

STATE OF NORTH CAROLINA
COUNTY OF MECKLENBURG

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
Civil Action No: 07 CVS 5097

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

Plaintiffs,

v.

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

Defendants.

**PLAINTIFFS' BRIEF IN SUPPORT OF
MOTIONS FOR CIVIL CONTEMPT AND
FOR ENFORCEMENT OF
PRELIMINARY INJUNCTION**

On April 12, 2007, this Court specifically enjoined the Fund Defendants and “all of their officers, agents, servants, employees, and attorneys, and all persons and entities acting in active concert or participation with them” from filing any purportedly assigned conspiracy or racketeering claims “arising from or relating in any respect to the Le-Nature’s Credit Agreement” against either of the Wachovia plaintiffs “in any court other than this Court.” Preliminary Injunction ¶¶ 1 & 2. As is set forth in the verified motion filed herewith, on September 17, 2007, the Fund Defendants nevertheless filed a new civil action in Federal District Court in the Southern District of New York (07-CIV 8139) (herein the “New York Action”) asserting purportedly assigned racketeering conspiracy claims directly relating to the Le-Nature’s Credit Agreement against plaintiff Wachovia Capital Markets, LLC (“WCM”). Accordingly, the Wachovia plaintiffs have moved this Court to schedule a hearing and order the defendants to appear and show cause why they should not be held in contempt for violating the Preliminary Injunction. In addition, the Wachovia plaintiffs request that this Court enter such orders, and

grant such further relief as may be appropriate and proper, to cause the defendants to cease and desist their violation of the Preliminary Injunction.

Legal Points

A. The defendants have violated the Preliminary Injunction.

In their filings with this Court on November 17, 2007, the defendants implicitly take the position that their assertion of federal racketeering conspiracy claims against WCM in the New York Action does not violate the Preliminary Injunction because they have not asserted any claims against WCM arising under state law. Put another way, they have implicitly construed ordering paragraph 2 of the Preliminary Injunction only to prohibit the filing of claims arising under state law. The paragraph reads, in pertinent part:

The Enjoined Persons and Entities are *prohibited from asserting, as set forth in paragraph one above, the following statutory or common law causes of action, whether arising under the law of North Carolina or of any other state (collectively “Personal Tort Claims”):* (a) fraudulent and negligent omissions or misrepresentations, or both, (b) constructive fraud, (c) negligence, (d) breach of fiduciary duty, (e) tortious interference, (f) unfair trade practices, (g) *racketeering*, (h) *conspiracy to commit any of the aforelisted causes of action*, (i) aiding or abetting the commission of any of the aforelisted causes of action; and (j) any other causes of action founded in whole or in part upon allegedly tortious conduct.

Preliminary Injunction, Ordering Paragraph 2 (emphasis added). This paragraph flatly prohibits the assertion of “the following statutory or common law causes of action” and specifically includes “racketeering” and “conspiracy” claims within its scope. Construing this paragraph as not precluding the assertion of federal racketeering conspiracy claims in the New York Action distorts and misinterprets its meaning.

The defendants apparently intend to justify the assertion of alleged federal racketeering conspiracy claims in the New York Action by relying on the phrase “whether arising under the law of North Carolina or of any other state.” The language of the paragraph demonstrates that

this phrase in no respect narrows the scope of the Preliminary Injunction to state law claims, however, because it is illustrative, not restrictive, and does not limit the scope of the prohibition on assertion of claims otherwise set forth in paragraph 2. No one who attended the Preliminary Injunction hearing could reasonably have thought that the order covered only state-law claims, and no fair and reasonable reading of the Preliminary Injunction supports such a conclusion either.

Construing the Preliminary Injunction in the manner that the defendants implicitly assert to be correct would be anomalous given the nature of Judge Ervin's ruling, particularly in the context of the arguments asserted at the Preliminary Injunction hearing. At the hearing, the defendants were seeking permission freely to buy, sell, and assert purportedly assigned tort claims against the Wachovia plaintiffs. Counsel for Wachovia urged that the defendants be enjoined from asserting any purportedly assigned claims (other than contract claims) completely, or that alternatively the defendants be enjoined from transferring such claims and required to assert all such claims in this Court. Transcript of Preliminary Injunction Hearing at 10–11 & 64–65 (pages from Transcript attached hereto). Otherwise, as counsel argued, Wachovia would be forced to play an impossible game of “judicial whack-a-mole” – because every time Wachovia tried to assert champerty claims against the holder of a purported claim, or to obtain a determination of the enforceability of an assignment, the defendant could and would simply transfer the claim to another person or entity. *Id.* at 65. Thus, absent an injunction, Wachovia would have been prevented from being able to obtain an adjudication of its claims against the defendants in a single forum of its choice (this Court), which would have allowed the defendants effectively to undermine the North Carolina Supreme Court's prohibitions against champerty. *Id.* at 72–75 & 84–86; *see also Investors Title Ins. Co. v. Herzig*, 330 N.C. 681, 689, 413 S.E.2d

268, 271-72 (1992) (if allowed, the assignment of statutory and common law tort claims “would wreak havoc by creating a market for claims of a personal nature”). Judge Ervin decided to grant the alternative relief requested by the Wachovia plaintiffs and specifically enjoined the Fund Defendants both from transferring or assigning claims, and from asserting such claims “in any court but this Court.” Given this background, it would stand logic on its ear to conclude that Judge Ervin intended to preclude trading of statutory and common law tort claims against Wachovia only if those claims arose under state law.

Additional context from the Preliminary Injunction hearing further confirms the meaning of the Preliminary Injunction. At the hearing, the defendants argued that an injunction should not issue because some of their claims might arise under the laws of states other than North Carolina, which they contended would require the application of champerty laws of other states. Transcript of Preliminary Injunction Hearing at 55–61 (relevant pages attached as Appendix A).¹ Judge Ervin reasoned from the bench and in the Preliminary Injunction itself that the defendants could and should be required to make these arguments in this Court. *Id.* at 85-86; Preliminary Injunction ¶ 8. Viewed in light of the Court’s rejection of these arguments by defendants, it becomes apparent that the phrase “whether arising under the law of North Carolina or of any other state” serves only to clarify the Injunction, not delimit it.

In addition, when no overriding federal prohibition on assignment is applicable, whether a federal claim has been or can be validly and contractually assigned is determined by applicable state champerty law. *See Martin v. Morgan Drive Away, Inc.*, 665 F.2d 598 (5th Cir. 1982). It would be particularly anomalous to interpret the Preliminary Injunction to preclude the transfer

¹ This argument lacks validity in any event. As a matter of fundamental public policy, a North Carolina court will not enforce a champertous assignment to allow a claim to be asserted under the law of any state. *Boudreau v. Baughman*, 322 N.C. 331, 368 S.E.2d 849 (1988).

or assertion of purportedly assigned state law claims, but not to cover federal law claims when state law determines the enforceability of purportedly assigned claims whether arising under state or federal law. Federal racketeering claims can be asserted in this Court, *Tafflin v. Levitt*, 493 U.S. 455, 458 (1990), so there are no questions about this Court's ability to adjudicate federal racketeering conspiracy claims if and when it becomes appropriate and necessary for the Court to do so.

B. The Preliminary Injunction is valid.

Defendants contend that *Donovan v. City of Dallas*, 377 U.S. 408 (1964), prevents this Court from enjoining the assertion of claims in federal court. In other words, to the extent that the Preliminary Injunction prevents the defendants from asserting either federal or state claims in federal court, the defendants contend it is invalid. The defendants never asserted this argument at the time the Preliminary Injunction motion was being briefed and argued, so they are precluded from asserting it now. *See McGuinn v. City of High Point*, 219 N.C. 56, 62, 13 S.E.2d 48, 52-53 (1941). In addition, the argument is incorrect as a matter of law – a review of the Preliminary Injunction illustrates the fallacy in the defendants' position.

In relying on *Donovan*, the defendants fundamentally misunderstand or mischaracterize the effect of the Preliminary Injunction. The various documents transferring interests in the Credit Facility (as is explained in numerous prior briefs filed in this action) transfer (i) contractual claims against Le-Nature's for loan repayment, and (ii) to the extent allowable by law, statutory and common law tort claims against third parties. The specific language of the assignments is as follows:

For an agreed consideration, the Assignor hereby irrevocably sells and assigns to the Assignee, and the Assignee hereby irrevocably purchases and assumes from the Assignor, subject to and in accordance with the Standard Terms and Conditions and the Credit Agreement, as of the Effective Date inserted by the

Administrative Agent as contemplated below (i) all of the Assignor's rights and obligations in its capacity as a Lender under the Credit Agreement and any other documents or instruments delivered pursuant thereto to the extent related to the amount and percentage interest identified below of all of such outstanding rights and obligations of the Assignor under the respective facilities identified below (including without limitation any letters of credit, guarantees, and swingline loans included in such facilities) **and (ii) to the extent permitted to be assigned under applicable law, all claims, suits, causes of action and any other right of the Assignor (in its capacity as a Lender) against any Person, whether known or unknown, arising under or in connection with the Credit Agreement, any other documents or instruments delivered pursuant thereto or the loan transactions governed thereby or in any way based on or related to any of the foregoing, including, but not limited to, contract claims, tort claims, malpractice claims, statutory claims and all other claims at law or equity related to the rights and obligations sold and assigned pursuant to clause (i) and (ii) above**

First Harkness Aff. (filed 3/14/07) ¶ 20 & Exh. C (emphasis added). The Preliminary Injunction has no effect on the trading or assertion of claims against Le-Nature's for repayment of its loans, nor does it affect the trading or assertion of contract claims, or of tort claims against any person or entity other than the Wachovia plaintiffs and their employees. Preliminary Injunction, Conclusions of Law ¶ 8; Transcript of Preliminary Injunction Hearing at pp. 84–86 (explanation of scope of Preliminary Injunction by Judge Ervin). Thus, the Preliminary Injunction affects only a subset of the claims potentially transferred by the assignment language quoted above.

With respect to this small subset of claims, the Preliminary Injunction prevents the defendants from attempting to trade statutory and common law tort claims against the Wachovia plaintiffs by assignment (or otherwise) unless the assignee agrees to be joined in this action and bound by the Injunction. Preliminary Injunction, Ordering Paragraph 4 (prohibiting “further assignment or attempted assignment of such Personal Tort Claims unless each further assignee executes and delivers the Consent and Agreement form attached hereto, and agrees to the conditions and restrictions in this paragraph”). Thus, the Injunction limits the transfer or attempted transfer of statutory and common law tort litigation claims against the Wachovia

plaintiffs. By asserting this Court's authority and control over the alleged tort claims in which the defendants were trafficking, by virtue of the Consent and Agreement procedure established by Ordering Paragraph 4, the Preliminary Injunction allows plaintiffs to pursue their claims against the defendants to conclusion for the reasons explained in Section A. As the Injunction specifically explains:

[U]nless this Court enters this Preliminary Injunction to ensure that any person or entity to which any Fund Defendant assigns any such Personal Tort Claims is bound by this Order and consents to be joined in this action, it will be impractical for the Plaintiffs to obtain the determination they seek in a reasonable and orderly manner consistent with the interests of justice. The same restriction must be placed upon all future assignees to which any Fund Defendant transfers, or purports to transfer, a Personal Tort Claim. Should the Fund Defendants be allowed to assign such Personal Tort Claims against Plaintiffs while this action is pending, without restriction, a multiplicity of suits in a number of jurisdictions will likely result. . . . The controversy presented for resolution in this action should be fully and solely resolved in this Court to prevent the Plaintiffs from being subjected to a multiplicity of lawsuits concerning the effectiveness and enforceability of the assignments and any future assignments of Personal Tort Claims against the Plaintiffs arising from or relating to the Credit Agreement.

Preliminary Injunction, Findings of Fact ¶¶ 17 & 18.

The above-quoted language demonstrates that the Preliminary Injunction does not attempt to require that all Le-Nature's-related claims against or involving Wachovia be brought in this Court; in fact, Judge Ervin specifically noted in the Injunction that the Fund Defendants here could assert assigned contract claims against Wachovia elsewhere. *Id.*, Conclusions of Law, ¶ 8. He also recognized that syndicate members which dealt directly with Wachovia (which are commonly referred to as "original holders") could bring claims elsewhere because they had not purchased tort claims through assignments. *Id.* Thus, the Preliminary Injunction was limited in purpose and scope: it asserts jurisdiction over assigned tort claims against Wachovia so that Wachovia can obtain an adjudication of the validity of the assignments in one

forum, as is explained in the preceding section of this brief.² Conversely, the Injunction effectively asserts this Court’s jurisdiction over such assigned tort claims and places specific restraints on the transfer of such claims by requiring that any assignee execute a “Consent and Agreement” setting forth restrictions and conditions on the assignment of the claims, including that the assignee agree to be joined in this action. *Id.*, Ordering Paragraph 4.³

The *Donovan* decision itself specifically recognized that a state court is not precluded from enjoining federal litigation when the state court first acquires and asserts jurisdiction over property, or a “res.” 377 U.S. at 412-13. Here, as is explained above, this Court has done exactly that. Tort claims are recognized as property under § 12-3(6) of the General Statutes and under North Carolina’s enactment of the Uniform Commercial Code. *See* G.S. §25-9-102(a)(13); §25-9-109(d)(12); *see also* comment 15 to § 25-9-109(d)(12). The Preliminary Injunction asserts control over such property. Thus, the Preliminary Injunction rests on solid legal ground, as recognized by the *Donovan* decision itself and by a long line of Supreme Court cases beginning with *Princess Lida of Thurn & Taxis v. Thompson*, 305 U.S. 456, 466 (1939).

Put another way, the Preliminary Injunction can validly restrain the Fund Defendants (and their agents and attorneys) from filing a federal action because this Court has asserted jurisdiction over the very claims that the defendants attempt to assert in the federal action. *See id.* As the Court explained in *Princess Lida*:

² In their brief seeking to set aside the Preliminary Injunction, the defendants mischaracterize the scope of the Injunction by contending that it was intended to require that all Le-Nature’s-related claims against Wachovia be brought in this court. Defendants’ Brief at 1-3. Reading the Injunction itself demonstrates that Judge Ervin issued an Injunction with a much narrower scope and purpose, as is explained in the text above.

³ Except for the defendants in North Carolina, all of the plaintiffs in the New York action are original holders. Put another way, the only secondary holders that are plaintiffs in New York are the Fund Defendants here. *See* ¶¶ 163 & 170-176 of the New York Complaint, filed in this action by the defendants on September 17th.

[T]he principle applicable to both federal and state courts that the court first assuming jurisdiction over property may maintain and exercise that jurisdiction to the exclusion of the other, is not restricted to cases where property has been actually seized under judicial process before a second suit is instituted, but applies as well where suits are brought to marshal assets, administer trusts, or liquidate estates, and in suits of a similar nature where, to give effect to its jurisdiction, the court must control the property.

305 U.S. at 466. The *Donovan* Court cited *Princess Lida* and recognized its continuing validity. See 377 U.S. at 412. Because Ordering Paragraph 4 of the Preliminary Injunction assumed control over the assigned tort claims against Wachovia in order to protect this Court's jurisdiction, *Donovan* in no way invalidates the Injunction.

The Wright, Miller & Cooper treatise succinctly explains the controlling analysis here as follows:

[I]n all cases involving a specific piece of property, real or personal (including intangible property), the federal court's jurisdiction is qualified by the ancient and oft-repeated rule—often called the doctrine of prior exclusive jurisdiction—that when a court of competent jurisdiction has obtained possession, custody or control of particular property, that possession may not be disturbed by any other court.

Whatever court is entitled to retain control of the res may protect its jurisdiction against encroachment by any other court. Despite the established general rule of federalism that a federal court may not enjoin state court proceedings, it is recognized aspect of the statutory exception to this policy that a federal court may enjoin interference by a state court with its exclusive possession of a res if “necessary in aid of its jurisdiction.” But if a state court is entitled to possession of the property, the federal court must decline to assert jurisdiction, and federal proceedings may be enjoined to protect the state court's jurisdiction.

14 Wright, Miller & Cooper, Federal Practice & Procedure §3631; see also *Hohenberg Bros. Co. v. Anderson Logistics Service Corp.*, 6 F. Supp.2d 1377, 1379 (S.D. Ga. 1998); *Jenkins v. Martin*, 2006 WL 2852300 (7th Cir. 2006); cf. *Straus v. Straus*, 987 F. Supp. 52 (D. Mass. 1997); see also *United States v. Bank of New York & Trust Co.*, 296 U.S. 463 (1936). Thus, even if

defendants had argued *Donovan* at the Preliminary Injunction hearing, that decision would not have precluded entry of the Injunction.

Conclusion

For the reasons set forth above, the Wachovia plaintiffs request that this Court hold defendants in civil contempt, and take such actions and enter such orders, and grant such other and further relief, as may be appropriate and proper to cause the defendants to cease and desist their violation of the Preliminary Injunction, whether pursuant to G.S. §5A-21 *et seq.* or any other applicable statute, or the common law.

This 10th day of October, 2007.

s/Robert W. Fuller

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RULE 15.8 CERTIFICATION

I certify that this brief complies with BCR 15.8.

This the 10th day of October, 2007.

s/Robert W. Fuller
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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed this pleading with the North Carolina Business Court today, provided email notification of the filing today to counsel of record in accordance with the Court's Order of June 11, 2007, and served the following counsel of record by hand delivery or by regular U.S. mail, postage-prepaid (as indicated below) and addressed as follows, all in accordance with the North Carolina Rules of Civil Procedure and the Rules of the North Carolina Business Court:

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This the 10th day of October, 2007.

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