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Re: *Red Oak Fund, L.P. v. Digirad Corporation, et al.*
C.A. No. 8559-VCN
Date Submitted: July 11, 2013

Dear Counsel:

Plaintiff Red Oak Fund, L.P. (“Red Oak”) lost a close stockholder vote for control of Defendant Digirad Corporation’s (“Digirad”) board. Blaming its unsuccessful effort on election irregularities attributable to Digirad’s incumbent board¹ and management, it brought this action under 8 *Del. C.* § 225 purportedly to validate its rights to a fair election and to obtain a prompt, new election without having to wait for next year’s shareholders’ meeting.

¹ The other Defendants are the members of Digirad’s board.

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Section 225 actions are summary proceedings.² Bogging down in pre-hearing procedural motions may risk denying a plaintiff the primary benefit of an expedited proceeding.³ On the other hand, if there is no reasonably conceivable basis upon which a plaintiff can succeed, it makes little sense to burden the defendants with the cost of a trial and with the distraction from arguably more important corporate functions and objectives.

It is in this context that the Court is called upon to resolve Defendants' motion, brought under Court of Chancery Rule 12(b)(6), to dismiss Red Oak's Verified Amended Complaint (the "Complaint") for failure to state a claim upon which relief can be granted. Perhaps out of more caution than is warranted, the Court, for the following reasons, will deny the motion.

In evaluating a complaint confronted with a motion to dismiss, the Court must draw all reasonable inferences in favor of the plaintiff and deny the motion if there is a "reasonably conceivable" set of circumstances under which the plaintiff

² *Box v. Box*, 697 A.2d 395, 398 (Del. 1997) (citations omitted).

³ *See T.R. Investors, LLC v. Genger*, 2012 WL 5471062, at *1 (Del. Ch. Nov. 9, 2012) ("8 *Del. C.* § 225 is designed to protect the wealth-creating potential of a Delaware corporation by allowing this court to resolve quickly and efficiently disputes over the composition of its board of directors.") (citations omitted).

could prevail.⁴ A shareholder frustrated with the outcome of a board election may invoke 8 *Del. C.* § 225 “to determine the validity of the votes cast.”⁵

Red Oak’s challenges to the voting fall into three general, if imprecisely defined, categories:

1. To induce shareholders to be on the winning side, Defendants repeatedly reported non-public preliminary totals of the voting which Defendants knew to be inaccurate because of their having allowed the counting of treasury shares that should not have been voted.⁶ These numbers supported management’s assertion that the election would be “not even close.”⁷

2. Defendants withheld material, negative financial information until immediately after the voting had concluded.

3. Digirad’s board did not disclose its intentions to adopt a Tax Benefit Preservation Plan (*i.e.*, a poison pill).⁸

⁴ *Cent. Mortg. Co. v. Morgan Stanley Mortg. Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2001); *In re China Agritech, Inc.*, 2013 WL 2181514, at *23 (Del. Ch. May 21, 2013).

⁵ *Hewlett v. Hewlett-Packard Co.*, 2002 WL 549137, at *9 (Del. Ch. Apr. 8, 2002).

⁶ Compl. ¶ 34.

⁷ In the final tally, Digirad’s incumbents won by a margin of approximately six percent of the outstanding shares.

⁸ Whether a rights plan will be adopted would typically be difficult to predict and might well be too speculative, uncertain, or immaterial to report. In this instance, the plan was adopted three weeks after the annual meeting. Compl. ¶ 44.

These claims, Red Oak hopes, will coalesce into a valid challenge to the fairness of Digirad's disclosures to its stockholders. Unless coercive or materially misleading, the communications (or absence thereof) will not likely sustain Red Oak's position.⁹ The disclosures upon which Red Oak has focused may not individually suffice, but, when considered collectively, they may raise a sufficient basis for another vote. This is, ultimately, a matter of context, and context is best assessed at trial.

In part, Digirad constructed its defense—and it did so with some persuasive power—on facts not set forth in the Complaint.¹⁰ The Court, however, must, at

Digirad has moved to strike Red Oak's allegations regarding the adoption of the rights plan. It argues that they should have been presented by way of a motion to supplement under Court of Chancery Rule 15(d) and not as an amendment pursuant to Court of Chancery Rule 15(a). Red Oak is not attacking the validity of the rights plan; instead, it is challenging the Defendants' failure to disclose their intentions regarding it during the course of the election process. That is an appropriate topic for amendment, and leave to amend should be "freely given when justice so requires." Ct. Ch. R. 15(a). Defendants' motion to strike will, therefore, be denied. It may be worth noting that, even though the claim could have been filed somewhat more promptly and even if it should have been accomplished through a motion to supplement, a motion to supplement would likely have been granted, leaving the parties in substantially the same position as they now find themselves.

⁹ "[F]alse or misleading statements must be material to those receiving the statements, which means that there must be a 'substantial likelihood that the disclosure of [the additional information] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available' to the shareholders." *Hewlett v. Hewlett-Packard Co.*, 2002 WL 549137, at *9 (citing *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985); see also *Zaucha v. Brody*, 1997 WL 305841, at *4 (Del. Ch. 1997) (applying this standard to disclosure claims in a § 225 action).

¹⁰ Its opening brief is augmented with approximately twenty exhibits.

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this stage, look to the Complaint and documents that were incorporated into it. Although Red Oak's Complaint may not seem overwhelming on its face, the Court cannot fairly conclude that it is not "reasonably conceivable" that Red Oak could prevail at trial. That, especially in the context of an expedited proceeding, counsels against dismissal.

Accordingly, Defendants' Motion to Dismiss is denied.¹¹

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-K

¹¹ Red Oak also moved to compel. The facts upon which Red Oak relies—at least as set forth in the Complaint—are narrow and focused on the election process, which, in essence, commenced when the Defendants mailed the first set of proxy materials to shareholders on April 4, 2013. Defendants provided documents from that time until three days after the annual meeting—or until Digirad filed its Form 10-Q and released its negative financial information. Red Oak seeks to expand the discovery period to as far back as February 27, 2013, and for another three days beyond Defendants' post-meeting production.

Given the nature of a summary proceeding with a necessarily restricted scope of discovery, Red Oak asks for documents not likely to lead to admissible evidence. That Defendants concocted a nefarious plan during the additional pre-meeting period lacks any support. Moreover, the additional period of discovery would impose an unjustified burden on Defendants. A balancing of these competing interests leads to the conclusion that Red Oak's motion to compel should be denied.