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Civil Procedure—Injunctions

'Serious Questions' Standard Alive and Well For Preliminary Injunctions in Second Circuit

An arbitration between a hedge fund and Citigroup Global Markets Inc., its prime broker, was properly enjoined because the case presented a "serious question" as to whether the hedge fund was a "customer" of CGMI with respect to the disputed credit default swap transaction, the U.S. Court of Appeals for the Second Circuit said March 10 (*Citigroup Global Markets Inc. v. VCG Special Opportunities Master Fund Ltd.*, 2d Cir., No. 08-6090-cv, 3/10/10).

Judge John M. Walker Jr. affirmed the district court's grant of a preliminary injunction, demonstrating the Second Circuit's continued endorsement of the "serious questions" standard in the face of the Supreme Court's decision in *Winter v. Natural Resources Defense Council Inc.*, 77 U.S.L.W. 4001 (U.S. 2008). The defendant read *Winter* to require a much more rigid, "more likely than not," standard regarding a plaintiff's likelihood for success on the merits, the court said.

The Second Circuit recognized that in the wake of *Winter*, several courts, including the Fourth and Ninth Circuits, "have retreated from a flexible approach in assessing the merits of a movant's case." The court considered these opinions to be a misreading of *Winter*, particularly in light of the Supreme Court's other decisions on the matter, including *Munaf v. Geren*, 76 U.S.L.W. 4392 (U.S. 2008), and *Nken v. Holder*, 77 U.S.L.W. 4310 (U.S. 2009).

Steven G. Mintz, who represented the defendant hedge fund, told BNA March 19 that the Second Circuit's opinion was at "direct odds" with the Supreme Court's opinions. "There is no confusion that in all the recent pronouncements of the preliminary injunction standard . . . [the Supreme Court] ha[s] used the term 'likelihood' " when discussing success on the merits.

Allan J. Arffa, attorney for CGMI, said that his client was "very satisfied" with the decision. "We believe that the decision was very well reasoned," and the Second Circuit "came to the right conclusion," Arffa told BNA March 22.

Tale of Two Citi's. VCG Special Opportunities Master Fund Ltd., a hedge fund based on the Isle of Jersey, and CGMI entered into a prime brokerage agreement in July 2006. Subsequently, VCG and Citibank N.A., an affiliate of CGMI, entered into a CDS agreement.

When Citibank later "declared a writedown" regarding the assets underlying the agreement, VCG became obligated to pay Citibank $10 million, the court said.

VCG filed suit in district court, alleging that Citibank had violated the terms of the parties' agreement. Around the same time, VCG began Financial Industry Regulatory Authority arbitration proceedings against CGMI under FINRA Rule 12200 governing disputes between FINRA members and their "customers," arising in connection with the "business activities" of the member.

CGMI responded with a motion for a preliminary injunction in the district court, arguing that VCG was not a "customer" regarding the CDS transaction and that their dispute was not connected to "business activities" governed by FINRA.

The district court granted CGMI's request for injunctive relief. Although it found that CGMI "failed to make a showing of 'probable success' on the merits based on its claim that there was no customer relationship between CGMI and VCG," the district court held that CGMI's evidence "raised 'serious questions' as to whether VCG was in fact a customer of CGMI with respect to the swap transaction."

A 'Venerable Standard.' The Second Circuit first noted that: "For the last five decades, this circuit has required a party seeking a preliminary injunction to show '(a) irreparable harm and (b) either (1) likelihood of success on the merits or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly toward the party requesting the preliminary relief.' "

VCG, on the other hand, argued that the Supreme Court's decisions in *Winter*, *Munaf*, and *Nken* "have eliminated this circuit's 'serious questions' standard," the court said.

Specifically, *Winter* lays out the following standard for issuing a preliminary injunction:

> A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest.

As read by VCG, *Winter* would require the party requesting a preliminary injunction to demonstrate that, "it is more likely than not to succeed on its underlying claims, or in other words, that a movant must show a greater than fifty percent probability of success on the merits," the court said.

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The court disagreed, highlighting the flexibility of the "serious questions" standard, which allows district courts to grant preliminary injunctions "in situations where it cannot determine with certainty that the moving party is more likely than not to prevail on the merits of the underlying claims, but where the costs outweigh the benefits of not granting the injunction."

Further, limiting preliminary injunctions to cases where the outcome is essentially a foregone conclusion robs them of their usefulness, the court said.

In fact, prior to *Winter*, seven circuit courts recognized a standard for preliminary injunctions that allowed for flexibility regarding success on the merits, the court noted. The Supreme Court also expressed a favorable view of such standards prior to the three cases relied on by VCG, it said.

In *Ohio Oil Co. v. Conway*, 279 U.S. 813 (1929), the Supreme Court held that "where the questions presented by an application for an interlocutory injunction are grave, and the injury to the moving party [in the absence of such an injunction] will be certain and irreparable . . . the injunction usually will be granted."

The Second Circuit viewed *Ohio Oil* as a direct endorsement of a flexible approach akin to the "serious questions" standard. Additionally, none of the Supreme Court's more recent decisions undermine its past approval, the court said.

Neither *Munaf*, *Winter*, nor *Nken* directly addressed the issue of a moving party's likelihood of success on the merits, the court said. Had the Supreme Court intended to eliminate the flexibility inherent in the preliminary injunction standards embraced by seven circuit courts, as well as by the Supreme Court itself in *Ohio Oil*, "one would expect some reference to the considerable history" of those standards, the Second Circuit held.

Absent a direct command from the Supreme Court, the Second Circuit refused to abandon its "venerable standard," recognized since at least 1953. To do so would ignore "the needs of the district courts in confronting motions for preliminary injunctions in factual situations that vary widely in difficulty and complexity," the court said.

Serious Questions? VCG argued that the district court erred by holding that both the question of whether VCG was CGMI's "customer," and whether the CDS agreement constituted "business activities" under FINRA Rule 12200, were "serious questions."

The question of VCG's status as a "customer" was strictly a factual matter and also highly disputed, the court said. Thus, "this uncertainty poses a serious question going to the merits of CGMI's claims," it held.

Having determined that the district court properly treated VCG's customer status as a "serious question," the court did not address the issue of whether the CDS agreement was a "business activity."

Finally, the district court's decision that the balance of hardships "tipped decidedly in CGMI's favor" was appropriate because an injunction would simply freeze the arbitration, allowing VCG to continue should the factual disputes be resolved in its favor, the court said.

Judges Wilfred Feinberg and Robert A. Katzmann joined the opinion.

'Collision Course.' Mintz, attorney for VCG, told BNA that this case was ideal for a grant of certiorari from the Supreme Court.

"The Second Circuit has now put itself on a collision course with the Supreme Court," Mintz said. "Judge Walker wrote an opinion begging for a cert grant."

CGMI's Arffa, on the other hand, did not see the holding as contrary to Supreme Court precedent at all. "The

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Supreme Court decision in *Winter* did not displace the longstanding Second Circuit standard for granting preliminary injunctions," he said.

According to Mintz, VCG will file a motion soon for en banc review of the case. Given the stance the panel took in opposition to the Supreme Court's precedents, the rest of the judges "may want to collectively decide whether the entire circuit court feels the same way," Mintz said.

Then again, a confrontation with the Supreme Court may be exactly what the appeals court had in mind. "Judge Walker wanted to justify 50 years of law," Mintz said, and to tell the Supreme Court, if you want that body of law to change, "you better tell us loud and clear directly."

Mintz, Terence W. McCormick, and Joshua H. Epstein, Mintz & Gold, New York, represented VCG. Arffa, and Karen R. King, Paul, Weiss, Rifkind, Wharton & Garrison, New York, represented CGMI.

By Tom P. Taylor

Full text at http://pub.bna.com/lw/086090.pdf.