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Citigroup's $60 Billion Suit Over Failed Merger Back in State Court

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A $60 billion lawsuit brought by Citigroup Inc. in the wake of its failed bid to buy Wachovia Corp.'s banking assets for some $2.1 billion will be heard in state court, a federal judge in Manhattan has ruled.

Citigroup brought the action in state Supreme Court, claiming that Wachovia Corp. "flagrantly" violated an exclusivity agreement it signed with Citigroup in late September. Wells Fargo Corp. agreed to purchase Wachovia for approximately $15 billion the following month.

Citing Citigroup's request for relief under §126(c) of the Emergency Economic Stabilization Act, the so-called bailout package signed by former President George W. Bush in early October, Wachovia and Wells Fargo sought to remove the suit to federal court.

Citigroup maintained that the stabilization act reference in its prayer for relief was a vestige of an earlier complaint which it voluntarily dismissed, and a mere typographical error which the court should disregard.

Refusing to base subject matter jurisdiction on a "typographical error," Southern District Judge Shira A. Scheindlin granted Citigroup's motion to remand the action to state court and directed Wachovia and Wells Fargo to pay $10,000 in costs and fees.

In September 2008, as Wachovia teetered on the verge of collapse, Citigroup struck an agreement to take over the ailing bank for about $2.1 billion.

As part of this deal, Wachovia agreed that it would not negotiate or enter into competing acquisition agreements during an exclusivity period that was to end Oct. 6.

But approximately three days before the exclusivity provision was set to expire, the Citigroup-Wachovia merger was scuttled when Wells Fargo made a $15 billion bid for Wachovia. On Oct. 4, Citigroup brought an action in state court, alleging breach of contract against Wachovia for violating the exclusivity agreement and tortious interference with contract against Wells Fargo. The complaint also claimed the merger violated §126(c) of the Emergency Economic Stabilization Act, which makes unenforceable agreements limiting the ability to acquire "any insured depository institution" in a transaction in which the Federal Deposit Insurance Corp. exercises its authority to confront "systemic risk" under the Federal Deposit Insurance Act.

That same day, Wells Fargo and Wachovia removed the action to federal court. Citigroup then dismissed the suit and initiated a new action in state court, which omitted the §126 cause of action. The new suit asked for $20 billion in compensatory damages, and no less than $40 billion in punitive damages.

However, attorneys for Citigroup neglected to drop the reference to the stabilization act in the prayer for relief.

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All litigation came to a temporary halt on Oct. 6, when the three parties entered into a "standstill agreement" prohibiting them from engaging in "all formal litigation activity."

Then on Oct. 9, Citigroup issued a press release announcing that it could not resolve its differences with Wells Fargo, and vowing to pursue damage claims against Wachovia and Wells Fargo. Wachovia and Wells Fargo filed notice of removal of the original action and the pending action.

According to Citigroup, Wachovia and Wells Fargo "have breached yet another contract by filing purported Notices of Removal of a complaint that asserts no federal claim -- premised on nothing more than a typographical error -- more than 12 hours before" the standstill agreement expired.

"Defendants' attempt to extract a tactical advantage from the obviously ministerial error should be rejected for what it is," Citigroup argued.

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Wachovia and Wells Fargo countered that the reference to the bailout act was "no error" and claimed that Citigroup should not be permitted to "have it both ways" by retaining its federal cause of action but avoiding removal.

Judge Scheindlin, in *Citigroup Inc. v. Wachovia Corporation*, No. 08-CV-8668, found the defendants' arguments "unpersuasive."

FEDERAL PRE-EMPTION

Since the complaint only references the bailout act in the prayer for relief, "it is reasonable that Citigroup simply neglected to delete this one reference to the EESA when it served its latest complaint," the judge wrote.

Under the well-pleaded complaint rule, "a plaintiff may avoid federal jurisdiction by relying solely on state law. Thus, as long as Citigroup did not intend to plead a federal cause of action under the EESA, it is irrelevant that the facts in the Complaint would support one," Judge Scheindlin wrote.

She also rejected defendants' argument that the "complete preemption" of Citigroup's state law claims by §126(c) of the stabilization act provided an additional basis for removal.

Wachovia and Wells Fargo maintained that the "longstanding federal interest in the national banking industry, particularly when coupled with the explicit requirement of direct (and historically rare) FDIC involvement in a 'connect[ed]' transaction before Section 126(c) is triggered, leaves little doubt that Congress would not have wished state law or state courts to assume a role in applying Section 126(c) or -- even worse -- in applying state law inconsistent with Section 126(c)."

"Defendants misunderstand the law on complete preemption," which only applies when a federal statute provides for an exclusive cause of action for a plaintiff's claims and when Congress meant for such a claim to be dealt with as "arising under the laws of the United States," Judge Scheindlin noted. "Section 126(c) of the EESA does not even satisfy the first prerequisite."

And while the statute "may" provide defendants with a "federal defense against Citigroup's claim," the existence of a federal defense does not justify removing a state law claim to federal court, she concluded.

Gregory P. Joseph, Pamela Jarvis, Sandra M. Lipsman, Mara Leventhal, Rachel M. Cherington, and Samuel N. Fraidin of the Gregory P. Joseph Law Office and Paul A. Engelmayer and Charles C. Platt of Wilmer Cutler Pickering Hale and Dorr represented Citigroup. Mr. Joseph did not return calls for comment.

Eric Seiler, Bruce S. Kaplan, Andrew W. Goldwater, and Andrew W. Shilling of Friedman, Kaplan, Seiler & Adelman represented Wachovia and Wells Fargo. Mr. Kaplan declined to comment on the ruling.

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