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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' REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS AND MOTION TO STRIKE

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Dated: June 27, 2013

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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, respectfully submit the following Reply Brief in Further Support of Defendants' Motion to Dismiss and Motion to Stay. As set forth in the Digirad Parties' Opening Brief, Plaintiff Red Oak Fund, L.P. ("Red Oak" or "Plaintiff") has failed to state a viable claim under 8 *Del. C.* § 225 ("Section 225"). Red Oak's opposition papers only serve to confirm that fact, and the Verified Complaint ("Complaint") should be dismissed. Red Oak's belated and procedurally improper attempt to supplement the Complaint does nothing to affect that result—the Supplement[1] fails to state a claim and was inexplicably late in being filed. Because the Supplement is governed by Ct. Ch. R. 15(d), it should be stricken and leave to file denied as futile. Despite making multiple attempts, and having ready access to the information necessary to state a viable claim if one existed, Red Oak has simply failed to do so.

PRELIMINARY STATEMENT

Red Oak's Opposition Brief confirms two flaws in its pleadings. First, Red Oak offers no causal link between any alleged statements by Defendants apart from a conclusory allegation that "But for the individual defendants' misrepresentations, . . . the Management Slate would not have been elected." Compl. ¶ 46. While Red Oak claims to know the names of significant Digirad shareholders, it does not identify a single vote that was affected by any alleged misrepresentations. Nor does it explain why approximately 6.6 million shares were unaffected and voted with Red Oak. Red Oak also comes up short in providing a rationale for sophisticated

[1] Unless otherwise defined, capitalized terms have the meanings ascribed in the Digirad Parties' Opening Brief in Support of Their Motion to Dismiss and the Digirad Parties' Motion to Strike.

institutional shareholders to be swayed by claims regarding a preliminary count of revocable proxies in advance of a shareholder meeting. Red Oak now contends that institutional players acted to obtain information from management about "the industry in general, competitors, products and many other things." Pl.'s Br. in Opp'n to Mot. to Dismiss ("Opp'n Br.") at 14. The suggestion that shareholders were swayed by such immaterial matters fails as a matter of law. Red Oak's brief offers a second theory—that shareholders might not "give the proxy statement careful consideration." *Id.* at 8. But no such claim is made in the pleadings. Nor is any specific professional investment manager identified who did not give consideration to the proxy statement.

The second flaw in Red Oak's opposition shares a common trait with the first. It promotes a proxy contest without end. Thus, Red Oak seizes on two post-meeting events to generate non-disclosure claims—an NOL rights plan and a Form 10-Q. This is a tactic that could be used in virtually every contest to manufacture disclosure claims. In its Amended Complaint, for example, Red Oak now claims a lack of disclosure during the contest regarding an NOL Rights Plan adopted three weeks after the annual meeting. Red Oak voiced no opposition to such a plan when the contest was underway; the Digirad Board gave no contrary assurance. Indeed, Red Oak cites no misrepresentation at all, but instead claims non-disclosure of alleged plans. If Red Oak wished to cast itself as an opponent of such a plan during the contest, it could have done so. With the benefit of post-meeting events, Red Oak now champions a new cause and asks for a second bite of the apple. The Court should rebuff this tactic.

In a similar fashion, Red Oak asks the Court to adopt a novel disclosure standard that would ride roughshod over federal disclosure requirements and render virtually every annual

meeting subject to collateral attack. Under SEC regulations, reporting companies are encouraged to mail their proxies for the annual meeting within 120 days of the end of their fiscal year. *See* Instruction G to Form 10-K. The policy is self-evident: Shareholders meet annually to evaluate the Board based on annual results. Because the annual report on Form 10-K is due within 60–90 days of year-end, i.e., by March 1 to March 31 for companies with calendar year financial reporting, companies generally have annual meetings in April and May. According to Red Oak, however, reporting companies should not be soliciting proxies when they have information about first-quarter results and a Form 10-Q (which would be due by May 10 or 15) is not on file. Red Oak's proposal would render every annual meeting subject to collateral attack based on after-the-fact financial disclosures. This tactic too fails as a matter of law, and Red Oak's claims should be dismissed in their entirety.

ARGUMENT

I. RED OAK MISSTATES THE STANDARD OF REVIEW IN ORDER TO OBFUSCATE ITS FAILURE TO STATE A VIABLE CLAIM

Red Oak devotes three pages of its opposition brief to addressing the standard of review that applies to a Rule 12(b)(6) motion to dismiss. Opp'n Br. at 4–6. Red Oak's focus on the Rule 12(b)(6) standard and its assertion that the Digirad Parties' opening brief "distorts" the standard are puzzling, because Red Oak and the Digirad Parties agree on the relevant standard and cite many of the same decisions in support of their recitation of the standard. *Compare id. with* Defts.' Br. in Support of Mot. to Dismiss ("Digirad Br.") at 13–15. Red Oak's discussion of the standard of review is, in reality, an attempted sleight of hand designed to mask two dispositive failures in Red Oak's pleadings. The first failure is the absence of any non-conclusory allegation that any of the Digirad Parties' alleged misrepresentations or omissions determined the outcome of the Election. The second, related failure in Red Oak's pleadings is

the fact that none of the alleged misrepresentations or omissions identified in the Complaint or the Supplement was material.

In an attempt to circumvent its lack of any non-conclusory allegation that any of the Digirad Parties' alleged misconduct determined the outcome of the election, Red Oak contends that "mere conclusory allegations without underlying facts can and should be scrutinized . . . ." Opp'n Br. at 5. That, however, is not the standard—conclusory allegations without underlying factual support are *disregarded* in evaluating the sufficiency of the plaintiff's allegations in the context of a Rule 12(b)(6) motion. As the Supreme Court recently reiterated: "We do not, however, credit conclusory allegations that are not supported by specific facts, or draw unreasonable inferences in the plaintiff's favor." *Norton v. K-Sea Transp. Partners L.P.*, __ A.3d __, 2013 WL 2316550, at *3 (Del. May 28, 2013) (citation omitted). The Supreme Court has also made clear that conclusory allegations are simply not "well pleaded" for purposes of Rule 12(b)(6). *See Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 140 (Del. 1997) ("In evaluating ADM's motion to dismiss, therefore, the Court of Chancery was required to assume the truthfulness of all well-pleaded (i.e., nonconclusory) allegations of the complaint for purposes of the motion."); *see also id.* ("It is well established, however, that conclusions . . . [contained in the complaint] will not be accepted as true without specific allegations of fact to support them.") (ellipsis and alteration in original) (internal quotation marks and citation omitted). Red Oak is simply wrong when it argues that conclusory allegations may be "scrutinized;" wholly conclusory allegations are of no value in assessing the sufficiency of a complaint.

As for the second fatal deficiency in its allegations, Red Oak complains that the Digirad Parties have attempted to "cloud the applicable 12(b)(6) standards" by attaching certain of the

parties' public SEC filings for the Court's consideration. Opp'n Br. at 6. According to Red Oak, "Defendants' decision to laboriously cite and analyze ***irrelevant written proxy materials*** is an attempt to shift focus away from the relevant issues in this case." *Id.* (emphasis added). Red Oak's claim that the parties' written proxy materials (or other SEC filings) are "irrelevant" to evaluating Red Oak's disclosure-based Section 225 claims cannot be squared with either this Court's or the Supreme Court's precedent.

"A claim based on disclosure violations must provide some basis for a court to infer that the alleged violations were material." *Loudon*, 700 A.2d at 141. That is, "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."[2] *Id.* (emphasis added). When evaluating the materiality of supposed omissions or misstatements in a proxy statement, the Court—as a matter of both precedent and logic—looks to the existing SEC filings to determine what the "total mix" of information available to stockholders consisted of. *See, e.g.*, *Brinckerhoff v. Tex. E. Prods. Pipeline Co., LLC*, 2008 WL 4991281, at *4–7 (Del. Ch. Nov. 25, 2008) (analyzing relevant SEC filings to determine the applicable "total mix" of information and holding that plaintiff's disclosure claims "fall away" once the totality of defendant's public disclosures was considered). Red Oak's suggestion that its allegations should be considered without the context provided by the Digirad Parties' and Red Oak's public disclosures leading up to the Election is indistinguishable from the argument this Court rejected in *Brinckerhoff* when it refused to examine an allegedly misleading letter "in isolation" and viewed the letter instead "as a part of the total mix of information available to unitholders." *Id.* at *6. *See also* Digirad Br. at

[2] The requirement to plead "how the omission caused injury" in the context of a disclosure-based Section 225 claim is another way of stating that a Section 225 plaintiff must plead that the alleged disclosure violations were outcome determinative. Unless the outcome would have been different, there is no cognizable injury.

18–19 (discussing decisions in which this Court has considered "the information made known by all parties to a proxy contest" in determining the "total mix" of information available to stockholders).

Fundamentally, Red Oak's opposition to the Digirad Parties' Motion to Dismiss is predicated on the elimination of *any* standard that the Complaint must satisfy to survive a Rule 12(b)(6) motion. According to Red Oak, conclusory allegations may be relied upon so long as they are "scrutinized," and the materiality of alleged disclosure violations cannot be resolved on a motion to dismiss. Opp'n Br. at 5–6. If Red Oak were correct, no disclosure-based claim could *ever* be dismissed. That is not what Delaware law provides,[3] and the Court should reject Red Oak's invitation to write Rule 12(b)(6) out of the law.

II. RED OAK'S FAILURE TO PROVIDE ANY NON-CONCLUSORY ALLEGATIONS THAT THE OUTCOME OF THE ELECTION WAS DETERMINED BY THE SUPPOSED DISCLOSURE VIOLATIONS IS A SUFFICIENT REASON TO GRANT THE MOTION TO DISMISS

A. Section 225 Claims Are Not Actionable Unless the Alleged Misconduct Was Outcome Determinative

In their opening brief, the Digirad Parties established, with citation to four decisions, that in order to state a viable Section 225 claim Red Oak must plead that the allegedly inadequate or improper disclosures were outcome determinative. *See* Digirad Br. at 29–32. Red Oak's attempts to distinguish the relevant decisions are unpersuasive and only serve to underscore the

[3] *See, e.g.*, Digirad Br. at 29 n.5, 30–31 (collecting decisions); *Brinckerhoff*, 2008 WL 4991281, at *4–7 (finding alleged disclosure violations immaterial and granting motion to dismiss); *Orman v. Cullman*, 794 A.2d 5, 32 (Del. Ch. 2002) ("It is proper, therefore, for this Court to address the question of materiality of the plaintiff's alleged omissions in the context of a Rule 12(b)(6) motion to dismiss."); *In re Best Lock Corp. S'holder Litig.*, 845 A.2d 1057, 1072–73 (Del. Ch. 2001) (finding alleged disclosure violations immaterial and granting motion to dismiss); *In re KDI Corp. S'holders Litig.*, 1990 WL 201385 (Del. Ch. Dec. 13, 1990) (Berger, V.C.) ("Disclosure claims do not survive a motion to dismiss simply because they are inserted in the Complaint.").

requirement that a Section 225 plaintiff plead misconduct that changed the outcome of the election.

Red Oak attempts to distinguish *Zaucha v. Brody*, 1997 WL 305841 (Del. Ch. June 3, 1997), *aff'd* 697 A.2d 749 (Del. 1997) because it was decided after trial. Red Oak's argument is a non sequitur. Whether or not *Zaucha* was decided after trial, the point is the applicable standard it announced and that Red Oak does not contest. The relevant question, as held by *Zaucha*, "is not simply whether there was a disclosure violation, but whether any such violation warrants setting aside the result." *Id.* at *5. In Red Oak's words, the standard is that "trivial disclosure violations" cannot form the basis of a successful Section 225 claim. *See* Opp'n Br. at 18. While *Zaucha* may have been decided after trial, where it is plain from the face of the complaint that the disclosure violations alleged do not warrant setting aside the result of an election or solicitation (whether due to their "trivial" nature or otherwise), the plaintiff has failed to state a viable claim. That is, of course, the purpose of Rule 12(b)(6)—to weed out claims based on factual allegations that fail to meet the "reasonable conceivability" test. Red Oak's Opposition Brief does not even attempt to explain how or why its allegations rise to the level of disclosure violations that warrant setting aside the result of the Election in the context of *Zaucha*.

Red Oak's attempt to distinguish *Kurz v. Holbrook*, 989 A.2d 140 (Del. Ch.), *aff'd in part and rev'd in part sub nom. Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377 (Del. 2010) is even less persuasive. Red Oak does not argue that Vice Chancellor Laster misstated the law when he held that "vote buying should merit review only if it is disenfranchising, in the sense of actually affecting the outcome of the vote." *Id.* at 178. According to Red Oak, *Kurz* "has no application here" because it dealt with vote buying rather than alleged disclosure violations. Opp'n Br. at 18. Red Oak fails to explain why this is so. What is the difference between a

Section 225 claim based on allegations of vote buying and one based on alleged disclosure violations? More to the point, why does a Section 225 claim based on disclosure violations merit review *even if one assumes that the disclosure violations did not alter the outcome of the election*? Surely, Section 225 does not exist to provide a forum to further explicate Delaware disclosure standards while leaving the results of an election unchanged. Simply stated, the distinction Red Oak has drawn between this action and *Kurz* is one without a difference.

Red Oak fails to even draw a trivial distinction between its claims and those at issue in *A.R. Demarco Enters., Inc. v. Ocean Spray Cranberries, Inc.*, 2002 WL 31820970, at *7 (Del. Ch. Dec. 4, 2002). Red Oak asserts that *Ocean Spray Cranberries* "concerned a § 225 claim where the complaint failed to assert *any* flaws that would call the election into question" and dealt with a situation where "an immaterial number of votes (2%) were miscounted." Opp'n Br. at 19. Those statements are true, but only serve to underscore the Digirad Parties' point—unless the factual allegations in a complaint "call the election into question" by relating to a material shift in the voting results, the plaintiff fails to state a viable Section 225 claim.[4] Red Oak goes on to attempt to distinguish the substance of its allegations from the allegations in *Ocean Spray Cranberries*. Any difference between the two sets of allegations, however, does nothing to undermine the Digirad Parties' argument that Section 225 claims must be based on factual allegations that the underlying violations altered the outcome of the election.[5] Red Oak's effort to argue that its allegations call the Election into question is tantamount to a concession that,

[4] The 2% of votes allegedly miscounted were only "immaterial" due to the margin of victory in the election at issue in *Ocean Spray Cranberries*. Had the margin been 1%, the miscounted votes would have been material because they would have swung the outcome of the election. In other words, the *only* reason that the plaintiff's allegations of miscounted votes in *Ocean Spray Cranberries* failed to state a claim was because the votes at issue were not outcome determinative. Red Oak does not, and cannot, dispute this proposition.

[5] As discussed below, Red Oak's allegations, like those in *Ocean Spray Cranberries*, fail to establish any improprieties in the Election.

notwithstanding the rest of Red Oak's strained argument on this point, there *is* an outcome determinative requirement for Section 225 claims.

Finally, Red Oak tries to distinguish *Hewlett v. Hewlett-Packard Co.*, 2002 WL 549137 (Del. Ch. Apr. 8, 2002) by ignoring what Chancellor Chandler wrote. According to Red Oak, *Hewlett* "actually held" that a Section 225 claim survived a motion to dismiss because the plaintiff alleged that "management procured proxies by disclosing material information that it knew to be false." Opp'n Br. at 19. That is simply not what *Hewlett* held. The Court expressly stated that its denial of the defendants' motion to dismiss was based on a variety of factors and required more than the mere conclusory allegation that management knowingly disseminated false information:

> I reiterate that the plaintiffs in this case have done more than just allege in conclusory form that they thought the defendant was lying. Such a bare-bones allegation would not be sufficient to invoke § 225 after a party lost a proxy contest. The plaintiffs here have specifically identified reports to management by the integration team that can be verified and that would, accepting the alleged facts as true, prove the bad faith of HP management. The credibility of these allegations, made primarily upon information and belief, is bolstered by the fact that one of the plaintiffs, Walter Hewlett, is a director of the defendant corporation and as such has access to confidential company documents. Finally, the alleged misstatements pertain to integration, an issue that was particularly important to ISS, an institution that was effectively able to dictate the vote of a block of shares ***that we now know was likely outcome determinative***. ***It is in light of all these factors that I conclude that the plaintiffs may proceed with this challenge under § 225.***

2002 WL 549137, at *10 n.24.

In sum, Delaware decisions are clear, and Red Oak does not and cannot persuasively dispute, that a plaintiff must allege outcome determinative misconduct in order to state a viable Section 225 claim seeking to invalidate a corporate election.

B. Red Oak's Lone Outcome Determinative Allegation is Conclusory

Red Oak concedes that its only outcome determinative allegation is the conclusory assertion in Paragraph 46 of the Complaint that "[b]ut 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." Opp'n Br. at 20. *See also id.* at 17 (quoting the same conclusory allegation). This allegation is a paradigmatic conclusion and this Court has dismissed complaints for relying on less obviously conclusory allegations. *See Gibralt Cap. Corp. v. Smith*, 2001 WL 647837, at *13 (Del. Ch. May 9, 2001) (dismissing claim as improperly based on "conclusory" allegation that "[b]ased upon the large discount to market -- Ichor shares never sold below $1.50 at this time -- plaintiff believes, and therefore alleges, that the shares were sold to the defendants or their affiliates.").

Presented with the opportunity to point to the factual allegations in the Complaint that support its single, conclusory outcome determinative allegation, Red Oak merely asserted—without explanation—that "[t]he facts pled in the Verified Complaint and the reasonable inferences drawn from them support Red Oak's contention that the Defendants[] would not have been elected but for their misconduct." *Id.* Red Oak's half-hearted effort to tie its outcome determinative conclusion to the factual allegations in its Complaint is not argument—it is *ipse dixit*.

While that fact alone is sufficient to dispose of the issue, there is an obvious reason why Red Oak is left with nothing but its own say-so: the reasonable inferences drawn from the Complaint belie Red Oak's conclusory outcome determinative allegation. While the Complaint alleges that multiple stockholders were informed of the Management Slate's large early lead in preliminary voting and the Digirad Parties' supposed prediction that the election was "sewn up," the Complaint identifies only one specific stockholder that received this information—Somerset.

The Complaint further alleges that Somerset nonetheless voted for the Red Oak slate of director nominees. The only reasonable inference to draw from these alleged facts is that the Digirad Parties' supposed electoral predictions either had no effect on voting, or had the effect of causing stockholders *to vote for Red Oak*.[6] There is no basis upon which to infer that the predictions caused stockholders to vote for Digirad or dissuaded them from voting at all.[7]

Further, Red Oak's attempt to analogize its allegations to those in *Portnoy v. Cryo-Cell Int'l*, 940 A.2d 43 (Del. Ch. 2008) only underlines why Red Oak's claims should be dismissed. *See* Opp'n Br. at 20 ("Red Oak's allegations are quite similar to those in *Portnoy* . . . ."). In *Portnoy*, the plaintiff specifically alleged that the defendants' slate purportedly won the election by, at most, 673,477 votes. *See Portnoy* Compl., 2007 WL 4945752, ¶ 94.[8] The *Portnoy* Complaint went on to specifically allege the names of stockholders whose votes were obtained by alleged misconduct as well as the number of votes that were improperly voted for the defendants' slate and identified an amount of votes at issue that would have swung the outcome

[6] For this reason, Red Oak's attempt to make much of the Digirad Parties' supposedly "false" contention that the Complaint alleges that only one specific stockholder was informed of the prediction of electoral victory is a straw man. *See* Opp'n Br. at 11. The Digirad Parties' statement that only one specific stockholder was identified in the Complaint as having received the prediction of victory was not false—Somerset is the only such stockholder identified in the Complaint. The Digirad Parties' point was not to ignore the allegation that other, unnamed stockholders also heard the same prediction. Instead, the point was that, given that the only specific example provided by Red Oak was a stockholder that voted for the Red Oak slate, there is no basis to infer that the other, unnamed stockholders were misled into voting for the Management Slate based on the alleged prediction of victory.

[7] Red Oak's inability to come forward with allegations supporting an inference that the Digirad Parties' alleged misconduct determined the outcome of the election is particularly telling because Red Oak claims to be aware of which stockholders voted for which slate of nominees. *See* Opp'n Br. at 12 ("It is widely known that proxy solicitors . . . are hired precisely to identify, contact and track the votes of many beneficial owners."). Armed with this knowledge from its own proxy solicitor, it would have been a simple matter for Red Oak to identify a stockholder whose vote for the Management Slate was premised on misleading disclosures.

[8] A copy of the *Portnoy* Complaint is attached hereto as Exhibit A.

of the election. *See id.* ¶¶ 95–104 (identifying 1,308,667 allegedly improper votes). In other words, the *Portnoy* Complaint alleged the very facts that Red Oak insists are unnecessary to state a Section 225 claim. *See* Opp'n Br. at 19 ("Simply put, Defendants[']contention that a § 225 Plaintiff must allege precisely which and how many shareholder votes were affected by the improper or inadequate disclosure has no merit.").

Red Oak's refrain that the predictions of victory were material even if not outcome determinative also rings completely hollow given that Red Oak offers absolutely no response to the argument that an early lead for the Management Slate was not only predictable, but expected given the timing of the parties' proxy solicitations. *See* Digirad Br. at 24; Compl. ¶ 17 ("it was inescapable that *initial returns* of proxy instructions would necessarily be weighted toward" the Management Slate). This fact renders any preliminary voting tallies (or predictions based on such tallies) immaterial, because all Digirad stockholders were aware of the timing of the parties' respective solicitations and thus cognizant of the "inescapable" tilting of the early returns toward the Management Slate. *See id.; see also* Compl. ¶ 37 ("Thus it was natural – and both contestants knew and expected – that the earliest preliminary proxy returns would be weighted towards the Management Slate."). Finally, Red Oak fails to address the fact that the "total mix" of information provided by both sides of the contest made clear that the vote was in doubt and that "only your last voted proxy will count." Ex. G to Digirad Br. at 8; Ex. J to Digirad Br. at 5. The written disclosures to Digirad's stockholders makes clear that the results would not be known until the meeting was held.

III. RED OAK'S RULE 14A-9-BASED CLAIMS ARE INCOHERENT AND CONTRARY TO LAW

A. Red Oak Has Not Alleged a Rule 14a-9 Violation

The Digirad Parties' opening brief demonstrated that, at most, Red Oak has alleged that Defendants made a prediction of electoral victory, which is not actionable under § 14(a) of the Securities Exchange Act or Rule 14a-9 promulgated thereunder, let alone sufficient to anchor a Section 225 claim seeking to invalidate an election. As predicted by the Digirad Parties, Red Oak's opposition seizes on language in certain federal Rule 14a-9 decisions indicating that "claims of sure victory" are "potential violations of the rule." *Compare* Digirad Br. at 21 n.3 *with* Opp'n Br. at 10 ("yet that case [*Mgmt. Assistance, Inc. v. Edelman* (*MAI*)] confirms that 'claims of sure victory [are] potential violations of the rule.'"). Red Oak does not attempt to address, however, the Digirad Parties' argument that the federal decisions' reference to "claims of sure victory" do not refer to strong predictions—or even predictions purporting to claim certain victory. *See* Digirad Br. at 21 n.3.

The fatal flaw in Red Oak's "claims of sure victory" argument is that, to qualify as such a claim for purposes of Rule 14a-9, the assertion must be one that indicates that victory is a mathematical certainty or otherwise a *fait accompli* due to a preexisting voting agreement or something equivalent. As the *MAI* court put it and as Digirad's opening brief pointed out, there is a difference between claims that the management group *will* win and that it *must* win. 584 F. Supp. at 1020. The only case cited by Red Oak in support of the proposition that claims of "sure victory" violate Rule 14a-9 is *Gould v. Am. Haw. S.S. Co.*, 331 F. Supp. 981, 993 (D. Del. 1971).[9] As both the *MAI* court and the Digirad Parties' opening brief explained, *Gould* is a

[9] Red Oak also cites to *Edelman v. Salomon*, 559 F. Supp. 1178, 1186 (D. Del. 1981), *see* Opp'n Br. at 8–9, but *Edelman* did not turn on any alleged claims regarding the certainty of management's victory in an election or solicitation. Instead, *Edelman* issued the unremarkable

"must win" case because it involved an assertion that 64 percent of the stockholders' votes were contractually committed to management when, in reality, no such commitment existed. *See* Digirad Br. at 21 n.3. Here, however, Red Oak's allegations are of the "will win" and not the "must win" variety, and Red Oak specifically states as much. *See* Compl. ¶ 35 ("Eberwein strongly and repeatedly claimed that the management slate ***would no doubt win the election***, with or without Somerset's votes.") (emphasis added).

Red Oak does not allege that the Digirad Parties claimed to have locked in an outcome determinative amount of votes. All that is alleged in the Complaint is that certain of the Digirad Parties claimed that preliminary returns indicated that "it's not even close," the Management Slate "has this sewn up" and "it's a landslide." Compl. ¶ 36. Digirad's stockholders—most of whom are sophisticated investors and no strangers to annual meetings or proxy contests—were also well aware, however, that only the last-in-time proxy card submitted by each stockholder would count, and therefore that the preliminary returns were not indicative of definitive, binding or locked-in votes. *See* Digirad Br. at 22. The Management Slate's early lead could have been wiped out at any time by a sufficient block of stockholders switching their votes. *See* Compl. ¶ 18 (interim tabulations "are preliminary in nature and subject to change until voting is complete"). Thus, in light of the information available, the Digirad Parties' alleged prediction of a "landslide" victory did not even arguably violate Rule 14a-9 and was immaterial to Digirad's stockholders. *See* Digirad Br. at 20–21.

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holding that management's misrepresentation of the amount of stock beneficially controlled by members of management was material to a solicitation seeking to eliminate cumulative voting and to classify the board. *See id.* at 1184. Here, Red Oak does not allege that the Digirad Parties misrepresented the preliminary results and, as explained below, the preliminary results in the Election were immaterial to Digirad's stockholders' voting decisions.

B. Red Oak's Rule 14a-9 Claims are Illogical

In its Opposition Brief, Red Oak beats a hasty retreat from its allegations that the potential for abusive disclosure of preliminary voting results is "especially strong in the context of microcap companies like Digirad" because stockholders in a "microcap" company need access to management in order to obtain information about the company. Compl. ¶ 21. In the Complaint, this alleged need for information influences voting in board elections because stockholders fear being frozen out of access to management. *Id.* ¶ 22. According to the Opposition Brief, however, Digirad's size is completely irrelevant. *See* Opp'n Br. at 13 ("Defendants' [alleged] attempts to influence voting by falsely claiming a 'landslide' victory are wrong and actionable regardless of the company's size."). Red Oak's desire to separate itself from its initial allegations is understandable, because those allegations simply do not make any sense.

Red Oak mocks as "absurd" the Digirad Parties' argument that the purported information stockholders hope to obtain from microcap companies' management is either illegal or immaterial inside information. *Id.* According to Red Oak, stockholders in microcap companies "are merely doing what market analysts often do with larger-cap companies." *Id.* at 14. What Red Oak does not and cannot explain, however, is how any stockholder in a microcap company can logically fear being unable to seek such "market analyst"-like information itself. As the Digirad Parties detailed in their opening brief, under Regulation FD any material information disclosed to *one* stockholder must be publicly disclosed to *all* stockholders. *See* 17 C.F.R. § 243.100. Therefore, even accepting Red Oak's "freeze out" allegations, any stockholders who are cut off from contact with a microcap company's management will nonetheless receive—through public disclosure—the same information that allegedly favored stockholders receive from management. The only information that will not be disseminated to both groups of

stockholders is, by definition, immaterial information that need not be publicly disclosed. Red Oak's opposition concedes this point, claiming that stockholders voted against their better judgment to gain access to information from management about "the industry in general, competitors, products and many other things." Opp'n Br. at 14. As a matter of pure logic, Red Oak's "freeze out" allegations thus reduce to the incoherent claim that stockholders' votes are influenced by their desire for illegal or immaterial inside information. Such a claim is not actionable in the context of a Section 225 claim or anywhere else.

IV. RED OAK'S 10-Q ALLEGATIONS DO NOT STATE A VIABLE SECTION 225 CLAIM

A. Red Oak's Attempt to Rewrite its Form 10-Q Allegations Should Be Rejected

The Complaint alleged that Digirad's Form 10-Q for the first quarter of 2013 revealed two pieces of negative financial information that were unknown prior to the Election and material to Digirad stockholders: (1) Digirad's net revenues declined in Q1 2013 compared to Q1 2012 and (2) Digirad's net losses "nearly doubled." Compl. ¶ 41 (emphasis in original). The Digirad Parties' opening brief demonstrated that this purported negative financial information was well known to Digirad stockholders prior to the Election because it was contained in or anticipated by the Form 10-K released on March 13, 2013. Digirad Br. at 28–29. In response, Red Oak does not directly defend its initial allegations, but instead attempts to rewrite them, claiming that Digirad's losses "were not the only or even most significant negative financial information," and pointing to supposed "additional information" that was "revealed" in the Form 10-Q for the first quarter of 2013. Opp'n Br. at 16 (citing Digirad's "overall gross margin" decrease, adjusted net loss excluding restructuring costs, and general and administrative expenses as a percentage of revenue). These newly-identified supposed deficiencies in the Digirad Parties' pre-Election disclosures, which are absent from the Complaint, cannot save Red

Oak's claims. "For a contention to rise to the status of a claim that will be considered on a motion to dismiss, it must be alleged in the complaint." *Weiss v. Rockwell Int'l Corp.*, 1989 WL 80345, at *4 (Del. Ch. July 19, 1989) (Jacobs, V.C.). "The plaintiff, having not seen fit to embody his contentions in his complaint, cannot now be heard to interpose those contentions, in the form of arguments advanced in his brief, as a basis to defeat a Rule 12(b)(6) motion to dismiss." *Id.*

B. The Allegedly Negative Information in the 10-Q Was Disclosed in Digirad's 10-K

Red Oak never addresses the Digirad Parties' argument that the purportedly negative financial information that the Complaint identifies as being disclosed in Digirad's Form 10-Q (the year-over-year decrease in revenues and increase in net losses) was already part of the "total mix" of information available to stockholders through Digirad's 2012 Form 10-K filing. Instead, Red Oak argues that the information known to stockholders "is a factual dispute that cannot be resolved in this Motion to Dismiss." Opp'n Br. at 16. As explained above, Red Oak is wrong; a Rule 12(b)(6) motion is the appropriate stage at which to determine what information was known to stockholders, and the Court is not bound to blindly accept Red Oak's allegations where the allegations are belied by the content of Digirad's public filings. *See, e.g.*, *Brinckerhoff*, 2008 WL 4991281, at *7 (examining SEC filings and holding that allegedly withheld information was in fact disclosed in prior public filings). Moreover, where the allegedly omitted information is merely cumulative of information that is already publicly available, it is immaterial. *See In re Best Lock Corp.*, 845 A.2d 1057, 1072–73; *see also Abrons v. Maree*, 911 A.2d 805, 813 (Del. Ch. 2006) ("Consistent and redundant facts do not alter the total mix of information . . . .").

It is clear from Digirad's SEC filings that both the likely revenue decrease and the likely increase in net losses were apparent to stockholders. The net losses were almost entirely driven

by restructuring charges incurred as part of Digirad's turnaround plan. *See* Ex. A to Digirad Br. at 5. The restructuring charges, in turn, were discussed in Digirad's Form 10-K. *See* Ex. S to Digirad Br. at 18, 47 n.11. Similarly, the decrease in year-over-year revenues reflected in the 10-Q was "primarily the result of a decrease in the number of camera sales in [Digirad's] Diagnostic Imaging segment along with pricing pressure associated with [Digirad's] DIS business." Ex. A. to Digirad Br. at 13. Digirad's Form 10-K disclosed both. Ex. S to Digirad Br. at 18 ("it is also likely that the long-term volume and total revenue of our Diagnostic Imaging camera sales will decrease"); *id.* ("Our market has been negatively affected by . . . pricing pressures . . . ."). As a result of the disclosures in the 10-K, the supposedly negative information in the 10-Q was available to Digirad's stockholders in advance of the Election, and Red Oak's 10-Q based claims should be dismissed.

C. The Timeliness and Scope of the 10-Q Further Expose Red Oak's Fallacious Claims

The Digirad Parties' opening brief explained that Digirad was under no obligation to file its 10-Q prior to the Election and, if anything, filed the 10-Q early. *See* Digirad Br. at 27. Red Oak asserts that this argument is a "red herring" because the issue is not the timing of the 10-Q, but rather the disclosure of negative financial information. Opp'n Br. at 15 ("Red Oak's complaint is not that the 10-Q should have been filed earlier . . . ."). Red Oak's brief is again at odds with its Complaint, which alleged: "*The Form 10-Q that management purposefully delayed until one business day after the annual meeting* reflected management's most recent poor performance . . . ." Compl. ¶ 42 (emphasis added). Red Oak thus put the timing of the 10-Q at issue in its Complaint, but now acknowledges that the 10-Q was timely and apparently concedes that the 10-Q itself need not have been filed any earlier than it was. Red Oak's effort to separate the "financial results" contained in the 10-Q from the 10-Q itself should be rejected. While

federal reporting requirements are designed to ensure that stockholders have a company's 10-K in advance of the annual meeting,[10] the timeline for quarterly filings dictates that the 10-Q may be filed without regard to the date of the company's annual meeting. Red Oak's approach of mining post-meeting financial reports for alleged non-disclosures, if blessed by the Court, will effectively guarantee a Section 225 suit from every unsuccessful insurgent in a proxy contest. Clever, resourceful and experienced counsel will always be able to conjure some type of inconsistency or gap between a post-meeting quarterly report and the contents of management's proxy solicitations.

Red Oak's argument that the Digirad Parties' discussion of positive stock price movements during the proxy contest somehow required disclosure of the quarterly results from the 10-Q is another non sequitur. The Management Slate "fight letter" dated April 4, 2013 stated that Digirad's stock price had increased "approximately 33%" from the date the Board was reconstituted—February 7, 2013—to April 1, 2013. Ex. E to Digirad Br. at 3. That statement was not a disclosure of anything new; Digirad's historical stock prices were and are a matter of public knowledge. Red Oak cites no authority for the proposition that the need for disclosure of the first quarter's results was "heightened" because the Digirad Parties pointed out positive movement in the Company's stock since the formation of the newly reconstituted Board. Moreover, the results reported in the 10-Q do not address the relative performance of the Company from February 7, 2013 through April 1, 2013 but rather the financial results during two snapshots in time—March 31, 2012 and March 31, 2013. Discussions of share price and financial performance are commonplace in proxy contests, but SEC regulations do not impose

[10] General Instruction G(3) to Form 10-K permits the information contained in Part III of Form 10-K to be incorporated by reference to the registrant's definitive proxy statement, which involves the election of directors, if such definitive proxy statement is filed with the SEC not later than 120 days after the end of the fiscal year covered by the Form 10-K.

any obligation to alter the timetable for financial reporting when they occur. Red Oak's novel standard would expose proxy participants to the Hobson's choice of remaining silent on such matters or delaying the annual meeting until well after the year-end results are published.

V. RED OAK'S SUPPLEMENT IS PROCEDURALLY IMPROPER AND SHOULD BE STRICKEN WITHOUT LEAVE TO RE-FILE

On June 13, 2013, Red Oak filed its Supplement. The Digirad Parties promptly moved to strike the Supplement on June 18, 2013, arguing that it was a supplemental pleading governed by Rule 15(d) because it relates to the Rights Plan adopted after Red Oak filed its Complaint and that Red Oak failed to obtain the required leave of Court before filing the Supplement.[11] *See* Mot. to Strike ¶¶ 9–12. The Digirad Parties further argued that Red Oak should be denied leave to file the Supplement because Red Oak's supplemental allegations regarding Digirad's Rights Plan fail to state a claim and because Red Oak improperly delayed in filing the Supplement. *Id.* ¶¶ 13–25. Red Oak responded to the Motion to Strike on June 20, 2013, arguing that the Supplement was properly filed under Rule 15(a) because it concerns pre-Complaint events and that Red Oak did not unduly delay in filing the Supplement. In its Opposition Brief, Red Oak argued that the Supplement states a viable claim. *See* Opp'n Br. at 20–23.

A. Red Oak's Purported Amended Complaint is Really a Supplemental Pleading

Rule 15(d) governs "supplemental pleadings" that set forth "transactions or occurrences or events which have happened since the date of the pleading sought to be supplemented." Red Oak's Supplement alleges that Digirad implemented the Rights Plan "[t]here weeks after the

[11] Red Oak pointed out that the Supplement also added allegations related to Digirad's alleged delay in publishing its first quarter 2013 earnings release. Resp. to Mot. to Strike ("Resp.") ¶ 4. The Digirad Parties agree that these allegations are proper amendments under Rule 15(a); however, the earnings release allegations do not add anything material to Red Oak's 10-Q allegations and fail to state a claim for the reasons discussed above in the context of Red Oak's 10-Q claims.

May 3 annual meeting" and that the Digirad Parties "did not disclose prior to the annual meeting that they were ***considering*** a new poison pill to increase their ownership of Digirad but restrict most large shareholders from doing so." Supplement ¶¶ 44, 47 (emphasis added). The Digirad Parties' Motion to Strike demonstrated that the Supplement addresses conduct that occurred after the Complaint was filed; namely, the adoption of the Rights Plan on May 23, 2013.

Red Oak's response to the Motion to Strike claims that the challenged conduct is not the adoption of the Rights Plan, but the alleged pre-Complaint consideration of the Rights Plan. Resp. ¶ 5. However, Red Oak's Opposition Brief belies this self-serving argument through its candid admission that "the 'potential' for adopting a rights plan is a far cry from doing so." Opp'n Br. at 22. In other words, had the Rights Plan not been adopted, the Supplement would never have been filed. Red Oak is not really taking issue with the pre-Election consideration of the Plan but rather the fact that the Plan was adopted. More fundamentally, the Supplement sets forth a transaction that occurred since the date the Complaint was filed—the May 23, 2013 adoption of the Rights Plan. As such, the Supplement clearly falls within Rule 15(d) and requires leave of Court.

B. Red Oak's Rights Plan-Related Allegations Do Not State a Claim

In the Motion to Strike, the Digirad Parties argued that the Rights Plan-related allegations fail to state a claim because, on the face of the Supplement, it is clear that any discussion of the potential for adoption of the Rights Plan would not have changed the outcome of the election because the stockholders who may have reacted negatively to the Rights Plan voted for Red Oak anyway. Mot. to Strike ¶¶ 14–15. Red Oak offers no response to this argument in either its Response or its Opposition Brief.

The Motion to Strike also argued that the mere consideration of a rights plan (and the concomitant potential that a rights plan would be adopted) were immaterial in the context of the

Election. *Id.* ¶¶ 16–21. In response, Red Oak admits that the potential for adopting a rights plan is a "far cry" from actually implementing one. Opp'n Br. at 22. Red Oak's argument, however, only bolsters the immateriality of the Digirad Board's alleged consideration of a rights plan prior to the annual meeting—consideration of such a plan is not the issue; the implementation of one is. Further, Red Oak fails to articulate why the Digirad Parties were under a duty to disclose their consideration of a rights plan in the first instance. There is no general duty to provide rolling updates on a company's plans or potential actions unless (1) a prior representation, previously true, has become misleading absent the update or (2) the plans represent a "radical departure" from prior policy. *In re Wayport, Inc. Litig.*, 2013 WL 1811873, at *23–24 & n.4 (Del. Ch. May 1, 2013); *see also Unanue v. Unanue*, 2004 WL 2521292, at *12 & n.98 (Del. Ch. Nov. 3, 2004) (holding that there is no requirement to disclose future plans of directors elected by consent during the solicitation where there is no evidence that directors intended to alter significantly the company's method of doing business). Digirad never represented that it would not adopt an NOL-related rights plan, nor was the consideration of a rights plan a radical departure from Digirad's corporate policy, and therefore Defendants had no duty to disclose the mere consideration of a rights plan.[12]

Red Oak also feigns naivety regarding the import of the parties' discussion during the proxy contest of the 2012 standstill agreement and the utilization of Digirad's NOLs as a key corporate asset. It was obvious to all Digirad stockholders that an NOL-related rights plan was discussed in 2012 and that Digirad's NOLs were viewed by both sets of director nominees as an

[12] To the extent Red Oak's Supplement intends to suggest that the adoption of the Rights Plan was a breach of fiduciary duty because it restricts certain large stockholders from acquiring additional shares of Digirad stock, but does not directly affect two of the Digirad Parties, *see* Supplement ¶¶ 46–47, disclosure couched in those terms was plainly not required. *See Brinckerhoff*, 2008 WL 4991281, at *7 ("disclosure of some alleged and unfounded future intent to breach fiduciary duties is certainly not" required by Delaware law).

asset worth protecting. Given that context, disclosing that the Management Slate was considering or would consider the adoption of a rights plan would not have significantly altered the "total mix" of available information. *See* Mot. to Strike ¶ 19.

Moreover, Red Oak had every opportunity to make an issue of a potential NOL rights plan if Red Oak (1) opposed such a plan and (2) thought its opposition to an NOL rights plan could help garner votes in the Election. Red Oak did not raise the issue in any of its proxy solicitations, however, making clear that Red Oak either did not view the specter of an NOL rights plan as a significant issue in the election or could not truthfully state that it opposed one. Either way, the Election had nothing to do with the potential for an NOL rights plan, and *Coates v. Netro Corp.*, 2002 WL 31112340 (Del. Ch. Sept. 11, 2002) is thus directly on point despite Red Oak's attempt to distinguish it.[13] Because pursuit of Red Oak's Rights Plan-related allegations would be futile, the Supplement should be stricken. *See Agilent Techs., Inc. v. Kirkland*, 2009 WL 119865, at *5 (Del. Ch. Jan. 20, 2009).

C. Red Oak's Supplement was Inexcusably Delayed

Red Oak does not dispute that its delay in filing the Supplement consumed a full one third of the parties' time to prepare for trial from the date of the hearing on the Motion to Expedite and fails to explain why it was necessary to wait three weeks to add four paragraphs to the Complaint. Instead, Red Oak seeks to minimize the prejudice resulting from the Supplement. In the first instance, Red Oak is incorrect to assert that "serious" prejudice is required for leave to

[13] Red Oak's argument regarding *Coates* relies on platitudes about stockholders' supposedly "typical" reaction to rights plans. Red Oak conveniently ignores the actual context of the Election, in which both sets of nominees agreed that the Company's NOLs should be studied, preserved, and used to maximize cash flows. *See* Mot. to Strike ¶¶ 18–19. In that context, it is not reasonable to infer that using a rights plan as a mechanism to protect Digirad's NOLs would have been material in the Election. *See Unanue*, 2004 WL 2521292, at *8 & n.67 (collecting decisions and holding that the materiality of disclosures is addressed from the point of view of a reasonable stockholder of the particular company in question).

supplement or amend a pleading to be denied. *See* Resp. ¶ 8. Sufficiently serious prejudice to the opposing party is a sufficient, but not a necessary, ground for denial of leave to amend or supplement. *See In re Trust for Gore*, 2010 WL 5561813, at *2 n.9 (Del. Ch. Dec. 23, 2010) ("The liberal policy favoring amendments may yield to concerns that allowing an amendment would cause undue prejudice ***or*** undue delay.") (emphasis added) (citing *Tomczak v. Morton Thiokol, Inc.*, 1985 WL 21142, at *1 (Del. Ch. Oct. 5, 1985)). Red Oak's inexplicable delay alone is a sufficient reason to deny leave to supplement the Complaint.

Further, Red Oak glosses over the fact that the parties were in the midst of dispositive motion briefing when the Supplement was filed as well as the highly compressed schedule, looming discovery deadlines and Red Oak's desire to delve into the sideshow of the Digirad Board's discussions regarding an NOL-related rights plan at any time during 2013. Any one of these problems, standing alone, would demonstrate prejudice sufficient to justify denial of leave to pursue the Supplement. *See, e.g.*, *Knutkowski v. Cross*, 2011 WL 6820335, at *2 (Del. Ch. Dec. 22, 2011) (suggesting that undue prejudice from an amendment would exist where the parties were "in the midst of case-dispositive motions" or a discovery cutoff date "loomed"); *Sokol Holdings, Inc. v. Dorsey & Whitney, LLP*, 2010 WL 599330 (Del. Super. Ct. Feb. 19, 2010) ("Prejudice is especially likely to exist if the amendment involves new theories of recovery or would require additional discovery.") (internal quotation marks and citation omitted).

CONCLUSION

For the foregoing reasons and the reasons set forth in their Opening Brief, the Digirad Parties respectfully request that Red Oak's purported Amended Complaint be stricken as an improper supplemental pleading, leave to file the Supplement be denied, and Red Oak's Complaint dismissed with prejudice for failure to state a claim.

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