

IRVING EHRENHAUS, On Behalf Of Himself And
All Others Similarly Situated,

Plaintiff,

v.

JOHN D. BAKER, II, PETER C. BROWNING,
JOHN T. CASTEEN, III, JERRY GITT, WILLIAM
H. GOODWIN, JR., MARYELLEN C.
HERRINGER, ROBERT A. INGRAM, DONALD
M. JAMES, MACKEY J. MCDONALD, JOSEPH
NEUBAUER, TIMOTHY D. PROCTOR, ERNEST
S. RADY, VAN L. RICHEY, RUTH G. SHAW,
LANTY L. SMITH, G. KENNEDY THOMPSON,
DONA DAVIS YOUNG, WACHOVIA
CORPORATION, and WELLS FARGO &
COMPANY,

Defendants.

**REPLY BRIEF IN SUPPORT OF PLAINTIFF'S
AMENDED MOTION FOR EXPEDITED DISCOVERY**

Plaintiff respectfully submits this reply brief in further support of his motion for expedited discovery and scheduling a hearing on his application for a preliminary injunction.

PRELIMINARY STATEMENT

Defendants' opposition is a fount of hyperbole and spin. Using scare tactics that are contradicted by numerous public reports and analyses – not to mention the strongly optimistic statements of Wachovia's own President – Defendants seek to justify draconian actions of its

Board that have effectively disenfranchised the public shareholders' vote and precluded any chance of a topping bid by Citigroup or any other potential acquirer. Importantly, the provision of the Merger Agreement granting Wells Fargo almost 40% of Wachovia's vote on the Merger (the "Share Exchange") is unenforceable under the Emergency Economic Stabilization Act of 2008 (the "EESA") and should be invalidated immediately for this reason alone. Defendants ignore this argument in Plaintiff's opening brief.

Defendants correctly state that to be granted expedited proceedings, Plaintiff must demonstrate compelling urgency and a colorable claim. Plaintiff easily meets this standard: absent enjoining Wells Fargo from voting their improperly obtained shares (Defendants anticipate the shareholder vote will take place in December) or the Court invalidating the Share Exchange, the public shareholders of Wachovia will be denied a full and fair vote on the Merger and be irreparably harmed. If this transaction is so obviously in the best interests of the Company, as Defendants imply or state at every turn, they should not be afraid of making full disclosure, including their reasons why this is such a favorable transaction, and let the public shareholders vote.

ARGUMENT

I. DEFENDANTS' FEAR-MONGERING IS BASED ON OVERSTATEMENTS AND MISSTATEMENTS OF FACT

The incredible rhetoric unleashed by Defendants suggesting that our very American way of life will be threatened if the Merger is not approved (or even slowed down by this Court) is based on a rather shaky factual foundation. This section seeks to separate the facts from some of the many myths created by Defendants.

Myth 1. Receivership is the only option left to Wachovia if the Merger with Wells Fargo fails. (Def. Br. at 2, 4.)

Reality: Notwithstanding that Wachovia was distinguishing itself as far more sound than other banks and financial institutions being affected by the weakening real estate market and U.S. economy as late as the week of September 22, 2008,¹ assuming arguendo that it faced potential Receivership one week later as Defendants claim, Wachovia's announced transaction with Citigroup, Inc. ("Citigroup") on September 29, 2008, thwarted that hypothetical result as lauded by Wachovia, federal regulators and the financial press. See, e.g., Green Aff., Ex. A. For example, the day the Wachovia/Citigroup deal was announced, U.S. Treasury Secretary Henry Paulson issued a press release stating, "As a result of this transaction, all Wachovia depositors will be protected and Wachovia's senior and subordinated debt will be assumed by Citigroup." See Green Aff., Ex. B. The financial press noted that a planned Wachovia/"Citigroup deal [] had been seen as a big boost for both Citi and Wachovia." See, e.g., Green Aff., Ex. C. Even Wachovia's CEO Steel chimed in by calling Citigroup "a strong partner to preserve the stability and quality of our [Wachovia's] banking franchise." Green Aff., Ex. A at p.2.

While Plaintiff is not advocating the Citigroup deal over the Wells Fargo Merger or vice versa, the point is that either deal, which are very different, would have "saved" the Company from Receivership, as perhaps another future deal might do if the obstacle of the Share Exchange

¹As stated in Plaintiffs' Opening Brief ("Pl. Br.") at pp. 3-4, on September 15, 2008, Wachovia CEO, Robert Steel, went on Jim Cramer's Mad Money TV show and publicly represented that Wachovia was in far better shape than financial institutions experiencing widely publicized problems and that the Company would survive as a standalone entity. Thereafter, during the week of September 22, 2008, Steel sent a memo to Wachovia employees "affirming that the company was sound and more diversified than Washington Mutual after that lender failed." See Ex. A to the Affidavit of Anthony D. Green dated October 30, 2008 (the "Green Aff.").

is removed.

Myth 2. The Federal Reserve considers this particular Merger to be crucial to the stability of the U.S. Banking System and the Court should not overrule the Federal Reserve’s Judgment (Def. Br. at 2, 4, 6.)

Reality: The FDIC also strongly pushed for, and facilitated, a Wachovia/Citigroup transaction. As admitted by CEO Steel in his Affidavit submitted by Defendants, FDIC “Chairman [Sheila] Bair **directed** Wachovia to commence negotiations with Citi,” and under the terms of the Agreement-in-Principle between Wachovia and Citigroup, the FDIC committed to use taxpayer money to facilitate a Wachovia/Citigroup deal. Merritt Aff., Ex. 1 at ¶¶ 8-11 (emphasis added), Ex. 2 at ¶¶ 4-5. In fact, even after the Merger with Wells Fargo was announced, the FDIC publicly reiterated its support for a Wachovia/Citigroup deal. See Green Aff., Ex. D. Specifically, FDIC Chairman Bair stated that “the FDIC stands behind its previously announced agreement with Citigroup . . . adding that it would pursue a resolution with all three companies.” Id. at p. 2; see also Green Aff., Ex. C (“statements from the Federal Reserve, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corp. appear to favor the Citigroup deal” over a Wells Fargo deal) at p. 1.²

Myth 3. Wachovia would not have been able to obtain the benefits of the Wells Fargo offer without the Share Exchange. (Def. Br. at 13.)

Reality: The limited, one-sided record submitted by Defendants suggests that the

²While the Board of Governors of the Federal Reserve approved the Merger, it only reviewed whether the Merger would result in too much concentration in the banking markets that Wachovia and Wells Fargo operate in, whether the resulting company would have the resources (managerial, financial, future prospects) to operate going forward, and whether the public benefits to be achieved by the transaction would be greater than adverse effects that the transaction could have (undue concentration of resources, decreased or unfair competitions, conflicts of interests, or unsound banking practices). The Board of Governors did not pass on the Defendants’ fiduciary duties to Wachovia shareholders, which is the relevant inquiry here. The Federal Reserve also did not consider the Share Exchange or the fairness of the Merger to Wachovia’s shareholders. See Merritt Aff., Ex. 7.

Board barely, if at all, considered the Share Exchange and that virtually no negotiations between Wells Fargo and Wachovia took place before the Wachovia Board signed off on the Merger Agreement. As detailed in the Steel Affidavit, on October 2, 2008, at approximately 7:15 p.m., Steel received a phone call from the FDIC Chairman informing him that Wells Fargo might make a bid for Wachovia. Merritt Aff., Ex. 1 at ¶ 16. Steel informed the Chairman that Wachovia could not even consider a Wells Fargo deal because of its agreement with Citigroup unless Wachovia had a signed and board-approved merger agreement from Wells Fargo. *Id.* At approximately 9:04 p.m. on that night, such a proposed merger agreement was e-mailed to Wachovia. *Id.* at ¶ 18. By conference call at 11:00 p.m. that night, the Wachovia Board approved the Wells Fargo proposal subject to receipt of fairness opinions from its financial advisors, which were subsequently delivered “orally early in the morning of Friday, October 3.” *Id.* at ¶ 19. Thus, the Wachovia Board approved the Merger approximately two hours after anyone at Wachovia saw it for the first time. This set of facts raises serious questions as to how forcefully the Board negotiated the Share Exchange provision, if it did at all, as well as how carefully the Board considered a transaction that, among other things, largely disenfranchised its shareholders from having a say on the Merger.

II. PLAINTIFF DEMONSTRATES “SOME COMPELLING URGENCY”

Plaintiff easily demonstrates “compelling urgency” here. Defendants confirm that the shareholder vote is expected to occur in December 2008. Def. Br. at 2. If the vote takes place and Wells Fargo is allowed to vote 39.9 % of all Wachovia shares in favor of the Merger, the public shareholders will not have any significant role in deciding whether this significant transaction should take place and will be irreparably harmed. As this Court recognized in First

Union Corp. v. Suntrust Banks, Inc., 2001 NCBC 9A (N.C. Super. 2001), “The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.” Id. at ¶ 12 (quoting Blasius Indus. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988)). The disenfranchisement of the public shareholders of Wachovia is certainly “compelling,” and because the vote will take place within the next two months, the resolution of these issues is “urgent.”

III. PLAINTIFF ASSERTS A COLORABLE CLAIM FOR BREACH OF FIDUCIARY DUTY

Plaintiff also easily demonstrates that his claims are “colorable.”³

Ordinarily, deal protection devices are employed to protect an acquirer from being merely a “stalking horse.” In the usual case, the board of the target insists on an effective “fiduciary out” clause, one that allows the target to back out of the transaction should a superior offer appear. In exchange for such a fiduciary out clause, the acquirer insists on, among other things, a termination fee that will appropriately compensate the acquirer if the deal should fail. See, e.g., In re Lear S’holder Litig., 926 A.2d 94, 107 (Del. Ch. 2007). These devices encourage an initial bidder to come forward but, at the same time, allows for the possibility of a topping bid, which, in turn, can be considered by the target’s board in keeping with its fiduciary duties.

In First Union, Judge Tennile provided a detailed analysis of deal-protection devices in a

³Defendants ignore their own indication that Plaintiff need only demonstrate a colorable claim by implying, in text and in the headings in their brief, that Plaintiff must *now* meet the standards for obtaining a preliminary injunction. In so doing, Defendants would deprive Plaintiff from obtaining the evidence needed to even attempt to satisfy this standard.

proposed stock-for-stock merger.⁴ Under the Court’s analysis, North Carolina law requires:

(a) that directors have the power and authority to plan, develop, design, negotiate and contract for mergers and other acquisitions fundamental to the corporation’s business strategy, (b) that shareholders have the right to vote on any such fundamental changes in corporate structure and (c) that their vote results in a free, uncoerced and informed valuation of the proposed corporate action.

2001 NCBC 9A, at ¶ 66. The Court found to be compelling the suggestion that “a judicial emphasis on uncoerced shareholder choice makes sense in trying to balance the competing pressures from shareholders and directors in the circumstances of stock-for-stock mergers.” Id. ¶ 67. According to the Court, the standard of review in such cases should not diverge from “the obligation of the board not to interfere with the shareholder franchise” and should limit “the board’s ability to intrude on the stockholder’s co-equal right to approve mergers.” Id. ¶ 75. In defining what would constitute improper coercion, the Court asked: “Will the vote ‘be a valid and independent exercise of the shareholders’ franchise, without any specific preordained result which precludes them from rationally determining the fate of the proposed merger?’” Id. ¶ 81 (quoting In re IXC Comm’n, Inc. S’holders Litig., 1999 Del. Ch. LEXIS 210, at *2 (Del. Ch. Oct. 27, 1999)).

According to the First Union Court, “With the review process adopted by the Court, the

⁴Defendants surprisingly argue that “Prior cases where the facts do not involve a bank that was on the edge of failure and an ongoing national financial crisis are simply not relevant.” Def. Br. at 14; see also id. at 14-15 n.10 (attempting to distinguish First Union on the same basis). Defendants cite to no case that stands for the radical proposition that during this financial crisis all laws protecting shareholders, including fiduciary duties of a company’s board, should be disregarded. On the contrary, the disregard for proper corporate governance that the Board exhibited here is the type of conduct that arguably led to the financial crisis. Especially during these times of crisis, the Court should not permit such abuses.

non-termination clause [the defensive measure at issue] gets reviewed for the specific reason that good public policy requires – directors must fulfill their fundamental statutory obligations and shareholders should have an uncoerced vote.” Id. ¶ 152.

Here, in violation of their “fundamental statutory obligations,” the Board impermissibly tied its hands by entering into an ineffectual “fiduciary out,” which does not, in fact, allow for an “out,” but only a non-recommendation. Thus, under the Merger Agreement, regardless of what future events might occur, the Board cannot, under any circumstances, cause Wachovia to withdraw from the Merger Agreement. In First Union, the Court explained that “to the extent that a contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable.” Id. ¶ 89 (quoting Quickturn Design Sys. v. Shapiro, 721 A.2d 1281, 1292 (Del. 1998)). As a result of the ineffectual fiduciary out provision, the Share Exchange should be invalidated because it interferes with the Board’s fiduciary duties, which do not end with the signing of the Merger Agreement. See Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930 (Del. 2003) (emphasizing “the board’s continuing responsibility to effectively exercise its fiduciary duties at all times after the merger agreement is executed”).

The Share Exchange also has a coercive effect on the shareholder vote. Defendants, in fact, all but concede that the shareholder vote will have a “specific preordained result.” See Def. Br. at 13 (“The share exchange was meant to assure . . . that the Wells Fargo/Wachovia merger was indeed likely to close”). The details of the Share Exchange support this conclusion in that

Wells Fargo has obtained 39.9% of Wachovia's voting power.⁵ Considering that directors and officers of Wachovia, many of them with potentially lucrative golden parachutes that are triggered by the transaction, hold 2.48% of the Company's common stock, only 7.63% of the unaffiliated outstanding shares have to vote for the Merger for it to be approved. It is, therefore, clear that the Share Exchange will not allow for the "valid and independent exercise of the shareholders' franchise." While Defendants suggest that Wachovia's shareholders "remain free, if they wish, to reject the Wells Fargo merger and take their chances on another future," Def. Br. at 14, this statement is belied by Defendants' admission that because of the Share Exchange the Merger was "likely to close." Def. Br. at 13.⁶

Moreover, the Share Exchange combined with the ineffective fiduciary out has meant, and will continue to mean, that neither Citigroup nor any other potential acquirer will come to Wachovia with a potentially superior offer.⁷ Thus, no one will ever know if there is a better

⁵Defendants point to the fact that Citigroup has not modified its original proposal in light of the Wells Fargo deal. However, like any other potential bidder, why would Citigroup make a topping bid now that Wells Fargo has almost 40 percent of the vote and will have this voting power into the future? Moreover, Citigroup is suing Wachovia for breaching their prior agreement.

⁶Defendants' insinuation that Plaintiff is the only shareholder that is displeased with the Merger is off-base. In fact, unrelated shareholders have set up a website to challenge the Merger and Defendants' usurpation of the shareholders' vote at <http://www.wachoviavoteno.com>. Since the announcement of the Merger Agreement with Wells Fargo, over 600 comments have been posted, the vast majority of which are from shareholders expressing their anger at Defendants over their actions in connection with the Merger. Moreover, since the filing of this action, counsel for Plaintiff has been inundated with phone calls and emails from Wachovia shareholders who overwhelmingly support this action.

⁷Defendants argue that in the time between the announcement of the Merger and the consummation of the Share Exchange, Wachovia did not receive any indications of interest from any other potential suitor. However, the Merger Agreement, itself, bound Wachovia to enter into the Share Exchange. See Green Aff., Ex. E (the Share Exchange), at Article 6. No potential bidder would realistically come forward under circumstances where Wachovia was contractually

alternative than the Merger unless these defensive mechanisms are invalidated (or, at least, substantially weakened).⁸

Aside from being invalid under the First Union Court's analysis, Defendants ignore Plaintiff's argument that the Share Exchange is unenforceable pursuant to the EESA. (Pl. Br. at 6-7.) By their silence, Defendants concede that Plaintiff's claim is, at least, colorable.

Furthermore, at the same time the Board was limiting its own ability to take future action and agreeing to the Share Exchange, the Company's senior executives were anticipating receiving obscenely large golden parachute payments upon the consummation of the transaction. Thus, Bob Steel, who has already announced that he will not remain with the merged company and thus will end up working for Wachovia for less than six months, is slated to receive as much as \$21.2 million in severance, and other senior executives can receive as much as an additional \$99.2 million, depending on whether they remain at the post-Merger Company or not. Unlike the usual golden parachute that compensates an executive when leaving a company, here, even if these Wachovia senior executives retain their jobs, they will be entitled to significant payments totaling many millions of dollars upon consummation of the Merger.⁹

obligated to hand almost 40 percent of its voting power to one of its competitors.

⁸While the First Union Court "specifically omitted a preclusive prong" from its analysis, 2001 NCBC 9A, at ¶ 76, it did recognize that "there might [] be situations in which the court could find that preclusive actions had an impermissible coercive effect." Id. Here, the effect of the lockup provision (i.e., the Share Exchange) has an additional coercive effect in that shareholders will feel pressured to vote for the Merger because they will understand that there is effectively no other alternative to consider and no possible alternative that could otherwise surface in the future.

⁹Steel and senior management favor locking up this deal with Wells Fargo not to protect their employment positions, but because they stand to reap many millions of dollars in golden parachute payments and will never have to work again. Moreover, Defendants acknowledge in their own press release of October 3, 2008 announcing the Merger that "three members of the

IV. DEFENDANTS' BOND ARGUMENT IS UNPERSUASIVE

Defendants make the conclusory argument that simply because the case involves a transaction “involving approximately \$15 billion in consideration payable to Wachovia shareholders,” Def. Br. at 11, that “defendants would be entitled to have plaintiff post a bond in the billions of dollars.” Nothing Defendants state leads to that extreme conclusion. In fact, beyond asserting that the deal might fall through, Defendants do not provide a credible explanation of damages. Here, as Defendants concede, Wells Fargo is not entitled to a termination fee under any circumstances,¹⁰ and Defendants do not explain why if the deal fell through there would be any damages, let alone damages in the billions of dollars. Considering that every U.S. bank of comparable size to Wachovia has received billions of dollars in the Bailout to keep them afloat, there is no indication that Wachovia would be treated any differently, no indication that the Citigroup deal could not be reconstituted, and no indication that Wachovia could not now survive as a stand-alone entity.¹¹ Moreover, even if Defendants are somehow correct that there is potentially billions of dollars of damages, the Court “has discretion to dispense with the security requirement, or to request mere nominal security, where requiring security would effectively deny access to judicial review.” See Cal. ex rel. Van De Kamp v. Tahoe Reg'l Planning Agency, 766 F.2d 1319, 1325 (9th Cir.), amended on other grounds, 775

Wachovia Board will be invited to join the Wells Fargo & Company Board when the transaction is completed.” See Green Aff., Ex. F.

¹⁰Wells Fargo had no need to require a termination fee here where the Wachovia Board had no right to terminate the transaction for a more favorable deal, and where Wells Fargo was handed almost 40 percent of Wachovia’s voting rights.

¹¹In fact, FDIC Chairman Bair has confirmed that had the government acted sooner, Wachovia would have benefitted from the Bailout. See Green Aff., Ex. G.

F.2d 998 (9th Cir. 1985).¹² If a billion dollar bond is required to challenge any large merger transaction, boards will have unfettered license to make any decision they like related to such mergers – including breaching their fiduciary duties – without any fear of oversight by the courts. Such a conclusion is not, and cannot be, consistent with the law of North Carolina.

Moreover, Plaintiff seeks only to enjoin Wells Fargo from voting its shares or to have the lockup invalidated. Neither alternative should stop the deal. The result would be that the public shareholders would win back their right to a full and informed vote on the Merger. Whether or not that vote resulted in the approval of the Merger, Defendants could not claim any compensable damages since Defendants contend Wachovia shareholders are currently free to vote “no.” Def. Br. at 14.

CONCLUSION

Defendants state that “this transaction is indisputably in the best interest of both Wachovia shareholders and the public at large,” Def. Br. at 15, and that “any reasonable Wachovia shareholder motivated to obtain the best possible outcome in this extraordinary market can only hope that the merger closes.” Id. at 16. If Defendants believe these statements are true, one wonders why they do not explain their reasoning as to why the Merger is such a great transaction in their soon to be filed proxy statement and let the shareholders have a free and unencumbered vote for or against the transaction.

¹²Because N.C. R. Civ. P. 65(c) is patterned on Federal Rule 65(c), North Carolina courts look to the federal law for guidance. See Keith v. Day, 60 N.C. App. 559, 560-61 (N.C. App. 1983).

For all the foregoing reasons, as well as those in Plaintiff's Opening Brief, Plaintiff respectfully requests that the Court grant Plaintiff's motion for expedited proceedings.

Dated: October 30, 2008

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I hereby certify that the foregoing brief complies with Rule 15.8 of General Rules of Practice and Procedure for the North Carolina Business Court.

s/ Carl L. Stine

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