
2 approximately 6:00 p.m. on August 12th, Citibank sent out a second set
3 of Recall Notices, similarly listing an “Amount Paid in Error” and
4 advising each recipient that “we have paid Interest accrual from May 29th
5 to August 11th. An additional amount was included in your interest
6 payment in error and you were overpaid. Please return the amount listed
7 below as soon as possible.” *Id.* Citibank distributed a third set of Recall
8 Notices the next day, August 13th, largely identical to the second set of
9 notices sent out the previous day. *Id.* Finally, Citibank sent additional
10 follow-up Recall Notices a few days later, stating that “on August 11,
11 2020, Citibank funds were mistakenly remitted to you. To be clear, those
12 funds belong solely to Citibank; they are not borrower or Revlon 2016
13 Loan facility funds. In view of this mistaken transfer, you are legally
14 obligated to return those funds and, as is standard industry practice when
15 fund transfers occur mistakenly, we expect that you will return those
16 funds to Citibank immediately.” *Id.* Throughout this period, Citibank also
17 made other efforts to contact the Debtholders and their related entities,

1 including Defendants, regarding return of the erroneous transfers. *Id.*

2 **F. Defendants' Responses to the August 11 Wire Transfers** ⁸

3

4 Managers representing approximately two hundred Debtholders

5 honored Citibank's Recall Notices and returned about \$385 million to

6 Citibank. However, the ten Defendants representing 126 Debtholders

7 with approximately \$500 million in debt refused to return the funds.

8 Six of the ten Defendants did not become aware that their clients

9 had received payments exceeding accrued interest until their receipt of

10 notification from Citibank that the payment had been made in error. *Id.*

11 at 406 (Bardin Hill), 407 (Greywolf), 408 (New Generation and Medalist),

12 and 409 (ZAIS and Tall Tree).

13 The four remaining Defendants became aware of the principal

14 payment prior to receipt of the Recall Notices:

15 (i) Allstate learned of the transaction on the morning of August 12

16 and raised the question in-house, "Could this be a mistake?" but made

⁸ The responses of the Defendants are laid out in further detail in the district court's opinion.

1 no effort to learn the answer other than by checking to see whether the
2 principal payment had gone to its Debtholder-clients. *Id.* at 406. At trial,
3 the author of the message testified that "her reference to a 'mistake'
4 . . . was not to Citibank or Revlon, but to the possibility that the report of
5 funds received had been mistaken." *Id.* at 438. Allstate was sent a Recall
6 Notice by 3:05. *Id.* at 406.

7 (ii) Brigade received an email from an administrator for several of
8 its clients, attaching a cash flow statement indicating the payment. *Id.* at
9 407. It received the email at 11:29. *Id.* at 436. By around 2:30 p.m., Jeffery
10 Frusciante, a bank debt manager at Brigade, messaged Brigade's internal
11 counsel, asking: "Revlon full paydown?" *Id.* at 407. Shortly thereafter,
12 Frusciante noted that Citibank "just . . . sent a notice" advising that the
13 share of principal was "released erroneously." *Id.*

14 (iii) Symphony took steps to determine from administrators and
15 custodians for its Debtholder-clients whether each of them had received
16 similar payments of principal, and on learning that each had received
17 such payments, it instructed a custodian to apply the funds on its books

1 as a loan paydown. Citibank sent Symphony a recall notice at 2:23 p.m.
2 On receipt of Citibank's Recall Notice advising of the error, it instructed
3 its custodians not to comply. *Id.* at 408.

4 (iv) At HPS, early on the morning of August 12, a fund
5 administrator sent management an email expressing surprise that "there
6 was a full princip[al] repayment on this instrument . . . as the [Calculation
7 Statement sent by Citibank] does not indicate it." *Id.* at 407. By that
8 afternoon, HPS learned from the administrators of its funds that the full
9 amount of principal and interest had been received from Citibank the day
10 before. Around 2:30 p.m., it received Citibank's Recall Notice. *Id.*

11 In no instance did any Defendant call Citibank or Revlon or make
12 any other inquiry (other than ascertaining the receipt by its Lender clients
13 of payments equaling the outstanding balance on their loans).

14 **G. Procedural History**

15 Citibank commenced this litigation on August 17, 2020 by filing suit
16 against Brigade, bringing claims of unjust enrichment, conversion,
17 money had and received, and payment by mistake.

1 The next day, Citibank filed a second lawsuit alleging substantially
2 identical claims against HPS and Symphony. Finally, on August 20, 2020,
3 Citibank filed a third lawsuit bringing the same claims against the
4 remaining Defendants. The district court promptly issued temporary
5 restraining orders (“TROs”) barring the Defendants and their “agents,
6 servants, employees, officers and all persons and entities in active concert
7 and participation with them” from “removing, withdrawing,
8 transferring, assigning, or otherwise disposing of” the funds in
9 contention. The district court also consolidated the three cases pursuant
10 to Federal Rule of Civil Procedure 42(a)(2). On consent of the parties, the
11 consent of the Defendants to extensions of the TROs, and a finding of
12 good cause, the district court consolidated the hearing on any motion for
13 a preliminary injunction with trial on the merits, as expressly authorized
14 by Federal Rule of Civil Procedure 65(a)(2).⁹

⁹ We express special admiration for the district court’s handling of Citibank’s motion for a preliminary injunction to freeze the funds it had accidentally paid. The court, after granting TROs, secured the consent of the Defendants (excepting one which did not yet have counsel but

thereafter, upon obtaining counsel, made no objection) to an extension of the TROs through trial. The court then consolidated the hearing on the preliminary injunction motion with trial and conducted trial without unnecessary delay, after allowing the parties the time needed for discovery. In circumstances where the non-moving parties will not suffer excessive harm resulting from such an extension of a TRO through trial, this procedure substantially serves the interests of all concerned, potentially saving very substantial time and money without adverse consequences.

Many preliminary injunction rulings, including appeal from the district court's grant or denial of relief, take close to a year, or more, to resolve. In addition, in many cases the ultimate ruling on preliminary injunction will fail to make clear which side will ultimately prevail, thus still requiring trial on the merits. This can be for many reasons, including that the standard for grant of a preliminary injunction turns not on entitlement to final relief but only on *likelihood* of success on the merits, that the trial evidence will not be limited to the preliminary injunction evidence, and that at trial there may be a new factfinder (the jury). In short, separate proceedings on the preliminary injunction motion can consume vast amounts of time and money with very little benefit. We of course recognize that in many cases the imminence of irreparable harm to one side or the other requires immediate, separate litigation of the motion, but in other cases, the procedure adopted by the district court can vastly improve the efficiency and value of the judicial process. *See* FED R. CIV. P. 65, advisory comm. note to 1966 amendment ("The authority [to consolidate the preliminary injunction hearing with a trial on the merits] can be exercised with particular profit when it appears that a substantial part of evidence offered on the application will be relevant to the merits and will be presented in such form as to qualify for admission on the trial proper It is believed that consolidation can be usefully availed of in many cases.").

1 In December 2020, the district court held a bench trial. Due to the
2 ongoing COVID-19 pandemic, with agreement of the parties, the bench
3 trial was conducted remotely using a Zoom-based video-conferencing
4 platform with direct testimony taken largely by affidavit.

5 Following the trial, the district court ruled that the Defendants were
6 entitled to keep the funds mistakenly paid. Relying on the *Banque Worms*
7 decision of the New York Court of Appeals, *Banque Worms v. BankAmerica*
8 *Int'l*, 570 N.E.2d 189 (N.Y. 1991), the court concluded that Defendants had
9 “established the elements of the discharge-for-value defense,” *id.* at 415,
10 reasoning that on the date of the mistaken payment, the Debtholders
11 were creditors of Revlon; each was owed – in principal and interest – the
12 exact amount of money that they received from Citibank; neither the
13 Debtholders nor the Defendants made misrepresentations to induce the
14 mistaken wire transfers; nor were the Debtholders or the Defendants on
15 notice of Citibank’s mistake. *Id.* at 431-39. Citibank brought this appeal.

1 On June 15, 2022, while this appeal was under advisement, Revlon
2 filed for Chapter 11 bankruptcy. *In re: Revlon, Inc.*, No. 22-10760 (DSJ)
3 (Bankr. S.D.N.Y.).¹⁰

4 STANDARD OF REVIEW

5 “[A]fter a bench trial, we review the district court’s finding of fact
6 for clear error and its conclusions of law *de novo*. Mixed questions of law
7 and fact are also reviewed *de novo*.” *Kreisler v. Second Ave. Diner Corp.*, 731
8 F.3d 184, 187 n.2 (2d Cir. 2013) (citation omitted).

9 DISCUSSION

10 I. The *Banque Worms* Exception

11
12 The traditional rule of New York law governing mistaken
13 payments generally calls for restitution of the mistaken payment unless
14 the recipient so significantly changed its position in reliance on the
15 mistake that it would be unjust to require repayment. The Court of
16 Appeals has explained, “In the area of restitution, New York has long
17 recognized the rule that ‘if A pays money to B upon the erroneous

¹⁰ The automatic bankruptcy stay does not apply to this appeal.

1 assumption of the former that he is indebted to the latter, an action may
2 be maintained for its recovery.'" *Banque Worms*, 570 N.E.2d at 191.

3 This rule "is predicated upon the principle that a party who pays
4 money under a mistake of fact, to one who is not entitled thereto, must in
5 equity and good conscience be permitted to get it back. That is a well-
6 recognized principle of law" *Ball v. Shepard*, 95 N.E. 719, 721 (N.Y.
7 1911); see also *Kingston Bank v. Eltinge*, 40 N.Y. 391, 395 (1869) ("The
8 defendants have received the money, which should have been paid to the
9 plaintiffs, by their assent it is true, but which assent was based upon a
10 mistake of fact. The principles of law will not permit the defendants to
11 retain this money, unless there is something in the case to take it out of
12 the general rule.").

13 The ruling of the New York Court of Appeals in *Banque Worms*
14 endorsed an exception to that traditional rule based on the First
15 Restatement's discharge-for-value principle.

16 In *Banque Worms*, Security Pacific International Bank, acting on
17 behalf of its client Spedley Securities, had mistakenly sent nearly \$2

1 million by wire transfer to Banque Worms, intended as repayment of
2 Worms's loan to Spedley. *Banque Worms*, 570 N.E.2d at 190. The mistaken
3 payment resulted from the following circumstances (in somewhat
4 simplified version).

5 Worms had extended a loan to Spedley that was due and payable.
6 *Banque Worms v. Bank Am. Int'l*, 726 F. Supp. 940, 940 (S.D.N.Y. 1989).
7 Worms called for repayment, and Spedley accordingly instructed its
8 bank, Security Pacific, to send its repayment using funds provided by
9 Spedley. *Id.* Spedley, however, then changed its mind and sent Security
10 Pacific a countermanding instruction, now directing that the funds be
11 paid to a different payee. *Banque Worms*, 570 N.E.2d at 190-191. In the
12 confusion arising from its client's change of instructions, Security Pacific
13 mistakenly sent the repayment to Worms. *Id.* at 191.

14 Upon recognition of its mistake Security Pacific demanded that
15 Worms return the mistaken payment. *Id.* Worms refused to return the
16 mistaken payment. *Id.* In the ensuing litigation, initially brought in the

1 United States District Court for the Southern District of New York,
2 Security Pacific sought restitution.

3 Upon appeal, our court certified to the New York Court of Appeals
4 the question whether “New York would apply the ‘Discharge for Value’
5 rule as set forth at Section 14 of the [First] Restatement of Restitution or,
6 in the alternative, whether. . . New York would apply that rule that holds
7 money paid under a mistake may be recovered, unless the payment has
8 caused such a change in the position of the receiving party that it would
9 be unjust to require the party to refund.” *Id.* The Court of Appeals
10 concluded that “the discharge-for-value” rule would be applied, and that
11 Worms was entitled to keep the funds. *Id.*

12 The term *discharge-for-value* was first employed (so far as we know)
13 by the American Law Institute in its 1937 First Restatement of Restitution
14 as the caption for the principle set forth in Section 14. First Restatement §
15 14. The text of the rule set forth under that caption reads as follows:

16 A creditor of another or one having a lien on another’s
17 property who has received from a third person any benefit in

1 discharge of the debt or lien, is under no duty to make
2 restitution therefor, although the discharge was given by
3 mistake of the transferor as to his interests or duties, if the
4 transferee made no misrepresentation and did not have
5 notice of the transferor's mistake.

6
7 First Restatement § 14. The Restatement described that rule as "a specific
8 application of the underlying principle of bona fide purchaser," the rule
9 covered at Section 13 of the First Restatement. First Restatement § 14 cmt.

10 a.

11 The *Banque Worms* court explained:

12 When a beneficiary receives money *to which it is entitled and has no*
13 *knowledge that the money was erroneously wired*, the beneficiary
14 should not have to wonder whether it may retain the funds; rather,
15 such a beneficiary should be able to consider the transfer of funds
16 as a final and complete transaction, not subject to revocation.

17
18 570 N.E.2d at 196 (emphases added).

19 The Court related its ruling to New York's then recent adoption of
20 Article 4A of New York's Uniform Commercial Code governing wire
21 transfers of funds. The Court noted in an extensive discussion that the
22 New York legislature, by adopting Article 4A, had accorded importance
23 to the "speed, efficiency, certainty [of wire transfers] (i.e. to enable

1 participants in [wire] fund transfers to have better understanding of their
2 rights and liabilities), and finality.” *Id.* at 195. It reasoned that “[the]
3 discharge-for-value rule is consistent with and furthers the policy goals
4 of finality in business transaction and may appropriately be applied in
5 respect to electronic funds transfers.” *Id.* at 196.

6 In this litigation in the district court, the Defendants pleaded the
7 applicability of *Banque Worms* and the First Restatement’s discharge-for-
8 value rule. Citibank advanced three arguments in opposition:

- 9 (i) Under the *Banque Worms* opinion, the discharge-for- value
10 rule applies only when the recipient of the mistaken payment
11 is “entitled” to the funds. It has no application here as the 2016
12 Loan was not payable for another three years;
- 13 (ii) The Defendants did not receive value in satisfaction of the
14 discharge-for-value rule as none of them credited Revlon on
15 their books after receipt of Citibank’s apparent repayment of
16 Revlon’s loan;

1 (iii) The Defendants had constructive notice, which qualifies as
2 “knowledge,” of the error, and therefore do not qualify under
3 the discharge-for-value rule for relief from the obligation to
4 make restitution.

5 The district court in a thorough and careful opinion rejected each of
6 these contentions.

7 Notwithstanding the district court’s impressive and scholarly
8 handling of the case, we respectfully disagree with some of its
9 conclusions. We conclude that Citibank is entitled to prevail under the
10 New York rule expressed in *Banque Worms* because (i) under the
11 standards of New York law, the Defendants had constructive notice of
12 Citibank’s error, and (ii) the Defendants were not entitled to the money
13 at the time of Citibank’s accidental payment, as required by the *Banque*
14 *Worms* ruling.

15 **A. Defendants cannot claim the benefit of the discharge-for-value**
16 **rule because they were on notice of a mistake.**

17
18 As we read the law of New York, the discharge-for-value rule does
19 not shield the beneficiary of a mistaken transfer from claims for

1 restitution if the beneficiary is on inquiry notice of the mistake. We
2 conclude further, based on the facts available to the Defendants on
3 August 11, that the standard of inquiry notice was satisfied. The facts
4 were sufficiently troublesome that a reasonably prudent investor would
5 have made reasonable inquiry, and reasonable inquiry would have
6 revealed that the payment was made in error.

7 **1. New York's notice standard**

8
9 The parties agree that in New York the recipient of a mistaken
10 payment does not receive the benefit of the discharge-for-value rule if it
11 has constructive notice that the payment resulted from a mistake. As
12 expressed in Section 14 of the First Restatement, the transferee of the
13 payment "is under no duty to make restitution therefor . . . if the
14 transferee made no misrepresentation and *did not have notice of the*
15 *transferor's mistake.*" First Restatement § 14 (emphasis added). Although
16 in agreement that Section 14's reference to "notice" and Banque Worms
17 reference "knowledge" mean constructive notice, the parties disagree as

1 to how the standard of constructive notice is understood in New York
2 law.

3 Defendants contend that constructive notice is evaluated by asking
4 what the transferee “knew or should have known” of the transferor’s
5 mistake.¹¹ Citibank contends that New York law applies the inquiry
6 notice standard, of which the New York Court of Appeals has written:

7 One who has reasonable grounds for suspecting or inquiring
8 ought to suspect, ought to inquire, and the law charges him
9 with the knowledge which the proper inquiry would
10 disclose. . . . If a person has knowledge of such facts as
11 would lead a fair and prudent man, using ordinary
12 thoughtfulness and care, to make further accessible inquiries,
13 and he avoids the inquiry, he is chargeable with the
14 knowledge which by ordinary diligence he would have
15 acquired. Knowledge of facts, which, to the mind of a man of
16 ordinary prudence, beget inquiry, is actual notice, or, in other
17 words, is the knowledge which a reasonable investigation

¹¹ Defendants argued below that, for the purpose of the discharge-for-value rule, a transferee has notice of a transferor’s mistake only if he or she has “actual knowledge” of the error. The district court rejected this argument, finding that the discharge-for-value rule required application of a constructive notice standard. *In re Citibank*, 520 F. Supp. 3d at 430. Defendants do not challenge that conclusion on appeal, and instead argue that constructive notice here means “knew or should have known” rather than on inquiry notice.

1 would have revealed.

2 *Fidelity & Deposit Co. of Maryland v. Queens County Trust Company*, 123
3 N.E.370, 372-73 (N.Y. 1919).

4 The district court did not decide that issue – finding that it was
5 unnecessary to do so because, in the district court’s view, the Defendants
6 lacked constructive notice under either standard, *Citibank*, 520 F. Supp.
7 3d at 431-440, and, in any event, if inquiry notice is the standard, this
8 would not negate the Defendants’ entitlement to the discharge-for-value
9 defense because the Defendants conducted a reasonable inquiry which
10 did not reveal the error. *Id.* at 439-40. The district court reached the latter
11 conclusion on the basis that four of the ten Defendants – Allstate, Brigade,
12 HPS, and Symphony – ascertained that more than one of their Lender
13 clients had received payment of the outstanding principal amount of their
14 loans, supporting the inference that Citibank had paid to the penny the
15 outstanding principal and accrued interest, that this constituted
16 reasonable inquiry, and it did not reveal the error. *Id.*

1 We believe Citibank has the better argument as to what constitutes
2 constructive notice in New York. Both New York law and the First
3 Restatement apply the inquiry notice standard and not a standard of
4 “knew or should have known.” As noted above, the Court of Appeals
5 endorsed the inquiry notice standard in *Fidelity & Deposit Co. of Maryland*.
6 It had previously adopted the same standard in *Williamson v. Brown*, 15
7 N.Y. 354, 362 (1857) (“where a purchaser has knowledge of any fact,
8 sufficient to put him on inquiry as to the existence of some right or title
9 in conflict with that he is about to purchase, he is presumed either to have
10 made the inquiry, and ascertained the extent of such prior right, or to
11 have been guilty of a degree of negligence equally fatal to his claim, to be
12 considered as a bona fide purchaser.”), and in *Anderson v. Blood*, 46 N.E.
13 493, 495 (N.Y. 1897. *See also Majer v. Schmidt*, 564 N.Y.S.2d 722, 725 (1st
14 Dep’t 1991) (“A person is chargeable with constructive notice of any fact
15 which would have been disclosed by a reasonably diligent inquiry if
16 circumstances are such as to indicate to a person of reasonable prudence

1 and caution the necessity of making inquiry to ascertain the true facts and
2 he or she avoids such inquiry.”).

3 New York courts have applied this interpretation of constructive
4 notice in many different contexts. *Bennett v. Buchan*, 76 N.Y. 386, 390
5 (1879) (applying an inquiry notice standard in determining whether an
6 assignee of a judgment took the assignment with notice that the judgment
7 was worth less than the amount covenanted in the assignment); *Claflin v.*
8 *Lenheim*, 66 N.Y. 301, 305-07 (1876) (applying an inquiry notice standard
9 to determine whether the seller of goods was on notice that the purchaser
10 lacked authority to purchase goods on behalf of the defendant); *Majer*,
11 564 N.Y.S.2d at 725 (applying an inquiry notice standard to determine
12 whether recipients of funds were aware that the funds had been illegally
13 converted from an estate); *Metro. Life Ins. Co. v. Morris*, 507 N.Y.S.2d 713,
14 715 (2d Dep’t 1986) (applying an inquiry notice standard to determine
15 whether property owners had been aware of a court order permitting
16 them to redeem property). And in *In re Brainard Hotel Co.*, 75 F.2d 481 (2d
17 Cir. 1935), this Court stated in a case governed by New York law that

1 whether a hotel that had received funds stolen from a guest as repayment
2 for funds embezzled from the hotel could refuse to make restitution to
3 the guests on the grounds that it was a bona fide purchaser turned on
4 whether the hotel's treasurer "should have suspected that [the money]
5 was improperly procured, and should have pressed his suspicions by
6 inquiry." *Id.* at 482.

7 Conversely, we are aware of no New York cases where a party's
8 liability turned on whether the party had constructive notice of a fact, but
9 the court declined to apply an inquiry notice standard.

10 The First Restatement also makes clear that inquiry notice is the
11 applicable standard to assess discharge-for-value under Section 14.¹²
12 According to the First Restatement, the discharge-for-value rule "is a
13 specific application of the underlying principle of bona fide purchase." §

¹² The same standard of inquiry notice is also espoused by the Third Restatement of Restitution and Unjust Enrichment, which states that "[a] person has reason to know a fact if . . . other facts known to the person would make it reasonable to infer the existence of the fact, or prudent to conduct further inquiry that would reveal it." RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT ("Third Restatement") § 69(3)(c).

1 14, cmt. a. The bona fide purchaser rule is covered in Section 13 of the
2 First Restatement. Comment b to Section 13 tells that “the rules
3 determining when there is notice are stated in Section 174.” Section 174
4 in turn states that:

5 A person has notice of facts giving rise to a constructive trust
6 not only when he knows them, but also when he should
7 know them; that is when he knows facts which *would lead a*
8 *reasonably intelligent and diligent person to inquire* whether
9 there are circumstances which would give rise to a
10 constructive trust, and if such inquiry when pursued with
11 reasonable intelligence and diligence would give him
12 knowledge or reason to know of such circumstances.

13 First Restatement § 174, cmt. a (emphasis added).¹³

¹³ Defendants argue against this conclusion by pointing out that Section 14 explicitly states that “comment a on Section 13 is applicable,” but makes no such statement about comment b, the comment which refers to Section 174. We find no merit in the argument. Comment a to Section 13, which elaborates on the principle of bona fide purchases concludes by saying the principle it describes “also operates under the circumstances stated in Section 14.” Comment b to Section 13 makes cross references to other sections covering several of the terms employed in Section 13’s description of the bona fide purchase principle. We find wholly unpersuasive the Defendants’ argument that comment b of Section 13 has no application to Section 14,

1 We are not persuaded by the arguments the Defendants advance
2 against application of the inquiry notice standard. They argue that “New
3 York courts have rejected an inquiry notice standard for cases involving
4 monetary transactions”, but the cases they cite in support of this
5 proposition – *First Union Nat’l Bank v. A.G. Edwards & Sons, Inc.*, 691
6 N.Y.S.2d 491, 492 (1st Dep’t 1999), and *Hartford Accident & Indem. Co. v.*
7 *Am. Express Co.*, 542 N.E.2d 1090, 1096 (N.Y. 1989) – are inapposite. In
8 both cases, victims of a fraud had sought to recover from those who had
9 received, through normal commercial transactions, some of the
10 fraudulently obtained funds. Under the circumstances, it was necessary
11 for the plaintiffs to demonstrate that the ultimate recipients had accepted
12 the funds in bad faith. *Hartford Acc.*, 542 N.E.2d at 1094 (holding that UCC
13 § 3-304(7), applicable to transactions involving negotiable instruments,
14 required a showing of bad faith to demonstrate notice); *First Union Nat’l*,
15 691 N.Y.S.2d at 492 (requiring subjective bad faith or dishonesty for

notwithstanding Section 14’s explicit reference to the bona fide purchaser principle of Section 13.

1 recovery, by analogy to cases involving commercial paper). Both courts'
2 rulings in favor of the defendants turned not on the inapplicability of the
3 inquiry notice standard to issues of constructive notice, but on the fact
4 that inquiry notice was insufficient to establish bad faith as required.
5 *Hartford Acc.*, 542 N.E.2d at 1096; *First Union Nat'l*, 691 N.Y.S.2d 492.
6 These cases do not suggest that constructive notice, in the context of the
7 discharge for value defense, turns on any standard other than inquiry
8 notice.

9 Defendants further contend that the inquiry notice standard is
10 incompatible with the *Banque Worms* decision. We reject the argument.
11 *Banque Worms* contained no discussion of the standard of notice because
12 Worms, the recipient of the mistaken payment, had no reason whatsoever
13 to suspect that there was a mistake. The standard of notice had no bearing
14 on that case.

15 Finally, Defendants argue that *Banque Worms* implicitly rejected
16 an inquiry notice standard by stating that the recipient of a wire transfer
17 “should not have to wonder whether it may retain the funds” and

1 “should be able to consider the transfer of funds as a final and complete
2 transaction, not subject to revocation”. *Banque Worms*, 570 N.E.2d at 196.
3 We disagree. The quoted passage had nothing to do with the type of
4 notice utilized in determining whether the recipient of a mistaken
5 payment is entitled to the discharge-for-value defense. As noted above,
6 in the *Banque Worms* case, there was no issue of notice. The Court had no
7 reason to discuss it. The Defendants’ interpretation, furthermore, would
8 eliminate not only inquiry notice but all forms of notice.

9 In sum, we find it clear that inquiry notice is the applicable notice
10 standard in adjudicating a discharge-for-value defense in New York.

11 Implicit in the descriptions of the inquiry notice standard, although
12 not expressly stated, is the need in some instances in applying the
13 standard to hypothesize not only the reasonably prudent investor but
14 also certain facts providing an incentive to make inquiry. The
15 descriptions of the inquiry notice standard by New York courts quoted
16 above make frequent reference to “prudence,” to the proposition that the
17 hypothetical person “ought to inquire” so that failure to do so would

1 make the person “guilty of a degree of negligence,” to the “necessity of
2 making inquiry to ascertain the true facts,” and to “the existence of some
3 right of title in conflict with that he is about to acquire.” All of these imply
4 that the hypothetical prudent person must be imagined to risk suffering
5 some loss or harm if the benefit received proves illusory, as well as that
6 the potential loss would be avoidable if the person learned the true facts.
7 Prudence does not impose a duty to learn the true facts when one is not
8 at risk of loss or when knowing the true facts would not help one avoid
9 the loss. One cannot be said to lack prudence, or to be negligent, in failing
10 to inquire when knowledge of the true facts would change nothing.

11 On the facts of this case, the lenders who received an unexpected
12 apparent early repayment of principal from an insolvent debtor, in
13 circumstances where there were visible red flags warning that the
14 payment may have resulted from a mistake, had no incentive to
15 investigate to ascertain the truth. Their investigations in the hope of
16 learning the true facts would not have helped them avoid adverse
17 consequences. If the Lenders or their Loan Managers had called Citibank

1 and learned that the payments resulted from mistake, there is nothing
2 they could have done to change their circumstances.

3 In such circumstances, applying the inquiry notice rule requires
4 hypothesizing about the hypothetical prudent person that he faces a
5 circumstance akin to there being “some [unknown] right or title in
6 conflict with that he is about to acquire,” *Anderson*, 152 N.Y. at 293, such
7 that, by investigating the red flags to determine the true facts, he could
8 avoid the risk of loss that will arise if he fails to investigate. *See also*
9 *Williamson*, 15 N.Y. at 362; Third Restatement § 69 cmt. f (“The standard
10 that determines the inferences to be drawn and the inquiries to be made
11 is that of a reasonable and prudent person *whose interests would be served*
12 *by obtaining the knowledge in question.*”) (emphasis added).

13 In other words, to apply the inquiry notice test in these
14 circumstances, it is necessary to imagine that the hypothetical reasonably
15 prudent person, who, upon receiving the payments received by the
16 Defendants, and knowing the facts available to the Defendants, faces a
17 risk of loss if the payment turns out to be mistaken, a risk he could avoid

1 by learning the true facts. If the suspicions and warnings raised by the
2 red flags are so remote and improbable that it is consistent with
3 reasonable prudence to ignore them without making inquiry, then the
4 person is not on notice of the facts that reasonable inquiry would have
5 revealed. On the other hand, if reasonable prudence on confronting those
6 suspicions and warnings would call for making inquiry in the interest of
7 avoiding a risk of the loss that would befall him if the payments proved
8 mistaken, the person is on notice of the facts that would be revealed by
9 reasonable inquiry.

10 **2. The facts of the August 11 transfer exhibited red**
11 **warning flags that would have caused a reasonably**
12 **prudent person who faced an avoidable risk of loss to**
13 **make reasonable inquiry as to whether the transfer**
14 **resulted from mistake.**

15
16 In our view, the Defendants are not shielded from Citibank's claims
17 for restitution under the discharge-for-value rule because they were on
18 inquiry notice that the unexpected and surprising apparent repayment of
19 the full principal amount of their loans was attributable to mistake. On

1 August 11, Defendants were aware of four red warning flags consisting
2 of facts suggestive of accident or mistake.

3 a) *The absence of prior notice of a prepayment, to which the Lenders were*
4 *contractually entitled.* As explained below, the 2016 Loan Agreement
5 required that Citibank give the Defendants prior notice if Revlon
6 undertook to prepay the principal of the Loan. Section 2.11(a) of the
7 Agreement, entitled “Optional Prepayments,” permitted Revlon to make
8 prepayments, but only “upon irrevocable written notice delivered to
9 [Citibank] . . . three Business Days prior thereto.” Agreement, § 2.11(a).
10 “Upon receipt of any such notice, [Citibank was required to] *promptly*
11 *notify each relevant Lender thereof.*” *Id.* (emphasis added).

12 The Defendants, however, had received no prior notice from
13 Citibank. In fact, they did not even receive such a notice of Revlon’s intent
14 to prepay together with the payment itself on August 11, at which time
15 Citibank sent them notice of the interest being paid without reference to
16 any payment of principal. The absence of prior notice from Citibank
17 raised a substantial red flag supporting suspicion. Why would Citibank,

1 the Lenders' agent, have failed to perform its contractually required
2 obligation to give the Lenders prior notice of Revlon's huge
3 prepayment?¹⁴

4 In discussing the improbability of so gigantic a banking error, the
5 district court emphasized that Citibank was "one of the most
6 sophisticated financial institutions in the world." *In re Citibank*, 520 F.
7 Supp. 3d at 433. That same factor supports the unlikelihood that Citibank
8 would have neglected to give its clients a contractually required
9 notification in a matter of such importance.

10 b) *The apparent inability of the insolvent Revlon to make a near \$1 billion*
11 *repayment.* A hypothetical prudent investor, who suddenly received an
12 unannounced prepayment of the principal of the loan would have been
13 astonished, in light of Revlon's apparent deep insolvency, that it could

¹⁴ This was all the more surprising in that, had Revlon intended to prepay the Loan on August 11, it would have been contractually obligated to notify the Citibank five calendar days before, on Thursday August 6, three business days before the prepayment. Accordingly, five days would have passed without Citibank performing its contractual obligation to give its principals the prompt notice to which they were entitled.

1 find the resources to make a payment of nearly \$1 billion.¹⁵ The
2 Defendants believed at the time (as alleged on their behalf in the UMB
3 Bank Complaint filed on the day following the August 11 transfer) that
4 Revlon was insolvent by as much as \$1.71 billion. The belief that Revlon
5 was deeply insolvent would have prompted substantial doubts on the
6 part of the hypothetical prudent investor of Revlon's ability to make such
7 a huge cash payment.

8 Those doubts would have been heightened by the fact that, as the
9 UMB Bank Complaint filed on behalf of the Lenders explained, in May
10 2020, a few months previously, Revlon had committed as collateral assets
11 that were "enormous relative to the value of the entire Revlon
12 enterprise," UMB Comp. ¶ 2, in part by withdrawing collateral it had
13 previously committed to the 2016 Loan, committing it instead to the May
14 2020 loan, in order to secure \$800 million of new financing. Furthermore,

¹⁵ A reasonable person in the Defendants' position, on seeing that one or more of his client-Lenders received what appeared to be full repayment of principal would assume that all Debtholders received a full paydown, as the Agreement provided that optional prepayments had to be made on a pro rata basis. Agreement § 2.11(c).

1 the Defendants recognized (and the UMB Bank Complaint alleges) that
2 the COVID-19 pandemic, which was rampant in August 2020, had had
3 disastrous effects on Revlon's make-up business, further restricting
4 Revlon's access to funds. The UMB Bank Complaint, seeking to bar
5 Revlon from diverting collateral from the 2016 Loan, expressed the
6 Defendants' fear that Revlon would be incapable of paying their loan
7 when it came due. To a prudent investor who knew what the Defendants
8 knew, Revlon's sudden deployment of nearly a \$1 billion to retire the
9 2016 Loan three years before it was due would have seemed
10 bewilderingly improbable. This was a second red flag that would have
11 stimulated doubt in the prudent investor as to whether the payment
12 resulted from mistake.

13 c) *In view of the fact that the 2016 Loan was trading at 20-30 cents on the*
14 *dollar, it could have been retired far more cheaply than by paying its full value.*

15 A third red flag arose from the fact that, by reason of Revlon's perceived
16 inability to repay the 2016 Loan, loan participations were trading at 20-30
17 cents on the dollar. If Revlon wished to retire the 2016 Debt prematurely,

1 it could do so far more cheaply by buying available participations on the
2 market (until Revlon's purchases drove the price up to par) rather than
3 by paying the full-face amount of the entire debt. But there was no
4 evidence of rising market prices indicative of any sustained buying. It
5 would have seemed strange and improbable to a prudent investor for the
6 insolvent Revlon to pay much more than it needed to pay to retire the
7 Loan.

8 *d) Revlon's elaborate contrivance only four days earlier to avoid*
9 *acceleration of the 2016 Loan made no sense if Revlon was planning to retire that*
10 *debt a few days later.* As recounted above, only four days prior to the
11 August 11 surprise payment, Revlon had made an exchange offer to
12 holders of the 2021 Notes. The apparent purpose of the exchange offer (as
13 confirmed by the testimony of Revlon's former treasurer) was to avoid
14 accelerating the maturity of the 2016 Loan through failure to retire the
15 2021 Notes by November 16, 2020.¹⁶ If Revlon had been planning a

¹⁶ J.A. 861 [Tr. 889] (testimony of Warren) ([Q.] Mr. Warren, was one of the ways that Revlon was looking to address the springing maturity an

1 *voluntary* acceleration of the 2016 Loan four days later, it had no reason to
2 engage in the elaborate maneuver of the exchange offer to avoid its
3 *involuntary* acceleration.

4 * * *

5 The district court never expressly stated a conclusion as to whether,
6 under an inquiry notice standard, the facts of the August 11 transaction
7 were suspicious enough to give rise to a duty to inquire. This was because
8 the court reasoned that, if there was such a duty, the Defendants had
9 discharged it by ascertaining that Citibank's payment exactly matched
10 the outstanding principal plus accrued interest. However, the district
11 court did conclude that "most of [Citibank's] purported red flags do not
12 withstand scrutiny. And even taking them together they do not add up
13 to notice of the mistake". *In re Citibank*, 520 F. Supp. 3d at 440; *id.* at 439
14 ("it is far from clear that the facts known to any Defendant (or its agents)

exchange offer -- can you tell me publicly whether or not Revlon -- can
you tell me one of the ways that Revlon was looking to address the
springing maturity? A. Yes. . . . Revlon did launch an exchange offer
looking to exchange for new notes, as well as some cash considerations,
existing 2021 notes.).

1 made it prudent to conduct further inquiry.”) (internal quotation marks
2 removed). To the extent that the district court’s conclusion included the
3 assessment that the facts of the August 11 transfer would not have
4 sufficiently aroused the suspicions of a reasonably prudent investor to
5 prompt further inquiry, we disagree.

6 What the district court found most persuasive was the fact that
7 Citibank’s payment matched to the penny the amount of outstanding
8 principal plus interest owed to each lender. The court reasoned that:

9 where, as here, a lender is minding her own business, and
10 receives an unexpected and unscheduled payment from a
11 borrower that matches exactly the amount of the borrower’s
12 outstanding debt, it is reasonable to assume that the
13 borrower has intentionally paid off the debt. In fact, it might
14 even be unreasonable to assume otherwise.

15 *Id.* at 433.

16

17 The court further found that the Defendants “believed, and were
18 justified in believing, that the payments were intentional” because of the
19 improbability “that Citibank, one of the most sophisticated financial

1 institutions in the world, had made a mistake that had never happened
2 before, to the tune of nearly \$1 billion.” *Id.* at 451.

3 In rejecting Citibank’s arguments regarding specific red flags, the
4 court reasoned as follows.

5 As to Citibank’s argument based on Citibank not having sent the
6 Defendants prior notice of Revlon’s intent to prepay, the district court
7 dismissed this as having no red-flag significance. According to the district
8 court’s reasoning, because the Agreement did not define the word
9 “promptly,” the Agreement “did not necessarily require” that Citibank
10 notify the Defendants before, or even together with, the actual
11 prepayment. *Id.* at 443 (internal citation removed). The district court
12 further relied on the fact that Citibank’s officer who signed the Amended
13 Loan Agreement conceded in his testimony that “he did not know if
14 Citibank's obligation to ‘promptly’ notify the Lenders had to be satisfied
15 prior to payment or could be satisfied up to seven days after” *Id.*

16 As for Citibank’s argument based on the Defendants’ belief that
17 Revlon was deeply insolvent and lacked means to make a payment of

1 nearly \$1 billion, the district court, while acknowledging that the
2 argument “would undoubtedly raise a red flag in most instances,” *id.* at
3 446, rejected it in the circumstances of this case for two reasons. The first
4 was that, in the May 2020 Transaction, “Revlon was known to have paid
5 off hundreds of millions of dollars in debt, some at par, even though its
6 ‘liquidity position’ had been ‘extremely tight[.]’” *Id.* If Revlon had done
7 this in May, the district court reasoned, a reasonable investor would
8 conclude that Revlon could do it again in August. The district court’s
9 second reason was that “Revlon was known to have the financial backing
10 of billionaire Ronald Perelman and his holding company, MacAndrews
11 & Forbes Inc., an investment firm that owned approximately 85% of
12 Revlon’s equity.” *Id.* Defense witnesses had testified to having been
13 “surprised many times over the years that [Revlon was] able to get some
14 sort of a refinancing or prop up one of their entities . . . in spite of a view
15 that it was going to be very difficult or impossible to do so.” *Id.* “Given
16 the reputations and history of Revlon and Perelman,” the district court
17 concluded that those beliefs “were not unreasonable.” *Id.* It added that

1 the Defendants’ antagonisms that led to the August 12 filing of the UMB
2 Bank lawsuit made it “even more reasonable” for Defendants to believe
3 “that Revlon and Citibank, perhaps with the help of Perelman and
4 MacAndrews & Forbes, had figured out a creative way to” avert or
5 neutralize that threatened suit. *See id.* at 447.

6 We believe that the district court’s reasoning in deprecating
7 Citibank’s arguments based on these red flags depended on errors of law
8 primarily involving the application of the inquiry notice test.

9 The district court’s reasoning depended heavily on its factual
10 findings that the Defendants believed in good faith that the payments
11 they received were not the product of mistake, coupled with the court’s
12 conclusion that those beliefs were reasonable. We think this reasoning
13 represented a misunderstanding of the inquiry notice test. The test is not
14 whether the recipient of the mistaken payment reasonably believed that
15 the payment was genuine and not the result of mistake. The test is
16 whether a prudent person, who faced some likelihood of avoidable loss
17 if the receipt of funds proved illusory, would have seen fit in light of the

1 warning signs to make reasonable inquiry in the interest of avoiding that
2 risk of loss. In other words, when the information available to the
3 recipient of an apparent repayment includes facts supporting a
4 reasonable suspicion of mistake, the question is not whether the recipient
5 reasonably believed the payment was valid. It is whether a reasonably
6 prudent investor, focusing on all the available information (some
7 supporting the validity, some supporting doubts) who would be at risk
8 of an avoidable loss if the payment proved illusory, would have found
9 the factors supporting doubt sufficiently troublesome in the mix to
10 warrant making reasonable inquiry, in which case the recipient would be
11 chargeable with the knowledge that such reasonable inquiry would have
12 revealed. It is an objective test, not dependent on what the actual recipient
13 believed.¹⁷

¹⁷ Defendants argue that, under an inquiry notice standard, a court may impute to a party that which would have been learned via a reasonable inquiry only if, prior to the inquiry, the truth of the fact to be discovered via the hypothetical inquiry would appear to a reasonable person to be “probable, not merely possible.” Defs.’ Br. at 43. The only authority the Defendants cite in support of this proposition did not concern the issue

of notice in the context of a defense of bona fide purchaser for value. The issue in *Newman v. Warnaco Grp., Inc.*, 335 F.3d 187, 193 (2d Cir. 2003), was when the statute of limitations for federal securities fraud claims will begin to run. Our court ruled that the statute begins to run “when the circumstances would suggest to an investor of ordinary intelligence the probability that she has been defrauded” and that “[t]he fraud must be probable, not merely possible.” *Id.* We agree with the Defendants that, under New York’s inquiry notice test, the likelihood of fraud must be more than a mere possibility. It is always possible that the facts are otherwise than as represented. But the Defendants’ argument that it must be probable, *i.e.* more likely than not, is not consistent with standard established by the New York Court of Appeals for notice in the context of a bona fide purchaser defense. The standard, as explained above, is neither “possible” nor “probable”: it is somewhere in between and was defined by New York’s highest court as falling where a hypothetical prudent investor would be prompted to make inquiry, rather than simply assume that the facts are as represented. *Reynolds v. Com. Fire Ins. Co.*, 47 N.Y. 597, 604 (1872) (“[W]hatever is notice enough to excite attention, and put a party upon his guard and call for inquiry, is notice of everything to which such inquiry might have led.”); *Miner v. Edwards*, 634 N.Y.S.2d 306, 307 (4th Dep’t 1995) (“[I]f the facts within the knowledge of the purchaser are of such a nature, as . . . to excite the suspicion of an ordinarily prudent person and he fails to make some investigation . . . he will be chargeable with that knowledge which a reasonable inquiry, as suggested by the facts, would have revealed”) (internal quotation marks removed); *see also Fid. & Deposit Co. of Maryland*, 123 N.E. at 372 (“One who has *reasonable grounds* for suspecting or inquiring ought to suspect, ought to inquire, and the law charges him with the knowledge which the proper inquiry would disclose”) (emphasis added).

1 Thus, where, as here, there are numerous recipients of the mistaken
2 payment, the test comes out with the same result for each payee,
3 regardless of one optimistic recipient having believed in good faith that
4 the payment was valid, while another pessimistic recipient dwelled on
5 the reasons to doubt, and a third recipient, like a number of these
6 Defendants, having been oblivious to the issue. So long as the pertinent
7 available information was the same for each, the result of the test would
8 be the same for each.

9 With respect to several issues, the district court, we think
10 incorrectly, justified its conclusions on the grounds that the Defendants'
11 belief that there was no mistake was reasonable under the circumstances.
12 A conclusion that those beliefs on the part of the Defendants were
13 reasonable does not, however, negate that a reasonably prudent investor,
14 to whom the red flag information was available, would have made a
15 simple inquiry to avoid a loss. Those red flags were not explained away
16 by the unlikelihood that a mistaken payment would have matched the
17 amount of the outstanding debt.

1 Furthermore, we disagree with the district court’s reasoning in its
2 assessment of the extent to which the red flags would have raised the
3 suspicions of a hypothetical prudent investor. In particular, the court’s
4 analysis of the red flag consisting of Citibank’s failure to give the Lenders
5 notice suffered from legal error. As noted above, because Citibank’s
6 contractual obligation was to give the Lenders notice “promptly” upon
7 receipt of Revlon’s contractually mandated three days prior notice, and
8 because “promptly” was not defined in the Agreement, the district court
9 concluded that Citibank had no contractual obligation to give the Lenders
10 notice prior to the impending payment and could have waited for several
11 days until after the Lenders’ receipt of the payment without breaching its
12 contractual obligation.

13 We do not think that the Agreement’s requirement of prompt
14 notification could be reasonably interpreted as allowing delay of several
15 days so that the notice would not have arrived until after the payment.
16 Although it is true that “promptly” was not further defined by the
17 contract, that term is well understood to mean “without delay,”

1 “immediately,” or “at once.” Oxford English Dictionary (3d ed. 2007
2 online version) (defining “promptly” as “in a prompt manner; readily,
3 quickly; at once, without delay; directly, forthwith, there and then.”);
4 American Heritage Dictionary of the English Language (5th ed. 2022
5 online version) (defining “promptly” as “[b]eing on time; punctual” or
6 “[c]arried out or performed without delay”); Merriam-Webster
7 Dictionary (<https://www.merriam-webster.com/dictionary/promptly>)
8 (defining “promptly” as “in a prompt manner; without delay; very
9 quickly or immediately”). We are aware of no evidence that could
10 support the conclusion that Citibank, by waiting more than five days to
11 inform the Lenders of an incoming full prepayment of the Loan, could
12 have been said to have acted “without delay”. Of course, how much delay
13 the term “promptly” can accommodate can vary in different
14 circumstances. But, for this circumstance, the district court’s
15 interpretation of the contractual term stripped that term of its contractual
16 purpose. The provision of the Agreement, first requiring Revlon to give
17 three days’ notice to Citibank, and then requiring Citibank to “promptly”

1 notify the Lenders, had an obvious double purpose: first, to give Citibank
2 advance opportunity to prepare to discharge its obligations to receive and
3 pass on Revlon's prepayment, and then to give the Lenders advance
4 opportunity to make provisions for advantageous immediate
5 reinvestment of the funds. If, in accordance with the district court's
6 interpretation, Citibank's obligation to pass along the notice "promptly"
7 permitted Citibank to wait three, or five, or more, days before bothering
8 to advise the Lenders, effectively depriving them of any opportunity to
9 plan in advance for the reinvestment of the funds, the clause requiring
10 Citibank to act "promptly" would lose its purpose. The Lenders had no
11 need to be told of Revlon's intent to prepay after they had received the
12 prepayment.

13 We believe the district court also erred in the significance it
14 accorded to the testimony of Citibank officials to the effect that they did
15 not know whether the contractual requirement to act "promptly"
16 constituted a legal requirement of *prior* notification. For example,
17 Tichauer, the officer who signed the Loan Agreement on behalf of

1 Citibank, testified (as summarized by the district court) that “he did not
2 know if Citibank’s obligation to ‘promptly’ notify the Lenders had to be
3 satisfied prior to payment[.]” *In re Citibank*, 520 F. Supp. 3d at 443. The
4 district court treated this testimony as effectively negating Citibank’s
5 argument that the Defendants’ nonreceipt of a prior notification from
6 Citibank was a red flag. We believe this was erroneous. The Defendants
7 had no awareness of Tichauer’s thinking on whether Citibank would
8 have been under legal obligation to give prior notice. Furthermore, the
9 reluctance of nonlawyers to give legal conclusions on the question
10 whether Citibank would have been in breach of contract had little bearing
11 on the significant question. The crucial question was whether a
12 hypothetical prudent investor who might have incurred avoidable loss if
13 the surprise payment proved illusory would have seen Citibank’s failure
14 to give notice as a factor supporting doubt, which, when taken together
15 with the other visible red flags, would have led the prudent investor to
16 make inquiry. While we cannot say that the testimony of Citibank’s lay
17 witnesses in response to questions about legal conclusions had no

1 relevance whatsoever, it had little bearing on the significant question and
2 could not justify negating Citibank's contention that the nonreceipt of
3 prior notice would have constituted a factor contributing to alerting the
4 suspicions of the hypothetical prudent investor.

5 Furthermore, we believe the district court erred in its two reasons
6 for minimizing the degree to which Revlon's apparent insolvency would
7 raise doubts about its ability (or desire) to raise nearly \$1 billion to prepay
8 a loan by three years: first that Revlon, despite similar liquidity issues, had
9 managed a few months before to execute the May 2020 transaction,
10 raising over \$800 million in new funding and second, that Ronald
11 Perelman had a reputation for bailing out Revlon.

12 As for Revlon's recent success in securing new funding despite its
13 dire financial condition, the fact that four months earlier Revlon had
14 managed, despite its insolvency, by pledging what the Lenders' agent
15 described in the UMB Bank litigation as an enormous percentage of its
16 total assets, to borrow \$800 million made it *less likely*, rather than more
17 likely, that Revlon would be able to do this again four months later in

1 August 2020. The collateral used to enable the May 2020 borrowing was
2 no longer available to support a borrowing in August 2020 to prepay the
3 2016 Loan. And as for the Defendants' deus ex machina hypothesis – that
4 Ronald Perelman had injected \$1 billion of new money into Revlon --
5 there had been no reports in the financial press of Revlon's obtaining any
6 new financing.¹⁸

7 We also believe that the district court erred in giving weight to the
8 proposition that a hypothetical prudent investor was unlikely to be
9 troubled by these red flags if none of the recipients in the Lender-
10 Defendant camp found them troublesome. *See In re Citibank*, 520 F. Supp.

¹⁸ Citibank further argued in its opening brief that “[n]one of Revlon’s disclosures for the 2021 Notes [Exchange] mentioned a simultaneous effort to raise additional capital to pay the 2016 Term Loan, though disclosure of such an effort would be expected as a matter of securities law.” Citibank’s Br. at 46-47. Citibank supports its contention by pointing to the fact that, Todd Eric Warren, Revlon’s former corporate treasurer, on cross-examination agreed with the statement from Citibank’s lawyer that “if Revlon was seeking to raise several hundred million dollars to pay off the term loan at the same time that it had the exchange offer open, that that would have had a material impact on the exchange offer and that financing effort would have had to have been disclosed?” J.A. 868 [Tr. 916-17]. Defendants have not argued to the contrary.

1 3d at 431-32, 435-39. That inference, however, does not follow under the
2 inquiry notice test because the circumstances of the hypothetical prudent
3 investor differ so substantially from those of the Defendants and Lenders.

4 First, the hypothetical prudent investor is charged with awareness
5 of all the information that was available to the recipients of the mistaken
6 payment. The Lenders and Defendants did not necessarily focus on the
7 oddity that, in spite of its contractual obligation, Citibank had not given
8 prior notice of the coming prepayment; the improbability that Revlon
9 could have found the money to make a near \$1 billion prepayment in its
10 weakened financial condition; the unlikelihood that Revlon would have
11 made the August 7 exchange offer for the purpose of avoiding an
12 involuntary obligation to prepay the 2016 Loan if it was planning in any
13 event to prepay that Debt four days later; and the unlikelihood that
14 Revlon would pay par to retire the debt when a part of the debt could be
15 retired more cheaply by purchases in the marketplace. These thoughts
16 may not have crossed the minds of Lenders or Defendants at the moment
17 of receipt of payment. On the other hand, the hypothetical prudent

1 investor is charged under the inquiry notice test with awareness of all the
2 information that was available to the recipients of the payments. The test
3 requires that he contemplate these concerns, of course giving them no
4 importance if he concludes they have no importance.

5 Second, the hypothetical prudent investor faces a risk of avoidable
6 loss if the payment proves illusory. His prudence in guarding against
7 such a loss gives him a motivation and obligation to evaluate whether the
8 red flags warn of a sufficient likelihood of loss to prompt inquiry. If that
9 likelihood is sufficiently high, his prudence requires that he inquire. The
10 Lenders and Defendants in contrast bore no risk of any loss that was
11 avoidable. They had no incentive to ponder the likelihood that the
12 payment would prove illusory. Making inquiry would not have
13 improved or changed their outcomes.

14 As a result, the reactions of the Lenders and Defendants afford little
15 or no basis for assessing the hypothetical reaction of the reasonably
16 prudent investor.

1 Finally, Defendants and the district court identify several
2 additional facts that weigh in favor of a belief of the genuineness of the
3 transfer. These include the fact that the calculation statement received by
4 the Lenders described the interest being paid as “due”, a fact that would
5 be true only if Revlon was paying principal, *In re Citibank*, 520 F. Supp. 3d
6 at 443, and that the impending filing of the UMB Bank Complaint gave
7 Revlon a motivation to rid itself of troublesome lenders who were
8 threatening litigation. *Id.* at 446-47. We do not disagree that these facts
9 tend to weigh in favor of a belief that the payment was genuine.
10 Nonetheless, there remained troublesome red flags suggestive of doubts
11 that were not explained away by the facts pushing in the opposite
12 direction. The force of the factors supporting doubt need only be
13 sufficient to prompt a prudent investor to make inquiry.
14 Notwithstanding factors that tended to support genuineness, the factors
15 supporting doubt were sufficiently troublesome to prompt a prudent
16 investor at least to make a telephone call to Citibank. That is all that was
17 needed to satisfy inquiry notice.

1 In sum, considering the factors correctly cited by the district court
2 as supporting a reasonable belief that the payment was genuine, together
3 with the factors identified by Citibank as red flags supporting doubt, we
4 conclude that a reasonably prudent investor who faced an avoidable risk
5 of loss if the payment proved mistaken and therefore subject to recall,
6 would have seen fit to make a telephone call to inquire of Citibank.

7 **3. A reasonable inquiry would have revealed the**
8 **mistake.**
9

10 The district court concluded that reasonable inquiry would not
11 have revealed the mistake. We respectfully disagree.

12 The court arrived at this conclusion through the following
13 reasoning. The court observed that John Byrne, an expert witness for
14 Citibank, testified as to how a financial institution would investigate a
15 circumstance in which it received from a bank more money than it
16 expected, a phenomenon known as a “cash break.” He testified that,
17 when you have a cash break, you then investigate why there is a
18 discrepancy, stating further:

19 Q. What does that investigation involve, in your opinion?

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A. It's a series of many things. It's third-party market data, it's wisdom in some cases. And if the tools aren't available in-house or immediately to you, then you go to the source and determine who the source is representing, while typically there is an issuer or paying agent, trustee, what have you. So in this case, you go back to Citibank, ask for further clarification as to what the payment represents, get some type of confirmation as to what the payment represents. If you're unhappy with that response, then you contact the issuer itself, in this case it would be Revlon.

J.A. 930 [Tr.1167]. The district court interpreted Byrne's explanations to mean that "a reasonable inquiry could involve 'many things,'" including "third-party market data" and "wisdom in some cases." *In re Citibank*, 520 F. Supp. 3d at 439. According to Byrne, "your wisdom gives you the ability to do a sanity check . . . as to whether the information that you are being told is sufficient." J.A. 940 (Tr. 1207). Then, in the district court's words, "[a]ccording to Byrne, it was only if the flags remained red after consulting these sources – market data and 'wisdom' – that a reasonable investor would have consulted the sender of the funds to confirm whether the payments were intentional." *In re Citibank*, 520 F. Supp. 3d at 439. The court then quoted Byrne, "[i]f the tools aren't available in house or immediately to you, . . . then you go to the source." *Id.*

1 Based on this testimony, the district court concluded that a
2 reasonably prudent financial institution would not have necessarily gone
3 to the source to ask whether there was an error. The court pointed out
4 that some of the Defendants had taken the trouble to ascertain that “other
5 Lenders had received a full paydown”, and that the payments “matched
6 the outstanding principal and interest to the penny.” *Id.* at 440.
7 “[A]pplying their ‘wisdom’ and experience, [the Defendants] concluded
8 that the payments were intentional full prepayments of the loan.” *Id.* The
9 court relied on the testimony of Caraher, an executive of one of the
10 Defendants, that “when a borrower or its administrative agent pays the
11 exact amount owed in outstanding principal and interest, that is a clear
12 indication that the loan is being paid down” and that he had “never, in
13 almost 20 years in the industry, seen such a transfer made by accident.”
14 *Id.* (quoting J.A. 550 (Caraher Aff. ¶ 20)). The district court concluded that
15 “[o]n Byrne’s own view, that satisfied any duty of inquiry that a
16 reasonable investor may have had. It follows that, even if Defendants are
17 charged with the knowledge that a reasonable inquiry would have

1 yielded . . . they were not on notice that the payments were made by
2 mistake." *Id.*

3 The fulcrum of the district court's reasoning was the proposition,
4 which the district court attributed to Byrne, that "it was only if the flags
5 remained red after consulting . . . market data and 'wisdom' that a
6 reasonable investor would have consulted the sender of the funds." *Id.* at
7 439-40. The problem with the court's conclusion that the reasonable
8 investor would not have inquired of the sender of the funds is that the
9 red flags representing the reasons for doubt *did* remain red
10 notwithstanding that the payments matched the amount of principal plus
11 accrued interest.

12 The low likelihood of error when the payment matches the amount
13 of the debt did nothing to explain away the four factors described above
14 that furnished reasons for doubt. Those factors remained troublesome.
15 The fact that the payment matched the amount of the debt did nothing to
16 explain or dispel these sources of doubt. Under Byrne's formula, after
17 consultation of market data and wisdom, the flags would have remained

1 red. The prudent investor, who, unlike these Defendants, ran a risk of
2 incurring an avoidable loss if the payment proved illusory, would have
3 placed a call to its agent Citibank to ask.

4 And beyond Byrne's testimony, we do not believe that, as a matter
5 of New York law, an inquiry ascertaining that the payment matched the
6 amount of the debt would qualify as a "reasonable inquiry" as the term
7 is understood in the context of the inquiry notice standard. Under New
8 York law, if a party has ready access to information that will either
9 confirm or quiet their suspicions, a reasonable inquiry requires accessing
10 that information. *Fid. & Deposit Co. of Maryland*, 123 N.E. at 373 (a
11 reasonable inquiry by a bank into why checks cashed by one of its
12 customers were countersigned by a clerk of court would involve asking
13 the customer why the checkers were countersigned); *Ward v. City Trust*
14 *Co. of New York*, 84 N.E. 585, 588 (N.Y. 1908) (a reasonable inquiry by a
15 trust company into the propriety of a corporate officer's use of corporate
16 funds to pay personal debts would have included an examination into
17 whether the company's board of directors authorized the officer to so use

1 the funds, where “[t]he minute book of the board was open to
2 examination by representatives of the trust company . . .”). And if the
3 first inquiry fails to answer material questions that could have been
4 answered by a further inquiry that was not unreasonably onerous, and
5 that a reasonable person would have readily identified as a reasonable
6 inquiry, the first inquiry does not satisfy the obligation under New York
7 law to make inquiry, or be charged with the knowledge that the inquiry
8 would have produced. *See Ward*, 84 N.E. at 588 (a bank could not satisfy
9 the obligation of inquiry into why corporate officers were using corporate
10 funds to repay personal debts by simply asking the corporate officers
11 what they were doing because the officers could not be relied upon to
12 give a truthful answer as they were “acting in their own interest”, and
13 because a different inquiry – checking the minute book of the board –
14 would just as easily reveal if the officers were acting within the scope of
15 their authority). Here, a call to Citibank would have been an easy and
16 obvious inquiry which, unlike simply confirming internally that the size
17 of the payment matched the size of the debt, would have answered any

1 suspicion that the August 11 payment resulted from mistake. A payee
2 who failed to call Citibank or Revlon, but relied instead on nothing more
3 than ascertaining that the payment matched the debt, could not be said
4 to have conducted a reasonable investigation.

5 In sum, while it was reasonable for the Defendants to begin their
6 inquiry to resolve the red flags by ascertaining that the payments equaled
7 the size of the debt, when that fact failed to explain away the red flags,
8 the inquiry notice test required them to take the easy further step of
9 placing a call to their agent Citibank, which had sent the payment.
10 Having failed to make that call, they were chargeable with notice of what
11 they would have learned. We conclude that the Defendants were on
12 notice of Citibank's mistake and were thus ineligible to claim the
13 discharge-for-value defense.

14 **B. Defendants are not protected by the *Banque Worms* ruling**
15 **because on August 11, they were not entitled to the money they**
16 **received from Citibank, as Revlon's debt was not yet payable.**

17
18 As we read the *Banque Worms* opinion, it made clear that the rule it
19 espoused operated in favor of a recipient of a mistaken payment who was

1 “entitled” to the money. This is not only because the Court of Appeals
2 said so, but also because every precedential ruling on which the *Banque*
3 *Worms* opinion relied in support of denying restitution of a mistaken
4 payment involved present entitlement of the payee to the money it
5 received and two of the precedents expressly stated that that the rule was
6 for circumstances in which the money was “due” to the recipient of the
7 funds. In our case, the Defendants (and their Lenders) were not entitled
8 to receive repayment for the Loans. Repayment was not due for another
9 three years.

10 In undertaking to justify its ruling allowing Worms to keep the
11 moneys paid to it by mistake, the Court explained,

12 When a beneficiary receives money *to which it is entitled* and has no
13 knowledge that the money was erroneously wired, the beneficiary
14 should not have to wonder whether it may retain the funds; rather,
15 such a beneficiary should be able to consider the transfer of funds
16 as a final and complete transaction, not subject to revocation.

17

18 570 N.E.2d at 196 (emphasis added).

1 Worms was entitled to the money. The Defendants in our case were
2 not. Worms' loan to Spedley was payable, and Worms had demanded
3 payment. The Loan in our case was not payable for three more years.

4 The term "entitled" denotes "a legal right", Oxford English
5 Dictionary (3d ed. 2013 online version) (defining "entitled" as "that has a
6 legal right or just claim to do, receive, or possess something"); American
7 Heritage Dictionary of the English Language (5th ed. 2022 online version)
8 (defining "entitle" in pertinent part as "[t]o furnish with a right or claim
9 to something."); Black's Law Dictionary (11th ed. 2019) (defining "entitle"
10 as "[t]o grant a legal right to or qualify for"). A creditor has a "legal right"
11 to funds loaned only when the debtor has an obligation to pay those
12 funds. Indeed, Defendants do not cite a case (and we are aware of none)
13 in which a Lender was described as "entitled" to funds, without
14 qualification, when the lender had no right to demand payment until a
15 future date.¹⁹

¹⁹ Defendants argue that the Court of Appeals held that the discharge-for-value rule applied not because Spedley's debt to Worms was

1 Moreover, none of the New York precedents cited by the *Banque*
2 *Worms* Court as support for its ruling, so far as they revealed, involved a
3 debt that was not yet payable, *Carlisle v. Norris*, 215 N.Y. 400, 404-05
4 (1915); *Stephens v. Bd. of Educ. of City of Brooklyn*, 79 N.Y. 183, 185 (1879)
5 (converted funds); *Southwick v. First Nat. Bank*, 84 N.Y. 420 (1881) (debt
6 presently owed to a bank by its customer); *White v. Cont'l Nat. Bank*, 64
7 N.Y. 316, 317 (1876) (drawn bank draft); *Smith & McCrorken v. Chatham*
8 *Phenix Nat. Bank & Tr. Co.*, 267 N.Y.S. 153, 3154-55 (1st Dep't 1933)
9 (deposited check); *State Farm Mut. Auto. Ins. Co. v. Stokos*, 317 N.Y.S.2d

payable, but because Worms was a creditor of Spedley. Defs.' Br. at 18-19. Defendants claim this reading is supported by the *Banque Worms* Court's later statement that "[a]pplication of the 'discharge for value' rule to the circumstances presented here is particularly appropriate [among other reasons because] as a creditor of Spedley, Banque Worms was a beneficiary entitled to the funds who made no misrepresentation and did not have notice of the transferor's mistake." 570 N.E.2d at 197-98 (quotation marks removed). While it is true that Worms was entitled to the money and had demanded repayment, if its loan to Spedley had not been payable for another three years, as here, Worms would not have been "entitled" to receive payment. We see no reason to doubt that the court used the term "money to which it is entitled" with full awareness of its meaning, and not to mean "money it has loaned but to which it is not yet entitled."

1 706, 707 (Civ. Ct. 1970) (bill for auto repairs). Two of the cited precedents
2 described the rule that justified denial of restitution in terms of the payees
3 having received payment of a debt that was “due.” *Carlisle*, 215 N.Y. at
4 415 (“If defendants received the proceeds in good faith and without
5 notice of any wrong and credited them on an *indebtedness due them*,
6 plaintiff is not entitled to recover them back.”) (emphasis added); *New*
7 *York Title & Mortgage Company v. Title Guarantee & Trust*, 201 N.Y.S. 529,
8 531 (1st Dep’t 1923) (“The question now arises on this appeal whether the
9 plaintiff, New York Title and Mortgage Company, may recover from the
10 defendant Title Guarantee and Trust Company the money paid in
11 satisfaction of the debt *due it* by Stainton.”) (emphasis added).
12 Accordingly, we see no reason to believe that the Court of Appeals did
13 not mean what it said in characterizing the principle as applicable to a
14 beneficiary’s receipt of “money to which it is entitled.”²⁰

²⁰ Defendants argue that the Court of Appeals did not treat these cases as “stating the modern governing standard under New York law”, but rather as “as an example of one of two ‘divergent’ lines of historical authority.” Defs.’ Br. at 27. While Defendants are correct that the Court

1 This reading of the discharge-for-value rule, furthermore, better
2 harmonizes with New York’s “general rule” covering the receipt of
3 mistaken payments, which is that a party receiving money as the result
4 of a mistake must return it. *Ball*, 95 N.E. at 721. The *Ball* court described
5 the rule as “predicated upon the principle that a party who pays money
6 under a mistake of fact, to one who is not entitled thereto, must in equity
7 and good conscience be permitted to get it back” *Id.*; see also *Kingston*
8 *Bank*, 40 N.Y. at 395; *Nat’l Bank of Com. in New York v. Nat’l Mechanics’*
9 *Banking Ass’n*, 55 N.Y. 211, 213 (1873) (“It is now settled, both in England
10 and in this State, that money paid under a mistake of fact may be
11 recovered back, however negligent the party paying may have been in

of Appeals did not claim that the rules applied in these cases was identical to the rule applied in *Banque Worms*, the Court of Appeals clearly viewed these cases as indicative of the nature of the discharge-for-value rule. Specifically, the Court of Appeals identified *Carlisle, White, Smith & McCrorken, New York Title & Mortgage*, and *State Farm* as “cases that arguably lend[] support to the proposition that New York, long ago, embraced the ‘discharge for value’ rule”, *Banque Worms*, 570 N.E.2d at 189. Furthermore, the Court of Appeals cited *Southwick* and *Stephens* as cases applying rules motivated by the sort of finality concerns that supported the Court to endorsement of the discharge-for-value rule. *Id.* at 195-96.

1 making the mistake, unless the payment has caused such a change in the
2 position of the other party that it would be unjust to require him to
3 refund.”); *Union Nat. Bank v. Sixth Nat. Bank*, 43 N.Y. 452, 455 (1871) (“If
4 the money is paid under the impression of the truth of a fact which is
5 untrue, it may, generally speaking, be recovered back, however careless
6 the party paying may have been in omitting to use due diligence to
7 inquire into the fact.”). This rule is rooted in “equity and good
8 conscience.” *Ball*, 95 N.E. at 721; *Mfrs. Hanover Trust Co. v. Chem. Bank*, 559
9 N.Y.S.2d 704, 707 (1st Dep’t 1990) (“The principle that a party who pays
10 money, under a mistake of fact, to one who is not entitled to it should, in
11 equity and good conscience, be permitted to recover it back is
12 longstanding and well recognized and rests ‘upon the equitable
13 principle that a person shall not be allowed to enrich himself unjustly at
14 the expense of another.’” (quoting *Miller v. Schloss*, 113 N.E. 337, 339 (N.Y.
15 1916)); see also *Columbia Mem’l Hosp. v. Hinds*, N.E.3d, No. 36, 2022 WL
16 1572408, at *6 (N.Y. May 19, 2022) (identifying whether “a benefit has
17 been conferred on the defendant under mistake of fact or law” as a factor

1 in whether “it is against equity to permit a party to retain what is sought
2 to be recovered.”). In light of these principles, we see no reason to believe
3 that the Court of Appeals, confronting our facts, would expand the
4 exception represented by discharge-for-value beyond the scope that the
5 Court expressly delineated in *Banque Worms*, and beyond the scope of the
6 precedential authorities on which it relied.

7 A further reason that seems to us to favor a present entitlement
8 requirement is that it better supports the reasons for the rule. According
9 to the Reporters’ Notes to the First Restatement, the rule serves as an
10 administratively convenient way to allocate a loss between two parties
11 where “there is no reason in justice why one should suffer rather than the
12 other”. §§ 13-14 Reporters’ Notes. That condition is generally present
13 when the mistaken payment is to one to whom the debt is due. On the
14 other hand, when as here, where a transferee receives a mistaken
15 payment on a debt not yet due, there often can be significant reasons why
16 the mistaken payment ought to be returned and denial of restitution can
17 result, as here, in a substantial disruption of the contractually adopted

1 order, as well as substantial reason in justice why the transferee should
2 not be allowed to benefit from the mistake. This is illustrated by the
3 present facts. Application of the discharge-for-value rule to our facts
4 brings the Lenders a huge windfall over and above what they bargained
5 for,²¹ while an order of restitution would leave them exactly where they
6 contracted to be. *Cf. Deutsch Tane Waterman & Wurtzel, P.C. v. Hochberg*,
7 890 N.Y.S.2d 755, 757 (App. Term 1st Dep't 2009) ("In the absence of any
8 claim or showing that defendants detrimentally changed their position as
9 a result of the plaintiff's single, surplus tax payment, defendants may not
10 reap a windfall by retaining the payment, even if the payment may be
11 said to have resulted from negligence.").

12 The district court rejected Citibank's argument that, in order to
13 qualify for the benefit of the discharge-for-value rule the recipient of the
14 mistaken payment must be entitled to the funds. It justified that

²¹ It is true, of course, that prepayment is not *always* a windfall for creditors. But in those instances when retaining mistakenly prepaid funds is not in the creditor's interest, the creditor can simply opt to return the money.

1 conclusion primarily on the grounds that Section 14 of the First
2 Restatement does not mention a requirement of present entitlement or
3 debt due, as well as the fact that what the district court characterized as
4 the “leading cases applying the discharge for value rule” do not mention
5 a present entitlement element. *See In re Calumet Farm, Inc.*, 398 F.3d 555
6 (6th Cir. 2005), *Gen. Elec. Capital Corp. v. Cent. Bank*, 49 F.3d 280 (7th Cir.
7 1995), *Qatar Nat’l Bank v. Winmar, Inc.*, 650 F. Supp. 2d 1, 10 (D.D.C. 2009),
8 and *NBase Commc’ns, Inc. v. Am. Nat’l Bank & Tr. Co. of Chi.*, 8 F. Supp. 2d
9 1071 (N.D. Ill. 1998). In addition, the district court cited a case in which
10 the prevailing payee did not have a legal entitlement to the funds. *See*
11 *Chase Manhattan Bank v. Burden*, 489 A.2d 494, 497 (D.C. 1985).

12 We are not persuaded by the district court’s reasoning or its
13 precedents. While the district court is correct that Section 14 of the First
14 Restatement does not mention a present entitlement requirement, it is the
15 *Banque Worms* opinion, not the Restatement, that represents the law of
16 New York. As noted, the *Banque Worms* opinion expressly specifies
17 “entitlement” to the monies.

1 With respect to the four cases described by the district court as, the
2 “leading cases,” which did not specify a requirement of entitlement, we
3 see two answers. First, none of them are New York cases. Second, while
4 it is correct that none of them specifies a requirement of entitlement, none
5 of them, so far as they reveal, involves a debt that was not yet due, and
6 none specifies that the rule applies to such a debt. Finally, as to *Chase*
7 *Manhattan Bank v Burden*, the beneficiary in that case was not a creditor
8 but a limited partner. *Chase Manhattan Bank*, 489 A.2d at 494. The rule
9 there enforced thus differed significantly from both Section 14 and *Banque*
10 *Worms*. Moreover, the District of Columbia court’s decision was
11 substantially motivated by considerations of equity and fairness, *id.* at
12 497, considerations which disfavor the Defendants here.

13 Defendants argue that *Banque Worms* should be read to reject a
14 present entitlement requirement on the grounds that it would contravene
15 *Banque Worms*’s emphasis on the importance of finality if wire transfers
16 require “a creditor who receives payment on an outstanding loan before

1 it comes due . . . [to] wonder whether it may retain the funds.” Defs.’ Br.
2 at 26.

3 But while it is true that the *Banque Worms* court gave importance to
4 finality of wire transfers, it does not follow that the *Banque Worms* court
5 gave higher value to finality over all other values. To the contrary, the
6 Court explicitly left standing New York’s basic rule requiring return of
7 the mistaken payments, except where identified exceptions are
8 applicable. It also provided exceptions from denial of restitution based
9 on equitable factors that arise, for example, when the transferee made
10 misrepresentations or had notice of the mistake. There is no suggestion
11 in *Banque Worms* that all such disputes are to be resolved in favor of
12 finality, or that the undoubtedly significant factor favoring finality
13 necessarily prevails over all competing values.²²

²² Defendants also argue that interpreting *Banque Worms* to include a present entitlement requirement would contravene the Court of Appeals’s conclusion that “risk should be allocated to the bank transferor responsible for a mistaken transfer.” Defs.’ Br. at 24. But that sentence represented the Court’s response to the facts of that case. The Court was not saying that, mistaken transferors should always bear the

1 In summary, the Court of Appeals's specified requirement of
2 entitlement to the money, combined with the cases it cited as precedents
3 for the rule, and its continued espousal of New York's general rule that
4 mistaken payments should be returned, lead us to conclude that, in New
5 York, a creditor may not invoke the discharge-for-value rule unless the
6 debt at issue is presently payable. Here, the debt on which Citibank
7 mistakenly made a payment was not due for another three years. As a
8 result, Defendants may not invoke the discharge-for-value rule as a shield
9 against Citibank's claims for restitution.

10 CONCLUSION

11 The judgment of the district court is VACATED and the matter is
12 REMANDED to the district court for further proceedings consistent with
13 this opinion. Defendants, their officers, agents, employees, successors,
14 and all those in active concert or participation with them are enjoined

loss. It was clear, furthermore, that in the Court's assessment, Worms' entitlement to the money was an important factor along with the absence of equitable reasons for depriving Worms of the money it had received.

1 from removing, withdrawing, transferring, assigning, or otherwise
2 disposing of the funds in contention in this suit (except with the approval
3 of Citibank) until authorized by this court (or the Supreme Court) or by a
4 ruling of the district court from which no appeal is taken.

5 **ADDENDUM**

6 LEVAL, J.

7 Writing for myself alone and not for Judge Sack or the Court, I add
8 two short discussions, first questioning whether an accidental payment
9 of the sort made here by Citibank comes within the scope of the
10 Restatement's discharge-for-value rule, and, second, responding briefly
11 to Judge Park.

12 **A. Does the Restatement's discharge-for-value rule apply to**
13 **monies transferred purely by accident?**

14
15 Although this issue has not been raised in the briefing, I question
16 whether the facts of this case come within the discharge-for-value rule of
17 the Restatement. Under its formulation, the discharge-for-value rule
18 applies where a transferee "received from a third person any benefit *in*
19 *discharge of the debt or lien . . .* [where] the discharge was given by mistake

1 of the transferor *as to his interests or duties.*” First Restatement § 14
2 (emphases added).

3 First, the defense is limited to the circumstance in which the
4 transferee “received from a third person any benefit *in discharge of the debt*
5 *or lien.*” It speaks of the understandings under which “the discharge was
6 given.” This clause refers to the transferor’s motivations and intentions
7 in making the payment. The payment must have been made with the
8 intention to discharge the debt or lien in question. The rule has no
9 application when the third-party transferor made the payment for a
10 different reason – without intention to discharge the debt or lien, as
11 would be the case if the payment was made as payment for a new
12 purchase of goods by the debtor (or for any other reason).

13 Citibank had no intention to discharge Revlon’s debt. Indeed,
14 it had no intention to make a payment at all. The payment was made by
15 accident and unintentionally, as the result of failing to check all the boxes
16 on Flexcube’s matrix necessary to override the default setting that would

1 result in payment. The payment was not made “in discharge of a debt”
2 notwithstanding that Defendants so perceived it.

3 Second, the Restatement rule applies in circumstances where
4 the transferor’s payment resulted from his “mistake . . . as to his interests
5 or duties.” Citibank was not mistaken as to its interests or duties. It
6 understood all of these perfectly and intended to act in accordance with
7 a correct understanding of them. Its only mistake was its belief that
8 checking a single Flexcube box would ensure that the money would
9 remain in the bank.

10 Each of the illustrations to Section 14 of the First Restatement
11 involves a transferor making a payment with the intention to discharge a
12 debt or lien where the transferor made the payment based on either a
13 mistake as to the duty to make the payment, or a mistake as to what
14 would be received in return. The same is true of every precedent cited in
15 the Reporter’s Notes as an example of a consistent outcome. §§ 13–14
16 Reporters' Notes.

1 In my view, the facts of this case simply do not conform to
2 those calling for the application of the rule of Section 14.

3 *Banque Worms* in contrast applied the rule in circumstances that fall
4 under the rule of Section 14. Security Pacific intentionally paid Worms
5 with the intention to discharge the debt owed by Spedley, in the mistaken
6 belief that Spedley's specific instructions to do so remained effective. No
7 precedential case cited in the *Banque Worms* opinion fails to conform to
8 the fact pattern described in the Restatement version of the rule. *Carlisle*,
9 215 N.Y. at 404 (converted shares of stock deposited as payment on an
10 account by the debtor); *Stephens*, 79 N.Y. at 185 (proceeds of a forged
11 mortgage used as repayment for converted funds); *Southwick*, 84 N.Y. at
12 421 (drawn funds used, "with the assent of the drawers," to pay the
13 balance on an overdrawn account); *White*, 64 N.Y. at 317 (payor bank
14 intentionally paid payee bank the amount of a forged draft); *Smith &*
15 *McCrorken*, 267 N.Y.S. at 154–55 (bank intentionally paid out a check that
16 it was previously ordered not to pay); *New York Title & Mortgage Company*,
17 201 N.Y.S. at 530–31 (creditor intentionally paid off debtor's debt under a

1 mistake of fact); *Stokos*, 317 N.Y.S.2d at 707 (insurance company paid for
2 auto repairs under the mistaken belief that it has an obligation to cover
3 the repairs).

4 It therefore appears to me that the discharge for value rule has no
5 application to the payment made in this case – an accidental payment
6 made without intent to pay, without intent to discharge a debt or lien,
7 and without mistake as to the transferor’s duties or interests.

8 Resolution of this question is of course unnecessary to deciding this
9 case. I include the discussion in case it may be helpful in the analysis of
10 future similar disputes.

11 **B. The Time Taken to Produce this Judgment.**

12 This judgment has taken a long time to produce. I take sole
13 responsibility for that. Judge Park’s complaint on that ground has some
14 merit. I truly regret that I did not get the job done faster. That issue,
15 nonetheless, calls for some discussion. The delay resulted in part from
16 our making a change of disposition. Judge Sack and I originally
17 determined to certify the question to the New York Court of Appeals. I

1 wrote a draft opinion to that effect. We then decided against certification
2 -- primarily because certification ordinarily results in at least a year's
3 further delay and because we became increasingly persuaded, despite
4 initial uncertainties, that the law of New York, for the reasons explained
5 above, favors Citibank's position.

6 In addition, we have not found the answers to be as
7 straightforward, obvious, and easy as Judge Park does. The arguments
8 advanced for the parties by their exceptionally able counsel, raise
9 complex, subtle questions that required care and study. The district
10 court's impressive 101-page ruling in favor of the Defendants also
11 required confrontation of numerous substantial arguments. The solutions
12 advocated by Judge Park were not advanced by Citibank or debated in
13 the parties' briefing. Nor, in my view, do they reflect the law of New York.

14 A decision of a court of appeals must satisfy two requirements,
15 which pull it in different directions. It should, as rapidly as reasonably
16 possible, tell the parties who wins. At the same time, recognition that the
17 decision serves as precedential law requires that it rest on, and clearly

1 explain, sound legal principles. In a money dispute, the parties ordinarily
2 care little for the precedential effect of the decision; their interest is to get
3 a rapid answer to who gets the money. A court, however, must pay
4 careful attention to the decision's precedential function. This is because
5 unavoidably the decision will affect the resolution of future disputes and
6 influence public behavior and business planning. A decision of a
7 precedential court that rests on unsound, poorly reasoned, or poorly
8 explained, legal principles will therefore cause great future mischief.
9 Finding the best accommodation between the objectives of speed and
10 legal soundness is not always easy.