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BOARDBRIEFS

Avoiding Wire Transfer Pitfalls: Five Lessons from In re Citibank

by Michael Odom, Phelps Dunbar

The banking industry wires an estimated $5.4 trillion each day. Banks have policies and procedures in place to protect against erroneous wires, but sometimes those systems fail. A recent example of an erroneous wire is found in the case of In re Citibank.

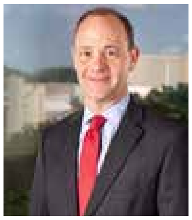
Revlon took out a syndicated loan with Citibank serving as the administrative agent for the lenders. In 2020, Revlon directed Citibank to execute a rollup transaction with some of the lenders that involved payment of accrued interest to all lenders. In attempting to make the interest payments, Citibank mistakenly wired the full amount of the outstanding principal balance owed to all of the lenders, three years prior to the maturity date. Citibank discovered the error the next day and demanded the return of the funds wired in excess of accrued interest. Although some of the lenders returned the mistaken payments, other lenders who received approximately $500 million refused to return the money and Citibank filed suit to recover the funds.

The trial court, applying New York law, ruled that the lenders were not required to return the money to Citibank. On appeal, the Second Circuit Court of Appeals reversed the trial court's decision. The appeals court held that the lenders should have made reasonable inquiry after receiving Citibank's recall notices and reasonable inquiry would have revealed that the payments were made in error. The appeals court also reasoned that the lenders were not entitled to keep the erroneous payments because the loan did not mature for another three years.

Citibank's error occurred despite following its process of having three people review the payments before they were sent. After the trial court's decision, many institutions began to include "erroneous payment provisions" which aim to protect administrative agents by providing a direct contractual right for an agent to seek the return of erroneously paid money. Even after the reversal of the trial court's ruling, erroneous payment provisions are still recommended.

Had the trial court's decision stood, it would have increased the potential liability for payments made in error. Even though the decision has been vacated, banks can still take precautions to reduce the chance of future error and minimize liability resulting from any errors. Below are steps that banks can take to avoid wire transfer pitfalls:

1. Review policies and procedures and consider broader internal review of payments over established amounts.
2. Ensure key employees are adequately trained on software systems used to process payments.
3. In extraordinary transactions where there might be a heightened risk of error, notify the payee before initiating the payment of the amount intended to be paid, and that any additional amount paid is in error.
4. Encourage employees to elevate extraordinary transactions or requests to superiors before processing.
5. Review participation agreements to ensure that they have appropriate claw-back provisions that obligate the participants to cooperate in returning funds in the event of a mistaken payment.



Michael Odom is a partner at Phelps Dumbar. He represents clients in a broad variety of real estate and finance transactions. He brings his experience in litigation and an eye on the long term to his work with clients, offering insight into what could go wrong down the line and structuring deals to minimize the chance of future issues. But if disputes do arise, Michael is a seasoned litigator well-prepared to help clients find practical solutions.