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IN THE SUPREME COURT OF THE STATE OF DELAWARE

GYÖRGY B. BESSENYEI AND ROBERT S. GOGGIN, III,	:	No. 648, 2012
Plaintiffs-Below, Appellants,	:	Court Below:
v.	:	Court of Chancery of the State of Delaware, Honorable John W. Noble (C.A. No. 7572-VCN)
VERMILLION, INC., BRUCE A. HUEBNER, WILLIAM C. WALLEN, PH.D, JAMES S. BURNS, PETER S. RODDY, CARL SEVERINGHUAS, JOHN F. HAMILTON, and GAIL S. PAGE,,	:	
Defendants-Below, Appellees.	:	

APPELLANTS' REPLY BRIEF

Dated: March 19, 2013

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I. THE QUESTION OF WHETHER PLAINTIFFS COMMITTED FRAUD WAS SQUARELY BEFORE THE TRIAL COURT AND, AS A MATTER OF LAW, THE LEGAL STANDARD GOVERNING DISMISSAL UNDER RULE 41(b) CANNOT BE WAIVED.

Implicitly acknowledging that it cannot meet the standard governing dismissal under Rule 41(b) set forth in *Paron Capital Mgmt., LLC v. McConnon*,[1] *Postorivo v. AG Paintball Holdings, Inc.*,[2] or the numerous other cases cited by Plaintiffs in their Opening Brief, Vermillion[3] argues that Plaintiffs should be precluded from relying upon any such authority because Plaintiffs previously stated that the Court's analysis in *Parfi Holdings AB v. Mirror Image Internet, Inc.*[4] was applicable to the motion to dismiss. (Ans. Br. p. 20)

Vermillion further argues that since it did not expressly accuse Plaintiffs of committing fraud, the issue is not properly before this Court and cases analyzing Rule 41(b) dismissal in that context (such as *Paron*) are not pertinent. (*Id.*)

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[1] *Paron Capital Mgmt., LLC v. McConnon*, 2012 Del. Ch. LEXIS 13 (Jan. 24, 2012).

[2] *Postorivo v. AG Paintball Holdings, Inc.*, 2008 Del. Ch. LEXIS 120 (Aug. 20, 2008).

[3] For purposes of this Reply Brief, the term "Vermillion" refers to all of the Appellees/Defendants below.

[4] *Parfi Holdings AB v. Mirror Image Internet, Inc.*, 954 A.2d 911 (Del. Ch. 2008).

Vermillion's position is incorrect both as a matter of fact and law.

A. The Question of Whether Plaintiffs Committed Fraud Was Plainly Before the Trial Court.

Although Vermillion, tactically avoided using the word "fraud" before the Trial Court, the conduct Vermillion alleged Plaintiffs to have committed is nothing short of fraudulent. For example, Vermillion argued that Plaintiffs actually knew the verifications were defective but deliberately used them anyway:

> "Plaintiffs *did not mistakenly* use defective verifications. Instead, Plaintiffs *knowingly and deliberately* on three separate occasions employed *falsely* executed verifications."

(D.I. 90, p. 22) (emphasis added).

Even more important – and regardless of the words Vermillion chose – the nature of Vermillion's accusations was well understood by the Trial Court, which recognized that Vermillion was implicitly accusing the Plaintiffs of committing a fraud on the Court:

> "[T]he implicit allegation by Mr. Athey [Vermillion's counsel] is that this complaint was filed *fraudulently*."

(D.I. 89, Tr. p. 7:15-17) (emphasis added).

Vermillion's assertion that the question of whether Plaintiffs committed a fraud on the Court was not raised before the Trial Court is therefore misplaced. The fact that Vermillion ultimately could not establish that Plaintiffs' conduct was fraudulent does not mean that the claim was not raised.

B. <u>As a Matter of Law, a Party Cannot "Waive" the Controlling Legal Standard.</u>

The mere fact that Plaintiffs stated that the Court's analysis in *Parfi* applied to Vermillion's Rule 41(b) motion to dismiss was not meant (and cannot be reasonably interpreted) to imply that all other case law governing dismissal under Rule 41(b), including *Paron* and *Postorivo*, is somehow inapplicable. Plaintiffs made no such concession, and even if they did, it would have no legal effect.

This is because parties cannot choose the legal standard to be applied to a motion; rather, it is for the Court to determine and apply. Much like this Court is obligated to apply the proper standard of review regardless of what standard the parties assert in their briefs, it is a trial court's responsibility to apply the proper legal standard on a motion to dismiss.

Although this is a basic premise, it is well recognized. "A party's concession on the standard of review does not bind the court, as '[s]uch a determination remains for this court to make for itself.'" *United States of America v. Bain*, 586 F.3d 634, 639 (8th Cir. 2009) (quoting *K&T Enters., Inc. v. Zurich Ins. Co.*, 97 F.3d 171, 175 (6th Cir. 1996)). *See also Worth v.*

Tyler, 276 F.3d 249, 262 n.4 (7th Cir. 2001) (noting courts, not parties, determine the standard of review; it cannot be waived); *Izzarelli v. Rexene Prods. Co.*, 24 F.3d 1506, 1519 n.24 (5th Cir. 1994) (the standard of review cannot be waived); *Brown v. Smith*, 551 F.3d 424, 428 (6th Cir. 2008) ("a party cannot 'waive' the standard of review by failing to argue it") (citations omitted).

Indeed, if courts were compelled to apply only the legal standard urged by the parties, courts would often be forced to apply incorrect standards to motions, an illogical result. *See Town of Chandler, Indiana v. Indiana-American Water Co.*, 892 N.E.2d 1264, 1268 (Ind. Ct. App. 2008) ("To apply [the rule] in the manner which Indiana-American urges would mean that this court could not apply the appropriate standard of review if a party misstated the standard of review in its briefs. The parties may choose their arguments, but they do not choose the standard of review applicable to their case.") (citations omitted). This Court is thus free to review the Trial Court's decision under all proper standards and governing law.

II. SUPPORT FOR THE TRIAL COURT'S DISMISSAL OF THIS ACTION CANNOT BE FOUND IN *PARON, POSTORIVO, PARFI* OR SEEMINGLY ANY OTHER CASE TO HAVE CONSIDERED DISMISSAL UNDER RULE 41(b).

A. *Paron Capital Mgmt., LLC v. McConnon*

In *Paron Capital Mgmt., LLC v. McConnon*, the Chancery Court held that in order to prevail on a Rule 41(b) motion to dismiss based on a supposed fraud on the court, a defendant "must show by clear and convincing evidence that Plaintiffs' and their counsel's conduct unfairly prevented him from presenting his defense." 2012 Del. Ch. LEXIS 13 at *26. Vermillion cannot possibly meet this standard as it has never argued (and cannot credibly argue) that the defective notarizations prevented it from presenting its defense. Instead, Vermillion merely notes that *Paron* is not binding on this Court and is otherwise distinguishable.

Vermillion's attempt to distinguish *Paron* is misplaced. Although Vermillion argues that *Paron* is inapplicable because *Paron* "involved evidentiary issues . . . rather than direct violations of the court or anything similar to the circumstances presented by this case,"[5] the *Paron* Court specifically noted that its analysis applies where a plaintiff "violate[s] the Rules of this Court or its orders." *Id.* at *25. *Paron* is thus squarely on point.

[5] *See* Ans. Br. p. 25.

B. *Postorivo v. AG Paintball Holdings, Inc.*

Nor can Vermillion find support in *Postorivo v. AG Paintball Holdings, Inc.* In *Postorivo*, the Chancery Court noted that the following factors provide a useful guideline in determining whether dismissal is an appropriate sanction for a party's misconduct: "(1) the existence of certain extraordinary circumstances, (2) the presence of willfulness, bad faith, or fault by the offending party, (3) the consideration of lesser sanctions to rectify the wrong and to deter similar conduct in the future, (4) the relationship or nexus between the misconduct drawing the dismissal sanction and the matters in controversy in the case, (5) prejudice and the public interest, and (6) the degree of the wrongdoer's culpability." 2008 Del. Ch. LEXIS 120, at *75 (Aug. 20, 2008)(citing *Perna v. Electronic Data Systems, Corp.*, 916 F. Supp. 388, 397 (D.N.J. 1995)). None of these factors are present here.

1. Existence of extraordinary circumstances.

No "extraordinary circumstances" are present here. Although Vermillion argues that the defective notarizations were not merely "technical errors" (Ans. Br. p. 31), even if true, such a fact does not rise to the level of extraordinary circumstances.

2. Presence of willfulness, bad faith, or fault.

Plaintiffs are at fault inasmuch as it is ultimately their responsibility to ensure that they comply with all rules of Court. However, the Trial Court declined to find that the Plaintiffs or Ms. Bennett acted in bad faith or otherwise knew or even suspected that the verifications were defective. This factor thus mitigates against dismissal.

3. Consideration of lesser sanctions.

As discussed in Plaintiffs' Opening Brief and this Reply Brief, *infra* p. 17, the Trial Court never considered the imposition of any other sanctions in lieu of dismissal. Equally important, neither the Trial Court nor Vermillion has ever advanced a reason why a less drastic remedy (such as sanctions or fee-shifting) would have proven ineffective.

4. Relationship nexus.

The misconduct at issue (*i.e.*, the defective verifications) has no relationship whatsoever to the matters in controversy (*i.e.*, the Board's decision to eliminate a shareholder seat in the midst of a proxy contest it knew it would lose). Vermillion's failure to at least concede this factor in its Answering Brief is surprising. (Ans. Br. p. 32)

5. Prejudice and the public interest.

With respect to prejudice, the only prejudice identified by Vermillion in its Answering Brief was "having to endure expedited proceedings and delay their annual meeting." (Ans. Br. p. 32) However, this supposed prejudice was not caused by the use of defective notarizations, but rather the lawsuit itself. Moreover, Vermillion's claim with respect to delaying their annual meeting is disingenuous inasmuch as Vermillion, months after the Trial Court's decision, has still not conducted the annual meeting.

With respect to the public interest, Vermillion's assertion that dismissal serves the public interest by protecting the integrity of the judicial process in future proceedings (Ans. Br. p. 32) is misguided as lesser sanctions would serve the same purpose, a point which Vermillion has yet to dispute. In addition, this is not an action for monetary damages, but rather one brought under *Blasius* and *Unocal* to invalidate the decision of a publicly traded company's board of directors to eliminate a director seat in the midst of a proxy contest it knew it would lose. As all Vermillion shareholders are affected by the dismissal of Plaintiffs' claims, the public interest mitigates against dismissal.

6. The degree of the wrongdoer's culpability.

Although Vermillion asserts that "the court below examined the conduct of each plaintiff and their counsel and found each to be at fault" (Ans. Br. p. 32), the Trial Court specifically declined to find that either Plaintiff knew that the notarizations failed to comply with Pennsylvania law. Going one step further, with respect to Mr. Bessenyei, the Court held that, as a Hungarian national living abroad, he had *no reason to know* that the verifications were defective.

The only reason offered by the Court for the dismissal of Mr. Bessenyei was the bare conclusion that he is "fairly charged with the consequences of [Mr. Goggin and Ms. Bennett's] acts." (Mem. Op. p. 21) However, the Trial Court did not explain why Mr. Bessenyei was fairly charged with those acts, nor did the Trial Court cite to any rule, law or other precedent that would support that conclusion. In addition, despite Vermillion's suggestion otherwise, the Court found that counsel's actions did not warrant any sanction at all.

As such, none of the *Postorivo* factors support the dismissal of Plaintiffs' claims.

C. *Parfi Holding AB v. Mirror Image Internet, Inc.*

In *Parfi*, the Court held that the sanction of dismissal was warranted where the plaintiff made a series of knowingly false statements about the impossibility of prosecuting a related arbitration, all for the purpose of having the Court reverse its prior decision granting a stay of the action pending the outcome of the arbitration. The Court held that "the harsh sanction of dismissal" under Rule 41(b) is proper where: 1) a party knowingly misleads a court of equity; and 2) the misconduct is intended to secure an unfair tactical advantage. *Id.* at 932-33. Neither factor is present here.

1. No finding that the Plaintiffs committed any deliberate misconduct.

In *Parfi*, the Court found as a factual matter that the plaintiff *knowingly, and in bad faith*, lied to the Court. In contrast, the Trial Court in the present action specifically declined to find that Plaintiffs or Ms. Bennett knowingly misled the Court. (Mem. Op. p. 20)

In its Answering Brief, Vermillion made numerous misstatements relating to both the Trial Court's findings as well as the Plaintiffs' position. For example, Vermillion asserts that Plaintiffs do not challenge that the Court of Chancery found "that [Plaintiffs] engaged in litigation misconduct, including a lack of candor, that undermined the integrity of the judicial process." (Ans. Br. p. 26) Vermillion also claims that Plaintiffs do not challenge the Court's "conclusions [regarding Goggin's] ethical misconduct of having knowledge of his employee, Ms. Bennett's, unlawful actions in notarizing the verifications. . ." (Ans. Br. p. 27)

To be clear, these assertions are incorrect and constitute revisions of the Trial Court's Opinion. While Plaintiffs are not appealing the Trial Court's holding that the verifications were defective, Plaintiffs deny that they ever committed "misconduct" or that they believed or even suspected that the notarizations failed to comply with Pennsylvania law.

More importantly, the Trial Court, after reviewing the videotape depositions of Mr. Goggin and Ms. Bennett as well as the written transcript of Mr. Bessenyei's deposition and contemporaneous documentary record, specifically declined to find that Plaintiffs or Ms. Bennett knew or even suspected that the verifications were defective. Again, with respect to Mr. Bessenyei, the Court held that, as a Hungarian national residing in Switzerland, he did not even have a reason to know that the notarizations were defective.[6] (Mem. Op. p. 10)

This result is not surprising. To have rejected Plaintiffs' testimony, the Court would have first had to have concluded that: 1) Ms. Bennett fabricated her entire testimony about the notarial process; 2) the emails about the process knowingly omitted references to some knowledge by Ms. Bennett, Mr. Goggin and Mr. Bessenyei that the notarizations were not valid; 3) Mr. Goggin never actually asked Ms. Bennett whether

[6] *See* Mem. Op. p. 10 ("As a non-lawyer and as a Hungarian national residing in Switzerland, it is understandable if Bessenyei did not have an appreciation for the notary laws of Pennsylvania, or that he did not know that under Pennsylvania law he was required to appear personally before the notary public in order for notarizations to be valid.")

she could perform the notarization or knew that the conclusions reached by Ms. Bennett were wrong; and 4) Messrs. Goggin and Bessenyei nevertheless proceeded rather than simply having Mr. Bessenyei find a notary or dropping Mr. Bessenyei, who was not a necessary party, as a plaintiff.

The Plaintiffs' lack of knowingly wrongful conduct makes this case distinguishable from *Parfi*, in which the Court found that the plaintiff made knowingly false statements of fact for the sole purpose of having the Court reverse an earlier order.[7]

2. No unfair tactical advantage.

Parfi is also distinguishable from the present case because the *Parfi* Court found that the plaintiff knowingly misled the Court to achieve an "unfair tactical advantage." *Parfi Holding AB*, 954 A.2d at 933. Although the Trial Court in this case stated (in passing) that the "Plaintiffs achieved short-term

[7] Courts have near-universally recognized that dismissal under Rule 41(b) is inappropriate absent a showing of dilatory or intentional misconduct. *See e.g., Lockhart v. Coastal Int'l Sec.*, 2012 U.S. Dist. LEXIS 166330, at *19 (D.D.C. Nov. 21, 2012) (dismissal under Rule 41(b) "is ordinarily limited to cases involving egregious conduct by plaintiffs, who are particularly dilatory, act in bad faith, or engage in deliberate misconduct, particularly when such conduct results in prejudice to the opposing party that is 'so severe as to make it unfair to require the other party to proceed with the case.") (quoting *Peterson v. Archstone Cmtys. LLC*, 637 F.3d 416, 418 (D.C. Cir. 2011)); *Gardner v. United States*, 211 F.3d 1305, 1309 (D.C. Cir. 2000) (deterrence of future misconduct justifies dismissal under F.R.C.P. 41(b) only "when there is some indication that the client or attorney consciously fails to comply with a court order cognizant of the drastic ramifications").

tactical benefits by avoiding compliance with the notary laws" (Mem. Op. p. 22), the Court never explained what those tactical benefits were.

In its Answering Brief, Vermillion attempts (for the first time) to explain the tactical advantage gained by Plaintiffs through the defective notarizations, noting that Plaintiffs sought preliminary injunctive relief and that "by filing their papers quickly, Plaintiffs were able to obtain expedited treatment rather than proceed in the ordinary course." (Ans. Br. p. 29) Vermillion's argument is flawed on a number of levels.

First, the Trial Court itself never identified what the "tactical benefits" were that Plaintiffs gained through the notarizations. Nor was it readily apparent from the Court's Opinion. In fact, until this Answering Brief, Vermillion never even argued that Plaintiffs achieved any tactical advantage through the defective verifications, much less identified any. As such, Vermillion is simply guessing as to what tactical benefits the Court was referring.

Moreover, Vermillion's claim that use of defective notarizations somehow afforded Plaintiffs a tactical advantage in terms of timing is factually erroneous. At the time Plaintiffs filed their Complaint, Vermillion had not even set a date for the annual meeting. By law, the meeting could not have gone forward on less than ten (10) days notice. *See* 8 *Del. C.* § 222 ("[T]he written notice of any meeting shall be given not less than 10 nor more than 60 days before the date of the meeting. . ."). Thus, to the extent Plaintiffs needed to file their Complaint before the annual meeting was held, there was no reason that the Complaint had to be filed that day or even that week. As such, there was more than enough time for Mr. Bessenyei to drive to a local notary (*e.g.*, most banks) and get the verification notarized. Alternatively, as noted by the Trial Court in its Opinion (Mem. Op. p. 8), Mr. Bessenyei could have simply provided a sworn declaration in lieu of a notarized verification pursuant to the Delaware Uniform Unsworn Foreign Declarations Act, 10 *Del. C.* ch. 53A.

It also bears repeating that Mr. Bessenyei was not a necessary party to this action. Mr. Goggin is a Vermillion shareholder and could simply have brought the lawsuit on his own. Thus, if Plaintiffs were truly under some exigent circumstance, Plaintiffs could have dropped Mr. Bessenyei as a plaintiff and the litigation could have proceeded without him.

Vermillion also ignores the fact that only one of the three defective notarizations related to the original Complaint. The other two verifications were submitted with the Amended Complaint and Plaintiffs' interrogatory responses. To the extent that the only tactical benefit achieved by Plaintiffs related to the timing of the filing of the original Complaint, Vermillion must concede that Plaintiffs achieved no tactical benefits whatsoever with respect to the defective notarizations relating to the Amended Complaint and interrogatory responses.

Even if we were to accept Vermillion's flawed assertion that Plaintiffs achieved some small tactical advantage by using the defective verifications – *e.g.*, not causing Mr. Bessenyei to drive to a notary – such a "tactical advantage" is not remotely similar to that present in *Parfi*, where the plaintiff in that case deliberately misled the Court in order to cause it to reverse its earlier decision – misconduct that went to the very heart of that litigation. *Parfi* is thus not remotely analogous to this action.

D. The Two Cases Cited by Vermillion Do Not Support Its Position.

In an effort to rebut *Paron*, *Postorivo* and the scores of other cases analyzing Rule 41(b) cited to by Plaintiffs in their Opening Brief, Vermillion cited only two cases, neither of which are supportive of its position: *Gebhart v. Ernest DiSabatino & Sons, Inc.*, 264 A.2d 157 (Del. 1970) and *Rowdy v. Rowdy*, 2008 WL 2520788 (Del. June 23, 2008), a four-paragraph opinion in which this Court affirmed the dismissal of a Family Court action against a *pro se* party.

Unlike the present case, in both *Gebhart* and *Rowdy*, the lower courts dismissed the actions where the respective parties engaged in dilatory conduct by repeatedly failing to follow court orders,[8] effectively impeding the orderly administration of those cases. Here, nothing the Plaintiffs did impeded this action from going forward. Nor did Plaintiffs violate any Court order or otherwise engage in any dilatory conduct. Those cases are thus not analogous and do not support the Trial Court's dismissal of this action.

[8] Although *Gebhart* involved the violation of numerous Court orders, the Court's Opinion in *Rowdy* only addresses the appellant's violation of one order and does not specify if there were other orders that were similarly ignored.

III. THE TRIAL COURT NEVER CONSIDERED WHETHER LESSER SANCTIONS WOULD BE APPROPRIATE OR EFFECTIVE.

In the context of a Rule 41(b) involuntary dismissal, "courts are mindful that dismissal is the ultimate blow to a lawsuit. . . . Accordingly, such a drastic sanction is generally reserved for instances where the defaulting party's misconduct is correspondingly egregious." *Smith v. Williams*, 2007 Del. Super. LEXIS 394, at *10 (July 27, 2007) (citations omitted). Dismissal is generally inappropriate when lesser sanctions are satisfactory. *See* 8 *Moore's Federal Practice* 3d. § 41.53[3][i].

Here, the Trial Court appeared to give no consideration to whether any other sanction other than dismissal would be effective or warranted. (Mem. Op. p. 20) Numerous courts have found such failure, in and of itself, to constitute reversible error. *See e.g.*, *Jackson v. City of New York*, 22 F.3d 71, 76 (2d Cir. 1994) (reversing dismissal when there was no indication trial court considered lesser sanctions for failure to obey pre-trial orders); *Alvarez v. Simmons Market Research Bureau, Inc.*, 839 F.2d 930, 932-33 (2d Cir. 1988) (reversing dismissal when it did not appear that court gave any consideration to efficacy of lesser sanctions); *Peterson v. Archstone Communities, LLC*, 637 F.3d 416, 419 (D.C. Cir. 2011) (dismissal vacated because Court did not try "less dire alternatives" before resorting to dismissal).

In response, Vermillion argues that the Trial Court did, in fact, consider lesser sanctions, namely: 1) whether it should dismiss one or both of the Plaintiffs; and 2) whether fee-shifting (as an *additional* remedy) would be appropriate. (Ans. Br. pp. 33-34) Vermillion's analysis is flawed.

While it is true that the Trial Court considered whether it should dismiss one or both Plaintiffs, the Trial Court never considered whether any sanction *less than dismissal* (even for one plaintiff) would be effective. With respect to fee-shifting, even Vermillion concedes that the Trial Court only considered fee-shifting as an *additional* remedy on top of – not in lieu of – dismissal. The Trial Court gave no consideration to whether fee-shifting (or any other remedy short of dismissal) would be an adequate punishment for the defective verifications.

Equally important, neither the Court in its Opinion or Vermillion in its Answering Brief, have ever disputed Plaintiffs' assertion that a remedy short of dismissal (such as fee-shifting or sanctions) would have proven an appropriate and effective remedy. Under these circumstances, the Trial Court's dismissal constituted an abuse of discretion.

CONCLUSION

For the foregoing reasons, and for those contained in Plaintiffs' Opening Brief, Plaintiffs-below György B. Bessenyei and Robert S. Goggin, III respectfully request that the Chancery Court's Opinion and Order be reversed.

Dated: March 19, 2013

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