IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

RED OAK FUND, L.P.,	:	
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Plaintiff,	:	
	:	
v.	:	**C.A. No. 8559-VCN**
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DIGIRAD CORPORATION, JEFFREY E. EBERWEIN, CHARLES M. GILLMAN, JOHN M. CLIMACO, JAMES B. HAWKINS, and JOHN W. SAYWARD,	:	
	:	
Defendants.	:	

MEMORANDUM OPINION

Date Submitted: August 15, 2013
Date Decided: October 23, 2013

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John M. Seaman, Esquire and J. Peter Shindel, Jr., Esquire of Abrams & Bayliss LLP, Wilmington, Delaware, and Thomas J. Fleming, Esquire and Jennifer L. Heil, Esquire of Olshan Frome Wolosky LLP, New York, New York, Attorneys for Defendants.

NOBLE, Vice Chancellor

I. INTRODUCTION

Before the Court is an action by Plaintiff Red Oak Fund, L.P. ("Red Oak") against Defendants Digirad Corporation ("Digirad"), Jeffrey E. Eberwein ("Eberwein"), Charles M. Gillman ("Gillman"), John M. Climaco ("Climaco"), James B. Hawkins ("Hawkins"), and John W. Sayward ("Sayward," and, collectively, the "Defendants"). Red Oak sued the Defendants under 8 *Del. C.* § 225 after losing a contested election to replace Digirad's board of directors.

Red Oak asks the Court to find the contested election invalid, and therefore to order a new election to be held as soon as practicable, because of alleged breaches of fiduciary duty and other conduct by the Defendants that created an unfair proxy contest—namely, (i) touting to certain stockholders the preliminary results of the election favoring management; (ii) failing to inform Red Oak or its proxy solicitor that the preliminary proxy reports from Broadridge Financial Services, Inc. ("Broadridge") were inaccurate because they listed a proxy for Digirad's treasury stock voting for management; (iii) delaying the release of purportedly final, negative financial results from the most recent quarter until after the election; and (iv) failing to disclose that the board was considering a rights plan to protect Digirad's Net Operating Losses ("NOLs").

This post-trial memorandum opinion contains the Court's findings of fact and conclusions of law. For the reasons set forth below, Red Oak has not demonstrated that the Defendants breached any fiduciary duties or otherwise engaged in conduct that created an unfair election process. Accordingly, the Court finds the contested election valid.

II. THE PARTIES

Red Oak, a Delaware limited partnership based in New York City, invests in public and private companies that generally have a market capitalization less than $200 million.[1] Leading up to the proxy contest, Red Oak was Digirad's fourth-largest stockholder, owning 5.6% of its common stock.[2] David Sandberg ("Sandberg") is the managing member of Red Oak Partners, LLC, which is the general partner of Red Oak.[3]

Digirad, a Delaware corporation based in Poway, California, is a national provider of "in-office nuclear cardiology and ultrasound imaging services to physician practices and hospitals." It also operates a "nuclear camera sales and product services business."[4]

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[1] Pre-Trial Stipulation and Order ("Pre-Trial Stip.") ¶ 1; Trial Tr. ("Tr.") 6.
[2] Pre-Trial Stip. ¶ 1.
[3] *Id.* ¶ ¶ 2-3.
[4] *Id.* ¶ 4; Joint Ex. ("JX") 192.

Digirad has five directors: Eberwein, who serves as chairman, as well as Gillman, Climaco, Hawkins, and Sayward (collectively, the "Board").[5] The Board was up for reelection at Digirad's 2013 annual stockholder meeting, held on May 3, 2013[6] (the "Election").[7]

III. BACKGROUND

At the time of the Election, Digirad's Chief Executive Officer was Todd Clyde ("Clyde"), and its Chief Financial Officer was Jeffrey Keyes ("Keyes").[8] These two executives were the most involved in the conduct at issue in this action.

After taking a 5.6% position in Digirad, Red Oak announced on February 27 that it would nominate a slate of five directors to replace the Board at the Election.[9] Digirad filed its definitive proxy statement with the Securities and Exchange Commission ("SEC") on April 4.[10] From then until the Election, both Digirad and Red Oak issued press releases and fight letters encouraging stockholders to vote for their respective nominees.[11]

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[5] Pre-Trial Stip. ¶¶ 5-9.
[6] Unless otherwise noted, the dates referenced in this memorandum opinion are during 2013.
[7] *Id.* ¶ 25.
[8] JX 176.
[9] Pre-Trial Stip. ¶ 10.
[10] JX 176.
[11] *See, e.g.*, JX 184-187; Pre-Trial Stip. ¶¶ 17-20, 22-24.

A. *The Alleged Material Misstatements Touting the Preliminary Election Results*

The first alleged material misstatement involves information potentially shared between John Grau ("Grau"), Digirad's proxy solicitor,[12] and Tyson Bauer ("Bauer"), a sell-side stock research analyst at Kansas City Capital Associates.[13] Eberwein understood Bauer to be familiar with Digirad's stockholder base, including several of its larger stockholders.[14] On April 23, Eberwein asked Gillman to speak with Bauer and Ross Taylor ("Taylor"), a Portfolio Manager at Somerset Capital Advisors ("Somerset"), about persuading Somerset, a Digirad stockholder, to support management in the Election based on a commitment to improve Digirad's on-going stock buyback program.[15] In late March, Digirad had increased the buyback from $4 million to $12 million.[16]

Bauer testified that Gillman told him that management believed it could not lose the Election if it received the support it expected from the proxy advisor firms.[17] Soon thereafter, on April 24, Bauer asked for "indisputable proof"[18] or some other evidence supporting why Digirad was "so confident" that it was "going to win," which was information he was ultimately seeking on behalf of Taylor.[19]

[12] Tr. 116-17.
[13] Bauer Dep. 5.
[14] Eberwein Dep. 125.
[15] JX 101.
[16] JX 175.
[17] Bauer Dep. 18.
[18] JX 150.
[19] Bauer Dep. 31-32.

Gillman apparently told Bauer that Grau would contact him. Bauer testified that, over the course of these limited conversations, Gillman did not provide him with any stockholder names, voting percentages, or other preliminary proxy tally details.[20]

In the meantime, and after presentations by Digirad[21] and Red Oak,[22] both Institutional Shareholder Services ("ISS") and Glass, Lewis & Co., L.L.C. ("Glass Lewis") recommended on April 22 that Digirad stockholders vote to reelect the Board.[23] Management soon touted this recommendation publicly, issuing a press release by the morning of April 23.[24]

Within a day, Grau and Bauer began a series of three phone conversations. Grau thought that Bauer was "somebody working with the [c]ompany who was going to assist . . . in reaching out to shareholders that may be clients of his."[25] The first call with Bauer on April 24, Grau testified, left him "very confused" because "[Bauer] wanted to know more information than [Grau] would have ever expected anyone to be interested in."[26] But Grau, believing "at the time[] that [Bauer] was an agent of Digirad's," nonetheless shared "some back-of-the-envelope numbers on where [he] thought the vote was . . . factoring in . . . where the vote would be

[20] *Id.* 29-30.
[21] JX 179.
[22] JX 180.
[23] JX 193.
[24] *Id.*
[25] Tr. 172.
[26] *Id.* 172-73.

given the ISS recommendation."[27] Bauer's notes from the three conversations with Grau list a series of percentage breakdowns showing management first ahead 34% to 12%, then 45% to 10%, and finally management at just under 50% with 63% of shares included.[28] These percentages, Bauer testified, reflected Grau and Digirad's opinion of expected votes—particularly based on the recently announced recommendations of ISS and Glass Lewis in support of management—and not an official tally or a list of stockholders who had submitted proxies.[29]

Bauer and Grau offer competing views on the reasons why the expected vote percentages were shared. Bauer assumed that "there's no purpose for [Grau] to call [him] with those numbers" unless Grau wanted him to share them with stockholders.[30] In stark contrast, Grau testified that it was Bauer who "wanted to know" the information.[31] Consistent with his thinking that "Bauer was working for [Digirad]," Grau further testified that he did not know Bauer was having conversations with Somerset's Taylor; that he did not intend for Bauer to communicate these numbers to stockholders; and that he would not have given to

[27] *Id.* 174.
[28] JX 151; Bauer Dep. 43-46.
[29] *Id.* 36-37 ("So I had asked [Grau] basically, you know, for a fact these are actually votes that are in, and which then he had to backpedal and say, 'No, we're not saying that these people have voted and that's what's in the tally. We're just saying that typically these people . . . will vote with whatever the recommendation of ISS is.'"). *See also id.* 49 ("This was their opinion how they were going to vote after I quizzed [Grau] on it.").
[30] *Id.* 47.
[31] Tr. 172.

Bauer the expected vote numbers had he known Bauer would share that information with stockholders.[32]

The second alleged material misstatement about the preliminary proxy tallies occurred during a conversation between Eberwein and Taylor. The testimony directly conflicts over whether Eberwein described the preliminary election results as a "landslide," with Taylor testifying that Eberwein said it[33] and Eberwein testifying that he did not.[34] Regardless of whether Eberwein ever said "landslide," the evidence is consistent in showing that Eberwein did not reveal to Taylor specific numbers, aside from a disputed reference to a few index funds, or the specific source of his information on preliminary voting tallies.[35]

Somerset, along with three other of Digirad's five largest stockholders (including Red Oak), voted for Red Oak's slate.[36]

B. *The Proxy Submitted for Digirad Treasury Stock*

In early April, the competing proxy solicitors—Grau of InvestorCom, Inc. for Digirad[37] and Peter Casey ("Casey") of Alliance Advisors for Red Oak[38]—noticed an issue with how much stock was entitled to vote at the Election. Grau compared the March 12 record date list from the Depository Trust Company

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[32] *Id*. 176-77.
[33] Taylor Dep. 72.
[34] Eberwein Dep. 136.
[35] *Compare id.* 136-38, *with* Taylor Dep. 72-76, 214-15.
[36] Tr. 108.
[37] *Id.* 116-17.
[38] *Id.* 12.

("DTC") with Digirad's proxy statement, which revealed what he described as a DTC "overhang of approximately 1,075,000 shares."[39] An overhang meant that the DTC list of Digirad stock held in street name included more stock than the number of shares that Digirad identified in its proxy as eligible to vote. Casey also recognized the overhang and asked Grau's team whether the difference was due to Digirad's treasury stock. Grau's team confirmed on April 8 that treasury stock was the cause of the discrepancy, but, when Casey asked in a response email that same day where Digirad held its treasury stock, no one replied.[40]

Digirad held the repurchased treasury stock from its buyback program at broker Raymond James & Co. ("Raymond James"), apparently in street name. By March 12, the record date for the Election, Digirad held 1,073,641 shares of treasury stock with the broker.[41] Dan Warnock ("Warnock"), a member of Keyes' financial team, was the Digirad accounting manager in charge of "making sure that the financial activity through the [Raymond James treasury stock] account was appropriate." Warnock's responsibilities included receiving regular statements from Raymond James about the account.[42]

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[39] *Id.* 149. Digirad had 19,266,685 outstanding shares of common stock entitled to vote in the Election. JX 176.
[40] JX 89.
[41] JX 159.
[42] Tr. 227-28.

On April 9, Warnock received "an e-mail from Raymond James routed through Broadridge"[43] soliciting a proxy for the Election.[44] Under the impression that he may have personally owned Digirad stock at Raymond James, Warnock clicked an electronic link in the email, which presumably directed him to a webpage through which he then submitted a proxy in favor of management. As Keyes testified, "it wasn't apparent to [Warnock] when he pulled up the link how many shares were . . . to be voted or the fact that they might have been the company's treasury shares."[45]

By at least April 15, just under three weeks before the Election, the proxy solicitors were receiving preliminary reports from Broadridge.[46] During the Election, Broadridge's function was to be an independent third party that received proxies and shared its tabulations of these proxies in periodic reports with Digirad and Red Oak.[47] Of course, as more stockholders submitted new proxies, the preliminary Broadridge reports changed.

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[43] *Id.* 225.
[44] JX 174.
[45] Tr. 225-26. On April 22, Warnock emailed Keyes to check and see if he knew why Warnock might have received the email; nothing in the email suggests that Warnock could have known that he would be submitting a proxy for Digirad's treasury stock. JX 174. Keyes testified that he did not recall receiving this email from Warnock at the time because the end of April—in the midst of the Election, the preparation of the first quarter financial results, and the early considerations of the NOL protection plan—was an "extremely busy" time for him. Tr. 228.
[46] *See, e.g.*, JX 58.
[47] Tr. 16-17 ("They receive the vote tabulations, so when shareholders place a vote, either by mail or online, it comes to Broadridge, and throughout the election, they will provide the voting updates and those preliminary tabulations to each side."). Generally, the first Broadridge report tends to be issued fifteen days before the meeting, with the next report generally nine days before

Broadridge provided preliminary reports about the Election to only the proxy solicitors, not Digirad's stockholders. Grau reformatted the Broadridge reports before sending them to Digirad,[48] while Casey either just forwarded[49] or similarly reformatted the reports before sharing them with Red Oak.[50] The reports from Broadridge did not name the beneficial owners who had submitted proxies; instead, they listed by street name custodian the proxies submitted for management, for Red Oak's slate, and for withhold.[51] Armed with the preliminary Broadridge reports, Grau and Casey, working independently, were generally able to figure out how Digirad's larger, institutional stockholders were voting.[52]

Digirad and Red Oak used the preliminary Broadridge reports and the stockholder information gleaned by their proxy solicitors in developing and refining their solicitation strategies.[53] Grau admitted that his strategy advice may slightly change in a particular vote if his client had a large lead in the preliminary reports, but he testified that, in general, he "would never stop soliciting proxies

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the meeting, and thereafter at least daily reports. *Id.* 126. The report on the last day before the meeting is called "the contested vote, which is really the first official vote tally," and all earlier reports are considered preliminary. *Id.* 127.

[48] *Id.* 127-28.

[49] JX 58.

[50] JX 73.

[51] Tr. 20; JX 58.

[52] Tr. 143 (explaining that, although being what many consider a microcap company, Digirad had "a reasonable amount of institutional ownership"). A proxy solicitor could bring industry experience to this deductive process, such as by identifying which stockholders tended to hold their shares through particular custodians or which holders historically voted the recommendation of proxy advisor firms, especially ISS. *Id.* 123-25; JX 109.

[53] Tr. 13.

because it ain't over until it's over."[54] In contrast, Sandberg described Red Oak's solicitation strategy during the Election as a "fluid process" and a "cost[-]benefit" analysis that depended in large part on the preliminary results.[55] For example, Sandberg testified that it would have been a "game changer" had Red Oak known that the Broadridge reports leading up to the Election were inaccurate.[56]

After Warnock had inadvertently and unknowingly voted the treasury stock, the preliminary reports from Broadridge sent to Digirad and to Red Oak reflected that a large block at Raymond James—over one million shares, around 6% of Digirad's outstanding stock—had voted for management.[57] Reading the Broadridge reports, both Grau and Casey likely recognized that such a significant stockholder (or group of stockholders) could be valuable to their respective clients, and each set about trying to identify who beneficially owned those shares.

By April 25, Casey was still unable to identify the unknown stockholder.[58] On April 26, he again asked Grau's team where Digirad held its treasury stock, but Grau affirmatively declined to provide that information.[59] Grau later testified that, at the time of that response, he did not yet think that the treasury stock had been

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[54] *Id.* 144-45
[55] *Id.* 24.
[56] *Id.* 51.
[57] *See, e.g.*, JX 201 (reflecting in the contested vote the change in proxies over several earlier reports).
[58] JX 74.
[59] JX 90.

voted, and, moreover, it was not industry practice to provide such additional information.[60]

Around this time, Grau was starting to have some luck in discovering who owned the Raymond James stock. On April 24, he had inquired about where Clyde held his personal stock,[61] thinking that the large block might be owned by an insider.[62] Clyde noted that he held some stock with one broker and the rest was held at Raymond James. Grau then asked for Clyde to put him in touch with someone at Raymond James who might answer some of his questions.[63]

Separately, in an email the morning of April 26, Grau asked Keyes if Digirad held its treasury stock at Raymond James.[64] Before Keyes answered the question, Grau emailed Eberwein, Clyde, and Keyes to inform them that he was becoming "concerned that for some reason Raymond James voted the 1,000,000 shares being held in treasury as part of the buyback."[65] In an April 27 email to Keyes, Grau seems to have concluded that Raymond James did vote Digirad's

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[60] Tr. 161-62 ("[I]t's standard practice in my business to provide the other solicitor in a proxy contest with the [DTC and Non-Objecting Beneficial Owner] lists requested, and I think it's the responsibility of each solicitor to do the necessary research regarding shareholders and where accounts are held[.] . . . [P]art of my job is not just making phone calls, but it's also trying to uncover where certain shares are held.").
[61] JX 120.
[62] Tr. 152-53.
[63] JX 120.
[64] JX 121.
[65] JX 120.

treasury stock.[66] None of Eberwein, Clyde, or Keyes appears at that time to have informed anyone else at Digirad about the proxy submitted for the treasury stock.[67]

In the same email to Keyes, Grau explained that he would "exclude[]" the treasury stock from the future updates, based on the preliminary Broadridge reports, that he would send to Digirad.[68] To be clear, the preliminary Broadridge reports that Grau and Casey received still reflected approximately one million shares of treasury stock at Raymond James voting for management, but Grau "removed it from [his] vote report and any other correspondence that went to [Digirad]."[69] Casey did not have the same insight; he and Red Oak still operated under the assumption that the Broadridge reports reflected proxies submitted for stock entitled to vote.

Keyes repeatedly testified that he did not know for sure at any point before the Election that a proxy had been submitted for the treasury stock.[70] However, Grau's decision to remove the Raymond James block from his future updates to Digirad shows that at least he was fairly confident that treasury stock had been voted, and Keyes and Digirad continued to rely on Grau throughout the Election.[71]

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[66] JX 121.
[67] Post-Trial Arg. Tr. 5.
[68] JX 121; Tr. 155.
[69] Tr. 155 ("[M]y client never had knowledge of those Raymond James shares ever voting outside of these couple of email correspondences . . . .").
[70] *See, e.g.*, *id.* 216-18, 221-22.
[71] JX 121.

Keyes soon thereafter had a conversation with the independent inspector of elections, memorialized in a May 1 letter, in which he informed the inspector that Digirad had 1,073,641 shares of treasury stock held at Raymond James that "should not be considered outstanding for purposes of [Digirad's] 2013 Annual Meeting."[72] Keyes testified that he assumed informing the independent inspector was an appropriate way to yield "an accurate vote result";[73] he also testified that Digirad still had not informed Broadridge, Red Oak, or Casey about the suspected voting of treasury stock.[74]

The May 2 contest vote issued by Broadridge still included treasury stock voting for management.[75] Based on that contest vote and the supplemental report the morning of the Election, Sandberg emailed his slate of nominees on May 3 to let them know they had lost "by approx[imately] 46% to 34%."[76] The email attributed the loss "due to losing ISS";[77] yet, as Sandberg testified, he did not know until after the Election about the alleged "game changer"—that the Broadridge reports had listed a proxy submitted for Digirad's treasury stock.[78] At trial, although Sandberg did admit the importance of the ISS recommendation in the

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[72] JX 159; Tr. 220-21.
[73] *Id.* 223.
[74] *Id.* 271.
[75] JX 201.
[76] JX 129.
[77] *Id.*
[78] Tr. 51. ("Six percent means we only had to change votes of 3 percent or just achieve 6 percent in total. A whole new slew of options would become available to us.").

proxy contest, he insisted that "had [Red Oak] known that the vote was closer than the [Broadridge] information [it was] receiving and [it] had pushed harder, [he] think[s] [Red Oak] would have won."[79]

On May 10, Digirad announced the final results of the Election. The independent inspector certified that the Board had been reelected over Red Oak's slate by a vote of 40% to 34%.[80] The 6% difference between Sandberg's May 3 email listing a result of 46%-34% and the May 10 final vote tally of 40%-34% is the Digirad treasury stock that may not lawfully be counted in a stockholder vote.[81]

C. *The Delayed Financial Results*

At Digirad, the person responsible for "oversee[ing] the entire process of the financial reporting, 10-Q, [and] earnings release preparation" was Keyes.[82] As recounted in Keyes' trial testimony, the way in which Digirad adapted the close of a financial quarter into an SEC filing and corresponding earnings release involved "a whole series of events that need[ed] to occur." This series included a financial close process, accounting reconciliations, a formal review by Digirad's

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[79] *Id.* 59.
[80] Pre-Trial Stip. ¶ 28.
[81] *See* 8 *Del. C.* § 160(c); *see also In re Best Lock Corp. S'holder Litig.*, 845 A.2d 1057, 1088 (Del. Ch. 2001) (explaining how this statute operates "to prevent, as a means of board entrenchment, the use of corporate assets by an incumbent board to purchase stock of its corporation . . . which those directors could then cause to be voted in their favor.").
[82] Tr. 231.

independent accounting firm, the preparation of board and audit committee presentations, and the drafting of an earnings release.[83]

During 2013, Digirad set tentative earnings release dates several months in advance, generally for scheduling purposes. These dates were internal and not made public "typically until a couple weeks before the actual date."[84] Digirad's first financial quarter of fiscal year 2013 ended on March 31 ("Q1 2013").[85] By no later than March 29 (and likely much earlier), Digirad had earmarked April 25 as the date when it would release the financial results for Q1 2013 (the "Q1 2013 Results"), but even then there was already an expectation that the date would "most likely change to May 3."[86]

Soon after the close of Q1 2013, Digirad, under Keyes' direction, began the process to prepare the Q1 2013 Results. One of his first steps was deciding with Clyde around April 1 to delay the internal release date for the Q1 2013 Results from April 25 to May 3, the date of the Election.[87]

Keyes testified he and Clyde made this decision, without any input from the Board,[88] for several reasons, including: a recently announced company restructuring that had created "a more complex accounting process which required

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[83] *Id.* 232-33.
[84] *Id.* 237.
[85] JX 189.
[86] JX 160 (scheduling, at the same time, August 1 and November 1 as the internal dates for earnings releases for the remaining quarters of 2013).
[87] Tr. 238.
[88] *Id.*

more in-depth review" by its accounting firm; Digirad's controller, a key member of Keyes' financial team, was not only hired at the end of January (meaning that Q1 2013 was his first quarter with Digirad), but he also "went out for paternity leave in mid-April"; and Keyes' "audit partner from [the accounting firm] was still recovering . . . from having his appendix taken out the prior month."[89]

Despite the delay, the team diligently continued to prepare the Q1 2013 Results. On April 10, Keyes was copied on an email from a team member in which the Q1 2013 Results were described as in Digirad's software and "finalized."[90] Keyes testified that this description, particularly so soon after the close of the quarter, did "absolutely not" mean that the Q1 2013 Results were ready to be filed with the SEC. Instead, there were still "major activities that need[ed] to occur."[91]

Three emails from the following week—an April 17 draft earnings release from Digirad's public relations firm;[92] an April 18 mark up of the earnings release by Keyes;[93] and an April 19 first round of comments on a draft Form 10-Q by Digirad's accounting firm[94]—all show the steps needed to prepare the Q1 2013 Results. Indeed, Keyes once more testified that, around the time of these three emails, Digirad still "had many days and really a couple weeks' worth of work yet

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[89] *Id.* 233-34.
[90] JX 162.
[91] Tr. 240.
[92] JX 166.
[93] JX 165.
[94] JX 164.

to complete" before it would be in a position to file with the SEC.[95] Keyes' April 18 mark-up of the draft earnings release, while it changed certain wording, kept the language showing that Digirad's total revenue dropped 12% and its gross profit fell 24% compared to the prior year.[96]

On April 24, Keyes and his team circulated another draft of the Q1 2013 Results to the accounting firm by email, presumably still expecting the release on May 3.[97] But, by the next day, when Keyes solicited input from the Board on the "complete proof" (a request on which he would follow up on April 30), Keyes and Clyde had decided to delay the release of the Q1 2013 Results for a second time, from May 3 to May 6.[98] Keyes again testified that the Board did not instruct them to make the change, and he further noted that he did not remember any discussions about delaying the release as a way for Digirad to not have to file the Q1 2013 Results before the Election.[99]

The second delay was also made for several reasons. First, it gave Digirad "a little bit more time to . . . push through" an "unforeseen" accounting adjustment on April 24.[100] Second, Digirad's accounting firm still needed to sign off on several things, including comments on the management representation letter and a

[95] Tr. 244.
[96] JX 165, 166.
[97] JX 169.
[98] JX 170.
[99] Tr. 248-49.
[100] *Id.* 248.

restructuring memorandum.[101] Finally, Keyes and Clyde noticed that May 3 was a Friday, and they then realized "that a lot of East Coast investors often are not available for the calls due to the time difference." Because they "wanted to make sure that [they] didn't inappropriately . . . leave anybody from the call that might want to attend the conference call,"[102] Digirad moved the release of the Q1 2013 Results to May 6, which was the Monday after the Election.

On May 6, Digirad released the Q1 2013 Results and held a call for investors.[103] The Q1 2013 Results generally reflected the April 17 draft and Keyes's April 18 mark up: year-over-year total revenue decreased 12% and gross profit decreased 24%.[104]

D. *The Board's Early Considerations of Protecting Digirad's NOLs*

In the weeks leading up to the Election, certain individuals at Digirad started to consider how they might protect the company's NOLs, a potentially valuable asset, going forward. Creatures of the Internal Revenue Code (the "Code"), NOLs "are tax losses, realized and accumulated by a corporation, that can be used to shelter future (or immediate past) income from taxation."[105] During their 20-year lifespan, "[i]f taxable profit has been realized . . . the NOLs operate either to

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[101] JX 172.
[102] Tr. 248.
[103] JX 189.
[104] *Compare* JX 188, *with* JX 165 *and* JX 166.
[105] *Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 589 (Del. 2010).

provide a refund of prior taxes paid or to reduce the amount of future income tax owed."[106]

Section 382 of the Code limits the use of NOLs by corporations that have experienced an "ownership change," which typically occurs if the company's stock ownership changed by more than 50% during the most recent three-year period. But, in large part what matters is only the change in ownership for stockholders with 5% or more of the corporation's stock, since the stock owned by all holders with less than 5% is collectively treated as stock owned by a single 5% holder.[107] Accordingly, corporations interested in protecting their NOLs may try both to contain the number of new 5% holders and to discourage existing 5% holders from acquiring more stock—for instance, with a version of a poison pill, dubbed an NOL protection plan, with the trigger set at 5% of the corporation's common stock.[108] NOLs may also affect a company's ability to buy back stock.

The decision by a board of directors to implement an NOL protection plan typically requires some planning and forethought because of the complexities of Section 382. Based on his firsthand experience as a director at companies that have adopted these plans, Sandberg testified that a company would typically start by hiring an outside tax consultant to do a Section 382 study that looks at, among

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[106] *Id.*
[107] *See* 26 U.S.C.A. § 382 (2012).
[108] Such a plan would typically afford grandfather status to current 5% holders. *See, e.g.*, *Versata Enters.*, 5 A.3d at 595.

other things, the possible effects of issuing new equity and stock sales by stockholders owning more than 5%. The resulting back-and-forth between management and the tax experts can take a while, according to Sandberg, and then the actual plan itself is "a fairly long, complex document that takes some time" to draft, usually with outside counsel.[109]

Digirad's consideration of its NOL protection plan (the "NOL Rights Plan" or the "Plan") started in April, but it had been actively working with consultants on conducting and updating a Section 382 study for some time.[110] In an April 18 email to Clyde and Keyes, Eberwein noted that he had asked Climaco to work with them "on putting in place an NOL protection plan right after [the Election]."[111] The next week, on April 26, Eberwein followed up with this group "to check in on the status of implementing an NOL protection plan."[112]

On April 29, the Board held a meeting during which Eberwein "discussed with the Board the concept of a net operating loss protection plan." Only at this point in time did the entire Board become aware of Digirad's early considerations of the Plan. After "[q]uestions were asked and discussion ensued," the Board directed Keyes and Climaco "to work collaboratively to determine if a net

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[109] Tr. 60-62.
[110] *Id.* 260; JX 203.
[111] JX 204.
[112] JX 205.

operating loss protection plan is feasible for [Digirad] and . . . how a potential plan would look."[113]

From this meeting until two weeks after the Election, Keyes, who "oversaw" this process as well,[114] worked with Digirad's outside tax experts and lawyers to draft the NOL Rights Plan, which he then circulated to the Board on May 17.[115] Later that day, in an email to the Board, the NOL Rights Plan is described by the assistant to Clyde and Keyes as a "high priority item" such that a Board meeting was being scheduled to discuss it on May 20.[116] The Board soon thereafter adopted the NOL Rights Plan, and it went into effect on May 24.[117]

IV. CONTENTIONS

Red Oak contends that the Defendants "disenfranchised voters and impeded the integrity of the [E]lection"[118] through a series of material misstatements and omissions about: (i) the statements by Grau to Bauer and by Eberwein to Taylor; (ii) the proxy submitted for Digirad's treasury stock and the inaccurate, preliminary Broadridge reports; (iii) the delayed Q1 2013 Results; and (iv) the early considerations of the NOL Rights Plan.[119]

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[113] JX 209.
[114] Tr. 261.
[115] JX 206.
[116] JX 207.
[117] JX 208.
[118] Pl.'s Pre-Trial Br. 22.
[119] *Id.* 23-27, 29-31.

Showing that these actions were material misstatements and omissions, Red Oak concludes, would prove a breach of fiduciary duty by the Board. But, even if the Board's conduct was not a breach of fiduciary duty, Red Oak still contends that the Defendants' actions created an unfair election process. Under both the breach of fiduciary duty and unfair conduct theories, Red Oak requests that the Court find the Election invalid under 8 *Del. C.* § 225 and thereby order Digirad to hold a new election as soon as practicable.[120]

In response, the Defendants argue that their conduct did not constitute material misstatements or omissions.[121] They insist that the Grau and Eberwein statements were based on expectations, and that no one at Digirad intended to vote the treasury stock.[122] Similarly, because the treasury stock vote was only listed in the Broadridge reports, and those reports were never disclosed to Digirad's stockholders, the Defendants contend that the Board had no fiduciary duty to disclose the submitted treasury stock proxy to Red Oak.[123]

The two delays in releasing the Q1 2013 Results, the Defendants argue, were not intentional or related to the pending Election but instead were "for practical reasons."[124] Likewise, the Defendants contend that because the Board had not

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[120] *Id.* 34.
[121] Defs.' Pre-Trial Br. 30-33.
[122] *Id.* 12, 41-42.
[123] *Id.* 42-43.
[124] *Id.* 21-22.

made a decision about the NOL Rights Plan before the Election beyond a request for more information about its feasibility, it was not under a duty to disclose those early considerations.[125]

Finally, the Defendants argue that the evidence, in addition to not proving a breach of fiduciary duty by the Board, does not show an unfair election process.[126] For these reasons, the Defendants ask the Court to find the Election valid and to deny Red Oak's request for a new election.[127]

V. ANALYSIS

Under Delaware General Corporation Law ("DGCL") § 225, "[u]pon application of any stockholder, . . . the Court of Chancery may hear and determine the validity of any election." If the Court finds that the election was invalid, it "may order an election to be held in accordance with [DGCL] § 211 or § 215."[128] A Section 225 action is summary in nature:[129] its scope should be "limited to determining those issues that pertain to the validity of actions to elect . . .

[125] Post-Trial Arg. Tr. 43-44.
[126] Defs.' Post-Trial Mem. 3-5.
[127] Defs.' Pre-Trial Br. 47.
[128] 8 *Del. C.* § 225(a). The statute grants to this Court further equitable authority to "make such order respecting further or other notice of such application as it deems proper under the circumstances." *Id.*; *see also Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43, 82-83 (Del. Ch. 2008) (deeming it "a fitting and proportionate remedy" to require the incumbent directors themselves, rather than the corporation (and thus the stockholders), to bear the costs of a new election).
[129] *See Box v. Box*, 697 A.2d 395, 398 (Del. 1997).

director[s]."[130] The Court here must determine whether the Defendants made material misstatements or omissions while soliciting proxies for the Election and whether the Defendants' conduct made the Election process unfair in order to determine the validity of the Election.

One of the most frequent theories under which stockholders have asked this Court to find an election invalid is a breach of fiduciary theory—in particular, a claim that the company and the board of directors made material misstatements or omissions during the proxy solicitation process.[131] The Court begins its analysis of the so-called duty of disclosure, which necessarily "derives from the duties of care and loyalty,"[132] with the long-standing and oft-cited proposition that "directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[133] The materiality threshold—by which "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote"[134]—means that "[t]he board is not required to

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[130] *Genger v. TR Investors, LLC*, 26 A.3d 180, 199 (Del. 2011); *see also Box*, 697 A.2d at 398 (explaining the policy for limiting a Section 225 action as a summary proceeding as "to prevent a Delaware corporation from being immobilized by controversies about whether a given officer or director is properly holding office").

[131] *See generally* DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 8.08[a]-[b] (2013).

[132] *Pfeffer v. Redstone*, 965 A.2d 676, 684 (Del. 2009).

[133] *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992).

[134] *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) ("[T]here must be a substantial likelihood that the

disclose all available information."[135] But, directors are still required "to provide a balanced, truthful account of all matters disclosed in the communications with shareholders."[136] This duty not to make material misstatements or omissions and to correct materially misleading statements applies to a corporation's proxy statement disclosures and other statements during an election of directors,[137] and the standard is "measured from the point of view of the reasonable investor."[138]

A breach of fiduciary duty for material misstatements or omissions, as Red Oak correctly noted,[139] does not require proof of causation or reliance by the reasonable stockholder. There is also no requirement to show "a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote."[140] Instead, "it must be shown that the fact in question would have been relevant to [the reasonable stockholder]."[141]

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disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available")).

[135] *Stroud*, 606 A.2d at 85; *see also TCG Sec., Inc. v. So. Union Co.*, 1990 WL 7525, at *7 (Del. Ch. Jan. 31, 1990) ("The simple fact of the matter is that a reasonable line has to be drawn or else disclosures in proxy solicitations will become so detailed and voluminous that they will no longer serve their purpose. The *Rosenblatt* test works well in demarcating the appropriate line . . . .").

[136] *Malone v. Brincat*, 722 A.2d 5, 12 (Del. 1998).

[137] *See Stroud*, 606 A.2d at 86.

[138] *Zirn v. VLI Corp.*, 621 A.2d 773, 779 (Del. 1993).

[139] Post-Trial Arg. Tr. 11.

[140] *Zirn*, 621 A.2d at 778-79 (quoting *TSC Indus.*, 426 U.S. at 449).

[141] *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1289 (Del. 1989).

Delaware has declined "to fashion a rule that attempts to draw . . . a bright line of disclosure for directorial elections."[142] In addition, this Court has been warned "against grafting equitable fiduciary duties onto the clearly delineated statutory requirements" of the DGCL.[143] When presented with a material misstatement or omission claim, this Court must keep in mind that materiality is a "mixed question of fact and law."[144] In the election context, Delaware case law provides some guidance as to what type of information is and is not material.

In reviewing a dismissal of a Section 225 lawsuit for failure to state a claim, the Delaware Supreme Court held that the "inner workings and . . . day-to-day functioning"[145] of a board's special litigation committee "are not the proper subject of disclosure," and neither is "speculat[ion] about its future plans."[146] Similarly, it also held that a director, in a contested consent solicitation to replace the board, was not required to disclose the vesting conditions of previously disclosed stock options granted to several directors because "[t]he details of how and when certain options would vest would not have been important to [the stockholders'] decision" on how to "vot[e] on a slate of directors."[147] Conversely, a board's "disclosing of material information that it knew to be false" in a proxy solicitation was found to

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[142] *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 144 (Del. 1997).
[143] *Unanue v. Unanue*, 2004 WL 5383941, at *9 (Del. Ch. Nov. 3, 2004, revised Nov. 9, 2004) (citing *Stroud*, 606 A.2d at 87).
[144] *Cede & Co. v. Technicolor, Inc.*, 636 A.2d 956, 957 (Del. 1994).
[145] *Loudon*, 700 A.2d at 144.
[146] *Id.* at 145.
[147] *Brody v. Zaucha*, 697 A.2d 749, 755 (Del. 1997).

be a cognizable claim in a Section 225 action.[148] These precedents reinforce that what is material and thus needs to be disclosed is a function of what would be important to the reasonable stockholder's voting decision.[149]

The Court expressly declines to fashion a bright-line rule that an election may be found invalid under Section 225 only if there is a breach of fiduciary duty. There are likely yet-to-be-seen scenarios in which the election process could be prejudicial or unfair to a proxy contestant to warrant invalidation of the election without a breach of fiduciary duty—for instance, for intentional misconduct directed at the proxy contestant or for reasons completely outside the control of the corporation and its board of directors. But, outside of the breach of fiduciary theory to invalidate an election, a petitioning party should offer more than mere speculation about the possible consequences of the perceived unfair election.

Just because a particular stockholder in hindsight claims that then-unknown information would have been "material" to its proxy solicitation strategy, it does not follow that that information would have been material to the reasonable stockholder in deciding how to vote. In other words, nondisclosure of material

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[148] *See Hewlett v. Hewlett-Packard Co.*, 2002 WL 549137, at *9 (Del. Ch. Apr. 8, 2002).

[149] *See Kaplan v. Goldsamt*, 380 A.2d 556, 565 (Del. Ch. 1977) ("[W]hile a corporation must adequately inform shareholders as to matters under consideration, the requirement of full disclosure does not mean that a proxy statement must satisfy unreasonable or absolute standards. . . . There is obviously no requirement to include insignificant information. . . . Provided that the proxy statement viewed in its entirety sufficiently discloses the matter to be voted upon, the omission or inclusion of a particular item is within the area of management judgment.") (citations omitted).

information to stockholders is not coterminous with nondisclosure to a proxy contestant of information that the contestant would find important—only the former is necessarily a breach of fiduciary duty; the latter may, with more proof, be evidence of an unfair election process. However a stockholder seeks to argue that an election should be found invalid, the petitioner must prove that relief is warranted by a preponderance of the evidence.[150]

A. *The Preliminary Results of the Election*

Red Oak argues that the Defendants made materially misleading statements before the Election by sharing non-public information about the preliminary results in two ways: by Grau's sharing of voting expectations with Bauer and by Eberwein's making of confident predictions to Taylor.

The Court first finds that the statements by Grau were not material. Both Grau and Bauer acknowledged that they were reflective of Digirad's expected proxy votes, not actual votes.[151] Grau testified that he did not "inflate the lead" in these conversations by including the treasury stock.[152] The preponderance of the evidence shows that the conversations were not intended to be shared with stockholders and were not made with any knowledge that Bauer would share the

[150] *See Hockessin Cmty. Ctr., Inc. v. Swift*, 59 A.3d 437, 453 (Del. Ch. 2012) (citing *In re IAC/InterActive Corp.*, 948 A.2d 471, 493 (Del. Ch. 2008)).
[151] Bauer Dep. 36; Tr. 174.
[152] *Id.* 176.

information with stockholders. They were made with just the opposite intent—Grau thought Bauer was working for Digirad.

Likewise, the Court finds Eberwein's statements were not material. The testimony conflicts over whether any "landslide" comment was made,[153] and although Eberwein may have mentioned certain funds by name, the preponderance of the evidence does not show that Eberwein told Taylor about the actual proxies submitted by any particular stockholder.

Red Oak's final argument is that these statements created an unfair election process because of Digirad's status as a microcap company. Sandberg testified that even suggestions to stockholders about strong preliminary results for management in an election for a public company the size of Digirad can have at least two prejudicial effects: they can "pressure certain shareholders not to want to vote against what's clearly the winning side," and they can even "dissuade shareholders from voting at all."[154] This potentially difficult management-stockholder dynamic does not warrant subjecting microcap companies to additional

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[153] Taylor Dep. 72; Eberwein Dep. 136.

[154] Tr. 43. After an election, management at a small public company like Digirad can typically discern which stockholders voted for and against it. The apparent fear is that "if you don't support [management], they have no reason or obligation to want to spend their time speaking with you," which can lock a stockholder out of access to information important to its investment decision, especially where there may not be Wall Street coverage of the company. *Id.* 46.

fiduciary duties or requiring additional protections against an unfair election process.[155]

Because the integrity of the election process is an essential part of the foundation of Delaware corporate law,[156] the Court takes very seriously claims of an unfair election process because of misleading or inadequate disclosures.[157] But, the Court also does not take lightly either finding an election invalid or imposing the equitable remedy of ordering a new one. Fair elections should be based on the disclosure of all material information to stockholders,[158] but the Court here cannot find the Election invalid for want of adequate disclosure based on speculation about alleged misstatements that is unsupported by a preponderance of the evidence. These alleged misstatements do not render the Election invalid.

B. *The Treasury Stock Proxy and the Preliminary Broadridge Reports*

Next, Red Oak argues that the Defendants breached their fiduciary duties and created an unfair election process by failing to disclose affirmatively to Red Oak, individually, or along with the rest of Digirad's stockholders, that the

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[155] *See Stroud*, 606 A.2d at 87; *Unanue*, 2004 WL 5383941, at *9.

[156] *See MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1126 (Del. 2003) (citing *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988)).

[157] *See Giuricich v. Emtrol Corp.*, 449 A.2d 232, 239 (Del. 1982) ("[C]areful judicial scrutiny will be given a situation in which the right to vote for the election of successor directors has been effectively frustrated and denied.").

[158] *See Portnoy*, 940 A.2d at 71 (invalidating an election for, among other reasons, material misstatements and omissions in the disclosures to stockholders).

Broadridge reports were inaccurate.[159] In the opinion of Sandberg, it would have been a "game changer" for Red Oak's proxy solicitation strategy had it known that the preliminary 12% lead for management should have been just 6%.[160]

The evidence does not demonstrate that the Defendants caused the treasury stock held at Raymond James to be voted. Only after Red Oak commenced this action and the resulting discovery did the Defendants even learn how a proxy was submitted for the treasury stock.[161] What remains unanswered, or at least not revealed during this proceeding, is how exactly Raymond James came to solicit a proxy for the Digirad treasury stock. But, what is clear from the evidence is that the Defendants cannot be said to have directly caused the voting of the treasury

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[159] Pl.'s Pre-Trial Br. 26-27; Post-Trial Arg. Tr. 6, 8.

[160] Tr. 51, 24 ("[W]e make the judgments based on where we are in the election, what votes we think we can sway, and it's a cost[-]benefit.").

The Defendants assert that Red Oak should be precluded from presenting the "game changer" theory for the first time at trial without suggesting it in the sworn pleadings because it unfairly prejudices them. Defs.' Post-Trial Mem. 1-3. The Defendants cite two cases in support of this argument. In one, the court prevented a plaintiff from presenting documentary evidence for the first time at trial where it did not previously produce the documents after a discovery request (and a related court order). *Digiacobbe v. Sestak*, 1998 WL 684149, at *6 (Del. Ch. July 7, 1998). In the other, the court declined to grant leave for the plaintiff to amend the complaint to add a previously (and consciously) abandoned claim after both trial and the court's post-trial opinion because it would unfairly prejudice the defendant. *Those Certain Underwriters at Lloyd's, London v. Nat'l Installment Ins. Servs., Inc.*, 2008 WL 2133417, at *10 (Del. Ch. May 21, 2008). Neither of these holdings is applicable here; Red Oak is not presenting documentary evidence for the first time at trial, nor is it seeking to amend the complaint. And, a claim of breach of fiduciary duty for not disclosing to Red Oak and Digirad's other stockholders that the Broadridge reports were inaccurate was listed in the Pretrial Stipulation. Pretrial Stip. C(1)(d); Post-Trial Arg. Tr. 12. For these reasons, the Defendants' prejudice argument is unpersuasive.

[161] Tr. 224-25.

stock. Keyes testified that no one instructed Warnock to vote the treasury stock.[162] As Red Oak conceded, the voting was "accidental[],"[163] and no evidence contradicts this conclusion. To be sure, it is less than "best practices" of governance for a corporation to hold treasury stock in street name at a retail brokerage firm which then solicits a proxy for its treasury stock, but even the "highly unusual policy of maintaining its [treasury] shares in street name at a retail brokerage account" is not a *per se* unlawful corporate act.[164]

The overriding legal question here is whether the Defendants breached their fiduciary duties or created an unfair election process by failing to inform Red Oak of their suspicion. According to Red Oak, this duty would have attached when the Defendants knew, or at least began to operate under the assumption, that Raymond James voted the treasury stock,[165] which the Court finds to be at the time of Grau's April 27 email to Keyes. The alleged "misleading" of Red Oak, the theory goes, calls into question the fairness of the election.[166] This framed a novel question.

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[162] *Id.* 229-30.
[163] Post-Trial Arg. Tr. 4.
[164] *Id.* 7.
[165] Pl.'s Pre-Trial Br. 26-27.
[166] Post-Trial Arg. Tr. 51.

The argument for a duty to disclose such information to one stockholder to use in its proxy contest strategy is unpersuasive. It clashes with the well-established principles that teach that disclosure of material information, when required under Delaware law because the directors seek stockholder action, must be to all stockholders to inform their voting decisions.[167] Thus, if the Board owed Red Oak a duty to disclose that the Broadridge reports were inaccurate, it would have to have been a duty the Board owed to all stockholders.

No cited Delaware authority supports the proposition that the Board was under a fiduciary duty to disclose to its stockholders either the Broadridge reports or the voting of the treasury stock, which could be seen only in the reports.[168] Red Oak conceded that Broadridge did not provide these preliminary reports to the public or to Digirad's stockholders.[169] Proxy contests happen all the time without management disclosure of preliminary proxy tabulation reports, and the Court is loath to find a breach of fiduciary duty under the circumstances for such a

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[167] Delaware courts have framed the duty of disclosure as a duty owed by the directors for the benefit of the stockholders—*i.e.*, the duty is to disclose material information to the corporation's stockholders as a whole. *See Barkan*, 567 A.2d at 1289; *see also Brody*, 697 A.2d at 755. The duty attaches when the board "seeks shareholder action," which happens when the board puts forth a matter upon which the stockholders collectively must vote, such as to elect directors at the annual meeting. *Stroud*, 606 A.2d at 84. The primary sections of the DGCL that implicate the duty—the notice of meeting provision and the charter amendment provision—refer to disclosures to the stockholders, plural. *See* 8 *Del. C.* § 222(a), 242(b)(1). And, the materiality standard for what needs to be disclosed is from the point of view of a "reasonable shareholder," not any single stockholder. *Rosenblatt*, 493 A.2d at 944.

[168] Nor was the Board required to disclose where Digirad held its treasury stock.

[169] Pl.'s Pre-Trial Br. 5.

customary and inoffensive practice without an exceedingly compelling argument rooted in Delaware law, which Red Oak has not presented. Because Digirad never affirmatively disclosed the preliminary Broadridge reports to all stockholders, or even to some stockholders (such as Red Oak), Digirad also cannot be said to have assumed a duty to disclose whether the reports remained accurate.[170] This type of asymmetry of information appears to be an honest and unfortunate mistake, not anything approaching intentional misconduct.[171]

Accordingly, the Board did not owe a fiduciary duty to disclose to Red Oak that some of them may have known, or at least assumed, that the preliminary Broadridge reports did not accurately reflect the number of shares that could actually be voted at the Election.[172] The preliminary Broadridge reports were

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[170] *Cf. In re Wayport, Inc. Litig.*, 2013 WL 5345477, at *23-24 (Del. Ch. May 1, 2013) (finding, in an action for fraud, that a party did not assume a duty to update because the party had not made a material misstatement) (citing Rest. (Second) of Torts § 551, cmt. h (1977)).

[171] The Court's decision should not necessarily be read to control where a corporation submitted a proxy for its treasury stock in bad faith, which could implicate a duty to disclose, if not a duty to revote the stock to "withhold" or "abstain," to maintain a fair election process. *See In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006) (defining bad faith to include "where the fiduciary acts with the intent to violate applicable positive law"). That more interesting question is not before the Court today.

[172] Red Oak further argues that once the Defendants learned that the Broadridge preliminary reports did not accurately reflect the proxies that could be voted, they then had a duty to take other action that might have made the reports less inaccurate—such as submitting a new proxy for the treasury shares in which Digirad would change its vote to "withhold." Post-Trial Arg. Tr. 8. Putting aside the issue of whether Digirad knew how a proxy was submitted for the treasury stock before the Election—knowledge that appears a necessary precondition to submit a new proxy—Red Oak has not cited any Delaware authority that would support such an affirmative duty under these facts. The Court earlier did not find a failure to disclose—and the Court, by extension, does not find a fiduciary duty for the Defendants to take affirmative action to correct a likely inaccuracy of which they were aware but for which they were not under a duty to disclose.

"preliminary" by their very terms[173]—meaning that they were subject to change and thus possibly inaccurate. The Court is not convinced that ensuring the accuracy of these reports, without a showing of something akin to intentional misconduct or self-initiated disclosure to the stockholders, is a matter of Delaware law. Therefore, the Defendants did not breach their fiduciary duties here in any way that would warrant a new election.

Moreover, Red Oak has not demonstrated why the Court should find an unfair election process because of Red Oak's reliance on the inaccurate, preliminary Broadridge reports. It is far too speculative a basis to invalidate an election by arguing that one's solicitation strategy would have been different if one knew then what one knows now. Relief under Section 225 that is not based on a breach of fiduciary duty would require proof of an unfair election process for the stockholders—and Red Oak has not demonstrated by a preponderance of the evidence how a proxy solicitation strategy based on preliminary Broadridge reports inaccurately listing Digirad's inadvertently submitted treasury stock proxy amounts to an unfair election process for the stockholders at large, even if the information asymmetry disadvantaged Red Oak. The accidental voting of the treasury stock and the nondisclosure that the Broadridge reports were inaccurate do not invalidate the Election.

[173] *Id.* 49.

C. *The Q1 2013 Results Release*

Red Oak asserts that the Defendants breached their fiduciary duties and created an unfair election process by concealing "material negative financial information"—the Q1 2013 Results.[174] The Court finds that the Defendants had reasonable justifications for delaying the release of this information.

As an initial matter, and before analyzing the factual record, the Court takes judicial notice that the federal securities laws require a publicly traded company to file a Form 10-Q within forty-five days of the end of a financial quarter if the company is a non-accelerated filer.[175] Digirad was identified as a non-accelerated filer on its Form 10-Q that it eventually filed on May 6.[176] Therefore, Digirad was not required under the federal securities laws to file the Q1 2013 Results on a Form 10-Q until forty-five days after the end of the quarter on March 31, which, as the Defendants correctly note, would have been May 15.[177] No other provision of the federal securities laws, Delaware law, or Digirad's governing documents mandates an earlier deadline.

One theory Red Oak asserts is that Digirad was under a duty to disclose the Q1 2013 Results before May 6 because the preliminary results it had calculated by April 17—namely, the "decreased gross revenues, decreased segment revenues and

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[174] Pl.'s Pre-Trial Br. 30.
[175] *See* 17 C.F.R. § 249.308a (2012); *see also* D.R.E. 202(d)(1).
[176] JX 189.
[177] *See* Def.'s Pre-Trial Br. 20.

decreased gross profits"[178]—were "final."[179] The cited evidence does not support this theory.

That the expected Q1 2013 Results remained constant throughout Digirad's review process does not necessarily mean that the numbers were final by April 17; it much more likely suggests that the review process confirmed their accuracy. Based on the evidence presented, including the uncontested testimony by Keyes about the detailed steps that needed to occur after April 17 and the reasonable justifications for both the first and second delays,[180] the Court cannot find that the Defendants had "final" information before Digirad actually submitted the Q1 2013 Results to the SEC for release on May 6.

A second theory advanced by Red Oak is that moving the release date of the Q1 2013 Results was a way for the Defendants to hide the negative results until after the Election. The facts presented also do not support this theory of intentional misconduct.

Red Oak suggests that intent can be inferred by contrasting the release of the Q1 2013 Results with Digirad's earlier releasing of preliminary financial results in February for fiscal year 2012 and its subsequent releasing of final results for the

[178] Pl.'s Pre-Trial Br. 30.
[179] Post-Trial Arg. Tr. 19 (arguing that the "final" information included two important declines: "a revenue decline year over year of over 10 percent and a gross return of a whopping over 25 percent").
[180] Tr. 233-34, 248.

second quarter of 2013 "a mere thirty days after the quarter-end."[181] The Court cannot find within these cited examples anything supporting Red Oak's argument. The original April 25 and May 3 dates appear to have been internal, working dates, the setting of which was a regular process at Digirad.[182] Red Oak has not pointed the Court to any evidence that the Defendants made any public representations that Digirad would release the Q1 2013 Results on either April 25 or May 3. The only public date referenced for the release of the Q1 2013 Results that the Court has found in the evidence is May 6. Of course, that date may have been "later than [Red Oak] certainly expected," according to Sandberg's testimony,[183] but Red Oak has not shown that this expectation was directly based any publicly available information other than its own hunch from Digirad's past practice (and its own desire to use any potential negative results against management during the Election).

No cited authority demonstrates why it was improper for Digirad to release the Q1 2013 Results on May 6. That the release of the Q1 2013 Results was internally set to be "concurrent with a contested election of directors"[184] is not

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[181] Pl.'s Pre-Trial Br. 32; JX 198.
[182] *See, e.g.*, Tr. 237 ("[W]e set our earnings dates out many—many quarters out into the future, mainly as an exercise to make sure that all our board members are available and we try to schedule things out. But they can always change because we don't announce our specific earnings release dates typically until a couple weeks before the actual date."); *see also* JX 160 (scheduling Digirad's earnings release dates for the rest of the year in a March 29 email).
[183] Tr. 57.
[184] Post-Trial Arg. Tr. 19.

enough to warrant a special duty of disclosure. Instead, the only release date that it appears Digirad was required to meet was that identified by the Defendants—the May 15 deadline of forty-five days after the close of the quarter as required by the SEC.[185]

The primary way in which Red Oak attacks the Defendants' proffered justifications for the two delays is the lack of "any contemporaneous documentary corroboration."[186] But, that the Defendants have not introduced into evidence corroborating contemporaneous documents that support Keyes' testimony does not prove intentional misconduct or an unfair election process caused by the Defendants. By contrast, and more importantly, Red Oak introduced no testamentary or documentary evidence that supports its accusation that the Defendants intentionally delayed or concealed the Q1 2013 Results until after the Election. Without a preponderance of the evidence, this argument is unpersuasive.[187]

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[185] *See* 17 C.F.R. § 249.308a (2012).

[186] Pl.'s Post-Trial Mem. 5.

[187] The Court can certainly envision a situation, unlike that presented here, in which a stockholder shows by a preponderance of the evidence that a company intentionally delayed releasing financial results until after a stockholder vote, even if the release date is still before the relevant SEC deadline. Such conduct may warrant serious judicial scrutiny over whether the vote should be found valid. *See Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) ("[I]nequitable action does not become permissible simply because it is legally possible.").

In sum, Red Oak proposes that the Court require directors to disclose sufficiently final (but still preliminary) results of a financial quarter in spite of possible (and reasonable) decisions to delay releasing that information—and all before the corporation needs to disclose that information under the federal securities laws. Imposing such a duty appears to be precisely the type of "grafting" of a more robust fiduciary duty of disclosure that the Delaware Supreme Court has cautioned against requiring for privately-held corporations, and the underlying policy is equally applicable to public companies including Digirad here.[188] Therefore, the nondisclosure of the Q1 2013 Results until May 6 was not a material omission, and the Defendants thus did not breach their fiduciary duties or otherwise create an unfair election process.

D. *The NOL Rights Plan*

Finally, Red Oak contends that the Defendants breached their fiduciary duties and created an unfair election process by failing to disclose that they had already "analyzed and evaluated"[189] whether to implement an NOL Rights Plan before the Election. By way of counterfactual, Red Oak asserts that it would have been "highly implausible" for the NOL Rights Plan not to have been "analyzed and

[188] *See Stroud*, 606 A.2d at 87 ("The trial court's extension of the duty of disclosure beyond that mandated by statute effectively amends the law. It is important that there be certainty in the corporation law. We emphasize that the Court of Chancery must act with caution and restraint when ignoring the clear language of the [DGCL] in favor of other legal or equitable principles.").
[189] Pl.'s Pre-Trial Br. 33

evaluated by the Board until after the May 3 election"[190] because of the purported weeks-long process needed to implement it.[191]

The evidence presented at trial and in the post-trial document production does not establish that the Board had voted or in some other way decided to adopt the Plan before the Election. The minutes from the April 29 Board meeting document when the full Board first discussed what the NOL Rights Plan might look like.[192] These minutes show that the Board, four days before the Election, was still discussing the NOL Rights Plan as a "concept" to see if it would be "feasible" for Digirad; as Keyes testified, "no decision was made."[193] Without evidence that actually shows that the Board had decided to implement the NOL Rights Plan before the Election—such as a resolution adopting the Plan or some other affirmative approval before May 3—the Court finds the Board had nothing to disclose at that time.

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[190] *Id.*

The Defendants did not produce documents about the Board's pre-Election consideration of adopting an NOL Rights Plan before the trial on August 7, 2013, and the individuals who Red Oak deposed were instructed to not answer questions about the NOL Rights Plan. Post-Trial Mem. 5-6. The apparent reasoning by the Defendants was a pending motion to strike from the Complaint Red Oak's allegations about the NOL Rights Plan. After the Court denied the motion, *Red Oak Fund, L.P. v. Digirad Corp.*, 2013 WL 4014283, at *2 (Del. Ch. Aug. 5, 2013), Defendants supplemented the joint trial exhibits with documents about the NOL Rights Plan.

[191] Tr. 60-62.

[192] JX 209.

[193] Tr. 262.

The Court also cannot conclude that the Board's failure to disclose that a few directors and two senior executives were involved in determining if a plan was "feasible" and seeing "how a potential plan would look" was material. That these individuals were just researching how to implement the Plan appears to the Court to be exactly the kind of "inner workings and . . . day-to-day functioning [that] are not the proper subject of disclosure."[194] Moreover, having to disclose by May 3 whether a majority of the Board would eventually vote to adopt the NOL Rights Plan would be a requirement that "would oblige [Digirad] to speculate about its future plans" and is accordingly "not an appropriate subject for a proxy disclosure."[195] A possible decision that might be reached several weeks away is far too speculative for the Court to require disclosure, even during a proxy contest.

Testimony from Sandberg that Digirad's stockholders "would want to know about [what the company's plans were for implementing the NOL Rights Plan] because it's material"[196] is not enough to require disclosure of the Board's inner workings and speculative, future decisions.[197] The Court is also not convinced that

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[194] *Loudon*, 700 A.2d at 144.
[195] *Id.* at 145.
[196] Tr. 63.
[197] *Loudon*, 700 A.2d at 144.
Red Oak further argues that disclosure was required because it was material that the NOL Rights Plan "directly impeached what was being said in the proxy statements about the buyback plan." Post-Trial Arg. Tr. 18-19. For support, Red Oak points to an email from Keyes to Eberwein on April 17 in which Keyes mentions how implementing an NOL protection plan would allow Digirad to buy back a maximum of "approximately $8.5 million [of stock] . . . at current prices." JX 204. Red Oak argues that this upper cap of $8.5 million is different from the

a reasonable stockholder would find these early considerations about protecting intangible assets important when deciding how to vote in the Election.[198] The Court thus cannot hold that Digirad's directors failed to disclose their subjective considerations of a proposed action where there was no conclusive decision to take the action.

The Defendants' nondisclosure of the early considerations of the NOL Rights Plan also cannot be said to have created an unfair election process for the same reasons that the alleged misstatements about the preliminary voting results, the purported failure to disclose that the Broadridge reports were inaccurate, and the delays in releasing the Q1 2013 Results did not create an unfair election process. This alleged nondisclosure, once again, does not make the Election invalid.

VI. CONCLUSION

For the foregoing reasons, the Court finds that the Board did not breach its fiduciary duties by making any material misstatements or omissions during the Election. In addition, the Court finds that Red Oak did not establish that the

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"[$]12 million that was reflected in the proxy statement." Post-Trial Arg. Tr. 18. This argument is unpersuasive not only because the Board was still approximately two weeks away from voting to have Climaco and Keyes research further whether such a plan was feasible, but also because the figure in the email was undoubtedly speculative because it reflected the "current price[]" of Digirad stock, which was subject to, and did, change. *See* JX 196 (charting the changes in the stock price from mid-March through the end of June). Were Digirad's stock price to rise modestly, a $12 million buyback would have been feasible.

[198] *See Brody*, 697 A.2d at 755.

Defendants in some other way created an unfair election process. Therefore, the Court finds the Election valid, and the Defendants are entitled to judgment in their favor.

An implementing order will be entered.