

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

Defendants argue that they should not be held in contempt because (i) the Preliminary Injunction allowed them to assert assigned federal claims, but not assigned state claims, and (ii) in any event, under *Donovan v. Dallas*, they are entitled to pursue any assigned claims – whether state or federal – in federal court. Defendants' first argument both misconstrues the Injunction and yields an interpretation inconsistent with its purpose, as is demonstrated by the language of the Injunction itself and by Judge Ervin's comments at the Preliminary Injunction hearing. Defendants' second argument misinterprets *Donovan* and *Princess Lida*. The key issue under these cases is whether this Court's "possession, custody or control of particular property" would be undermined or disturbed by the defendants' New York action. 14 Wright, Miller & Cooper, Federal Practice & Procedure §3631. The Preliminary Injunction is valid under *Donovan* and *Princess Lida* because it asserts control over the very claims that the defendants are attempting to bring in New York.

A. The Preliminary Injunction.

The language of the Injunction itself belies the defendants' arguments. In arguing that the Injunction does not apply to purportedly assigned federal claims, the defendants are asking that this Court reinterpret the italicized phrase quoted below:

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 . . .***

to read "***to the extent*** arising under the law of North Carolina or of any other state." Such an interpretation would rewrite the Injunction. Moreover, the defendants' interpretation would create logical inconsistencies with its other provisions, such as paragraph 18 of the Findings of Fact ("***Any other proceedings*** instituted concerning these issues would be duplicative, wasteful, vexatious, and harassing"), and paragraph 8 of the Conclusions of Law (explaining need to allow "assertion of assigned Personal Tort Claims ***solely as counterclaims in this action***"). This language – which reflects a specific concern with a multiplicity of actions – cannot be reconciled with the notion that Judge Ervin intended only to enjoin the assertion of assigned state claims, while allowing assigned federal claims to be asserted freely in any other court. Reading the entire Injunction leaves no real questions about its meaning.

Moreover, for the defendants' position to be sustained, this Court would also have to interpret the word "state" as used in the phrase at the end of the block quote above to mean any one of the fifty States, but not to include the United States, even though the United States is also a sovereign "state." This interpretation would be contrary to common usage. When a writer refers to one or more of the fifty States, the word "State" is normally capitalized – but the word "state" is not capitalized when referring generally to the federal government or to any generic body politic. *See* Government Printing Office Style Manual §3.19 (available on the internet at

www.gpoaccess.gov/stylemanual/browse.html). Thus, the defendants' proposed interpretation of the Injunction would require the Court not only to rewrite part of the language of the Injunction – in a manner inconsistent with its other provisions – but would also require the Court to construe the term “state” in a manner inconsistent with accepted standards.

The defendants' proposed interpretation of the Injunction also conflicts with Judge Ervin's oral ruling on the record at the Injunction hearing. When determining whether an order supports a finding of contempt, “the court should consider the entire background behind the order, including the conduct the order was meant to enjoin or secure, the interests that it was trying to protect, [and] the manner in which it was trying to protect them” 17 Am. Jur. 2d Contempt §137 (*citing U.S. v. McMahon*, 104 F.3d 638 (4th Cir. 1997)). In this regard, Judge Ervin stated at the hearing:

The Court will allow the motion for preliminary injunction. The injunction, however, is going to have to be modified from the earlier language as follows: First, I think we'd have to limit the filing of **tort claims which are subject to the assignment such that those claims may be filed in this action. They may not be filed in any other court, whether it's a state court, federal court, or courts of another state.**

Transcript at 84 (emphasis added) (attached to Wachovia's initial brief). In granting the Injunction, Judge Ervin in no respect distinguished state claims from federal claims, or indicated that he intended to enjoin the assertion of state claims but not federal claims.

Perhaps it goes without saying that Court orders are not to be taken lightly, or examined under a microscope for possible drafting ambiguities or loopholes. “Obedience is required more to the spirit than to the letter of the injunction; a violation of the spirit of an injunction, even though its strict letter may not have been disregarded, is a breach of the mandate of the court.” 42 Am. Jur. 2d Injunctions, §316; *Middleton v. Middleton*, 159 N.C. App. 224, 226-227, 583 S.E.2d 48, 49 (2003) (“Defendant violated the spirit and intent of the order Accordingly, the

trial court properly concluded, based on its findings of fact, that defendant was in contempt of the consent judgment."); *Weston v. John L. Roper Lumber Co.* 73 S.E. 799, 800 (N.C. 1912) (applying this rule to injunctions). Here, the language of the Injunction prohibited the defendants from filing their New York suit, and the intent of the Injunction is equally clear. The defendants have purposefully disregarded this Court and should be held in civil contempt.

B. *Donovan and Princess Lida.*

The *Donovan* decision specifically recognized that a state court may enjoin federal litigation when the state court first acquires and asserts control over property under the “prior exclusive jurisdiction” rule. 377 U.S. at 412-13 (1964). The Wright & Miller treatise explains the rule 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. As the above quote explains, whether a state court can enjoin a federal proceeding turns on whether the federal action will interfere with property over which the state court has asserted control.

The defendants argue that the outcome turns on whether both the federal and state proceedings are in rem. Contrary to defendants’ arguments, however, *Donovan* itself explicitly

holds that the proper inquiry is whether the state court has exercised control over property before the federal proceeding is instituted, which the Court characterized as a proceeding either in rem *or* quasi in rem:

An exception has been made in cases where a court has custody of property, that is, proceedings in rem or quasi in rem. In such cases this Court has said that the state or federal court having custody of such property has exclusive jurisdiction to proceed. *Princess Lida v. Thompson*, 305 U.S. 456, 465-68.

377 U.S. at 412. In urging their polar dichotomy – suggesting that all actions be characterized as in rem or in personam – defendants ignore the *Donovan* Court’s specific reference to quasi in rem actions. Quasi in rem actions, as the name implies, are “a halfway house between in rem and in personam jurisdiction. The action is not really against the property; rather it involves the assertion of a personal claim of the type usually advanced in an in personam action and the demand ordinarily is for a money judgment, although in some contexts the objective may be to determine rights in certain property.” 4A Wright, Miller & Cooper § 1070; *see also* Black’s Law Dictionary (Rev. 4th ed. 1968) (defining quasi in rem as a “term applied to proceedings which are not strictly and purely in rem, but are brought against the defendant personally, though the real object is to deal with particular property”).

In *Princess Lida* and the other prior exclusive jurisdiction decisions explicitly validated in *Donovan*, the Supreme Court repeatedly explained that the focus is on control over property. A federal court must “of necessity yield” when the state court has “control of the property which is the subject of the suit in order to proceed with the cause and to grant the relief sought.” *Penn General Casualty Co. v. Commonwealth of Pennsylvania ex rel. Schnader*, 294 U.S. 189, 195-96 (1935); *see also United States v. Bank of New York & Trust Co.*, 296 U.S. 463, 477-478 (1936); *Princess Lida*, 305 U.S. at 465-48. The basic principal underlying the prior exclusive jurisdiction rule is to “avoid unseemly and disastrous conflicts in the administration of our dual

judicial system and to protect the judicial processes” of the state court. *Penn General*, 294 U.S. at 195-96 (internal citations omitted). Moreover, the rule is not limited to cases “in which property has been actually seized pursuant to judicial process” – it also applies “when to give effect to its jurisdiction, the court must control [the] property.” *Bank of New York*, 296 U.S. at 477-78.

Defendants do not contest the plaintiffs’ point in their prior brief that tort claims are property under applicable North Carolina statutes. *See* Wachovia’s Brief in Support of Motions for Civil Contempt and for Enforcement of Preliminary Injunction at 8. The Injunction here asserted exactly the kind of control over the tort claims contemplated by the prior exclusive jurisdiction rule. *See id.* at 6-8. While every injunction does not assert control over property, the Preliminary Injunction here does so by placing limitations on the transfer of the tort claims that the defendants want to assert – which control validates the Injunction under *Princess Lida* and *Donovan*. *See Thompson v. Fitzgerald*, 198 A. 58, 64 (Pa. 1938) *aff’d sub nom. Princess Lida v. Thompson*, quoting *Amusement Syndicate Co. v. El Paso Land Improvement Co.*, 251 F. 345 (D.C. Tex. 1918) (“It is true that injunction acts only in personam; but it is also true that possession of specific property may be, and often is, effected by and through injunctive process. These considerations . . . clearly distinguish this case from one strictly in personam where only a personal judgment is in view, and brings it within the rule that as between two courts of concurrent jurisdiction the one which gets the case first holds it to the exclusion of the other.”). Injunctions are often used by a court to seize control of a res when actual physical possession of the res is impossible. *See Pennington v. Fourth National Bank of Cincinnati, Ohio*, 243 U.S. 269, 272 (1917) (stating that injunctions are “frequently resorted to in order to reach and apply property which cannot be attached at law”).

The decision of the Court of Appeals in *Staton v. Russell*, 151 N.C. App. 1, 565 S.E.2d 103 (2002) illustrates the flaws in defendants’ argument. In *Staton*, the appellants argued that an anti-suit injunction granted by the trial court should be dissolved because the case was in personam. In rejecting the appellants’ arguments, the Court of Appeals explained that the action fell within the prior exclusive jurisdiction rule even in the absence of seizure or attachment of property, because the parties sought “declaratory judgments defining the validity of documents and trusts and the right to property.” *Id.* at 11; 565 S.E.2d at 109 (citing *Kline v. Burke Constr. Co.*, 260 U.S. 226 (1922) – one of the predecessor cases to *Princess Lida*).¹

Moreover, this Court’s assertion of its power and control over the allegedly assigned tort claims does not break new ground. In *Insurance Commissioner of Michigan v. Arcilio*, 561 N.W.2d 412, 417-18 (1997), applying *Donovan* and *Princess Lida*, the Court held that a state trial court’s assertion of exclusive control over tort claims warranted an injunction against the assertion of those claims in a federal action.² The Court explained that assertion of claims in federal court would “usurp” the state court’s control over the claims. *Id.* Defendants’ attempt to assert in New York the very tort claims over which this Court has asserted control therefore violates the explicit language of *Donovan*, in which the Court specifically stated that “the state or

¹ Judge Ervin concluded that the Injunction in this action was necessary to avoid “delay or interfere[nce] with adjudication of the parties’ rights in this action,” *i.e.*, with plaintiffs’ claims for declaratory relief. Preliminary Injunction, Conclusions of Law ¶3. This Conclusion of Law tracks the holding of the Court of Appeals in *Staton v. Russell* nearly word for word. *See Staton*, 151 N.C. App. at 11 (trial court was “authorized to enjoin [defendants] from bringing a new action in another court where that other action has the potential to delay or interfere with adjudication of [plaintiffs’] rights.”).

² Numerous other cases recognize that claims are property subject to a court’s control. *See O’Conner v. Lee-Hy Paving Corp.*, 579 F.2d 194, 201-03 (2d Cir. 1978) (asserting control over contractual claims) (overruled on other grounds); *Baker v. Young*, 798 P.2d 889, 894 (Colo. 1990) (asserting control over contractual claims); *Atkinson v. Superior Court*, 316 P.2d 960, 964-65 (Cal. 1957) (asserting control over employers’ contractual obligation to make payments to the plaintiffs under a collective bargaining agreement).

federal court having custody of [the] property [first] has exclusive jurisdiction to proceed.” 377 U.S. at 412.

The defendants stray even further afield when they assert that the plaintiffs’ failure to cite G.S. §1-75.8, which they describe as “North Carolina’s in rem jurisdiction statute,” somehow has relevance here. This assertion misunderstands both *Donovan* and the constitutional limits on jurisdiction. Starting with *Donovan*, as is explained above, the issue is not whether property has been seized in an action where the basis for the assertion of jurisdiction is in rem or quasi in rem – the issue is whether the federal action will interfere with the state court’s exclusive control over property that the state court must control to give effect to its judgment. *See Bank of New York, supra*. The terms “in rem” and “quasi in rem” can be used to describe both a basis for jurisdiction and a type of action. The *Donovan* Court used the terms to describe a type of action – i.e., an action in which a court has asserted control over property – not a basis for jurisdiction. *See Bank of New York*, 296 U.S. at 477-78 (prior exclusive jurisdiction rule is not limited to cases “in which property has been actually seized pursuant to judicial process” – it also applies “when to give effect to its jurisdiction, the court must control [the] property.”); *Wright & Miller, supra*, §3631; *see also Thompson v. Fitzgerald*, 198 A. 58, 66 (Pa. 1938) *aff’d sub nom. Princess Lida v. Thompson*, 305 U.S. 456 (1939) (“The line of distinction between proceedings in personam and those in rem . . . is not to be drawn with academic nicety. . . . [but rather with] practical regard for the orderly and efficient administration of justice.”) Thus, whether Wachovia relies on §1-75.8 as a basis for jurisdiction has no relevance to the *Donovan/Princess Lida* analysis.

Moreover, the defendants’ argument assumes that Wachovia would benefit in its personal jurisdiction arguments by relying on §1-75.8, which is not correct. After *International Shoe*, courts initially still allowed the assertion of jurisdiction in rem or (more usually) quasi in rem in

instances when the plaintiff could find and seize by court process tangible or intangible property of the defendant from which a judgment could be satisfied – even if the seizure were simply fortuitous and the forum had no relationship at all to the parties or their dispute. *See* 4A Wright, Miller & Cooper §1071; 16 Moore’s Federal Practice §108.70. The Supreme Court held this practice to be unconstitutional in *Shaffer v. Heitner*, 433 U.S. 186 (1977) and *Rush v. Savchuk*, 444 U.S. 320 (1980), however, and decreed that the *International Shoe* minimum contacts test would govern in all cases, whether in personam, quasi in rem, or in rem. *See generally* 4A Wright, Miller & Cooper §1071; 16 Moore’s Federal Practice §108.80. Thus, in a state such as North Carolina where the long arm statute extends to the full limits of due process, G.S. §1-75.8 neither helps nor hurts a plaintiff to establish jurisdiction over the defendant in a case such as this one. *See* 16 Moore’s §108.80[2][b] (noting possibility of using property seizure statutes as a basis for jurisdiction when “defendant has minimum contacts with the forum state, but the state’s . . . long-arm statute may not [extend to the limits of due process]”). Moreover, quasi in rem jurisdiction has other inherent limitations greatly circumscribing its utility in many cases, including this one. *See* 4A Wright, Miller & Cooper §1070. The broader jurisdictional provisions in G.S. §1-75.4 avoid any questions about whether this Court’s judgment can only be enforced against any property subject to the Court’s control – questions that would be problematic in the context of the plaintiffs’ indemnification claim and other claims for affirmative relief. *See id.*

In summary, the propriety of the Injunction, under the standards set forth in the *Donovan/Princess Lida* line of cases, turns on whether the Injunction asserts control over property (which it does) and whether the federal action in New York would infringe this Court’s

exclusive jurisdiction over that property (which it would). Thus, the Injunction falls within the parameters of the prior exclusive jurisdiction rule sanctioned by *Donovan*, and is not invalid.

C. Waiver/Effect of the Preliminary Injunction.

Defendants dismiss the argument that, having failed to raise *Donovan* at the Preliminary Injunction hearing, they are barred from relying on that case now. The applicability of the *Princess Lida* prior exclusive jurisdiction exception to *Donovan* makes the waiver issue moot. If the *Princess Lida* line of cases were inapplicable here, however, the defendants' failure to raise their *Donovan* argument at the Preliminary Injunction hearing would bar them from relying on it now. *See McGuinn v. City of High Point*, 219 N.C. 56, 62, 13 S.E.2d 48, 52-53 (1941). While defendants contend boldly that constitutional rights and arguments cannot be waived, they are mistaken in that position. Waivers of constitutional rights and arguments are often enforced, even when the waiver results in incarceration or the imposition of the death penalty. *See State v. Gaiten*, 277 N.C. 236, 239, 176 S.E.2d 778, 781 (1970); 28 Am. Jur. 2d Estoppel and Waiver §213 ("As a general proposition, rights guaranteed by the state or federal constitution may be waived.").

Moreover, as is explained at length in the Wachovia plaintiffs' brief opposing dissolution of the Preliminary Injunction, even absent any waiver, the defendants are bound by Judge Ervin's factual and legal determinations. *See McGuinn, supra*. Judge Ervin concluded that in order to afford appropriate relief, the Court should assert control over the tort claims at issue here. *See, e.g.*, 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”). Under *McGuinn*, the defendants cannot now ignore the Findings, Conclusions, and other provisions of the Injunction.

D. Update on Status of New York action.

Yesterday, at a pre-motion conference (which is standard procedure in the Southern District of New York) Judge Chin granted the request of the New York defendants in the letters attached hereto as Appendix A and ordered full briefing to be completed by mid December (initial briefs on November 13; response on December 4; reply on December 11) of a motion to be filed by the New York defendants to dismiss the New York action under *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 768 (2d Cir. 1994), *cert. denied*, 513 U.S. 1079, (1995), *Motorola Credit Corp. v. Uzan*, 322 F.3d 130, 135 (2d Cir. 2003), and similar precedent. Judge Chin indicated that, in the event the New York action is not dismissed on these grounds, the defendants should proceed to assert and brief a broader motion to dismiss, as is contemplated in the New York defendants’ letters, attached.

E. Conclusion.

The Wachovia plaintiffs request that this Court hold defendants in contempt and employ such other measures as may be appropriate to compel compliance with the Preliminary Injunction.

This 1st day of November, 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 1st day of November, 2007.

s/Robert W. Fuller

Robert W. Fuller

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 1st day of November, 2007.

s/Robert W. Fuller
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