21-0487-cv

United States Court of Appeals

for the

Second Circuit

CITIBANK, N.A.,

Plaintiff-Appellant,

– v. –

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

Defendants-Appellees,

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

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR *AMICUS CURIAE* LOAN SYNDICATIONS AND TRADING ASSOCIATION IN SUPPORT OF PLAINTIFF-APPELLANT AND REVERSAL

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INTEREST OF *AMICUS CURIAE*[1]

The Loan Syndications and Trading Association ("LSTA") is a not-for-profit financial services trade association that represents a broad and diverse membership of almost 550 firms involved in the origination, syndication, and trading of commercial loans. Its members include commercial banks, investment banks, broker-dealers, mutual funds, insurance companies, fund managers, hedge funds, and other institutional lenders, as well as services providers and vendors. Since before the turn of the century, the LSTA has served as the only trade association solely focused on the $1.2 trillion U.S. syndicated loan market. That industry supports 1,140 borrowers, contributes over $2.7 trillion in annual economic output, and employs over 10 million Americans.

The LSTA's membership includes thought leaders from all sides of the market, including institutional lenders, arrangers, administrative agents, and firms that provide supporting services (legal, accounting, consulting, technology,

[1] All parties have consented to the filing of this brief. This brief was not authored in whole or in part by counsel for a party. No person other than the *amicus* made a monetary contribution intended to fund the preparation or submission of this brief. The plaintiff is a member of the LSTA as are most of the defendants. The plaintiff is represented by one of its executives on the Board of Directors and Executive Board of the LSTA and one of the defendants is represented by one of its executives on the Board of Directors of the LSTA. Both of those executives are former Chairs of the LSTA's Board of Directors. In accordance with the LSTA's long-standing policy, no representative of any of the parties to this litigation was involved in the decision to file this amicus brief.

analytics, clearing, and settlement). The abiding and common interest of those disparate constituencies in the success of that market gives the LSTA a deep-seated and well-founded interest in its "core mission," "promot[ing] a fair, orderly, efficient, and growing corporate loan market while advancing and balancing the interests of all market participants" (loan market participants commonly being referred to as "LMPs"). The LSTA has filed amicus briefs in numerous cases raising legal questions affecting the syndicated loan market, in the Supreme Court,[2] this Court,[3] and in the court below.[4]

This case involves the obligation of lenders in a syndicated credit agreement to return funds sent to them by mistake from the agent bank for the borrower. While largely automated, some transactions in the syndicated lending market require manual touches, and given the large volume of transactions, mistakes do happen. It is important to the stability of the syndicated lending market that courts respond to those mistakes with an understanding of the context in which they occur and a rule

[2] Those cases include, among others, Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017); Bank of America, N.A. v. Caulkett, 575 U.S. 790 (2015); RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639 (2012).

[3] Those cases include, among others, In re MPM Silicones, LLC, 874 F.3d 787 (2nd Cir. 2017); Marblegate Asset Mgmt., LLC v. Education Mgmt. Finance Corp., 846 F.3d 1 (2nd Cir. 2017); In re DBSD North America, Inc., 634 F.3d 79 (2nd Cir. 2011).

[4] Those cases include, among others, this case and In re Enron Corp., 379 B.R. 425 (S.D.N.Y. 2007).

of law that provides clarity and certainty. The decision of the court below allowing the defendants to retain those funds already has already significantly disrupted the drafting and negotiation of credit facilities and the expectations of LMPs. By granting favorable treatment of the defendants that opportunistically retained the funds sent to them by mistake, it has disadvantaged the cooperative participants that voluntarily returned those funds. That differentiation starkly undermines the spirit of cooperation necessary to a well-functioning market. As long as participants live under the cloud of the decision below, they can never be sure that routine cooperative behavior will not have serious adverse consequences for them and their clients.

The decision to file in this matter was not taken lightly, because member firms are parties on both sides of the case: Citibank on the plaintiff's side and eight of the defendants. Amicus filings are recommended by a litigation committee roughly split between representatives of institutional lenders that regularly participate as lenders under term-loan tranches of syndicated facilities and commercial and investment banks that originate and syndicate loans and often serve as administrative agents. Recommendations by the litigation committee to proceed with an amicus brief are subject to the approval of the either the LSTA's executive board or its full board, each of which is similarly split.[5] Ultimately, decisions to file amicus briefs reflect

[5] Given the importance of the issue presented and that LSTA members are on both sides of the dispute, the decision to file an amicus brief in this case was submitted to the full board.

the LSTA's long-standing desire that its advocacy support "a fair, orderly, and efficient marketplace that engenders confidence."[6] We believe that the LSTA's uniquely informed and balanced perspective will be useful to the Court.

SUMMARY OF ARGUMENT

We expect that the briefs of the parties will continue their debate about the proper doctrinal attributes of *Banque Worms v BankAmerica Int'l*, 77 N.Y.2d 362 (1991), and the discharge-for-value rule it adopted. Although we agree with the arguments of plaintiff Citibank on that topic, our filing does not repeat those arguments. Rather, this filing offers our perspective as the trade association solely focused on syndicated lending, the market in which the mistaken payment occurred. Specifically, we file this brief to explain to the Court why we believe it would benefit the various participants involved in that market for the law to reject the district court's unsettling decision and require the return of mistakenly transmitted payments like the one at issue here.

1. Practical aspects of syndicated lending support the return of payments transmitted by mistake. Given the high volume of transactions executed by administrative agents in connection with syndicated loans, errors are inevitable, even when administrative agents use prudent safeguards. The administrative agents that handle the authorization and transmittal of payments operate on thin margins;

[6] As explained at https://www.lsta.org/about.

obligating them to "insure over" those mistakes would be much more costly for borrowers and lenders in a syndicated facility than requiring recipients to return the mistaken payments. LMPs recognize that principle, and it is the custom and practice of LMPs routinely to return incorrect payments.

2. It is especially jarring to allow recipients to retain mistaken payments of funds that are not yet due. When a lender decides to provide a loan under a syndicated credit facility term-loan tranche that has an established amortization schedule, it has contracted to receive that money at particular times, often with periodic interest payments compensating for the deferral of repayment. To allow a lender to keep a mistaken payment elevates the effects of a simple mistake over the bargained-for expectations on the basis of which the loan was made.

Analogizing to a right of setoff is instructive. If a bank holds a deposit from one of its customers at the same time as that customer owes the bank a long-term amortizing promissory note, the bank cannot unilaterally set the deposit off against the not-yet-mature loan. Under the rule applied by the district court, the bank would be in a better position if it receives the funds by mistake than it would be if the funds come as the intentional act of the depositor. That result makes no sense.

3. Rules that courts establish for commercial transactions need to account for market norms and expectations and can cause grave disruption when they fail to account for the context of the transactions to which those rules apply. *Compare, e.g.*,

Winter Storm Shipping, Ltd. v TPI, 310 F.3d 263 (2nd Cir. 2002), *with*, *e.g.*, *Shipping Corp. of India, Ltd. v Jaldhi Overseas Pte Ltd.*, 585 F.3d 58 (2nd Cir. 2009). In this context, permitting the retention of mistaken payments is the outcome that would disrupt expectations, raise costs, and chill the participation of banks acting as administrative agents. Compelling a return of the payments is the outcome that well-meaning actors in the market expect, the outcome that supports the stability of syndicated lending transactions, the outcome that conforms to more than 30 years of market practice, and indeed the action that many of the recipients of mistaken funds here took of their own volition.

ARGUMENT

I. Practical Aspects of Syndicated Lending Support the Return of Mistaken Payments.

Several overlapping features of syndicated lending support an obligation to return mistaken payments.

First, while largely automated, some aspects of administering a syndicated loan are handled manually. As the opinion of the district court well illustrates (Op. at 12-16), payments are authorized and made through the activity of individuals entering information into and selecting among fields in often-intricate electronic interfaces. Given the high volume of wire transactions that move funds from the borrower to the administrative agent and then to the lenders (and vice versa), mistakes occur from time to time even with the exercise of extraordinary care: if

transactions are handled correctly 99.9% of the time, a mistake will plague one out of every 1000 transactions.[7] And, indeed, mistakes of one sort or another happen with sufficient frequency for LMPs to expect them, to be consciously aware of the possibility that a strange or unexpected payment in fact is mistaken, and to abide by the norms for responding to them.

Second, the administrative agents that handle the transmittal of payments to lenders under syndicated lending facilities operate on thin margins commensurate with their ministerial role.[8] For that fee level to make sense, it must be understood that administrative agents bear little or no risk, and that they are not exposed to liability for sums thousands of times larger than the fees received for distributing those payments. Based on the current fee structure, administrative agents have not expected to insure the costs of mistaken payments. The low fee structure reflects an understanding that administrative agents do not bear those risks, because lenders promptly return mistaken payments. Thus, it should surprise no one that the

[7] While it is impossible to estimate the precise number of transactions that administrative agents process over the course of a year, the following data are instructive. The LSTA/Refinitiv Mark-to-Market Pricing Service currently provides trade prices for more than 3,000 U.S.-based loan facilities. According to S&P Global LCD, there are an average of 57 individual lenders in a lending syndicate for this market.. Assuming agents make only 12 interest payments per year to each of the lenders in respect of each of the facilities, the number of annual distinct transactions would exceed two million each year.

[8] The fee paid to administrative agents on even multi-billion-dollar loan facilities typically ranges from only $50,000 to $150,000 per annum.

syndicated loan market has, from its inception, operated on that basis: LMPs routinely return or redirect misdirected payments, payments in incorrect amounts, and payments made by mistake.[9]

As the district court recognized, the New York Court of Appeals rejected a parallel argument against adoption of the discharge-for-value rule in *Banque Worms* itself. District Court Op. 96-97 (discussing *Banque Worms*, *supra*, 77 N.Y.2d at 375, and suggesting that the *Banque Worms* court rejected "the exact same arguments"). But *Banque Worms* did not hold that considerations of market stability are irrelevant. Rather, it found those concerns insufficient to justify wholesale rejection of the discharge-for-value rule. That finding rested in part on the court's assessment of doctrinal requirements and in part on two distinct factual conclusions: that banks easily could minimize the risks of the particular error made in that case; and that ordering a return of payments that were due and owing to the recipient would disrupt commercial expectations. *See Banque Worms*, 77 N.Y.2d at 372-76.

As mentioned above, we leave the doctrinal arguments for the most part to the parties; our primary goal here is to address those two factual points as they apply to the district court's interpretation of the discharge-for-value rule in the context of

[9] Reinforcing its view that the return of mistaken payments is the well-established market norm, the LSTA is not aware of any litigation since its inception in 1995 (other than the present case) in which a lender refused to return a mistaken payment to an administrative agent.

mistaken payments. Specifically, experience has shown that it is not possible to eradicate all errors (a point we address in the text above) and obligating recipients to return funds that were received in error would be less disruptive than allowing them to retain them (a point we address in Point III, *infra*). The district court's extension of *Banque Worms* to this new and unforeseen context is a misreading of the decision of the New York Court of Appeals, not a faithful application of it.

II. Requiring Recipients to Return Mistaken Payments Is Especially Easy to Justify When the Payments Are Not Yet Due.

Although this brief does not address the doctrinal details of the discharge-for-value rule or the district court's understanding of it, we do have a strong view that it is senseless, and contrary to well-established market practice, to apply the discharge-for-value rule where payments are not yet due – particularly payments of as-yet-unmatured future installments of obligations that have a contractually defined payment and amortization schedule.[10]

Doctrinally, the court might address that problem in a variety of ways. Whatever the doctrinal framework, we do think it is important to underscore the

[10] Almost all syndicated loans permit borrowers, upon prior notice to lenders, to prepay loans at their option (subject in many cases to the lenders' rights to decline such prepayments). Lenders, on the other hand, cannot compel a prepayment of a loan that is not mandated under the credit agreement. Consequently, as-yet-unmatured future obligations are not due until maturity or until a borrower chooses to prepay them (subject to proper prior notice), absent the occurrence of some event that leads to acceleration of the loan or some other triggering of a mandatory prepayment.

weak justification any LMP has for retaining such payments. Lenders transfer and assume rights and obligations under loans and the related credit agreements based on their assessment of the rate of return that they will receive over time if the obligations are paid as contractually agreed, taking account of their perceptions regarding the likelihood of default and future shifts in relevant interest-rate markets.

Allowing a lender to retain an unexpected and mistaken prepayment does nothing to fulfill those bargained for expectations. Rather, it allows the recipient to achieve a windfall,[11] a benefit for which the recipient has not bargained, a return not justified by its up-front calculations of the desirability of making a loan to a particular borrower. Similarly, when entering into a financial obligation, a borrower bargains not only for the rate it will pay, but also for the required term of that loan and the amount and dates of required repayments. The expectation among LMPs is that the agent will earn a nominal fee for (1) processing borrower's instructions, (2) communicating and coordinating among borrower and relevant lenders, and (3) coordinating payments among the relevant parties. In turn, the expectation is that the agent will not take on additional liabilities and will be indemnified for risks associated with the transaction. Allowing a recipient to retain mistaken payments

[11] To be sure, on some occasions an unexpected early payment will not be a windfall, and indeed might be unwanted if, among other things, the obligation bears an above-market interest rate. We expect that recipients in those circumstances would be even more likely to return the mistaken payment than the recipients of the mistaken payments at issue here.

also disrupts the bargained-for expectations of the borrower and administrative agent. Comparing the recipient's windfall to the situation of the administrative agent that sent the payment by mistake, it makes no sense to allow the recipient to retain the funds. *Cf.* Restatement (3rd) of Restitution § 6 (2011) ("Payment by mistake gives the payor a claim in restitution to the extent payment was not due.").[12]

An analogy to the common-law right of setoff is instructive. Consider a New York bank holding an unmatured obligation of one of its customers. If that bank happened to have on deposit funds of that same customer, it could not set those funds off against the obligation, for the simple reason that the obligation is not yet mature. *See*, *e.g.*, *Marine Midland Bank v Graybar Electric Co.*, 41 N.Y.2d 703, 707-08 (1977). That is not an odd or obscure eccentricity of the common law. On the contrary, it is "fundamental law" that "[i]f the debt carries a specific maturity date rather than being payable on demand, the bank must be very careful not to exercise setoff until the date arrives," Barkley Clark, *Bank Exercise of Setoff: Avoiding the Pitfalls*, 98 BANKING L.J. 196, 206 (1981). The most obvious explanation is that allowing the party with the deposit to set it off against the unmatured obligation would "undermine the contractual relationship between the parties which rendered

[12] Illustration 3 to that provision is particularly relevant: "A instructs B Bank to transfer to C the interest accruing on an account controlled by A and to retain the principal on deposit. Failing to record the instructions properly, B transmits both interest and principal to C. B has a claim in restitution against C to recover the principal."

the debt unmatured in the first place," Stephen L. Sepinuck, *The Problems with Setoff: A Proposed Legislative Solution*, 30 WILLIAM & MARY L. REV. 51, 67 (1988).

If a bank that already had these funds on hand could not set them off against the unmatured obligation, it makes little sense for a fortuitous wire transfer to grant the recipient a greater right to use those funds to satisfy that same obligation.

III. Requiring Recipients to Return Mistaken Payments Conforms to Settled Market Expectations.

Courts on occasion have struggled in crafting rules to govern the high-stakes world of wholesale funds transfers. Among other things, decisions inconsistent with the norms and practices of parties that engage in particular transactions have led to dislocation for such transactions and turmoil in the courts. Indeed, the suggestion that consequential damages might be appropriate as a response to improper execution of a payment order was one of the factors motivating the drafting and enactment of UCC Article 4A. *See* Carl Felsenfeld, *Strange Bedfellows for Electronic Funds Transfers: Proposed Article 4A of the Uniform Commercial Code and the UNCITRAL Model Law Symposium: Revised U.C.C. Article 3 & (and) 4 and New Article 4A*, 42 ALA. L. REV. 723, 729 (1991) (discussing the role of *Evra Corp. v Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982) (per Posner, J.) in the development of UCC Article 4A); *see also* UCC § 4A-305 cmt. 2 (rejecting and criticizing *Evra*).

This Court's decision in *Winter Storm Shipping, Ltd. v TPI*, 310 F.3d 263 (2nd Cir. 2002), offers a more recent example. The court in that case held that plaintiffs

enforcing admiralty judgments could collect them from accounts of intermediary banks located in New York through which wire transfers of funds going to or from the defendants had passed. The resulting "explosion" of litigation, "critical commentary," and other "unforeseen consequences of *Winter Storm*" led the Second Circuit to overrule its own decision in *Shipping Corp. of India, Ltd. v Jaldhi Overseas Pte Ltd.*, 585 F.3d 58 (2009). Reversal of the decision below puts this court once again in a position to protect, rather than undermine, the stability of New York's financial markets. *See also Banque Worms*, *supra*, 77 N.Y.2d at 373 (noting importance of avoiding decisions that would "introduce confusion and danger into all commercial dealings").

Although the issues in those cases are remote from the issues before the Court in this case, the fallout from the disruption in market expectations caused by *Winter Storm* is directly relevant to the central point of this filing. Specifically, as we have explained above, mistaken payments in the syndicated loan market always have been returned voluntarily, consistent with market expectations and norms; defendants' actions were unexpected and contrary to both market practice and expectations. Indeed, many recipients returned funds sent in error in this case, totaling hundreds of millions of dollars. The decision below effectively punished compliance with market norms by disadvantaging the cooperative actors and advantaging the opportunistic actors that retained the mistaken payment. For lenders that previously

assumed that *Banque Worms* applied to such a rare set of transactions as to be irrelevant to routine daily activities, the message absent reversal will be that you should "think twice" before doing the right thing. Nothing about that is good for orderly process or the smooth and seamless interaction of the syndicated loan market.

Nor is the problem one that easily can be resolved by amendments to the agreements that govern many aspects of the transactions in the syndicated loan market. For one thing, those amendments would not directly apply to the billions of dollars of outstanding loans, much of which will not mature for years into the future. Moreover, the significant amount of time and effort required to agree, deploy and implement acceptable protective terms will, at best, only return the industry to the status quo ante, the well-functioning market that existed before the district court's decision.

Finally, we must also point out the untenable and uncertain position in which the unqualified breadth of the district court's reading of *Banque Worms* leaves market participants. *Banque Worms* did not disrupt the market when it was understood to apply to the narrow and unusual situation that the New York Court of Appeals considered, a payment that was due on a revolving line of credit that bore no plain marks of error. *See Banque Worms*, *supra*, 77 N.Y.2d at 364-65. But if that narrow exception is extended to potentially justify the retention of any type of

mistaken transmission depending on an analysis of particular facts and circumstances, then lenders now must freeze whenever they receive potentially mistaken funds – retain counsel, consult their investors, seek information from other LMPs – instead of promptly doing the "right" thing that they routinely have been doing from the inception of the market over thirty years ago: return money to which they have no present entitlement.

To be clear, we offer our perspective on this transaction as an association pursuing the interests of all LMPs. It is unusual for the LSTA to file in a case, like this one, in which numerous members have direct interests on both sides of the matter. Notwithstanding the tension that it causes, the importance of this question to the stability of the industry and the clarity that we perceive in commercial expectations compel us to offer this brief. In the end, we believe that regular participants in the syndicated loan market would be surprised and disappointed to find that the law entitles recipients to retain mistaken payments. We also are convinced that a decision by this Court validating the retention of mistaken payments would exacerbate the destabilization of the syndicated lending market and the ability to make, transfer, and assume loans under credit agreements by encouraging the kind of non-cooperative opportunistic behavior that subverts any commercial relationship or market dependent on trust and transparency. If the Court is trying to find the answer most consonant with commercial expectations and least likely to disrupt

them, it should reverse the decision below and require defendants to return the payments.

CONCLUSION

Because the decision of the district court extends *Banque Worms* far beyond its original domain, and undermines the smooth functioning of the syndicated loan market, we respectfully submit that this Court should reverse.

Dated: May 6, 2021
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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Rules 29(a) and 32(a)(7)(B) of the Federal Rules of Appellate Procedure because it contains 4432 words.

This brief complies with the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in Times Roman 14-point font.

Dated: May 6, 2021

Respectfully submitted,

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