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Can a U.S. District Court Enjoin a Defendant from Transferring or Assigning Assets Held Outside of the Court's Jurisdiction?

by *Jay E. Grenig*

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ISSUE

The question is whether a United States district court may issue a preliminary injunction prohibiting a defendant from transferring or assigning assets unrelated to the plaintiff's underlying claim and held outside of the court's jurisdiction in order to ensure that funds will be available to satisfy a potential money judgment.

FACTS

Grupo Mexicano de Desarrollo, S.A. is a Mexican holding company that constructs and operates roadways. From 1990 to 1994, Grupo participated in the Mexican government's program to develop an intercity highway network. Under this program, the Mexican government granted concessions to build and operate toll roads to companies willing to arrange private financing for the construction of the roads. Because of economic problems, the revenues from toll road traffic fell below anticipated levels.

In order to retire more than $100 million of high-interest Mexican bank debt and to secure working capital to fund ongoing operations, in 1994 Grupo sold institutional investors $250 million of unsecured notes due in 2001. The notes are "unconditionally and irrevocably" guaranteed by five Grupo subsidiaries. Eleven United States investment funds ("Investors") purchased approximately $75 million of the notes.

Three years later, Grupo experienced serious financial difficulty. It expressed substantial doubt that it could continue as a going concern. In August 1997, Grupo failed to make the interest payment on the notes. The guarantors also failed to set up and meet their obligations. As a result of this default, Investors caused acceleration of the principal.

A few days later, the Mexican government came to the rescue by

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GRUPO MEXICANO DE DESARROLLO, S.A. V. ALLIANCE BOND FUND, INC.
DOCKET NO. 98-231

ARGUMENT DATE:
MARCH 31, 1999
FROM: THE SECOND CIRCUIT

Case at a Glance

The Supreme Court is being asked to determine whether, in order to ensure that funds will be available to satisfy a potential money judgment, a U.S. district court may issue a preliminary injunction prohibiting a Mexican toll road operator from transferring or assigning assets unrelated to the underlying claims of the U.S. investors.

implementing the Toll Road Rescue Program. Mexico promised to issue government-guaranteed Toll Road Notes to Grupo and other toll-road operators to reimburse them for unpaid construction receivables and expenses. In return for the Toll Road Notes, the Mexican government would eventually take over ownership and operation of the toll roads. In its third-quarter 1997 financial statement, Grupo disclosed that it expected to receive $309 million in Toll Road Notes.

In addition to the money Grupo owed the Investors, it owed more than $450 million to other creditors. The five largest creditors were the Mexican government, numerous Mexican banks, additional Mexican financial institutions, trade creditors, and terminated employees. Because the Mexican government's program would not fully alleviate its financial difficulties, Grupo began to restructure its debt, reduce costs, and seek additional equity contributions.

In October 1997, Grupo issued a press release stating that during the first nine months of 1997 it had revenues of $119 million, but an expected loss of more than $800 million. After totaling its assets and debts, Grupo had a negative net worth of $214 million.

After discovering that Grupo had assigned over $100 million in Toll Road Notes to settle other obligations, Investors filed suit on Dec. 12, 1997, in U.S. District Court for the Southern District of New York. Investors alleged that Grupo had defaulted on its obligation under the notes. They sought damages for Grupo's breach of its contractual obligations and a preliminary injunction restraining Grupo from assigning the Toll Road Notes.

On the day before the hearing on the preliminary injunction, an officer of Grupo revealed that Grupo had assigned approximately $250 million in Toll Road Notes to the Mexican banks and other creditors.

The district court granted the preliminary injunction under Rule 65 of the Federal Rules of Civil Procedure, restraining Grupo and the guarantors from dissipating, transferring, conveying, or otherwise encumbering the Investors' right to receive or benefit from the issuance of the Toll Road Notes. The district court found that Investors would almost certainly succeed on their breach of contract claims against Grupo and that without the injunction they faced an irreparable injury, since Grupo's financial condition and dissipation of assets would frustrate any judgment recovered.

Grupo appealed to the U.S. Court of Appeals for the Second Circuit, arguing that the district court was powerless under Rule 65 to enjoin the use of a specific asset unless the plaintiff claims an equitable interest in the asset. Grupo asserted that Rule 64 is the only procedural mechanism to prevent a litigant from concealing or transferring assets in order to frustrate a potential judgment.

The Court of Appeals affirmed the district court's decision, holding that the mere fact that the property lies outside the boundaries of New York state did not render the court powerless. It explained that if the court has personal jurisdiction over the defendant and if use of the injunctive power is appropriate, the court may order a defendant to bring the assets to the court or restrain the use of the assets. The court held that the district court's finding that Grupo planned to use the Toll Road Notes to satisfy Mexican creditors to the exclusion of Investors supported a finding that the investors would suffer irreparable injury absent preliminary injunctive relief. 143 F.3d 688 (2d Cir. 1998). It recognized that the court could not have granted an injunction under Rule 64 of the Federal Rules of Civil Procedure because under New York law a preliminary injunction is unavailable in an action for a sum of money only. The United States Supreme Court granted Grupo's petition for certiorari.

After Grupo failed in its appeal, the district court entered final judgment in favor of Investors and against Grupo in the amount of $82,444,259. The court converted the preliminary injunction into a permanent injunction pending satisfaction of the award of money.

Case Analysis

Under Rule 64 of the Federal Rules of Civil Procedure, "all remedies providing for the seizure of the person or property for the purpose of securing satisfaction of the judgment ultimately to be entered in the action are available under the circumstances and in the manner provided by the law of the state in which the district court is held." Available remedies include arrest, attachment, garnishment, "and other corresponding or equivalent remedies." Injunctive relief may be granted under Rule 64 if authorized by the applicable state law. According to the Second Circuit, the law of New York does not allow the use of a preliminary injunction in an action for a sum of money only.

Rule 65 establishes the procedure for securing preliminary injunctive relief in civil actions. The purpose of a preliminary injunction is to preserve the status quo between the parties pending a final determination of the merits. The Supreme Court has upheld the use of Rule 65.

Grupo argues that the preliminary injunction interfered with its efforts to restructure its debt and substantially impaired its ability to continue its operations in the ordinary course of business. Grupo points out that, if the Court of Appeals' decision is reversed, it will be entitled to damages to the extent that it can show harm resulting from the wrongful issuance of the injunction. Grupo stresses that it has no assets or operations in the United States.

According to Grupo, the inherent powers of the district courts do not provide a basis for the injunction. Grupo asserts that it is exclusively for Congress to extend the inherent powers of the federal courts beyond those that existed at common law.

Investors disagree, contending that since the court had personal jurisdiction over the parties, it had the power to issue a preliminary injunction against Grupo to restrain it from dissipating its principal assets pending the outcome of the litigation, in order to preserve the status quo and protect the court's ability to render an effective judgment.

Noting that the district court's jurisdiction was based on diversity of citizenship, Grupo argues that a federal district court sitting in diversity must rely exclusively on state law remedies to preserve a defendant's assets to secure a potential money judgment. It declares that New York law does not authorize the remedy provided by the district court. According to Grupo, permitting a plaintiff to obtain an injunction in federal court under these circumstances would mean that a plaintiff could obtain a remedy in federal court that would be unavailable to a plaintiff in some state courts.

Even if state law governs the issuance of injunctions by federal courts in diversity cases, Investors say that the injunction entered against Grupo is consistent with applicable New York law. In any event, Investors insist that federal law governs the issuance of preliminary injunctions in federal court.

Investors argue that a district court has the power to issue a preliminary injunction preventing a creditor's use and dissipation of certain assets where there is a threat of the debtor's insolvency or threat of its dissipation of assets. They stress that in this case money damages would be an inadequate remedy because of the impending insolvency of the defendant and the defendant's engaging in a pattern of secreting or dissipating assets to avoid judgment. Investors claim that preliminary injunctions are necessary in cases such as this to prevent a creditor from transferring or assigning assets in order to frustrate collection of monetary damages.

Investors argue that Grupo's appeal is moot because the district court entered a permanent injunction into which the temporary injunction had merged. According to Investors, Grupo has no damages claim for being wrongfully enjoined because it lost on the merits and voluntarily abandoned its appeal from the permanent injunction.

In an amicus curiae (friend of the court) brief, the Dominican Republic asserts that the Second Circuit's decision is a serious intrusion by the United States courts into the sovereign rights of other nations, particularly their rights to enforce their own debtor-creditor systems over property owned by their citizens within their territory. The Dominican Republic claims that exercising judicial control over extraterritorial assets in the context of a financially troubled foreign company threatens to conflict with local authority and reorganization systems.

In another amicus brief, however, the Securities Industry Association disagrees, asserting that the issue here is the power to issue an injunction. It asserts that considerations of "comity" bear only on whether such an injunction should be issued in a particular case. (Comity is the recognition that one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience and to the rights of its own citizens or of other persons who are under the protection of its law.)

SIGNIFICANCE

A preliminary injunction is a form of "equitable relief" ordering someone to do something or to refrain from doing something. Even though there no longer are separate law and equity courts, and there is only one form of civil action under the federal rules, injunctive relief continues to be viewed as "extraordinary," and courts are reluctant to issue an injunction if the claimant can secure adequate relief by an award of money damages.

While the Supreme Court has never expressly sanctioned the use of a preliminary injunction to secure a potential money judgment, it has recognized that under certain circumstances a district court may issue a preliminary injunction restraining a defendant from disposing of assets. In *Deckert v. Independence Shares Corp.*, 311 U.S. 282 (1940), plaintiffs sought an order enjoining the defendant from disposing of any assets pending the outcome of their action for fraudulent misrepresentation. The Supreme Court sustained the grant-

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ing of the injunction holding that the injunction was a reasonable measure to preserve the status quo pending final determination of the case. The Court in *Deckert* upheld the use of a preliminary injunction to preserve a final equitable remedy of restitution or constructive trust.

In *De Beers Consolidated Mines, Ltd. v. United States,* 325 U.S. 212 (1945), the Supreme Court held that a motion for a preliminary injunction restraining defendants from transferring assets outside the United States should have been denied because the preliminary relief sought dealt with a matter lying wholly outside the issues in the suit where there was no possibility of an eventual money judgment.

More recently, in *United States v. First National City Bank,* 379 U.S. 378 (1965), the Court upheld a preliminary injunction in a suit seeking payment of back taxes. Relying on statutory authority for the use of injunctions in suits seeking payment of back taxes, the Court stated that once personal jurisdiction of a party is obtained, the district court has authority to order it to freeze property under its control.

Several circuits have held that a district court may use a preliminary injunction to prevent the dissipation of assets pending outcome of a case. See, e.g., *Teradyne Inc. v. Mostek Corp.,* 797 F.2d 43 (1st Cir. 1986); *Hoxworth v. Blinder, Robinson & Co.,* 903 F.2d 186 (3d Cir. 1990), *United States ex rel. Taxpayers Against Fraud v. Singer Co.,* 889 F.2d 1327, 1330 (4th Cir. 1989); *EBSCO Indus., Inc. v. Lilly,* 840 F.2d 333 (6th Cir.), cert. denied, 488 U.S. 825 (1988), *Airlines Reporting Corp. v. Barry,* 825 F.2d 1220 (8th Cir. 1987); *In re Estate of Marcos,* 25 F.3d 1467 (9th Cir. 1994), cert. denied, 513 U.S. 1126 (1995).

However, other circuits have held that a preliminary injunction may not issue to prohibit transferring or conveying assets unrelated to a plaintiff's claim. See, e.g., *United States v. Cohen,* 152 F.3d 321 (4th Cir. 1998); *In re Fredeman Litigation,* 843 F.2d 821 (5th Cir. 1988); *Home-Stake Prod. Co. v. Talon Petroleum,* 907 F.2d 1012 (10th Cir. 1990); *Rosen v. Cascade Int'l, Inc.,* 21 F.3d 1520 (11th Cir. 1994).

The Supreme Court will have to resolve this split among the circuits. If the Court upholds the Second Circuit, it will become more difficult for defendants to transfer or assign assets in order to hinder or defeat collection of a judgment for damages. On the other hand, such a decision should take into account the practical implications of preventing a defendant from using its property for an indefinite period. It is possible that, in some cases, such an injunction could prevent a defendant from restructuring its final obligations or paying debts owed to third parties in order to continue as a viable enterprise.

If the Court does not uphold the Second Circuit's decision, it could increase the risk and costs associated with transnational investments and create a disincentive to investments in entities whose assets are overseas. This could seriously harm the global marketplace and United States investors who invest in those markets by depriving investors of an effective remedy.

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Amicus Briefs

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