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Case No. 8559-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

RED OAK FUND, L.P.,	)	
Plaintiff,	)	
v.	)	C.A. No. 8559-VCN
DIGIRAD CORPORATION, JEFFREY E. EBERWEIN, CHARLES M. GILLMAN, JOHN M. CLIMACO, JAMES B. HAWKINS, and JOHN W. SAYWARD,	)	
Defendants.	)	

DEFENDANTS' OPENING BRIEF IN SUPPORT OF MOTION TO DISMISS

Of Counsel:

Thomas J. Fleming, Esq.
Jennifer L. Heil, Esq.
OLSHAN FROME WOLOSKY LLP
Park Avenue Tower
65 East 55th Street
New York, NY 10022

Dated: June 11, 2013

John M. Seaman (#3868)
J. Peter Shindel, Jr. (#5825)
ABRAMS & BAYLISS LLP
20 Montchanin Road, Suite 200
Wilmington, DE 19807
(302) 778-1000

Counsel for Defendants Digirad Corporation, Jeffrey E. Eberwein, Charles M. Gillman, John M. Climaco, James B. Hawkins, and John W. Sayward

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Defendants Digirad Corporation ("Digirad," or the "Company"), Jeffrey E. Eberwein, Charles M. Gillman, John Climaco, James B. Hawkins, and John W. Sayward (collectively, the "Individual Defendants" and together with Digirad, the "Digirad Parties" or "Defendants"), by and through their undersigned counsel, hereby submit the following Opening Brief in Support of Motion to Dismiss. As set forth below, the Verified Complaint (the "Complaint") filed by Plaintiff the Red Oak Fund, L.P. ("Red Oak" or "Plaintiff") should be dismissed pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim upon which relief may be granted and specifically for failure to adequately allege a fiduciary duty of disclosure claim or that the results of any new election of directors would be any different so as to set aside the results of the annual election of directors of Digirad under 8 *Del. C.* § 225.

PRELIMINARY STATEMENT

For more than a month this Spring, the incumbent Board of Digirad engaged in a heated proxy contest with a competing slate nominated by plaintiff Red Oak Fund, L.P. ("Red Oak"). Through proxy statements, fight letters, and press releases, each side reviewed the merits of the competing slates, the progress of the incumbent Board's restructuring plan, and alternatives proposed by Red Oak. Both proxy advisory firms recommended in favor of the incumbent Board and at the annual meeting on May 3, the incumbents prevailed. Red Oak now invokes Section 225 of the General Corporation Law and asks this Court to vacate the meeting results. Remarkably, Red Oak makes no challenge to the extensive written record submitted to Digirad shareholders. Instead, Red Oak bases its claim on three alleged misdeeds, each which suffers from a legal deficiency. The Complaint also suffers from a related flaw, the inability to plead any colorable causal link between the alleged misdeeds and the final vote, *i.e.*, that the outcome of the annual meeting was in fact altered by the alleged misstatement.

To start, Red Oak alleges that Digirad incorrectly voted treasury shares, which then appeared in the proxy count provided by Broadridge Financial Services, Inc. ("Broadridge") to each side's solicitor. But this information could not have entered the total mix of information received by Digirad shareholders. Red Oak concedes that the Broadridge counts were never disseminated to shareholders and further that Red Oak spotted the obvious error right away. No claim is made that these shares were included in the final vote.

Red Oak further claims that Digirad should have released its quarterly financial report in advance of the meeting. But the financial report was not due, under federal law, until May 15, 2013. No court has ruled that reporting deadlines for public companies must be accelerated due to a proxy contest. Nor does Red Oak identify any specific information in the Form 10-Q that would have altered the landscape had it been disclosed earlier.

Red Oak's core claim is its contention that the Digirad incumbents made predictions of the outcome of the vote to unidentified, institutional shareholders. According to Red Oak, these shareholders were pressured to side with a perceived winner for fear of retaliation and losing access to unspecified information about the Company in the future. The flaws here are multiple:

A. The proxy materials delivered by each side made clear that every vote was revocable up to the time of the annual meeting. Digirad's institutional shareholders were thus well advised that the outcome was uncertain, as no one could foresee how shares would be voted. Indeed, Red Oak worked hard to garner votes right up to the meeting date. Sophisticated financial players thus well understood that the outcome of the vote could not be known until the meeting was held.

B. The alleged power of the prevailing party to favor its supporters with corporate information makes no sense. As a public company, Digirad is prohibited from providing material non-public information on a selective basis.

C. Red Oak's pleading even contradicts its own theory. The sole stockholder who Red Oak specifically identifies as having heard the alleged prediction of victory not only voted against management, but also advised Red Oak that it heard the prediction, an act that would expose the stockholder to supposedly feared retaliation.

D. Last, Red Oak offers no explanation as to how Digirad could reliably identify how shareholders who held in "street name" voted, since their beneficial ownership is not disclosed on any proxy tally.

In short, the extensive written record that preceded the meeting precludes Red Oak's claim that predictions of voting outcomes to sophisticated institutional shareholders altered the total mix of information regarding the competing slates or was even material to the contest.

Red Oak's Complaint suffers from another, related flaw. It fails to adequately plead causation. In paragraph 46 of the Complaint, Red Oak alleges that the outcome of the annual meeting was changed as a result of the alleged statements about the meeting results. Red Oak's pleading falls short of providing any colorable factual support for this conclusory statement. Red Oak, for example, does not identify by name or classification, a sufficient number of shareholders whose votes it would have obtained absent these statements. This omission is especially problematic in light of Red Oak's assertion that it knows how shareholders were voting. Nor does Red Oak explain how so many shares were voted in its favor. In other words, what made some shareholders immune to the alleged pressure that overwhelmed others? The final vote (approximately 7.8 million for the incumbents and 6.65 million for Red Oak) confirms

that millions of shares were freely voted without fear of retaliation. The infirmities in Red Oak's causation theory are underscored by the deficiencies in its pleading regarding alleged false statements. How could remarks to sophisticated financial players, that are contrary to the written proxy materials and on their face and immaterial to the merits of the competing slates, cause a change in the outcome?

For the reasons set forth below, Defendants respectfully submit that Red Oak's bid to impose costly litigation on Digirad management and its incumbent Board should be rejected. Red Oak's Complaint should be dismissed for failure to state a claim.

STATEMENT OF FACTS

The Digirad Parties dispute many of the material factual allegations of the Complaint. For purposes of this motion, however, the well-pleaded, non-conclusory allegations in the Complaint are accepted as true.

A. The Parties

Digirad is a Delaware corporation with its principal place of business in Poway, California. Compl. ¶ 4. Digirad "is a leading developer and manufacturer of solid-state gamma cameras for nuclear cardiology and general nuclear medicine applications." (http://www.digirad.com/company.html). It "is one of the largest national providers of in-office nuclear cardiology imaging and ultrasound services to physician practices, hospitals and imaging centers." Digirad Corp. Form 10-Q (May 6, 2013) (attached as Exhibit A). The Individual Defendants comprise the entirety of the Company's board of directors (the "Board") and are each highly-qualified for a Board position at the Company. The Company's proxy materials disclosed, among other things:

> Jeffrey E. Eberwein is the chairman of the Board. Compl. ¶ 5. Mr. Eberwein has 20 years of Wall Street experience and is the

Founder and CEO of Lone Star Value Investors, LLC, an investment firm.

Charles M. Gillman is a member of the Board. *Id.* ¶ 6. In June 2001, Charles M. Gillman was employed by Nadel and Gussman, LLC ("NG") to serve as portfolio manager of certain investment portfolios of NG and its related family interests. NG is a management company located in Tulsa, Oklahoma that employs personnel for business entities related to family members of Herbert Gussman.

John M. Climaco is a member of the Board. *Id.* ¶ 7. Mr. Climaco is the President and Chief Executive Officer, as well as member of the board of directors, of Axial Biotech, Inc., a venture-backed molecular diagnostics company specializing in spine disorders, which he co-founded in January 2003.

James B. Hawkins is a member of the Board. *Id.* ¶ 8. Mr. Hawkins has over two decades of experience as chief executive of successful medical device companies. Since April 2004, Mr. Hawkins has served as the President, Chief Executive Officer and a director of Natus Medical Incorporated, a provider of healthcare products used for the screening, detection, treatment, monitoring, and tracking of common medical ailments such as hearing impairment, neurological dysfunction, epilepsy, sleep disorders, and certain newborn conditions.

John W. Sayward is a member of the Board. *Id.* ¶ 9. From September 2005 to January 2007, Mr. Sayward was a partner at Nippon Heart Hospital LLC, a company that built and managed cardiovascular care hospitals in Japan.

Plaintiff Red Oak is a Delaware limited partnership with its principal place of business in New York, New York. *Id.* ¶ 3. At the time of the May 2013 director election at issue in this case, Red Oak beneficially owned 1,041,619 shares of Digirad's common stock, or approximately 5.4% of the Company's voting shares. *Id.*

B. Red Oak's 2012 Negotiations With Digirad

In 2012, Red Oak nominated an alternative slate of directors in connection with Digirad's 2012 annual meeting of stockholders and election of directors. Red Oak claimed to be dissatisfied with the performance of Digirad's board of directors and with various corporate

governance and compensation practices of Digirad. *Id.* ¶ 12. Red Oak then owned less than 1% of Digirad's common stock. In response, Digirad agreed to adopt certain changes in its corporate governance standards and compensation practices. *Id.* ¶ 13. As a result, Red Oak agreed that it would not pursue its nomination of an alternative slate of directors for the 2012 annual meeting. *Id.* Red Oak thereafter acquired a substantially larger position in Digirad common stock.

C. The 2013 Proxy Contest

The 2013 proxy contest for the election of directors at Digirad (the "Election") involved a vigorous public debate, with each side advocating the merits of their candidates through numerous public filings. Red Oak's Complaint fails to identify a single false or misleading statement by Digirad in those extensive filings, some of which are described below. Instead, Red Oak points to alleged oral statements made, not to Red Oak, but to other stockholders, only one of which is even identified, *see id.* ¶ 35, as the basis for seeking a do-over of the Election.

On February 26, 2013, Red Oak sent a letter to Digirad's Board informing it that Red Oak would nominate five directors to run in opposition to the Company's five nominees in the 2013 annual meeting of stockholders and election of directors, which was eventually scheduled for May 3, 2013. *Id.* ¶ 14.

Anticipating a potential contest, the Company's Board moved quickly to address recent developments. On March 27, 2013, Digirad filed with the SEC, as proxy solicitation material, a presentation to stockholders entitled "Moving Forward." Digirad Corp. Stockholder Presentation (Mar. 27, 2013) (attached as Exhibit B). The presentation highlighted specific improvements made at the Company since the 2012 annual meeting. These improvements included the introduction of four non-employee directors and a reduced board size, a restructuring of the business to focus on cash flow generation, a focus on strategic acquisitions, relocation of certain

of the Company's functions to Atlanta, Georgia to reduce costs and overhead, an increase in the Company's stock buyback program from $4 million to $12 million, and the elimination and reorganization of certain management positions. *See* Exhibit B at 1–6.

On April 4, 2013, Digirad issued its definitive proxy statement (the "Digirad Proxy Statement"). *See* Digirad Corp. Schedule 14A (Apr. 4, 2013) (attached as Exhibit C). The Digirad Proxy Statement recommended that stockholders vote for the Company's nominees, the Individual Defendants, and highlighted improvements made at the Company over the past year. *See* Exhibit C, *passim*. Also on April 4, 2013, Digirad issued its 2012 Annual Report, which contained an address to stockholders by Todd Clyde, the Chief Executive Officer. Digirad Corp. Annual Report (Apr. 4, 2013) (attached as Exhibit D). That same day, Mr. Eberwein, the Chairman of the Board, issued Digirad's first "fight letter" to stockholders. *See* Digirad Corp. Fight Letter (Apr. 4, 2013) (attached as Exhibit E). The April 4, 2013 letter noted the Company's recent improvements, emphasized the qualifications of its director nominees, and noted certain drawbacks relating to Red Oak's slate of nominees. *See* Exhibit E at 1–5.

On April 10, 2013, Red Oak mailed its Definitive Proxy Statement (the "Red Oak Proxy Statement") to stockholders. *See* Red Oak Schedule 14A (Apr. 10, 2013) (attached as Exhibit F). Red Oak presented a litany of alleged mistakes by the Digirad Board, touted the qualifications of its own nominees, and advised that its nominees would, among other things:

- Review the strategic alternatives process and possibly re-open the process pending the outcome of the review.
- Consult with well-credentialed individuals who Red Oak or the Board knows, including operators who successfully run their own services business similar to DIS and have achieved higher gross margins and lower operating expenses than Digirad. They would assist the Board in evaluating whether Digirad's operations are efficient and generating optimal returns to stockholders.

- Oversee a 382 NOL study to understand what type of structural flexibility may exist towards utilizing the NOL assets to create additional stockholder value.

- Utilize the collective networks of Red Oak's nominees to retain a competent advisor and bring in deal flow and evaluate potential acquisition opportunities which may make sense when combined with Digirad's tax loss carry forwards. Establish an initial acquisition search budget at $100,000, and curb hotel and travel costs (e.g., no first class) to ensure spending discipline.

- Review and rebid on most corporate costs, including audit, proxy services, D&O, etc. with a mindset towards unilateral reductions, including some which Digirad has not yet made.

As the solicitation progressed, both sides sought support from Institutional Shareholder Services Inc. ("ISS"), a leading proxy advisory firm. On April 15, 2013, Digirad filed with the SEC a copy of its ISS presentation, which tracked its March 27, 2013 presentation to stockholders. *See* Digirad Corp. Presentation to ISS (Apr. 15, 2013) (attached as Exhibit G). On April 16, 2013, Red Oak filed its own ISS presentation with the SEC. *See* Red Oak Presentation to ISS (Apr. 16, 2013) (attached as Exhibit H).

Red Oak issued additional fight letters to stockholders on April 16, 19, and 25, 2013, which are attached as Exhibits I, J and K, respectively. Digirad issued a responsive fight letter on April 18 and a press release on April 26, 2013, which are attached as Exhibits L and M, respectively. These communiqués argued the merits of the competing slates, the progress of Digirad under current management, and the claims by Red Oak.

On or about April 23, 2013, both ISS and Glass Lewis & Co. ("Glass Lewis") recommended that stockholders vote for all five of Digirad's nominees as well as all other Company proposals. Digirad promptly issued a press release announcing their support. *See* Digirad Corp. Press Release (Apr. 23, 2013) (attached as Exhibit N). Digirad's press release quoted the ISS report:

> …the dissidents have not put forth nor does there appear to be a clear course of action that should be taken instead of what the board is currently doing. In this case, we highlight the changes the company has made in the last year including: a resized management team, a new strategic plan, a process to refocus its business model and rationalize its cost structure, and the positive governance changes. The dissident plan left us wanting in light of these events. Accordingly, the dissident has not made a compelling case that change at the board level is warranted.

Exhibit N at 4. The press release also quoted the Glass Lewis report:

> …we take issue with certain aspects of the plan that the Dissident seeks to implement. In particular, the Dissident appears to us to be advocating a plan involving more board-level strategic reviews, despite the fact that the current board has conducted and completed such a review approximately two months ago. As such, we believe that giving board control to the Dissident Nominees at this time may result in costly delays in terms of implementing the Company's restructuring plan.

Id.

Red Oak's pleading does not challenge *any* of these numerous disclosures by Digirad in its extensive written proxy materials. Nor does Red Oak suggest that ISS and Glass Lewis were misled.

On May 3, 2013, Digirad convened its annual meeting of stockholders at which the Election was held. Digirad announced that the preliminary Election results on May 8, 2013 indicated that approximately 78% of the outstanding shares were voted and "a solid majority were cast for each of the five Digirad nominees." Digirad Corp. Fork 8-K (May 8, 2013) at 9 (attached as Exhibit O). On May 10, 2013, the independent inspector of elections delivered its final vote tabulation for the 2013 annual meeting. The results confirmed that approximately 78% of the outstanding shares were voted. *See* Digirad Corp. Form 8-K (May 10, 2013) at 9 (attached as Exhibit P). Approximately 40% of the shares voted were cast in favor of Digirad's nominees, and approximately 34% of the shares voted were cast in favor of Red Oak's nominees. Compl.

¶ 33. Digirad's nominees received approximately 1.2 million more votes than Red Oak's nominees. *See* Exhibit O at 3.

D. The First Quarter 2013 Form 10-Q

On May 6, 2013, Digirad filed its Form 10-Q for the first quarter of 2013. Compl. ¶ 41. The Form 10-Q noted that the Company's net losses and net losses per share had approximately doubled as compared to the first quarter of 2012. *Id.* Digirad, however, had already disclosed information relating to these losses in multiple previous SEC filings. For example, on March 5, 2013, Digirad filed a Form 8-K that announced that the Company had decided to restructure its Diagnostic Imaging business to reduce costs and to focus on maximizing cash flow from the Company's DIS services business. *See* Digirad Form 8-K (Mar. 5, 2013) (attached as Exhibit Q). That Form 8-K stated that there would be costs associated with the restructuring, but that there was not an estimate for those costs at that time. *Id.* at 4.

On March 13, 2013, Digirad filed a Form 8-K/A, which stated that the Company had performed an analysis on the estimated costs associated with the restructuring effort and concluded that they would range from $1.8 million to $2.3 million. *See* Digirad Form 8-K/A (Mar. 13, 2013) (attached as Exhibit R) at 5. The Form 8-K/A went on to state: "These costs will be recognized as restructuring and related costs over fiscal year 2013. Included in this estimated range is approximately $1.5 million of employee related costs, while the remaining costs include contract termination costs and other related costs. Of the total restructuring charges, approximately $1.7 million to $2.0 million is expected to result in additional cash outlay in fiscal year 2013." *Id.*

Also on March 13, 2013, Digirad filed its Form 10-K for the fiscal year ended December 31, 2012, a copy of which is attached as Exhibit S. The Company disclosed in Note 11 of the

10-K relating to subsequent events the same $1.8 million to $2.3 million estimate relating to the restructuring costs as in the Form 8-K/A. *See* Exhibit S at 47.

In its Form 10-Q filed on May 6, 2013, Digirad stated that it had booked approximately $1 million of the restructuring charges during the first quarter. Exhibit A at 5. As a result, the Company's net losses doubled in the first quarter of 2013 as compared with the first quarter of 2012 from $1.268 million to $2.419 million. *Id.* These charges and losses were entirely consistent with the financial disclosures in the Company's earlier Forms 8-K, 8-K/A, and 10-K, which were filed with the SEC in March 2013, well before any of the proxy voting began in mid-April 2013. The net losses in the first quarter of 2013 were therefore not in any way a surprise to stockholders.

NATURE AND STAGE OF THE PROCEEDINGS

On May 15, 2013, Plaintiff filed the Complaint seeking a declaration pursuant to Section 225 of the Delaware General Corporation Law that the election of directors conducted at Digirad's May 3, 2013 annual meeting was invalid and that the results of that election are null and void. Compl. ¶ 1. The Complaint is based on three spurious allegations: (1) that Digirad attempted to vote the Company's approximately 1 million treasury shares in the election, *see id.* ¶¶ 25–33; (2) that Digirad's management improperly predicted the outcome of the election to certain stockholders *see id.* ¶¶ 34–40; and (3) that Digirad filed its Form 10-Q one business day after the meeting, on May 6, 2013, which Red Oak characterizes as a "refusal" by Digirad "to disclose poor financial performance" ahead of the meeting, *see id.* ¶¶ 41–44.

The Complaint alleges that on or about April 8, 2013, Red Oak's proxy solicitor obtained a list that indicated that there were 20,169,852 Digirad shares outstanding. *Id.* ¶ 27. Believing this number to be too high, Red Oak's proxy solicitor asked whether it mistakenly included approximately 1 million treasury shares, and Digirad's proxy solicitor indicated that it did. *Id.*

The Complaint goes on to allege that on April 17, 2013, Broadridge reported over 1 million votes cast by Raymond James in favor of Digirad's nominees. *Id.* ¶ 28. Plaintiff does not contend this vote was shown, or available, to shareholders—or that Red Oak relied upon the alleged erroneous vote.

The Complaint also alleges that certain unnamed members of Digirad management attempted to unfairly influence stockholders' votes through oral statements claiming that the Digirad nominees would win the election. Red Oak further suggests that stockholders in microcap companies such as Digirad are particularly vulnerable in an election because investors may fear retaliation by management and thus lose access to information regarding the Company. *Id.* ¶¶ 21–24. The Complaint thus makes the bizarre allegation that stockholder voting "may have little to do with the merits of the differing slates themselves." *Id.* ¶ 22. According to Red Oak, "[i]f a shareholder visibly opposes management or current directors who ultimately prevail in a contested election, that shareholder risks alienating the only people who can provide information about its investment." *Id.*

As discussed below, this theory suffers from several flaws. First, as a matter of law, public companies cannot "favor" investors with their disclosures. Second, the vast majority of stockholders own their stock in street name and, as beneficial owners, their names are not generally known to management. Third, if institutional shareholders are indeed subject to such pressure, Plaintiff offers no explanation why so many shares voted against management.

As its sole example of an alleged misleading prediction, the Complaint states that on April 26, 2013, Jeffrey Eberwein spoke by telephone with a representative of non-party Somerset, purportedly claiming that the Digirad nominees would win the election with or without Somerset's votes. *Id.* ¶ 35. Contrary to the pleading's theory, Somerset was not swayed

by any alleged pressure, as it voted against management and thereafter shared its decision with Red Oak. *Id.*

Lastly, the Complaint alleges that Digirad management purposely delayed the filing of the Company's Form 10-Q until May 6, 2013, one business day after the annual meeting, purportedly to hide the Company's "poor performance" until after the annual meeting. *Id.* ¶¶ 41–44. As discussed in more detail below, Digirad's Form 10-Q was not due until May 15, 2013, 45 days after the quarter ended March 31, 2013.[1] Red Oak thus seeks either to modify the timelines for financial reporting or to impose novel federal disclosure obligations. In any event, the alleged poor performance had already been disclosed in prior public filings.

On May 15, 2013, Red Oak filed a Motion for Expedited Proceedings. On June 6, 2013, the Court granted Plaintiff's Motion to Expedite and set trial in this matter for August 7, 2013, while giving Defendants leave to file a dismissal brief. On June 6, 2013, Defendants filed their Motion to Dismiss. This is the Digirad Parties' Opening Brief in Support of their Motion to Dismiss.

ARGUMENT

I. LEGAL STANDARD

Pursuant to Court of Chancery Rule 12(b)(6), a claim must be dismissed if it fails to assert sufficient facts that, if proven, would entitle the plaintiff to relief. "[T]he governing pleading standard in Delaware to survive a motion to dismiss is 'reasonable conceivability.'" *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 537 (Del. 2011). When considering a motion to dismiss, the Court will accept all well-pleaded factual allegations in the Complaint as true, accept even vague allegations in the Complaint as "well-pleaded" if

[1] *See* http://www.secfile.net/SEC_calendar.htm#EDGAR_Filing_Deadlines_for_Quarterly_and_Annual_Reports.

they provide the defendant notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof. *Id.* at 536.

The Court, however, need not "accept conclusory allegations unsupported by specific facts or ... draw unreasonable inferences in favor of the non-moving party." *Price v. E.I. du Pont de Nemours & Co., Inc.*, 26 A.3d 162, 166 (Del. 2011); *Lewis v. Aronson*, 466 A.2d 375, 380 (Del. Ch. 1983) ("[c]onclusions of law or fact ... will not be assumed to be true without specific allegations of fact which support the conclusion."), *rev'd on other grounds*, 473 A.2d 805 (Del. 1984) (citations omitted); *Wolf v. Assaf*, C.A. No. 15339, 1998 WL 326662 (Del. Ch. June 16, 1998) (dismissing complaint alleging conclusory disclosure claims). "A trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences." *Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988), *rev'd on other grounds*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

Moreover, on a motion to dismiss the Court may consider, for certain purposes, the content of documents that are integral to or are incorporated by reference into the Complaint. For example, as this Court held in *Orman v. Cullman*, "the Proxy Statement, and any other documents incorporated into it, are incorporated by reference into the complaint and will be considered on [a] motion [to dismiss]." *Orman*, 2002 WL 416957, at *2 (Del. Ch. Feb. 26, 2002, *rev.* Mar. 1, 2002); *see also Gerber v. EPE Holdings, LLC*, 2013 WL 209658, at *1 n.12 (Del. Ch. Jan. 18, 2013) (holding that a document is "integral" to the Complaint when it is, *inter alia*, "given a defined term and referred to explicitly and implicitly throughout the Complaint"); *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 727 (Del. Ch. 1999) (where complaint cited disclosures made in proxy statement and provisions of certificate of incorporation, both could be

considered on motion to dismiss). The Court may also rely on and take judicial notice of SEC filings "to the extent the facts put forth in those filings is not subject to reasonable dispute." *Gerber*, 2013 WL 209658, at *5 n.52 (citations omitted).[2] Documents outside of the pleadings may also be considered in ruling on a Rule 12(b)(6) motion "when the document is not being relied upon to prove the truth of its contents." *Vanderbilt Income & Growth Assocs., L.L.C. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996) (citing *In re Santa Fe. Pac. Corp. S'holder Litig.*, 669 A.2d 59, 69-70 (Del. 1995)); *Abbey v. E.W. Scripps Co.,* 1995 WL 478957, at *1, n.1 (Del. Ch. Aug. 9, 1995) ("In deciding a motion to dismiss under Rule 12(b)(6), the court may judiciously rely on proxy statements not to resolve disputed facts but at least to establish what was disclosed to shareholders.").

It is therefore proper for the Court to consider the parties' proxy solicitation materials, as well as certain other documents not relied upon for the truth of the matters asserted, in analyzing the sufficiency of the Complaint to withstand a motion to dismiss. *See Santa Fe Pac. Corp.*, 669 A.2d at 69 (holding that it was proper for court to consult proxy to analyze disclosure claim "because the operative facts relating to such claim *perforce* depend upon the language of the Joint Proxy") (emphasis in the original). As shown below, Red Oak has failed to set forth in its Complaint allegations that can withstand the Defendants' motion and, therefore, the Complaint should be dismissed.

II. THE COMPLAINT SHOULD BE DISMISSED IN ITS ENTIRETY

Red Oak brings this action pursuant to Section 225 of the Delaware General Corporation Law. Section 225 provides that "[u]pon application of any stockholder ..., the Court of Chancery may hear and determine the result of any vote of stockholders." 8 *Del. C.* § 225(b). Section 225

[2] This fact is significant here, where Red Oak does not challenge the accuracy of *any* of Digirad's disclosures in its proxy materials, annual reports or quarterly reports.

proceedings "are only appropriate to resolve narrow issues bearing directly on the validity of the questioned election or the integrity of the voting process." *Infinity Investors Ltd. v. Takefman*, C.A. No. 17347, 2000 WL 130622, at *4 (Del. Ch. Jan. 28, 2000); *accord Arbitrium (Cayman Islands) Handels AG v. Johnston*, 1997 WL 589030, at *3 (Del. Ch. Sept. 17, 1997) ("The scope of a proceeding under 8 *Del. C.* § 225 is narrow."). "[W]hether an issue is properly litigable in a Section 225 action turns, ... upon a determination of whether it is necessary to decide [the issue] in order to determine the validity of the election ...." *Kahn Bros. & Co. Profit Sharing Plan & Trust v. Fischback*, 1988 WL 122517 (Del. Ch. Nov. 15, 1988).

Red Oak is attempting to shoehorn what are essentially federal securities law and breach of fiduciary duty of disclosure claims into Section 225's limited remedy for voting irregularities. The fundamental flaws in its attempt to do so are (a) the complete absence of any cognizable voting irregularity and (b) the complete lack of any alleged facts suggesting ***how*** the vote would be any different had the disclosures Red Oak seeks been made. Red Oak's entire theory relies upon the wholly conclusory and unsupported allegation that the "Management Slate would not have been elected" but for the individual defendants' alleged misrepresentations, omissions and improper conduct. Compl. ¶ 46. However, Red Oak fails to allege a single fact—even on information and belief—to support this naked conclusion. In fact, the only example in Red Oak's Complaint of a stockholder who allegedly received any improper information from Digirad or its Proxy Solicitor—Somerset—decided to vote *for* Red Oak and *against* the Management Slate. This Court has previously dismissed a Section 225 claim for an analogous failure to "assert any flaws that would call the . . . election into question." *A.R. DeMarco Enters., Inc. v. Ocean Spray Cranberries, Inc.*, 2002 WL 31820970, at *7 (Del. Ch. Dec. 4,

2002). As in *Ocean Spray Cranberries*, none of Red Oak's theories state a claim that would entitle it to relief under Section 225 and its Complaint should be dismissed.

III. RED OAK'S DISCLOSURE CLAIMS ARE WHOLLY WITHOUT MERIT AND MUST BE DISMISSED

To be actionable in the Section 225 context, "false or misleading statements must be material to those receiving the statements, which means that there must be a 'substantial likelihood that the disclosure of [the additional information] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available' to the shareholders." *Hewlett v. Hewlett-Packard, Inc.*, C.A. No. 19513-NC, 2002 WL 549137, at *9 (Del. Ch. Apr. 8, 2002). It is proper "to determine the total mix of information available to shareholders at the motion to dismiss stage before the factual record has been developed more fully." *Id.* at *10. Red Oak's Complaint fails to state a claim that the purportedly inadequate or inaccurate disclosures by the Digirad Parties in connection with the Election were material to Digirad's stockholders. In fact, Red Oak makes no claim of any error in any of the extensive written materials publicly filed and disseminated to stockholders in a months-long proxy contest. Nor does Red Oak challenge the pro-management recommendations of two independent advisory firms, ISS and Glass Lewis.

Instead, Red Oak alleges that the Election should be invalidated for three reasons: (1) Digirad purportedly advised certain stockholders that the Management Slate would win the Election based on preliminary vote tallies compiled by Broadridge, which is not a violation of any law; (2) Digirad allegedly caused its broker—Raymond James—to vote treasury shares in favor of the Management Slate, even though this disclosure never reached stockholders; and (3) Digirad delayed filing its Form 10-Q for the first quarter of 2013 until May 6, the day after the Election, to avoid disclosing negative financial results, except for the fact that the negative one-

time first quarter charges had already been disclosed to stockholders. Compl. ¶¶ 25–44. Equally importantly, however, Red Oak fails to allege how the results of the Election would have been any different with different disclosures. With its reliance on conclusory allegations alone, Red Oak fails to state a Section 225 claim, and the Complaint should be dismissed.

A. Red Oak's Disclosure Claims Seek Information That Would Not Alter the Total Mix of Information Provided to Digirad Stockholders in the Election

It is well established that a plaintiff bringing a disclosure claim in Delaware must allege that the additional information would "have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Rosenblatt v. Getty Oil Cos.*, 493 A.2d 929, 944 (Del. 1985) (quoting *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). *See also State of Wis. Inv. Board v. Peerless Sys. Corp.*, 2000 WL 1805376, at *17 (Del. Ch. Dec. 4, 2000) ("*Peerless*").

In looking at the "total mix" of information available to a company's stockholders, this Court has routinely considered the information made known by all parties to a proxy contest. In *Peerless*, for example, this Court granted summary judgment in favor of defendant on a similar disclosure claim. Peerless involved a challenge to the adjournment of an annual stockholders meeting on a proposal to add shares to the Peerless stock option plan. At the time of the meeting the proposal would have been defeated, but passed by a slim margin when the meeting was reconvened thirty days later. Plaintiff, State of Wisconsin Investment Board ("SWIB"), brought suit against Peerless alleging claims for breach of fiduciary duty and false and misleading statements on the ground that the company had failed to adequately disclose to its stockholders all material information relating to the adjournment. *Id.* at *1. In granting summary judgment for Peerless on the disclosure claim, this Court found persuasive that, in a letter to Peerless

stockholders, SWIB had alerted stockholders to the very information it complained Peerless had wrongfully failed to disclose:

> Given these disclosures by SWIB to all the Peerless shareholders, even if the defendants had made the Adjournment Period Disclosures, these disclosures would not have significantly altered the total mix of information available to the Peerless shareholders.

Id., at *18.

The Court of Chancery reached a similar conclusion in *In re Seminole Oil Gas Corp.,* 150 A.2d 20 (Del. Ch. 1959). *Seminole Oil* involved a hard-fought proxy battle over the election of directors and the issuance of shares by the corporation to a contract partner. Just as in this case, shareholders in *Seminole Oil* were bombarded with information about the opponents' respective positions. *See id.* at 23 (the parties "made charges against and answers to one another which were spelled out at length" to the shareholders). Plaintiff sued over allegedly misleading statements in the company's proxy statement. In rejecting plaintiff's request for a revote based on the alleged disclosure violations on the part of defendant, Chancellor Seitz held:

> It is my view that the court may exercise discretion in determining whether even material misrepresentations made during a proxy solicitation campaign warrant the ordering of a new election. Where, as here, the conflicting claims and answers were presented to the stockholders at length, I think that is a fact which militates against the ordering of a complete resolicitation. This is particularly true since the alleged misrepresentations were pointed out to the solicited stockholders.

Id. at 23–24.

B. The Allegedly Improper or Inadequate Disclosures Were Neither Material nor Misleading

Red Oak argues that Digirad's disclosures were not "full or fair" because Digirad and its agents "were improperly reporting the outcome of an election *and* including in their vote tally treasury shares that they knew the company was not entitled to vote . . . ." Mot. to Expedite ¶ 8.

This argument is based on demonstrably false premises and fails to demonstrate that the disclosures significantly altered the "total mix" of information available to Digirad's stockholders.

1. A Prediction as to the Outcome of the Election is Not a Violation of Any Law

Red Oak's Complaint belies the assertion that Digirad or its management was purporting to "report the outcome" of the Election to any stockholders. The only specific allegation in the Complaint along these lines is that Digirad "***predicted*** the outcome" of the Election to a *single stockholder*—Somerset—that nonetheless *voted for the Red Oak slate of director nominees*. Compl. ¶¶ 36–38 (emphasis added). As to Somerset, Digirad's predictions plainly were not material because Somerset voted for Red Oak's slate. *Id.* ¶ 35. Red Oak attempts to circumvent that gaping hole in the theory of its case by making the vague and noncommittal allegation that Digirad's supposed prediction of the outcome of the Election "***may*** violate [Exchange Act] Section 14(a) and Rule 14a-9." *Id.* ¶ 19 (emphasis added). However, "predictions regarding the results of a solicitation are not materially misleading or otherwise actionable under rule 14a-9." *Mgmt. Assistance Inc. v. Edelman*, 584 F. Supp. 1016, 1020 (S.D.N.Y. 1984) ("*MAI*"); *see also Jewelcor Inc. v. Pearlman*, 397 F. Supp. 221, 242 (S.D.N.Y. 1975) (holding that oral solicitation inaccurately indicating that a particular proposal had been defeated when no vote had actually been taken was "insufficient to demonstrate a violation of § 14(a)").

As the court in *Jewelcor* stated, "it has been held in a similar situation that 'there is nothing prohibitory of a reporting in proxy material of the existing fact or status of the solicitation.'" 397 F. Supp. at 259 (citing *Layritz v. Condec Corp.* (S.D. Ohio 1967) (Slip Op. at 33)). *See also Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 449 F. Supp. 951, 960 (S.D.N.Y. 1978) ("Berner's predictions of victory did not run afoul of Rule 14a-9. While the rule might be

violated by a claim of sure victory calculated to induce wavering shareholders to jump upon an apparently victory-bound bandwagon, we have no such conduct here. Berner's prediction of victory cannot be regarded as anything but a claim of confidence in his own position. We doubt that such an expectable exclamation of confidence would divert a reasonable shareholder from the task of coolly determining how best to vote his shares in light of the opposing platforms."), *aff'd in part, rev'd in part*, 584 F.2d 1195 (2d Cir. 1978).[3] Here, a reasonable stockholder would understand, just as Somerset did, that predictions regarding election results are simply predictions and such forecasts would not cause a stockholder to vote against his better judgment.

Red Oak's allegations here are substantively indistinguishable from *MAI* and *Jewelcor* and easily distinguished from *Gould v. Am. Haw. S.S. Co.*, 331 F. Supp. 981, 990-92 (D. Del. 1971), in which the court held that claims that 64 percent of stockholders were contractually

[3] The Digirad Parties expect that Red Oak will respond with reference to language from certain Rule 14a-9 decisions like *Kennecott Copper* to the effect that "claims of sure victory" are "potential violations of the rule," and argue that its allegations regarding Digirad management's predictions of victory are such "potential[ly]" actionable "claims of sure victory." *See, e.g.*, *MAI*, 584 F. Supp. at 1020; *Kennecott Copper*, 449 F. Supp. at 960. An examination of the relevant decisions, however, reveals that the courts have not equated strong predictions with claims of sure victory. *MAI* is instructive. The alleged 14a-9 violation in that case was management's representation "that Edelman would be able to obtain proxies from only 28 percent of MAI shareholders, that MAI management would win the proxy contest and that shareholders should vote the management proxy." *Id.* at 1019. The *MAI* court distinguished the situation present in that case from *Gould v. Am. Haw. S.S. Co.*, 331 F. Supp. 981, 990–92 (D. Del. 1971), in which the court held that a claim that 64 percent of stockholders were contractually committed to vote in defendants' favor, when there was no such contractual commitment, violated Rule 14a-9. The claim that 64 percent of the vote was locked up effectively made the vote in *Gould* a foregone conclusion, and *that* is the type of "claim of sure victory" referenced in the federal decisions. As the *MAI* court held, the statement at issue in that case claimed only "that the management group ***will*** win, but does not suggest that management ***must*** win. Thus, it is not a claim regarding the results of a solicitation and is not proscribed by rule 14a–9." 584 F. Supp. at 1020 (emphasis added). Here, Red Oak alleges only that Digirad management communicated that preliminary voting results indicated that the Management Slate would win, not that it necessarily had to win. There was no pro-management voting agreement or other lockup in effect during the Election and the preliminary votes could be changed at any time. Red Oak thus fails to state a claim, even assuming that a "potential" Rule 14a-9 violation may be bootstrapped into a disclosure violation adequate to support a Section 225 action.

committed to vote in defendants' favor, when there was no such contractual commitment, violated Rule 14a-9. Here, Red Oak does not allege Digirad did anything other than *truthfully* disclose to Somerset "the range of votes already cast" and then made "predictions" based on that "range of votes." Compl. ¶¶ 36–37.

Moreover, Digirad stockholders—including Somerset—were well aware that the Election was not over as of April 26, 2013 and that the votes already cast were revocable. *See* Compl. ¶ 18 (interim Broadridge tabulations "are preliminary in nature and subject to change until voting is complete"). Digirad disclosed throughout the proxy process, including on April 26, 2013, that "only your last dated proxy will count" and prior votes could be revoked. Exhibit M at 8. Red Oak also stressed that a vote for management could be changed, advising shareholders "if you have already turned in a WHITE proxy card, you have every right to change your vote by voting a later-dated BLUE proxy card. Just please do so today." Exhibit J at 5. Red Oak itself did not believe that continuing to contest the election of the Management Slate was a "futile gesture" as it continued to work to ensure the victory of the Red Oak slate. *See Edelman v. Salomon*, 559 F. Supp. 1178, 1186 (D. Del. 1983).

Significantly, Red Oak has been unable to identify any instance in which a simple prediction of the results of a proxy contest is a violation of Delaware or federal law. The only cases cited by Red Oak, *Gould* and *Edelman v. Salomon*, deal with allegations of *false* statements about the status of the vote. In *Gould*, the false statement was that stockholders holding more than 60% of the vote were parties to an agreement to vote together. 331 F. Supp. at 990–92. In *Salomon*, the false statement was management only had the power to vote 2.8 percent of the shares of the company's stock where management actually controlled "a block of stock many times that size." 559 F. Supp. at 1184.

Finally, there is no allegation in the Complaint that any specific stockholder (or any reasonable stockholder) refused to vote for the Red Oak slate or abstained from voting entirely because of any predicted interim results. Red Oak offers no coherent or plausible explanation as to how the alleged statements affected sophisticated institutional shareholders, many of whom presumably ignored them and voted for Red Oak. *See Kennecott Copper*, 449 F. Supp. at 960. As the proxy materials made clear, each vote was revocable and subject to change at any minute—and thus unpredictable. The sole theory articulated in the Complaint—a supposed desire to stay in the good graces of management—does not hold water. As a matter of law, Digirad management could not make selective disclosure of material information. If siding with the winner was a priority, why did so many vote with Red Oak? Finally, who are the shareholders who were so influenced? Red Oak engaged in active solicitation and claims the identity of shareholders is readily obtained, but it is silent on this critical point.

2. The Complaint Does Not Allege There Was Any Disclosure Regarding Treasury Shares; Therefore, There Can Be No Disclosure Violation

To the extent Red Oak attempts to base its claim on any supposed inaccuracy in the preliminary vote reports due to Raymond James' mistaken vote of treasury shares in favor of the Management Slate, the alleged error is immaterial. Red Oak concedes that the mistaken vote appeared on a Broadridge tally that was never made public. *See* Compl. ¶ 18 ("Broadridge reports are not public documents, but are provided only to the election contestants"); *see also id.* at ¶ 28 (that Raymond James incorrectly voted treasury shares was "[u]nknown to the public at the time"). Whether Raymond James was mistaken in voting treasury shares for the Management Slate (as Defendants submit is the case), or was intentional (as Red Oak alleges), Red Oak's admission that the information was never communicated to stockholders confirms that the mistaken voting of treasury shares was immaterial.

More importantly, Red Oak alleges that the treasury shares were *excluded* from the final vote by the inspector of elections. *See* Compl. ¶ 31 (inspector "excluded the treasury shares before certifying the results of the election"). Nor was Digirad required to report the mistaken over-vote by Raymond James. *See Stroud v. Grace*, 606 A.2d 75, 84 n.1 (Del. 1992) ("to comport with its fiduciary duty to disclose all relevant material facts, a board is not required to engage in 'self-flagellation' and draw legal conclusions implicating itself in a breach of fiduciary duty from surrounding facts and circumstances").

In any event, it is plain from Red Oak's Complaint that its claims regarding the significance of the preliminary vote totals are makeweight. Red Oak alleges that, for strategic reasons, Red Oak "intentionally issued its definitive proxy statement after Digirad issued its own so that Red Oak's final proxy statement would be able to comment on the accuracy and content of Digirad's proxy statement." *Id.* ¶ 17. As Red Oak admits, the "natural consequence" of that strategic decision is that "supporters of the Management Slate were able to start returning their proxy instructions approximately one week before supporters of the Red Oak Nominees . . . ." *Id.* Thus, "it was inescapable that *initial returns* of proxy instructions would necessarily be weighted toward" the Management Slate. *Id.* (emphasis in original). Precisely because of this "inescapable" fact, any disclosure of the initial returns was not material and could not have altered the total mix of information available to stockholders. Stockholders were well aware of the timing of the competing slates' proxy solicitations and therefore knew to discount the impact of any initial returns, even leaving aside the equally "inescapable" fact that votes could be changed until the conclusion of the Election.

3. There Can Be No Disclosure Claim Based on a Purported Desire for Illegal or Immaterial Inside Information

Red Oak's novel theory of why the preliminary vote tallies or predictions of the outcome of the Election were material to Digirad stockholders must be rejected as contrary to law. According to the Complaint, predictions that the Management Slate would prevail in the Election were material because Digirad is a "microcap" company and its stockholders rely on management to provide "information" directly to the stockholders because analysts and market researchers do not follow Digirad. *See id.* ¶¶ 21–24. Thus, according to Red Oak, because of Digirad's "microcap" size, stockholders were acutely cognizant of the need to remain in management's good graces. *See id.* At the same time Red Oak makes these allegations, it explains why they are legally irrelevant because Red Oak concedes that the allegations "have little to do with the merits of the differing slates themselves." Compl. ¶ 22. The "total mix" of information available to stockholders in connection with an annual meeting for election of directors cannot reasonably include information *unrelated* to the Election itself, but which is instead premised on access to either illegal or immaterial inside information from management.

Regardless of its size, Digirad is a public company and subject to SEC reporting requirements related to material information. In particular, Regulation FD requires that companies publicly disclose any material information disclosed to any stockholder, broker-dealer, investment advisor, or investment analyst, among others. *See* 17 C.F.R. § 243.100. Apparently, Red Oak believes that Digirad stockholders would fear being on the "wrong" side of the Election because doing so would cut off potential access to non-public information. Of course, Digirad does not illegally disclose inside information to particular stockholders, and the alleged concern of being cut off from illegal inside information cannot be a legitimate motivation for any Digirad stockholder during the Election. Red Oak's bizarre allegation cannot state a

claim that stockholders were deprived from illegal access to inside information. If the information in question is material, it must be disclosed to all stockholders under Regulation FD. If the information is immaterial, then it is impossible to conceive of why a stockholder would change its vote in a hotly contested director election to preserve the ability to obtain such information. In either event, Red Oak's theory of why access to a "microcap" company's inside information would influence proxy voting makes no sense and cannot support Red Oak's claims. Even if Red Oak can somehow resuscitate the logic behind its "microcap" access theory, Red Oak cannot avoid the fact that it has failed to allege in non-conclusory fashion that *any* stockholder changed its vote (or withheld its vote) based on its desire for access to information. *See In re Delta Pine & Land Co. S'holders Litig.*, 2000 WL 875421, at *7 (Del. Ch. June 21, 2000) ("I need not conclude that plaintiffs' argument is illogical to conclude that it is imaginary.") (granting motion to dismiss).

Red Oak's claim fails for yet another reason. Red Oak fails to allege how management would even know which stockholders voted against a slate in order to "blacklist" that stockholder from inside information. Nearly all of Digirad's stock is held in "street name," and the Broadridge omnibus proxy does not identify the names of beneficial owners of stock. Therefore, Digirad cannot "punish" a stockholder that voted against the Management Slate because Digirad *does not know* how all individual beneficial owners voted.

4. Digirad's 10-Q Was Filed Early and Simply Repeated "Negative" Information That Had Already Been Disclosed

In addition to the supposed Election result-related disclosures, Red Oak's Complaint alleges that Digirad and its management improperly failed to disclose Digirad's quarterly report on Form 10-Q prior to the Election. *See* Compl. ¶¶ 41–43. Not only was the 10-Q timely filed

under federal law, the "negative" information that Red Oak claims was hidden had already been disclosed on multiple occasions.

Pursuant to SEC regulations, Digirad has 45 days after the close of each fiscal quarter (other than one that concludes a fiscal year) to file its quarterly report on Form 10-Q with the SEC.[4] Digirad's first fiscal quarter for 2013 closed on March 31, 2013, meaning that Digirad had until May 15, 2013 to file its Form 10-Q. If anything, Digirad filed its 10-Q early, not late. There can be no disclosure violation for complying with federal reporting requirements. Even more fundamentally, Digirad had no duty to file its 10-Q early and, under SEC regulations, was only required to provide its *annual report* (*i.e.*, Form 10-K) to stockholders in advance of the annual meeting. 17 C.F.R. § 240.14a-3(b). *See* Exhibit S at 22. This requirement is logical, as the annual meeting election is a referendum on the directors' performance during the previous year. Red Oak's allegation that the timing of Digirad's 10-Q had to be accelerated to occur in advance of the annual meeting has no basis in law or equity.

Red Oak claims that the timing of Digirad's 10-Q served to withhold from stockholders financial information showing that Digirad's net losses increased on a year-over-year basis versus the first quarter of 2012 and that the Company suffered a "severe decline . . . in financial performance." Compl. ¶¶41–42. Red Oak, however, entirely omits the facts that a significant plank in the platform of the Management Slate was the restructuring effort put in place on February 28, 2013 and Digirad's disclosure that there would be expenses associated with that restructuring. *See, e.g.*, Digirad Corp. Form 8-K (Feb. 28, 2013) (attached as Exhibit T); *see also* Exhibit M at 5 (noting Glass Lewis' view that "giving board control to the Dissident Nominees at this time may result in costly delays in terms of implementing the Company's restructuring

[4] Digirad is a "non-accelerated filer" under SEC regulations. *See* 17 C.F.R. § 240.12b-2.

plan."). The benefits of that restructuring plan would not have been seen in the first quarter of 2013, and in fact virtually all of the decrease in financial performance between 1Q 2012 and 1Q 2013 is the up-front cost of Digirad's restructuring effort. *See* Exhibit A at 5 (showing an increase in losses of $1,127,000 over 1Q 2012, of which $1,004,000 were restructuring charges). Page 8 of Digirad's first quarter 2013 10-Q, at Note 5, further explains that the restructuring charge includes costs related to a reduction in force and that total restructuring costs would be approximately $1.8 to $2.3 million in 2013. *Id*.

This one-time charge was no news to stockholders. Digirad's 10-K, filed on March 13, 2013, explained that, as part of the restructuring plan, the Company would incur charges in the first quarter, including charges relating to a reduction in force. Exhibit S at 18. The 10-K also explained in the notes to financial statements that, in connection with the restructuring plan announced on February 28, 2013, Digirad estimated that it "will incur approximately $1.8 million to $2.3 million (unaudited) in restructuring charges during fiscal year 2013," including approximately $1.5 million of employee related costs. *Id.* at 47, Note 11.

Red Oak was fully aware of the disclosure of these anticipated charges and commented on them in its proxy materials. In Red Oak's April 25, 2013 Form 14A filing (Exhibit K at 2), Red Oak complained to stockholders that in Digirad's restructuring plan the "numbers don't add up." *Id.* Thus, Red Oak, along with all other Digirad stockholders, already knew about the estimated charges that eventually appeared in the May 6, 2013 10-Q well before it was filed. More importantly, Digirad never concealed any alleged "poor financial performance" from its stockholders, Compl. ¶ 43, but instead properly and timely disclosed to stockholders the anticipated costs of its restructuring plan.

The choice at the Election was not driven by short-term financial performance, but rather whether management should be given the opportunity to pursue its long-term strategic plan or whether the Red Oak slate offered a better option for stockholders. The 10-Q reflecting financial results prior to the implementation of management's restructuring effort was therefore immaterial, and the salient information from the 10-Q was disclosed to Digirad stockholders in advance of the annual meeting.

IV. THE COMPLAINT SHOULD BE DISMISSED BECAUSE THE ALLEGED MISCONDUCT WAS NOT OUTCOME DETERMINATIVE

In a Section 225 action seeking a re-vote based on alleged disclosure violations, the question "is not simply whether there was a disclosure violation, ***but whether any such violation warrants setting aside the result***." *Zaucha v. Brody*, C.A. No. 15638-NC, 1997 WL 305841 (Del. Ch. June 3, 1997) (emphasis added), *aff'd,* 697 A.2d 749 (Del. 1997) (refusing to set aside solicitations for election of directors based on alleged disclosure violations).[5] In other words, to allege an actionable Section 225 claim, Red Oak must also allege that the supposedly inadequate or improper disclosures related to the Election were outcome determinative. *See, e.g.*, *Kurz v. Holbrook*, 989 A.2d 140, 177–78 (Del. Ch. 2010), *aff'd in part and rev'd in part sub nom. Crown EMAK Partners, LLC v. Kurz,* 992 A.2d 377 (Del. 2010) (holding that, in a Section 225 proceeding, "vote buying should merit review only if it is disenfranchising, in the sense of actually affecting the outcome of the vote"); *Ocean Spray Cranberries*, 2002 WL 31820970, at *7 (dismissing Section 225 claim where, even if the plaintiff's allegations regarding a flawed vote tabulation and misrepresentations/omissions in connection with an election were true, it was

[5] Although *Zaucha* and *Seminole* "both reached their conclusions about the total mix of information after trials" it is "not necessarily impossible to determine the total mix of information available to shareholders at the motion to dismiss stage before the factual record has been developed more fully." *Hewlett*, 2002 WL 549137, at *10. As stated above, this Court has previously dismissed Section 225 claims where the alleged election improprieties were not outcome determinative. *See Ocean Spray Cranberries*, 2002 WL 31820970, at *7.

not alleged that the opposition slate would have won the election); *cf. Hewlett*, 2002 WL 549137, at *10 n.24 (denying motion to dismiss Section 225 claim because, among other things, allegedly concealed information was important to ISS, which was "effectively able to dictate" the vote of a block of shares that "was likely outcome determinative"). Where, as here, the Court can determine as a matter of law that the "total mix" of information would not be affected by the alleged additional disclosures, the results of the Election would be no different and the Complaint should be dismissed.

Red Oak's sole allegation regarding the effect of the Digirad Parties' supposed acts or omissions on the outcome of the Election is: "But for the individual defendants' misrepresentations, omissions and improper conduct—all in violation of the [*sic*] fiduciary duties—the Management Slate would not have been elected." Compl. ¶ 46. There is not a single factual allegation in the Complaint supporting this naked conclusion. Red Oak completely fails to identify *any* stockholder, either by name or classification, who would have voted differently if the disclosures were as Red Oak wished. Red Oak's omission is fatal. It well knows the difference in the vote outcome and claims to know how others voted. It should be able to allege specific shareholders whose votes were purportedly lost, and thereby altered the outcome. Its failure to do so can only be explained by the absence of any genuine link between the alleged statements and how Digirad's institutional shareholders voted.

Red Oak cannot simply proffer a conclusory allegation that results would be different, and then go forward in discovery to find stockholders who now say that they might have voted differently to change the results of the election. Absent a non-conclusory allegation that Digirad's alleged misconduct affected the outcome of the election, the Complaint should be dismissed. *See, e.g.*, *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 141 (Del. 1997)

(holding that, to state a disclosure claim, "a pleader must allege that facts are missing from the proxy statement, identify those facts, state why they meet the materiality standard and how the omission caused injury"); *In re BJ's Wholesale Club, Inc. S'holders Litig.*, 2013 WL 396202, at *13, *15 (Del. Ch. Jan. 31, 2013) (dismissing complaint where, among other things, "[e]xcept for conclusory allegations" the complaint failed to plead that any omission from a proxy statement resulted from disloyalty); *In re Alloy, Inc.*, 2011 WL 4863716, at *11 (Del. Ch. Oct. 13, 2011) (dismissing complaint where "Plaintiffs provide[d] nothing more than conclusory allegations that the presence of a contingent fee structure must have influenced" defendant's financial advisor); *In re NYMEX S'holder Litig.*, 2009 WL 3206051, at *12 (Del. Ch. Sept. 30, 2009) (dismissing complaint and holding that conclusory allegations alone do not state a disclosure claim).

As discussed above, the only stockholder that the Complaint alleges was provided with management's "prediction" of the outcome of the Election voted for Red Oak's slate, not the Management Slate. *Id.* ¶ 35. The Complaint does not allege that any stockholder voted differently than it otherwise would have as a result of hearing any "prediction" of the outcome of the Election, let alone that there is a sufficient swing bloc of votes that did so such that the Red Oak slate would have prevailed in the absence of Digirad's supposed misconduct.[6]

In fact, the only alleged basis for Red Oak's conclusion that the outcome would have been different in the absence of Digirad's Election predictions is Red Oak's claim that Digirad stockholders were influenced by their desire for inside illegal or immaterial information. *See id.* ¶¶ 21–24. As discussed above, that assertion is illogical and does nothing to support Red Oak's

[6] Even the mistaken vote of treasury shares by Raymond James was not outcome determinative; those shares were not counted by the inspector of elections in either the preliminary or final Election vote, *see* Compl. ¶ 31.

ipse dixit regarding the outcome of the Election. Again, the only stockholder identified by Red Oak who received the alleged false prediction voted against management. *See id.* ¶¶ 35–37. Further underscoring the fact that Digirad's alleged disclosures were not outcome-determinative is the fact that Red Oak was both aware of the treasury share non-issue and was providing its own contrary predictions regarding the outcome of the Election to Digirad stockholders. *See id.* ¶¶ 27, 40. Even assuming that one side's disclosures are inadequate, "the court will consider information provided by the opposing party in determining whether to set a contested solicitation aside." *Zaucha*, 1997 WL 305841, at *5 (citation omitted). Red Oak's claims, which are grounded in nothing more than conclusory allegations, should be dismissed.

CONCLUSION

Red Oak has failed to state a Section 225 claim—the disclosures it challenges were not material and are not alleged to have been outcome determinative. For the reasons set forth above, the Digirad Parties respectfully request that Red Oak's Complaint be dismissed with prejudice.

/s/ John M. Seaman
John M. Seaman (#3868)
J. Peter Shindel, Jr. (#5825)
ABRAMS & BAYLISS LLP
20 Montchanin Road, Suite 200
Wilmington, DE 19807
(302) 778-1000

Counsel for Defendants Digirad Corporation, Jeffrey E. Eberwein, Charles M. Gillman, John M. Climaco, James B. Hawkins, and John W. Sayward

OF COUNSEL:

Thomas J. Fleming, Esq.
Jennifer L. Heil, Esq.
OLSHAN FROME WOLOSKY LLP
Park Avenue Tower
65 East 55th Street
New York, NY 10022

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