

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

08 CIV 55207

CITIGROUP GLOBAL MARKETS INC.,

Plaintiff,

v.

VCG SPECIAL OPPORTUNITIES MASTER
FUND LIMITED f/k/a CDO PLUS MASTER
FUND LIMITED,

Defendant.

Case No. 08 CV _____

VERIFIED COMPLAINT 2008

Plaintiff Citigroup Global Markets Inc. (“CGMI”), by its undersigned attorneys, Paul, Weiss, Rifkind, Wharton & Garrison, LLP, as and for its complaint against defendant VCG Special Opportunities Master Fund Limited f/k/a CDO Plus Master Fund Limited (“VCG”) in this action, alleges on its own knowledge or otherwise on information and belief:

Nature of the Action

1. This is an action to enjoin an arbitration that defendant VCG has initiated against its prime broker, CGMI, before the Financial Industry Regulatory Authority (“FINRA”), entitled *VCG Special Opportunities Master Fund Limited f/k/a CDO Plus Master Fund Limited v. Citigroup Global Markets Inc.* (FINRA Dispute Resolution Arbitration Number 08-01430) (the “FINRA Arbitration”).
2. The FINRA Arbitration relates to a credit default swap (“CDS”) transaction between VCG and CGMI’s affiliate Citibank, N.A (“Citibank”). VCG has already brought an action regarding the same CDS transaction in this Courthouse entitled *VCG Special Opportunities Master Fund Ltd. v. Citibank, N.A., No. 08 CV 01563* (BSJ) (the “SDNY Action”), in which it asserts breach of contract, breach of the implied

covenant of good faith and fair dealing, unjust enrichment and related claims against Citibank.

3. Although CGMI was not a party to, and did not broker, the CDS transaction, and despite the pending SDNY Action regarding the CDS transaction, VCG nonetheless initiated the FINRA Arbitration in Boca Raton, Florida, against CGMI, alleging that CGMI “suggested and arranged” the CDS transaction and “suckered” VCG into what VCG now refers to as an “unfair and exceptionally risky” transaction so that CGMI’s “sister affiliate” Citibank could “steal” money from VCG’s accounts.

4. Whatever CGMI’s role in the CDS transaction, the July 17, 2006 prime brokerage agreement between VCG and CGMI (the “Prime Brokerage Agreement”) expressly provides that *no* dispute between those parties arising from or otherwise relating to that agreement, or relating to any transaction entered into under that agreement, will be resolved by arbitration.

5. Moreover, VCG’s blatant attempt to open a “second front” (and a duplicative one) with respect to its meritless complaints about the CDS transaction is entirely inappropriate.

6. Accordingly, by this action, CGMI seeks a declaratory judgment that, under the clear and unambiguous terms of the parties’ agreement, VCG is precluded from proceeding with the FINRA Arbitration, and a permanent injunction preventing VCG from doing so.

7. CGMI also seeks to litigate in this action any of the purported (and meritless) claims VCG in fact is raising against CGMI with respect to the CDS transaction, and will seek to have this action consolidated with the SDNY Action.

The Parties

8. Plaintiff CGMI is a corporation organized and existing under the laws of the State of New York, with its principal place of business in New York, New York.

9. Upon information and belief, defendant VCG is an Isle of Jersey exempted corporation having its principal place of business at Le Masurier House, St. Helier JE2 4YE Jersey, Channel Islands.

10. Upon information and belief, VCG was initially incorporated under the name of "CDO Plus Master Fund Ltd." in Jersey on June 13, 2006, and changed its name to "VCG Special Opportunities Master Fund Limited" effective November 21, 2006.

11. Upon information and belief, VCG is a hedge fund with experience investing in credit derivative transactions, including CDS transactions, and has approximately \$50,000,000 of capital under management.

Jurisdiction and Venue

12. This Court has subject matter jurisdiction over this complaint based on 28 U.S.C. § 1332, because the parties are of diverse citizenship, and the amount in controversy is over \$75,000, exclusive of interest and costs.

13. Venue is proper in the Southern District of New York pursuant to 28 U.S.C. § 1391(d).

14. Jurisdiction and venue are also proper here by virtue of Paragraph 20 of the Prime Brokerage Agreement, in which the parties expressly submit to the jurisdiction and venue of this Court.

Factual Background

The Prime Brokerage Agreement

15. On July 17, 2006, VCG and CGMI entered the Prime Brokerage Agreement, pursuant to which CGMI contracted to provide prime brokerage services (generally, clearing and settling trades in fixed income securities) for VCG. (Ex. A.)

16. The Prime Brokerage Agreement, which is governed by New York law (*id.* ¶ 19), expressly provides that: “NO DISPUTE OR CONTROVERSY BETWEEN THE PARTIES HERETO ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY TRANSACTION HEREUNDER OR BREACH HEREOF OR THEREOF SHALL BE SUBJECT TO OR SETTLED BY ARBITRATION.” (*id.* ¶ 20) (capitalization in original).

The CDS Transaction

17. Separately, in September of 2006, VCG and Citibank entered into a standard International Swaps and Derivative Association, Inc. (“ISDA”) Master Agreement, contemplating that the parties would subsequently enter into various CDS transactions. CGMI was not a party to, and did not broker (nor settle or clear) the ISDA Master Agreement between VCG and Citibank.

18. Thereafter, in the summer of 2007, VCG approached Citibank to enter into a specific CDS transaction referencing a collateralized debt obligation vehicle (or “CDO”). CDOs are structured finance vehicles that generally own certain assets, often debt securities or other revenue-generating assets, and in turn issue their own debt and equity to investors.

19. Under a typical CDS transaction of this type, one party (known as the “protection buyer”) pays periodic fixed amounts to the other party (the “protection

seller”) with respect to a specified amount of a “reference obligation” (usually, a debt instrument such as a bond or note) issued by a “reference entity,” here, a CDO. In return, the protection seller is generally obligated to provide certain consideration to the protection buyer if specific events occur with respect to the reference obligation or the reference entity (usually, a negative event with respect to the creditworthiness of the reference entity or obligation). The CDS protection buyer need not actually own the reference obligation or have any relationship to the reference entity.

20. On or about June 29, 2007, Citibank and VCG entered into a CDS transaction for which a CDO called the “Millstone III CDO LTD III-A” (the “Millstone III CDO”) served as the defined “Reference Entity,” and the Millstone III CDO’s Class B Notes, due July 5, 2046, served as the defined “Reference Obligation.”

21. The CDS transaction was comprised of four agreements, , including the ISDA Master Agreement (collectively, the “CDS Contract”), all based on market standard documentation provided by ISDA.

22. Under the CDS Contract, Citibank acted as protection buyer and agreed to make periodic “Fixed Payments” to VCG, which acted as protection seller. In return, VCG agreed to make certain “Floating Payments” upon the occurrence of certain defined “Floating Amount Events” with respect to the Reference Obligation, the Millstone III CDO Class B Notes. In addition, the parties’ CDS Contract permitted Citibank, in the event of changes in the market value of the CDS Contract, to demand that VCG post additional collateral with Citibank to secure VCG’s payment obligations under the CDS Contract. CGMI was not a party to, and did not broker (nor settle or clear)the CDS Contract.

23. Between July and November 2007, the cost of CDS protection referencing CDOs increased substantially due to negative market conditions. Beginning in August 2007, Citibank was entitled to, and did, pursuant to the CDS Contract, request additional collateral from VCG as security against VCG's payment obligations under the CDS contract. VCG satisfied these requests, sometimes using funds from its prime brokerage account for this purpose.

24. On January 9, 2008, Citibank notified VCG that a Floating Amount Event occurred under the CDS Contract in the form of an "Implied Writedown" and that, as a result, VCG owed Citibank \$10,000,000.

25. VCG refused to pay Citibank the \$10,000,000.

26. Citibank therefore exercised its rights under the CDS Contract to cause an early termination of the parties' CDS Contract, apply the collateral VCG had posted to the amount VCG owed to Citibank and demand payment from VCG of the remaining amount owed.

27. Thus, pursuant to its rights under the CDS Contract, Citibank notified VCG that it was setting off a portion of the \$10,000,000 VCG owed to Citibank against \$9,325,747.62 of posted collateral held by Citibank, resulting in \$674,252.38 due and payable from VCG to Citibank, with interest.

The Southern District of New York Litigation

28. Instead of paying the amount it owed Citibank under the CDS Contract, in February of 2008, VCG filed the SDNY Action against Citibank. (Ex. B.)

29. In its complaint in the SDNY Action, VCG alleges that Citibank's requests for additional collateral were improper (*id.* ¶¶ 1-2, 34) and that Citibank was not

entitled to the \$10,000,000 payment because no Implied Writedown occurred under the parties' CDS Contract (*id.* ¶¶ 1, 3, 37-41).

30. On April 23, 2008, Citibank answered VCG's complaint, asserting various defenses, and brought a counterclaim for breach of the CDS Contract by VCG. (Ex. C.) Citibank alleges that it was indeed entitled to demand additional collateral from VCG under the CDS Contract, that an Implied Writedown had in fact triggered VCG's Floating Payment obligations, and that VCG's failure to pay its Floating Payment obligations and to indemnify Citibank constitute breaches of the CDS Contract. (*Id.* ¶¶ 28, 35, 58).

31. On May 20, 2008, VCG answered Citibank's counterclaim. (Ex. D.) On May 22, 2008, VCG and Citibank had a Rule 26(f) conference and agreed upon a discovery schedule.

The FINRA Arbitration

32. Despite having already initiated a lawsuit in the Southern District of New York in connection with the CDS Contract, despite the fact that CGMI was not a party to and did not broker the CDS Contract, and despite the plain language of Paragraph 20 of the Prime Brokerage Agreement prohibiting arbitration, on May 1, 2008, VCG initiated the FINRA Arbitration by filing a Statement of Claim in the Boca Raton dispute resolution office of FINRA against CGMI, alleging various wrongdoing by its prime broker CGMI in connection with the same CDS Contract at issue in the SDNY Action. (Ex. E.)

33. In the FINRA Arbitration, VCG alleges that CGMI breached various duties supposedly owed to VCG by inducing VCG into the CDS Contract, which VCG now calls an unfairly risky transaction, to benefit CGMI's "sister affiliate,"

Citibank. (*Id.* at 4-5). VCG alleges that Citibank's demands for additional collateral provide "circumstantial evidence" that CGMI had "inside information" before the CDS Contract was formed and that the CDS Contract was intended to benefit Citibank at VCG's expense. (*Id.* at 8). Based on these allegations, VCG's Statement of Claim asserts that CGMI is liable to VCG for "breach of fiduciary duty," "negligence," "fraud" and other wrongdoing. (*Id.* at 2.)

34. CGMI's answer to VCG's statement of claim is currently due June 27, 2008.

First Claim for Relief
(Declaratory Judgment as to Non-Arbitrability)

35. CGMI repeats and realleges the allegations of paragraphs 1 through 34 of the Complaint above, as if fully set forth here.

36. An actual and present controversy has arisen between the parties with respect to whether VCG is precluded by its Prime Brokerage Agreement with CGMI (or otherwise) from pursuing the FINRA Arbitration against CGMI.

37. Because the express terms of the Prime Brokerage Agreement clearly preclude VCG from pursuing the FINRA Arbitration against CGMI (and given the duplicative nature of the FINRA Arbitration), CGMI is entitled to a declaratory judgment that VCG is precluded from proceeding with the FINRA Arbitration.

Second Claim for Relief
(Declaratory Judgment as to Lack of Wrongdoing by CGMI)

38. Plaintiff CGMI repeats and realleges its allegations of paragraphs 1 through 37 of the Complaint above, as if fully set forth here.

39. As evidenced by VCG's complaint in the FINRA Arbitration, an actual and present controversy exists between VCG and CGMI as to whether, with

respect to the CDS Contract, CGMI owes any fiduciary or other duty to VCG, or breached any such duty, or VCG is otherwise entitled to any relief as to CGMI.

40. Because CGMI owes no fiduciary duty or any other duty to VCG with respect to the CDS Contract, breached no duties owed to VCG with respect to that contract, and because VCG is not entitled to any relief as to CGMI with respect to the CDS Contract, CGMI is entitled to a declaration so stating.

Prayer for Relief

WHEREFORE, CGMI is entitled to judgment as against VCG:

- (i) temporarily, preliminarily and permanently enjoining VCG from proceeding in any way with the FINRA Arbitration;
- (ii) declaring that VCG is not entitled to proceed in any way with the FINRA Arbitration;
- (iii) declaring that CGMI neither owed nor breached any duties allegedly owed to VCG as to the CDS Contract and that VCG is not entitled to any relief as to CGMI as to the CDS Contract;
- (v) awarding CGMI all attorney's fees and other costs associated with this action; and

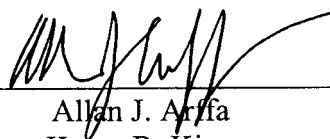
- (vi) awarding any other and further relief that the Court deems just and proper.

Dated: June 18, 2008
New York, New York

Respectfully submitted,

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

By: _____



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VERIFICATION

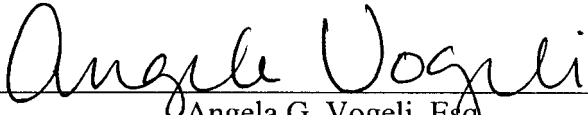
I, Angela G. Vogeli, Esq., declare under penalty of perjury under the laws of the United States of America, and pursuant to 28 U.S.C. § 1746, that:

I am Vice President and Legal Counsel at Citigroup Global Markets Inc.

I have read the foregoing Complaint and know the contents thereof.

The allegations contained in the Complaint are true and correct, based on my personal knowledge, information or belief, or based upon information provided to me by others in the company whom I believe to be the most reliable sources for such information.

Executed on this 18th day of June, 2008



Angela G. Vogeli, Esq.