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Case Number 517,2013

IN THE SUPREME COURT OF THE STATE OF DELAWARE

REINHARD WARNKING and SOUND INTERVENTIONS, INC., a Delaware Corporation,	)	
Defendants-below/Appellants,	)	No. 517, 2013
v.	)	Court Below- Delaware Court of Chancery, C.A. No. 7387-VCN
RECOR MEDICAL INC., a Delaware Corporation,	)	
Plaintiff-below/Appellee.	)	

ANSWERING BRIEF ON APPEAL OF APPELLEE RECOR MEDICAL, INC.

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NATURE OF THE PROCEEDINGS

Plaintiff-Appellee ReCor Medical stipulates to Defendant-Appellants' statement of the Nature of the Proceedings in their Corrected Opening Brief of October 16, 2013 ("Defs.' Opening Br."), except to add that ReCor also alleged a claim of Breach of Fiduciary Duty below. The Court of Chancery did not rule on that claim because it found for ReCor on ReCor's Breach of Contract claim. ReCor's Breach of Fiduciary Duty claim is an alternative ground for affirmance of the Court of Chancery's decision, and ReCor discusses it below.

SUMMARY OF ARGUMENTS[1]

ReCor denies the first three unnumbered paragraphs of Defendants' Summary of Arguments, and ReCor responds to the two numbered summary arguments as follows:

Defendants' First Argument

1. ReCor denies the two unnumbered paragraphs in Defendants' section captioned as "The Invention does not contain any Proprietary Information that is related to the business of ProRhythm." While Defendants pose two slightly different questions in their "Summary of Argument" section and their "Argument" section, ReCor assumes that the question as presented in Defendants' "Argument" section is the appropriate question to be addressed: "Did the evidence presented at trial prove that Mr. Warnking's Invention contained Proprietary Information related to the business of ProRhythm?"[2] Regardless, either way, Defendants pose the wrong question. This is not a patent case. The Court of Chancery was not called upon to determine whether the technology at issue rises to the level of an "invention" in the patent law context. In its July 16 Opinion, the Court of Chancery admonished, "This is not a patent case. It is a contract dispute that

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[1] Defendants' Corrected Opening Brief did not comply with Supreme Court Rule 14(b)(vi), which requires that the argument be summarized "in separate numbered paragraphs."

[2] Defs.' Opening Br. at 8 (emphasis added).

requires the Court to interpret both the IAA and APA. The relevant provisions of the IAA refer to both patentable and non-patentable items."[3]

2. ReCor asked the Court of Chancery to resolve whether Defendant Warnking "conceived" of the technology at issue (as later disclosed in his patent applications) while he was employed as ProRhythm's President, CEO, and a Director, and whether that technology related to the business of ProRhythm. The Court of Chancery found that Warnking did indeed conceive of the technology while he was at ProRhythm and that the technology at issue relates to the technology at ProRhythm. Thus, the Court of Chancery ruled that by operation of Warnking's Employment Agreement (the "IAA" to which Defendants refer), ProRhythm was the rightful owner of that technology. And, because under the Asset Purchase Agreement (the "APA" to which Defendants refer), ReCor purchased all of the assets of ProRhythm, ReCor was therefore the rightful owner of the technology that Warnking conceived while he was at ProRhythm.

3. Defendants also allege that "there is no evidence" to support the Court of Chancery's finding, but that is far from the truth. Amazingly, Defendants use the phrase "no evidence" 16 times throughout their Opening Brief. It is in large part because of Defendants' allegation of "no evidence," and their very short "Statement of Facts," that ReCor sets forth the facts below in such detail in

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[3] B257 (July 16, 2013 Memorandum Opinion ("July 16 Opinion") at 30).

chronological order—to show that there was ample evidence adduced at trial to support the Court of Chancery's holding.

4. In the end, Defendants simply disagree with the findings and conclusions that the Court of Chancery drew from the evidence.[4] As ReCor explains below, not only is the Court of Chancery's Opinion devoid of "clearly erroneous" findings, but also the facts presented at trial support that Opinion.

Defendants' Second Argument

5. Defendants next contend, "The Chancery Court's remedy was inequitable and not justified." ReCor denies the unnumbered paragraph containing that contention. The relief that ReCor sought and obtained was tied directly to Warnking's breach of contract and breach of fiduciary duty. Specifically, ReCor alleged that the patent applications that Warnking filed after he left ProRhythm's employment belong to ReCor because the patent applications describe technology conceived and developed by Warnking and his colleagues while at ProRhythm, and, thus, they became ReCor's property under the Asset Purchase Agreement, through which ReCor purchased all of ProRhythm's technology. The relief that ReCor sought and obtained was to have the patent applications assigned to ReCor, the rightful owner, and to enjoin Defendants from using that technology. After the Court of Chancery found that the technology described in Warnking's patent

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[4] *See, e.g.*, Defs.' Opening Br. at n.4.

applications was conceived and developed at ProRhythm and that it belonged to ReCor, the Court of Chancery's judgment assigning those patent applications to ReCor, and enjoining Defendants from using that technology, was equitable and justified.

6. Defendants contend now in litigation that renal denervation using ultrasound was in the public domain before Warnking conceived of it. That fact is belied by Warnking's express efforts to protect exactly what is contained in the first patent application that he filed 30 days after he left ProRhythm's employment:

> [A] method of ablating renal nerves from inside the renal artery . . . [that] desirably include[s] the step of positioning . . . an ultrasonic transducer desirably having a cylindrical shape, in proximity to the kidney inside the renal artery. The transducer may be actuated to generate ultrasonic energy that may damage renal nerves surrounding the renal artery without causing necrosis of surrounding tissue.[5]

Defendants cannot now credibly argue in this litigation that what Warnking believed in 2009 was an invention was actually in the public domain all along. Not surprisingly, the Court of Chancery expressly found that Warnking was not a credible witness: "[T]he testimony of Warnking and Dr. Nakagawa relating to the June 27 study is less than credible."[6]

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5 A342 (excerpt from "Brief Summary of the Invention" in the '429 patent application).

6 B242 (July 16 Opinion at 15).

STATEMENT OF FACTS

Defendants present surprisingly little content in their Statement of Facts, and they provide sparse citations to the record, even though they pepper their Arguments with alleged facts. Thus, ReCor presents below a more detailed chronology of events upon which the Court of Chancery relied in making its findings, citing to the record throughout.

A. Warnking and ProRhythm

ProRhythm (originally named Transurgical) was a medical device company focused on using ultrasound technology for various cardiovascular therapies.[7] Based upon Warnking's expertise in ultrasound, Warnking became the President, CEO, and Director of ProRhythm, beginning in 2001 through his departure from the company on September 30, 2009.[8] In his capacity as an executive of ProRhythm, Warnking signed an Employee Non-Disclosure, Non-Competition and Invention Assignment Agreement (the "IAA").[9] In the IAA, Warnking expressly assigned to ProRhythm any idea that he conceived. The contract did not require an

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7 B107-B108 (Trial Tr. Vol. I at 15:15-16:2 (Iyer)).

8 B090 (Pre-Trial Stipulation and Order dated Sept. 11, 2012, at 3 ¶ 10).

9 A35 (Employee Non-Disclosure, Non-Competition, and Invention Assignment Agreement).

invention, nor any testing; conception alone was sufficient to make the idea a ProRhythm asset.[10]

ProRhythm's most successful therapy was mitral valve repair using their ultrasound technology.[11] In addition to its mitral valve repair device, ProRhythm had explored and developed a number of ultrasound applications, many of which were intravascular or minimally invasive in nature, and all of which utilized ultrasound technology.[12] ProRhythm sought patent protection for many of its innovations.[13]

Over the years, ProRhythm explored that technology and those therapies, but eventually the company experienced financial problems. Due to a shortage of funds and an inability to raise additional funding, ProRhythm filed a Chapter 11 bankruptcy petition on December 11, 2007.[14] By August of 2009, it had become clear that ProRhythm would be liquidated. On August 30, 2009, ReCor and ProRhythm executed an Asset Purchase Agreement (the "APA") under which ReCor acquired substantially all of the assets of ProRhythm, including all of

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10 A35.

11 B121 (Trial Tr. Vol. I at 213:2-4 (Warnking)).

12 B114-B115 (Trial Tr. Vol. I at 143:8-144:8 (Merino)).

13 B031 (Warnking Dep. Tr. at 29:4-18).

14 B090 (Pre-Trial Stipulation and Order dated Sept. 11, 2012, at 3 ¶ 13).

ProRhythm's technology and intellectual property.[15] On September 30, 2009, Warnking formally left ProRhythm's employment.[16] The Bankruptcy Court subsequently approved the APA, and ReCor's purchase closed in October.[17]

B. Ultrasound for Renal Denervation Is Conceived at ProRhythm

1. ProRhythm Employees Discuss Ultrasound Renal Denervation with Each Other and with Outside Medical Consultants

Stepping back, in February of 2009, one of ProRhythm's outside medical consultants, Dr. Raoul Bonan, suggested to ProRhythm's David Smith (Vice President of Sales and Marketing) that ProRhythm should consider using its expertise in ultrasound technology in connection with the newly emerging therapy of renal denervation.[18] Renal denervation is the deliberate destruction of the renal nerves between the brain and the kidneys surrounding the renal arteries. Doctors had found that renal denervation has positive effects for patients suffering from high blood pressure, but no one had tried renal denervation using ultrasound energy. A company called Ardian had recently published a significant article detailing the merits of renal denervation using radio frequency ("RF") energy

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15 A237-A310 (Asset Purchase Agreement).

16 B118 (Trial Tr. Vol. I at 209:1-3).

17 B091 (Pre-Trial Stipulation and Order, dated September 11, 2012, at ¶ 21).

18 A130 (email from Bonan to Smith); *see also* B073-B077 (Smith Dep. Tr. 24:20-28:9).

catheters, and Dr. Bonan thought that ProRhythm might be able to use its ultrasound technology for that therapy as well.[19]

Smith relayed Dr. Bonan's email regarding renal denervation to Warnking, stating, "he is probably thinking HIFU [*i.e.*, high-intensity focused ultrasound] is a better way to do this."[20] A month later, on March 24, 2009, Smith forwarded another email to Warnking noting that Medtronic had invested $47 million in Ardian.[21] This significant investment by Medtronic caused Smith to characterize renal denervation as a "serious idea."[22]

Over the next few months, Warnking, Smith, Dr. Bonan, and others affiliated with ProRhythm exchanged several emails relating to the concept of ultrasound technology in renal denervation therapy. On April 1, 2009, Smith sent Warnking slides from a recent Ardian presentation.[23] On April 16, 2009, Smith sent an email to Yong Zou, a ProRhythm employee involved in engineering research and product development, with a technical description of a renal denervation procedure used by Ardian.[24]

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19 A130 (email from Bonan to Smith); *see also* B073-B077 (Smith Dep. Tr. 24:20-28:9).

20 A130 (email from Smith to Warnking).

21 A131-A133 (email from Smith to Warnking).

22 A131 (email from Smith to Warnking).

23 A141 (email from Smith to Warnking).

24 A143 (email from Smith to Zou).

In May and June of 2009, Smith and Warnking each separately expressed to Dr. Bonan that ProRhythm would be interested in doing renal denervation research in connection with upcoming studies. In a May 19, 2009 email to Dr. Bonan, Smith inquired about the possibility of adding some renal artery work at the end of an upcoming animal study.[25] Later, in a June 24, 2009, email from Warnking to Dr. Bonan, Warnking apologized "for not getting around to the renal denervation experiments," but Warnking promised to do a renal denervation study "during one of the upcoming training sessions."[26]

At about this time, Plaintiff ReCor Medical, Inc. approached Warnking and ProRhythm about buying ProRhythm's assets out of bankruptcy. For the next few months, ReCor engaged in diligence on ProRhythm and its internal and external ultrasound technologies and therapies, concluding with the signing of the APA on August 30, 2009.[27]

In June of 2009, Dr. Hiroshi Nakagawa, another of ProRhythm's outside medical consultants, who worked at the University of Oklahoma, suggested to Warnking that ProRhythm should explore the use of ultrasound technology in

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25 A152 (email from Smith to Bonan).

26 A157 (email from Warnking to Bonan).

27 B106-B110 (Trial Tr. Vol. I at 14:19-18:17 (Iyer)).

connection with renal denervation therapy, just as Dr. Bonan had done four months earlier. In an email to Warnking, Dr. Nakagawa wrote:

> Enclosed is a manuscript of catheter ablation of renal sympathetic nerve plexi to treat resistant hypertension. I believe that ultrasound ablation catheter . . . will be much better than RF catheter. Are you interested in this project?[28]

Warnking responded in a June 9 email to Dr. Nakagawa stating,

> we cannot do anything right now since it looks like if [ReCor] is successful in buying the [mitral valve] assets the rest of ProRhythm Inc will be liquidated . . . . ***Any new development we would start now would just be sold in the liquidation.***[29]

Warnking then forwarded that email internally to his core group of employees, Dr. Yegor Sinelnikov (ProRhythm's Research and Development Manager), Zou, and Smith, stating, "Just FYI; so you say the same thing."[30]

Warnking's words "so you say the same thing" are significant. Warnking's efforts to hide the ultrasound renal denervation research from ReCor during its diligence, thinking that revealing it would lead to ReCor's obtaining it if ReCor purchased the assets, reveals the significance of the research and supports the Court's finding that Warnking was less than credible. Of course, whether or not it was revealed does not change the fact that ReCor acquired all technologies and other assets under the APA and IAA.

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28 B001-B002 (email from Nakagawa to Warnking).

29 B001 (email from Warnking to Nakagawa) (emphasis added).

30 B001 (email from Warnking to Sinelnikov, Zou, and Cichy).

2. The June 27, 2009, Renal Denervation Experiment

On June 27, 2009, Dr. Nakagawa conducted a live dog study on behalf of ProRhythm at the University of Oklahoma.[31] During that study, Dr. Nakagawa performed a lengthy experiment involving an ultrasound treatment for mitral valve repair. At the conclusion of the mitral valve experiment, Dr. Nakagawa, with the assistance of Yong Zou, another ProRhythm employee, conducted a 30 to 45-minute renal denervation experiment using ProRhythm's Touch-Up ultrasound catheter, which Zou had brought with him to the study.[32]

Warnking denied that he was present at the study. Consistent with their efforts to hide renal denervation from ReCor during ReCor's diligence of ProRhythm, Warnking, Smith, and Zou all refused to admit that Warnking attended the June 27, 2009, dog study, even though the case report that Zou completed identifies Warnking as being present[33] and Warnking's travel receipts show that he was in Oklahoma that day.[34] Zou and Dr. Atsushi Ikeda (another University of Oklahoma researcher) both testified that they do not remember whether Warnking was even present at any portion of the June 27 experiment or

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31 A158-A165 (HIFU Animal Case Report Form).

32 B091 (Pre-Trial Stipulation and Order dated Sept. 11, 2012, at 4 ¶ 17).

33 A158 (HIFU Animal Case Report Form (identifying Zou and Warnking as PRI Representatives)).

34 B003-B011 (Warnking Expense Report).

even traveled to Oklahoma. When confronted with his travel records, however, Warnking reluctantly agreed that he probably was at the mitral valve portion of the study, but he continued to deny that he stayed for the renal denervation portion of the study.[35] The Court of Chancery did not find the witnesses credible on this issue, and it found that Warnking was likely present during the entire June 27 dog study.[36]

During the renal denervation portion of the dog study, Dr. Nakagawa performed three separate tests on the renal arteries.[37] Each test appeared to be designed to measure how different amounts of ultrasound energy would affect the nerves surrounding the renal artery. Specifically, Dr. Nakagawa inserted ProRhythm's Touch-Up catheter into the dog's renal artery, which had the effect of ablating the dog's renal nerve and renal artery tissue.[38] During or after the study, Zou prepared an animal case report setting forth the details of the test.[39] Moreover, the notes of the mitral valve portion of the study and the notes of the renal denervation portion of the study were kept together on the same data sheet.[40]

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35 B124-B129 (Trial Tr. Vol. I at 219:12-224:19 (Warnking)).

36 B242-B243 (July 16 Opinion at 15-16).

37 A166; A171.

38 A166; A171.

39 A158-165; B183 (Trial Tr. Vol. II at 433:2-13 (Zou)).

40 A166-A197 (experiment data sheet).

As is typical following animal studies, the dog was sacrificed, and Dr. Nakagawa resected the renal arteries and kidneys and preserved them for pathology analysis.[41] The histology reports were expected to be back much sooner, but they did not become available until December 14, 2009,[42] two months after ReCor closed the APA deal. Although ReCor notified Dr. Nakagawa that ReCor owned all of ProRhythm's assets,[43] Dr. Nakagawa transmitted the histo-pathology results from both the mitral valve and renal denervation experiments to Warnking, Smith, and Zou, all of whom had, by that time, left ProRhythm and started SII.[44]

While Defendants contend that the renal denervation portion of the study was "*ad hoc*" and conducted by Dr. Nakagawa independent of ProRhythm, the evidence shows otherwise. Dr. Nakagawa alerted Dr. Ikeda, his assistant, about the renal denervation portion of the study so that Dr. Ikeda could properly prepare and set up for the experiment.[45] ProRhythm employee Yong Zou, who provided the ultrasound catheter to Dr. Nakagawa to use in the mitral value portion of the study, also personally brought to Oklahoma another ProRhythm ultrasound catheter for the renal denervation portion of the study. Indeed, Dr. Ikeda emailed

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41 A169 (experiment data sheet); B055 (Nakagawa Dep. Tr. at 41:6-18).

42 B160 (Trial Tr. Vol. II at 332:1-8 (Nakagawa) (discussing A166-A197)).

43 B012 (email from Iyer to Nakagawa).

44 B192 (Trial Tr. Vol. II at 459:16-22 (Smith)); B175-B176 (Trial Tr. Vol. II at 361:1-362:4 (Nakagawa)).

45 B064-B065 (Ikeda Dep. Tr. at 45:6-46:3).

Zou on July 9 asking, "What was the power and time for renal artery ablations?"[46] Zou responded on July 10, "The power and time were 40wx10s, 40wx20s, and 40wx30s."[47] At trial, Dr. Nakagawa testified that he sent the histo-pathology reports to the former ProRhythm employees because it was their "top secret" information.[48]

This evidence of top secret information about a pre-planned study in Oklahoma attended personally by two ProRhythm employees from New York does not support Defendants' position that the renal denervation dog experiment was an "*ad hoc*" study. Instead, it was a planned and material ProRhythm effort to conduct research on ultrasound renal denervation. The facts that ProRhythm paid for Dr. Nakagawa's time, his laboratory, and the dog, and that Dr. Nakagawa performed the experiment with ProRhythm's catheters, in the presence of two members of ProRhythm management, show that the Court of Chancery did not "clearly" err in finding that this animal study was conducted for the benefit of ProRhythm as part of its furtherance of renal denervation research.

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46 A210 (email from Ikeda to Zou).

47 A210 (email from Zou to Ikeda).

48 B175-B176 (Trial Tr. Vol. II at 361:1-362:4 (Nakagawa)).

3. ProRhythm Employees Continue to Consider Renal Denervation as They Plan Their Exit from ProRhythm

On August 21, 2009, Zou emailed Jung, a former employee of ProRhythm, stating, "I really liked the reno [*sic*, renal] denervation project and I want to pursue that one if I get a chance. I don't know how much [Dr. Nakagawa] has told you, the denervation procedure is much easier than thought."[49] Indeed, Zou also testified in his deposition that the June 27 study showed that it was "probably easy for us to pursue" renal denervation, with "us" referring to the engineers at ProRhythm.[50] Jung had sent an email to Smith and Warnking in early July stating that Dr. Nakagawa had told him, "given HIFUs non-interaction with blood and its effectiveness at damaging nerves . . . he can think of no better energy form than HIFU to treat hypertension."[51]

Zou sent an email to Jung on August 31, 2009, inquiring, "You mentioned last time that you might be able to get some funding for the denervation project? What does it take?"[52] A month later, Jung responded, "So what's going on? Anything on denervation?"[53] Zou forwarded that email to Smith and Warnking,

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49 A217 (email from Jung to Zou).

50 B047 (Zou Dep. Tr. 91:18-92:16).

51 A207 (email from Jung to Smith and Warnking).

52 A319 (email from Zou to Jung).

53 A318 (email from Jung to Zou).

asking how he should respond.[54] Smith replied, "I wouldn't share much with him at this time. He has too many resources at his disposal to do this himself."[55]

On September 1, 2009, Dr. Nakagawa advised Warnking that he would "get the histology from the dog which we ablated the renal artery by this weekend."[56] A week later, Warnking replied to that email, asking, "What did the renal histology suggest? In order to move forward with this we could use some positive news."[57]

C. Warnking Files Patent Applications on Ultrasound Renal Denervation

Smith, Warnking, and Zou terminated their ProRhythm employment on September 30, 2009.[58] Within 30 days of Warnking's departure, on October 29, 2009, he filed two patent applications in the United States seeking to protect renal denervation therapy using ultrasound catheter technology (the "'429 patent application" and the "'455 patent application"). In the '429 patent application, Warnking expressly set forth what he believed he had invented:

> A method of ablating renal nerves from inside the renal artery . . . [that] desirably include[s] the step of positioning . . . an ultrasonic transducer desirably having a cylindrical shape, in proximity to the kidney inside the renal artery. The transducer may be actuated to

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54 A318 (email from Zou to Warnking and Smith).

55 A318 (email from Smith to Zou).

56 A311 (email from Nakagawa to Warnking).

57 A311 (email from Warnking to Nakagawa)

58 B091 (Pre-Trial Stipulation and Order dated September 11, 2012 at 4 ¶ 20).

> generate ultrasonic energy that may damage renal nerves surrounding the renal artery without causing necrosis of surrounding tissue.[59]

That is exactly what had been conceived and researched at ProRhythm and what Dr. Nakagawa had actually performed using the ProRhythm ultrasound catheter in the June 2009 dog study. On January 6, 2010, Warnking filed a third provisional patent application (the "'618 application") that related to the '429 patent application.[60] On October 8, 2010, Warnking assigned to SII the '429, '455, and '618 patent applications.[61]

D. Warnking and His Former ProRhythm Colleagues Found SII to Exploit Ultrasound Renal Denervation

SII Marketing Director Smith testified that as of August 2009, he was very interested in pursuing ultrasound renal denervation work, and he pushed for its development by trying to convince Warnking to start a company with him.[62] Smith also sought to recruit Zou.[63] Smith and Zou approached Warnking and suggested that the three of them form a new company to pursue ultrasound renal denervation, which they ultimately did. Although SII was not formally incorporated until months later, by the first week of December 2009, Warnking, Smith, and Zou had,

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59 A342 (excerpt from "Brief Summary of the Invention" in the '429 patent application).

60 A378-A432 ('618 patent application).

61 B091 (Pre-Trial Stipulation and Order dated September 11, 2012, at 5 ¶ 25).

62 B187-B189 (Trial Tr. Vol. II at 454:22-456:1 (Smith)); B080-B081 & B084-B085 (Smith Dep. Tr. at 39:10-40:12 & 90:22-91:5); B038-B039 (Warnking Dep. Tr. at 212:15-213:8).

63 B187-B189 (Trial Tr. Vol. II at 454:22-456:4 (Smith)).

in essence, established SII as a new company and located office space to rent in Stony Brook, New York, which they moved into during January 2010.[64]

Dr. Nakagawa received the histo-pathology reports about the June 27 study in mid-December 2009, long after ReCor had acquired ProRhythm and Warnking had founded SII.[65] Dr. Nakagawa did not send the results to ReCor, even though he was aware that ReCor had acquired all the assets of ProRhythm, but instead Dr. Nakagawa forwarded the "top secret" reports to Smith at SII. Those results showed some therapeutic promise and helped to convince SII to pursue the technology. Indeed, Smith eventually included a portion of the renal denervation study in a draft SII presentation to investors.[66] Although Smith claimed that he was "not sure that it went to anybody," Smith emailed Dr. Nakagawa on August 5, 2010, to inform him that a potential investor in SII "may also want to know about the one animal experiment that we did"—referring to the June 27 experiment.[67]

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64 B191-B192 (Trial Tr. Vol. II at 458:11-459:1 (Smith)).

65 B160 (Trial Tr. Vol. II at 332:1-8 (Nakagawa) (discussing A166-A197)).

66 B013-B024 (PowerPoint slides); B192-B193 (Trial Tr. Vol. II at 459:16-460:11 (Smith)).

67 A321 (email from Smith to Nakagawa).

ARGUMENT

I. THE COURT BELOW PROPERLY FOUND THAT WARNKING CONCEIVED OF THE RENAL DENERVATION TECHNOLOGY WHILE AT PRORHYTHM, AND THAT IT WAS, THEREFORE, PRORHYTHM'S PROPERTY

A. Question Presented

Did the evidence presented at trial prove that Warnking's Invention contained Proprietary Information related to the business of ProRhythm?

B. Standard and Scope of Review

ReCor agrees with Defendants regarding this Court's standard of review of the Court of Chancery's Opinion on the first argument: findings of historical facts are subject to the clearly erroneous standard of review, while questions of law must be reviewed *de novo*.

C. Merits of the Argument

Throughout their Opening Brief, Defendants fall far short of explaining how the Court of Chancery's holdings are "clearly" erroneous in view of the above facts. Indeed, Defendants finish their section on the first issue by stating:

> because there is ***no evidence*** that renal denervation was within the scope of ProRhythm's business and there is no evidence supporting the Court of Chancery's conclusion that the renal denervation portion of the June 27 study brought renal denervation within the scope of ProRhythm's business, the Court of Chancery's finding that the Invention belonged to ProRhythm was ***erroneous***.[68]

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[68] Defs.' Opening Br. at 28 (emphasis added).

The oft-repeated bare conclusion that there was "no evidence" flies in the face of (1) the extensive exchange of emails about renal denervation using ProRhythm's ultrasound technology; (2) the June 27 renal denervation animal study conducted by Dr. Nakagawa on behalf of ProRhythm and attended by ProRhythm employees; and (3) the efforts of Warnking and others at ProRhythm to hide the technology from ReCor while ReCor was conducting its due diligence in connection with its purchase of ProRhythm's assets.

As presented above, Warnking and his ProRhythm colleagues discussed the concept of using ultrasound energy for renal denervation within and outside of ProRhythm. They exchanged numerous emails with each other, as well as with outside medical consultants, from as early as February of 2009 until they all left ProRhythm at the end of September 2009. The culmination of that idea was the renal denervation dog study performed on June 27, 2009, in Oklahoma with ProRhythm ultrasound catheters and with Warnking and his engineer Yong Zou in attendance. In December of 2009, Dr. Nakagawa provided the results of that study—a pathology report—to the ex-ProRhythm employees, and that group (subsequently incorporated as SII) continued what they had begun at ProRhythm.

In view of the discussion among ProRhythm management and engineers about the merits of ultrasound renal denervation, the use of a ProRhythm ultrasound catheter to perform the renal denervation portion of the dog study, the

use of ProRhythm funds to pay for the dog study, and the follow up efforts to obtain the pathology report, only one conclusion results: ultrasound renal denervation was conceived at ProRhythm prior to ReCor's acquisition of substantially all remaining assets, including all remaining technology. If there had been no conception, then why did Warnking instruct his colleagues to hide the information from ReCor during its diligence of ProRhythm? It is because Warnking knew, as he alluded in his emails, that ReCor would end up with that technology, as it should have.

Defendants contend that the June 27 renal denervation experiment was an "*ad hoc*" study that ProRhythm did not authorize. ReCor addresses that unsupportable contention above. In sum, first, ProRhythm paid for the renal denervation portion of the study, including the histo-pathology report. Dr. Nakagawa used two different ProRhythm catheters to perform the mitral and renal portions of the study, the latter of which ProRhythm engineer Zou personally brought to Oklahoma. Indeed, Zou participated in the renal portion of the experiment. Moreover, notes of both portions were kept on the same data sheets. And, once the results of the renal denervation study were ready, Dr. Nakagawa sent them to Warnking and the other former employees of ProRhythm, all of whom by then were at SII, with Dr. Nakagawa as a consultant and shareholder.

In its appeal, Defendants take liberty with the facts. Defendants allege that ProRhythm did not spend a dime on renal denervation.[69] Yet the testimony that Defendants cite (*i.e.*, A644) shows only that the renal portion of the dog study resulted in no additional marginal cost to ProRhythm or to the University of Oklahoma. There is no dispute that ProRhythm paid the entire cost for that June 27 animal study. Thus, Defendants' claim that not a dime was spent on renal denervation is incorrect. Defendants also ignore the corporate resources that ProRhythm expended in evaluating ultrasound renal denervation technology, as demonstrated in the email communications among Warnking, Smith, Zou, and ProRhythm's researchers concerning the opportunity that ultrasound renal denervation offered.

Defendants also introduce new evidence into the record, relying upon a color sketch on page 12 of their Opening Brief. ReCor has never seen that illustration before; it was not presented at trial; and it is not even clear what it is supposed to portray. The fact that Defendants must add to the record in an attempt to support their appeal further undermines their contention that the Court of Chancery committed "clear" error.

Given the existence of all of the evidence, the lack of credibility of Defendants' witnesses, and the absence of any explanation about how the Court of

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[69] Defs.' Opening Br. at 32.

Chancery's Opinion is "clearly" erroneous (as opposed to simply wrong in Defendants' minds), Defendants' appeal of the first issue must fail. Not only did the Court of Chancery not clearly err in its findings, it did not err at all.

II. THE COURT OF CHANCERY'S REMEDIES WERE EQUITABLE AND APPROPRIATE, AS WAS ITS AWARD OF ATTORNEYS' FEES

A. Question Presented

Did the Court of Chancery properly exercise its discretion to grant final injunctive relief and attorneys' fees?

B. Standard and Scope of Review

This Court reviews the Court of Chancery's fashioning of remedies for an abuse of discretion. *See Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 175 (Del. 2001). A Court of Equity has broad discretion to shape and to adjust the remedy to achieve justice under the facts of a particular case. *Agilent Technologies, Inc. v. Kirkland*, 2010 Del. Ch. LEXIS 34, at *32 (Del. Ch. Feb. 18, 2010).

C. Merits of the Argument

1. Defendants Did Not Raise the Remedy Issues Below

In their Opening Brief, Defendants were required to provide "a clear and exact reference to the pages of the appendix where [they] preserved each question in the trial court." Supr. Ct. R. 14(b)(vi)(A)(1). Under the Supreme Court Rules, "Only questions fairly presented to the trial court may be presented for review . . . ." Supr. Ct. R. 8.; *Tumlinson v. Advanced Micro Devices, Inc.*, No. 672, 2012, --- A.3d ----, 2013 WL 4399144, at *3 (Del. Aug. 16, 2013) (citing *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, 68

A.3d 665, 678 (Del. 2013)) ("Under Supreme Court Rule 8, a party may not raise new arguments on appeal.").

Defendants, however, do not cite to any portion of the record where they preserved the right to challenge any part of the Court of Chancery's remedies—not the transfer of the technology and patent applications to ReCor, not the injunction against further use of the technology, and not the grant of ReCor's attorneys' fees.[70] Indeed, Defendants did not preserve these issues in the trial court. Defendants' argument below focused on whether the technology was encompassed by the IAA. Defendants did not argue to the Court of Chancery that, even if the technology was properly found to be subject to the provisions of the IAA, it would be inequitable to grant to ReCor its requested relief of assigning the patent applications, enjoining Defendants' further use of the technology, and rewarding ReCor its reasonable attorneys' fees. On this basis alone, this Court can and should deny the portion of Defendants' appeal related to the remedies granted by the Court of Chancery. Moreover, Defendants' challenge to the Court's remedies may be rejected on the merits as well.

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[70] Defendants did not cite any portion of the record where they preserved their first question presented either.

2. Defendants Never Show, or Even Attempt to Show, That the Court of Chancery Abused Its Discretion

At no time do Defendants suggest that the Court of Chancery abused its discretion. Instead, they simply express their disagreement with the remedies imposed. After the Court of Chancery decided that the technology described in the Warning's (now SII's) patent applications belong to ReCor, it was necessarily equitable to order that those patent applications and technology be transferred to ReCor. Indeed, that is the only appropriate equitable remedy under the circumstances. Otherwise, in commercializing the very technology that it purchased from ProRhythm, ReCor would be at risk of potentially infringing any patents that might otherwise issue to Defendants from the subject patent applications. That would undermine the rights that ReCor bargained for and acquired in the APA.

Defendants argue that the later patent applications "contain[] developments and technology that were not in Mr. Warnking's mind in October 2009."[71] However, there is no dispute that those later patent applications claim priority to the October 2009 application.[72] Under patent law, Defendants' claim of priority is an admission that what is claimed in those later applications was conceived at the same time as the material in the earlier application. *See, e.g.*, 37 C.F.R. § 1.78.

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71 Defs.' Opening Br. at 30.

72 *See, e.g.*, A494.

The Court of Chancery's narrowly tailored injunction is likewise equitable. The injunction is limited both in scope (expressly exempting renal denervation technology that was in the public domain at the time that the applications were filed) and in time (limiting the injunction to four years, unless the patents issue). The Court of Chancery found that the technology belongs to ReCor and that the patent applications seeking to protect such technology belong to ReCor. It would be inequitable to permit Defendants, who admittedly had a head start in developing the technology because they kept it secret from ReCor, to use the technology in competition against ReCor. Thus, precluding Defendants from enjoying the fruit of the poisonous tree, that Warnking planted, is not an abuse of discretion.

While Defendants contend that the circumstances here fail to meet the standard for a permanent injunction, they do so only in conclusory form with little citation to the record. For example, Defendants refer to the patent applications as costing millions of dollars,[73] but Defendants provide no citation to the record. That is because there is no such evidence. Defendants also rely upon allegations that the technology encompassed in the patent applications (that they are enjoined from practicing) took years of development to reduce to practice.[74] Again, Defendants

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73 Defs.' Opening Br. at 29.

74 *Id.*

make no citation to the record. Indeed, there is no evidence of either statement, as neither "fact" was presented at trial.

Even if Defendants could support their argument with evidence, the Court of Chancery did not abuse its discretion in granting a narrowly tailored injunction in favor of ReCor, the innocent party, and against Warnking, the breaching party. The fact that Warnking may have undertaken additional efforts and expense to develop ProRhythm's technology, after misappropriating it, does not mean that the Court of Chancery's balancing of the equities was an abuse of discretion. As between the innocent party, ReCor, and the wrongdoer, Warnking, the Court of Chancery found the balance of equities favors ReCor. If Defendants are instead arguing that some third parties are harmed by the injunction, such as innocent independent investors in SII (if there are any), then the proper remedy for any such third parties is a claim against Warnking or SII sounding in contract or tort relating to representations that Defendants may have made concerning their ownership of the technology. Any alleged third-party harm thus does not upset the balance of equities as between ReCor and the Defendants.

3. Warnking Stipulated to Injunctive Relief and Specific Performance in the IAA

There is no dispute about the contents of the IAA, that Warnking executed it, or that it is enforceable. In the IAA, Warnking expressly agreed that (1) any ideas that he conceived would become ProRhythm's property; (2) a breach of the IAA

by Warnking would "cause irreparable damage" to the company; and (3) the company would have "the right to an injunction, specific performance or other equitable relief" in addition to other available remedies.[75] Delaware courts "have long held" that such provisions are enforceable against the breaching party. *See Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 68 A.3d 1208, 1226 (Del. 2012) (collecting cases). The remedies that the Court of Chancery granted comport with the express language of the IAA and this Court's unambiguous case law upholding the enforcement of such provisions.

4. The Award of ReCor's Reasonable Attorneys' Fees

There is no dispute that the IAA contract includes an enforceable attorneys' fees provision: "The prevailing party in any litigation arising under this Agreement shall be entitled to recover his or its attorneys' fees and expenses in addition to all other available remedies."[76] Under the APA, ReCor acquired the right to pursue ProRhythm's contractual right to reasonable attorneys' fees.[77] At no time during the lawsuit did Defendants raise the issue that the attorneys' fees provision was illegal, fraudulent, or improper. Defendants, therefore, have conceded that if ReCor prevails on the contract dispute, then ReCor may be

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75 A38 (Invention Assignment Agreement at § 5).

76 A35 (Invention Assignment Agreement at § 2).

77 A272 (Asset Purchase Agreement at § 11.16).

awarded its reasonable attorneys' fees. Thus, holding that ReCor succeeded in its Declaratory Judgment claim that the IAA was breached, the Court of Chancery appropriately enforced the contract by awarding fees.

For those reasons, ReCor hereby respectfully requests an award of the reasonable attorneys' fees that it has incurred in connection with this appeal.[78]

5. ReCor's Breach of Fiduciary Duty Claim Is an Alternative Ground for Affirmance

As an independent ground for affirmance of the Court of Chancery's decision, Warnking, Smith, and Zou violated their fiduciary duties to ProRhythm. ReCor acquired ProRhythm's claim against Warnking, Smith, and Zou for breach of fiduciary duty when ReCor acquired all of ProRhythm's tangible and intangible assets under the APA. ReCor preserved its breach of fiduciary duty claim at the trial court.[79] In its Opinion, the Court of Chancery ruled that it did not need to address ReCor's breach of fiduciary duty claim, because the Court of Chancery granted ReCor the relief that it requested under the IAA.[80]

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78 ReCor will separately present a motion in this Court in accordance with Rules 20(f) and 30, or it will make such request in the Court of Chancery, whichever this Court prefers. *Cf. Scion Breckenridge Managing Member LLC*, 68 A.3d at 688 & n.114 (noting this Court's discretion to direct that this issue be decided in the Court-below).

79 B092-B093 (Pre-Trial Stipulation and Order at 5 & 6); B217-B221 (ReCor's Opening Post Trial Brief at 18-22).

80 B273 (July 16 Opinion at 46).

It has long been black letter law that "officers and directors are not permitted to use their position of trust and confidence to further their private interests . . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest." *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939). "A claim for breach of fiduciary duty requires proof of two elements: (1) that a fiduciary duty existed and (2) that the defendant breached that duty." *Beard Research, Inc. v. Kates*, 8 A.3d 573, 601 (Del. Ch. 2010).

ReCor established both elements in the Court of Chancery. Warnking, Smith, and Zou violated their fiduciary duties, which arose from their positions of trust and confidence in ProRhythm, when they took and sought to exploit the ultrasound renal denervation technology for their own account, through their new company, SII.

Under fundamental principles of agency law, an agent owes his principal a duty of loyalty, good faith, and fair dealing. These duties encompass the corollary duties of an agent to disclose information that is relevant to the affairs of the agency entrusted to him and to refrain from placing himself in a position antagonistic to his principal concerning the subject matter of his agency. *Beard Research, Inc. v. Kates*, 8 A.3d 573, 601 (Del. Ch. 2010). Specifically, a

> breach of fiduciary duty occurs when a fiduciary commits an unfair, fraudulent, or wrongful act, including misappropriation of trade

> secrets, misuse of confidential information, . . . or usurpation of the employer's business opportunity.

Id. at 602.

Warnking was the President, the CEO, and a Director of ProRhythm during his entire tenure with the company.[81] Smith was ProRhythm's Vice President of Sales and Marketing.[82] Zou was ProRhythm's principal software engineer and IT manager.[83] Accordingly, Warnking, Smith, and Zou were "traditional corporate fiduciaries" at ProRhythm, which include "officers and directors" as well as "key managerial personnel." *Beard*, 8 A.3d at 601. As such, each of them owed a fiduciary duty to ProRhythm. Those principals breached their fiduciary duties by misusing ProRhythm's confidential information regarding ultrasound renal denervation and by usurping the corporate opportunity to pursue ultrasound renal denervation. The evidence demonstrates that Warnking, Smith, and Zou knew of the potential of ultrasound renal denervation. Yet, none of the ProRhythm principals ever disclosed this exciting opportunity to ProRhythm's board of directors.[84] Instead, on June 9, 2009, Warnking went out of his way to ensure that

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81 B090 (Pre-Trial Stipulation and Order dated Sept. 11, 2012, at 3 ¶ 10).

82 B089 (Pre-Trial Stipulation and Order dated Sept. 11, 2012, at 2 ¶ 6).

83 B180 (Trial Tr. Vol. II at 416:15-17 (Zou)).

84 B137 (Trial Tr. Vol. I at 235:9-13 (Warnking)); B149-B150 (Trial Tr. Vol. II at 319:9-320:8 (Warnking)).

Smith, Zou, and Dr. Sinelnikov (all of whom are now with SII) actively refrained from discussing renal denervation.[85]

Then, two months after the June 27, 2009 experiment, on September 8, 2009, Warnking pressed Dr. Nakagawa for the histology from the renal portion of the experiment, stating, "In order to move forward with this we could use some positive news."[86] In view of Warnking's position as President, CEO, and director of ProRhythm, one would have expected that Warnking would have been acting on behalf of ProRhythm when he sought that information from Dr. Nakagawa. However, he was not. By that time, Smith was already encouraging Warnking to start a new company focused on ultrasound renal denervation, and Warnking was acting for his own account, not for ProRhythm.[87]

Thus, Warnking and the others breached their fiduciary duties to ProRhythm by not attempting to commercialize the ultrasound renal denervation technology for the benefit of ProRhythm. The Court of Chancery never reached this issue because ReCor had already won on the merits of its Declaratory Judgment claim of breach of contract. Thus, ReCor's breach of fiduciary duty claim is an independent basis for affirming the decision of the Court of Chancery.

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85 B001 (email from Warnking to Sinelnikov, Zou, and Cichy).

86 A311 (email from Warnking to Nakagawa).

87 B132-B134 (Trial Tr. Vol. I at 228:12-230:1 (Warnking)).

CONCLUSION

For all of the reasons articulated above, ReCor respectfully requests that this Court (1) affirm the decision of the Court of Chancery in all respects; and (2) award to ReCor the reasonable attorneys' fees that it has incurred in connection with this appeal, pursuant to the prevailing party provision in the IAA and APA.

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