
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

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
REPLY BRIEF**

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MAY 4, 2006

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ARGUMENT¹

I. ABDO'S UNDISCLOSED USE OF BI'S CONFIDENTIAL NEGOTIATING STRATEGY PRECLUDES BUSINESS JUDGMENT RULE REVIEW

Appellees do not dispute that Abdo attended the February 17, 2004 Board meeting during which BI's negotiator and the Board discussed the deal terms on which BI "anticipated having to make concessions" (Op. 18), and that Abdo thereafter negotiated the Transaction on BFC's behalf. Nor do they dispute that Abdo obtained for BFC terms that Joseph told the Board on February 17 he would resist surrendering, but would concede if necessary. Yet, Appellees still maintain that the business judgment rule should apply to this infected process. At various points, they mischaracterize, and even argue with, the Court of Chancery decision they seek to uphold. At other points, they mischaracterize the evidentiary record. And woven throughout their briefs are misstatements of the legal standard under Section 144 and Delaware fiduciary duty law.²

A. The Board Discussed Confidential Negotiating Strategy with its Financial Advisor at the February 17, 2004 Meeting

Abdo argues that the BI negotiating positions he learned during the February 17 Board meeting were not confidential. Abdo Br. 9, 23, 31, 34. The record overwhelmingly shows that they were, and nothing in the Opinion is to the contrary. For starters, BI's counsel elicited from Kevin Aoki that Abdo lectured him in late 2003 that *all* BI Board discussions are confidential:

¹ This Reply Brief uses the terms defined in Appellant Benihana of Tokyo, Inc.'s Opening Brief, dated March 9, 2006 (the "Opening Brief" or "OB"). The Answering Brief of Appellees BFC Financial and John E. Abdo, dated April 13, 2006, is cited as "Abdo Br.," and the Answering Brief of Appellees Benihana, Inc., Norman Becker, Darwin Dornbush, Max Pine, Yoshihiro Sano, Joel Schwartz, Robert B. Sturges and Takanori Yoshimoto, dated April 13, 2006, is cited as "BI Br."

² Due to space constraints, we cannot address every mischaracterization in Appellees' answering briefs. For example, Appellees argue that BOT now concedes that every BI director who approved the Transaction was independent. That is not the case. BOT has waived objection to the Court of Chancery's finding that a majority of the approving directors were independent, but that by no means constitutes a concession that every approving director was independent. Moreover, BOT has argued, and thus has not waived, that the approving directors were not independent when they "ratified" the Transaction in late October 2004. OB 17.

Q. And what was that discussion?

A. *Jack [Abdo] had said to me that as a director of this company you need to keep information that you hear from the board meeting privileged and confidential. And he specifically said to your father and to -- of course, to others. But he was specifically talking about my relationship with my father.*

* * *

Q. Okay. And the nominating committee members including Mr. Abdo were -- just wanted the reassurance that you were keeping that information confidential, correct?

A. He said that he would take it at face value, and then he reminded me that if something were to happen he would take action against it immediately.

C007.1-7.3 at 119-20 (emphasis added).

BI considered the January and February 2004 Board meetings with BI's financial advisor particularly sensitive. The anticipated Convertible Preferred offering terms that Joseph discussed with the Board at those meetings bears the legend "Confidential." A313. The same is true for the entire Board Book, which contained nonpublic projections, analyses of competitive strategies and financing alternatives, valuations, and other nonpublic BI information. A267-350. And when Schwartz sent the negotiated term sheet to the Board on April 30, 2004, his cover memo bore the bold legend: "STRICTLY CONFIDENTIAL." A430.

Despite this compelling record, Abdo maintains that he was not constrained to keep confidential the Board's February 17 strategy session. He dismisses Joseph's discussion that day as merely mouthing "market truisms." Abdo Br. 31. After reading Abdo's Brief, one might wonder why BI paid Joseph anything—let alone a hefty advisory fee—for rendering the "common sense" advice that everyone already knew (Abdo Br. at 28), and why the Board even bothered instructing Joseph to negotiate. If issuing convertible preferred were only a matter of filling out a form based on universally known "market truisms," there would be no need to negotiate such instruments. But as Joseph told the Board, and Appellees do not dispute, convertible preferred offerings "are heavily-negotiated." A481. Consistent with *that* "market truism," the Board expected the Transaction's terms to be negotiated with the buyer. Op. 18-19. Negotiation, by definition, entails formulating strategy, including establishing

objectives, planning tactics, assessing leverage and bargaining chips, and considering worst and best cases.³ That is what the Board discussed on February 17. As the court found, for example, Joseph and the Board discussed “areas in which they anticipated having to make concessions,” and items on which they anticipated “a battle.” Op. 18. By necessity, any discussion of a term that Joseph would seek but would “give it away, if I had to” (A91 at 648) was confidential.⁴

Abdo even mischaracterizes his own testimony in arguing that he “learned no ‘inside information’ that was of value to him in negotiating with Benihana.” Abdo Br. 9. Abdo’s counsel asked “did you, Mr. Abdo, learn any inside information that was of value to you in negotiating with Benihana once you decided to negotiate?” A118 at 796-97. But Abdo sidestepped the issue by modifying his lawyer’s leading question:

A. From the standpoint of understanding this type of transaction that we did?

Q. Yes.

Id. Although Abdo may have understood “this type of transaction” before February 17, he did not know *Joseph’s and the Board’s views* regarding the terms that were most important to BI, and those that BI would seek but surrender should the investor resist. Thus, while Abdo proclaimed that he “received 10, 12 [proposed equity offerings] per month” (A118 at 798), in no other context did he know the issuer’s private perspective on how it would negotiate each deal term.

B. Abdo’s Negotiating Role, and the Improvements He Negotiated for BFC, Constituted Material Information

BOT has demonstrated that Abdo’s use of BI’s confidential negotiating strategy to benefit BFC was material to the Board’s approval decision. OB 14-19. Appellees respond by criticizing BOT for comparing the terms in the PPM term sheet to the final Transaction terms. BI Br. 7-8. They argue that this Court should use as a point of comparison not the April PPM term sheet, but the January/February “anticipated term sheet.” Appellees are wrong because the starting point for Joseph’s negotiation with Abdo was the PPM term sheet.

The chronology is straightforward. On January 29, Joseph presented the

³ See, e.g., *In re Formica Corp. S’holder Litig.*, 1989 WL 25812, *7 (Del. Ch. March 22, 1989) (describing special committee’s strategizing and negotiation-planning process in buy-out negotiations with management team).

⁴ See, e.g., *Gioia v. Texas Air Corp.*, 1988 WL 18224, *3 (Del. Ch. Mar. 3, 1988) (protecting defendant’s alternatives-planning information from risk of disclosure to its negotiation adversary).

Board with the anticipated terms for the Convertible Preferred offering it was recommending. On February 17, Joseph discussed with the Board improvements it would seek from those terms, and explained its contemplated strategy depending on a potential buyer's demands. Joseph would thereafter perform due diligence and go to the market with a PPM. In other words, the PPM represented the terms BI would offer to the market, whereas the January/February term sheet represented BI's confidential fallback position. In a true arm's length negotiation, the counter-party would know only the PPM terms, but not the fallback position, as Abdo did. Thus, assessing Abdo's negotiating advantage from his access to BI's negotiating strategy requires examining the extent to which he negotiated changes to the PPM term sheet that benefited BFC, including bringing the terms closer to the January/February anticipated term sheet. As BOT has demonstrated, Abdo (i) moved the maturity from perpetual to ten years; (ii) made the second tranche draw-down mandatory; (iii) reduced the interval between the two tranches from a five-year maximum to one-to-three years; (iv) obtained preemptive and anti-dilution rights; and (v) reduced from four to two quarters BI's grace period for missing dividend payments. OB 8-10.⁵

Appellees accuse BOT of mischaracterizing the record in showing how Abdo unfairly obtained BI's agreement to a mandatory second tranche draw-down, and how the Court of Chancery overlooked that evidence. Abdo Br. 9, 29; BI Br. 6. Again, the record is straightforward.

The January/February anticipated term sheet provided for a \$20 million convertible preferred offering. A313. But even when the Board was under the misimpression that BI's debt was \$37.3 million as opposed to \$20 million (OB 7), the Board still wanted to divide the offering into two \$10 million tranches, the second one being at BI's option. A91 at 648. So Joseph's PPM provided that the offering would be "up to 20,000,000," with two draw-downs, the second of which would be "within five years from closing, at the option of the Company, . . ." A383. After Abdo negotiated for BFC, however, the second draw-down was to be "within three years from closing, but no sooner than 12 months after closing, . . ." and the "at the option of the Company" provision was removed. A448; C179 at 1631-32; A128 at 886.

Joseph's testimony vividly showed the insight Abdo had on these terms because of his presence at the February 17 Board meeting:

Q. Under the term sheet as originally proposed
by Morgan Joseph in the Private Placement

⁵ As Appellees point out (Abdo Br. 28, n.26) BOT incorrectly cited "A18" in showing how Abdo used his unfair advantage to obtain BI's grant of preemptive rights. OB 8. The correct citation is A180.

Memorandum, whether Benihana drew down the second \$10 million tranche of convertible preferred stock was wholly at Benihana's option, right?

A. Yes.

Q. And that meant that Benihana would never have to draw down those funds if it didn't need them, right?

A. Right.

Q. And then if you go to the term sheet that appears in the May 6th board book, as agreed by BFC, that's no longer the case, right?

A. Right.

Q. Under the term sheet that was agreed with BFC, Benihana was required to draw down the second \$10 million tranche, right?

A. That's right.

Q. That is a change that is unfavorable to Benihana and favorable to BFC, right?

A. Yes, it is.

Q. That's a material difference between the two term sheets, right?

Mr. Nowak: Object to the form.

A. It's material. You would rather have an open option. Again, I have to point out I have told the company we weren't going to get that.

Q. That's something that Mr. Abdo requested?

A. Yes, it is.

Q. That change?

A. Right. Although I may well have told the board that we wouldn't get that, and he was at the board meeting. So it may have been pretty much a no-brainer that he came -- I don't remember for sure.

I clearly remember explaining to the company, which means Joel [Schwartz] and maybe Mike Burris, I'm not sure, that we weren't going to get an option, and I think there is a good chance I said that at the board meetings, which Jack would have been at. So he would have known that this was a nice fake.

Q. So he had a pretty good negotiating advantage on that one, didn't he?

A. He had a nice shot at getting us to change that.

* * *

Q. Okay. And during the negotiations Mr. Abdo requested, and you agreed, to make the draw-down of the second tranche mandatory, right?

A. Yes.

Q. . . .

But you had previously -- and you had previously advised the Benihana board that Benihana was probably going to give that one up, right?

A. Yes, I had.

Q. And since Mr. Abdo had been at the prior board meetings, he would have known to use your words, your words, that it was a nice fake, right?

A. Yes, he would have.

A164 at 238-40, 107 at 737-38. The Board never knew these critical facts.

Appellees describe BOT as "mistaken" in arguing that the Court of Chancery missed Abdo's shooting-fish-in-a-barrel negotiation of a mandatory second tranche. Abdo Br. 29, n.27. But they cite nothing in the Opinion that even remotely references the above testimony. Even more telling, Appellees fail to mention that testimony in seventy pages of combined briefing.

Instead, Appellees congratulate Abdo for not also insisting that BI meet "performance criteria" as a condition to BI drawing down the second tranche.

Abdo Br. 9, 13, 29. This is the ultimate red herring. Why would Abdo need performance criteria when BI was (i) virtually debt-free, (ii) profitable, (iii) getting a \$10 million injection to improve profitability, and (iv) a company in which Abdo had longed since the late nineties to buy a controlling block? While performance criteria might have been a factor were the interval between the two draw-downs five years as the PPM provided (A383), it was far less important after Abdo negotiated that interval down to one-to-three years (A448), particularly with the Preferred Stock Purchase Agreement's "no material adverse changes" protection. C197 at 1646. Shortening the interval between the tranches was itself a faithless act—Abdo knew from the February 17 Board meeting that Joseph would "give away" two tranches if necessary (A91 at 648), so Abdo likewise knew that Joseph would be willing to shorten the interval between those tranches. Thus, while Abdo allowed Joseph to portray himself as winning the performance criteria negotiating "battle" (Abdo Br. 9), it was Abdo who unfairly won the negotiating war by forcing BI to surrender the right, among others, to forego a second tranche.

Abdo further misportrays his own testimony in arguing that "Abdo testified that he did not need Joseph" to tell him to demand a mandatory second tranche. Abdo Br. 23, 9. In fact, Abdo testified that he did not need *BFC employee Phil Bakes to tell him that*. A127-28 at 885-86; A426. Of course, Abdo already knew this from participating in the February 17 Board meeting, and (as Abdo points out in his brief) Abdo had already obtained BI's concession to a mandatory second tranche draw-down before receiving Bakes' April 26 memo. Abdo Br. 12, n.12 & 29, n. 29. The bottom line is that both Abdo and Bakes believed that the PPM terms—which included BI's option on the second tranche—were "fair to both sides." A155 at 148, A426. And Abdo concedes that Joseph too considered the PPM's terms "fair." Abdo Br. 12, 30 n.29.

C. The Board Did Not Know That Abdo Had Negotiated the Transaction on BFC's Behalf

Given the powerful evidentiary record that Abdo obtained terms for BFC that he had learned BI would concede during a confidential BI Board meeting, Appellees grope for the safety net of Board disclosure. They repeatedly argue that the Board knew that Abdo had negotiated the Transaction on BFC's behalf. Abdo Br. 14-17, 21-22, 24-26; BI Br. 9, 16. The problem for Appellees, however, is that this directly contradicts the Court of Chancery's express finding:

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.

Op. 25. Appellees nowhere argue that the court's nondisclosure finding was

clearly erroneous. Nor could they: the finding is supported not only by the Schwartz testimony cited in the Opinion,⁶ but also by (i) Pine's testimony,⁷ and (ii) the failure of any BI Board member (other than Schwartz and Dornbush) to testify that he knew of Abdo's negotiating role. Even assuming, as Appellees argue (Abdo Br. 16), that Pine was inquiring about Abdo's future negotiating role, neither he nor the Board knew that Abdo had ever negotiated at all.

Because Appellees cannot live with the court's nondisclosure finding, they distort it. They argue that the court meant only that Abdo's negotiating role was not disclosed *at the May 6 Board meeting*, but that the Board had learned about it previously. Abdo Br. 26 n. 23. This argument is nonsensical. Had the court believed that the Board knew of Abdo's negotiating role before May 6, it would not have found that "the Benihana Board was not informed that Abdo himself negotiated the terms on behalf of BFC." Rather, its finding would have been exactly the opposite. And none of the evidence Appellees cite shows that the Board was *ever* told—at least not until the eve of trial and the commencement of an NASD inquiry—that Abdo had negotiated the Transaction's terms.

First, Appellees argue that the Board Book for the May 6 meeting disclosed Abdo's negotiating role. Abdo Br. 15. The language they quote, however, skirts and obfuscates the issue of whether Abdo negotiated:

Shortly after beginning this process [of preparing the PPM and identifying prospective investors] Morgan Joseph was approached by John Abdo, BFC Financial Corporation's

⁶ A54 at 95-96:

Q. After Morgan Joseph explained that BFC would be the purchaser, Mr. Pine asked a question about Mr. Abdo's involvement in negotiations; right?

A. Yes.

Q. And you recall that either Mr. Joseph or Mr. Huffman told the Beni board—the Benihana board at the May 6th meeting that there has been no significant changes to the term sheet; right?

A. Yes.

⁷ A135 at 995:

Q. And that is at the May 6 meeting, you did not know that Mr. Abdo had personally negotiated the term sheet prior to May 6?

A. Correct.

(“BFC”) Vice Chairman and a member of the Benihana’s [sic] Board of Directors, indicating that BFC would be interested in investing in the Company on terms comparable to those contemplated in the PPM.

Following BFC’s overture, the Company and Morgan Joseph have negotiated a proposed term sheet for BFC to invest in the Company.

A446. Stating that “the Company and Morgan Joseph have negotiated a proposed term sheet for BFC to invest” does not convey that Abdo himself had negotiated against them. The litmus test of the Board Book’s disclosure failure is Pine’s testimony. As Appellees concede, Pine “read the May 6 Board Book on May 5” (Abdo. Br. 15); yet, he “did not know that Mr. Abdo had personally negotiated the term sheet . . .” (A135 at 995). And the Book also does not tell the Board—which never saw the PPM term sheet (Op. 25)—that

- Abdo had negotiated improvements to the PPM terms for BFC’s benefit and to BI’s detriment; and
- The improvements Abdo negotiated were terms Joseph had told the Board on February 17 he would surrender if necessary.

Second, Appellees cite Schwartz’s testimony that he had informally told Board members before the May 6 meeting that Abdo “was involved in the transaction.” A53 at 89-90. But the nebulous “involved” descriptive simply parallels the inadequate Board Book disclosure. And as the other Schwartz testimony Appellees cite makes clear, Schwartz only told Board members before the May 6 meeting that BFC was the proposed “counterparty” or “third party.” A53-54 at 92-93 (Schwartz told Sturges and Becker before May 6 that BFC would be the counterparty); B26 at 917 (“several days” before the May 6 meeting, Schwartz told Sturges that “it looked like BFC wanted to do this deal”).

Third, Appellees argue that “the Board members understood that Mr. Abdo would have been involved in the negotiations.” BI Br. 9. But all Appellees cite is Pine’s testimony that he thought that Abdo would be BFC’s “ultimate decisionmaker” (A135 at 994-95), and that he liked BFC and Abdo (B32 at 972-73). Delaware law clearly distinguishes between those who negotiate—such as board negotiation committees—and those not involved in negotiations who act as “ultimate decisionmakers”—such as entire boards.⁸

⁸ See, e.g., *In re Emerging Commc’ns, Inc. S’holder Litig.*, 2004 WL 1305745, *43 (Del. Ch. June 4, 2004) (distinguishing between duties owed by special

Understanding Abdo’s “ultimate decisionmaker” status is a far cry from knowing that he personally negotiated for BFC to obtain terms he had been told at a Board meeting that BI would resist but concede if necessary.

Fourth, Appellees point out that Abdo made BFC’s presentation to the Board on May 6. Abdo Br. 16. But that generalized presentation was simply about BFC and its investment philosophy. A122-23 at 825-26, C007. With the full Board as his captive audience, Abdo failed to disclose how he personally negotiated improvements for BFC.⁹

Thus, as the Court of Chancery found, the majority of the Board was never told that Abdo had negotiated the Transaction on BFC’s behalf, let alone the improvements he negotiated from the PPM. That finding eviscerates Appellees’ answering briefs.

D. Appellees Mischaracterize the DGCL Section 144(a)(1) Standard

Appellees twice distort the legal standard under Section 144(a), albeit half-heartedly and without supporting authority. First, Appellees argue that Section 144(a)(1)’s disclosure requirement of “the material facts as to . . . the contract or transaction” is satisfied if the Board knew “the specifics of the contract itself.” BI Br. 15. Appellees’ narrow construction would have Section 144(a)(1) apply even if the insider had secretly bribed, extorted or defrauded company officials during the negotiations, as long as the approving directors knew “the specifics of the contract itself.” Of course, that is not the law— “material facts as to the transaction” encompass not only the contract’s terms, but also the process by which those terms were negotiated.¹⁰ This is consistent with the broad materiality definition Appellees concede: information that is “relevant and of a magnitude to be important to directors in carrying out their fiduciary

committee that negotiated with CEO and non-committee directors who played no negotiating role).

⁹ See *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 441-42 (Del. 1996) (stressing importance of duty to be candid with fellow directors); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 709-10 (Del. 1983) (parent’s nominee directors owed duty of candor to fellow subsidiary directors, and should have disclosed report important to buy-out negotiations); *HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 119 (Del. Ch. 1999) (directors have “unremitting obligation” to deal candidly with fellow directors).

¹⁰ See, e.g., *Kahn v. Lynch Commc’n. Sys., Inc.*, 638 A.2d 1110, 1119-20 (Del. 1994) (controlling shareholder’s buy-out offer ultimatum was material to transaction).

duty of care in decision making.” BI Br. 15.¹¹

Second, Appellees argue that even if the Transaction does not satisfy Section 144(a)'s first two subsections, it could still satisfy Section 144(a)(3) even without an “entire fairness” finding. BI Br. 17. That argument is remarkable given BI counsel’s argument below that “prong three [of Section 144] is that it’s an entirely fair transaction.” C005-6. This Court has recognized that Section 144(a)(3) provides that “a non-disclosing interested director can remove the taint of interestedness by proving the entire fairness of the challenged transaction.”¹²

E. Abdo Breached his Fiduciary Duty to BI, Which Also Precludes Business Judgment Rule Review

Although Appellees misleadingly label Section 144 a “safe harbor,” they do not contest that Section 144 is only a floor for board conduct, not a ceiling. OB 19. As BOT has also demonstrated, Abdo breached his duty of loyalty by misusing the information he learned at the February 17 Board meeting. OB 19-22. Appellees respond that even if Abdo breached his fiduciary duty, business judgment rule review was still appropriate. They are wrong.

Numerous courts have held that a board member’s fiduciary breach requires “entire fairness,” rather than business judgment rule, review.¹³ *Cede & Co. v. Technicolor, Inc.*, which Appellees quote out of context, is not to the contrary. There, a director who had played no negotiating role received a finder’s fee for arranging an arm’s length third-party transaction. The question for the Court was whether the director’s receipt of a benefit not shared by other stockholders, standing alone, overcame the business judgment rule.¹⁴ The answer

¹¹ See *In re Walt Disney Co. Derivative Litig.*, 2005 WL 2056651, *39-41 (Del. Ch. Aug. 9, 2005) (Eisner did not violate duty of care in hiring Ovitz, in large part, because Eisner informed “himself of all material information reasonably available,” including negotiation process and company’s overall needs).

¹² *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 366 n.34 (Del. 1993).

¹³ See, e.g., *Emerald Partner*, 787 A.2d 85, 94 (Del. 2001) (CEO’s “stance on both sides as a corporate fiduciary, *alone*, is sufficient to *require* the demonstration of entire fairness.”) (emphasis in the original); *Bomarko v. ITI*, 794 A.2d 1161, 1177-78 (Del. Ch. 1999) (applying entire fairness review, where CEO lied to board about availability of alternate financing); *AC Acquisitions v. Anderson, Clayton*, 519 A.2d 103, 111 (Del. Ch. 1986) (“where a self-interested corporate fiduciary has set the terms of a transaction and caused its effectuation, it will be required to establish the entire fairness of the transaction to a reviewing court’s satisfaction”).

¹⁴ *Cede*, 634 A.2d at 362-63.

was no, because there “must be evidence of disloyalty.”¹⁵ Among the non-exclusive examples the Court provided of such “misconduct” were “fraud upon the corporation or board” and “abdication of directorial duty.”¹⁶

Unlike *Cede*, the issue here is not whether Abdo’s mere financial interest in the Transaction overcomes the business judgment rule. This case involves “evidence of disloyalty” because Abdo used confidential information he learned as a BI director to negotiate against BI for a third party. It also involves fraud on the board because the Board was not told of Abdo’s negotiating role, even though it inquired, nor was it told of the BI-adverse changes that Abdo negotiated. And unlike the finder’s fee in *Cede*, Abdo’s breach went to the heart of the negotiation and board-approval processes.

Abdo tries to distinguish *Hollinger Int’l Inc. v. Black*,¹⁷ by arguing that Conrad Black was “relentlessly faithless.” Abdo Br. 31. But the court specifically identified Black’s breach of board confidentiality as a discrete fiduciary breach.¹⁸ That breach occurred when Black gave a prospective purchaser a “negotiating document” from a Hollinger International board meeting that contained the financial advisor’s share value range for a potential sale of International. Like Black, Abdo gave a prospective purchaser (BFC) BI’s term ranges, received at a BI board meeting, for a contemplated transaction.

¹⁵ *Id.* at 363.

¹⁶ *Id.*

¹⁷ 844 A.2d 1022, 1046 (Del. Ch. 2004), *aff’d per curiam*, 872 A.2d 559 (2005) (stating that Black appealed findings that he violated duties of loyalty and confidentiality, among others, and affirming opinion below, except for *dicta*).

¹⁸ 844 A.2d at 1046. Appellees similarly argue that the fiduciaries in *Agranoff v. Miller*, 1999 WL 219650, at *19-21 (Del. Ch. Apr. 12, 1999), *Odyssey Partners LP v. Fleming Cos., Inc.*, 1996 WL 422377, at *3-4 (Del. Ch. July 24, 1996), and *Brophy v. Cities Serv. Co.*, 70 A.2d 5, 7 (Del. Ch. 1949), engaged in other wrongdoing. But as in *Hollinger*, the courts in those cases identified the misuse of confidential information as a discrete fiduciary breach.

II. APPELLEES CANNOT PROVE ENTIRE FAIRNESS BECAUSE OF FUNDAMENTAL PROCESS DEFECTS THAT INFECTED THE TRANSACTION'S TERMS

The numerous defects in the negotiation and approval process, and the resulting detriment to BI and its shareholders, preclude an entire fairness finding. OB 22-23. In February, after being given grossly-inflated net debt figures, the directors agreed to eschew debt for equity, thereby ensuring an unnecessarily dilutive transaction for all BI shareholders. At the same time, they approved diluting away BOT's voting control by accepting Joseph's recommendation for issuing preferred stock with immediate "as-if-converted" voting rights, a recommendation Joseph made without investigating whether a company with BI's conservative leverage had ever granted such preferred stock rights. C011 at 173-74. In Abdo's presence, Joseph and the Board discussed and agreed on their negotiating game-plan for the equity offering. The Board then authorized Joseph to conduct due diligence, prepare a PPM, and thereafter negotiate the best possible terms for BI. But instead of marketing the PPM, Schwartz and Dornbush gave company-insider Abdo a no-shop. Schwartz and Dornbush also allowed Joseph to negotiate the PPM's terms with Abdo, even though Abdo was armed with BI's confidential negotiating strategy from the February Board meeting. Abdo then caused Joseph to concede terms that Abdo had been told as a Board member that BI would seek but concede if necessary. The approving directors were not told that Abdo negotiated on BFC's behalf, were never given the PPM, and were assured that there were "no significant changes," thus deterring them from probing further into how the stacked negotiations hurt BI.

BI did not set up a committee of independent directors to negotiate at arm's length. Nor did the approving directors have their own independent legal or financial advice—even though Schwartz personally sought legal advice about how to handle this related-party transaction, he did not arrange for any such advice for the rest of Board. A49 at 73. Thus, at least one director did not appreciate the significance of the corrected net debt figures, and would have approved the Transaction even if he had been told that management's primary purpose was to dilute BOT. A173-74 at 188-90; C009 at 113-14. Although the Board obtained a post-approval fairness opinion, it was from a financial advisor whose fee depended on the Transaction closing—with each tranche earning Joseph an additional \$400,000—and who was pitching BFC for business in the weeks before it rendered the opinion.¹⁹ The Board then failed to negotiate with an unaffiliated third party (Yamano) that offered identical financing terms,

¹⁹ BFC's control of Joseph competitor Ryan Beck (Abdo Br. 18 n.17) would not prevent BFC from referring Joseph financial advisory work—such as in matters where Ryan Beck had a conflict or lacked expertise or resources.

except less dilutive of BOT and BI's other shareholders because the preferred stock it proposed would convert into one-vote per-share Class A stock, and not ten-votes per-share Common stock. A559. And the Board failed to use that new offer to re-negotiate better terms from BFC.

Recognizing the myriad process defects, Appellees rely on two cases in which favorable transaction terms allowed defendants to satisfy their entire fairness burden.²⁰ In *Shamrock*, the Court of Chancery found an employee stock option plan entirely fair, even though the directors were not informed that several groups opposed using employee pay-cuts to fund it. But this did not lead to a unfair process finding because "all of the directors knew that employees would not be happy with the idea of a pay cut."²¹ There was also arm's-length price-setting, and the court found that the plan would cost the shareholders nothing.

In *Emerald Partners*, the Court of Chancery found both fair process and fair price in the former CEO Hall's buyout. Hall and another director affiliated with him attended "some board meetings where the proposed merger was discussed, and, on some occasions, Hall and Berlin also conferred with [the Board's financial advisor]."²² But the court found that those process flaws: (i) did not infect the price or "compromise[] the non-affiliated directors' ability to negotiate the merger terms on an arms-length basis. . . with appropriate adversarial vigor"²³—indeed, they negotiated a better price for the shareholders; and (ii) did "not overcome the preponderating force of the other credible evidence,"²⁴ such as the use of an informal special committee of independent directors, who were assisted by independent legal and financial advisors. This Court affirmed, but noted *in dicta* that there were "many process flaws in this case [that] raise serious questions as to the independent directors' good faith."²⁵

Significantly, the board in *Emerald Partners* knew about the insider's activities, but still negotiated improvements independently and at arm's length. Here, in contrast, the Board did not know (i) of Abdo's negotiating role, or (ii)

²⁰ BI Br. 21, citing *Emerald Partners v. Berlin*, 2003 WL 21003437 (Del. Ch. Apr. 28, 2003), *aff'd*, 840 A.2d 641 (Del. 2003) and *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257 (Del. Ch. 1989).

²¹ *Shamrock*, 559 A.2d at 270.

²² 2003 WL 21003437 at *8.

²³ *Id.* at *10.

²⁴ *Id.* at *23.

²⁵ *Emerald Partners v. Berlin*, 840 A.2d 641 (Del. 2003) (cited by Appellees as 2003 WL 23019210).

the BI-adverse changes he had negotiated for BFC. Nor did it know that the tainted “negotiations” from the PPM resulted in worse terms for BI.

While there might be isolated cases in which favorable terms overcome process defects, a defective process usually infects price and precludes an entire fairness finding.²⁶ For example, in *Kahn v. Tremont Corp.*,²⁷ this Court held that a flawed negotiating process was so intertwined with the price, that even a price “in a broad range of fairness” could not save the result. Likewise, in *Bomarko Inc. v. Int’l Telecharge, Inc.*,²⁸ the unfairness of the process, whereby the CEO concealed financing alternatives, also “infected” the terms. And in *Weinberger v. UOP, Inc.*,²⁹ a corporate parent’s decision not to share its higher valuation before making an offer for the subsidiary—even though the subsidiary’s president viewed the 50% premium offer as “generous,” and the offer was supported by a fairness opinion—prevented an entire fairness showing.

Thus, Joseph’s self-serving testimony that “we ended up where we wanted to be” is irrelevant—the correct question is not whether the terms are somewhere in a fairness range, but whether the process defects infected those terms.³⁰ This Transaction illustrates why it is usually impossible to divorce price review from process. For example, Abdo negotiated from what he and BFC’s Bakes both called “fair” terms in the PPM, and all the changes worsened the deal for BI: (i) BFC could now force BI to draw down the second tranche within three years, A128 at 886; (ii) BFC gained the right to force BI to redeem the Preferred in full after ten years, Op. 23; (iii) BFC obtained anti-dilution and preemptive rights, *id.* A180 at 343-44; (iv) BI was barred from issuing another class of equity with more senior voting rights, A128 at 888; and (v) BFC secured the right to a second director if BI did not pay BFC’s dividends for two quarters, instead of four quarters as in the PPM, Op. 23. And the Board’s decision to dilute all BI shareholders by issuing equity was tainted by (i) management’s

²⁶ See *Solomon v. Armstrong*, 747 A.2d 1098, 1113 n.39 (Del. Ch. 1999) (“entire fairness review invokes a standard so exacting that it ordinarily, but not invariably, results in a finding of liability”), *aff’d*, 746 A.2d 277 (Del. 2000).

²⁷ 694 A.2d 422 (Del. 1997).

²⁸ 794 A.2d 1161, 1183 (Del. Ch. 1999).

²⁹ 457 A.2d 701, 705-6, 709 (Del. 1983).

³⁰ *Id.* See also *HMG/Courtland Props., Inc. v. Gray*, 749 A.2d 94, 115 (Del. Ch. 1999) (invalidating transaction as unfair, and stating that director’s interest in transaction is “important factor in determining whether the transaction . . . resulted in a fair price,” where director’s undisclosed interest may explain the previously approved low price).

concern regarding BOT's control;³¹ (ii) the inflated net debt figures on which the Board relied; (iii) Joseph's failure to investigate whether financially sound companies grant immediate "as-if-converted" voting rights; and (iv) the Board's failure to explore adequately the less-dilutive Yamano offer or to use that offer to re-negotiate with BFC for less dilution.³²

Appellees argue that the Transaction is fair because the 5% "coupon" or dividend rate is lower than the 5.5% to 6.5% rate in the January/February anticipated term sheet. Abdo Br. 12, 28; BI Br. 8, 17, 20. After performing due diligence between February 17 and April, Joseph believed that 5% was the appropriate dividend rate to use in the PPM. Thus, although several Board members pointed to the 5% dividend rate as comparing favorably to January/February term sheet, they never saw the PPM, and thus did not know that 5% was the rate Joseph had chosen for the offering. Joseph did include in the PPM a \$100,000 (\$0.25 per share) standby fee for the period in which the second tranche would be unissued. A384. That fee, which was not in the January/February term sheet but ultimately was part of the Transaction, partially offset the lower dividend rate. Notably, BFC's Bakes did not mention the PPM's 5% dividend rate as an area for BFC to improve in negotiations. A426-29. And while Abdo did not try to negotiate a higher coupon, he negotiated a decrease from five years to one-to-three years in the delay before the second 400,000 shares would issue, thereby imposing on BI additional years, at \$500,000 a year, of dividend payments. And armed with the knowledge that the 5% rate was lower than the Board anticipated, Abdo could more forcefully negotiate other terms in BFC's favor than could any arm's-length investor.

Appellees also note the one change in the PPM's terms that turned out to benefit BI: the conversion price was set based on the ten-day average trading price before the Transaction's public announcement, as opposed to the ten days before closing. Abdo Br. 12-13; BI Br. 8. Schwartz admitted, however, that he "had no way of knowing whether that change would work to Benihana's benefit or to BFC's benefit." A53 at 89. The reason it ultimately benefited BI is that the market punished BI's stock "substantially" after BI announced the dilutive Transaction. B18 at 672.

³¹ See *Strassburger v. Earley*, 752 A.2d 557, 576 (Del. Ch. 2000) (court's entire fairness analysis considered CEO's improper purpose in undertaking share buy-back transaction).

³² See *NL Indus., Inc. v. MAXXAM, Inc.*, 1997 WL 187317 (Del.Ch. Apr. 4, 1997) (finding related-party loan transactions unfair, in part, due to availability of less costly alternatives).

III. THE TRANSACTION’S DILUTIVE PURPOSE AND THE BOARD’S FAILURE TO REASONABLY INVESTIGATE NON-DILUTIVE FINANCING OPTIONS REQUIRE REVERSAL

A. The Court of Chancery Erred in Failing to Connect BI Management’s Late 2003 Desire to Dilute BOT’s Voting Control With its January 2004 Proposal to Grant Immediate As-If-Converted Voting Rights to a New Investor

BOT has demonstrated that the Transaction achieved BI management’s two purposes: (i) raising funds to renovate BI restaurants; and (ii) ridding them of BOT’s voting control. OB 25-26. Delaware law holds that when both proper and improper purposes motivate a transaction, it would be “a mockery” to suggest that the latter purpose was only incidental. *Id.* 24-25. Thus, the Court of Chancery erred in failing to void the Transaction. *Id.*

Appellees do not contest that where both proper and improper purposes motivate a transaction, the latter cannot be deemed incidental. But they argue that only a primary *entrenchment* purpose is improper. BI Br. 22, 26. They then cite Schwartz’s long-term employment contract and BI’s staggered Board in arguing that there could not have been an entrenchment motive. *Id.* 23. And they similarly argue that Schwartz’s concern regarding Keiko Aoki’s imminent ascension at BOT was not about the potential loss of board seats, but “for the Company as a whole.” *Id.*

The absence of an entrenchment motive, however, is not the panacea Appellees seek. As *Blasius Indus., Inc. v. Atlas Corp.*³³ makes clear, it does not matter whether management believed that it was acting in the corporation’s best interests and had no entrenchment motive—transactions executed for the primary purpose of diluting control shareholders are improper. OB 26, 29-30.

Appellees characterize as an “isolated instance” Schwartz’s August 2003 consideration of issuing 16.5 million Class A shares to dilute BOT’s voting power from 51% to 28%. BI Br. 24. But the record shows that this conduct was consistent with his and Dornbush’s concerns regarding, and approach toward, BOT in late 2003 and early 2004. Schwartz considered the massive Class A share issuance immediately upon learning that Rocky Aoki had willed his BOT interest to Keiko. C002 at 23-24, A147 at 1046-47. He and Dornbush also simultaneously considered other measures to dilute BOT, such as BI issuing a Class A stock dividend. Op. 68-69, A147-48, A183, A190. And Appellees concede (albeit in a footnote) that only two months later, Schwartz and Dornbush arranged for Joseph’s first project to be a November 4, 2003 presentation on the

³³ 564 A.2d 651, 663 (Del. Ch. 1988).

sale of a substantial portion of BOT's control block. BI Br. 5 n.4, A206. That undisputed fact, which the Court of Chancery overlooked (OB 25), ties Schwartz's hiring of Joseph with his late 2003 desire to eliminate BOT's voting control. That tie is also evident in Joseph's outline for a November 10, 2003 meeting, which included among the agenda items: (i) "Timing for presentation to the Board"; (ii) "Company options for dealing with the potential sale of control interest," including "Diffuse Ownership"; (iii) "issues with the [BOT] trust"; (iv) "Financing requirements"; and (v) "Projected equity needs." C203-4. Joseph's and BI management's November activities link Schwartz's late 2003 BOT control concern with Joseph's January 2004 Board presentation, which recommended equity financing with immediate, as-if-converted, voting rights.

Appellees leave unanswered the question BOT posed: "Why was that term [immediate, as-if-converted, voting rights] so essential to a financing for the financially-sound BI?" OB 26. Their silence is not surprising given that Joseph did not recall "focusing on" or having done "any work" on whether a company "in financial circumstances similar to [BI]'s" had ever issued preferred stock with as-if-converted voting rights. C011 at 173-74. In light of Joseph's November activities, there is no mystery that part of the impetus for that provision was to resolve Schwartz's and Dornbush's concerns regarding BOT.

As the court found in *Canada Southern Oils v. Manabi Exploration Co.*,³⁴ a key to the primary purpose analysis is examining the company's need for the dilutive equity's proceeds. Joseph advised the Board that its "short-term funding need is not substantial" (A273)—even while Joseph was using BI debt figures that were inflated by more than \$17 million (A305)—and to "issue equity when you can, not when you need it" (Op. 17, A86 at 631).³⁵ Yet, Appellees resist conceding that BI issued equity merely because "it could." BI Br. 24. They argue that the Board actually opted for a "mix" of equity and debt, and claim, without a record cite, that BI has at some point used its pre-existing Wachovia credit line "in part, to carry out the renovation and construction plan." *Id.* But as BOT has shown, BI used the convertible preferred proceeds to pay off the pre-existing Wachovia debt and for a money market fund deposit. OB 7. Appellees cite no record evidence to the contrary. Nor do Appellees challenge BOT's showing that even had BI "borrowed all the funds necessary for even its

³⁴ 96 A.2d 810, 813 (Del. Ch. 1953).

³⁵ The inflated \$37.3 million debt figure cannot be explained by delayed projects alone—it was higher than even BI's existing credit line. OB 7. And contrary to BI's assertion, delaying those projects did reduce the need for additional financing, because newly-earned operating income would become available in the interim to fund those projects. A81 at 608, 611.

most aggressive remodeling plan, BI still projected to be even more conservatively leveraged each year, without the issuance of additional equity.” OB 7; *see* A99 at 706. Given BI’s conservative leverage and the “highly feasible” debt options (A101 at 714), its choice of dilutive convertible preferred must have been motivated, at least in part, by a desire to dilute BOT.

Appellees also concede that another relevant factor in the primary purpose analysis is whether “the directors [ever] offered the controlling shareholder the option to purchase the shares.” BI Br. 25. Although Appellees (BI Br. 25) and the Court of Chancery (Op. 71) try to distinguish *Canada Southern* on this basis, there is no evidence that BI ever offered the Convertible Preferred to BOT. Rather, all Appellees can do is attack BOT for not making “a legitimate proposal demonstrating sufficient funding needed to participate.” BI Br. 25. But focusing on BOT’s financial wherewithal turns the primary purpose analysis on its head. Far more relevant is the evidence—which Appellees do not dispute—that BI’s management and Board preferred BFC over BOT. A58-A60, Op. 51. Indeed, Joseph recommended the Transaction, in part, to obtain “a new investor class, and balance for BI’s concentrated ownership structure.” A445.

Critically revealing is BI’s response in May 2004, when BOT’s counsel presented Yamano’s offer. As BOT has demonstrated, Schwartz and the Board gave short shrift to this offer, even though its terms were identical to the Transaction, but less dilutive. OB 12-13. Appellees now say that Yamano’s proposed dividend rate was a percentage point higher than the Transaction’s dividend rate. BI Br. 11. But they are incorrect: both the Yamano term sheet and the Transaction term sheet provide for a 5% dividend (\$1.25 annually per \$25 share). *Compare* A433 (Transaction summary term sheet approved by Board on May 6) *with* A560 (Yamano offer summary term sheet presented by BOT’s counsel to Board on May 28). Appellees also characterize the Yamano offer as “simply litigation-inspired.” BI Br. 11. Their cite is to deposition testimony of an attorney who summarized Yamano’s terms before sending them to the Board, not to any evidence that the offer was not genuine. BI cannot explain why BI never contacted Yamano, nor re-negotiated with BFC after receiving Yamano’s less-dilutive offer. OB 31.

Appellees’ other attempt to distinguish *Canada Southern* is by noting that the directors’ meeting notice there did not reference the proposed dilutive transaction, which suggested that it “was rushed to avoid the stockholder taking action to protect its interests.” BI Br. 25. Appellees contrast this case, where BOT’s Kevin Aoki had notice of each Board meeting in which the Convertible Preferred offering was discussed. *Id.* This is a distinction without a difference. Appellees do not dispute that when Kevin objected to the dilution BOT would suffer, Schwartz responded: “What are you going to do about it? You have one vote on the board.” OB 9. Thus, Schwartz knew he had no need to “rush.”

Appellees callously argue that BOT should not complain because after the June 2004 \$10 million draw-down diluted BOT's voting power from 51% to 42.5%, "BOT fought and won a proxy contest" for one director. BI Br. 22. Were it not for BI's June 2004 issuance of 400,000 preferred shares with immediate "as-if-converted" voting rights, BOT would have been able to install that director without a fight. Even more disingenuous is Appellees' extra-record characterization of BOT "apparently los[ing] interest" in conducting another proxy fight in the fall of 2005 after BI's second draw-down. *Id.* In fact, the circumstances of BI's August 2005 draw-down provide additional compelling evidence—which the Chancery Court also overlooked—of BI management's dilutive purpose. As of July 2005, BI's already conservative net debt/EBITDA ratio had been reduced to 0.15x. C013 at 2. In other words, a single year's cash flow could repay all BI debt *six times over*. *Id.* And yet, BI drew down the entire \$10 million second tranche in August 2005. Thus, just in time for the fall 2005 Board elections—and with no need for additional equity financing—BI diluted BOT from 42.5% to 36.5%. In so doing, BI protected against a repeat of BOT's November 2004 proxy contest victory. Thus, like Schwartz's November 2003 hiring of Joseph that led to the Convertible Preferred issuance, BI's August 2005 draw-down was at least partially motivated by BI management's concern regarding BOT's voting power.

B. The Court of Chancery Erred in 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 Voting Control

BOT has shown why this Court should adopt a *Unocal* "proportionality" test in the narrow circumstances presented here: the company issues stock that eliminates a shareholder's voting control after management expressed a concern about that control. OB 28. Under those circumstances, the board should be required to show that it reasonably investigated whether the company's legitimate objectives could be satisfied through a nondilutive transaction. Appellees argue that BOT has waived this argument by not making it below, and that adopting this test would upset the balance between board power and shareholder interests. They are wrong on both counts.

BOT presented this argument below. Under Delaware Supreme Court Rule 8, "mere raising of the issue is sufficient to preserve it for appeal," even where, as here, the trial court does not address that issue.³⁶ Count II of BOT's

³⁶ *Telxon Corp. v. Meyerson*, 802 A.2d 257, 263 (Del. 2002) (allowing argument on appeal as "implicitly raised below," even though not addressed by the trial court); *Watkins v. Beatrice Cos.*, 560 A.2d 1016, 1020 (Del. 1989) (citing *Sergeson v. Delaware Trust Co.*, 413 A.2d 880, 881-82 (Del. 1980) (*per curiam*))

Amended Complaint alleged that (i) the Transaction was approved in response to events that did not “constitute a threat to corporate policy,” and “was not reasonable in response to any such threat”; and (ii) BI’s directors wrongfully refused to consider alternative transactions before diluting “BOT’s controlling ownership.” Am. Compl. at 29-30. Similarly, BOT argued post-trial that “the Court need not find a subjective intent to dilute and entrench even on the part of Schwartz. It is enough that the BFC Transaction deprived BOT of voting control and was unnecessary to meet Benihana’s financing need.” BOT Post-Trial Reply Brief 15. In any event, this Court long-ago held that a plaintiff may raise on appeal an additional reason why the challenged conduct was improper.³⁷

On the merits, Appellees do not address either of the two policy justifications BOT has advanced: (i) the inherent conflict that applies in control situations, and (ii) the critical importance of the control franchise and control premium. OB 29-30. Thus, Appellees cannot deny that both policy reasons are important and relevant.

Appellees argue that adopting the reasonable investigation test would upset the “balance” between the board’s interest in issuing equity and the controlling shareholder’s interests. BI Br. 28. But in the event this Court were to uphold the Court of Chancery’s primary purpose holding, a serious *imbalance* in those interests would be exposed. As the Opening Brief showed, “every court that has considered reasonably analogous facts has inferred a primary dilutive purpose.” OB 27. But now, managements and boards concerned with a shareholder’s voting control will be emboldened to meet their financing needs with equity offerings that eliminate that control. Contrary to current Delaware precedent, those dilutive transactions will now be upheld as long as the approving boards *disregard* the dilutive impact. And many control shareholders would have difficulty blocking those transactions without an expensive court battle in which they would have to show a specific intent to dilute. The result would be that Delaware’s policy of protecting the control shareholder franchise would be severely undermined.

In contrast, adopting the test BOT proposes would not “intrude” on boards’ abilities “to manage the business and affairs of the Company.” BI Br.

(allowing argument on appeal raised in letter to trial court, irrespective of whether court ruled on it).

³⁷ *Kerbs v. California Eastern Airways, Inc.*, 90 A.2d 652, 659 (Del. 1952) (allowing appellant to raise an “additional reason in support” of proposition argued below as long as not “an entirely new theory of his case”—having argued at trial that board’s conduct was illegal, Appellant could rely on different Code section on appeal).

27. First, the test would only apply in narrow circumstances—*i.e.*, where management or the board has a concern about a controlling shareholder and soon thereafter approves a transaction that eliminates that shareholder’s control power. Second, the test would only require that the board reasonably investigate whether it could satisfy the company’s legitimate financing needs without eliminating the shareholder’s voting control. A board that does not have a primary dilutive purpose should have no problem conducting that investigation without compromising its ability “to issue stock to raise needed capital.” BI Br. 26.

Appellees rely on *Glazer v. Zapata Corp.*,³⁸ but their own description of the case distinguishes it as not involving a controlling shareholder: “Plaintiff, the holder of 38.8% of the common shares, . . .” BI Br. 27. Other facts in *Glazer* show that it is not even remotely analogous: nine months before Glazer purchased his shares, Zapata’s board had adopted a business plan for the company’s “survival” that included liquidating assets to reduce more than \$145 million in debt, and an “issuance of equity.”³⁹ Indeed, at the time Glazer purchased his Zapata stock, “the Company was pursuing an acquisition of Lantana Corp., which if it had closed would have involved the issuance of some 28.3 million Zapata shares.”⁴⁰ Here, in contrast, (i) BI was conservatively leveraged; (ii) BI had not considered an equity issuance before BOT became a controlling shareholder; (iii) BI management did not even retain a financial advisor until after they became concerned about BOT’s voting control and had begun considering ways of eliminating it; (iv) the first project that the financial advisor undertook involved advice on buying out or eliminating BOT’s control; and (v) the control shareholder lost its control premium and rights without compensation.

This is hardly the “balance” for which Delaware law should strive. The Court of Chancery here failed to apply the primary purpose test consistent with its prior holdings, thereby changing the legal landscape for controlling shareholders. This Court should restore order by requiring boards to adopt the minimal discipline of reasonably investigating non-dilutive transactions before issuing equity that eliminates an estranged shareholder’s voting control.

³⁸ 658 A.2d 176 (Del. Ch. 1993).

³⁹ *Id.* at 178-79.

⁴⁰ *Id.* at 179.

IV. BFC'S CONVERTIBLE PREFERRED STOCK IS VOID UNDER THE BI CHARTER'S UNAMBIGUOUS PREEMPTIVE-RIGHTS BAR

DGCL Section 102(b)(3) bars preemptive rights grants unless “expressly” authorized in the company’s certificate of incorporation. As demonstrated in the Opening Brief, BI’s Certificate does not “expressly” allow for preemptive rights. OB 32-34. To the contrary, it expressly prohibits them: “no stockholder shall have any preemptive right to subscribe to or purchase any issue of stock or other securities of the Corporation.” A566. The Court of Chancery erred by failing to enforce that clear language.

Appellees never address the Opening Brief’s showing that the Certificate’s preemptive rights bar is unambiguous. Instead, they rely on *Garza v. TV Answer, Inc.*,⁴¹ in suggesting that DGCL Section 102(b)(3) “may be ambiguous.” BI Br. 31. But *Garza* did not construe a charter; in fact, the charter there was silent on preemptive rights. For that reason, the question in *Garza* was whether preemptive rights could be issued absent express authorization in the charter. That question could not be resolved on a motion to dismiss. This case provides exactly what was missing in *Garza*—a charter that expressly bars preemptive rights.

BOT has also shown that there is no conflict between the Certificate’s preemptive rights bar and Article 4(b)’s general blank-check provision. Construing “the agreement as a whole, giving effect to all provisions therein,” with specific language controlling over general language, Article 4(b) allows the grant of all special rights, *except* preemptive rights. OB 34. But Appellees propose “harmonizing” the two provisions by throwing out the specific preemptive rights bar. BI Br. 32-33. This is contrary to both common sense and established contract construction principles.

Appellees propose other novel contract construction rules. First, they argue, without authority, that the Court should have “a high degree of assurance” before construing as prohibitory any charter provision modeled on the DGCL. BI Br. 30. Appellees characterize the DGCL as an “enabling statute” that is “rarely prohibitory in nature.” BI Br. 29. This philosophical discussion is beside the point, given the interplay between the DGCL and BI’s Certificate. The DGCL establishes a rule that preemptive rights are not allowed, unless the charter expressly grants such rights. Rather than expressly granting those rights, the Certificate expressly forbids them. Under those circumstances, there is no room for a reasonable construction that the Board can somehow grant preemptive rights.

⁴¹ 1993 WL 77186 (Del. Ch. Mar. 15, 1993).

Second, Appellees argue that the Certificate’s preemptive rights bar should be ignored because it is “boilerplate.” But Appellees prove in their answering briefs that “boilerplate” barring preemptive rights is *not* universally used, because it was absent from the *Garza* charter. The logical inference, therefore, is that BI’s founders made a decision to include that prohibition in the Certificate. In any event, Appellees’ unsupported “boilerplate” theory is unworkable. It would set up a regime whereby plaintiffs seeking to enforce charter provisions would have to prove that each such provision is not “boilerplate,” but was specifically tailored for the corporation. This would call into question most Delaware charter provisions that use standardized language, which many companies adopt precisely for the predictability of established contract construction precedent.⁴²

Appellees suggest that boards should be allowed to grant preemptive rights even absent charter authorization. They argue that since boards sometimes *limit* rights contained in their charters, such as by entering into debt covenants that restrict the company’s pre-existing right to pay dividends, they should also be allowed to “grant. . . rights” not authorized in their charter. BI Br. 29-30, n.11. There is no citation for this proposition—nor could there be. The proper way for boards to “grant” a power specifically excluded from the charter is to propose that the shareholders amend the charter.

Nor can Appellees avoid the established rule that “stock issued without authority of law is void and a nullity.”⁴³ Appellees attempt to distinguish *Staar* by noting that the board there did not properly approve the stock issuance. BI Br. 33. But this Court has interpreted *Staar* more broadly, citing it for the principle that stock issued “without authority of law” is void.⁴⁴

⁴² See *Brazen v. Bell Atl. Corp.*, 695 A.2d 43, 48 (Del. 1997) (“drafters of corporate documents bear the responsibility for the selection of appropriate and clear language” and thus cannot disown their own language, even if it is “boilerplate” terminology); *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 398 (Del. 1996) (declining to consider negotiation-intent evidence before interpreting boilerplate indenture provision, stating that such a review of individual negotiations would create uncertainties in interpretation of boilerplate provisions and should be avoided).

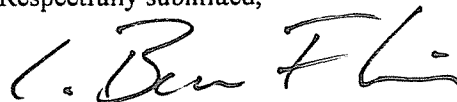
⁴³ *Staar Surgical Co. v. Waggoner*, 588 A.2d 1130, 1136 (Del. 1991).

⁴⁴ See *Shintom Co., Ltd. v. Audiovox Corp.*, 888 A.2d 225, 228-30 (Del. 2005) (stating that “preferred shares that do not comport with the statutory requirements of the Delaware General Corporation law are void,” in considering whether DGCL §151(c) requires preferred stock to confer dividend rights).

CONCLUSION

For all the foregoing reasons and those in the Opening Brief, the Court of Chancery's December 11, 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,



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MAY 4, 2006

CERTIFICATE OF SERVICE

I, C. Barr Flinn, hereby certify that on May 4, 2006, I caused to be served two true and correct copies of the foregoing Appellant Benihana of Tokyo, Inc.'s Reply Brief upon the following counsel of record in the manner indicated below:

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