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Bank error in your favour – The $900 million wire transfer mistake: Practical implications in the Canadian lending context

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Summary

In August 2020 an unprecedented black swan event occurred when Citibank N.A. (Citibank), acting as an administrative agent in a loan facility, accidentally wired out almost US$900 million and paid off the borrower's loan early – with Citibank's own money.

Borrowers and lenders typically focus on the meat and potatoes commercial matters in a loan transaction, however Citibank's recent payment error raises the question of what happens when a debt is paid early – by mistake and without authorization. Can the payer that made the mistake recoup the amounts erroneously paid? Even if it can, should parties be adding additional protections to the loan agreements just in case?

A United States federal court recently considered Citibank's situation and concluded that the agent bank was not entitled to recoup its mistaken payment. At that moment, payers of debt obligations of all kinds were put on notice that the risk of loss lies with them. While this litigation is based on United States law (and is likely to be appealed), it is instructive in Canada and has spurred a flurry of contractual protections in credit facilities and amendments. Bank lenders and creditors of all kinds in Canada should consider implementing clawback provisions and other contractual and administrative protections to ensure that mistaken payments are not made and, if made, are recoverable. These measures are discussed below.

How we got here: Facts and U.S. litigation

On February 16, 2021, a U.S. federal judge held in *In Re Citibank August 11, 2020 Wire Transfers* [PDF] (the Revlon Decision) that Citibank, as administrative agent, was not entitled to recover over US$500 million that it had mistakenly wired to pay off a syndicated loan for Revlon, Inc. (Revlon), but which the receiving creditors refused to repay.[1] During a complex transaction, Citibank intended to transfer an interest payment of US$7.8 million to Revlon's lenders. Instead, because of unintuitive back-office software, Citibank wired almost US$900 million of its own money, the exact amount down to the penny of the principal and interest owing on Revlon's loan. The lenders in that credit facility thought Revlon had decided to pay off the loan early – until Citibank asked for the money back.

The recipient of a mistaken payment is usually required to give it back, on the basis of unjust enrichment. However, under the discharge-for-value exception to that rule, New York law allows creditors to keep money that was owed to them, even if the payment was unintentional. This position supports the policy goal of finality in business transactions,

especially for instantaneous wire payments.

The discharge-for-value principle recognizes that payers should bear the risk of loss from an accidental payment because they are in the best position to avoid payment errors in the first place. Although the Revlon Decision is likely to be appealed, several banks have implemented contractual terms to ensure recovery of mistaken payments in the future.

Practical considerations for Canadian lenders and administrative agents

While the Revlon Decision is not binding in Canada, it has spurred a number of banks to update their practices to address the risk of erroneous payments. Canadian regulators, lenders and borrowers, and others whose business may involve mistaken payments of contractual obligations, should also consider implementing contractual protections and new standard administrative practices to prevent a similar mishap.

The Loan Syndication Trading Association (LSTA) recently published model language to address erroneous payments for inclusion in credit agreements. Canadian banks are also including tailored clawback provisions that extend beyond existing clawback provisions. The clawback clause affords a lender or administrative agent a contractual right to recover any mistaken payments. Canadian banks are opting to include expanded clawback provisions, which generally contain the following elements

- how to determine that a payment is erroneous, such as based on a discrepancy from the payment notice or otherwise.
- that the erroneous payment must be held in trust or the recipient creditor must return any erroneous payment with interest required within a specified time.
- that the recipient creditor of a mistaken payment waives applicable defences.

Adding a similar clause to Canadian credit agreements that have an administrative agent may help to ensure that a mistaken payment would be returned if an agent bank makes a mistaken payment without a customer's authorization. In addition to contractual protections, borrowers and other payers should also consider adopting other security procedures to verify payments, detect errors and insure against losses. For example, a practice of providing a standardized payment notice in advance of a wire transfer could help parties avoid costly litigation. In the Revlon Decision, the judge suggested that such a notice might state

You will shortly receive a wire payment of $X. This payment is for interest only; it does not include any payment of principal. If you receive more than $X, any excess would be the result of an error and you would not be entitled to keep it.

Under the Canadian test for recovery of money paid under a mistake of fact (discussed below), one of the defences (which would otherwise allow the creditor recipient to keep the mistaken payment) may not be available, "where the payee, being aware of the payer's mistake, did not receive the money in good faith."[2] It may be easier to prove that a recipient of a mistaken payment did not receive the money in good faith if the entity making payments had an established policy of sending out advance payment notices, such that the recipient would be aware that any change from that payment must be a mistake, and that therefore the recipient did not receive (or keep) the money in good faith.

Application of the Revlon Decision in the Canadian context

The leading Canadian case on mistaken payments is *B.M.P. Global Distribution Inc. v. Bank of Nova Scotia*, 2009 SCC 15 (*Global*). In *Global*, the court adopted the following test (known as the *Simms* test) for recovering money paid under a mistake of fact:

- If a person pays money to another under a mistake of fact that causes the payer to make the payment, the payer is *prima facie* entitled to recover it as money paid under a mistake of fact. The *prima facie* entitlement to recover mistaken payment applies regardless of any negligence of the payer.
- Notwithstanding that, the *prima facie* right to recover may fail if one or more of the following exceptions are found to be present:
    - The payer intends or is deemed by law to intend that the payee shall have the money in all circumstances, whether the mistaken fact is true or false. This exception is less important in these circumstances because of course a payer would not intend the recipient creditor to keep funds sent out by mistake.
    - The payment is made for good consideration, in particular if the money is paid to discharge, and does discharge, a debt owed to the payee by the payer or by a third party by whom the payer is authorized to discharge the debt. The key factor in this exception is the requirement that the third party authorizes the payer to discharge the debt. As such, on the facts of the Revlon Decision (where the underlying debtor, Revlon, did not request or authorize the repayment of the loan), this exception to the bank recovering the erroneously wired funds would likely not apply, because the bank was not authorized to discharge the debt by the debtor.
    - The recipient of the mistaken payment materially changed their position in good faith reliance on the mistaken payment, or is deemed in law to have done so, such that it would be inequitable to require the recipient to return the funds (or a portion of them).[3]

This last factor is likely critical to the analysis of the remarkable facts of the Revlon Decision in the Canadian context. The *Simms* test was adopted from English law, and the court's commentary in another English case, Lloyds Bank PLC v. Independent Insurance Co. Ltd., is instructive. In that case, Justice Waller suggested that the bank that mistakenly wired the funds, Lloyds Bank PLC (Lloyds), should not be entitled to recover the funds unless the debt from the debtor, WF Insurance Services Limited (WF), to the receiving creditor, Independent Insurance Co. Ltd. (Independent Insurance)) would be re-instated. Although determined on other reasons, Justice Waller had concerns that the underlying debtor under the loan, WF, could argue that the debt had been discharged (by the mistaken payment from Lloyds), and that this legal uncertainty put the recipient creditor of the funds (Independent Insurance) in a materially changed position. Given the investment that lenders put into having enforceable loan documents, the prospect that requiring a receiving creditor to return funds paid by mistake may create uncertainty around the enforceability of the debt is a material issue.

Unless a Canadian court would be willing to concurrently make an order that the debt was enforceable and reinstated in full, there is a risk that the recipient of the mistaken payment could argue that the noted exception should apply, and the recipient should be entitled to keep the erroneous wire transfer. A court may find that issuing an order establishing the enforceability of the debt (from the underlying debtor to the recipient of the funds) is beyond

the scope of the immediate court proceedings (because the underlying debtor is not a party to the proceeding, which would only be between the mistaken payer and the recipient creditor).

While everyone involved with wire transfers, big or small, hopes to never experience a wire transfer error, if the funds are sent to the holder of a debt then there remains a risk that Canadian courts would reach the same practical result (that the receiving creditor keeps the money paid by mistake) through application of the *Simms* defences under Canadian law, as the court in the Revlon Decision did through application of the New York discharge-for-value principle.

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[1] Some creditors had voluntarily repaid the mistaken payments, which accounts for the difference between the total amount of the mistaken payments and the amount of Citibank's loss.

[2] *Barclays Bank Ltd. v. WJ Simms, Son and Cooke (Southern) Ltd.*, [1979] 3 All ER 522 (*Simms*), cited in *Global* at p. 695.

[3] *Global* at para 22.