Court Finds Mindbody CEO Liable Under *Revlon* and That Buyer Aided and Abetted Disclosure Violations

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In March 2023, the Delaware Court of Chancery issued a rare decision holding an officer personally liable for damages for breach of fiduciary duty under a post-closing Revlon enhanced scrutiny analysis. Specifically, the Chancellor's post-trial opinion in *In Re Mindbody, Inc. Stockholder Litigation*[1] imposed liability on the target's CEO for sale process failures in connection with the buyout of a technology company by a private equity firm. The opinion also held the CEO liable for presenting misleading disclosures to stockholders to get the acquisition approved, and held the acquiror liable for aiding and abetting those misleading disclosures.

Officers and directors of Delaware corporations, private equity sponsors, investors and practitioners should pay close attention to *Mindbody*'s guidance on post-closing judicial review of sale process requirements and proxy disclosures.

Background

Based on the evidence at trial, the court found that, after nearly two decades of building Mindbody, Inc., its CEO and director, Richard Stollmeyer, had grown "physically and emotionally exhausted." For personal reasons, he desired liquidity, and by early 2018, he was ready to sell.

The court found that, after receiving what Stollmeyer characterized as a "mind blowing" presentation about the amount of money portfolio company chief executives could make while working under the umbrella of the eventual buyer, Vista Equity Partners Management, LLC (Vista), he became "smitten" with Vista and "effectively greased the wheels for Vista" to emerge as the acquiror from the board's sale process. The court catalogued the several instances in which Stollmeyer gave the board no information or only partial information about his conversations with Vista. For example, before Mindbody's board of directors had even discussed a sale of the company, Stollmeyer alerted Vista that he was looking for a "good home" for the company in the near term.

Vista expressed interest in acquiring the company at a "substantial premium" to its stock price. In response to Vista's interest, the board established a transaction committee, which developed guidelines to manage communications with potential acquirors. However, the court found that Stollmeyer "ignored" the guidelines, including by tipping Vista about the board's upcoming formal sale process. The company's banker also tipped Vista as to Stollmeyer's target deal price of $40 per share. With this information, the court found that Vista, which was known for very aggressive and quick negotiations, "bragged" internally that it was "'able to conduct all of [its] outside-in work before the process launched'" and to "'move swiftly in the process to provide the board with a highly certain offer within 3 days of receiving data room access.'"

Vista submitted an offer to acquire the company for $35.00 per share and imposed a 24-hour deadline for acceptance. The board countered with $40.00, and Vista replied with its "best and final" offer of $36.50. On December 23, 2018, the company and Vista entered into a merger agreement at $36.50 per share. Though the merger agreement provided for a 30-day go-shop period, Stollmeyer went on vacation half-way through the go-shop period and instructed management to decline go-shop presentations in his absence unless "urgent."

[1] C.A. No. 2019-0442-KSJM (Del. Ch. Mar. 15, *revised* Mar. 21, 2023).

Under the merger agreement, Vista had rights to review the company's proxy statement and was "obligated" to notify the company if it was aware of any material omitted facts. The court found that the proxy statement "sterilized" Stollmeyer's interactions with Vista — omitting (among other things) any reference to multiple important meetings he had with Vista and Vista's statement about paying a "substantial premium." On February 14, 2019, the company's stockholders approved the merger and the transaction closed the next day.

Plaintiffs brought suit arguing that the board and breached their fiduciary duties by tilting the sale process in Vista's favor and by failing to disclose material information in the proxy statement. Plaintiffs also contended that Vista and others aided and abetted those breaches. Prior to trial, plaintiffs settled with or dismissed all defendants except Stollmeyer and Vista.

Claims Against the CEO

Process Claims

The court first evaluated plaintiffs' claim for breaches of fiduciary duty against Stollmeyer, in his role as an officer for the company, for improperly tilting the sale process in favor of Vista. The court characterized the facts as illustrating a "paradigmatic" *Revlon* claim, which it described as a situation where "a conflicted fiduciary who is insufficiently checked by the board [] tilts the sale process toward his own personal interest in ways inconsistent with maximizing stockholder value."

The court found that Stollmeyer suffered a disabling conflict because of his desire for a quick sale and near-term liquidity, and the expectation that he would receive post-merger employment and significant equity-based incentives as a Vista portfolio company executive. The court similarly found the record "riddled with instances" where Stollmeyer tilted the sale process in Vista's favor.

The court also found that Stollmeyer, in his role as CEO, had left the board "in the dark" about the extent of his personal interests or his interactions with Vista. The board knew nothing of Stollmeyer's need for liquidity or desire for a near-term exit, and knew nothing about his preference for Vista or Vista's head start in the sale process. The court determined that the board had failed to adequately oversee Stollmeyer and that Stollmeyer's breaches of fiduciary duties in failing to disclose certain information to the board rendered the sale process outside the "range of reasonableness" required to satisfy enhanced scrutiny under *Revlon*.

In assessing damages for Stollmeyer's breaches of fiduciary duty for "corrupt[ing] the [sale] process," the court assented to plaintiffs' lost-transaction theory of damages (*i.e.*, the amount that Vista would have paid per share in an uncorrupted process). Based on "internal Vista bets" about where the deal price would land, the court rejected plaintiffs' claim that Vista would have paid $40.00 per share (the high-end of Vista's internally approved price range), and found that it would have paid $37.50, or $1.00 more than the deal price, per share. The court awarded $1.00 per share in damages.

Disclosure Claims

The court next analyzed plaintiffs' disclosure claims as an independent ground for liability. The court found that Stollmeyer was in a "unique position of informational asymmetry" because he was the only person at the company who knew the full nature of his interactions with Vista. The court found that Stollmeyer knowingly withheld information from the stockholders and created a false narrative about his interactions with Vista. The court observed that perhaps one of the disclosure issues, standing alone, would not meet the required materiality standard, but taken together, the partial and complete omissions rendered the proxy statement materially misleading.

The court awarded "nominal" damages because plaintiffs made no attempt to prove the reliance and causation elements required for the compensatory damages they sought. However, the court stated that nominal damages "need not be minimal," and acknowledged its equitable discretion when there is an "obvious wrong" and no "mathematical basis for deriving a damages figure." Using this discretion, the court examined prior case law and awarded $1.00 per share in damages, overlapping with the damages awarded under the process claim.

Aiding and Abetting Claim Against the Buyer

Plaintiffs advanced two theories for aiding and abetting liability against Vista. First, plaintiffs alleged that Vista aided and abetted Stollmeyer's sale process breaches. The court rejected this argument as untimely because plaintiffs waited almost three years to specifically identify the claim and only expressly argued it for the first time after trial.

Second, plaintiffs alleged that Vista aided and abetted Stollmeyer's disclosure violations. The court centered its analysis on whether Vista "knowingly participated" in Stollmeyer's violations. For knowledge, the court found that Vista knew the extent and content of its pre-merger interactions with Stollmeyer and knew they were not fully disclosed in the proxy statement. The court found the required participation in Vista's "contractual obligation … to correct any material omissions" in the proxy statement. Thus, the court determined that Vista knowingly participated in the breach by not speaking up when contractually required to do so. The court imposed joint and several liability on Vista for the $1.00 per share in damages.

Key Points

- Delaware courts expect officers to act under the direction of the board and to keep the board informed of their actions and motivations. Both sides of the director-officer relationship need to be mindful of the expectations of Delaware law when it comes to oversight and disclosure at the board level. This includes the obligation of officers to inform directors of early-stage communications with potential acquirors and any potential conflicts.

- Directors have an obligation under Delaware law to disclose material information to stockholders in advance of a stockholder vote. In the merger context, most post-closing stockholder class actions seeking money damages in the Delaware courts include disclosure claims, at a time when the company cannot supplement or correct disclosures. As a result, it is vital for corporate fiduciaries to make judgment calls about what disclosures should be made well in advance of any litigation being filed.

- The *Mindbody* decision suggests that a successful post-trial disclosure claim will require a remedy, even if it is just a "nominal" damages award. In *Mindbody*, that nominal figure was $1 per share, or about $46 million total, based on the outstanding number of shares at issue, excluding shares held by the CEO. Whether or not that becomes a default "nominal" figure in future cases with post-closing disclosure violations remains to be seen.

- In *Mindbody*, the acquiror was jointly and severally liable for the officer's disclosure-related fiduciary duty breach in part because of language in the merger agreement that obligated it to notify seller if it became aware that any disclosures were materially misleading or incomplete. Acquirors should carefully review and understand their obligations under the respective merger agreement, and consider their contractual obligations with their advisors when reviewing merger-related disclosures.

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