A BILLION-DOLLAR MISTAKE: RESTITUTION AND THE DISCHARGE-FOR-VALUE RULE

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INTRODUCTION

In August 2020, Citibank attempted to pay $7.8 million to various creditors of its customer Revlon.[1] The payment was intended to be an installment on Revlon's syndicated loans.[2] Unfortunately, Citibank mistakenly wired almost a billion dollars of its own money to Revlon's creditors—an amount that paid off Revlon's debt completely.[3] The next morning, Citibank noticed its mistake and attempted to recover the payments.[4] Although some of the lenders returned the funds at Citibank's request, others balked.[5] After Citibank sued those non-returning lenders to recover the payments, the trial court held that the lenders were entitled to keep the mistaken payments.[6]

In February 2021, around the same time that the *Citibank* judgment was handed down, Charles Schwab mistakenly deposited $1.2 million into a bank account belonging to one of its customers, Kelyn Spadoni.[7] Charles Schwab had intended to deposit only $82.56.[8] By the time the brokerage house realized its mistake and attempted to reclaim the money, Ms. Spadoni had withdrawn the funds.[9] Charles Schwab notified the authorities, and Ms. Spadoni was arrested on charges of theft.[10] A sheriff's spokesman explained the arrest: "She has no legal claim to that money . . . . Even if it was put in there by mistake. It was an accounting error."[11]

The underlying facts in these situations are remarkably similar. In both cases, one party mistakenly paid another party far more money than it had intended to pay. In one case, however, the recipient of the mistaken payment was permitted by the district court to keep the funds and, in the other, the recipient was arrested for retaining the funds. The legal doctrine invoked to explain the difference between these two outcomes is known as the "discharge-for-value"

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[1] *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 396 (S.D.N.Y. 2021), *vacated sub nom*. Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

[2] *Id.*

[3] *Id.*

[4] *Id.* at 404–05.

[5] *Id.* at 406–09.

[6] *Id.* at 451–52. After this article was ready for publication, the Second Circuit issued its opinion reversing the district court in this case. *See* Citibank N.A. v. Brigade Cap. Mgmt., LP, No. 21-487, 2022 WL 4102227 (2d Cir. Sept. 8, 2022). The Second Circuit's opinion merits full treatment in a separate article, and neither time nor space permit such a treatment in this article as it is going to press. Nevertheless, an addendum at the end of this article offers a brief overview of the Second Circuit's opinion.

[7] Michelle Hunter, *Accused of Pocketing $1.2 Million Mistakenly Deposited in Her Account, JPSO Employee Arrested*, NOLA.COM (Apr. 9, 2021, 8:15 AM), https://www.nola.com/news/crime_police/article_2feb07a8-98b9-11eb-a676-0f0f5ccc3e47.html [https://perma.cc/Y2CU-2QEM].

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.*

rule under the First Restatement of Restitution[12] or, in the language of the Third Restatement, the "bona fide payee" defense.[13] Under this rule, a recipient of a mistaken payment who lacks notice of the mistake at the time of transfer may keep the mistaken payment to the extent that the payor owed a preexisting debt to the payee.[14]

New York famously adopted the discharge-for-value rule in *Banque Worms v. BankAmerica Int'l*,[15] primarily citing concerns about the finality of payments. This article examines the discharge-for-value rule and argues that the rule cannot be satisfactorily explained on the basis of finality of payments. This article also analyzes other potential justifications for the discharge-for-value rule and concludes that the best explanation for the discharge-for-value rule is presumed reliance by the payee. Finally, this article considers the implications of this presumed-reliance rationale on the operation of the discharge-for-value defense. It suggests that the presumed-reliance explanation informs the controversial question of the relevant point in time for determining whether the recipient had notice of the payor's mistake. It also suggests that the rule may fit better within restitution's equitable framework if it operated as a rebuttable presumption of reliance.

I. MISTAKEN PAYMENTS, THE GENERAL PRINCIPLE OF RESTITUTION, AND THE LIMITED EXCEPTIONS

As a general rule, a party who receives a mistaken payment from another party must return the funds.[16] This is true even though the recipient may have done nothing to encourage or cause the mistake and the mistake was entirely the fault of the payor's negligence. The mistaken payment has resulted in the unjust enrichment of the payee, because the law generally treats a mistaken transfer of money as ineffective to confer on the recipient an ownership interest in the transferred funds—or, at least ineffective to confer an ownership interest superior to that of the payor.[17] Consequently, the recipient must return the payment.

In other words, the law of restitution imposes liability on an innocent recipient of a mistaken transfer, even though the transferor may have been negligent,

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12 RESTATEMENT (FIRST) OF RESTITUTION § 14 (AM. L. INST. 1937).

13 RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 (AM. L. INST. 2011).

14 *See id.*; RESTATEMENT (FIRST) OF RESTITUTION § 14 (AM. L. INST. 1937).

15 Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 197–98 (N.Y. 1991) (responding to a question certified from the Second Circuit).

16 *See, e.g.*, *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 396 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022) ("The law generally treats a failure to return money that is wired by mistake as unjust enrichment or conversion and requires that the recipient return such money to its sender.").

17 RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 6 (AM. L. INST. 2011).

"because . . . the recipient is not being asked to bear any loss."[18] The law will require the recipient of a mistaken payment to return the payment, as long as the recipient's end position is no worse than it would have been had the mistaken payment never been made. For example, had Ms. Spadoni returned the excess $1.2 million that Schwab inadvertently deposited into her account, she presumably would have been no worse off than if the mistake had never happened.

If, however, returning a mistaken transfer would impose a loss on an innocent recipient, the law provides the recipient with a defense to a claim in restitution.[19] One such defense is called change of position. This defense allows a recipient to keep mistakenly transferred property to the extent that the detrimentally affected recipient changed her position in good faith and with reasonable belief that she was entitled to the property.[20] For example, if an insurer pays a widow $50,000 for her husband's life insurance when the policy was for only $5,000, the insurer would initially have a claim in restitution for the excess $45,000. But, if the widow, without notice of the insurer's mistake, spent $30,000 on a lavish funeral for her late husband, and if, without the excess funds, she would have spent only $5,000, she has a partial defense to the insurer's restitution claim. Specifically, the insurer could recover only $20,000 instead of $45,000, because the widow spent $25,000 extra in reliance on the funds.[21] The change of position defense implements a fundamental tenet of the law of restitution, namely, that an innocent recipient cannot be left worse off once the transaction is reversed than she would have been had the transaction never occurred.

The change of position defense does not apply to a recipient who caused the transfer or who had notice—including inquiry notice—of the underlying mistake. Suppose, for example, that, upon discovering an extra $1.2 million accidentally deposited by Schwab in her brokerage account, Sally hits the casinos and gambles away $100,000. Because she knew or should have known that the money was there by mistake, she could not assert a change of position defense, and she would be liable in restitution for the full $1.2 million, even though this liability leaves her $100,000 worse off than if she had never received the mistaken payment. If, however, Sally somehow reasonably believed the money to be hers, and she gambled $100,000 away, then her liability in restitution would be reduced by the amount that she spent in changing her position (that is,

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[18] *Id.* § 65 cmt. a.

[19] This defense will generally hold as long as the recipient did not cause the mistaken transfer and lacked notice of the mistake.

[20] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 65 (AM. L. INST. 2011) ("If receipt of a benefit has led a recipient without notice to change position in such manner that an obligation to make restitution of the original benefit would be inequitable to the recipient, the recipient's liability in restitution is to that extent reduced.").

[21] This example comes from Illustration 9 of RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 65 (AM. L. INST. 2011), which is in turn based on Mut. Life Ins. Co. of Baltimore v. Metzger, 172 A. 610, 612 (Md. 1934).

$100,000). In that case, by requiring her to return only $1.1 million, the law avoids forcing an innocent recipient to bear a loss resulting from Schwab's mistake.

Generally, a party with a restitution claim may recover mistakenly transferred property from the hands of third parties who receive the property without paying consideration.[22] Thus, if Sally gifts $1 million to her mother, Schwab would have a claim in restitution against Sally's mother. Schwab could recover against Sally's mother, even if she had no reason to know of the mistake, unless and until she detrimentally relied on the money, in which case the mother could assert the change of position defense.

If, however, Sally had transferred $1 million to an art dealer in exchange for a painting, Schwab would not have a claim against the art dealer as long as the art dealer lacked notice of the error. Although, in these two examples, both Sally's mother and the art dealer took the money in good faith, the important distinction is that the art dealer gave value in exchange for the money (that is, "purchased" the money for value), whereas the mother did not give value.[23] The art dealer will defend any claim by pointing to its status as a good faith purchaser for value under the Uniform Commercial Code[24] (or, at common law, a bona fide purchaser for value).[25]

The bona fide purchaser defense is really a specific application of the change of position defense. By selling the painting to Sally, the art dealer changed his position (gave up the painting) in reliance on the transaction. Thus, the Restatement (Third) recognizes that "the rules governing bona fide purchase might be described as the conditions of a presumption favoring the change-of-position defense."[26]

The discharge-for-value defense, in turn, is akin to the bona fide purchaser defense—that is, the creditor who receives the payment could be considered a

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[22] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 58(2) (AM. L. INST. 2011).

[23] In this example, both the mother and the art dealer were "purchasers" of the money as the term is used in the law, even though only the art dealer was a purchaser "for value." *See* U.C.C. § 1-201(b)(29)–(30) (AM. L. INST. & UNIF. LAW COMM'N 2001).

[24] *See* U.C.C. § 2-402 (AM. L. INST. & UNIF. LAW COMM'N 1977).

[25] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 66 (AM. L. INST. 2011).

[26] *Id.* § 66 cmt. a. There are of course some differences, an important one of which is that the law does not attempt to re-value the exchange in the case of a bona fide purchaser, but it might in a change-of-position case. If, for example, the art dealer had sold Sally an $800,000 painting for $1 million, the law would nevertheless consider the art dealer a bona fide purchaser of the $1 million. The difference in value could go to whether the dealer was on inquiry notice of an anomaly in the transaction, but, assuming the art dealer's commercial good faith, we would not make him turn over the $200,000 profit. In change of position cases, however, we might. We could say that the art dealer's detrimental change of position amounted to only $800,000, whereas he received $1 million. Thus, the art dealer may be required to return $200,000 to Schwab in such a case. *See generally id.* ("[T]he defense of change of position is typically asserted by a recipient who could not make the simpler factual showing required by [the bona-fide-purchaser defense].").

bona fide purchaser of the transferred money.[27] Thus, "the policies involved in the protection of a bona fide purchaser are also involved in the defense of discharge for value."[28] But, to be a bona fide purchaser, the transferee must give "value," so the key question in this situation is what "value" the creditor gave. The law's answer to this is that the creditor gives value by discharging the antecedent debt to the extent of the payment.[29] Under this analysis, the "for value" requirement of the bona fide purchaser defense is met because the transfer discharges the prior indebtedness of the transferee. This, of course, is the basis for the name discharge *for value*.[30]

In the language of the Restatement (Third) of Restitution, the discharge-for-value rule applies when a payee "without notice" receives a mistaken payment, to the extent that "the payee accepts the funds in satisfaction or reduction of the payee's valid claim as creditor of the payor or of another person."[31] The Restatement limits the defense to situations in which the "payment becomes final, and the payee learns of the payment and its ostensible application, before the payee has notice of the facts underlying the restitution claim the defense would cut off."[32] "[A] payment becomes final when the payor is no longer entitled to countermand or recover it without the aid of legal process."[33]

Not all courts recognize the discharge-for-value rule. Some courts, concerned about the equities of allowing the recipient of a mistaken payment to retain the payment without any evident reliance, treat these cases as ordinary change-of-position cases in which the recipient can keep the mistaken payment only if it can prove good faith reliance on the payment.[34]

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27 *Id.* § 67 cmt. a ("Although there is a close relationship between the rules of §§ 66 and 67, distinctive features of the law's treatment of money payments make it convenient to state the rules separately."); *In re* Calumet Farm, Inc., 398 F.3d 555, 559 (6th Cir. 2005) ("Thus, when a creditor receives what appears to be a payment on a debt from someone other than the debtor, the creditor becomes a bona fide purchaser and may keep the mistaken payment if the creditor discharges the obligation of its debtor prior to becoming aware of the mistake."); RESTATEMENT (FIRST) OF RESTITUTION § 14 cmt. a (AM. L. INST. 1937) (describing discharge-for-value rule as a "specific application" of the bona fide purchaser rule).

28 3 GEORGE E. PALMER, PALMER'S THE LAW OF RESTITUTION § 16.6 (Gail F. Whittemore ed., 3rd ed. 2020).

29 *See id.*

30 RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmt. a (AM. L. INST. 2011) ("The thought behind the expression 'discharge for value' is that the protected recipient of a payment is treated as a bona fide purchaser of the money, to the extent the payee gives value by accepting the payment in discharge of an antecedent debt.").

31 *Id.* § 67(1).

32 *Id.* § 67(2).

33 *Id.*

34 *See, e.g.*, Wilson v. Newman, 617 N.W.2d 318, 321–22 (Mich. 2000); *see also* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmt. b (AM. L. INST. 2011) (describing this view as the "minority rule").

II. THE *CITIBANK* DISTRICT COURT'S THREE KEY CONCLUSIONS[35]

The application of the discharge-for-value rule was the key source of disagreement between the parties in the *Citibank* case. Following its mistaken payments amounting to nearly a billion dollars, Citibank sued the Revlon loan managers[36] who refused to return the erroneously transferred funds. Citibank sought restitution for the amounts of the mistaken payments and requested a temporary restraining order to prevent the lenders from transferring the disputed funds, pending the outcome of the litigation.[37]

The trial court granted the temporary restraining order in Citibank's favor.[38] The parties then stipulated to an extension of the restraining order as a preliminary injunction through trial.[39] The court held a trial following expedited discovery.[40] Thereafter, the court entered findings of fact and conclusions of law and held that the discharge-for-value rule entitled the lenders to retain the disputed funds.[41] As of the writing of this article, the case was on appeal before the Second Circuit.

At the trial-court level, Citibank raised three arguments related to the discharge-for-value rule. It argued that the rule applies only if the lender has a "present entitlement" to the funds. Citibank also contended that the relevant standard for whether a transferee had "notice" of the mistake was inquiry notice, as opposed to actual notice. And, finally, Citibank argued that the relevant time for determining whether the transferee had "notice" is when the transferee credits the money to the debtor's account. Each of these arguments is discussed in turn.

A. "Present Entitlement" Is Not Required

First, Citibank argued that the discharge-for-value rule applies only when the debt is due or, stated differently, when the creditor has a "present entitlement" to the money from the payor.[42] Under this analysis, the discharge-for value defense would not have applied in *Citibank*, because the loan principal

[35] *See generally In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

[36] The defendants in the case were "investment or collateral managers that maintain contractual relationships with, and manage the funds for, entities that hold pieces of the 2016 Term Loan and that have refused, to date, to return the funds Citibank wired on August 11, 2020." *Id.* at 396–98.

[37] *Id.* at 409–10.

[38] *Id.* at 409.

[39] *In re* Citibank Aug. 11, 2020 Wire Transfers, No. 20-CV-6539 (JMF), 2021 WL 1905002, at *1–2 (S.D.N.Y. May 12, 2021).

[40] *Id.* at *1.

[41] *Id.* at *2.

[42] *Citibank*, 520 F. Supp. 3d at 419–20.

was not yet "due" at the time of the payment; so, the lenders would not have had a "present entitlement" to the funds.

Citibank's "present entitlement" argument rested on language in the New York Court of Appeals's opinion in *Banque Worms*,[43] suggesting that a beneficiary who receives money "to which it is entitled" ought to be able to consider the transfer final.[44] Thus, Citibank reasoned, the *Banque Worms* rationale only applies if the transfer is of money actually due and owing at the time of the transfer.[45] The *Citibank* district court rejected this argument, noting that it found no support in the Restatement (First) of Restitution Section 14, which had been adopted by the New York Court of Appeals in *Banque Worms*.[46] The court concluded,

> that the recipient of funds need not show that an outstanding debt was "due" when it received the funds in order to invoke the discharge-for-value defense. Instead, it is sufficient for the party invoking the defense to show that, at the time the funds were received, it was a *bona fide* creditor.[47]

Although Citibank lost this argument regarding a "present entitlement" in the district court, the creditor's "present entitlement" is not irrelevant to the discharge-for-value question, even under the district court's view. The question of whether the debt is due and owing—whether, in the language of Citibank, the transferee has a "present entitlement" to the payment at the time of the transfer—may bear on the issue of the transferee's "notice" of the mistake.

Recall that, to claim shelter under the discharge-for-value rule, a transferee must lack notice that the transfer is a mistake. If the lender does not expect a prepayment, or specifically expects that there will *not* be a prepayment, this expectation suggests the lender has some level of notice that a payment may be a mistake. In contrast, if the lender has reason to believe that the debtor intended to prepay the principal of the loan, then the lender may be entitled to invoke the discharge-for-value rule even though the debt was not then "due" in the sense that Citibank used the term.[48]

The case cited by the district court in *Citibank* offers a good example of a situation in which the discharge-for-value rule applied even though there was

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[43] *See* Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 197–98 (N.Y. 1991).

[44] *Citibank*, 520 F. Supp. 3d at 418 (quoting *Banque Worms*, 570 N.E.2d at 196).

[45] *Id.* at 419.

[46] *Id.*

[47] *Id.* at 421. The Second Circuit disagreed and held that present entitlement is a requirement for the discharge-for-value rule. *See* Citibank, N.A. v. Brigade Cap. Mgmt., LP, No. 21-487, 2022 WL 4102227, at *23–26 (2d Cir. Sept. 8, 2022).

[48] In rejecting Citibank's motion for a stay pending appeal, the court noted that, although Revlon was not obligated to pay the principal on the loan at the time of Citibank's payment, one could argue that the principal was "due" under a secondary definition of the word, which can mean "*either* [i]mmediately enforceable *or* [o]wing or payable; constituting a debt." *In re* Citibank Aug. 11, 2020 Wire Transfers, No. 20-CV-6539 (JMF), 2021 WL 1905002, at *1, *3 (S.D.N.Y. May 12, 2021) (alteration in original) (quoting *Due*, BLACK'S LAW DICTIONARY (11 ed. 2019)).

no "present entitlement" to a payment. In *Chase Manhattan Bank v. Burden*,[49] a limited partner received a distribution from the partnership under the distribution agreement. The partner did not have a "present entitlement" to the distribution because "the general partner[] had complete discretion under the partnership agreement to distribute partnership capital."[50] But the limited partner had no reason to know the distribution was in error until several months later, by which time he "had spent most of the money."[51] In that case, the District of Columbia Court of Appeals applied the discharge-for-value rule in affirming summary judgment in favor of the limited partner.[52] What mattered was not that the payee had a "present entitlement" to the money—that is, that the money was at that time legally due and owing to the payee—but that the payee reasonably believed the payment to be intentional rather than the result of a mistake.

B. *Inquiry Notice Suffices to Eliminate the Defense*

Citibank also raised an argument centered on the type of notice required to cut off application of the discharge-for-value rule. Specifically, the parties disagreed about whether actual notice was required (as the defendants argued) or whether constructive notice would suffice (as Citibank contended).[53] In other words, is the discharge-for-value defense limited to those situations in which the creditor receiving a mistaken payment *actually knew* of the mistake, or is it enough that the recipient creditor had reason to inquire into the circumstances surrounding the payment?

In *Citibank*, the court concluded, like the other courts that have considered the issue,[54] that constructive notice suffices.[55] This conclusion makes sense, particularly when one places the footings of the discharge-for-value rule in the bona fide purchaser context, as the Restatement (Third) does.[56]

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[49] Chase Manhattan Bank v. Burden, 489 A.2d 494, 494–95 (D.C. 1985).

[50] *Id.* at 497.

[51] *Id.* at 495. Of course, spending the money may well qualify the limited partner for a change-of-position defense to the restitution claim. *See supra* Part I.

[52] *Chase Manhattan Bank*, 489 A.2d at 494, 497–98.

[53] *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 415 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

[54] *See, e.g.*, Qatar Nat'l Bank v. Winmar, Inc., 650 F. Supp. 2d 1, 10 (D.D.C. 2009); *In r*e Calumet Farm, Inc., 398 F.3d 555, 560 (6th Cir. 2005) ("Any sensible application of the discharge-for-value rule in this unique setting must account for constructive as well as actual notice of a mistake.").

[55] *Citibank*, 520 F. Supp. 3d at 430; *see also id.* at 428 (collecting additional cases).

[56] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmt. a (AM. L. INST. 2011) ("Although there is a close relationship between the rules of §§ 66 and 67, distinctive features of the law's treatment of money payments make it convenient to state the rules separately."); *Calumet*, 398 F.3d at 559 ("Thus, when a creditor receives what appears to be a payment on a debt from someone other than the debtor, the creditor becomes a bona fide purchaser and may keep the mistaken payment if the creditor discharges the obligation of its debtor prior to becoming aware of the mistake.").

A loan manager or lender who has reason to doubt the intent behind a payment may not bury its head in the sand, ask no questions, and claim refuge behind the discharge-for-value rule. As in the bona fide purchaser context, the discharge-for-value rule requires good faith on the part of the payee,[57] which includes conducting an adequate inquiry when the circumstances warrant it.[58] For example, if a lender received a transfer for the full amount of the loan on the day after the loan was disbursed, it seems likely that the lender would be on inquiry notice that this payment may have been by mistake, even though, in that case, the lender would not have had *actual notice* of the error.[59] As discussed above,[60] the payee's lack of a "present entitlement" is a factor that informs the determination of whether the payee had notice of the error.

A recipient generally will not have actual notice of a mistake at the time they receive the payment. It is almost unimaginable that the payor would notify the recipient that the payment is in error *before it sends the payment*. If the payor knows of the mistake before the payment is made, it will usually be able to prevent the mistaken payment. For that reason, recipients are far more likely to have inquiry notice of a mistaken payment before they have actual notice of the mistake.

If actual notice of the mistake were to be required, lenders would be incentivized not to ask questions and to accept all transfers blindly, even where the circumstances indicated that the payment was a mistake. For example, the lender hypothesized above, who received repayment in full on the day after disbursing a long-term loan, could retain the funds and shelter under the discharge-for-value defense, even though the lender would have been all but certain that a mistake had been made. Thus, the commentary to the Restatement (Third) says that the law of notice may "authorize an inference by the finder of fact about what a purchaser . . . should at least have suspected" or may impute knowledge "on the ground that a purchaser has neglected reasonable steps that are appropriately required as a condition of protection."[61]

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57 *See Citibank*, 520 F. Supp. 3d at 428; *see also* Credit Lyonnais N.Y. Branch v. Koval, 745 So. 2d 837, 841 (Miss. 1999) ("The discharge[-]for[-]value rule is [a] specific application of the underlying principle of bona fide purchase . . . . It is appropriate then that we look to our precedents regarding bona fide purchasers on the issue of notice. Our statutory and case law indicates that . . . where the purchaser has knowledge of facts which would cause a reasonable person to inquire, he is charged with inquiry notice of those facts which could be uncovered by diligent investigation." (internal quotation marks and citation omitted)).

58 RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 69(3)(c) (AM. L. INST. 2011).

59 *Citibank*, 520 F. Supp. 3d at 421.

60 *See supra* Section II.A.

61 RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 69 cmt. c (AM. L. INST. 2011).

C. The Relevant Time for the Payee's Notice Is the Moment of Transfer

The remaining disagreement between the parties in the *Citibank* case was the timing of the notice at issue. Obviously, by the time the litigation has begun, the recipient has notice of the mistake—the mistaken payment forms the basis of the lawsuit. But, in most cases, the recipient does not know of the mistake at the moment of payment. Notice of the mistake occurs sometime between the payment and the litigation. The question then is, at what point in time should the recipient's notice of the mistake be evaluated in order to apply the discharge-for-value rule? As phrased by the Sixth Circuit, "is the relevant event when the beneficiary's bank receives the money, or when the beneficiary learns that the money is in its account, or when the beneficiary credits the money to the debtor's account?"[62]

This question mattered in *Citibank* because, under the trial court's findings of fact, some of the loan managers first received notice of the error during the day following the transfers that took place in the evening of August 11, 2020.[63] For example, portfolio managers for Allstate (which manages the accounts of some of the lenders) expressed surprise at the early paydown the morning of August 12, 2020, and they suggested that it might be a mistake.[64] The portfolio managers later discussed the possibility that Revlon was attempting to pay off some lenders to manipulate voting rights related to the loans.[65] That afternoon, Allstate received a recall notice from Citibank, giving Allstate written notice of the error.[66]

There were other loan managers who received and retained the mistaken payments. Some of them learned about the payments and the mistake at the same time,[67] and some of them initially made plans to return the payments—or even instructed their banks to return the payments to Citibank—before they participated in a conference call with lenders, loan managers, and counsel.[68]

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[62] *In re* Calumet Farm, Inc., 398 F.3d 555, 559–60 (6th Cir. 2005).

[63] In *Citibank*, the lenders were represented by loan administrators, and the court concluded—and the parties seemed to agree—that all knowledge of the loan administrators was imputable to the lenders. *See Citibank*, 520 F. Supp. 3d at 425–27 ("Parsing the specifics of when each Lender *and* each Lender's agent learned of particular facts and whether and when each communicated these facts to the others would be a next-to-impossible task. Application of the discharge-for-value rule should not turn on such fact-intensive particulars.").

[64] *Id.* at 406.

[65] *Id.*

[66] *Id.*

[67] These included Greywolf, *id.* at 407, Medalist, *id.* at 408, New Generation, *id.*, and ZAIS, *id.* at 409. The lenders generally had administrators (many of whom were defendants in the case), and the administrators generally had custodians of the funds, who in some cases learned about the payments earlier than the loan administrators, and whose knowledge the court imputed to the lenders. *Id.* at 425–26.

[68] These included HPS, *id.* at 407–08, Medalist, *id.* at 408, New Generation, *id.*, and ZAIS, *id.* at 409. The administrators for some lenders had returned the payments to some of their clients before stopping the remaining payments (Medalist, *id.* at 408 and ZAIS, *id.* at 409). It

This history makes clear that many of the payees in *Citibank* could not plausibly argue that they relied on an entitlement to the money before they learned of the mistake. But, in the earlier case of *Banque Worms*, the New York Court of Appeals, addressing an issue certified from the Second Circuit, adopted the discharge-for-value rule and, in so doing, explicitly rejected any requirement of reliance in the discharge-for-value rule.[69]

The *Citibank* court held that, in the discharge-for-value analysis, the relevant time for evaluating notice was the moment the payee received the payment.[70] Although the court recognized that this rule might not be necessitated by the policies behind the rule,[71] it thought itself bound by the Second Circuit's and New York Court of Appeals's holdings in *Banque Worms*.[72] The court concluded that Citibank's argument—that the proper time to evaluate notice is when the lender takes some action to credit the debtor's account—risked introducing confusion into commercial dealings because, while the precise moment of receipt of funds was easy to identify, "it is unclear—even after a six-day trial—what a 'discharge' of the Revlon debt would have entailed, let alone how to pinpoint it in time."[73] An inquiry into the timing of "discharge" would, the court believed, "require a fact-intensive inquiry in every case, at least in the syndicated loan context."[74]

In *Banque Worms*, the federal district court applied the discharge-for-value rule and specifically decided that the relevant time for notice was at the time of the mistaken transfer.[75] If the recipient had notice of the mistake when it received the transfer, there could be no discharge for value. Otherwise, said the district court in that case, the transfer was final, even where the payee received notice of the error only two hours after the transfer.[76] Security Pacific, who was seeking to recoup its mistaken payment in the case, appealed, arguing that New York did not recognize the discharge-for-value rule and that the mistakenly transferred funds were recallable unless the recipient could demonstrate a change of position in good faith reliance on the payment.[77] The Second Circuit

is an interesting question whether there is any potential liability on the parts of the administrators or custodians to those lenders whose payments were returned.

69 Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 191 (N.Y. 1991).

70 *Citibank*, 520 F. Supp. 3d at 425.

71 *Id.* at 451 ("Were the Court writing on a blank slate, it is far from clear that it would reconcile these principles in a way that allowed the Non-Returning Lenders to keep the money that Citibank indisputably transferred by mistake.").

72 *Id.* at 423.

73 *Id.* at 424.

74 *Id.*

75 Banque Worms v. Bank America Int'l, 726 F. Supp. 940, 942 (S.D.N.Y. 1989), *aff'd*, 928 F.2d 538 (2d Cir. 1991).

76 *Id.* ("Accordingly, any awareness by [Banque Worms] of [Security Pacific's] mistake two hours after the funds were transferred by wire [was] not material.").

77 *See* Banque Worms v. BankAmerica Int'l, 928 F.2d 538, 540–41 (2d Cir. 1991).

certified this question to the New York Court of Appeals, and that court held that New York would apply the discharge-for-value rule.[78]

The New York Court of Appeals rested its decision on the importance of finality of payments, particularly in the context of electronic transfers of funds. The court said that the discharge-for-value rule "is consistent with and furthers the policy goal of finality in business transactions and may appropriately be applied in respect to electronic funds transfers."[79] This was true because

> [w]hen a beneficiary receives money to which it is entitled and has no knowledge that the money was erroneously wired, the beneficiary should not have to wonder whether it may retain the funds; rather, such a beneficiary should be able to consider the transfer of funds as a final and complete transaction, not subject to revocation.[80]

The district court in *Banque Worms* addressed the timing-of-notice issue, but neither the Second Circuit nor the New York Court of Appeals explicitly addressed it. The district court in *Citibank*, however, opined that the Second Circuit's holding in *Banque Worms* implicitly included a conclusion that the time for determination of notice was the instant of the transfer.[81]

Not all courts that have considered the timing issue have agreed that the relevant time for notice is at the time of payment. In *In re Calumet*, the Sixth Circuit took a different position, analogizing the discharge-for-value defense to that of the bona fide purchaser.[82] Under that reasoning, the transfer of value occurs only when the payment is in some way credited to the debtor's account.[83] The Seventh Circuit, however, in a case decided under Wisconsin law, read the *Banque Worms* decision as holding that "a creditor should be able to treat funds credited in apparent payment of a debt as irrevocably his, unless news of the error precedes arrival of the funds."[84]

The Restatement (Third), like the *Citibank* district court, suggests that using the time of "discharge" as the relevant time for the notice requirement is unworkable because it is too imprecise.[85] But the Third Restatement does not

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78 *Id.*

79 Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 196 (N.Y. 1991).

80 *Id.*

81 *See In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 422 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

82 *In re* Calumet Farm, Inc., 398 F.3d 555, 560 (6th Cir. 2005). Other courts have reached a similar conclusion. *See* Qatar Nat'l Bank v. Winmar, Inc., 650 F. Supp. 2d 1, 9 (D.D.C. 2009); NBase Commc'ns, Inc. v. Am. Nat'l Bank & Tr. Co., 8 F. Supp. 2d 1071, 1076–77 (N.D. Ill. 1998) (determining that "giving value means crediting the debtor's account.").

83 *Calumet*, 398 F.3d at 560 ("[T]his approach is consistent with one of the underlying principles of the discharge-for-value rule; namely, that the creditor has given value for the mistaken payment.").

84 Gen. Elec. Cap. Corp. v. Cent. Bank, 49 F.3d 280, 284 (7th Cir. 1995).

85 *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 reporter's note h (AM. L. INST. 2011) ("Such a test is rejected as arbitrary, difficult to verify, and subject to manipulation. Most importantly, the action of the payee's bookkeeper in posting a credit

adopt a time-of-payment rule for notice. Instead, it indicates that the critical moment is when the payee learns of the payment.[86]

III. JUSTIFICATIONS FOR THE DISCHARGE-FOR-VALUE RULE

In *Banque Worms*, the New York Court of Appeals invoked several rationales to justify its application of the discharge-for-value rule. Many scholars have been critical of the court's reasoning in *Banque Worms*,[87] and the *Citibank* case may help to cement that criticism. The justifications invoked by the *Banque Worms* court included finality of payments, loss avoidance, and deterrence of fraud.

A. *Traditional Justifications*

1. *Finality of Payments*

The justification for the discharge-for-value rule most heavily relied on in *Banque Worms* was the finality of payments.[88] This is the rationale most often invoked to explain the rule,[89] and the *Citibank* court appeared to endorse the finality justification. Specifically, the court opined that the creditor in this context "should generally be allowed to keep and use the money as it wishes, without fear that the former will develop a case of borrower's remorse and claim that the payment was by mistake."[90] But a policy of finality of payments cannot do much work to explain a discharge-for-value defense in light of the general recognition of a claim in restitution in cases of mistaken payments.

The most obvious problem with using finality of payments to justify the discharge-for-value rule is that the antecedent debt would seem irrelevant to this justification. In other words, if the primary concern is finality of payments, why not *always* permit recipients of mistaken payments to keep the funds, ra-

(whatever form that action may take) is irrelevant to the underlying reason for granting an affirmative defense in these cases. By contrast, the consensus rationale relates directly to the payee's knowledge that a payment has been received.").

[86] *Id.* § 67(2) ("A payee is entitled to the defense described in this section only if payment becomes final, and the payee learns of the payment and its ostensible application, before the payee has notice of the facts underlying the restitution claim the defense would cut off.").

[87] *See, e.g.*, Andrew Kull, *Defenses to Restitution: The Bona Fide Creditor*, 81 B.U. L. REV. 919, 921 (2001); DOUGLAS LAYCOCK & RICHARD L. HASEN, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 781–82 (5th ed. 2019).

[88] Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 195–96 (N.Y. 1991) ("The 'discharge for value' rule is consistent with and furthers the policy goal of finality in business transactions and may appropriately be applied in respect to electronic funds transfers.").

[89] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmt. b (AM. L. INST. 2011) ("The usual modern justification of such a rule refers to the special interests of finality in payment transactions . . . .").

[90] *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 451 (S.D.N.Y. 2021), *vacated sub nom*. Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

ther than limiting the policy to cases involving antecedent debts? A policy of finality of payments should endorse Sally's actions in keeping Schwab's misdirected payment.[91] But the law has long required non-creditors to return mistakenly transferred funds.[92] Allowing for restitution in those cases undermines the finality-of-payment policy.

Of course, we might say that, in the non-creditor cases, there is another policy at stake: unjust enrichment. But why is the enrichment unjust in non-creditor cases, but it is acceptable in cases of an antecedent debt? Finality of payments cannot justify the discharge-for-value rule without eliminating restitution more broadly.[93] So, the justification for the rule must come from elsewhere.

It is noteworthy that industry practice has resisted, at least to some extent, the idea that a mistakenly paid creditor can keep the money in the absence of reliance, suggesting that finality of payments does not serve an overriding value in the industry. For example, many of the lenders in *Citibank* returned the mistaken payments; of the approximately $894 million[94] in mistaken payments, more than $336 million was apparently returned by lenders,[95] including several million dollars returned by some of the defendants before they changed their minds and decided not to return the payments.[96] Moreover, several of the defendants initially instructed banks to return the funds[97] or stated that they intended to return the funds "first thing tomorrow"[98]—before changing their minds. And several members of the banking and lending industry filed *amicus* briefs in the *Citibank* appeal, suggesting that industry practice would support a rule requiring return of the funds.[99] As the comments to the Restatement (Third) note, "[t]he object of the rule . . . is not the 'finality' of payment transactions without more (an end that would better be served by denying restitution altogether), but the security of expectations of ostensible ownership—expectations that are reasonably formed on receipt of money to which the payee is apparently entitled."[100]

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[91] *See supra* Part I.
[92] *See supra* Part I.
[93] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmt. h (AM. L. INST. 2011).
[94] *Citibank*, 520 F. Supp. 3d at 403.
[95] Defendants' clients were owed about $558.6 million of the $894 million, *id*. at 398, but some of them returned some of the money before concluding that they were not obligated to do so. *Id*. at 407–09.
[96] *See supra* note 68.
[97] *Citibank*, 520 F. Supp. 3d at 408 (Medalist); *id*. at 409 (ZAIS).
[98] *Id*. at 407–08 (HPS).
[99] Brief for Loan Syndications & Trading Ass'n as Amicus Curiae Supporting Appellant at 8, Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).
[100] RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmt. h (AM. L. INST. 2011).

2. Shifting Risk to the Party Who Could Have Avoided the Loss

Another ground on which the discharge-for-value rule has been justified is that, if one party must bear the loss of a mistaken transfer, it should be the party that made the mistake and caused the transfer (and, consequently, the party in the best position to prevent the loss). The New York Court of Appeals suggested as much in *Banque Worms*,[101] and the *Citibank* court reiterated it.[102]

The loss-avoidance justification is "the reflexive, rudimentary reasoning of modern tort law, by which a party identified as a superior risk-bearer is chosen to bear some associated loss."[103] Most scholars would undoubtedly agree with the notion that incentives matter and that a party who bears the risk of loss is, as a general rule, more likely to take care to avoid the loss. But this loss-avoidance argument fails to adequately justify the discharge-for-value rule for several reasons.

First, this justification assumes that there is an actual loss to be borne. In the context of mistaken payments, however, there is no actual loss resulting from the payment unless the recipient has relied on the payment.[104] Take the *Citibank* case, for example. In *Citibank*, before the mistaken payment, the non-returning lenders had a partially secured claim[105] against Revlon for roughly $550 million. There was, of course, a risk that Revlon would not be able to repay the loan, but the lenders knowingly accepted this risk when they lent money to Revlon under the terms and conditions of the loan agreements. If the lenders were forced to return the mistaken payments, they would be exactly where they were before the mistake—they would hold an identical partially secured claim against Revlon for $550 million. In other words, returning the mistaken payments would return the lenders precisely to their pre-mistake position.[106] The lenders would be left no worse off after the mistaken payment than they were before the payment was made, and thus, there is no actual loss to be borne by virtue of the mistaken payment.

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[101] Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 197 (N.Y. 1991) ("[A] mistake such as occurred here can be effectively held to a minimum through the utilization of 'commercially reasonable' security procedures in effecting wire transfers.").

[102] *Citibank*, 520 F. Supp. 3d at 450 ("[T]he *Banque Worms* court's conclusion that the transferor bank is the party best positioned to avoid error—and thus the party that should bear the risk of loss—appears to have been correct.").

[103] Kull, *supra* note 87, at 922.

[104] See *id*. ("The result in *Banque Worms* cannot be justified by reference to superior risk bearing, because the risk in question does not correlate to the loss being assigned.").

[105] Some of the lenders were concerned that prior transactions approved by the lending group had left the creditors under-secured. *Citibank*, 520 F. Supp. 3d at 399. The security position of the lenders is not clear from the opinion but, whatever it was before the mistaken payment, the lenders would have retained the same security position if they returned the mistaken payment.

[106] Counsel for Citibank made this point in closing argument during the trial, stating, "[T]his was a mistake, it was an error, and [Citibank] should get the money back, and [Defendants] will still have the benefit of their bargain because they still have their loans." *Id*. at 448 (alterations in original).

The *Banque Worms* court's risk-allocation justification is also in some tension with its desire for speed in these wire transactions.[107] The more care and pre-transfer protocols that are necessary for risk protection, the less speed to be expected in the transactions. Speedy transactions and complex or time-intensive controls are in tension with one another. Moreover, a party who is willfully blind to reasonable standards becomes an officious intermeddler, so some level of reasonable care is inherent in the restitutionary system, although mere negligence will not foreclose restitution.[108]

In any event, it is far from clear that the discharge-for-value rule places the proper incentives on all sides to maximize economic efficiency. Some have argued that the rule, at least as applied in *Citibank*, results in inefficiency.[109] And, in some discharge-for-value cases, both the payor and the payee were in a similar position to avoid the loss. Consider, for example, a case in which a thief steals a car, borrows money from Lender using the car as security, and then sells the car to Buyer. Buyer pays a portion of the sales price to Lender before discovering that the title is forged and that Buyer has not acquired good title to the car. If Buyer seeks to recover from Lender in restitution, Lender will rely on the discharge-for-value rule to defeat Buyer's claim,[110] even though, in that case, it would seem that Buyer and Lender were both in a similar position to avoid the loss—that is, they both conferred value to the thief based on the forged title.

Perhaps most importantly, the risk-bearer justification again proves too much because it is not clear what role the antecedent debt plays in the risk-bearer analysis. If the goal is to incentivize care on the part of payors, there is no reason to permit the payor to recover mistaken payments generally. Like finality of payments, this goal is at odds with restitution's restorative principle, and the antecedent debt does no justificatory work in that case.[111] If this policy

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[107] *See* Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 194 (N.Y. 1991) ("Funds are moved faster and more efficiently than by traditional payment instruments . . . .").

[108] *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 5(3) (AM. L. INST. 2011) (recognizing that a claimant bears the risk of mistake when they decide to act in the face of a recognized uncertainty).

[109] Eric Talley, *Discharging the Discharge-for-Value Defense*, 18 N.Y.U. J.L. & BUS. 147, 197–98, 201–02 (2021) (discussing the advent of so-called "Revlon Blocker" provisions and the effects of this case in the syndicated loan industry); *see also* Brief of Am. Bankers Ass'n et al. as Amici Curiae Supporting Appellant at 4, Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022) (brief of trade group and payments company arguing that the district court's decision in Citibank is inconsistent "with industry norms and the important policy goals of speed, efficiency, certainty, uniformity, and finality in wire transfers . . . .").

[110] *See generally* Gaffner v. Am. Fin. Co., 206 P. 916, 918 (Wash. 1922).

[111] One could, perhaps, posit that erroneous payments are more likely to be made to parties in which preexisting debts are involved, so that this rule covers most of the cases. But, even if that is true, a perusal of restitution scholarship quickly reveals an abundance of cases involving mistaken payments to those without preexisting debts, so this category is certainly plentiful.

controls, any party who receives a negligently made payment should be permitted to retain it, since the negligent party was in the best position to prevent it. But that is not the law, which generally permits even negligent parties to recover mistaken payments.[112]

3. *Guarding Against Contrived Claims of Mistake*

In *Citibank*, the court intimated one more potential justificatory basis for the discharge-for-value rule: to guard against claims of mistake contrived after an intentional transfer was made.[113] Or, as the court put it,

> if one party owes money to another and pays that money back to the penny, the latter should generally be allowed to keep and use the money as it wishes, without fear that the former will develop a case of borrower's remorse and claim that the payment was by mistake.[114]

Of course, in *Citibank* and in *Banque Worms*, there was no suggestion that the claim of mistaken payment was contrived. In both cases, the payments were made with funds that belonged to someone other than the borrower—Citibank's funds (as the loan administrator) in *Citibank*[115] and Security Pacific's funds (as the debtor's bank) in *Banque Worms*.[116] It is not clear that later-contrived claims of error have been a problem in general (either in restitution generally or in the specific context of antecedent debt), and the party claiming mistake bears the burden of proving mistake. More importantly, the rules surrounding the discharge-for-value defense, such as the timing of the notice of the error—can be used to help weed out contrived claims.

B. *The Rule as Establishing a Presumption of Reliance*

One potential justification for the discharge-for-value rule, not often voiced, relates to the recipient's ability to rely on the mistaken payment. If the discharge-for-value rule is simply a specific application of the change-of-position defense, then the rule effectively operates as an irrebuttable presumption of reliance. Although neither *Banque Worms* nor *Citibank* specifically suggested that a presumption of reliance could justify the rule, both courts im-

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112 Consider the most obvious example, in which a cashier inadvertently gives a customer excess change of $100. The cashier is negligent, and the customer may have done nothing to encourage the overpayment or may not even have noticed it. But the law of restitution allows the store to recover the overpayment. *See generally* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT part III, ch. 7, topic 1, intro. note (AM. L. INST. 2011) ("Restitution often allows a culpable (typically negligent) claimant to recover from a defendant who is altogether blameless.").

113 *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 451 (S.D.N.Y. 2021), *vacated sub nom*. Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

114 *Id.*

115 *Id.*

116 Banque Worms v. BankAmerica Int'l, 928 F.2d 538, 539–40 (2d Cir. 1991).

plied that reliance has a role to play. For example, the *Citibank* court's discussion of finality of payments and contrived claims of mistake pointed to reliance; the court wrote that the creditor should be able to "use the money as it wishes" without fear about later-instituted and fraudulently created cries of mistake.[117] It also wrote that reconciling the competing policies at stake in these cases is particularly difficult "in an age when money can be transmitted from one party to another instantaneously and investors can, and often do, redeploy available funds almost as quickly."[118] And the New York Court of Appeals in *Banque Worms* wrote that "the beneficiary should not have to wonder whether it may retain the funds; rather, such a beneficiary should be able to consider the transfer of funds as a final and complete transaction."[119]

A presumption of reliance may serve the equities as well as judicial economy in discharge-for-value cases. Consider a set of related cases in which a debtor repays its lender, using funds that the debtor fraudulently acquired from someone else or using funds that had been mistakenly transferred to the debtor. For example, imagine that Sally—the hypothetical unintended recipient of a $1 million deposit from Schwab[120]—used the erroneous Schwab payment to pay off Chase Bank's mortgage on her house. In this example, Chase is not a direct recipient of the mistaken transfer; instead, it received an intentional transfer from Sally. But the funds used by Sally had been mistakenly transferred to her by Schwab. Suppose that Schwab requests Chase Bank to return the mortgage payment. Is Chase obligated to return the funds?

To explore this question, we can return to another earlier example. We said above that, if Sally had gifted $1 million to her mother, Schwab would have a claim in restitution against Sally's mother, even if the mother did not have notice of the mistake, so long as the mother has not changed her position in good faith reliance on the money.[121] The mother is unjustly enriched by the gift of someone else's money, and the mother will be no worse off than her rightful (pre-gift) position if she returns the money.

If we view Chase in the position of the mother—as essentially the recipient of a gift—then Chase should have to return the funds. We could point out that, if it returned the funds, Chase would be no worse off than its pre-transfer position as holder of a mortgage securing an outstanding loan owed by Sally. Juxtapose this result with an example in which Chase is more clearly a bona fide purchaser for value. Suppose that Sally had used the $1 million to buy land from Chase's real estate holdings. In that case, Chase can be considered a bona

117 *Citibank*, 520 F. Supp. 3d at 451.
118 *Id.*
119 Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 196 (N.Y. 1991).
120 *See* the hypotheticals raised *supra* Part I.
121 *See supra* Part I. Detrimental reliance would allow the mother to interpose a change-in-position defense.

fide purchaser for value of the money,[122] and Chase should be able to keep the funds.

When Sally uses erroneously transferred funds to pay off her mortgage at Chase, there are sound arguments both for allowing Chase to keep the funds and for requiring Chase to turn the funds over to Schwab. Chase is not quite in the same position as a gift recipient, but it is not quite in the same position as a seller who transfers fresh value (such as land) in reliance on the funds. Chase had every legal right and reason to expect its loan to be repaid at some point, and the payment was not a gift, even if it was made before the full loan was due. But, unless Chase lent Sally more money or took some other action after it received the repayment, we can hardly say that Chase "relied" on the payment. By requiring Chase to repay the money, we would return Chase to precisely the position it had voluntarily assumed earlier—a lender to Sally secured by a mortgage on her real property.

That said, if we require Chase to return the funds to Schwab in this situation, there may not be a limiting principle with which we are comfortable. Suppose, for example, that, after receiving Sally's payment, Chase used the money to pay off a debt that it owed Regions Bank, and then Regions used the money to pay down a debt it owed to Bank of America. Now, perhaps Bank of America would have to return the funds.[123] Payments could be traced into and out of various exchanges to and from various parties—a result that, in a credit economy, would indeed undermine the finality of payments.

Just as importantly, Chase's reliance on the payment, although real, may be tremendously difficult to prove. Chase, like many sophisticated financial entities, is an enormous operation with many daily transactions—both incoming and outgoing—of all sizes. How would Chase prove that it took some action in reliance on Sally's mortgage payment? Suppose, for example, that it takes Schwab a year to discover that Sally paid her mortgage at Chase with the funds Schwab mistakenly transferred into her account. Chase may not be able to point to any particular transaction in the intervening year that it would not have made but for having received Sally's mortgage payment, but it seems that Chase would be justified in generally relying on the status quo at that point.[124] Even a smaller operation or an individual may make purchases in reliance on an entitlement to the funds, without being able to identify any one particular purchase that it would not have made without the funds.

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[122] *See* Kull, *supra* note 87, at 924 ("It is both awkward and relatively unusual—though logically possible—to describe a payee as a purchaser of money.").

[123] Perhaps the lender could show reliance by having marked the debt instrument as "Paid," but, at least in theory, even if the lender has marked the note as "Paid," a court could cancel the notation and return the lender to its prior position.

[124] *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmt. b (AM. L. INST. 2011) ("Any lapse of time increases the likelihood of reliance on the part of the payee—reliance that is inherently likely in any event, since any payee within the rule of this section takes the money in the reasonable belief that he is entitled to it.").

Perhaps the most obvious proof of reliance in a case like this would be if Chase released a security interest[125] or canceled a debt instrument. In other words, Chase could demonstrate that it had discharged the debt in reliance on the payment. Even in that case, the canceled debt instrument in theory could be judicially undone, restoring Chase's position as a creditor, so that Chase could return the money without detriment to its original position.[126] But there are good reasons to consider payment to be final in such a case—"it is generally unwise to pursue the unwinding of transactions this far."[127] To judicially undo the cancellation of a payment obligation and to reinstate the debt would require impleader of—or a separate lawsuit against—the third-party debtor (Sally, in Schwab's lawsuit against Chase in this example), who certainly has a right to be heard and who may have relied on the payment notation (by, for example, taking out a new loan or making a new expenditure).[128] The daunting prospect of such wide-ranging and voluminous litigation is reason enough to consider demonstrable reliance such as a "paid" notation to be final, even if the court could theoretically eliminate the detriment from the reliance.[129]

Against this backdrop, it is possible that the court's concern in *Banque Worms* with finality of payments, though inartfully expressed, may have been a recognition of what is in effect a presumption of reliance. In other words, one might posit that a party who receives a payment believing that it is to pay down or eliminate an antecedent debt will soon rely on the payment, especially in "an age when . . . investors can, and often do, redeploy available funds" almost instantaneously.[130] At some point, the payee relies on the overall bottom line, even if they cannot point to specific reliance on a particular dollar in the bottom line.

This theory—that presumed reliance drives the discharge-for-value rule—also offers the only sensible explanation for the requirement that the payee

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[125] *See id.* § 67 cmt. d.

[126] It would be exceptionally difficult for Chase to prove that it relied on Sally's payment through some identifiable and truly irreversible transaction.

[127] PALMER, *supra* note 28, § 16.6(b).

[128] In some cases, the original recipient of the mistaken transfer will have had notice of the mistake, and thus could not claim good faith reliance. But, in others, the original recipient could use the discharge-for-value defense. And, if the money had gone through several intermediate transfers between the time that Schwab paid Sally and discovered its mistake, multiple parties may have to be impleaded—Regions, Chase, and Bank of America may all have to be joined in the above hypothetical.

[129] Moreover, even in the land-purchase example, in which Sally used the money to purchase land from Chase, we could theoretically return the land to Chase and require Chase to relinquish the purchase price, but the law does not attempt to unwind such transactions. *See* PALMER, *supra* note 28, § 16.6(b). Similarly, we could require the art dealer discussed above to turn over the purchase price while requiring Sally to return the art. But the law does not attempt to unwind these transactions.

[130] *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 451 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

lacked notice of the mistake. If finality of payments alone were the motivation, the payee's notice *vel non* should be irrelevant.[131] As long as the payee did nothing to cause or encourage the payment, the payee's knowledge or notice of the mistake seems to matter only insofar as that payee could not be expected to rely on an entitlement to the payment.

This "presumed reliance" explanation also helps to make sense of another requirement often discussed in these cases: that the recipient be aware of the claim at the time it receives the funds or, stated differently, that the payment is received "in [d]ischarge of a [k]nown [c]laim."[132] Occasionally, a party may receive a payment that actually would discharge a valid claim, but the recipient does not know of either the payment or the claim. Consider *In re Brainard Hotel Co.*,[133] in which a hotel cashier stole money from the hotel's till, and then reimbursed the till by stealing a hotel guest's money from the safe. The guest then sued the hotel. According to Palmer, the discharge-for-value rule does not apply in this case because, although the defendant hotel had a valid claim against the cashier, and the claim would have been discharged when the cashier reimbursed the till, the hotel "did not give value," since it was unaware that this claim existed at the time of repayment.[134] The Restatement (Third) takes the same position.[135] If the discharge itself does the work of "value," then why require that the recipient know of the claim in order to invoke the discharge-for-value defense? This requirement—that the recipient know of the claim at the time of the payment—as well as the requirement that the recipient lack notice of the mistake, must rest on a presumed reliance rationale for the discharge-for-value rule.[136]

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[131] If the payee *intentionally caused* the mistaken payment, that would be a reason to require restitution, even in the case of an antecedent debt. And a payee who intentionally caused the mistaken payment would likely have notice of the mistake. But the analysis is not identical—it would be possible to have notice of the mistake without causing the mistake. Indeed, the statement of the rule in New York, as articulated by the court in *Citibank*, views the causal question separately from the notice question. *Id.* at 396 ("Under New York law . . . [t]he recipient is allowed to keep the funds if they discharge a valid debt, the recipient made no misrepresentations to induce the payment, and the recipient did not have notice of the mistake."). That these are two separate prongs in the analysis makes clear that a party with notice of the mistake must return the funds even if that party did nothing to cause the mistake in the first place.

[132] PALMER, *supra* note 28, § 16.6(d).

[133] *In re* Brainard Hotel Co., 75 F.2d 481, 481–82 (2d Cir. 1935).

[134] PALMER, *supra* note 28, § 16.6(d).

[135] *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 illus. 25 (AM. L. INST. 2011).

[136] The presumed-reliance view is also consistent with the Restatement (Third's) treatment of setoffs by a creditor. *See id.* § 67 illus. 6.

> Buyer pays Seller for aviation fuel by weekly funds transfers to Seller's account with Bank. Buyer is mistaken about the quantity of fuel being delivered: after several months, Buyer's overpayments amount to $650,000. Seller becomes insolvent and ceases deliveries. Bank sets off the balance of Seller's account against Seller's indebtedness to Bank. Because Buyer can trace its $650,000 overpayment into the closing balance of Seller's account (§ 59), Buyer

IV. THE CONTOURS OF THE RULE UNDER A PRESUMPTION-OF-RELIANCE RATIONALE

If the most plausible rationale behind the discharge-for-value rule is that one who receives a payment toward an antecedent debt will soon rely on the payment, it will be beneficial to examine the contours of the rule with that purpose in mind. Stated differently, if the rule operates to effect a presumption of reliance in cases of antecedent debt, then we can examine the defense to determine how well its implementation aligns with this rationale.

As an irrebuttable presumption, the rule is of course overinclusive. There will be some cases in which the discharge-for-value rule insulates the recipient from a restitution claim even though the recipient did not in fact rely on the payment. Rules are like that—they are over- and under-inclusive, and they inevitably give rise to some arbitrary results.[137] It may not be possible to completely eliminate arbitrary results while maintaining a strong discharge-for-value rule, but there are at least two ways that we could potentially soften the rule to cabin its over-inclusiveness. One is to require some form of "acceptance" of the payment by the payee before the payee has notice of the mistake—in other words, to make the relevant time for notice the moment of the payee's "acceptance" of the payment, rather than the moment of payment or the moment the payee learns of the payment. The second is to weaken the discharge-for-value rule from an irrebuttable presumption of reliance to a rebuttable presumption of reliance. These potential solutions could be adopted individually or in tandem.

A. *Evaluating the Recipient's Notice at the Time of "Credit"*

The defendant who wants to invoke the discharge-for-value rule in defense to a claim in restitution must show that he or she was not on notice that the payment was in error.[138] But, as discussed above,[139] it has never been clear exactly what moment in time we should examine the defendant's notice—or lack thereof—of the error.

Part of the reason that the relevant time for the notice element in the discharge-for-value defense has remained unclear is that courts have not clearly articulated the proper purpose for the rule. In *Citibank*, the court held that the relevant time for the notice was the time the payment was received.[140] This

would be entitled—as against Seller's unpaid general creditors—to restitution of this amount via constructive trust; but Bank may retain the funds free of Buyer's restitution claim, if Bank made the set-off without notice of Buyer's mistake.

137 *See* MindGames, Inc. v. W. Publ'g Co., 218 F.3d 652, 657 (7th Cir. 2000).

138 *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67(2) (AM. L. INST. 2011).

139 *See supra* Section II.C.

140 *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 425 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

would, perhaps, make sense if the only purpose of the discharge-for-value rule is to allocate risk of loss to the person best situated to prevent the loss, since only a recipient with notice of a forthcoming mistaken transfer could possibly act to stop the transfer, assuming, of course, that the notice sufficiently preceded the transfer.

But, for the reasons discussed above,[141] loss allocation makes a poor justification for the discharge-for-value rule. And, in any event, it would be quite uncommon that the recipient would learn that a forthcoming transfer—one that had not yet been made—was going to be in error.[142] Moreover, there is general agreement that loss allocation does little to justify the discharge-for-value rule because no loss exists merely as a result of the mistaken transfer.[143] Not until the recipient detrimentally relies on the payment would the recipient be forced to bear a loss by returning the payment. Thus, the notice requirement is poorly implemented if it is merely about shifting risk.

The best explanation for the notice requirement is that it serves to tether the rule to its reliance-based underpinnings. A party with notice of the error cannot thereafter rely on an entitlement to the mistakenly transferred funds. So, when exactly should the recipient's notice of mistake eliminate the discharge-for-value defense? Or, to put it in the language of the Sixth Circuit, "[i]n a wire transfer setting, is the relevant event when the beneficiary's bank receives the money, or when the beneficiary learns that the money is in its account, or when the beneficiary credits the money to the debtor's account?"[144]

There is certainly no reason to presume reliance by a payee who knew the payment was in error before it was even received. This tells us that *at least* notice before the payment was made should suffice to defeat the discharge-for-value defense, but it does not tell us whether courts should adopt a later point in time. The *Citibank* court adopted this weak version of the notice requirement in holding that the relevant time for notice was at the moment of payment (or, more precisely, when payment was received).[145] In this respect, it seems the *Citibank* decision reflects bad policy.[146]

Suppose, for example, that the lenders in *Citibank* received a notice that Revlon intended to pay \$5,000 overnight. That night, the lenders received a \$5,000,000 payment, and they learned of the payment the following morning.

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[141] *See supra* Section III.A.2.

[142] Moreover, there could be some cases where a party with notice of the mistake did not have the opportunity to prevent the transfer, even if the notice slightly preceded the transfer. The rule would capture those cases without justification—that is, the rule would over-inclusively capture cases where notice of the mistake preceded the actual transfer, but the recipient was not in a position to prevent the transfer before it happened.

[143] *See, e.g.*, Kull, *supra* note 87, at 922.

[144] *In re* Calumet Farm, Inc., 398 F.3d 555, 559–60 (6th Cir. 2005).

[145] *Citibank*, 520 F. Supp. 3d at 425.

[146] To be fair, and as the district court noted in *Citibank*, that policy is at least arguably implicitly mandated by the New York Court of Appeals's holding in *Banque Worms* and its subsequent effectuation in the Second Circuit. *See id.*

At the time *of payment*, the lenders lacked notice of the mistaken payment—indeed, they may have been asleep and not known of the payment at all. But if we think that the lenders should have to return the excess in this example—that is, that they cannot invoke the discharge-for-value rule—then the notice requirement is about something other than preventing the mistake, and the relevant timing of the notice should not be limited to the moment of payment.

Although the *Citibank* court expressly held that the pertinent time for notice is the moment at which payment is received,[147] the court's later discussion seemed to suggest that the court may have viewed the question more in line with the Restatement (Third)'s approach—that is, that the case turns on whether the payee has notice at the time he or she learns of the payment. In addressing the issue of notice, the court discussed in detail the communications from the loan managers both before and after Citibank sent its recall notices requesting that the payment be returned.[148] It found that, at the time they learned of the transfer, the loan managers believed the payment was an intentional payoff.[149] The court based its finding on the relative paucity of communications suggesting the transfer was a mistake.[150] Later, in discussing whether the loan managers had met an inquiry notice standard, the court pointed out that "many Defendants, surprised by the unexpected payment, took or directed a closer look at the payments and the corresponding notices . . . [and] concluded that the payments were intentional full prepayments of the loan."[151] All of this discussion would seem largely irrelevant to a moment-of-payment notice standard, suggesting that the court took a different approach despite its clear statement that notice would be determined at the moment of payment.[152]

There is no reason to presume a payee relied on a mistaken transfer before it received the transfer, but there is also no reason to presume that a recipient relied on any received funds before it learned of the payment. Thus, by cutting off the notice inquiry at the moment the recipient receives the payment, the *Citibank* court's holding—if not its application—does not go far enough. We could strengthen the notice element by concluding, along with the Restatement (Third) of Restitution, that the time that matters is when the recipient learns of the payment.[153] This does a better job of tailoring the discharge-for-value rule to the presumption of reliance that explains it, because it eliminates those cases in which the payee was notified of the mistake after it had received the payment but before it even knew that it had received the payment. But this approach may still not quite go far enough.

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[147] *See id.*

[148] *Id.* at 431–39.

[149] *Id.* at 439–40.

[150] *Id.*

[151] *Id.*

[152] *See id.* at 425.

[153] *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67(2) (AM. L. INST. 2011).

Consider, for example, what should be the result in a case in which the lender receives a payment overnight, at 3:00 AM. At 5:00 AM, the payor notices the mistake and immediately sends an email and leaves voicemails notifying the lender of the error. At 7:00 AM, the lender's employees arrive at work. Under the Restatement (Third)'s approach, the payor's ability to recover will depend on the order in which its employees perform their tasks—specifically, whether they review the night's payments before they read their emails or check their voicemails.[154] If they review the payments—and learn about this payment—immediately before they see the email or check the voicemail notifying them of the mistake, then, under the Restatement (Third)'s approach, the recipient would keep the payment.[155] If, however, the employees read the emailed notice of mistake or listen to their voicemail before they review the nightly payments, then the recipient would have to return the funds, because it had notice of the mistake before learning of the payment.[156] If the recipient received email notice of both the payment and the error, then the application of the discharge-for-value rule would hinge on the order in which they read their emails. This result seems arbitrary rather than based in considerations of equity.

We could further strengthen the connection between the discharge-for-value rule and its presumed-reliance rationale by suggesting the relevant time for notice is when the recipient credits the account of the payor or otherwise acts to "receive" the funds on the debtor's account in some way. This comes closer to requiring some form of actual reliance.[157]

Some courts have set out a rule like this—the leading one being the Sixth Circuit's decision in *Calumet*.[158] In that case, the court expressly held that the relevant time for determining notice is the moment the creditor credits the debtor's account.[159] This approach, the court said, "is consistent with one of the underlying principles of the discharge-for-value rule; namely, that the creditor has given value for the mistaken payment."[160] The court emphasized the equities of the case: "Returning the $550,000 paid out by First National to extricate

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[154] *Id.* ("A payee is entitled to the defense described in this section only if payment becomes final, and the payee learns of the payment and its ostensible application, before the payee has notice of the facts underlying the restitution claim the defense would cut off.").

[155] *Id.* at cmt. g ("When payment and notice have been received in quick succession, the rule is that payment must become final—and the payee must have knowledge of the payment—before the payee has notice of the facts giving rise to the restitution claim.").

[156] Indeed, the order in which the employees learn of the payment and the error could be determined by the order in which they read their emails.

[157] Even this level of action is not necessarily irreversible detrimental reliance, because it potentially could be judicially reversed. Nevertheless, line-drawing concerns militate against judicially "undoing" such a transaction, as discussed above. *See supra* notes 125–29 and accompanying text; *see also* LAYCOCK & HASEN, *supra* note 87, at 782 ("[I]t is hard to draw a line between Price v. Neal and *Banque Worms* . . . . But reliance has never been required in the forged check cases, and it is generally not required in the antecedent debt cases.").

[158] *See In re* Calumet Farm, Inc., 398 F.3d 555 (6th Cir. 2005).

[159] *Id.* at 560.

[160] *Id.*

itself from its transmission error will . . . put the parties in the same position that they would have been in had the error in transferring the funds not occurred."[161]

There are at least two charges that could be leveled against a rule that pins the notice element on the timing of "acceptance" or crediting of the debtor's account. The first is that this rule, too, has the potential for arbitrary results. The second is that the rule is unworkable because it relies on the recipient's internal accounting processes, and these processes will be varied across the industry.

The first charge is well-taken. This rule, like other rules, may result in some outcomes that seem arbitrary or at odds with the equitable result. If the recipient happens to conduct its accounting credits moments before it received a recall notice from the payor notifying the recipient of the error, the rule would permit the recipient to retain the payment, even though there would be no irreversible detrimental reliance. So, this rule would share a weakness of the Restatement (Third)'s rule—that of over-inclusiveness. But this rule would eliminate at least some of the over-inclusiveness of the Restatement (Third)'s rule by eliminating those situations in which the recipient learns of the payment mere seconds or minutes before being notified of the error. So, moving the moment of notice to "acceptance" or "credit" rather than the moment of payment or of learning about the payment reduces at least some over-inclusiveness.[162] In addition, once the recipient has credited the debtor's account, the recipient has demonstrably relied on the payment, even if the credits could, in theory, be reversed.

The *Citibank* court found the second charge—the unworkability of a timing requirement determined by crediting the account—convincing.[163] The court in that case noted that "[t]he moment that the wired funds were received by the Lenders (or perhaps, in some instances, their agents) is easy to pinpoint. "By contrast, it is unclear—even after a six-day trial—what a 'discharge' of the Revlon debt would have entailed, let alone how to pinpoint it in time."[164] The court also noted that this would mean "that the relevant moment in time would

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[161] *Id.* at 562.

[162] The rule could potentially be attacked as under-inclusive in a way that the Restatement (Third)'s rule is not, in that this rule would not by itself capture a situation in which the recipient learned of the payment and, based on the payment, entered into a new transaction before the payment had been credited in the recipient's books. But, in such a situation, the recipient has clear reliance and, consequently, a clear claim to a change of position defense. And, in any event, such a situation seems unlikely.

[163] *In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 424 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

[164] *Id.* Similarly, the Restatement (Third)'s Reporters Notes reject a "credit" approach as "arbitrary, difficult to verify, and subject to manipulation" while positing that "the consensus rationale relates directly to the payee's knowledge that a payment has been received." RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 reporter's note h (AM. L. INST. 2011).

vary from creditor to creditor and require a fact-intensive inquiry . . . ."[165] As noted above,[166] however, while the *Citibank* court held that the moment of payment was the relevant point in time to determine the recipient's notice, the court nevertheless turned to the fact-intensive inquiry into the lender's knowledge of mistake when they learned about the payment. Although it is not clear why this examination would be necessary under a moment-of-payment standard, it is not obvious that a moment-of-crediting standard would impose a significantly greater inquiry than the one undertaken by the court in *Citibank*.

In any event, the Restatement (Third)'s standard—examining the payee's notice at the time the payee learned of the payment—would likewise involve an examination into a fact internal to the lender that, as in *Citibank*, would require a fact-intensive inquiry of internal communications and records of the lenders.[167] This is especially true given the inquiry notice standard, under which the lender's knowledge of the circumstances surrounding the transfer will be discoverable. The Sixth Circuit in *Calumet* dismissed the concern that a moment-of-crediting standard was too imprecise:

> [n]or . . . will this approach undermine the discharge-for-value rule on the theory that the rule will kick in only after the beneficiary on its own terms makes an accounting of how the transfer should be credited. The time value of money being what it is, most commercial recipients of such transfers can be counted on to promptly credit the debtor's account. As in most settings, at any rate, the rule applies only to commercially reasonable accountings.[168]

A moment-of-payment standard for examining notice under the discharge-for-value rule is largely indefensible given the purposes of the rule. The Restatement (Third)'s standard—pointing to the time the recipient learned of the payment—is better inasmuch as it eliminates some of the arbitrary results, but it requires a more in-depth factual inquiry. A moment-of-crediting standard likewise requires a more in-depth factual inquiry than the moment-of-payment standard, but it (1) eliminates additional arbitrary results beyond those eliminated by the Restatement (Third), (2) would pin notice to the moment of at least some level of reliance, and (3) would not seem to burden courts or parties to a significantly greater degree.

B. Shifting to a Rebuttable Presumption of Reliance

As a tool for implementing a presumption of reliance by a payee, the discharge-for-value rule is a rather blunt instrument, operating in all circumstances involving a payment made to a party holding an antecedent debt. In other

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165 *Citibank*, 520 F. Supp. 3d at 424.

166 *See supra* notes 147–52 and accompanying text.

167 Indeed, although the *Citibank* court's explicit holding was that the moment of payment created the line for notice, the court *nevertheless* conducted a fact-intensive inquiry related to what the lenders believed *when they learned of the payments at issue*. *Citibank*, 520 F. Supp. 3d at 421, 425, 431–39.

168 *In re* Calumet Farm, Inc., 398 F.3d 555, 560 (6th Cir. 2005).

words, to the extent the rule implements a presumption of reliance, the presumption is irrebuttable. But this raises the question of whether such a presumption of reliance ought to be irrebuttable, or whether a rebuttable presumption would serve the purposes of the rule while striking a better balance overall.

As a bright-line rule, an irrebuttable presumption of reliance is of course over-inclusive.[169] It will sweep in cases where there was clearly no reliance. Some over- or under-inclusion may be tolerable to advance judicial efficiency and avoid protracted litigation. On the other hand, when hundreds of millions of dollars are at stake, as they were in the *Citibank* case, it may be that litigation is inevitable, even if the outcome were largely preordained. After all, the *Citibank* lawsuit took place in a legal landscape in which the district court thought the New York rule to be both binding and clear.[170]

In some situations, it will not be a matter of great injustice whether the payor recovers the mistaken payment or the payee keeps it. If the borrower is solvent and maintains an ongoing relationship with the lender, the lender may very well want to return the money to the borrower and collect interest on the outstanding loan. And, where the borrower is solvent, both the mistaken payor and the payee are likely to be made whole in the end.

For example, Citibank's erroneous payment came from its funds—not those of its client (and the debtor) Revlon. If Revlon had been solvent and expected to remain solvent, and if Citibank did not recover its payments to the lenders, then Citibank would have been able to look to Revlon to be made whole. Citibank would not have a claim for immediate repayment from Revlon, but it would be equitably subrogated to the position of the lenders whom it paid off. In other words, Citibank would stand in the shoes of the lenders, subject to the same terms and conditions of the loan agreement.[171] Certainly, Citibank did not choose to lend money to Revlon the way that the creditors did and, consequently, may not be satisfied with the interest rate, the amount or kind of collateral, or the other terms of the agreement, but those concerns would be relatively minor inconveniences if Revlon were able to timely fulfill all of its payment obligations.

Similarly, if Citibank recovers its mistaken payment from the lenders, those lenders retain the benefit of Revlon's outstanding loan obligations, and will be repaid in time according to the loan schedule, as long as Revlon remains solvent. The mistaken-payment question becomes worth litigating when the

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[169] *See supra* Section IV.A.

[170] *In re* Citibank Aug. 11, 2020 Wire Transfers, No. 20-CV-6539 (JMF), 2021 WL 1905002, at *3 (S.D.N.Y. May 12, 2021) (denying Citibank's motion for reconsideration); *Citibank*, 520 F. Supp. 3d at 421 (finding the outcome "compelled by the Second Circuit's decision in *Banque Worms*."). The Second Circuit disagreed, and Judge Park, concurring only in the judgment, described the case as "a straightforward case that many smart people have grossly overcomplicated." Citibank, N.A. v. Brigade Cap. Mgmt., LP, No. 21-487, 2022 WL 4102227, at *28 (2d Cir. Sept. 8, 2022) (Park, J., concurring).

[171] *See generally* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 24 cmt. a (AM. L. INST. 2011) (describing equitable subrogation).

debtor (Revlon in *Citibank* and Spedley in *Banque Worms*) seems unlikely to be able to pay its debts as they come due. In *Banque Worms*, Spedley had been forced into involuntary liquidation,[172] and, in *Citibank*, the lenders understandably doubted Revlon's ability to make the payments and were preparing a lawsuit declaring Revlon in default on the loans.[173] In fact, the market as a whole doubted Revlon's ability to make on-time payments, as evidenced by the fact that the debt instruments were trading at between twenty and thirty cents on the dollar.[174] In a case of the debtor's likely insolvency, such as *Citibank*, the discharge-for-value rule makes all the difference because it determines whether the lenders or Citibank will be left holding the bag—with no money inside.

Because the primary situation in which the adoption of the discharge-for-value rule makes a significant difference involves a debtor in financial trouble, litigation surrounding the discharge-for-value rule may involve a relatively small subset of mistaken-payment situations. First, the situation must be one in which there was an antecedent debt at issue,[175] and, second, the debtor on the antecedent debt must be at significant risk of default. This may explain why, at least according to *amici* in the Citibank case, the return of a mistaken wire transfer is industry practice.[176]

Given the relative rarity of the need for the discharge-for-value rule and its potential to work mischief, it may be tempting to simply argue that the rule is not worth the trouble. The law could simply eliminate the discharge-for-value rule and instead allow the payor's claim in restitution unless and until the payee can demonstrate that it changed its position in good faith reliance on the payment. This was the position the Michigan Supreme Court took in *Wilson v. Newman*[177] when it expressly rejected the rule.

Even without the discharge-for-value rule, the recipient could still keep a mistaken payment to the extent that it could demonstrate good faith reliance on an entitlement to the payment. This would simply be an application of the change-of-position defense and would be consistent with the usual requirement in restitution that the recipient must return an unjust enrichment in the absence of detrimental reliance. The discharge-for-value rule, by implementing a pre-

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172 *See* Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 191 (N.Y. 1991).

173 *Citibank*, 520 F. Supp. 3d at 409. The lenders' concerns were warranted; while appeal was pending, Revlon filed for Chapter 11 bankruptcy protection. *See* Order Confirming that the Automatic Stay Does Not Apply to the Citibank Appeal, *In re* Revlon, Inc., No. 22-10760-dsj (Bankr. S.D.N.Y. June 17, 2022).

174 Brief for Appellant at 45–46, Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

175 Without the antecedent debt, there is an unquestioned claim for a return of the funds in restitution, unless the payee reasonably believed that it was entitled to the funds.

176 Brief for Loan Syndications & Trading Ass'n as Amicus Curiae Supporting Appellant, *supra* note 99, at 7–8.

177 *See* Wilson v. Newman, 617 N.W.2d 318, 322 (Mich. 2000).

sumption of reliance, relieves the payee of the burden to prove reliance,[178] but it leads to arguably unjust results when the absence of reliance is clear, such as in *Banque Worms* and *Citibank*. At the same time, eliminating the discharge-for-value rule would disserve payees who may have generally relied on the payment but cannot identify a particular transaction undertaken in such reliance.[179]

Wilson v. Newman—the case in which the Michigan Supreme Court rejected the discharge-for-value rule—provides a helpful illustration of why the discharge-for-value rule is useful, at least in some form. In *Wilson*, a judgment creditor attempted to collect a judgment against the judgment debtor's rights in any insurance policy held by the garnishee insurance company.[180] The insurance company misidentified an insurance interest of $43,000 that it believed it held on behalf of the judgment debtor, but the policies actually belonged to a different person who had the same name as the judgment debtor.[181] The insurance company paid this interest to the judgment creditor but, after discovering its mistake, the insurer sought to recoup the money from the judgment creditor.[182] The court ordered restitution, rejecting the discharge-for-value rule and requiring restitution unless the payee could demonstrate reliance.[183]

The judgment creditor in *Wilson* argued that, because of the insurer's erroneous payment, the creditor had forgone other collection efforts.[184] The court agreed that, if the judgment creditor had forgone collection efforts in reliance on the insurance proceeds, this would support a change-of-position defense, if the collection efforts would have been successful.[185] But the court placed the burden to prove detrimental reliance on the judgment creditor.[186] This means that, to establish the change-of-position defense, the judgment creditor will have to convince a jury that it would have undertaken other collection efforts (reliance) *and* that those other collection efforts would have been successful (*detrimental* reliance). This would be a heavy burden because proving the likely success of such efforts involves a necessarily speculative component.

In *Wilson*, it would be difficult to determine what would have happened in a counterfactual universe in which the judgment creditor had not received the mistaken payment. In other words, there will be significant uncertainty about

178 *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 67 cmts. a & b (AM. L. INST. 2011) ("[T]he most salient feature of § 67 is that it protects a payee without the need to demonstrate any change of position on receipt.").
179 *See supra* Section III.B.
180 *Wilson*, 617 N.W.2d at 319–20.
181 *Id.* at 319.
182 *Id.*
183 *Id.* at 321–22.
184 *Id.* at 322.
185 *Id.* ("If the plaintiffs can demonstrate a change of position or detrimental reliance as a consequence of having received the mistaken payment, they may be entitled to retain all or part of the funds mistakenly paid by Allmerica.").
186 *See id.* (requiring "the plaintiffs [to] demonstrate . . . detrimental reliance as a consequence of having received the mistaken payment . . . .").

what might have been, and the party that bears the burden of proof on the issue will be at a disadvantage in having to prove the counterfactual. For that reason, *Wilson* offers an example of why a rebuttable presumption of reliance created by the discharge of antecedent debt would remain valuable to the payment recipients in many cases—such a presumption would shift the risk of lack of proof to the payor. And shifting this risk makes sense, given the core restitutionary tenet discussed above that the recipient of a mistaken payment should never be left worse off than it would have been without the payment.[187] Moreover, it was the payor's mistake that creates the uncertainty. While there is no merit to the suggestion that the payor's negligence should cut off a claim in restitution entirely,[188] it makes sense to place the risk of uncertainty on the payor when it was the payor's mistake that caused the uncertainty.[189] Indeed, in many cases involving mistaken payments to lenders, reliance may be present but difficult to prove.[190]

Under a rebuttable presumption of reliance, the burden would fall to the insurer in *Wilson* to satisfy the factfinder that the judgment creditor would not have undertaken any effective collection methods in the absence of the insurance payment. Where, for example, the $43,000 payment satisfied only a small portion of the judgment, and the judgment creditor continued to attempt to collect from the judgment debtor's assets even after the insurance payment, it seems likely that a presumption of detrimental reliance could be rebutted. The key effect of the rebuttable presumption of reliance in this case would be to allocate the risk of a failure of proof to the mistaken payor, furthering the policy that the payee ought not be left worse off by virtue of the mistake. This approach would make sense given the difficulty in proving reliance that often arises with these cases.[191]

In cases such as *Citibank* and *Banque Worms*, the payor would likely be able to meet this standard. In both of those cases, the notice of the mistake came very shortly after the payment was made[192] and before some of the de-

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[187] *See supra* Part I.

[188] *See generally* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT ch. 7, topic 1, intro. note (AM. L. INST. 2011) ("Restitution often allows a culpable (typically negligent) claimant to recover from a defendant who is altogether blameless.").

[189] *See generally* Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251, 265 (1946) ("The most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created.").

[190] *See In re* Citibank Aug. 11, 2020 Wire Transfers, 520 F. Supp. 3d 390, 408–09 (S.D.N.Y. 2021), *vacated sub nom.* Citibank, N.A. v. Brigade Cap. Mgmt., No. 21-0487-cv, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

[191] Although there may be some concern with a burden to prove a negative, the law has embraced such presumptions in other contexts. For example, an insurer may be presumed to be prejudiced by an insured's delay in notifying the insurer of a loss. In such a case, the insured bears the burden of proving an absence of prejudice. *See, e.g.*, U.S. Specialty Ins. Co. v. N602DW, LLC, No. 3:16-cv-02092, 2017 WL 4467481, at *3 (M.D. Tenn. Oct. 5, 2017).

[192] Banque Worms v. BankAmerica Int'l, 726 F. Supp. 940, 940 (S.D.N.Y. 1989), *aff'd*, 928 F.2d 538 (2d Cir. 1991) (describing notice of the mistake was given two hours and fifteen

fendant lenders had learned of the payment (even if their agents had already learned of the payment). And, at least in *Citibank*, many of the debt holders suspected the payment may have been in error when they learned of it.[193] At least one debt holder even segregated the funds so that they could be returned if necessary.[194] Non-reliance would be evident in such cases.

Contrast these cases with cases in which the recipient credited the debtor's account in some fashion, or marked the account as paid, or otherwise directed the payment toward the outstanding balance. These actions would strongly corroborate the presumption of reliance.[195] The presumption would be unlikely to be rebutted in such cases.

The two potential solutions outlined here—adopting a moment-of-credit standard for evaluating notice and implementing a rebuttable presumption of reliance—could be used in tandem or independently to better reflect the policies behind the discharge-for-value rule.[196] Adopting a rebuttable presumption of reliance would overlap significantly with reviewing the recipient's notice of mistake as of the time the recipient credits the debtor's account. But their adoption in tandem, as opposed to adopting one or the other, would make a difference in a small subset of cases. In *Citibank*, for example, one defendant's custodians credited the Revlon account based on some of the payments, but later reversed the credit and were instructed to retain the funds rather than return them.[197] In a case like this, determining notice at the time of credit may permit the lender to retain the funds, even though a presumption of reliance would likely be rebutted in such a case, given the later reversal of the credit. Thus, a

minutes after the payment was sent); *Citibank*, 520 F. Supp. 3d at 403–05 (describing payment around 6:00 PM with recall notices at 2:25 PM the following afternoon).

193 *See supra* Section II.C. On the day following the transfer, a group of lenders including most of the *Citibank* defendants sued Revlon for defaulting on the loan, and the lenders notified Revlon that the loan was being accelerated. The lawsuit, of course, had been in the works for some time, and most of the loan agents were still learning about the payments at the time the suit was filed and the loan was purportedly accelerated. Citibank argued that this lawsuit and acceleration showed that the loan had not been "discharged" at the time the defendants were on notice of the mistake. The court stated that this argument "ultimately fails in light of the Court's conclusion . . . that the relevant point in time to assess notice is when the payments were received." *Citibank*, 520 F. Supp. 3d at 445 n.40.

194 *See Citibank*, 520 F. Supp. 3d at 408 (describing HPS instruction to keep funds out of cash reports "so we don't invest it by accident" and New Generation holding funds in suspense); *id*. at 409 (describing Tall Tree holding funds in an unapplied account).

195 Although, in theory, such credits could be judicially undone in order to enable the payee to return the funds and still retain its pre-payment position, the law has tended to avoid requiring transactions to be reversed. Thus, this type of reliance should suffice to permit the recipient to retain the funds.

196 If the two solutions discussed in this article are used together, then the presumption could apply even if the debtor's account had not yet been credited. There are other ways—besides crediting the account—that the recipient may have relied on the payment. If the rebuttable presumption of reliance is adopted, then a particular cutoff for the timing of notice may be unnecessary—the timing of the notice of mistake would go toward whether the presumption of reliance by the recipient can be successfully rebutted.

197 *See Citibank*, 520 F. Supp. 3d at 408–09.

jurisdiction adopting this approach would need to determine whether it preferred the clearer—but more likely overinclusive—use of the "credit" as the relevant time for notice to the recipient, or the more flexible use of the rebuttable presumption of reliance.

CONCLUSION

The primary difference between the circumstances of the *Citibank* case—in which the lenders were permitted to retain the mistaken payment—and those of Schwab—in which the recipient of the mistaken payment was criminally charged—relate to the existence of an antecedent debt in *Citibank*. It was this antecedent debt that enabled the lenders to resist Citibank's claim in restitution under the shelter of the discharge-for-value rule.

The discharge-for-value rule has long been part of the landscape of restitution claims, and it continues to give rise to difficult cases. By determining the role of the antecedent debt in the justifications for the rule, we can enhance the robustness of the debate around the rule by enabling those on all sides to consider the policies at stake. In *Banque Worms*, the New York Court of Appeals rested the discharge-for-value rule on the need for finality. This Article has argued that, notwithstanding the court's discussion of the need for finality, the only logical support for the rule is a presumption of reliance.

A recognition of reliance as the basis for the rule would enable progress in three respects. First, it would enable courts to properly evaluate the utility of the rule. Second, it would enable courts to determine whether, given the rule's purpose, the timing of the notice relevant to the rule should be something other than the moment of payment, as the district court held in *Citibank*. Finally, it would enable courts to consider whether to view the rule as creating a rebuttable presumption of reliance rather than an irrebuttable presumption. The contours of the discharge-for-value rule can be sharpened through judicial discussion and resolution of these issues with a clear-eyed view of the purposes of the rule.

ADDENDUM—THE SECOND CIRCUIT'S VIEW

After this article was prepared for publication,[198] the Second Circuit released its opinion reversing the District Court in *Citibank*.[199] Given publication

[198] In individual opinions, Judge Leval, the author of the majority opinion, and Judge Park, who concurred only in the judgment, addressed the length of time that the court took to issue its decision. Judge Park criticized the delay and lamented the "dire repercussions for Revlon" and the harm to Citibank that resulted from "the uncertainty our indecision has caused them." Citibank, N.A. v. Brigade Cap. Mgmt., LP, No. 21-487, 2022 WL 4102227, at *40 (2d Cir. Sept. 8, 2022) (Park, J., concurring). In response, Judge Leval provided a peek behind the curtain into the panel's deliberations. He disclosed that the majority initially decided to take the relatively unusual step of certifying the case to the New York Court of Appeals (as had been discussed at oral argument), but the majority changed their minds "because [they] became increasingly persuaded, despite initial uncertainties, that the law of New

constraints of time and space, a full treatment of the Second Circuit's opinion is not possible here, but this Addendum offers a brief overview of the Second Circuit's resolution of the case.

In short, the panel majority reversed the district court on two grounds. First, it held that New York applies an inquiry-notice standard for the discharge-for-value rule, and the lenders were on inquiry notice of Citibank's mistake.[200] The majority thought that the absence of any notice of prepayment, coupled with the apparent insolvency of Revlon as well as other circumstances, should have signaled to the lenders that the payment was likely a mistake.[201] The panel characterized the district court's error as one of law rather than fact (an important distinction given the applicable standards of review), because "[t]he test [for inquiry notice] is not whether the recipient of the mistaken payment reasonably believed that the payment was genuine and not the result of mistake[,]" but instead "[t]he test is whether a prudent person, who faced some likelihood of avoidable loss if the receipt of the funds proved illusory, would have seen fit in light of the warning signs to make reasonable inquiry in the interest of avoiding that risk of loss."[202] Having concluded that the red flags in the transfer were enough to compel reasonable inquiry, the panel then concluded, contrary to the district court's findings, that the lenders would have discovered the mistake if they had undertaken a reasonable inquiry.[203]

The second ground on which the panel majority rested its outcome—and the one that Judge Park found most persuasive in his concurrence[204]—was that the discharge-for-value rule contains a present-entitlement requirement,[205] an argument that is discussed above.[206] The panel noted that some New York cases "described the rule that justified denial of restitution in terms of the payees having received payment of a debt that was 'due.'"[207]

York . . . favors Citibank's position." *Id*. at *27 (Leval, J., add.). Judge Leval also said the majority did not find "the answers to be as straightforward, obvious, and easy as Judge Park does," and he noted the due care required in issuing a precedential decision. *Id*. at *27—28 (Leval, J., add.). Judge Park's initial concurrence took a more accusatory tone regarding the delay, but he softened the tone a bit in an amended concurrence filed a week later. *Compare id*. at *28, *40 (Park, J., concurring (amended)), *with* Concurring Opinion at 2, 28–30, Citibank, N.A. v. Brigade Cap. Mgmt., LP, No. 21-487, 2022 WL 4102227 (2d Cir. Sept. 8, 2022).

199 *See Citibank, N.A.*, 2022 WL 4102227.

200 *Id*. at *14–15.

201 *Id*. at *15–16.

202 *Id*. at *18.

203 *Id*. at *21–23.

204 *See id*. at *33–34, *33 n.13 (Park, J., concurring). Judge Park generally agreed with the majority's reasoning on this point, but he criticized the majority's "close reading of caselaw on present entitlement" for a requirement that he believed was "rooted in equity, not caselaw." *Id*. at *33 n.13 (Park, J., concurring). Judge Park also contended that "discharge for value tracks ordinary setoff principles." *Id*. at *34 (Park, J., concurring).

205 *Id*. at *23–26.

206 *See supra* Section II.A.

207 *Citibank, N.A.*, 2022 WL 4102227, at *24.

As the panel recognized and as is discussed above,[208] limiting the discharge-for-value rule "better harmonizes with New York's 'general rule'" requiring the return of mistaken payments.[209] That said, the majority also discussed the rule in terms of "an administratively convenient way to allocate a loss,"[210] but, as discussed above, loss allocation does not make sense in this context—at least not if the "loss" is thought to stem from the mistaken transfer rather than the lenders' underlying loan transaction.[211]

The Second Circuit's reading of the present-entitlement requirement may limit the discharge-for-value rule in a way that the deciding courts never intended. Certainly the district court thought so. Moreover, it is far from clear that this requirement reflects the law as it has developed in New York. But these questions—as well as an analysis of the court's prudent-person-facing-a-likelihood-of-loss test for inquiry notice—merit a longer discussion than can be supplied in this short addendum.

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208 *See supra* Part III (arguing that the most commonly asserted bases for the rule tug against the general rule and that understanding the rule as implementing a presumption of reliance helps to harmonize the discharge-for-value exception with the underlying purposes of restitution).

209 *Citibank, N.A.*, 2022 WL 4102227, at *24.

210 *Id*. at *25.

211 *See supra* Section III.A.2.