Delaware Decisions Highlight Pleading Requirements for Fiduciary Duty Claims in the Face of Disinterested Director Approval

Contributors

Art Bookout, Counsel

Veronica Bartholomew, Associate

Gregory Ranzini, Associate

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Several recent Delaware decisions have analyzed allegations attempting to plead breach of fiduciary duty claims against executive directors even though the underlying transaction was approved by a majority-disinterested-and-independent board of directors. These decisions emphasize the need for directors to actively monitor potential conflicts among officers and highlight the pleading requirements for plaintiffs to successfully state a breach of fiduciary duty claim arising from allegations of a "supine" board or a board that was allegedly misled by a conflicted officer.

On June 30, 2020, the Delaware Supreme Court confirmed in *City of Fort Myers General Employees' Pension Fund v. Haley*[1] that a board of directors is permitted to delegate the task of negotiating a transaction to an otherwise conflicted officer of the company. While the Supreme Court acknowledged that "[t]here is nothing inherently wrong with a Board delegating to a conflicted CEO the task of negotiating a transaction," as long as the conflict is "adequately disclosed to the Board and the Board ... properly oversee[s] and manage[s] the conflict," it reversed the trial court's dismissal of breach of fiduciary duty claims because the executive director "failed to disclose his 'interest in the transaction to the board,'" and "'a reasonable board member would have regarded the existence of [the] material interest as a significant fact in the evaluation of the proposed transaction.'"

Two more recent decisions from the Court of Chancery, *In re Mindbody, Inc., Stockholders Litigation*[2] and *City of Warren General Employees' Retirement System v. Roche*,[3] provide additional color on the pleading requirements to sustain a cause of action under this narrow theory. In *Mindbody*, the court refused to dismiss claims against Mindbody's CEO and chairman of the board because the detailed allegations related to his "subjective desire for near-term liquidity and the opportunity to continue as CEO of the post-merger entity" created a conflict, and his failure to inform his fellow directors prevented the court from relying on the disinterested board's approval of the merger to dismiss the claims. By contrast, in *Roche*, the Court of Chancery deferred to the approval of the disinterested board and dismissed fiduciary duty claims because the complaint failed to adequately allege a conflict or that the purported conflict was used to mislead or manipulate the board.

Mindbody

Background

In *Mindbody*, plaintiffs alleged that three defendants "tilted" the company's 2019 sale process in favor of Vista Equity Partners due to conflicts of interest, though the complaint focused primarily on Mindbody's CEO and chairman, Richard Stollmeyer. The Court of Chancery dismissed the claims against an outside director, Eric Liaw, because the complaint failed to make nonconclusory allegations sufficient to state a claim. However, the court refused to dismiss claims against Mr. Stollmeyer and Mindbody's CFO and COO, Brett T. White.

[1] 235 A.3d 702 (Del. 2020) ("*Haley*").

[2] 2020 WL 5870084 (Del. Ch. Oct. 2, 2020) ("*Mindbody*").

[3] 2020 WL 7023896 (Del. Ch. Nov. 30, 2020) ("*Roche*").

Stollmeyer's Alleged Personal Conflicts

Liquidity-driven conflicts

The plaintiffs alleged that Mr. Stollmeyer's "personal financial situation was such that it required cash flow" and he "seemed stretched as of 2018" due to investments in family ventures, loans to family members and friends, a pledge to a local college (of which the majority was unpaid), home renovation plans exceeding $1 million and "a sizeable mortgage." The plaintiffs further alleged that Mr. Stollmeyer needed to increase his liquidity in early 2018 because he told his financial advisor that (i) he would be "digging into" his line of credit to fund expenses, (ii) the sale of his Mindbody stock pursuant to a new 10b5-1 plan was "'top of mind'" for him, and (iii) he likely intended to sell most or all of his stock. Plaintiffs also alleged that Mr. Stollmeyer viewed his net worth as "'locked inside' Mindbody stock," that he was unable to liquidate his pre-merger holdings except under his 10b5-1 plan, and that he made public statements that analogized his situation to "'sucking through a very small straw.'"

The court remarked that it "need not infer that Mr. Stollmeyer subjectively desired near-term liquidity — he said as much himself." The court concluded that "[a]lthough it is a rare set of facts that will support a liquidity-driven conflict theory," Mr. Stollmeyer's "self-professed fatigue of 'sucking through a very small straw' makes it reasonably conceivable that this case fits the rare fact pattern."

Employment-driven conflicts

The court noted that the plaintiffs' liquidity-driven and prospective employment theories of conflicts "work in combination to land a powerful one-two punch on Stollmeyer." Once again, the court noted that it "need not infer that Stollmeyer subjectively desired future employment and compensation from Vista — he said as much himself":

- Mr. Stollmeyer communicated to investment banker Qatalyst that he was "motivated to sell to a buyer who would retain his management team" and was then connected with Vista;
- Mr. Stollmeyer attended the CXO Summit, which he described as "mind-blowing" and "inspiring," and texted a Vista principal that the presentations were "very impressive"; and
- on the day of the merger announcement, Mr. Stollmeyer texted his financial advisors that "Vista's in love with me (*and me with them*). No retirement in my headlights."

As a result, the court found that the complaint adequately alleged that Mr. Stollmeyer harbored a material self-interest that conflicted with the interests of the Mindbody stockholders.[4]

Failure to Disclose Material Conflicts to the Board

The defendants argued that even if Mr. Stollmeyer were conflicted and tilted the sales process in Vista's favor, the claims should be dismissed because the plaintiffs failed to allege that a majority of the Mindbody board that approved the merger was interested or lacked independence. Characterizing the allegations against Mr. Stollmeyer as "degrees more troubling" than those in *Haley*, the court concluded that the plaintiffs adequately alleged that Mr. Stollmeyer "suffered from material conflicts in the sale process that he failed to disclose to the Board" and that the board "would have viewed them as relevant and of a magnitude to be important in

[4] The court refused to dismiss duty of care claims against Mr. White because it found sufficient the allegations that he, among other things, "obeyed Stollmeyer's instructions not to disclose Vista's expression of interest to the Board," and provided "timing and informational advantages" to Vista throughout the sales process. Because Mr. White was only an officer of Mindbody, duty of care claims were not subject to dismissal under Mindbody's exculpation provision in its Certificate of Incorporation.

carrying out their decisionmaking process." These allegations included the same allegations that conflicted Mr. Stollmeyer, as well as the following:

- Mr. Stollmeyer did not immediately disclose Vista's expression of interest to his fellow directors, instructed management not to disclose it, and did not inform the board of his interactions with Vista leading up to and surrounding its expression of interest;
- Mr. Stollmeyer did not inform the board of his dealings with Qatalyst before a later-formed transaction committee also retained Qatalyst; and
- Mr. Stollmeyer eliminated bidders from the sales and go-shop process that he did not wish to work for, while providing timing and informational advantages to Vista by declining to share diligence with other potential bidders and solely providing Vista with comparatively greater data room access and the company's quarterly results.[5]

The court concluded that, while a majority of the board was not even named as defendants in the action, these allegations (among others) made it "reasonably conceivable that the Board lacked material information and failed to adequately oversee Stollmeyer." Thus, "at the pleading stage, the presence of a disinterested and independent majority of the Board [did] not defeat a claim for liability."

Roche

Background

In *Roche*, the plaintiff alleged that two of Blackhawk's executive directors, CEO and President Talbott Roche and Executive Chairman William Tauscher, breached their fiduciary duties solely in their capacities as officers by (i) manipulating the board to approve a buyout by Silver Lake Partners, L.P. and P2 Capital Partners in order to maintain their employment and earn equity in the post-buyout entity, and (ii) misleading stockholders through a materially misleading proxy statement. The Court of Chancery dismissed these claims but sustained a claim for breach of the duty of care against Mr. Roche (in his capacity as CEO) for approving allegedly misleading disclosures in the proxy statement issued in connection with the transaction.

Failure To Allege Personal Conflicts

Plaintiff alleged that Mr. Roche and Mr. Tauscher were self-interested because activist stockholders threatened their employment with Blackhawk and, as in *Mindbody*, the executives were conflicted by the prospect of future employment post-sale. The court held that there were no facts supporting the plaintiff's claims regarding any fear from an activist and that statements complimentary of management in offer letters did not demonstrate a conflict when there was no allegation that the executive directors entered into employment agreements or discussed terms of employment with the buyers pre-announcement.

Failure To Allege Board Deception or Manipulation

The court also held that, "even assuming the Complaint contained sufficient allegations that Roche and Tauscher suffered from a material conflict of interest (and it does not), the Complaint fails to allege that Roche and Tauscher breached their fiduciary duty of loyalty by manipulating or deceiving the Board into approving the Buyout." While the court noted that none of the nonexecutive members of the board were alleged to have breached their fiduciary duties (and the executive members were named as defendants only in their capacities as officers), the court still found it necessary, as in *Mindbody*, to examine the allegations related to the board's conduct because of plaintiff's allegations of a "supine" or deceived board of directors.

[5] The court also noted that the transaction committee formed by the board initially had a narrower scope of authority and never retained its own counsel.

First, the court held that the complaint did not adequately allege that the board was "supine." The complaint did not allege that any of the 10 outside directors were dominated by Mr. Roche or Mr. Tauscher, suffered from any conflict of interest or acted in bad faith. The court found that the allegations of the complaint demonstrated that the board met repeatedly, engaged with management and advisers, and deliberated during regular intervals during the buyout process.

Second, the court held that the complaint did not adequately allege that Mr. Roche and Mr. Tauscher deceived their fellow directors. Notably, despite ultimately sustaining a claim for breach of the duty of care against the CEO Mr. Roche after finding that it was reasonably conceivable that the proxy statement omitted material information or was misleading, the court held that there were no well-pled allegations that he or Mr. Tauscher misled the rest of the board regarding the proxy statement.

Takeaways

- These decisions highlight the recent increase in "supine" or deceived-board claims and the need for directors and officers to disclose potential or actual self-interest related to transactions under consideration. They also serve as a reminder that boards need to actively probe and monitor potential conflicts, particularly when entrusting officers to negotiate potential transactions.
- As officers of a Delaware corporation are not exculpated from monetary liability for breaches of the duty of care under 8 Del. C. §102(b)(7), they may be further susceptible to such allegations in the context of a sales process or related disclosures. See, also in this edition of Insights: The Delaware Edition, "Recent Trends in Officer Liability." Skadden previously discussed recent cases involving officer liability in our March 23, 2020, client alert, "Reevaluating the Board Risk Oversight Process: Implications of Marchand and Other Recent Developments."
- Corporations and their boards of directors should continue to consult internal and outside counsel for guidance regarding the proper evaluation, disclosure and oversight of director and officer conflicts, and committees of the board should always evaluate the need for separate counsel.

Contacts

Litigation

Cliff C. Gardner
302.651.3260
cgardner@skadden.com

Edward B. Micheletti*
302.651.3220
edward.micheletti@skadden.com

Robert S. Saunders
302.651.3170
rob.saunders@skadden.com

Paul J. Lockwood
302.651.3210
paul.lockwood@skadden.com

Jenness E. Parker
302.651.3183
jenness.parker@skadden.com

Jennifer C. Voss
302.651.3230
jennifer.voss@skadden.com

Mergers & Acquisitions

Faiz Ahmad
302.651.3045
faiz.ahmad@skadden.com

Steven J. Daniels
302.651.3240
steven.daniels@skadden.com

Allison L. Land
302.651.3180
allison.land@skadden.com

Corporate Restructuring

Anthony W. Clark
302.651.3080
anthony.clark@skadden.com

Joseph O. Larkin
302.651.3124
joseph.larkin@skadden.com

*Editor

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One Rodney Square / 920 N. King St. / Wilmington, Delaware 19801 / 302.651.3000

One Manhattan West / New York, NY 10001 / 212.735.3000