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## *Can a Federal Court Review a State Court's Review of a Federal Court?*

by Robert H. Abrams

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**Parsons Steel, Inc.**  
v.  
**First Alabama Bank of Montgomery**  
(Docket No. 84-1616)

*Argued December 3, 1985*

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The facts of this case, involving several parties having similar names and a welter of litigation involving closely-related claims with a bankruptcy thrown in for good measure are certain to be confusing. Still, they form the basis for potentially important questions about the finality of judgments and the relative roles of federal and state courts. The merits of the case raise a basic question about the doctrine of *res judicata*, "the thing decided." The specific *res judicata* issue involves an ill-understood subdoctrine called merger and bar.

### ISSUES

In particular, this case considers the effect of a judgment on one claim as a basis for precluding later litigation involving slightly different claims and slightly different parties but still arising from the same series of transactions as the case earlier decided.

The federal-state relations issue is likewise technical, but also important. Here, a state court initially found that an earlier federal judgment did not bar litigation of related claims in the state court action. In fact, a multi-million dollar verdict was entered in the state court litigation. Thereafter, the original federal court ruled that to "protect and effectuate" its earlier judgment, the winners in the state court were enjoined from further prosecution of their state court litigation. This meant that they were barred from collecting on their state court judgment, and the state court trial and verdict were effectively set at naught. This action by the federal court occurs at the intersection of two federal statutes that control the workings of the federal judiciary. One is the statutory analogue to the Constitution's Full Faith and Credit Clause. This first statute, 28 U.S.C. 1738, commands that state court proceedings are entitled to full faith and credit in *all* courts within the United States. The other statute, 28 U.S.C. 2283, announces a

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general rule that federal courts must not enjoin or stay state court litigation unless the injunction is "necessary in aid of its jurisdiction, or to protect or effectuate its judgments." This case forces a reconciliation of the exceptions clause of section 2283 with its own general rule and that of section 1738.

### FACTS

Edward and Melba Parsons owned substantially all of the stock in Parsons Steel, Inc. (Steel). That corporation was the parent of a subsidiary corporation, Parsons Steel Industries, Inc. (Industries). The First Alabama Bank of Montgomery (Bank) was the major financial backer of Industries. In the fall of 1978, Industries owed the Bank \$1,000,000 in secured loans which Edward knew could not be repaid when due. After negotiations with the Bank, Michael Orange, one of the Bank's other customers, became actively involved in managing Industries. Within a month Orange, finding the situation at Industries worse than imagined, bowed out. At that point the Bank felt its loan, which was in default, was in danger of being totally lost and foreclosed. Industries' assets were sold at a foreclosure sale. The buyer was a corporation (OSI) owned by Orange.

Against this unhappy and unprofitable background, litigation ensued and ensued and ensued. The first lawsuit was filed in February, 1979, in state court by Parsons, Steel and Industries against the Bank, one of its officers, Orange and his company OSI. The crux of this suit was that the Bank fraudulently forced the Parsons to allow Orange to gain ownership of Industries. This suit was still pending three months later when a second suit was filed in the United States District Court for the Middle District of Alabama. In this second suit, the Parsons and the parent company (Steel) were the plaintiffs and the Bank alone was defendant. Industries—by this time adjudicated bankrupt in a separate federal proceeding—was not a party, nor was the trustee appointed by the bankruptcy court to marshal the bankrupt's assets. The federal lawsuit alleged a violation of federal banking laws insofar as the acts of the Bank that allowed Orange to gain control of Industries was a type of unusual banking practice prohibited by the federal statute.

For a time, the two lawsuits proceeded on parallel courses through the discovery phases. After some procedural maneuvering the federal suit, although filed later, went to judgment first in June of 1981. This federal

court judgment in favor of the defendants was affirmed by the Eleventh Circuit Court of Appeals. Defendants thereafter raised the defense of *res judicata* in state court, but this defense was not accepted by the state court. Later, the trustee in bankruptcy who had succeeded Industries as a plaintiff in the state court action amended the complaint to add a count based on violation by the Bank of the Uniform Commercial Code in the foreclosure sale of Industries' assets to OSI. Slowly the state court litigation was resolved. First, in January of 1983, Orange and OSI reached a settlement with the plaintiffs and were dismissed from the litigation. The remainder of the case was tried to a jury which returned a verdict for: Edward, \$1 million; Melba, \$1 million; the trustee for Industries, \$2 million; and Steel, \$1.

As if two lawsuits were not enough, the Bank and its officer filed a third action, this time returning to the federal court in which they had prevailed earlier. Rather than seeking to litigate the merits a third time, this lawsuit requested that the federal court enjoin the enforcement of the state court verdict because the state court litigation of the merits was barred by the original federal judgment in favor of the Bank and the proper operation of the doctrine of *res judicata*. Eventually, this final litigation resulted in a reinstatement of the Bank's original victory, and now, the Eleventh Circuit's affirmation of the decision in favor of the Bank is under review in the United States Supreme Court.

#### BACKGROUND AND SIGNIFICANCE

Fortunately, the significance of this case can be roughly gauged without knowing a good deal about the workings of *res judicata*. On a superficial level, this case is significant because a substantial amount of money hangs in the balance. Still the more important aspects of the case are some of the possible ramifications it could have for the finality of judgments and relations between state and federal courts.

For the Supreme Court to affirm in this case it would have to opt for a position that says, in effect, a lower federal court can overrule a state court in regard to the proper effect to be given to a federal court judgment. This would be extraordinary in comparison to the position usually taken that the proper method for correcting state court errors of federal law is appeal within the state court system, followed, if necessary, by United States Supreme Court appellate review. At present, the only role lower federal courts have in reviewing state court decisions is in regard to *habeas corpus* relief for state prisoners. Still, there is an allure to saying that the lower federal courts should not be forced to sit idly by and watch state courts erroneously construe the effect of previously-entered federal judgments.

For the Supreme Court to reverse in this case is consistent with prevailing norms regarding the lack of authority for the lower federal court to correct errors of

federal law made by state courts. Additionally, the federal statutory framework also tends to support reversal. Section 1738 commands respect for state court judgments. By its terms, that statute does not differentiate between correct and incorrect judgments. Likewise, reversal is consistent with the general rule of section 2283 that forbids federal injunction of state proceedings except in narrowly defined circumstances.

There, of course, lies the rub. In this case, the federal court is of the opinion that its injunction of enforcement of the state court verdicts is necessary to protect its own prior judgment from de facto invalidation by the state court. Congress has provided an exception to the general rule to allow federal courts to protect and effectuate their judgments. If the Supreme Court agrees with the Bank that this is one of the exceptions that Congress intended, the case will be affirmed.

#### ARGUMENTS

*For Edward and Melba Parsons (Counsel of Record, Frank M. Wilson, 418 S. Hull Street, Montgomery, AL 36104; telephone (205) 269-2343)*

1. The state court judgment was entitled to full faith and credit under 28 U.S.C. 1738.
2. The injunction issued in this case is barred by another federal statute, 28 U.S.C. 2283, which is not an implied exception to the full faith and credit statute.
3. The action of the federal court in this case is not what Congress intended when it allowed enjoining state proceedings to protect or effectuate judgments.
4. The federal court lacked jurisdiction to entertain a suit seeking to review a state court judgment.
5. It would violate due process to bar the trustee from recovery on the basis of the original federal suit because neither the bankrupt nor the trustee was a party to the original action.
6. A proper respect for the functioning of state courts in our federal system prohibits an injunction against enforcement of the state court judgment in this case.
7. Equitable principle forbid an injunction enforcing the state court judgment in this case.

*For First Alabama Bank of Montgomery (Counsel of Record, M. Roland Nachman, Jr., P. O. Box 668, Montgomery, AL 36101; telephone (205) 832-8800)*

1. The courts below properly found this case to be an instance in which an injunction of enforcement of a state court judgment was necessary to protect or effectuate a prior federal judgment.
2. The state court litigation was barred by the original federal judgment, and relitigation of matters previously decided in the federal action was improper.
3. The trustee is not denied due process in being barred by the prior federal action because he was in privity with the others who were parties to that action.