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11 SUPERIOR COURT OF THE STATE OF CALIFORNIA  
12 COUNTY OF MARIN

13 RICHARD HATTAN, et al., On Behalf of )  
14 Themselves and all Others Similarly Situated, )  
15 Plaintiffs, )  
16 vs. )  
17 RESTORATION HARDWARE, INC., et al., )  
18 Defendants. )

VIA FAX  
Case No. CV 075563  
MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT OF  
PLAINTIFFS' MOTION FOR  
PRELIMINARY INJUNCTION  
DATE: June 11, 2008  
TIME: 10:30 a.m.  
DEPT: B

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**GLOSSARY OF TERMS**

1 2 3 4 5 6	<b>Board</b>	The board of directors of Restoration. The members are: Gary G. Friedman (“Friedman”), Robert E. Camp (“Camp”), Robert C. Hamer III (“Hamer”), Raymond C. Hemmig (“Hemmig”), Glenn J. Krevlin (“Krevlin”), M. Ann. Rhoades (“Rhoades”) and T. Michael Young (“Young”).
7 8	<b>Catterton</b>	Catterton Partners – a private equity firm that invests exclusively in the consumer industry, and is participating in the MBO Group.
9 10 11	<b>drop dead date</b>	The date by which parties to a merger agreement agree they will consummate a merger agreement. In this action, the MBO Group agreed to move the drop dead date from April 30, 2008 under the First Merger Agreement to June 30, 2008 under the Second Merger Agreement.
12 13 14 15 16	<b>excluded party</b>	Under the terms of a merger agreement with a buyer, a target company may be prohibited from communicating with other interested buyers after the end of a go-shop period. However, if the target company decides an offer from another interested buyer who participated in the go-shop process may constitute, or could lead to, a better deal for the shareholders, the target company can designate the other interested buyer as an “excluded party” and continue negotiations with it. In this action, excluded party status, if granted, also permits Sears to take its proposal directly to shareholders via a tender offer.
17 18	<b>First Merger Agreement</b>	Agreement and Plan of Merger among Restoration and the MBO Group, dated November 8, 2007, for \$6.70/share.
19 20	<b>go-shop</b>	Under the terms of a merger agreement with a buyer, a target company may be allowed to solicit other offers during a limited period of time. That period of time is called the “go shop” period.
21 22 23 24	<b>Independent Committee (“IC”)</b>	A committee of Restoration directors established for the purposes of addressing Catterton’s August 15, 2007 letter indicating its interest in acquiring the company at \$7.25/share. The committee, at formation, consisted of: Camp, Hamer, Hemmig, Krevlin, Rhoades and Young. On October 12, 2007, Krevlin advised the IC that he was an interested party in the Proposed Merger and resigned. The chairperson of the IC is Hemmig.
25 26 27	<b>management incentive plan</b>	A plan that outlines financial benefits, including equity stakes, that will accrue to management when certain performance levels are met. In this case, the management incentive plan contemplates that up to 20% of the equity of the post-merger company will be allocated to the management. This equity will vest over time and be cashed out at a liquidity event (if the company is sold or goes public).

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<b>management-led buyout (“MBO”)</b>	A form of acquisition where a target company’s existing management rollover their equity into a merger and acquire a large part or all of the target company post-merger.
<b>MBO Group</b>	The management buyout group in this action. The members are: Friedman, Catterton, Vardon Capital Management, LLC, Palo Alto Investors, LLC, Reservoir Master Fund, L.P., and Glenhill Advisors, LLC. Krevlin has sole voting and investment power with regard to shares beneficially owned by funds affiliated with Glenhill Advisors, LLC.
<b>MoFo</b>	Morrison & Foerster, LLP – the outside legal counsel for Restoration. MoFo became the company’s outside legal counsel by way of its long-standing relationship with Friedman, and currently serves as counsel to management.
<b>private equity firm</b>	A company that invests in businesses as a financial buyer – or a buyer for whom the purchase of a target company represents a pure financial investment.
<b>Proposed Merger</b>	The merger, proposed by the MBO Group and agreed to by the Board, pursuant to which the MBO Group will acquire all the outstanding shares of Restoration for \$4.50/share. The transaction also contemplates, among other things: (1) continued employment for the members of Restoration’s management; (2) equity rollover for the members of Restoration’s management; and (3) an equity incentive plan for the post-transaction management.
<b>Proxy</b>	Definitive Proxy Statement on Schedule 14A, filed by Restoration with the Securities and Exchange Commission on May 9, 2008, and disseminated to Restoration shareholders. The Proxy sets the shareholder vote on the Proposed Merger for June 12, 2008.
<b>Restoration</b>	Restoration Hardware, Inc. – a specialty retailer of hardware, bathware, furniture, lighting, textiles, accessories and gifts. Referred to as “Restoration” or the “Company.” Restoration is incorporated in Delaware.
<b>reverse termination fee</b>	A fee that buyers pay to target companies if the buyers breach a merger agreement and walk away from a deal before the deal is completed. In this action, the reverse termination fee under the First Merger Agreement was \$10.68 million, but the Board did not collect this fee from the MBO Group and instead entered into the Second Merger Agreement. The reverse termination fee under the Second Merger Agreement is \$10.68 million.
<b>rollover equity</b>	Where shareholders of a target company exchange their shares for ownership interests in the company post-transaction, rather than being cashed out with the other public shareholders.

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<b>Sears</b>	Sears Holdings Corporation – a leading home appliance retailer in North America and a retail sales leader in tools, lawn and garden, home electronics, and automotive repair and maintenance.
<b>Second Merger Agreement</b>	Agreement and Plan of Merger among Restoration and the MBO Group, dated January 24, 2008, for \$4.50/share.
<b>standstill agreement</b>	An agreement by which a target company furnishes non-public information to the interested buyer and in exchange, the interested buyer is prohibited from: (1) purchasing any more of the target’s outstanding shares; (2) soliciting proxies from shareholders; (3) communicating with other parties any information related to the non-public information or the negotiations; (4) negotiating a merger with the target company unless authorized by the target company; and/or (5) making a tender offer directly to, or even communicating with, the target company’s public shareholders. In this action, the standstill agreement in place prevents Sears from even making a request that the standstill agreement be waived.
<b>strategic buyer</b>	Buyers for whom the purchase of a target company enhances their strategic plan, either by adding capacity, expanding markets, adding synergistic operations, etc. In comparison, financial buyers are those for whom the purchase of a target company represents a pure financial investment.
<b>tender offer</b>	A public offer by an interested acquirer made directly to all stockholders of a corporation to sell their stock to it at a specified price for a specified time.
<b>termination fee</b>	The fee that the target company pays to the buyer if it terminates the merger agreement in favor of a superior proposal, or materially breaches the merger agreement. In this action, the termination fee in the Second Merger Agreement is \$7.1 million, with expenses, \$10.66 million.
<b>UBS</b>	UBS Securities LLC – a financial advisor for the IC. UBS gave a written opinion as to the fairness, from a financial point of view, of the Proposed Merger on November 7, 2007, and January 22, 2008.

1 We [Sears] did not want our ability to offer a higher price to [Restoration] shareholders  
2 to be blocked by the Independent Committee because we were concerned that the  
3 process was unfair, that they were favoring management and that they wouldn't let us  
make a superior proposal. That was our whole concern and it was supported by the way  
we were treated in the process.

4 Deposition Transcript of William C. Crowley, dated April 30, 2008 ("Crowley Tr.") at 67:5-13 (Ex. 1).<sup>1</sup>

5 **I. INTRODUCTION**

6 "[W]e [Sears] don't trust the process, we don't trust the [independent] committee." *Id.* at 68:5-  
7 6. Nor should they have. From its inception in April 2007, the sales process for the Company was  
8 designed to make Friedman, the Company's Chairman, President and Chief Executive Officer ("CEO"),  
9 a very rich CEO of a privately-held company that was no longer beholden to shareholders. Sears,  
10 which repeatedly offered to pay shareholders more for the Company, was merely a temporary obstacle  
11 that the MBO Group had to vanquish. The IC formed by defendants was the vehicle to make this  
12 happen.

13 It did not matter that Sears played by the IC's rules and submitted an offer for the Company  
14 within the framework that the IC set up. It did not matter to the IC that Sears expressly set out to be  
15 considered an "excluded party" pursuant to its standstill agreement with the Company and thus be  
16 permitted to make a tender offer directly to shareholders if it was not treated fairly by the IC. In the  
17 end, the IC rejected Sears' proposal outright and refused to designate Sears an excluded party, ensuring  
18 that Friedman gets everything he wants via the Proposed Merger. Shareholders, by contrast, are  
19 prevented from choosing Sears' higher offer for the Company. Defendants' conduct in the sales process  
20 was and is in violation of Delaware law: "When directors bias the process against one bidder and  
21 toward another not in a reasoned effort to maximize advantage for the stockholders, but to tilt the  
22 process toward the bidder more likely to continue current management, they commit a breach of  
23 fiduciary duty." *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 64 (Del. Ch. 2007).

24 Under these facts, plaintiffs have "established a reasonable probability of success that the  
25 [Restoration] board is breaching its fiduciary duties by misusing the standstill agreement in order to

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27 <sup>1</sup> All "Ex. \_\_\_" references are to the Declaration of Stephen J. Oddo in Support of Plaintiffs'  
28 Motion for Preliminary Injunction filed concurrently herewith.

1 prevent [Sears] from . . . presenting a bid that [Restoration] stockholders could find materially more  
2 favorable than the” Proposed Merger. *Id.* at 63. Moreover, absent an injunction, “the [Restoration]  
3 stockholders may be foreclosed from ever considering [Sears’] offer, a result that, under our precedent,  
4 threatens irreparable injury.” *Id.* at 92. To prevent this irreparable harm to the Company’s  
5 shareholders, the Court should enjoin defendants from (i) enforcing the standstill agreement; (ii) paying  
6 any termination fee to the MBO Group; and(iii) holding the shareholder vote, currently scheduled for  
7 June 12, 2008. Such action is required to permit Sears to make a tender offer directly to Restoration’s  
8 shareholders and to allow the Company to disclose the material information that defendants have  
9 omitted from the Proxy.

## 10 **II. FACTUAL BACKGROUND**

11 The sale of Restoration was unilaterally initiated by Friedman for Friedman and his close-knit  
12 management team in April 2007, when he set up a number of meetings with private equity firms about a  
13 going-private management led buyout. Among other private equity firms, Friedman met with  
14 representatives of Catterton. Deposition Transcript of Gary Friedman, dated May 2, 2008 (“Friedman  
15 Tr.”) at 49:7-9, 57:11-58:01 (Ex. 2). Friedman was introduced to Catterton principle Michael Chu  
16 (“Chu”) by the Company’s former Chief Operating Officer, John Tate, who now works as a private  
17 equity “headhunter.” *Id.* at 49:10-12, 55:12-18. From the start it was clear that any transaction with  
18 Catterton would involve continued employment for Friedman and his management team, the potential  
19 to rollover their equity into the surviving company, and the promise of an even bigger cut of the equity  
20 to Friedman once the Company was private. *Id.* at 56:16-25; Ex. 3. In later conversations with Sears,  
21 Friedman demonstrated his clear preference “to do a deal where he would go private in a management  
22 buyout, and he would receive a large equity component of the business and have a potential to gain  
23 personal wealth well in excess of [a] transaction with a strategic partner.” Crowley Tr. at 19:19-20:2  
24 (Ex. 1).

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