ALERT MEMORANDUM

# Delaware Chancery Court's *Mindbody* Decision – Lessons for Private Equity Buyers in Take-Private Transactions

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In a recent opinion addressing breaches of fiduciary duties and disclosure violations in connection with a take-private of Mindbody, Inc. by Vista Equity Partners, the Delaware Court of Chancery reinforced the significance (to both buyers and sellers) of avoiding conflicts in a sell-side process and ensuring all material facts are disclosed to the target's board *and* stockholders. The *Mindbody* opinion, while addressing unusual facts, serves as a helpful guide for buyers in take-private transactions.

## Case Context

The Delaware Supreme Court's iconic decision in *Revlon*[1] dictates that once a company determines to sell itself for cash, the company's board is required to act towards a specific objective: obtaining the best price reasonably available for the company. In 2015, however, the Delaware Supreme Court in *Corwin* established that the enhanced scrutiny of *Revlon* would not apply to cash-out mergers, and instead the deferential business judgment rule would apply, *if* the transaction was "approved by a *fully informed*, uncoerced majority of the disinterested stockholders."[2] This so-called *Corwin* cleansing made it substantially more challenging for stockholder plaintiffs to obtain damages on *Revlon* claims, as a finding that the disinterested stockholder vote was fully informed and uncoerced would effectively end the case (not only as to the directors, but also as to third parties alleged to have aided and abetted the board's breaches of its *Revlon* duties). As a result, before the recent *Mindbody*[3] decision, there had been very few instances of stockholder plaintiffs succeeding on *Revlon* claims. But on March 15, 2023,

[1] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 175 (Del. 1986).
[2] *Corwin v. KKR Fin. Holdings, LLC*, 125 A.3d 304, 305–06 (Del. 2015).
[3] *In re Mindbody, Inc. Stockholder Litigation,* C.A. No. 2019-0442-KSJM, memo. op. (Del. Ch. Mar. 15, 2023).

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the Delaware Court of Chancery found Mindbody's founder and CEO, Richard Stollmeyer, liable on what it called a "paradigmatic *Revlon* claim"[4] (and related disclosure claims) in connection with Vista Equity Partners' $1.9 billion acquisition of Mindbody in 2019. Additionally, the court found Vista liable for aiding and abetting Stollmeyer's disclosure violations.

## Background and Court Decision

In August and September 2018, before Mindbody's board of directors had embarked on a sale process or even discussed a possible sale, Stollmeyer unilaterally began engaging with Vista about a possible transaction. He indicated that he was tired of being CEO of a public company, planned to step down in two or three years and wanted to find a "good home" for Mindbody.[5] He attended Vista's "CXO Summit" on October 9, where he was impressed by the wealth created for Vista's portfolio company CEOs while under Vista ownership, and pitched Mindbody to Vista; on the same day, he texted Mindbody's president stating that Vista "really love[s] me, I love them."[6] Following the CXO Summit, Vista became interested in a deal and began obtaining the necessary approvals to "sprint" to signing a deal with Mindbody in an effort to reduce interloper risk.[7] On October 15, Vista delivered an oral expression of interest to Stollmeyer, which he shared with his management team on October 17.[8] However, Stollmeyer did not inform the full board until October 23[9] – eight days after Vista's expression of interest. The Mindbody board acted swiftly to implement a transaction committee, which established communication guidelines. But Mindbody's financial advisor still tipped Vista that Stollmeyer expected to receive a $40 minimum per share offer,[10] and Stollmeyer informed Vista on November 10 that Mindbody would be running a formal deal process, before the November 30 launch date of that process (and well before other bidders were informed).[11]

Chancellor McCormick found that Mindbody's board was "in the dark" during the sale process, unaware that the founder and CEO was under a "disabling conflict" due to his desire for near-term liquidity and "love" for the private equity buyer (following the CXO Summit), and that he tilted the sale process in favor of Vista.[12] In particular, the court found that Stollmeyer had "an interest in near-term liquidity, a desire to sell fast, and an expectation that the CEO would receive post-merger employment accompanied by significant equity-based incentives."[13] For example, he made statements to others that he was ready to sell and needed liquidity, and reached out to Mindbody's largest stockholder who had similar desires to exit to confirm its interest in a sale without any board involvement. Both Stollmeyer and this other stockholder also were motivated to sell by the looming expiration of super-voting provisions attached to their shares. None of this was disclosed to the board. Nor was the fact that Stollmeyer tipped Vista on Mindbody's anticipated launch of the formal sale process and his expectation of a $40 minimum per share deal price, which placed Vista in a position to make its first offer on December 18, three days after the data room opened, and its "best and final offer"[14] on December 20. Following Vista's initial offer, the Mindbody transaction committee directed its financial adviser to inform all potential bidders to make an offer, but no other bidder was in a position to submit a firm offer, thus creating a lack of competition for Vista in its effort to buy the company.

Furthermore, the court agreed with the plaintiff that stockholders were "as in the dark as the board,"[15] and that Stollmeyer violated his duty of disclosure by knowingly withholding information from the proxy materials relating to his private interactions with Vista.

[4] *Id.* at 86.
[5] *Id.* at 91.
[6] *Id.* at 28.
[7] *Id.* at 33.
[8] *Id.* at 93.
[9] *Id.*
[10] *Id.* at 48.
[11] *Id.* at 51.
[12] *Id.* at 86, 97.
[13] *Id.* At 86.
[14] *Id.* at 65.
[15] *Id.* at 97.

Additionally, Vista was found liable for aiding and abetting Stollmeyer's breach of the duty of disclosure. Vista reviewed and was involved in drafting the Mindbody proxy statement to obtain necessary stockholder approval, and was aware that the proxy omitted mention of Vista's early discussions with Stollmeyer, which gave it significant information and timing advantages. To remedy these breaches, the court determined damages equaled $1.00 per share, a 2.7% premium to the agreed deal price of $36.50 per share, which was supported by evidence of the amount Vista would have been willing to pay as further discussed below.

## Takeaways for Private Equity Buyers

Well-advised private equity buyers generally recognize that in a take-private transaction, while typical negotiating dynamics exist, there is nevertheless alignment between the buyer and the target regarding the target board's compliance with its fiduciary obligations in a sale context. The *Mindbody* decision illustrates why private equity buyers should be cautious when initially engaging with founders/CEOs who express a strong interest to do a deal ahead of any board-initiated process, and who may make decisions for idiosyncratic reasons (for example, near-term liquidity or post-acquisition employment). Even where, as in *Mindbody*, a CEO owns material amounts of stock, that does not automatically align the CEO's interests with the other stockholders from a legal point of view. The facts and context matter, and if it seems "too good to be true," that simply may be the case. And it is important to remember that not only are many of the risks and costs associated with stockholder litigation ultimately owned by the buyer following closing of a take-private transaction, the buyer can have independent exposure for aiding and abetting target fiduciaries' breaches in some circumstances.

In *Mindbody*, the court repeatedly pointed to Stollmeyer's financial incentives, "love" for Vista and his rejection of other bidders for personal reasons. As much as buyers enjoy and can benefit from being on the good side of a target's management team, it is important that buyers actively take steps throughout the process to protect themselves from aiding and abetting target fiduciaries' violation of their duties and to limit their post-closing exposure.

— **Avoiding Aiding and Abetting Disclosure Violations**: In *Mindbody*, the court imposed aiding and abetting liability on Vista due to its failure to – as it was contractually required to do – ensure that target stockholders received an "accurate, full, and fair characterization of" the historic events of the transaction prior to the stockholder vote.[16] Vista reviewed the proxy statement but did not suggest enhancements to the disclosure regarding preliminary engagement that it had with Stollmeyer, which based on the facts of the case Vista was uniquely positioned to do, as only it and Stollmeyer were aware of these interactions. In addition, while Vista implicitly hinted that Stollmeyer's role was secure and that Vista could help him build immense wealth if it acquired Mindbody, this was also not disclosed. While this topic is always a risk to be managed in a sponsor-backed take-private because there is no buy-side management team to step in, the overall context of the interactions led the court to find Vista crossed the line and exposed itself to aiding and abetting liability. Finally, Vista could have, but did not, take any proactive measures to help Stollmeyer stay on the right side of the line – which is one of the only ways a third party can shield itself from this sort of liability, as the underlying breach is not generally within its control. For example, Vista could have asked or reminded Stollmeyer to ensure his board was informed of their interest and interactions to mitigate claims that it knowingly participated in any breach by Stollmeyer.

— **Err on the side of disclosure:** For procedural reasons, Vista's liability for aiding and abetting was rooted not in its participation in Stollmeyer's

[16] *Id.* at 102 (citations omitted).

*Revlon* violations, but in the lack of disclosure of those violations. The *Mindbody* opinion does not mean that buyers should no longer invite CEOs of companies of interest to their conferences or continue seeking to get ahead of competitors by forming a cordial relationship with a company's management team. Rather, the opinion reinforces the importance of disclosing all material facts to a target's board and stockholders. The *Mindbody* opinion emphasized that buyers and targets cannot rely upon a "sterilized narrative"[17] of the parties' interactions, in which partial disclosures obscure material facts which may reveal potential conflicts of target fiduciaries and missteps in the sale process. Critically, full disclosure would have triggered the protection of the business judgment rule under *Corwin*, which "cleanses" not only primary claims against the target directors and officers, but aiding and abetting claims against third parties as well.

— **Written Communications:** Similar to the advice frequently given to target board members, buyers should also be careful with written communications, including text messages and materials prepared for a buyer's investment committee, on deal-related topics. Chancellor McCormick's decision rested in no small part on text messages among Stollmeyer, financial advisors and the Vista deal team that were clearly not intended for public consumption. For example, to determine the damages award, the court relied on a photo sent via text message by one Vista deal team member to another, showing Vista employees' over-under guesses of the eventual deal price (the over-under was $1.00 more than the deal price). Another internal Vista text suggested that Vista employees should "stick to their story"[18] regarding when they began discussing a potential deal with Stollmeyer and Mindbody's financial advisors – which story was not, in fact, true. In the context of a fiduciary breach claim, communications like these make it easier to find aiding and abetting liability against a third party buyer (whom the court may otherwise view as unconnected to problems with the target side sale process), as they demonstrate the requisite awareness of wrongdoing and can also give the court a hook on which to base a damages award.

— **Role of Advisors**: Legal and financial advisors are responsible for assisting principals in achieving their goals while seeking to ensure the transaction may proceed within the bounds of the law. Even when there are one or two missteps, competent advisors – legal and financial – should guide principals with carefully thought-through mitigation strategies to minimize the risks relating to stockholder litigation. The court noted that certain of the missteps in this case, standing alone, might not have met *Corwin's* materiality standard; however, taken together, the facts ultimately led to liability for both the target CEO and the private equity buyer. Private equity buyers should recognize this risk and utilize their advisors to timely flag any missteps, particularly after signing when the proxy is being prepared. As noted by stockholders' counsel in Mindbody, "good advisors and outside directors can often mitigate a poor start or a single misstep along the way."[19] However, in order for advisors to effectively assist buyers in developing an appropriate disclosure plan, the advisors need to be informed of all potentially relevant and material facts (bearing in mind that stockholders can, and frequently do, invoke their rights to inspect otherwise confidential books and records under DGCL § 220 before filing complaints alleging the disclosures were inadequate).

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[17] *Id.* at 100.
[18] *Id.* at 70.
[19] Alison Frankel, *Delaware's new Mindbody decision is vivid reminder: Tainted deals are not okay*, REUTERS (Mar. 16, 2023), https://www.reuters.com/legal/transactional/delawares-new-mindbody-decision-is-vivid-reminder-tainted-deals-are-not-okay-2023-03-16/.