

STATE OF NORTH CAROLINA  
COUNTY OF MECKLENBURG

IN THE GENERAL COURT OF JUSTICE  
SUPERIOR COURT DIVISION  
C.A. No. 07 CVS 5097

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WACHOVIA BANK, NATIONAL  
ASSOCIATION and WACHOVIA CAPITAL  
MARKETS, LLC,

Plaintiffs

v.

HARBINGER CAPITAL PARTNERS  
MASTER FUND I, LTD. et al.,

Defendants

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DEFENDANTS' REPLY MEMORANDUM IN SUPPORT OF MOTION TO DISSOLVE  
PRELIMINARY INJUNCTION AND STAY ACTION

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## PRELIMINARY STATEMENT

Plaintiffs' arguments to maintain the preliminary injunction do not pass the "straight face" test. Preliminarily, Defendants could not "waive" a constitutional protection rooted in the Supremacy Clause that applies to all state courts, prohibiting them from enjoining, even indirectly, proceedings in federal courts. Nor can Plaintiffs nullify a controlling Supreme Court precedent by reversing course and declaring that that they are now proceeding *in rem*.<sup>1</sup>

Plaintiffs also cannot credibly argue that the "multiplicity of actions" Judge Ervin feared might still arise now that all Defendants have joined in a single action. Any lingering doubt was eliminated by Defendants' recent offer to stipulate that any further assignment of claims would be conditioned on the assignees' agreement to assert those claims only in the same action or same court.

The contention that this Court lacks jurisdiction to modify an interlocutory injunction issued by Judge Ervin, whom Plaintiffs sought to disqualify as a potential judge for this action after first suggesting that he hear the motion for preliminary injunction, is too clever by half. When a case is certified pursuant to Rule 2.1, the concern that one Superior Court judge may sit in judgment of another no longer applies. Further, the authorities are clear that a preliminary injunction may always be modified when the equities require it.

Plaintiffs' argument that no stay should be granted is similarly unavailing. Plaintiffs concede that a stay would be appropriate if the stay merely postponed the litigation "pending the resolution of the same matter in another sovereign court." (Pl. Br. at 10.) Because plaintiffs could assert the instant claims as permissive counterclaims, and will undoubtedly raise

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<sup>1</sup> As explained in Part II of Defendants' Brief Opposing Motion for Civil Contempt, this simply is not an *in rem* action. Plaintiffs' own conduct – including their claims, the relief sought, and the personal jurisdiction discovery pursued – demonstrates that.

champerty as a defense in New York, the issuance of a stay will, in fact, appropriately postpone this litigation pending the resolution of the same matter in New York.

Finally, although North Carolina courts can exercise exclusive jurisdiction to determine ownership of real property situated in North Carolina, it does not follow that only North Carolina courts may decide claims first alleged in North Carolina. Instead, a court must examine the *Lawyers Mutual* factors to determine whether it is appropriate to stay an action here while the same subject matter is tried elsewhere. Plaintiffs have not rebutted Defendants' showing that a stay is required.

## **ARGUMENT**

### **I. PLAINTIFFS HAVE NOT OVERCOME DEFENDANTS' FACTUAL AND LEGAL SHOWING THAT THE PRELIMINARY INJUNCTION SHOULD BE DISSOLVED.**

#### A. *Donovan* Prohibits State Courts From Enjoining the Assertion of Claims in Federal Court.

As explained in detail in Defendants' Brief Opposing Motion for Civil Contempt, *Donovan v. City of Dallas*, 377 U.S. 408 (1964), holds that state courts are not empowered, either directly or indirectly, "to restrain federal-court proceedings in *in personam* actions." *Id.* at 412-413. *Donovan* goes to the very *power* of state courts to enjoin the assertion of any claims in federal court, and thus cannot be "waived" by a party. In addition, as also explained more fully in Defendants' Brief Opposing Motion for Civil Contempt, if state courts could simply re-classify claims as "property," *Donovan* would be rendered a nullity and the Supremacy Clause ignored. That cannot be. There is thus no question that if the injunction operates to bar the assertion of claims in federal court, it violates *Donovan*. For that reason, alone, it should be dissolved.

B. Plaintiffs Can No Longer Identify Any Alleged Harm in the Absence of an Injunction.

Plaintiffs' stated reason for seeking a preliminary injunction, and Judge Ervin's stated reason for granting it, was to prevent Plaintiffs from *defending* "a multiplicity of suits in a number of jurisdictions." (Order at 6.) When Defendants eliminated that threat by joining in a single action, Plaintiffs' theory of the "harm" they need protection from changed. Plaintiffs now seek protection from *initiating* multiple litigations against debt assignees. They speculate that if any claim is reassigned, they will be sent "on a completely futile and endless wild goose chase in search of the correct defendant to sue." (Pl. Br. at 7, 8.)<sup>2</sup> In response to that argument, Defendants offered a stipulation that precludes the possibility of any assignee filing in another jurisdiction:

Defendants will require that any future transferee, if any, of their respective interests in the bank debt will bring any claims against Plaintiffs, if the future transferee wishes to assert such claims, either as a member of existing litigation by the group of Defendants or, if that is not procedurally possible, in the same court in which such action is pending.<sup>3</sup>

Demonstrating that their argument was merely pretextual, Plaintiffs swiftly rejected Defendants' offer.<sup>4</sup>

C. Plaintiffs Did Not Render the Preliminary Injunction Immutable by Successfully Objecting to Judge Ervin.

Plaintiffs' argument that one "Superior Court Judge may not overrule another Judge" (Pl. Br. at 3-4) is misguided. That concern arises only if one of the parties is clearly engaged in

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<sup>2</sup> This argument is, of course, completely at odds with Plaintiffs' contention that this Court already has *in rem* jurisdiction over those claims.

<sup>3</sup> See October 11, 2007 letter to Plaintiffs' attorney, Robert Fuller, attached as Exhibit B to the Affidavit of James B. Gatehouse, executed on October 22, 2007 ("Gatehouse Aff.").

<sup>4</sup> Gatehouse Aff. Exh. C.

“judge shopping,” or where the modification of the original order by the second judge would serve to undermine the issuing judge’s authority. See *State v. Woolridge*, 357 N.C. 544, 549-50, 592 S.E.2d 191, 194 (2003) (clearly identifying the policy underlying the rule). Those concerns were at issue in all the cases cited by Plaintiffs. In each, the second judge’s modification of the issuing judge’s order undermined the issuing judge’s authority and permitted the moving party to re-litigate an issue that had previously been decided against it.<sup>5</sup>

Here, it is Plaintiffs, not Defendants, who are attempting to game the system. It was Plaintiffs, not Defendants, who objected to Judge Ervin’s further participation as a potential Rule 2.1 judge. Plaintiffs’ argument that another judge cannot modify the injunction is unavailing. Reconsideration is available when a case has been designated as exceptional pursuant to Rule 2.1. Thus, in *Ruff v. Parex, Inc.*, 1999 N.C.B.C. 6, Judge Tennille concluded that he could revisit a class certification decision made by Judge Fullwood. In doing so, he explained that “the designation and assignment of this case as exceptional pursuant to Rule 2.1 . . . serves as a justification for the Court’s exercise of its discretion in connection with the trial management issues the Court must oversee.” *Id.* at \*28. Had this case not been transferred pursuant to Rule 2.1, any Superior Court judge properly hearing a motion to dissolve, be it Judge Ervin or another, could have exercised his discretion to dissolve the preliminary

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<sup>5</sup> In *McGuinn v. City of High Point*, 219 N.C. 56, 13 S.E.2d 48 (1941), one judge issued a permanent injunction and a second modified it notwithstanding that the movants’ argument for modification was substantially similar to their earlier argument against issuance of the injunction. The second judge did so because he interpreted the law differently. In *Dublin v. UCR, Inc.*, 115 N.C. App. 209, 444 S.E.2d 455 (1994), one judge certified a class and a subsequent judge decertified it. In *First Financial Ins. Co. v. Commercial Coverage, Inc.*, 154 N.C. App. 504, 572 S.E.2d 259 (2002), one judge refused to adopt a referee’s report without further investigation but a second judge did. *State v. Woolridge*, 357 N.C. 544, 592 S.E.2d 191 (2003), involved an order by a second judge overturning a suppression order. In *Calloway v. Ford Motor Co.*, 281 N.C. 496, 189 S.E.2d 484 (1972), the defendant moved unsuccessfully to amend its answer; a second judge then permitted the amendment, finding that the first judge’s order misinterpreted the law.

injunction in light of the New York Action. It would be inequitable to require Defendants to live with an injunction that no longer serves its intended purpose solely because Plaintiffs went judge shopping.<sup>6</sup>

D. To the Extent Even Required, Dissolution of the Preliminary Injunction Is Supported by a Substantial Change of Circumstances.

Plaintiffs argue that *McGuinn* requires a substantial change in circumstances to modify an injunction. *McGuinn*, however, concerned modification of a permanent injunction; not a preliminary injunction. A motion to modify or dissolve a preliminary injunction rests within the sound discretion of the trial judge. *See Huskins v. Yancey Hosp. Inc.*, 238 N.C. 357, 360, 78 S.E.2d 116, 119-120 (1953); *Lance v. Cogdill*, 238 N.C. 500, 504, 78 S.E.2d 319, 322 (1953). Defendants' motion to dissolve merely asks this Court to address the continued usefulness of the preliminary injunction, which, by its very nature, is only a temporary measure.

In any event, Defendants have established a substantial change in circumstances. The primary concern underlying Judge Ervin's order – avoiding a multiplicity of lawsuits – has been cured by the filing of the New York Action. All Defendants here have joined the Initial Lenders (who are not covered at all by Judge Ervin's injunction) and have filed claims against numerous potentially liable parties. The parties include not only Plaintiffs in this action, but also many others who are not even parties in North Carolina. The New York Action is thus more comprehensive than Judge Ervin could have hoped to achieve by issuing the preliminary injunction. Judge Ervin did not account for this possibility in issuing the preliminary injunction

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<sup>6</sup> Because Judge Ervin is not within this district or an adjoining district, this Court may appropriately consider modification of the preliminary injunction. *See* G.S. § 1-498. Indeed, Judge Ervin has effectively been disqualified from hearing Defendants' motion. *Cf.* G.S. § 7A-49.1.

– rather, he expressly contemplated that *many* actions might be brought (in New York, Delaware, the Cayman Islands, for example). (P.I. Tr. at 48:8-49:5.)<sup>7</sup>

Should the injunction continue, at least two actions will proceed in two jurisdictions. Dissolution of the injunction will, in contrast, permit all parties, including additional parties not subject to the preliminary injunction in North Carolina, to assert all their claims against each other in a *single* action.

## **II. THIS ACTION SHOULD BE STAYED TO PREVENT A SUBSTANTIAL INJUSTICE.**

### **A. The Court Should Disregard Plaintiffs’ Improbable Threat Not to Assert Counterclaims.**

Plaintiffs’ argument that a New York court could not accord relief on their champerty claims is meritless. It does not follow that because Plaintiffs’ potential counterclaims are not compulsory that they are not permissive either. Clearly they are. The real issue is whether Plaintiffs’ claims *may*, as opposed to *must*, be brought in New York. Because they can, New York is a completely adequate forum for Plaintiffs’ claim.

That champerty is recognized as an affirmative claim under North Carolina law avails Plaintiffs nothing. Champerty may be asserted as a defense in New York. *Bluebird Partners, L.P. v. First Fidelity Bank, N.A.*, 94 N.Y.2d 726, 731 N.E.2d 581 (2000). Thus, even if Plaintiffs were allowed to proceed with their champerty claim in North Carolina, it would be unreasonable to assume that Plaintiffs would not also raise champerty as a defense in New York, thus making judicial inefficiency a certainty.

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<sup>7</sup> Excerpts from the preliminary injunction hearing transcript cited herein have been attached to the Gatehouse Aff. as Exhibit D.

B. Plaintiffs' Reliance on *Green* Is Utterly Misplaced.

Plaintiffs rely on *Green v. Wilson*, 163 N.C. App. 186, 592 S.E.2d 579 (2004), for the proposition that “entry of a stay would be improper here because this Court has already asserted jurisdiction over the tort claims against Wachovia that the Defendants have attempted to trade by assignments.” (Pl. Br. p. 10) This reliance is untenable. In *Green*, the plaintiffs filed suit to quiet title to real property in North Carolina but the defendant filed suit in Georgia, where the plaintiffs lived. The *Green* court held that North Carolina had exclusive *in rem* jurisdiction. Accordingly, the Georgia court could not determine the ownership of the North Carolina property. This case is entirely distinguishable. The New York Action involves federal racketeering claims against Wachovia (and an array of claims against the other parties) – not the disposition of title to real property.

C. There Can Be No Dispute That, Absent a Stay, Enormous Inefficiency Will Result.

Where, as here, North Carolina lacks *in rem* jurisdiction, the more flexible “substantial injustice” test applies to determine whether to stay a North Carolina proceeding. *See Motor Inn Mgmt., Inc. v. Irvin-Fuller Dev. Co.*, 46 N.C. App. 707, 266 S.E.2d 368 (1980); *Kintz v. Amerlink Ltd*, 2005 N.C. App. LEXIS 2389 (unpublished).<sup>8</sup> Defendants’ stay request clearly satisfies the “substantial injustice” requirements of N.C. Gen. Stat. § 1-75.12 and a stay will “merely postpone[] litigation here pending the resolution of the same matter in another sovereign court.” (Pl. Br. at 10). As shown below, Plaintiffs have not overcome Defendants’ showing that the facts relevant to the issuance of a stay, as enumerated in *Lawyers Mutual Liability Insurance*

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<sup>8</sup> The *Kintz* opinion is attached as an Exhibit hereto.

*Co. v. Nexsen Pruet Jacobs & Pollard*, 112 N.C. App. 353, 435 S.E.2d 571 (1993), militate in favor of a stay.<sup>9</sup>

Nature of the Case. Significantly, Plaintiffs do not dispute that their action was a preemptory strike intended to secure them a litigation advantage. Because that is undisputed, the first factor favors a stay.

Convenience of the Witnesses. Plaintiffs' argument that the convenience of the witnesses favors a North Carolina forum depends on two critical, but incorrect, assumptions: that Plaintiffs will not raise any defense to the claims asserted against them in New York and that Defendants will assert no claims or defenses if the North Carolina action is not stayed. If, however, the North Carolina and New York actions proceed simultaneously "with judgment in the first action to be concluded being afforded such collateral estoppel or res judicata effect as may be appropriate" (Pl. Br. at 11), it would be unreasonable to assume that there would be "far more witnesses and documents in North Carolina that may be of relevance to this lawsuit than in any other State." (Pl. Br. at 19.) In that event, the witnesses would largely be from New York, with some coming from Pennsylvania.

Availability of Compulsory Process. Governing North Carolina law, as enunciated in *Lawyers Mutual*, requires North Carolina courts to consider the availability of compulsory process to require the appearance of witnesses at trial. Ignoring this clear law, Plaintiffs cite only out-of-state cases for the proposition that the transfer of an action is not mandatory when third-

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<sup>9</sup> "[I]n determining whether to grant a stay, it is not necessary that the trial court find that *all* factors positively support a stay, as long as it is able to conclude that (1) a substantial injustice would result if the trial court denied the stay, (2) the stay is warranted by those factors present, and (3) the alternative forum is convenient, reasonable and fair." *Lawyers Mutual*, 112 N.C. App. at 357, 435 S.E.2d at 574; *see also Kintz*, 2005 N.C. App. LEXIS 2389 (unpublished). But even if Defendants were obligated to meet each of the ten factors of the test, they have done so.

party witnesses can provide videotaped deposition testimony. This is irrelevant because North Carolina courts hold that a party's ability to present its case through live witnesses is a factor that must be considered in ruling on a stay application. Accordingly, this factor also militates in favor of a stay.

Ease of Access to Sources of Proof. Plaintiffs have not challenged Defendants' showing that important documents maintained by non-parties are more likely obtainable in a federal action than in a state court action. Such documents include those relating to Le Nature's' audits, Le Nature's' executives' misconduct, the transfer of Credit Facility interests, and the procedures and findings of the court-appointed custodian. Accordingly, the fourth factor also favors a stay.

Applicable Law. The central issue in this action is whether the LSTA Standard Terms are enforceable. Though Plaintiffs disparagingly refer to the LSTA purchase agreement as a "side agreement," it is a detailed document that has been adopted for use throughout the country. Wachovia Bank itself is represented on the LSTA committee responsible for drafting and updating the agreement. The LSTA Standard Terms provide that third-party claims are transferred with the debt and that New York law applies to such transfers. As pointed out by the LSTA, the uniform application of those terms promotes stability and liquidity in the debt market. Ignoring these important issues, Plaintiffs simply contend that North Carolina bars the sale of purely personal tort claims. Even if that were true – and it is hardly established that any such rule would apply here – Judge Ervin expressly noted that it is not clear whether North Carolina champerty law would apply to Defendants' claims.<sup>10</sup>

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<sup>10</sup> At the preliminary injunction hearing Judge Ervin *explicitly rejected* Wachovia's argument that North Carolina law must apply to this action, and instead declined to rule on what law will apply to the assignability of tort claims. (Tr. at 67: 15-23, 85: 24-25.)

Plaintiffs have asserted causes of action for champerty, indemnification, declaratory and injunctive relief and unfair trade practices, but Plaintiffs' arguments and case law are purely champerty-based. See *Charlotte-Mecklenburg Hosp. Authority v. First of Georgia Ins. Co.*, 340 N.C. 88, 91, 455 S.E.2d 655, 657 (1995); *Andrews v. Strategic Outsourcing, Inc.*, 2006 WL 1967382 (July 12, 2006 W.D.N.C.) (unpublished).<sup>11</sup> Although North Carolina law recognizes champerty as an affirmative claim, Plaintiffs are really asserting disguised defenses to Defendants' more substantive fraud-based claims. Plaintiffs have not shown that a New York federal court would be incapable of determining whose law applies and, if relevant, whether Defendants' commercial claims are "purely personal tort claims" within the meaning of North Carolina law.

In contending that North Carolina courts would necessarily apply the State's champerty law notwithstanding any choice of law analysis, Plaintiffs deliberately overlook *DaimlerChrysler Corp. v. Kirkhart*, 148 N.C. App. 572, 580, 561 S.E.2d 276, 283 (2002), in which the court explained North Carolina's interest in ensuring that its champerty rules do not conflict with modern commercial realities. Significantly, *DaimlerChrysler* is the most recent North Carolina state case to address champerty and maintenance in a commercial context. This factor thus supports a stay.

Burden of Litigating Matters Not of Local Concern. Plaintiffs do not dispute that this action raises matters of national and international concern. Wachovia transacts business internationally, syndicates loans to banks and investors everywhere, and has billions of dollars in assets throughout the United States. Wachovia Bank identifies New York as one of its principal places of business. Further, Plaintiffs do not dispute that the interpretation and application of

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<sup>11</sup> The *Andrews* opinion is attached as an Exhibit hereto.

LSTA requirements are of national concern and that this action has significant implications for the national debt market. Accordingly, this factor militates in favor of a stay.

Convenience of Access to Another Forum. Plaintiffs do not contest that New York would be a convenient, reasonable and fair forum for them<sup>12</sup> and that they have substantial resources to expend on litigation and already transact substantial business in New York. Instead, they disingenuously argue, based on *American Motorists Insurance Co. v. Avnet, Inc.*, 98 N.C. App. 385, 391 S.E.2d 50 (1990), that New York is not convenient merely because Wachovia might bring a motion to dismiss that action on some basis. (Pl. Br. at 11.) *American Motorists* does not require this Court to speculate concerning the outcome of any such motion; in *American Motorists*, the other action had *already* been dismissed. Moreover, Defendants' motion to dismiss *this* action for lack of personal jurisdiction is pending. Thus, this factor also favors a stay.

Choice of Forum. A plaintiff's choice of forum is accorded little weight when the plaintiff brings a preemptory strike intended to secure a perceived advantage in litigation. Plaintiffs claim that this rule does not apply because they purportedly assert "affirmative claims." Their claims for champerty and unfair trade practice violations, however, are all aimed at preventing the Secondary Lenders from pursuing their tort claims against Plaintiffs.

Plaintiffs have failed to distinguish *Coca-Cola Bottling Co. Consolidated v. Durham Coca-Cola Bottling Co.*, 141 N.C. App. 569, 579, 541 S.E.2d 157, 164 (2000), in which the Court of Appeals held that when there are two suits involving overlapping issues, a trial court should determine whether the first-filed suit "is merely a strategic maneuver to achieve a

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<sup>12</sup> See *Lawyers Mutual*, 112 N.C. App. at 357, 435 S.E.2d at 573 (conditioning the issuance of a stay on the availability of an alternative "convenient, reasonable and fair" forum).

preferable forum.” Because Plaintiffs’ suit clearly is a strategic maneuver, Plaintiffs are not entitled to the deference ordinarily accorded to a plaintiff’s choice of forum.

Other Practical Considerations. Plaintiffs do not contest that New York also has a substantial interest in the outcome of litigation and that all parties to the New York Action (except the Le Nature’s executives) are either headquartered in New York or routinely conduct business there. Plaintiffs do not dispute that New York courts routinely address complex banking and financial disputes in a reasonable and fair manner. Accordingly, on balance the factors a North Carolina court must consider in weighing a stay application militate strongly in favor of the requested stay.

**CONCLUSION**

For the reasons set forth above and in Defendants' moving papers, this Court should dissolve the preliminary injunction and stay this action pending the outcome of the New York Action.

Respectfully submitted this the 22nd day of October, 2007.

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## **RULE 15.8 CERTIFICATION**

I certify that this brief complies with BCR 15.8.

This the 22nd day of October, 2007.

/s/ James B. Gatehouse

## **CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a copy of the Defendants' Reply Memorandum in Support of Motion to Dissolve Preliminary Injunction and Stay Action was served on this day by e-mail and by hand-delivery as follows:

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This the 22nd day of October, 2007.

/s/James B. Gatehouse