DELAWARE CORPORATE LAW BULLETIN

Chancery Court Again Refuses Preliminary Dismissal due to Well-Pled Allegations that Sale Process Orchestrated by Target Company Fiduciary Failed To Satisfy *Revlon* Standards

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Unable to establish Corwin defense, defendant-director confronted with well-pled allegations of disabling conflicts, favoritism toward preferred bidder, and withholding of material information from board and stockholders, loses bid for pleading-stage dismissal.

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INTRODUCTION

Several recent decisions of the Delaware Court of Chancery ("*Chancery Court*") have considered the interplay between two iconic Delaware Supreme Court decisions rendered in the corporate sale context: *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) ("*Revlon*"); and *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015) ("*Corwin*"). In *Revlon*, the Delaware high court proclaimed that, "in the change-of-control context, the duty of loyalty requires 'the maximization of the company's value at a sale for the stockholders' benefit' " (quoting *Mindbody* here and throughout the piece unless otherwise noted). The *Revlon* court also designated "enhanced scrutiny" as the applicable standard of review for claims questioning corporate fiduciary adherence to their so-called "*Revlon* duties" (quoting *Kahn*).

Nearly thirty years later, *Corwin* provided corporate fiduciaries with a powerful tool to defend post-closing damages actions alleging breach of "*Revlon* duties" (quoting *Kahn*). Under *Corwin*, a "fully informed, uncoerced vote of the disinterested stockholders" will, in effect, "cleans[e]" any such breach. *Corwin* also addressed the application of *Revlon* to litigation challenging corporate sales transactions. According to the *Corwin* court, "*Revlon* [is] primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing. [*Revlon* was] not [a] tool[ ] designed with post-closing money damages claims in mind . . . " (quoting *Corwin*).

To some, *Corwin* signaled the demise of *Revlon*. Between a concern that the Chancery Court would rubber-stamp stockholder votes in favor of tainted transactions, together with the non-applicability of enhanced review of fiduciary actions in connection with post-closing damages claims, would Revlon continue to act as a brake on fiduciary

malfeasance in connection with corporate sales? The answer would appear to be a resounding yes.

First, the authors of Delaware Corporate Law Bulletins have chronicled numerous decisions in which the Chancery Court found *Corwin* inapplicable due to, among other reasons, an uninformed or a coerced stockholder vote. Further, as the Chancery Court cautioned in *In re Massey Energy Co. Derivative & Class Action Litig.*, 160 A.3d 484 (Del. Ch. 2017) ("*Massey*"), *Corwin* "was never intended to serve as a massive eraser, exonerating corporate fiduciaries for any and all of their actions or inactions preceding their decision to undertake a transaction for which stockholder approval is obtained" (quoting *Massey*). For a discussion of *Massey*, see Robert S. Reder, *Chancery Court Declares* Corwin *is not a "Massive Eraser" for all Fiduciary Wrongdoing*, 72 VAND. L. REV. EN BANC 93 (2018).

Second, in *Kahn v. Stern*, 183 A.3d 715 (Del. 2018) ("*Kahn*"), the Delaware Supreme Court explained that "*Revlon* remains applicable as a context-specific articulation of the directors' duties" in those cases where *Corwin* cleansing is not available (quoting *Kahn*). For a discussion of *Kahn*, see Robert S. Reder & Victoria L. Romvary, *Delaware Supreme Court Clarifies Pleading Standard in Post-Closing Damages Action Alleging Breach of "Revlon Duties*," 72 VAND. L. REV. EN BANC 29 (2018).

The following year, in *Morrison v. Berry*, No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019) ("*Morrison*"), the Chancery Court cited *Kahn* for the proposition that "*Revlon* applies to the underlying company sale process—and is thus a context-specific lens through which to look at the defendants' duties" (quoting *Morrison*). When viewed through this "lens," plaintiff's allegations of director misconduct in conducting a sale process fell short of the high bar for pleading directors' breach of their duty of loyalty, leading to dismissal of defendant-directors' motion to dismiss (quoting *Morrison*). For a discussion of *Morrison*, see Robert S. Reder & Lorin Hom, *Chancery Court Dismisses Breach of Fiduciary Duty Claims Against Target Company Directors Despite Unavailability of* Corwin *Defense,* 73 VAND. L. REV. EN BANC 111 (2020).

Next, in *In re USG Corp. S'holder Litig.*, No. 2018-0602-SG, 2020 WL 5126671 (Del. Ch. Aug. 31, 2020) ("*USG*"), the Chancery Court presented a more detailed analysis of the *Revlon* "context-specific lens" identified in *Morrison* (quoting *Morrison*). In *USG*, defendant-directors sought pleading-stage dismissal on the basis of two alternative defenses: *first*, any alleged breach of fiduciary duty was "cleansed" under *Corwin* by virtue of the stockholder vote approving the transaction; and, *second*, if *Corwin* "cleansing" was not available,

plaintiffs failed to adequately plead breach of fiduciary duties by the directors (quoting *USG*). After rejecting the *Corwin* defense, the Chancery Court articulated that, in accordance with *Revlon*,

> where a board decides to sell the company and thus terminate stockholder ownership, the director[s'] fiduciary duties mandate that they concentrate on securing the best price. Put differently, to comply with *Revlon*, "when a board engages in a change of control transaction, it must not take actions inconsistent with achieving the highest immediate value reasonably attainable" (quoting *USG*).

For a discussion of *USG*, see Robert S. Reder & Spencer H. Lutz, *No* Corwin*, No Problem: Chancery Court Discusses* Revlon*'s Role in Analyzing Post-Closing Damages Claims Against Target Company Directors,* 74 VAND. L. REV. EN BANC 71 (2021).

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Recently, in *In re Mindbody, Inc. S'holders Litig.*, No. 2019-0442-KSJM, 2020 WL 5870084 (Del. Ch. Oct. 2, 2020) ("*Mindbody*"), Vice Chancellor Kathaleen S. McCormick of the Chancery Court observed that "the paradigmatic *Revlon* claim involves a conflicted fiduciary who is insufficiently checked by the board and who tilts the sales process toward his own personal interests in ways inconsistent with maximizing stockholder value." According to the *Mindbody* plaintiffs, "this cautionary tale provided the template" for 2019's all-cash sale of MINDBODY, Inc. ("*Mindbody*" or the "*Company*") to private equity firm Vista Equity Partners ("*Vista*"). Focusing on alleged malfeasance by the Company's founder, Richard Stollmeyer ("*Stollmeyer*"), Vice Chancellor McCormick rejected Stollmeyer's *Corwin* defense and found that plaintiffs' claims that Stollmeyer breached his "*Revlon* duties" (quoting *Kahn*) satisfied the "reasonably conceivable" standard for defeating his motion to dismiss.

I. FACTUAL BACKGROUND

A. Stollmeyer Expresses Interest in Private Equity Buyout

Mindbody, founded in 2001 by Stollmeyer, operates "cloud-based business management and payments software for the wellness services industry." Stollmeyer, who served as Chairman of the Company board of directors ("*Board*") and CEO, controlled 19.8% of the Company's voting power. In his own words, not only was Stollmeyer's wealth "locked inside" Mindbody, but liquidating his holdings through market sales would be like "sucking through a very small straw." As he also

admitted, his ability to sell shares was "top of mind" due to significant personal expenses.

Stollmeyer was not Mindbody's largest stockholder. That distinction belonged to venture capitalist Institutional Venture Partners ("*IVP*"), an early investor which controlled 24.6% of the Company's voting power. IVP generally "seeks to exit its investments between three to five years," but it "could not easily sell its large block of Mindbody stock on the public markets without accepting a discount." IVP's general partner served as a member of the Board ("*IVP Board Representative*").

In an August 2018 meeting with investment banking firm Qatalyst Partners ("*Qatalyst*"), Stollmeyer "shared his frustrations with running a public company and his preference for selling Mindbody to a private equity fund that would agree to employ Stollmeyer and his management team in the post-merger entity." At about this time, Stollmeyer also met with a principal of Vista. Vista was known for "retaining management in take-private transactions and offering them compensation packages with significant upside." Vista subsequently invited Stollmeyer to a summit at which "Vista hyped its 'history of generating enormous wealth' " for its portfolio company CEOs.

The following month, "Stollmeyer endorsed an analyst report issued by Wells Fargo Securities, which provided a price target of $45 per share based on the Company's growth projections." Soon thereafter, J.P. Morgan maintained a favorable "Overweight" recommendation with a price target of $48 per share.

Then, in October, Vista provided Stollmeyer with "a direct expression of interest" to acquire Mindbody at a "substantial premium" to its recent average trading price of $38.46 per share. Not only did Stollmeyer fail immediately to disclose Vista's offer to the Board, but also he instructed the other members of his management team not to do so.

B. Management Lowers Earnings Guidance

The following month, Stollmeyer suddenly turned bearish. During an analyst earnings call, Stollmeyer lowered the Company's guidance for projected revenues, thereby taking a position "inconsistent with management's actual expectations" as reflected in "contempor[ary] communications." As part of this bearish strategy, in a Securities and Exchange Commission ("*SEC*") filing the same day as the earnings call, Mindbody "projected revenues of $65 to $67 million, reflecting a $1 to $3 million reduction from the projected $68 million Mindbody had disclosed in August of that year."

Not surprisingly, Mindbody stock fell to $32.63 per share following the earnings call. The stock then opened at $25.00 the next day, down from a high of $41.25 in October when Stollmeyer still was touting Mindbody's prospects. Stollmeyer seemingly was unperturbed, advising Qatalyst that they "are resetting street expectations to position [them]selves up for future . . . raises."

C. Vista Becomes Management's Favored Bidder

Shortly after being informed of Vista's expression of interest, the Board established a Transaction Committee ("*Committee*") "initially formed 'for the limited purpose of reviewing the potential engagement of a financial advisor to assist Mindbody with evaluating potential strategic alternatives and evaluating candidates for this role, including Qatalyst.' " The IVP Board Representative chaired the Committee, with Stollmeyer serving as one of four members. Subsequently, the Committee's charge was expanded to oversee the transaction process and make a recommendation to the Board.

Stollmeyer successfully "pushed to retain Qatalyst" as advisor and, with Qatalyst's assistance, "selected potential bidders for Qatalyst to contact." These potential bidders apparently "did not include 'logical' financial or strategic buyers, including those that 'may not have needed Stollmeyer and his management team." Throughout this process, Stollmeyer kept in touch with Vista, even sharing access to over 1,000 documents in a data room. Other potential bidders "received less information and in a less timely fashion."

Armed with this superior intelligence, on December 18 Vista offered to purchase the Company for $35 per share in cash. Qatalyst relayed to Stollmeyer that Vista, if it is the winning bidder, intended to provide management with "a 10% equity stake in the post-merger entity, doubling management's pre-deal stake." At the time, although other potential bidders were still conducting due diligence, they were told "to provide an indication of interest within the next 24 to 48 hours." Unable to "produce bids on 'a timeline that would be competitive with Vista,' " all "other potential bidders withdrew."

After "[t]he Board instructed Qatalyst to seek . . . $40," on December 21 Vista made its " 'best and final' offer of $36.50." Two days later, following Board approval of this offer, Vista and Mindbody signed a merger agreement ("*Merger Agreement*"). At the transaction's announcement, "the Company 'tout[ed] that the Merger provided a 68% premium to Mindbody's per share closing price of $21.72 on December 21.' " Not disclosed was that the transaction price also reflected "an 18.2% discount to Mindbody's 52-week high of $44.60 per share . . . and

a 5.1% discount to Mindbody's 30-day . . . average price before Vista's initial expression of interest."

In response to inquiries "whether he was 'going to retire' " after the buyout, Stollmeyer "responded: . . . 'Vista's in love with me (and me with them). No retirement in my headlights. However, I will likely sell most or all of my stock.' "

D. Go-Shop

The Merger Agreement called for a 30-day, post-signing "go-shop period during which Mindbody could solicit and negotiate alternative acquisition proposals." The go-shop operated on a relatively tight time frame, commencing on Christmas Eve 2018 and ending on January 22, 2019. Somewhat unusually, to achieve a reduced termination fee, a competing bidder was required to "make a contractually defined 'Superior Proposal' that had to be accepted within the go-shop period." Moreover, the data room made available to go-shop bidders had "some subtractions" from the data provided to Vista.

The go-shop proved to be a nonevent. Two potential bidders soon dropped out, indicating that "they could not compete . . . because of the go-shop's highly compressed timeline." Management delayed negotiating a potential strategic bidder's due diligence requests until near the end of the go-shop period. And Stollmeyer went on vacation until only eight days remained in the go-shop period, thereby delaying management discussions with potential bidders. Finally, during the go-shop period, Mindbody produced fourth-quarter results exceeding estimated revenues; although management provided these favorable results to Vista, they were given to no other potential bidder.

E. Definitive Proxy

Following the end of the go-shop period, Mindbody filed its definitive proxy statement (as subsequently supplemented, the "*Definitive Proxy*") with the SEC to solicit stockholder approval of the transaction. The Definitive Proxy disclosed neither "the extent of Stollmeyer's interactions with Vista," nor that Stollmeyer provided Vista with more, and timelier, diligence materials, nor Mindbody's positive fourth-quarter results.

On February 14, Mindbody stockholders voted to approve the Vista buyout. The transaction closed the following day.

F. Litigation Ensues

Soon after Mindbody issued the Definitive Proxy, several Mindbody stockholders (collectively, "*Plaintiffs*") brought a class action lawsuit in Chancery Court. In *Count I*, Plaintiffs claimed that Stollmeyer and another corporate officer "breached their fiduciary duties in their capacities as officers by initiating, timing, and tilting the sale process in favor of Vista in their own self-interest." In *Count II*, Plaintiffs claim that Stollmeyer and the IVP Board Representative "breached their fiduciary duties in their capacities as directors by failing 'to disclose all material information to Mindbody stockholders' in advance of the stockholder vote." Specifically, Plaintiffs focused on two sets of alleged "disclosure deficiencies": *first*, Stollmeyer's conflicts and dealings with Vista, including (i) discussions relating to Stollmeyer's post-closing employment, (ii) Vista's early expressions of interest in Mindbody before the sales process began in earnest, and (iii) the advantages given to Vista over other potential bidders; and *second*, Stollmeyer's "about-face" in the November 2018 guidance provided to analysts, followed by the positive fourth-quarter results that were withheld from stockholders before they voted on the buyout.

Defendants moved to dismiss. Vice Chancellor McCormick denied the motions of Stollmeyer and the other corporate officer but granted the motion of the IVP Board Representative. The balance of this Delaware Corporate Law Bulletin focuses on the disposition of the claims against Stollmeyer.

II. VICE CHANCELLOR MCCORMICK'S ANALYSIS

A. Corwin Defense Not Available

On the basis of Plaintiffs' pleadings, Vice Chancellor McCormick found the alleged disclosure deficiencies "more than sufficient to defeat a *Corwin* defense at the pleading stage." Demonstrating the interplay between *Corwin* and *Revlon*, she stipulated that "where facts alleged make the paradigmatic *Revlon* claim reasonably conceivable, it will be difficult to show on a motion to dismiss that the stockholder vote was fully informed." Without the benefit of *Corwin* cleansing, the question became whether Plaintiffs adequately pled that Stollmeyer breached his fiduciary duties.

B. Revlon Pleading Requirements

Because the Vista buyout "was a final-stage transaction presumptively subject to . . . *Revlon*," Vice Chancellor McCormick explained that "[t]he court must therefore examine whether the fiduciaries of the corporation have performed their fiduciary duties 'in the service of a specific objective: maximizing the sale price of the enterprise.' " When operating in this mode, "directors are generally free to select the path to value maximization, so long as they choose a reasonable route to get there."

This was not, however, the end of the analysis. Because Stollmeyer, in his capacity as a director, was exempt from personal damages for breach of his duty of care under a Delaware General Corporation Law section 102(b)(7) exculpatory provision in the Company's certificate of incorporation, the Vice Chancellor explained that Plaintiffs "must still plead facts sufficient to state a non-exculpated claim against" Stollmeyer. However, with Revlon serving as a " 'context-specific articulation of the directors' duties[,]' [w]ell pleaded facts that track the paradigmatic *Revlon* theory will typically support a non-exculpated claim as to the conflicted fiduciary."

C. Breach of Fiduciary Duty Claims Against Stollmeyer

Despite Stollmeyer's significant Company stock holdings, which ordinarily would have "aligned" his interests with those of other Mindbody stockholders, Plaintiffs successfully pled that it was "reasonably conceivable" that Stollmeyer "placed his interests in conflict with the interests of the Mindbody stockholders," thereby exposing him to liability for breach of his duty of loyalty.

1. Stollmeyer Conflicted

Plaintiffs alleged that "Stollmeyer's subjective desire for near-term liquidity and the opportunity to continue as CEO of the post-Merger entity placed his interests in conflict with the interests of the Mindbody stockholders." Ironically, Plaintiffs' task of satisfying the "reasonably conceivable" standard was eased by Stollmeyer's own admissions, not the least of which was his "self-professed fatigue of 'sucking through a very small straw' " to liquidate his holdings *via* market sales. According to the Vice Chancellor, "Plaintiffs' liquidity-driven and prospective-employment theories of conflicts work in combination to land a powerful one-two punch on Stollmeyer, rendering

it reasonably conceivable that Stollmeyer subjectively harbored interests in conflict with those of the Mindbody stockholders."

2. Stollmeyer Tilted the Sale Process

Plaintiffs also alleged that Stollmeyer "tilted the sale process in Vista's favor by: (a) lowering guidance to depress Mindbody's stock and make it a more attractive target at the time Vista was looking to acquire Mindbody and (b) providing Vista with timing and informational advantages over other bidders."

With respect to Stollmeyer's bearish guidance "about-face," the Vice Chancellor found "it reasonably conceivable that Stollmeyer strategically tanked Mindbody's stock price so that Vista could . . . 'buy the Company on the cheap.' " These actions were, "of course, inconsistent with value maximization" mandated by *Revlon*.

As to Vista's "informational and strategic advantages" during both the due diligence and go-shop periods, the Vice Chancellor found it "reasonably conceivable that Vista was given . . . advantages that uniquely positioned it for success." Further, she found "the go-shop's highly compressed timeline" to be, in a word, "problematic."

3. Stollmeyer Withheld Information

Stollmeyer argued that, even if he "was conflicted and tilted the sale process toward Vista, . . . as a general rule, a plaintiff 'can only sustain a claim for . . . breach of the duty of loyalty by pleading facts showing that it is reasonably conceivable that each of a majority of the board is conflicted.' " No one questioned the motivation of the other Board members (other than the IVP Board Representative). Plaintiffs, however, pointed to an "exception to this general rule, which applies when it is adequately alleged that . . . a conflicted fiduciary failed to disclose material information to the board, a theory sometimes referred to as 'fraud on the board.' "

In this connection, Vice Chancellor McCormick explained that "fraud-on-the-board . . . involve[s] two materiality inquiries—the first is whether the key fiduciary's alleged conflicts were material to him, and the second is whether the board would have viewed information concerning those alleged conflicts as material." The Vice Chancellor found that the two materiality inquiries favored Plaintiff's position, noting it "reasonably conceivable" that "[g]iven the materiality" of the conflicts not disclosed by Stollmeyer, "the Board would have viewed them as relevant and of a magnitude to be important in carrying out their decisionmaking process." Accordingly, the fraud-on-the-board

theory supported the Vice Chancellor's refusal to dismiss Plaintiffs' claims against Stollmeyer.

CONCLUSION

Mindbody follows a recent line of Chancery Court decisions in which corporate dealmakers not only failed to establish a successful *Corwin* defense but also, at least at the preliminary motion stage of the litigation, failed to convince the Court they abided by their "*Revlon* duties" (quoting *Kahn*). Clearly, *Corwin* has not become the rubber stamp some feared, while *Revlon* has continued vitality in establishing the standard of conduct for corporate fiduciaries involved in major M&A activity. In *Mindbody*, Vice Chancellor McCormick called upon over thirty-five years of learning under *Revlon* in determining that Plaintiffs adequately pled conflicts, favoritism, and the withholding of information on the part of Stollmeyer to warrant denial of his pleading-stage motion to dismiss. Such actions are no more countenanced by the Chancery Court today than they were back in the day when *Revlon* shook the corporate world.

POSTSCRIPT

As will be chronicled in future Delaware Corporate Law Bulletins, in two opinions issued in early 2021, Chancery Court Vice Chancellor J. Travis Laster has written extensively about the interplay of *Corwin* and *Revlon* and provided a detailed methodology for analyzing *Revlon* claims against corporate fiduciaries in a post-*Corwin* world. In this connection, Vice Chancellor Laster distinguished between the "transactional justification setting"—applicable when plaintiffs seek pre- or post-closing *equitable relief* under *Revlon*—and the "personal liability setting"—applicable to post-closing *damages claims* under *Revlon*. *See Firefighters' Pension Sys. v. Presidio, Inc.*, 251 A.3d 212 (Del. Ch. 2021); *In re Columbia Pipeline Grp., Inc.*, No. 2018-0484-JTL, 2021 WL 772562 (Del. Ch. Mar. 1, 2021).