

EFiled: Mar 9 2006 11:25PM
 Filing ID 10762634
 Case Number 36,2006



IN THE
Supreme Court of the State of Delaware

BENIHANA OF TOKYO, INC., individually
 and on behalf of BENIHANA, INC.,

*Plaintiff Below,
 Appellant,*

No. 36, 2006

- v -

BENIHANA, INC., JOHN E. ABDO,
 NORMAN BECKER, DARWIN DORNBUSH,
 MAX PINE, YOSHIHIRO SANO,
 JOEL SCHWARTZ, ROBERT B. STURGES,
 TAKANORI YOSHIMOTO, and
 BFC FINANCIAL CORPORATION,

*Defendants Below,
 Appellees.*

APPEAL FROM THE COURT
 OF CHANCERY OF THE
 STATE OF DELAWARE, IN
 AND FOR NEW CASTLE
 COUNTY, C.A. No. 550-N

**APPELLANT BENIHANA OF TOKYO, INC.'S
 OPENING BRIEF**

OF COUNSEL:

Jonathan Rosenberg
 Alexandra A. Lewis
 O'MELVENY & MYERS LLP
 7 Times Square
 New York, NY 10036

C. Bart Flinn (#4092)
 Elena C. Norman (#4780)
 D. Fon Muttamara-Walker (#4646)
 YOUNG CONAWAY STARGATT
 & TAYLOR, LLP
 The Brandywine Building
 1000 West Street, 17th Floor
 P.O. Box 391
 Wilmington, DE 19899-0391
 (302) 571-6600

*Attorneys for Plaintiff Below,
 Appellant Benihana of Tokyo, Inc.*

MARCH 9, 2006

TABLE OF CONTENTS

| | <u>Page</u> |
|---|-------------|
| TABLE OF AUTHORITIES..... | iii |
| NATURE OF PROCEEDINGS..... | 1 |
| SUMMARY OF ARGUMENT..... | 2 |
| STATEMENT OF FACTS..... | 4 |
| BOT Controlled BI From Its Inception..... | 4 |
| 2003 — BI Management Considers Ways To Dilute BOT..... | 5 |
| BI Simultaneously Considers A Remodeling And Expansion Plan..... | 6 |
| January 29: "Raise Equity When You Can, Not When You Need It"..... | 6 |
| February 17: The Board Decides To Issue \$20 Million In Convertible Preferred, Rather Than Raising Money Less Expensively Through Wachovia..... | 6 |
| Joseph Presents BI's Negotiating Strategy To Abdo And The Board..... | 8 |
| Abdo Chooses To Negotiate On BFC's Behalf..... | 9 |
| Abdo Negotiates Deal Improvements For BFC's Benefit..... | 9 |
| May 6: Board Approval..... | 10 |
| Joseph Pitches BFC For Business Before Rendering Its Fairness Opinion..... | 12 |
| Board Rejects Non-Dilutive Offers..... | 12 |
| October 2004: Post-Lawsuit "Ratification"..... | 13 |
| ARGUMENT..... | 14 |
| I. THE COURT OF CHANCERY ERRED IN APPLYING THE BUSINESS JUDGMENT RULE TO ABDO'S SELF-DEALING TRANSACTION WITH BI..... | 14 |
| A. Standard of Review..... | 14 |

| | | |
|------|---|----|
| B. | The Court of Chancery Erred in Holding That DGCL Section 144(a)(1) Applies Because the Approving Directors Did Not Have All Material Information Regarding the Transaction..... | 14 |
| C. | Even if DGCL Section 144(a)(1) Applied, The Court of Chancery Erred in Applying the Business Judgment Rule Because of Abdo's Fiduciary Duty Breach | 19 |
| D. | The Transaction Does Not Meet The Entire Fairness Standard | 22 |
| II. | THE COURT OF CHANCERY ERRED IN FAILING TO PROTECT BOT'S CONTROL INTEREST FROM UNILATERAL DILUTION..... | 24 |
| A. | Standard of Review | 24 |
| B. | The Court of Chancery Erred in Relegating the Dilutive Purpose to Merely "Incidental" After Finding a Dilutive Concern | 24 |
| C. | The Court of Chancery Erred By Not Requiring the Board To Show That It Reasonably Investigated Whether BI's Funding Needs Could Be Satisfied Through Alternative Financing That Did Not Strip BOT's Control Power | 28 |
| III. | THE COURT OF CHANCERY SHOULD HAVE INVALIDATED THE TRANSACTION BECAUSE BI'S CERTIFICATE OF INCORPORATION PROHIBITS BI FROM GRANTING PREEMPTIVE RIGHTS | 32 |
| A. | Standard of Review | 32 |
| B. | The Preemptive Rights Grant Renders the Convertible Preferred Void | 32 |
| | CONCLUSION | 35 |

TABLE OF AUTHORITIES

Cases

| | |
|---|------------|
| <i>Agranoff v. Miller</i> , 1999 WL 219650 (Del. Ch. Apr. 12, 1999) | 20, 21 |
| <i>Blasius Indus. Inc. v. Atlas Corp.</i> , 564 A.2d 651 (Del. Ch. 1988)..... | 26, 29, 30 |
| <i>Bomarko, Inc. v. Int'l Telecharge, Inc.</i> , 794 A.2d 1161 (Del. Ch. 1999), <i>aff'd</i> , 766 A.2d 437 (Del. 2000)..... | 22 |
| <i>Brehm v. Eisner</i> , 746 A.2d 244 (Del. 2000) | 14, 18 |
| <i>Brophy v. Cities Serv. Co.</i> , 70 A.2d 5 (Del. Ch. 1949)..... | 20, 21 |
| <i>Canada Southern Oils v. Manabi Exploration Co.</i> , 96 A.2d 810 (Del. Ch. 1953)..... | 24, 26, 27 |
| <i>Cede & Co. v. Technicolor, Inc.</i> , 634 A.2d 345 (Del. 1993) (" <i>Cede LP</i> ") | 14, 17, 20 |
| <i>Condec Corp. v. Lunkenheimer Co.</i> , 230 A.2d 769 (Del. Ch. 1967)..... | 24, 25, 27 |
| <i>Doe v. Cahill</i> , 884 A.2d 451 (Del. 2005) | 24 |
| <i>E.I. duPont de Nemours v. Shell Oil Co.</i> , 498 A.2d 1108 (Del. 1985) | 33 |
| <i>Gentile v. SinglePoint Fin. Inc.</i> , 788 A.2d 111 (Del. 2001) | 32 |
| <i>Goodwin v. Live Entm't, Inc.</i> , 1999 WL 64265 (Del.Ch. Jan. 25, 1999)..... | 15 |
| <i>Gregory v. Correction Connection Inc.</i> , 1991 WL 42992 (E.D. Pa. March 27, 1991)..... | 31 |
| <i>HMG/Courtland Props., Inc. v. Gray</i> , 749 A.2d 94 (Del.Ch. 1999)..... | 15, 19 |
| <i>Holland v. Nat'l Auto. Fibres, Inc.</i> , 194 A. 124 (Del. Ch. 1937)..... | 34 |

| | |
|--|------------|
| <i>Hollinger Int'l, Inc. v. Black</i> , 844 A.2d 1022 (Del. Ch. 2004), <i>aff'd</i> , 872 A.2d 559 (Del. 2005)..... | 16, 20, 21 |
| <i>In re Cox Commc'ns, Inc. S'holders Lit.</i> , 879 A.2d 604 (Del. Ch. 1995)..... | 19 |
| <i>In re Emerging Communications, Inc. Shareholders Litig.</i> , 2004 WL 1305745 (Del. Ch. June 4, 2004)..... | 23 |
| <i>In re Walt Disney Co. Der. Lit.</i> , 2005 WL 2056651 (Del.Ch. Aug. 9, 2005)..... | 17 |
| <i>Ivanhoe Partners v. Newmont Min. Corp.</i> , 533 A.2d 585 (Del.Ch. 1987)..... | 29 |
| <i>Kahn v. Lynch Commc'n Sys.</i> , 669 A.2d 79 (Del. 1995)..... | 14 |
| <i>Kaiser Aluminum Corp. v. Matheson</i> , 681 A.2d 392 (Del. 1996)..... | 32 |
| <i>Katell v. Morgan Stanley Group, Inc.</i> , 1993 WL 205033 (Del. Ch. June 8, 1993)..... | 34 |
| <i>Levitt v. Bourvier</i> , 287 A.2d 671 (Del. 1972)..... | 4, 24 |
| <i>Mendel v. Carroll</i> , 651 A.2d 297 (Del. Ch. 1994)..... | 30 |
| <i>Mills Acquisition Co. v. MacMillan, Inc.</i> , 559 A.2d 1261 (Del. 1988)..... | 22, 29 |
| <i>Nassau Gallery, Inc. v. Nationwide Mut. Fire Ins. Co.</i> , 2003 WL 21223843 (Del. Super. April 17, 2003)..... | 34 |
| <i>Odyssey Partners LP v. Fleming Cos., Inc.</i> , 1996 WL 422377 (Del. Ch. July 24, 1996)..... | 20 |
| <i>Packer v. Yampol</i> , 1986 WL 4748 (Del. Ch. Apr. 18, 1986)..... | 24, 26, 27 |
| <i>Paramount Commc'ns, Inc., v. Time, Inc.</i> , 571 A.2d at 1140 (Del. 1989)..... | 29 |
| <i>Sachs v. Seminole Oil & Gas Corp.</i> , 150 A.2d 20 (Del. Ch. 1959)..... | 25 |
| <i>Shintom Co., LTD v. Audiovox Corp.</i> , 888 A.2d 225 (Del. 2005)..... | 32 |

| | |
|--|---------------|
| <i>Smith v. Nu-W. Indus., Inc.</i> , 2000 WL 1641248 (Del. Ch. Oct. 25, 2000)..... | 17, 33 |
| <i>Staar Surgical Co. v. Waggoner</i> , 588 A.2d 1130 (Del. 1991) | 32, 34 |
| <i>Stahl v. Apple Bancorp, Inc.</i> , 1990 WL 114222 (Del. Ch. 1990) | 29, 30 |
| <i>Stasch v. Underwater Works, Inc.</i> , 158 A.2d 809 (Del. Super. 1960)..... | 34 |
| <i>T. Rowe Price Recovery Fund, L.P. v. Rubin</i> , 770 A.2d 536 (Del. Ch. 2000)..... | 22 |
| <i>TSC Indus. v. Northway, Inc.</i> , 426 U.S. 438 (1976)..... | 15 |
| <i>Unocal Corp. v. Mesa Petroleum Co.</i> 493 A.2d at 955 | 3, 28, 29, 31 |
| <i>Weinberger v. UOP, Inc.</i> , 457 A.2d 701 (Del. 1983) | 22 |
| <i>Williams v. Geier</i> , 671 A.2d 1368 (Del. 1996) | 30 |
| <i>Wood v. Coastal States Gas Corp.</i> , 401 A.2d 932 (Del. 1979) | 34 |
| <i>Zirn v. VLI Corp.</i> , 621 A.2d 773 (Del. 1993) | 15, 18 |
| Statutes | |
| 8 Del. C. §102(a)(4)..... | 32 |
| 8 Del. C. §102(b)(3) | 3, 33, 34 |
| 8 Del. C. §144(a)(1)..... | 2, 14 |
| 8 Del. C. §144(a)(3)..... | 14 |
| 8 Del. C. §151(a)..... | 32 |

NATURE OF PROCEEDINGS

Benihana of Tokyo, Inc. ("BOT") appeals the Court of Chancery's December 19, 2005 Order and Final Judgment (Exhibit A) denying BOT's direct and derivative claims against directors of Benihana Inc. ("BI") and a company controlled by BI director John Abdo, BFC Financial ("BFC"). BOT was BI's controlling shareholder until July 2004, when BI issued \$20 million in convertible preferred stock to BFC (the "Transaction.")

BOT's derivative claim alleged, among other things, that BI director Abdo—BFC's 30% owner—used confidential BI information to negotiate the Transaction's terms on BFC's behalf. BOT's direct claim alleged, among other things, that the Transaction was void because its primary purpose was to dilute BOT's voting control. BOT also alleged that the Transaction was *ultra vires* because it granted BFC preemptive rights, in breach of the BI Certificate of Incorporation's preemptive rights bar.

Trial began on November 9 and ended on November 15, 2004. The Court of Chancery rendered its opinion on December 8, 2005 (Exhibit B).

On the derivative claim, the court acknowledged that Abdo had learned BI's strategy for negotiating the convertible preferred while attending the BI Board's February 17, 2004 meeting. The court also found that Abdo thereafter negotiated terms for BFC that he had learned BI would concede if necessary. And the court found that the Board members who approved the Transaction did not know that Abdo had negotiated on BFC's behalf. Nevertheless, the court ruled that Section 144(a)(1) of the Delaware General Corporations Law ("DGCL") applied and that Abdo had not breached his fiduciary duties.

On the direct claim, the court found that BI CEO Joel Schwartz "was concerned about BOT's control of [BI] in late 2003." The court also found that Schwartz explored various transactions in late 2003 to dilute BOT or buy out its control position. Nevertheless, the court held that Schwartz's concern about BOT's control did not "infect his own or the Board's decisionmaking process," and that "neither Dornbush nor a majority of the members of the [BI] Board had entrenchment or dilution of BOT as their sole or primary purpose in approving" the Transaction.

The court also held that BI's Certificate's provision that "[n]o stockholder shall have any preemptive rights . . ." only "clarif[ies] that no shareholders possessed preemptive rights at common law." According to the court, the Certificate's "blank check authorization" sufficiently enables preemptive rights grants.

BOT filed its Notice of Appeal on January 18, 2006.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred in applying the business judgment rule because BI Director John Abdo negotiated the Transaction against BI on BFC's behalf after learning the details of BI's negotiating strategy at a BI Board meeting. That conduct—which the Court of Chancery found based on uncontradicted record evidence—bars business judgment rule review for two reasons.

First, DGCL Section 144(a)(1) cannot cleanse this related-party transaction. That statute requires that the Board have the material facts regarding the Transaction. Here, the Board did not know that Abdo negotiated the Transaction on BFC's behalf. That fact was material to the Board's approval decision, because Abdo knew the terms that BI wanted and the terms it would concede in negotiations. Even in response to specific inquiry from a director, the Board was not given this critical information.

Second, Abdo breached his fiduciary duty of loyalty. Once in possession of BI's confidential strategy for negotiating the convertible preferred, Abdo was bound not to use that information against BI to further his own interests. But as the Court of Chancery found, Abdo not only negotiated against BI, he was BFC's sole negotiator. To maximize his improper negotiating advantage, Abdo obtained BI's no-shop commitment. And he cashed-in that advantage by extracting terms he had learned as a BI fiduciary that BI would concede.

Because the business judgment rule does not apply, the Court of Chancery should have applied the entire fairness test. It follows from the uncontradicted record facts that the Transaction was not entirely fair. Abdo's misuse of BI's confidential information alone precludes an entire fairness finding. Also fatal to an entire fairness finding is management's lack of candor with the Board, including (i) failing to disclose Abdo's negotiating role; (ii) lulling the Board into the false belief that the deal terms had not changed significantly during the negotiation process; and (iii) allowing the Board to believe for more than three months that BI was burdened by nearly twice its actual debt. Nor did the Board meaningfully consider the "highly feasible" less-expensive debt alternatives available to "conservatively-leveraged" BI.

2. The Court of Chancery erred in finding that BI's management and Board did not have a primary purpose to dilute BOT's control power. Where a transaction is motivated by two purposes—one legitimate, the other to eliminate the control franchise—the improper dilutive purpose cannot be deemed "incidental." Here, the Court of Chancery found that BI management "was concerned with BOT's control in late 2003." In furtherance of that concern, BI management (i) analyzed ways to eliminate BOT's voting control through stock issuances; and (ii) obtained a financial advisor's valuation of BOT's control

premium. Thus, BI management had two objectives in late 2003 and early 2004: (i) raising funds for a long-term restaurant renovation project; and (ii) eliminating BOT's voting control. The Transaction satisfied both objectives. Under these circumstances, it was error for the court to hold that the improper dilutive purpose was merely incidental to the legitimate fund-raising objective. Moreover, every Delaware case that has confronted analogous facts has inferred an improper purpose where, as here, a financing diluted an estranged controlling shareholder, when a readily-available non-dilutive transaction would have satisfied the company's legitimate financing needs.

The Court of Chancery also erred by failing to hold the BI Board to a showing that it reasonably investigated whether the asserted legitimate business objective could be achieved by means short of stripping BOT's control power. The Court should adopt this modified *Unocal* standard for cases such as this where, concerned about a control shareholder's power, the Board eliminates the control franchise. That objective test is necessary because of (i) the omnipresent spectre of entrenchment in control situations; and (ii) the control franchise's importance in Delaware and the property right embodied in the control premium. The BI Board cannot satisfy that test because it did not reasonably investigate whether a non-dilutive transaction could have satisfied BI's renovation funding needs.

3. The Court of Chancery erred by failing to find the BFC convertible preferred *ultra vires*. BI's Certificate of Incorporation provides that "no stockholder shall have any preemptive right to subscribe to or purchase any issue of stock or other securities of the Corporation." The Court of Chancery, however, deemed that language "boilerplate," meant only "to clarify that no shareholder possessed preemptive right at common law." The court ruled that the Certificate's general "blank check authorization" allowed a preemptive rights grant. In so ruling, the court violated established contract construction principles.

First, the plain meaning rule required the court to enforce the Certificate's unambiguous terms. But the court erred in failing to enforce the Certificate's unambiguous preemptive rights bar. Second, the court was required to construe the Certificate so as to give effect to each provision. DGCL Section 102(b)(3), which as a matter of law is incorporated in BI's Certificate, was amended in 1967 to abrogate the common law rule that stockholders had preemptive rights. The court rendered the Certificate's preemptive rights bar inoperative by construing it as only replicating Section 102(b)(3). Third, the Certificate's specific prohibitive language should control over its general permissive language. But the court construed in the reverse, *i.e.*, making the Certificate's generalized blank check authorization control over its specific preemptive rights bar.

STATEMENT OF FACTS

BOT Controlled BI From Its Inception

BOT was founded in 1963 by Rocky Aoki, its sole owner, to run several Japanese-style restaurants in the United States. BI was incorporated in 1994, and is now a publicly-traded Delaware company. BOT transferred most of the Benihana restaurants to BI, which now operates one of the largest teppan-style Asian restaurant chains in the United States, as well as several sushi restaurant chains.

BOT was BI's controlling shareholder from 1994 until its voting control was diluted in the Transaction. Op. 2-3. BI has two common stock classes—Common, which has 10 votes per share, and Class A Common, which has 1 vote per share. Common votes for 75% of the directors, and Class A votes for a separate slate of the other 25%. Op. 4. As of 2003, BOT owned 50.9% of the Common, and 2% of the Class A. Op. 4.

BOT has been an unusual company because of Rocky Aoki's legal difficulties and family conflicts. In 1998, Rocky pleaded guilty to insider trading in another company's stock. To avoid issues with BI restaurant liquor licenses, he placed BOT's stock into the Benihana Protective Trust. As of 2003, the trustees were Rocky's three adult children, Kana Aoki Nootenboom, Kyle Aoki, Kevin Aoki, and then-family attorney (and current BI director) Dornbush. A489. In 2003, Rocky married Keiko Aoki, a woman thirty years his junior who did not get along with Rocky's children. Rocky then changed his will so that Keiko would inherit the BOT stock. Op. 7. This resulted, of course, in acrimony between Rocky and his children. A65-66, 70, 142-43.

Despite the internal squabbles, BOT remained BI's controlling stockholder in early 2004. As of that time, BI had nine directors: John Abdo, the Chairman of BI's compensation/stock options committee and the Vice Chairman and 30% owner of BFC; Schwartz, BI's President and CEO; Dornbush, BI's Secretary, "in effect" general counsel, board member of the BFC-controlled Levitt Corp., partner with Schwartz and Sano in a financial consulting firm Dorsan Group, counsel for Restaurant Associates for "more than 40 years" (A139) and a former Aoki family advisor (Op. 6.); Taka Yoshimoto, BI's Executive Vice President, Operations; Robert Sturges, a non-management director, Max Pine, a non-management director and retired Restaurant Associates CEO; Yoshihiro Sano, a non-management director; Norman Becker, a non-management director who also sits on the board of the BFC-controlled Bluegreen; and Kevin Aoki, BI's Vice President, Marketing, who is not a defendant in this case.

Abdo had been interested in buying significant blocks of BI stock since the 1990's. Op. 6. Abdo told Dornbush when the Trust was formed in 1998 that if Rocky ever wanted to sell his stock, "I've always liked this company and if that would be Rocky's pleasure, I would certainly be interested in talking with him." A115. Abdo again told Dornbush around 2000 that "if the shares or whatever are ever for sale, you know, let me know." A149.

2003 — BI Management Considers Ways To Dilute BOT

In 2003, Schwartz and Dornbush were facing two important, and seemingly unrelated, issues: funding a planned remodeling and expansion project, and preventing Keiko Aoki from making BI management decisions.

On August 28, 2003, Dornbush learned that Rocky had willed his BOT stock to Keiko. Op. 7; A147. That news sent shock waves throughout BI. Dornbush told Schwartz that he would have to "weather the storm," because Keiko would presumably be hostile to management. Op. 8; A145. Dornbush "shared the concern" that Keiko would "take control or be the spokesperson for [BI] through the share ownership that she would control, even if not be able to own, and do unto Benihana what she did unto BOT, which is remove all of the people who were there for 20 years of service and emasculate them from anybody who was a friend of Rocky and, if you would, people that with her representatives." A145. He also discussed his concerns with Abdo and Pine. A144.

Also on August 28, Schwartz and Dornbush began investigating transactions with the same common denominator: diluting BOT. Schwartz proposed that BI issue a 10-to-15 percent annual Class A stock dividend. Op. 68-69; A183, 147. BI's Certificate of Incorporation provides that if the proportion of Common shares falls below 12½%, then both Common and Class A would vote together for the Common's 75% of directors (but Class A would continue to vote separately for the other 25%). Op. 9. Schwartz calculated how long it would take to "meet the [12½%] threshold in the Certificate."

Dornbush asked an associate in his law firm to write a memo analyzing this proposal. The memo offered additional dilutive suggestions, such as issuing a 40% Class A stock dividend. A190; A148.

Schwartz then suggested tripping the 12½% threshold immediately by issuing 16.5 million Class A shares. Op. at 69; A192; A43, 148. BI's controller reported to Schwartz and Dornbush that this "would have reduced BOT's percentage of the vote to approximately 29%." Op. 9; A192. "Dornbush responded that it would not be [feasible to do such a stock issuance] and suggested that there would not be a legitimate business purpose for issuing that number of shares." Op. 9. As the Court of Chancery found, Schwartz's

consideration of the 16.5 million share issuance "shows that he was concerned about BOT's control of [BI] in late 2003." Op. 70.

BI Simultaneously Considers A Remodeling And Expansion Plan

Also in mid-to-late 2003, BI hired the design and architecture firm WD Partners to assist with a five-year remodeling and expansion project. Op. 13; A233. On October 24, 2003, BI hired Morgan Joseph ("Joseph"), a financial advisor, to explore "external capital sources including . . . public and private debt and equity securities." A194.

Joseph's first presentation was not about raising money for the five-year remodeling plan. Rather, at Dornbush's request, Joseph prepared a 27-page book to "address the valuation for the potential sale of a significant portion of the [BI] Common Stock held by [BOT]." A209; A103, 150. Joseph opined that a 35-to-40% control premium to BOT would be reasonable. A209; A98. This translated into a \$6-7 million control premium as of November 4, 2003.

Dornbush testified that Schwartz was interested in buying out BOT to "bring together management and a major position in the company." A151. This was apparently a recurring theme: "Mr. Schwartz was always asking me whether I thought the trust would be interested in selling any of their BOT shares, and I said not during Rocky's lifetime." A150. Op. at 8-9.

January 29: "Raise Equity When You Can, Not When You Need It."

During the Board's January 29, 2004 meeting, WD Partners described their restaurant remodeling plan, BI officers reported on the RA Sushi expansion campaign, and Joseph reported on the "range of strategic and financial planning matters as they relate to the Company's five-year business, strategic and capital plan." A354. Joseph presented the Board book (JX37) and discussed the various financing alternatives. He recommended that BI issue preferred equity, because "the oldest rule in our business is you raise equity when you can, not when you need it." Op. 17, A86. The book's "Anticipated Term Sheet" included voting rights for the convertible preferred "as if converted." A313. The directors, including Abdo, took the book with them to "study and deliberate" in preparation for the Board's February 17 meeting. Op. 17.

February 17: The Board Decides To Issue \$20 Million In Convertible Preferred, Rather Than Raising Money Less Expensively Through Wachovia

Joseph's February presentation focused on two funding proposals — a Wachovia loan and issuing equity. A361. Wachovia would lend up to \$60 million, in addition to BI's existing debt, as long as BI did not borrow more than 1.5 times its EBITDA. Based on BI management's five-year EBITDA projections, this would have given BI a more than \$36.6 million borrowing

capacity in 2004, which would have increased annually, reaching to \$55.7 million by 2007. A305. This is far in excess of what BI needed. BI has not even needed the \$20 million it ultimately obtained from BFC, which has been used: (i) to pay off a loan for which BI was paying a tax-deductible 2% annual interest rate; and (ii) for a money market fund deposit, which pays BI approximately 1% annual interest (while BI pays BFC a 5% non-deductible annual dividend). A84.

Joseph analyzed BI's borrowing capacity under the Wachovia proposal against BI's current debt, and concluded that there would be a shortfall in the project's first two years. A281, 305. This "was a very important consideration" for the Board in choosing convertible preferred over the Wachovia proposal. A169-70. But this shortfall projection was wrong because it was based on grossly inflated debt figures. That is, Joseph's Board book used \$37.3 million as BI's debt, when it was only \$20 million. A305; A47. Schwartz did not correct these inflated debt figures, even though he knew that BI's preexisting credit facility was only \$28 million. *Id.*

BI was very conservatively leveraged. Op. 17. It planned to remodel at a measured pace, with projects not expanding to additional locations if the remodeled or new locations were not profitable. A100-1. Operating income would fund most of the capital expenditures. A81. Thus, had it borrowed all the funds necessary for even its most aggressive remodeling plan, BI still projected to be even more conservatively leveraged each year, without the issuance of additional equity. A292; A57.

Joseph deemed the Wachovia proposal "clearly the least expensive form of [raising] capital." A85, 88. Issuing equity, on the other hand, was the most expensive: "obviously senior debt is the least expensive form of financing. . . if we wanted to do long-term debt, it would be more expensive. If we wanted to do equity, it would be even more expensive. . ." A85. BOT's expert, J.T. Atkins (whom the Court of Chancery did not mention in its opinion), testified that "the companies who [sic] issued convertible preferred stock in the last — in the 18 months. . . are all small [and] . . . highly leveraged, or they're emerging growth and technology companies. These are the kind of companies that don't have the kind of financial options that [BI] has." A77. Even Joseph's list of comparable restaurant company financings did not include a single convertible preferred issuance. *Id.*, discussing A307.

The preferred stock Joseph recommended would be convertible into Common, with "as if converted" voting rights. Joseph calculated that BOT's voting control would be reduced to 33.7% Common and to 29.8% aggregate. A312; A119. Joseph's Board book spun the preferred stock's dilutive effect as a benefit to BI: "The Company may also gain several additional benefits from a convertible preferred placement, including . . . a new investor class, and balance

for its concentrated ownership structure." A273. Schwartz understood that this would have a "detrimental impact on the control premium that BOT would receive if it were to sell its stock." A45. Kevin Aoki asked whether the preferred could be convertible into Class A rather than Common, but Joseph responded that a purchaser would most likely want Common conversion rights. A58.

Joseph Presents BI's Negotiating Strategy To Abdo And The Board

Fred Joseph took the Board (including Abdo) through the Board book's "Anticipated Term Sheet." A313. In so doing, he identified those terms that (i) BI would seek; (ii) would be willing to concede; (iii) he expected a buyer would dislike; and (iv) he expected a buyer would demand:

- Joseph discussed reducing the \$20 million commitment by proposing two \$10 million tranches. He would negotiate for BI's option not to issue the second tranche, but confided that this would be a "hard sell." Thus, the agreed strategy was that Joseph would "try [for just one tranche] and I'd give it away, if I had to." A91. Conversely, Joseph would try to make the second tranche not subject to BI's performance (*i.e.*, the investor could not back out if BI were under-performing), but that too would be a "hard sell." *Id.*
- BI would pay a (non-tax-deductible) 6% dividend, plus or minus ½%.
- The conversion premium would be 20%, plus or minus 2½%. Op. 18. A lower conversion premium would give the buyer more stock on conversion, and thus would be more dilutive.
- Schwartz wanted the stock to have no maturity date on which BI would have to redeem it. Op. 18; A50. Although Joseph would try for a perpetual term, he confided that he might have to accede to a 5 or 10-year term. *Id.*, A91.
- The investor "should" have immediate voting rights as if converted. Op. 19; A46.
- BI might have to offer preemptive rights. A50; A18
- BI might have to offer one board seat, and potentially a second if BI missed four consecutive quarterly dividends. A49.
- The investor might want veto power over material corporate actions. Joseph would try to limit the veto power to highest-dollar-value transactions. A49.

Joseph's plan following the February 17 meeting was to perform due diligence on BI, send out the Private Placement Memorandum ("PPM"), and then conduct a fair negotiation: "You know you're going to have a negotiation. You try to get someone to negotiate, but you don't want to give the store away by giving them the terms that you might have done better than. And I explained that to the Board." A90; A361.

Abdo Chooses To Negotiate On BFC's Behalf

Two or three days after the February 17 Board meeting, Abdo suggested to Joseph that BFC buy the preferred stock. Op. 21. Abdo had told his BFC partner, Alan Levan, about the proposed investment "in synopsis form." *Id.*; A118. Both Abdo and Levan had made similar investments in other companies, and each had the authority to negotiate for BFC. A112. But Abdo alone negotiated on BFC's behalf. Op. 22. Schwartz and Dornbush "welcomed Abdo's involvement in the Transaction." Op. 21, 54. Abdo immediately requested BI's no-shop commitment, and Schwartz and Dornbush agreed. Op. 54; A106, 119.

Around the same time, Kevin Aoki expressed his concern that the preferred stock would unduly dilute BOT. Schwartz's response: "what are you going to do about it? You have one vote on the board." A58-59.

Abdo Negotiates Deal Improvements For BFC's Benefit

Fred Joseph sent the PPM only to Abdo, and the two of them were the sole negotiators. Op. 22; A48. Abdo viewed the deal as offered in the PPM as "a fair transaction. And I thought, actually, it was fair to both sides." A155. And BFC executive Phil Bakes wrote to Abdo in April 2003 that "the Benihana deal is a great one and is something we should have no hesitation about doing — not only in concept, but also under the Terms contained in the term sheet that was in the [PPM] book." A426.

But Abdo negotiated even better terms. The following describes the major terms as provided in the PPM, and those that Abdo then negotiated for BFC:

- Although the PPM made the second tranche draw-down "at the option of the Company," Abdo negotiated BFC's right to mandate a second tranche draw-down. Op. 22-23. Abdo knew from the February 17 Board meeting that the PPM's optional second tranche provision was "a nice fake." A107, 164. Joseph's understated testimony was that "[Abdo] had a nice shot at getting us to change that." *Id.*

- Abdo negotiated from five to three years the PPM's waiting period for a second tranche draw-down. A128.
- Abdo negotiated BFC's right to force BI to redeem the preferred in full after ten years. Op. 23.
- Abdo extracted an anti-dilution right. Op. 23.
- Abdo negotiated preemptive rights to purchase a proportional amount of any new BI voting securities. Op. 23.
- Abdo negotiated a provision barring BI from issuing another class of equity with more senior voting rights. A128.
- Abdo negotiated a right to a second director if BI did not pay BFC's dividends for two quarters. Op. 23.
- Following Joseph's due diligence, he set the dividend in the PPM at 5%, rather than 5½-6½% dividend he discussed with the Board in February. A383; A98.
- The PPM granted a 1% "standby fee" for shares committed, but not yet issued — *i.e.* a \$100,000 annual "dividend" on the second tranche until it issued. Op. 23.
- The PPM (as with Joseph's January 2004 proposal) granted immediate, as if converted to Common, voting rights. Op. 23.
- The conversion premium in the PPM was 15% (which was more dilutive than the 17½-to-22½% Joseph suggested on February 17). A448; A91.
- The PPM granted a veto right for transactions outside the ordinary course of business, including "significant acquisitions of assets, the sale of assets and change of control or liquidation" of BI. A384.

No term changed for BI's benefit between the PPM and the final May 6th term sheet. A163; A52.

May 6: Board Approval

The Board met on May 6th to discuss and approve the convertible preferred placement. Although some directors knew that it was Abdo's company making the investment, the full Board was not told until the meeting. Schwartz had sent the new term sheet to the Board on April 30, but did not indicate that BFC was the purchaser. Op. 24; A430-35. And just the day before the meeting, Dornbush refused to disclose the investor to Kevin Aoki. A72.

Joseph presented an updated book at the meeting. A57. The Board “never received the PPM.” Op. 25; A54. The January book was not re-circulated, and the directors did not compare the two term sheets. A55; A166.

Abdo provided background information on BFC and then excused himself for the remainder of the meeting. Op. 25. Pine “inquired about Abdo’s involvement in the negotiations. . . .” Although Schwartz and Dornbush knew (A418; A422; A50, A126), “the Benihana Board was not informed that Abdo himself negotiated the terms on behalf of BFC.” Op. 25, citing A54. Certainly, the Board knew of Abdo’s “position as a principal of BFC [and the ultimate decision-making role he presumably had over BFC’s investments].” Op. 25-26. But none of Joseph, Schwartz and Dornbush disclosed Abdo’s negotiating role.

Rather, Joseph’s response to Pine’s question was “that no significant changes to the terms had been made.” Op. 25; A54, 72, 135. Pine believed him: “My recollection is that the term sheet that was agreed upon with BFC was precisely the same term sheet that was proposed earlier by MJ. Frankly, I never compared them, but my understanding is that they are the same.” A135; A166. Directors Becker, Sano, and Yoshimoto also thought that there were no changes, or at least no changes to BI’s detriment. A157 (thought that BFC was agreeing to do the transaction on the terms that Morgan Joseph had gone out to the market with); A171-72 (finalized terms were better for BI “than the initial term that has been set forth by Morgan Joseph”); A182 (voted for the Transaction because it was “almost identical of the January 29th material”). Whether there were changes, was “obviously an important issue” for Pine. A135. Schwartz, Joseph and Abdo all admitted that there were material changes to BI’s detriment. A51-52, 107, 128, 128.1.

Joseph’s May 6 Board book used the correct BI debt figures. A444. Joseph testified that BI could borrow under the Wachovia proposal for its projected remodeling needs, and have an additional \$26.8 million in borrowing capacity left-over by 2007. *Id.*, A99. Even with the 1.5x EBITDA restriction, BI would have had to miss its projected 2007 EBITDA by almost 50%—an “unlikely scenario”—for the Wachovia proposal to become insufficient. A100. Because Sano had “nothing to compare,” he did not appreciate the significance of the corrected debt figures. That is, he remained ignorant that the “Wachovia proposal, if accepted by Benihana, would have provided sufficient financing under the base case and accelerated RA [sushi chain expansion] scenarios through 2007.” A173-74. The Board did not reconsider the Wachovia proposal. A174.

The Board unanimously approved the Transaction (with Abdo, Dornbush, and Kevin Aoki abstaining), subject to a fairness opinion. The Board

voted for Joseph to render the opinion even though a portion of the firm's fee was contingent on the transaction closing. A362; A438; A93.

Schwartz understood that the Transaction diluted BOT and "had a detrimental impact on [BOT's] control premium." A45. After the May 6 meeting, Kevin Aoki approached Schwartz, Abdo, and Dornbush to inquire whether BOT or the Trust could finance the second tranche "in order to avoid dilution of BOT's interest in [BI]." Op. 26. They rejected his funding suggestion. A152. Abdo rejected Kana Aoki Nootenboom's similar request because the \$10 million second tranche was a BFC "asset." A124; Op. 26-27.

Joseph Pitches BFC For Business Before Rendering Its Fairness Opinion

Just one day later, May 7, 2004, Fred Joseph (whom the Securities and Exchange Commission had previously barred from holding a supervisory position in the securities industry for three years) had lunch with BFC's Phil Bakes. The next business day, Bakes emailed Joseph, that "[a]fter the dust clears a bit on the BNFN situation, I would like to meet with some of your colleagues, particularly in the M&A arena, and also brainstorm the financing options, long and short term, for BFC given our planned operating model." A485.

On May 18, 2004, Joseph told Schwartz that the fairness opinion was ready. A59. Schwartz publicly announced the Transaction that same day. DX70. On May 20, BOT's counsel sent a letter to the Board, objecting to the Transaction. A506; A95. Schwartz distributed the letter with the message that it was already taken care of: "Mr. Schwartz stated that the Company would respond to BOT's letter and Mr. Dornbush added that the Company had previously addressed the issues raised in the letter and did not believe that there was merit to the position expressed in the letter." A498.

Also on May 20, Joseph presented its fairness opinion. A510. One of Joseph's "key observations" was that "the addition of a significant ownership position in [BI] by a professional investment group may be viewed positively by the market. Institutional investors may view the Company as now having greater influence from an investor with goals and objectives more consistent with their own." A530. Schwartz too deemed this a "benefit." A176.

Board Rejects Non-Dilutive Offers

On May 28, 2004, BI received an offer from Yamano Holdings, forwarded by BOT's attorneys. Op. 28; A557. Schwartz asked Becker, Pine, and Sturges to review the offer as an "independent *ad hoc* committee." Op. 27. Two days later, they "discussed it [by telephone] and recommended that the proposal not be pursued." A131, 137.

But Yamano's terms were identical to the Transaction except for the date on which the conversion is set. Yamano's preferred stock, however, would convert into lower-voting Class A, thus rendering it less dilutive, both to BOT and other BI shareholders. A60. Both Schwartz and Joseph agreed that Yamano's terms were better for BI stockholders than BFC's terms. *Id.*, A109. But Schwartz preferred to have BFC as a stockholder. A60.

At the June 11, 2004 meeting, Joseph "informed [BI] that it considered the Yamano Offer inferior" and "not worth pursuing." Op. 28. The basis for this conclusion was that Yamano's offer was subject to due diligence. The Board reviewed the offer "quickly" because "it did not want to risk losing" BFC's investment (Op. 28)—even though Abdo had been looking to invest in BI since the 1990s, and BI would not need any of the initial \$10 million for at least four months. A62.

The Board summarily rejected two other offers based almost entirely on Joseph's view that they were "inappropriate." Op. 29. And although the Board discussed "BOT's concerns regarding the dilutive effect" of the Transaction, it ratified the Transaction. Op. 29-30.

Schwartz and Abdo signed the deal documents on June 8, 2004. Op. 26. BOT's vote went from 50.6% to 42.5% on June 29, 2004, and then to 36.5% in August 2005, when BFC drew down the second tranche. Op. 4, 30. And unlike the scenario Joseph presented in November 2003, BOT received nothing for its control power, let alone a 35-40% premium.

October 2004: Post-Lawsuit "Ratification"

Schwartz represented to NASDAQ that the Transaction did not involve a related-party. A156-60. NASDAQ requires that the audit committee or another independent body approve all related-party transactions. Thus, BI's Audit Committee (Becker, Pine, and Sturges) met on October 27, 2004 to "rectify a deficiency in Benihana's process under NASDAQ standards." A132, 138.

The same day, BI's counsel reviewed BOT's allegations in this lawsuit. Op. at 31, A130. The full Board (other than Kevin Aoki), ratified the Transaction. Op. at 32. Trial began two weeks later.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN APPLYING THE BUSINESS JUDGMENT RULE TO ABDO'S SELF-DEALING TRANSACTION WITH BI

A. Standard of Review

This Court's review of legal rulings "is plenary and requires no deference."¹ The formulation of the duty of loyalty involves questions of law that are subject to *de novo* review by this Court.²

B. The Court of Chancery Erred in Holding That DGCL Section 144(a)(1) Applies Because the Approving Directors Did Not Have All Material Information Regarding the Transaction

DGCL Section 144 addresses the common law rule that transactions with directors are void. It provides several means by which directors can avoid *per se* invalidity. The section on which the Court of Chancery relied applies where "[t]he material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board"³

The Court of Chancery erred in applying Section 144(a)(1) because the directors did not know that BFC's negotiator had learned the confidential details of BI's negotiating plan. Because Section 144(a)(1) is inapplicable, the court should not have sustained the Transaction unless the directors proved that it was entirely fair to all BI shareholders.⁴ But the court never applied the entire fairness test and, thus, the judgment should be reversed.

Section 144(a)(1)'s materiality standard is objective from the standpoint of reasonable directors.⁵ Information is material if it would be "relevant and of a magnitude to be important to directors in carrying out their fiduciary duty of care in decision making."⁶ The court need not, however, find that the omitted

¹ *Kahn v. Lynch Commc'n Sys., Inc.*, 669 A.2d 79, 84 (Del. 1995).

² *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993) ("*Cede II*").

³ 8 Del. C. §144(a)(1).

⁴ See 8 Del. C. §144(a)(3).

⁵ *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000).

⁶ *Id.*

information would have changed the directors' decision.⁷

Here, the materiality question boils down as follows:

Would a reasonable director deciding whether to approve a related-party transaction consider relevant and important that the related party's negotiating representative had been privy to the company's confidential negotiating strategy, including those terms on which the company would concede if necessary?

The question answers itself. The inescapable conclusion is that it was material to the BI directors' approval decision to know that Abdo had negotiated on BFC's behalf the terms of the convertible preferred, because BI's negotiator had revealed to Abdo the areas on which BI "anticipated having to make concessions." Op. 18-19.

According to Joseph, smaller privately placed convertible issues "vary widely" and each is "heavily negotiated." A481. Thus, any reasonable board considering a private convertible issuance, especially one issued to a related party, would consider important the nature and extent of the negotiations over its terms. The BI Board was no different. Joseph told the Board on February 17 (A90), and the Board "understood that Morgan Joseph would endeavor to negotiate the best deal for BI." Op. 18-19. And in May 2004, the Board "formally was informed of BFC's negotiations with BI." Op. 25.

Critical to understanding any negotiation process is knowing who negotiated for each side. Hence, the Court of Chancery identified the negotiating parties: "Morgan Joseph negotiated on behalf of BI. Abdo negotiated on behalf of BFC." Op. 22. And apparently to indicate that they were capable of arm's length negotiations, the court noted that "Morgan Joseph had no prior business relations with Abdo or BFC."⁸

⁷ *Zirn v. VLI Corp.*, 621 A.2d 773, 778-79 (Del. 1993) (materiality standard "does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote"(quoting *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)); *Goodwin v. Live Entm't, Inc.*, 1999 WL 64265, at *6 (Del. Ch. Jan. 25, 1999) (same). See also *HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 115 (Del. Ch. 1999) (stating that it is not necessary for omitted information to have changed directors' vote before applying entire fairness test to materially misrepresented transaction).

⁸ *Id.*

Consistent with the importance of who negotiated, the Board sought out that information during the May 6 meeting. And they specifically asked about the participation of BFC's Abdo, because they knew he had attended the Board's February 17 strategy session. But the Board was never told the truth:

though [Board member] Pine had inquired about Abdo's involvement in negotiations, the BI Board was not informed that Abdo had negotiated the terms on behalf of BFC. Op. 25.

Neither Schwartz nor Dornbush said anything in response to Pine's direct question, or Joseph's non-answer. Op. 25; A179.

Despite this overwhelming record of a material omission, the Court of Chancery still applied Section 144(a)(1). Each of the court's reasons for doing so (Op. 55-57) was error.

First, the court downplayed the importance of the February 17 meeting:

The Board, however, did not vote for the final terms of the transaction at the February 17 meeting; instead they approved a course of action and considered the terms for the Preferred Stock offering discussed at that meeting more akin to a "wish list." Op. 56.

That the Board did not vote that day on final terms is a *non sequitur*. The point is that Abdo learned during that meeting the "concessions" BI "anticipated having to make." Op. 18. This is in addition to the "wish list" items to which the court referred. And he learned it straight from BI's negotiator, Fred Joseph. It follows that Abdo had a tremendous negotiating advantage against BI.⁹

Second, the court stated that "BOT [did not] prove at trial that Abdo knew at the February 17 meeting that BFC would offer to purchase the Preferred Stock." Op. 56. This too is beside the point under Section 144 (although relevant under the duty of loyalty discussed below). The relevant disclosure issue is whether the Board was informed of Abdo's involvement in the negotiations, not when Abdo decided to conduct those negotiations. So long as Abdo negotiated before the May 6 Board meeting, that fact needed to be disclosed, especially when the question was specifically asked.

⁹ See *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1046 n.50 (Del. Ch. 2004) (finding that the company negotiator's information about desired value ranges was material and important, and thus it was improper for a fiduciary to disclose to a third party), *aff'd per curiam*, 872 A.2d 559 (2005).

The court's third reason is that "the Board had adequate time to consider the transaction after they knew that Abdo acted on behalf of BFC." Op. 56. By "acted on behalf of BFC," the court did not mean "negotiated on behalf of BFC"—the court found that the Board was not given that information. Op. 25. Rather, the court was referring to the fact that "Abdo made the presentation to the board on behalf of BFC at the May 6 meeting," and that the Board knew "of Abdo's position as a principal of BFC and the ultimate decision making role he presumably had over BFC's investments." Op. 25-26 & n.90. But knowing that Abdo was involved at the end, *after* the terms had been negotiated, is quite different from knowing that Abdo negotiated those terms.¹⁰

Thus, it makes no difference that "the Board met on May 20 and again on June 11, and voted to proceed with the transaction after considering BOT's objections and the purported alternatives suggested by BOT's counsel." Op. 56. At neither meeting was the Board told that Abdo had negotiated on BFC's behalf. And both meetings were after BI's May 18 public announcement that the Board had already approved the transaction.¹¹ Indeed, the June 11 meeting was three days after BI had irrevocably committed to the Transaction. The court similarly erred in relying on the October 27, 2004 "ratification." Op. 56, n.190. By that time, the first \$10 million tranche was drawn down, and the ratifying directors had already been sued for breaching their fiduciary duties in approving the Transaction, and understood that they needed to ratify the Transaction.¹²

The court's fourth reason is that "Benihana also obtained a fairness opinion from Morgan Joseph before they [sic] consummated the BFC

¹⁰ Op. 25. Similarly, when the court stated that "Schwartz recalled having conversations with Becker, Sturges, Sano and possibly Pine, before the May 6 meeting, informing them of Abdo's involvement," Op. 55 (incorrectly citing Schwartz's deposition instead of trial testimony), it could only have been referring to Schwartz's testimony that he told those Board members that BFC was buying the convertible preferred. A53-54.

¹¹ *Smith v. Van Gorkom*, 488 A.2d 858, 884 (Del. 1985) (finding no curative effect in ratification preceded by press release that "had the clear effect of locking" board into announced agreement); *In re Walt Disney Co. Der. Lit.*, 2005 WL 2056651, at *41 (Del. Ch. Aug. 9, 2005) (criticizing Disney's CEO for "prematurely issu[ing] a press release that placed significant pressure on the board to accept" the already-announced hiring of a second-in-command, "and approve his compensation package in accordance with the press release").

¹² *Cede II*, 634 A.2d at 362 (holding that director's decision can only be considered disinterested when "based entirely on the corporate merits of the transaction" and not on "personal or extraneous considerations").

Transaction.” Op. 56. But Section 144(a)(1)’s materiality requirement provides no carve-out for related-party transactions on which the board obtains a fairness opinion. And Joseph’s opinion was anyway given that Joseph (i) would not receive a significant component of its compensation unless a transaction closed (A167), and (ii) pitched BFC for business during the period between the Board’s May 6 approval and the May 20 opinion. A485.

The court’s fifth and final reason cuts to the heart of its erroneous decision. It found that the evidence does not support the conclusion “that BFC obtained better terms in the Transaction than it would have otherwise, because Abdo negotiated the deal after having attended the January and February Board meetings.” Op. 56. The court’s reliance on this speculative finding was both legally and factually erroneous. The materiality standard is based on whether the information would have been important to the directors’ decision-making—it is irrelevant whether the result would have been different.¹³

More telling than speculating on the terms BFC “would have” obtained, is examining the uncontradicted evidence of the material negotiating advantage Abdo’s involvement brought BFC. For example, Abdo learned on February 17 Joseph’s views that BI “would have a difficult time getting a perpetual maturity for the issuance.” Op. 18. Abdo then extracted from BI a ten-year maturity. Op. 23. Schwartz testified that this change was materially adverse to BI’s interests. A52. Similarly, Abdo knew from attending the February 17 Board meeting that BI would be willing to grant preemptive rights. A50; A180. He then successfully negotiated preemptive rights for BFC (Op. 23), another material change that was unfavorable to BI. A52. And BFC obtained an even more significant negotiating advantage that the court flat-out missed.

In listing the likely BI concessions that Joseph disclosed on February 17, the court overlooked that Joseph discussed how “we weren’t going to get a non-mandatory second tranche.” A164. Thus, the court did not appreciate how the fix was in when “BFC negotiated . . . the right to require Benihana to draw down the second tranche of convertible preferred stock.” Op. 23. Abdo knew from the February 17 Board meeting that the PPM’s provision of a non-mandatory second \$10 million tranche was only “a nice fake,” thus giving Abdo a “pretty good negotiating advantage.” A107; A164. Not surprisingly, Abdo negotiated a mandatory second tranche draw-down, which both Schwartz and Joseph admitted was a material change to BI’s detriment. A51, 107. It is hard to imagine clearer evidence of the unfair negotiating advantage BFC secured with Abdo as its negotiator.

Thus, not only was the Board not given this material information, it was

¹³ *Brehm*, 746 A.2d at 259; *Zirn*, 621 A.2d at 778-79.

given a false sense of security to preclude further inquiry. Joseph's response to Pine's inquiry about Abdo's negotiating role was that "no significant changes to the [January 2004] term sheet had been made." Op. 25; A54, 72, 135. But as described above, changes *were made* that Schwartz, Joseph and Abdo admitted were materially adverse to BI.

What if the tables been turned, and Joseph had obtained access to BFC's negotiating strategy? The record evidence provides insight. A BFC employee told Abdo that he believed the transaction "a great one . . . something we should have no hesitation about doing—not only in concept, but also under the Terms contained in the [PPM] term sheet that was in the book." A426. But Abdo kept BFC's internal strategy discussions confidential, and negotiated to sweeten the deal for BFC. Included among those improvements was a mandatory second tranche. Had Joseph been a fly on BFC's wall, instead of the reverse, he presumably would have negotiated harder (or not at all) for an optional second tranche. For its part, the Board could not have made an informed decision without knowing how Abdo's involvement undermined BI's leverage.

C. Even if DGCL Section 144(a)(1) Applied, The Court of Chancery Erred in Applying the Business Judgment Rule Because of Abdo's Fiduciary Duty Breach

Section 144 only establishes "a floor for board conduct but not a ceiling."¹⁴ It deals only with *per se* invalidity on the grounds of self-interest.¹⁵ Even if the Transaction satisfied Section 144(a)(1), a fiduciary duty breach would disqualify business judgment rule treatment.¹⁶

The undisputed evidence demonstrates that Abdo breached his fiduciary duty of loyalty to BI. He committed that breach when he used against BI, and in BFC's favor, the confidential information he had learned as a BI director. Abdo never took any steps to distance himself from the BI-BFC negotiation process so that BFC would not have the benefit of BI's confidential negotiating strategy. To the contrary, he alone negotiated one-on-one with Fred Joseph, the very person from whom Abdo had learned the financial terms on which BI would concede. He then locked-in BI's negotiating disadvantage by obtaining BI's agreement not to shop the convertible preferred to any other potential investor. And to seal the fiduciary duty breach, Abdo extracted several of the pro-BFC terms he had been told in confidence that BI would concede.

¹⁴ *HMG/Cortland Props.*, 749 A.2d at 114 n.24.

¹⁵ *In re Cox Commc'ns, Inc. S'holders Lit.*, 879 A.2d 604, 614-15 (Del. Ch. 1995).

¹⁶ *Id.*

"This Court has traditionally and consistently defined the duty of loyalty of officers and directors to their corporation and its shareholders in broad and unyielding terms."¹⁷ The duty of loyalty bars directors from using "their position of trust and confidence to further their private interests."¹⁸ Requiring "the most scrupulous observance," the duty obligates directors to protect the corporation's interests, avoid any conflict between duty and self-interest, and "refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers."¹⁹

A fiduciary's misuse of confidential information violates the duty of loyalty.²⁰ For example, in *Hollinger Int'l. v. Black*, a board member concealed a third party's interest in buying company assets, and diverted that corporate opportunity to his controlling holding company. The court held that the director also violated his duty of loyalty by "improperly using confidential information belonging to International to advance his own personal interests and not those of International,"²¹ when he funneled to the prospective purchaser confidential information he had obtained during an International board meeting. Similarly, in *Agranoff*, the company's President conspired with a third party to take over the company and breached his duty of loyalty by misusing the company's confidential information to further the take-over plan.²²

Abdo similarly breached his duty of loyalty by using the confidential information he learned as a BI director to improve BFC's negotiating position against BI. He attended the February 17 Board meeting not as a BFC

¹⁷ *Cede II*, 634 A.2d at 361.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Hollinger*, 844 A.2d at 1061 (holding that a director violated his duty of loyalty by, among other things, providing confidential information to a third party to further his self-interested plan); *Agranoff v. Miller*, 1999 WL 219650, at *19-21 (Del. Ch. Apr. 12, 1999) (same). See also *Odyssey Partners LP v. Fleming Cos., Inc.*, 1996 WL 422377, at *3-4 (Del. Ch. July 24, 1996) (noting that creditor who is also a director of debtor corporation may not use debtor's confidential information to "advantage himself in his creditor capacity"); *Brophy v. Cities Serv. Co.*, 70 A.2d 5, 7 (Del. Ch. 1949) (holding that fiduciary may not use confidential corporate information for personal profit).

²¹ *Hollinger*, 844 A.2d at 1061-62.

²² *Agranoff*, 1999 WL 219650 at *19-21.

representative, but as a BI director. His duty of loyalty obligated him to keep confidential the information he learned at that meeting and use it only to promote BI's interests; the law barred him from misappropriating or using that information against BI.

In refusing to find a breach, the Court of Chancery focused on what Abdo knew on February 17: "Nor did BOT prove at trial that Abdo knew at the February 17 meeting that BFC would offer to purchase the Preferred Stock." Op. 56. But this finding only goes to the severity and timing of the fiduciary breach, not whether Abdo committed that breach. There was no finding in any of *Hollinger*, *Agranoff*, or *Brophy* that the fiduciary had the faithless intent at the time he received the confidential information—rather, in each case, the duty of loyalty breach resulted from how the fiduciary misused the confidential information in the days and weeks after he received it.

Taking the Court of Chancery at face value that it only dawned on Abdo two-to-three days after the February 17 meeting that BFC should buy the convertible preferred, his duty of loyalty still required that he not use against BI the confidential information he learned at that meeting. He was duty-bound to extricate himself from the negotiation process by, for example, (i) telling Joseph to contact BFC Chairman Alan Levan about the investment opportunity; and (ii) informing Levan and his other BFC colleagues that he could not discuss the BI offering.

But far from recusing himself, *Abdo remained intimately involved as BFC's exclusive negotiator*. And worse still, he obtained BI's commitment not to market this deal to anyone who, unlike him, did not know BI's negotiating strategy. He then capped off his disloyalty by obtaining BI's agreement to a mandatory second tranche draw-down, a non-perpetual maturity, and preemptive rights—terms Abdo knew BI would be better-off without, but would concede if necessary. The Court of Chancery would have done well to focus on Abdo's state of mind while he was dealing from a stacked deck, rather than his mindset during the February 17 meeting.

But even considering Abdo's state of mind through February 17, the court's duty of loyalty standard was erroneously lax. It is uncontradicted that Abdo had wanted to buy a controlling BI block since the 1990's. Abdo received on January 29, 2004, a Board book setting out BI's contemplated terms for a convertible preferred offering. It defies logic and common sense that Abdo did not consider BFC at least a *potential* investor before he walked into the February 17 meeting. But the Court of Chancery deemed it necessary for BOT to prove that Abdo "*knew*" by February 17 that BFC "*would* offer to purchase the preferred stock." Op. 56 (emphasis added). This was error. As long as BFC was a potential investor, Abdo's duty required that he recuse himself from the

Board's February 17 discussion. Yet, he soaked in BI's entire negotiating strategy, thereby improperly favoring BFC's over BI's interests.

D. The Transaction Does Not Meet The Entire Fairness Standard

In the event this Court were to find that entire fairness review is appropriate, it should hold that the Board and BFC cannot sustain their burden under that standard. Entire fairness review is "exacting" and "rigorous."²³ It requires the defendant to show both fair dealing and fair price.²⁴

A transaction cannot survive entire fairness review when the Board did not have all material information.²⁵ In *Weinberger*, for example, a corporate parent did not share with its subsidiary a report that purchasing the subsidiary's stock would be a "good investment" even at a higher price.²⁶ This Court held that there was no "fair dealing" because the subsidiary's board did not have this "material" information.²⁷ Similarly, Abdo never shared with Joseph or the Board BFC's view that the PPM terms were "fair," (A155) "great" and "something we should have no hesitation about doing." (A426). Instead, Abdo negotiated even better terms. Abdo and BI management also withheld other material facts from the Board, including that Abdo negotiated the Transaction.

Preserving confidential negotiating information is also crucial to an entire fairness finding. In *In re Emerging Communications, Inc. Shareholders*

²³ *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1279 (Del. 1988) (finding that a proposed take-over did not meet entire fairness standard, in part, because the bidder received a "tip" from company insider regarding its bid).

²⁴ *Bomarko, Inc. v. Int'l Telecharge, Inc.*, 794 A.2d 1161, 1179-80 (Del. Ch. 1999), *aff'd*, 766 A.2d 437 (Del. 2000) (analyzing both process and price of going-private transaction under entire fairness standard); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 712 (Del. 1983) (parent company unable to demonstrate that subsidiary buy-out was fair because of undisclosed material information).

²⁵ See *Weinberger*, 457 A.2d at 710-11 (finding uninformed approval "meaningless"; fair dealing includes "the obvious duty of candor"); *T. Rowe Price Recovery Fund, L.P. v. Rubin*, 770 A.2d 536, 552 (Del. Ch. 2000) (enjoining agreement with interested fiduciary, in large part because directors did not adequately review agreement's fairness and consider various legal and business issues); *Bomarko*, 794 A.2d at 1180 (finding going private transaction not entirely fair based, in part, on material omissions during board presentation).

²⁶ *Weinberger*, 457 A.2d at 705.

²⁷ *Id.* at 714.

Litig.,²⁸ for example, a board committee negotiating with the CEO routed committee communications through the CEO's office, thus, "giv[ing] [the CEO] access to the committee's confidential deliberations and strategy." This contributed to the court's no fair dealing finding.²⁹ Here, Abdo not only had "access" to the confidential information, but also possessed and used it. This precludes a fair dealing finding.

Among other facts rendering the Transaction unfair are the following:

- The February 17 decision to eschew debt in favor of a more expensive equity transaction was based, in part, on inflated debt and shortfall numbers that were not corrected until May 6.
- The Board did not meaningfully consider less expensive debt transactions, including negotiating with Wachovia, even though Joseph had opined that they were "highly feasible" and that BI had "no need to deleverage" by issuing equity. A101.
- Due to its conservative debt structure, BI did not need to provide immediate as-if-converted voting rights or board seats, even as part of a convertible preferred issuance.
- Abdo obtained a no-shop agreement from BI.
- No committee of independent directors was appointed to negotiate and consider the transaction. A49.
- BI directors did not have separate legal or financial advisors.
- The Board relied on Joseph's fairness opinion, even though (i) the majority of its fee depended on the Transaction closing; and (ii) Joseph was pitching BFC for business between May 6 and the May 20 fairness opinion. A485.
- Schwartz publicly announced the Transaction before the Board reviewed the fairness opinion.
- BI never contacted Yamano, Cardinal, or Trinity to follow up on their proposed offers, even though Yamano's offer was "logically more favorable" to BI shareholders. A109.
- The Board did not renegotiate with BFC after receiving Yamano's offer.

²⁸ 2004 WL 1305745 (Del. Ch. June 4, 2004) (Jacobs, J, sitting by designation).

²⁹ *Id.* at *36-41 (emphasis added).

II. THE COURT OF CHANCERY ERRED IN FAILING TO PROTECT BOT'S CONTROL INTEREST FROM UNILATERAL DILUTION

A. Standard of Review

This Court will accept the Court of Chancery's factual findings only "[i]f they are sufficiently supported by the record and are the product of an orderly and logical deductive process."³⁰ This Court may substitute its own findings of fact where "the findings below are clearly wrong and the doing of justice requires their overturn."³¹ Inferences and legal conclusions based on those facts require no deference.³² Insofar as formulating an appropriate legal standard is at issue, that is a question of law and the standard of review is *de novo*.³³ This Court's review of the reasonableness of the Board's response would be a mixed question of law and fact.³⁴

B. The Court of Chancery Erred in Relegating the Dilutive Purpose to Merely "Incidental" After Finding a Dilutive Concern

Delaware courts hold that where the primary purpose of a transaction is to dilute a controlling shareholder, the transaction is void.³⁵ A court will not find

³⁰ *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972).

³¹ *Id.*

³² *Id.* (citing *Nelson v. Murray*, 211 A.2d 842, 844 (Del. 1965)); *Cede II*, 634 A.2d at 360.

³³ *See, e.g., Doe v. Cahill*, 884 A.2d 451, 455 (Del. 2005).

³⁴ *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003) (reviewing reasonableness of the board's response as a mixed question of law and fact; same standard of review adopted by majority and dissenting opinions).

³⁵ *Packer v. Yampol*, 1986 WL 4748, at *16-18 (Del. Ch. Apr. 18, 1986) (enjoining super-voting stock issuance to CEO, inferring a primary motive to entrench, where his conduct was "unnecessary" for the attendant fund-raising); *Condec Corp. v. Lunkenheimer Co.*, 230 A.2d 769, 775-76 (Del. Ch. 1967) (invalidating a stock issuance as having a primary purpose to thwart tenders, where issuance of a substantially smaller number of shares would have served the alleged legitimate business purpose); *Canada Southern Oils v. Manabi Exploration Co.*, 96 A.2d 810, 813-14 (Del. Ch. 1953) (finding primary purpose to dilute the controlling shareholder, based on the speed and secretiveness of an otherwise-legitimate stock sale, and enjoining the transaction).

an invalid purpose where dilution was merely incidental to an otherwise valid corporate purpose.³⁶ But where raising money and diluting the controlling shareholder's influence are among the board's objectives, it would be a "mockery to suggest that the 'control' effect of an agreement in litigation is merely incidental to its primary business objective."³⁷

The Court of Chancery found that Schwartz "was concerned about BOT's control of [BI] in late 2003," and that he had demonstrated that concern by considering a massive issuance of Class A shares to dilute BOT. And although the court did not also expressly ascribe that concern to Dornbush, it necessarily follows from the record that he shared that concern. Thus, Schwartz and Dornbush had two objectives in late 2003 and early 2004, one valid, the other improper: (i) raising funds to renovate BI's restaurants; and (ii) ridding BI of BOT's voting control. The Transaction achieved both objectives. Under these circumstances, the law required an improper primary purpose finding. The court committed legal error by failing to make that finding.

Perhaps the best proof of the integral link between the two objectives lies in the circumstances of Joseph's engagement. Schwartz and Dornbush hired Joseph in late October 2003, less than two months after they brainstormed methods of diluting BOT in the wake of Rocky willing his stock to Keiko. While it would have been logical for Schwartz and Dornbush to hire a financial advisor to address the BOT control issue, the stated purpose of Joseph's engagement was to assist in "analyzing [BI's] sources and uses of capital over the next five years pursuant to its current business plan and certain alternative strategies." A200. But although the stated purpose was valid, Joseph's very first presentation was not about the renovation plan. Rather, its November 4, 2003 book was about buying out BOTs' control stock. A206. It is obvious, therefore, that Joseph was addressing, in part, the BOT control issue when just two months later, its first and only funding recommendation to the Board was issuing preferred stock that would be convertible into BOT's Common stock and with immediate, as if converted, voting rights. This is particularly so in view of the various "highly feasible" non-dilutive means available to finance BI's renovation plan. A101.

The court overlooked this powerful evidence. Nowhere in the court's opinion is there any mention of Joseph's November 4, 2003 presentation, let alone that it was Joseph's first assignment. The court thus missed this critical connection between BI management's two purposes.

³⁶ *Condec*, 230 A.2d at 776.

³⁷ *Id.* See *Sachs v. Seminole Oil & Gas Corp.*, 150 A.2d 20, 24 (Del. Ch. 1959).

The court erroneously minimized other evidence of management's dilutive purpose, because of its view that a dilutive purpose could be rescued by a "legitimate justification." That is, in discussing how Schwartz considered issuing 16.5 million shares to dilute BOT, the court stated that "Plaintiff exaggerates the importance of this incident." Op. 68. Relying on Schwartz's testimony that having separate Class A and Common share classes undermined BI's liquidity, the court found that "Benihana had legitimate reasons for considering a stock issuance that might have the effect of diluting BOT shares." Op. 69.

The primary purpose test focuses on the intent to dilute, not the "legitimacy" of or justification for that dilutive intent.³⁸ Even if management had a legitimate or good faith reason for its dilutive intent, that intent would still constitute a breach.³⁹ The court thus erred by finding, in effect, that the presence of a legitimate reason to dilute rendered the dilutive purpose incidental.

The court also overlooked BI's financial condition in making its primary dilutive purpose evaluation. BI was not faced with dire financial circumstances in which it had no choice but to issue dilutive stock.⁴⁰ Rather, it was raising equity because "it could," and thus had strong leverage to negotiate a non-dilutive transaction. Yet, Joseph proposed right out of the box a convertible preferred with immediate, as-if converted, voting rights. Why was that term so essential to a financing for the financially-sound BI? Once Abdo jumped at this golden opportunity, Schwartz and Dornbush immediately agreed not to seek any other potential investors. And even though BI only wanted to commit to a \$10 million financing, it acceded to BFC's \$20 million funding demand, thereby further diluting BOT.⁴¹

The facts here are similar to those in *Canada Southern*. There, management used a legitimate fund-raising opportunity to dilute the controlling family with whom management had a falling out. There was no dispute that the company needed to raise funds, but the court doubted that its financial needs

³⁸ *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 663 (Del. Ch. 1988).

³⁹ *Id.*

⁴⁰ *See Canada Southern*, 96 A.2d at 813 ("While defendant was obviously in need of current operating funds I am not persuaded that its long range financial prospects were as bad as defendant sought to represent them.").

⁴¹ *Cf. Packer*, 1986 WL 4748, at *16 ("An inequitable purpose can be inferred where the directors' conduct has the effect of being unnecessary under the circumstances, of thwarting shareholder opposition, and of perpetuating management in office.").

were "dire."⁴² The court found that management had the "primary purpose . . . to deprive [the family] of the majority voting control," in part, because (i) management "assumed" that the family did not want to help with the financing; (ii) other directors were aware of the stock issuance's dilutive effect, but voted for it anyway; and (iii) the president had a recent falling out with the family, and promptly advised a brokerage firm of the dilution.⁴³

Rather than using *Canada Southern* as guidance, the Court of Chancery searched for factual differences. First, it noted that the company in *Canada Southern* did not have a "major financial crisis." Op. 70-71. But neither did the "conservatively leveraged" BI. Rather, management in both cases satisfied the company's financing need in a manner that diluted an estranged control shareholder. Second, the court noted that the *Canada Southern* directors "never offered the controlling shareholder the option to purchase the shares, choosing instead to blindly assume they would not help. . . [whereas] BOT had the opportunity to help fund the construction and Renovation Plan, but failed to make any proposal demonstrating that they had the necessary funds." Op. 72. This distinction also rings hollow, because Dornbush, Schwartz and Abdo refused BOT's offer to buy the second tranche. A41-42, 124, 152. BI's directors admitted that they did not want BOT to invest. Op. 51. Third, the court noted that *Canada Southern*'s "notice for the directors' meeting made no reference to the possibility of selling shares of the company." But here too there was evidence of "too little disclosure," because the Board was: (i) given inflated debt information that was not corrected for more than three months (and even then not in a clear way); (ii) not told that BFC was the investor until the eleventh hour before the May 6 meeting; and (iii) never told that Abdo had negotiated the Transaction.

The Court of Chancery similarly scoured *Packer* and *Condec* for factual distinctions. Op. at 73-74. But each dilutive transaction case will, of course, have its own wrinkles. The point is that every court that has considered reasonably analogous facts has inferred a primary dilutive purpose. Nor did the Court of Chancery cite any contrary authority. The overwhelming record here provides all the hallmarks of a dilutive purpose—senior management was concerned about a shareholder's control power; it explored ways of diluting or buying out that shareholder; it immediately thereafter presented a financing transaction that diluted away the control power; the financing raised \$20 million that the company might never need and was chosen in favor of less expensive debt that would have raised twice or more; and the financing opportunity was

⁴² 96 A.2d at 813.

⁴³ *Id.*

given to a director who knew of management's concern about the controlling shareholder and had access to the company's negotiating strategy. By failing to draw the straightforward and unmistakable inference of a dilutive purpose, the court separated itself from settled jurisprudence of this State.

C. The Court of Chancery Erred By Not Requiring the Board To Show That It Reasonably Investigated Whether BI's Funding Needs Could Be Satisfied Through Alternative Financing That Did Not Strip BOT's Control Power

This Court should hold that even where the evidence does not warrant a primary dilutive purpose finding, the board should not have license simply to disregard a stock issuance's dilutive effect. Where, as here, the company's management is concerned about a shareholder's control, and then issues stock that removes that control power, the business judgment rule should not apply unless the board shows that it conducted a reasonable investigation to determine whether the company's legitimate objectives could be satisfied through a nondilutive transaction. Because the BI Board did not, and could not, make that showing, the judgment below should be reversed.

In *Unocal Corp. v. Mesa Petroleum Co.*, this Court discussed the "inherent conflict" under which a board operates in control situations.⁴⁴ Those circumstances present "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . ."⁴⁵ The Court warned that "inequitable action may not be taken under the guise of law."⁴⁶ Thus, rather than relying solely on a particular judge's evaluation of a board's subjective purpose, this Court established an objective test "to ensure that a defensive measure to thwart or impede a takeover is indeed motivated by a good faith concern for the welfare of the corporation and its stockholders, which in all circumstances must be free of any fraud or other misconduct."⁴⁷ That test requires the board to show that (i) it "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed;" and (ii) the defensive measure was "reasonable in relation to the threat posed."⁴⁸

In decisions that followed *Unocal*, this Court held that for a defensive

⁴⁴ 493 A.2d 946, 955 (Del. 1985).

⁴⁵ *Id.* at 954.

⁴⁶ *Id.* at 955.

⁴⁷ *Id.*

⁴⁸ *Id.*

measure to be reasonable in relation to the threat posed, it must be "proportionate."⁴⁹ This requires, at a minimum, that the board reasonably investigate whether a less restrictive response could eliminate the threat.⁵⁰

Although *Unocal* and its progeny were decided in the takeover context, the policy concerns they addressed also apply to transactions that change the company's control structure. This Court should similarly hold that where, as here, management is concerned about a shareholder's control power, the board must prove that it conducted a "less-restrictive" analysis before approving a transaction that eliminates the shareholder's control power. Two principal reasons justify such enhanced scrutiny.

First, as in takeover situations, the board has an inherent conflict when considering transactions that eliminate a shareholder's control power. That conflict presents the same "omnipresent specter" that the board acted primarily to entrench itself rather than furthering the company's best interests. And where, as here, management is concerned about a shareholder's control power and perceives it as a threat, the same "omnipresent specter" exists that management might be harboring an improper dilutive purpose. Thus, before a fact-finder credits directors' inherently self-serving testimony that they only sought to further a legitimate corporate objective, it should take the additional precaution of making them show that they investigated less restrictive means of achieving that same objective.

Second, the shareholder franchise is critical to Delaware's corporate governance structure.⁵¹ The control franchise has tangible value in the form of a

⁴⁹ *Paramount Commc'ns, Inc., v. Time, Inc.*, 571 A.2d 1140, 1142, 1154-55 (Del. 1989). See also *Ivanhoe Partners v. Newmont Min. Corp.*, 533 A.2d 585, 609 (Del. Ch. 1987).

⁵⁰ *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d at 1286 (declining to uphold lockup agreement where it "was not necessary" to induce bidders, and disproportionately hurt company by giving up "crown jewels"); *Ivanhoe Partners*, 533 A.2d at 609 (granting preliminary injunction where board's "reasonable goals . . . did not require, for their accomplishment" adopting more restrictive alternative); *Paramount*, 571 A.2d at 1140 (upholding management's response to hostile bidder as not "overly broad," but noting that management actions may be struck down where unreasonable or "nonproportionate").

⁵¹ *Blasius*, 564 A.2d at 659 ("[t]he shareholder franchise is the ideological underpinning of the legitimacy" of corporate structure and division of power between directors and shareholders); *Stahl v. Apple Bancorp, Inc.*, 1990 WL 114222, at *5 (Del. Ch. 1990) ("Where the franchise is involved a special

control premium:

Financial markets in widely traded corporate stock accord a premium to a block of stock that can assure corporate control . . . In all events, it is widely understood that buyers of corporate control will be required to pay a premium above the market price for the company's traded securities.⁵²

Any board action that dilutes the control power out of existence both impairs the franchise and extinguishes the control shareholder's property interest. Here, Joseph assigned a 35-40% value to that property interest, which amounted to \$6-7 million as of late 2003. Delaware law should not *encourage* boards to *disregard* the control franchise, as the Court of Chancery effectively found the BI board did here. Rather, the law should incentivize boards to take the control franchise into account, so as to avoid extinguishing it unnecessarily.

We do not suggest that this intermediate test apply anytime a board interferes with a controlling shareholder's voting rights, such as by adjourning an annual meeting,⁵³ adopting a bylaw regulating shareholder voting,⁵⁴ or increasing the board's size.⁵⁵ In those instances the primary purpose test suffices because the control shareholder retains the ability (consistent with its fiduciary duties) to protect its interests. But when the Board approves a transaction that eliminates a shareholder's control power, it has forever changed the company's control structure and unilaterally extinguished a valuable property right. In those extraordinary circumstances, equity requires that the transaction be proved entirely fair, unless the board reasonably investigated non-dilutive means of advancing the corporate good.

To be sure, no Delaware court has applied this intermediate requirement in cases involving stock issuances that dilute away a shareholder's control power. But the courts in those cases did not need to consider such a requirement because they found that the board had a primary purpose to dilute. And as described above, the facts giving rise to the primary dilutive purpose finding in those cases

obligation falls upon courts to review with care action that impinges upon legitimate election activities.").

⁵² *Mendel v. Carroll*, 651 A.2d 297, 305 (Del. Ch. 1994).

⁵³ *Stahl*, 1990 WL 114222.

⁵⁴ *Williams v. Geier*, 671 A.2d 1368 (Del. 1996).

⁵⁵ *Blasius*, 564 A.2d 651 (Del. Ch. 1988).

are analogous to those at issue here.

A federal court, however, has held that a *Unocal* "proportionality" test should apply even absent an improper purpose finding. In *Gregory v. Correction Connection Inc.*,⁵⁶ the company's stock issuance to its officers diluted Dick Gregory's ownership from seventy to twenty-nine percent. The court found "sufficient evidence in the [summary judgment] record to suggest that defendants made the [stock] issuance for the proper and compelling corporate purpose of raising capital for a financially strapped CCI."⁵⁷ Still, the court granted plaintiff summary judgment because the defendants did not show that they had "conducted a reasonable investigation to determine that the [stock] issuance was the least restrictive means of raising needed capital for CCI."⁵⁸ Thus, defendants had failed to satisfy the "proportionality" element of "the altered *Unocal* inquiry."⁵⁹ This led the court to entire fairness, rather than business judgment rule, review.

This Court should announce a similar standard. The results would be greater protection for the control franchise and a more thorough and candid board process in approving dilutive stock issuances.

Here, the record is clear that the Board did not reasonably investigate whether a non-dilutive transaction could have satisfied BI's renovation funding needs. In fact, the whole premise for the stock issuance was that BI should issue it simply because "it could." BI could easily have funded the renovations under the Wachovia proposal, as Joseph conceded. And to the extent Wachovia's proposal was not perfect, the Board should have investigated Wachovia's flexibility or other "highly feasible" debt options. Nor did the Board adequately consider the less-dilutive Yamano proposal or use it to re-negotiate with BFC. Instead, the Board accepted an insider dilutive transaction without ever shopping the financing to the debt and equity markets.

⁵⁶ 1991 WL 42992 (E.D. Pa. March 27, 1991) (applying Delaware law).

⁵⁷ *Id.* at *28.

⁵⁸ *Id.*

⁵⁹ *Id.*

III. THE COURT OF CHANCERY SHOULD HAVE INVALIDATED THE TRANSACTION BECAUSE BI'S CERTIFICATE OF INCORPORATION PROHIBITS BI FROM GRANTING PREEMPTIVE RIGHTS

A. Standard of Review

The Court of Chancery's interpretation of agreements, such as certificates of incorporation, is a conclusion of law subject to *de novo* review.⁶⁰

B. The Preemptive Rights Grant Renders the Convertible Preferred Void

Under DGCL Section 151(a), a corporation's certificate of incorporation determines its shares' "designations, preferences, and relative, participating, optional or other special rights, and qualifications, restrictions, and limitations."⁶¹ Article 4 ¶2 of BI's Certificate of Incorporation bars preemptive rights: "no stockholder shall have any preemptive right to subscribe to or purchase any issue of stock or other securities of the Corporation." A566. In violation of the Certificate, BI issued shares to BFC with preemptive rights. Because "stock issued without authority of law is void and a nullity,"⁶² BFC's preferred stock is void.

The Court of Chancery recognized that a corporation's certificate of incorporation "is a contract among the shareholders" and, thus, "general rules of contract interpretation" apply.⁶³ The court also acknowledged the plain-language rule of contract construction: "If no ambiguity is present, the court must give

⁶⁰ *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 394 (Del. 1996).

⁶¹ 8 Del. C. §151(a); *see also* 8 Del. C. §102(a)(4) (requiring that the certificate of incorporation set forth a statement of these rights and restrictions).

⁶² *Staar Surgical Co. v. Waggoner*, 588 A.2d 1130, 1136 (Del. 1991). *See also Shintom Co., LTD v. Audiovox Corp.*, 888 A.2d 225, 228 (Del. 2005) ("Preferred shares that do not comport with the statutory requirements of the Delaware General Corporation law are void.").

⁶³ Op. 35 ("Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply."). *See also Gentile v. SinglePoint Fin. Inc.*, 788 A.2d 111, 113 (Del. 2001) ("It is a fundamental principle that the rules used to interpret statutes, contracts, and other written instruments are applicable when construing corporate charters and bylaws."); *Staar*, 588 A.2d at 1136 ("[A] corporate charter is both a contract between the State and the corporation, and the corporation and its shareholders.").

effect to the clear language of the Certificate.⁶⁴ But the court nevertheless construed the BI Certificate's plain mandate that "no stockholder shall have any preemptive right" to mean something other than what it says.

The court implicitly found the BI Certificate's preemptive rights bar ambiguous because of DGCL Section 102(b)(3), which provides that "[n]o stockholder shall have any preemptive right to subscribe to an additional issue of stock or to any security convertible into such stock unless, and except to the extent that, such right is expressly granted to him in the certificate of incorporation." The court noted that before the statute's 1967 amendment, it allowed certificates to contain provisions "limiting or denying to the stockholders the preemptive rights to subscribe to any or all additional issues of stock of the corporation." Op. 36. The statute's pre-1967 form gave rise to a common law presumption that shareholders possessed preemptive rights unless the certificate provided otherwise. Thus, according to the court, the BI Certificate's preemptive-rights bar was mere "boilerplate" adopted only "to clarify that no shareholder possessed preemptive rights under the common law." The court then relegated this "boilerplate" to governing shareholder rights on incorporation, but not "contractually granted preemptive rights." Op. 38.

With the Certificate's preemptive rights bar out of the way, the court used Article 4(b) as authority for the preemptive rights granted to BFC. That section, which does not even contain the phrase "preemptive rights," vests the Board with authority to issue preferred stock with "the voting powers, if any, designations, preferences and relative, participating, optional or other special rights." According to the court, this general "blank check authorization" sufficed. The court "reinforced" its interpretation with a nod to "the fundamental principle that parties should have the freedom to contract and that their contracts should not easily be invalidated." Op. 37.

The court's long and twisted journey of contract and statutory construction contained many pitfalls of error. At the outset, the court erred in implicitly finding an ambiguity. The Certificate's mandate is nose plain: "no stockholder shall have any preemptive right to subscribe to or purchase any issue of stock or other securities of the Corporation or any treasury stock or other security." When contracting parties choose such clear and unambiguous language to govern their relationship, the court's obligation is to enforce that language, not to look for ways around it.⁶⁵ The shareholders are free to amend

⁶⁴ Op. 36 (quoting *Smith v. Nu-W. Indus., Inc.*, 2000 WL 1641248, at *3-4 (Del. Ch. Oct. 25, 2000)).

⁶⁵ *E.I. duPont de Nemours v. Shell Oil Co.*, 498 A.2d 1108, 1113-15 (Del. 1985) (clear language must be upheld lest contract's "overall scheme" be negated).

their contractual relationship to provide expressly for preemptive rights. But the Board's unilateral preemptive rights grant in the face of the Certificate's preemptive rights bar frustrated the shareholders' "freedom to contract," a right that, ironically, the court purported to champion.

The court reasoning based on DGCL Section 102(b)(3) was similarly inappropriate. The 1967 amendment clearly requires that preemptive rights be "expressly granted . . . in their certificate of incorporation." The BI Certificate nowhere "expressly" grants any preemptive rights. And just to make extra certain that no Certificate provision would somehow be misconstrued, the shareholders clearly expressed their *contrary* intent.

It is simply not plausible that a Certificate adopted nearly three decades after Section 102(b)(3)'s amendment would have sought to address pre-1967 common law rights. A566. And since the DGCL is incorporated into the Certificate,⁶⁶ there was no need for the Certificate also to address those pre-1967 common law rights. The upshot of the Court of Chancery's reasoning was for the preemptive rights bars in the DGCL and BI's Certificate to cancel each other out. That absurd result cannot stand.⁶⁷

Nor should the Court of Chancery have been swayed by Article 4(b)'s grant of board power to issue new share series with "relative, participating, optional or other special rights." A court must "construe the agreement as a whole, giving effect to all provisions therein,"⁶⁸ and "specific language in a contract controls over general language."⁶⁹ Thus, the Certificate's specific preemptive rights bar controls over its more generalized "blank check authorization." Reading the two provisions together, and with a view towards giving each separate effect, the Board had the power to vest new issuances with various special rights, *except* preemptive rights.

⁶⁶ *Staar*, 588 A.2d at 1136.

⁶⁷ *Nassau Gallery, Inc. v. Nationwide Mut. Fire Ins. Co.*, 2003 WL 21223843 at *3 (Del. Super. April 17, 2003) (Court followed insurance contract's plain language where alternative would create "absurd result").

⁶⁸ *DuPont*, 498 A.2d at 1113; *Wood v. Coastal States Gas Corp.*, 401 A.2d 932, 937 (Del. 1979); *Holland v. Nat'l Auto. Fibres, Inc.*, 194 A. 124 (Del. Ch. 1937).

⁶⁹ *Katell v. Morgan Stanley Group, Inc.*, 1993 WL 205033, at *4 (Del. Ch. June 8, 1993); *Stasch v. Underwater Works, Inc.*, 158 A.2d 809, 812 (Del. Super. 1960).

CONCLUSION

For the foregoing reasons, the Court of Chancery's December 19, 2005 Order and Final Judgment should be reversed and remanded for determination of the appropriate remedies on BOT's direct and derivative claims.

Respectfully submitted,



C. Barr Flinn (#4092)
Elena C. Norman (# 4780)
D. Fon Muttamara-Walker (#4646)
YOUNG CONAWAY STARGATT
& TAYLOR, LLP
The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, DE 19899-0391
(302) 571-6600

OF COUNSEL:

Jonathan Rosenberg
Alexandra A. Lewis
O'MELVENY & MYERS LLP
7 Times Square
New York, NY 10036
(212) 326-2000

*Attorneys for Plaintiff Below, Appellee
Benihana of Tokyo, Inc.*

MARCH 9, 2006

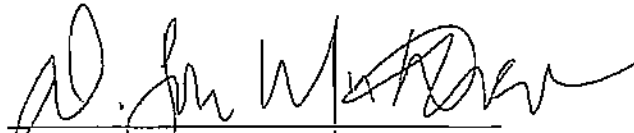
CERTIFICATE OF SERVICE

I, D. Fon Muttamara-Walker, hereby certify that on March 9, 2006, I caused to be served two true and correct copies of the foregoing *Appellant Benihana of Tokyo, Inc.'s Opening Brief* upon the following counsel of record in the manner indicated below:

BY LEXIS NEXIS FILE & SERVE and HAND DELIVERY

Gregory V. Varallo, Esquire
Lisa Zwally Brown, Esquire
Richards Layton & Finger, P.A.
One Rodney Square
920 North King Street
Wilmington, DE 19801

John G. Harris, Esquire
Reed Smith LLP
1201 Market Street
Suite 1500
Wilmington, DE 19801



D. Fon Muttamara-Walker (No. 4646)
YOUNG CONAWAY STARGATT
& TAYLOR, LLP
The Brandywine Building
17th Floor
1000 West Street
Wilmington, DE 19801
(302) 571-6600

EFiled: Mar 9 2006 11:25PM
Filing ID 10762634
Case Number 36,2006



EXHIBIT A



GRANTED WITH MODIFICATIONS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

BENIHANA OF TOKYO, INC., individually and)
on behalf of BENIHANA, INC.,)

Plaintiff,)

C.A. No. 550-N

v.)

BENIHANA, INC., JOHN E. ABDO, NORMAN)
BECKER, DARWIN DORNBUSH, MAX PINE,)
YOSHIHIRO SANO, JOEL SCHWARTZ,)
ROBERT B. STURGES, TAKANORI)
YOSHIMOTO, and BFC FINANCIAL)
CORPORATION,)

Defendants.)

FINAL ORDER AND JUDGMENT

This _____ day of _____, 2005,

WHEREAS, plaintiff Benihana of Tokyo, Inc. ("BOT") having filed its Complaint and motion for expedition in this matter on July 2, 2004;

WHEREAS, the Court having granted in part the request for expedited proceedings;

WHEREAS, BOT filed an Amended Complaint on October 8, 2004;

WHEREAS, the Court having held a trial in this matter on November 9, 10, 12 and 15, 2004;

WHEREAS, the Court having received post-trial briefs and having heard post-trial argument on April 4, 2005;

WHEREAS, the Court, by Opinion dated December 8, 2005, found against BOT and for Defendants on all claims asserted in the Amended Complaint for the reasons set forth in the Opinion;

NOW, THEREFORE, IT IS HEREBY FINALLY ORDERED, ADJUDGED AND DECREED as follows:

1. Final judgment is entered in favor of Defendants Benihana, Inc., John E. Abdo, Norman Becker, Darwin Dornbush, Max Pine, Yoshihiro Sano, Joel Schwartz, Robert B. Sturges, Takanori Yoshimoto, and BFC Financial Corporation and against plaintiff BOT, both individually and derivatively, on all claims asserted in BOT's Amended Complaint;
2. Except as expressly set forth herein, no party is entitled to any damages or attorneys' fees as a result of any claims asserted in this action; and
3. Costs are awarded to Defendants as the prevailing party.

IT IS SO ORDERED this _____ day of _____, 2005.

Donald F. Parsons, Jr.
Vice Chancellor

Court: DE Court of Chancery

Judge: Parsons, Donald F.

File & Serve reviewed Transaction ID: 7656143

Current date: 12/19/2005

Case number: 550-N

Case name: CONF ORDER Benihana of Tokyo Inc vs Benihana Inc

The Final Order and Judgment is granted subject to the following modification:

Paragraph 3 of the proposed Final Order and Judgment is hereby stricken without prejudice to the ability of any party to apply for costs.

/s/ Judge Donald F Parsons Jr

Exhibit B

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

BENIHANA OF TOKYO, INC., individually)
and on behalf of BENIHANA, INC.,)
)
Plaintiff,)

v.)

Civil Action No. 550-N

BENIHANA, INC., JOHN E. ABDO,)
NORMAN BECKER, DARWIN)
DORNBUSH, MAX PINE, YOSHIHIRO)
SANO, JOEL SCHWARTZ, ROBERT B.)
STURGES, TAKANORI YOSHIMOTO,)
and BFC FINANCIAL CORPORATION,)
)
Defendants.)

OPINION

Submitted: August 3, 2005
Decided: December 8, 2005

REVISED COVER PAGE

C. Barr Flinn, Esquire, Richard H. Morse, Esquire, Danielle Gibbs, Esquire, Kevin M. Baird, Esquire, Glenn C. Mandalas, Esquire, YOUNG CONAWAY STARGATT & TAYLOR, LLP, Wilmington, Delaware, *Attorneys for Plaintiff Benihana of Tokyo, Inc.*

Gregory V. Varallo, Esquire, Lisa M. Zwally, Esquire, RICHARDS LAYTON & FINGER, P.A., Wilmington, Delaware; C. Thomas Tew, Esquire, Dennis Nowak, Esquire, Jeffrey Tew, Esquire, TEW CARDENAS, LLP, Miami, Florida, *Attorneys for Defendants Benihana, Inc., Norman Becker, Darwin Dornbush, Max Pine, Yoshihiro Sano, Joel Schwartz, Robert B. Sturges and Takanori Yoshimoto*

John G. Harris, Esquire, REED SMITH LLP, Wilmington, Delaware; Alan K. Cotler, Esquire, REED SMITH LLP, Philadelphia, Pennsylvania; Alan H. Fein, Esquire, STEARNS WEAVER MILLER WEISSLER ALHADEFF & SITTERSON, P.A., Miami, Florida, *Attorneys for Defendants BFC Financial Corporation and John E. Abdo*

PARSONS, Vice Chancellor.

Plaintiff, Benihana of Tokyo, Inc. (“BOT”), seeks rescission of an agreement between Defendants Benihana Inc. (“Benihana” or the “Company”) and BFC Financial Corporation (“BFC”) to issue \$20 million of Benihana preferred stock to BFC (the “BFC Transaction” or “Transaction”). BOT’s complaint asserts that: (1) the BFC Transaction violated 8 *Del. C.* § 151 and Benihana’s Certificate of Incorporation by granting BFC shares with preemptive rights and is therefore void as *ultra vires*; (2) eight of Benihana’s nine directors, namely, John E. Abdo, Norman Becker, Darwin Dombush, Max Pine, Yoshihiro Sano, Joel Schwartz, Robert B. Sturges and Takanori Yoshimoto (collectively, “Director Defendants”) breached their fiduciary duties of loyalty and care in approving the BFC Transaction; (3) the BFC Transaction had an improper primary purpose to dilute BOT’s interest in Benihana and entrench certain Director Defendants; (4) the BFC Transaction should receive entire fairness review and fails such review; and (5) BFC aided and abetted the Director Defendants in their actions. Additionally, BOT seeks damages for costs it incurred in a proxy contest that allegedly would have been unnecessary if the BFC Transaction had not occurred. If the Court does not rescind the BFC Transaction, BOT seeks compensatory damages.

BOT filed its Complaint on July 2, 2004, along with motions for expedited proceedings and a preliminary injunction. The Court granted in part the request for expedited proceedings. Trial was held from November 9 through 15, 2004.¹ This Opinion reflects the Court’s post-trial findings of fact and conclusions of law.

¹ After post-trial briefing and argument, the parties became engaged in settlement negotiations and requested that the Court defer rendering an opinion pending the

For the reasons stated below the Court finds as follows: (1) the Board had authority under Benihana's Certificate of Incorporation and the applicable provisions of the DGCL to issue the preferred stock with preemptive rights that is the subject of the BFC Transaction; (2) a majority of the informed, disinterested and independent directors approved the transaction; (3) the directors did not have an improper purpose of entrenchment; (4) the directors did not breach their fiduciary duties of loyalty and care; and (5) the BFC Transaction was a valid exercise of the Board members business judgment. Accordingly, the Court will deny BOT's claims for relief and enter judgment in favor of Defendants.

I. FACTS²

A. The Parties

Rocky Aoki founded BOT in 1963 as a New York corporation. BOT owns and operates Benihana restaurants outside the continental United States and owns intellectual property interests in the Benihana name and trademarks. Rocky Aoki also founded nominal Defendant Benihana. Benihana was incorporated on December 6, 1994 as a Delaware corporation with its principal place of business in Florida; it operates and

outcome of those negotiations. In August 2005, the parties withdrew that request after their efforts to settle failed.

² The following summary includes the facts pertinent to the issues presented at trial. For additional background facts see *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 2005 WL 583828 (Del. Ch. Feb. 28, 2005).

franchises Benihana restaurants within the continental United States. BOT has been a controlling stockholder of Benihana since its incorporation.³

Initially, Rocky Aoki owned 100% of BOT and thereby indirectly controlled Benihana. In 1998, after he pled guilty to insider trading charges unrelated to Benihana, Rocky Aoki put his 100% ownership interest of BOT into the Benihana Protective Trust (the "Trust") to avoid regulatory problems regarding Benihana's liquor licenses stemming from his status as a convicted felon. Defendant Dornbush, a trusted friend and the family attorney, advised Rocky Aoki in that matter. The trustees of the Trust are

³ In the Amended Verified Complaint ("Complaint") BOT states that it "brings this action both individually and derivatively on behalf of Benihana, Inc. and its stockholders." Compl. at 1. Certain Defendants moved to dismiss any derivative claims in the original complaint on the ground that they were not derivative in nature. In response, BOT confirmed that Counts I – III are direct claims, but asserted that Counts IV, for breach of the duty of loyalty, and V, for breach of the duty of care, are both direct and derivative in nature. Defendants based their motion in part on technical defects in Counts IV and V that BOT corrected in its Amended Verified Complaint, filed October 8, 2004.

In assessing whether a claim is direct or derivative the Court must determine "(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)." *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004). Certain aspects of Counts IV and V are derivative. In particular, Count IV alleges that the Director Defendants engaged in acts of unfair dealing and consummated the BFC Transaction for an unfair price. That is a derivative claim. *Noerr v. Greenwood*, 1997 WL 419633, at *2 (Del. Ch. July 16, 1997) (characterizing as derivative a claim for unfair dealing in connection with a self-interested option issuance). Count V alleges, among other things, that the Director Defendants breached their fiduciary duties to Benihana by engaging in a self-dealing transaction without exercising the appropriate quantum of care. That, too, is a derivative claim. *Levine v. Smith*, 1989 WL 150784, at *1 (Del. Ch. Nov. 27, 1989). Defendants' arguments to the contrary are unpersuasive. Therefore, Defendants' motion to dismiss the derivative claims is denied.

Rocky Aoki's three children, Kana Aoki Nootenboom ("Kana Aoki"), Kyle Aoki and Kevin Aoki, and, until recently, Defendant Dornbush. The directors of BOT are Kana Aoki, Defendant Dornbush, and until recently, Kevin Aoki and Defendant Yoshimoto. Kevin Aoki also serves as a vice president of marketing and a director of Benihana.⁴

Benihana has two classes of common stock outstanding, common stock ("Common Stock") and Class A common stock. Benihana has 3,018,979 shares of Common Stock issued and outstanding. Each share of Common Stock entitles its holder to one vote. Additionally, Benihana has 6,134,225 shares of Class A common stock issued and outstanding, with each share having 1/10 vote. The holders of Class A common stock have the right to elect 25% of the Benihana Board of Directors, rounded up to the nearest whole director.⁵ The holders of the Common Stock elect the remaining directors.⁶

BOT owns 50.9%, or 1,535,668 shares, of Benihana's Common Stock and 2%, or 116,754 shares, of Benihana's Class A common stock. Before the BFC Transaction, BOT also had 50.9% of the Common Stock voting power. The Transaction caused a decrease in BOT's voting power in two steps: first to 42.5% and then to 36.5%.

Since June 2003, Benihana has had a nine member board of directors (the "Benihana Board" or "Board"). Defendants Abdo, Becker, Dornbush, Pine, Sano,

⁴ Kyle Aoki also is employed at Benihana.

⁵ PTO at 3.

⁶ *Id.*

Schwartz, Sturges and Yoshimoto are all directors of Benihana. The Benihana Board is classified; the holders of Class A common stock elect three directors, and the holders of Common Stock elect six directors. Each year the stockholders elect one third of the directors for three year terms, including one director elected by Class A common stockholders.

Defendant BFC is a publicly traded Florida corporation with its principal place of business in Florida. BFC is a holding company for various investments, including a 55% controlling ownership interest in Levitt Corporation, which in turn has a 37% ownership interest in Bluegreen Corporation. BFC invests in companies they like and can understand and that have managements that BFC admires as having a high degree of integrity and character.⁷ BFC does not get involved in the management of the companies they invest in or frequently change boards of directors or management.⁸ Abdo's job at BFC is to identify opportunities for investments in companies that are run by people BFC would admire.⁹

At all times material to this case, Abdo was a director and the vice chairman of BFC and owned approximately 30% of its stock. He and BFC Chairman, Alan Levan,

⁷ Tr. at 826 (Abdo). Citations in this form refer to the trial transcript and, where it is unclear from the text, the witness testifying.

⁸ *Id.*

⁹ Tr. at 758 (Abdo). Abdo identified Benihana as one of those companies.

together control BFC.¹⁰ Abdo also serves as president of Levitt Corporation and vice chairman of the boards of directors of both Levitt and Bluegreen.

Abdo has long had an interest in Benihana.¹¹ He was appointed to the Board in 1991 as an independent director.¹² On the day he was nominated to the Board he purchased 10,000 shares of Benihana stock.¹³ He subsequently purchased more Benihana stock.¹⁴ After it was announced that Rocky Aoki would resign from the board due to an insider trading conviction Abdo told Dornbush that if Rocky sold any of his stock he would have an interest in purchasing it.¹⁵ That is the only situation Abdo recalled where he initiated a conversation in which he expressed an interest in purchasing stock from Rocky Aoki or BOT.¹⁶

Defendant Dornbush is a director and corporate secretary of Benihana and, in effect, acts as its general counsel. He served as counsel to Benihana in the BFC Transaction. Together with Abdo, Dornbush also serves as a director on Levitt's board.

Defendant Schwartz is a director of Benihana as well as its president and chief executive officer. Thus, Schwartz receives a significant portion of his income from his

¹⁰ PTO, Admitted Fact 9.

¹¹ Tr. at 840 (Abdo).

¹² Tr. at 759-60 (Abdo).

¹³ Tr. at 840.

¹⁴ *Id.*

¹⁵ Tr. at 768, 840-42 (Abdo).

¹⁶ Tr. at 768.

salary, bonuses and options in Benihana. In addition, Schwartz is a partner in the Dorsan Group, a financial consulting firm whose other partners include Defendants Dornbush and Sano.

Defendant Yoshimoto works for Benihana as Executive Vice President of Restaurant Operations. His position is subordinate to Dornbush and Schwartz.

Both Yoshimoto and Schwartz have multi-year employment contracts that guarantee their annual salaries and require the Company to pay all salary remaining under the contract within 20 days of any termination without cause.¹⁷ Yoshimoto's contract expires in 2006, Schwartz's in 2009.¹⁸

In addition to being a director of Benihana, Defendant Becker is a director of Bluegreen Corporation along with Abdo.

B. Concern Regarding Future Control of BOT

In early 2003, Rocky Aoki became displeased with the actions of his trusted advisors and members of his family to whom he had ceded control of BOT (and indirect control of Benihana).¹⁹ Around this time period, Rocky Aoki first retained counsel other

¹⁷ See Benihana, Inc. Form 10-K/A, filed Sept. 4, 2001 for fiscal year ending Apr. 1, 2001, at Ex. 10.07, § 8 (Schwartz) and Ex. 10.12, § 8 (Yoshimoto), <http://www.sec.gov/Archives/edgar/data/935226/000093522601500010/form10-k2001.txt>; see also Benihana, Inc. Form 10-K, filed July 2, 2004 for fiscal year ending March 28, 2004, at Ex. 10.18 (renewal of Schwartz's employment contract through 2009), <http://www.sec.gov/Archives/edgar/data/935226/000093522604000019/form10-k2004.txt>.

¹⁸ *Id.*

¹⁹ See, e.g., JX 6, 10; Tr. at 771 (Abdo).

than Dornbush to advise him with regard to the Trust. Rocky even suggested that Dornbush and Yoshimoto resign as directors of Benihana. In or around August 2003, Rocky Aoki also prepared a codicil to his will that provided for distribution of all of BOT's stock to his new wife, Keiko Aoki, 25% passing to her in fee simple and 75% passing to her in the form of a life estate with the remainder to his children. Thus, upon Rocky Aoki's death, complete control of BOT and indirect control of Benihana would pass to Keiko Aoki and not to his children. This development created varying degrees of concern among not only Kevin and Kana Aoki, two of Rocky Aoki's children who served as trustees of the Trust, but also some members of the Benihana Board.²⁰

According to Schwartz, Benihana frequently received comments from investors and Wall Street about changing from two classes of common stock to one, because it would improve the liquidity of Benihana.²¹ Due to the two tiered structure of Benihana's stock Schwartz always asked Dornbush "whether [he] thought the trust would be

²⁰ See Tr. at 149–50, 153–54 (Kana Aoki), 235, 254 (Kevin Aoki). Dornbush testified that he told Schwartz that if Keiko were hostile to management, "you [referring to Schwartz] and the other executives have employment agreements in place, and you'll have to weather the storm or do what you want to do at that point in time." Dornbush Dep. at 164. Schwartz, the CEO of Benihana, is 63 years old and has an employment agreement with Benihana that prevents his termination except for cause until 2009.

²¹ Tr. at 29 (Schwartz).

interested in selling any of their BOT shares."²² Dornbush always responded to these inquiries by saying that BOT would not sell their shares during Rocky's lifetime.²³

The Certificate of Incorporation provides that if the number of shares of Common Stock falls below a specified threshold (12 1/2%) of the total number of shares of Class A and Common Stock, then the Class A stock not only votes separately for 25% of the directors, but also votes with the Common Stock for the remaining 75% of the directors. In all cases, however, the Class A stock would have only a 1/10 vote.

In late August 2003, Dornbush and Schwartz examined different means by which they could trigger the provision of the certificate which would cause the Common Stock and Class A stock to vote together for the directors previously elected by the Common Stock alone.²⁴ In one scenario, Schwartz determined that Benihana would have to issue 16.5 million Class A shares to meet the threshold in the Certificate. Such a stock issuance would have reduced BOT's percentage of the vote to approximately 29%. Schwartz asked Dornbush whether that scenario was feasible. Dornbush responded that it would not be and suggested that there would not be a legitimate business purpose for issuing that number of shares.²⁵

²² Schwartz Dep. at 69.

²³ *Id.*

²⁴ JX 21, 22, 23; Tr. at 28–30 (Schwartz).

²⁵ Tr. at 1053–55 (Dornbush).

1. The proposal of an option to purchase BOT's interest in Benihana

On September 10, 2003, shortly after learning of the change to his father's will, Kevin Aoki had dinner with Abdo and discussed the growing tension among the Aoki family. Kevin told Abdo that the amount of control their father's new wife exerted over their father disturbed the Aoki children.²⁶ The parties dispute whether Abdo, on the prompting of Dombush, approached Kevin Aoki at the September 2003 dinner about purchasing BOT's stock in Benihana.

In the second half of 2003 and into 2004, the Aoki children who served as trustees experienced many pressures and concerns as a result of their father's changed behavior after his remarriage. For example, after Rocky Aoki married Keiko, he decided that he no longer wanted to pay the premiums on his life insurance policies that benefited his children.²⁷ Further, against their father's wishes, Kevin and Kana Aoki, who served as trustees of an insurance trust that owned Rocky Aoki's life insurance policies, refused to cancel the policies. Since that time Kevin and Kana Aoki have used the cash surrender value of the policies to pay the premiums that Rocky Aoki refuses to pay.²⁸ Though the Aoki children tried to discuss this matter with their father, their relationship had deteriorated to the point where Rocky Aoki, through counsel, informed them that he would not meet with them outside of Keiko's presence.²⁹

²⁶ Tr. at 245–46 (Kevin Aoki).

²⁷ See DX 122.

²⁸ Tr. at 150 (Kana Aoki).

²⁹ Tr. at 249 (Kevin Aoki).

By early 2004, the Aoki children, upon the recommendation of Dornbush, had retained separate counsel to represent them. In that context, the Aoki children met with Dornbush in late January and mid March 2004 (the “Option Meetings”). The Aoki children sought a solution to protect themselves against their father’s threats and pressures.³⁰ Additionally, they wanted to protect Benihana, as well as Kevin and Kyle’s jobs at Benihana, from Keiko’s control and find a way to pay the insurance premiums.³¹ At the March 2004 meeting, Dornbush suggested issuing an option to purchase BOT’s interest in Benihana. This effectively would have shielded Benihana, and Kyle and Kevin’s jobs, from Keiko’s control and provided cash to BOT so the children could pay Rocky’s life insurance premiums. The Aoki children, however, felt uncomfortable selling BOT’s interest in Benihana during their father’s lifetime, so they suggested that the option would be exercisable only upon Rocky’s deathbed. The Aoki children also wanted to “[k]eep [the] door open for dad,” i.e., provide a mechanism through which they could cancel the option if they reconciled with their father.³² Dornbush expressed skepticism about finding a buyer willing to accept a transaction with such a cancellation feature. In fact, Dornbush “identified [Abdo] as the only person [he knew] who would

³⁰ See DX 123; Tr. at 160–61, 192 (Kana discussing Rocky Aoki’s threat to cut her and Kevin out of his will entirely if they did not do as he requested with regard to the Trust).

³¹ Tr. at 250–51 (Kevin Aoki), 1027–28 (Dornbush).

³² DX 123. The record is unclear as to how the exercisability of the proposed option would relate to Rocky Aoki’s health or even his death. The parties never reached the stage of exchanging a written proposal for such an option.

entertain buying” such an option.³³ Abdo knew of the pressure Rocky Aoki had placed on Kevin Aoki, and Dornbush felt that Abdo “was truly supportive” of Kevin.³⁴

After the meeting Dornbush had with Kyle, Kevin and Kana Aoki, Dornbush and Kevin met with Abdo for lunch in March 2004. Kevin Aoki denies that he “asked [Abdo] if he would be interested in buying cancelable options for the purchase of BOT shares in Benihana,”³⁵ at the March 2004 lunch meeting.

I do not find this testimony credible because both Kevin’s sister, Kana Aoki, and Dornbush testified that approaching Abdo with regard to purchasing a cancelable option was exactly the course of action the Aoki children agreed upon at the Option Meetings.³⁶ Therefore, I find that Kevin Aoki approached Abdo at the March 2004 lunch meeting about purchasing an option for the BOT shares.

In addition, I find that there is no credible evidence that Abdo approached Kevin Aoki at the September 2003 dinner meeting about purchasing BOT’s interest in Benihana. The only evidence in support of that allegation is the testimony of Kevin Aoki. Having concluded that Kevin’s recollection of who approached whom about purchasing the option at the March 2004 lunch meeting is faulty, I likewise consider unreliable his testimony regarding what transpired at the September 2003 dinner meeting. Further, I find Abdo’s testimony with regard to these two meetings credible and

³³ Tr. at 1028.

³⁴ Tr. at 1029.

³⁵ Tr. at 256.

³⁶ See Tr. at 182–84 (Kana Aoki), 1028 (Dornbush).

convincing. Abdo is vice chairman of BFC's board of directors, president of Levitt Corporation and vice chairman of the boards of directors of both Levitt and Bluegreen. As discussed below, he had no need, financial or otherwise, to keep his director position at Benihana. Though he may have found an opportunity to acquire BOT's Benihana Common Stock attractive, the cancellation feature of the option offered by the Aoki children made the proposed investment much less enticing. Thus, I accept Abdo's testimony regarding what transpired at the September 2003 dinner meeting and the March 2004 lunch meeting.

C. The State of Benihana's Businesses

In 2003, Benihana realized that it needed to renovate many of its restaurant facilities because they were aging and quickly becoming outmoded in the face of new competition in the marketplace.³⁷ Benihana hired WD Partners to evaluate, plan and design the necessary renovations to help the Company maintain its competitive position within the market. WD Partners determined that Benihana needed to construct new teppan and sushi restaurants³⁸ as well as renovate its older restaurants. They projected that these construction and renovation efforts (the "Construction and Renovation Plan") would last at least five years.

³⁷ Tr. at 553-54, 561 (Burris). Mark Burris is Benihana's CFO.

³⁸ Benihana restaurants typically use teppan style cooking, which involves cooking on a large griddle usually built into the diner's table. In recent years Benihana acquired the Ra and Haru restaurant chains, which focus more on sushi style food preparation.

Implementation of the Construction and Renovation Plan would require capital. In 2003, Benihana had an existing line of credit with Wachovia.³⁹ Mark Burris, Benihana's CFO, approached Wachovia to determine their ability to finance Benihana's Construction and Renovation Plan. On October 17, 2003, Burris wrote a file memo with a copy to Schwartz that analyzed Wachovia's proposal for providing debt financing to Benihana. Burris concluded that, "the need for additional financing is clear if we are to continue capex [capital expenditures] at our projected rate."⁴⁰ At trial, Burris explained that he felt uncomfortable relying solely upon the Wachovia proposal to satisfy Benihana's financing needs because it contained a provision limiting the amount Benihana could borrow to 1.5 times earnings before interest, taxes, depreciation, and amortization ("EBITDA"). This restriction on the financing plan, which spanned five years, threatened to limit substantially Benihana's ability to borrow funds.

To illustrate, though Wachovia offered a line of credit of \$60 million, Benihana could borrow that amount only if its EBITDA equaled or exceeded \$40 million. In 2003, however, Benihana's EBITDA was far below that amount. Moreover, if Benihana's earnings declined in the near term,⁴¹ the covenant could limit further its ability to borrow

³⁹ Tr. at 558 (Burris).

⁴⁰ JX 29.

⁴¹ The evidence indicated that many events outside of the Company's control can affect Benihana's earnings. Consumers view Benihana as a restaurant to go to for celebratory occasions. Therefore, periods of time when the social climate does not support celebrating, such as during the gulf war and post 9/11, can negatively affect Benihana's earnings. See Tr. at 556-57 (Burris).

funds from Wachovia. Consequently, Benihana's EBITDA represented an equally important figure to the \$60 million cap in considering the proposed Wachovia financing. In fact, in his memo to the file Burris stated that, "it seems unlikely that we will use the entire \$60 million availability under any circumstances unless there is improvement to profitability."⁴²

1. Financing alternatives explored

Given the less than satisfactory financing option offered by Wachovia,⁴³ Benihana retained the investment banking firm Morgan Joseph & Co., Inc. ("Morgan Joseph") to determine what other financing options the Company might use to carry out its five year Construction and Renovation Plan.⁴⁴ As a part of its due diligence, Morgan Joseph met with Benihana's management, including Schwartz, Kevin Aoki and Burris, to gain a better understanding of their views regarding the need for renovation of the teppan style restaurants, acquisition potential, and expansion of the Ra sushi bars.⁴⁵

After meeting with management, Morgan Joseph studied Benihana's financial projections and conducted sensitivity analyses. Morgan Joseph determined that because Benihana

⁴² JX 29.

⁴³ *Id.*; Schwartz Dep. at 176-77.

⁴⁴ JX 30; Tr. at 38-39 (Schwartz). In the past, Morgan Joseph had given Benihana financial advice in the form of fairness opinions and assistance on equity offerings. Tr. at 618-19 (Joseph). Fred Joseph, the Morgan Joseph representative who advised Benihana regarding the matters at issue in this litigation, testified at trial.

⁴⁵ Tr. at 620-21 (Joseph).

had not in recent years made its projections [Morgan Joseph had become] very concerned about embarking on an extensive refurbishment plan, needing to do more acquisitions, if you could find appropriate acquisitions, and having a very close call in terms of capital availability depending on operating cash flow.⁴⁶

Morgan Joseph wanted to ensure that Benihana did not embark on its five year Construction and Renovation Plan, which everyone including Kevin Aoki agreed was necessary to remain competitive, only to run out of capital before its completion and end up as a bankruptcy candidate.⁴⁷

2. January 9 meeting of the Executive Committee

On January 9, 2004, Morgan Joseph met with the Executive Committee, comprised of Abdo, Schwartz and Dornbush,⁴⁸ to discuss financing vehicles available to Benihana to fund the Construction and Renovation Plan. Morgan Joseph expressed its concern regarding the “closeness of the company’s capital needs to its availability” and the vulnerability of their projected growth forecasts, which depended on the success of the renovation plan.⁴⁹ The Executive Committee and Morgan Joseph discussed their respective goals and concerns, as well as various financing alternatives available to the

⁴⁶ Tr. at 621.

⁴⁷ Tr. at 621–22.

⁴⁸ See JX 32.

⁴⁹ Tr. at 623. See also JX 36 (board book prepared by Morgan Joseph for the January 9 Executive Committee meeting).

Company. These alternatives included bank debt, high yield notes, convertible debt or preferred stock, traditional equity financing and sale/leaseback options.⁵⁰

The parties all agree that Benihana was conservatively leveraged during the relevant time period.⁵¹

3. January 29 meeting of the Benihana Board

Following the January 9, 2004 meeting, Morgan Joseph decided to recommend convertible preferred stock as an appropriate financing vehicle for Benihana and created a board book that analyzed the recommended stock issuance and set forth the anticipated terms for it. Morgan Joseph presented the board book to the Benihana Board at a January 29, 2004 meeting. Once again, they reviewed the financing alternatives of bank debt, high yield notes, convertible debt or preferred stock, traditional equity financing and sale/leaseback options, and the Board discussed them.⁵² Morgan Joseph recommended that Benihana obtain equity financing first to gain flexibility, then use the equity financing as leverage to negotiate better terms on their existing line of credit with Wachovia.⁵³ According to Joseph, “the oldest rule in our business is you raise equity when you can, not when you need it. And Benihana’s stock had been doing okay. The markets were okay. We thought we could do an equity placement.”⁵⁴ Morgan Joseph

⁵⁰ See JX 36.

⁵¹ Tr. at 106 (Schwartz), 298–99 (Atkins), 703 (Joseph).

⁵² See JX 37; Tr. at 638–39 (Joseph).

⁵³ Tr. at 630–31.

⁵⁴ Tr. at 631.

recommended a convertible preferred stock specifically because it felt “that adding the additional long-term capital match[ed] the company’s long term needs [for capital expenditures.] . . . provide[d] the flexibility for the company to grow internally and pursue the other opportunities [i.e., acquisitions]. . . [a]nd reduce[d] [the] company’s dependence on bank debt.”⁵⁵ The Benihana directors were told to take the board books home to study and deliberate.

4. February 17 meeting of the Benihana Board

On February 17, 2004, the Benihana Board met again to discuss the terms of the recommended convertible preferred stock issuance. Morgan Joseph discussed the feasibility of obtaining certain terms the Company wanted. For example, during the meeting, Morgan Joseph noted the following areas in which they anticipated having to make concessions: (1) that it “was going to have quite a battle to keep the investor from putting performance criteria on the company as a condition of executing the second takedown;” (2) that it would most likely have to pay a coupon, or dividend, of “probably six percent, plus or minus a half;” (3) that the conversion premium would probably be “20%, plus or minus 2 ½%,” (4) that Benihana would have a difficult time getting a perpetual maturity for the issuance, and that the notes typically have a maturity range of 5 to 10 years; and (5) that Benihana will likely have to “give up two board seats.”⁵⁶ Thus, the Board understood that, while Morgan Joseph would endeavor to negotiate the best

⁵⁵ Tr. at 640–41.

⁵⁶ Tr. at 76–78 (Schwartz), 649 (Joseph).

deal for Benihana, several of the terms they had discussed were more akin to a “wish list.”⁵⁷

At the conclusion of the February 17 meeting, the Benihana Board decided to pursue convertible preferred stock as an additional means of financing. Abdo attended both the January 29 and February 17 meetings. At the February 17 meeting Morgan Joseph proposed that the convertible preferred stock should have immediate voting rights as though they had been converted.⁵⁸ Joseph explained their reasoning as follows: “Someone is not going to come in, put in money, be illiquid, have a larger holder and not have their voting rights from Day 1.”⁵⁹

The convertible preferred stock discussed at the February 17 meeting differed in certain respects from the three classes of preferred stock (Series A, A-1 and A-2) Benihana previously had authorized. None of those classes carries with it the right to a directorship, voting rights or preemptive rights.⁶⁰

5. Actual versus projected net debt figures

The board books used in the January 29 and February 17 meetings contained a “base case” scenario that calculated capital shortfalls if Benihana relied solely upon the proposed Wachovia line of credit. Morgan Joseph based its figures for this “base case”

⁵⁷ Schwartz Dep. at 274.

⁵⁸ Tr. at 54–55 (Schwartz).

⁵⁹ Tr. at 650; *see also* Tr. at 646–47 (Joseph) (regarding conversion right to Common Stock), 797 (Abdo).

⁶⁰ *See* JX 96 (Stock Purchase Agreement).

scenario on calculations of net debt by Burris that included several renovation projects that did not occur during Benihana's fiscal year 2004 because of zoning and other temporary delays.⁶¹ Benihana did not cancel these projects, but rather deferred them to a later point in time. It also did not consider the attendant delay to cause a fundamental change in the Company's need for capital.⁶²

By the February 17 Board meeting Benihana's management knew of the change in net debt figures, but failed to mention it to Morgan Joseph. Morgan Joseph later discovered the discrepancy when it conducted additional due diligence in connection with preparing the private placement memorandum.⁶³ This discovery, however, did not alter Morgan Joseph's opinion that Benihana should not rely solely on the Wachovia line of credit to finance the Construction and Renovation Plan. Fred Joseph testified that:

I wasn't obsessed by the slight shortfall [created by the projected, not actual, net debt figures]. I was very concerned about the fact [that] there just wasn't enough room in the Wachovia proposal and, you know, a terrorist attack, two-percent decline in sales growth and the company would have been in real trouble on its cap[e]x requirements.⁶⁴

Additionally, Morgan Joseph preferred a flexible strategy because it believed that Benihana needed flexibility to take advantage of attractive acquisition opportunities that

⁶¹ See Tr. at 651.

⁶² Tr. at 67 (Schwartz), 657 (Joseph).

⁶³ Tr. at 651.

⁶⁴ Tr. at 636.

might present themselves.⁶⁵ In fact, Benihana ended up not only with lower actual net debt figures for fiscal year 2004, but also lower EBITDA figures. The lower net debt figures would have made more funds available to Benihana to borrow under the Wachovia offer. The lower EBITDA figures, however, would have limited the amount of those funds. Thus, changes in these figures offset each other to a certain extent.⁶⁶

Morgan Joseph corrected the net debt figures in the board books it created going forward.

D. Abdo Approaches Morgan Joseph on Behalf of BFC

Shortly after the February 17 Board meeting Abdo talked to his partner Alan Levan about having BFC attempt to purchase the preferred stock Benihana planned to issue to finance the Construction and Renovation Plan.⁶⁷ Levan responded that he thought it was a good deal and trusted Abdo's instincts regarding the investment.⁶⁸

Two or three days after the February 17 meeting, Abdo contacted Joseph and told him BFC had an interest in purchasing the Benihana convertible preferred stock being offered to finance the Construction and Renovation Plan.⁶⁹ Joseph then contacted Benihana which welcomed Abdo's involvement in the Transaction.⁷⁰

⁶⁵ Tr. at 631–32 (Joseph).

⁶⁶ Tr. at 659 (Joseph).

⁶⁷ Tr. at 799–800 (Abdo).

⁶⁸ *Id.*

⁶⁹ Tr. at 800, 866 (Abdo).

⁷⁰ Tr. at 801 (Abdo).

In early April 2004, Morgan Joseph sent its private placement memorandum to BFC and negotiations began.⁷¹ Although Abdo did not indicate whether BFC generally accepted the term sheet contained in the private placement memorandum, the parties agreed not to shop the issuance to anyone else for a short period to foster more productive negotiations with BFC.⁷²

Morgan Joseph negotiated on behalf of Benihana. Abdo negotiated on behalf of BFC. Morgan Joseph had no prior business relations with Abdo or BFC. In fact, Morgan Joseph directly competed with Ryan Beck, an investment bank that BFC controlled.⁷³

1. Negotiation of the convertible preferred stock issuance

Negotiations between BFC (Abdo) and Benihana (Morgan Joseph) continued through the end of April 2004. The ultimate terms of the BFC Transaction are reflected in a stock purchase agreement (the “Stock Purchase Agreement” or “SPA”). Those terms include the issuance of 800,000 shares of convertible preferred stock for \$20 million in two separate tranches of \$10 million apiece.⁷⁴ The second tranche would issue within one to three years after the first.⁷⁵

⁷¹ Tr. at 72 (Schwartz).

⁷² Tr. at 652 (Joseph).

⁷³ Tr. at 656 (Joseph).

⁷⁴ Tr. at 662 (Joseph). Morgan Joseph had the authority to negotiate whether the purchase price would be paid in cash or common stock. *Id.*

⁷⁵ *Id.* Benihana reportedly issued the second tranche on August 4, 2005. *See* Letter to Court from C. Barr Flinn, dated August 22, 2005.

BFC negotiated to obtain the following terms: (1) the right to require Benihana to draw down the second tranche of convertible preferred stock; (2) BFC's right to one director seat on the Benihana Board and an additional seat if Benihana missed its dividend for two consecutive quarters;⁷⁶ (3) BFC's preemptive right to purchase a proportional amount of any new voting securities issued by Benihana;⁷⁷ (4) BFC's right to require Benihana to redeem the full \$20 million of convertible preferred stock at any time after 10 years;⁷⁸ (5) anti-dilution and liquidation provisions;⁷⁹ (6) BFC's right to a standby fee;⁸⁰ and (7) BFC's right to immediately vote on all matters, including elections of directors, with the voting power associated with the amount of Common Stock into which their preferred stock was convertible, even if such stock has not yet been converted.

⁷⁶ See Tr. at 664 (Joseph). The parties negotiated that Benihana would not add an additional director seat to the Board. Instead, Abdo would continue to serve on the Board but serve in the capacity of BFC's representative. Additionally, though BFC obtained the right to receive an additional director seat after two consecutive quarters of missed dividends, rather than four as Benihana initially hoped for, Morgan Joseph considered the negotiated term, "fairly standard." *Id.*

⁷⁷ PTO at ¶ 23. BFC requested this term and Benihana did not object. See Tr. at 663-64 (Joseph).

⁷⁸ This result was consistent with Morgan Joseph's prediction that it would be difficult for Benihana to get a perpetual maturity in the issuance. Tr. at 649. Additionally, Morgan Joseph obtained "the right for [Benihana] to pay that redemption in stock if they wanted to at their option." Tr. at 654.

⁷⁹ Tr. at 663, 665 (Joseph). These terms were considered very standard.

⁸⁰ Tr. at 665. Benihana wanted to avoid this, but, in the end, Morgan Joseph opined that it was a reasonable fee.

For its part, Morgan Joseph negotiated several terms that they considered beneficial to Benihana. Those terms included: (1) no performance criteria could be placed on Benihana as a condition of executing the second tranche; (2) a coupon rate, or dividend, of five percent;⁸¹ and (3) a conversion price of 115% of the original volume based on a 10 day average *before* the announcement of the Transaction.⁸²

Morgan Joseph believed that Benihana got what they wanted through the negotiations. Joseph testified that he

ended up quite satisfied that we had a transaction that, in what [he] considered material aspects, the amount, the two takedowns, the dividend and conversion premium. This sort of hierarchy of importance and you can get hung up on all these points, but you got to remember what's most important. On the important points we ended up where we wanted to be.⁸³

Schwartz sent the negotiated term sheet to the Board on April 30, 2004, but did not indicate that BFC was the other party to the negotiations.⁸⁴ Schwartz, however, informally told Becker, Sturges, Sano, and possibly Pine of BFC's role as the counterparty before the May 6, 2004 Board meeting.⁸⁵

⁸¹ Tr. at 649. This was better than the "six percent, plus or minus a half" Morgan Joseph told Benihana to be prepared to pay.

⁸² See Tr. at 663 (Joseph), 804 (Abdo). This term was likely to benefit Benihana because pre-announcement prices generally exceed pre-closing prices. In fact, the pre-announcement conversion price in this instance was higher.

⁸³ Tr. at 655.

⁸⁴ Tr. at 90 (Schwartz).

⁸⁵ Tr. at 89-90, 92, 93.

E. The May 6 Benihana Board Meeting

On May 6, 2004, the Benihana Board met again to consider the convertible preferred stock issuance. At this meeting, the entire Board formally was informed of BFC's negotiations with Benihana. Abdo made a presentation on behalf of BFC and explained its business philosophy. He then excused himself from the remainder of the meeting. Morgan Joseph circulated an updated board book that contained the negotiated terms and corrected net debt figures. They reviewed the new terms with the Board and pointed out the changes in the net debt figures.⁸⁶ In addition, the Board specifically discussed changes that had been made with regard to the conversion price and preemptive rights.⁸⁷

The Benihana Board, however, never received the private placement memorandum that Morgan Joseph prepared after the February 17 Board meeting and gave to BFC in April 2004. Therefore, the Board members were only familiar with the proposed terms discussed at the January 29 and February 17 Board meetings and the negotiated terms presented to them at the May 6 meeting. Morgan Joseph told the Board that no significant changes to the terms had been made.⁸⁸ Additionally, though Pine had inquired about Abdo's involvement in the negotiations, the Benihana Board was not informed that Abdo himself negotiated the terms on behalf of BFC.⁸⁹ The Board did

⁸⁶ Tr. at 657.

⁸⁷ Tr. at 96 (Schwartz).

⁸⁸ Tr. at 95–96 (Schwartz), 1062–63 (Dornbush).

⁸⁹ Tr. at 95 (Schwartz).

know, however, of Abdo's position as a principal of BFC and the ultimate decision making role he presumably had over BFC's investments.⁹⁰

At the conclusion of the May 6 meeting, the Board voted to approve the BFC Transaction subject to receipt of a fairness opinion. Dornbush and Kevin Aoki attended the meeting and participated in the discussions but abstained from voting. All six remaining directors voted in favor of the Transaction.

F. Closing of the BFC Transaction

On May 20, 2004, the Benihana Board met again to consider the BFC Transaction, which now was supported by a favorable fairness opinion from Morgan Joseph. The Board then approved the transaction. On June 8, 2004, Schwartz executed the Stock Purchase Agreement on behalf of Benihana, and Abdo executed it on behalf of BFC.

1. BOT's concern over the dilutive effect of the BFC Transaction

After the May 6 Board meeting, Kevin Aoki approached Schwartz, Abdo and Dornbush to inquire if either his father or BOT could finance the second tranche of the BFC Transaction in order to avoid dilution of BOT's interest in Benihana.⁹¹ The proposals Kevin Aoki made, however, were not realistic. Despite Rocky Aoki's long history with the Company and desire to exert control over it, he had "never brought financing to the table."⁹² Consequently, management did not view Rocky as a viable

⁹⁰ In fact Abdo made the presentation to the board on behalf of BFC at the May 6 meeting. JX 66 at 2. *See also* JX 68.

⁹¹ Tr. at 226–28 (Kevin Aoki).

⁹² Tr. at 227 (Kevin Aoki).

funding source.⁹³ The other scenarios Kevin presented as to how BOT could raise the necessary capital to participate in the second tranche demonstrated his lack of financial expertise and sophistication, and were likely to result in adverse tax consequences.⁹⁴ Furthermore, BFC had no motivation to give up the second tranche for which it had just negotiated.

In mid-May 2004, after learning of the BFC Transaction, Rocky Aoki discussed his displeasure regarding it with Kevin. The trustees of the Trust objected to the dilutive effect of the Transaction as well.⁹⁵ Because of concern for Kevin and Kyle Aoki's work environment, however, the trustees delegated the task of complaining about the BFC Transaction to Ken Podziba, a family friend.⁹⁶ Thereafter, representatives of the Trust and Rocky Aoki communicated their objections regarding the BFC Transaction to the Benihana Board and recommended alternative financing offers for Benihana's consideration.⁹⁷

⁹³ *Id.*

⁹⁴ Tr. at 228 (Kevin Aoki).

⁹⁵ Tr. at 142 (Kana Aoki).

⁹⁶ *Id.*

⁹⁷ *See* JX 88.

2. Alternative financing offers

On May 28, 2004, Benihana received an offer from Yamano Holdings (the “Yamano Offer”).⁹⁸ Schwartz asked Becker, Pine and Sturges to form an independent ad hoc committee to review the offer.⁹⁹ Schwartz also sent the Yamano Offer to Morgan Joseph for evaluation.¹⁰⁰ Benihana reviewed both transactions quickly because it did not want to risk losing the BFC Transaction, which the Board had already announced.¹⁰¹ Though the Yamano Offer terms appeared to differ from the BFC Transaction only in that the preferred would convert into Class A common stock rather than Common Stock, Yamano stated that it would need to conduct due diligence and then possibly negotiate the terms further.¹⁰² The ad hoc committee concluded that the Yamano Offer was inferior because it was “very much underdeveloped” and an important term, the conversion price, was “on its face inferior.”¹⁰³ Additionally, Morgan Joseph informed Benihana that it considered the Yamano Offer inferior to the BFC Transaction and not worth pursuing.¹⁰⁴

⁹⁸ Defendants objected to the admission of this offer on hearsay grounds. Tr. at 682–84. After considering this objection and consistent with my ruling at trial (Tr. at 685–86), I will admit PX 78 for the limited purpose of showing what was submitted to the Board, but not for the truth of the matter asserted in the document.

⁹⁹ Tr. at 117–19 (Schwartz).

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² Tr. at 928–29 (Sturges).

¹⁰³ *Id.*; Joseph testified that he believed the Yamano Offer was inferior because he “was very much put off by the fact it was subject to due diligence. When someone comes in and they want to tell you they want to do a deal, you have a bird in hand.

On June 3, 2004, Benihana received an offer from Cornell Capital Partners (the “Cornell Offer”).¹⁰⁵ Schwartz submitted this proposal to Morgan Joseph for review. Morgan Joseph concluded that the short term Cornell Offer was inappropriate to finance Benihana’s five year Construction and Renovation Plan.¹⁰⁶

Finally, on June 4, 2004, Benihana received a letter from Trinity Capital.¹⁰⁷ Once again, Benihana sent this letter to Morgan Joseph for review. Morgan Joseph concluded that Trinity Capital’s letter did not even constitute an offer of financing; rather, it was “another investment bank saying ‘We’d like to be your investment bank.’” Additionally, Morgan Joseph opined that the suggested financing terms were “just flat out ridiculous.”¹⁰⁸

On June 11, 2004, the Benihana Board met to consider these three alternative proposals. The Board also discussed BOT’s concerns regarding the dilutive effect of the

And there’s the subject of due diligence. That can be an immense risk, unless they’re a well-known, prestigious institution; and you know they know all they’re going to know about the company.” Tr. at 678–79.

¹⁰⁴ Tr. at 124 (Schwartz).

¹⁰⁵ PX 86. As with PX 78, I will admit PX 86 to the extent it shows what Cornell said and the proposal it put forward, but not for the truth of the matters asserted in the document.

¹⁰⁶ Tr. at 678–79; This offer had short term financing which even Cornell’s witness admitted would not be appropriate for long term capital expenditures. Kanakis Dep. at 48–49, 52–53.

¹⁰⁷ PX 82. At the pretrial conference Defendants objected to the admission of this offer on hearsay grounds. *See supra* n.82. I overrule Defendants’ objection for the same reasons as the Cornell Offer.

¹⁰⁸ PX 678–79.

BFC Transaction.¹⁰⁹ The Board determined not to pursue any of the alternative proposals and voted to ratify the BFC Transaction.¹¹⁰

3. Filing of the Certificate of Designations

Benihana's Certificate of Incorporation gives the Benihana Board the power to issue "blank check" preferred stock.¹¹¹ Accordingly, and as required by § 4(l) of the Stock Purchase Agreement, Benihana filed a Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock of Benihana ("Certificate of Designations") with the Delaware Secretary of State on June 29, 2004.¹¹² This action immediately reduced BOT's voting interest from 50.9% to 42.5%, and then further reduced it to 36.5% in or around August 2005, when BFC took down the second tranche. Likewise, BFC acquired a 16.5% voting interest in Benihana when the Certificate of Designations was filed, which increased to 28.3% upon issuance of the second tranche.

4. Procedural History

The Complaint was filed July 2, 2004 along with motions for expedited proceedings and a preliminary injunction.¹¹³ Defendants moved to dismiss on July 28, 2004. They filed further motions to dismiss on October 15 and 18. At trial on November 14, 2004, I partially denied Defendants motion to dismiss. In February 2005, I

¹⁰⁹ See JX 88.

¹¹⁰ See *id.* Abdo, Dornbush and Kevin Aoki abstained from the vote.

¹¹¹ See Certificate of Incorporation, Art. 4(b).

¹¹² See JX 96.

¹¹³ The Court granted in part the request for expedited proceedings.

issued a memorandum opinion denying Defendants motion to dismiss as to BFC under Chancery Court Rules 12(b)(2) for lack of personal jurisdiction and 12(b)(5) for insufficient service of process, and as to all remaining Defendants under Rule 19 for failure to join an indispensable party.¹¹⁴ Regarding Defendants' motion to dismiss the derivative claims, I found that the Complaint met all pleading requirements under Rule 23.1, but deferred decision regarding whether claims IV and V are derivative in nature pending further development of the case.¹¹⁵

G. Subsequent review of the BFC Transaction

On October 27, 2004, Benihana's Audit Committee, consisting of Becker, Pine and Sturges, met to review the BFC Transaction again. The Audit Committee analyzed the BFC Transaction to rectify a deficiency in Benihana's process under NASDAQ's standards.¹¹⁶ As permitted by the applicable rules, Dornbush and Kevin Aoki participated in the discussion, although they were not members of the Committee. At the October 27 meeting, counsel to Benihana reviewed all of the allegations raised by BOT in the Amended Complaint in this action. The Audit Committee then deliberated and decided to ratify the BFC Transaction.

¹¹⁴ *Benihana of Tokyo*, 2005 WL 583828.

¹¹⁵ The parties agree that BOT's claims I through III are direct. *Id.* at *9. *See supra* n.3.

¹¹⁶ The NASDAQ Stock Market on which Benihana is listed had advised the Company that NASDAQ's rules required that the BFC Transaction be approved by the Audit Committee or other independent body of the Board. *See* JX 131.

Later on October 27, 2004, the full Benihana Board met. After counsel to Benihana again reviewed the allegations raised in the Amended Complaint, the Board voted to ratify the BFC Transaction.

II. ANALYSIS

BOT challenges the BFC Transaction on several grounds. First, BOT contends that the transaction is void because it violated 8 *Del. C.* § 151 and the applicable provisions of Benihana's Certificate of Incorporation.

BOT also claims that the BFC Transaction is invalid because the Board adopted it for an improper primary purpose of diluting BOT's interest in Benihana and entrenching certain Director Defendants and that the Director Defendants breached their fiduciary duties of loyalty and care in approving the Transaction.

The issues raised by BOT's legal argument under 8 *Del. C.* § 151 are distinct from the entrenchment and breach of fiduciary duty claims. Therefore, the Court begins its analysis with the § 151 claim.

A. The Validity of the BFC Transaction Under 8 *Del. C.* § 151(a)

Benihana's Certificate of Incorporation states that: "No stockholder shall have any preemptive right to subscribe to or purchase any issue of stock or other securities of the Corporation or any treasury stock or other security."¹¹⁷ In connection with the sale of preferred stock to BFC, Benihana granted BFC preemptive rights to purchase Benihana

¹¹⁷ Pl.'s Opening Pretrial Br. Ex. 19, Art. Fourth.

stock.¹¹⁸ In particular, the Stock Purchase Agreement provides that Benihana shall not issue, sell or transfer any of its equity securities unless the Company provides BFC at least 30 days prior written notice specifying the price and other material terms of the issuance. During a defined period thereafter, BFC has the right to purchase at the same price up to the number of offered shares necessary for BFC to maintain the percentage ownership in the Company it had immediately before such issuance based on its purchase of preferred shares.¹¹⁹

BOT argues the BFC Transaction is invalid based on 8 *Del. C.* § 151(a) and the absence of any authorization in Benihana's Certificate of Incorporation for the Board to issue stock with preemptive rights. In response, Benihana argues that the Court should interpret the language in its Certificate of Incorporation as not prohibiting Benihana from granting preemptive rights by contract because the language of 8 *Del. C.* § 102(b)(3), which Benihana contends the language quoted above from its Certificate of Incorporation mirrors, has been interpreted to "not necessarily prohibit contractual preemptive right[s]."¹²⁰

¹¹⁸ SPA, Art. 4(k)(ii). The Certificate of Designations for the convertible preferred stock incorporated the terms of the SPA by reference. Certificate of Designations, Sec. 2.

¹¹⁹ SPA, Art. 4(k)(i), (ii).

¹²⁰ Defs.' Post-Trial Ans. Br. at 45 (quoting Frank Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations & Business Organizations*, § 5.16 (2004) (discussing *Garza v. TV Answer, Inc.*, 1993 WL 77186 (Del. Ch. Mar. 15, 1993)).

Thus, this Court must address whether the Benihana Board had the authority to grant preemptive rights to BFC in connection with its purchase of preferred stock consistent with the Delaware General Corporation Law (“DGCL”) and its charter. In particular, the Court must consider the interplay of certain provisions of the DGCL with Benihana’s Certificate of Incorporation and the Board’s action in issuing the preferred stock.

Section 151 of the DGCL allows corporations to issue one or more classes of stock or one or more series of stock within a class, including stock with redemption rights, conversion features and other special rights.¹²¹ The powers, preferences, rights and other characteristics of such shares, however, “shall be stated and expressed in the Certificate of Incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation.”¹²² In addition, 8 *Del. C.* § 151(g) provides:

When any corporation desires to issue any shares of stock of any class or of any series of any class of which the powers, designations, preferences and relative, participating, optional or other rights, if any, or the qualifications, limitations or restrictions thereof, if any, shall not have been set forth in the certificate of incorporation or in any amendment thereto but shall be provided for in a resolution or resolutions adopted by the board of directors *pursuant to authority expressly vested*

¹²¹ See 8 *Del. C.* §§ 151(a), (b) and (e). The DGCL is a part of the certificate of incorporation of every Delaware corporation. See 8 *Del. C.* § 394.

¹²² 8 *Del. C.* § 151(a). See also *Staar Surgical Co. v. Waggoner*, 588 A.2d 1130, 1135 (Del. 1991).

*in it by the certificate of incorporation or any amendment thereto, a certificate of designations setting forth a copy of such resolution or resolutions and the number of shares of stock of such class or series as to which the resolution or resolutions apply shall be executed, acknowledged, filed, recorded and shall become effective, in accordance with § 103 of this title.*¹²³

Therefore, the Court also must consider the terms of Benihana's charter.

The relevant section of Benihana's Certificate of Incorporation is Article 4(b). This Article vests the Board with authority to "issue from time to time the Preferred stock of any series and to state in the resolution or resolutions providing for the issuance of shares of any series the voting powers, if any, designations, preferences and relative, participating, optional or other special rights" -- i.e., a blank check authorization.¹²⁴ The BFC Transaction gives BFC the preemptive right to purchase additional equity securities of Benihana if the Company issues or transfers any of its equity securities and to do so at the same price and terms being offered to others.¹²⁵

"Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply."¹²⁶

¹²³ 8 *Del. C.* § 151(g) (emphasis added).

¹²⁴ Pl.'s Opening Pretrial Br. Ex. 19, Art. 4(b).

¹²⁵ See Stock Purchase Agreement ¶ 4(k).

¹²⁶ *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) (citing *Berlin v. Emerald Partners*, 552 A.2d at 488, *Hibbert v. Hollywood Park, Inc.*, 457 A.2d at 342-43, and *Ellingwood v. Wolf's Head Oil Ref. Co.*, 38 A.2d 743, 747 (Del. 1944)). See also *Staar*, 588 A.2d at 1136 (stating that "a corporate charter is both a contract between the State and the corporation, and the corporation and its shareholders" and that "[t]he charter is also a contract among

Accordingly, certificates of incorporation are “interpreted using standard rules of contract interpretation which require a court to determine from the language of the contract the intent of the parties If no ambiguity is present, the court must give effect to the clear language of the Certificate.”¹²⁷

Benihana disputes BOT’s contention that the BFC Transaction is invalid. Benihana contends that the language in its Certificate of Incorporation regarding preemptive rights should not be interpreted as prohibiting Benihana from granting preemptive rights by contract when issuing preferred stock. They base this argument on the ambiguity they claim surrounds the intended purpose of the language in 8 *Del. C.* § 102(b)(3) and the parallel language in the Certificate of Incorporation. In that regard, Benihana relies on the 1967 and 1969 amendments to § 102. Before the 1967 amendments, § 102(b)(3) provided that a certificate of incorporation may contain provisions “limiting or denying to the stockholders the preemptive rights to subscribe to any or all additional issues of stock of the corporation.”¹²⁸ As a result, a common law rule developed that shareholders possess preemptive rights unless the certificate of incorporation provides otherwise. In 1967, the Delaware Legislature reversed this presumption. Section 102(b)(3) was amended to provide in pertinent part: “No

the shareholders themselves”); *Waggoner v. Laster*, 581 A.2d 1127, 1134 (Del. 1990).

¹²⁷ *Smith v. Nu-W. Indus., Inc.*, 2000 WL 1641248, at *3–4 (Del. Ch. Oct. 25, 2000).

¹²⁸ David A. Drexler, Lewis S. Black, Jr. & A. Gilchrist Sparks, III, *Delaware Corporate Law and Practice*, § 6.02[3] (2002).

stockholder shall have any preemptive right to subscribe to an additional issue of stock or to any security convertible into such stock unless, and except to the extent that, such right is expressly granted to him in the certificate of incorporation."¹²⁹

Thereafter, companies began including boilerplate language in their charters to clarify that no shareholder possessed preemptive rights under common law.¹³⁰ Consistent with that practice Benihana's Certificate of Incorporation states that "[n]o stockholder shall have any preemptive right to subscribe to or purchase any issue of stock or other securities of the Corporation, or any treasury stock or other treasury securities."¹³¹ I conclude that this type of boilerplate language concerning preemptive rights applies only to common law preemptive rights and not to contractually granted preemptive rights.¹³² Such a conclusion is reinforced by the fundamental principle that parties should have the freedom to contract and that their contracts should not easily be invalidated.¹³³

¹²⁹ 8 *Del. C.* § 102(b)(3).

¹³⁰ See Balotti at Form 1.12 ("The holders of the Common Stock shall have no preemptive rights to subscribe for any shares of any class of stock of the Corporation whether now or hereafter authorized.").

¹³¹ JX 95, Art. 4.

¹³² See Andrew Nichols, *Shareholder Preemptive Rights*, 39-DEC BBJ 4, 24 (1995) ("[A] preemptive right may be viewed as a term of art which refers only to a right granted to all the shareholders, but does not include contractual rights granted to a subset of the shareholders who negotiate with the issuer for their individual right to acquire additional shares in defined circumstances. Second, the intent of the legislature in adopting provisions limiting or reversing the common law rule creating preemptive rights may have been only to reach the imposition of such rights as a matter of common law, but not to preclude individually negotiated contractual rights.").

¹³³ *Id.* at 27.

The blank check provision in Benihana's Certificate of Incorporation suggests that the certificate was never intended to limit Benihana's ability to issue preemptive rights by contract to purchasers of preferred stock. Therefore, I do not read Article 4 of the charter as doing anything more than confirming that the common law presumption does not apply and that the Certificate of Incorporation itself does not grant any preemptive rights. The broad authorization to the Board to issue preferred stock and the Board's approval of the BFC Transaction and subsequent filing of an appropriate Certificate of Designations presents a different situation. Hence, I conclude that the Board did have the authority to issue the preferred stock with preemptive rights that is the subject of the BFC Transaction under Benihana's Certificate of Incorporation and the applicable provisions of the DGCL.¹³⁴

B. The Applicable Standard of Review for the BFC Transaction

Before addressing the alleged breaches of fiduciary duties, the Court must determine whether it should judge the BFC Transaction under an entire fairness standard or the business judgment rule. There is no dispute that the BFC Transaction is an interested transaction; at a minimum, Abdo, a director of Benihana, had an interest in it as

¹³⁴ In that regard, I note that the preemptive rights apply only to the Preferred Stock and the owner of the Preferred Stock. If, for example, BFC converted certain of the Preferred Stock and sold one half of the resulting common shares, there would be no preemptive rights with respect to those shares. BFC would continue to have preemptive rights, however, in the converted shares and the preferred shares it still retained. Additionally, the preemptive rights provided for in the SPA (¶ 4(k)) do not apply to any stock issuance after the Termination Date, defined as "the date on which the Purchaser ("BFC") and its Affiliates cease to own at least 25% of the total number of Preferred Shares [under the SPA] outstanding." SPA, ¶ 4(k)(ii).

a director of BFC. Benihana argues, however, that the BFC Transaction qualifies for one of the “safe harbor” provisions of 8 *Del. C.* § 144(a) because a majority of informed and disinterested directors of the Board voted in favor of the Transaction. Defendants have the burden to demonstrate that one of the safe harbors of § 144 applies.¹³⁵ If this Court determines that Defendants have not satisfied § 144, entire fairness review applies.¹³⁶ If the Court determines that Defendants have satisfied § 144, then the transaction is protected against being invalidated solely because it is an interested one and the burden shifts to BOT to demonstrate that the transaction was unfair.¹³⁷ Further, if the requirements of § 144(a)(1) have been met, Abdo’s “interest” in the Transaction would not vitiate the presumptions of the business judgment rule.¹³⁸

¹³⁵ *Cooke v. Oolie*, 2000 WL 710199, at *13 n.41 (Del. Ch. May 24, 2000).

¹³⁶ *HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 114 (Del. Ch. 1999).

¹³⁷ *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1169–71 (Del. 1995); *In re Cox Commc’ns, Inc. S’holder Litig.*, 879 A.2d 604, 614–15 (Del. Ch. 2005).

¹³⁸ When a court reviews a board’s decision that is challenged as a breach of duty, “it should decline to evaluate the wisdom and merits of a business decision unless sufficient facts are alleged with particularity, or the record otherwise demonstrates, that the decision was not the product of an informed, disinterested, and independent board.” *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1279 (Del. 1988); *see also Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984); *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). It is only after the presumption of the business judgment rule is rebutted that the burden shifts and the fiduciary must “demonstrate that the transaction complained of was entirely fair to the stockholders.” *Williams v. Geier*, 672 A.2d 1376, 1378 (Del. 1984).

1. The Applicability of Section 144(a)(1)

Under 8 *Del. C.* § 144(a)(1):

No contract or transaction between . . . a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction, or solely because any such director's or officer's votes are counted for such purpose, if:

(1) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum.

As discussed below, six of the nine Benihana directors, Pine, Sturges, Sano, Becker, Schwartz and Yoshimoto, voted to ratify the BFC Transaction (the "Voting Directors"). Abdo excused himself from the meeting during both the discussion and vote on the Transaction, while Dornbush and Kevin Aoki abstained from the vote only. BOT contends that § 144(a)(1) does not apply here, because the Voting Directors were neither informed of the material facts regarding Abdo's interest in the BFC Transaction nor disinterested.

To determine whether the prerequisites of §144(a)(1) are met, the Court must examine the interestedness of each of the Voting Directors, as well as the information available to them. Even if the requirements of § 144(a)(1) were not met, Defendants still could avoid having the interested BFC Transaction rendered void or voidable by proving

that it was “fair as to the corporation” under § 144(a)(3). Defendants, however, seek to invoke not only the benefits of the safe harbor of § 144(a)(1), but also the presumptions of the business judgment rule.

In general, the business judgment rule is a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”¹³⁹ In *Brehm v. Eisner*, the Delaware Supreme Court identified several circumstances in which the business judgment rule would not apply.

Thus, directors’ decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.¹⁴⁰

With that in mind, this Court ultimately must determine the applicability of both § 144(a)(1), which speaks in terms of “disinterested directors,” and the business judgment rule, which depends on the disinterestness and independence of the directors.

¹³⁹ *Aronson*, 473 A.2d at 812.

¹⁴⁰ 746 A.2d 244, 264 n.66 (Del. 2000). *See also In re Walt Disney Co. Deriv. Litig.*, 2005 WL 2056651, at *36 n.464 (Del. Ch. Aug. 9, 2005). The Delaware Supreme Court defines “disinterested directors as those directors that neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.” *Williams*, 671 A.2d at 1377 n.19 (internal citations omitted). Likewise, “independent means that a director’s decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences.” *Id.* (internal citations omitted).

To avoid unnecessary duplication in reviewing the circumstances of the individual directors, the analysis that follows addresses the allegations of interest and lack of independence as to each Voting Director. Regarding independence, the party alleging domination and control of a company's board of directors bears the burden of proving such control by showing a lack of independence on the part of the directors.¹⁴¹ In assessing director independence, the court must apply a subjective "actual person" standard, instead of an objective "reasonable director" standard.¹⁴² An independent director is one whose decision "is based on the corporate merits of the subject before the board rather than extraneous considerations or influence,"¹⁴³ while a director who is not independent is "dominated or otherwise controlled by an individual or entity interested in the transaction."¹⁴⁴ Control over individual directors is established by facts demonstrating that "through personal or other relationships the directors are beholden to the controlling person"¹⁴⁵ or so under "their influence that their discretion would be sterilized."¹⁴⁶

¹⁴¹ *Odyssey Partners, L.P. v. Fleming Co.*, 735 A.2d 386, 407 (Del. Ch. 1999).

¹⁴² *Orman v. Cullman*, 794 A.2d 5, 24 (Del. Ch. 2002).

¹⁴³ *Aronson*, 473 A.2d at 816.

¹⁴⁴ *In re Maxxam, Inc.*, 659 A.2d 760, 773 (Del. Ch. 1995).

¹⁴⁵ *Aronson*, 473 A.2d at 815.

¹⁴⁶ *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993).

BOT advances several grounds for its argument that the directors were interested in or lacked independence with respect to the BFC transaction. I address those grounds below.

2. Were the Voting Directors disinterested and independent?

a. Pine, Sano and Sturges

Plaintiff argues that Pine, Sano and Sturges were interested because the BFC Transaction removed a threat to their incumbency.¹⁴⁷ Defendants respond by arguing that even after the BFC Transaction BOT had sufficient voting power to remove directors. In particular, a successful proxy fight by BOT caused Sano to lose his Board seat in the 2004 election. Further, Defendants contend that neither Pine nor Sturges “needs” or “depends on” his Benihana directorship.¹⁴⁸

Entrenchment, self-dealing, or financial interest can indicate that a director is interested or lacks independence.¹⁴⁹ There is no evidence that Pine, Sano or Sturges has any financial interest in the BFC Transaction, only BOT’s allegations of an entrenchment motive. BOT, however, must prove that the directors believed they were vulnerable to

¹⁴⁷ In their brief BOT makes similar assertions for the other directors, but they do not provide any further detail regarding how the BFC Transaction removes a threat to their incumbency in the context of their “director independence” or interest arguments. Instead, BOT discussed its incumbency arguments in the sections of its briefs challenging the propriety of the directors’ purpose. Accordingly I treat that aspect of BOT’s argument in the “improper purpose” section of this opinion.

¹⁴⁸ Defs.’ Post-trial Ans. Br. at 13.

¹⁴⁹ *Grobow v. Perot*, 539 A.2d 180, 188 (Del. 1988).

being removed from office, and that they took entrenchment action.¹⁵⁰ “In most circumstances Delaware law routinely rejects the notion that a director’s interest in maintaining his office, by itself, is a debilitating factor.”¹⁵¹ Further, the fact that directors receive fees for their services does not establish an entrenchment motive on their part.¹⁵²

Plaintiff has failed to prove that Pine, Sano or Sturges depends financially on his Benihana directorship. Pine is a lifelong restaurant executive and the former CEO of Restaurant Associates, Inc. Sturges is a lawyer, entrepreneur and gaming industry executive. Apart from a conclusory allegation about threats to their incumbency, BOT offered no evidence of specific facts relating to the financial or other benefits these individuals received for being Benihana Directors. Thus, I find that BOT has failed to show that Pine, Sano or Sturges were either interested in the BFC Transaction or lacked independence from anyone else who was.

b. Schwartz and Yoshimoto

BOT argues that Schwartz and Yoshimoto, as directors and officers of Benihana, were interested in the BFC transaction because it removed a threat to their incumbency. As discussed later in connection with Plaintiff’s contention that the directors acted for an improper entrenchment purpose, I find that BOT has not proven that allegation. Thus, for the reasons explained *infra*, Plaintiff’s allegations of entrenchment do not provide an

¹⁵⁰ *Grobow v. Perot*, 526 A.2d 914, 923 (Del. Ch. 1987).

¹⁵¹ *Soloman v. Armstrong*, 747 A.2d 1098, 1126–27 (Del. Ch. 1999).

¹⁵² *Kahn v. MSB Bancorp, Inc.*, 1998 WL 409355, at *3 (Del. Ch. July 16, 1998).

adequate basis for concluding that either Schwartz or Yoshimoto was interested in the BFC Transaction.

Plaintiff also contends that Schwartz and Yoshimoto lacked independence because they were dependent on Abdo for their compensation. Particularly, Abdo served as chairman of both Benihana's compensation committee and nominating committee and as a member of the executive committee.¹⁵³ Defendants deny that Schwartz and Yoshimoto were beholden to Abdo, contending that Abdo lacked unilateral power to affect their positions. Defendants also argue that the cases cited by BOT do not apply because they relate to Rule 23.1 and not 8 *Del C.* § 144(a)(1).¹⁵⁴

In *Rales*, the court analyzed the independence issue on a motion to dismiss.¹⁵⁵ In that case the interested directors were brothers who held a 44% controlling interest in the company.¹⁵⁶ One employee director received approximately \$1 million per year from the company and the other received \$300,000 per year from another company in which the brothers served as vice presidents and owned a majority of the stock.¹⁵⁷ The court found

¹⁵³ Schwartz Dep. at 89; Abdo Dep. at 14.

¹⁵⁴ Defendants' attempt to distinguish the cases cited by BOT because they deal with independence in the context of demand excusal lacks merit. In *Aronson*, which defined the test for demand excusal under Chancery Court Rule 23.1, the court cited 8 *Del C.* § 144(a)(1) as the proper standard for determining director independence under Rule 23.1. 473 A.2d 805. Moreover, Defendants have not cited any case that supports their position that the test for independence under § 144(a)(1) differs from that under Rule 23.1.

¹⁵⁵ 634 A.2d 927.

¹⁵⁶ *Id.* at 930.

¹⁵⁷ *Id.* at 937.

that the interested directors' position as chairman of the company's executive committee placed them in a position to exert considerable influence over the other directors who were employees of the company. Therefore, the court concluded that reasonable doubt existed as to whether the employee directors could consider impartially an action that was contrary to the interest of the interested directors. The situation here is quite different.

Unlike *Rales*, this case involves a post-trial assessment of independence. The Court has the benefit of a full record, including the opportunity to consider Schwartz's trial testimony and review Yoshimoto's deposition. In addition, both Schwartz and Yoshimoto had multi-year employment contracts that established their base salaries and prohibited their termination except for cause.¹⁵⁸ Furthermore, Abdo did not have unilateral power to determine the employee directors' bonuses and other compensation. Instead, he chaired a three member committee charged with that responsibility.

This Court will not find a director beholden unless the purported controlling person has "unilateral" power to substantially affect the director.¹⁵⁹ Plaintiffs concede that there is no evidence that Abdo ever threatened to use his power as chairman of the

¹⁵⁸ See Benihana, Inc. Form 10-K/A, filed Sept. 4, 2001 for fiscal year ending Apr. 1, 2001, at Ex. 10.07, § 8 (Schwartz) and Ex. 10.12, § 8 (Yoshimoto), <http://www.sec.gov/Archives/edgar/data/935226/000093522601500010/form10-k2001.txt>. According to Benihana's 10K for the fiscal year ended March 28, 2004, Schwartz's salary ranged from \$317,308 to \$339,195 and his bonuses from \$57,334 to \$114,000 between 2002 and 2004. During the same period, Yoshimoto's salary increased from \$174,519 to \$186,135 and his bonuses ranged from \$61,000 to \$39,334. JX 97 at BNH000561.

¹⁵⁹ *Texlon Corp. v. Meyerson*, 802 A.2d 257, 264 (Del. 2002).

committee to affect the officers' compensation adversely.¹⁶⁰ Thus, based on the evidence presented at trial I find that Schwartz and Yoshimoto were independent.

Even if I concluded that Schwartz and Yoshimoto were "interested" based on concerns about incumbency (which I have not) or lacked independence, their conflicts would not vitiate the approval of the BFC Transaction by the disinterested and independent majority.¹⁶¹ Because a majority of the disinterested and independent directors approved the BFC Transaction, the interested nature of that transaction does not render it either void or voidable solely for that reason, provided the material facts as to Abdo's and any other director's or officer's interest were disclosed or known to the Benihana Board.¹⁶²

c. **Becker**

BOT contends that Becker was not independent because he and Abdo serve as outside directors of Bluegreen Corporation, a subsidiary of BFC.¹⁶³ BOT further

¹⁶⁰ Pl.'s Post-trial Reply Br. at 13 n.16; see *In re Delta & Pine Land Co. S'holders Litig.*, 2000 WL 875421, at *8 (Del. Ch. June 21, 2000) (dismissing claim because complaint lacked allegations that chairman of compensation committee exercised financial influence or control over employee directors).

¹⁶¹ *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1168 (Del. 1995).

¹⁶² 8 *Del. C.* § 144(a)(1).

¹⁶³ Pl.'s Opening Post-trial Br. at 33.

emphasizes that Abdo invited Becker to join the Bluegreen board,¹⁶⁴ for which Becker receives \$44,000 per year as compensation.¹⁶⁵

Defendants argue that none of these facts is out of the ordinary or demonstrates that Becker's directorship at Bluegreen was of such importance to him, financially or otherwise, that it clouded his judgment with respect to the BFC Transaction.¹⁶⁶ Defendants further contend that the cases cited by BOT are not apposite, because they are pretrial decisions, and therefore do not support a conclusion that BOT met its burden at trial in challenging Becker's independence from Abdo.¹⁶⁷

I agree. Becker's appointment to the Bluegreen board did not involve extraordinary circumstances; people normally get appointed to boards through personal contacts. Further, BOT has not proven that Becker's Bluegreen appointment combined with his modest compensation clouded his judgment with respect to the BFC Transaction.

This Court has held that a finding for purposes of a motion to dismiss that reasonable doubt exists as to a director's independence or disinterest has "very limited significance."¹⁶⁸ Such a determination only enables a plaintiff to proceed to discovery and potentially to trial, where the plaintiff must prove by a preponderance of the evidence

¹⁶⁴ Becker Dep. at 11.

¹⁶⁵ *Id.* at 9, 11–14.

¹⁶⁶ Defs.' Post-trial Ans. Br. at 15.

¹⁶⁷ *Id.* at 14–15.

¹⁶⁸ *Siegman v. Tri-Star Pictures, Inc.*, 1989 WL 48746, at *12 (Del. Ch. May 5, 1989).

that the director in fact lacked independence or was interested.¹⁶⁹ Thus, I do not find persuasive the pre-trial decisions cited by BOT.

Turning to the post-trial decisions cited, BOT asserts that the reasoning in *Kahn v. Tremont Corp.* controls this decision.¹⁷⁰ According to BOT, Becker, like the directors in *Kahn*, lacks independence because he “had previous affiliations with [Abdo, the interested party] or companies that he controlled and, as a result received significant financial compensation or influential positions on the boards” of companies Abdo controlled.¹⁷¹

Plaintiff’s reliance on *Kahn* is misplaced. First, the board member in *Kahn* received more than ten times the compensation Becker receives for his position on the Bluegreen board.¹⁷² Second, unlike this case, three of the directors in *Kahn* failed to attend the informational meetings concerning the transaction; yet, they promptly ratified suggestions of the director to whom the court held they were beholden.¹⁷³ Consequently, the factual showing in *Kahn* was much stronger than the evidence BOT presented here.

¹⁶⁹ *Aronson*, 473 A.2d at 812.

¹⁷⁰ Pl.’s Post-trial Reply Br. at 13 (citing *Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997)).

¹⁷¹ *Id.* (citing *Kahn*, 694 A.2d at 429–30).

¹⁷² Becker received \$44,000 per year for serving on the Bluegreen board whereas the director in *Kahn* received \$10,000 a month as a consultant to the company and over \$325,000 in bonuses. *Kahn*, 694 A.2d at 429–30.

¹⁷³ *Id.*

Thus, the holding in *Kahn* does not support a post-trial finding that Becker was not independent or that he was interested in the BFC Transaction.

The facts in *In re Maxxam, Inc.*, another post-trial decision cited by Plaintiff, also are far more egregious than this case.¹⁷⁴ In *In re Maxxam*, the court identified three board members who lacked independence. The financial compensation those directors received greatly exceeded Becker's compensation as a Bluegreen director.¹⁷⁵ Becker's relatively small compensation of \$44,000 did not make him beholden to Abdo. Thus, Plaintiff failed to meet their burden at trial in demonstrating that Becker's position on the Bluegreen board made him beholden to Abdo.

Next BOT asserts that Becker lacked independence from Schwartz because he had been Schwartz's close friend for 40-45 years and the two met every ten to fourteen days.¹⁷⁶ This relationship does not destroy Becker's independence, however.

¹⁷⁴ 659 A.2d at 774.

¹⁷⁵ *Id.* The court discussed the three board members' financial dependence as follows: "(1) In 1988 a MAXXAM subsidiary retained former Governor John Connally (who had recently emerged from personal bankruptcy and was not financially independent) as a consultant. Under the terms of his consulting contract, Governor Connally was paid \$250,000 per year, and the contract was renewed annually until Governor Connally's death in 1993. ... (2) John Seidl had been Chairman and CEO of ... another ... controlled entity, since 1989. In that capacity, Mr. Seidl received an annual salary of \$450,000, and in the year of the Mirada transaction, he received additional compensation of over \$4.8 million through a Kaiser incentive plan. ... (3) William Leone was President of MAXXAM from 1980 to 1990. In his last year as MAXXAM's President, Leone received over \$900,000 in compensation from that company. After the end of his term he entered into a one year \$250,000 consulting contract with a MAXXAM subsidiary. That contract was operative at the time of the ... transaction." *Id.*

¹⁷⁶ Pl.'s Opening Post-trial Br. at 33.

“[A]llegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director’s independence.”¹⁷⁷ In this case, the evidence only shows that Becker had a longstanding friendship with Schwartz. This alone does not render Becker interested in the BFC Transaction or prove he lacked independence, especially where, as discussed elsewhere in this opinion, Schwartz was not interested in the Transaction and did not lack independence.

Plaintiff further contends that Becker’s hostility toward BOT precluded him from acting independently. Specifically, BOT relies on Becker’s deposition testimony that he wasn’t comfortable with BOT running a major part of the Company. Defendants accuse Plaintiff of mischaracterizing Becker’s deposition. They contend that the deposition refers to concerns about Rocky Aoki’s influence over the Company, not BOT’s.

Specifically, Becker had indicated that he didn’t know if he would have been in favor of an alternative that involved selling \$10,000,000 of the preferred stock to each of BFC and BOT. When asked why at his deposition, Becker explained:

Well, because of all the things that have happened with the trust, Benihana and Rocky being a convicted felon, I am not sure I would feel comfortable for the other shareholders of the company if we had a felon – not controlling but having severe influence over such a significant part of the company.¹⁷⁸

¹⁷⁷ *Beam v. Stewart*, 845 A.2d 1040, 1051–52 (Del. 2004); *In re Western Nat’l Corp. S’holders Litig.*, 2000 WL 710192, at *12 (Del. Ch. May 22, 2000) (rejecting inference that longtime friendships prevented the director from being independent).

¹⁷⁸ Becker Dep. at 127–28.

Rather than demonstrating that Becker was “hostile to BOT,” as Plaintiff claims, this testimony suggests that he simply was wary of Rocky Aoki’s involvement in Benihana. Moreover, even if Becker were hostile to BOT, that fact alone would not be sufficient, in my opinion, to demonstrate that Becker either was an interested director or lacked independence from Schwartz and Abdo for purposes of the BFC Transaction.

3. Material facts disclosed or known

BOT argues that the Voting Directors were uninformed because they were not aware: (a) that Abdo himself negotiated on behalf of BFC, (b) that significant changes to the term sheet were made as a consequence of the negotiations with BFC, or (c) of the correct net debt figures. According to BOT, the actions of Schwartz, Dornbush and Abdo constitute undisclosed self-dealing, deception and manipulation of the Board which require application of the entire fairness standard.

To be informed a board does not need to know every fact. Rather, the board is responsible for considering material facts that are reasonably available, not those that are immaterial or out of the board’s reasonable reach.¹⁷⁹ The term “material” in this context means “relevant and of a magnitude to be important to directors in carrying out their fiduciary duty of care in decisionmaking.”¹⁸⁰

¹⁷⁹ *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000).

¹⁸⁰ *Id.* at 260 n.49 (internal quotations omitted). In the different context of a disclosure to stockholders, “[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.” *Id.* (internal quotations omitted).

a. **Abdo's negotiation of the Transaction on behalf of BFC**

BOT argues that Abdo concealed his interest in the BFC Transaction too long.¹⁸¹ Specifically, they assert that Schwartz, Dornbush and Abdo were required to disclose Abdo's interests in the BFC Transaction before the January 29 and February 17 Board meetings.¹⁸² Plaintiff contends that Abdo had two different interests in the BFC Transaction that he failed to timely disclose to the Board: (1) that he previously discussed purchasing Benihana stock from the Aoki children; and (2) that he represented BFC in the negotiations. Defendants contend that Abdo fully and timely informed the Board about his interests in the BFC Transaction at the May 6 meeting.¹⁸³ They dismiss Abdo's discussions with the Aoki children as immaterial to the BFC Transaction and contend that the Board members knew that Abdo acted on behalf of BFC.

There are several problems with Plaintiff's argument that Abdo had a duty to disclose prior discussions with the Aoki children to the Benihana Board in connection with the January 29 and February 17 Board meetings. First, after hearing the testimony and considering the available evidence, I have found that Abdo did not approach Kevin Aoki at their September 2003 dinner meeting about the possibility of Abdo purchasing BOT's stock in Benihana.¹⁸⁴ Further, that allegation related only to Abdo's interest in the stock; there is no mention of a purchase on behalf of BFC. Second, there is no evidence

¹⁸¹ Pl.'s Post-trial Rely Br. at 4.

¹⁸² *Id.* at 5.

¹⁸³ Defs.' Post-trial Ans. Br. at 20.

¹⁸⁴ *See supra*, B.

of any other communication between Abdo and any of the Aoki children regarding a possible purchase of BOT shares until the March 2004 lunch meeting he had with Kevin. In addition, the evidence indicates that Abdo did not approach his partner at BFC, Levan, about having BFC purchase \$20 million worth of Benihana convertible preferred stock until immediately after the February 17 Board meeting. Thus, I find that neither Abdo nor BFC had made a decision to attempt to purchase the convertible preferred shares at the time of the February 17 meeting. Therefore, Abdo did not breach any disclosure obligation to Benihana or his fellow directors in failing to disclose his or BFC's interest at the February 17 and earlier meetings.

The facts relating to Abdo's participation in the negotiations with Morgan Joseph are as follows. Two or three days after the February 17 meeting, and with Levan's approval, Abdo advised Joseph that BFC had an interest in purchasing the Benihana convertible preferred stock being offered to finance the Construction and Renovation Plan. Benihana welcomed Abdo's involvement. In early April 2004, Morgan Joseph sent its private placement memorandum to BFC and negotiations began between Joseph and Abdo. The negotiations continued through the end of April. By agreement, Benihana did not shop the issuance to anyone else during that period. Schwartz sent the negotiated term sheet to the Board on April 30, 2004, but did not indicate BFC was the purchaser. Schwartz informally identified BFC's role to Becker, Sturges, Sano and possibly Pine before the Board meeting on May 6, at which the directors reviewed the proposed transaction.

As a member of the Benihana Board Abdo had an “unremitting obligation” to deal candidly with his fellow directors.¹⁸⁵ This obligation requires directors to take affirmative steps to disclose any interest they may have in a transaction.¹⁸⁶ Absent special circumstances in which the board would have reason to expect earlier disclosure, however, a director has no duty to disclose his interest in a transaction until he seeks board approval of the transaction.¹⁸⁷

Here, the disinterested directors, at least, knew that Abdo acted on behalf of BFC before the May 6 meeting. Schwartz recalled having conversations with Becker, Sturges, Sano, and possibly Pine, before the May 6 meeting, informing them of Abdo’s involvement.¹⁸⁸ Further, Abdo made a presentation to the Board on behalf of BFC at the May 6 meeting. Thus, the directors knew that Abdo represented BFC. Also, Morgan Joseph, not Abdo, negotiated the terms on behalf of Benihana.

BOT suggests that Abdo’s participation in the negotiations was unfair, because he attended the meetings at which Benihana’s Board determined the parameters of their

¹⁸⁵ *HMG/Courtland Props.*, 749 A.2d at 119.

¹⁸⁶ *Id.*

¹⁸⁷ *Cf., e.g., Metro Commc’n Corp. BVI v. Advanced Mobilecomm Tech., Inc.*, 854 A.2d 121, 153 (Del. Ch. 2004) (no fiduciary duty to make disclosures to stockholders except when requesting stockholder action); *Raskin v. Birmingham Steel Corp.*, 1990 WL 193326, at *5 (Del. Ch. Dec. 4, 1990) (“The state law duty of candor arises when the board elects to or has a duty to seek shareholder action. If the board does not seek shareholder action...it has, in my opinion, no distinctive state law duty to disclose material developments with respect to the company’s business.”).

¹⁸⁸ Schwartz Dep. at 89–90, 92, 93.

proposed stock offering. Plaintiff also argues that by failing to disclose Abdo's involvement in the negotiations, Schwartz and others tainted the process. The Board, however, did not vote for the final terms of the transaction at the February 17 meeting; instead, they approved a course of action and considered the terms for the Preferred Stock offering discussed at that meeting more akin to a "wish list."¹⁸⁹ Nor did BOT prove at trial that Abdo knew at the February 17 meeting that BFC would offer to purchase the Preferred Stock. Further, the Board had adequate time to consider the transaction after they knew that Abdo acted on behalf of BFC. For example, after the May 6 meeting and before the BFC Transaction was consummated, the Board met on May 20 and again on June 11, and voted to proceed with the transaction after considering BOT's objections and the purported alternatives suggested by BOT's counsel.¹⁹⁰ Benihana also obtained a fairness opinion from Morgan Joseph before they consummated the BFC Transaction.

BOT also insinuates that BFC obtained better terms in the Transaction than it would have otherwise, because Abdo negotiated the deal after having attended the January and February Board meetings. The evidence does not support that conclusion. As Joseph explained at trial, the negotiations involved give and take on a number of points, but Benihana "ended up where we wanted to be" in what Joseph "considered

¹⁸⁹ Schwartz Dep. at 274.

¹⁹⁰ These ratifications, as well as the October 27, 2004 ratification after consideration of the allegations in BOT's Amended Complaint, provide additional, independent grounds to conclude that the informational component of 8 *Del. C.* § 144(a)(1) was satisfied.

material aspects, the amount, the two takedowns, the dividend and conversion premium.”¹⁹¹

In addition, Abdo’s interest in acquiring Benihana stock was not material to the BFC Transaction. None of the directors testified that they might have voted differently on the BFC Transaction had they known of Abdo’s earlier indications of interest in buying Benihana stock. Abdo’s potential purchase for a million dollars of an option to acquire Benihana stock from the Aoki children is not analogous to a significant investment of over \$20 million by BFC. I therefore find unpersuasive BOT’s argument that Abdo should have told the Board about his discussions with the Aoki children in September 2003. First, as previously found, the Aoki children initiated that contact with Abdo. Hence, Abdo was not actively seeking to purchase Benihana stock. Second, the Aoki children did not communicate with Abdo again until March 2004. Consequently, BOT failed to prove that Abdo’s discussions with the Aoki children ever reached a point at which he would have been required to inform the Board about them.

b. “no significant changes to the term sheet”

Plaintiff asserts that Joseph deceived the Board as to the nature and extent of the negotiated changes Morgan Joseph and BFC made to the term sheet.¹⁹² They contend that Joseph misled the Board at the May 6 meeting when he told them that there had been

¹⁹¹ Tr. at 655.

¹⁹² Pl’s Opening Post-trial Br. at 5.

“no significant changes in the term sheet.”¹⁹³ Characterizing this statement as “an obvious deception,” BOT contends the following material changes were made to the term sheet:

(1) While the term sheet proposed by Morgan Joseph provided for perpetual preferred stock and gave BFC no right to force a redemption, Abdo requested and Joseph agreed to give BFC the right to force Benihana to redeem the full \$20 million at any time after ten years at BFC’s option; (2) While the term sheet proposed by Morgan Joseph had given Benihana the option of not issuing the second \$10 million tranche, Abdo requested and Joseph agreed to make that issuance mandatory; (3) While the term sheet proposed by Morgan Joseph did not provide the purchaser with preemptive rights to purchase a proportional amount of any new voting securities issued by Benihana, Abdo requested and Joseph agreed to give such rights to BFC; and (4) While the term sheet proposed by Morgan Joseph provided that the purchaser would have the right to appoint an additional director to the Benihana Board if Benihana missed 4 consecutive dividend payments, Abdo requested and Joseph agreed to give BFC the right to appoint the additional director if Benihana missed just 2 consecutive dividend payments.¹⁹⁴

Defendants deny that Joseph’s statement that there were “no significant changes” deceived the Board. They argue that Plaintiff has not produced any evidence that Joseph intended to deceive the Board or that the Board culpably ignored any material fact contained in the term sheet.¹⁹⁵

¹⁹³ *Id.* at 5 (citing Tr. at 95–96 (Schwartz), 996–97 (Pine)).

¹⁹⁴ *Id.* at 5–6 (internal record citations omitted).

¹⁹⁵ Defs.’ Post-trial Ans. Br. at 21–22.

The parties do not dispute that changes were made to the term sheet. In fact the Board expected that changes would be made to the January 29 term sheet.¹⁹⁶ Thus, my analysis centers on whether the Board did not know about any significant changes.

The Board knew of several changes in the term sheet. For example, the January 29 term sheet called for an interest rate of 6% plus or minus 0.5%, but the May 6 term sheet provided for a rate outside that range, 5%. The Board discussed this change at the May meeting.¹⁹⁷ Moreover, the directors took home the May board book that contained the May 6 term sheet, and therefore had an opportunity to review the term sheet.

Benihana's negotiator, Joseph, believed that although changes had been made to the term sheet, Benihana ended up where it wanted to be. Joseph described the changes that evolved through negotiation as follows:

We negotiated the approvals required for material corporate actions. I thought BFC was reasonable in their request. Those negotiations were not terribly intense. They made some suggestions. We asked to move a few of them around, and that was okay. On the board seats, we had some

¹⁹⁶ Tr. at 918–19 (Sturges) (“Q. By the way, the sheet that was in the January 29 book, did you consider that to be a developed term sheet, or what was your view of that document? A. There was, as I recall, a one–page outline in the January 29 book, which I considered to be a wish list, a financing that Morgan Joseph thought could be achieved. But I certainly expected, as had been my experience with investment bankers saying what the financing is going to look like, you know, and then the ultimate end product, there is very often, as a result of give and take and a negotiation, some changes. And Morgan Joseph went through kind of the evolution of the term sheet and where it now stood as a result of discussions with BFC.”).

¹⁹⁷ Tr. at 919–20 (Sturges).

discussions and got it down to one. So I ended up quite satisfied that we had a transaction that, in what I considered material aspects, the amount, the two takedowns, the dividend and conversion premium. This sort of hierarchy of importance and you can get hung up on all these points, but you got to remember what's most important. On the important points we ended up where we wanted to be.¹⁹⁸

I find this testimony credible and that Joseph honestly believed that the changes to the term sheet were not significant. Hence, I find that Joseph did not mislead the Board.

c. Correct net debt figures

Plaintiff contends that Joseph and Schwartz misled the Board at the February 17 Board meeting when they told them that Benihana expected to have \$37.3 million of net debt at the close of their fiscal year, on March 30, 2004.¹⁹⁹ In particular, Plaintiff asserts that Schwartz and Joseph knew they had presented incorrect net debt figures to the Board.²⁰⁰ According to Plaintiff, this deception caused the Board to decide not to rely solely upon the Wachovia Proposal to finance the renovation.²⁰¹ Defendants deny that Joseph and Schwartz intentionally deceived the Board at the February 17 meeting.²⁰²

¹⁹⁸ Tr. at 655; *see also* Tr. at 648–55.

¹⁹⁹ Pl.'s Opening Post-trial Br. at 7 (citing Tr. at 731 (Joseph), 67 (Schwartz)). At the close of the fiscal year Benihana actually reported net debt of \$19.3 million. Joseph Dep. at 21.

²⁰⁰ Pl.'s Opening Post-trial Br. at 7 (relying on Schwartz's testimony that "there was not much likelihood that Benihana's net debt would go above \$20 million by the end of the fiscal year" and that the board of directors "certainly knew that Benihana's net debt was not going to go above . . . \$28 million.")

²⁰¹ *Id.*

²⁰² Defs.' Post-trial Ans. Br. at 23.

Further they contend that even though the projections ultimately proved to be incorrect, this misstatement was immaterial because the Board received correct and accurate information at the May 6, 2004 Board meeting.²⁰³

At trial Joseph and Schwartz explained why the actual net debt figures differed from the projections. The disparity resulted in part from unforeseen delays in certain projects, caused by issues related to zoning, building inspections, and review by architectural boards.²⁰⁴ For example, the Philadelphia location was delayed due to problems complying with zoning ordinances.²⁰⁵ I find that Joseph and Schwartz did not intentionally misstate the net debt figures.²⁰⁶

Additionally, although the Board had the wrong net debt figures at the February 17 meeting, they did not make any irreversible decision based on that information. In fact, the Board met again on May 6 to consider debt financing. At the meeting, Joseph, acting on behalf of Morgan Joseph,

made the point, wanted to make the point that -- some capital expenditures had been delayed so that the debt balance end of '04 was less than we projected earlier. And there was some discussion about this page [which reflects the updated cash flow projections based on the base case] at the -- at the board meeting. And we pointed out that based on our conversation

²⁰³ *Id.*

²⁰⁴ Tr. at 754 (Joseph), 588 (Burris).

²⁰⁵ Tr. at 588 (Burris).

²⁰⁶ *See, e.g.*, Tr. at 588 (Burris) (“[T]hose kind of things you can’t predict with any degree of certainty whether the project is going to be completed or not. It’s certainly prudent that it — to complete these projects, to estimate these projects to be completed for the purpose of maintaining our financial security.”)

with management, we believed that these were temporary deferrals as opposed to fundamental long-term changes in capital needs.

Q. And did those changes result in any changes in your conclusions?

A. No, they did not.²⁰⁷

Finally, the alleged misstatement in net debt figures was immaterial to the decision to use equity financing. The Defendant Directors testified that the decision to finance the renovations of the majority of the Benihana restaurants with equity rather than debt resulted from a desire to avoid the debt to EBITDA covenant that Wachovia required.²⁰⁸ Benihana expected these renovation efforts to last at least five years.²⁰⁹ Some Directors feared that this covenant might restrict Benihana's access to necessary funds, thereby hindering the renovation plan if Benihana had a bad year.²¹⁰ Moreover, while the Board may have considered the net debt figures important in determining what kind of financing alternatives to pursue, those figures comprised only a small part of the overall package of information presented to the directors. Based on all the evidence, I find that the alleged misstatement in the net debt figures was unintentional and immaterial in view of the later correction.

²⁰⁷ Tr. at 657; *see also* Tr. at 754 (Morgan Joseph learned about the change in net debt figures "during our due diligence in preparing the private placement memorandum and then pointed it out quite extensively at the May 6th board meeting.").

²⁰⁸ *See, e.g.*, Tr. at 910–12 (Sturges), 967–68 (Pine).

²⁰⁹ Tr. at 658 (Joseph).

²¹⁰ Tr. at 910–12 (Sturges), 968–71 (Pine).

4. Conclusion (applicability of § 144)

While I find that the Benihana Board's approval of the BFC Transaction meets the requirements of 8 *Del. C.* § 144(a)(1), that section merely protects against invalidation of a transaction "solely" because it is an interested one.²¹¹ "Nothing in the statute sanctions unfairness to [the Company] or removes the transaction from judicial scrutiny."²¹² Defendants assert that if they meet the requirements of § 144(a)(1), the transaction is beyond the reach of entire fairness. That is not necessarily correct.

Satisfying the requirements of § 144 only means that the BFC Transaction is not void or voidable *solely* because of the conflict of interest.

While non-compliance with §§ 144(a)(1), (2)'s disclosure requirement by definition triggers fairness review rather than business judgment rule review, the satisfaction of §§ 144(a)(1) or (a)(2) alone does not always have the opposite effect of invoking business judgment rule review.... Rather, satisfaction of §§ 144(a)(1) or (a)(2) simply protects against invalidation of the transaction 'solely' because it is an interested one. As such, § 144 is best seen as establishing a floor for board conduct but not a ceiling.²¹³

Thus, equitable common law rules requiring the application of the entire fairness standard on grounds other than a director's interest still apply.²¹⁴

²¹¹ *HMG/Courtland Props.*, 749 A.2d at 114 n.24.

²¹² *Fliegler v. Lawrence*, 361 A.2d 218, 222 (Del. 1976).

²¹³ *HMG/Courtland Props.*, 749 A.2d at 114 n.24 (internal citations omitted).

²¹⁴ "[Section] 144 has been interpreted as dealing solely with the problem of per se invalidity The somewhat different question of when an interested transaction might give rise to a claim for breach of fiduciary duty — i.e., to a claim in equity — as left to the common law of corporations to answer. Mere compliance with § 144 did not necessarily suffice." *In re Cox Commc'ns*, 879 A.2d at 614–15.

Because BOT also contends that the Director Defendants breached their fiduciary duties of loyalty and care, my analysis does not end with the “safe harbor” provisions of § 144(a).

C. Improper Primary Purpose

Plaintiff contends that the Board approved the BFC Transaction for the improper purpose of entrenching the Board members in office.²¹⁵ Defendants argue that BOT has not met their burden on this issue because: (1) BOT has not shown that any of the directors subjectively had entrenchment as the sole or primary purpose of their actions; (2) the BFC Transaction had a *de minimis* entrenchment effect, if any, given Benihana’s preexisting corporate governance structure; and (3) a majority of the directors voting on the BFC Transaction did not have an entrenchment purpose and their assent to the transaction was not the result of fraud or manipulation by their fellow-directors.²¹⁶

Corporate fiduciaries may not utilize corporate machinery for the purpose of perpetuating themselves in office.²¹⁷ A plaintiff charging a primary purpose of entrenchment bears a heavy burden of proof at trial.²¹⁸

²¹⁵ Pl.’s Opening Post-trial Br. at 26. Plaintiff further contends that a by-product of the BFC Transaction is the dilution of BOT’s controlling interest from just over 50 percent to approximately 36 percent. *Id.* at 1. To the extent that some or all of the Defendant Directors had a primary purpose to dilute BOT’s stock ownership, that also could constitute an improper purpose. *Flight Options Int’l, Inc. v. Flight Options, LLC*, 2005 WL 2335353 (Del. Ch. July 11, 2005).

²¹⁶ Defs.’ Post-trial Ans. Br. at 27.

²¹⁷ *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439–40 (Del. 1971).

²¹⁸ *Nomad Acquisition Corp. v. Damon Corp.*, 1988 WL 383667, at *1 (Del. Ch. Sept. 20, 1988).

A successful claim of entrenchment requires plaintiffs to prove that the defendant directors engaged in action which had the effect of protecting their tenure and that the action was motivated *primarily or solely* for the purpose of achieving that effect.²¹⁹

Where a board's actions are shown to have been taken for the purpose of entrenchment, they may not be permitted to stand.²²⁰

The fact that a plan has an entrenchment effect, however, does not mean that the board's primary or sole purpose was entrenchment.²²¹ Conversely, where the objective sought in the issuance of stock is not merely the pursuit of a business purpose but also to retain control, a court will not accept the argument that the control effect of an agreement is merely incidental to its primary business objective.²²²

Plaintiff asserts that Dornbush and Schwartz pursued the BFC Transaction in order to entrench themselves in office. BOT further asserts that Dornbush and Schwartz subsequently misled the Board when they convinced them that debt financing did not represent the best mechanism to fund the renovation project. Additionally, Plaintiff contends that Dornbush and Schwartz felt threatened by Keiko Aoki because Dornbush testified that "if Keiko gained control," Schwartz would have to "weather the storm"

²¹⁹ *In re Fuqua Indus., Inc. S'holders Litig.*, 1997 WL 257460, at *10 (Del. Ch. May 13, 1997) (emphasis added).

²²⁰ *Schnell*, 285 A.2d at 439.

²²¹ *Williams*, 1994 WL 514871, at *3.

²²² *Condec Corp. v. Lunkenheimer Co.*, 230 A.2d 769, 776 (Del. Ch. 1967).

because she “presumably would be hostile to management.”²²³ Dornbush further testified that he “shared” a “concern” that, upon obtaining control of Benihana, Keiko Aoki, would “remove all of the people who were there for 20 years of service.”²²⁴ BOT also contends that, after the BFC Transaction, Schwartz persuaded Sano to switch directorships with him precisely “so that [he] [was]n’t at risk of being removed from the board of directors of Benihana if BOT could, together with other stockholders, win the election” at the 2004 annual meeting.²²⁵

Although, as Plaintiff points out, Keiko may be “hostile to management,” it still would take her several years to exert meaningful control over Benihana. Further, although Keiko’s potential hostility may have given the directors a reason to entrench themselves that does not mean *ipso facto* that the directors approved the BFC transaction primarily or solely for that purpose. The law requires more than just a motivation to entrench.²²⁶

Dornbush was a named partner of a law firm that is “general counsel to Benihana.”²²⁷ For fiscal year 2003, the law firm, where Dornbush’s son also was a partner, received fees from Benihana of more than \$1,000,000.²²⁸ Dornbush is 75,

²²³ Pl.’s Post-trial Reply Br. at 15 (citing Tr. at 1038 (Dornbush)).

²²⁴ Tr. at 1039.

²²⁵ Schwartz Dep. at 391.

²²⁶ See *In re Fuqua Indus., Inc.*, 1997 WL 257460, at *10.

²²⁷ Tr. at 1041 (Dornbush).

²²⁸ Dornbush Dep. at 15–16; Tr. at 1042 (Dornbush).

however, and no longer a profit sharing partner in his law firm. Dornbush separately received \$5,000 a month from Benihana for consulting services.²²⁹ Dornbush testified at trial and I found him to be a credible witness. Having considered Dornbush's testimony and that of several other witnesses and having reviewed the relevant documentary evidence, I find that Dornbush did not facilitate the BFC Transaction primarily or solely for the purpose of protecting his tenure or that of any other director.

Although Schwartz had no significant source of income other than the compensation he received from Benihana,²³⁰ he has an employment agreement with Benihana that prevents his termination as CEO, without cause, until 2009. Even after completion of the BFC Transaction, BOT is still the largest stockholder of Benihana. Moreover, although BFC generally invests for the long term and does not frequently change management, there is no evidence of any special relationship between BFC or Abdo on the one hand and Schwartz and Dornbush on the other. BFC presumably will expect good performance from Benihana and its managers. Hence, it is reasonable to infer that BFC would not hesitate to remove Schwartz from his positions if grounds for a termination for cause existed.

BOT also cites various actions Schwartz took in 2003 and 2004 that it contends support a finding that Schwartz acted for an improper entrenchment purpose. For example, Plaintiff suggests that Schwartz acted improperly when he switched

²²⁹ Tr. at 1042 (Dornbush).

²³⁰ Tr. at 6 (Schwartz).

directorships with Sano. By making that change, Schwartz had the Class A, instead of the Common, stockholders vote for his election.²³¹ This action shows that Schwartz recognized the threat BOT potentially posed to his directorship. The switch, however, effectively reduced BOT's ability to remove Schwartz from office, thus reducing his motivation to approve the BFC Transaction solely or primarily for entrenchment purposes.

Plaintiff also asserts that Dornbush's law firm and Schwartz looked into the possibility of issuing a large number of Class A shares, just to dilute the BOT shares.²³² They further assert that Dornbush even admitted that had the shares been issued for that reason, it would have been for a non-legitimate purpose.²³³

In my opinion, Plaintiff exaggerates the importance of this incident. Schwartz explained that Benihana constantly considered the effect of a stock issuance that would combine the Common and Class A shares.²³⁴ Before the BFC Transaction, the Common and Class A shares had unequal voting rights.²³⁵ The Class A shareholders exclusively elect 25% of the directors and have 1/10 vote per share; the Common Stock vote on the

²³¹ See Schwartz Dep. at 391.

²³² Pl.'s Post-trial Reply Br. at 16–17.

²³³ *Id.* at 16 (citing Tr. at 1054–55 (Dornbush)).

²³⁴ Tr. at 28 (Schwartz). He testified that “[w]e constantly asked that question, was there any way that the company considering, is the company discussing the common — the combination of the two shares, collapsing the [common and class A] shares so that it would become one vote, one share, and there would be more liquidity.” *Id.*

²³⁵ Tr. at 24.

remaining 75% of directors.²³⁶ Schwartz testified that the Common shareholders and the Class A shareholders constantly encouraged Benihana to consider combining the two share classes because it would increase the Company's liquidity.²³⁷ This was particularly important to Benihana because the constant complaint from Wall Street was that "there's no liquidity because of this situation."²³⁸ Therefore, Benihana had legitimate reasons for considering a stock issuance that might have the effect of diluting the BOT shares.

On August 28, 2003, Schwartz sent a fax to Dornbush discussing the effect on voting rights if Benihana continued to issue a dividend of 10 or 15% per year.²³⁹ Schwartz calculated that if Benihana issued a 10% dividend every year then by 2016 the amount of Common Stock outstanding would fall below the 12.5% threshold for triggering the Class A shares ability to participate with the Common Stock in the election of their 75% of the directors.²⁴⁰

Another hypothetical scenario Schwartz discussed with Dornbush around September 2003 was the feasibility of issuing over 16 million Class A shares and thereby causing the percentage of Common Stock to fall below 12.5% of the total.²⁴¹ Such a

²³⁶ *Id.*

²³⁷ Tr. at 29 (Schwartz).

²³⁸ *Id.*

²³⁹ JX 21.

²⁴⁰ *Id.* He also calculated that if Benihana issued a 15% dividend of Class A shares every year then by 2011 the outstanding Common stock would fall below the threshold. *Id.*

²⁴¹ *See supra*, at 7-8.

transaction would have diluted BOT's voting power to less than 30%. As previously mentioned, Dornbush indicated that such a transaction would not be feasible and would be for a nonlegitimate corporate business purpose.

I find that Schwartz's consideration of the latter scenario, even if only in passing, shows that he was concerned about BOT's control of Benihana in late 2003. Considering all the evidence, including the testimony of Schwartz and Dornbush, however, I find that Schwartz's concern did not infect his own or the Board's decisionmaking process in connection with the BFC Transaction. I likewise conclude that neither Dornbush nor a majority of the members of the Benihana Board had entrenchment or dilution of BOT as their sole or primary purpose in approving the BFC Transaction. Instead, I find that the directors who approved the BFC transaction did so on an informed basis, acting in good faith, and believing they were acting in the best interests of Benihana.

Plaintiff cites three cases in which the court found a motive to entrench because the Board could have addressed the asserted need by alternative nondilutive means and failed to give an adequate explanation as to why the directors chose a dilutive financing scheme. Defendants assert that each of these cases is distinguishable. I will address each in turn.

In *Canada Southern Oils v. Manabi Exploration Co.*, the board approved a dilutive issuance which caused the majority shareholder to lose control of the company.²⁴² The board claimed it needed to issue the shares to raise funds to solve their

²⁴² 96 A.2d 810 (Del. Ch. 1953).

financial crisis. The court, however, did not believe the company had a major financial crisis and had doubts as to whether the directors could justify the dilutive issuance without giving plaintiff the opportunity to purchase the shares.²⁴³

Further, the court found persuasive several facts not present in this case. First, the directors never offered the controlling shareholder the option to purchase the shares, choosing instead to blindly assume they would not help.²⁴⁴ In this case BOT had the opportunity to help fund the construction and Renovation Plan, but failed to make any proposal demonstrating that they had the necessary funds. Second, the notice for the directors' meeting made no reference to the possibility of selling shares of the company.²⁴⁵ In contrast, the Benihana directors met several times to discuss their funding options and knew each time they would discuss the funding issue. The court in *Canada Southern Oils* held that:

When the undisputed facts are viewed cumulatively I find it reasonabl[e] to infer that the primary purpose behind the sale of these shares was to deprive plaintiff of the majority voting control. Hagan and his associates did too much too soon with too little disclosure to justify a contrary conclusion.²⁴⁶

²⁴³ *Id.* at 813–14.

²⁴⁴ *Id.* at 813.

²⁴⁵ *Id.*

²⁴⁶ *Id.*

That is not the case here.²⁴⁷ The Benihana Board had valid reasons to use equity as opposed to debt financing. Everyone, including Kevin Aoki, agreed that the Company needed to proceed with its Construction and Renovation Plan. Benihana carefully considered the BFC Transaction and had Morgan Joseph explore the option of debt financing. Morgan Joseph concluded that debt financing was not the best option because they feared it might reduce the flexibility Benihana needed to take advantage of attractive acquisition opportunities that might present themselves.²⁴⁸ For example, the Wachovia financing offer contained a provision limiting the amount Benihana could borrow to 1.5 times EBITDA. This restriction, which spanned five years, could have substantially limited Benihana's ability to borrow funds.

Morgan Joseph also recommended that Benihana obtain equity financing first so that it could gain flexibility, and then use that financing as leverage to negotiate better terms on their existing line of credit with Wachovia.²⁴⁹ In Joseph's words, "[T]he oldest rule in our business is you raise equity when you can, not when you need it."²⁵⁰ Thus, unlike the situation in *Canada Southern Oils*, I find the Benihana Board had legitimate and substantial reasons for favoring the BFC Transaction over relying exclusively on debt financing.

²⁴⁷ Among other differences, *Canada Southern Oils* dealt with a preliminary injunction, which involves a different standard than a post-trial situation like this case.

²⁴⁸ Tr. at 631–32 (Joseph).

²⁴⁹ Tr. at 630–31.

²⁵⁰ Tr. at 631.

Plaintiff relies on *Packer v. Yampol* for the proposition that “[a]n inequitable purpose can be inferred where the directors’ conduct has the effect of being unnecessary under the circumstances, of thwarting shareholder opposition, and of perpetuating management in office.”²⁵¹ The situation in *Packer v. Yampol*, however, was far more egregious than here. In *Packer* the board approved the issuance of stock in the midst of a proxy fight. The issuance included “supervoting” features, conferring upon the holders 44% of the corporation’s total voting power. This allowed defendants to “virtually assur[e] the outcome of the election of directors.”²⁵²

As previously stated, Benihana had a legitimate need for financing that reasonably could be satisfied through equity financing. Secondly, Benihana did not issue the stock in the midst of a proxy contest; rather the stock issuance was conceived, presented and negotiated months before any contest, or even the threat of a contest. Finally, unlike *Packer*, the stock issuance did not “virtually assur[e] the outcome of the election of directors.” In fact, after the BFC Transaction, BOT won a proxy contest to remove one of the incumbent directors from his seat.²⁵³

²⁵¹ 1986 WL 4748, at *16 (Del. Ch. Apr. 18, 1986).

²⁵² *Id.* at *9.

²⁵³ The proxy contest occurred after BFC purchased the first tranche of Preferred Stock. In its brief, BOT argues that the margin by which it won was so small that it would have lost had the second tranche already occurred. Pl.’s Post-trial Reply Br. at 17 (citing JX 103; Atkins Dep. at 218–19). That argument relies on speculation, and BOT presented no other evidence that suggests that the BFC Transaction virtually assured the election of any directors. To the extent BOT’s complaint is that it might no longer control the election of certain directors, there is no evidence that anything in the Certificate of Incorporation, the bylaws, or a

*Condec Corp. v. Lunkenheimer Co.*²⁵⁴ is equally distinguishable. There the transaction at issue was a share exchange that brought in no new capital to the Company and had no corporate purpose other than to reduce plaintiff's stock holdings.²⁵⁵ The court also noted the "haste with which the basic . . . transaction was hammered out."²⁵⁶ Such extreme circumstances do not exist in this case.

Further, even if the Court were to have found, which I did not, that one or two of the Benihana directors acted for the sole or primary purpose of entrenchment, a majority comprised of other directors voted to approve the BFC Transaction and I have found that their assent to the transaction was not the result of fraud or manipulation by their fellow directors. An entrenchment effect alone, even assuming such an effect exists in this cause, is not enough to demonstrate a primary or sole purpose to entrench.

Therefore, Plaintiff has failed to meet their burden as to the claim of improper purpose. I find that the primary purpose of the BFC Transaction was to provide what the directors subjectively believed to be the best financing vehicle available for securing the necessary funds to pursue the agreed upon Construction and Renovation Plan for the Benihana restaurants.

separate contract gave BOT the right to control the Company or to be protected from dilution. *See Harrah's Entm't, Inc. v. JCC Holding Co.*, 802 A.2d 294, 314 (Del. Ch. 2002) (customary for agreements concerning board control to be cemented by voting agreements).

²⁵⁴ 230 A.2d 769 (Del. Ch. 1967).

²⁵⁵ *Id.*

²⁵⁶ *Id.*

D. Director Defendants' Alleged Breaches of the Duty of Loyalty

BOT contends that Schwartz, Dornbush and Abdo, with the help of Morgan Joseph, manipulated the board process that led to the approval of the BFC Transaction, thereby breaching their fiduciary duties. Further, Plaintiff asserts that each of the directors breached their duty of loyalty by approving the BFC Transaction in order to protect their own incumbency.²⁵⁷

The Delaware Supreme Court has described the duty of loyalty as follows:

Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. . . . A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest.²⁵⁸

No safe-harbor exists for divided loyalties in Delaware.²⁵⁹ The duty of loyalty, in essence, “mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder

²⁵⁷ Pl.’s Opening Post-trial Br. at 41.

²⁵⁸ *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); *In re Walt Disney Co.*, 2005 WL 2056651, at *33–34.

²⁵⁹ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983).

and not shared by the stockholders generally.”²⁶⁰ “The classic example that implicates the duty of loyalty is when a fiduciary either appears on both sides of a transaction or receives a personal benefit not shared by all shareholders.”²⁶¹

In my opinion, Schwartz, Dornbush and Abdo, did not manipulate the Board to approve the BFC Transaction, either individually or in concert with one another or Morgan Joseph. As discussed above, the directors did not act out of a motivation to entrench themselves or any other self-interest or as a result of domination or control by an interested director. In addition, because the Board is staggered, it would have taken Keiko Aoki two or three years after Rocky Aoki’s death to remove the directors from their positions, even if the BFC Transaction had not occurred.

Having already found that a majority of disinterested and independent directors approved the BFC Transaction and that the Transaction was not entered into for an improper purpose, I find no grounds to believe that the directors breached their fiduciary duty of loyalty. BOT has the burden of proving their contrary allegation by a preponderance of the evidence. They have not met their burden. Therefore, I conclude that none of the Director Defendants breached their fiduciary duty of loyalty.

E. Director Defendants’ alleged breaches of the duty of care

Plaintiff contends that the directors violated their fiduciary duty of care by failing to inform themselves of basic information about the BFC Transaction.²⁶² Defendants

²⁶⁰ *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

²⁶¹ *In re Walt Disney Co.*, 2005 WL 2056651, at *33–34 (internal quotations omitted).

argue that even if the directors failed properly to inform themselves, their conduct in this case does not rise to the level of gross negligence, and therefore cannot constitute a violation of the duty of care.²⁶³

The duty of care includes a duty that directors inform themselves, before making a business decision, of all material information reasonably available to them.²⁶⁴ The duty also includes a requirement that directors reasonably inform themselves of alternatives.²⁶⁵

Director liability for breaching the duty of care “is predicated upon concepts of gross negligence.”²⁶⁶ In the duty of care context gross negligence has been defined as “reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason.”²⁶⁷ Because duty of care violations are actionable only if the directors acted with gross negligence, and because in most instances money damages are unavailable to a plaintiff who theoretically could prove a duty of care violation, such violations are rarely found.²⁶⁸

²⁶² Pl.’s Opening Post-trial Br. at 41.

²⁶³ Defs.’ Post-trial Ans. Br. at 34–35.

²⁶⁴ *Aronson*, 473 A.2d at 812.

²⁶⁵ *UIS, Inc. v. Walbro Corp.*, 1987 WL 18108, at *2 (Del. Ch. Oct. 6, 1987).

²⁶⁶ *Aronson*, 473 A.2d at 812.

²⁶⁷ *Tomczak v. Morton Thiokol, Inc.*, 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990) (internal quotations omitted).

²⁶⁸ *In re Walt Disney*, 2005 WL 2056651, at *33.

The challenged directors' conduct in this case does not rise to the level of gross negligence. First, the directors were encouraged to take the February board books home and study them. These books outlined alternative methods of financing the BFC Transaction.²⁶⁹ Second, Morgan Joseph specifically discussed the change in net debt figures at the May 6 meeting and distributed the final term sheet with BFC to the directors.²⁷⁰ The Board also obtained a fairness opinion from Morgan Joseph.

Further, the Board met several times after the May 6 meeting to discuss the BFC Transaction. The Board met on May 20 and June 11, and voted to proceed with the transaction after considering BOT's objections and the purported alternatives suggested by BOT's counsel. Additionally, the disinterested and independent directors who voted in favor of the transaction constituted a majority of the Board. These facts demonstrate that the Board took adequate steps to review the BFC Transaction. Therefore, the directors did not breach their fiduciary duty of care.

F. Summary of the Court's Application of the Business Judgment Rule

In *In re RJR Nabisco, Inc. Shareholders Litigation*, the Court stated:

The business judgment form of review encompasses three elements: [1] a threshold review of the objective financial interests of the board whose decision is under attack (i.e., independence), [2] a review of the board's subjective motivation (i.e., good faith), and [3] an objective review of

²⁶⁹ Tr. at 633-40 (Joseph).

²⁷⁰ Tr. at 657.

the process by which it reached the decision under review (i.e., due care).²⁷¹

In this case, I have followed those steps and I have first concluded that a majority of the disinterested and independent directors approved the BFC Transaction. Then, I found that the directors acted with a good faith belief that equity financing represented the best method to finance Benihana's Construction and Renovation Plan and that the directors believed equity financing best served the interests of the Company. Finally, after reviewing the process through which the directors approved the Transaction I have found that the directors reached their decision with due care. Consequently, the Board validly exercised their business judgment in approving the BFC Transaction. This Court will not disturb that decision.

III. CONCLUSION

For the reasons stated in this Opinion, the Court concludes that the Benihana Board validly approved the BFC Transaction and denies all BOT's claims for relief, whether asserted individually or derivatively. In particular, the Court holds that the BFC Transaction was not void *ab initio* as *ultra vires* and that the Director Defendants did not breach any fiduciary duty to Benihana or its stockholders in connection with the BFC Transaction. Because Plaintiff has failed to establish liability on the part of any of the Director Defendants, I also dismiss Plaintiff's claims against BFC for aiding and abetting those Defendants.

²⁷¹ 1989 WL 7036, at *13 (Del. Ch. Jan. 31, 1989).

Defendants counsel shall prepare a proposed form of judgment and submit it, on notice, within 10 days.

IT IS SO ORDERED.

IN THE SUPREME COURT OF THE STATE OF DELAWARE

BENIHANA OF TOKYO, INC., individually
and on behalf of BENIHANA, INC.,

Plaintiff Below,
Appellant

v.

BENIHANA, INC., JOHN E. ABDO,
NORMAN BECKER, DARWIN
DORNBUSH, MAX PINE, YOSHIHIRO
SANO, JOEL SCHWARTZ, ROBERT B.
STURGES, TAKANORI YOSHIMOTO,
and BFC FINANCIAL CORPORATION

Defendants Below,
Appellees

No. 36, 2006

Court Below:
Court of Chancery
of the State of
Delaware in and for
New Castle County,
C.A. No. 550-N

*Original
Separate
Folder*

COMPENDIUM OF UNREPORTED OPINIONS IN SUPPORT OF
APPELLANT BENIHANA OF TOKYO, INC.'S OPENING BRIEF

OF COUNSEL:

Jonathan Rosenberg
Alexandra A. Lewis
O'Melveny & Myers LLP
7 Times Square
New York, NY 10036

C. Barr Flinn (#4092)
Elena C. Norman (#4780)
D. Fon Muttamara-Walker (#4646)
Young Conaway Stargatt
& Taylor, LLP

The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, DE 19899-0391
(302) 571-6600

Attorneys for Plaintiff Below,
Appellant Benihana of Tokyo, Inc.

Dated: March 9, 2006

IN THE SUPREME COURT OF THE STATE OF DELAWARE

BENIHANA OF TOKYO, INC., individually)
and on behalf of BENIHANA, INC.,)
)
Plaintiff Below,)
Appellant)
)
v.)
)
BENIHANA, INC., JOHN E. ABDO,)
NORMAN BECKER, DARWIN)
DORNBUSH, MAX PINE, YOSHIHIRO)
SANO, JOEL SCHWARTZ, ROBERT B.)
STURGES, TAKANORI YOSHIMOTO,)
and BFC FINANCIAL CORPORATION)
)
Defendants Below,)
Appellees)

*Original
Separate
folder*

No. 36, 2006
Court Below:
Court of Chancery
of the State of
Delaware in and for
New Castle County,
C.A. No. 550-N

APPENDIX TO APPELLANT BENIHANA OF TOKYO, INC.'S OPENING BRIEF

OF COUNSEL:

Jonathan Rosenberg
Alexandra A. Lewis
O'Melveny & Myers LLP
7 Times Square
New York, NY 10036

C. Barr Flinn (#4092)
Elena C. Norman (#4780)
D. Fon Muttamara-Walker (#4646)
Young Conaway Stargatt
& Taylor, LLP
The Brandywine Building
1000 West Street, 17th Floor
P.O. Box 391
Wilmington, DE 19899-0391
(302) 571-6600

Attorneys for Plaintiff Below,
Appellant Benihana of Tokyo, Inc.

Dated: March 9, 2006