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August 14, 2013

The Honorable John W. Noble
Court of Chancery - Judicial Chambers
417 South State Street
Dover, DE 19901

VIA FILE & SERVEXPRESS
Redacted Public Inspection Version
Filed August 16, 2013

RE: Red Oak Fund LP v. Digirad Corporation, et al., C.A. No. 8559-VCN

Dear Vice Chancellor Noble:

This is the Post-Trial Memorandum of Plaintiff Red Oak Fund, L.P. ("Red Oak"). The evidence at trial and the deposition lodged with the Court prove that Defendants denied Digirad's shareholders a fair election. Defendants were so devoted to winning that they unfairly manipulated the election in several ways and interfered with the corporate franchise.

1. **Digirad created the "unheard of" circumstance that caused the Broadridge reports to be materially misleading and then concealed that fact.**

The evidence conclusively proved the following: (1) Digirad maintained its treasury shares *not* with its transfer agent (as is customary), but in a retail brokerage account in street name with Raymond James & Co., the brokerage firm that managed the Company's share buyback program; (2) an employee of Digirad apparently inadvertently voted approximately 1.2 million shares of Digirad treasury shares in favor of the Management Slate; (3) the result was what Digirad's proxy solicitor John Grau called the "unheard of" and "absurd" situation of treasury shares being held in street name and voted in a proxy contest (Trial Transcript ("Tr.") 186, 162); (4) each side's proxy solicitors actively, but unsuccessfully, tried to identify the beneficial owner(s) of the 1.2 million shares voted by Raymond James; (5) with the help of Digirad's CEO and CFO, Grau pieced together the buyback program, the treasury shares held by

Raymond James and the large vote cast by Raymond James to conclude "almost beyond my belief" (Tr. 204) that the treasury shares had been voted and the Broadridge reports were "inaccurate" (Tr. 189) by about 1.2 million votes, or 5-6% of the Company's total issued and outstanding shares; (6) Grau "was comfortable enough to relay that" conclusion to Digirad management on April 27 (Tr. 188), six days before the annual meeting; (7) for Grau's and Digirad's *internal* purposes, they thereafter adjusted the inaccurate Broadridge reports to account for the error, but; (8) Digirad never informed Broadridge that its reports were misleading, never informed Red Oak that the Broadridge reports were misleading and never re-voted the treasury shares to "withhold" or "abstain" so as to cure the misleading Broadridge reports sent to Red Oak. Digirad informed the Inspector of Elections of the error in late April (Tr. 269, JX159), but still never informed Broadridge or Red Oak (Tr. 271).

Red Oak's proxy solicitor (Peter Casey), who did not have access to Digirad's CEO and CFO, realized on his own that treasury shares *existed*, but Grau pointedly refused to tell him *where* those shares were held, much less that those shares had been *voted*. Digirad's attempt to keep Casey in the dark was successful. Knowing only that treasury shares *existed* was not nearly enough information for Casey to reach the extraordinary conclusion that such shares were held at Raymond James and had been voted. Digirad could have readily cured the misleading Broadridge reports by re-voting the Raymond James shares as "withhold" or "abstain." They refused to do so.

Digirad's deception "was a game changer" (Tr. 50). Grau and Eberwein had already discussed in a related scenario that it is "a good tactic . . . to deflate the dissident" (JX100) and that is what happened. Even though Red Oak's David Sandberg felt optimistic that Dimensional Fund might change its vote of approximately 5% to the Red Oak slate, that switch would only reduce Red Oak's apparent deficit of about 22% to 10-12%. Red Oak did not give up on the

election during that last week (Tr. 33), but nor was it "overly active" (Tr. 33). Overcoming an apparent best-case scenario of a 12% deficit was "an unrealistic hurdle" (Tr. 51).

If Sandberg had known what Digirad knew and concealed, however, "a whole new slew of options would become available" (Tr. 51). For example, he could have again contacted Perkins Capital, which had already changed its vote *twice* and thus appeared to be on the fence (Tr. 53). He could have contacted Ensign Peak directly, instead of relying on an intermediary to ensure that Ensign Peak followed through to vote for the Red Oak slate. Red Oak did not "chase that down" (Tr. 54), because the deficit appeared too large with or without Ensign Peak. (In fact, apparently through an administrative error, Ensign Peak did not vote for Red Oak's slate despite an instruction to do so. Thus Ensign Peak was a prime opportunity for Red Oak had it known it would be worth the effort to "chase that down".)

Digirad caused its treasury shares to be held in street name, and Digirad caused those shares to be voted. Both oddities may have been innocent, but nevertheless Digirad is responsible for both. Digirad's subsequent concealment that those facts caused the Broadridge reports to be materially misleading, however, was neither accidental nor innocent and should not be rewarded.

2. Defendants compounded their concealment by spreading deceptive information about the preliminary voting results.

Defendants disclaim informing third parties of the non-public Broadridge voting reports, but the deposition testimony of non-party witnesses proves the contrary. Tyson Bauer is an objective independent broker who trades in Digirad stock and currently manages Digirad's share repurchase program. Bauer testified that Grau called him on three separate occasions and revealed to him detailed non-public information on the preliminary vote tallies. JX151; Bauer Dep. 36-37. Although Grau later claimed his initial disclosures to Bauer were the result of

confusion on his part, Grau called Bauer *twice thereafter* and continued reporting the non-public preliminary Broadridge tallies. Bauer Dep. 43. Grau told Bauer that as for "the incumbents, there was no way they were going to lose." Bauer Dep. 49-50. Bauer did not ask for the repeated updates from Grau and felt there was "no purpose for [Grau] to call me with those numbers unless he felt that I was going to convey those" to the large shareholders Bauer knew. Bauer Dep. 45-47.

Defendant Jeffrey Eberwein also actively tried to influence voters by discussing the Broadridge reports. Eberwein told Bauer that management was going to win without the votes of the first or third largest shareholders. Bauer Dep. 55-56; JX125 ("Jeff actually told me they don't need THB or Somerset . . ."). Eberwein told Taylor that Eberwein was "getting information on a daily basis" about the vote (Taylor Dep. 215; Eberwein Dep. 135) and that the election was a "landslide." Taylor Dep. 72-73.

These disclosures are improper because they attempt to discourage voting by those who may favor the dissident slate. They especially inhibit a fair election in microcap companies like Digirad. Digirad receives no independent published research or analysis whatsoever. Tr. 43-44. An investor's only source of information beyond public filings is company personnel, none of whom have any obligation to talk to any particular investor. Despite Digirad's pre-trial claims to the contrary, the evidence is overwhelming that Digirad knew how large shareholders voted. Thus the risk of bucking the "bandwagon" by voting against management is tangible and real. Taylor likewise testified to the risk of voting against management of a microcap company. Taylor Dep. 202, 232-33 ("the biggest fear is . . . losing the ability to ask questions on conference calls. That . . . is probably one of the most damaging things a management can do to an investor like myself"). Finally, Tyson Bauer has heard other investors express the exact same fear of being "blackballed" by management. Bauer Dep. 88-90.

3. Defendants concealed highly negative first quarter performance until immediately after the annual meeting.

Defendants knew no later than April 17, 2013 that Digirad's first quarter results would show steep declines in two key metrics - revenues and gross profits. The final twice-delayed earnings release of May 6 (JX188) reflected the exact same declines in revenues and gross profits that Digirad knew about on or before April 25 (JX170), April 17 (JX166; JX165), and April 10 (JX162). These came after claims during the proxy contest that "noted the company's recent improvements." Defendants' Pre-Trial Brief at 7.

Defendants' various excuses for twice delaying the negative earnings release (staff illness, *etc.*) are unpersuasive. None has any contemporaneous documentary corroboration. More importantly, none can overcome the fact that Digirad had accurate information regarding its revenues and profits weeks before the annual meeting. Digirad released quarterly data only two months before-- based on "preliminary" revenue information – when that preliminary information was *positive*. JX197. Digirad should have done precisely the same thing in April before asking shareholders to vote for directors. Instead, Defendants again concealed information that would have been material to a reasonable shareholder, thereby denying all Digirad shareholders a fair election.

4. Digirad concealed the intention to adopt an NOL rights plan until immediately after the shareholder meeting.

Digirad did not produce documents regarding its pre-election consideration of adopting an NOL rights plan until after trial.[1] Further, Digirad instructed its deponents not to answer any questions concerning the NOL rights plan. Eberwein Dep. 39-40. Even in the face of this serious handicap, however, the evidence shows precisely what Red Oak alleged in its Amended Verified Complaint regarding Digirad's failure to disclose its intention to adopt an NOL rights plan.

[1] The parties are supplementing the trial exhibits with documents produced after trial.

On April 10, 2013, Chairman of the Board Jeffrey Eberwein proposed conducting a tender offer as a way to "win over" the Company's largest shareholder in the election. JX203 at DRAD6858. His plan contemplated further analysis under "section 382", announcing a tender offer before the election, and "execute the tender offer AFTER the s/h mtg." *Id.* (emphasis in original). The tender offer was dropped, but one week later Eberwein asked CFO Keyes, CEO/board member Clyde and board member John Climaco to work together "on putting in place an NOL protection plan *right after our s/h mtg* . . ." JX204 at DRAD6256 (emphasis added). Eberwein followed up on April 26, one week before the election, "to check in on the status of implementing an NOL protection plan." JX205. And immediately *after* the annual meeting, implementing the NOL plan was a matter of "urgency" (JX206) and "a high priority item" (JX208). Digirad published at least three "fight letters" and press releases after April 10 (JX182, 185, 187) but did not disclose that at least half the board already planned to adopt an NOL plan "right after" the contested election of directors. The board did so on May 23.

Adopting the NOL Rights Plan was a material event. Digirad filed a Form 8-K with the SEC regarding the plan. JX195. The Digirad NOL plan limits shareholders to acquiring no more than 5% of Digirad's stock. *Id*; Tr. 61. Thus regardless of the tax benefits it may address (the merits of which are not at issue here), the plan unquestionably imposes restrictions on ownership that some shareholders may oppose. Thus, Eberwein's intention to adopt a plan "right after our s/h mtg" is highly material and should have been disclosed (Tr. 63).

It is worth noting that 4 of the 5 largest shareholders voted against the Management Slate. Thus the NOL Rights Plan restricted management's largest *opponents* from acquiring more stock, but did not restrict Defendants themselves, who own under 5% each. Eberwein was reluctant to delay implementation of the plan even for ten days (JX208) – because during those ten days the dissident large shareholders would have been able to acquire more stock.

5. Digrad's unclean hands defenses are legally and factually irrelevant.

Defendants argue that miscellaneous actions by David Sandberg supposedly make equitable relief under Section 225 unwarranted here. This is a red herring. As explained in *Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43, 81-82 (Del. Ch. 2008)*:

> Denying [plaintiff] relief on the basis of unclean hands would work an inequitable result by denying . . . stockholders the right to fairly conducted election of directors, something that DGCL § 225 was enacted to ensure. It would be unjust to permit the defendants to invoke [plaintiff's conduct] to shield themselves from accountability for their inequitable behavior.

It may be possible to take a plaintiff's behavior into account in shaping the final relief, "but in a manner that is more proportionate and that does not injure the [company's] electorate." *Id.*

In any event, the supposed "unclean hands" do not hold up. Digirad constructs a conspiracy theory under which Sandberg supposedly used "code words" to [redacted] Digirad's preoccupation with Ross Taylor is equally misplaced. Sandberg never met Taylor (Tr. 37) and only shared Sandberg's understanding of the voting tally *after* Somerset had voted its shares, and even then he told Taylor the Red Oak slate was *trailing*. (Tr. 41). That hardly risked creating a bandwagon that would discourage voting. Thus, for both legal and factual reasons, Defendants' equitable defenses cannot excuse their failure to afford Digirad shareholders a fair election.

Respectfully,

/s/ *Elizabeth M. McGeever*

Elizabeth M. McGeever (ID No. 2057)

EMM:ls

cc: Register in Chancery (File & ServeXpress)
John M. Seaman (File & ServeXpress)