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Case No. 5890-VCL

**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| MICHAEL SCULLY, On Behalf of himself and All Others Similarly Situated,<br><br>Plaintiff,<br><br>v.<br><br>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,<br><br>Defendants. | ) | C.A. No. 5890-VCL |

**PLAINTIFF'S MOTION FOR EXPEDITED PROCEEDINGS**

Plaintiff Michael Scully ("Plaintiff"), by his undersigned attorneys, respectfully moves this Court for an Order in the form attached hereto expediting discovery in this Action. The grounds for this Motion are as follows:

## I. PRELIMINARY STATEMENT

This is a shareholder class action on behalf of the public shareholders of NightHawk Radiology Holdings, Inc. ("NightHawk" or the "Company") against NightHawk and its Board of Directors (the "Board" or the "Individual Defendants") and certain other entitles involved in a proposed transaction through which the Company will merge with Virtual Radiologic Corporation, a wholly owned subsidiary of Providence Equity Partners LLC ("Providence"), through Virtual Radiologic Corporation's wholly-owned subsidiary, Eagle Merger Sub Corporation ("Eagle," Virtual Radiologic Corporation, Providence and Eagle are collectively referred to as “vRad”), for inadequate consideration and without adequate disclosure (the “Proposed Merger” or “Merger”).

On September 27, 2010, vRad and NightHawk issued a joint press release announcing that they had entered into a definitive Agreement and Plan of Merger, dated September 26, 2010 (“Merger Agreement”) for vRad to acquire NightHawk in a deal valued at approximately $170 million. Under the terms of the Merger Agreement, NightHawk shareholders will receive $6.50 in cash for each share of NightHawk stock that they own.

Plaintiff and the public shareholders of NightHawk common stock (the “Class”) are threatened with imminent irreparable injury because the defendants have caused NightHawk to give vRad several unfair and preclusive deal provisions and failed to provide adequate disclosure in the Preliminary Registration Statement on Form 14A (the “Proxy”) filed with the Securities and Exchange Commission (“SEC”) on October 7, 2010.

No shareholder meeting has yet been scheduled. According to the Proxy, however, NightHawk and vRad expect completion of the Merger in the fourth quarter of 2010 or the first quarter of 2011. Proxy at 12.

## II. FACTUAL BACKGROUND[1]

This Merger is the result of ongoing negotiations with vRad since March 2010 and is not the result of an open auction sales process. NightHawk and vRad began discussing the potential combination in March 2010 and the discussions were led by NightHawk’s senior management. After executing a non-disclosure agreement with vRad, conducting high level financial due diligence discussion with vRad and receiving an indication of interest from vRad to purchase the

[1] Plaintiff incorporates by reference the facts asserted in the Complaint, but sets forth herein a basic summary of the facts surrounding the Merger.

Company for $7.00 per share, on July 2, 2010, the NightHawk Board finally decided to retain Morgan Stanley & Co., Inc. as the Company's financial advisor to evaluate the benefit of a potential transaction with vRad. On July 6, 2010, NightHawk received an unsolicited investment proposal to acquire up to 100% of the Company from a third-party referred to in the Proxy as Party A, but rather than explore this or other strategic alternatives, entered into an exclusivity agreement with vRad on 2, 2010. NightHawk's exclusive negotiations with vRad culminated in the Merger Agreement signed on September 26, 2010.

Despite the fact that the Individual Defendants failed to conduct an adequate "market check" prior to entering into the Merger Agreement,[2] these defendants implemented several additional preclusive and unfair deal protections to inhibit potential alternate transactions. Indeed, the Board negotiated an excessive termination fee and a short thirty-day go-shop period in the Merger Agreement. The go-shop period expires on October 26, 2010 and may be extended by fifteen days to suitors with whom NightHawk was already negotiating on that date. The Merger negotiated by the Individual Defendants provides NightHawk shareholders with grossly inadequate consideration.

Compounding the unfairness of the Merger is defendants' attempt to coerce NightHawk shareholders to relinquish their shares based on materially incomplete and misleading disclosures contained in the Proxy. Namely, among other things, the Proxy is incomplete and fails to adequately inform shareholders regarding the financial prospects for NightHawk and the financial analyses performed by Morgan Stanley in support of the Merger. In particular, the Proxy fails to disclose all of the underlying methodologies, projections, key inputs and multiples relied upon and observed by Morgan Stanley. This information is necessary for shareholders to

[2] In fact, the Company has not conducted a proper "market check" since the period beginning in April and ending in December 2008. *See* Proxy at 17.

evaluate and properly assess the credibility of the various analyses performed by Morgan Stanley and relied upon by the Board in recommending the Proposed Transaction. The Proxy is deficient and should provide, *inter alia*, the following:

i. The complete financial projections and forecasts for NightHawk. In particular, free cash flows for 2010 to 2015 or the inputs to arrive at the free cash flows.

ii. The identity and price target of the equity research analysts utilized in the *Securities Research Analysts' Future Price Targets*.

iii. A description of the criteria and multiples observed by Morgan Stanley for each company in its *Comparable Company Analysis.* Further, a description of the criteria for the selected reference range used in the analysis should be provided.

iv. A description of the criteria to select the EBITDA multiple range and discount rate used by Morgan Stanley in the *Present Value of Future Stock Price Analysis.*

v. A description of 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.* Further, a description of the criteria for the selected reference range used in the analysis should be provided.

vi. A description of the criteria to select the discount rate and perpetuity growth rate used by Morgan Stanley in the *Discounted Cash Flow Analysis.* Further, a description of whether the *Discounted Cash Flow Analysis* included consideration of stock-based compensation and whether the analysis takes into consideration net operating losses (if any).

vii. A description of the criteria to select the leverage ratios of 4.0x to 5.0x and an interest rate of 9% used by Morgan Stanley in the *Leveraged Buyout Analysis.*

As indicated in the Proxy Statement, the Individual Defendants failed to shop the Company to potentially interested buyers or perform a proper market check in the more than one and half years preceding the execution of the Merger Agreement, however, the Proxy does not disclose the reasons for said conduct.

The Proxy also fails to disclose material information regarding the alternatives available to the Company besides the Proposed Transaction and the efforts being undertaken or that will be undertaken during the go-shop period provided in the Merger Agreement to attempt to seek a better transaction.

The Proxy also fails to disclose the number of options that are unvested versus vested for each Company officer and director as shown on page 35 of the Proxy.

Accordingly, Plaintiff seeks injunctive and other equitable relief to prevent the irreparable injury that Company shareholders will continue to suffer absent judicial intervention.

These facts, among others stated in the Complaint, demonstrate the immediate need for Court intervention to avoid irreparable harm to NightHawk's shareholders who, without further disclosure by defendants, lack the information necessary to cast an informed vote on the Merger. Accordingly, Plaintiff's motion for expedited proceedings should be granted.

## III. ARGUMENT

### A. The Law Governing Motions to Expedite Proceedings

This Court acts "with a certain solicitude for plaintiffs" and "has followed the practice of erring on the side of more [expedited] hearings rather than fewer." *Giammargo v. Snapple Beverage Corp.,* No. 13845, 1994 WL 672698, at *2 (Del. Ch. Nov. 15, 1994). "A party's request to schedule an application for a preliminary injunction, and to expedite the discovery related thereto, is normally routinely granted. Exceptions to that norm are rare." *In re Int'l Jensen Inc. S'holders Litig.,* No. 14992, 1996 WL 422345, at *1 (Del. Ch. July 16, 1996). As the Delaware Supreme Court has observed, "Delaware courts are always receptive to expediting any type of litigation in the interests of affording justice to the parties." *Box v. Box,* 697 A.2d 395, 399 (Del. 1997).

The threshold for obtaining expedited proceedings is low. In order for the Court to grant a motion for expedition, plaintiff must merely "articulate a sufficiently colorable claim and show a sufficient possibility of a threatened irreparable injury." *Gomi Investors, LLC v. Schimmell Holdings, Inc.*, No. 2278-N, 2006 WL 2304035, at *1 (Del. Ch. July 27, 2006); *see Police & Fire Ret. Sys. of The City of Detroit v. Bernal*, No. 4663-CC, 2009 WL 1873144, at *1 (Del. Ch. June 26, 2009) (quoting *Giammargo,* 1994 WL 672698, at *2). This Court has noted that "[m]otions to expedite require something of an almost superficial factual assessment in order to determine whether imposing the burdens resulting from expedition is warranted." *County of York Employees Ret. Plan v. Merrill Lynch & Co., Inc.,* No. 4066-VCN, 2008 WL 4824053, at *6 (Del. Ch. Oct. 28, 2008).

Irreparable harm generally exists where the injury cannot be compensated adequately in damages. *Alpha Builders, Inc. v. Sullivan*, C.A. No. 698-N, 2004 Del. Ch. LEXIS 162, at *19 (Del. Ch. Oct. 5, 2004). A claim for irreparable harm "must be of a nature that no fair and reasonable redress may be had in a court of law and that to refuse the injunction would be a denial of justice." *State v. Delaware Educ. Ass'n*, 326 A.2d 868, 875 (Del. Ch. 1974).

**B. Expedited Proceedings are Necessary and Appropriate and Therefore Should be Granted**

Here, Plaintiff has articulated a colorable claim of irreparable harm for which mere money damages will not serve as an adequate remedy. The flawed sales process controlled by NightHawk's management and later approved by the Individual Defendants, coupled with the material omissions in the Proxy all raise colorable claims meriting expedited treatment. *See In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 452 (Del. Ch. 2002) ("[I]rreparable injury is threatened when a stockholder might make a tender or voting decision on the basis of materially misleading or inadequate information"); *see County of York Employee Ret. Plan v. Merrill Lynch & Co.*, No. 4066-VCN, 2008 WL 4824053, at *5-13 (Del. Ch. Oct. 28, 2008 ) ("*Merrill Lynch*"); *see also Gilmartin v. Adobe Resources Corp.*, No. 12467, 1992 WL 71510, at *13 (Del. Ch. April 6, 1992) (granting plaintiffs' motion for preliminary injunction and holding "the right to cast an informed vote is specific, and its proper vindication in this case requires a specific remedy such as an injunction, rather than a substitutionary remedy such as damages"); *Eisenberg v. Chicago Milwaukee Corp.*, 537 A.2d 1051, 1062 (Del. Ch. 1987) (shareholder's right to make an informed, uncoerced decision requires specific, not substitutional remedy for which damages would be neither meaningful nor adequate).

This Court has expressed a strong preference to adjudicate claims seeking injunctive relief to remedy defendants' alleged violations of the fiduciary duty of disclosure before the shareholder action sought. *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 356-63 (Del. Ch. 2008). The facts stated above, readily establish colorable claims for relief meriting expedited proceedings in advance of a preliminary injunction hearing.

First, the Proxy fails to provide complete and fair disclosure of the financial projections underlying the Merger, including NightHawk's financial prospects and Morgan Stanley's fair summary and key inputs for its analyses in support of its fairness opinion. In particular, Morgan Stanley performed a discounted cash flow ("DCF") analysis that relied on NightHawk's financial projections for 2010 through 2015. Nevertheless, the Proxy failed to disclose the free cash flows or the inputs necessary to calculate the free cash flows during these years. In transactional cases such as this, courts have found the DCF analysis, driven by management financial projections, to be the most reliable indicator of value of a company's stock on the date of a merger transaction.

*See, e.g.*, *In re Toys "R" Us, Inc. S'holders Litig.*, 877 A.2d 975, 1013 (Del. Ch. 2005) ("a DCF model . . . is the model most consistent with what the Company's stockholders would receive in an appraisal"); *ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 925 (Del. Ch. 1999) ("this court favors the discounted cash flow approach").[3]

The importance of such projections was explained by the Delaware Chancery Court in *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007). In *Netsmart*, the company failed to disclose the projections underlying the DCF analysis conducted by the board's financial advisor. The Chancery Court held that such underlying projections were crucial to the shareholders' decision, explaining:

> ***Faced with the question of whether to accept cash now in exchange for forsaking an interest in Netsmart's future cash flows, Netsmart stockholders would obviously find it important to know what management and the company's financial advisor's best estimate of those future cash flows would be.*** In other of our state's jurisprudence, we have given credence to the notion that managers had meaningful insight into their firms' futures that the market did not. Likewise, weight has been given to the fairness-enforcing utility of investment banker opinions. It would therefore seem to be a genuinely foolish (and arguably unprincipled and unfair) inconsistency to hold that the best estimate of the company's future returns, as generated by management and the Special Committee's investment bank, need not be disclosed when stockholders are being advised to cash out. . . . ***Indeed, projections of this sort are probably among the most highly-prized disclosures by investors. Investors can come up with their own estimates of discount rates or (as already discussed) market multiples. What they cannot hope to do is replicate management's inside view of the company's prospects.***

*Id.* at 203.

The Individual Defendants failed to disclose NightHawk's free cash flows or even the key inputs necessary to reach free cash flows, which are critical to an understanding of the basis for the projections. Recently, this Court required full and fair projection disclosure and enjoined

[3] *See also Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1155, n.18 (Del. Ch. 2006)("the DCF model of valuation is a standard one that gives life to the finance principle that firms should be valued on the expected value of their future cash flows, discounted to present value in a manner that accounts for risk. The DCF method is frequently used in this court, and [the court] . . . prefer[s] to give it great, and sometimes even exclusive, weight when it may be used responsibly."); *Gilbert v. MPM Enter., Inc.*, 709 A.2d 663 (Del. Ch. 1997), *aff'd*, 731 A.2d 790 (Del. 1999) (concluding "DCF analysis [was] the best method for discerning MPM's going concern value at the date of the merger").

the shareholder vote until defendants made full disclosure of these crucial projections. *Maric Capital Master Fund, Ltd. v. Plato Learning, Inc.*, No. 5402-VCS, 2010 Del. Ch. LEXIS 115, at *8-9 (Del. Ch. May 13, 2010) ("Management's best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information." ).

Second, Morgan Stanley fails to provide a fair summary or the key inputs for the analyses performed by Morgan Stanley and merely states conclusory black box results skipping all intermediate steps, which subject the results to susceptible manipulation as the underlying key inputs are not disclosed. For example, the *Comparable Company Analysis* and *Selected Precedent Transaction Analysis* performed by Morgan Stanley are nothing but conclusory analyses that only disclose a resulting implied per share equity value. Shareholders are thus unable to evaluate the data underlying the *Comparable Company Analysis* and *Selected Precedent Transaction Analysis* and are forced to rely only on Morgan Stanley's conclusions. Moreover, Morgan Stanley does not even describe or identify the companies used in its *Selected Precedent Transaction Analysis*.

Third, the Proxy fails to disclose the identity and price targets of the equity research analysts that Morgan Stanley utilized in the *Securities Research Analysts' Future Price Targets*. Such information is material to shareholders in deciding whether to vote for or against the Merger.

Fourth, the Proxy fails to disclose the criteria that Morgan Stanley used to select the EBITDA multiple range and discount rate used in its *Present Value of Future Stock Price Analysis*.

Fifth, the Proxy fails to disclose the criteria that Morgan Stanley used to select the discount rate and the perpetuity growth rate in its *Discounted Cash Flow Analysis* and whether the analysis included stock-based compensation and net operating losses (if any).

Sixth, the Proxy fails to disclose the criteria that Morgan Stanley used to select the leverage ratios and interest rate used in its *Leveraged Buyout Analysis*.

As the Delaware Chancery Court explained in *In re Pure Resources, Inc. S'holders Litig.*, 808 A.2d 421, 449 (Del. Ch. 2002): ***"The real informative value of the banker's work is not in its bottom-line conclusion, but in the valuation analysis that buttresses that result."*** The court went on to explain "a [] stockholder engaging in the before-the-fact decision whether to tender would find it ***material to know the basic valuation exercises that [the investment bankers] undertook, the key assumptions that they used in performing them, and the range of values that were thereby generated.***" *Id.* Therefore, "***failure to disclose the information will deprive the stockholders of information material to making an informed decision whether the exchange ratio is favorable to them***." *Id.* at 808 A.2d at 449-450 (emphasis added; footnotes omitted).

Similarly, as explained by the court in *Netsmart*:

> Once a board broaches a topic in its disclosures, a duty attaches to provide information that is "materially complete and unbiased by the omission of material facts." For this reason, when a banker's endorsement of the fairness of a transaction is touted to shareholders, the valuation methods used to arrive at that opinion ***as well as the key inputs and range of ultimate values generated by those analyses must also be fairly disclosed.*** Only providing some of that information is insufficient to fulfill the duty of providing a "fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of the [] board as to how to vote … rely."

924 A.2d at 203.

Like *Pure Resources, Netsmart*, Defendants have provided shareholders with Morgan Stanley's conclusions, but deprived them of the information material to their decision to cast their vote for or against the Merger.

## CONCLUSION

For the reasons set forth above, and as detailed in Plaintiff's Complaint, Plaintiff respectfully requests entry of an Order, in the form filed herewith, scheduling a preliminary injunction hearing and authorizing Plaintiff to conduct expedited discovery in support thereof.

Dated: October 12, 2010

**COOCH AND TAYLOR, P.A.**

*/s/ Blake A. Bennett*

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