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Case No. 5890-VCL

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

MICHAEL SCULLY, On Behalf of Himself and All Others Similarly Situated, Plaintiff, v. NIGHTHAWK RADIOLOGY HOLDINGS, INC., DAVID ENGERT, PETER Y. CHUNG, DAVID J. BROPHY, CHARLES R. BLAND, JEFF TERRILL, VIRTUAL RADIOLOGIC CORPORATION and EAGLE MERGER SUB CORPORATION, Defendants.	)	C.A. No. 5890-VCL

NIGHTHAWK DEFENDANTS' MEMORANDUM OF LAW IN OPPOSITION TO PLAINTIFF'S MOTION FOR EXPEDITED PROCEEDINGS

MORRIS, NICHOLS, ARSHT & TUNNELL LLP
Kenneth J. Nachbar (#2067)
Susan W. Waesco (#4476)
1201 N. Market Street
P.O. Box 1347
Wilmington, DE 19899-1347
(302) 658-9200
Attorneys for Defendants NightHawk Radiology Holdings, Inc., David Engert, Peter Y. Chung, David J. Brophy, Charles R. Bland and Jeff Terrill

OF COUNSEL:

David J. Berger
Gregory L. Watts
WILSON SONSINI GOODRICH ROSATI, P.C.
650 Page Mill Road
Palo Alto, CA 94304

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Defendants NightHawk Radiology Holdings, Inc. ("NightHawk" or the "Company"), David Engert, Peter Chung, David Brophy, Charles Bland and Jeff Terrill (the "Individual Defendants," and together with NightHawk, the "NightHawk Defendants") respectfully submit this Memorandum of Law in Opposition to Plaintiff's Motion for Expedited Proceedings (the "Motion").

INTRODUCTION

This litigation is yet another reflexive purported class action challenge to a recently announced merger. While the complaint contains the by now "boilerplate" allegations typical in these cases, what makes this situation unusual are the specific terms of the challenged transaction. In particular, this is an arm's-length merger between two unrelated parties where there is no allegation of self-dealing and the premium being proposed exceeds 100% of the unaffected market price of the Company's stock, while the deal terms include a 30-day "go shop" period. Perhaps not surprisingly given this reality, none of the allegations are sufficient to state a claim, or support a request for expedited proceedings.

On September 27, 2010, NightHawk announced that its Board of Directors (the "NightHawk Board") had unanimously approved a merger agreement (the "Merger Agreement") with Virtual Radiologic Corporation ("vRad"), pursuant to which vRad will acquire NightHawk for $170 million in cash (the "Proposed Merger"). The Proposed Merger, at a price of $6.50 per share, represents a premium of 132% of the Company's trading price for the 90 days prior to the announcement of the Proposed Merger, and a 100% premium of the Company's trading price the day before the announcement. *See* NightHawk's Form 8-K filed with the Securities and

Exchange Commission ("SEC") on September 27, 2010 (the "NightHawk 8-K"), Ex. 99.1;[1] Preliminary Proxy ("Prelim. Proxy") at 3.[2] The Merger Agreement contains a "go shop" provision, allowing NightHawk to seek additional bids for a period of 30 days, which may be extended an additional 25 days if another bidder emerges. *See* Merger Agreement at 2; Prelim. Proxy at 46-47. The initial 30 day period ends on October 26, 2010. Prelim. Proxy at 7.

Within 24 hours of the announcement of the Proposed Merger, the first purported class action lawsuit was filed. The case was filed in Arizona state court (NightHawk's principal place of business is in Scottsdale, Arizona). Between September 28 and October 7 a total of six essentially identical purported class actions were filed in the same Arizona court, all alleging the same claims and seeking to enjoin the Proposed Merger.

On October 7, 2010 NightHawk filed its Preliminary Proxy with the SEC. Although the Proposed Merger is expressly conditioned upon approval by a majority of NightHawk's shareholders, no definitive proxy has been finalized or mailed, and no date has been set for the required shareholder meeting. The Preliminary Proxy discloses that the Company hopes to consummate the transaction in the fourth quarter of 2010 or the first quarter of 2011. Prelim. Proxy at 12; Plaintiff's Motion for Expedited Proceedings ("Pl.'s Mot.") at 2.

This case was filed on October 8, the day after the Preliminary Proxy was filed. Not surprisingly, this action is very similar to the Arizona cases, although it adds some largely "boilerplate" alleged disclosure claims. Plaintiff filed his motion to expedite proceedings a few days later.

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[1] NightHawk's 8-K, with its exhibits, is attached hereto as Exhibit 1. The Merger Agreement is attached as Exhibit 2.1 to the NightHawk 8-K.

[2] The Company's Preliminary Proxy is attached hereto as Exhibit 2.

Plaintiff's motion should be denied for at least two distinct reasons. First, there is no need or basis for expedition here. The go-shop period has not expired; no shareholder meeting has been scheduled; and the definitive proxy has not even been filed. As such, there is no basis for requiring expedited proceedings at this time. Rather, Plaintiff can move forward under normal time frames and if, and when, there is some need for exigency then he can set forth the specific basis for such relief.

Second, Plaintiff's allegations do not meet the basic standards necessary to obtain expedited relief. As is well established, "[a] motion to expedite should be granted only if 'the plaintiff has articulated a sufficiently colorable claim and shown a sufficient possibility of a threatened irreparable injury, as would justify imposing on the defendants and the public the extra (and sometimes substantial) costs of an expedited preliminary injunction proceeding.'" *Lonergan v. EPE Holdings LLC,* -- A.3d --, 2010 WL 3987173, at *6 (Del. Ch. Oct. 11, 2010) (quoting *Giammargo v. Snapple Beverage Corp.,* 1994 WL 672698, at *2 (Del. Ch. Nov. 15, 1994)). As described in more detail herein, Plaintiff fails to present a colorable claim that could justify imposing the burden of expedited proceedings on the parties and the Court.

For these fundamental reasons, the NightHawk Defendants respectfully request that Plaintiff's Motion for Expedited Proceedings be denied.

BACKGROUND

A. The Merger.

On September 26, NightHawk entered into the Merger Agreement pursuant to which vRad will purchase NightHawk for $6.50 per share. Pl.'s Mot. at 2. The merger agreement is the result of a process that began in December 2008. Prelim. Proxy at 17. At that time, with the assistance of the investment banking firm Morgan Stanley, the Company

contacted ten potential buyers before determining that at that time the Company was better off continuing as a standalone entity. *Id.*

Beginning in May 2009, the CEOs of NightHawk (Mr. Engert) and vRad (Mr. Kill) began intermittent talks regarding a potential business combination. *Id.* On May 12, 2010, Mr. Engert reported on his conversations with Mr. Kill to the NightHawk Board, which authorized Mr. Engert to continue talks with Mr. Kill. *Id.* On May 17, 2010, vRad announced its agreement to be acquired by affiliated investment funds of Providence Equity Partners, L.L.C. ("Providence"), which led to a termination of discussions between NightHawk and vRad. *Id.* at 18.

On June 2, 2010, Mr. Engert and a representative of Providence had an initial discussion regarding a possible acquisition of NightHawk by Providence. *Id.* This led to an NDA being signed on June 7, 2010; a non-binding letter of interest from Providence to acquire NightHawk on June 29, 2010; NightHawk's retention of a financial advisor (Morgan Stanley) on July 2, 2010; and ultimately culminated – after months of negotiations – in the NightHawk Board approving the Proposed Merger on September 26, 2010. *Id.* at 18-24. The deal was announced on September 27, 2010. NightHawk 8-K, Ex. 99.1.

During this entire negotiation process with vRad (from April through September 2010), the Company received only one unsolicited vague offer by "Party A," offering to acquire 51-100% of NightHawk shares at a price range between $3.50 and $4.50 per share. Prelim. Proxy at 19. This was well below vRad's offer of $6.50 per share.[3] NightHawk 8-K, Ex. 99.1.

The $6.50 per share offer from vRad represents a 100% premium over the Company's closing price the day before the Proposed Merger was announced, and a 132%

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[3] NightHawk also received an unsolicited initial inquiry – but no offer – from "Party B" on August 16, 2010. On September 20, 2010, Party B relayed a preliminary, non-binging indication of interest to acquire 100% of NightHawk's shares at a price range from $3.50 to $4.50 per share. Prelim. Proxy at 21, 23.

percent premium over the Company's trading price for the 90 days prior to the announcement of the Proposed Merger. Prelim. Proxy at 3, 24-25. Closing of the Proposed Merger is expressly conditioned upon the approval of holders of a majority of NightHawk shares, as well as various regulatory approvals and other conditions. *Id.* at 51. The Merger Agreement contains standard deal protection provisions, including a termination fee ranging from $3.7 million (approximately 2.1% of the total deal value) to a maximum of $6.6 million (approximately 3.7% of the total deal value).[4] Merger Agreement at 53-54; Prelim. Proxy at 8, 53. The Merger Agreement includes a 30-day "go-shop" provision that allows the Company to solicit superior offers until October 26. Merger Agreement at 41-42; Prelim. Proxy at 46. During this period, the Company may actively "solicit, initiate and encourage acquisition proposals" from any other interested parties. *Id.* Once the go-shop period has ended, the Merger Agreement provides an additional 25 days – until November 20, 2010 – to further negotiate with bidders who made bids during the go-shop period (and any termination arising from this would use the lower termination fee). Merger Agreement at 42-43; Prelim. Proxy at 47. And NightHawk may always entertain unsolicited offers if the NightHawk Board determines in good faith that the offer constitutes, or is reasonably likely to result in, a superior proposal. *Id.*

B. The Preliminary Proxy.

NightHawk filed its Preliminary Proxy on October 7. It details the factual background leading up to the NightHawk Board's approval of the Proposed Merger. Prelim. Proxy at 17-24. It further explains why the NightHawk Board unanimously believes the Proposed Merger will provide the greatest value to NightHawk shareholders, and lists and

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[4] Plaintiff asserts that the termination fee is "effectively . . . a termination fee of $9,000,000." Compl. ¶ 47. This is incorrect. The Merger Agreement caps the termination fee and reimbursable expenses at $6.6 million. Merger Agreement at 53-54; Prelim. Proxy at 8, 53.

describes the reasons why shareholders should vote in favor of it. *Id.* at 24-26. The Preliminary Proxy also includes Morgan Stanley's fairness opinion, summarizes the work done by Morgan Stanley in rendering the opinion, describes the various data points upon which Morgan Stanley relied in coming to its conclusions, and discloses Morgan Stanley's various analyses. *Id.* at 26-33.

As of this date, NightHawk's Preliminary Proxy is still being reviewed by the SEC. There is no scheduled date for filing the final proxy. There is no scheduled date for the shareholder vote. Pl.'s Mot. at 2.

C. The Arizona Lawsuits.

On September 28, 2010 – one day after the Proposed Merger was announced – the first lawsuit challenging the deal was filed in the Superior Court of the State of Arizona, Maricopa County,[5] captioned *Israni v. NightHawk Radiology Holdings, Inc., et al.*, Case No. CV2010-025059. Plaintiff there, like here, alleges that the members of NightHawk's Board of Directors breached fiduciary duties owed to NightHawk's stockholders by agreeing to sell NightHawk for inadequate consideration and pursuant to an unfair process, and seeks to enjoin the Proposed Merger. On October 7, 2010, plaintiff in the *Israni* action moved to expedite discovery; the opposition papers are due October 27; a ruling is expected shortly thereafter (on the papers – no hearing is currently set).[6]

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[5] NightHawk is a Delaware corporation headquartered in Arizona. *See* Compl. ¶ 6.

[6] Six virtually-identical actions were filed in Arizona between September 28 and October 7, 2010. *Lalone v. NightHawk Radiology Holdings, Inc., et al.*, Case No. CV2010-028112 (Ariz. Sup. Ct.); *Watts v. Engert, et al.*, Case No. CV2010-028127 (Ariz. Sup. Ct.); *LaTorre v. NightHawk Radiology Holdings, Inc., et al.*, Case No. CV2010-028176 (Ariz. Sup. Ct.); *Newman v. Engert, et al.*, Case No. CV2010-028262 (Ariz. Sup. Ct.); *Israni v. NightHawk Radiology Holdings, Inc., et al.*, Case No. CV2010-025059 (Ariz. Sup. Ct); and *Yu v. Engert, et al.*, Case No. CV2010-028403 (Ariz. Sup. Ct.). A motion to consolidate these cases was filed last week.

D. This Action.

Plaintiff filed his complaint here October 8, 2010. Plaintiff's essential allegation is that the NightHawk Board violated fiduciary duties owed to public shareholders by approving the Proposed Merger via a "process" and at a "value" that was "fundamentally unfair." Compl. ¶ 3. Plaintiff also scoured the Preliminary Proxy to rustle up a handful of alleged disclosure claims, focusing primarily on Morgan Stanley's financial analyses in concluding that the deal was fair to NightHawk shareholders from a financial point of view. Compl. ¶¶ 51-54. There are no allegations questioning the independence or disinterestedness of a majority of the NightHawk Board members who considered and voted to approve the Proposed Merger with vRad. The only allegation of deal bias relates to a single defendant, Mr. Engert, who is alleged to have "successfully negotiated an agreement whereby he will remain with the surviving entity as a highly paid consultant." Compl. ¶ 45. As disclosed in the Preliminary Proxy, Mr. Engert will receive $60,000 for his six-month advisory services. Prelim. Proxy at 34.

Plaintiff filed his Motion to Expedite Proceedings on October 12, 2010, the same day he served a set of document demands on the NightHawk Defendants and filed a motion for preliminary injunction.

LEGAL STANDARD

It is well-settled under Delaware law that the Court "does not set matters for an expedited hearing or permit expedited discovery unless there is a showing of good cause for why that is necessary." *Greenfield v. Caporella*, 1986 WL 13977, at *2 (Del. Ch. Dec. 3, 1986). Moreover, this Court has recognized that expedited proceedings impose substantial burdens on the Court and the parties. *See In re Yahoo! Inc. S'holders Litig.*, 2008 WL 2627851, at *1 (Del. Ch. June 16, 2008) ("To successfully earn expedition, the movant must show good cause why it is necessary to impose upon the counterparty and the Court . . . substantially increased burdens

of time, effort, and expense."); *In re 3Com S'holders Litig.*, 2009 WL 5173804, at *1 (Del. Ch. Dec. 18, 2009) (noting "'extra (and sometimes substantial)'" expense of expedited proceedings) (citation omitted).

To obtain expedited discovery, Plaintiff must show an exigency, and further bears the burden of demonstrating (1) a sufficiently colorable claim, and (2) a sufficient threat of irreparable injury. *Lonergan,* 2010 WL 3987173, at *6 (Del. Ch. Oct. 11, 2010) (citing *Giammargo*, 1994 WL 672698, at *2). Failure to make the requisite irreparable injury showing precludes the imposition of expedited proceedings, regardless of whether a colorable claim is demonstrated. *See In re W. Nat'l S'holders Litig.*, 1998 WL 51733, at *1 (Del. Ch. Feb. 4, 1998). *See also In re Tri-Star Pictures, Inc.*, 1989 WL 997177, at *1 (Del. Ch. Oct. 2, 1989) (recognizing that pleading may be inadequate on its face such that permitting expedited discovery would "inflict[] an injustice upon the parties and wast[e] the resources of the Court."). Plaintiff has not met his burden to justify expedition here.

ARGUMENT

I. THERE IS NO EXIGENCY JUSTIFYING EXPEDITED PROCEEDINGS.

A fundamental reason why expedited discovery must be denied is that there simply is no emergency justifying expedition. NightHawk is still in the midst of the go-shop period, no date has been set for the shareholder meeting necessary to approve the pending proposed transaction and the Company's Preliminary Proxy is just that – preliminary. If and when a shareholder meeting is set for a vote on the existing transaction with vRad, then it may be appropriate to have expedited proceedings assuming if – and this is a big assumption – Plaintiff can meet his burden to show that the definitive proxy may be deficient. However, at this stage any claim of exigency is illusory, and Plaintiff's Motion should be denied on this basis alone.

See United Vanguard Fund, Inc. v. TakeCare, Inc., 727 A.2d 844, 847 (Del. Ch. 1998) (noting that the court denied motion for expedited discovery where bidding process was still ongoing at time of motion); *Casale v. Bare,* 2009 WL 296262, at *2 (Del. Ch. Jan. 27, 2009) (in denying expedited proceedings, court stated that to grant a motion for expedited proceedings, "the Court must find some imminent circumstance demanding immediate action").

II. PLAINTIFF HAS NOT ASSERTED A SUFFICIENTLY COLORABLE CLAIM TO WARRANT EXPEDITED PROCEEDINGS.

Plaintiff asserts that defendants violated fiduciary duties owed to NightHawk stockholders because allegedly they failed (a) "to take steps to maximize the value of NightHawk to its public shareholders," and (b) "to fully disclose . . . all material information necessary to cast an informed shareholder vote on the Proposed Transaction." Compl. ¶¶ 58, 59. These claims are not sufficiently colorable as a matter of law, and provide separate grounds for denying the Motion.

A. Plaintiff's Challenges to the Fairness of the Transaction Are Deficient.

When pursuing a sale of the Company, NightHawk's directors had a duty to maximize value for its stockholders. *Revlon Inc. v. MacAndrews & Forbes Holdings*, *Inc.,* 506 A.2d 173, 182 (Del. 1986). But in evaluating this duty, the Court may not superimpose its judgment on what should have been done, but instead "determine if the directors' decision was, on balance, within a range of reasonableness." *In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 1001 (Del. Ch. 2005); *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45-46 (Del. 1994) ("[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have

decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness").

There is "no single blueprint" by which directors must satisfy their *Revlon* obligations, and courts "recognize[] the broad power of the board to make decisions in the process of negotiating and recommending a 'sale of control' transaction, so long as the board is informed, motivated by good faith desire to achieve the best available transaction, and proceeds 'reasonably.'" *Equity-Linked Investors, L.P. v. Adams*, 705 A.2d 1040, 1055 (Del. Ch. 1977).

Here, there are no specific factual allegations – merely the standard "boilerplate" conclusory charges – that the NightHawk Board was uninformed, improperly motivated and/or acted unreasonably. Indeed, the record is directly to the contrary. First, this is an arms-length, third party transaction done at a substantial premium. There is no allegation that there was any pre-existing relationship between anyone at NightHawk and anyone at vRad, nor could any such allegation be made. Further, it is undisputed that the NightHawk Board was advised throughout this process by Morgan Stanley, one of the country's leading investment banks. Further, in addition to being at a substantial premium to the Company's 30-day and 90-day trading averages, the transaction includes a 30-day go-shop (with extension rights for qualified bidders), and a fiduciary out for any unsolicited superior proposal.

As a result, Plaintiff's allegation that the directors "failed . . . to perform a proper market check" is insufficient to state a claim. *In re Wheelabrator Techs. Inc. S'holders Litig.*, 1992 WL 212595, at *9 (Del. Ch. Sept. 1, 1992) (the mere allegation that the "directors failed to conduct a market check to assure themselves that there were no superior alternative transactions" is "insufficient" to support a claim). *See also In re Toys "R" Us,* 877 A.2d at 1000 ("[T]he duty

to take reasonable steps to secure the highest immediately available price does not invariably require a board to conduct an auction process or even a targeted market canvass.”).

Plaintiff also makes a perfunctory argument that higher bidders were stymied by the Merger Agreement’s “onerous and preclusive deal protection devices” (Compl. ¶ 46) – specifically, the no-shop, termination fee, and “matching rights” provisions in the Merger Agreement. Compl. ¶¶ 47-50; Pl.’s Mot. at 3. As is by now textbook law, these deal terms are routinely approved, and are not indicative of a breach of fiduciary duty. *See, e.g.,* Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors,* 2804-27, 2922-3036 (6th ed. 2009) (discussing the application of the business judgment rule to no-shop, go-shop, termination fees and matching rights provisions).

Delaware courts routinely uphold transactions that include no-shop provisions. *See McMillan v. Intercargo Corp.*, 768 A.2d 492, 506 n.63 (Del. Ch. 2000) (“’Contrary to plaintiffs’ suggestion, [the no-shop and no-talk provisions] do not foreclose other offers, but operate merely to afford some protection to prevent disruption of the Agreement by proposals from third parties that are neither bona fide nor likely to result in a higher transaction.’”) (citation omitted); *ACE Ltd. v. Capital Re Corp.*, 747 A.2d 95, 106 (Del. Ch. 1999) (a no-shop provision prohibiting a board of directors from “play[ing] footsie with other potential bidders or . . . stir[ring] up an auction . . . is perfectly understandable, if not necessary, if good faith business transactions are to be encouraged”); *In re Lukens Inc. S’holders Litig.*, 757 A.2d 720, 725 (Del. Ch. 1999) (dismissing *Revlon* claim in case where the merger agreement contained a “‘no solicitation’ clause . . . preventing the . . . board from soliciting a competing takeover offer” where that clause “was connected to the customary ‘fiduciary out,’ allowing the board to

adequately inform itself and take action on any unsolicited 'superior proposal' from a third party"), *aff'd, Walker v. Lukens, Inc.,* 757 A.2d 1278 (Del. 2000).

The termination fees here – $3.7 million (approximately 2.1% of the enterprise value of the deal) for termination during the go-shop period, or $6.6 million (approximately 3.7% of the enterprise value) in worst-case scenario – are in line with Delaware cases finding such provisions routine and acceptable.[7] *See e.g., In re 3Com,* 2009 WL 5173804, at *7 (4% termination fee does not state a colorable claim for breach of fiduciary duty); *Kysor Indus. Corp. v. Margaux, Inc.*, 674 A.2d 889, 897 (Del. Super. Ct. 1996) ("Commentators have expressed the view that liquidated damage provisions in the one-to-five percent range of the proposed acquisition price are within a reasonable range . . ."); *In re Toys "R" Us,* 877 A.2d at 1019 (termination fee equal to 3.75% of acquisition price was reasonable and not undue deterrent to higher bids); *In re Dollar Thrifty S'holder Litig.*, 2010 WL 3503471, at *29-30 (Del. Ch. Sept. 8, 2010) (rejecting preliminary injunction request, including plaintiffs' challenge to 3.5% termination fee).

Matching rights are also common contractual features in merger agreements that Delaware courts consistently uphold. *In re 3Com,* 2009 WL 5173804, at *7 (denying a motion for expedited discovery where the plaintiff complained about matching rights and other merger provisions that "are standard merger terms, are not *per se* unreasonable, and do not alone constitute breaches of fiduciary duty"); *In re Toys "R" Us,* 877 A.2d at 1017 ("[N]either a termination fee nor a matching right is *per se* invalid. Each is a common contractual feature that,

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[7] The termination percentages are similar when measured against total equity: a $3.7 million termination fee is approximately 2.2% of total equity value; $6.6 million is approximately 3.9% of total equity value.

when assented to by a board fulfilling its fundamental duties of loyalty and care for the proper purpose of securing a high value bid for the stockholders, has legal legitimacy.”).

In sum, Plaintiff’s perfunctory complaints about these standard and reasonable deal provisions cannot support a colorable claim of breach of fiduciary duty against the NightHawk Board. *In re 3Com*, 2009 WL 5173804, at *7 (in rejecting plaintiffs’ motion for expedited discovery on fiduciary claims challenging (i) the no-solicitation and matching rights provision, (ii) a termination fee and expense reimbursement provision representing over 4% of the equity value of the merger, and (iii) the failure to solicit other buyers before entering into the transaction, the court stated “I find that none of these allegations support a colorable claim that fiduciary duties were breached.”).

B. Plaintiff Fails to State a Sufficiently Colorable Disclosure Claim.

Plaintiff must allege material misstatements or omissions.[8] The materiality threshold does not equate to a requirement that all potentially useful information be disclosed. *In re Siliconix Inc. S’holders Litig.*, 2001 WL 716787, at *9 (Del. Ch. June 19, 2001) (“Delaware law does not require disclosure of ‘all available information’ simply because available information ‘might be helpful.’”) (citation omitted). Indeed, too lenient a materiality standard runs “the risk that corporations will ‘bury the shareholders in an avalanche of trivial information, a result that is hardly conducive to informed decision making.’” *Skeen v. Jo-Ann Stores, Inc.*, 1999 WL 803974, at *4 (Del. Ch. Sept. 27, 1999) (citation omitted), *aff’d*, 750 A.2d 1170 (Del. 2000). This analytical guidepost reveals that Plaintiff’s disclosure claims – and particularly

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[8] *See Solomon v. Armstrong*, 747 A.2d 1098, 1128 (Del. Ch. 1999) (plaintiff bears burden of showing material omissions), *aff’d,* 746 A.2d 277 (Del. 2000); *Pfeffer v. Redstone*, 965 A.2d 676, 686 (Del. 2009) (information is material if a reasonable stockholder would consider it important in voting on proposed transaction or would find that the information has altered the “total mix” of information available).

those related to alleged deficiencies related to Morgan Stanley's analysis (discussed *infra*) – are not actionable.

Plaintiff's disclosure allegations fall into two categories: (i) the failure to include additional background information, and (ii) the failure to include additional information regarding Morgan Stanley's financial analysis. Neither of these assertions has merit.

1. <u>Background Information</u>.

Plaintiff asserts that the Preliminary Proxy should have disclosed why NightHawk did not solicit potentially interested buyers for the eighteen months leading up to the Merger Agreement. Compl. ¶ 51. It did. *See* Prelim. Proxy at 21 (disclosing reasons NightHawk agreed to exclusive negotiations with vRad). More generally, this type of negative disclosure is not an actionable, material omission. *See In re Lukens*, 757 A.2d at 736 ("[W]hy the board chose not to take particular courses of action" is "plainly not material"); *McMillan v. Intercargo Corp.*, 1999 WL 288128, at *9 (Del. Ch. May 3, 1999) ("It is difficult to understand how the identities of the companies that did not express an interest in purchasing [the target] and that did not make an offer could be significant to [the target's] stockholders considering whether or not to accept the only offer . . . on the table"). The Preliminary Proxy details all salient events leading up to the Proposed Merger – *see* Prelim. Proxy at 17-24 – and facts that did not lead to the Proposed Merger are irrelevant and immaterial.

Plaintiff next contends that the Proxy fails to disclose "the alternatives available to the Company" and "the efforts that will be undertaken during the go-shop period" to seek a better deal. Compl. ¶ 52. This disclosure claim also lacks merit. The Preliminary Proxy makes clear that the vRad transaction is the only merger candidate to date (and that the only other party expressing interest in acquiring NightHawk was at a price range far below the $6.50 per share offered by vRad). Prelim. Proxy at 19, 23. Moreover, any disclosure claim based on

NightHawk's supposed failure to disclose what will happen in the ongoing no-shop period is bizarre.[9]

Plaintiff's final disclosure claim based on the omission of material background information is that the Preliminary Proxy fails to disclose the number of options that are unvested (versus vested) for each officer and director. Compl. ¶ 53. But the Preliminary Proxy clearly sets forth the total payments to each officer and director for vested and unvested options and restricted stock units. Prelim. Proxy at 35. This is sufficient to show any purported deal bias, and Plaintiff does not make any attempt to explain how the itemization of vested versus unvested options held by directors would "'*significantly* alter[] the "total mix" of information made available.'" *Skeen,* 750 A.2d at 1172 (citation omitted) (emphasis added). This disclosure of director and officer compensation from the deal is sufficient as a matter of law. *See Krim v. ProNet, Inc.*, 744 A.2d 523, 528 (Del. Ch. 1999) (dismissing duty of loyalty claim because all of the defendants' alleged interests in the merger were disclosed).

As the foregoing shows, Plaintiff has failed to assert a sufficiently colorable disclosure claim based on supposed deficiencies in the background information of the Proposed Merger.

2. Financial Disclosures.

Plaintiff broadly argues that a disclosure claim lies because the Proxy "fails to disclose all of the underlying methodologies, projections, key inputs and multiples relied upon and observed by Morgan Stanley . . ." Compl. ¶ 53; Pl.'s Mot. at 7. But the law does not require such exhaustive disclosures. *See Van de Walle v. Unimation, Inc.*, 1991 WL 29303, at *16 (Del.

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[9] Presumably, any material developments in the go-shop period will be included in supplemental disclosures to NightHawk's shareholders prior to any vote on the Proposed Merger.

Ch. Mar. 7, 1991) ("A proxy statement need not disclose all the wealth of detail presented to or considered by the corporation's directors and advisors, whether or not material."); *In re General Motors (Hughes) S'holder Litig.*, 2005 WL 1089021, at *16 (Del. Ch. May 4, 2005) (declining to order disclosure of "raw data behind" financial advisors' summaries), *aff'd*, 897 A.2d 162 (Del. 2006); *Skeen*, 1999 WL 803974, at *6 ("'disclosure of methodologies and analyses used by an investment banker have generally been held by the Court of Chancery not to be material'") (citation omitted).

Rather, the law requires that stockholders be given a "fair summary" of a banker's analysis – *see In re JCC Holding Co.*, 843 A.2d 713, 721 (Del. Ch. 2003) – and "to know the basic valuation exercises that [the financial advisor] undertook, the key assumptions that [it] used in performing them, and the range of values that were thereby generated." *In re Pure Resources, Inc., S'holders Litig.*, 808 A.2d 421, 449 (Del. Ch. 2002); *In re CheckFree Corp. S'holders Litig.,* 2007 WL 3262188, at *2 (Del. Ch. Nov. 1, 2007) (the "proper frame of analysis" for determining whether disclosure of financial information is required is a determination of whether the proxy statement at issue provides "'a fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of their board as to how to vote on a merger or tender rely.'") (citation omitted).

Such a "fair summary" is exactly what NightHawk provides here. In particular, the Preliminary Proxy enumerates the analyses performed by Morgan Stanley, including a Comparable Company Analysis, a Present Value of Future Stock Price Analysis, an Analysis of Selected Precedent Transactions, a Discounted Cash Flow Analysis, and a Leveraged Buyout Analysis. Prelim. Proxy at 30-31. The Preliminary Proxy also summarizes the methodology used in each analysis, describes the key assumptions used by Morgan Stanley for each analysis,

and discloses the per share range of values generated by each analysis. *Id.* Moreover, the Preliminary Proxy further discloses a summary of the internal financial projections that Morgan Stanley received from NightHawk management, including projections of revenue, adjusted gross profit, adjusted EBITDA and adjusted EPS for the years 2010 through 2015. *Id.* at 32-33. This disclosure is sufficient. *See, e.g., In re 3Com*, 2009 WL 5173804, at *3 (finding plaintiff "failed to assert a colorable reason as to why management should be required to provide full versions of the projections underlying the already disclosed summaries [where] management has made the Proxy more accessible to investors by summarizing the financial information relied on in connection with the Merger.").

The level of detail provided in the Preliminary Proxy easily satisfies the "fair summary" standard, and while Plaintiff nitpicks about the failure to disclose minute underlying details of Morgan Stanley's analyses, such details are immaterial as a matter of law. *See Globis Partners, L.P. v. Plumtree Software, Inc.*, 2007 WL 4292024, at *11-13 (Del. Ch. Nov. 30, 2007) (the duty of disclosure in this context "does not extend to the provision of information to permit stockholders to make 'an independent determination of fair value'") (citation omitted); *In re SunGard Data Sys., Inc. S'holders Litig.*, 2005 WL 1653975, at *2 (Del. Ch. July 8, 2005) (denying expedited discovery for merely quibbling with the details of the banker's analysis where proxy provided adequate summary); *TCG Sec., Inc. v. S. Union Co.*, 1990 WL 7525, at *7 (Del. Ch. Jan. 31, 1990) (no duty to disclose details concerning investment banker's valuation methodology); *Abbey v. E.W. Scripps Co.*, 1995 WL 478957, at *3 (Del. Ch. Aug. 9, 1995) (such details will "rarely if ever be material").

Not surprisingly, Plaintiff does not like the financial analyses conducted by Morgan Stanley, which all reflect that the $6.50 per share offer from vRad is a very good deal for

NightHawk shareholders. Plaintiff is desperate to create the impression that these analyses are flawed, unreliable and materially misleading. Plaintiff therefore argues that the failure to disclose certain analytical criteria used by Morgan Stanley in each of its analyses constitutes a material omission in the Preliminary Proxy.[10] But even a cursory examination of Plaintiff's attacks on these Morgan Stanley analyses reveals the weakness of these purported disclosure claims.

3. Securities Research Analysts' Future Price Targets.

Morgan Stanley "reviewed the public market trading price targets for the Company common stock prepared and published by securities research analysts prior to September 26, 2010" (Prelim. Proxy at 29), and then discounted the analysts' price targets using a 12.5% cost of equity to derive a range of present values of approximately $3.11 to $3.56 per share (*i.e.,* significantly below the $6.50 per share proposal from vRad). *Id.* Plaintiff attempts to concoct a material omission by arguing that the Proxy should disclose the price target of the equity research analysts used in this analysis. *See* Compl. ¶ 53(ii); Pl. Mot. at 4. This is a silly argument. Morgan Stanley used all price targets published by analysts following NightHawk. Both the identity of these analysts and their published price targets are publicly accessible and not in dispute. Thus, there can be no disclosure claim by omission in this analysis. *County of York Emps. Ret. Plan v. Merrill Lynch & Co.,* 2008 WL 4824053, at *12 (Del. Ch. Oct. 28, 2008) (finding no colorable disclosure claim where plaintiff demanded "the source of the consensus analyst estimates [Merrill] used to perform it analysis" – finding sufficient proxy disclosure stating that "consensus estimates" were "the mean publicly available analyst estimates.").

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[10] *See* Compl. ¶¶ 53(i)-(vii); Pl.'s Mot. at 9.

4. Comparable Company Analysis.

Morgan Stanley compared certain financial information of NightHawk with publicly-available information for certain "peer group" companies in the radiology, healthcare department outsourcing, and healthcare staffing industries, and analyzed certain statistics for each of these companies based on estimates for the peer group companies provided by I/B/E/S and public filings.[11] This detailed and fully explicated analysis resulted in a wide range of implied value per share, which range was disclosed. Prelim. Proxy at 38-39.

Plaintiff argues that there are material omissions in this analysis because the Preliminary Proxy should have disclosed "a description of the criteria and multiples observed for each company" in the analysis. But the Preliminary Proxy does identify each peer group company, and further discloses the range of company multiples found in the four "Department Outsourcing" companies and the two "Healthcare Staffing" peer group companies (while not specifying the multiple for every single company). Prelim. Proxy at 29. But this does not a disclosure claim make because what Morgan Stanley did was clear and fully disclosed – the fact that Plaintiff may want more granularity which he may find potentially useful is of no moment. *See In re Siliconix*, 2001 WL 716787, at *9 ("Delaware law does not require disclosure of 'all available information' simply because available information 'might be helpful.'") (citation omitted). Such granularity is not needed to understand Morgan Stanley's analysis; nor is it material, and Plaintiff has failed to show otherwise.

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[11] I/B/E/S is the Institutional Brokers' Estimate System, a widely respected database owned by Thomson Reuters that compiles financial information on over 45,000 companies, including earnings estimates.

5. Present Value of Future Stock Price Analysis.

Morgan Stanley performed an illustrative analysis of the present value of the Company's theoretical implied future price per share. The Preliminary Proxy details the steps in that analysis, and discloses that the implied value per share of NightHawk common stock "ranged from $2.83 to $3.79" (again, significantly below the $6.50 per share vRad proposal). Prelim. Proxy at 30. Plaintiff argues that disclosure on this analysis is deficient because it does not include "a description of the criteria to select the EBITDA multiple range and discount rate used by Morgan Stanley." Compl. ¶ 53(iv); Pl.'s Mot. at 4, 9.

Not true. The Preliminary Proxy does, in fact, disclose the criteria for the EBITDA multiple range used by Morgan Stanley. Prelim. Proxy at 30 (". . . EBITDA multiples of 5.2x (current Company AV to NTM EBITDA multiple) and 7.6x (current median Department Outsourcing AV to NTM EBITDA multiple) . . ."). Likewise, the Preliminary Proxy explains that the discount range of 11% to 14% in this analysis was based on "cost of equity." In short, there is disclosure of what Plaintiff says is omitted; thus, this purported basis for a disclosure claim is not colorable.

6. Selected Precedent Transaction Analysis.

Morgan Stanley conducted an analysis based on selected prior transactions that resulted in an estimated per-share value of NightHawk common stock ranging from $4.28 to $4.88 per share (*i.e.,* well below the $6.50 per share offer from vRad). Plaintiff advances a disclosure claim because the Preliminary Proxy purportedly fails to describe the identity of the companies as well as the criteria and multiples observed by Morgan Stanley for each company in its *Selected Precedent Transaction Analysis.* Compl. ¶ 53(v); Pl.'s Mot. at 4, 9.

Not so. The Preliminary Proxy discloses the companies used by Morgan Stanley in this prior transaction analysis – vRad and then separately, "all cash acquisitions of U.S. public

companies with market capitalizations of less than $1 billion during the prior 20 years period." Prelim. Proxy at 30. Plaintiff may disagree with the selection of vRad (or some other Company with a market capitalization of less than $1 billion) in any precedent transaction analysis, but that does not constitute a colorable disclosure claim. *See In re 3Com*, 2009 WL 5173804, at *3 (in rejecting plaintiffs' alleged financial disclosure allegations relating to Goldman's analyses, the court noted that "[t]here is no disclosure violation here, merely a disagreement with Goldman's methodology."). Mere quibbles with methodologies (and inputs into those methodologies) do not give rise to a colorable disclosure claim. *Id.* at *6.

7. Discounted Cash Flow Analysis.

Morgan Stanley conducted a discounted cash flow ("DCF") analysis that resulted in a per share estimated value of NightHawk common stock ranging from $4.03 per share to $5.45 per share (again, well below the $6.50 per share offer from vRad). Prelim. Proxy at 31. Morgan Stanley's DCF methodology is described as follows:

> Morgan Stanley analyzed the Company's business using information provided by Company management, including certain financial forecasts prepared by Company management for the fiscal years 2011through 2015, discounted back to December 31, 2010. Morgan Stanley used discount rates ranging from 9.00% to 10.50%, reflecting estimates of the Company's weighted-average cost of capital. Estimated terminal values for the Company were calculated using the perpetuity growth method by growing the 2015 unlevered free cash flow by a perpetuity growth rate range of 2.00% to 3.00%. This analysis resulted in a range of illustrative per share value indications of $4.03 per share to $5.45 per share.

Id.

Plaintiff argues that the DCF disclosure needs to include "a description of the criteria to select the discount rate and perpetuity growth rate used by Morgan Stanley [in the DCF Analysis]. Further, a description of whether the DCF Analysis included consideration of

stock-based compensation and whether the analysis takes into consideration NOLs (if any)." Compl. ¶ 53(vi); Pl.'s Mot. at 7.

But the Preliminary Proxy *does* disclose the criteria used to calculate the discount range of 9.0% to 10.5% – the Company's weighted average cost of capital. Prelim. Proxy at 31. Moreover, perpetuity growth rates are determined largely by estimates of GDP growth, and in this economy, a 2-3% perpetuity growth rate is very reasonable (if not generous). Finally, adjusting for stock-based compensation is standard practice in DCF analyses, and requiring Proxy disclosures on such industry standards is unnecessary. And in all events, Delaware courts have specifically held that this kind of allegation is insufficient to assert a colorable disclosure claim for purposes of expedited discovery. *See Merrill Lynch & Co.,* 2008 WL 4824053, at *12 (rejecting plaintiff's claim that failure to disclose the manner in which "the financial advisors derived the discount rates that they used in their analyses" constituted a colorable disclosure claim).

8. Leveraged Buyout Analysis.

Morgan Stanley conducted an illustrative LBO analysis to estimate the theoretical purchase price that a financial buyer could pay to acquire the Company. Prelim. Proxy at 31. The steps in that analysis were disclosed, and Morgan Stanley concluded that "this analysis implied a value range of $3.12 per share to $4.10 per share using Company management forecasts." *Id.* Plaintiff argues that this disclosure is deficient because it fails to disclose a description of the leverage ratios of 4.0x to 5.0x and interest rate of 9%" used in this analysis. Compl. ¶ 53(vii); Pl.'s Mot. at 4, 9.

Again, the Preliminary Proxy does disclose why these leverage ratios and weighted-average interest rate were used: the "professional judgment and expertise" of Morgan Stanley. Prelim. Proxy at 31. Plaintiff may disagree with this expertise, but that does not constitute a colorable disclosure claim. *See In re 3Com*, 2009 WL 5173804, at *3 (in rejecting plaintiffs'

alleged financial disclosure allegations relating to one of Goldman's analyses, the court noted that "[t]here is no disclosure violation here, merely a disagreement with Goldman's methodology."). Mere quibbles with methodologies (and inputs into those methodologies) do not give rise to a colorable disclosure claim requiring expedited proceedings to avoid irreparable harm. *Id.* at *6.[12]

The foregoing shows just how far Plaintiff is reaching to concoct colorable disclosure claims based on the financial disclosures pertaining to Morgan Stanley's work on its fairness opinion. At bottom, Plaintiff's challenges to the disclosures regarding Morgan Stanley's financial analyses are textbook examples of attempts to exploit the "limitless opportunities for disagreement on the appropriate valuation methodologies to employ, as well as the appropriate inputs to deploy within those methodologies" that "simply cannot be the basis of a disclosure claim." *Id.*. Under Delaware law, a board is not required to "include [the investment banker's] entire report exactly as it saw it when it made its decision to recommend" a transaction. *In re MONY Group Inc. S'holder Litig.*, 852 A.2d 9, 28 (Del. Ch. 2004); *see also In re Best Lock Corp. S'holder Litig.*, 845 A.2d 1057, 1073 (Del. Ch. 2001) ("Delaware courts have held repeatedly that a board need not disclose specific details of the analysis underlying a financial advisor's opinion.").

For this fundamental reason, Plaintiff's alleged financial disclosure claims are deficient and cannot support Plaintiff's Motion for Expedited Proceedings.

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[12] Plaintiff's reliance on *In re Netsmart Technologies, Inc. Shareholders Litigation,* 924 A.2d 171 (Del. Ch. 2007) and *Maric Capital Master Fund, Ltd. v. Plato Learning, Inc.,* 2010 WL 1931084 (Del. Ch. May 13, 2010) (Pl.'s Mot. at 8-9) is misplaced and unavailing. In *Netsmart*, the Court required additional disclosure of certain management projections used to generate the DCF analysis conducted by the investment bank because without such additional disclosure, the proxy's affirmative disclosure of other projections would be rendered materially misleading. 924 A.2d at 203. This scenario is not present here. Nor is the *Maric* scenario. There, the Court required additional disclosure where the proxy at issue contained discounts to cash flow rates significantly different than the discounts that were actually used – actively misleading investors. 2010 WL 1931084, at *1-3.

CONCLUSION

There is no exigency here. Moreover, the breach of fiduciary duty claims in Plaintiff's Complaint – including the alleged disclosure claims – are not actionable as a matter of law. Plaintiff contends that in these types of cases, "the threshold for obtaining expedited proceedings is low." Pl.'s Mot. at 6. Respectfully, it is not this low. Plaintiff's Motion should be denied.

MORRIS, NICHOLS, ARSHT & TUNNELL LLP

/s/ Susan W. Waesco
Kenneth J. Nachbar (#2067)
Susan W. Waesco (#4476)
1201 N. Market Street
P.O. Box 1347
Wilmington, DE 19899-1347
(302) 658-9200
Attorneys for Defendants NightHawk Radiology Holdings, Inc., David Engert, Peter Y. Chung, David J. Brophy, Charles R. Bland and Jeff Terrill

OF COUNSEL:

David J. Berger
Gregory L. Watts
WILSON SONSINI GOODRICH
ROSATI, P.C.
650 Page Mill Road
Palo Alto, CA 94304

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